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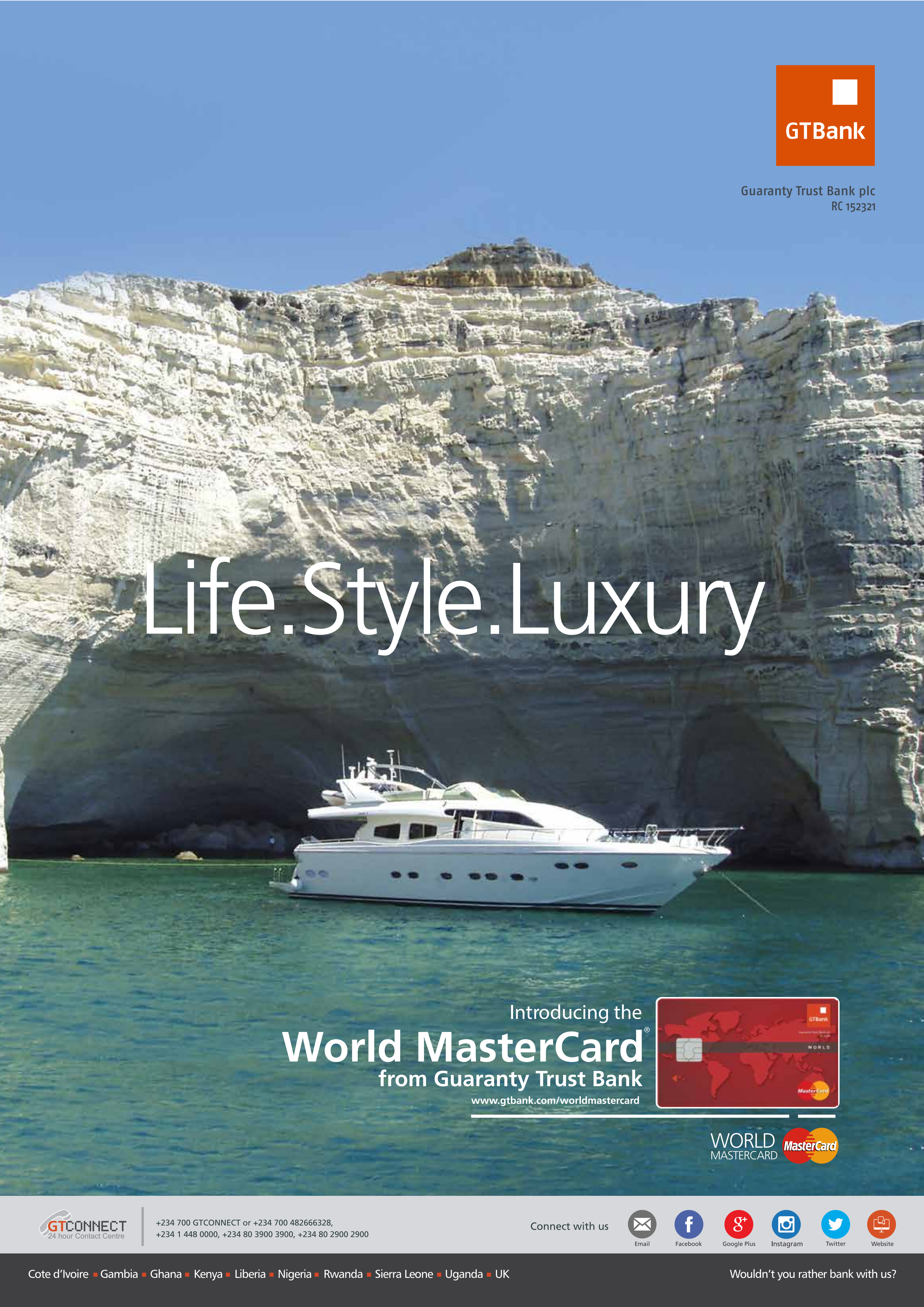
Sub-Saharan Africa in the Face of Declining Commodity Prices

Economic Outlook for 2015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Analyst, Trading & Sales

Content

FOREWARD
Segun Agbaje

CONTIRIBUTORS
GTBank Research, Yinka Holloway
Deji Oguntonade, Subuola Abraham
Ayokunle Yusuf

FEATURED CONTIRIBUTOR
Nick Kochan

BRANDING & DESIGN
Communication
& External Affairs

PHOTO CREDIT - COVER
Tolulope Danfodio

Foreword

Welcome to the maiden edition of *The Corvus*, a financial and economic publication of Guaranty Trust Bank Plc. Much like Corvus provided the Romans with superior intelligence during the Punic Battle, the essence of this magazine is to provide relevant and timely information to our discerning readers.

2015 has been described by many economists and analysts as the year of cautious optimism. The International Monetary Fund (IMF) expects the world economy to grow faster than it did in 2014 with the recovery in US driving global growth. Given the great concern among central banks about deflation, disinflation and low inflation, central bank policies especially in the Euro area and the Far East are expected to be broadly anti-deflationary. Falling energy prices should contribute to a slowing of reported inflation in many countries, motivating some central banks to further ease or temporarily postpone tightening. While net oil-importing countries are already enjoying the benefits of falling energy prices, which include a reduction in factor or input cost, boost in consumer spending power and greater propensity to save, among others; net oil-exporting countries have had to contend with declining fiscal revenues and for Nigeria in particular, the potential threat to implementation of the Capital Expenditure budget looms. The progress in technology will be phenomenal, smart phones will almost seem to be able to read their owner's minds and many things we do and experience in our daily lives will become digitised.

In this maiden edition of *The Corvus*, we look at topical issues ranging from, Sub Saharan Africa in the face of declining commodity prices to the rise of digital payments and how GTBank is positioned to offer cutting edge payment solutions to our customers, the cost of compliance and non-compliance with the United States Foreign Account Tax Act, trends in global regulation and its implication for the regulation of African markets and the changing economics of oil price movements.

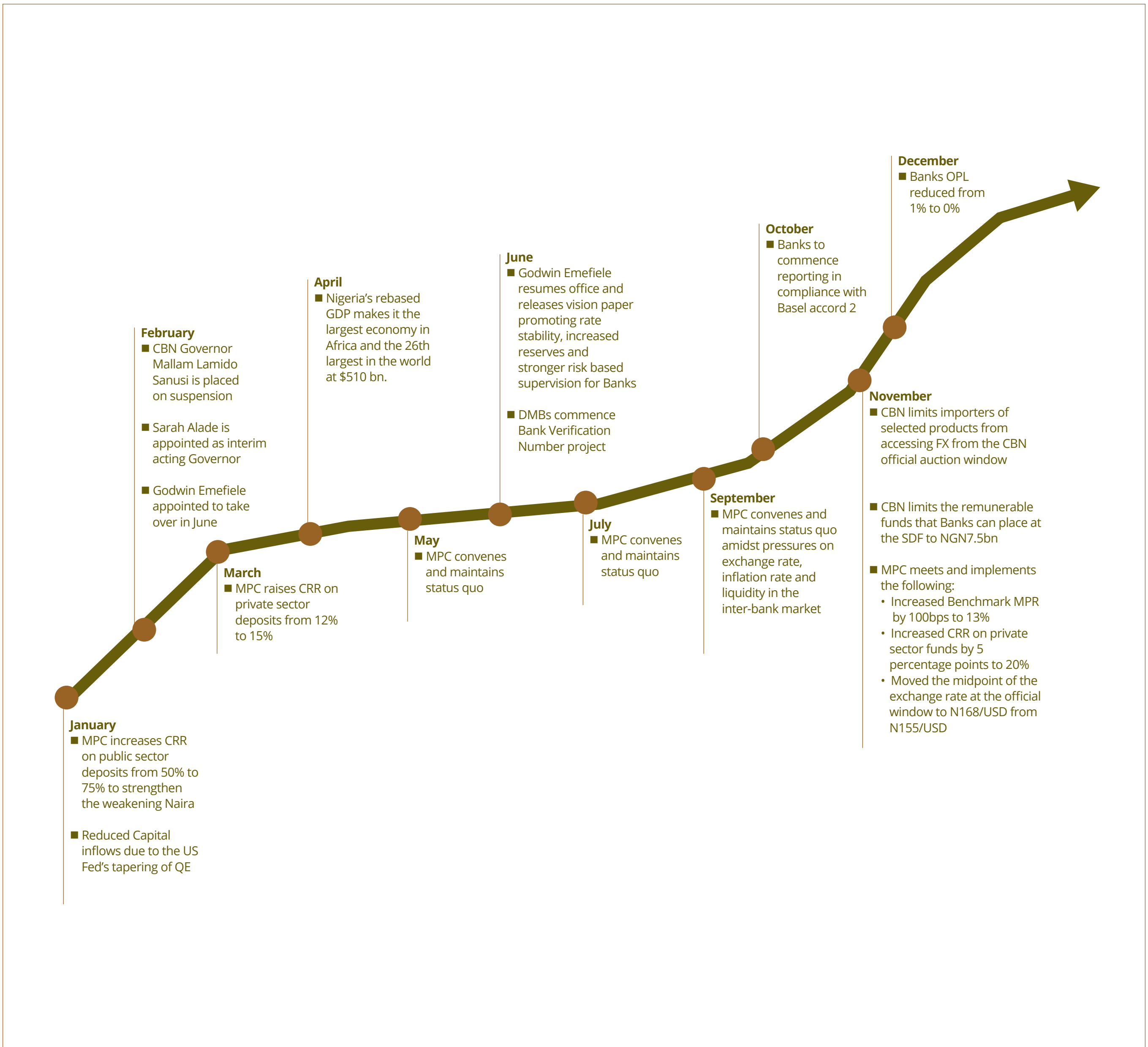
Not everyone can agree on what the future will hold or what will matter most; the range of voices in *The Corvus* makes this edition an interesting read. I hope you find the articles as instructive and informative as I found them.

