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CIRCULAR TO BANKS AND OTHER FINANCIAL INSTITUTIONS

GUIDELINES FOR SHARED SERVICES ARRANGEMENTS

The absence of standards on shared services and transfer pricing arrangements in the Nigerian banking industry was evidenced on the uneven management of shared services with the attendant concerns on governance, financial and tax management practices.

The Central Bank of Nigeria (CBN) in response thereto, issued an Exposure Draft on November 18, 2019 to streamline the activities of institutions engaged in shared services and transfer pricing. The Exposure Draft also sought to harvest stakeholders' opinions on the abuses including the use of shared services arrangements as a tax shield.

In consideration thereof, the following Guidelines on Shared Services Arrangements for Banks and Other Financial Institutions in Nigeria is hereby issued for compliance.

The effective date for the full compliance with the provisions of the Guidelines shall be June 1, 2022.

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GUIDELINES

FOR

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1 INTRODUCTION

Nigerian banks with foreign parents and banks within the non-operating financial holding company (HoldCo) structure participate in centralized or shared services arrangements with their parent companies and other entities in the group. The main drivers for sharing of services among group entities are the need to ensure cost efficiencies, leverage existing expertise and maintain consistency throughout the group. An intra-group charge is billed to the benefitting group members, in consideration of the services provided to them.

The absence of standards for the application of costs related to shared services and ensuing pricing arrangements has resulted in uneven management of shared services in the banking industry and has been a source of concern for regulators, especially in view of its governance, financial and tax implications.

This Guidelines is, therefore, issued to provide guidance to banks and other financial institutions under the regulatory and supervisory purview of the Central Bank of Nigeria (CBN) on the initiation and evaluation of shared service arrangements and other matters connected thereto. It sets operational standards for banks and other financial institutions in line with best practice and ensures compliance with Executive Order 5 of the Federal Government of Nigeria, signed on February 12, 2018, which seeks to promote the development of indigenous capacity and local content in contracts and science, engineering and technology, as a necessary tool to drive national competitiveness and productivity.

This Guidelines, issued in exercise of the powers conferred on the CBN under the Central Bank of Nigeria Act, 2007 (CBN Act) and the Banks and Other Financial Institutions Act, 2020 (BOFIA), complements the CBN's Guidelines for Licensing and Regulation of Financial Holding Companies in Nigeria. It covers the general principles that guide shared services arrangements in Nigeria, approved shared services, transfer pricing and regulatory reporting requirements. Compliance with the provisions of this Guidelines is mandatory for all institutions licensed by the CBN.

The Guidelines shall be read in conjunction with the provisions of the CBN Act, the BOFIA, other subsidiary legislations made under the Acts, as well as written directives, notices, circulars, frameworks and other guidelines that the CBN and other regulators in the financial services sector have issued or may issue from time to time.

2 SCOPE/LIMITATIONS OF THE GUIDELINES

The provisions of this Guidelines shall apply to the following financial institutions:

a. Commercial banks;
b. Merchant banks;
c. Financial Holding Companies;
d. Other Financial Institutions;

e. Payment Services Banks; and
f. Other payment services as licensed by the CBN.

Provided that the financial institution is either:

(i) A parent company operating in Nigeria and licensed by the CBN; or

(ii) A subsidiary company licensed by the CBN and carrying on its operations in Nigeria.

3 OBJECTIVES

The objectives of this Guidelines include:

(i) To set out supervisory expectation in respect of shared services arrangements between a parent company and its subsidiary.

(ii) To ensure that the fees received or paid reflect the services rendered, taking into account the assets used and the risks assumed.

(iii)To ensure that financial institutions comply with the extant transfer pricing regulation in Nigeria.

(iv)To reduce operational cost of benefitting institutions.

4 GENERAL PRINCIPLES

4.1 Financial institutions are expected to establish policies and procedures to ensure that shared services are conducted at arm's length. In particular, the institutions should submit their shared services policies as approved by the board to the Central Bank of Nigeria which should, at the minimum:

- Detail the services to be shared;
- Indicate how the services would be shared, including the roles and responsibilities of the parties involved;
- Indicate the methodology for pricing shared services, including standards for timely recording and settlement (including frequency of settlement);
- Specify the governance structure for reporting exceptions to policy; and
- Be reviewed annually.

