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Foreword

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The disruptive effect of Technology continues to bring about major transformation in the financial services sector with FinTech startups and alternative finance solutions encroaching upon established markets. It is now becoming obvious that the accelerating pace of technological change is the most creative force – and also the most destructive – in the financial services ecosystem today. In "Technology and the Financial Services Industry", we set out to capture what the technological advancements are and the real world implications of these changes on the financial services industry.

The new IFRS 9 standard will have significant impact on profitability with banks making major changes to their systems and processes, as well as developing the necessary skills to handle the complex modelling requirements. "IFRS 9: Impairment of risk assets – Implementation challenges and strategy" captures our experience so far while working with Banks towards putting in place an implementation plan.

While the success story of the Nigeria pension industry continues, we recognise a number of factors that will have immense influence on the future of the industry which stakeholders should take note of in the article, "The Nigerian Pension Industry; Navigating the Future Landscape".

It is no longer news that Nigeria currently grapples with difficult macroeconomic conditions following the protracted uncertainties around global oil prices. This has seen a sharp drop in Government revenue, and has put immense pressure on the exchange rate with inflation rising. In these conditions, local and foreign businesses are less likely to take risks and invest while local businesses struggle to sustain operations and remain profitable. Our article "What's next for Nigeria's economy? Navigating the rocky road ahead" examines the challenges faced by businesses and what Financial Institutions can do to survive. In the same vein, we've also discussed "The use of Restructuring to preserve value" which is especially essential in these times in order to ensure the future profitability of banks are not compromised.

Finally, the dwindling fortune from oil has naturally seen an increased interest by government in other sources of revenue such as taxation. This is a trend we expect to continue going forward hence there is need for financial services type entities to keep up with their tax obligations to avoid issues with the regulator and tax authorities. Two articles in this year's journal shines some light on this. "How effective is your tax function in dealing with tough and uncertain tax times?" dwells on ways to improve operational effectiveness of tax functions in order to ensure their survival in the current terrain while "5 tax issues that could cost the financial services industry a lot of money" highlights key emerging tax issues that the financial services industry needs to consider and prepare for.

It is my hope that this publication gives a good understanding of current trends in the financial services sector in Nigeria while presenting a glimpse of what is to come. We are happy as always, to discuss any of the topics with you in detail while looking forward to your comments and feedback.

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Technology and the Financial Services Industry

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The financial services industry has seen radical technology led changes over the past few years. We've witnessed considerable innovations in the way and method of delivering banking transactions, payment methods and exchange mechanisms. Many executives have continually looked to their IT departments to improve efficiency and facilitate game-changing innovation – while somehow also lowering costs.

Meanwhile, FinTech startups are encroaching upon established markets, leading with customer friendly solutions developed from the ground up and unencumbered by legacy systems. These disruptors are fast-moving companies, focused on a particular innovative technology or process in everything from mobile payments to insurance. And, they have been attacking some of the most profitable elements of the financial services value chain. This has been particularly damaging to the incumbents who have historically subsidised important but less profitable service offerings.

In our recent PwC Global FinTech Survey, industry respondents told us that a quarter of their business, or more, could be at risk of being lost to standalone FinTech companies within five years[1]. With technology finding its way into every aspect of our daily living, startups are currently innovating better ways of moving money around the world and are coming up with payment solutions that have the potential of changing the way money is spent. Trends indicate that:

- Successful disruptors typically offer a better customer experience and greater convenience at a much lower price
- The effects of disruptors vary significantly across countries and value chains, largely because of differences in regulatory barriers and the robustness of local FinTech ecosystems
- Regulatory authorities are caught between wanting to encourage competition and innovation and wanting to provide meaningful oversight of these disruptors.

Although online payments are yet to become mainstream and achieve at least a 50% adoption rate by internet users in Nigeria, there have been steps in this direction. Many financial tech startups have come from nowhere and have started treading in the murky waters including the likes of Paypal and Skrill[2] . Mention must be made of the likes of Etransact, Quickteller, Paga, Readycash, CashEnvoy and the others that have been brave enough to solve perhaps one of the most basic problems of business - trade.

In this paper, we highlight key themes that IT executives in the finance industry will need to address as they begin their strategic planning for the medium-to-longer term.

1. PwC Global FinTech Survey 2016
2. #FinTech: Here are Nigeria's top 5 financial technology startups

Technology forces that matter

FinTech will drive the new business model

Financial technology, also known as fintech, is an economic industry composed of companies that use technology to make financial services more efficient. Financial technology companies are generally startups trying to disintermediate incumbent financial systems and challenge traditional corporations that are less reliant on software. For a long time, there have been significant barriers to entry in the FS Industry due to the advantages that large firms had in size, and their networks added a multiplier effect. However, that has not been the case in recent years as FinTech disruptors have been finding a way in. These disruptors (which are often start-ups) are usually focused on a particular innovative technology or process. In Nigeria, this includes innovations around payments platforms, (e.g. Pay with Capture, Paga, etc.) lending platforms (e.g. PayLater, C24 limited etc.) and Banking services which includes GT Bank's *737* and Diamond Bank's "esusu". These new technological processes have considerably changed the way in which banking transactions are being carried out. According to a recent PwC report on Fintech "81% of banking CEOs are concerned about the speed of technology change". This implies that organizations which fail to adopt innovative technologies in their modes of operations may stand the risk of becoming extinct in the nearest future.

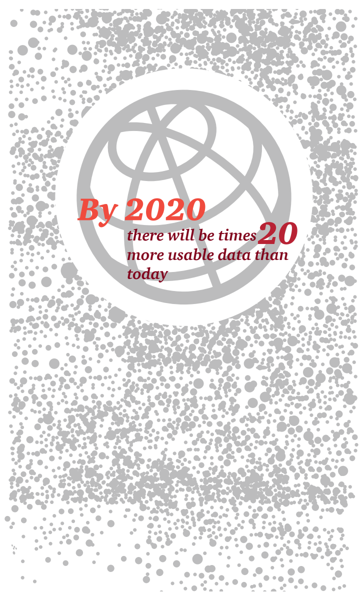
Sharing economy will be embedded in every part of the system

Within the next decade, consumers will need banking services, but they may not turn to a bank (in its current form) to get them. This is not fantasy; it is where things are headed. It is now becoming obvious that the accelerating pace of technological change is the most creative force – and also the most destructive – in the financial services ecosystem today.

The implication of this for the FS industry in Nigeria is that there would be decentralized asset ownership and rising information technology to find efficient users of capital rather than turning to a bank as an intermediary.[3] Rather than use relatively expensive bankers to settle the connection between those who have and who want, the FinTech innovators are using technology to make cheaper, faster and better matches. A typical example will be the Lending Club which is the world's largest online marketplace connecting borrowers and investors. They are transforming the banking system to make credit more affordable and investing more rewarding. Operating at a lower cost than traditional bank lending programs they pass the savings on to borrowers in the form of lower rates and to investors in the form of solid returns.

Customer intelligence will be the most important predictor of revenue growth and profitability

Customer intelligence is the process of gathering and analysing information regarding customers; their details



3. Financial Service Technology 2020 and Beyond: Embracing disruptions

and their activities, in order to build deeper and more effective customer relationships and improve strategic decision making. The advances in technology have given businesses access to data thereby increasing their ability to predict future trends in the business space.

Research shows that by the year 2020, there will be 20 times more useable data than there is today. [4] This means that technology advances will give businesses access to exponentially more data about what users do and want. But it also implies that there will be a divergence between companies who use data to their advantage and those who do not. The winners will be able to price products based on a deeper understanding of risk; the losers will merely compete on price, compressing their margins with lower revenues and proportionately higher payouts.

Advances in robotics and Artificial Intelligence (AI) will start a wave of 're-shoring' and localisation

ATMs (Automated Teller Machine) are robots. They are very simplistic, purpose-built robots – but they provide consistent, convenient, low-cost service and customers have grown to trust them. First introduced in Nigeria in 1987[5], the use of ATMs have grown to becoming the general and widely acceptable way of cash withdrawals. Adeoti in a paper[6], noted that ATMs played a key role in any retail banks' efforts to use technology as a quality weapon to defeat competition."

ATMs provide a major role in offering convenience, speedy and round the clock services. Thus, we urge financial institutions to rapidly ramp up their efforts to understand and develop a vision for their use of robotics and AI. They will need to find and integrate more industrial engineers into their talent pool. And they will need to learn from industries such as manufacturing and technology that have used robots extensively for decades.

The public cloud will become the dominant infrastructure model

Today, many financial institutions use cloud-based software-as-a-service (SaaS) applications for business processes that might be considered non-core, such as CRM, HR and financial accounting. In spite of huge efforts from prominent OEMs and SIs to promote Cloud Computing in Nigeria, uptake continues to be met with lukewarm reception, primarily fueled by fears that the data held in the cloud are not safe. Experts believe that with the current 6.8 to 10 percent broadband penetration in Nigeria, the economy still remains a huge market for cloud computing[7].

52% of asset management CEOs surveyed in our recent publication: "Financial Services Technology 2020: Embracing Disruption" believe that cloud computing will be strategically important to their organisations. With customers demanding a flexible, personalised system experience[8], and with costs continuing to drop, the cloud is here to stay. Incidentally, the sharing economy also plays a role here. For example, the payments infrastructure of many industrial, healthcare and smaller FinTech institutions are being provided by conventional banks. These banks are selling their infrastructure as a service to others, and leveraging the cloud to do it.