Segun Agbaje

Macro Economic Trends in 2015

In the first two quarters of the year, Nigeria recorded year-on-year GDP growth rates above 6% in the midst of declining worldwide growth trends. This trend continued in the third quarter as Nigeria recorded a Q3 year-on-year GDP growth of 6.23% driven by the Non-Oil sector which grew by 7.5%.

2014 at a glance



Offsetting what would have otherwise been a stable pre-election year, declining oil prices set the tone for tighter monetary policies, market turbulence and the inevitable devaluation of the Naira in the 4th quarter. The combined effect of declining oil prices, gradual capital flight, a reduction in FX supply, and the import dependent nature of the Nigerian economy resulted in sustained pressure on the Naira. The CBN continued to defend the Naira by employing tightening measures which included upward adjustments in the CRR, increased controls on BDC sales, and imposing restrictions on FX sales to certain industries.

In spite of the measures executed by the CBN, the country's reserves dropped to a 6-month low of $36.7 billion (as at 25th of November, 2014), and this compelled the CBN to devalue the Naira (the exchange rate moved from N 155/USD to N 168/USD) and adjust the width of the band around the midpoint (from +3 to +5) in an attempt to stabilize the currency. The struggle for price stability largely dictated monetary policy for 2014 and we expect that concerns around price discovery/stability will greatly influence 2015 monetary policy.

Outlook for 2015, the Election year

The General Elections are expected to be free and fair. In addition to the elections, other prospects of macro economic importance for 2015 include:

- Weak Oil prices in H1 2015
- Further Pressure on the Exchange Rate
- Slower GDP growth
- Growth of Import Substitution programs
- Capital flows

Weak Oil Prices in H1 2015

Given the international variables contributing to the weakened state of Oil prices and OPEC's intent to maintain current levels of supply, even if prices go to as low as $20 per barrel, we do not expect a reversal in the direction of oil prices in the first half of 2015. We however, expect that this may change later in the year as declines in supply are expected in the second half of 2015.

Further Pressure on the Exchange Rate

Oil revenues currently account for more than 75% of government revenue and close to 90% of foreign exchange income. Given that weak oil prices are expected to prevail till mid-2015, we expect FX supply to suffer a significant decline. In spite of Government efforts to diversify the economy and to reduce demand for FX, we do not see this

taking effect in the short-term. We are, however, confident in the Central Bank's ability to hold the current official exchange rate steady, for oil prices above $55 per barrel.

Slower GDP Growth

We expect a slowdown of 100 – 150bps in GDP growth for 2015 from the current growth levels of 6.23%. This forecast is supported by the recent tightening of monetary policy, the devaluation of the Naira and the continued slump in the oil market. The rate of growth will be further challenged by the fact that growth calculations would now be based on a larger base vis-à-vis the rebased GDP.

Growth of Import Substitution

In addition to previous import substitution initiatives restricting the importation of fertilizers, sugar, cement, fish and other items, the FGN in 2014 placed restrictions on the importation of certain classes of vehicles and automobile spare parts through increased tariffs and levies. The FG expects that the policy would create jobs, reduce the dependence on imported vehicles, thereby reducing the demand for FX for the purposes of vehicle ownership. Faced with dwindling oil revenue, we expect the FG to ramp up efforts in this regard.

The FG along with other institutions are taking a closer look at implementing more import substitution programs in 2015 with an aim to diversify from and dampen the effects of oil prices on the economy. The Ministry of Industry, Trade and Investment, the CBN and the Ministry of Petroleum Resources are also working together to discover ways to cut down the importation of finished petroleum products. We expect to see further restrictions on importation coming into effect particularly in the Agriculture sector, on items such as oil palm, nuts, and rubber goods.

Capital flows

In line with analyst expectations, oil prices are expected to rebound in late 2015. This development is expected to promote price stability, while allaying the fears of the foreign investors who exited the market as a result of uncertainties driven by market turbulence and lack of confidence in the Naira. The return of these portfolio inflows is expected to strengthen the Naira and capital markets.

Tax, Real Income and Disposable Income

So far the Federal Government of Nigeria ("FGN") has revised its 2015 Budget Oil price benchmark downwards twice, from $78 to $73 and to $65 (a 13% drop from 2014 benchmark of $75) despite the fact that oil prices today are under $60 and analysts have recommended a conservative Benchmark of $50 (vis-à-vis $45 benchmark for 2009 Budget). The FG will need additional sources of revenue to offset income lost as a result of a drop in oil prices as oil revenue accounts for over 75% of government revenue.

In the drive to ramp up its revenue, the FG will focus on luxury taxes and value added taxes which will affect most individuals and households. For luxury taxes, new private jet import surcharges are expected to generate N3.70 billion, luxury yacht surcharges N1.6 billion, luxury car import surcharges N2.60 billion, luxury surcharge on champagnes, wines and spirits N2.30 billion . For Value Added Tax, the FG has stated its intent to review the tax policy which could see the Value Added Tax (currently at 5 percent) raised by another 5 percent. This drive is premised on the fact that Nigerians pay the lowest VAT in the world.

Companies are also expected to bear their own share of the burden as the FG is set to plug leakages and loopholes that have arisen as a result of tax waivers and exemptions. The Government has already commenced a review of pioneer status exemptions to some oil companies which could unlock up to N36billion in additional tax revenues in 2015.

The FG/FIRS has also employed McKinsey, a consulting firm, to boost its

Income Tax revenues as it aims to collect an additional N160 billion in tax receipts and an aggregate of about N460 billion over and above the 2014 levels in the 2015-2017 period.

In the event that the FG is unable to offset oil-price induced losses, the first casualty will be Capital Expenditure spending given the sensitive nature of recurrent expenditure. A massive reduction in capital expenditure, will adversely affect the construction sector, government contractors, the agriculture sector and all other traditional direct and indirect, beneficiaries of Capital expenditure. These in addition to the rise in the inflation rates expected as a result of import dependence and currency devaluation would ultimately lead to a contraction in the real sector.

2015: The Banking Industry

Liquidity, capitalization and other banking sector themes

2014 at a Glance

For the majority of 2014, the CBN maintained its focus on price stability despite the change of guard at the helm from Mallam Lamido Sanusi Lamido to Mr. Godwin Emefiele in June 2014. The CBN was largely successful at stabilizing the Naira through the use of monetary policies to reduce liquidity and currency speculation; however as oil prices continued to drop, the CBN was left with little choice but to devalue the Naira.

