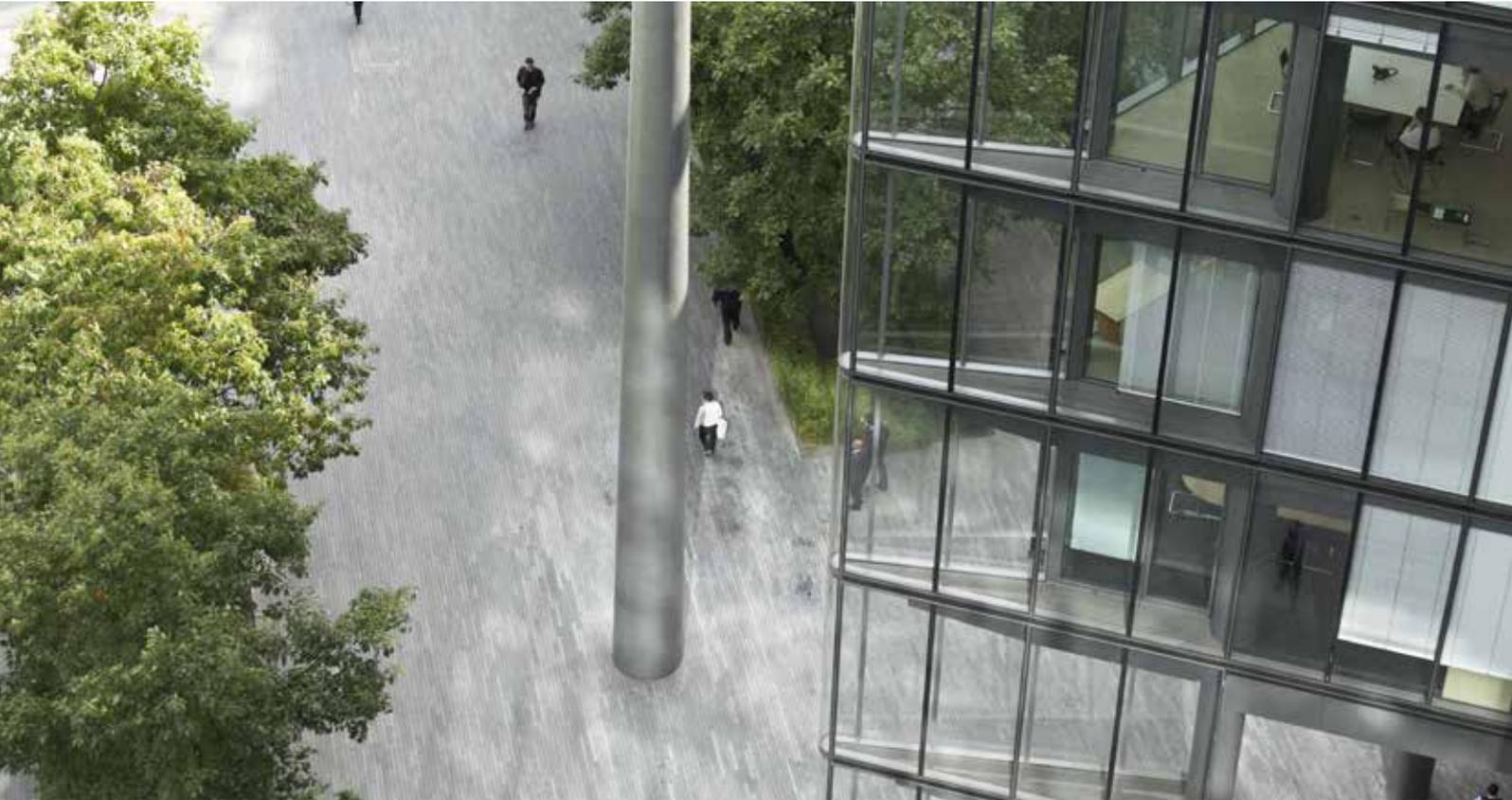




The future shape of financial services in Africa



*The Africa financial services journal
April 2015*



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Editor's note



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This edition of our annual African financial services journal examines what the future of financial services might look like for Africa. We look at significant strategic, technical and operational issues and the roles these might play in changing the market landscape.

Globally, the outlook for financial services is solid. But the rise of disrupters in the market, especially from unexpected places, has provoked the need for financial services entities to rethink their strategies. It also means that innovation and technology have moved a few notches up on their agendas. This is particularly true for Africa where the market is less mature or saturated, giving rise to opportunities for new entrants to challenge the status quo.

Coupled with this is the expectant growth of Africa's economies. More and more of the population is becoming part of the formal financial system with elements unique to the African market, such as mobile phone technology and its prevalence, fuelling growth. A large portion of the market still remains untapped and the race is on for financial services companies to find new and innovative ways to get customers on board. Navigating the regulatory and political environments remain a huge challenge. The financial services firms that find effective ways to work within these constraints will come out on top.

In this publication, we try to bring some of these challenges, which often increase in complexity over time, to light. It is becoming crucial for financial services to be very agile in this ever-changing market, and an appetite for diversification and innovation is essential.

I hope that this collection of articles will provide some insight into the future state of financial services in Africa. We welcome your comments and feedback regarding this and other PwC financial services publications.

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A marketplace without boundaries





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Key findings of PwC's 18th Annual Global CEO Survey in the financial services sector

PwC's 18th Annual Global CEO Survey, released at Davos in January 2015, assesses CEO confidence about future prospects and explores how they are building local capabilities and realising opportunities in new markets. This year's survey looks at how business leaders are finding new ways to compete in an era of unprecedented digital change.

While 1 300 CEOs from 77 countries took part in the 18th Annual Global CEO Survey, this feature provides a summary of the findings on issues specifically affecting the financial services sector. It is based on 410 interviews with financial services CEOs (175 from banking and capital markets in 54 countries; 80 from insurance in 37 countries; and 155 from asset managers in 46 countries).



Download the global report, assess the results and explore the CEO interviews from our 18th Annual Global CEI Survey online at www.pwc.com/ceosurvey.

Banking and capital markets CEOs

Despite a renewed sense of optimism in the banking and capital markets (BCM) industry, CEOs recognise that the challenges facing the industry are

immense, the risk of disruption is very real, and the pace of change is ever increasing.

In spite of growing concerns about global economic growth, 92% of BCM CEOs are optimistic about their companies' growth prospects over the next three years, but only 43% expect global economic growth to improve over the next 12 months, down from 56% in 2014.

When it comes to BCM CEOs' perception of key social, economic and policy threats to their own company's growth prospects, the survey shows concerns about over-regulation have grown from 80% to 89% in 2015, with 87% believing that changes in regulation will continue to have a disruptive effect over the next five years.

Robert Sullivan, PwC's Global Banking and Capital Markets Leader, says:

The ability to get on top of regulation is hampered by lingering uncertainty over details and lacking information on the details on the one hand, and the potential for reactive, piecemeal and organisationally challenged implementation on the other. It is therefore vital to develop a proactive approach to regulation, headed by a regulatory leader charged with liaising with regulators, assessing the strategic impact and coordinating the response.



New market entrants/non-traditional players are also perceived as a threat by BCM CEOs in that they are disrupting existing models, largely by better serving customer needs at distinct points of the value chain. New entrants are able to use technology to provide a better customer experience, at a reduced cost, unencumbered by legacy infrastructure or business models.

When considering what actions to take to drive growth and mitigate these threats, digital transformation, innovative collaborations, diversity, and a proactive approach to regulatory management were identified as key themes.

According to the survey, 86% of BCM CEOs recognise the importance of the CEO being the champion of digital technologies in helping to make the most of their digital investments. The majority of CEOs (93%) see mobile technologies as important (more than the cross-industry average of 81%). As consumers shift more and more of their activity to their mobile devices, it is vital that banks are able to move from traditional branch-based engagement models to seamless multi-channel models.

More than 40% of BCM CEOs see joint ventures, strategic alliances and informal collaborations as an opportunity to strengthen innovation and gain access to new customers and new/emerging technologies. More than a quarter of BCM CEOs say they use alliances to access skills. They can be a good way of bringing talent on board that otherwise might not want to work in a typical banking environment.

In addition, BCM CEOs are looking for a much broader range of skills when hiring talent than they did in the past. At the same time they recognise the challenges, with 71% seeing the limited availability of key skills as a threat to growth, compared to 61% last year.

Insurance CEOs

Insurance CEOs believe there are more opportunities in the sector than there were three years ago. However, 61% see more threats and 69% are concerned about disruption from change to distribution channels.

David Law, PwC Global Insurance Leader, says:

The fact that people are living longer and have more wealth to protect presents insurers with an opportunity. However, challenges include mounting commoditisation and the need to have lower-cost digital distribution and advanced digital profiling to respond more effectively to customer demands.

More than in any other industry, regulation is the biggest concern for insurance CEOs. With Solvency II now less than a year from going live and other regional and local changes looming on the horizon, the report says the challenge for business is how to minimise the upheaval and build the new requirements into a reliable and cost-efficient business as usual.

Insurance CEOs recognise how digital technology can assist them to sharpen data analytics, strengthen operational efficiency and enhance customer experience. Almost half of CEOs plan to enter into a new joint venture or strategic alliance over the next 12 months. Two thirds see these initiatives as an opportunity to gain access to new customers, much more than in other sector in financial services. Over half of insurance CEOs say it is likely that insurers will also compete in sectors other than their own over the next three years.



However, compared to other sectors, the extent of their inroads into other sectors is limited.

Other findings show that most insurance CEOs (80%) are looking for a much broader range of skills. Diversity is now recognised as a key way to enhance business performance, innovation and customer satisfaction.

Transformation in the insurance industry is accelerating, creating opportunities for some and threats for others.

Slow adaption is not a viable option in the face of relentless disruption and change. Insurers need to be more radical in challenging and changing business models and they need to move more quickly in developing the necessary competitive capabilities if they want to sustain growth and keep pace with market expectations.

Asset management CEOs

Asset management CEOs are adapting to a changing world. They are optimistic about growth in assets and revenues. A high 95% of asset management CEOs say they are 'very' or 'somewhat' confident about growth over the coming three years. Yet they are also aware of the challenges they face. Compared with three years ago, when the after-effects of the financial crisis were even stronger than today, they see both greater opportunities and more threats. Sixty-five percent of asset management CEOs either 'agree' or 'agree strongly' that there are more opportunities, while 56% see more threats.

'Asset managers face a volatile environment over the next three years but there's never a time when all the variables are completely positive or negative,' says Barry Benjamin, PwC's Global Asset Management Leader. 'Opportunities exist because of some of the megatrends, but there will also be challenges for those asset

managers that do not have a strategy to succeed in high-growth areas.'

The findings of our 18th Global CEO Survey echo the conclusions of PwC's Asset Management 2020 white paper, which predicted global assets under asset management would exceed \$100 trillion by 2020 (up from \$63.9 trillion in 2012), with much of the growth coming from emerging markets in Asia and Latin America. The paper also predicted the emergence of new fee models and opportunities in products that might disrupt traditional banking, as well as the rise of passive funds and ETFs.

A high 88% of asset management CEOs express themselves to be either 'very' or 'somewhat confident' about their revenue growth as they look forward to 2015, rising to 95% over three years. Yet with fees under pressure from the rise of ETFs and passive funds, it is no surprise they remain vigilant on costs. Almost half (46%) aim to cut costs in 2015, which is less than in other industry sectors of this year's CEO survey.

With economic conditions varying significantly across the globe, 39% of asset management CEOs think the global economy will improve in 2015, but 45% think it will stay the same. Their perspective might depend on where they are based.

China and the US are viewed as the most important countries for growth in 2015. But the growth prospects are matched by threats, including economic, social and policy threats. Foremost among these is over-regulation, about which 83% of asset management CEOs indicate they are 'extremely' or 'somewhat' concerned.

A fifth of asset management CEOs (20%) plan to grow through cross-border mergers and more than a quarter (29%) through domestic mergers in 2015 – a higher percentage than for the rest of the financial services sector.

The rapid expansion of ETFs as well as the growth potential of Asia and the need for scale is driving a desire to reshape businesses.

Asset managers are also partnering more widely to access new opportunities. Almost a third (31%) of asset management CEOs reported engaging with customers through joint ventures, strategic alliances or informal collaborations, while another 32% are considering doing so.

Asset management CEOs are continuing to expand their workforces, with 61% planning to increase their headcount in 2015. However, only 47% have a strategy in place to promote diversity and inclusion. Those businesses that do have diversity and inclusion strategies see clear benefits. Eighty-two per cent believe they enhance business performance. In our view, active management of diversity and inclusion can be a competitive differentiator as asset managers compete for talent.

Although asset managers haven't embraced digital technologies to the same extent as their peers in banking, a high percentage regard them as 'strategically important' in a number of areas. These include data mining and analysis, cyber security and mobile technologies for customer engagement.

By 2020 technology will have become mission-critical to drive customer engagement, data mining for information on clients and potential clients, operational efficiency and regulatory and tax reporting.



*Opportunity beckons for prudent
public debt financing*





Dr Roelof Botha
Economic Advisor PwC

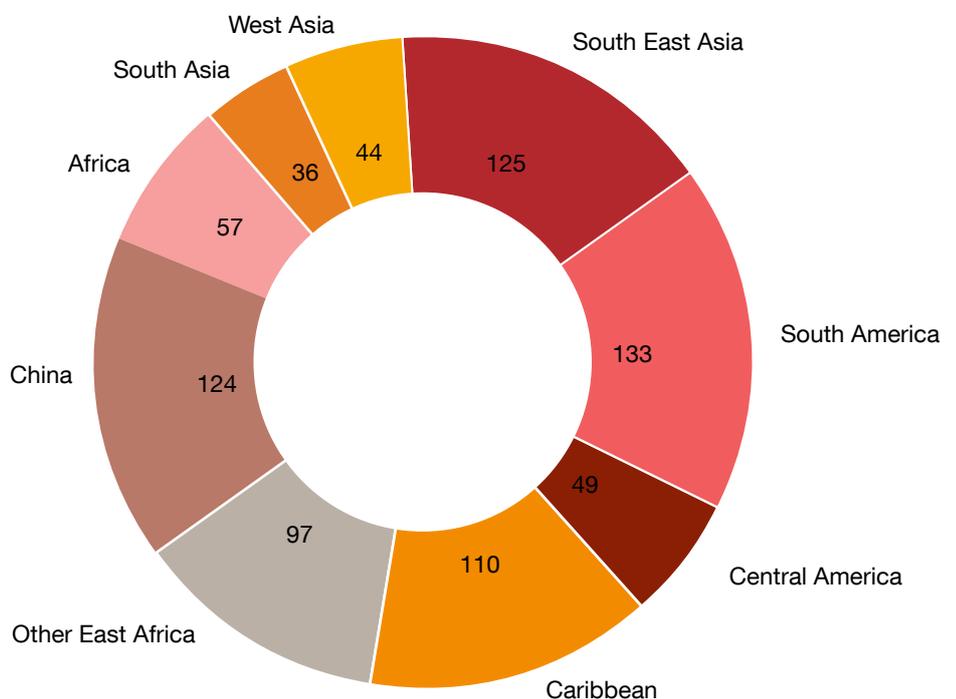
Analysis of the ratios between public debt and foreign direct investment (FDI) suggests that sub-Saharan Africa is under-borrowed by global standards.

According to the latest World Investment Report, published by the United Nations Conference on Trade & Development (UNCTAD), global inflows of FDI recovered from a disappointing decline in 2012 to reach a level of more than \$1.4 trillion in 2013.

This figure is almost 19% higher than the figure for 2009, when FDI took a severe beating in the wake of the world recession. Unfortunately, Africa only managed to attract 3.9% of global FDI, with the socio-political instability experienced by several North African countries having acted as a deterrent in recent years.

Sub-Saharan Africa (SSA) nevertheless managed to increase its inflows of FDI from a low of US\$37 billion in 2009 to US\$41.7 billion in 2013, with South Africa, Mozambique, Nigeria and Ghana proving the four most popular destinations for multinational companies.

Figure 1: FDI inflows to developing regions, 2013

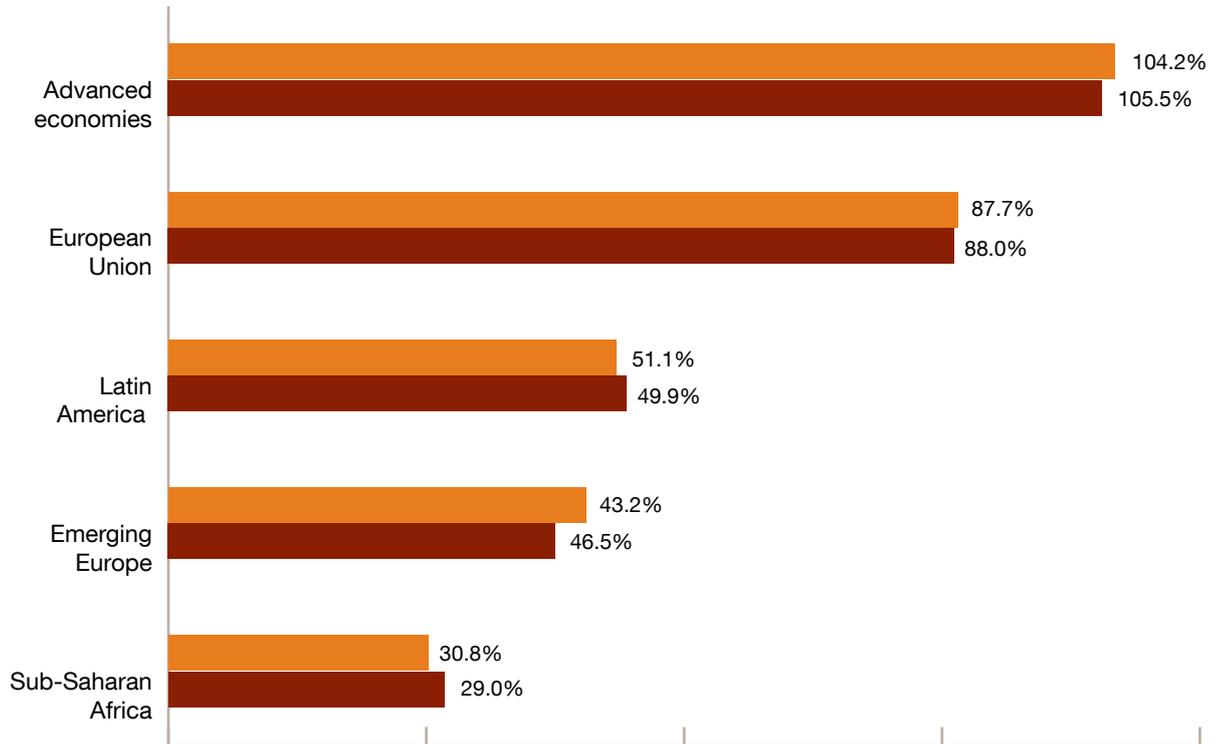


Source: UNCTAD

Gross public debt/GDP ratios in most African countries are very low by international standards and a comparison between the regional ratios of public debt to FDI inflows clearly reveals an opportunity for African countries to accelerate economic development via sovereign debt financing.

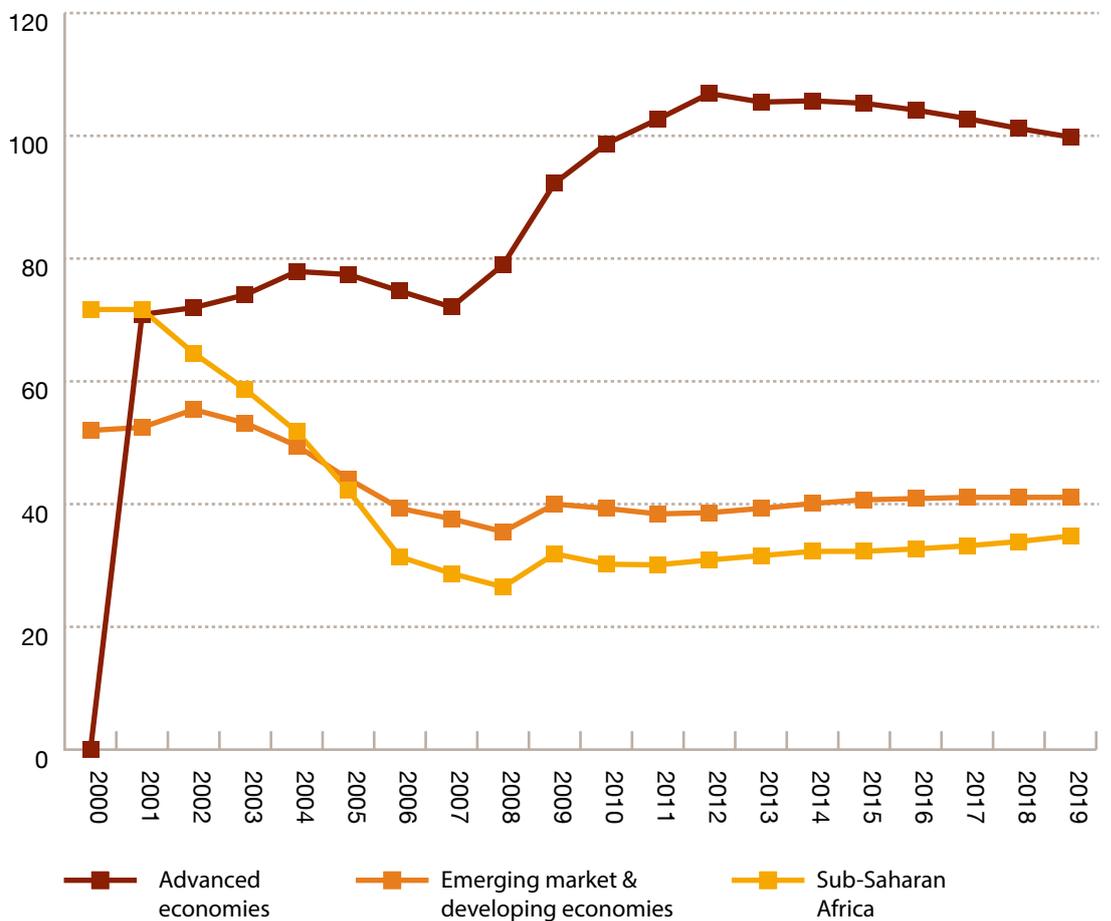


Figure 2: Ratio of government gross debt to GDP, selected regions



Source: IMF

Figure 3: General government gross debt (% of GDP)



Source: IMF, World Economic Outlook database

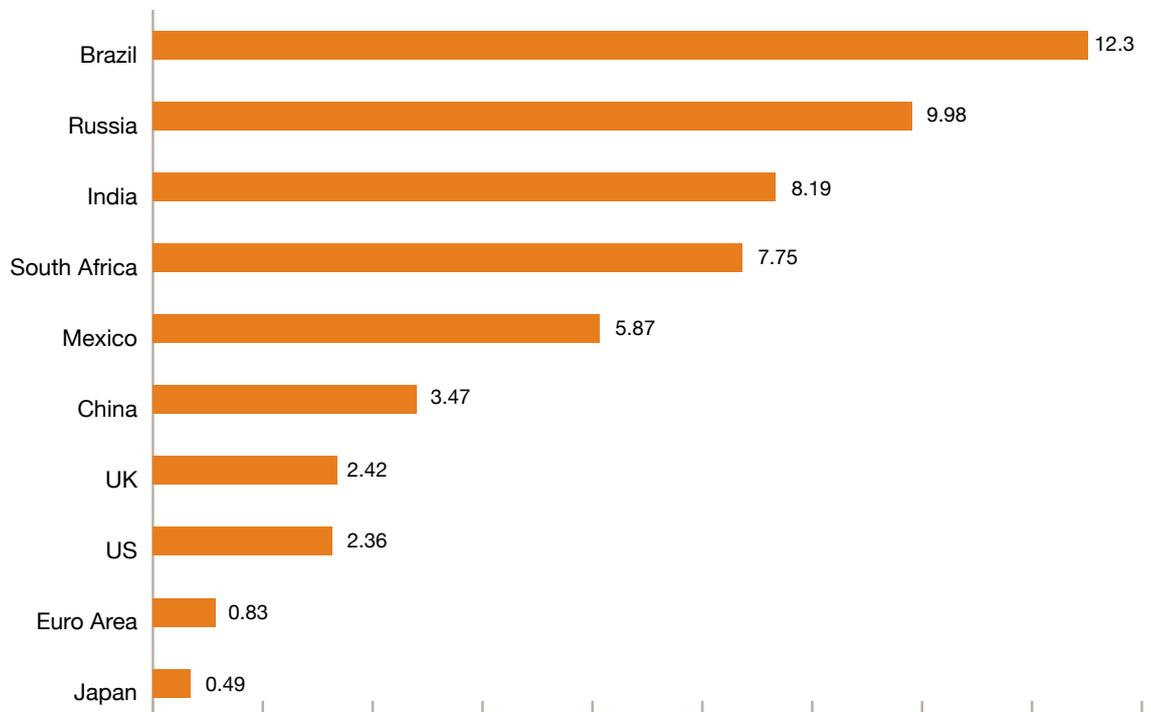


Against the background of large fiscal deficits and low growth scenarios for Europe, it seems unnatural for high-growth economies in Africa with acceptable corporate governance standards to rely so heavily on FDI to boost capital formation.

Fortunately, the prospect of exceptionally low interest rates continuing in most advanced economies well into the future has shifted the attention of fund managers to countries and regions with more attractive bond yields.

The new-found appetite for higher-yielding debt has been assisting a growing number of developing countries to make their debuts on international capital markets, including a number of countries in SSA.

Figure 4: 10-year government bond yields, November 2014



Source: Economist Intelligence Unit

One example is Rwanda, which issued its first international bond in 2013. The issue of US\$400 million 10-year bonds was administered by Citigroup and BNP Paribas and was eight times oversubscribed, allowing for a relatively low yield of just below 6.9%. Since then, the yield on these bonds has followed the near universal downward trend and was quoted at 6.1% in London in September 2014 much to the surprise of many European economists.

Despite the small size of the Rwanda bond issue, its yield is competitive when compared to the current yields on sovereign bonds of four of the five BRICS countries.



In keeping with its commitment to prudent macroeconomic policies, the Government of Rwanda resisted the temptation of enlarging the bond issue, stating that it would not deviate from the country's national budget.

The proceeds of the bond issue were allocated to repaying several government loans, complete the construction of a convention centre in the capital, Kigali, and finance a hydro-electricity project.