Cyber-security will be one of the top risks facing financial institutions

The sophistication of the cyber security threats targeting the financial sector will continue to increase due to the following forces:

- Use of third-party vendors
- Rapidly evolving, sophisticated and complex technologies
- Cross-border data exchanges
- Increased use of mobile technologies by customers,

4. The Digital Universe in 2020: Big Data, Bigger Digital Shadows, and Biggest Growth in the Far East', International Data Corporation, December 2012
5. C.A., Jegede. "Effects of Automated Teller Machine on the Performance of Nigerian Banks." American Journal of Applied Mathematics and Statistics 2.1 (2014): 40-46
6. Automated Teller Machine (ATM) Frauds in Nigeria: The way out. Journal of Social Science 27(1):53-58
7. Nigeria still big market for cloud computing - Vanguard news
8. Financial Services Technology 2020 and Beyond: Embracing Disruptions

including the rapid growth of the Internet of Things
- Heightened cross-border information security threats

These existing and emerging threats are however not insurmountable, and carry considerable opportunities. Improving cyber security in Nigeria's financial services sector and tackling these threats presents an opportunity to inspire confidence in Nigerian banks and will provide the needed drive to enhance and galvanise existing efforts to modernise, expand and develop the sector

Asia will emerge as a key center of technology-driven innovation

Around the world, the middle class is projected to grow by 180% between 2010 and 2040. Asia's middle class is already larger than Europe's. By 2020, the majority share of the population considered "middle class" is expected to shift from North America and Europe to Asia-Pacific. Non-cash payments in emerging Asia are growing by 22% owing to increasing internet use and the adoption of mobile payments[9]. Over the next 30 years, some 1.8 billion people will move into cities, mostly in Africa and Asia, creating one of the most important new opportunities for financial institutions. These trends are directly linked to technology-driven innovation.

Regulators will turn to technology, too

Regulators globally, are rapidly adopting a wide range of data gathering and analytical tools too. They are trying to learn more about individual institutions' activities and overall systemic activity. They also hope to monitor the industry more effectively and to predict potential problems instead of regulating after the fact. A typical example will be the Federal Inland Revenue Service's (FIRS) roll out of three electronic-tax payment platforms (ePPs) on 20 June 2016 to enable taxpayers remit their taxes through an online payment portal. The roll out of the ePPs via three platforms (Remita, NIBSS and Interswitch), if properly implemented would improve the ease of paying taxes in Nigeria. Taxpayers would now have the avenue to remit the tax due with the click of a button on any electronic device that is connected to any of the three platforms. Similarly, measures such as the 2014 introduction of the Bank Verification Number (BVN) have aimed to tackle low-level fraud and cybercriminal activity in the financial services sector in Nigeria.

This is only the beginning. As financial institutions themselves continue to automate controls and monitoring in - Know Your Customer/Anti Money laundering (KYC/AML), trade surveillance, reconciliations and other areas, regulators will seek direct access to these tools – either on an ongoing basis or during supervisory reviews. As a result, firms will need to make data and control transparency, priorities as they implement these tools and comply with data requests. It is shortsighted to focus solely on compliance with current regulations.

Operational Priorities for the medium-to-long-term

To benefit from these technological developments, we recommend that financial institutions focus on these key priorities:
1. Update their IT operating model to get ready for the 'new normal'.
2. Build their technology capabilities to get more intelligent about their customers' needs.
3. Prepare their architecture to connect to anything, anywhere.
4. Pay more attention to cyber-security before it becomes urgent.
5. Make sure they have access to the talent and skills needed.

Over the air card issuing, china

Over the air (OTA) or remote card issuing is an emerging operating model in china, which uses host card emulation (HCE), trusted service manager (TSM) or magnetic secure transmission (MST) technology to store bank card informatin into phones, and make remote card issuing and mobile contactless payments

OTA provides a means to load, activate and personlise a NFC payment application by leveraging the mobile phone wireless networks. A mobile phone user can initiate the OTA provisioning process from wherever he or she has network access. The source of the payment application requires specific authotisation from an issuer and the keys required to access the secure element on the phone

9. Firstdata: Non cash payments growing, 2014

Update your IT operating model to get ready for the 'new normal'

Increasingly, financial services and FinTech are becoming inseparable, putting IT into a critical position. IT will require specialists with expertise in everything from data analytics, robotics, and user-experience design to cyber-security and integration. These specialists will need to be able to consult with the business in order to better understand what the business is trying to accomplish and agree on the best way forward.

Similarly, IT specialists will likely be the ones who help FS organizations' teams become more comfortable with new forms of AI-driven decision making. Huge amounts of data will be available, but it will not be beneficial if one does not possess the resources to extract meaningful conclusions from the data. Firms will turn to IT teams for non-IT skills too; there is no way to separate out project management and risk management. And, of course, all individual projects will need to be consistent with the overall IT and business strategy.

Build the technology capabilities to get more intelligent about your customers' needs

As we have noted, customer intelligence – and the ability to act in real-time on that intelligence – is one of the key trends affecting the financial services industry, and it will drive revenue and profitability more directly in the future. By 2020, we expect that the 'new normal' operating model will be customer- and context-centered

Mobile was originally developed as a nice-to-have add-on to electronic banking. However, advances in networks and mobile devices have flipped the hierarchy. Now, you need to adopt a mobile-first view of features and development.

Privacy is another critical concern. Customers must feel their information will be used to benefit them, and not in a way that intrudes upon their private lives.

Finally, as these technologies advance, financial institutions will quickly bump into some human capital limitations. AI already has practical implications and companies need to be investing in it today. We are already seeing a high demand for AI experts. Companies will need to consider how they will address this talent gap in the short-term, even as they develop strategies for the long-term.

Prepare your architecture to connect to anything, anywhere

Here are just a few of the endpoints that will need to coexist and cooperate:

- Enterprise databases, data warehouses, applications and legacy systems
- Cloud services

PwC's retail banking 2020 survey indicates a growing awareness to develop a more customer-centric business model, but a significant gap in preparedness remains.

61%

of bank executives say that a customer-centric model is "very important"

75%

of banks are making investments in this area (this pattern is consistent globally)

Only

17%

feel "very prepared

Source: PwC Retail Banking 2020 Survey

- Business-to-Business (B2B) connections, linking to comparable systems at partners and suppliers
- Business-to-Consumer (B2C) connections, linking to apps, wearables and mobile devices at an individual user level
- Bring-Your-Own-Device (BYOD) connections, using an enterprise mobility strategy to link to employees and contractors
- Third party 'big data' sources
- Internet of Things (IoT) sensors

Given the FinTech trends we have discussed, it is important that the FS Industry builds hybrid integration platforms assuming true interoperability across multiple products or suites. In the next few years, this will be the most effective way to share common infrastructure and maintain architectural integrity with native, on-premises data integration.

You cannot pay enough attention to cyber-security

Cyber-risk management is complex and rapidly evolving. To stay ahead, companies will need executive management engagement, ongoing governance, risk management techniques, threat correlation, collaboration throughout the organisation and adoption of a new operating model. In the financial sector, this takes on an added dimension, because the perceived rewards for the hackers are so appealing. We recommend executive management focus on the following:

- Proactively manage cyber-risk and regulation
- Establish a commercially reasonable cyber-security capability
- Develop a world class cyber-response
- Acquire, develop and retain key talent
- Align cyber-security team with business risks

According to PwC's Global Economic Crime Survey 2016, there are four key technologies all Financial Services organizations should be aware of in order to protect and grow their business:

1. Big Data Analytics
2. Biometrics
3. Block Chain
4. Advanced IT Security

Make sure you have access to the talent and skills needed

For years, traditional financial institutions have designed their offerings from the inside out: 'this is what we will offer,' rather than 'what do our customers want?' But this model no longer works. And the skills and interests of today's IT team members and third-party talent may not be up to the challenges of tomorrow's technical environment, where partnering with customers will be essential. The issue runs deeper than developing a different competency model. Companies will need to understand what is already working and what needs to be done differently. This might involve changes across the human capital strategy through revitalised recruitment, learning and development, partnering and cultural initiatives. Typically, this could include efforts such as:

- Recruiting expert talent from other technology organisations and think-tanks, rather than staying focused on recruiting from within the financial services industry
- Developing robust learning modules to enhance the skills of executives, IT – and non-IT staff
- Taking more active steps to create and foster a culture of innovative thinking and talent development
- Engaging more extensively and creatively with third-party sources of talent, including the use of "talent exchanges"

Conclusion

Traditionally, banks have been the primary means of accessing financial services, but given the problems of reaching branches in geographically remote communities, the question of how to deliver affordable and accessible financial services remains in the scene. And according to a recent PwC report; Emerging Markets Driving the payments transformation, meeting the need for financial inclusion, has been achieved by rapid expansion of new technologies and innovations, which are helping to make it more economically viable for banks to reach the 'unbanked or 'underbanked' populations. Technology has leapfrogged from branch banking to e-banking and now mobile money, which has helped to create pockets of strength. In emerging markets which includes Nigeria, the growth of mobile penetration has had a massive impact on financial inclusion, with people moving from no previous banking history to being able to make payments via a mobile phone.

Financial institutions have a lot on their plate: emerging competitors, shifting demographics, rising customer expectations and changing regulations. Technology offers solutions, allowing them to cut costs and become more efficient at what they do. But this is tricky, because it is a classic 'limited time offer'. Most technology is not proprietary, so it is a bit of a race: if you blink, you might find that your competition has already built up advantages that are now harder for you to match.

At PwC, we work with clients to build IT 2020 Readiness Programs that help executives understand where they stand, and what they will need to support business strategy by the end of the decade.

What next for Nigeria's economy?
Navigating the rocky road ahead

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Nigeria in the eye of the storm

For net oil exporters like Nigeria, the fall in oil price by 60% in 2015 had far reaching impact on the economy with government revenue declining rapidly, foreign investors exiting the domestic market and the Naira value coming under pressure.

We have been here before

Oil-related crises are not new to Nigeria. Two previous episodes of falling prices had resulted in a free-falling Naira and slowing economic growth:

- 1986 Global Oil Glut: an oversupply of oil built up in the 1980s as demand weakened and new forms of energy were developed. Average oil prices fell 48% between 1985 and 1986. This led to an economic contraction over the next two years, with the Naira depreciating by over 70%.
- 1997 Asian Financial Crisis: during 1997 and 1998 the oil price gradually declined in response to cooling demand as the financial crisis in Asia deepened. While the Naira initially stood firm and growth continued, the deteriorating political situation led to a devaluation of 75% in 1999.

Nigeria's performance in the wake of the 2008 global financial crisis was more encouraging. As volatility rippled out from the US-subprime crisis, Brent Crude fell from $145/bbl to below $40 in the space of six months. However, stronger domestic growth fundamentals combined with a weak US$ prevented the Naira falling further than 20% against the dollar. Economic growth resumed at pre-shock levels only two years later.

