# Banking Supervision Annual Report 2015

Bank of Botswana

# MISSION STATEMENT

The principal objective of the Bank of Botswana (Bank) is to promote and maintain monetary stability, efficient payments mechanism, liquidity, solvency and proper functioning of a soundly based monetary, credit and financial system in Botswana.

In view of the foregoing, the Bank's mission is to promote and maintain a safe, stable, sound, efficient and competitive banking system. In its supervisory role, the Bank is guided by the Bank of Botswana Act (CAP. 55:01), Banking Act (CAP. 46:04) (Banking Act), Banking Regulations 1995, Bureaux de Change Regulations 2004 and relevant directives, policies and guidelines issued under the Banking Act, which govern the establishment and conduct of financial institutions over which the Bank has supervisory authority.

Accordingly, the Bank seeks to promote market integrity, competition, fair trading practices and a high standard of governance through consultation and open communication with market players. Furthermore, the Bank is committed to upholding a high standard of professional conduct, in line with international regulatory and accounting standards for effective banking supervision.

In order to achieve these goals, the Bank

(a) sets transparent criteria, guidelines and other requirements for market entry, as set out in the Licensing Policy;

(b) establishes and updates, on a regular basis, prudential policies and standards;

(c) monitors solvency, liquidity, large exposures, insider loans, provisioning and risk management strategies, as well as the adequacy of management and governance structures for the sound operation of banks;

(d) establishes effective systems for off-site surveillance and on-site examinations, including reporting, accounting, auditing and disclosure standards; and

(e) ensures timely supervisory action and compliance with the banking and other related laws governing the operations of banks in Botswana.

# Banking Supervision Annual Report 2015

Bank of Botswana

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BANK OF BOTSWANA: BANKING SUPERVISION

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# LIST OF ACRONYMS

| | |
|---|---|
| ALCO | Asset-Liability Committee |
| AML/CFT | Anti-Money Laundering and Combating the Financing of Terrorism |
| ATA | Average Total Assets |
| ATMs | Automated Teller Machines |
| BancABC | African Banking Corporation of Botswana Limited |
| Banking Act | Banking Act (CAP. 46:04) |
| Bank Gaborone | Bank Gaborone Limited |
| Bank SBI | Bank SBI Botswana Limited |
| Barclays | Barclays Bank of Botswana Limited |
| Baroda | Bank of Baroda (Botswana) Limited |
| BBS | Botswana Building Society |
| BIS | Bank for International Settlements |
| BOBA | Bank of Botswana Act (CAP. 55:01) |
| BoBCs | Bank of Botswana Certificates |
| BOI | Bank of India (Botswana) Limited |
| BSB | Botswana Savings Bank |
| BSE | Botswana Stock Exchange |
| CAMELS | Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk |
| Capital Bank | Capital Bank Limited |
| CCR | Counterpart Credit Risk |
| CIUs | Collective Investment Undertakings |
| DSTV | Digital Satellite Television |
| D-SIBs | Domestic Systemically Important Banks |
| EBC EBC | Guernsey Limited |
| ESAAMLG | Eastern and Southern Africa Anti-Money Laundering Group |
| FATF | Financial Action Task Force |
| FIA | Financial Intelligence Agency |
| FNBB | First National Bank of Botswana Limited |
| FRPGA | Financial Ratio and Peer Group Analysis |
| FSAP | Financial Sector Assessment Programme |
| GDP | Gross Domestic Product |
| HHI | Herfindahl-Hirschman Index |
| IFSC | International Financial Services Centre |
| IMF | International Monetary Fund |
| IT | Information Technology |
| KBAL | Kingdom Bank Africa Limited |
| LAR | Liquid Assets Ratio |
| LHS | Left Hand Scale |
| MFDP | Ministry of Finance and Development Planning |
| MoU | Memorandum of Understanding |
| NCDs | Negotiable Certificates of Deposits |
| NCCFI | National Coordinating Committee on Financial Intelligence |
| NDB | National Development Bank |
| NIM | Net Interest Margin |
| NPLs | Non-Performing Loans |
| NRA | National Risk Assessment |
| ORS | Off-site Rating System |
| OSS | Off-site Surveillance System |
| PIN | Personal Identification Number |
| PPR | Primary Reserve Requirement |
| QIS | Quantitative Impact Study |
| RAS | Risk Assessment System |
| RBS | Risk-Based Supervision |
| RBZ | Reserve Bank of Zimbabwe |
| RHS | Right Hand Scale |
| ROAA | Return on Average Assets |
| ROE | Return on Equity |
| RWA | Risk-Weighted Assets |
| SADC | Southern African Development Community |
| SMS | Short Message Service |
| Stanbic | Stanbic Bank Botswana Limited |
| Stanchart | Standard Chartered Bank Botswana Limited |
| SWIFT | Society for Worldwide Interbank Financial Telecommunication |
| USD | United States dollar |
| VAT | Value Added Tax |
| VISA | Visa International Service Association |
| ZAR | South African rand |

# FOREWORD

The world economy was characterised by slow global demand for commodities in 2015. In Botswana's case, the slowdown in demand for diamonds and copper/nickel, coupled with both a debilitating drought situation and intermittent power outages in the country, resulted in a deceleration in economic growth, with GDP contracting by 0.3 percent in 2015. In the circumstances, prospects for job creation were subdued.

Against the backdrop of sluggish global and domestic economic activity, asset quality in the banking sector weakened, albeit marginally, with the Non-performing Loans (NPLs) to Total Loans and Advances Ratio rising from 3.6 percent in December 2014 to 3.9 percent in 2015. The Bank reduced the Primary Reserve Requirement from 10 percent to 5 percent in April 2015, in order to bolster liquidity in the banking system, thus releasing additional funding resources (P2.3 billion).

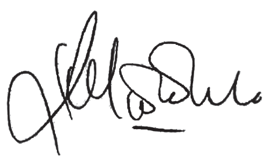
Due to the weak macroeconomic environment, the banks' profitability was on a downward trend during the year. That notwithstanding, domestic banks continued to be financially safe and sound as they satisfied the prescribed prudential thresholds for capital adequacy, credit concentration, liquidity and foreign currency exposures. In addition, domestic banks' financial soundness indicators compared favourably with other regional banking sectors.

The off-shore bank, Kingdom Bank Africa Limited (KBAL), was placed under Temporary Management effective February 16, 2015 for three (3) months as its financial condition had not improved and it had defaulted on requests for deposits withdrawals. After the expiry of the temporary management of KBAL, the liquidation process was initiated. However, the liquidation process was entangled with legal disputes raised by some creditors. By the end of 2015, the matter was still with the High Court.

The Bank continued to enhance its supervisory outreach by entering into Memoranda of Understanding (MoUs) with other supervisory authorities, and participated in supervisory colleges for banking groups that have local subsidiaries.

The parallel run of the new Capital Measurements and Capital Standards for Botswana (Basel II) and the old Capital Framework (Basel I) ended in December 2015. Consequently, the Board of the Bank approved implementation of Basel II effective January 1, 2016.

Overall, in 2015, banks were compliant with key prudential requirements as expected and were resilient. Where incidences of non-compliance occurred, corrective action was instituted, not least through consultation and engagement with the banks concerned. The annual bilateral and trilateral meetings continued to serve as mechanisms through which emerging banking sector challenges were addressed, with a view to finding durable solutions.



Linah K Mohohlo
GOVERNOR

# INTRODUCTION

The Bank continued to maintain regulatory and supervisory oversight of commercial banks, bureaux de change and a deposit-taking microfinance institution in 2015. Kingdom Bank Africa Limited (KBAL)'s banking licence was revoked during the year, thereby reducing the total number of licensed banks to 10. KBAL was an off-shore bank that operated in the International Financial Services Centre (IFSC). Commercial banks' branch network and ATMs decreased as more e-banking platforms were introduced. In addition, commercial banks launched products with enhanced security features and improved functionality.

The banking sector was dominated by five banks, which accounted for 90 percent of total banking assets. The level of competitiveness, as measured by the Herfindahl-Hirschman Index (HHI), was moderate and is expected to improve further once the two new banks, Bank of India (Botswana) Limited (BOI) and Bank SBI Botswana Limited (Bank SBI)[1], fully employ their capital and expand their operations. The associated market dynamics emanating from pressure on banks to develop and improve their products and services, in order to increase their profitability, should also contribute to enhancing competitiveness.

The country's financial depth and development indicators improved marginally with the ratios of Private Sector Credit and Banking Credit to Gross Domestic Product (GDP) increasing from 29.1 percent and 31.7 percent in 2014 to 31.6 percent and 32.4 percent in 2015, respectively.

The banking sector balance sheet as well as key prudential and statutory indicators showed some improvement. Total banking assets grew by 12.7 percent to P76.6 billion in 2015 (December 2014: 13.4 percent increase to P68 billion). All banks reported an increase in their asset base. Loans and Advances also grew (7.1 percent) to P48.3 billion in December 2015, albeit at a much smaller rate compared to a year earlier. On the other hand, the ratio of NPLs to Total Loans and Advances increased from 3.6 percent at the end of 2014 to 3.9 percent in December 2015. Most of the NPLs (52 percent) were attributable to the household sector. The ratio of aggregate Large Exposures to Unimpaired Capital declined from 229.9 percent in 2014 to 194 percent in 2015, thus remaining within the 800 percent maximum prudential limit.

Total customer deposits grew by 16.4 percent to P60 billion in 2015. Customer deposits constituted the largest part of liabilities (78.3 percent) and were the primary source of funding growth in banking assets. However, balances due to other banks and credit institutions declined as banks continued to mobilise funding from alternative sources, including debt securities.

Banks were adequately capitalised in the period under review, with the Capital Adequacy and Core Capital Ratios surpassing the minimum prudential and statutory requirements of 15 percent and 50 percent, respectively. The aggregate Capital Adequacy Ratio was 20.2 percent; some banks issued new subordinated debt instruments that qualify for inclusion as Tier II regulatory capital under Basel II, and this resulted in an increase in the level of subordinated debt from P1 billion (2014) to P1.6 billion (2015).

The industry's profitability decreased during the year as a result of a combination of narrowing interest margins and an increase in operating expenses. Consequently, Return on Average Total Assets (ROAA) and Return on Equity (ROE) were below historical trends for the Botswana banking sector, but comparable to international norms. Overall, the banking sector met minimum statutory requirements, including all the key CAMELS components.

[1] State Bank of India (Botswana) Limited changed its name to Bank SBI Botswana Limited (Bank SBI) in 2015.

# INTRODUCTION (CONTINUED)

Meanwhile, the two-year moratorium on upward adjustment of bank charges, which was effected on January 1, 2014 in view of customer complaints, expired on December 31, 2015.

The Board of the Bank approved the adoption of Basel II as a basis for the determination of capital adequacy for domestic banks effective January 1, 2016. This followed a satisfactory Basel I/II parallel run and completion of consultations with relevant stakeholders.

The detailed contents of this Report are organised as follows: Chapter 1 highlights the structure of the financial sector with particular emphasis on banks, while Chapter 2 assesses the financial performance of the banking sector in 2015. Chapter 3 delves into licensing and consumer protection issues, and Chapter 4 presents an update on Basel II implementation and its associated capital impact assessment as well as developments of the international supervisory framework. Chapter 5 provides a summary of key issues arising from the on-site and off-site examinations processes. Appendices are provided at the end of the Report.

# CHAPTER 1

## BOTSWANA FINANCIAL SYSTEM AND SELECTED INDICATORS

# CHAPTER 1:

## BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS

### STRUCTURE OF THE FINANCIAL SECTOR AND OTHER SUPERVISED FINANCIAL INSTITUTIONS (COMMERCIAL BANKS, STATUTORY BANKS AND NON-BANK FINANCIAL ENTITIES)

1.1 The Bank continued to regulate and supervise commercial banks, bureaux de change and a deposit-taking microfinance institution as shown in Diagram 1.1 (Appendix 1). As at December 31, 2015, there were 10 licensed commercial banks and three statutory banks. The total number of bureaux de change increased from 56 in 2014 to 57 in 2015.

### BANKING SECTOR: BRANCH NETWORK AND OTHER DELIVERY CHANNELS

1.2 Table 1.1 shows the number of bank branches and Automated Teller Machines (ATMs) (2013 to 2015). A total of five (5) additional ATMs were installed in 2015. One bank embarked on a restructuring exercise, which resulted in the closure of ten (10) of its ATMs. Consequently, the number of ATMs decreased from 420 to 415 in the period under review. Similarly, the number of branches were reduced to 114 in December 2015, following one bank's consolidation of some of its branches. The number of branches and ATMs for statutory banks were unchanged at 15 and 12, respectively. In terms of the geographical dispersion of the branch network, the South-East District had the highest concentration of branches at 56, followed by the Central District with 24 (Appendix 2). The two districts accounted for 61.5 percent of the total banking sector branch network as at December 31, 2015. As a percentage of total population, the two districts represented 32.3 percent in 2015.

Table 1.1: Banks, Branches and other Delivery Channels: 2013 - 2015

| | | BRANCHES AND SUB-BRANCHES | | | ATMs | | |
|---|---|---|---|---|---|---|---|
| | | 2013 | 2014 | 2015 | 2013 | 2014 | 2015 |
| Commercial Banks | Barclays | 42 | 41 | 38 | 112 | 116 | 117 |
| | Stanchart | 15 | 19* | 19 | 65 | 68 | 68 |
| | FNBB | 22 | 22 | 22 | 141 | 172 | 173 |
| | Stanbic | 11 | 11 | 11 | 26 | 26 | 29 |
| | BancABC | 8 | 8 | 8 | 10 | 10 | 10 |
| | Baroda | 3 | 3 | 3 | 6 | 6 | 6 |
| | Bank Gaborone | 6 | 7 | 7 | 27 | 18 | 8 |
| | Capital Bank | 4 | 4 | 4 | 4 | 4 | 4 |
| | Bank of India | 1 | 1 | 1 | - | - | - |
| | Bank SBI | 1 | 1 | 1 | - | - | - |
| | KBAL | 1 | 1 | - | - | - | - |
| | ABN AMRO (On-shore & Off-shore) | 1 | - | - | - | - | - |
| Total (Commercial Banks) | | 115 | 118 | 114 | 391 | 420 | 415 |
| Statutory Banks | BSB | 2 | 2 | 2 | - | - | - |
| | BBS | 10 | 9 | 9 | 10 | 12 | 12 |
| | NDB | 4 | 4 | 4 | - | - | - |
| Total for Statutory Banks | | 16 | 15 | 15 | 10 | 12 | 12 |
| Aggregate | | 131 | 133 | 129 | 401 | 432 | 427 |

*Figures revised

1.3 Access to banking services can also be represented by the number of bank accounts opened relative to the adult population[2]. In 2015, the number of accounts opened stood at 1.13 million and the adult population was 1.49 million. Consequently, the Aggregate Number of Bank Accounts to Adult Population ratio declined from 80.2 percent in 2014 to 75.9 percent in December 2015. However, given that a single person can have multiple accounts, the ratio only provides a rough indication of access to banking services. According to the third FinScope Consumer Botswana 2014 Survey (results released July 14, 2015), Botswana was ranked number 5 in the SADC region with regards to financial inclusion and there were 9 branches per 100 000 adult population as at December 31, 2015.