Following the August 2014 summit of African leaders hosted by the United States in Washington, Rwanda announced its intention to issue its second international bond for a reported US\$1 billion in 2015 to fund the construction of an airport and power generation plants.

According to information supplied by Standard Bank, which plays a leading role in Africa's capital market activity, a monthly average of approximately US\$800 million in sovereign bonds have been issued in the continent over the past two years.

Other African countries that are tapping burgeoning investor demand for developing country gilts include South Africa, Zambia, Kenya, Senegal and Angola.

The US-Africa Leadership Summit primarily focussed on trade, investment and security issues on the continent and provided a useful opportunity for African heads of state to discuss progress with reforms aimed at creating a more attractive business environment.

The proceedings culminated with President Barack Obama announcing US investment commitments to Africa of US\$33 billion.

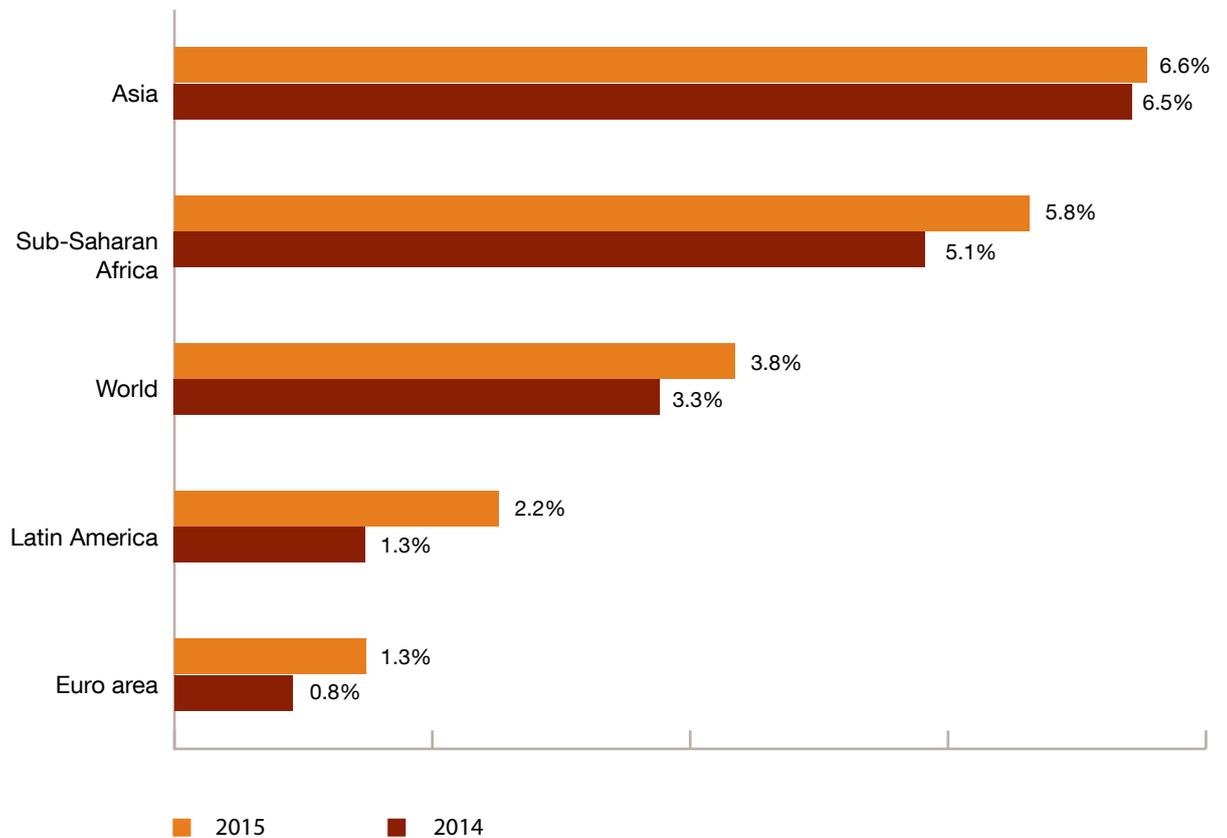
Fortunately, most of the emerging economies in SSA have not experienced any meaningful declines in the latest global competitiveness rankings.

The 2014/2015 Global Competitiveness Report (GCR) published by the World Economic Forum (WEF) reveals further progress with financial market development in Africa, with the growing size of several of the economies on the continent also contributing to fairly sound global rankings for market demand.

According to the WEF, the SSA region has provided some reason for cheer in recent years amidst an otherwise gloomy global economic environment. On average, the region is expected to continue registering real GDP growth of between 5% and 6% over the medium term, with several countries growing their economies at even faster rates.



Figure 5: Regional GDP growth forecasts, 2014 and 2015



Source: IMF

Unfortunately, the region's relatively strong performance in market efficiency stands in contrast to a poor performance across all basic requirements for competitiveness. More than half of the 20 lowest ranked countries in the GCR are in SSA, and areas that remain in urgent need of policy reforms include infrastructure, health, education and institutional efficiency.

Hopefully, increased access to capital market funding for infrastructure projects, especially in energy, as well as improved public sector corporate governance, will witness a strengthening of the competitiveness of SSA over the next couple of years.



IFRS 9: Not just a new standard, but a new way to manage credit risk



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Introduction

What is this new beast called IFRS 9? Is it actually a beast and how different is it from IAS 39? Could it just be IAS 39 by another name? We don't believe so and in this section we explain why IFRS 9 represents not just a change in a standard, but actually requires a change in how we manage credit risk all together.



Challenges

What does it mean to implement IFRS 9? What are some of the questions that you should be asking to stir up debate or action in your organisation? We look at both the technical and operational challenges that we anticipate and that we are seeing the industry grappling with as it plans to implement this new standard.



Rest of Africa

For banks operating in the rest of Africa where skills are scarce and the management of credit risk is less sophisticated, what does the new standard mean? Where do you start and what are the immediate priorities? We also highlight the difficulties we foresee given the diverse central bank prudential regulations in place across the continent.



Next steps

IFRS 9 is mandatory for annual periods beginning on or after 1 January 2018, so can it wait until 2017? Unfortunately it can't and we explain why.

Introduction

After lengthy deliberations, the IASB published the complete version of IFRS 9 Financial Instruments¹, which replaces most of the guidance in IAS 39. The IFRS 9 standard dealing with impairment requires the recognition of credit losses based on expected credit losses:

- Either 12-month or lifetime expected credit losses for:
 - Amortised cost assets;
 - Debt instruments at fair value through other comprehensive income (FVOCI); and
 - Loan commitments and financial guarantees.

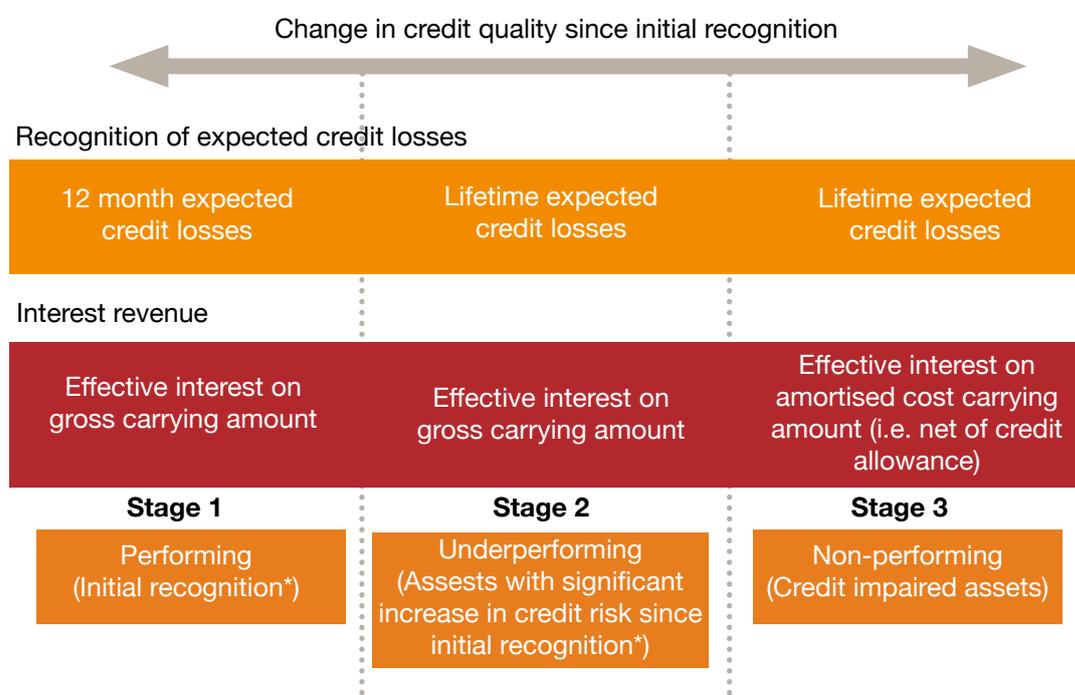
Credit losses will no longer be limited to the 'incurred losses' currently recognised under IAS 39.

The new standard outlines a three-stage impairment model based on changes in credit quality since initial recognition.

¹ IFRS 9 is mandatory for annual periods beginning on or after 1 January 2018. Entities can elect to adopt the new standard early, however, from 1 February 2015 entities will only be allowed to early adopt the final version of IFRS 9 and not previous versions of IFRS 9.



Three-stage credit loss model



1

Stage 1 includes financial assets (loans) that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date (i.e. investment grade assets). For these assets, 12-month expected credit losses (ECLs) are recognised and interest revenue is calculated on the gross carrying amount of the asset (i.e. without deduction for credit allowance). Twelve-month ECLs are the expected credit losses that result from default events that are possible within 12 months after the reporting date. These are not the expected cash shortfalls over the 12-month period, but the entire credit losses on assets weighted by the probability that the loss will occur in the next 12 months.

2

Stage 2 includes financial assets that have had a significant increase in credit risk since initial recognition (unless they have low credit risk at the reporting date), but that do not have objective evidence of impairment. For these items, lifetime ECLs are recognised, but interest revenue continues to be calculated on the gross carrying amount of the asset. Lifetime ECL is an expected present value measure of losses that arise on default throughout the life of the asset. The standard requires that when determining whether the credit risk on a financial asset has increased significantly, the bank considers reasonable and supportable information available to compare the risk of a default occurring at the reporting date with the risk of a default occurring at initial recognition of the financial asset.

3

Stage 3 includes financial assets that have objective evidence of impairment at the reporting date. For these items, lifetime ECLs are recognised and interest revenue is calculated on the net carrying amount (i.e. net of credit allowance).



Challenges in the implementation of IFRS 9



What does it mean to implement IFRS 9? What are some of the questions that you should be asking to stir up debate or action in your organisation? We look at both the technical and operational challenges that we anticipate and that we are seeing the industry grappling with as it plans to implement this new standard.

Implementation of the standard, which is mandatory for annual periods beginning on or after 1 January 2018, presents a host of technical and operational challenges.

Technical challenges of applying IFRS 9

Criteria for moving between the stages

When assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, management looks at the change in the risk of a default occurring over the expected remaining life of the financial instrument, rather than the change in the ECL. A bank should compare the risk of default as at the reporting date with the corresponding expected risk of default that was estimated as at the date of initial recognition.

In our opinion, a simple or absolute comparison of the probability of default (PD) at initial recognition (average PD used for pricing purposes) and at the reporting date is not appropriate. All other things staying constant, the PD of a financial instrument changes with the passage of time. Banks therefore need to consider the relative maturity of a financial instrument at inception and at the reporting date when comparing PDs.

Moving from delinquency only models to forward looking models

IFRS 9's expected loss model requires banks to consider forward looking information and expected future level of risk to determine 12-month and lifetime ECLs" after stage of impairment instead of current wording. (e.g. macroeconomic data) in determining the stage of impairment and expected future level of risk to determine 12-month and lifetime ECLs in addition to inclusion in the 12-month ECLs or lifetime ECLs.

The model can be applied at an individual or portfolio level. However, some factors or indicators may not be identifiable at an instrument level. This might be the case for financial instruments such as retail loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument basis until a customer breaches the contractual terms.



In such cases, the factors or indicators should be assessed at a portfolio level. Management cannot avoid calculating lifetime ECLs by considering the assessment at an individual asset level only if information available at portfolio level indicates that there has been an increase in credit risk for the instruments included in the portfolio.

There will be limited instances in which delinquency only models (i.e. models that ignore forward looking information) will be appropriate under IFRS 9. However, if information that is more forward-looking than past due status is not available, there is a rebuttable presumption that credit risk has increased significantly since initial recognition no later than when contractual payments are more than 30 days past due. This presumption may be rebutted and banks will need to consider for which products they wish to collect reasonable and supportable evidence to rebut the presumption that there has been a significant increase in the credit risk.

Off-balance sheet items

IFRS 9 has removed the distinction that existed under IAS 39 between off-balance sheet credit exposures (loan commitments and financial guarantees) and on-balance sheet exposures. Banks will in future have to apply the ECL model to both on-balance sheet exposures as well as off-balance sheet exposures, such as loan commitments and financial guarantees.

IFRS 9 requires the ECLs to be measured over the maximum contractual period over which the bank is exposed to credit risk. However, as an exception, for certain revolving credit facilities such as credit cards and overdrafts, ECLs will be measured over the period the bank is expected to be exposed to credit risk. This would be driven by customer behavior and demonstrated credit risk mitigation actions implemented by

the bank. Therefore, IFRS 9 requires banks to model behavioural exposure at default (EADs) for revolving credit facilities. Banks will need to determine for which type of facilities a behavioural EAD is required and the period over which the EAD should be modelled. This assessment will require significant judgment and expertise.

Adapt existing models or build new ones

As discussed above, the standard allows banks to make the assessment of changes in credit risk by using a 12-month PD where it would not be expected to give a different result to using a lifetime PD. This does not mean that the 12-month PD used for regulatory purposes can be used without adjustment.

Twelve-month ECLs used for regulatory purposes are normally based on 'through the cycle' (TTC) probabilities of a default (that is, probability of default in cycle-neutral economic conditions) and can include an adjustment for prudence. The PDs used for IFRS 9 should be 'point in time' (PiT) probabilities (that is, probability of default in current economic conditions).

Regulatory PDs might be a good starting point, provided they can be converted to an IFRS 9 PDs. This can be done through the use of the PiT and regulatory TTC PDs with an assumed pattern of mean reversion to project the expected change in PDs. Under IFRS 9, estimates of PD will change as an entity moves through the economic cycle. Under many regulatory models, as PDs are calculated through the cycle, estimates are less sensitive to changes in economic conditions. Therefore, regulatory PDs reflect longer-term trends in PD behaviour as opposed to PiT PDs.

As a consequence, during a benign credit environment, IFRS 9 PD (PiT) will be lower than regulatory PD (TTC), while the adjustment will be the opposite during a financial crisis.

Banks will need to determine whether they will adapt existing models (regulatory, pricing or IAS 39 incurred loss models) or build new models to comply with IFRS 9. The decision to adapt existing models or build new ones may differ between banks.

The decision will include, for example, consideration of the following type of items: the level of sophistication of current models, how adaptable current models are, consideration of system requirements etc.

We envisage that the decision to build a new model or to retain an existing model will also vary from product to product due to the product's characteristics and the availability of forward-looking information.

Operational challenges

Skills and resources

IFRS 9 will increase the level of judgment (e.g. estimation of forward-looking lifetime credit losses), which will further increase the need for an experienced team to manage credit risk and impairments. These skills, which include risk, actuarial, accounting and economic skills, are scarce, particularly in Africa.

We expect that behavioural and macro-economic models will play an even more important role under IFRS 9 in

determining ECLs, increasing the need for skills in these areas. Specific areas of focus where specialised skills will be vital include:



- Assessing whether there has been a significant increase in credit risk when compared to expectations set at the point of origination;
- Determination of the triggers for moves between buckets (especially between stage 1 and 2);
- Incorporation of forward-looking information and macro-economic factors (forecasting) and the impact these have on ECLs;
- Definition of default; and
- Behavioural life of revolving credit facilities.

Banks should start planning their skills requirements for completing and delivering a project of this nature.

Systems and data

Systems and data have always been key components of good credit risk management. The ability of banks to obtain and maintain data is and has always been critical in the estimation of PD and loss given default (LGD), not only for financial reporting, but also for regulatory reporting and pricing decisions.

Having the systems to collect, maintain, interrogate and manipulate data to meet the business requirements has not only been important but has been used to gain competitive advantage in recent years.

Systems and data (both historical and forward looking) are bound to gain even more prominence under IFRS 9, as they will be critical in some of the key assumptions made, including:

- Expected life of the customer (maximum contractual period) to be able to determine lifetime losses, banks will need to estimate what

the life of the exposure is likely to be for a specific product. This will be made even more difficult by the recent trend of customers transferring their facilities from one bank to another;

- Expected credit loss due to events over the next 12 months and beyond based on reasonable and supportable forward-looking estimates; and
- Determination of relationship between credit risk and macro economic factors.

Currently, most entities do not collect the amount of credit information required by IFRS 9, in particular the term structure of credit risk at the point of origination.

Some of the systems currently being used by banks will also need to be significantly upgraded or replaced if they are to meet the demands of IFRS 9. The emphasis is likely to be on systems that can mine all the available data and be able to slice and dice the data efficiently to give businesses the ability not only to manage credit risk, but also provide valuable insights to inform decisions on strategy such as pricing.

Impact on capital, pricing and strategy

IFRS 9 introduces requirements that are far more onerous than those in IAS 39. These include:

- Pricing for more complex and onerous impairments;
- Complexity around the interaction of capital and impairments, including cases where the impairment basis would be more conservative than the capital basis;

- Strategies to deal with potential volatility in results when entire blocks of business move between Stage 1 and Stage 2 due to changing conditions;
- Ensuring consistency between lifetime estimates implicit in impairment, economic capital and pricing; and
- Product design to remain competitive.

These factors, together with many others, will force most banks to review their current product offering and associated capital requirements and to conclude on whether it still makes business sense to continue selling these products.

We also expect to see the new requirements having an impact on how banks price their products going forward (by way of further risk-driven differentiation in pricing). The current pricing structures will need to change in line with the new landscape.

Processes and impact on governance

We expect to see significant changes in the current governance structures. As the level of judgment in these impairment models increases, so will the need for strong and robust governance processes to challenge the assumptions and decisions made to ensure that the final answer is not only correct, but also aligns with the business model.

It is expected that the IFRS 9 models will make increased use of judgment. The models used to support these judgements will therefore also be subject to a lot more scrutiny due to the large potential impact these models could have. This would include back testing and monitoring of projected results to ensure models are robust and defensible.



The dynamic nature of these models will also mean more rigorous and frequent validation will be needed than has typically been necessary in the past.

All these factors could require an increase in the number of resources in these areas, but even more importantly, the need for increased skill level and experience.

Beyond South Africa, the use of internal data and modelling in assessing impairment and credit risk management has historically lagged behind the rest of the world. While this has begun to change, for most of the banks (with the exception of subsidiaries of international banks), accounting for impairment has mainly been regulatory driven and there has been very little investment in this area. Impairment accounting has been based on set thresholds based on the number of days a debt has been outstanding (delinquency). Typically, the level of sophistication of models and the granularity of models has lagged behind the rest of the world.

However, most of the regulators on the continent are now moving to adopting/incorporating international standards like IFRS and Basel as part of their regulations. This means that in the not-so-distant future, these standards will be an integral part of local prudential regulations, which even locally-based banks will be obliged to adopt.

It is therefore in the best interests of banks to have a proactive plan in place now so that when the investment is made, it is made with the strategic direction of the bank in mind and is not just a last-minute rush for purposes of compliance.



This is, however, unlikely to be a smooth process with the following being the key challenges we foresee:

- **Regulatory reporting v IFRS reporting**

Though we have indicated that we are seeing more and more regulators moving towards the adoption of international standards, this is not going to happen overnight. What remains in the meantime is the challenge of complying with both IFRS and local prudential requirements.

Under IAS 39 we saw the ‘accepted’ use of the non-distributable Statutory Regulatory Reserve to bridge any differences between the impairment required by prudential regulations and that required by IFRS.

We have also seen many regulators on the continent adopting a more aggressive approach in recognising impairment. For example, some regulators are requiring write-off of exposures after a specified number of days outstanding (despite the existence of collateral and any recovery efforts underway), which has only exacerbated the gap between IFRS and local regulations.

This discrepancy in treatment is likely to be made worse with the adoption of IFRS 9. Banks therefore need to start engaging with their regulators through their industry associations at this early stage to address how such differences will be resolved.

- **Data**

Unlike their international (and South African) peers, many banks in the Africa have very limited empirical data, if any, that can be used to inform the future expected performance of their current portfolios. Collecting such data takes time (minimum five years). Given this challenge, one of the

options would be for banks within the same country/similar market to share information.

This presents a new dynamic, as banks have not done this in the past, but it might present the only viable and cost-effective (at least in the short term) solution to the challenge. The other alternative would be to obtain data from other comparable countries across the world. Most banks have until now used the same data for prudential reporting and just adjusted (with some difficulty) for IFRS reporting. This will become more difficult under IFRS 9.

- **Systems and processes**

Collecting the data mentioned above also requires the right systems. Existing banking systems tend to be geared towards delivering to customers with little consideration being given to back office requirements, such as data warehousing and analytics which is more common in banks operating in more developed economies.

Developing these capabilities will require significant investment by banks, which some have already started making. Such investment should, however, be made with strategic intent in mind, especially with the emergence of data mining and data analytics as a differentiator and tool to gain competitive advantage.

Being able to collect the right data is one thing, the real benefits, however, lies in having the right tools to mine for the nuggets that lie beneath. In addition to the IT systems, adoption of IFRS 9 will require re-engineering of the current processes in place (and the control environment) to ensure that these are able to meet the increased demands under the new standard.

What we currently see in practice is credit supplying the exposure balances to the finance team and finance determining what the impairment should be. We foresee this role changing in line with other developed markets where credit takes ownership of the impairment numbers and finance acts as more of an independent check, challenging the reasonability of the impairment arrived at by credit.

- **Modelling and actuarial skills**

Modelling and actuarial skills are quite scarce in Africa, even in South Africa. In the past, the few local actuaries that have come up through the systems end up leaving for developed economies in search of deeper experience and gainful employment as a result of their skills not being appreciated locally.

The continent thus tends to rely on ‘fly-in’ consultants, something that is not going to be sustainable in the long run given the importance that the standard places on management being able to assess the expected credit losses on their exposures.

Banks will therefore need to invest in these resources. This is especially so given that retail business is expected to dominate the market and impairment assessment for this book is likely to be portfolio based and quite judgmental.

Some of the challenges mentioned above will probably be a blessing (and could offer a competitive advantage) to the subsidiaries of international banks that can draw upon the knowledge, expertise and resources within the group to make the transition at a minimal cost.



Next steps and implementation planning

In planning for the adoption of IFRS 9, here are the key items we believe management and credit committees should be thinking about.

A model development plan, including sufficient time to refine models. Refining models would be more important due to the significant changes from the current delinquency-driven models	Agreement of judgmental areas such as triggers for moving between stages and allowance for macro-economic conditions
Aligning current model development and processes such as management overlays to IFRS 9 requirements	Aligning impairment, regulatory capital, economic capital and pricing models
Assessment of skills required to complete and deliver this project and the hiring of resources to maintain sustainable solutions	A clear and concise communication plan to reach all affected stakeholders
Assessing the capabilities of current systems and available data to support expected credit loss modelling	Governance processes to support the inherent significant judgment introduced by modelling expected credit losses



Executive remuneration in financial services





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Change is coming

The financial services (FS) sector is being transformed and is currently going through an organisational overhaul (capabilities, structure, decision making, processes, technology and talent) needed to meet changing customer expectations.

This emerging marketplace also demands people who are comfortable with change. They will use their networked capabilities and new decision-making tools to accumulate knowledge much quicker than previous generations and move easily between projects and roles. Levels of pay may reflect how value was created in the past, but not going forward.

It's generally assumed that employee value increases with experience. But as part of the 'rise of wise young people', today's networked employees are able to acquire new skills much more quickly and make use of technology to supplement any gaps, making the rewards for seniority and experience less relevant.

As we look at how to put pay on a more sustainable basis, it will be important to ensure that reward assumptions reflect these developments. In particular, what conventional remuneration surveys indicate is the going rate may not reflect how much value people deliver in this changing marketplace. An important priority will therefore be the move from 'mark-to-market' pay scales to a 'mark-to-value' approach to reward in which staff are paid in line with the pivotal importance of their role and their contribution to customer understanding, sustaining relationships and other sources of long-term value creation.

Executive remuneration trends

This transition will also extend to FS executives' pay, but for now the debate about the level of executive pay continues as it is still at the top of the regulatory, legislative and shareholder agenda and frequently at the top of the news headlines. FS companies must still be able to clearly demonstrate how their remuneration policy supports the company's strategic plan and justify the link between pay and company performance.

Given this continued focus on executive pay, we look at some of the recent global developments to establish some key trends for Africa. Like South Africa, most countries in Africa prefer to adopt a best practice approach rather than a regulatory approach. However, where there are ties with the US and/or the EU, compliance with regulatory guidelines are not optional.

Internal equity

The CEO-to-median-worker pay ratio proposed by the US SEC has been heavily criticised in the US and still the EU proposal includes a slightly different but essentially similar pay ratio.

EU say-on-pay

On 9 April 2014, the European Commission published a proposal for a Directive that aims to encourage long-term engagement of shareholders and enhance transparency. This proposal is part of the Commission's Action Plan to harmonise European company law and corporate governance into a modern legal framework for more engaged shareholders and sustainable companies.



The recent EU say-on-pay proposal provides for the introduction of:

- A binding vote on remuneration policy proposals, i.e. remuneration policy proposals will have to be submitted to the general meeting of shareholders for their approval (binding vote);
- An advisory vote on remuneration reports, i.e. the remuneration reports will have to be submitted to the general meeting for their advice (non-binding vote);
- A detailed list of data and topics for the remuneration report, with specific emphasis on the link between pay and performance of directors;
- An internal pay ratio; and
- An obligation for the statutory auditor to include the remuneration report in the corporate governance statement and check that the information has been provided in accordance with the Directive/national legislation once enacted.

Internal pay ratio

The EU internal pay ratio should be disclosed and explained in the remuneration policy. The ratio is not primarily meant to be an indicator for external benchmarking purposes. The rationale for disclosing the ratio is, in fact, the remit of the supervisory board to take into account the employment conditions and remuneration of other employees when developing remuneration proposals for management board members. The proposal expresses this as follows:

The policy shall explain how the pay and employment conditions of employees of the company were taken into account when setting the policy or directors' remuneration by explaining the ratio

Would the obligation to disclose the company's internal pay ratio as proposed by the European Commission enhance transparency and facilitate a meaningful discussion with shareholders and other stakeholders?