Importance of oil to Nigeria

Oil as is common knowledge, is Nigeria's main source of foreign exchange earnings and government financing, (See Figure 1). The impact of the oil price drop on the economy has led to downward adjustments of growth expectations for the country by the World Bank who in June 2016 said Nigeria would grow at 0.8% this year, down from an estimate of 4.6 it made in January. This the bank said is owing to weakness resulting from oil output disruptions and low prices.

More so, Nigeria's economy contracted for the first time since 2004 in Q1 2016 with indications that a recession is imminent after a four-month delay in the nation's budget, stalled economic stimulus programs in addition to foreign-exchange restrictions, fuel shortages and a plunge in oil production following renewed militancy in the oil rich Niger Delta.

The federal government on Wednesday 13 June 2016 said its earnings had declined by 40 per cent as a result of the drastic fall in oil prices, as well as the persistent attacks on oil installations in the Niger Delta. As a result, it said the N6.06 trillion budget for this year will only be partially implemented.

Importance of oil and gas to the Nigerian economy in 2013

Source: PwC analysis of IMF Article IV 2014: Nigeria and Thomson Reuters Datastream

In 2015, PwC published a report titled – What next for Nigeria's economy? Navigating the rocky road ahead in the Economy watch – May 2015. The publication focused on possible economic scenarios to help organisations prepare for an uncertain environment in 2015 and 2016 following the decline in oil prices. We projected that even under a benign economic scenario, the Nigerian economy will struggle to realise growth much higher than 4.0% (Projections by the Federal ministry of Finance at the time was 5.5%). This projection was based on in-depth research and economic modeling by economists at PwC.

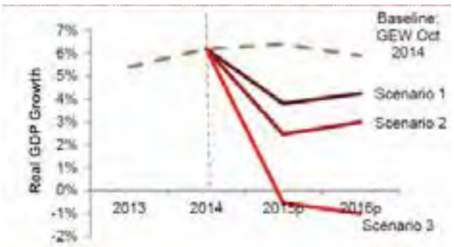
We emphasized that getting the policy response right matters a lot as the situation imposes a real 'human' cost on the population. On the other hand, businesses must react and adjust in the right way in order to be able to weather the storm.

More so, our World In 2050 analysis, expects GDP per capita to hit $10,000 in Nigeria in 2030 – just a one percentage point slower growth rate per year would see this development threshold delayed by almost a decade, to 2038.

The possible scenarios and outcomes

We explored two types of shocks in the May 2015 Economy watch report: an oil price shock and a political shock. The first scenario looks at oil price averaging $55/bbl over 2015 and stabilising at $70/bbl in 2016 with a smooth transition and maintenance of political stability in the country. Scenario 2, envisaged the re-emergence of Iran oil production in Q2 of 2015 which could drive oil prices to as low as $35/bbl and reaching a new equilibrium level of $60/bbl in 2016 consistent with the most bearish forecasts from analysis. The third scenario follows a similar pattern as scenario 2 with oil prices averaging $45/bbl in 2016 in addition to severe political or security shock arising from escalation of Boko Haram insurgency and/or resurgence of restiveness in the Niger Delta.

PwC Real GDP growth projections



Source: PwC projections, PwC Global Economy Watch (GEW)
October 2014, Thomson Reuters Datastream

The result of our study indicated that while the economy will continue to struggle even under the most optimistic scenario, there will continue to be growth in the economy even if oil prices fall to $35/bbl and average just $45/bbl in 2015. However, we expect that a deterioration of the political and security landscape could unnerve investors and tip the country into recession. If a 'medium' political shock occurs against the backdrop of a severe oil price scenario, Nigeria's economy could see zero growth or even contract in 2015 and again in 2016.

Gross government oil revenues will fall dramatically from their 2013 level: by $21bn alone in Scenario 1 (equivalent to a 50% decline) if recent oil production trends continue. This financing hole could widen to $10bn in Scenario 2, where significant debt issuance and cuts to recurrent expenditure will be needed. State governments could struggle to borrow on financial markets or pay their workers. Some highly-indebted states may miss planned interest payments on their debt.

In scenario 3, we assumed that oil production would fall by 15% through bunkering and other supply disruptions. Gross oil revenues would fall to a third of their 2013 level. Combined with difficulties administering tax collection from unstable parts of the country, we would expect the federal government to fall over three months behind on paying employee wages and government bond yields on US$-debt could approach 20%.

The effect on the exchange rate and inflation in our report was also telling. If the oil price continued to stabilise, the CBN's November 2014 adjustment of the exchange rate regime was going to be sufficient to ease pressure on the Naira in 2015. If oil prices deteriorated further however, we expected that a further 10% devaluation of the Naira will be necessary in 2015. Inflation the report stated was likely to accelerate as the Naira depreciated given Nigeria's heavy reliance on imports. While it was expected that some of this inflationary pressure will be offset by falling domestic fuel prices and lower rates of GDP growth, we expected inflation to be at least 3 percentage points higher than in 2014.

The impending recession indicates a manifestation of the worst case scenario in our projections (scenario 3) and requires proactive response by both policy makers in their fiscal and monetary response as well as business leaders especially in the financial services sector.

How Financial Institutions can prepare and respond

On the monetary policy side, the central bank will need to take the lead in closely scrutinising the evolving risk environment. The recently introduced flexible exchange rate should be allowed to operate with very minimal interventions. The Government can also take responsibility for developing a set of priorities for federal and state expenditure, aligned to the national development plan.

Financial Institutions (FIs) must note that all parts of their organisation could be affected by the current situation. We recommend companies prepare a coordinated response incorporating Business Planning, Treasury, Legal, Procurement, IT, Finance, HR and Tax. Organisations that prepare contingencies in functional silos will miss important interlinkages and potentially underestimate the risks.

As scenario 3 keeps unfolding as is currently the case, there are potentially significant changes and disruptions to the operations of Financial Institutions and in this situation, moving quickly will be of paramount importance. We recommend FIs to focus on the following four key imperatives:

1. ***Critically assess organisation strategy and status:***
   The need here is to assess whether your strategy and operations are appropriate for the changed business environment. FIs need to stress test their business plans and challenge existing forecasts to determine whether sufficient funds are available to drive business growth for the next 18 – 24 months. Furthermore, MIS and reporting systems must be realigned to give the relevant information at the right time, to make critical decisions. Winners will need to demonstrate agility and flexibility by preparing in advance for the future – starting with a robust Business Recovery and Resolution Plan.

2. ***Manage assets, people and capital:***
   Delayed interest and loan repayments from customers and increase in default rates have increased pressure on FIs to quickly find means to generate additional income from previously low income generating assets. Optimising cash management systems, creating an integrated banking application that ensures consistent customer experience across channels and reducing leakages are levers for FIs to carefully evaluate, whilst balancing against any potential knock-on impact with stakeholders especially foreign investors and regulators. On the people side, it is critical to identify key talent and retain them; along with continuous productivity improvement throughout the Organisation. Retaining and motivating the best people is critical to the organisation's future, and appropriate incentives must be planned to ensure a longer term commitment. Hence employee culture and performance measures must be aligned with the evolving business strategies.

3. ***Manage cost base:***
   The objective here is to drive operational performance and efficiency, remove waste and reduce unnecessary complexity. Options such as strategic out-sourcing, reviewing current agreements and even questioning the current business model are required to achieve this. The need is to plan and execute targeted rather than 'across the board' cuts, while continuing to invest in those areas that are required to achieve strategic goals. The challenge lies in managing profit with the help of cost-cutting targets and business process optimisation, without jeopardizing the long-term health of the Organisation.

4. ***Innovate:***
   The Financial Services industry is facing the omnipresent risk of disruptive innovation mostly led by non-banks who are targeting key areas such as payments and small-term lending which account for nearly 80% of daily customer interactions. Financial Institutions need to drive innovation by harnessing and optimising technology, driving better internal collaboration and knowledge sharing and bringing in new global insights. Once the core area of innovation is identified, FIs need to figure out how to best structure and allocate resources so that ideas and solutions can be quickly identified and implemented. While we should not underestimate the capacity of incumbents to assimilate innovative ideas, the disruption of the financial sector is clearly underway with disintermediation being the most powerful weapon. Customers

of the future will be more autonomous regarding choices, more informed, advised, more “social” and expect the FIs who serve them to respond accordingly.

Leading banks are responding by moving away from “managing branches” to managing customer experience across “integrated channels”. We believe this will be met through strong omni-channel capabilities enabling customers to interact with the bank seamlessly across channels and transition from one channel to another regardless of the transaction type or where they are in the process.

Financial Institutions, not already thinking in this direction, should seek to develop: (a) Business Recovery plan that is realistic, challenging and forces the taking of bold, and potentially unpalatable actions in advance of a stress, to avoid failure; (b) Systems implementation road map that enables the leveraging of the right combination of digital technologies and resources to create unique customer experiences; and (c) robust Financial model to grow market share, increase revenue and improve operational efficiency.

The FIs with the best contingency plans in place, with agreed actions and appropriate delegated authority allowing quick decisions; are the ones that will come out of this crisis in the best shape.

IFRS 9: Impairment of risk assets
Implementation challenges and strategy

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Introduction

On 24 July 2014, the IASB issued IFRS 9 Financial Instruments. This is the final version of the Standard and supersedes all previous versions, and is effective for annual periods beginning on or after 1 January 2018, with earlier application permitted. For banks this accounting standard will have the largest impact of any new standard since the introduction of IFRS.

The standard covers classification and measurement of assets and hedge accounting but the largest impact on business is likely to be the new approach for measuring impairment using an expected credit losses (ECL) approach.

What will most likely be impacted;

Profitability	We expect the day 1 impact on the balance sheet on transition to IFRS 9 to be significant. Going forward there would also be significant income statement volatilities with increase in credit loss impairments expected to be in the range of 25% to 50% for most financial institutions.
Systems and processes	IFRS 9 will require significant changes to credit processes and information systems. These changes will mean new data requirements, processes and models, and entities will need to consider appropriate level of governance and financial controls over these new requirements and ability to audit them.
Business strategy	Wider implication for the business in strategy, pricing and portfolio management. There is now a greater correlation between credit management and investment management strategies and financial reporting impacts. Entities also need to consider appropriate internal and external communication strategies of these impacts.
Financial reporting	IFRS 9 makes accounting for credit loss impairments more complex. Appropriate skill levels will need to be developed within the organization to handle this. Complex modelling requirements, increased disclosure requirements and a more robust credit risk assessment and monitoring will have to be managed while ensuring that normal business activities are not interrupted. There is also need to monitor impact of ECL provisioning on risk assets for capital adequacy purposes and the interaction of ECL impairment with the CBN prudential provisions and regulatory reserves.