[2] Adult refers to persons aged 15 years and above. The Population projection figures were adopted from Botswana Statistics Projections 2011 - 2026 Report; medium scenario projections were used.

## BANKING SECTOR EMPLOYMENT TRENDS: 2014 - 2015

1.4 Table 1.2 shows the employment levels in the banking sector for 2014 and 2015. Employment declined by 3.4 percent from 5 205 in 2014 to 5 030 in 2015. The reduction in employment levels was due to a variety of reasons ranging from merging of some posts/restructuring exercise, voluntary exit and retirement (for two banks), to retrenchment by one bank following the automation of its banking system in order to increase operational efficiencies. In contrast, one bank increased its staff establishment by 82, while a marginal increase in employment was noted for four banks.

Table 1.2: Employment Levels for Licensed Domestic Banks: 2014 - 2015

| | | 2014 | | | 2015 | | |
|---|---|---|---|---|---|---|---|
| | | CITIZENS | EXPATRIATES | TOTAL | CITIZENS | EXPATRIATES | TOTAL |
| Commercial Banks | Barclays | 1 235 | 6 | 1 241 | 1 185 | 11 | 1 196 |
| | Stanchart | 949 | 10 | 959 | 811 | 4 | 815 |
| | FNBB | 1 134 | 6 | 1 140 | 1 218 | 4 | 1 222 |
| | Stanbic | 583 | 4 | 587 | 570 | 5 | 575 |
| | BancABC | 246 | 8 | 254 | 260 | 8 | 268 |
| | Baroda | 29 | 12 | 41 | 32 | 12 | 44 |
| | Bank Gaborone | 276 | 9 | 285 | 246 | 7 | 253 |
| | Capital Bank | 118 | 9 | 127 | 87 | 8 | 95 |
| | Bank of India | 6 | 3 | 9 | 7 | 4 | 11 |
| | Bank SBI | 8 | 3 | 11 | 12 | 4 | 16 |
| | KBAL | 11 | 7 | 18 | - | - | - |
| Total (Commercial Banks) | | 4 595 | 77 | 4 672 | 4 428 | 67 | 4 495 |
| Statutory Banks | BSB | 145 | - | 145 | 156 | - | 156 |
| | BBS | 200 | 2 | 202 | 200 | 2 | 202 |
| | NDB | 186 | - | 186 | 177 | - | 177 |
| Total for Statutory Banks | | 531 | 2 | 533 | 533 | 2 | 535 |
| Aggregate | | 5 126 | 79 | 5 205 | 4 961 | 69 | 5 030 |

## NEW BANKING PRODUCTS AND SERVICES

1.5 During 2015, banks launched new products, delivery channels and enhancement of some of the services. These included cards with improved security features to reduce card fraud; scheme loans features; ATMs' enhanced functionality which allows for cash deposits; and risk management tailored products. Mobile banking services were improved by introducing additional services for customer convenience and efficiency, such as DSTV payments, PIN change, SMS alerts, cardless ATM withdrawals, account to-card or card-to-card account transfer, cardless ATM withdrawal (non-account holder), Mini statement, and money-send to local and international VISA card holders.

1.6 In a bid to promote a saving culture, banks developed and introduced various types of savings products. These included fixed deposits that pay interest up-front, and some that allow customers to access a portion of the overall fixed amount prior to maturity; as well as savings accounts that targeted lower income and the un-banked people, with a view to encouraging them to access banking services.

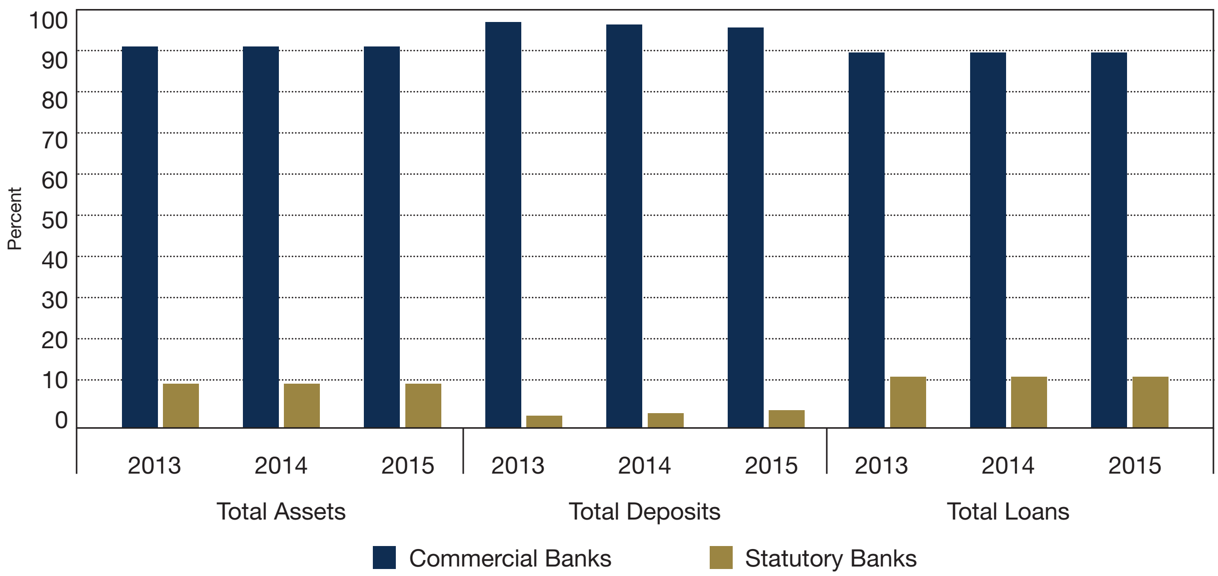
1.7 Most of the newly introduced products and services and/or enhancements to existing products were either offered free of charge or attracted minimal fees. The Bank approved the fees payable on some of the new products prior to their implementation by banks.

## BANKING SECTOR COMPETITION

### MARKET SHARE

1.8 The banking sector continued to be dominated by commercial banks as measured by the share of total assets, total deposits and total loans and advances at 91 percent, 95 percent and 89 percent, respectively. The remaining share was attributable to Statutory banks (Chart 1.1).

Chart 1.1: Banking Sector Market Share of Total Assets, Total Deposits and Total Loans and Advances

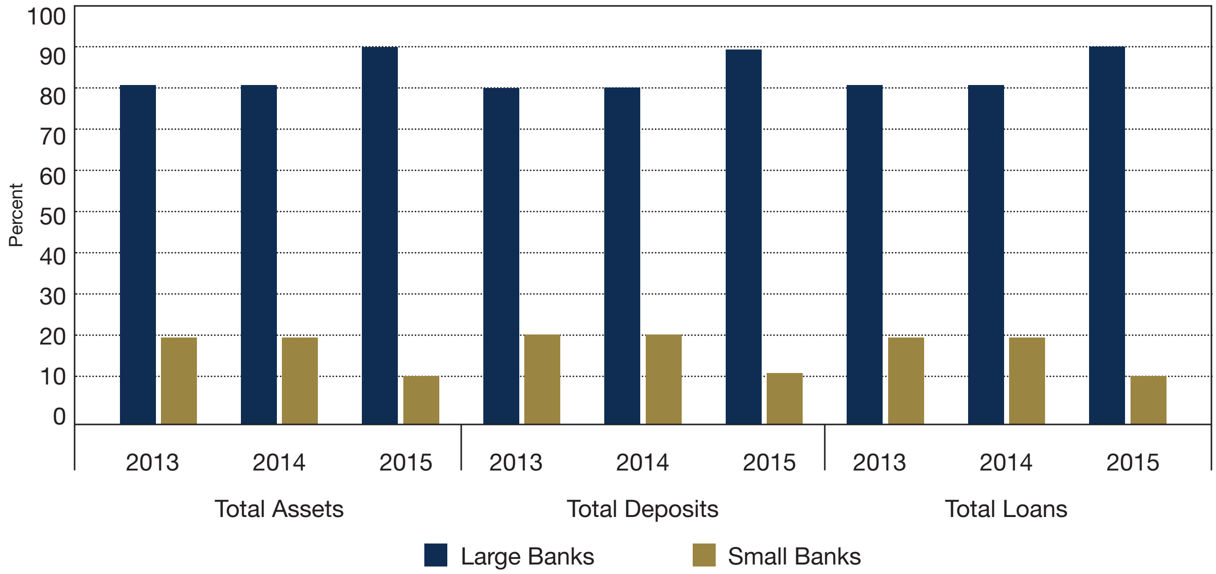



1.9 Chart 1.2 shows large[3] and small banks' market share in terms of total assets, total deposits and total loans and advances. The commercial banking sector continued to be characterised by oligopolistic market conditions, with the four largest banks accounting for approximately 79.2 percent (December 2014: 81 percent), 78.1 percent (December 2014: 79.4 percent) and 77.9 percent (December 2014: 80.1 percent) of total banking assets, total deposits and total loans and advances, respectively; a marginal decrease compared with the previous year. When one of the small banks is included, given its rapid growth, total banking assets, deposits and loans for the five banks account for approximately 90 percent.

[3] A large bank refers to a bank whose total assets constitute 10 percent or more of the aggregate banking sector total assets as at December 31, 2015.

1.10 Going forward, the Bank aims to develop a framework for assessing the degree to which domestic banks are systemically important, in line with the Basel Committee on Banking Supervision (the Committee) framework for dealing with Domestic Systemically Important Banks (D-SIBs). This will ensure that, in addition to size, D-SIBs are also assessed with regard to interconnectedness, substitutability and complexity.

Chart 1.2: Market Share of Total Assets, Total Deposits and Total Loans and Advances of Commercial Banks




## THE HERFINDAHL - HIRSCHMAN INDEX (HHI) OF COMPETITIVENESS

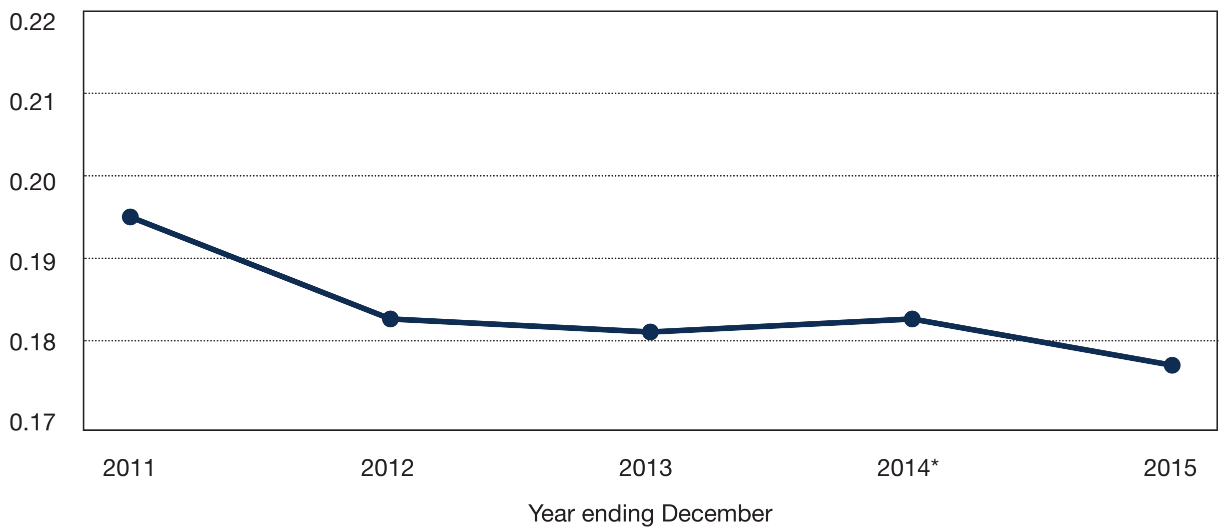
1.11 In general terms, the degree of competitiveness in the banking sector is dependent upon the structure and size of the industry. Competitiveness ranges from a highly competitive market with many banks of equal size, to uncompetitive monopolistic conditions, in which the industry is dominated by one bank. More often, banking markets are oligopolistic, the main feature of which is that a few players have market control, although not to the same extent as in the case of a monopolistic market condition. Typically, the existence of a larger number of banks of comparable size in the market induces competitive pricing, which reduces the degree of market power and collusion among banks. Market structure of many banking systems tends to be characterised by a few large banks (typically two to four banks), which account for the bulk of banking activities, including assets and liabilities. The Botswana banking sector has similar characteristics.

1.12 The Bank calculates the HHI[4], which is a widely used measure, to assess the degree of competition in an industry. The index takes into account the relative size and distribution of banks in the market. The measure approaches zero when a market consists of a large number of banks of relatively equal size or a highly competitive market environment.

1.13 Since 2011, the HHI has trended downwards, from 0.195 to 0.177 in 2015 (Chart 1.3), a development which shows gradual improvement in the degree of competition in the banking sector. Competiveness is likely to improve further once the two new banks, Bank of India (Botswana) Limited and Bank SBI Botswana Limited, fully employ their capital and increase their asset base.

[4] The HHI (calculated as the sum of squares of market shares of all banks) threshold levels determining the level of concentration in an industry are as follows: below 0.01 suggests a highly competitive market; below 0.1 indicates an unconcentrated market; between 0.1 and 0.18 indicates a highly concentrated market; with a monopolist, the HHI=1; with an industry of 100 equal size firms, the HHI=0.01.