Let's first compare the proposed CEO pay ratio disclosures:

EU pay ratio =

Average remuneration of management board members (executive directors) / Average remuneration of all other full-time employees.

US pay ratio =

Average remuneration of management board members (executive directors) / Median of total remuneration of all other employees.



As mentioned earlier, the two ratios are different and it is not surprising that there have been many criticisms in both the US and the EU around these proposed ratios. It is doubtful whether these rules will actually narrow the gap between employee remuneration and executive remuneration for a number of reasons:

- The ratio will not provide investors with useful or accurate information as it is largely dependent on the type of industry and location of operations;
- It requires data, estimates, assumptions and judgment calls to produce the ratio, which may be misleading/give a distorted view;
- Mandatory publication of an internal ratio will give rise to external benchmarking, which is likely to be meaningless;
- The ratio distracts from the real issue – can a company justify the amounts it pays to its executives and employees?

UK Corporate Governance Code

We also take a closer look at two of the new provisions included in the 2014 UK Corporate Governance Code which was published in September.

Clawback and malus

Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.

This provision will apply to all material incentive schemes, both long-term incentive plans and short-term bonuses. This should provide an opportunity for remuneration committees to correct outcomes from incentive plans when it emerges that decisions on pay-outs have been fundamentally ill-founded or the performance outcome does not reflect a significant negative event.

The Code does not outline the scenarios in which clawback or malus should take place, but leaves it to companies to specify those circumstances. The 2012 UK Corporate Governance Code provided that clawback should be considered ‘in exceptional circumstances of misstatement or misconduct’. While misstatement and misconduct will clearly be the core scenarios in which malus and clawback should be invoked, investors are likely to expect a broader range of eventualities, particularly for malus.

These trigger events might include regulatory fines or major corporate reputational issues. There may be a case for only activating a clawback provision for more serious misdemeanours, given the potential practical and legal difficulties inherent in recovery of sums already paid. Therefore, as has emerged in the FS sector, we expect to see an emerging practice of narrower conditions applying for clawback than for malus.

Post-vesting holding periods

For share-based remuneration, the remuneration committee should consider requiring directors to hold a minimum number of shares and to hold shares for a further period after vesting or exercise, including for a period after leaving the company, subject to the need to finance any costs of acquisition and associated taxation liabilities.

With increasing pressure from investors to encourage executives to take a longer-term view, most FTSE 350 companies now have shareholding requirements for executive directors and many companies have introduced a post-vesting holding period on equity incentive awards. The new UK Corporate Governance Code clearly gives a further nudge in the direction of adopting post-vesting holding.

Africa trend

We have already seen many of the remuneration committees of the major listed entities in South Africa begin to adopt these provisions voluntarily and this will no doubt soon be adopted by other major listed entities throughout Africa.



Strategic cost management: A challenge for Nigerian financial institutions





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Current realities

The fallout of the financial crisis in Nigeria as well as the impact of regulatory changes is prompting a crucial rethink of strategies, operating models and cost structures within Nigerian financial institutions (FIs). Recent reforms in the financial services landscape have contributed to declining income margins and increased operating costs:

- Cancellation of ATM maintenance fees;
- Gradual phasing out of Commission on Turnover (CoT) charges;
- Minimum requirement of a 3% interest rate on savings accounts;
- Increase in cash reserve requirement (CRR) on public sector deposits to 75%;²
- Increase in the Asset Management Corporation of Nigeria (AMCON) Resolution Costs levy from 0.3% to 0.5% of total assets³;
- Costs related to IFRS conversion;
- Costs associated with the transition to Basel II regulations (Nigerian banks were required to comply by June 2014)⁴; and
- Exclusion of particular reserves from the computation of regulatory capital and the limitation of Tier 2 capital (including Other Comprehensive Income (OCI) Reserves) to 33.33% of total Tier 1 capital.⁵

Prior to the banking crisis, Nigerian banks benefited from significant revenue growth accompanying the 'post-consolidation' era, cost reduction measures were merely focused on swift solutions that did not address ingrained operating model inefficiencies.

Following the crisis, banks have struggled with high operating costs, declining revenue growth and a comparatively high cost-to-income ratio. Few banks have been able to effectively manage this issue with the average cost-to-income ratio for the systemically important banks (SIBs) as high as 65% in 2013. This is relatively higher than average ratios recorded in other emerging markets and the BRICS: Brazil – 43%, Russia – 69%, India – 45%, China – 31% and South Africa – 55%⁶.

Also, results for the 2013 fiscal year show that Systemically Important Banks (SIBs) in Nigeria recorded negative profit growth; while 2014 first half-year performance results reveal that four SIBs declared a reduction in profit before tax (PBT) by an average of 13% compared to 2013 results. This trend is expected to continue with profits remaining under pressure into 2015, due to rising operational costs and tighter monetary policies.⁶

Other financial institutions face similar challenges. Revenue growth for insurance companies is threatened by low penetration (less than 2%) amongst Nigerians, limited product innovation and low public awareness. Capital market operators also have to grapple with the new minimum capital requirements released in December 2013.

¹ Central Bank of Nigeria (CBN) Revised Guide to Bank Charges, April, 2013

² Central Bank of Nigeria (CBN) Communiqué No. 93 of the Monetary Policy Committee Meeting of Monday 20 and Tuesday 21 January, 2014

³ Business Monitor International (BMI) Online: Commercial Banking Industry Forecast - Long-Term Promise Despite Short-Term Profit Pressure

⁴ PwC Financial Focus Publication - Risk and Regulations (Basel II Implementation in Nigeria)

⁵ Central Bank of Nigeria (CBN) Exclusion of Non-Distributable Regulatory Reserve and Other Reserves in the Computation of Regulatory Capital of Banks and Discount Houses August, 2014

⁶ Business Monitor International (BMI) Online: Commercial Banking Industry Forecast - Long-Term Promise Despite Short-Term Profit Pressure



These trends have ultimately resulted in a more aggressive focus on revenue growth, which is typically accompanied by significant cost investment and deferred return on investment. The ability to grow revenues while maintaining a tight rein on attendant costs is vital to delivering top-tier returns in the current market environment.

In response to the highly regulated and competitive business environment, financial institutions have resorted to cost management as one of the few directly controllable and manageable profit drivers. While traditional methods such as a reduction in headcount and outsourcing non-core capabilities brings short-term reprieve, this may not necessarily be the answer. Financial institutions need to take a long-term and strategic approach to cost management and implement significant and sustainable cost restructuring initiatives.

Tactical cost improvement is not enough

The old way of viewing all spend as simply a cost is not effective today. Yesterday's tactical solutions, despite consuming considerable resources, have failed in many organisations to deliver the planned reductions to the cost base and have not contributed to the creation of true competitive advantage in the long term.

In many cases the cost savings achieved in the short term have leaked away and the cost base has returned to previous high levels, but with the result of considerable damage to corporate structure, image, culture and morale. It is time to adopt some new thinking around cost as a strategic issue, which needs to be continuously optimised in the context of the entire business model of the organisation.

Often, the very business model itself may need to change to ensure the organisation remains competitive.

Tactical cost reduction and continuous improvement initiatives such as hiring freezes, staff rationalisation, deferring expenses, reducing travel/training and across-the-board budget cuts may deliver only short-term results.

However, these results are mostly incremental and captured savings are generally not sustainable in the long term, as they fail to address the underlying demand and supply-side cost drivers. Tactical cost management initiatives tend to focus on reactive and arbitrary cost reduction measures without necessarily addressing the spend culture and productivity/efficiency indices. For example, rather than focus on headcount reduction as the sole means of reducing branch operating expenses, financial institutions can consider identifying key reasons why customers visit the branch and provide alternative channels to serving them.

In today's competitive environment smart companies view all of their spend (direct and indirect) as an investment. They make smart investment decisions based on strategic vision and their internal capability to deliver value from that investment. They see cost or expense through a new lens; one that takes a holistic view of the organisation and is more aligned to addressing the reality of external pressures and the longer-term goals of the business.

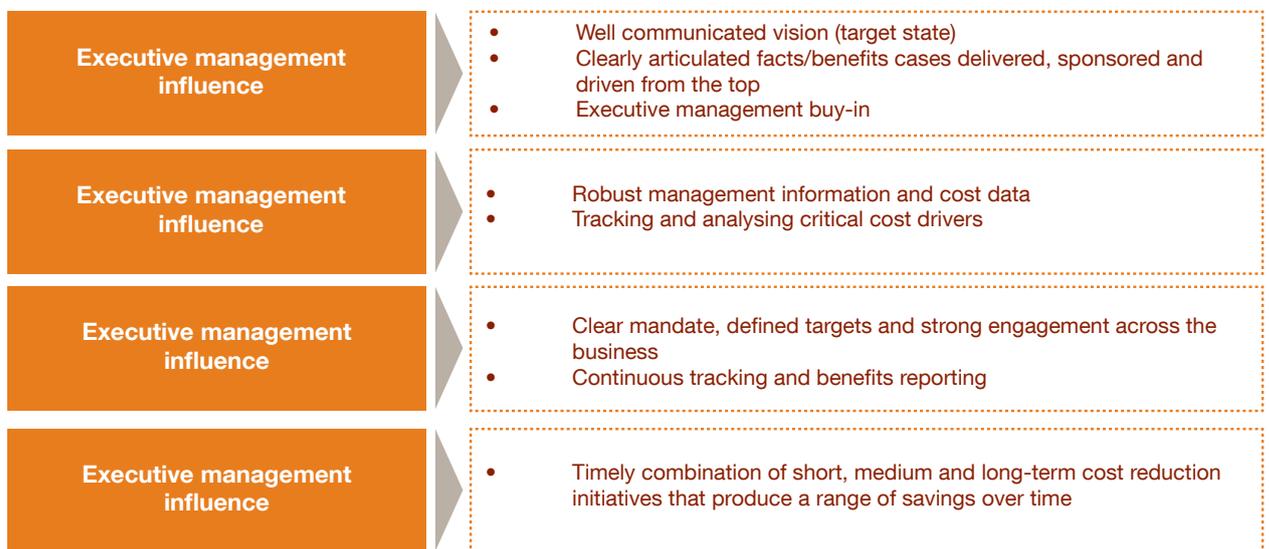


CEOs are seeking new frontiers in cost management

CEOs today are seeking more sustainable cost reduction measures. PwC's 17th Annual Global CEO Survey (2014) found that 57% of banking and capital markets CEOs identified cost management as a top priority in the coming months.⁷ In Nigeria, 80% of financial services CEOs surveyed said they were implementing cost reduction initiatives such as centralisation and outsourcing.

PwC's point of view: A different approach to cost management

Critical success factors for cost management/restructuring include:

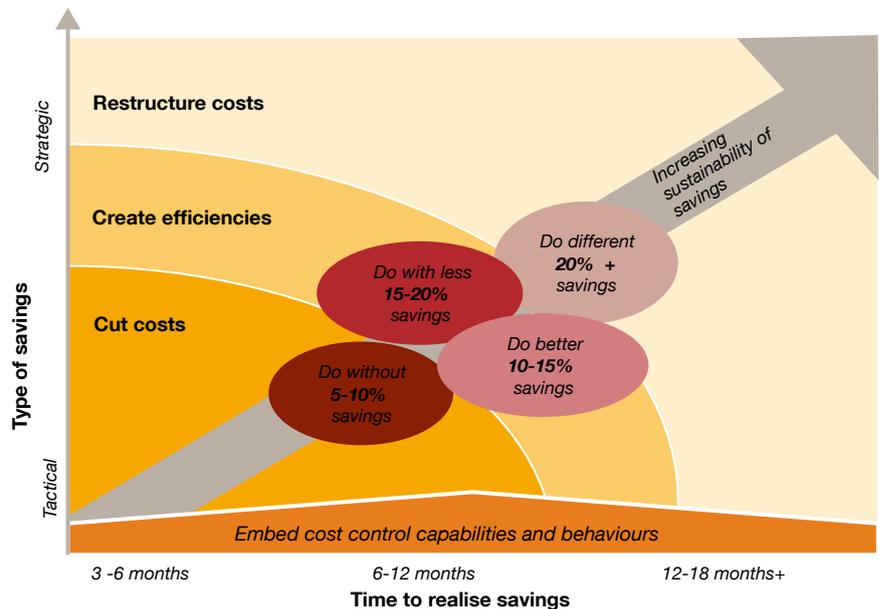


PwC's approach to cost management focuses on four key themes - 'doing without', 'doing better', 'doing with less' and 'doing differently'. Focusing on these themes will help financial institutions move beyond 'cost cutting' to 'cost restructuring' and facilitate the achievement of more sustainable results.

⁷ PwC 17th Global Annual CEO Survey 2014



The opportunity accelerator approach



Focus of activities	Savings levers	Opportunities
Restructure the cost base 'Do different' (20%+ savings)	Closures and exits	Close or sell underperforming/non-critical parts of the business, customer types and/or product offerings
	Strategic sourcing	Consolidate sourcing and vendor activity, create shared services, outsource non-core processes and platforms off-shore and replace core systems
Reduce infrastructure 'Do with less' (15-20% savings)	IT consolidation	Consolidate IT platforms, hardware, infrastructure and data centres
	Property optimisation	Review property demand and take advantage of what you have, look at ways to dispose of assets and reduce property-related spend via sourcing/vendor reviews
Create efficiencies 'Do better' (10-15% savings)	Process improvement	Reduce complexity, errors, duplication and improve standards around key processes across the business using methods such as lean and straight-through processing
	Business simplification	Simplify and reduce duplication of roles and activities, consolidate and rationalise similar functions and activities
Cut costs 'Do without' (5-10% savings)	Activity and headcount reduction	Review and challenge team activities, workload capacity, line management structures and reporting lines leading to headcount reduction
	Spend reduction and demand management	Challenge demand, discretionary spend and policy compliance, reduce/eliminate discretionary spend, contractor spend and re-negotiate vendor contracts.



In conclusion

As financial institutions seek to unravel the mystery that is cost management, CEOs need to take an objective look at their businesses and ask some critical questions:

- What are the potential cost implications of the current service delivery model?
- Has the product portfolio been reviewed to identify unprofitable or marginally profitable products?
- Are costs being 'postponed' and not 'managed'?

Government regulation protecting the consumer is increasing and price capping is becoming a common restraint on revenues for financial services organisations. This, coupled with globalisation that forces territories to compete for resources and investment, means that organisations need to radically reduce their cost base to retain good return on investment. Taking advantage of process and back office improvements is necessary.



Real estate: Building the future in Africa





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Real Estate 2020: Building the Future

During March 2014, PwC released its *Real Estate 2020: Building the future* report which highlights global trends and makes predictions about the real estate industry up to 2020. Some of these global trends are already evident in the African real estate industry and others will only start to appear in the future.

The six predictions made for 2020, and beyond, considered in the report are:

- The global investible real estate universe will expand substantially, leading to a huge expansion in opportunity, especially in emerging economies;
- Fast-growing cities will present a wider range of risk and return opportunities;
- Technology innovation and sustainability will be key drivers of value;
- Collaborating with governments will become more important;
- Competition for prime assets will intensify further; and
- A broad range of risks, including new risks, will emerge.

These predictions reflect the impact of global megatrends that will change the global real estate landscape considerably in the next five years, and beyond.. Africa will not be an exception. The six global megatrends highlighted in the report are:

- **Huge expansion in cities, with mixed results.** By 2020, the 21st century's great migration to the cities will be well underway. Cities will be swelling across the fast-growing countries in Asia, Africa, the Middle East and Latin America.

Even developed Western nations will be urbanising, albeit at a slower pace. But not all cities will prosper. While some will become great centres of wealth creation in a multipolar world, others are likely to fail.

- **Unprecedented shifts in population drive changes in demand for real estate.** Demographic shifts will affect demand for real estate fundamentally. The burgeoning urban middle-class populations in Asia, Africa and South America will need far more housing. Meanwhile, the advanced economies' ageing populations will demand specialist types of real estate, while their requirements for family homes will moderate.
- **Emerging markets' growth ratchets up competition for assets.** Real estate is an integral part of the emerging markets' growth phenomenon. Even as growth moderates in many emerging markets, the pace of construction activity remains rapid, increasing investment opportunities. The rise of emerging economies is also increasing competition among real estate managers and the investment community.
- **'Sustainability' transforms design of buildings and developments.** Cities contribute an estimated 70% of the world's energy-related greenhouse gases while occupying just 2% of its land. Their locations – often in low-elevation coastal zones – and large populations make them particularly vulnerable to the impacts of climate change, such as rising sea levels. As the world rapidly urbanises, so the pressures to make buildings more eco-efficient are mounting.



- **Technology finally comes to real estate and disrupts real estate economics.** By 2020, it will have both altered the economics of entire subsectors of the industry and changed the way that real estate developers and the investment community operate.
- **Real estate capital takes financial centre stage.** Private capital will play a critical role in funding the growing and changing need for real estate and its supporting infrastructure. Just as asset managers, real estate funds and sovereign wealth funds find the assets under their control swell, so governments will have increasing needs for capital to finance urbanisation. Private real estate capital will become an important partner of governments.

While the impact of most of these global megatrends are already being seen, there's a natural tendency to underestimate them. The impact of many of these megatrends on the African landscape will differ from those expected in developed countries.

The drivers of growth in Africa

From our analysis of these megatrends, we have identified eight potential drivers of growth in the real estate industry in Africa.

1

Africa's young population will drive demand for real estate and different types of real estate. There will be continued urbanisation, expansion in current cities and the rise of new cities across the continent.

According to the World Bank, Africa's median age was 19.7 years in 2012 and it is expected to increase to 25.4 years by 2050, making Africa the continent with the youngest population. The global megatrend relating to ageing populations and the consequent increase in the demand for retirement homes is therefore not expected to have a significant impact in Africa by 2020.

Projections suggest that in 2015 the continent will have a population of 226 million aged between 15 and 24 years.¹ This is expected to double by 2045.² This young population will drive growth in the demand for housing. This may include new or emerging residential subsectors such as student housing.

Africa is the world's second-largest and second-most populous continent at 30.2 million km², which is 20.4% of the total global land area. Mauritius is the most densely populated country on the continent with 639 people per km²,³ while Namibia is the least densely populated with three people per km².

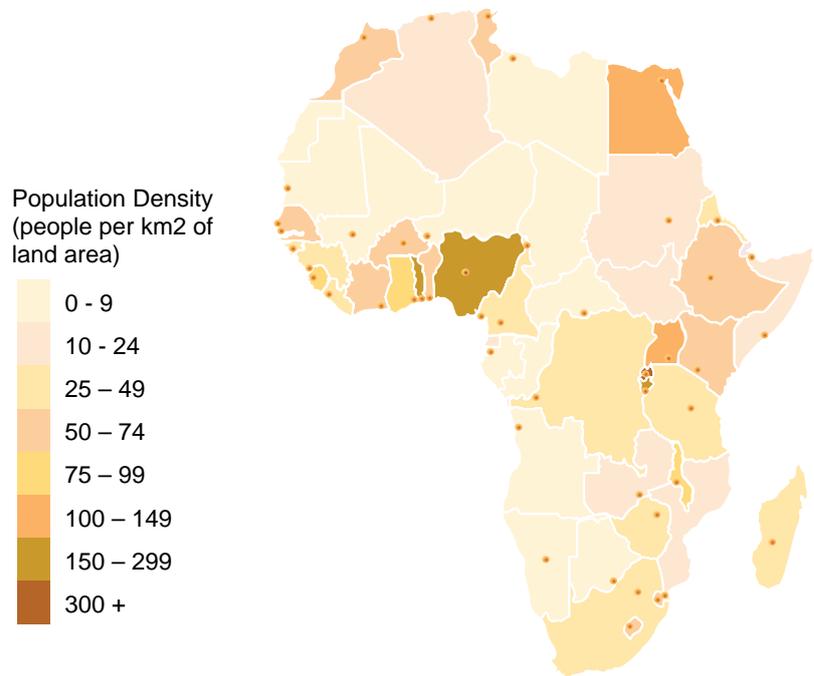
¹ "Population aged 15-24(thousands)", UNData – World Population Prospects: The 2012 Revision, <http://data.un.org/Data.aspx?d=PopDiv&f=variableID%3A21>

² "Promoting Youth Employment in Africa (2012)", African Economic Outlook, http://www.africaneconomicoutlook.org/theme/youth_employment/

³ "Data: Population density (people per sq. km of land area)(2013)", The World Bank, http://data.worldbank.org/indicator/EN.POP.DNST?order=wbapi_data_value_2013+wbapi_data_value+wbapi_data_valuelast&sort=desc

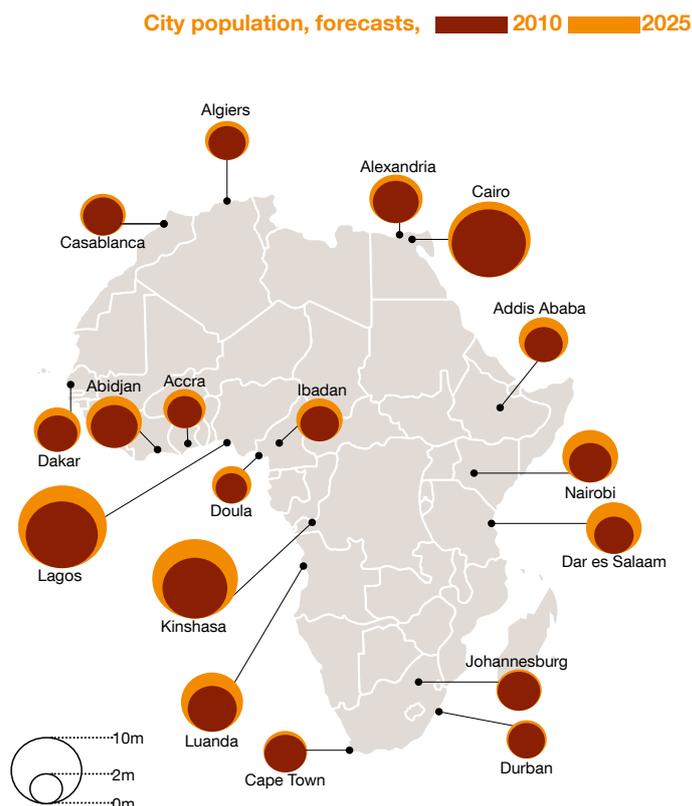


Figure 5: Population density in Africa



Continued urbanisation will have a major impact by 2020, and beyond. It is estimated that the urban population in Africa will increase to 56% in 2050, making it the most rapidly urbanising region in the world.⁴ The figure below shows the estimated urban population of a selection of African cities by 2025, compared to 2010:

Figure 6: Estimated urban population of a selected African cities, 2010 vs. 2025



The UN expects the fastest-growing urban agglomerations across Africa to be medium-sized cities and cities with fewer than one million inhabitants.⁵ The unprecedented demographic shifts will affect the demand for real estate fundamentally. In the residential sector, growing urban populations will increase demand for affordable housing, while a burgeoning middle-class will drive demand for more mid-range properties. While office, industrial, retail and residential will remain the dominant sectors, affordable housing, agriculture, healthcare, retirement and mixed-use properties will become significant sub-sectors in their own right.



2

Industrialisation will continue across Africa and will be accompanied by a rapid growth in the retail sector.

Indications suggest that much industrialisation will be funded by foreign investors, such as China. Intra-African trade and investment will continue to be an important driver of growth, as high-profile local companies expand into regional markets. The retail sector will also develop rapidly as growing populations and burgeoning middle classes demand greater volumes of more varied goods. The need for economic diversification, together with growth, will support the expansion of non-resource sectors and investment opportunities will arise through an increase in demand for real estate from these sectors.

3

The export of natural resources and agriculture will remain key sources of economic growth and will expose certain countries to increased risk.

Natural resources will remain a major source of economic growth in Africa. New discoveries continue to drive the growth of local activity, although a continued dependency on natural resources will present both opportunities and challenges for real estate developers and investors across the continent.

As global demand for food grows, revenue from Africa's agricultural output will increase, while the significant areas of uncultivated arable land will provide opportunities for growth. The risk presented by the economic fragility of commodity-exporting countries will need to be offset by the potential rewards from investment – either directly in helping to exploit new commodity discoveries, or indirectly through developments aimed at catering to the increased consumer demand resulting from associated economic growth.

4

Infrastructure shortages will create opportunities for investment.

Growth sectors will continue to create demand for infrastructure investment. Connections to road, rail and public transport are vital for urban success. Doing business in Africa remains a challenge as infrastructure lags well behind the rest of the world, but there are distinct regional differences. Recent PwC research suggests that infrastructure spending in sub-Saharan Africa will exceed US\$180 billion per annum⁸ by 2025, a growth rate of 10% per annum.⁶ Major infrastructure investment programmes in Nigeria and South Africa are now being accompanied by significant projects in other countries like Ghana, Kenya, Mozambique and Tanzania. However, a huge shortfall in government funding creates opportunities for private investors to support this development need through direct investment and public-private partnership (PPP) agreements.



5

The influence of government policy and legislation on the decision to invest will increase, while local partnerships will become increasingly important.

Increased political stability on the continent and increased participation in local partnerships will continue to ease investors' concerns relating to investing across Africa. Collaborating with governments or involving a local partner in future real estate developments in Africa will become more important to mitigate the risks. Governments and the investment community will have to work together to fund and build cities and their infrastructure.

6

Continued advancement within pension fund, stock exchange and banking regimes will facilitate investment and an increased range of investors will drive demand for real estate investment opportunities.

Development finance institutions (DFIs), sovereign wealth funds (SWFs) – government-run investment vehicles that manage state-owned assets – and private equity providers continue to enter the market alongside private capital and institutional investors, while developers and investors will find raising capital in the markets easier as the local financial apparatus develops. With interest from a range of investor classes and continued high returns, competition for prime real estate and infrastructure assets will increase.

7

Technology will impact on business and building practices as well as consumer behaviour.

Online technology is already having a significant impact on the finance and banking industry across Africa with the rise of mobile banking. However, the full impact of technology on real estate in Africa will only be felt in the medium to long term, as access to technology increases across the continent and the traditional consumer culture in Africa begins to change. Innovative and low-cost building technologies will also help make housing affordable.

⁸ Local currencies were converted to US dollar (US\$) and are approximate.