Over the first three quarters of the year, the CBN released very few circulars which focused on increasing CRR on both public and private sector deposits, and instructing Banks to commence reporting in accordance with Basel II. However in the last quarter, the Central Bank released several directives such as the exclusion of certain importers from the RDAS window, a further increase in CRR on private sector deposits, and other measures, in response to the pressure on the Naira which was attributable to falling oil prices, capital outflows and the front loading of orders by businesses concerned about a possible devaluation. It was eventually too expensive to continue supporting the Naira and the CBN had to devalue the local currency. Overall, the CBN's policy initiatives of the fourth quarter have been reactionary, which is understandable as most analysts did not anticipate that oil prices would drop to current levels.

2015 Outlook:

Policy Formulation

We expect a more proactive stance from the CBN in 2015. We expect more policies fostering currency stability, economic improvement and the continued development of growth sectors, stemming from the realization that there is a limit to what can be achieved solely through monetary policy.

Despite the release of Godwin Emefiele's Vision Paper, the general public is yet to appreciate or understand the new Governor's legacy due to the mini financial crisis that he has had to tackle very early in his tenure. In 2015, we expect to better understand the new Governor's priorities and personality as the macro environment stabilizes towards mid-2015.

Liquidity

Market liquidity has been adversely impacted over the last 2 years largely from increases in CRR which require banks to sterilize increasing amounts of funding. Going into 2015, we see greater liquidity constraints as a result of tighter monetary policies, capital outflows, reduced government revenue, and a slowdown in capital market activity. While this may be great for supporting the Naira, it will ultimately lead to an economic downturn. A further increase in CRR of Banks is unlikely due to the attendant impact on credit growth.

Credit Quality

We anticipate a slight increase in NPLs across the market as a result of secondary effects of the depreciation of the Naira. The absence of a Capital Market bubble going into this devaluation, will result in much lower credit quality issues compared with 2008/2009. The lessons learned from the 2008 oil price crash/devaluation have resulted in the implementation of sector limits, increased regulatory risk parameters, improved corporate governance and reduction in currency mismatches which greatly reduce the likelihood of high levels of NPLs compared with 2009.

Capitalization

The CBN mandated that all Banks commence reporting in accordance with Basel II reporting standards from October 2014. This will largely result in a few banks falling short of minimum requirements which will leave the affected banks with the option of either trying to raise equity in a weak capital market or reducing their asset size. The option of reducing asset size might be particularly attractive to some banks as it will solve immediate liquidity concerns pending when additional capital can be raised.

Inflation

As a result of the recent devaluation of the currency in our import dependent economy; increases in import duties, Corporate, Value Added and Luxury taxes, we expect a gradual pickup in inflation to low double digits by mid-year of 2015.

Interest Rates

We expect a further 50 -100bps increase in MPR in 2015. A combination of reduced liquidity in banks, rising costs of funding, continued pressure on the Naira and rising yields in fixed income investments will compel banks to increase lending rates in 2015. A resultant rise of 100 – 200bps in lending rates is likely.

Foreign Exchange

We expect continued pressure on the Naira through the first half of 2015 due to further declines in Oil prices and the upcoming February 14 General Elections. We expect increased volatility around the election period after which we expect pressure to reduce. As pressure continues to increase in the first half we expect that the CBN may consider adjusting the mid-point within a range of N180-N185 per USD, as reserves and oil prices continue to fall.

By **GTBank Research**

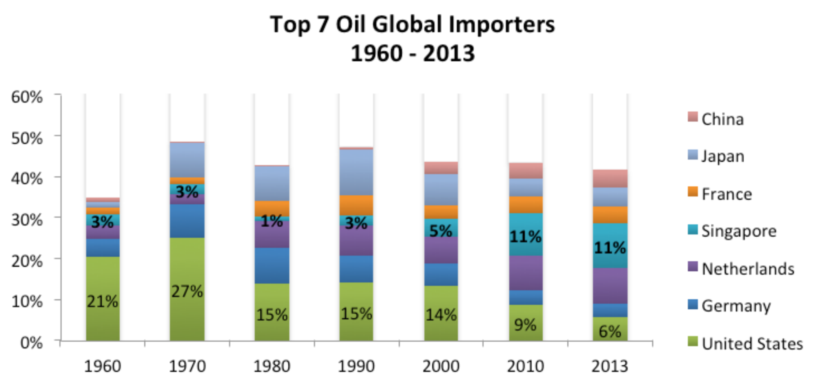
The Changing Economics of Oil Price Movement

Oil price volatility is nothing new

Since June 2014, oil prices have dropped by 46% to reach their lowest levels in over five years.

The slide in oil prices is largely attributable to weaker than expected global demand, reduced demand from the United States of America due to shale oil

Figure Top 7 Oil Importers as % of World Total



SOURCE: OPEC ANNUAL STATISTICAL BULLETIN 2014 – OIL AND GAS DATA

production and the return of a significant portion of Libyan production not seen since the onset of the Arab Spring. Of the known causes the most debated has been the influx of US Shale oil supplies which have effectively taken US crude oil demand out of the global market. In the 1970s, the US constituted as much as 32% of total world crude oil imports, however recent strides in the development of horizontal drilling and hydraulic fracturing (fracking) from tight shale have boosted US production and reduced the country's imports to just 6% of global demand.

Although the US has increased its domestic production, it is interesting to note that the United States does not actively export its excess crude products. During the OPEC oil embargo in the 1970s, the US imposed a ban on crude oil exports to restrict the movement of crude out of the country. This was deemed necessary during a period

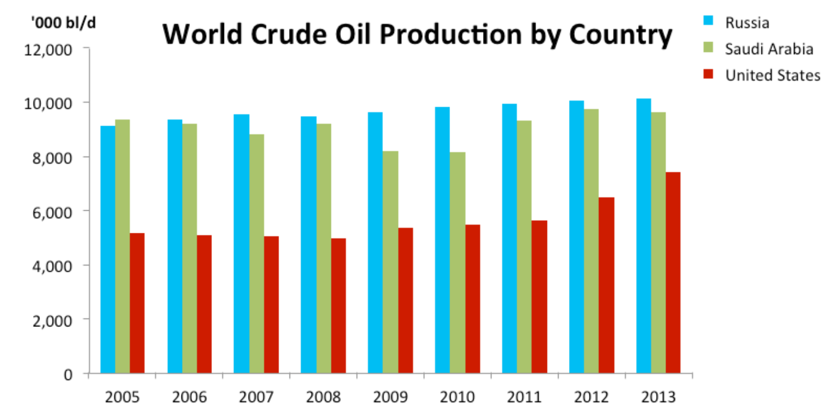


Figure 1 World Crude Oil Production by Country

characterized by astronomical increases in oil prices as a result of embargoes and low domestic production relative to consumption. Now, the US has grown to become one of the top three largest producers of crude oil (with Russia and Saudi Arabia) and the largest exporter of refined oil products, such as gasoline and diesel . Unlike crude oil, which is unprocessed, oil that has been refined can be exported freely from the US. Roughly three million barrels per day of refined oil products were exported from the US in 2013 versus seven hundred thousand from Saudi Arabia .

Motions have been put forward by various lobbyists in the US to remove the ban on US exports. According to a recent report by IHS titled the "US Crude Export Oil Decision", lifting this ban and allowing free trade will increase US production from the current 8.2 mb/d to 11.2mb/d and these crude exports would find ready markets in Europe and Asia.

Implications for countries that are economically dependent on commodity sales

Now that the world seems to be awash with oil and stockpiles of the commodity have soared, economists still struggle to paint a positive picture of the effect that tumbling energy prices could have on the global economy. According to a report by Moody's credit rating agency on global oil price volatility , lower oil prices will on average, be positive for global economic growth, however the impact will vary from country to country.

The Winners: According to Moody's, the beneficiaries of a drop in oil prices are countries that rely heavily on oil imports to satisfy their energy needs especially those that battle high inflation and large oil subsidies, such as India and Indonesia. For other countries like China, who do not face high levels of inflation, "a $60/b oil price would benefit private consumption and economic rebalancing, and somewhat moderate the on-going growth slowdown," according to the report.

The Losers: These would be oil exporting countries that mismanage their oil income. Moody's estimates that Venezuela and Russia may be hardest hit since they have large recurring expenditures that will pose a challenge. The Russian Ruble in particular has been hard hit. Coupled with economic sanctions imposed by the European Union and the US over its conflict with Ukraine, falling oil prices has not helped the jitters felt by holders of the Ruble. As a result, the economy has been plagued by chronic capital flight since the second half of 2014 which weakened the currency by 85% in 2014.