Chart 1.3: Herfindahl-Hirschman Index (HHI)



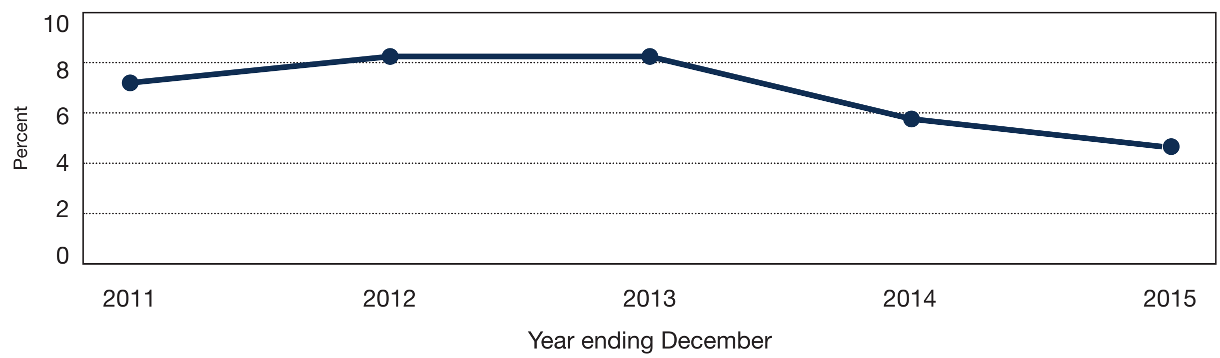

*The 2014 HHI figure was revised.

## NET INTEREST MARGIN AS AN INDICATOR OF COMPETITIVENESS

1.14 Net Interest Margin (NIM) can also be used as a proxy indicator of the level of competitiveness in the banking sector. Normally, increasing levels of NIM would be indicative of low levels of competition. Chart 1.4 shows a decline in NIM from 8.2 percent in 2013 to 4.7 percent in 2015, in this way suggesting that the level of competitiveness has improved over the period.

1.15 In the short-run, however, changes in NIM can be driven by other factors, such as high operating costs, poor loan quality and the macroeconomic environment, including inflation and interest rates. In this case, it was increasing costs of deposits (due to tight liquidity), while lending rates were reducing as a result of changes in the Bank Rate (policy rate).

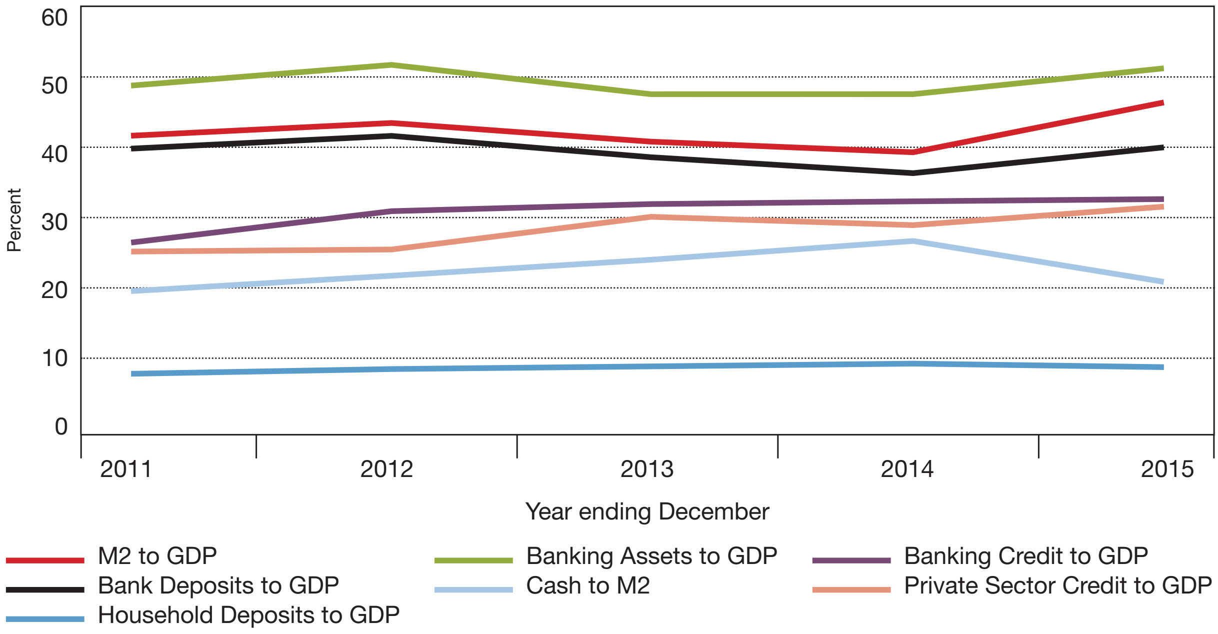
Chart 1.4: Banking Sector Trend of Net Interest Margin (NIM) for 2011 - 2015



## FINANCIAL DEEPENING AND DEVELOPMENT

1.16 Financial deepening refers to the extent of access to financial services which enables economic agents' meaningful participation in economic activities. Chart 1.5 shows several ratios which are commonly used as measures of financial deepening and development.

Chart 1.5: Financial Sector Deepening Indicators




*Private Sector Credit to GDP figures revised in accordance with the World Bank definition of Private Sector Credit

1.17 Financial depth and development, as approximated by the ratio of Private Sector Credit to GDP[5], increased from 29.1 percent in 2014 to 31.6 percent in 2015. When benchmarked against the 51.2 percent average Private Sector Credit to GDP ratios across countries (as reported by the World Bank's 2015/2016 Global Financial Development Report), the Botswana banking system was shallow. However, the ratio was higher than the Sub-Saharan average of 22.2 percent.

[5] The Private Sector Credit to GDP ratio as defined by the World Bank excludes credit issued to government; government agencies; and public enterprises.

1.18 Banking Assets to GDP Ratio increased by almost 4 percent to 51.4 percent. Similarly, the ratio of Household Credit and Banking Deposits relative to GDP increased by 1.5 percent and 4.1 percent to 19.2 percent and 40.2 percent, respectively, between 2014 and 2015. $M_2$ to GDP increased by 6.6 percent from 39.1 percent in 2014 to 45.7 percent in 2015. All these ratios were indicative of an improvement in the financial depth of the banking sector, although a rather narrow definition of financial deepening, as it does not encompass capital markets, insurance, pension and non-bank financial intermediaries.

1.19 Household deposits (retail banking deposits) to GDP declined from 9.3 percent in 2014 to 8.9 percent in 2015 following a relatively low growth rate in household savings (0.32 percent) compared to the 4.6 percent increase in nominal GDP. Similarly, Banking Credit relative to GDP recorded a marginal increase (0.7 percent) to 32.4 percent as at December 31, 2015 (December 2014: 31.7 percent).

1.20 Liquidity preference as measured by Cash[6] to $M_2$[7] ratio declined from 27 percent in 2014 to 21 percent in 2015.

1.21 Overall, compared to developed economies where banking services account for very high proportions of total income generated in the economy (with ratios in excess of 100 percent), the banking sector in Botswana remained relatively small vis-a-vis the size of the economy.

[6] Coins and notes in circulation and other money equivalents that are easily convertible into cash.
[7] $M_2$ (P68.1 billion) comprises all liabilities of financial corporations included in a country's definition of broad money. In the case of Botswana, $M_2$ comprises currency outside depository corporations, transferable deposits (demand deposits) and other deposits included in broad money (time and fixed deposits).

# CHAPTER 2

## PERFORMANCE OF REGULATED FINANCIAL INSTITUTIONS

# CHAPTER **2**:

## PERFORMANCE OF REGULATED FINANCIAL INSTITUTIONS

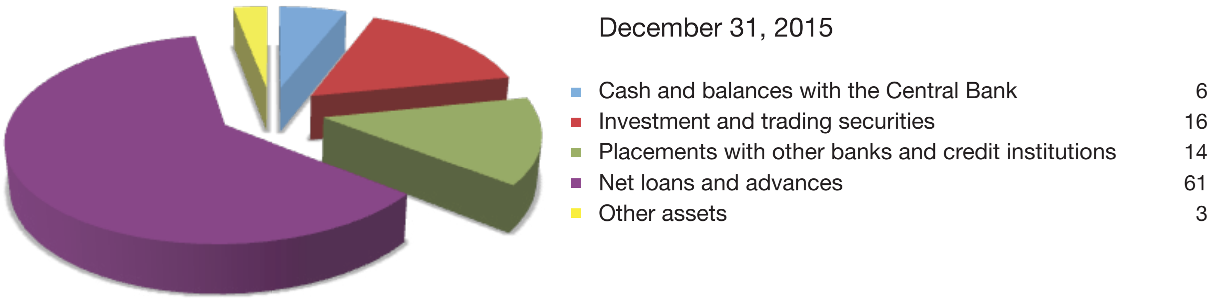
### COMMERCIAL BANKS

### STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

2.1 The aggregate commercial bank statement of financial position grew by 12.7 percent from P68 billion in 2014 to P76.6 billion in 2015. The growth rate was lower than that for 2014 at 13.4 percent. The main contributor to the asset growth was holdings of Bank of Botswana Certificates (BoBCs), which almost doubled in size to P8.2 billion. All banks had an increase in their asset base. On the liabilities side, total deposits, share capital and debt securities experienced significant growth.

2.2 Charts 2.1 and 2.2 show the composition of assets and liabilities for 2014 and 2015, respectively, while Charts 2.3 and 2.4 show the level of total assets, total deposits and total loans and advances, as well as their growth rates for the period 2011 - 2015.

Chart 2.1: Commercial Banks: Composition of Assets, 2014 - 2015 (Percent)



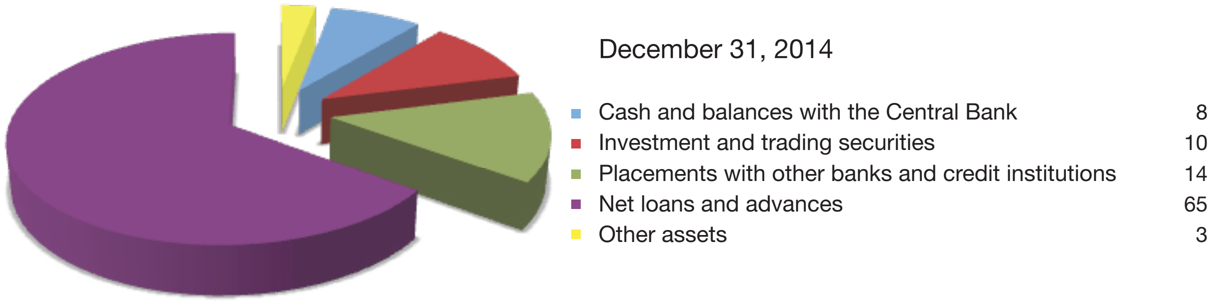
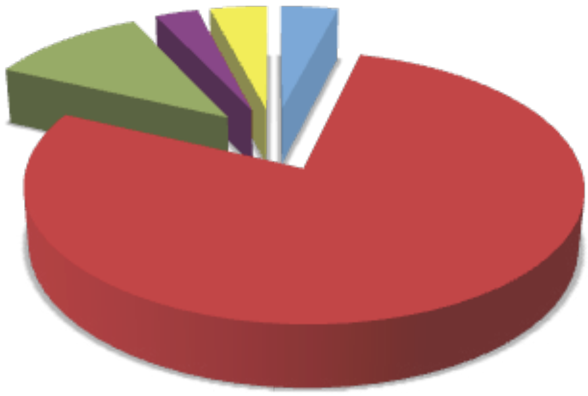
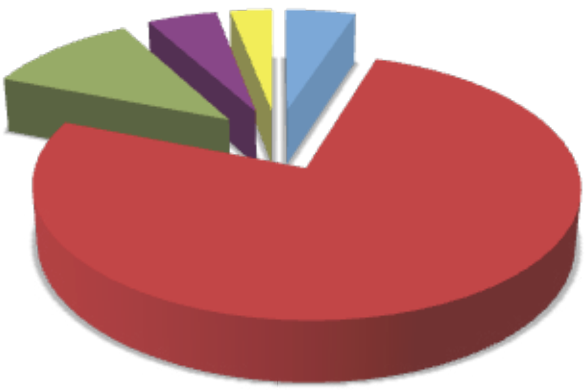



Chart 2.2: Commercial Banks: Composition of Liabilities, 2014 - 2015 (Percent)



December 31, 2015

| | |
|---|---|
| Due to other banks and credit institutions | 4 |
| Customer deposits | 78 |
| Shareholders' funds | 11 |
| Other liabilities | 3 |
| Debt securities and other borrowing | 4 |



December 31, 2014

| | |
|---|---|
| Due to other banks and credit institutions | 5 |
| Customer deposits | 76 |
| Shareholders' funds | 11 |
| Other liabilities | 5 |
| Debt securities and other borrowing | 3 |

Chart 2.3: Commercial Banks: Total Assets, Total Loans and Advances and Total Deposits, 2011 - 2015