The experience so far....

As at September 2015, 81% of banks in Africa had not assessed the impact of IFRS 9 and most banks plan to communicate the impact to the market in 2017. As at mid-year 2016 these numbers should have improved as a number of banks have begun the process of putting in place an implementation plan and seeking the required support in delivering on the change. However the quantitative impact on Nigerian banks is yet to be proved at this point.

At our last readiness assessment of the Nigerian Financial Institution, 9 out of the 21 banks were currently discussing their key ECL accounting policy and implementation decisions, assessing the impact this change will have on the existing system and analysing the learning curve necessary to tick the readiness workbook. Thereafter, we expect that banks will commence building their ECL models and performing a type of Smoke test to assess the IT system readiness.

Our key learnings from the assessments carried out so far are:

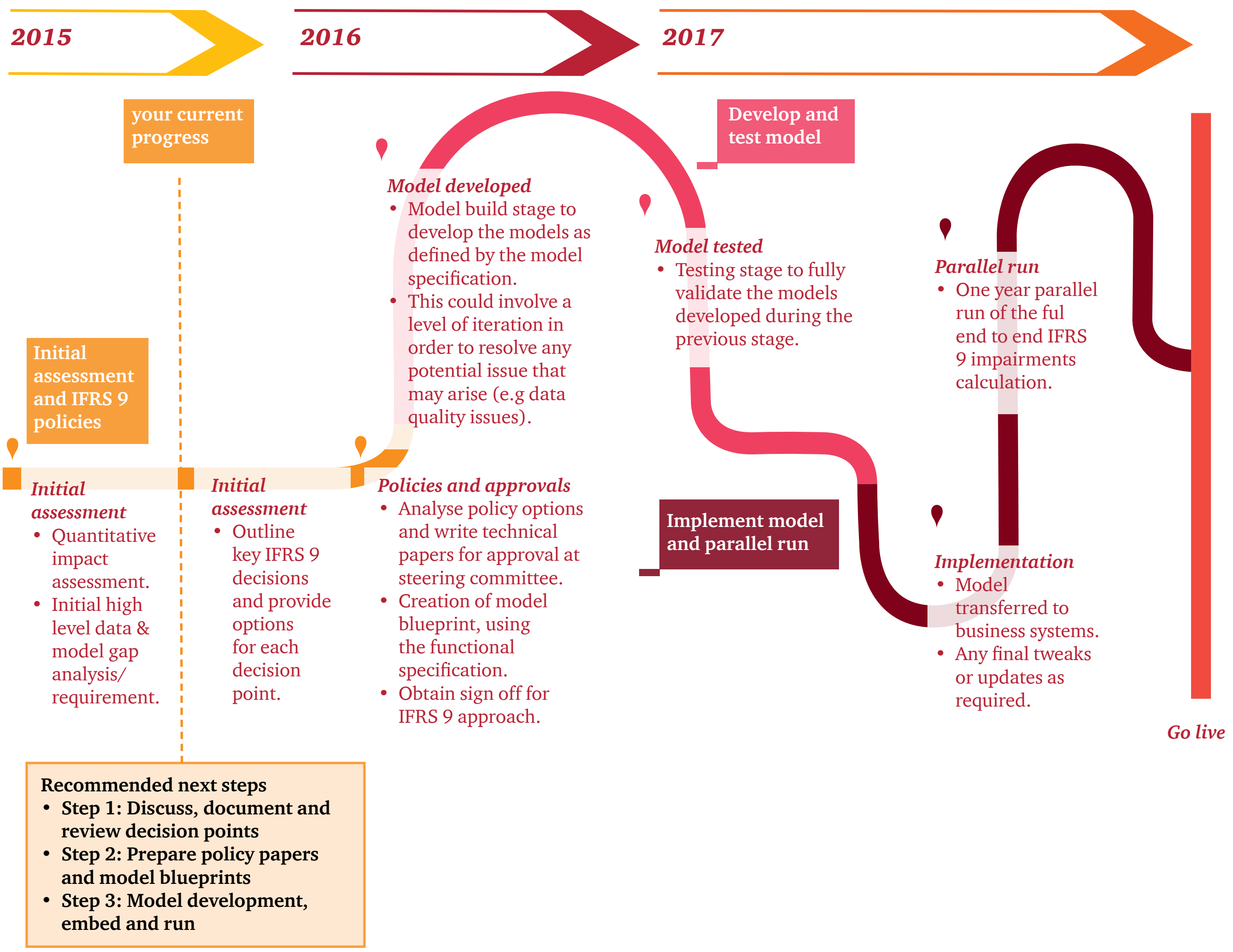
- Data governance and quality is key – everything depends on the data going in. If the data sources are not reliable, expect the results to be conflicting and sometimes unexplainable. Another consideration for Nigerian banks is that given all the restructuring and acquisitions that happened in the industry, it may be challenging getting adequate historic data for these legacy portfolios, same challenges may arise where there have been recent system changes. It might be inevitable to try to use modelling techniques to extrapolate for later periods using the information available, but this may not give the most accurate results but could be acceptable in certain circumstances.
- Don't lose time on academic debate – there could be a theoretical understanding of the potential financial statement impacts of certain requirements of the ECL method, however sometimes the practical application could yield different and surprising results. Consider building models at the impact assessment stage to prove the impact of taking certain options and alternatives and then refine your decisions as you implement.
- A number of areas of interpretation are still under debate – a lot of the decisions to be taken may be subject to interpretation, test your decisions to ensure they are conceptually sound. However, still expect more guidance either from the standard setters or the local regulatory bodies as time goes by.
- Identify interdependencies with other projects – a number of the inputs required for the IFRS 9 ECL computation can be leveraged off existing models (eg. Basel) and then adjusted as appropriate to arrive at more IFRS 9 compliant measures. So it will be necessary to understand where you are with these other models and where efficiencies and interdependencies can be achieved.
- Validation of previously unaudited processes – you must consider how to source for or develop the required inputs to the models and how these new processes can be controlled and validated, eg. Macro-economic factors forecasting.

Defining your IFRS 9 implementation strategy

There is no clear cut strategy for the implementation of IFRS 9, as implementation approach will differ from entity to entity considering factors such as the current state of the credit risk management process; eg extent of implementation of Basel and IAS 39 and how these have already been embedded within the systems and processes, it is also necessary to consider the relative size and different characteristics of the entity's loan portfolios, availability of adequately skilled internal resources to implement the new requirements and the entity's plans for future system changes and upgrades.

For such a complex accounting change such as IFRS 9, it is expected that entities, especially financial institutions should take a phased approach to implementation to avoid last minute surprises and costly mistakes.

So where are you now……..



Governance processes and controls will be particularly critical for implementing IFRS 9 Expected Credit Loss (ECL) and making key decisions on accounting policies and how to practically implement the new impairment requirements. Additional uncertainties around how the final guidance of Basel, the Enhanced Disclosure Task Force ('EDTF') and the IFRS Transition Resource Group ('ITG') will be applied in practice, as well as general emerging industry practice, add to the complexity in decision making.

What should management and those charged with governance be considering now?
IFRS 9 is not just an accounting change but a whole business change as the requirements of IFRS 9 will necessitate the entire reassessment of systems, processes and the business model in some instances. Most of these decisions will have to be driven first from a governance point of view before drilling down with those charged with implementation.

We can consider these decisions from the following areas;

Governance and controls:
ECL determination is complex and highly judgmental, a lot of the decisions taken on implementation will have significant financial statement impact and should be explainable and reasonable under the circumstances. Management is ultimately responsible for data quality, modelling, systems, processes and internal controls.

Sophistication and proportionality:
Management should consider relevant factors in determining the level of sophistication required in implementing IFRS 9 impairment, recognising that there is no one size that fits all.
For instance, for certain entities it may be more pragmatic to consider systems changes and integration along with the initial implementation of the standard, for others it may be better to carry out a desktop implementation first by building bespoke models and sourcing for required historical information inputs from existing systems and processes and external sources.

Transition issues:
Consider existing policies and practices that may need to be reassessed, and data considerations. Certain stop-gap measures and acceptable alternatives may need to be considered where certain historical information is not just available on transition, while processes can then be put in place for addressing these going forward.

The following are some of the questions management and those charged with governance should be asking now:

1. Do I have a multi-disciplinary project team and an identified project driver?
2. What are the data requirements and what is the capability of current systems and processes to generate this?
3. What are our plans for model building and parallel testing?
4. What are the planned governance over models and data sources?
5. Do we have enough skills in-house to handle this change?
6. How do we integrate IFRS 9 with our Basel implementation?
7. How do we keep up to date with additional guidance and interpretations to be issued by the ITG, EDTF and local regulators?
8. How have we assessed the following:
    - Consistency with budgeting/capital planning/stress tests?
    - what our regulators will expect?
    - the consequences to our financial performance?
    - the impacts to our compensation programmes?; and

- other unintended consequences as a result of the financial and regulatory impacts?

Conclusion

The time to act is now as a failed IFRS 9 implementation project could be potentially disastrous for a financial institution. By now any entity that expects to be significantly affected by IFRS 9 should be considering the following;

- articulate your implementation strategy using a phased approach,
- identify where you need help and begin to engage support,
- begin to identify the data, requirements and the gaps
- qualitative and quantitative impact assessment,
- risk policy documentation, and
- road map for implementation.

The Nigerian Pension Industry
Navigating the Future Landscape

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Remarkable success has been recorded since the introduction of the Contributory Pension Scheme in 2004 – however various competing forces will have great influence on the future pension industry landscape

Nigeria's pension reforms of 2004 was necessitated by the myriad of problems that plagued the "pay-as-you-go" schemes in the public sector and the varying types of pension schemes that existed within the private sector which resulted in retirees not getting retirement benefits. The Pension Reform Act (PRA 2004), the subsequent review and enactment of PRA 2014 introduced the Contributory Pension Scheme (CPS) which made it mandatory for employers and employees in both the public and private sectors to contribute towards employee retirement benefits. The new pension scheme introduced an autonomous tripartite system involving – The Regulator, The Administrator and The Custodian - to minimise the possibility of misappropriation of pension funds.