5 APPROVED SERVICES

5.1 A financial institution may, with the approval of the CBN, enter into Shared Services Agreement with its parent company in respect of:

a. Human Resources services;
b. Risk Management services;
c. Internal Control services;
d. Compliance services;
e. Marketing and Corporate communications;
f. Information and Communication Technology;
g. Legal services;
h. Facilities (Office Accommodation including Electricity, Security, Cleaning Services in that accommodation); and
i. Any other services as may be approved by the CBN from time to time.

Provided that:

i. the recipient entity does not have the expertise and capacity to carry out these services; and
ii. any other service provided outside the aforementioned SHALL NOT be charged to the recipient entity.

5.2 Financial institutions seeking to acquire technology on behalf of their foreign subsidiaries shall allocate the associated costs based on the actual volume and complexity of services consumed by the subsidiary. This is without prejudice to the local regulation of the host country.

5.3 Financial institutions with foreign parents shall ensure that in the case of technology transfer, the agreements thereto shall expressly convey rights to the local financial institution for the beneficial use of the technology.

6 GOVERNANCE

6.1 It is the responsibility of the board of the relevant financial institution to ensure that:

(i) approved Shared Services Agreements are in line with extant laws and regulations; and
(ii) the institutions have appropriate governance structures and policies in place for the Shared Services Arrangement.

6.2 The board shall be responsible for the oversight of shared service arrangements and ensure the reasonableness of fees charged for the services. The board may, however, delegate the responsibility for the monitoring and management of shared services to an appropriate specific board committee.

6.3 Where the Board delegates oversight to a Board Committee, the Committee must be headed by an independent director.

6.4 A Shared Services Agreement shall be executed between the recipient institution and the provider company, and should at the minimum include:

i. Commencement Clause
ii. Agreement to Provide Services
iii. Scope of services
iv. Applicable costing methods
v. Compensation and Cost Sharing
vi. Reporting and Timing of Payments
vii. Standards for Performance of Service
viii. Access to Employees and Information
ix. Confidentiality
x. Notices
xi. Force Majeure
xii. Indemnification
xiii. Duration
xiv. Termination (Termination for cause and Termination for convenience)
xv. Dispute resolution mechanism/procedure
xvi. Governing Law
xvii. Capacity building
xviii. General Provisions

6.5 The board of the recipient financial institution shall be responsible for the on-going viability of a shared service, set performance goals and metrics, and shall commission an independent consultant to determine the efficiency of the shared service arrangements on an annual basis.

6.6 All Shared Service Agreements must include a clause requiring parties to the agreement to review the agreement to reflect the recommendations arising from the independent review of the shared service arrangements.

6.7 The board of the recipient institution shall inform the board of the provider company, in a timely manner, of any issues that may impact the ongoing viability of the shared service arrangement or any significant deviation from the Shared Service Agreement.

6.8 Financial institutions shall demonstrate that the service to be shared is of strategic importance to their institutions and would contribute significantly to their overall vision and mission.

6.9 Financial institutions shall disclose in their annual report and website, the services shared within the group and the importance of those services to their institutions.

6.10 A financial institution that is the recipient of shared services shall ensure that the benefits offered by the shared services meet the quality control standards approved by its board. A financial institution shall retain the right to review performance criteria for the services rendered by the shared service provider.

6.11 All Shared Services Agreements involving foreign parents and their Nigerian subsidiaries shall include a provision for capacity building, where applicable. The Nigerian subsidiaries shall demonstrate that both the subsidiaries and their officials are benefiting from the technical service agreements. In addition, the CBN shall collaborate with relevant agencies to determine the adequacy or otherwise of the capacity building.

6.12 It is the responsibility of the provider of shared services to pay the salary and allowances of the staff used to provide shared services to other entities in a group.

7 TRANSFER PRICING

7.1 Shared services within a group, whether domestic or cross–border, have implications for both the taxpayers (that is, provider and recipient entities). The Federal Inland Revenue Service Income Tax (Transfer Pricing) Regulations, 2018 (the Regulations) provides guidance on treatment of related party transactions.

7.2 Financial institutions are required to comply with the provisions of the Regulations. In addition, they are required to note the following:

i. The transfer pricing method applied, in line with Section 5 of the Regulation, shall be clearly noted in the Shared Services Agreement. Accordingly, the permitted transfer pricing methods are as follows:

   a. Comparable Uncontrolled Price (CUP) method;
   b. Resale Price method;
   c. Cost Plus method;
   d. Transactional Net Margin method;
   e. Transactional Profit Split method;
   f. Any other method which may be approved by the CBN.

ii. Shared service fees shall be documented for all transactions between the service provider and the recipient in the same manner as if they were between unrelated parties. Such documentation shall not be by mere journal entries or set-off against any other inter-company account, and shall include contracts, invoices, bills or other similar documents.

iii. All Shared Services Agreements shall be entered on an arm's length basis. That is, the terms and conditions of the agreement shall be such that it must be consistent with similar agreements reached by unrelated parties.