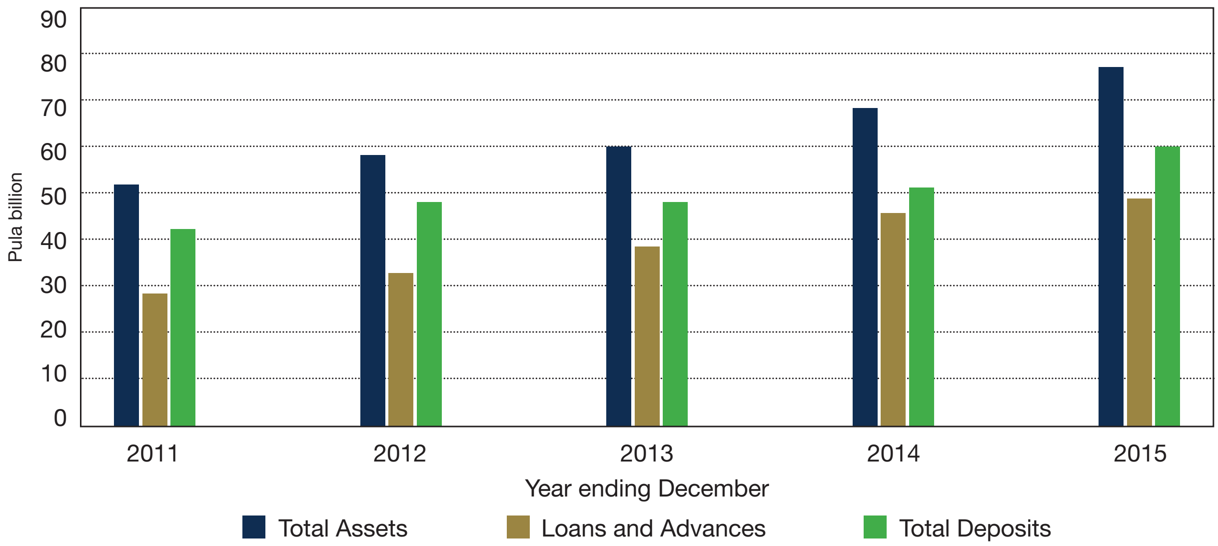
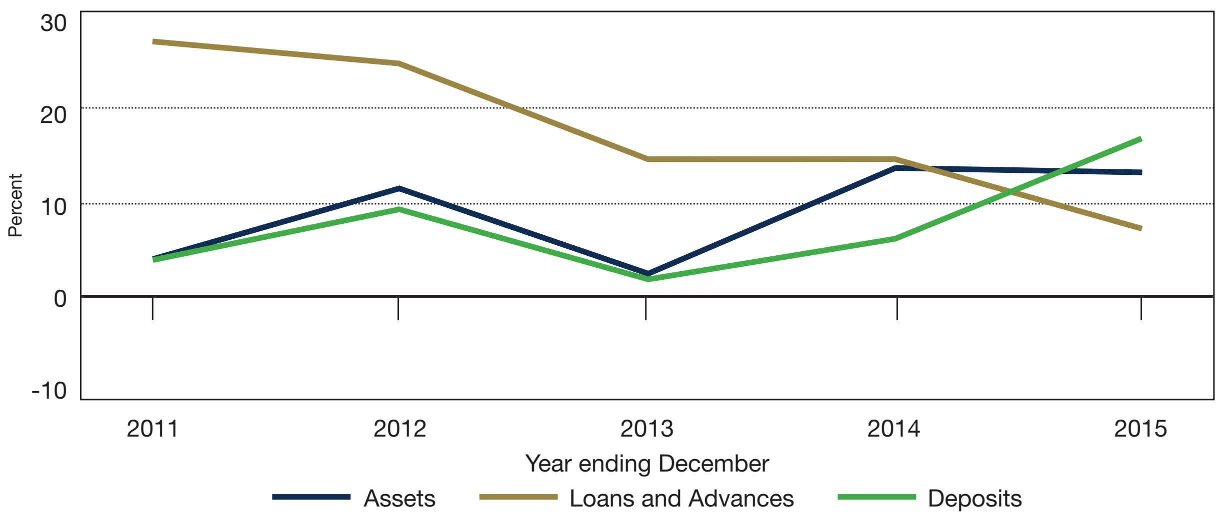



Chart 2.4: Commercial Banks: Annual Growth Rates of Total Assets, Total Loans and Advances and Total Deposits (Percent), 2011 - 2015

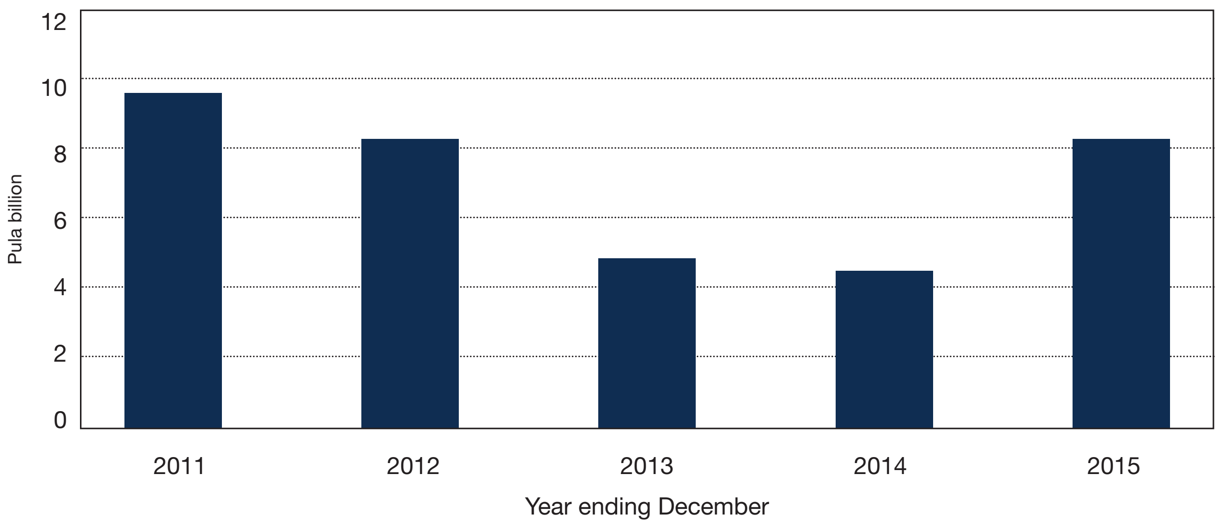



## LIQUID ASSETS, LIQUIDITY AND MARKET RISK

2.3 The banks' aggregate cash and balances with the Bank decreased (27.4 percent) from P5.8 billion in 2014 to P4.5 billion in 2015. This was mainly because of the reduction in the Primary Reserve Requirement (PRR) in April 2015 from 10 percent to 5 percent. In the event, commercial banks' placements with other banks and credit institutions increased by 9.3 percent to P10.5 billion in 2015 (December 2014: 50.3 percent increase to P9.6 billion). The banks have since scaled down on placements in response to the Basel II requirements for these assets. Under Basel II, the risk weights on bank placements with foreign banks are determined by the foreign banks' country sovereign ratings and risks. This could result in higher risk weights for placements in countries that have unfavourable sovereign credit ratings.

2.4 Funds released into the banking sector as a result of the reduction of the PRR from 10 percent to 5 percent were partly held in liquid form, which included holdings of BoBCs. BoBC holdings had been trending downwards since 2011; as shown in Chart 2.5. However, the trend was reversed in 2015. Overall, total liquid assets held by the banking sector increased to P11.8 billion as at December 31, 2015 (December 2014: P7.4 billion).

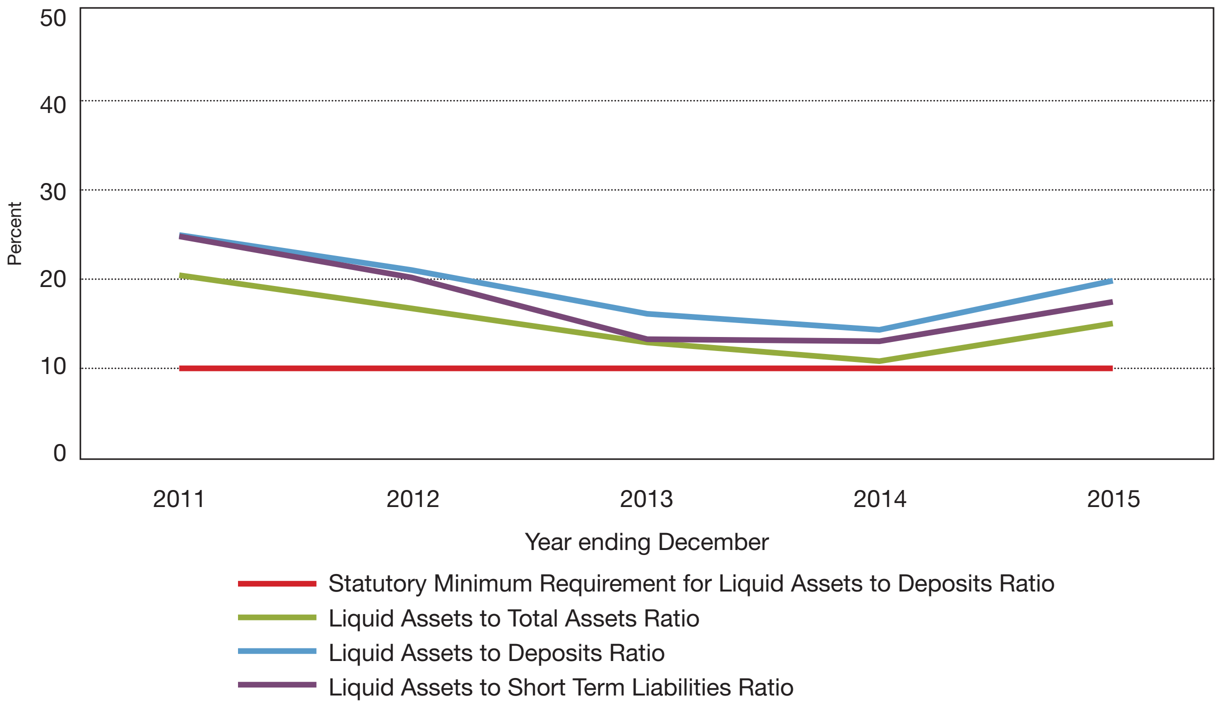
Chart 2.5: Commercial Banks: Market Value of Outstanding BoBC Holdings (P' billion)




## LIQUIDITY RISK

2.5 The substantial increase in liquid assets translated into improved market liquidity and liquidity ratios. As a result, the banking sector's Liquid Assets to Total Deposit Ratio increased from 14.5 percent in December 2014 to 19.7 percent in December 2015, which is substantially above the 10 percent minimum statutory requirement. Similarly, Liquid Assets to Total Assets Ratio increased from 10.9 percent in December 2014 to 15.4 percent in December 2015 (Chart 2.6).

Chart 2.6: Commercial Banks: Liquidity Ratio, 2011 - 2015




## MARKET RISK

2.6 In 2015, all banks complied with the Foreign Currency Exposure Directive No. BoBA 1/99, by maintaining the Foreign Exchange Currency Exposure to Unimpaired Capital Ratios below the required 15 percent, 5 percent and 30 percent limits[8] for major, minor and overall currency exposure, respectively. While it is acknowledged that market risk has other components, such as equity, interest rate and commodity risk, these other components are insignificant in the Botswana context.

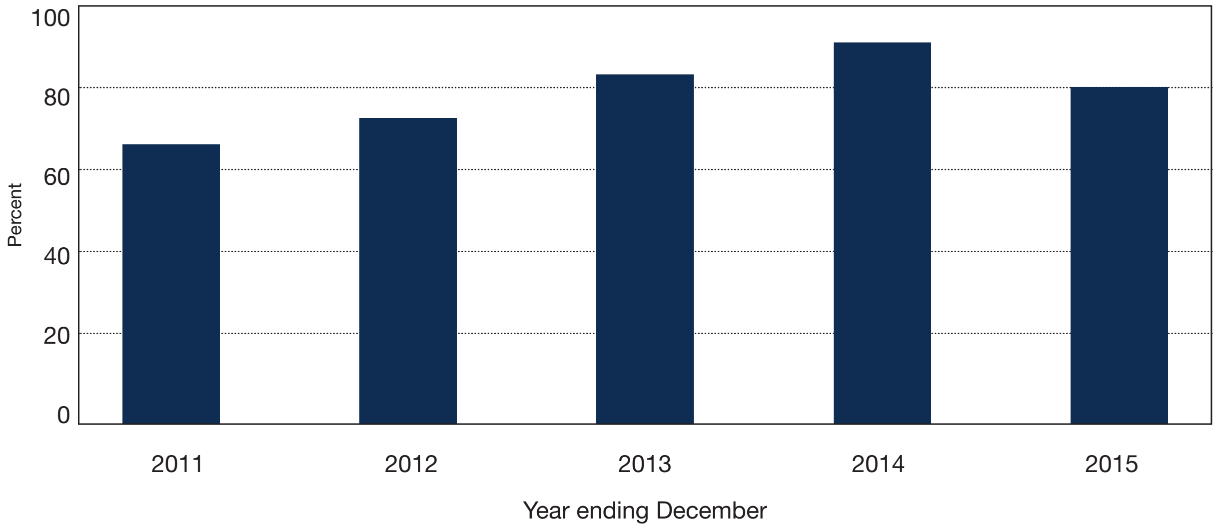
## LOANS AND ADVANCES, CREDIT RISK AND ASSET QUALITY

2.7 The growth rate of gross loans and advances decreased from 14.2 percent in 2014 to 7.1 percent in 2015. In absolute terms, gross loans and advances amounted to P48.3 billion in December 2015, compared to P45.1 billion in 2014. The slow credit growth rate in 2015 resulted from a combination of factors, including commercial banks' adoption of a more cautious approach to lending in the context of lower business confidence, higher cost of funds and reduced market liquidity in early 2015.

## ASSET QUALITY: LEVELS AND TRENDS

2.8 The financial intermediation ratio (Loans to Deposits Ratio) decreased from 87.6 percent to 80.6 percent in December 2015 (Chart 2.7). This ratio was marginally above the upper end of the recommended prudential range of 50-80 percent for the Botswana banking sector. Two banks had intermediation ratios above 80 percent, thus signifying potential liquidity problems in the event that other forms of funding are unavailable.