8

Sustainability will become entrenched in building design and occupier requirements, with Africa's most ambitious countries changing city design and building practices

In some countries where new cities are being built, developers are using eco-friendly technologies to reduce their environmental impact. Some of these technologies include solar building integration, climate responsive building strategies, renewable building materials, recycling and reuse, ecological building materials, an integrated planning process, low-cost design and the use of innovative design tools. This kind of approach can be seen in One Airport Square project in Ghana, for example. This trend is expected to continue in Africa, albeit at a slower pace than in the developed world. Konza City in Kenya, Eko-Atlantic in Nigeria and Roma Park in Zambia are just a few of the entirely new urban villages focusing on the concept of 'place making' in a sustainable way. Use of these new technologies will be accelerated by new sustainability legislation in the most progressive African markets.

Risks of investing in Africa

One of the key predictions made for 2020 relates to the emergence of new risks, together with the rewards attributed to the new risks. Africa has 54 very different countries with low connectivity between them, and there is no single answer to 'which countries to invest in'. Some of the additional risks of real estate investment in Africa include:

- The impact of political stability and changing government policy;
- A lack of economic diversity, with an overdependence on natural resources;
- Complex legal considerations, such as property ownership rights and investment restrictions;
- The volatility of local currencies against the US dollar; and
- The time frame of investments and restrictions on possible exit strategy (e.g. limited institutional investors as compared to more developed markets).

It is important that investors give consideration to these risks when investing in Africa.

Why Africa?

Despite these risks, real estate investors and developers continue to see the African market as a huge opportunity.

Investment returns from real estate in Africa's rapidly expanding economies significantly exceed those achievable in almost all developed markets. Forecasts of 20% net annual returns from investing in shopping malls, office blocks or industrial complexes in countries across Africa continue to draw in new investors.⁷



The opportunities across Africa are significant and span every sector. In almost all markets, demand for high-quality retail, office and industrial space continues to outstrip supply as international and local occupiers respond to new economic opportunities. Huge shortfalls in residential property across the continent give rise to opportunities for private development on a grand scale, while a lack of local funding for infrastructure projects provides a platform for new public-private partnerships.

Demographic shifts and changes in consumer behaviour create demand for different types of real estate, allowing for the entry of more specialist investors into the market.

Economic growth, improving political stability and ongoing investments in infrastructure are opening previously inaccessible markets, while increased transparency and availability of local partners is helping to improve the ease of doing business. Barriers to local market entry may be high, but by entering the market early, investors may be able to reap rewards in the form of high returns and exploit new opportunities as they arise.

African opportunities can be exploited best by combining the competitive advantage of individual countries into a coordinated business model. For example, such a model might combine developed South African capital markets with high retail growth in less developed countries.

Risk appetite remains an important consideration for any investor in Africa, but for those real estate companies that can accept and manage these risks, there are significant rewards on offer from the right investment.



For more information about the impact of global trends in Africa and the growth potential of the real estate in some of Africa's key markets, please see our **Real Estate: Building the Future of Africa** report at <http://www.pwc.co.za/en/publications/real-estate-building-the-future-of-africa-2015.jhtml?linktransform=no>.

⁴ "World Urbanization Prospects - Highlights: 2014 Revision", The United Nations, <http://esa.un.org/unpd/wup/Highlights/WUP2014-Highlights.pdf>

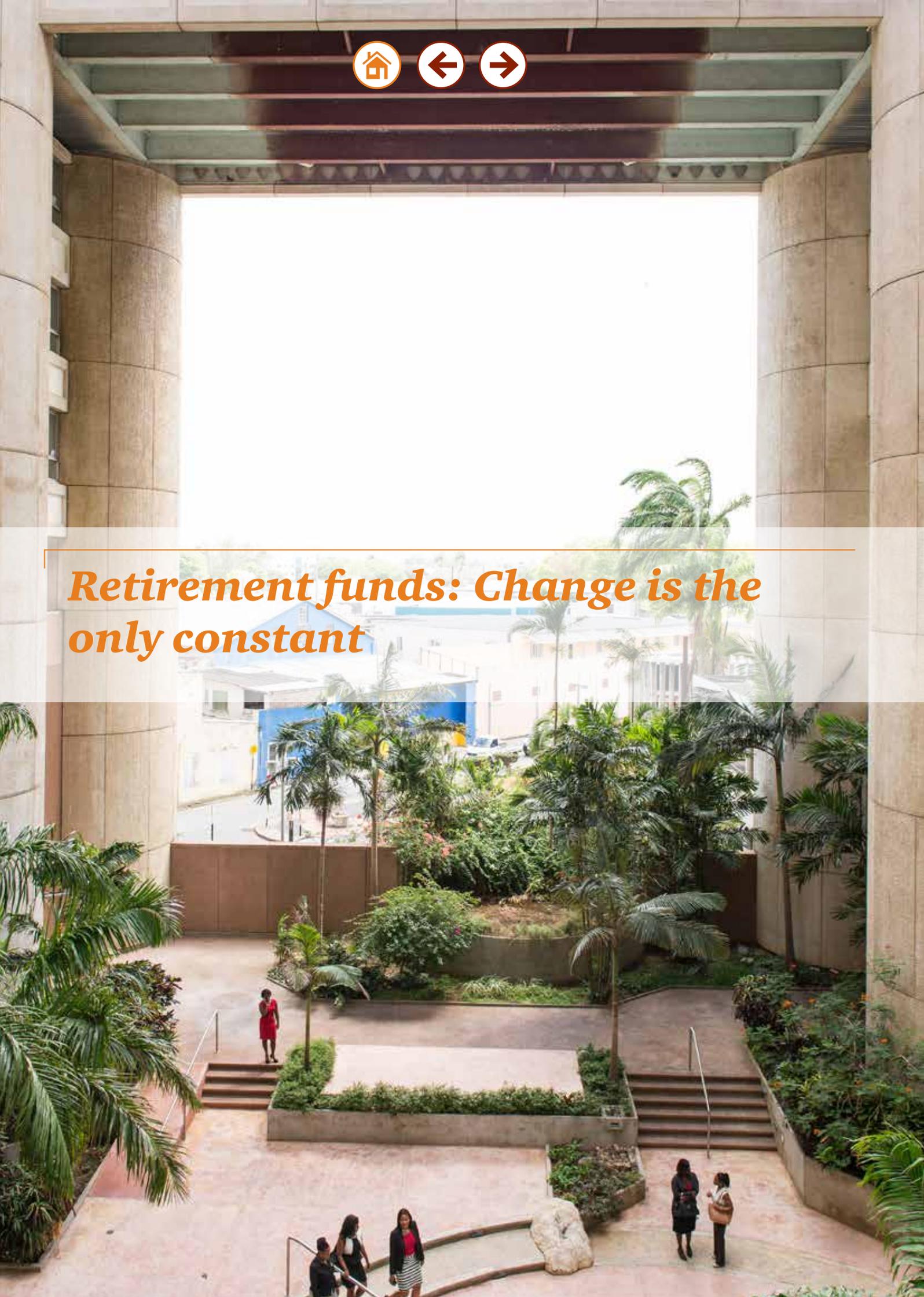
⁵ "World Urbanization Prospects - Highlights: 2014 Revision", The United Nations, <http://esa.un.org/unpd/wup/Highlights/WUP2014-Highlights.pdf>

⁶ "Capital project and infrastructure spending: Outlook to 2025 – Region Highlights", PwC and Oxford Economics, <http://www.pwc.com/gx/en/capital-projects/infrastructure/publications/cpi-outlook/regionalhighlights.jhtml>

⁷ "High stakes for high reward? Real estate funds come to Africa (2014)", Reuters, <http://www.reuters.com/article/2014/08/28/us-africa-realestate-investmentidUSKBN0GS1YI20140828>



Retirement funds: Change is the only constant





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Across Africa, governments and retirement fund regulators play an active role in protecting and shaping consumer rights, safeguarding retirement savings and the ultimate well-being of citizens, while also alleviating the burden of old age on the State.

‘Retirement reform’ is a term that you may have heard over the last few years. To address concerns relating to people not saving enough, not protecting their savings when moving jobs and not using their savings to provide a pension/ monthly income, the South African Government has proposed various changes to:

- Reduce the costs of retirement and investment products;
- Reform the annuities (pension income) market;
- Encourage preservation of benefits and portability when changing jobs;
- Implement a uniform approach to the tax treatment of retirement fund contributions;
- Improve fund governance and the role of trustees; and
- Implement incentives to promote retirement and other investment products.

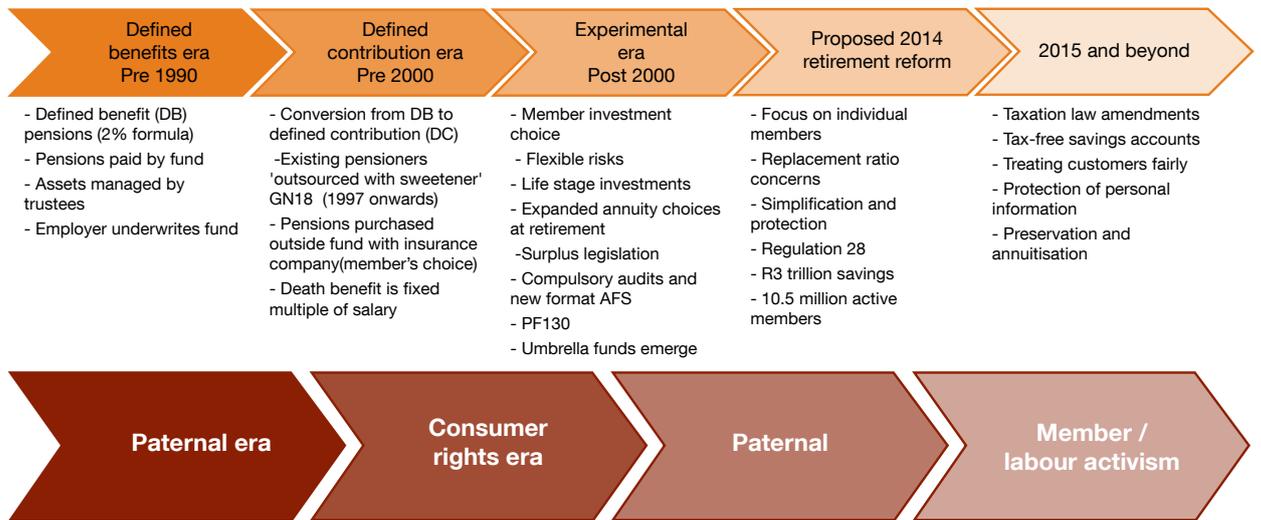
These proposed changes are collectively referred to as ‘retirement reform proposals’.



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The evolution of retirement funds in South Africa



It is evident from this analysis that the industry has evolved from a strong paternal era into a period of innovation and experimentation. This has led to increased ownership and responsibility for individual members without necessarily equipping them with the required experience, skills and tools to enable them to make informed decisions about their retirement savings. Coupled with this, the defined contribution environment has resulted in decreased preservation for retirement as individuals have had relatively easy access to retirement savings to fund short-term financial needs.

Retirement reform is ultimately aiming to protect all members of society and to ensure improved preservation and provision for retirement savings. A key requirement for the successful implementation of the proposed retirement and taxation law reform is the buy-in and support of industry and labour.

There has unfortunately been misinformation in the market and in the media, which has resulted in employees and members misunderstanding the changes and the context in which they are being made. This was also a major contributor to the recent postponement of the implementation of the so-called T-day.

Most of the proposed changes in the retirement fund discussion papers are at this stage just that – proposals – and have not yet found their way into law. Many are the subject of consultation between the Government, funds, employers and the retirement industry, while others are still being discussed by the Government, labour and business in forums such as Nedlac.

Facing reality

Throughout the period of evolution it has been clear that the savings rate among South Africans is inadequate and left too late. Add to this the rising impact of growing longevity and the increased cost of managing retirement savings and it becomes clear that the Government and industry are facing a number of key dilemmas that need urgent attention.



1

25% unemployment. Employed not forced to save (no “auto enrolment”).

86% of people without pension savings fall below tax threshold

2

60% of retirees take cash on retirement and pay the tax

3

Expected replacement ratio between 20% and 50% (25 to 45 year olds)

Goal = 60%-75%

4

Medical inflation > CPI

5

Longevity

Worldwide average 71

32 countries > 80 years

SA 60-71

6

Costs > 2%

1% saving = >25%-30% increase in capital over 40 years

Government intervention

In order to address some of the key challenges already referred to, the South African Government has actively embarked on driving eight key principles of reform.

Key principles of reform

- Making retirement fund savings compulsory
- Improved preservation
- Simplifying savings and portability
- Introducing default options
- More effective intermediation
- Tougher market conduct and more effective supervision
- Consolidation of funds
- Improving fund disclosure of costs

Although implementation of many of the proposals already published is still under discussion, having these matters on the agenda is a major step in the right direction.



The role of the fiscus

The Taxation Laws Amendment Act, 2013, was the first step in the reform process with the main aim being to align pension and provident funds, including changes to the tax treatment of contributions to pension funds, provident funds and retirement annuity funds, and the introduction of the annuitisation requirement for provident fund members at retirement.

With regard to the tax treatment of retirement fund contributions, Government has agreed to delay the implementation of laws originally set for 1 March 2015. For now, the delay will be for a year to allow for further consultations at the National Economic Development and Labour Council (Nedlac). But should there be no agreement at Nedlac by the end of June 2015, the implementation date may be moved to 1 March 2017.

This comes after the labour constituency at Nedlac requested that the implementation of these laws enacted in 2013 be postponed until further consultations between Government and Nedlac on social security reform.

The draft Response Document provides the reasons for the proposals made by the Treasury and SARS and deals with the following key issues relating to retirement fund reform:

- Amendments to the valuation of defined benefit fund contributions; and
- Introduction of tax-free savings accounts.

Tax-free savings accounts

It is common knowledge that South Africans have a very low savings rate. One of Government's initiatives to create a culture of savings is the introduction of tax-free savings accounts with effect from 1 March 2015.

The proposed tax-free savings account introduces a broader tax-incentivised savings vehicle for non-retirement savings. Such a vehicle could be comprised of interest-bearing and equity accounts. Interest and capital growth within these tax-preferred savings vehicles are exempted from income tax.

Contributions are made from after-tax income and are capped at an annual limit of R30 000 and a lifetime limit of R500 000 per individual. These limits will be adjusted over time to take account of inflation. Some exceptions to the annual limit will be introduced for taxpayers close to retirement. For example, tax payers aged 50 to 59 years would be allowed to invest up to half of their lifetime limit per annum.

If applied, the compounding effect is quite clear. Let's say you save R2 500 per month for 16 years and 8 months, your lump sum will be approximately R800 000 or R2.2 million at a projected growth of 6% or even 15%, which might be achievable taken equity growth into account.

The success of this proposed tax-free vehicle is arguably dependent on affordability. Recent press articles have indicated that consumer credit levels are at the highest levels since 2006, which raises further concerns about individuals' ability to transform into a culture of saving.

Tax treatment of contributions and annuitisation

The Act further includes the following changes, of which the implementation has been postponed to at least 1 March 2016, but possibly later, depending on the outcome of Nedlac consultations:

- Tax treatment of contributions to pension funds, provident funds and retirement annuity funds; and
- Annuitisation requirement for provident fund members at retirement.

The proposals for changes in the taxation treatment of contributions impact a wide variety of stakeholders, including employees, employers, fund administrators and regulators. It involves enhancements to administration systems, payroll systems and fund rules, but ultimately aims to simplify the taxation of retirement fund contributions and benefits.



The main changes are summarised below:

Taxation of contributions to retirement funds - 'T-day'

- 'T-Day' provisionally postponed to 1 March 2016
- Retirement fund contribution deduction = 27.5% (includes costs and risk premiums (GLA, PHI))
- Member + Employer (ER) contributions combined - higher of 'gross remuneration' or 'taxable income'
- Deduction capped at R350 000 p.a. with carry forward
- Irrespective of fund type (pension, provident or retirement annuity)
- Taxable income => claim against any source of income
- Fund rules to change (max 20% to 27.5%)
- Maximum income R1 272 727
- Stop 'salary sacrifice' (Employee needs maximum deduction, ER avoids fringe benefit tax administration)
- ER contributions = fringe benefit tax (formula for defined benefit) > impacts pay slips and employment contracts

The annuitisation requirement refers to the requirement, which is currently only applicable to pension funds, that only up to one third of the money may be taken in cash and the balance must be used to provide a monthly annuity/pension. This requirement, which will apply to provident fund members as well upon implementation, is only applicable on retirement. In the event of withdrawal (i.e. resignation, dismissal or retrenchment), there will be no annuitisation requirement. However, possible forced preservation upon withdrawal from a provident fund is still under investigation and may come to light in future reforms.

What should be on your agenda?

Within this dynamic landscape where Government and regulators continue to focus on savings, increased governance and member protection, each of us has to acknowledge that we play an integral role in the success of reform and the future shaping of the retirement fund industry:

- Employers have to ensure that their record keeping and communication is up to the required standards and that the correct member information reaches the administrators of their funds.
- Administrators' systems and processes have to continuously be developed to keep track with the enhanced requirements of

regulators and members' needs.

- Trustee boards of funds have a massive responsibility to ensure that their members' best interests are looked after from all angles. This can certainly only be achieved with strong governance structures in place.
- Members have to insist on adequate communication and education on matters dealing with their retirement savings and actively plan to improve their savings to work towards a comfortable retirement.

Ultimately, each member's destiny is in their own hands and members are responsible for ensuring that their retirement savings are adequate to support them when they need it.



Francophone Africa: A new battlefield for the banking industry





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As with other regions in Africa, the financial services industry in Francophone Africa is changing at a fast pace. This accelerated transformation is primarily the result of intensifying competitive pressure in markets where banking penetration remains generally low (under 20% on average). During the last decade, the industry experienced a consolidation process from which emerged a handful of key institutions with a multi-local footprint.

We can distinguish three families of players in the banking industry in Francophone Africa:

- European giants (e.g., Société Générale, BNP Paribas, BPCE);
- Moroccan pioneers (Attijariwaffa Bank, BMCE/ Bank of Africa and BCP group); and
- Sub-Saharan challengers (Ecobank, Orabank, BGFI, Afriland First Group).

European giants

The international French banks have a long track record in the region and remain in leading positions in key markets such as Côte d'Ivoire, Senegal or Cameroon. Their teams are competent, well trained and the local banks benefit from the maturity and sophistication of their parent companies.

They not only offer very competitive solutions in corporate banking but also in the high-end segments of retail banking. They have already deployed multi-channel strategies and have tested mobile banking in most of their operating markets. They now invest heavily in talent management and have started to share some of their operations at a regional level, adopting the operating model trends observed in Europe.

However, like many international banks since the 2008 crisis, they have become much more risk averse. This could be a handicap as they seek to address key segments such as SME banking where it is not always easy to collect reliable data and to apply international compliance rules.

The exceptional ROE levels and growth figures of some African subsidiaries should nevertheless convince European institutions that this region is full of promise and that strengthening their existing position through equity injection or targeted acquisitions in the Anglophone or Lusophone markets is a valuable strategy.

Moroccan pioneers

The last five years have been an intense period of geographical expansion for the three main Moroccan banks. Their home market has already reached a certain level of maturity and the growth prospects in the kingdom are now less significant. Besides classic corporate and retail banking activities, they have developed impressive know-how in order to address the diaspora, which represents up to 20% of total deposits in Morocco. They now intend to leverage this expertise in sub-Saharan countries like Senegal or Côte d'Ivoire, where there are also diaspora markets.



The most remarkable achievement of these three banks is their rapid success in new markets, which has mainly been achieved through external growth. In just a few years they have established operations in most of the key countries in Francophone Africa, becoming new champions in these markets.

In addition, they seem to have found the right balance between corporate alignment and local agility. Their challenges are mainly twofold: bring equity to sustain this growth and appetite (acquiring new customers has a cost), and managing efficiently the risk exposure by implementing the proper safeguards and governance in these new countries.

The sub-Saharan challengers

Whether they have a pan African ambition in their DNA like Ecobank or active private equity funds as shareholders that are pushing for regional expansion, like Orabank, the region has given rise to new contenders who have serious ambitions—and not only in Francophone Africa. Their African origin is indeed a strength since it allows them to be more reactive (the decision centres are nearby) and more importantly these banks' managers know the region well and its specificities.

There is no need to wait for ages to obtain a credit approval with these banks! Their deep understanding of local customer behaviours and needs also allows them to be more innovative in terms of products, services and solutions (particularly for SMEs or low-income clients). These banks are, in many cases, operating in relatively smaller markets and this is generating obvious complexity in terms of operating model consistency. Some are still operating as a 'group of banks' and they need now to become real 'banking groups'. To do so, they are investing in core banking systems, process alignment and streamlining, compliance and internal audit.

These three groups of players are often fighting for the very same clients and all of them have to transform themselves. The next challenges for all of them are to broaden their customer base (therefore contributing actively to banking penetration) and to reach a good level of operational efficiency in order to maintain appealing cost-to-income ratios and ROE. In a nutshell, they will strive to secure profitable growth.



FATCA in Africa





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What is FATCA?

FATCA is a United States federal law that requires US citizens, including individuals who live outside the United States, to report their financial accounts held outside of the United States, and requires foreign financial institutions to report to the Internal Revenue Service (IRS) about their US clients.

Starved of revenue, governments around the world are taking drastic action to address fiscal shortfalls. The US Internal Revenue Services (IRS) and US Department of the Treasury issued comprehensive final regulations implementing the information reporting and tax withholding provisions commonly known as the Foreign Account Tax Compliance Act (FATCA). FATCA primarily impacts FFIs (foreign financial institutions), non-financial foreign entities (NFFE) and qualified intermediaries (QIs). They are required to implement various provisions under FATCA, which was enacted as Section 501 in the Hiring Incentives to Restore Employment Act of 2010.

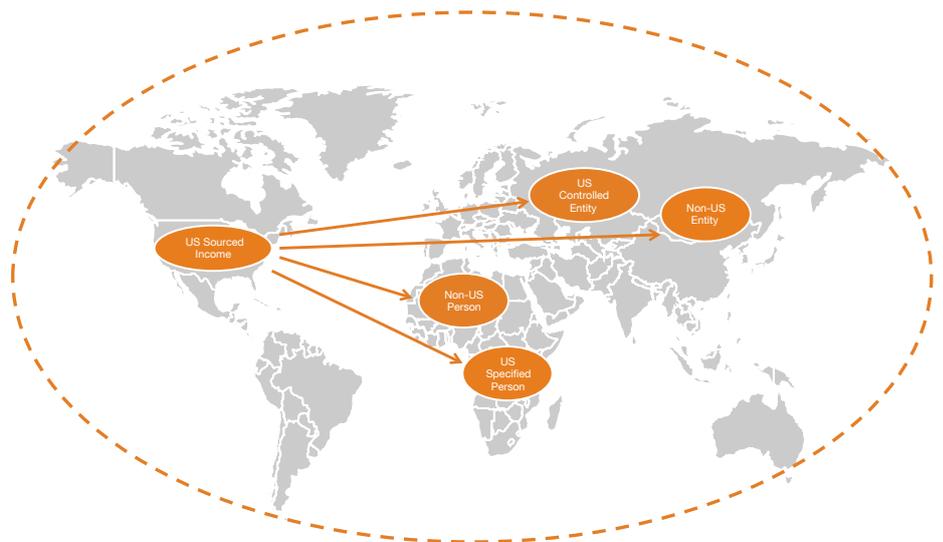
The key driver behind FATCA appears to be the widely held belief that US tax payers are using Foreign Financial Institutions (FFIs) to avoid paying taxes in the US. Therefore, the primary objective of FATCA is to detect, deter and discourage offshore tax evasion by specified US persons or US-controlled entities.

FATCA is a far-reaching piece of legislation which will enforce compliance with the US tax code by implementing a 30% tax withholding penalty on all US sourced FDAP (fixed, determinable, annual or periodic) income.

FATCA targets US-sourced FDAP income across the globe



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Who is impacted by FATCA?

Financial institutions who meet one or more of the following definitions are classified as an FFI:

- Accepts deposits in the ordinary course of a banking or similar business;
- Holds financial assets for the account of others, as a substantial portion of its business;
- Primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer:
 - Trading in certain financial products;
 - Individual or collective portfolio management; or
 - Investing, administering or managing money or financial assets on behalf of others.
- Is an insurance company (or the holding company of an insurance company) that issues, or is obligated to make payments with respect to a cash value insurance contract or an annuity contract.

An entity is also considered to be an FFI under the US Regulations if that entity is a holding company or treasury centre that:

- Is part of an expanded affiliate group (EAG) that includes other financial institutions, or
- If formed in connection with investment vehicles such as private equity funds, mutual funds, hedge funds, etc. is also considered to be an FFI.

Although FFIs are predominantly impacted by FATCA, there seems to be a common misconception about FATCA's global impact. Financial institutions and other types of businesses believe that if they do not meet the definition of an FFI, do not have any US investors or customers and do not invest in US assets, they are not subject to FATCA. This is a misnomer as these types of entities would still be exposed to the 30% withholding tax penalty, if they receive US-sourced FDAP income. If this were the case, they would be required to complete the applicable IRS documentation (or self certificate) in order to certify their US and Chapter 4 (Taxes to Enforce Reporting on Certain Foreign Accounts) status.

FATCA in Africa

Inter-governmental agreements

The primary purpose of an inter-governmental agreement (IGA) is to be a long-term solution to enable FATCA compliance for FFIs and direct reporting NFFEs. It does so by addressing, and in some instances, removing the domestic legal impediments that prevent registering FFIs on the IRS portal or reporting customer data outside the borders of the applicable country. Domestic legal impediments are local laws such as secrecy and data protection laws governing the industry and even to the country's constitutional law, relating to the right to privacy for example.



To overcome these legal restrictions (impediments), the United States collaborated with other governments to develop two model IGAs to implement FATCA. All IGAs contemplate that a partner government will require all FFIs located in its jurisdiction (that are not otherwise exempt) to identify US accounts and report information about US accounts.

In the absence of an IGA, a jurisdiction will be considered to be governed by the US Regulations. In contrast to the IGA, the US Regulations are more burdensome as they contain additional definitions not found in the IGA and local interpretation of the definitions in the US Regulations is not admissible.