The credit rating agency further states that countries like Saudi Arabia and Mexico may be relatively shielded as Saudi Arabia has reserves that safeguard its external accounts while Mexico has relatively limited exposure to oil in its external account and a conservative budget policy.

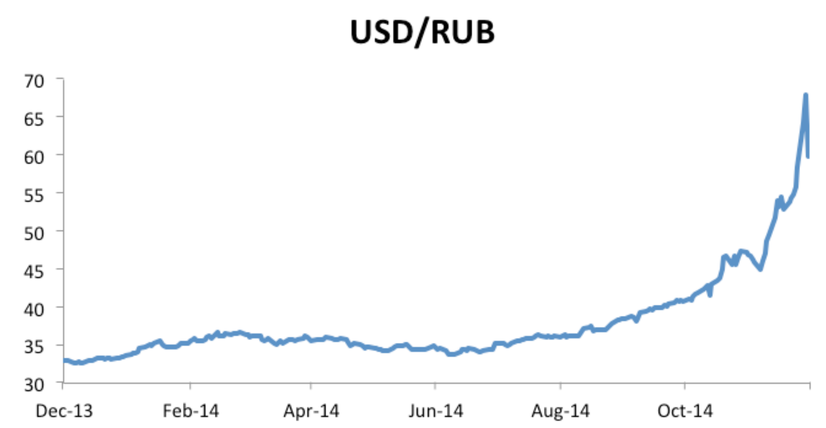


Figure 2 USD/RUB Cross rate

The Corner Solutions (Nigeria): Africa's largest economy and largest exporter of crude oil is also one of the continent's largest importers of petroleum products. On the import side, the country will benefit from decreasing oil prices as this will result in a reduction in public expenses incurred on costly petroleum subsidies. On the export side the country is adversely affected as it relies heavily on crude oil proceeds as a source of income to fuel its economic development.

As a result of the net negative impact of dropping oil prices, the Nigerian government cut spending for 2015, devalued the currency by approximately 8% and heavily intervened to support the Naira which is currently at an all-time low. The country's financial markets have been hit hard, the Nigerian Stock Exchange (NSE) All Share Index is down 20% in 2014 and monetary policies have been tightened with bank cash reserve ratios being taken as high as 75% for public sector funds. Interest rates, have also been hiked 100 basis points.

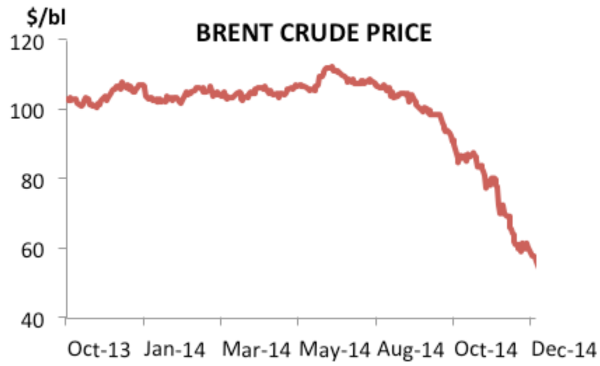


Figure 3 Brent Crude Oil Prices

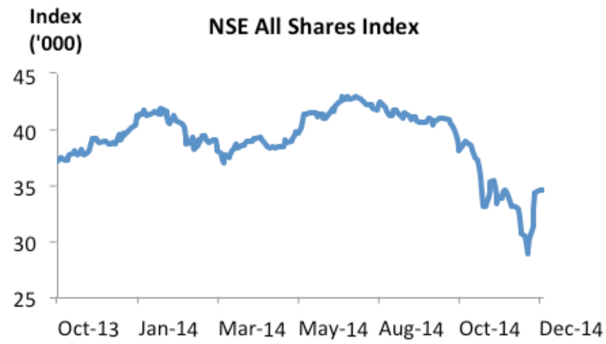


Figure 4 Nigeria Stock Exchange All Share Index (NSE ASI)

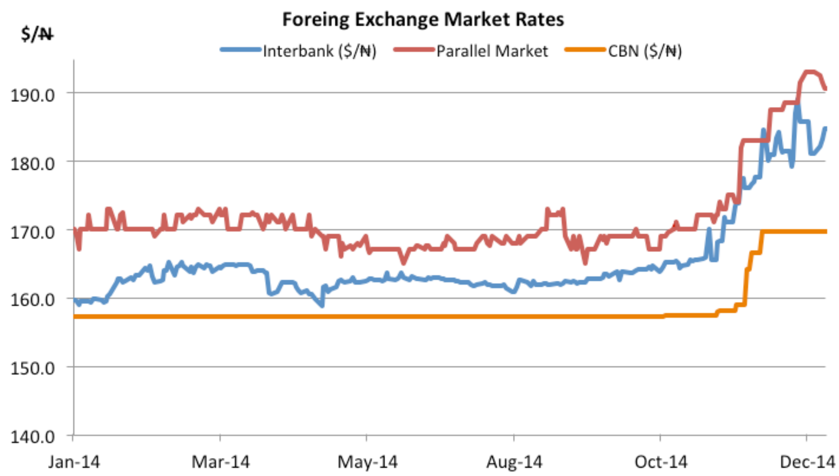


Figure 5 Naira Foreign Exchange Market Prices

Ceteris paribus, the fall in oil prices and the development of new methods of production should herald the beginning of a global economic stimulus. However, the real question we should be asking is, what is the real price of oil? The answer is critical to understanding and planning for the future. As a net exporter of crude oil, Nigeria can use its expectations of the future price of oil to smoothen out short term shocks and hedge against long term dips in oil prices.

By **Yinka Holloway**

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The Rise of Digital Payments

Sleeping better in the New Year

As the end of the month approaches, the frenzy of satisfying payments due commences. In addition to meeting due commitments, which range from salary payments, custom duty payments, replenishment of telephone airtime, to vendors payments, the average business owner is also saddled with the headache of preparing schedules, writing cheques and other paperwork to vendors, completing custom duty payment paperwork, as well as ensuring that required signatories are available to authorize necessary payments.

Further complicating the payment process, all required variables to ensure successful payments must be available at the end of every month and often within short notice. In the event that a key signatory is out of town, all payments will be placed on hold till he returns, which could result in severe loss of income and in extreme cases, bring the entire operations of the company to a halt.

After the business executive has properly executed all processes and documentation required to make payments, and has submitted duly completed payment documents and instruments to the bank, the payments are still subject to the risks of verification time, clearing time, delayed payments, reconciliation issues and bank errors all of which cost the business time and efficiency, ultimately resulting in reduced profits.

Every cloud has a silver lining

The advent of electronic banking has allowed companies do business at speeds never before possible. It has also given rise to new opportunities and efficiencies that were not possible just a few years ago. A business looking to deploy an e-banking solution can primarily use it either to gain cost efficiency or as an avenue for revenue collection.

Fortune, they say, favours the prepared mind. The fortunes of a business executive who has taken the time to explore the options and available features of electronic banking, are very different from the previously discussed executive. For example, the GTBank Automated Payment System (GAPS) possesses features which allow real-time automation and administration of salary payments, vendor payments, FX transfers to local and foreign parties, scheduling of payments at future dates etc. GAPS allows for remote approvals by authorised Signatories who can authorize transactions from their mobile devices.

The rigours of reconciliations are quelled as payments can be processed either as “Single debit, Multiple credit” or “Multiple debit, Multiple credit” to make the statements of accounts tidy and easy to understand. Transactions reporting on GAPS features customizable reports, provided to keep track of all transactions and ensure a seamless user experience. The payment system also allows you to store details of the beneficiaries therefore making recurrent payments easier.

For most companies supporting documents are required for all payments. With GAPS these supporting documents can be uploaded as part of the payments so the approvers wherever they are can download and view the supporting documents before authorizing the transactions.

Cost and other Efficiencies

The cost of an electronic payment is a fraction of the cost of processing a payment at a ‘Brick & Mortar’ location. In addition to obvious cost savings, electronic banking provides time savings, and increased operational efficiencies.

An added and often overlooked benefit to electronic banking is the goodwill generated towards the recipient who is grateful to receive instant payments devoid of inconvenience and logistical nightmares.