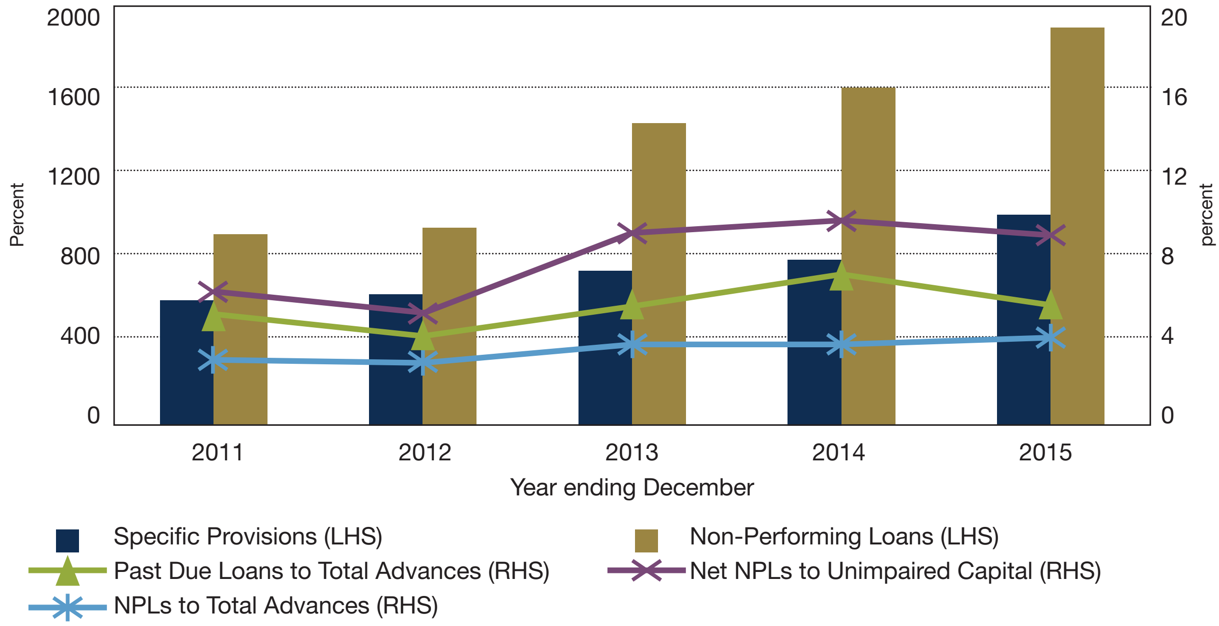
Chart 2.7: Commercial Banks: Loans and Advances to Deposits Ratio (Financial Intermediation)




2.9 Total past due loans (i.e. loans tainted by arrears) decreased (16.2 percent) to P2.7 billion in December 2015 (December 2014: P3.2 billion), while NPLs (i.e. impaired loans) increased by 18.1 percent to P1.9 billion. The increase in NPLs was due to business closures and consequent job losses in the mining (copper) and manufacturing sectors (notably the diamond sight holders). The household sector accounted for 52 percent of total NPLs as at December 31, 2015 (December 2014: 51.3 percent). The NPLs to Total Loans and Advances ratio increased marginally from 3.6 percent in December 31, 2014 to 3.9 percent in December 2015. The ratios differed considerably among individual banks, ranging from 1.2 percent to 8.4 percent. The banking sector's specific provisions grew to P1 billion as at December 31, 2015 (December 2014: P771 million), and covered 53.2 percent of NPLs as at December 31, 2015. Furthermore, the ratio of NPLs (net of specific provisions) to Unimpaired Capital decreased marginally to 9 percent as at December 31, 2015 (December 2014: 10 percent). However, the credit risk mitigation measures that banks have in place are expected to absorb any residual credit risk. Chart 2.8 shows trends in commercial bank asset quality indicators for the period 2011 - 2015.

[8] The 15 percent and 5 percent limits are for individual major (ZAR, USD, UK, Euro) and minor currency exposure, respectively.

Chart 2.8: Commercial Banks: Asset Quality Indicators, 2011 - 2015




## CREDIT CONCENTRATION RISK

## SECTORAL DISTRIBUTION OF COMMERCIAL BANKS' LOANS AND ADVANCES

2.10 Chart 2.9 compares the sectoral distribution of loans and advances between 2014 and 2015. Household loans and advances increased (13.4 percent) to P28.7 billion and accounted for the largest share of loans and advances (59.3 percent). Private sector enterprises loans and advances also increased (13.5 percent) to P18.4 billion and accounted for 38 percent of total loans and advances. The increase was driven mainly by more credit facilities granted to the sectors of Mining and Quarry, Tourism and Hotels, Commercial Real Estate, Agriculture, Forestry and Fishing (Chart 2.10).

Chart 2.9: Sectoral Distribution of Loans and Advances: 2014 - 2015 (Percent)


December 31, 2015

| | |
|---|---|
| Private Sector Enterprises | 38 |
| Public Sector Enterprises | 3 |
| Household Sector | 59 |

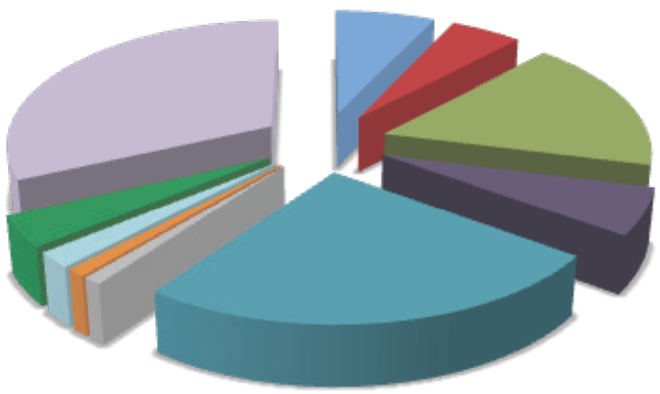

December 31, 2014

| | |
|---|---|
| Private Sector Enterprises | 36 |
| Public Sector Enterprises | 8 |
| Household Sector | 56 |

### THE STRUCTURE OF PRIVATE SECTOR ENTERPRISE LOANS AND ADVANCES

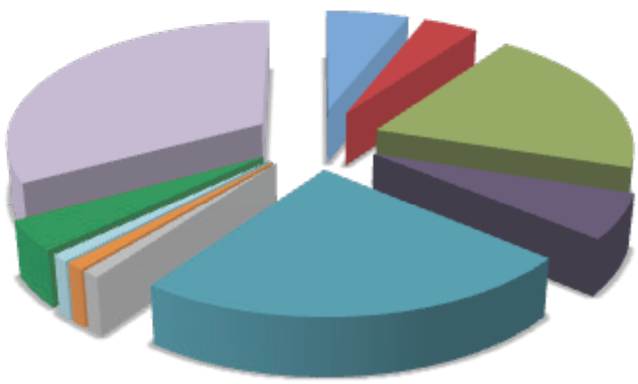
2.11 The market share of four of the ten sectors (Commercial Real Estate, Mining and Quarrying, Tourism and Hotels, Agriculture, Forestry and Fishing) improved slightly by between one and two percent in 2015 (Chart 2.10). Loans to the Manufacturing sector declined by three percent; Trade, Restaurants and Bars declined by one percent, while the other sectors remained constant.

Chart 2.10: Distribution of Private Sector Enterprise Loans: 2014 - 2015 (Percent)



December 31, 2015

| | |
|---|---|
| Agriculture, Forestry and Fishing | 7 |
| Mining and Quarrying | 5 |
| Manufacturing | 17 |
| Construction | 6 |
| Commercial Real Estate | 25 |
| Electricity | 1 |
| Telecommunications | 1 |
| Tourism & Hotels | 2 |
| Transport | 4 |
| Trade, Restaurants and Bars | 32 |



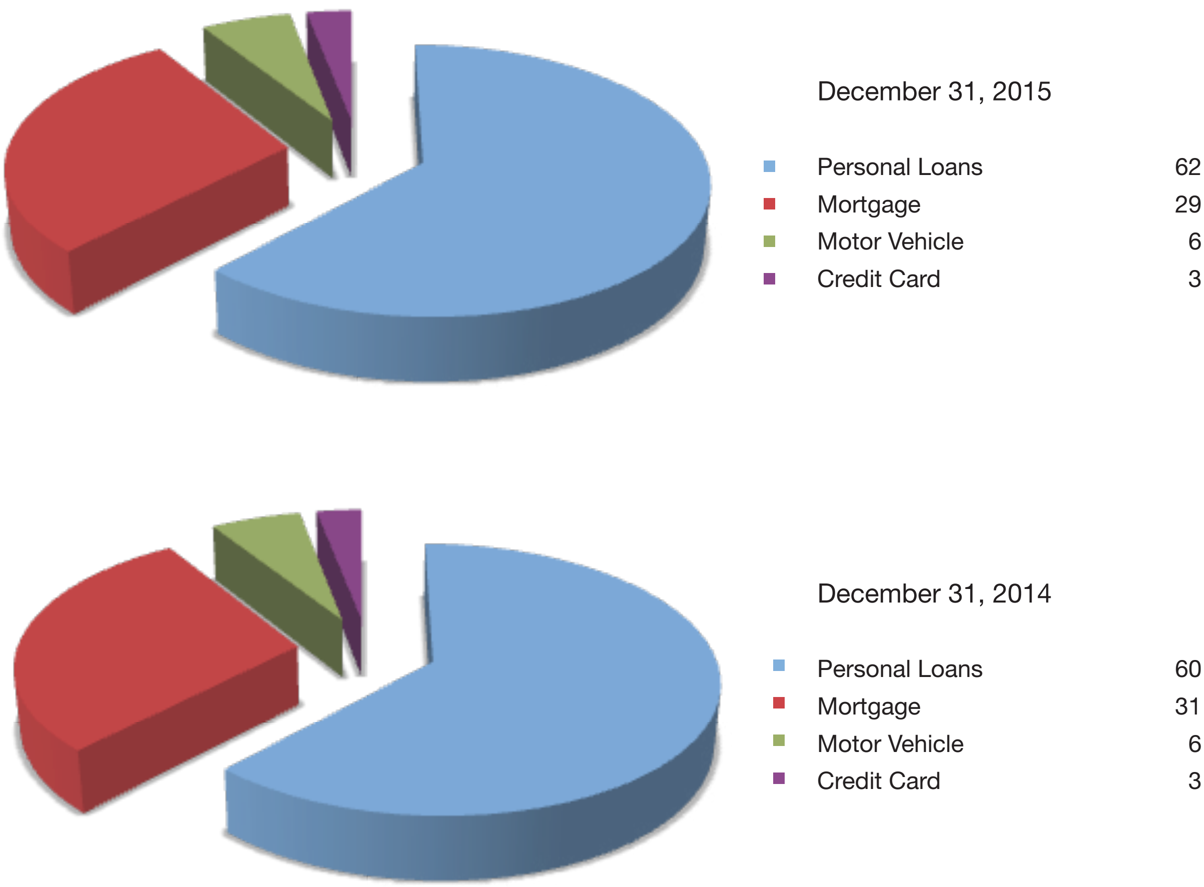
December 31, 2014

| | |
|---|---|
| Agriculture, Forestry and Fishing | 6 |
| Mining and Quarrying | 4 |
| Manufacturing | 20 |
| Construction | 6 |
| Commercial Real Estate | 24 |
| Electricity | 1 |
| Telecommunications | 1 |
| Tourism & Hotels | 1 |
| Transport | 4 |
| Trade, Restaurants and Bars | 33 |

### THE COMPOSITION OF HOUSEHOLD LOANS AND ADVANCES

2.12 The composition of loans and advances to households was almost unchanged in 2015 when compared with that of 2014 (Chart 2.11). Total credit to the household sector increased from P25.2 billion in December 2014 to P28.7 billion in 2015. The growth was driven by an increase in unsecured personal loans, which constituted the largest proportion of household loans (62.1 percent). Mortgage loans increased by 7.2 percent to P8.2 billion, although its share as a proportion of total retail lending declined to 28.8 percent (December 2014: 30.5 percent). The motor vehicle and credit cards segments maintained the respective shares of 6 percent and 3 percent.

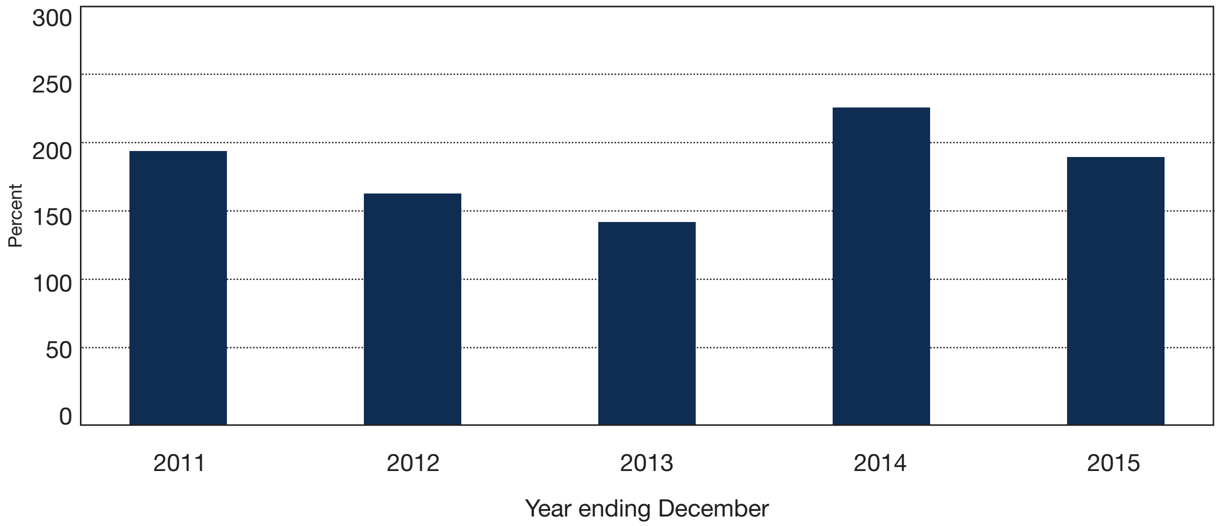
Chart 2.11: The Distribution of Household Loans and Advances (Percent)



## LARGE EXPOSURES

2.13 The ratio of commercial bank Large Exposures[9] to Unimpaired Capital decreased to 194 percent (December 2014: 230 percent) (Chart 2.12). The ratios differed considerably among individual banks, ranging from 60.8 percent to 609 percent. Large exposures declined from P19.2 billion in 2014 to P18.2 billion in December 2015, while unimpaired capital increased to P9.4 billion in December 2015 (December 2014: P8.4 billion). All banks maintained their Large Exposures to Unimpaired Capital Ratios within the recommended 800 percent prudential limit.

Chart 2.12: Commercial Banks: Large Exposures to Unimpaired Capital Ratio, 2011 - 2015



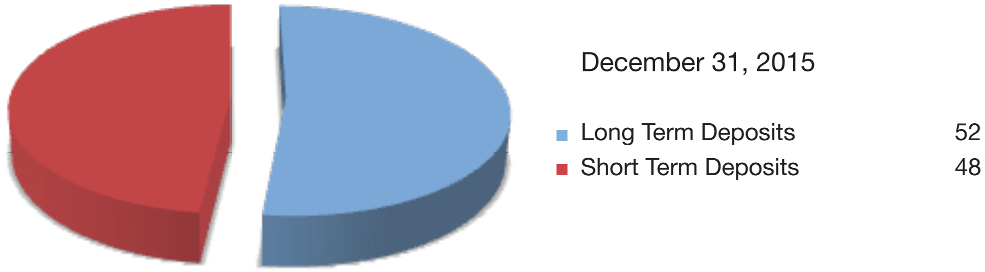

## LIABILITIES AND FUNDING STRUCTURE

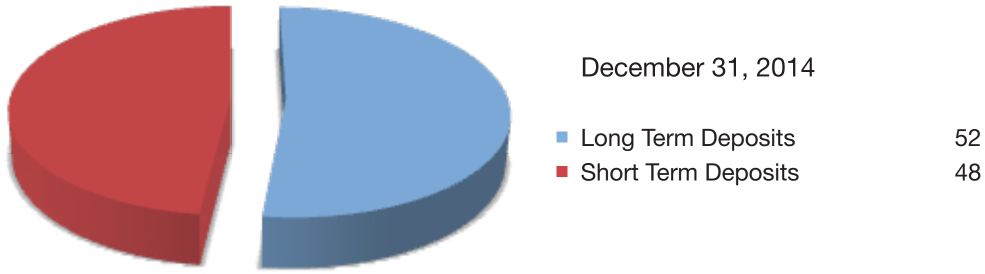
2.14 The main sources of funding (total deposits, shareholders' funds and debt securities) increased significantly in 2015. Total customer deposits increased (16.4 percent) from P51.5 billion in 2014 to P60 billion in 2015, and constituted the largest portion of liabilities and, as expected, were the primary source of finance for asset growth and other aspects of the banks' operations (withdrawal of deposits, etc.). However, there was a decline in balances due to other banks and credit institutions, from P3.6 billion in 2014 to P3.3 billion in 2015, as banks intensified the mobilisation of funding from alternative sources of borrowing, including debt securities.