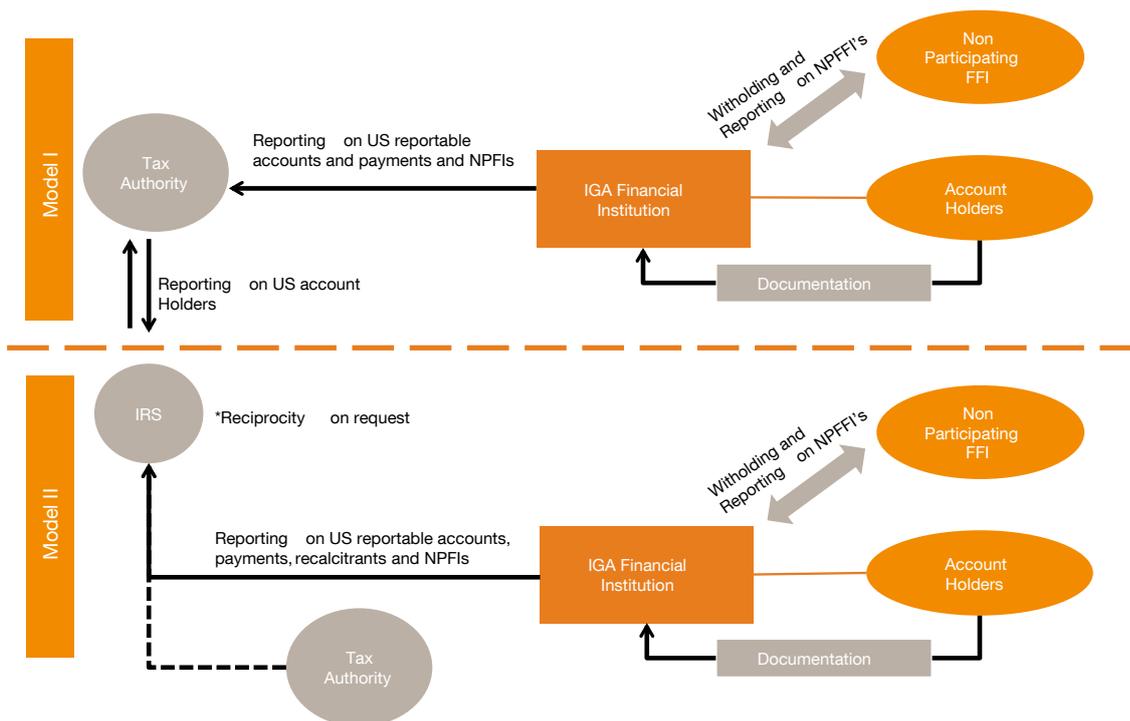
The Model I IGA stipulates that FFIs must report specified information on their US account holders to their local authority, otherwise known as the partner jurisdiction. This is usually the local tax/revenue authority. The partner jurisdiction will in turn exchange this information on an automatic basis with the IRS, if the agreement is based on reciprocity.

The partner jurisdiction will also be requested to complete an International Data Safeguard and Infrastructure Workbook. The information provided in the workbook will facilitate the evaluation of safeguards and provisions regarding confidentiality, use, and infrastructure effectiveness prior to information exchange.

The Model II IGA works slightly differently with partner jurisdictions agreeing and allowing all FFIs that operate in the jurisdiction to report specified information on US account holders directly to the IRS.

Each IGA model type has its own benefits and drawbacks. The onus to conclude such an agreement rests with each respective government.

The difference between reporting under a Model I and a Model II IGA





The status of IGAs in Africa

Historically, FATCA as a whole was not well received by many countries, especially in Africa. Slow to adopt it in Africa, many regulatory authorities either ignored the regulations or steered clear of them as they did not fully understand the implications on their economy or took a passive approach, waiting for other African countries to make the first move. Some revenue authorities in West Africa were under the impression that the US IRS would approach them directly to request their participation under the regime. To their surprise, no such contact has been made to date.

As previously mentioned, the responsibility lies with the respective country's government to initiate IGA negotiations and no hand holding compliance activities will be performed by the IRS or any US governmental authority.

In more recent developments, there have been a number of positive movements towards initiating IGA negotiations in some African countries. Countries like Zambia and Rwanda have publically announced their intention to enter into an IGA and others, like Lesotho, Mozambique and Kenya, have provided written confirmation that FFIs located in their jurisdictions may participate and register on the IRS portal, on meeting some of the conditions stipulated.

Countries like Botswana, Swaziland and Namibia allow for FFIs to write to their central banks or tax authorities for permission to participate under the FATCA regime. In most cases, permission is granted. The natural next step for countries like these is to start contemplating entering into an IGA with the IRS.

In some instances, reliance can be made on obtaining customer consent in order to overcome the existing legal prohibitions. This is further confirmed by certain announcements made by some central banks in Africa, such as in Lesotho.

Much frustration and anguish has been experienced by financial institutions whose head offices operate in more mature FATCA jurisdictions and have subsidiaries operating in non-IGA governed countries in Africa. In some instances, business decisions have been made to ignore local laws and become participating FFIs as the cost of non-compliance far outweighs the administrative penalty or fine that may be incurred from local regulators.

Conclusion

Although many deadlines have passed in terms of FATCA compliance, the US IRS will continue to be open to the prospect of engaging with and signing up more jurisdictions. One obvious benefit of having missed the initial deadlines is that non-IGA governed African countries have the opportunity to learn from and apply the lessons learned by other jurisdictions, such as South Africa, that have an IGA in place

With other reporting regimes on the horizon, like the Common Reporting Standard, it is imperative that countries in Africa not only prepare for US FATCA, but for an international tax reporting regime that will connect governments in order to facilitate the spontaneous and automatic exchange of tax-related information.

The overall FATCA landscape in Africa remains rocky and difficult, with many challenges still to overcome. With the increased level of FATCA awareness and knowledge, many African countries are however starting to warm up to FATCA and the benefits it can offer them in the future.



Financial services in Angola



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Let the competition (really) begin!

The Angolan economy was hit hard by the global financial crisis, but the economy is now revamping with robust GDP growth above 5% supported by strong fiscal and external balances, a stable exchange rate and decreasing inflation.

Angola's key economic indicators

	2012	2013 (e)	2014 (p)	2015 (p)
Real GDP growth	5.2	5.1	7.9	8.8
Real GDP per capita growth	2.1	2.0	4.9	5.8
CPI inflation	10.3	9.3	8.3	7.8
Budget balance % GDP	8.7	2.4	-5.0	-6.9
Current account balance % GDP	9.9	5.7	4.3	4.0

Source: African economic outlook (www.africaneconomicoutlook.org)

Angola's financial sector has enjoyed rapid post-civil war growth and the number of players has risen from just six banks in 1999 to 24 (three are state-owned) at present. Total banking assets have increased from US\$3bn in 2002 to US\$66bn in 2013. The number of insurance companies has also increased from just one in 2001 to around 20 in 2014.

A lot has changed for Angola's banks over the past four years. Gone are the days of making returns on equity of 30% by doing little more than investing into government treasuries. Today, in what many believe to be a reflection of a maturing financial sector and an economy growing more sustainably, investors are faced with an environment in which their margins are shrinking and competition is increasing. Banks' profits have been hit by lower interest rate margins and higher levels of provisions for non-performing loans.

The central bank of Angola (Banco Nacional de Angola, [BNA]) has carried out a set of reforms in recent years to improve its monetary policies and modernise the banking sector. In 2013 BNA issued relevant regulation to impose improvement in the corporate governance and internal control mechanisms at banks. Additionally, BNA has also issued legislation regarding foreign-exchange policies, forcing oil companies to execute their payments of goods and services via local banks using local currency. This measure has facilitated the growth of liquidity and income fees, offsetting the decrease in interest rate margins.

Angola has the third-largest banking sector in sub-Saharan Africa. Most financial services companies have strong links to Portugal and the five largest institutions control around 72% of all banking activity. According to the most recent available data, Angola's banking sector was hit by a rise in non-performing loans in 2013, a legacy of reckless lending over the past decade, with the NPL ratio for the banking sector reaching 11%. The lack of corporate transparency among banking clients and an inefficient legal system will continue to pose challenges for banks and regulators.

Angolan banks are not only expanding their branch networks in the domestic market, but are also considering other countries. BAI and Banco BIC are examples of this strategy.



BAI already has branches in Portugal and Cabo Verde; Banco BIC, already present in Portugal, has opened a representative office in South Africa and has plans to expand to Namibia, Mozambique, São Tomé e Príncipe and Brazil.

Banks that hope to emerge on top will have to find innovative ways of reaching new clients and developing more innovative products.

Market conditions

The maintenance of deposits-funding bases and high liquidity buffers will bolster financial stability. At 31 December 2013, capital buffers remained stable – banks presented an average solvency ratio of 20%, well above of the minimum required by the BNA of 10%. An example of the robustness of the Angolan banking system is the recent fall of BESA, one of the major banks in Angola. At the beginning of August 2014, the BNA placed Banco Espírito Santo Angola (BESA) into administration, following a BES resolution in Portugal, which did not have a contamination impact on the remaining banks.

Market conditions are also tougher for banks since the Angolan Government cut tax exemptions. Banks in Angola have also been hit by a declining interest rate environment. Angolan inflation fell to single digits for the first time in 2012 and has continued to decrease since then, settling at 8%, the lowest level ever reached. Yields on Government bonds, which banks tend to buy in large quantities, have dropped. Short-term treasury rates were as high as 20% in 2010 and today are just below 4%.

Despite government intervention and efforts to build infrastructures and create lending opportunities, there are still threats to the growth of Angolan banks such as the vulnerability to changes in oil prices and an ineffective legal system for enforcement for profit lending.

The Angolan financial system has to be able to keep up and help improve and finance the overall economy.

The emerging Angolan middle class is changing the way Angolans view banking services. They need more services like credit cards, mortgages and house insurance and quality client service. Although the percentage of adults with access to formal banking services has increased from 13.5% in 2011 to 30% in 2013, financial literacy and the bank networks are only now starting to gain momentum.

Challenges and opportunities in Angola's financial services sector

From tighter regulation to IFRS

BNA has been pushing through a host of regulations to bring bank practices more into line with the rest of the world. It has sought to strengthen anti-money laundering controls and risk management. During 2013, BNA implemented new regulations concerning the establishment and improvement of an adequate internal control system and corporate governance measures, with the objective of improving corporate transparency, internal policies and procedures for risk management and controls in order to mitigate the main risks arising from the activities of the banks.

The improvement of risk management, compliance and internal audit functions is crucial. As part of these aims, banks have been given two years to adopt International Financial Reporting Standards (IFRS).

In 2014 BNA has undertaken a special inspection programme, Asset Quality Assessment (AQA), to be performed in the 14 biggest banks in Angola regarding the quality of their assets and the assessment of impairment losses in their credit portfolios. AQA is being performed with reference to 30 June 2014 and conclusions will be reached before the end of this year.

Financial inclusion and financial literacy

Fostering financial deepening and inclusion is one of the major challenges to creating more opportunities and supporting private sector development and job creation. The authorities have launched a number of initiatives to improve credit access by small and medium-sized enterprises such as the Facilitating Credit Programme. At the end of 2013, the percentage of the total population with regular access to the bank system was around 30%, but BNA expects a significant increase in this rate.

Banks are now targeting their services and products to the small but growing middle class in major cities such as Luanda and Lobito. Banks face new challenges with the increase and improvement of their range of products and services. Some banks are looking at soon introducing mortgages, some have started offering insurance and car leasing loans, while a few have pushed into private banking.

To be successful, banks will need to continue expanding their branch networks, betting on efficient and quality training programmes for their employees and improving their information and communication technologies.



Economic diversification

Businesses still struggle because of the poor logistics network and electricity shortages. Angola is now changing from an oil-based economy into a more balanced economy. Its goal of reducing its import dependency is creating many business opportunities in the industrial sector (such as manufacturing), agri-business and food retail.

The infrastructure sector continues to attract most of the investment in Angola. The continued high level of investment from the public sector in infrastructure development translates into opportunities for foreign investors. Government priorities include the building of schools and hospitals, affordable housing, roads, electricity and providing access to clean water. These large-scale projects are a critical component of the nation's drive towards economic diversification.

While infrastructure development remains a core focus of the Government, it is also taking significant steps to build other high-growth non-oil sectors. Subsequently, the Government is offering attractive investment incentives not only in infrastructure, but also for organisations that can help build non-oil sectors such as agriculture, biotech, healthcare and education.

Angola's National Development Plan (2013-2017) provides for the establishment of a medium-term tax framework, an initiative being led by the IMF. The objective is to project revenues and expenses and create tax rules and regulations that will enable a stable macroeconomic programme.

Real estate prices

The real estate market in Angola is a concern. Property prices in Luanda, Angola's capital, remain high, but they are still below their peak of 2008, just before the country's economy was hit by a crisis triggered by a collapse in oil prices. A big part of the banks' growth has been financing the real estate bubble. The recent creation of credit bureaux and big investments by the Government in infrastructure has led to improvements.

Foreign exchange law

Perhaps the single largest change for the banking sector in 2014 was a new foreign exchange law for the oil and gas industry. It requires that all payments to oil suppliers are made through the local banking system rather than offshore. The biggest development will happen when foreign suppliers, which make up the bulk of those serving the industry, will have to be paid through the local banks, either in Kwanzas or in foreign currency.

Angolans are optimistic that, in the long term, the foreign exchange law will increase the use of its local currency, the Kwanza, in the economy and make it easier for local businesses and entrepreneurs to compete with foreign oil suppliers by more closely linking the upstream sector with the onshore economy.

Another consequence of the new law will be to open up the foreign exchange market to some extent. At the moment, banks access dollars via BNA weekly auctions. The new law's requirement for foreign suppliers to be paid locally will give new impetus to foreign exchange liquidity. It could even be one of the first steps towards Angola liberalising its capital account and allowing for the free convertibility of the Kwanza.

The increase of national currency deposits and other resources from clients will also be an important factor that will allow banks to decrease the dollarisation of the Angolan economy.

Accessing the best talent and key skills

Effective human resource management is crucial to all organisations' success. Angola's financial services sector is struggling to secure the best human resources, such as those people who can help develop their commercial network and help increase financial literacy.

Attracting and retaining the best human resources within this business context is one of the key challenges facing the boards of financial institutions. Technical and behavioural competencies will help banks to deliver professional financial services and leverage local relationships.

Conclusion

Angola offers huge business potential, but there is still much to be done. The country's position in most well-known rankings has been an issue and a burden to the Government and investors.

Obtaining the proper permits and business licences to operate in Angola is still time consuming; according to the 2014 World Bank Doing Business Index, Angola is one of the most time consuming countries for starting a business (ranked 178 out of 189 economies).



Angola's global index rankings

Index	Ranking
Transparency International Corruption Perception Index 2014	161 of 175
Heritage Foundation's Economic Freedom Index 2014	160 of 178
World Bank's Doing Business Index 2014	178 of 189
World Economic Forum Global Competitiveness Index 2014-2015	140 of 144
Global Innovation Index	135 of 142

Although there are still many goals to accomplish, the Angolan financial sector is established and improving in maturity. The financial services players in Angola are now facing an era of increasing competition, more knowledge about clients and the need for top talent. Financial sector policies are being modernised and some banks are considering internationalising their operations. Bank consolidation is expected in the near future and together with branch expansion, this will reshape the sector.

We believe that the competition in the Angolan financial services sector will become fiercer with sustainable growth, technology, human resources, innovation, efficiency and risk management at the top of the CEO agenda.



Money laundering and regulation





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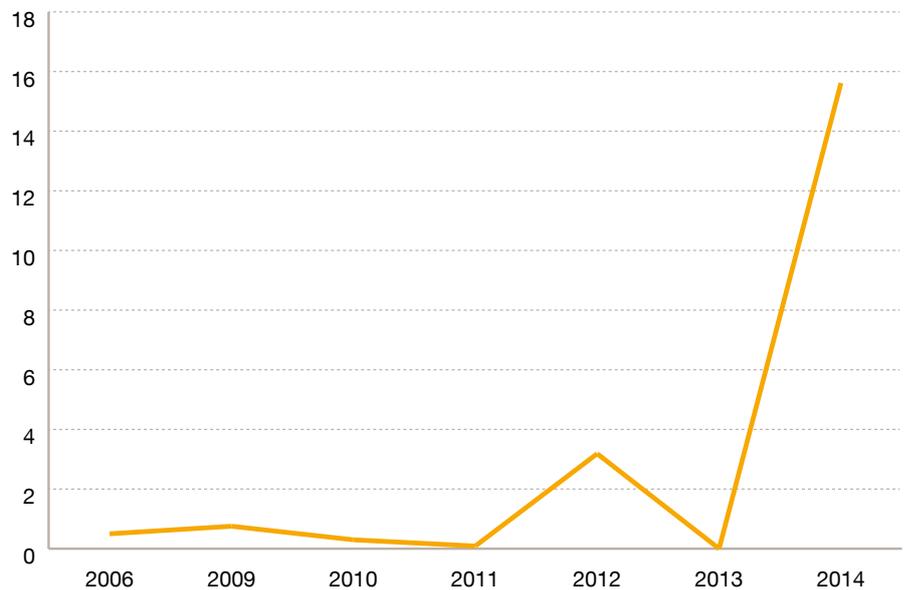
For the past few years, regulators in more developed markets have begun to turn their focus to anti-money laundering (AML) regulations, more specifically the enforcement of those regulations. This has particularly affected banks with operations in the USA and Europe. At the same time, fines have grown ever larger as regulators lose their patience and banks are often forced into settlement agreements for criminal and civil liability in addition to paying fines.

Largest fines paid

Year	Entity	Enforcement authority	Amount
2006	Royal Bank of Scotland	OFAC	\$500 million
2009	Lloyds TSB	OFAC	\$217 million
2009	Credit Suisse	OFAC/DOJ	\$536 million
2010	Barclays Bank	DOJ	\$298 million
2011	JP Morgan Chase	OFAC	\$88 million
2012	Standard Chartered	OFAC	\$327 million
2012	Standard Chartered	DFS	\$340 million
2012	ING Bank	OFAC	\$619 million
2012	HSBC	OFAC	\$1.9 billion
2013	GT Bank	FCA	£525 000
2014	BNP Paribas	OFAC	\$963 million
2014	BNP Paribas	DOJ	\$8.9 billion
2014	Standard Chartered	DFS	\$300 million
2014	Deutsche Bank	FCA	£4.7 million
2014	Standard Bank plc	FCA	£7.6 million
2014	Standard Bank	SARB	R60 million
2014	FirstRand	SARB	R30 million
2014	Absa	SARB	R10 million
2014	Nedbank	SARB	R25 million
2015	Deutsche Bank	SARB	R10 million
2015	Capitec Bank	SARB	R5 million



Figure 6: Total value of fines paid (\$ billions)



What these statistics clearly show is that non-compliance is no longer commercially viable. The largest fines are so large that they affect profitability and the value of shares. Executives that wilfully flouted requirements and circumvented controls earned their banks the largest fines, though even simple negligence has resulted in large fines being levied. One bank was fined for inadequate sanctions screening. Its defence? The system it had installed was too complicated and staff did not know how to operate it effectively.

The current state across Africa

Africa has thus far escaped relatively unscathed: the UK subsidiary of a South African bank received a £7.6 million fine for failings relating to its AML policies and procedures regarding corporate customers and their links to politically exposed persons.

The UK subsidiary of a Nigerian bank was fined £525 000 for failings in its AML controls for high-risk customers. Additionally, the South African Reserve Bank (SARB) has recently fined the four top South African banks for AML failings, and conducted inspections at a number of other banks including foreign banks that operate locally.

Indications are that AML is going to be a Central Bank of Nigeria (CBN) priority in the coming months.

While African banks, by and large, might not have much cause to fear that local regulators will be imposing fines worth billions of dollars' on them any time soon, they are not in a position to be complacent.



Key drivers of change

Foreign operations

This is probably the most obvious concern for all banks, including those in Africa. A number of so-called African banks have operations in Europe or the USA making them subject to the requirements of foreign-based regulators. Foreign regulators have not shied away from imposing fines on local branches of foreign banks. Operating in their country makes the foreign bank just as accountable as any local bank, possibly even more so due to the potentially heightened risk associated with foreign customers from less stringent jurisdictions.

Failing to meet the necessary standards will put banks at risk of being fined by the relevant enforcement authorities. In addition to this the regulator may feel that it is necessary to take control of the operations of the bank. The worst case scenario for any bank would be that their transgressions are so severe that it is felt that the best course of action would be to suspend their banking license.

Correspondent banking

In order to enter into a correspondent banking relationship with a foreign bank, thereby accessing a foreign market, banks need to meet higher requirements to satisfy the foreign bank that they are sufficiently risk averse so as not to introduce unnecessary risk to their operations.

Part of this is the requirement that AML systems should be sufficiently robust to meet the requirements of the foreign regulator. By allowing a foreign bank's customers access to your accounts, your organisation is duty bound to ensure that they are not being abused to launder money or move funds for sanctioned individuals or entities.

A foreign regulator will hold the bank responsible for any failings taking place on its accounts – regardless of the fact that they were the result of a lax correspondent bank. African banks will need to ensure that they take AML seriously in order to maintain their correspondent banking relationships.

Eight out of ten of the biggest banks by brand value in Africa have received fines from regulators.

Source: The Banker, 'Top 500 Banking Brands 2014'

Reputation

Adverse reputation should be a major concern for any bank. A negative reputation can frighten off customers and bring the regulator calling. A key example of just how damning a negative reputation can be is seen in the case of FBME.

The Federal Bank of the Middle East (FBME) is headquartered in Tanzania and is the country's largest bank with assets in the region of \$2 billion. Over 90% of its assets and global banking business are, however, located in Cyprus.

FBME is facing serious challenges following the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) naming it as a foreign financial institution of primary money laundering concern and proposing steps that will effectively shut FBME out of the US financial system.

Following this pronouncement, the Central Bank of Cyprus (CBC) took over the management of operations in Cyprus.

The CBC feared the FinCEN pronouncement would deal a serious blow to FBME's operations, endangering the stability of the Cypriot financial system and risking depositors' funds. The CBC intends to sell off operations to protect depositors.

Following the CBC's pronouncement, the central bank of Tanzania, Bank of Tanzania (BoT), took control of FBME's Tanzanian operations, protecting the stability of the Tanzanian banking system and the safety of customer deposits.

The actions of the CBC and BoT have resulted in their taking control of FBME. The bank is unlikely to survive in its present form. Central to this, however, is the fact that it was a bad reputation that set the chain of events into motion. Banks should pay heed to the fact that actions by unrelated foreign regulators can have disastrous consequences on their global operations.

What the future holds

In the past regulators focussed on a prescriptive approach. They dictated what banks needed to do in order to be compliant. Usually this took the form of providing lists of documentation that should be collected before a bank could take on a customer. The approach of regulators in this regard is changing.

When calculating fines, regulators take a bank's level of cooperation into account, as well as the fact that steps have been taken to rectify identified shortcomings.



Regulators are shifting to a collaborative risk-based approach, as advocated by the global inter-governmental Financial Action Task Force. In this approach, banks must evaluate the risk posed by each customer and treat them accordingly. Banks will no longer be able to claim compliance because they collected the correct documentation, they will need to show that they had a comprehensive view of their client and took appropriate steps to mitigate the risk posed by that client.

This has the benefit of giving banks the freedom to design their own controls, but equally exposes them to far greater risk for non-compliance as regulators will take a dim view in cases where a bank does not apply sound rationale when assessing the risk posed by a client.

What clients should be thinking about

Compliance with AML regulations is no longer optional, and must be embedded into a bank's operations to create a culture of compliance for bank employees at all levels.

The cost of implementing a sound AML regime pales in comparison to the fines being issued to banks. Even worse is the fact that having imposed a fine, the regulator will still expect the banks to take steps to rectify their shortcomings; so banks end up having to bear the implementation cost regardless.

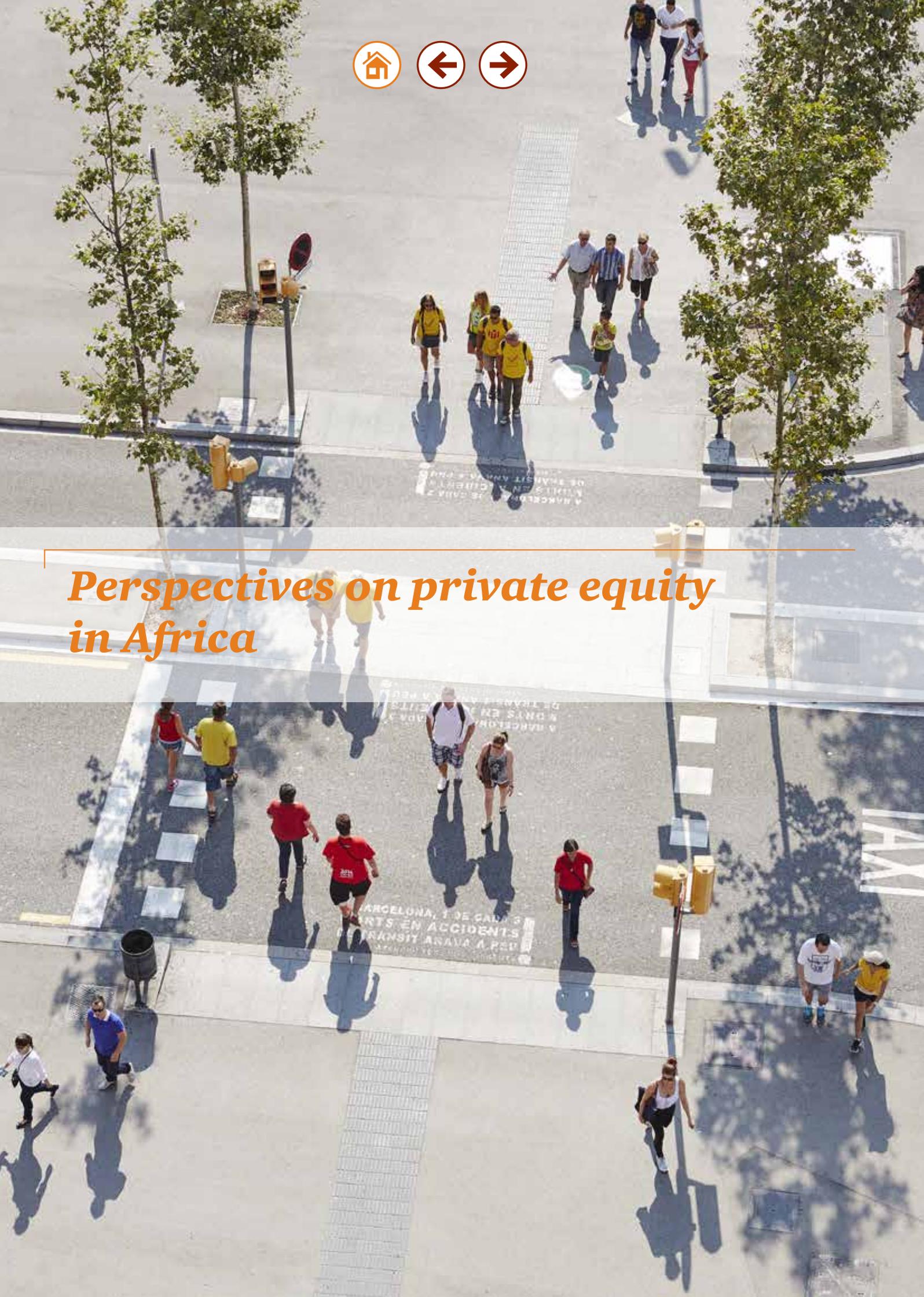
The cost of waiting

***Implementation Later = Implementation Now + Fines +
Regulatory Scrutiny + Reputational Loss***

Banks should proactively take steps to bring their AML regimes into line with local regulation and leading international practice – particularly if they have operations in other jurisdictions – while they can still do so on their own terms.



