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CBN issues Guidelines on shared services for financial institutions

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Introduction

The Central Bank of Nigeria (CBN) in May 2021 issued its Guidelines for Shared Services Arrangements (SSAs) for Banks and Other Financial Institutions (the Guidelines), to complement the CBN's Guidelines for Licensing and Regulation of Financial Holding Companies in Nigeria.

The Guidelines, which are mandatory for all institutions licensed by the CBN, have an effective date of full compliance of 1 June 2022 and set out the operational standards for banks and other financial institutions looking to set up or participate in SSAs. The Guidelines also seek to ensure compliance with Executive Order 5 of the Federal Republic of Nigeria (2018) which seeks to promote the development of indigenous capacity and local content in science, engineering and technology. You can find the Guidelines here.

Background

In 2010 the CBN repealed the Universal Banking Guidelines and introduced the New Banking Model which permitted banking groups with non-core banking operations to retain their non-core banking businesses by incorporating non-operating holding company (HoldCo) structures.

Apart from holding equity investment in banks and non-core banking businesses, HoldCos were permitted to, subject to CBN approval and compliance with the arm's length principle, provide shared services to the group with respect to ICT; facilities (office accommodation including electricity, security and cleaning services in that accommodation); legal services; any other services as may be approved by the CBN from time-to-time.

Objectives of the Guidelines

The objectives include: (a) to set out supervisory expectations in respect of SSAs between a parent company and its subsidiary; (b) to ensure that the fees received or paid reflect the services rendered, taking into account the assets used and the risks assumed; (c) to ensure that financial institutions comply with the extant transfer pricing (TP) regulations in Nigeria; and (d) to reduce operational cost of benefitting institutions.

Who is impacted by the Guidelines?

The Guidelines apply broadly to commercial banks; merchant banks; financial holding companies; other financial institutions; payment services banks; and other payment services as licensed by the CBN, provided that the financial institution is either (a) a parent company operating in Nigeria and licensed by the CBN; or (b) a subsidiary company licensed by the CBN and carrying on its operations in Nigeria.

What services are approved?

Financial institutions are permitted to, subject to CBN approval, enter into SSAs with their parent companies in respect of HR; risk management services; internal control services; compliance services; marketing and corporate communications; ICT; legal services; facilities; and any other services as may be approved by the CBN, provided that: (a) the recipient does not have the expertise and capacity to carry out these services; and (b) any services provided outside the aforementioned shall not be charged to the recipient.

The Guidelines also provide that financial institutions seeking to acquire technology on behalf of their foreign subsidiaries shall allocate the cost associated with the technology based on actual volume and complexity of services consumed by the subsidiary. Also, where a foreign parent transfers technology to a Nigerian subsidiary, the relevant agreements must expressly convey rights to the local financial institutions for the use of the technology.

Furthermore, financial institutions are required to submit their shared services policies (which provide details of the services to be shared, how the services are to be shared, the methodology for the pricing, governance structure for reporting etc.) for approval by the CBN.

The Guidelines and the TP Regulations

The Guidelines provide that groups entering SSAs shall ensure that the terms and conditions of such arrangements are in line with the arm's length principle, as provided for in the Income Tax (Transfer Pricing) Regulations, 2018 (TP Regulations). The Guidelines further require affected groups to maintain intercompany agreements, invoices, bills and other relevant documents in order to justify the shared services fees.

Regulatory Reporting, Compliance, and Governance

Regulatory Reporting

All relevant agreements must be submitted to the CBN for approval and will be subject to annual reviews. Affected groups must submit an independent consultant's report on the shared services fees and the SSA's level of compliance with the relevant laws no later than 31 January of each accounting year. Other reports required to be submitted in respect of the SSA must be submitted to the CBN no later than 15days after they are approved by parties to the agreement.

Non-compliance with the Guidelines is an offence punishable under section 96 of Banks and Other Financial Institutions Act, 2020 (BOFIA). This section gives the CBN Governor some discretion to impose a penalty. Non-compliance may also render the officers of the affected financial institution to administrative sanctions.

Governance

The Board is responsible for ensuring that SSAs are in line with the relevant laws and regulations; providing oversight over the SSA and the reasonableness of service fees; commissioning an independent consultant to determine the efficiency of the shared services on an annual basis; etc.

Financial institutions are also required to disclose the shared services and the importance of the services in their annual reports and on their websites.

Takeaway

Affected companies will need to take steps to comply with the Guidelines in order to avoid penalties and sanctions. They will need to put together their SSA TP policy, obtain the relevant approvals from the CBN, maintain the relevant transaction documents, and engage consultants to prepare the independent report required by the Guidelines.

From a policy perspective, the Guidelines suggest that approvals will be conditioned on capacity building initiatives. This could suggest that the CBN expects recipient entities to undertake the shared activities for themselves in the future. This may conflict with one of the stated objectives of the Guidelines i.e. to reduce the operational costs of benefiting institutions. This may also undermine the purpose of many SSAs that serve to reduce costs by consolidating resources. It is hoped that the CBN will prioritise business and efficiency concerns in its approval decisions.

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