Income generating strategy

Customers with regular receivables can automate their collections through the use of Direct Debit.

Direct Debit allows organizations such as Insurance companies, Credit and thrift societies, collect monthly contributions without visits to the customer or bank branch. A mandate sent to the bank electronically is all that is required to kick-off the process. This guarantees the timely receipt of income as beneficiaries are credited automatically.

Have you ever imagined how the fortunes of your business can change if you can automate your payments and collections to consummate on set dates?

Corporate organisations and SME’s can subscribe to the Guaranty Trust Automated Payment System (GAPS & GAPS Lite) an Internet Banking product that is designed to meet the varied remote banking needs of corporate organisations and SME’s. It is highly secure and customizable and is easily adapted to the need of the discerning customer.

By **Deji Oguntonade**

Demystifying Foreign Accounts Tax Compliance Act

On the 18th of February 2009, the United States Department of Justice announced that it had entered into a Deferred Prosecution Agreement with UBS AG, on charges of conspiring to defraud the United States of America by aiding and abetting tax evaders. It was alleged that through some of its Private Bankers, it participated in a cross border scheme which actively assisted US tax payers in establishing accounts designed to conceal the tax payer's identity or beneficial interest in accounts maintained through offshore companies.

This and other initiatives by the United States government, resulted in the discovery of several "US persons" and their previously secret, offshore accounts by the Internal Revenue Service (IRS).

The U.S. Government has since introduced the Foreign Account Tax Compliance Act (FATCA), which is likely the most far-reaching tax statute to date.

FATCA, which was enacted in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act, is an important development in U.S. efforts to combat tax evasion by U.S. persons holding investments in offshore accounts. Under FATCA, U.S. taxpayers holding financial assets outside the US are required to report those assets to the IRS.

To successfully implement FATCA, the united States Government will rely on Foreign Financial Institutions (FFIs) to report directly to the IRS, all information in its possession pertaining to accounts held by U.S. persons, or foreign entities with substantial ownership by U.S. persons.

What Does FATCA Require?

For FFIs to become FATCA compliant they need to either register with the IRS directly or through an Inter-Governmental Agreement (IGA).

The Inter-Governmental Agreement approach to FATCA is more efficient as:

• FFIs will report to their domestic authorities and governments who collate and share that information with the IRS.

• It addresses local data protection issues/legal barriers which may restrict FFIs from complying.

• Institutions in IGA jurisdictions are protected from "withholding tax" penalties.

• It eliminates the withholding requirement on passthru payments.
• US commits to reciprocity with respect to collecting and reporting on US accounts held by residents of the participating countries.

Cost of Compliance
FFIs have incurred huge expenses and burdensome processes ranging from engaging external consultants, establishing enhanced KnowYourCustomer processes and redesigning IT infrastructure, to changing internal policies and procedures (which include extensive revisions to account opening documentation).......all in an effort to aid the US government identify US Persons in their local jurisdiction.

FATCA defines US Persons as
Individuals:
• An individual who is a citizen or resident of the US.
• A holder of a U.S. passport regardless of whether or not they are resident in the U.S.
• An individual whose place of birth is the U.S.
• An individual who spends more than 180 days in the year in the U.S.

Corporate:
• A foreign entity which has one or more 'substantial US owners.'
• A 'substantial US owner' is a US person who owns directly or indirectly more than 10% shareholding of such foreign entity.

Cost of Non-Compliance
• FFIs who fail to disclose US accounts would be subject to a 30% withholding tax on any payment originating or passing through the United States and proceeds from the sale of equity or debt instrument of US issuers.
• Account holders who fail to provide information to FFIs to determine their FATCA status i.e. recalcitrant account holders will be subject to 30% US withholding tax in respect of payments originating or passing through the United States and proceeds from the sale of equity or debt instrument of US issuers.
• International trading relationships would be affected as FFIs are insisting on FATCA compliance as a basis for maintaining correspondent relationships.

FATCA is not the end of the journey……

The OECD and G-20 have developed the Automatic Exchange of Information, which is a single global financial account standard similar to FATCA. The Standard requires financial institutions to report information on accounts held by non-resident individuals/entities (including trusts and foundations) to their tax authorities. The tax administration securely transmits the information to the account holders' countries of residence on an annual basis.

A large number of jurisdictions have announced plans to implement the new Standard. Over 50 jurisdictions have committed to work towards having their first information exchanges by September 2017; with many more to follow in 2018.

Compliance with FATCA at What Cost?
If the costs and burden of compliance are perceived as too great for profitable operation in certain industries, it is possible that these industries will divest and restrict any financial interaction involving the United States, for example, many foreign investment funds – including private equity funds and hedge funds, as well as each of the numerous separate investment entities set up by these funds – will be subject in full to FATCA and will need to become participating FFIs and satisfy the due diligence, documentation and reporting requirements, in order to avoid adverse consequences.

By **Subuola Abraham**

Disclaimer: This publication has been written in general terms and therefore cannot be relied on to cover specific situations. This article is not in any way to be regarded as tax advice and affected parties would be strongly advised to seek professional tax advice on the subject.
This article articulates the views of the writer and is in no way representative of GTBank.

Sub-Saharan Africa in the Face of Declining Commodity Prices

As geo-political tensions and cross-border terrorism rages across the globe, the recent decline in the crude oil prices–the single, most important traded commodity in the world– introduces added economic uncertainty to a global economy still reeling from the economic downturn of 2008/2009. Depending on which side of the divide being considered, the continuous slide in the price of crude oil since mid-2014 presents a mixed bag of woes and opportunities. While declining oil prices constitute a significant strain on fiscal revenues of the net oil exporting countries, it has been a blessing to net importing economies.

In addition to oil, several major commodities such as gold, copper, cocoa etc have had their fair share of the 2014 blues. In light of the general decline in commodity prices, this article seeks to assess its impact on Sub-Saharan Africa economies, most of which are commodity-dependent, thus bringing to fore the causes of the commodity-dependence and examining ways in which economies can insulate themselves from re-occurrences.

We can draw a parallel between the evolution of an adult male and the evolution of the economies of developed countries like the United States, Japan, Germany or the United Kingdom. When a baby is born, it is initially helpless. Over time, the child learns to crawl, walk, and eventually run. In the same vein, the economic systems of advanced countries passed through these phases of development, first learning to survive on subsistence/nomadic farming, then progressing to mechanized commercial farming, then to mining of natural resources and exploration of foreign markets through product/commodity exports.

Subsequently, these countries achieved full-scale industrialization,

Table 1: Selected African countries by major export commodities

S/N	African Region	Country	2013 GDP ($bn)	Population ('Mn)	Per Capita GDP ($)	Major Exports	Main exports as a % of total export earnings	Share of Africa's 2013 GDP ($2.19tn)
1	West	Nigeria	509.9	173.6	2,937.2	Crude oil	95% of export earnings	23.2%
2	West	Ghana	47.9	25.9	1,850.6	Gold, Cocoa and Crude oil	Gold 44%, Crude oil 18%, Cocoa 16%	2.2%
3	West	Ivory Coast	30.9	20.3	1,521.2	Cocoa and Crude oil	Cocoa 28%, Crude oil 25%	1.4%
4	Southern	Angola	121.7	21.5	5,668.4	Crude oil	98% of export earnings	5.5%
5	Southern	Zambia	22.4	14.5	1,539.2	Copper	73% of export earnings	1.0%
6	Southern	South Africa	350.6	82.1	4,270.4	Solid Minerals	Gold 18%, Platinum 8%, Coal 7%, Diamonds 7%	16.0%
7	East	Congo DR	30.6	67.5	453.7	Copper, Crude oil	Copper 56%, Crude oil 14%	1.4%
8	East	Tanzania	33.2	49.3	674.7	Gold	33% of export earnings	1.5%
9	East	Kenya	53.4	44.4	1,204.1	Tea, Cut flowers and Coffee	Tea 21%, Cut flowers 13%, Coffee 6%	2.4%
10	Central	Cameroon	29.3	22.3	1,315.5	Crude oil and Cocoa	Crude oil 40%, Cocoa 8%	1.3%
11	Central	Gabon	19.3	1.7	11,580.8	Crude oil	85% of export earnings	0.9%
12	Central	Burundi	2.7	10.2	267.5	Gold and Coffee	Gold 39%, Coffee 25%	0.1%

SOURCE: WORLD BANK DATABOOK; ATLAS MEDIA, MIT; NBS

Table 2: Prices of major commodities exports by African countries

	2014 High	2014 Low	Price Change	Dec 31, 2014
	a	b	(b- a)/a	
Gold ($/oz)	1,321.8	1,171.1	-11.4%	1,184.1
Copper ($lb)	3.4	2.9	-16.9%	2.8
Cocoa ($/tn)	3,300.0	2,709.0	-17.9%	2,910.0
Coffee (US cents/lb)	203.1	110.7	-45.5%	166.6
Oil Price ($/bl)	115.4	55.9	-51.6%	52.0

SOURCE: WWW.INVESTING.COM, WWW.CBN.GOV.NG, WWW.OPEC.ORG

economic diversification and further consolidated on these achievements by maturing into service-driven economies. Their exports are comprised of tertiary goods and services while the bulk of fiscal revenue is derived from taxes. This is in stark contrast with the predicaments of their developing counterparts who remain specialized in the exportation of raw materials or commodities.