Perspectives on private equity in Africa





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Recognising and seizing the opportunity

Africa's rise to global economic prominence has been well documented for some time now. As John Hawksworth – PwC UK's chief economist – observes, the promise of Africa's economic growth offers significant opportunity, but these opportunities come with their share of challenges.

The private equity (PE) industry is one that is not unfamiliar with dealing with a variety of challenges and transforming them into lucrative opportunities. In South Africa, a cursory glance at the PE deal sheets for 2014 provides valuable insight. Perhaps the most significant theme emerging during the year was the heightened interest by large global PE firms to deploy substantial capital in African investments.

Driven by a search for yield, a greater appreciation of the quality of PE growth potential on the continent, and still uncertain macroeconomic forces at play within many of the advanced economies, a number of the largest global PE firms are looking to enhance their allocations of capital to African investments as a means to tap into the continent's growth story.

While Africa, and sub-Saharan Africa in particular, may have had the attention of the largest global PE players for some time now, the second half of 2014 saw the execution of some of the most exciting PE deals the South African industry has experienced for some time, with a number of large PE firms making their first investments in the country and materially enhancing their focus on closing deals in other parts of the continent.

Clearly, as the large global firms turn their ambitions into actual deal activity on the continent, there will be implications for the African PE industry and local PE firms – including significantly increasing levels of competition for a still relatively small number of large deals available. It will be interesting to see the response of local PE outfits to the recent activity by global firms, as they move to execute on their African ambitions and become substantial competitors to local firms.

At the same time, many of the traditional challenges of PE deal-making in Africa have not gone away or become any less important. These include intense deal competition, fund-raising challenges for local PE firms and, perhaps most importantly, identifying quality and skilled management teams in investee companies. Looking ahead, these challenges will be compounded by global economic and social shifts.

Industry survey

During April 2014, RisCura together with the African Private Equity and Venture Capital Association (AVCA) and the South African Venture Capital and Private Equity Association (SAVCA) conducted an inaugural study⁹ to provide an assessment of investor sentiment and perceptions of the attractiveness of Africa to private equity compared to other emerging markets.

The results of the study provide important insight into the views of the continent's PE potential and confirm much of the existing thinking regarding the opportunities and challenges for the African PE industry.

⁹ 'The search for returns: Investor views on private equity in Africa', www.riscura.com/press/press-room/search-returns-investor-views-private-equity-africa#sthash.sTgbnxlx.dpuf



Leading findings of the study:

- Africa was perceived as a more attractive market relative to other emerging markets by 70% of respondents.
- The investor base of the private equity landscape in Africa has evolved very much in line with the industry itself. Players in the field now range from pension funds, developmental foundations and endowments, to sovereign wealth funds, fund of funds, family offices and high-net-worth individuals.
- Investment in African PE requires an experienced management team with a track record of successful investments, from deal appraisal through to exit. With a limited number of investment opportunities available in each sector, regional funds seem to be a preferred investment vehicle.
- With many pension funds being first-time entrants into the private equity market, a preference for fund of funds reflects an emerging trend. These funds allow investors to rely on the expertise of experienced investment professionals at a higher level than at an individual fund level.
- For the continent, private equity has been and will continue to be a form of much-needed foreign direct investment. In some ways, this can be attributed to the growing view that returns on African private equity ventures compare favourably to that of listed equity over the medium term.
- In contrast to other more developed markets, the major driver of expected performance is underlying growth in earnings and the implicit underlying economic growth.

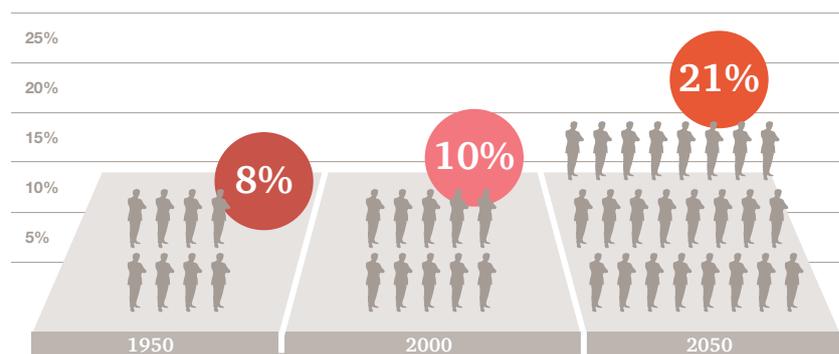
Potential impact of global megatrends on the private equity industry

PwC has identified five global megatrends whose impacts, intersections and collisions are reshaping the business world.¹⁰ We summarise these trends here from an emerging market and PE industry perspective and highlight the areas and industries where research suggests the most disruptive opportunities lie.

Demographic shifts

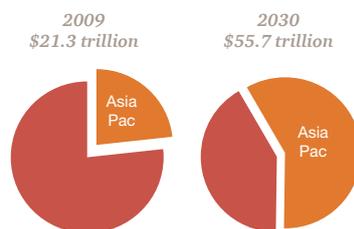
A growing population in most African countries, with a lower median age relative to many advanced economies around the world, increases the need for healthcare, education and other social services, making these potentially attractive areas for investment. At the same time, the prospect of increased privatisation of government-sponsored entities may open up new and previously untested investment opportunities in some countries.

Proportion of the world population aged 60 years or more



Source: UN report World Population Aging 1950-2050.

Spending of the global middle class, in 2005 US\$ PPP



Source: Data taken from OECD Development Centre Working Paper number 285, "The Emerging Middle Class In Developing Countries," January 2010.

¹⁰ Adapted from PwC US and UK research: Megatrends – Strategy and Leadership (www.pwc.com/megatrends) / PwC "Project Blue" (www.pwc.com/projectblue)



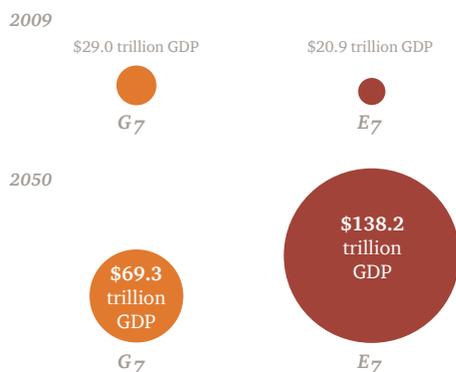
Shifts in economic power

Our research suggests that an increasingly multi-polar world will reshape the competitive environment for a range of companies and industries. Recent investor sentiment has shifted markedly in the direction of emerging economies and, within these, to countries and regions that offer the most compelling growth story to an increasingly discerning and international investor base.

As private equity firms become more global in their reach, scale and appetite, this may result in seismic shifts in local PE industries where large international firms focus their attention and resources. An increasingly competitive deals market in the US has also created more deal activity abroad, as PE firms continue to look for exclusive deals and higher returns in the most opportune markets.

Macroeconomic factors and the asymmetrical monetary policy responses of the advanced economies continues to result in a sustained low interest rate environment globally, fuelling a search for yield outside of traditional jurisdictions and asset classes. These factors in combination with increased levels of cross-border capital market activity and trade in the recent past, and the expected future, contribute further to the attractiveness of regions like sub-Saharan Africa, in particular, as a destination for strong forecast private equity growth.

GDP of G7 and E7 countries at US\$ PPP



Accelerating urbanisation

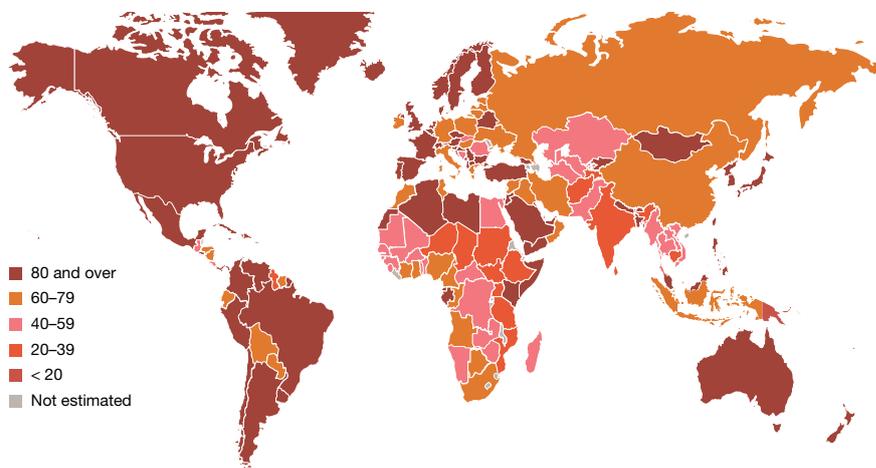
Currently, 50% of the world's population lives in cities. By 2015, the UN¹¹ estimates that there will be 22 megacities – those with populations of 10 million or more – with 17 of them located in developing economies. By 2030 the UN projects that 4.9 billion people will be urban dwellers. By 2050, the world's urban population will have increased by some 72%.

In developed economies and older cities in the developing world, infrastructure will be strained to capacity. In emerging economies, new cities will rise rapidly and require massive investments to accommodate growth.

Financing the growth of urbanisation in emerging economies will present significant opportunities for the PE industry and for those firms in particular that are able to pre-emptively position themselves to leverage this key megatrend.

Opportunities for investing in the growing need for infrastructure across the African continent, to sustain trends such as accelerating urbanisation and demographic shifts, will become increasingly evident.

Percentage of population in urban areas, 2030



Source: UN Department of Economic and Social affairs.

¹¹ The United Nations Department of Economic and Social Affairs, Population Division



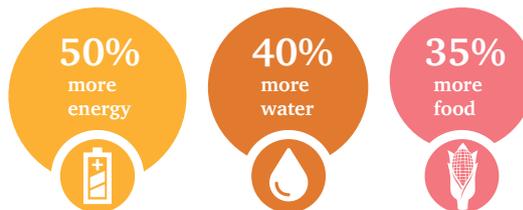
Climate change and resource scarcity

The growing population of the continent will continue to place significant pressure on governments to meet energy demands which, our megatrends research suggests, is expected to increase by 50% by 2030. The depletion of natural resources and other scarce commodities is forcing greater awareness on alternative forms of energy, an area which on its own is seeing considerable investor interest.

At the same time, the privatisation of energy supply may become an increasing possibility across many regions given the increase in capital needed to meet energy and environmental challenges.

These factors mean that climate and environmental challenges have the potential to give rise to the creation of new industries, while existing ones experience material disruption as a result of energy scarcity, climate change and a lack of resources.

Global resource requirements by 2030



Source: National Intelligence Council: *Global Trends 2030: Alternate Worlds*.

Coupled with these natural forces, sustainability as a core business strategy is rising to the top of many investors' lists when considering companies and ventures to invest in. This strategy is driven by an enhanced focus on environmental, social and governance (ESG) factors, as social responsibility and the compliance of the companies being invested in becomes a higher priority in a more socially conscious world.

While climate change and resource scarcity may appear to simply bring an increased focus on natural resource and commodity investments, the intersection of purely commercial considerations with ESG factors will start to influence PE investment decisions and possibly rank higher in the overall investment criteria.

Some players have already commented that social and ethical responsibility, in today's world, can present a tangible, commercial advantage. Private equity has the potential not only to generate significant returns, but its hands-on nature also helps build better businesses, societies and economies.

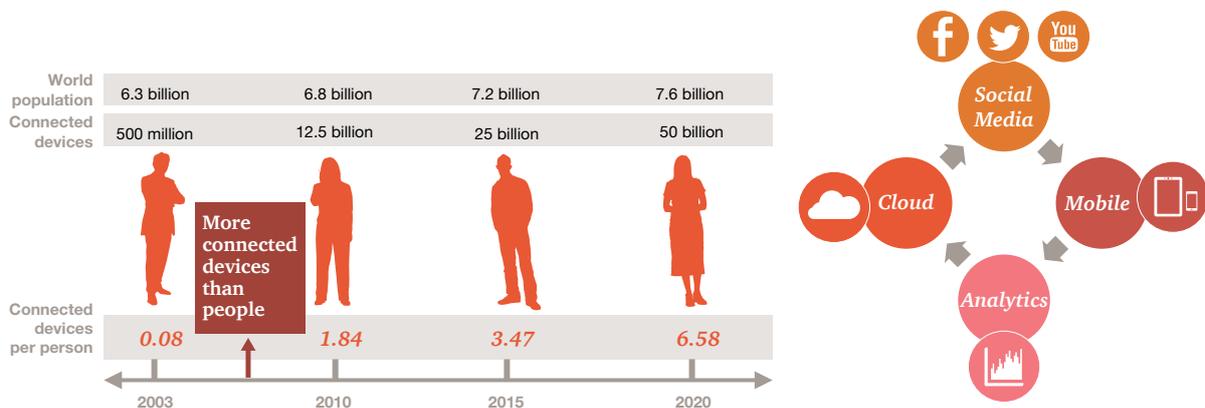


Technological breakthroughs

New investment opportunities are constantly opening up as a result of technological breakthroughs. Entire new industries are being created, which could have a significant impact on the size and shape of the world's manufacturing, and high-tech sectors and the companies that operate within them. Lower-cost, more agile electronic technology platforms, for example, have recently become very popular paving the way for accessing unbanked populations in key emerging markets, including in Africa.

The combination of the internet, mobile devices, data analytics and cloud computing will continue to transform our world. Many companies across all sectors are grappling with how these developments will affect consumer expectations, the way they interact with their customers and the underlying business models that support this.

The rise of the 'Internet of Things'



Source: Cisco Internet Business Solutions Group, April 2011.

Conclusion

In the short to medium term, Africa faces a range of very real challenges; challenges that those who will emerge as winners will need to ensure are appropriately considered, effectively mitigated, realistically appraised and, ultimately, turned into strategic advantage. Private equity firms have a track record of turning challenge to advantage and bringing with them significant benefits to the companies and communities they impact.

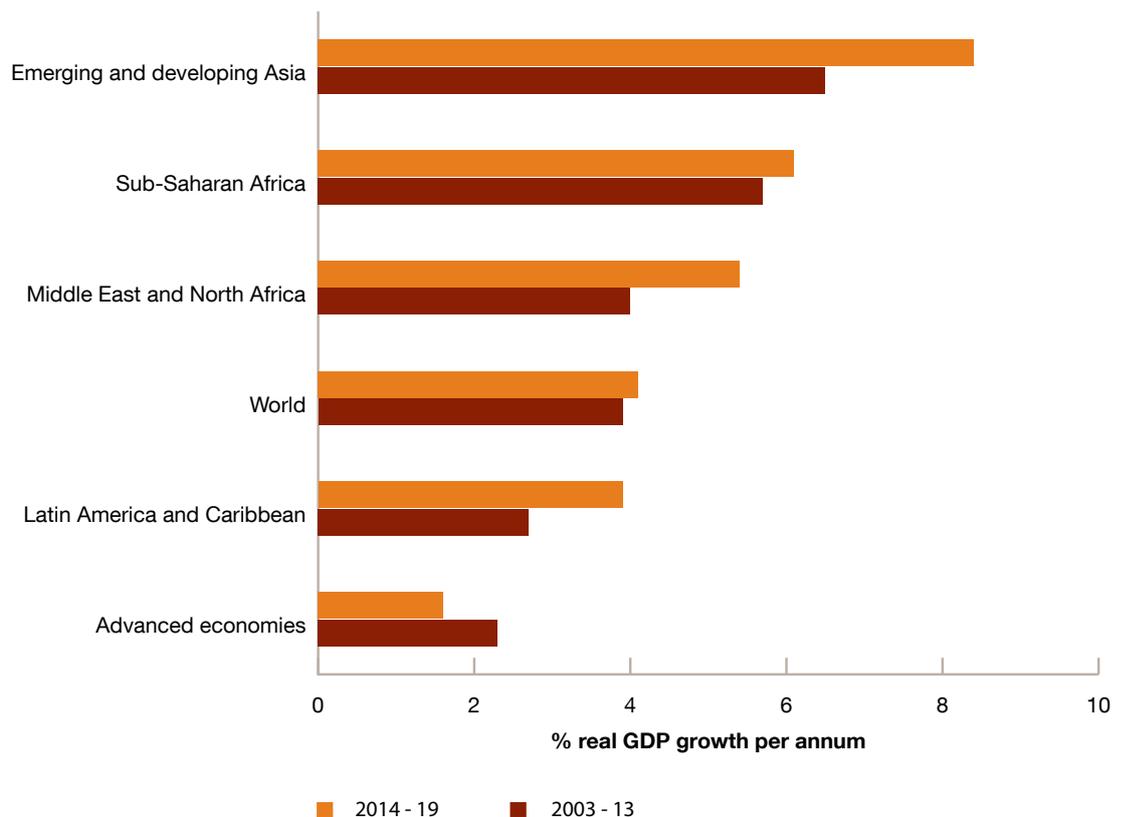
When done well, PE has the ability to generate significant returns for a range of stakeholders, while its implicitly hands-on and proactive nature also helps build better businesses. Understanding the current and emerging trends impacting the economic landscape will be vital for future success in a rapidly changing world.



Can Africa's economic rise be sustained?

During the second half of the 20th century, sub-Saharan Africa¹² was generally an underperformer in the global growth race. Over the past decade, by contrast, it has been one of the fastest growing parts of the world economy, as shown by the blue bars in Figure 7 below. But can this recent strong performance be sustained?

Figure 7: Past and projected GDP growth for major country groups



Source: IMF World Economic Outlook database (October 2014)

As Figure 7 shows, the latest IMF projections from October 2014 were optimistic on this question, suggesting that sub-Saharan Africa would grow by an average of just under 6% per annum over the rest of this decade. This would be only just below its average growth rate during 2003-13 and not far behind expected growth in emerging and developing Asia.

Strong projected growth in Africa reflects many of the factors highlighted in our megatrends research, including a relatively young, fast-growing workforce, rapid urbanisation, adoption of mobile communications technology and a rich endowment of natural resources in many African countries.

¹¹ Throughout this article we focus on sub-Saharan Africa since the North African economies are, for a variety of historical and geographical reasons, more naturally considered alongside the Middle Eastern economies for analytical purposes.

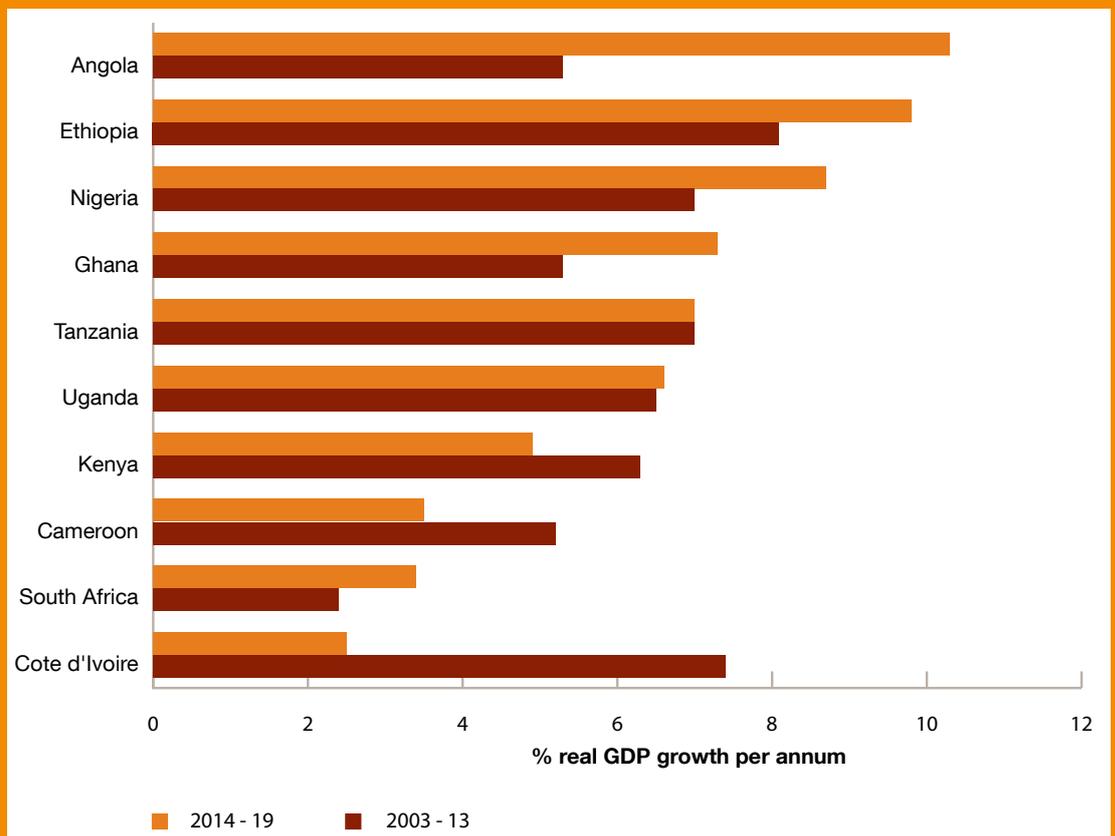


At the same time, however, we should recognise that:

- Africa is a large and diverse continent, so performance could vary considerably across countries (and indeed cities); and
- the IMF growth projections for Africa are not guaranteed to be achieved, being subject to many risk factors including commodity price volatility, rising militancy in some countries, Ebola and other health risks, and a longer-term need to improve both physical infrastructure and the political, legal and economic institutions required to support sustainable growth.

The first point can be illustrated by looking at past and projected growth (according to the IMF) for the ten largest economies in sub-Saharan Africa, which together account for around 80% of the region's total GDP (see Figure 2).

Figure 8: Past and projected GDP growth for 10 largest sub-Saharan African economies



Source: IMF World Economic Outlook database (October 2014)

Note: Countries ranked in descending order of total GDP in 2013

The divergence in past and projected growth between the region's two largest economies, Nigeria and South Africa (which together account for around half of the region's total GDP), is particularly stark. Nigeria is, based on recently revised GDP data, now ranked as the 20th largest economy in the world and, with the IMF projecting relatively healthy growth of around 7% per annum over the rest of this decade, it could move even further up the global league table.



By contrast, projected average growth of 2.4% for South Africa in 2014-19 is no better than the expected average for the world's advanced economies as shown in Figure 7, implying no further catch-up by Africa's second largest economy.

For the other major economies in the region, projected growth varies from just over 5% in Cameroon, Ghana and Angola to around 8% in Ethiopia. But, as Figure 8 shows, actual growth over the past decade has varied by much more than this and, in practice, this variability is likely to re-emerge in future due to the differential risks facing sub-Saharan economies.

Most obviously, while the recent sharp fall in oil prices could pose a significant risk for Nigeria and Angola in particular, most other sub-Saharan African economies are actually net oil importers and so might gain from this oil price fall if it is sustained. By contrast, economies like Kenya, Ghana and Cote d'Ivoire would be more heavily exposed to falls in coffee or cocoa prices.

The Ebola crisis understandably looms large as a risk factor at present, and is clearly a great human tragedy in the three West African countries where it has mostly been focused (Guinea, Liberia and Sierra Leone). However, outbreaks in Nigeria and elsewhere seem to have been brought under control, so the hope must be that the wider economic damage can be limited. It does, however, highlight the need to improve health systems across Africa, not least in its fast-growing megacities.

More generally, if Africa is to fulfil its potential, it needs long-term improvement in political, legal and economic institutions in order to provide the right environment for both domestic and international investment to proceed. Long-term investment in energy, transport and communications infrastructure is also critical, but won't happen without the right institutional environment. There has been encouraging progress in many African countries on these fronts in recent years, but there's clearly still a long way to go to get infrastructure and institutions up to the levels seen in Europe, North America or the leading Asian economies.

In summary, sub-Saharan Africa has huge potential and a strong recent track record of growth. But it remains a relatively high-risk place to do business and its long-term success is not guaranteed.



Tax governance transcends tax debate





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Companies worldwide are increasingly paying more attention to tax compliance, recognising the risk of both hefty fines and the potential of damage to corporate reputation. Governments, policymakers and the public are paying closer attention to corporate tax practices too, with more risks around tax than ever before.

There is a clear need for transparency and disclosure in tax matters and tax needs to be elevated on the corporate risk agenda, becoming an integral part of the enterprise-wide risk management framework.

Organisations are under significant pressure to provide assurance to the board, audit committee and external stakeholders about risk and tax control.

Never before has the need for strong internal corporate governance and risk management been more vital for organisations, their boards and their shareholders. There is a general move by tax administrations globally towards more cooperative initiatives that are built on mutual respect, trust and transparency. A number of tax administrations have introduced and are further developing initiatives that encourage organisations to consider good corporate governance and support tax risk management.

As far back as 2009, the OECD's Forum on Tax Administration issued its General Administrative Principles: Corporate Governance and Tax Risk Management report. The report found that many organisations had changed the way in which they approached corporate governance and tax compliance.

Although South Africa's King III Code of Corporate Governance does not address the issue of tax directly, its principles encompass risk management, including tax risks. Tax risk management should therefore be on the board's agenda, in line with the recommendations of King III.

How a large business manages tax risk can affect its financial performance and reputation. CEOs and boards of large businesses are increasingly considering tax risk management as part of their overall corporate governance.

Companies have become increasingly aware of the wider audience watching them and their business decisions, and these decisions include the company's strategy, behaviour and approach to tax. That audiences' newest and most influential members include a bigger than ever governmental and regulatory presence after base erosion and profit shifting became part of stakeholders' daily conversations and occupied a spot on the agenda for the OECD, G20 and G8.