Twelve years on, Nigeria has recorded remarkable success with the CPS having pension fund assets of over $25 billion, a contributor base of over 6.9 million workers and no incidence of pension funds being misappropriated.

However, Pension Fund Administrators (PFAs) are operating in a highly dynamic environment driven by competing forces, all which have a great influence on the future Pension Industry landscape. These forces known as STEP forces will trigger industry growth and facilitate the introduction of various innovative products and services. They include;

The Social/Contributor Force
Contributors are becoming increasingly aware of financial products and services while their perception of the ideal customer service experience is changing.

The Technological Force
Technological advancements are changing the way Financial Services providers do business and are providing new platforms to offer unique products and services to customers.

The Economic Force
Nigeria’s economic crisis triggered by reduced oil production capacity and falling oil prices has led to loss of employment impacting Assets under Management (AuM) and fee income. Operational costs have also increased.

The Political/Regulatory Force
The PRA 2014 has introduced new operating dynamics. The new regulations and guidelines imposed by the Regulator could impact PFAs either negatively and/or positively.

There has been a shift in contributor perception regarding the Nigerian Pension Industry, from total distrust to trust

The Social/Contributor Force

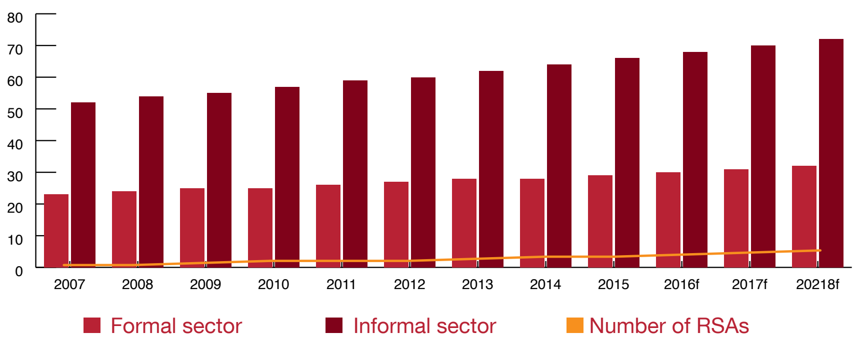
Contributors have gained trust in the CPS especially in the way it is being administered. They are also fully expectant that the new industry dynamics introduced by the re-enacted PRA 2014 would provide greater financial freedom when they retire. However, with this renewed faith in the industry, contributors will become more demanding and would require the following;

- ***Tailored pension fund products:*** Contributors will seek additional pension related services such as ***old age health insurance*** to finance medical expenses on retirement
- ***Personalised retirement savings advice:*** Contributors will demand sufficient financial information to take well-informed decisions and make voluntary contributions based on perceived retirement needs. They will also require easy to understand pension products and services devoid of complexity and technical jargon.
- ***Better returns on pension fund investment:*** Contributors will begin to demand better returns on pension savings and would clamour for the introduction of the ***multifund structure*** which would provide returns based on age and risk appetites
- ***Old age pension:*** Retirees who have returned to gainful employment will begin to demand ***old age pension services*** to enable them contribute to the scheme but with reduced industry fees
- ***Impact investment vehicles:*** Contributors in the future would seek to determine where their pension funds are being invested in order to make an impact in areas of personal interest

Paying attention to the social/ contributor force is important for PFAs which seek to increase Retirement Savings Account (RSA) base. A PFAs response to the other three forces is influenced by this force as market presence is determined by the ability to retain and attract contributors. This would become more important when the “transfer window” is opened which will enable contributors move their RSAs between PFAs.

As at 2015, only 7.4 % of the entire Nigerian working population (formal & informal) had been covered by the contributory pensions scheme. Total RSA registrations could reach 10 million by the end of 2018 at the current growth rate of 9%. By this projection, a demand gap (i.e. those not covered by any pension scheme) of ≈94 million workers could exist in both the formal and informal sectors. All PFAs have immense potential to increase market share and become a clear leader within the industry on all indices

Nigeria’s working population split by Informal/Formal sector (millions)



In order to successfully navigate through the social/contributor force, PFAs would need to;

- Develop a clearly articulated Go-To-Market Strategy with clear customer value propositions;
- Develop strategic partnerships to deliver additional financial services products to contributors;
- Develop staff competencies to provide relevant financial/pension advice to contributors on a need basis; and
- Improve customer service processes, platforms and environment.

The advent of digital trends such as mobile, analytics and cloud computing will enable PFAs to create collaborative solutions to advance business objectives

The Technological Force

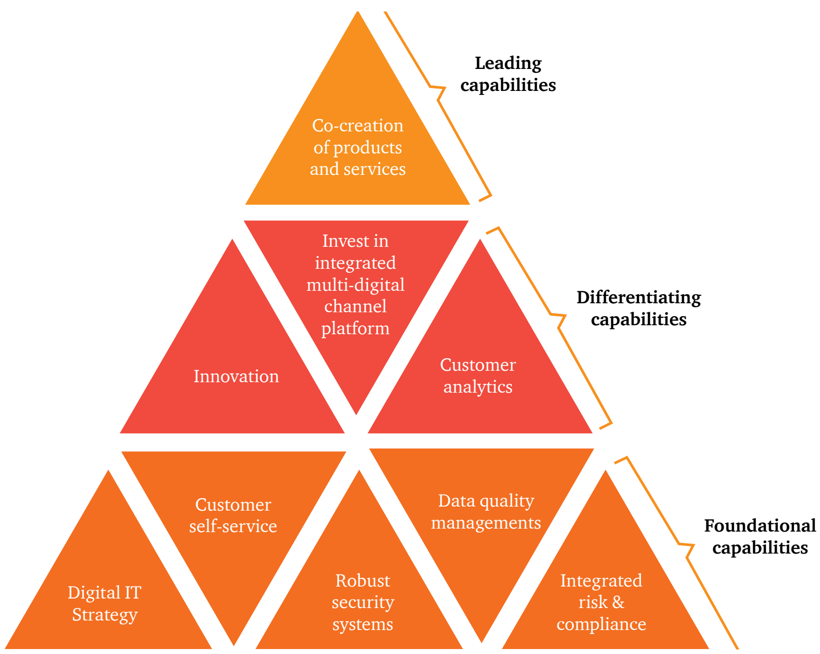
In order to be relevant in the future, PFAs need to become digital. This will involve having access points to contributors on social and mobile platforms, use cloud to rapidly develop and scale services as well as deploy analytics to continuously improve services.

Nigerians are becoming increasingly aware of and adopting digital services. They are also aware of the opportunities being connected creates in terms of service delivery and the demand for products and services. Social media further creates multiple avenues for contributors to influence the market perception of their service providers. These evolving digital trends can assist PFAs deliver differentiated experiences to contributors while if not handled appropriately could ultimately destroy its market reputation.

PFAs will need to determine what makes sense for their businesses in the digital age by developing a digital journey with costs savings and optimisation initiatives that will enhance customer awareness, acquisition, retention, engagement and loyalty across business areas in order to achieve market growth.

The digital journey initiatives should include;

1. A digital strategy which would be consistent with the corporate strategy objectives and enable new strategic options.
2. New digital platforms and data standards which should support communication and collaboration across the entire organisation.
3. Technology infrastructure which would enable staff operate, monitor and control processes. It should also enable change agility.
4. Technology standards which support process commonality and exchange of data in diverse application environments.



However, Pension Fund Operators face several harsh realities which range from the threat of unfunded retirement savings accounts to an increase in operational costs

The Economic Force

Nigeria is currently facing an economic crisis. Its reduced oil production capacity largely due to pipeline vandalism and poor maintenance culture along with the global drop in oil prices has put tremendous strain on her finances. The harsh economic climate has led to the folding up and downsizing of businesses with unemployment rates reaching an all time high of 23.9% by the fourth quarter of 2015. In addition, inflation rates have gone up from 8% in 2014 to 16.5% in June 2016 while fixed deposit interest rates have fallen from an average of 11% in 2014 to 5% in 2016.

As a result, Pension Fund Operators face several harsh realities which range from the threat of unfunded retirement savings accounts to an increase in operational costs.

- ***Increase in unfunded accounts***
  The loss of jobs largely due to the inability of employers to meet staff cost obligations causing some RSA accounts to become unfunded impacted AUM growth.
- ***RSA drawdowns***
  The loss of jobs resulting in contributors demanding access to their retirement savings especially if unable to secure another employment within 6 months of being laid off. This also leads to reduced AUM.
- ***Reduced contributions***
  The inability of some employers to pay salaries could result in pay cuts impacting contributions to RSAs.
- ***Increased cost of operations***
  PFAs have faced increases in operational costs largely due to inflation and the devaluation of the naira.

A PFA worst hit by the impact of the economic downturn could have up to 50% reduction in profits by 2016 year end as the case study below portends.

Income Statement (N millions)	***2015***	***2016 est.***	***Difference***	***Assumptions***
Fee income	5,329	4,127.04	(1,201.96)	At the current unemployment rate, 23.9% of accounts are likely to become unfunded.
Interest Income	213	96.8	(116.2)	PFA X rolls over its investment. At the current fixed deposit interest rate of 5%, RoI would drop by 6% i.e N 116.2 million
Other income	84	84	-	Assuming other income sources remain constant - though this is unlikely due to falling RoI rates
Operating Income	5,626	4,307.84	(1,318.16)	
Total Expenses	2,518	2,758.5	(240.5)	At the current inflation rate of 9.5%, expenses would go up
Profit before income tax	3,108	1,549.34	(1,558.66)	
Income tax	777	387.34	(389.66)	
Profit for the year	2,331	1,162.01	(1,168.99)	At the end of 2016 based on economic forces, PFA X could lose up to N 1.1 billion in profits.

Furthermore, in a bid to fund the national budget and diversify the economy, the Federal Government is seeking various 'bailout fund' options and may want to utilize pension funds for 'infrastructure' projects. In the future, PFAs may be required to invest in infrastructure bonds at less than competitive rates.

While the future economic outlook cannot be predicted with certainty, forward looking PFAs monitor economic trends and react swiftly to mitigate losses. These PFAs have;

1. A cost tracking and optimisation strategy.
2. A robust technology platform that reduces the need for staff to man each pension administration process.
3. A small and agile workforce, well equipped to handle their roles.
4. Processes managed for efficiency, control, and predictability.