While developed countries have been able to successfully navigate each of these phases, most African countries have not been able to advance beyond the exportation of raw commodities.

Unfortunately, almost every one of the over 50 developing economies in Africa has one or more natural resources in abundant supply which reduces the incentive to plan for or to specialize in producing secondary or tertiary goods for export.

As inferred earlier, the economic woes and successes of most African states are inextricably tied to the global demand and performance of a number of commodities. As an example, crude oil is the lifeline of Nigeria (70% of Nigeria's fiscal revenues, 40% of GDP, 95% of export earnings) and as a result of this, the Nigerian economy is hyper-sensitive to volatility in oil prices. In late 2014, when oil prices fell below $70 per barrel, the Central Bank of Nigeria (CBN), upon assessing the impact on the country's external reserves and macro-economic stability, was left with two options, which were either:

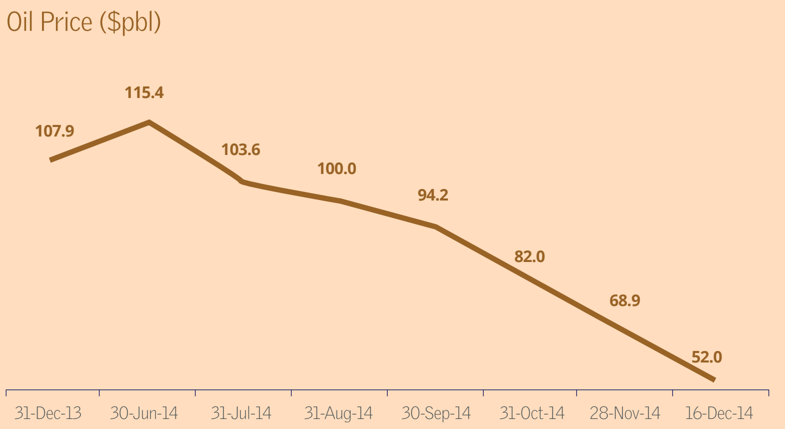
1. To Continue defending the value of the Naira in the face of declining reserves, capital flight, increasing demand for foreign exchange and speculation or

2. To Devalue the Naira, thereby reducing the pressure on the country's foreign reserves

The CBN's Monetary Policy Committee (MPC), at its November 2014 meeting, chose the better option of devaluing the Naira by 8.4% while tightening monetary policy through 5% and 1% increases in the Cash Reserve Ratio (CRR) on private sector deposits and interest rates (Monetary Policy Rate) to 20% and 13% respectively. The 2014 devaluation is reminiscent of the previous major devaluations of December 2008 (12.9%), January 2009 (10.0%) and November 2011 (N4.1%).

Ghana, the second largest economy in West Africa, makes for a more compelling argument as the impact of commodity price volatility has been more devastating on her economy when compared to Nigeria. According to an August 2014 report by The Guardian (a Nigerian Newspaper), upon discovery of oil in commercial quantities in 2007, expectations for the Ghanaian economy were very high, as the country hoped to make judicious use of her petrodollars while avoiding the ills of the "oil curse" currently afflicting Nigeria. The discovery presented Ghana with an additional viable source of income as it was

Graph 1: Trend of Oil price (Bonny Light) in 2014



SOURCE: WWW.CBN.GOV.NG

already the world's second-largest cocoa producer, and Africa's second largest gold exporter after South Africa. Ghana, it seemed, was the poster child for the much-vaunted 'Africa Rising' narrative. Today, while gold, oil and cocoa account for 44%, 18% and 14% (respectively) of Ghana's total exports, her economy is facing serious challenges. While the Nigerian Naira has depreciated by 12% from N160.00k per US dollar in December 2013 to N180.0 at the end of the first week of December 2014, the Ghanaian Cedi has fallen by 35% from GH¢2.35 per dollar to GH¢3.18 during the same period, thus making the Cedi one of the worst performing currencies in the world, alongside the Russian Rouble and the Kwacha, the local currency of Zambia whose primary export is also a commodity - copper.

Prices of goods and services have more than doubled in Ghana over the last two years, negatively impacting the standard of living of her citizens and leaving the country seeking support in the form of economic bailouts from the International Monetary Fund (IMF). This is further aggravated by the fact that the price of gold – Ghana's biggest export commodity – fell by 11.4% towards the end 2014 from a peak of $1,322 per troy ounce in February 2014, while the price of cocoa for which Ghana accounts for 21% of global supply (second only to Cote d'Ivoire which has a 38% global market share), also fell by 18% from the 2014 high of $3,300 per tonne. Just as the two largest economies in West Africa have been negatively impacted by declining commodity prices, the southern economies of Angola and Zambia have not fared any better. The Zambian economy was adversely impacted by a 17% decline in copper prices, from $3.44 per pound to $2.90 per pound between December 2013 and December 2014. As with Nigeria and Ghana, the domestic currency of the Zambian Kwacha fell 15% from December 2013 to December 4, 2014.

The story is not any different in East Africa where Congo Democratic Republic (DR), Tanzania and Kenya were vulnerable to price shocks in copper and crude oil, gold and tea respectively neither was it any better in Central Africa where Cameroon, Gabon and Burundi proved equally vulnerable to shocks from prices declines in Gold, Cocoa, Oil and other commodities.

Following our assessment of the impact of the decline in commodity prices on SSA economies, it is important to address the causes of the dependence on commodities and the future of commodity dependent economies. Most SSA states have remained dependent on commodities due to the lack of financial capacity and technical know-how, detrimental government regulation and lack of political will required to diversify their economies. South Africa provides a learning point for other African countries in this respect. Though solid minerals as shown in Table 1 contribute a significant portion to the South African economy, South Africa has successfully diversified her economy significantly across a range of industries such as automobile manufacturing and assembly, tourism, clothing and textiles, food processing, real estate, transport,

energy, financial and business services, agriculture and fisheries etc.

Fortunately, a lot of opportunities still exist for Sub-Sahara African economies. In Nigeria for example, other than telecommunications, financial services, cement and flour industries, most economic sectors/industries (just as in other African countries) remain vastly under developed. Industries, such as solid minerals, manufacturing, agro-processing, clothing and textiles present the government with a chance to diversify away from commodities.

With full appreciation of the underlying causes of commodity dependence, the way forward is clearly visible. Elected leaders must have the political will to carry out sweeping reforms which involve deregulation and privatization of major non-commodity oriented industries. Governments must also plan for a life without commodities. They must understand that governments (in matured economies) derive their income from taxes, and not from the sale of commodities. For government to maximize the generation of taxes, it must be interested in promoting an enabling environment for businesses to thrive. This works in the interest of the government, the industry and the private sector.