8 REGULATORY REPORTING

8.1 The Shared Services Agreement shall be submitted to the CBN for approval.

8.2 The report of an independent consultant's review of the fees and services rendered, which must reflect the extent of compliance with extant laws and regulations, must be submitted to the CBN annually.

8.3 The Shared Service Agreement shall be reviewed yearly to reflect current economic realities and submitted to the CBN for approval.

8.4 The report of the independent review regarding the shared services shall be submitted annually to the Director, Banking Supervision Department, or the Director, Other Financial Institutions Supervision Department, or the Director, Payment System Management Department, for commercial, merchant banks and financial holding companies; other financial institutions; or payment service banks, respectively, not later than January 31 of each accounting year. Other reports required by the section shall be submitted to the appropriate Director not later than 15 days after they are approved by the parties to the agreement.

9 COMPLIANCE

9.1 All financial institutions having shared services arrangements within their group shall comply with the provisions of this Guidelines.

9.2 Failure to comply with this Guidelines is an offence punishable under Section 96 of the BOFIA.

9.3 Failure to comply with the Guidelines may also render the officers of the concerned financial institution liable to administrative sanctions.

10 GLOSSARY

S/N	TERM/PHRASE	MEANING
1	Arm's length	This means the principle that the conditions of a controlled transaction should not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances.
2	Comparable Uncontrolled Price Method	This is a method in which the price charged for property or services transferred in a controlled transaction is compared with the price charged for property or services transferred in a comparable uncontrolled transaction.
3	Cost Plus Method	This is a method in which the mark up on the costs directly and indirectly incurred in the supply of goods, property or services in a controlled transaction is compared with the mark up on those costs directly or indirectly incurred in the supply of goods, property or services in a comparable uncontrolled transaction.
4	Financial Holding Company	Financial Holding Company (FHC) is an "other financial institution" licensed and regulated by the CBN for the purpose of making and managing (for its own account) equity investment in companies engaged in the provision of financial services.
5	Independent Director	An Independent Director is a member of the Board of Directors who has no direct material relationship with the bank or any of its officers, major shareholders, subsidiaries and affiliates; a relationship which may impair the director's ability to make independent judgments or compromise the director's objectivity in line with Corporate Governance best practices.
6	Independent consultant	This means an entity separate from the shared service provider or recipient, which has experience in appraisal or valuation of services.
7	Parent Company	A company that owns enough voting stock in another firm to control management and operation by influencing or electing its board of directors.
8	Provider institution/company	An institution/company that renders shared services to other institutions within the group under a shared services arrangement.
9	Reasonableness	This refers to the quality of being plausible or acceptable to a reasonable person. What is considered reasonable by many people is that about which there is agreement, if not among all, at least among a substantial number of people.

10	Recipient institution/company	An institution/company in a group that benefits from shared services rendered by another institution within the group under a shared services arrangement.
11	Resale Price Method	This means a method in which the resale margin that a purchaser of property in a controlled transaction earns from reselling the property in an uncontrolled transaction is compared with the resale margin that is earned in a comparable uncontrolled purchase and resale transaction.
12	Shared services	Shared services are services provided by a member of a group to one or more members of the group. Thus, the funding and resourcing of the service is shared.
13	Subsidiary	A subsidiary is a company controlled by another company, usually referred to as the parent company or the holding company.
14	Transactional Net Margin Method	This refers to a method in which the net profit margin relative to the appropriate base, including costs, sales or assets that a person achieves in a controlled transaction is compared with the net profit margin relative to the same basis achieved in a comparable uncontrolled transaction
15	Transactional Profit Split Method	This is a method in which the division of profit and loss that a person achieves in a controlled transaction is compared with the division of profit and loss that would be achieved when participating in a comparable uncontrolled transaction.
16	Transfer Pricing	Transfer pricing refers to the rules and methods for pricing transactions within and between institutions under common ownership or control.

FINANCIAL POLICY AND REGULATION DEPARTMENT
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