The PRA 2014 introduced several positive changes within the pension industry which would further impact the way PFAs do business

The Political/Regulatory Force

The PRA 2014 introduced several positive changes within the pension industry which will further impact the way PFAs do business. These changes include

1. Increase in contributions rate from 15% to 18%. A minimum of 10% and 8% for employer and employee respectively or a minimum of 20% for employers who wish to bear the full contribution costs.
2. Investment of pension funds in foreign investment vehicles albeit within the confines of the National Pension Commission's (PenCom) guidelines.
3. Establishment of a Pension Protection Fund to serve as a hedge for the funding of minimum pension guarantee.
4. RSA holders can now withdraw a maximum of 25% of their pension assets as equity contribution towards the payment of a residential mortgage.
5. Employers with less than 3 employees and self employed persons now entitled to participate under the scheme.
6. Stiffer penalties for the contraventions of the Pension Reform Act.

Although PenCom is yet to develop guidelines for the implementation of some of these key changes, their impact include an increase in AUM, diversified investment vehicles and fund security. Other expected regulatory changes could impact some PFAs negatively and would require the development of proactive response strategies.

The "transfer window":
PenCom is currently in the process to conclude the framework and relevant guidelines for the RSA transfer window. This could connote a positive or negative impact for PFAs and would lead to;

- Increased industry rivalry.
- The need to improve visibility and brand image to retain and attract customers from other PFAs.
- The need to ensure that in-house processes and procedures as well as technological platforms support the transactions necessary to ensure seamless transfers.

The multi-fund structure:
The introduction of the multi-fund structure would give RSA holders the opportunity to select where their pension fund assets would be invested based on their risk appetite. This could lead to an increase in operational costs. PFAs would need to ensure that they conduct:

- Background study and cost-benefit analysis into various investment options.

The PFA of the future has the dynamic capability to achieve renewable competitive advantage while navigating through the STEP forces

- Customer enlightenment and education for informed decision making.
- Increase investment performance monitoring and risk management.

Informal Sector Inclusion:
The PRA 2014 now makes it possible for those in the informal sector to participate in the contributory pension scheme and PenCom is in the process of setting up relevant structures to ensure smooth inclusion. This could result in additional fee income for PFAs who are properly positioned to take advantage of the situation.

PFAs in the future would need to ensure strict compliance with statutory requirements and best practices whilst ensuring they maintain and increase market share. This would involve:

1. A compliance strategy to engage the regulator and respond with agility to regulatory changes.
2. Appropriate technology infrastructure to support governance and compliance initiatives as well as business intelligence tools to support processes and process improvement initiatives.
3. A robust governance, risk & compliance framework.

Conclusion

In order to successfully navigate the future pension industry landscape in response to the STEP forces, PFAs will need to be “agile” and have the dynamic capability to achieve renewable competitive advantage. The PFA of the “Future” is a multi-dimensional organisation which does not focus on how to control the forces or how to make them more predictable or manageable, it is comfortable with the unknown and focuses on how to respond with them. The PFA of the future can therefor be able to:

1. move its resources quickly across its operations in a goal directed manner.

2. continuously scan the environment for emergent threat and opportunities.

3. rapidly form and dissolve internal and external relationships and make strategic changes to the nature of its relationships with minimal negative effects.

The use of Restructuring to preserve value

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Dwindling economic activity in Nigeria has reduced the business performance of various entities in the different sectors of the economy. Commercial Banks ("Banks") are under significant pressure to restore and improve net interest margins, interest earning assets, while ensuring that non-performing loans remain below the threshold set by the Central Bank of Nigeria. Over the last year, lending has become riskier with a noticeable increase in default rates. The primary focus of Banks now, more than ever, is to preserve value by minimising loan losses and free up capital to create more quality risk assets or improve its liquidity position.

In order to ensure the future profitability of Banks are not compromised, the trend where loan facilities are restructured without a good understanding of the Corporates ("Borrowers") and their business drivers needs to be discouraged. Many Banks in Nigeria have often restructured facilities just to avoid providing for the loan facilities without understanding the sustainability of such efforts.

Incomes and cash flows of many corporates ("borrowers") have been squeezed by wider market conditions and in some cases lack of appropriate planning and execution. Currently, several borrowers have cash flows that cannot sustain their current debt profiles. Increasingly, borrowers are asking Banks to restructure their loan facility ("facilities") and in some cases with the support of Regulatory authorities.

As an early preventive action, Banks can use informal workouts to reduce the required specific provisions for non-performing loans and preserve shareholder value. It is more important now than ever to ensure that borrowers whose facilities are being restructured have the appropriate underlying business fundamentals to be able to repay their restructured facilities, else the lenders will just be postponing 'dooms day' without addressing the fundamental issue. Banks can leverage on the principles governing informal workouts as highlighted in the "London Approach" below.

Informal Workouts

Why an informal workout? Traditional approaches to recovering outstanding and non-performing loans through the legal system may not always be the most efficient and effective way to preserve value in the current economic climate. During times of financial distress, the number of insolvency cases increase placing additional pressure on an already overburdened Court system. The turnaround time between when the petition is filed and judgement granted also increases. Further, the value recovered through the forced sale of assets is often not sufficient to offset the outstanding amount due from the borrower because of prevailing market conditions and the time needed to identify interested buyers, particularly in the case of specialised assets.

The main objectives for this approach include - minimising losses to Banks and other parties through coordinated negotiations; and avoiding unnecessary liquidations of viable companies

Given the absence of adequate insolvency laws with provisions to govern business restructuring in Nigeria, any out of Court restructuring is considered an “informal” arrangement. Informal workouts serve as a timely alternative to recovering funds lent to borrowers. PwC has been involved in arranging and negotiating informal workouts in Nigeria, at the instance of the Borrowers and also as an independent party. We believe this tool is yet to be fully appreciated by Banks and Borrowers alike, as it creates a framework to achieve an informed, sustainable and objective resolution mechanism.

The “London Approach”

The key principles governing informal workouts were first conceived by the Bank of England in the 1970s when the United Kingdom was in recession. This approach, commonly known as the “London Approach”, has been adopted in various forms globally and is premised on the assumption that cooperation will prevent greater loss to Banks, Corporates and, in turn, the wider economy. Insolvency legislation at the time did not provide for voluntary restructuring and The Bank of England chose to become actively involved with individual workouts. The main objectives for this approach include - minimising losses to Banks and other parties through coordinated negotiations; and avoiding the unnecessary liquidations of viable companies.

The principles of the “London Approach” are most widely used where there are multiple lenders and significant creditors. However, they are also applicable when a borrower is renegotiating their facility with one Bank. Various forms of the “London Approach” have been used in jurisdictions where the insolvency laws are not adequate and it remains relevant for the Nigerian market. Variations of the “London Approach” include – the INSOL International Principles for a Global Approach to Multi-Creditor Workouts, selected sections of the World Bank Principles for effective Insolvency and Creditor/ Debtors Rights System, and selected sections of the UNCITRAL Legislative Guide on Insolvency Law. However, in practice, Lenders and Borrowers have agreed the principles of the variant to be employed and adopted same.

Key Principles Governing the “London Approach”

The “London Approach” is based on the principle that Banks work with underperforming or distressed borrowers to resolve financial difficulties that would otherwise have resulted in insolvency (receivership or liquidation). Prior to agreeing to restructure a facility using this approach, Banks have to assess relevant financial information relating to the borrower, its business prospects, and sustainable debt capacity. From our experience, this review is key in ensuring that Banks support companies that are viable and are not only preventing the inevitable. At this point, the Banks may agree to defer taking punitive actions where the business fundamentals indicate that the interest of the Bank is better served by allowing the borrower to continue to operate as a going concern. Once this has been determined, the starting point for negotiations is agreeing a “Standstill” where the Banks agree not to enforce their security or demand payment for their debts for a period of time with the aim of ensuring that a consensual restructuring agreement is negotiated and agreed.

During the standstill period, the borrower will be required to provide the Bank with various information including:

- Details on the viability or the future profitability: Factors to be considered include the industry in which the company operates, product/service demand, company's positioning in the industry. In our experience this information is crucial in preventing further losses to the Bank.

- Possibility of fund generation through either sale of existing non-core assets or divestment of unprofitable segments of the business;
- Financial projections which confirm the sustainable debt capacity levels of the business;
- Action plans to ensure that factors which contributed to the challenges being faced by the business are being addressed. For any debt restructuring to be successful it should be accompanied by operational restructuring which addresses idiosyncratic issues that borrowers face;
- Steps identified by the borrower as being key for a successful restructuring and how these will be incorporated by Management.
- Plans to ensure that payment terms would be renegotiated with other significant creditors to the business;
- Confirmation from other significant creditors that they are aware that the borrower is going through a restructuring process and would not initiate any insolvency proceeding over an agreed timeline; and
- Management's capacity to drive the turnaround of the business.

The Banks would review the above information and use it as a basis to decide sustainable terms of the restructured facility and identify relevant monitoring safeguards to prevent any potential future default by the borrower.

Four Broad Stages of the "London Approach"

1 "Standstill" or breathing space during which time banks agree not to begin or continue insolvency proceedings against the company

2 Professional advisers introduced to the borrower by the Bank or consortium of banks

3 Negotiating and agreeing on the restructuring package for the borrower

4 Appointment of financial advisers to monitor results (assuming the terms of the restructuring is agreed by Borrower and Banks

Where has the "London Approach" been used?

During the financial crisis in South East Asia, many Banks adopted modified versions of the above approach to resolving the financial difficulties faced by borrowers that were still considered to be viable. There were instances where Regulatory Authorities stepped in on a case by case basis as the Bank of England did in the 1970s to ensure that some form of agreement was reached between Banks and Borrowers.

We are aware of a recent situation in West Africa where Regulatory Authorities stepped in to encourage a consurtium of Banks to restructure the facilities of a corporate body through an informal process. The Regulatory Authorities gave the Banks the option of specific provisions for a significant proportion of the loans or go through an informal work out. The said entity was indigenous and considered to be viable and of strategic importance to a critical economic sector. This was not the first time the facility to this borrower had been restructured but in the past a review of the company's business fundamentals was not done and as such cash flow per the restructured term sheet was not sustainable. Eventually, the borrower defaulted and its Bankers had to seek a more sustainable process for supporting the business. The new terms agreed included an extended moratorium on principal repayment and facility tenor, a reduction in interest rates and pay-off of one of the lenders who had more restrictive terms.