In addition, the public's interest has reached an all-time high with influence from NGOs, Civil Social Organisations (CSOs) and the media. Now, for the first time, CEOs are recognising the influence of these stakeholders on company strategy and the link to taxation. With country-by-country reporting and transparency regulations becoming the norm, tax information and disclosures are entering an era of enhanced reporting, reflecting a need to assess the total tax impact of an organisation in the tax jurisdictions in which it operates.

With the expanded stakeholder group has come the responsibility and expectations of a company by the users of the annual report information to change historic views on tax from an obligatory burden on a company's profits, to defining a responsible tax strategy as part of corporate social responsibility. Many companies are already making efforts to enhance their reporting on tax in an effort to remedy the decline in trust by public, social and governmental stakeholders and their cries for a 'fair amount in tax'.



A cohesive approach is required between tax strategy, tax risk management and corporate social responsibility to demonstrate tax as an instrument that creates shared value and not just as a cost. This will enable organisations to not only demonstrate value creation, but also meet the demands for enhanced tax information and disclosure by stakeholders.

Good tax governance is necessary and fundamental in linking strategic intent to demonstrating value creation and reporting on it. According to a recent report prepared by the Dutch Association of Investors for Sustainable Development, with support from PwC and the university organisations Oikos, there are six principle-based guidelines on what constitutes good tax governance in order to achieve this:

- Companies should define and communicate a clear strategy on tax governance;
- Tax must be aligned with the business and it is not a profit centre by itself;
- Respect the spirit of the law. Tax compliance behaviour is the norm;
- Know and manage tax risks;
- Monitor and test tax controls; and
- Provide tax assurance.

In addition, good tax governance requires a sound tax control framework (TCF) as a foundation. In its simplest form, this is a framework that will enable an organisation to file proper returns and effectively communicate on them. A good TCF covers all taxes borne and collected on behalf of tax administrations, embeds the guiding principle of good tax governance and enables information gathering to measure and manage an organisation's tax impact and value creation.



Cookies from criminals



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As a younger man I read a book called ‘The Gift of Fear’. It changed the way I perceive things in the world. The book, written by Gavin de Becker, teaches us to listen to our inner voice and rely on what it is saying to us. Often referred to as intuition, gut feel or a hunch we all possess this little voice. In the book de Becker provides insight into how we should listen to this voice, sometimes against our own logic.

Although the book is aimed at providing the reader with signs on surviving violence, the message is clear we should listen. As children we were warned not to take candy from strangers, but when the Internet came about, no such advice was given and most people perceive the Internet to be a library with definite boundaries. This it is not.

Although the threat of physical violence seems far removed from cybercrime, we need to apply the same instinctive thinking to the way we transact online.

In the time it will take you to the text in this block, approximately:



138 million emails will be sent, including spam;



25 000 items will be purchased on Amazon.com;



293 000 Facebook statuses will be updated;



15 000 songs will be downloaded; and



433 000 tweets will be sent out

It should come as no surprise that criminals are using these very mechanisms to commit crimes. The crimes committed online range from identity theft and fraud, to intellectual property theft, and theft of financial and personal data.

The landscape is changing and making headlines is a big concern

In PwC’s latest Global Economic Crime Survey, which featured responses from companies in 26 African countries, African respondents indicated that their companies have experienced a 21% increase in cybercrime incidents over the past 12 months. In South Africa, a 26% increase in cybercrime incidents was reported. Most companies are concerned about cybercrime being an external threat and a reported 21% of those surveyed claim that cyber incidents making headlines is their greatest concern.



Although the primary driver is financial gain, the knock-on effects of cybercrime extend beyond the financial loss suffered as a result of crime. Considerations that are often overlooked also include, but are not limited to, regulatory fines and risks, legal, investigation and/or enforcement costs, service disruption, reputational damage and the loss of personal identifiable information.

Knowing your tweets from your twits

A quarter of respondents to the survey didn't know if social media had been a source of their cybercrime. Criminals routinely use social media sites and applications as a delivery mechanism for malware and/or malicious content and the risks associated with these social media platforms is the ease with which data can be compromised.

At the Cybercon conference hosted in Johannesburg recently a panel of cybersecurity and digital forensic subject matter experts from across Africa discussed the issues relating to Cybercrime in Africa.

A representative from the US Secret Service was there to give his perspectives on cybercrime. The panel discussions centred around transnational crimes, mutual legal assistance and the challenges facing corporates and law enforcement agencies in Africa in tackling cybercrime.

A clear message emerged that most agencies and companies in Africa are uncertain as to what constitutes a cybercrime and also what reporting and/or incident response capabilities exist.

A member of the audience who was representing the South African State Security Agency provided comment on the current status of the proposed Cybersecurity Framework of South Africa, which would seek to address several concerns relating to issues of cybercrime and cybersecurity. The proposed Cybersecurity Framework would see stakeholders from within industry and Government agencies forming cooperative partnerships to fight cybercrime.

Several key industries were identified and the financial services sector was highlighted as a focus area. The South African Banking Risk Information Centre (SABRIC) was named a key stakeholder in the framework.

Susan Potgieter, General Manager of the Commercial Crime Office at SABRIC, noted that:

Several SABRIC member banks have operations or business interests in other African countries and from there the directive to SABRIC is to pursue collaboration with banking sectors in other African countries. The vision is for the sector to be able to share information, trends and typologies through nodal points in each country.

Knowing that some organised criminal nationals responsible for bank-related crime in South Africa, use South Africa as their base and travel to other African countries to perpetrate the same crimes, we believe that such a network will go a long way to strengthen the continent.

Fighting crime through informal and personal networks only, is not sustainable in our view and thus SABRIC is willing to share our model and experiences with the banking sector of countries that are interested in pursuing similar capabilities.

With the ambitious push into Africa by South African banks, more mature reporting mechanisms are now being adopted by smaller banks in African countries. A key area of concern for the forensic and investigative community is the lack of visibility of incidents occurring in-country as well as the lack of skills and knowledge of technology used in the commission of cybercrimes by the law enforcement agencies and the judiciary. Law enforcement agencies are often playing the proverbial game of catch-up with criminals when technology is used to commit crime.

A crime type currently receiving a lot of focus in Africa is card skimming. Although traditionally not a cybercrime, the level of sophistication and organisation shown by the criminals requires that a hi-tech approach is taken in the investigation of these crimes.



Skimming has a huge effect on the banking life cycle as it impacts on customer confidence, analysis and identification of compromised point of sale and ATM locations as well as the financial losses suffered as a result of the fraud committed.

The criminal groups currently identified as role players in this crime type are from the Eastern European countries, specifically Romania and Bulgaria. These organised crime groups have moved into Africa as a result of better cooperation between European law enforcement agencies and stricter penalties being imposed for skimming.

Law enforcement agencies seldom have visibility of incidents in neighbouring countries and as a result instances of cybercrime are not reported thoroughly and criminals move between countries without fear of detection.

Information gathering in transnational investigations poses significant challenges as in most cases the application for mutual legal assistance has to be undertaken by the judiciary and law enforcement agencies, which adds to the time required to investigate effectively. The challenge is compounded by the fact that not all African countries have enacted cybercrime-type legislation and rely mostly on traditional law when prosecuting cybercriminals.

Cybercrime is not a random act of mischief, in most cases it is focused and targeted. The victim is often a large corporation with interests across the continent. Tactics used by criminals include gathering of intelligence using company websites, social media platforms, social engineering and in some cases theft of company assets such as mobile phones and laptops.

This intelligence is used to formulate the attack, which will include the delivery of malware through spearphishing emails and vulnerability exploitation on the company information security architecture and websites.

Based on the Mandiant M-Trends report on malware, the average detection period for malware is now 229 days, which is 14 days less than in previous years.

Companies are spending less on security year on year and this is directly contributing to the successes of these cybercriminal targeting businesses.

Current trends within the financial services sector are that companies are increasing awareness and attempting to model known threats against their organisations.

How can we stop leaving cookies for criminals?

PwC is launching a programme whereby known threats and attack vectors will be modelled into a scenario and a simulation will be run against a company's security infrastructure. This programme will highlight weaknesses in the security postures of companies in a controlled and measured manner.



Solvency II and SAM





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With insurers facing a 16-month window in which to fully report on their solvency, key decisions around reporting processes and technologies need to be made with careful planning and insight as to how best to extract value from that which is required for the regulatory report.

The implications of these decisions extend beyond the unification of finance, actuarial and risk functions – market sentiment, earnings and insurers’ true performance will be made visible and the need for value to be properly understood will quickly rise up the board agenda. Analysts, investors and regulators will be looking closely at what is disclosed.

The challenge that remains is: How do insurers move from data to decisions?

New insights will emerge and leveraging these will give insurers the ability to harness reporting technologies that will shift the focus from compliance to decision support.

- The data sets necessary to meet the reporting requirements that are defined by the regulators consist of **several thousands of elements**.
- On top of this, regulators require data used in reports to meet **quality standards** in terms of accuracy, completeness and appropriateness.
- Some reports (such as the ‘Assets details Quantitative Reporting Templates [QRT]’) can have **millions of lines**.
- **Timelines** for quarterly reporting from 2018 onwards are **short**, at just 5 weeks.

Responding to the increased complexity resulting from regulatory requirements, we see finance, risk and actuarial functions moving towards each other to become a central component in the operating model of insurance companies.

Data to be included is fragmented and typically resides in a multitude of source systems, differing in data definitions, levels of granularity and supporting technologies.

Bringing the data together in a single repository and data architecture is essential in addressing data quality standards put forward by regulators.

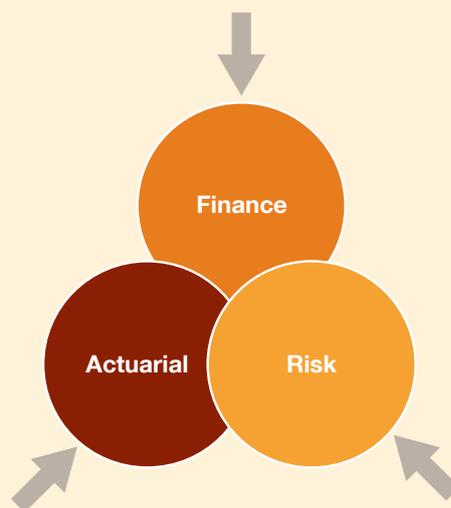
The key challenge for insurers will be to develop a ‘single source of the truth’ as a basis for integrated internal and external reporting.

This will allow insurers to leverage the investment made for regulatory compliance to improve governance, decision-making and strategic assurance.



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Impact of Solvency II on the insurance industry



- Finance, actuarial and risk functions will need to source, merge and manipulate data from **different functional domains** into to their reporting structure.



The state of the industry

Market leaders	Market norm	Market
<ul style="list-style-type: none"> • Design – high-level project plan developed/ key requirements assessed. • Technology – little progress – some basic understanding of options and vendors. • Data – high-level gap analysis performed by dataset (e.g. investments, geographical split etc.). Work needed to define exact data source per item and to plan gap closure. 	<ul style="list-style-type: none"> • Design – some initial thoughts on overall approach. • Technology – no progress. • Data – no progress. • x – not considered. 	<ul style="list-style-type: none"> • Design – complete. • Technology – vendor selected and some progress made on implementation. Focus on production of key S2 data sets. • Data – detailed data analysis exercise complete. Focus now on improving quality, closing gaps, designing system source recs. Key quantitative templates piloted. • Narrative – requirements assessed, skeleton structure designed

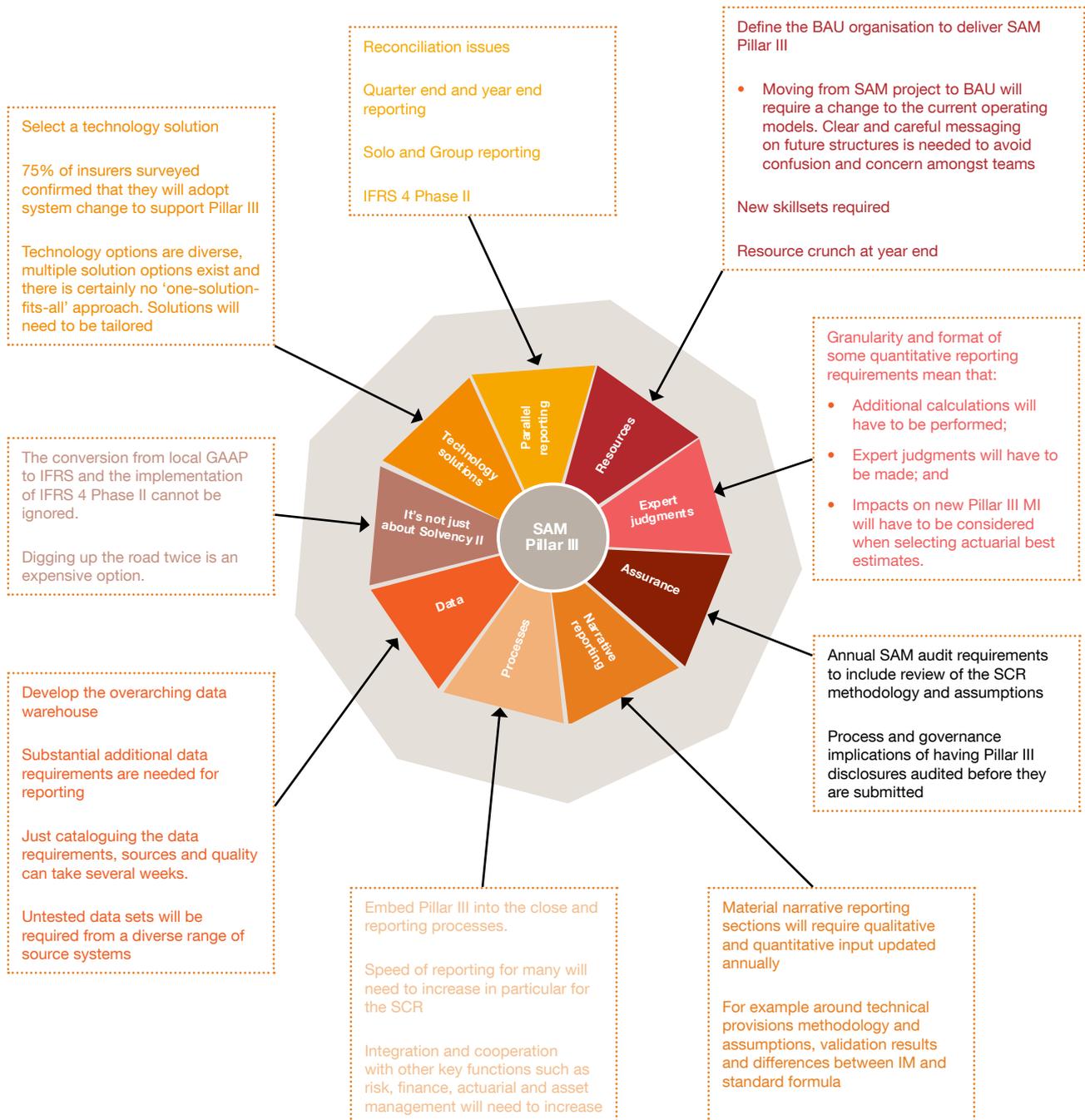
Design Principles for a Single Source of Truth Solution:

- All necessary data for finance, investment as well as risk is stored in a data repository such as a data warehouse (DWH);
- All data is stored in its rawest form as it is received from the data source and is time stamped and the source registered in the ‘details area’;
- Within the DWH new data is inserted, data is updated and no data is deleted (‘inserts and updates only’); all (business) rules are stored inside the metadata management layer (rules engine) and all data transformations are stored, ensuring full traceability;
- Results from applications such as risk engines and consolidations are stored in the results area of the DWH;
- Reconciliation rules between reports stored in the rules engines will support full overview of overlaps of all differences between reporting bases.

A holistic view is required around Pillar III and the typical challenges and considerations in embarking on Pillar III reporting are shown in the accompanying diagram.



Considerations for Pillar III reporting

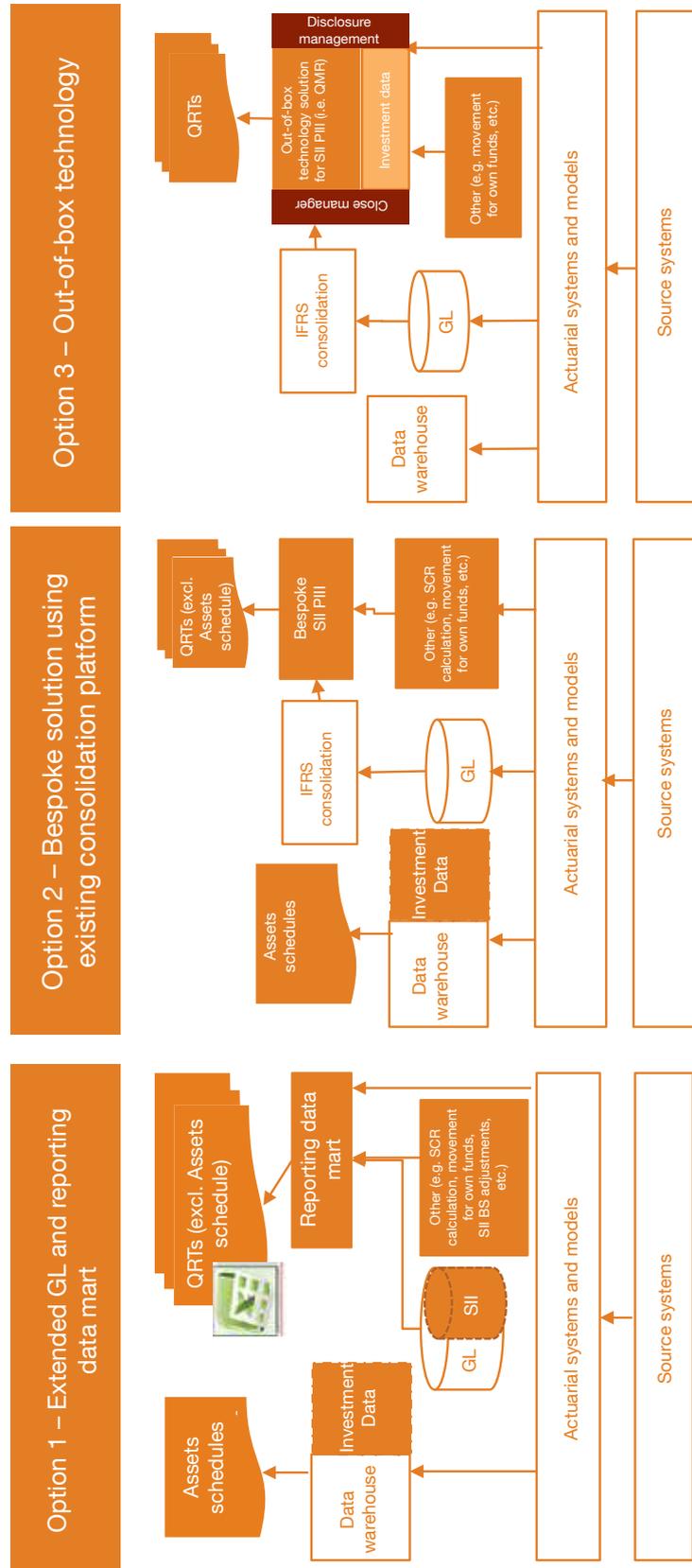


Solvency II and SAM Pillar III system options

Given the challenges set out earlier in this article, there are fundamental decisions required around the choice of systems architecture. Based on prior experience of delivering Solvency II and Pillar III solutions for various insurance companies, we have identified three broad options.



System options





Key system functional requirements for Solvency II / SAM Pillar III reporting

- Integration and validation of data from multiple source systems;
- The ability to enrich or supplement additional data manually in a controlled and auditable environment;
- A clear audit trail and mapping back to Local GAAP/IFRS reporting;
- The ability to amend and maintain a separate Solvency II / SAM Pillar III data model and exclude any non-Solvency II / SAM required data elements;
- Functionality to enable the validation of data, including relevant cross checks prior to reporting;
- Currency translation, elimination and consolidation of data as required; and
- Automated production and reporting of the Pillar III templates

Key questions to consider

- Do you need to report at Group level under Solvency II / SAM / local regime Pillar III?
- How many solo entities are required for reporting?
- Is any consolidation or aggregation of entities required for reporting?
- Do you have any Solvency II/SAM Pillar III reporting requirements outside of your local regime?
- Do you have an existing consolidation / financial reporting system? If not what do you use?
- What information and at what level of detail does your current data warehouse hold information?
- How mature is your data warehouse environment?
- How will you integrate detailed asset data from your investment manager / custodian into your data warehouse or Pillar III reporting?



Digital transformation in banking





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What does 'digital transformation' mean?

Digital transformation is the amendment of the organisation's business model to bring about business change that is enabled by digital technology to increase revenue, improve customer insight, respond to regulatory change and expand into new markets.

In the past, digital business meant e-commerce or automation to the consumer and financial institutions, but the landscape has changed. The rapid rise of social media, smart devices, big data and analytics and cloud computing has significant implications for banks, as there are new channels to interact with, sell to, educate and receive information from customers.

Technology and social media are making customers better informed, more connected and more vocal



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The move towards digital transformation has challenges

Technology is evolving with ever-increasing speed. Changes are challenging the business models of today's banks, as we are seeing new entrants come into the market to compete with different areas of banking. Within Africa, payment systems and lending activities have emerged outside traditional banking structures led by the mobile phone operators such as Vodafone using M-Pesa as their mobile banking platform.

In 77% of the better-performing organisations, the CEO was a champion of IT's business value, and the level of integration of business and technology was high. The data supports the idea that aligning businesses and technology starts at the top.

Source: PwC, 6th Annual Digital IQ Survey, 2014

An average of 63% of countries in Africa are investing in social media for external communication, collaboration and commerce.

Source: PwC, 6th Annual Digital IQ Survey, 2014

What is clear is that banking services will increasingly migrate away from physical, tangible distribution into technology-enabled channels.

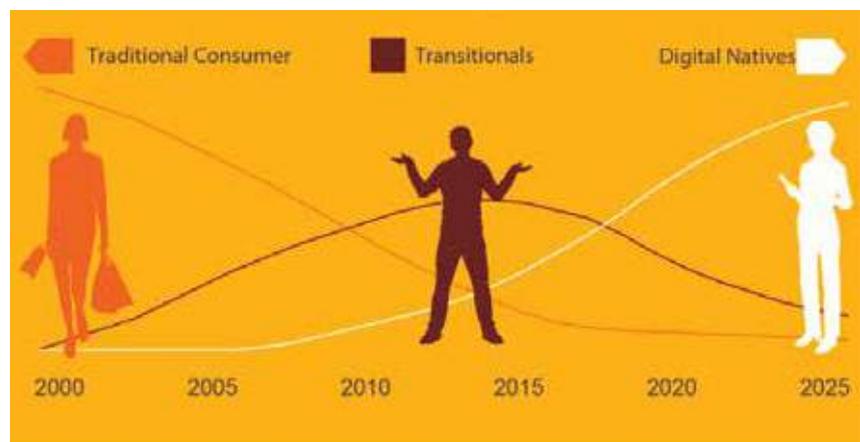


The challenge for banks is to exploit the potential of digital channels and platforms to develop deeper relationships with customers. They need to be able to use the wealth of data available to them to offer far more targeted and personalised services to customers.

Consumer transformation

As more customers enter the digital era, businesses need to adapt to the challenges being presented, where social media, cloud computing and mobile customer engagement are shaping today's digital ecosystem.

The changing digital customer



The traditional customer and the transitional customer did not grow up with the digital experience in terms of laptops, the internet and mobile devices. The traditional customer would likely use some technology at work, and as consumers, they typically resist the adoption of digital, because they find it difficult to use. The traditional customer in Africa typically has trust issues relating to the security and usage of digital and electronic platforms. The transitional customer, however, has adopted digital technology and integrated it into their lives. They see digital as a tool, and they understand the practical and convenience value of these channels.

However, by 2017 a new breed of customers will dominate – we call them digital natives. Digital natives had the opportunity to use laptops, the internet and mobile devices when growing up. They take digital for granted and are dependent on it as it is an integral part of their lives.

Within Africa, the digital natives are those that predominately use a mobile phone, compared to the rest of the world where the digital natives are omni-channelled. Mobile financial services are popular within Africa, as demonstrated by Vodafone's M-Pesa, which capitalised on the opportunity to promote digital banking into Africa.



How do banks adapt to digital change?

Banks need to identify the segments of digital natives they want to attract as customers – mobile phone user only vs. omni-channelled device users – and to be able to unlock future value. To do this, banks will need to move beyond cost reduction objectives towards providing new value for customers through a new ‘digital feature set’.

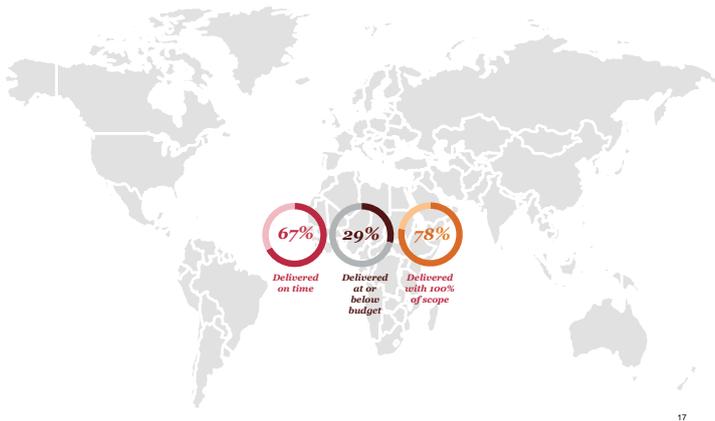
This needs to be based on innovations in: user experience; mobile devices and networks; social media and collaboration; customer analytics; and channel integration. These offerings will drive how to serve the customer and to allow digital to become an enabler to access new sources of revenue.

Companies in Africa are realising the need to create room for improvement with digital delivery to customers. PwC’s 6th Annual Digital IQ Survey, 2014 showed companies in Asia and Africa were more likely to use agile processes than their regional counterparts, possibly contributing to more success in delivering technology projects.