2.15 The relative share of deposits by maturity was unchanged between 2014 and 2015. Long-term deposits (time and savings) remained at 52 percent and short-term deposits (call and current) at 48 percent of total deposits (Chart 2.13). The gap between the terms to maturity of the deposits was minimal, compared to prior year(s).

[9] These are loans and advances of 10 percent and above of a bank's unimpaired capital.

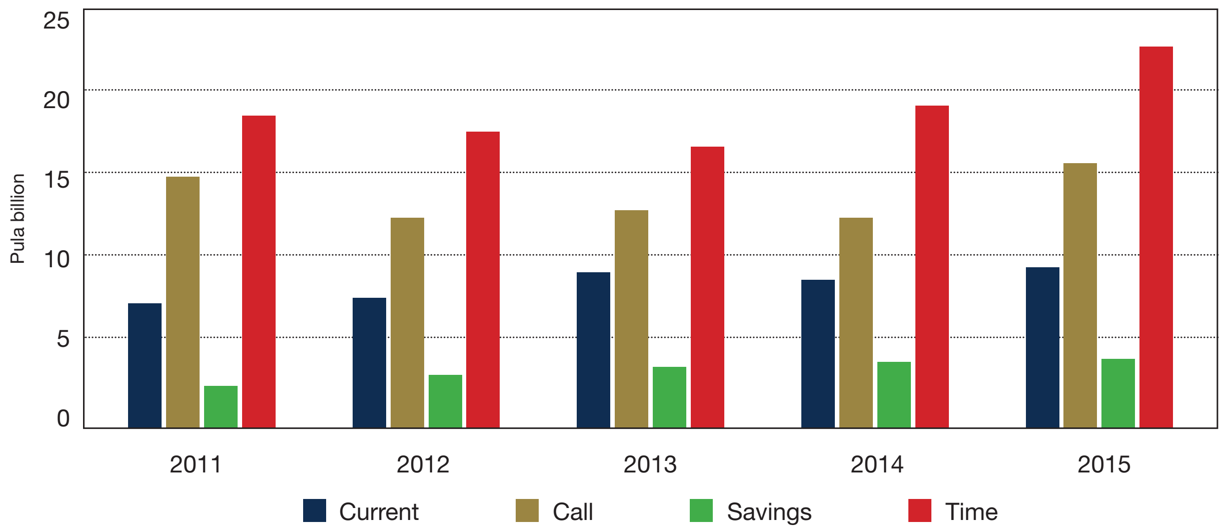
Chart 2.13: Commercial Banks: Deposits Type by Maturity (Percent)



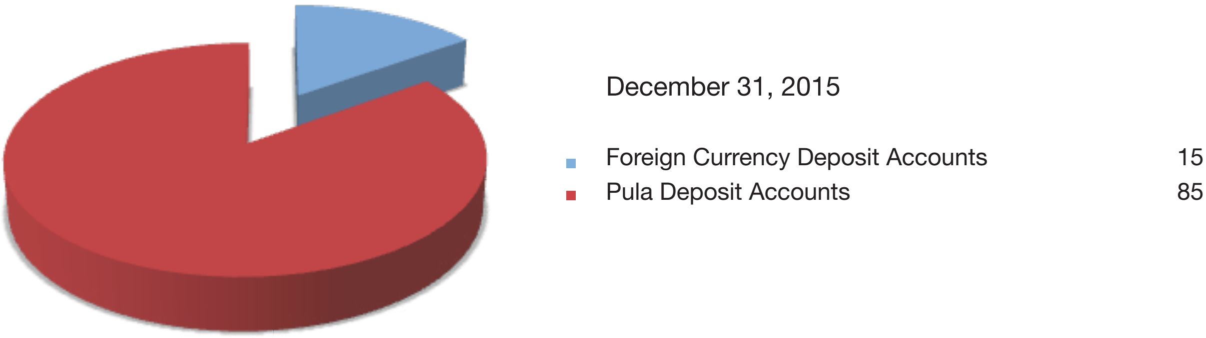

2.16 Chart 2.14 shows the value of Pula denominated deposits by type for the period 2011 to 2015. As at December 31, 2015, time deposits (fixed and notice) amounted to P22.4 billion (December 2014:P18.7 billion), and accounted for the largest proportion of total deposits (43.7 percent). The increase (19.7 percent) in time deposits was reflective of the banks' introduction of enhanced fixed deposits products. Savings deposits, which stood at P4.0 billion, constituted the smallest proportion of total deposits.

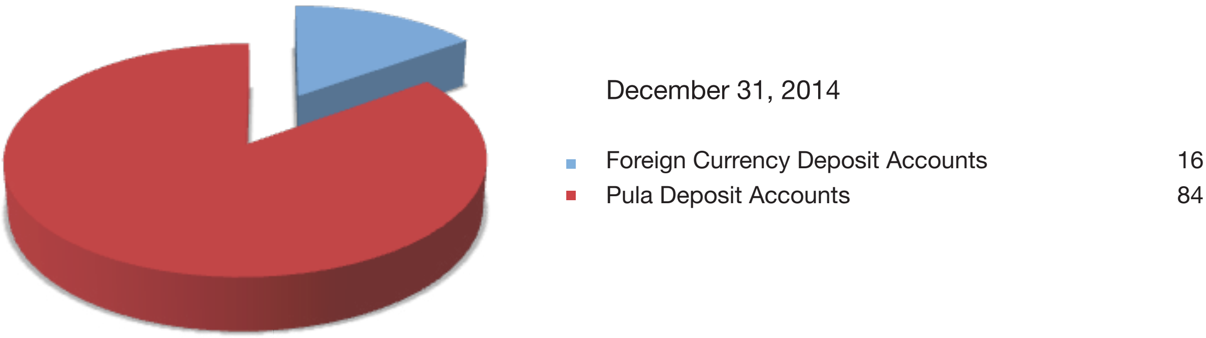
Chart 2.14: Commercial Banks: Share of Value of Pula Denominated Deposits (P' billion) by Type, 2011 - 2015



2.17 Foreign currency deposits amounted to P9 billion as at December 31, 2015 (December 2014: P8.2 billion). Chart 2.15 shows that, the proportion of foreign currency deposits to total deposits decreased slightly from 16 percent to 15 percent in December 2015. The United States dollar (USD) and the South African rand (ZAR) dominated foreign currency deposits, mainly due to the relative importance of these two currencies in the country's trade relations. However, most of the deposits (85 percent) were Pula denominated.

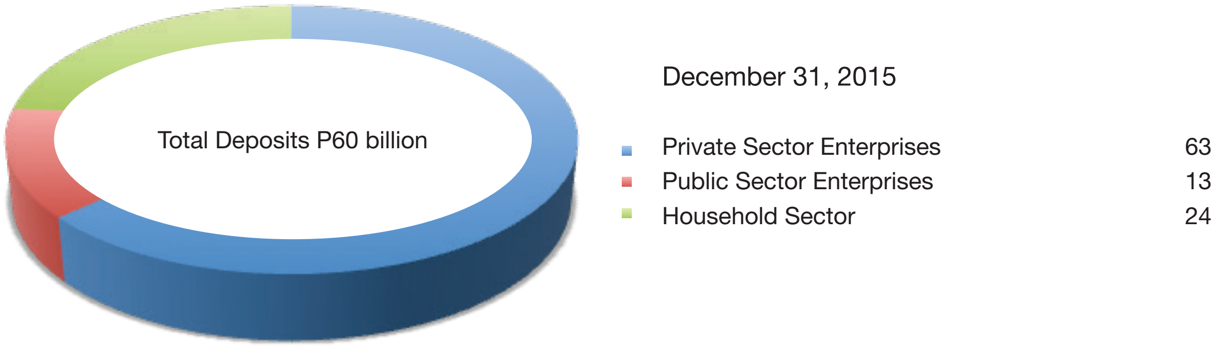
Chart 2.15: Commercial Banks: Share of Foreign Currency and Pula Denominated Deposits to Total Deposits (Percent)

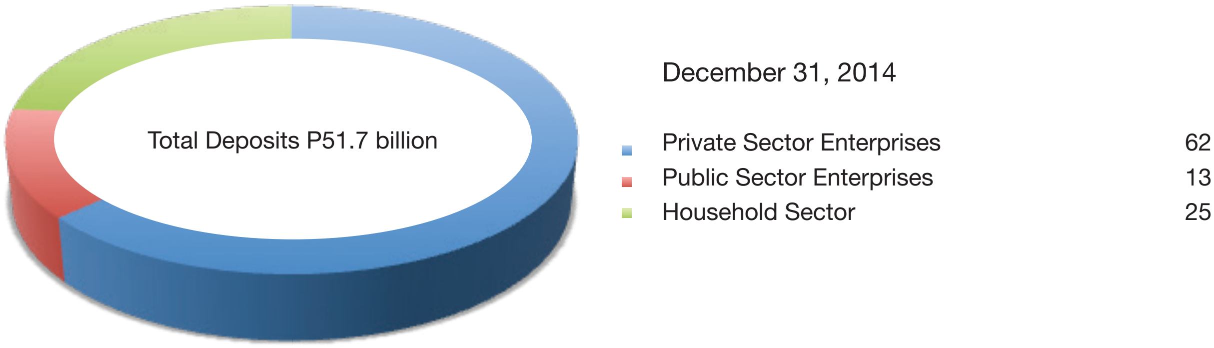



2.18 The bulk of deposits were mainly held by private sector enterprises (63 percent) in December 2015. The share of deposits for the household sector decreased marginally from 25 percent (December 2014) to 24 percent in December 2015, while the public sector's deposits remained unchanged at 13 percent. Total large deposits, which amounted to P24.6 billion, constituted 41 percent of total deposits in 2015 compared to 40 percent in 2014. Chart 2.16 shows the sectoral distribution of deposits in 2014 and 2015, respectively.

Chart 2.16: Commercial Banks: Sectoral Distribution of Deposits: 2014 - 2015 (Percent)




2.19 Other sources of funding (share capital, balances due to other banks, debt securities and other borrowings) comprised 10.7 percent, 4.3 percent and 4.1 percent of total funding, respectively, in 2015. Table 2.1 shows the sources of funding for the banking sector from 2011 to 2015.

Table 2.1: Main Sources of Funding (Pula Million)

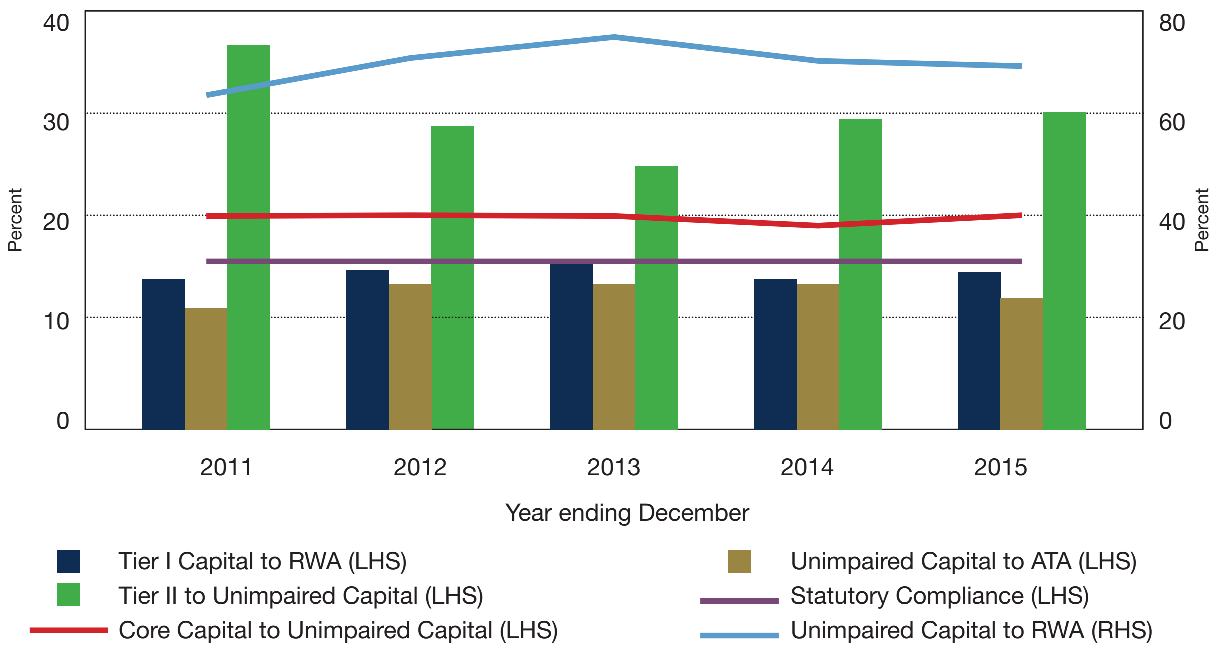
| CATEGORY (PERCENT) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Deposits | 43 178 | 47 219 | 48 589 | 51 492 | 59 940 |
| Growth Rate | 3.7 | 9.4 | 2.9 | 6.0 | 16.4 |
| Share of Total Funding | 83.7 | 81.5 | 81.0 | 75.7 | 78.2 |
| Other Liabilities | 1 827 | 2 925 | 1 207 | 3 109 | 1 997 |
| Growth Rate | (7.6) | 60.1 | (58.9) | 157.8 | (35.5) |
| Share of Total Funding | 3.5 | 5.0 | 2.0 | 4.6 | 2.6 |
| Share Capital | 4 696 | 5 548 | 6 479 | 7 724 | 8 195 |
| Growth Rate | 15.4 | 18.1 | 16.8 | 19.2 | 6.1 |
| Share of Total Funding | 9.1 | 9.6 | 10.8 | 11.4 | 10.7 |
| Due to other Banks | 990 | 1 320 | 1 394 | 3 581 | 3 308 |
| Growth Rate | 115.4 | 33.3 | 5.6 | 157.0 | (7.6) |
| Share of Total Funding | 1.9 | 2.3 | 2.3 | 5.3 | 4.3 |
| Debt Securities and Other Borrowings | 908 | 942 | 2 292 | 2 088 | 3 163 |
| Growth Rate | (37.7) | 3.7 | 143.5 | (8.9) | 51.5 |
| Share of Total Funding | 1.8 | 1.6 | 3.8 | 3.1 | 4.1 |
| **Total Funding** | **51 600** | **57 954** | **59 962** | **67 994** | **76 605** |

## CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

2.20 The commercial banks' unimpaired capital increased (12.5 percent) to P9.4 billion in December 2015. Consequently, the ratio of Unimpaired Capital to Risk-Weighted Assets increased to 20.2 percent in December 2015 (December 2014: 18.9 percent). On the other hand, the ratio of Core Capital to Total Capital was almost unchanged at 70.3 percent, as at December 31, 2015, thus signifying a good level and quality of capital for commercial banks. All commercial banks were adequately capitalised during the period under review, with Capital Adequacy and Core Capital Ratios exceeding the minimum prudential and statutory requirements of 15 percent and 50 percent, respectively.