In the last year, we note that a number of indigenous entities in the Energy sector due to factors ranging from delayed project completion to falling oil prices have restructured their facilities in order not to default on their local obligations. However, most of these restructuring have a high chance of failing as the London Approach wasn't employed. Hence, the participating Banks will need to have a critical look at those transactions.

Challenges with using the "London Approach"

As with any approach, there are challenges that arise with an out of Court restructuring, especially where the borrower is exposed to a club/ syndicate of Banks and potentially large/ significant creditors. Once a Bank or creditor "breaks ranks" for instance, it makes it difficult to obtain the collective agreement necessary to consensually restructure the facility. We recently supported a client with exposures to over six local Banks. These facilities were not syndicated and there had been a breakdown of trust and communication between the Banks and the Borrower. During the early stages of the informal process, one of the Banks instituted insolvency proceedings. It was then agreed that a Coordinating Committee which included PwC, legal advisers to the borrower and the Banks should take over the management of the process. The Coordinating Committee had representatives from the different Banks and this helped in coordinating the approach to the restructuring for the greater good of all parties involved.

During an informal workout, assessing the real financial and economic situation of a borrower can be difficult as the basis of any analysis relies heavily on information provided by the borrower. This can be mitigated by ensuring that a variety of quantitative and qualitative information are analysed during the initial business review. So in the case mentioned above, we provided the Banks with a Business Review report which answered key questions around the Borrowers- market, people, technology and debt capacity of the

Avoiding Bankruptcies of currently and potentially viable businesses helps to preserve jobs, and can be a driver of economic recovery

business. This information formed the basis of the restructured loan facility which included an upfront good faith payment, syndication of the restructured facility, and tenor extension. The newly agreed terms were considered more favourable for the most part to the Banks and the borrower.

Where there are many different classes of debts and non-banking creditors, it may be difficult to structure a transaction binding all the different Banks while ensuring that the large creditors are on board with the process. In such cases, the needs of the various classes of debt may be better served using formal insolvency procedures as these clearly sets out how different classes of debts are to be treated independent of size or nature.

Conclusion

Given our current economic climate and the absence of a formal legal and regulatory framework governing the restructuring process in Nigeria, it is now more important than ever before, to use out-of-Court restructuring processes to ensure the survival of many businesses. Avoiding Bankruptcies of currently and potentially viable businesses helps to preserve jobs, and can be a driver of economic recovery. Our experience in business turnarounds also lends credence to this, as through the 'London Approach' we have assisted businesses remain going-concerns and aided Banks in the turnaround of non-performing assets, as well as recouping their exposures to such businesses.

Most Banks agree that the "London Approach" or any of its variants accomplishes a number of goals including:

- Avoiding adverse publicity likely to cause further reputational damage to the borrower;
- Minimising losses and allowing the borrower to continue operating while providing repayment assurance to its Bankers and other significant creditors;
- Maintaining the borrowers' going concern, value and goodwill;
- Avoiding liquidation losses and other administrative expenses.

Banks need to understand and protect their rights, while still maintaining a cordial relationships with their borrowers. Bankers can seek the support of financial advisers to help with the restructuring process as well as monitor the borrower after a restructuring agreement to minimize the risk of defaults. Borrowers will also have to appreciate the financial, legal and strategic issues associated with any debt renegotiation. Formal insolvency proceeding in the Courts, often delay the turnaround process, can be expensive or can end up being more complex due the adversarial nature of the judicial process. It is therefore in the interest of both the Bank and borrower to utilize and adopt informal out-of-Court restructuring solutions.

5 tax issues that could cost the Financial Services Industry a lot of money

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A lot has been happening in the tax space. Maybe not a lot of it has happened in the financial services industry; but it is only a matter of time.

Here are five tax issues that we think business leaders in the financial services (FS) industry need to consider and prepare for, because as they say: "it is best to learn from the follies of others".

Tax exempt income and attributable expenses

We spent a good number of days this year trying to keep the Federal Inland Revenue Service (FIRS) out of a client's pockets. The client was being audited and the FIRS was asking for a big cheque running into billions of naira. One of the issues in contention was this: The client entity had tax exempt income streams, as well as taxable income streams; the FIRS believed the entity was using some of the expenses incurred in generating the tax exempt income to reduce the profits (and hence income tax due) from the taxable business.

In essence, the FIRS was making the argument that tax deductions should not be made for expenses that are attributable to income that is not taxable. This argument has a basis in law since the Companies Income Tax Act (CITA) only allows taxpayers to take deductions for expenses that have been incurred for the production of taxable profits.

While this case did not involve a financial services company, it is an issue FS players should begin to think seriously about. Before now, it was hard to imagine that the FIRS would raise such issues. This experience has shown that it is a real possibility.

The question for many companies in the FS industry is whether they have properly attributed expenses to their tax exempt income streams or whether they are guilty of deducting expenses related to exempt profits against taxable profits.

If business leaders have never considered this to be a serious risk, now would be a good time to reassess.

We managed to work out a good defence for this client; but not everybody will be that lucky. The trick is to start to prepare on time.

Do you have an approval from the Minister of Finance?

This question came from the FIRS during a recent tax audit. It caught a client entity off guard.

The company (a Nigerian company) had provided management services to another related Nigerian company.

The FIRS had refused the recipient company a tax deduction for the charge and was asking for 32% (income tax plus tertiary education tax) of the amount as additional tax. The reason? The recipient company did not have an approval for the management fee from the Minister of Finance.

Before now, companies would never get this type of query from the FIRS for a management fee charged between two Nigerian companies. Not that this provision of the law was new, it was just that the FIRS had never applied it to a transaction involving two Nigerian companies.

In the past this section was only applied to management fees from abroad. If you got a National Office for Technology Acquisition and Promotion (NOTAP) approval for the fees however, you were deemed to have satisfied the requirement of the law.

The lesson here is that more and more people at the FIRS are reading the law; and reading it well too.

Nigerian groups that operate shared service centres or have domestic head offices charges will need to take this one seriously.

It is better to look into this now before the FIRS comes knocking with an assessment.

Appropriate allocation of outbound charges for head office and other support services

Pareto's principle indicates that 80% of problems or success will come from only 20% of the possible sources.

Business leaders would have probably seen this play out over and over again; those handful of employees that drive 80% of profits; those 20% of branches or subsidiaries that create 80% of the group's problems; and the list goes on.

Many group or head office staff with oversight for non-Nigerian operations and other subsidiaries will admit that dealing with a number of the smaller businesses takes up an inordinate amount of their time and efforts.

But when it is time to charge for the services of the group or head office, what happens? Are, say, 80% of the group's costs charged to these businesses? Chances are they aren't. Very little, or nothing at all is charged; after all, the businesses are just growing and the group does not want to wipe out what little profits the subsidiaries have to show with these group charges.

This makes perfect sense from a business perspective, but not from the perspective of the FIRS. The FIRS wants a charge out of those costs so that more profits are shown in Nigeria and of course more taxes are paid.

But is charging only a small portion of the costs completely inappropriate? Not necessarily. Even in transactions between independent parties, Pareto's principle comes into play. Many independent consultants point out that their lesser paying jobs sometimes take up a disproportionate amount of their time; and they have to live with it.

With some careful thought, group companies in this situation can build a good case to justify their decision to charge only the costs that these fledgling businesses can afford to pay.

Depending on the materiality of the costs however, these groups may have to brace for a long fight with the FIRS.

Nigeria Stock Exchange (NSE) rules on interested party transactions

This one is a bit tricky and it usually comes as a surprise to most CFOs during our discussions. More often than not, they've never heard of this rule before.

Some of the questions they ask include: What do the rules require? Who is supposed to comply? When did the rules come into effect? These are the easier questions to answer.

The rules came into force in November 2014. They apply to listed companies (issuers). An issuer is required to get an approval from its shareholders in order to enter into recurring transactions with interested parties (defined as a controlling shareholder, CEO, directors, or any person related to these people).

The idea is to protect the interest of the minority shareholder by ensuring that the people that run or control the company do not ship out all the profits before it's time to distribute dividends. As part of the process, the issuer is required to obtain an opinion from an independent financial adviser. The opinion should confirm that the policies and procedures adopted by the issuer for the transactions with interested parties will give rise to commercial results and will not be detrimental to the interest of the issuer and minority shareholders.

To the tricky part: what happens if the issuer does not comply?

There is nothing specific in the rules that addresses this but some corporate lawyers will argue that that the penalty could be anything from having to pay a few hundreds of thousands of Naira, to being delisted (assuming the NSE one day starts to take this seriously). These views are from the application of some of the general penalty clauses that can be found in the NSE's listing rules.

And there could be other angles to this. What if the Financial Reporting Council of Nigeria (FRCN) wades in? What if the argument is that a defaulting issuer cannot record the transaction because the NSE rules have not been followed? What if, following the same logic, the FIRS argues that the charges are illegitimate and disallows them? What if there are disgruntled shareholders and the matter becomes publicised? How will the case be tried in the court of public opinion?

With matters like this, compliance could just be the cheaper option.

Country by Country Reporting

Have business leaders considered a situation where the FIRS could see all the profits that Multinationals (MNEs) report in all the different countries where they operate?

Let's paint a scenario. Imagine a colleague who you strongly feel should not be on the same pay grade as you because he does not work as hard or deliver half as much as you do. Now imagine you one day realise that he earns nearly twice as much as you? What would you do? Most people would either resign; or demand for a pay raise.

Similarly, information on profits made by MNEs in other countries could make the FIRS ask for more.

The FIRS plans to introduce Country by Country Reporting (CbyCR) legislation that will give it this type of information. MNEs with headquarters in Nigeria will have to submit data for all the countries where they operate. This data will include: number of people, revenues, value of assets; and profits (amongst other things) in each country.

For those with headquarters outside Nigeria, the FIRS could get this data from the tax authorities of the country where the headquarters is located. Alternatively, they could ask the Nigerian subsidiary to provide the information.