Delivering digital

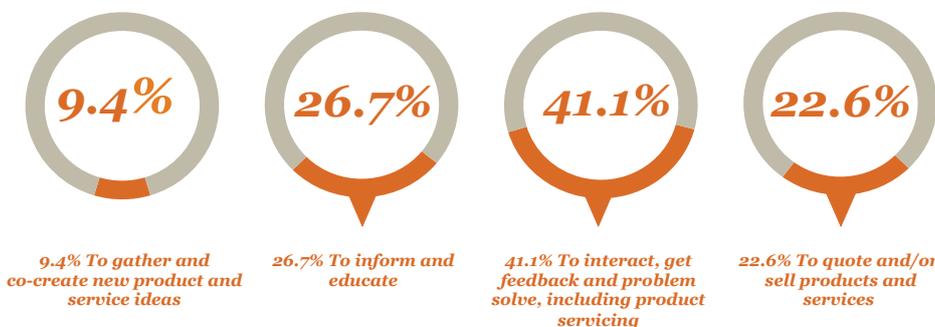
Companies in Asia and Africa were more likely to use agile processes than their regional counterparts, possibly contributing to more success in delivering IT projects.

Q: On average, how often did strategic IT initiatives fall within each of the following delivery categories in the last 12 months? Respondents who stated ‘always’ and ‘frequently’.



Source: PwC, 6th Annual Digital IQ Survey, 2014

African financial services companies’ approach to interacting with customers using mobile technology



Source: PwC, 6th Annual Digital IQ Survey, 2014

Banks in Africa are leveraging the high levels of mobile phone penetration to interact with their customers.



To succeed in business today, you don't need a digital strategy; you need a business strategy... for the digital age

Banks must acknowledge that the new digital feature set is changing the way customers interact with them. Understanding the different needs of different customer groups is essential, as a 'one-size fits all' approach will prove insufficient to meet the range of needs of digitally-enabled customers. Developing a vision and a strategy – with the customer at its heart – is the first step towards succeeding on this journey.

An average of 57% of countries in Africa are investing in mobile applications and technologies for customers.

Source: PwC, 6th Annual Digital IQ Survey, 2014

Evolving consumer multi-channel preferences drive new models, leading to true 'anytime, anywhere' banking.

Today's retail banks have evolved in recent years to offer a multi-channel experience, enabling customers to interact with them via a variety of channels (such as online, at a branch, via mobile or through a call centre). However, the customer experience is inconsistent across channels. The preferred model for customers – the omni-channel experience – enables customers to interact with banks seamlessly across channels, regardless of the transaction type or where they are in the process.

A financial services company has started distributing its information packs via tablets. Information is available anywhere and at any time.

In Africa, payment systems and lending activities have emerged outside traditional banking structures, led by mobile phone operators.

Banks have to foster agility and innovation to compete within the digital banking market

Ongoing innovation is fast becoming one of the most important prerequisites for the success of financial institutions. Leading innovators do not view innovation as a one-time 'quick fix', but rather as an ongoing approach that will yield lasting results. They may even be willing to incur a short-term cost to achieve a long-term gain.

Innovation needs to be embedded as a culture within the organisation. In some cases it may prove more effective to work successfully with innovators from technology, telecommunications and other non-traditional banking providers, than to go it alone. Identifying partners to acquire or help deliver the vision is of critical importance for banks in Africa wanting to enhance their customer value proposition to attract a larger customer base.

Technology companies are also entering the financial services arena, with Facebook applying for an Electronic Money Institution Licence and Google having launched its mobile wallet and PayPal entering the African market.

The challenge for incumbents will be to maintain focus and investment at a time when so much management time and financial resources are diverted to dealing with issues related to legacy and regulation.



What is the impact of digital change on banks?

Advancements in technology, a changing competitive landscape and evolving stakeholder attitudes and expectations are transforming financial services in Africa. While branch-based bricks-and-mortar retail service delivery is growing, digital mobile services and agency or satellite service providers increasingly account for a greater share of service delivery.

When banks look at their strategies and growth expectations, they need to carefully consider the impact that the digital age will have on products, channels, and services. Understanding who their customers are, what they need and how to deliver upon that will impact every aspect of their business. In order to succeed in the digital age, banks will need to master six core disciplines, depicted in the accompanying diagram.

Six core disciplines for banks to follow



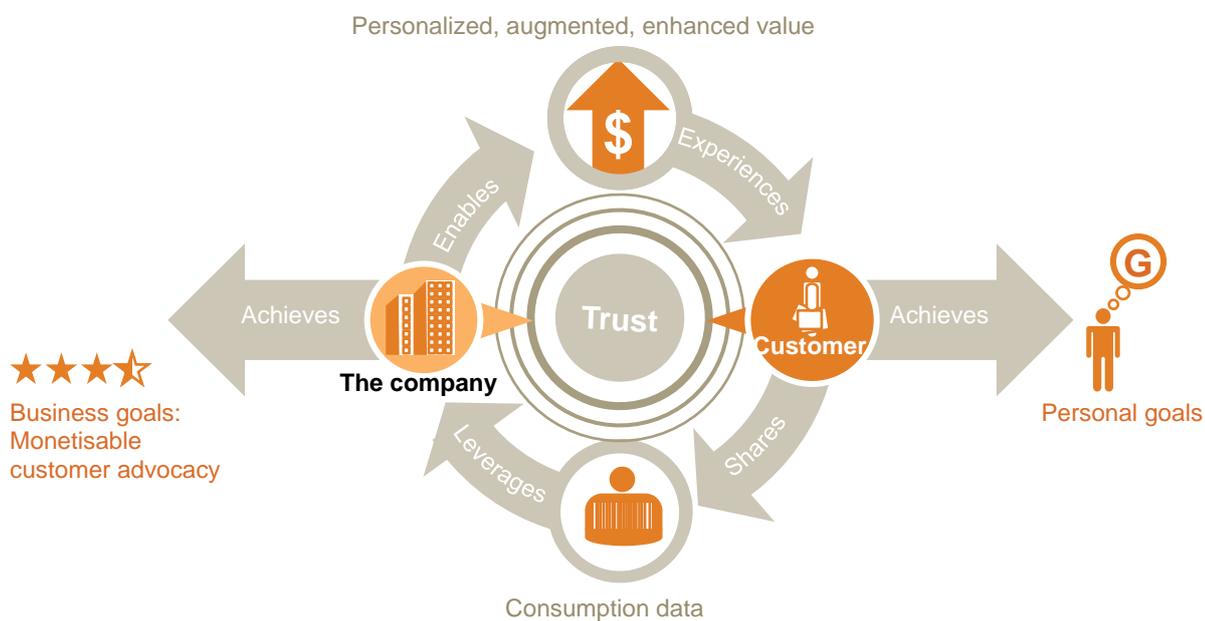
What next?

It all starts by listening to your customer for actionable insights across major life cycle events. Digital natives within emerging markets are leap frogging online banking and going straight to mobile and digital banking.

The cost of acquiring new customers will play a significant role in shaping banks' strategies and operating models. The strategy and operating model are key inputs to support the omni-channel customer experience by gaining value through connected experiences across multiple media platforms.



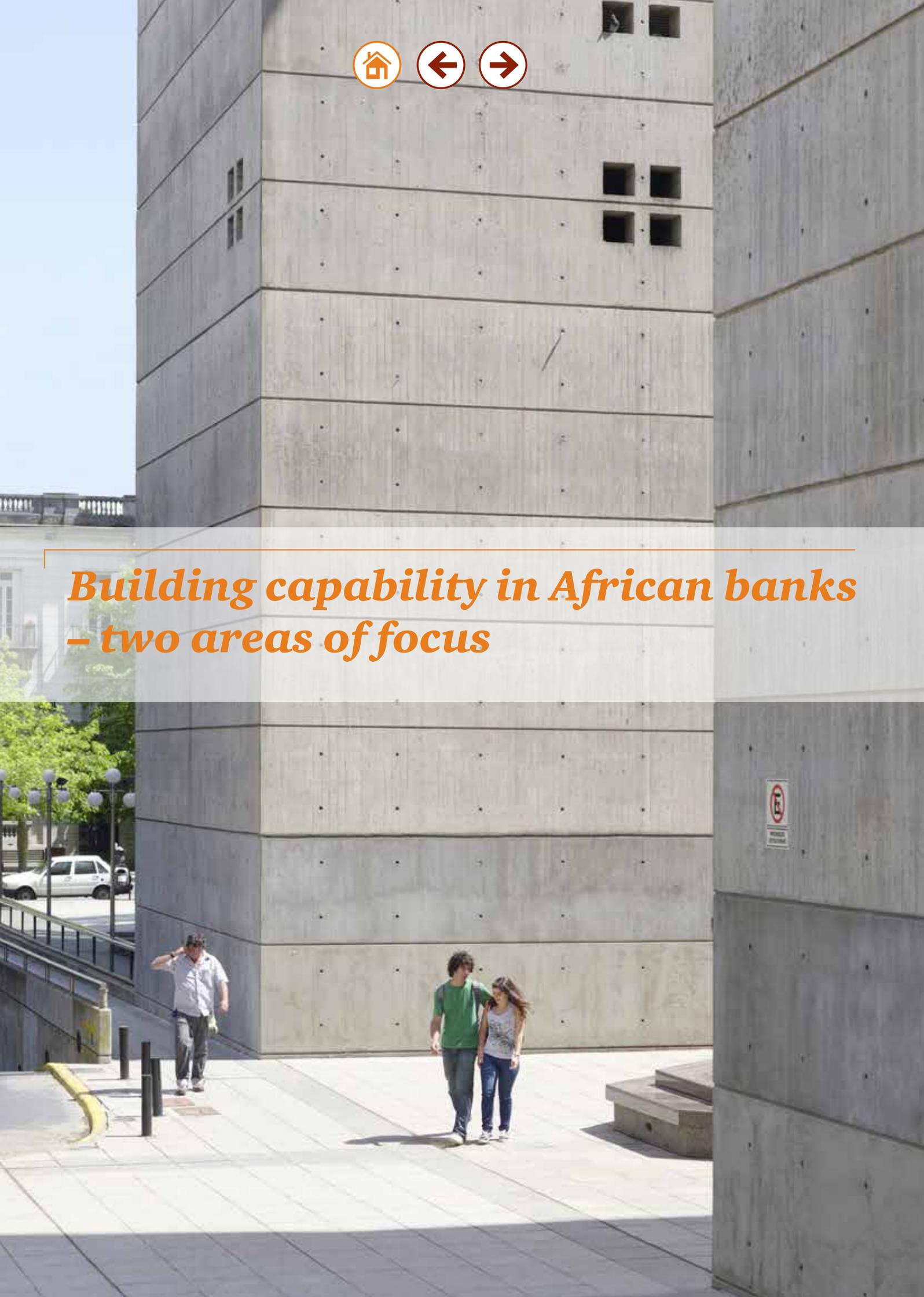
Personalised, augmented, enhanced value



The customer experiences will drive consumption and innovation, while banks will need to be able to manage value in a new exchange of trust and personal goals for monetised income. Banks should look for strategic acquisitions or partnerships with companies across different industries (mobile operators, technology firms) to assist in securing long-term positions in the battle against other banks for customer relationship dominance.



Building capability in African banks - two areas of focus





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Banking in Africa is difficult, a recent Worldbank policy research paper characterises why –

- Small size of economies and limited demand for savings, credit and insurance.
- Informal nature of participation in the economy, increasing risk and excluding large parts of society from formal banking.
- High volatility, increasing cost and undermining risk management.
- Governance issues in the public and private sectors.

(CSAE Working Paper WPS/2013 16, Banking in Africa, Thorsten Beck and Robert Cull)

Unique African challenges calling for uniquely African solutions.

Addressing governance

The economic crisis that began in 2008 increased the focus on the role of the board in effectively executing its responsibilities. There is quite some change in the corporate governance world - new perspectives on boardroom composition, higher levels of stakeholder engagement, more emphasis on emerging risks and strategies, and the increasing velocity of change in the digital world.

These factors, coupled with calls for enhanced transparency around governance practices and reporting and the very active regulatory and law-making environment are all accelerating the evolution, and in some cases creating a revolution, in the boardroom.

Boards are under intense scrutiny — from shareholders, regulators, politicians, the media, company employees, and other stakeholders. Directors know that since their work

happens behind closed boardroom doors, they rarely receive accolades for helping their companies succeed and avoid harm. However they are in the line of fire when things go wrong.

Given this scrutiny and the fact that they face an ever-evolving landscape, directors should focus on the scope of their key responsibilities and engaging in a considered process to discharge those responsibilities thoughtfully and thoroughly.

PwC, based on the King III recommendations, as well as the Annual Corporate Directors Survey (2013), identifies the need to supplement and enhance the opportunities for learning and development of directors in large private and public companies. King III recommends the induction and ongoing training of directors through formal processes. New and inexperienced directors may be suitably trained through formal induction and mentorship programmes. Directors should be kept up to date through regular briefings and continuing professional development programmes.

The percentage of directors, who believe annual training should be requirement, rose significantly to 59% from 52% last year based on the Annual Corporate Directors Survey* (2013). More than four in five directors use educational programs to stay abreast of emerging trends in corporate governance enabling them to discharge their oversight responsibilities.

The PwC survey shows that in 2013, directors spent even more time on education. In fact, one in four spent more than 16 hours in board education programs, an increase from 18% in 2012. Only one in five (19%) did not participate in continuing education in the last 12 months.



Capability building for directors should expose participants to the latest thinking on board leadership and governance, while equipping participants with the necessary procedural and process skills in the increasingly difficult area of boardroom interaction, leadership and decision-making.

Programmes may focus on a holistic environment, utilising relevant case studies and examples. Learning can further be enhanced by participants sharing their individual experiences, creating a real-time learning experience.

Through board training directors should gain valuable insight into –

- Changing expectations of directors.
- Appropriate board structures and the role of individual members and relevant committees.
- Impact of global regulatory standards on the organisation.
- Risk and crises management.
- Corporate governance and ethics in business.

Empowering African branch managers

As stated earlier, the African Banking system faces unique challenges. In this section a ‘grassroots’ perspective derived from qualitative interviews with Branch Managers across Africa hopes to provide some insight into the unique challenges faced by Branch Managers on the continent.

The role of the Bank Branch Manager

In considering what branch managers do, there seems to be some consistency in the key elements that make up their job description:

- Customer service and sales:
 - Ensure that customer service standards are set and maintained in line with the requirement of each market segment.
 - Ensure that customer needs are anticipated and met through provision of appropriate products and services via the most suitable channel.
 - Conduct a needs analysis to identify customer needs effectively when opening new accounts or giving product advice.
- Risk Management:
 - Identify major risks affecting the support function and ensure the necessary steps are taken to measure, monitor and control these risks.
 - Ensure maintenance of an effective control structure, with control activities defined at each level and duties appropriately segregated.
 - Monitor internal controls to ensure their adequacy and effectiveness.
 - Recommend revision of controls where appropriate, to address new or previously uncontrolled risks.
- Sales Management:
 - Develop micro market sales plans to achieve responsive sales budgets / targets for branch.
 - Gain a sound understanding of the different local market segments in the branch’s area of operation.
 - Manage the sales tracking system and provide coaching and feedback to the team
- Branch Profitability:
 - Visible assist the branch in achieving targets and standards of performance by revenue and expenditure with emphasis on the containment of controllable costs.
- Operations Management:
 - Optimize and streamline existing systems, processes and controls for cost-effective service delivery.
- Change management:
 - Initiatives through tracking and reporting on projects and conducting readiness assessments.

Unique African challenges

In their article ‘Banking in Africa’, Beck and Cull note the following major changes in Banking in Africa: ‘Banking in Africa has undergone dramatic changes over the past 20 years. While dominated by government-owned banks in the 1980s and subject to restrictive regulation – including interest rate ceilings and credit quotas – financial liberalization, institutional and regulatory upgrades and globalization have changed the face of financial systems across the region’. (CSAE Working Paper WPS/2013 16, Banking in Africa, Thorsten Beck and Robert Cull)

Low branch penetration levels due to low population density.

Perhaps the most striking difference between Africa and other developing markets is that population density is more strongly linked to financial development in Africa than elsewhere. Population density is also more closely linked to bank branch penetration in Africa than in other developing economies, and both are more strongly linked to firm-level access to external finance in Africa



than elsewhere (Allen et al., 2012b). Presumably, bank branch penetration figures remain low in Africa because of difficulties in achieving minimum viable scale in sparsely populated, low-income areas.

The challenge of foreign bank ownership

Beck and Cull furthermore illustrate the challenges from an ownership perspective: ‘While foreign bank penetration has increased from already high levels over the past decade, the composition of the foreign bank population has changed substantially. Long dominated by European banks, banks from emerging markets and – critically – from inside Africa have gained importance over the past years. After the end of Apartheid, several South African banks, most notably Standard Bank and ABSA, started expanding through the continent. More recently, two West African banks – Ecobank and Bank of Africa – have begun expanding throughout Sub-Saharan Africa. Similarly, Moroccan banks have started to expand south. Finally, and as consequence of the recent consolidation wave in Nigeria, Nigerian banks started expanding throughout West Africa, but increasingly also throughout the rest of the continent.’

On the positive side foreign bank ownership may help -

- Foster governance.
- Bring in much-needed technology and experience that should translate into increased efficiency in financial intermediation.
- Help exploit scale economies in small host countries.

Foreign bank ownership also holds some challenges according to Beck and Cull:

- The absence of a sound contractual and informational framework reduces the feasibility of small business lending further and thus the positive effect of foreign bank entry (Claessens and van Horen, 2014).
- The small size of many financial markets in Sub-Saharan Africa may make foreign banks reluctant to incur the fixed costs of introducing new products and technologies.

It is clear, based on the above, that the apparently straight forward branch manager world of work is a complex one and some of the immediate challenges may relate to the following:

- **Local market knowledge, job design and locus of control:** Branch managers want to be allowed to take responsibility for local business decisions. They need to find some compromise between growing market share through acquisitions and the lack of formal customer data and documentation.
- **Operations management and customer service:** Branch Managers want to be involved in the development of process designs and maps to enable them to factor in their local customer’s moments of truth.
- **Client spread and service:** Branches have customers who are from both the retail and corporate segments. When it comes to service at a branch level they treat customers equally and may not always see the benefit of servicing corporate clients.

- **Branch profitability:** Branch managers need to drive the top-line revenue, while at the same time managing cost. They need to have a good understanding of liabilities vs. assets in the branch and how to run a profitable branch.

Branch Managers in Africa are not merely executors of strategy, their challenges are tangible and complex and they need advanced skills and knowledge to be true local market CEOs.

In conclusion

Considering the realities faced by the African banking industry, banks need to build skills at all levels of the organisation.

By empowering directors and ensuring that they are equipped through continuous training and governance updates, banks can mitigate risk and ensure that directors are able fulfil their roles in the fullest sense of the word.

At a lower, but crucial, level it is vital that banks invest in the continuous development of their branch managers to permit them to manage all the aspects of the branch scorecard.

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Financial inclusion is a route out of poverty in Africa





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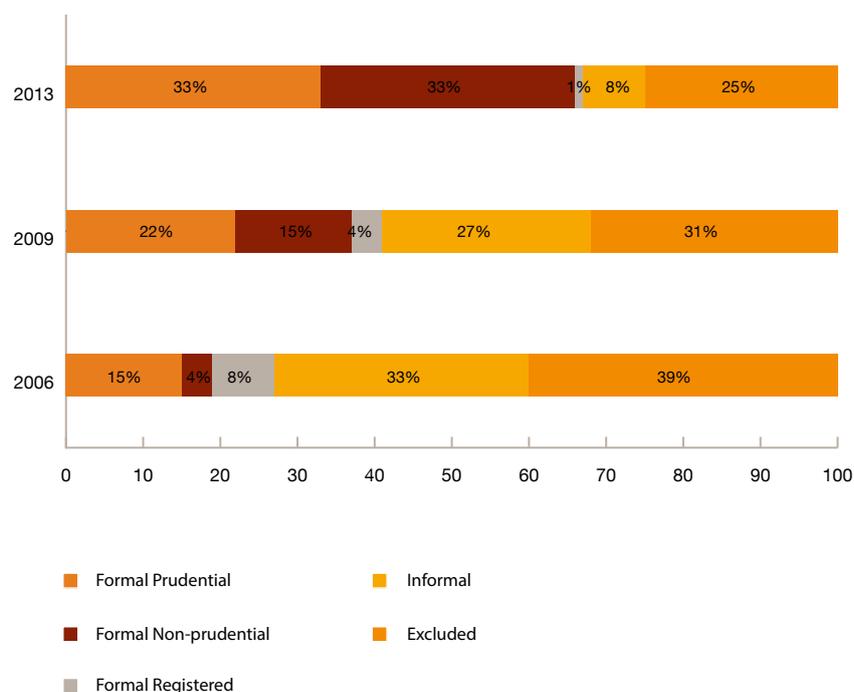
In Africa, financial inclusion is a macro-economic issue that has an inverse impact on poverty: increasing the number of people who participate in the formal financial system helps to reduce poverty. Many financially-excluded people are women and therefore greater financial inclusion also serves to bridge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

The origins of exclusion

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

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

Figure 9: Kenya makes leaps toward financial inclusion



This change is a result of innovative financial institutions bringing people into the system, even those people who were previously wary of entering brick-and-mortar branches. The agency banking model, pre-paid cards and mobile



services have completely demystified financial services and these products tend to be much cheaper for financial institutions to roll out and manage.

Financial inclusion defined

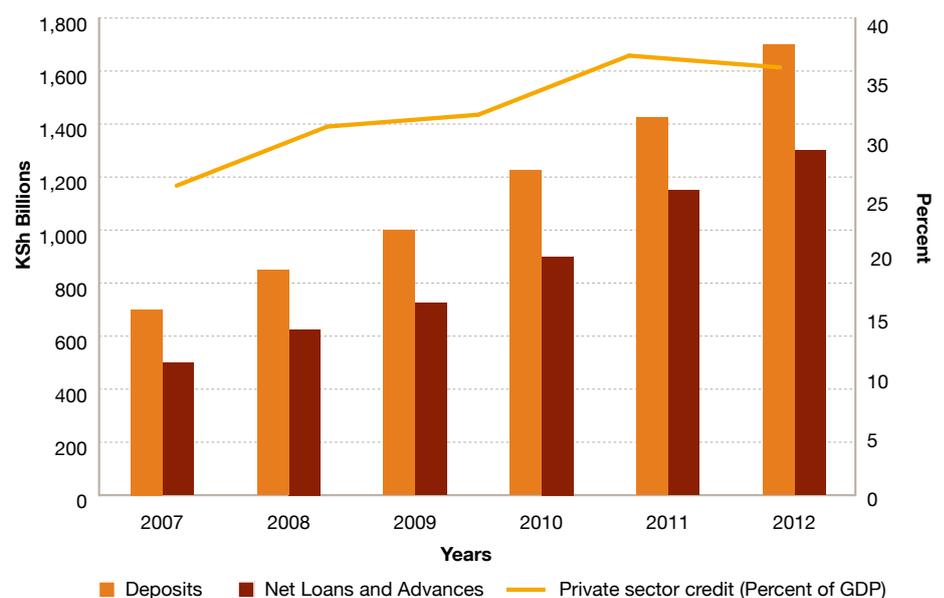
The unbanked are people who lack access to basic financial services. The under-banked are those who have access to bank accounts but they underutilise these services and often rely on alternative financial services, which can be more expensive. Globally, it is estimated that 2.5 billion people are under-banked.

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

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

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

Figure 10: Direct correlation between savings and credit expansion



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



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

Financial literacy about insurance and the overall penetration of insurance products is still lower than for banking and saving services, with just 3.65% of Africans having insurance. Some insurance may be mandatory by law (like motor vehicle insurance), in which case the uptake is very high.

Insurance can help smooth out the impact of life events like death or medical emergencies. Otherwise, when these events happen, they hit the uninsured particularly hard. The question is whether the banking sector's successes with regard to improving inclusion can be similarly replicated for insurance services. The regulatory environment and insurance business model may need to adjust in order to provide the innovative, flexible products that the uninsured need and want.

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

A joint approach to improving financial inclusion

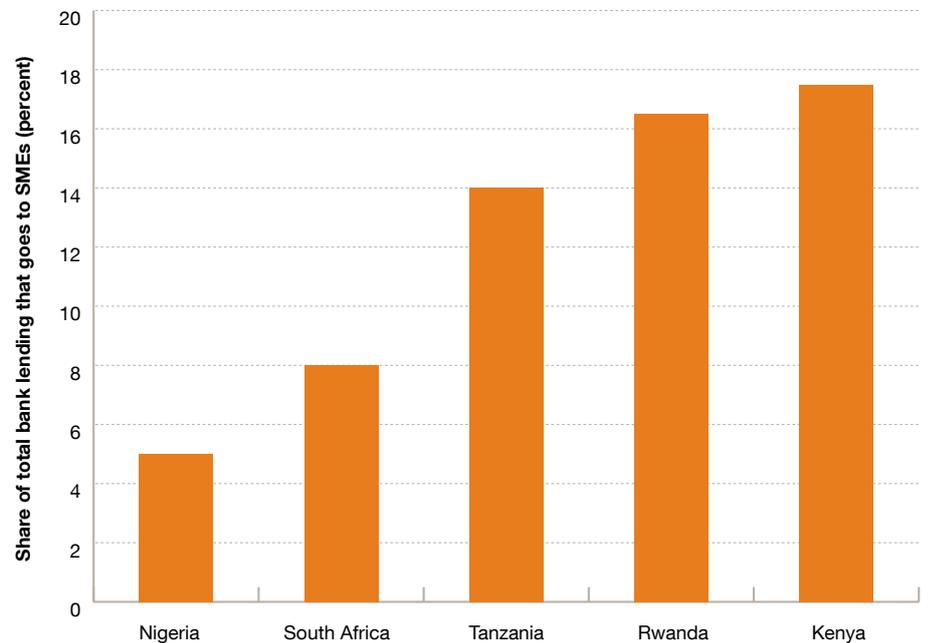
The private sector has a key role to play in developing technological innovations to drive down the cost of serving customers and providing opportunities to expand financial literacy. It can continue to invest in innovative services that are more flexible and agile, and re-look at current business operating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

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

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



Figure 11: Kenya leads SME lending in Africa



Source: World Bank, based on data from Central Bank of Kenya

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

Regulatory and political environments influence the ability of financial institutions to develop innovative products and services that thrive in the market profitably. Overall, economies in Africa have been favourable to innovation. Financial institutions are learning that flexible and agile innovations must be driven by demand. They are also learning that risk management is essential, since innovative products and services can open up their companies to new types of fraud. Many different public and private organisations are focused on financial inclusion, and the outcome is positive. Working together, we can provide a route out of poverty.



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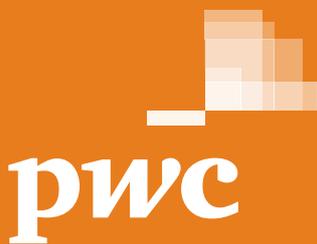
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