2.21 Some commercial banks issued new subordinated debt instruments that would qualify for inclusion as Tier II regulatory capital under Basel II. Consequently, subordinated debt increased (52.1 percent) from P1 billion to P1.6 billion as at December 31, 2015. The proportion of subordinated debt to Tier II capital was 56.4 percent in December 2015. Furthermore, the proportion of subordinated debt to unimpaired capital increased (12.4 percent) to 16.8 percent in 2015. Chart 2.17 shows the capital adequacy ratios over the five year period (2011-2015).

Chart 2.17: Commercial Banks: Capital Ratios, 2011 - 2015



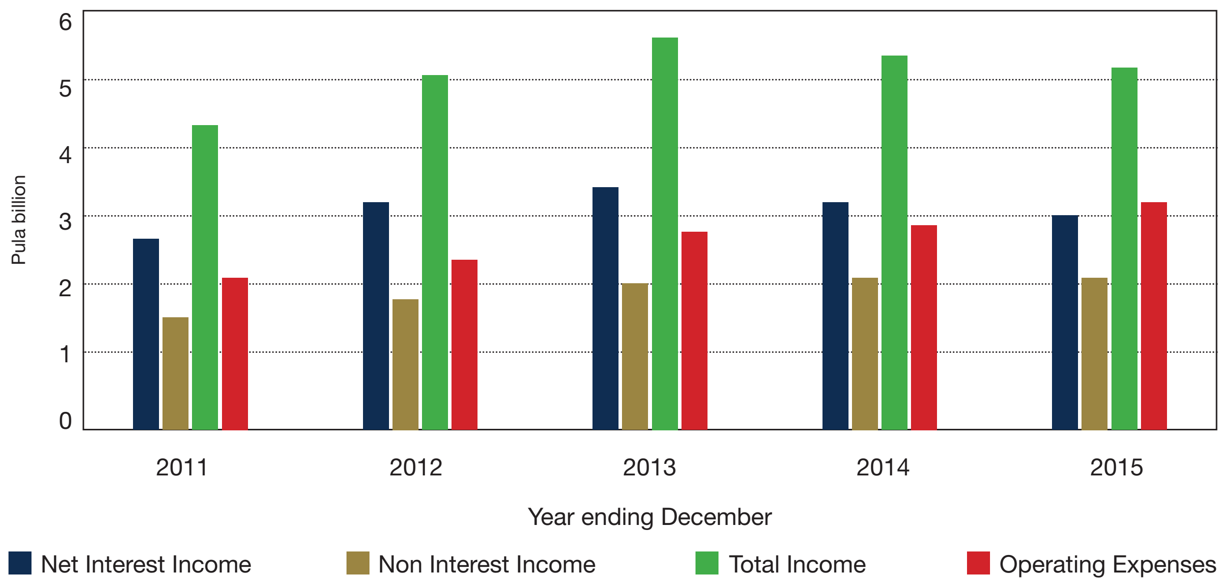

2.22 Overall, in 2015, commercial banks maintained strong balance sheets, characterised by healthy liquidity positions, strong capital levels and good quality of banking assets as well as prudent lending.

## COMPOSITION OF THE STATEMENT OF COMPREHENSIVE INCOME (COMMERCIAL BANKS INCOME STATEMENT)

2.23 Total income for commercial banks (net-interest income and non-interest income) decreased by 1.6 percent, from P5.4 billion to P5.3 billion in December 2015. Net interest income declined by 7.6 percent from P3.3 billion to P3 billion. The decline in net interest income was caused by a combination of a cumulative 150 basis points reduction in the Bank Rate, and increased interest expenses from P1.7 billion to P2.1 billion owing to aggressive competition for deposits as the industry experienced some liquidity pressure during the year. However, non-interest income grew by 5.3 percent from P2.2 billion to P2.3 billion in December 2015 due to fees/charges levied on new banking services and products, as well as foreign exchange fees and commission. Consequently, the share of non-interest income to total income increased to 42.7 percent in December 2015 (December 2014: 39.6 percent), while the ratio of Net Interest Income to Total Income decreased from 60.4 percent in December 2014 to 57.3 percent in December 2015.

2.24 Operating expenses have been on a five-year upward trend for several reasons, including increased rental costs (4 percent) and depreciation (8.9 percent). Total operating expenses increased (16.7 percent) to P3.2 billion in December 2015. The slow growth in income, combined with increasing operating expenses, led to a higher Cost to Income Ratio of 61.2 percent in December 2015 (December 2014: 51.2 percent), which fell outside the international norm for retail banks of 55 - 60 percent range. Chart 2.18 shows the trends and composition of income and expenses for commercial banks for the period 2011 - 2015.

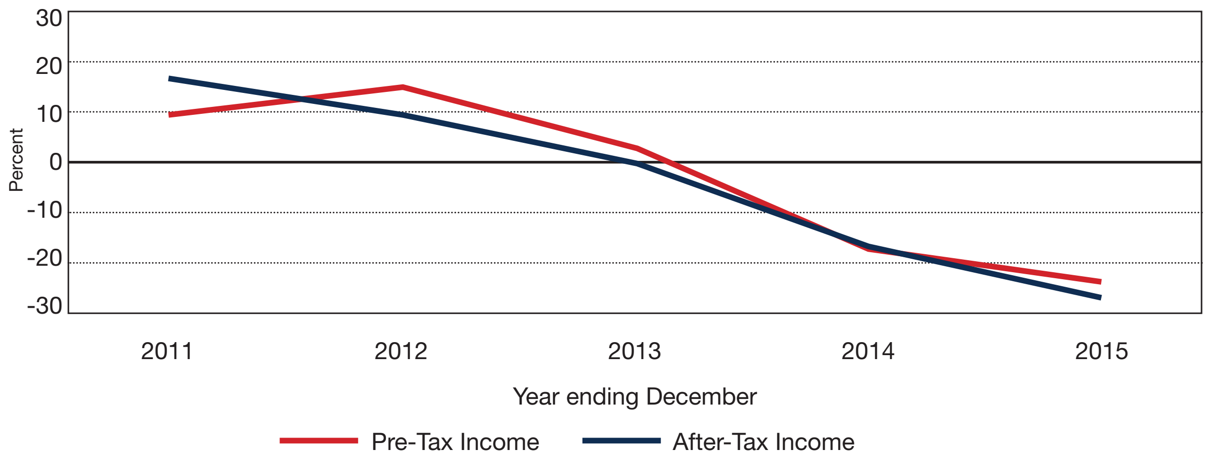
Chart 2.18: Commercial Banks: Composition of Income and Expenses, 2011 - 2015




## LEVELS, SOURCES AND TRENDS OF PROFITABILITY

2.25 Most banks, with the exception of two banks, reported net profit for the period ended December 31, 2015. The banking sector net income after tax continued its downward trend and decreased by 26.4 percent from P1.5 billion to P1.1 billion in 2015. The decrease in profitability was due to the squeeze in margins, an increase in provisions for impaired assets and an increase in operating expenses. Chart 2.19 shows commercial banks' pre-tax and after-tax profit growth rates.

Chart 2.19: Commercial Banks: Growth Rates of Pre-Tax and After-Tax Profits, 2011 - 2015

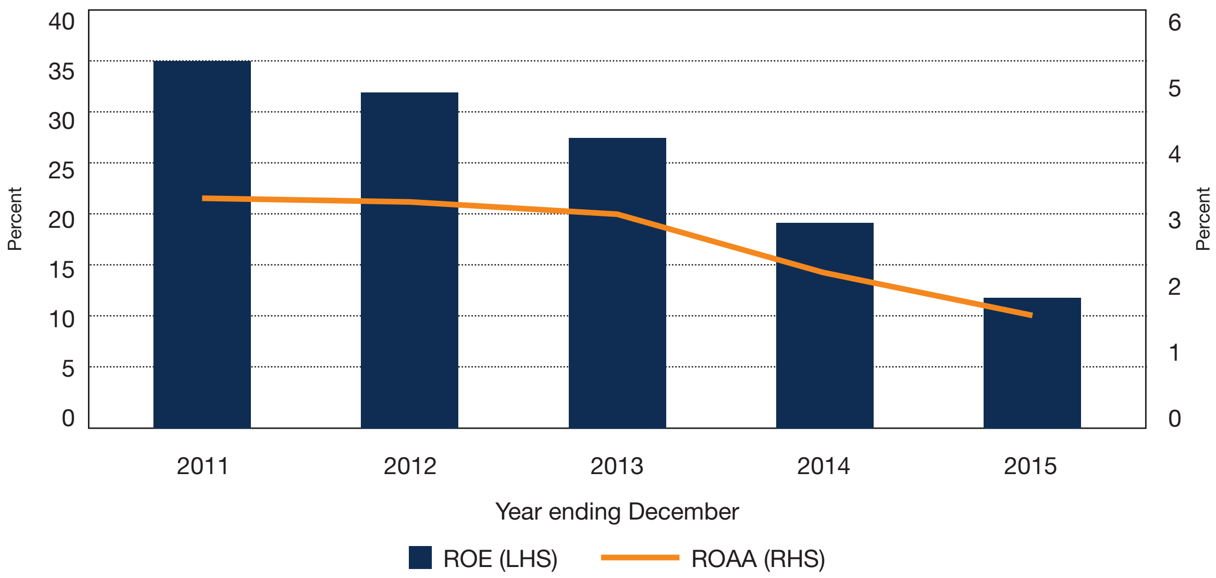


## PROFITABILITY AND OPERATING EFFICIENCY INDICATORS

### PROFITABILITY INDICATORS

2.26 As a result of the decrease in overall commercial banks profitability, key profitability indicators continued to decline (Chart 2.20). Return on Equity (ROE) decreased from 19.1 percent in December 2014 to 13.3 percent in 2015, while the Return on Average Assets (ROAA) declined from 2.3 percent to 1.5 percent. These ratios were below those of commercial banks of similar size in the region which recorded an average of 19.6 percent (ROE) and 2.6 percent (ROAA).

Chart 2.20: Commercial Banks: Profitability Indicators for Commercial Banks, 2011 - 2015




2.27 The ratio of Net Interest Income to Average Total Assets (ATA) decreased from 5.1 percent to 4.2 percent in December 2015, thus reflecting the banking sector's continued decline in efficiency in the employment of income generating assets (Table 2.2).

Table 2.2: Financial Performance Ratios (Percent)

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Income on Investments and Securities to Total Income | 21.8 | 8.3 | 11.3 | 4.5 | 4.3 |
| Non-Interest Income to Total Income | 37.3 | 35.1 | 36.4 | 39.6 | 42.7 |
| Net Interest Income to Total Income | 62.7 | 64.9 | 63.6 | 60.4 | 57.3 |
| Return on Equity (ROE) | 35.2 | 31.9 | 27.4 | 19.1 | 13.3 |
| Return on Average Assets | 3.3 | 3.2 | 3.0 | 2.3 | 1.5 |
| Net Interest Income to Average Total Assets | 5.4 | 6.0 | 6.0 | 5.1 | 4.2 |
| Interest Income to Average Earnings Assets | 11.5 | 11.9 | 11.8 | 8.8 | 7.9 |
| Non-Interest Income to Average Total Assets | 3.2 | 3.2 | 3.4 | 3.4 | 3.1 |
| Interest Expense to Average Total Assets | 3.3 | 2.7 | 2.7 | 2.6 | 2.9 |
| Earnings Retention | 48.0 | 90.8 | 69.9 | 70.1 | 37.6 |
| Interest Income on Loans to Average Total Assets | 6.6 | 7.5 | 7.7 | 6.9 | 6.3 |
| Non-Interest Expense to Average Total Assets | 4.1 | 4.3 | 4.6 | 4.3 | 4.5 |
| Gross Interest Income to Average Total Assets | 8.7 | 8.7 | 8.7 | 7.7 | 7.1 |

## OPERATING EFFICIENCY INDICATORS

2.28 Table 2.3 shows the trend in commercial banks' efficiency measures for the period 2011 to 2015. During the period, operating efficiency trended downwards as a result of decreased profitability. Net Income per Employee declined to P0.2 million in December 2015 (December 2014: P0.3 million), while Net Income to Employee Costs decreased from 107.9 percent to 77.3 percent in 2015. Conversely, Staff Cost per Employee declined marginally from P294 400 to P289 900 in 2015 due to the decline in employment levels, which was in part due to business re-organisation.

2.29 Commercial banks' core earning capability weakened further for the third year in a row, as indicated by the narrowing of net spread from 6.2 percent in 2014 to 4 percent in 2015. The reduction in the net spread resulted from the impact of low lending rates and the increase in the cost of funding. Consequently, the banking sector net interest margin also declined to 4.7 percent in December 2015 (December 2014: 5.8 percent). On the other hand, the Average Cost of Deposits increased from 2.9 percent in 2014 to 3.1 percent in 2015, whilst the return on loans and advances decreased to 9.7 percent in December 2015 (December 2014: 10.4 percent).