Governments can further insulate themselves from the volatilities of commodity prices, by increasing their raw material storage and processing capabilities. Governments can explore different options for financing and technical knowledge acquisition through partnerships with other governments, organizations or companies. Such partnerships will allow the governments use income from the proceeds of these partnerships to pay investors while growing the industry and increasing the technical capacity of the indigenes of those countries. As an example, Nigeria can build refineries for processing crude oil into end-user products such as petrol, diesel, kerosene, polyethylene paraffin wax, lubricating oils, fuel oil, sulphur, petroleum coke, jet fuel, naphtha, fuel oil etc. This will result in the creation of a vast number of jobs for chemical and other petroleum engineers, an upsurge in related downstream businesses in the host communities of the refinery plants, an increased tax base for the Government and the incalculable multiplier effects on the lives of the family members of all stakeholders such as employees, contractors and vendors to the refining plants etc. Not only will this accelerate the development of the country, it would help Nigeria conserve foreign exchange spent on importing refined oil which currently accounts for about 18% of the country's import spend. For this to be achieved, the respective governments of each SSA country need to create the enabling environment to attract investments. Tax holidays, specific import waivers, improved ease of doing businesses, availability of fully-functional public infrastructure among others are what will drive these much-desired investments.

Governments must build the social infrastructure that would enable businesses succeed. It is after this that a government can have the moral justification to demand taxes and aggressively pursue tax revenue generation. Income taxes as a percentage of GDP must be an important national Key Performance Indicator (KPI).

If the SSA governments adopt the suggested measures enumerated in this article with genuine intention, sincerity of purpose backed by strong political will, the vulnerability of the economies of the SSA states to commodity price volatility may be a thing of the past while also helping them realize their true economic potentials, thus setting them on the path of sustained and enduring socio-economic prosperity.

By **Ayokunle Yusuf**

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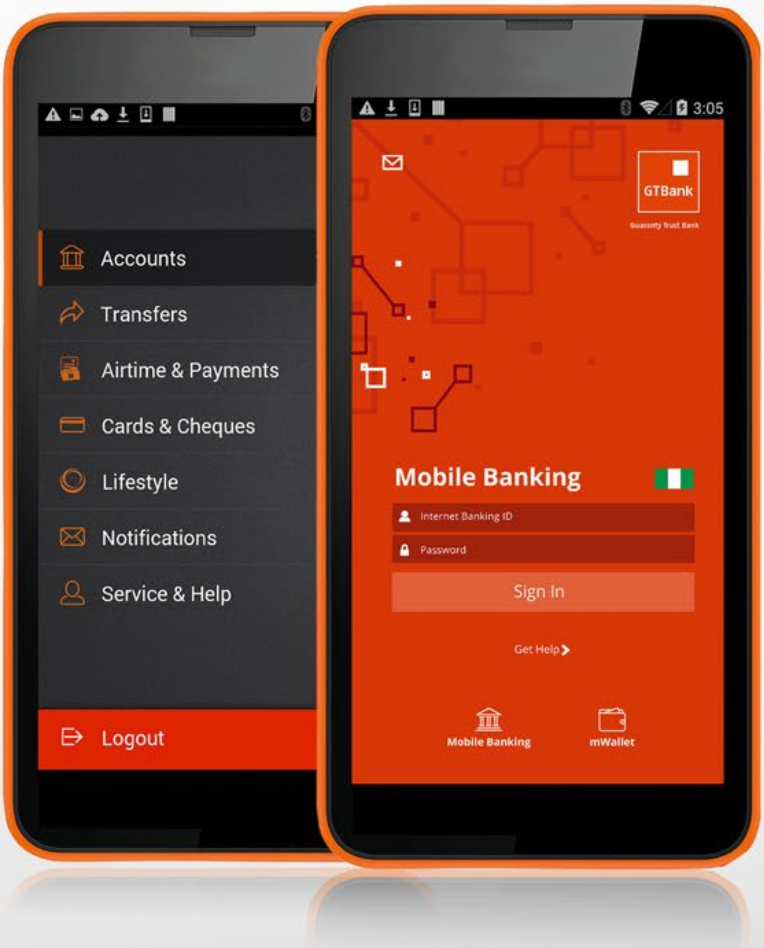

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Africa Makes Its Voice Heard at Global Regulatory Tables

Africa numbers among its countries some of the world's fastest growing economies. Its institutions are growing fast too. Many performed relatively well during the financial crisis. Yet, despite all these credentials, the Continent struggles to make itself heard at the tables of the global regulators. One observer said that the regulators 'pay lip service to Africa, but nothing more than that. Their real job is to straighten out the systemic banks and the financial system.'

To some extent, the regulators' attitude makes sense. Much of the activity of organisations like the G-20, the Financial Stability Board (FSB) and the Basel Committee of Banking Supervision relates to the large global banks forced to repair their balance sheets and regulatory mechanisms in the wake of the Global Financial Crisis. Africa does not possess such systemically, large institutions.

One may well ask: what is the relevance of this global regulatory drive to Africa's regulatory institutions, Africa's banks and Africa's consumers? What lessons can Africa take away from global regulatory changes?

The emerging regulatory framework following the global financial crisis is clearly relevant for Africa, as more African countries integrate into the global economy. The G-20 regulatory processes have to take into account the specific circumstances of African countries, and African countries have to make choices as to the proper sequence – or the appropriate building blocks – for adopting the international regulations. African countries, with the help of the FSB and other institutions, need to establish joint monitoring processes to assess the impact of the new regulatory framework on African economies.

This framework is far from a solution to Africa's macro-level financial risk. Africa has some particular problems in its economies that pose challenges. Such problems include volatility in asset prices and unpredictable cross-border flows. This has led a group of regulators and academics to argue that the Basel and G-20 rules are only partially relevant to Africa. They have said that 'adopting the Basel III reforms will be useful, to some extent, in Africa, but it will not be sufficient to deliver either the micro-prudential or the macro-prudential policy objectives.'

Regulators need to focus on three critical areas to give Africa the sound financial underpinning it requires. These are: setting regulations on the assets and business activities of banks which complement capital adequacy requirements as a micro-prudential tool; strengthening the supervision of banks to ensure that regulations are enforced; and creating an effective macro-prudential toolkit to address the multifaceted risks to the systemic stability of the financial system.'

The importance of targeting regulation around Africa's particular issues is critical to Peter Woolf, the head of the department of "World Economy and Development Financing" at the German Development Institute. He says (in an interview with the author), "For most African countries, the question of sequencing the adoption of these international standards to align them to local circumstances and to reconcile them with developmental goals, such as financial inclusion and economic growth, is a major policy issue."

While the value of global regulation may be questionable to Africa's financial institutions, of equal importance is the Continent's capacity to apply the necessary standards. Commentators talk of the need for extensive training of staff in compliance and regulation to implement the Basel and G-20 programmes. They point to studies conducted by the FSB in October 2011 and June 2012 that addressed the potential effects of the regulatory reforms on developing countries. The first FSB report notes that in "Emerging Market and Developing Economies with limited human and financial resources, the adoption of such [international] standards would need to proceed at a pace consistent with countries' supervisory capacity and level of financial system development".

African regulators have shown themselves confident in their capacity to implement much of the global regulatory system as it pertains to their financial systems. So academics note that the entire Basel I regime has been implemented across most African banks.

The next challenge to regulators, determined to follow the guidance of the G-20 policy-makers, is to establish the market mechanisms necessary to retain capital in their economies. The principal mechanism to achieve this is the domestic bond market. Large African economies have had domestic bonds markets for many years, but smaller markets struggle with economies of scale.

Domestic bond markets

International regulatory efforts to stimulate the development of local capital markets in Africa have their origins in the African Financial Market Initiative launched by the African Development Bank in 2008. This was launched in conjunction with the G-20 Action Plan to Support the Development of Local Currency Bond Markets (LCBM). The objectives of this initiative (according to the Policy Briefing 78 cited above) are six fold:

1. to contribute to the development of local currency debt markets in Africa
2. to reduce African countries' dependency on foreign currency denominated debt;
3. to help enlarge the investor base in African domestic debt markets;
4. to improve availability and transparency of African fixed income markets related data;
5. to provide alternative sources of long-term funding for borrowers in African currencies;
6. to create a permanent forum for the discussion and provision of technical assistance on domestic bond market issues.

This collaboration of the ADB and the G-20 has enabled African economies to participate in the G-20 initiative for capital market development via African institutions and African stakeholders. Knowledge of the characteristics of African bond markets and experiences of implementing specific measures in Africa can be created systematically through this initiative. This enables them to create the potential to give an African voice to the global G-20 process.

The key goal in developing local bond markets is to increase intermediation of domestic savings. Many African countries are at an early stage in this process, and even in Nigeria, where local bond markets are well developed, it is acknowledged that high net worth Nigerians put much of their liquid money out of the country, transferring it to international safe havens like Switzerland and Singapore. Many of course will keep a percentage inside the country and invest it in government or corporate bonds as part of an investment diversification strategy.