CbyCR will typically apply for large MNEs with group turnovers in excess of 750 Million Euros.

A number of proactive MNE groups are already assessing what CbyCR will mean for their business through simulations and test runs. Their observations are quite informative. Many of them agree that it is time consuming and that it takes a lot of effort to collate the data. They also think they will need to make changes to their IT systems to be able to generate some of the data required. Some groups found the results of their analysis alarming and could quickly see why any tax authority presented with the data would suspect foul play.

Most of the outbound MNEs in Nigeria are from the financial services industry and many of them will be required to comply with CbyCR regulations.

The smart thing to do now is to prepare and be ready.

Conclusion

The current thinking is that tax is the new oil. The FIRS' revenue targets are ambitious and there is a lot of pressure for the budgeted collections to be realised even though there have been significant shortfalls to date. If companies in the FS sector are not mindful, they could end up being unwilling (and unpaid) financiers of this "FIRS budget deficit".

The FIRS is not pulling any punches in the bid to increase tax revenues. Businesses outside of the financial services industry are witnesses to this already. You don't need a soothsayer to know that the focus will soon shift and it could be the financial services industry next.

With tax matters, a lot depends on getting the right advice on time and acting on it quickly.

Players in the financial services industry should start considering the extent to which the above matters could impact them… the clock is already ticking.

How effective is your tax function in dealing with tough and uncertain tax times?

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Introduction

It is no longer news that Nigeria's oil revenue has dwindled and alternative sources are needed to fund government expenditure. This has led to various initiatives and proposed laws to increase tax collection. The aggressiveness of the tax authorities is seen in the use of non-compliance stickers on company premises, increased tax audit exercises, and more cases in dispute. Considering their potential contribution to revenue, banks and other financial institutions have been a target.

State tax authorities are now collaborating with the Federal Inland Revenue Service (FIRS) in issuing non-compliance stickers, appointing companies as agents for collection of tax from defaulting taxpayers, and for banks to provide information on interest due on individual bank accounts. Consequence of non-compliance with tax laws can be distressing, leading to reputational and operational damage for the company.

The growing demand for efficiency of the tax function has exposed needs and weaknesses that can and must be addressed. It is imperative for companies to focus on ways to improve operational effectiveness of their tax function in order to ensure their survival in the current terrain and to arm the tax function with the necessary tools for a swift reaction to the aggression of the tax authorities.

Tax strategy: A roadmap to solving tax challenges

The starting point for transforming a tax function is having a 'detailed tax strategic plan'. This outlines the approach to be taken to achieve the companies' tax objectives. A tax strategy must contain input from tax, finance, IT, and other functions in order to achieve consensus. This is because a good tax function must be seen to be adding value to the business and not just a cost centre.

A company's tax strategy must be documented and updated annually to reflect changes in the tax environment. The document must define the objectives of the tax function and establish the key performance indicators for the tax function. By creating a multi-year strategy and plan, a tax function can add value to the business and align itself to the broader company objectives. For example, a good tax function should mitigate risks (such as penalties and interest) and take advantage of opportunities to save money from tax at the group and subsidiary level. A tax function that does not follow a strategy may be comfortable to stick to routine compliance roles or act without warning outside the overall strategy of the Board.

A company should critically assess its tax function's current capabilities against its desired state so as to highlight the areas that need improvement. Some of the questions that must be considered are;

- Is the tax function meeting today's challenges as well as getting ready for what lies ahead?
- Is it able to take on new responsibilities while efficiently performing current obligations?
- Does it fully support the needs of the business including responding quickly to planning requests that require analysis prior to shareholder meetings or press conferences?
- What is our policy on tax matters, and do we have a policy document containing this?

Defining these points in a strategy document helps the company to avoid mistakes such as employing a tax manager with the wrong profile for the business. An example of this can be employing a tax manager with only a tax compliance background when the company will be involved in mergers and acquisitions and complex investment structures in the immediate future.

Enablers of an effective tax function

In order to successfully implement a tax strategy, the tax function must consider the following tools and methodologies;

1. Data

The tax function is one of the largest consumers of data within an organisation—not only core trial balance data from financial systems, but also data from other transactional systems. Tax functions face significant challenges in gathering effective and timely data, hindering their ability to contribute more strategically to enterprise-wide decisions and to adequately respond to tax queries and investigations.

An economical way to address many of the tax function's data needs is to integrate financial systems with tax systems. This offers timely, tax-ready data for direct and indirect tax reporting and analysis that supports tax provision, compliance, and audit defense capabilities.

In many instances, the data of companies are not tax 'sensitised' and this can lead to material exposures. There are a number of well publicised instances which emphasise the importance of tax sensitized data. In one instance, a company gave financial information to the tax authorities with expense captions called "management services" for items which were routine logistics services. In another instance, a company accumulated a significant balance in an account described as "miscellaneous services" which is a red flag for tax auditors, thus resulting in tax exposures. There are other instances where data and presentation of ledgers prolonged the audit more than was necessary.

Tax representatives should provide input in a company's choice of accounting systems. This will;

a. Ensure the classification of certain revenue and expenses is automated to easily produce information required for tax compliance and tax audit defence.
b. Increase operational efficiencies by mapping comprehensive tax data requirements to the accounting systems to ensure information generated is optimized for tax.
c. Improve the quality of tax data by tax sensitising the chart of account and defining tax reporting requirements.

2. Technology

Faced with increasing regulatory complexity, growing globalisation and significantly increased scrutiny, the ability of the tax function to deliver reliable information and value is dependent on the processes that are in place and the technology that is deployed. Technology solutions for tax must be integrated seamlessly with the accounting systems as having an efficient and well integrated technology solution will not only reduce the financial reporting risk but improve compliance with the tax regulations.

Successful investment in technology results in faster and easier access to higher quality data and can reduce or eliminate the need for time consuming data collection, validation and manipulation within the tax function. Tax professionals are able to focus on more value adding activities thereby leading to improved job satisfaction and better staff retention.

3. Process

As the expectations from a tax function increase, there is little or no tolerance for errors in tax reporting. An avenue for minimizing tax reporting errors is by enhancing the efficiency of the tax function through process improvements.

Process improvement represents an opportunity to redeploy resources to pursue risk management, put in controls, communicate with stakeholders and business units, undertake tax strategic planning and ensure transparent disclosure. In addition to the technology improvements, process improvement is one of the best ways to substantially increase the chances that a tax function will consistently deliver on its commitments in the future.

For an organisation to get value from optimizing its tax processes, it must consider the following;

a. Does the organisation have a process for evaluating tax planning ideas and managing tax risks?
b. Are processes constantly reviewed to identify inefficiencies?
c. Does the organisation have process documents to guide new members of its tax team?

The processes must also be integrated with the shadow tax role in other departments within the organisation.

A tax process that functions effectively means that business owners can sleep well at night knowing that objections to tax assessments are being lodged at the right time, investment structures have been signed off with regards to tax, deadlines are not going to be missed, and the Board will be advised of material tax issues, among others.

4. People

Having the right people is a key enabler in delivering what is required of a tax function. Companies should re-evaluate their current talent needs against the desired additional capabilities so as to meet up with the increasing tax requirements. On the job training should be offered to bridge any knowledge gap identified and to ensure that the tax professionals within the organisation stay relevant.

Going forward, the data skills needed by tax professionals will be less about gathering and managing data and more about analyzing the data from a broader vantage point to make valuable decisions. In order to maximize the value of a tax function to an organisation, the tax professionals need to understand their roles and responsibilities and how they fit into the group's overall strategy. The need for an external tax advisor should be considered as this can provide insight in making strategic decisions. Senior members of management must also be involved in an oversight role in the tax function.

In PwC's recent research conducted globally on groups with foreign subsidiaries, most Chief Executive Officers believe that the skills required by their tax function will not just be limited to traditional accounting and tax qualifications, but there will be need for the tax function of the future to be equipped with Information Technology skills needed to react to constantly changing global business requirements. Apart from traditional accounting and tax qualifications such as Institute of Chartered Accountants of Nigeria (ICAN), Chartered Institute of Taxation of Nigeria (CITN), Association of Chartered Certified Accountants (ACCA) or Association of National Accountants of Nigeria (ANAN) qualifications, tax professionals in multinational groups may require skills such as programming, and financial modelling.

5. Risk management/Controls

Risk management has become increasingly important over the years, driven by increasing regulatory searchlight on corporate governance and some high profile risk issues (including material weaknesses in tax accounting). Organisations need to be aware of the tax risks and what controls need to be put in place to manage these risks.

One of the most important risks for the tax function is reputational risk. This is especially becoming prevalent in the form of various government commentary on media platforms about the tax affairs of specific taxpayers, as well as non-governmental organisations such as ActionAid and whistleblowing platforms demanding for more transparency in the tax affairs of multinationals including financial institutions. The ever increasing reputational risk facing companies means the risk profile in the tax space is shifting.

Tax risk deals with how the decisions, actions, inactions, activities and operations of an organisation impact on the tax affairs of that organisation and affects the organisation's strategy. Tax risk management strategy should focus on minimizing tax risks while maximizing the opportunities for tax optimisation.

Managing tax risks involves;

a. Identification of business processes that create exposure to tax risks;
b. Evaluation of the risks based on significance and likelihood of occurrence;
c. Evaluation of the control environment to identify the strength and weakness;
d. Designing a tax policy based on the result of the above; and
e. Reporting and dealing with publicity in the press, which is discussed in more detail under the communication enabler.

6. Communication

There are various stakeholder groups having different interests and agenda in every organisation. These could be internal (shareholders, employees) or external (tax authorities, host communities). Tax functions should place high priority on effective communication by anticipating the needs of each stakeholder group and employing the appropriate communication medium. For example, effective communication with tax authorities for navigating uncertainty around tax policies could be achieved through advanced pricing agreements, setting up enhanced relationship committees comprising representatives of the company and the tax authorities, and alternative dispute resolution mechanisms.

In the nearest future, regulators will demand transparency regarding global taxation, necessitating clear and thoughtful communications with public stakeholders about the tax affairs of the business.

Conclusion

An effective tax function is a viable tool that can be used to strategically position a company in the uncertain business terrain. Companies must focus on how their tax function should operate to achieve its objective of tax and regulatory compliance, optimisation of shareholder value and overall business growth.

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