The test for regulators seeking to build domestic bond markets is their ability to establish secure institutional and legal frameworks. These frameworks will ensure three factors: first, regular issuing of bonds by good names, both corporate and state; second, strong trading by established investors in newly issued bonds; third, a convincing and liquid secondary market for trading securities.

The creation of secure domestic bond markets in Kenya and Nigeria has provided a sound underpinning for the development of pension funds and insurance companies. Both these sectors have expanded with growth in liquidity in domestic bond markets, benefiting the wider economy. Multilateral organisations like the World Bank and the IMF have sought to stimulate the expansion of investing in collective instruments, with the subsequent underpinning of domestic bond markets.

Setting up and running bond markets places a pressure on the home country to fund both expertise and organisation. For example local bond markets require technical features, such as depositaries, where bonds are held. Local professional financial advisers will need to be trained in the custody and stock handling skills needed to manage both primary and secondary markets.

Regionalisation

Another regulatory priority for Africa is the speeding up of regionalisation. This will enable the continent to create more stable markets based on heightened communication between regulators and national banks. Greater economies of scale will enable such markets to be more cost effective as well as transparent. Regionalisation gives small countries a greater shout at the national table, where regulatory decisions are taken. It also adds to market liquidity and thus makes them more effective as trading places.

Coalescence around regulatory standards and practices can be achieved by Africa's regulators developing colleges of supervisors from different countries, as fora for central banks and supervisory authorities. This enhances transparent communication

between banks, as well as between banks and regulators. For example, banks can discuss specific circumstances with a regulator where the regulator would require a bank in its home country to withdraw their capital from (or reduce their exposure to) the operations it has in another country or market.

Three examples of successful regional cooperation in an African context are the East African Community, the West African Economic and Monetary Union, and the trade corridor from the south to the north of Africa.

- The East African Community consists of a regional intergovernmental organisation which embraces a banking sector covering Kenya, Burundi, Rwanda, Tanzania and Uganda. Under the umbrella of the EAC sits a Customs Union which allows free-market of goods, collection and customs revenue, as well as a development bank.
- The West African Economic and Monetary Union (comprising Togo, Niger, Cote d'Ivoire, Benin, Burkina Faso, Mali, Guinea Bissau, and Senegal) has a common accounting system, shared macro-economic policies, a legal and regulatory framework for banks and a regional stock exchange. Some issues remain around trade where cooperation has been less developed, although they have sought to build links for decades.
- The tripartite trade corridor from South Africa through the East African Community up to Ethiopia and Egypt offers a route forward for future integration of trade.

The more Africa strengthens its regional institutions, say observers, the greater the efficiency of markets, as well as the sharing and utilisation of skills and capital. The longer term result is a more effective and more regulated Continent that can relate to and respond to global regulatory norms.

The ultimate goal of the regionalisation process (for some African regulatory institutions) is a pan-African market and even a pan-African currency. This has been proposed by the African Union, which has outlined the setting up of an African Central Bank by 2021 and an African currency and market. While such goals are noteworthy, they are widely regarded as unrealistic. This does not detract from the value of the underlying message: that joined-up and expanded regional groups are critical for the efficient functioning of African markets. One commentator argued, *'Some African regulators know what is needed, where the gaps are. They know that the economies are for the most part too small. The Kenyan domestic financial market is too small, and that is why they need to go abroad for their financial instruments. You need regionalisation. This is going slowly both in west and East Africa. Things are going quite well for local currency bond markets. The G-20 is helping and they have a programme for developing local currency bond markets and there is some technical assistance.'*

Financial Inclusion

One outcome of the recent Brisbane summit was a re-affirmation of Africa's need for greater financial inclusion, as expressed in the G-20's Global Partnership for Financial Inclusion (GPFI) programme. Inclusion is seen by regulators as Africa's Achilles heel, as the Continent builds its own market mechanisms and seeks to achieve long term structures. One group of commentators have argued that

African countries fail to deliver greater financial development and inclusion because of their 'conservative approach to regulation'. They have further suggested that Africa should adopt a different approach to regulation based on a "best fit" rather than a "best practices" approach.

To further the goal of financial inclusion, Standard Setting Bodies (SSBs), responsible for negotiating and setting the international standards for the financial sector, are collaborating with the G-20 GPFI to move inclusion policies forward. A number of African non-G-20 member countries are engaged in the GPFI, namely Ethiopia, Kenya, Malawi, Nigeria, Rwanda, Tanzania, Uganda and Zambia. These countries have signed up to the GPFI process so that they can benefit from its peer-learning processes and participate in SSB discussions.

The G-20 general policy guidelines for financial regulation are implemented on the international level by the SSBs. The co-ordinating institution for the SSBs is the FSB, which is mandated directly by the G-20 and functions as a platform for engaging with non-G-20 member countries, particularly in the developing world. According to one development source, 'The financial inclusion agenda and the Development Working Group (DWG) were set up as a G-20 activity to show the outside world that they care for developing countries. It is a recognition that developing countries have different problems with respect to global finance than industrialised countries. The issue for poor developing countries is financial inclusion.'

Africa's banking system and the regulatory requirements

The Association of African Central Banks (AACB) is one of the major pan-African institutions to discuss regulatory and developmental issues and to formulate common African positions. In April 2011 the AACB suggested an action plan for joint work on regulatory issues to promote the 'collective voice' of African regulators. African banks have reason to feel well cushioned from the capital requirements of the Basel process as they were largely spared exposure to the more complex pre-crash financial instruments and markets. Such financial instruments proved highly detrimental to many globally systemic banks during the global financial crisis of 2008.

That is not to say that the largest banks in Nigeria and Kenya (as well of course from South Africa and selected institutions with cross-border reach) can ignore pressures for regulatory compliance as these are the passport to cross-border international expansion. They have no option but to implement rules laid out by global regulators. One banker told the author, 'we regard banks in Mexico or Indonesia as our peer group, not most African banks.'

In fact, levels of capital held by Nigerian banks generally surpass those required by the Basel process. Nigerian banks have reputations for being largely conservative institutions in any event, who have concentrated (for the most part) on quite 'boring' banking, while avoiding risky activities such as derivatives trading. Their balance sheets are generally regarded by regulators as well managed, with a minimal leverage risk. Such a 'conservative' posture has perhaps been less than helpful for their domestic economies, as they have played little part in development or environmental banking.

Capital buffers applied by Nigerian banks are seen as sufficient to protect against inefficient or ill-advised lending policies. But as one banking expert told the author, 'These are traditional banking risks that have been recognised by the risk buffers in terms of equity capital which are quite good in Africa. Most banks have risk buffers above the Basel standard.

The largest African banks conclude from the regulatory process that they must follow their instinct for greater caution and clearly watch their risk. The issue for the regulation of small African banks is more complex, and a

group of academics have observed that, 'African regulators may have been focusing too much on stability causing small banks to hold sub-optimal levels of capital'. These authors used a new database on regulation and supervision developed by the African Development Bank in collaboration with the Making Finance Work for Africa Partnership to describe the regulatory and supervisory environment in Africa.

As the regulations become more of a factor for Africa's financial supervisors, so too does the importance that their voices are heard at the tables of the G-20 and the Basel Committee on Banking Supervision. Many are speaking out but say that the largest developed countries do not hear them. One commentator said, 'they are paying lip service to Africa, not paying real heed to their demands.'

What is equally clear is that regulators like the Financial Stability Board are aware of their responsibility to emerging markets. So the FSB's chairman statement in November 2014 in advance of the Brisbane summit, stated, 'The FSB report on the review of the structure of its representation seeks G-20 endorsement of measures that seek in particular to strengthen the voice of emerging market and developing economies (EMDEs) in the FSB while also preserving the effectiveness of its decision-making process.'

Conclusion

The institutional framework for developing and putting forward African positions related to financial stability and financial systems reform are in place but have not yet been exhausted. The framework has to be strengthened through active participation of the members of these groups in order to have a substantial impact on international policy discussions and the G-20 processes in particular. In this sense, the African voice starts at the country level, to be aggregated through well-organised regional consultation processes.

By **Nick Kochan**

Nick Kochan is a London based financial and political journalist.

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