Table 2.3: Commercial Banks: Other Efficiency Measures, 2011 - 2015

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Average Cost of Deposits (%) | 3.4 | 3.0 | 3.0 | 2.9 | 3.1 |
| Return on Loans and Advances (%) | 13.4 | 13.3 | 12.4 | 10.4 | 9.7 |
| Net Interest Margin (%) | 7.2 | 8.2 | 8.2 | 5.8 | 4.7 |
| Net Spread (%) | 8.3 | 8.6 | 7.9 | 6.2 | 4.0 |
| Cost to Income (%) | 47.9 | 46.7 | 48.6 | 51.2 | 61.2 |
| Net Income to Employee Costs (%) | 168.7 | 156.4 | 142.2 | 107.9 | 77.3 |
| Net Income Per Employee (P'000) | 387.0 | 404.9 | 390.4 | 317.6 | 224.0 |
| Staff Cost Per Employee (P'000) | 229.4 | 258.8 | 274.5 | 294.4 | 289.9 |
| Assets Per Employee (P'000) | 12,090 | 13,238 | 13,190 | 14,610 | 16,451 |

## OPERATIONAL RISK

2.30 A review of the banks' internal controls by external auditors highlighted incidences of internal control deficiencies, which included outstanding items in the suspense accounts, (indicating delays in reconciliations); incorrect classification of dormant accounts; and lack of updates of valuation reports for property held as collateral.

## CORPORATE GOVERNANCE

2.31 The Board and senior management of commercial banks fulfilled the requirements in terms of composition, qualifications and experience. Appointed officials were found to be "fit and proper" in accordance with the relevant legislation, guidelines and international best practice. During 2015, the Bank received 46 applications for appointment to Boards as well as senior management positions; out of these, two were rejected. Half of the appointments were Botswana citizens. Of the 44 appointments approved, two were for the position of Managing Director and one for Board Chairmanship.

## A SUMMARY OF THE ASSESSMENT OF THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS USING THE OFF-SITE SURVEILLANCE SYSTEM

2.32 The Bank's off-site surveillance system (OSS)[10] and the annual risk assessment review showed that, as at the end of 2015, commercial banks were sound and stable, with only moderate weaknesses. This is an indication that the frequency of supervisory intervention should be maintained at moderate levels during 2016. Table 2.4 shows that the overall CAMELS ratings for 2015 ranged between 1.5 and 2.5, and this indicates an overall satisfactory performance. All banks performed well with regard to capital adequacy with a rating average of 1. However, the rating for asset quality averaged 3, which implies moderate weaknesses mainly due to a marginal increase in NPLs. Similarly, the earnings performance of commercial banks ranged between 3 and 4, and this suggests a partially adequate performance, which resulted from the narrowing of margins, increased impairments and an increase in operating expenses. In contrast, there was mixed performance in liquidity indicators with ratings ranging from 1 to 3.

2.33 Commercial banks' sensitivity to market risk was adequate with an average rating of 2, which signified moderate market risk. On the basis of the foregoing, the management component was rated 3.

[10] This is a quarterly monitoring tool based on CAMELS; it rates and ranks banks using an assessment of key financial soundness indicators.

Table 2.4: Banking Sector OSS Results as at December 31, 2015

| | CAPITAL ADEQUACY | ASSET QUALITY | MANAGEMENT[11] | EARNINGS | LIQUIDITY | SENSITIVITY TO MARKET RISK | OVERALL SCORE |
|---|---|---|---|---|---|---|---|
| BANKING SECTOR AVERAGE | | | | | | | |

Meaning of the Colour Codes

| | RATING | STRONG | | ADEQUATE | | PARTIALLY ADEQUATE | | WEAK | |
|---|---|---|---|---|---|---|---|---|---|
| CAMELS | Category | Band 1 | | Band 2 | | Band 3 | | Band 4 | |
| | Sub Category | B1-Upper | B1-Lower | B2-Upper | B2-Lower | B3-Upper | B3-Lower | B4-Upper | B4-Lower |
| | Score | 1.0 | 1.5 | 2 | 2.5 | 3 | 3.5 | 4 | 4.5 |
| Risk Assessment Summary | Risk Rating | Low | | Medium | | Medium High | | High | |

[11] Management is responsible for the activities and condition of the bank, which gives rise to the ratings assigned to each of the CAMELS components. Therefore, management of a bank is rated after all the other components and, as a general rule, it cannot be assigned a rating better than that of any of the components.

## STATUTORY BANKS

### STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

2.34 The aggregate statement of financial position for the three statutory banks trended upwards, as total assets increased (12 percent) from P6.7 billion in 2014 to P7.5 billion in 2015. The asset growth was primarily funded by deposits and borrowings, which grew by 53 percent to P3.3 billion and by 10.4 percent to P2.1 billion in 2015, respectively. Credit growth for statutory banks was subdued at 5.7 percent in 2015; this was lower than that of commercial banks growth of 7.1 percent (Appendix 7, Table 3).

### LIQUID ASSETS AND LIQUIDITY RISK

2.35 The liquid assets of statutory banks increased by more than 100 percent to P1.5 billion in December 2015, most of which was held in the form of balances with domestic banks. The Liquid Assets to Customer Deposits Ratio was 45.9 percent as at December 31, 2015 (December 2014: 33.7 percent).

### LOANS AND ADVANCES, CREDIT RISK AND ASSET QUALITY

2.36 Statutory banks' gross loans and advances increased by 5.7 percent to P5.9 billion in December 2015 (December 2014: P5.6 billion). The total past due loans continued to increase and reached P1 billion as at December 31, 2015 (December 2014: P923 million) of which NPLs amounted to P372.9 million. The NPLs to Total Loans and Advances Ratio was 15 percent in 2015; it was unchanged from the prior year. Specific provisions increased by 53.3 percent to P307.1 million in 2015, and the average Specific Provisions to NPLs Ratio increased to 33.7 percent in December 2015 (December 2014: 24.5 percent). The ratio was higher for one bank while the other two banks had most of their loans secured by the property or asset being financed.

### COMPOSITION OF STATUTORY BANKS LIABILITIES AND FUNDING STRUCTURE

2.37 Two statutory banks were largely funded by customer deposits (44.5 percent) followed by borrowings (27.7 percent) and shareholders' funds (25.2 percent). However, the ratio of Loans to Deposits decreased from 175.4 percent to 128.1 percent in December 2015. The relatively high Loans to Deposit Ratio reflected the fact that statutory banks relied more on capital and other funding sources, unlike commercial banks, where lending was funded, in the main, by public deposits.

### CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

2.38 Statutory banks were adequately capitalised and complied with the minimum statutory and prudential capital adequacy requirements. Moreover, the capital was of high quality as the Core Capital to Unimpaired Capital was 92.8 percent in December 2015, and Unimpaired Capital to Risk-Weighted Assets ratio was 44.3 percent.

### STATEMENT OF COMPREHENSIVE INCOME

2.39 Net profit of statutory banks increased by 22.2 percent to P100 million (December 2014: P82 million) in the year ended December 31, 2015. Consequently, ROAA and ROE improved from 1.3 percent and 4.1 percent in 2014 to 1.4 percent and 5.1 percent in 2015, respectively. There were also gains in other profitability indicators. Table 2.5 shows key performance indicators for statutory banks during the period 2011 - 2015.

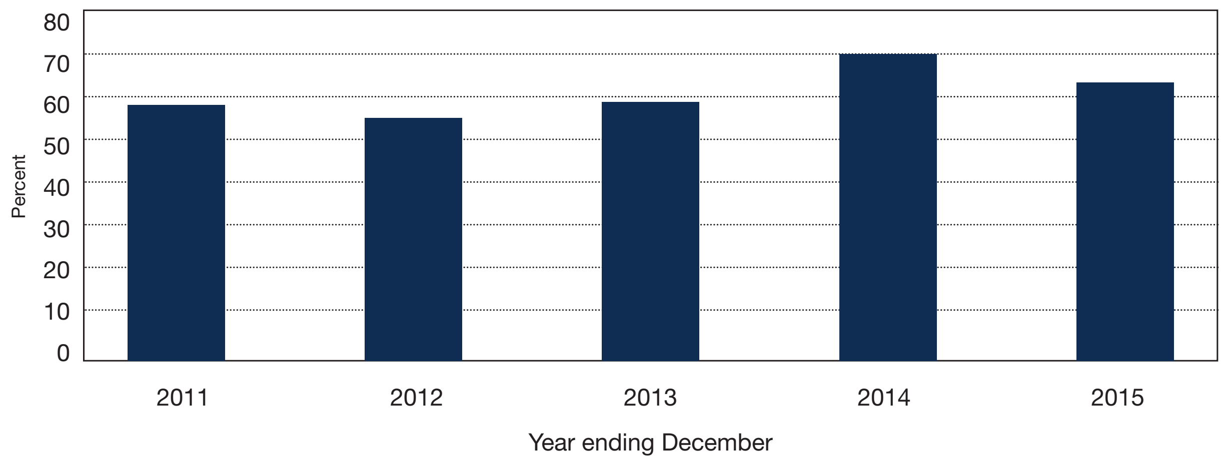
Table 2.5: Statutory Banks: Financial Performance Indicators, 2011 - 2015

| INDICATOR | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Net Income (P' million) | 86 | 121 | 121 | 82 | 100 |
| Net Income Growth (Percent) | (17.0) | 41.4 | (0.2) | (32.6) | 22.2 |
| Interest Income (P' million) | 377 | 455 | 561 | 525 | 639 |
| Net Interest Income (P' million) | 239.2 | 288.1 | 350.0 | 299.3 | 350.8 |
| Non-Interest Expense | 167 | 183 | 235 | 243 | 258 |
| Total Assets (P' million) | 4 279 | 5 099 | 5 938 | 6 689 | 7 492 |
| Average Total Assets (P' million) | 4 021 | 4689 | 5518 | 6 313 | 7 091 |
| Average Earning Assets (P' million) | 1 470 | 1 722 | 2 007 | 2 316 | 2 679 |
| Unimpaired Capital (P' million) | 1 815 | 1 634 | 1 860 | 2 012 | 1 944 |
| Risk-Weighted Assets (P' million) | 2 723 | 3 167 | 3 736 | 4 564 | 4 384 |
| Interest Income to ATA (Percent) | 9.4 | 9.7 | 10.2 | 8.3 | 9.0 |
| Interest Income to Average Earnings (Percent) | 25.6 | 26.4 | 27.9 | 22.7 | 23.8 |
| Cost to Income (Percent) | 57.8 | 54.7 | 58.6 | 70.0 | 63.1 |
| ROAA (Percent) | 2.1 | 2.6 | 2.2 | 1.3 | 1.4 |
| ROE (Percent) | 4.7 | 7.4 | 6.5 | 4.1 | 5.1 |

2.40 Despite the positive growth levels, the market share of statutory banks in terms of total assets and related components remained lower than that of the smallest commercial banks. It should also be noted that unaudited financial statements were used in respect of one statutory bank.

2.41 The Cost to Income Ratio, which had been trending upwards, declined from 70 percent in December 2014 to 63.1 percent in December 2015. This was mainly because of the increase in income. Going forward, it is likely that the Cost to Income Ratio might increase due to preparatory projects associated with the transition of these statutory banks to full-fledged commercial banks. Chart 2.21 shows the trend in the Cost to Income Ratio.

Chart 2.21: Statutory Banks: Cost to Income Ratio (Percent), 2011 - 2015



## NON-BANK FINANCIAL INSTITUTIONS

### BUREAUX DE CHANGE ACTIVITIES

### MARKET ENTRY AND EXIT

2.42 In 2015, the Bank licensed seven (7) bureaux de change; revoked four (4) licences, while two (2) licences were voluntarily surrendered. The licence revocation reasons included failure to resume operations after being granted permission to temporarily close the operations, and violations of the provisions of the Bank of Botswana (Bureaux de Change) Regulations (Regulations). Consequently, the total number of bureaux de change increased by one (1), from 56 in 2014 to 57 in 2015.

### ON-SITE EXAMINATIONS OF BUREAUX DE CHANGE

2.43 Thirteen bureaux de change were examined in 2015 for compliance with the Regulations. The on-site examinations revealed that only two bureaux de change complied with all the provisions of the Regulations, while the rest violated some provisions of the Regulations. Three bureaux were cautioned and eight were fined a total of P24 640 (VAT inclusive) for violating the regulations. The violations were as per Table 2.6.

Table 2.6: Violations of the Provisions of the Bank of Botswana (Bureaux de Change) Regulations

| REGULATION VIOLATED | DETAILS OF THE PROVISIONS OF THE REGULATIONS | NUMBER OF BUREAUX DE CHANGE |
|---|---|---|
| 5(2)(c) | Maintenance of minimum balance | 2 |
| 5(2)(e) | Effecting change in the composition of shareholders or principal officers without approval of the Bank | 2 |
| 6(d) | Failure to remain open during approved hours | 1 |
| 6(f)(i) | Failure to display operating hours of business | 1 |
| 6(f)(ii) | Failure to display buying and selling rate of the Pula against other currencies | 1 |
| 12(2)(a) | Failure to take reasonable measures to obtain information about the true identity of customer | 2 |
| 12(2)(d)(i) | Failure to identify and capture customer addresses | 4 |
| 12(2)(d)(vi) | Failure to continuously train employees on anti-money laundering measures | 4 |
| 13(1) | Exceeding daily transactional limits | 3 |
| 14(2) | Failure to keep duplicate copy of each receipt issued in the place of business | 1 |
| 15(1)(f) | Failure to maintain register for daily summary | 2 |
| 17 | Maintaining a financial year not ending 31st of March | 2 |
| 18(5) | Failure to submit auditor's report | 5 |
| 19(1) | Failure to produce share certificates during inspection by the Bank | 1 |
| 19(1) | Failure to produce bank statements during inspection by the Bank | 2 |
| 21(1) | Failure to display original licence | 1 |

## OFF-SITE SURVEILLANCE OF BUREAUX DE CHANGE

2.44 Sales and purchases of foreign currency at bureaux de change maintained an upward trend as they both increased from the 9.9 percent and 9.3 percent, respectively, reported in 2014 to 12.4 percent and 11.4 percent, respectively, in 2015 (Chart 2.22). The United States dollar (USD) and South African rand (ZAR) dominated the bureaux de change foreign exchange transactions during 2015.

Chart 2.22: Bureaux de Change: Sales and Purchases of Foreign Currency for 2015

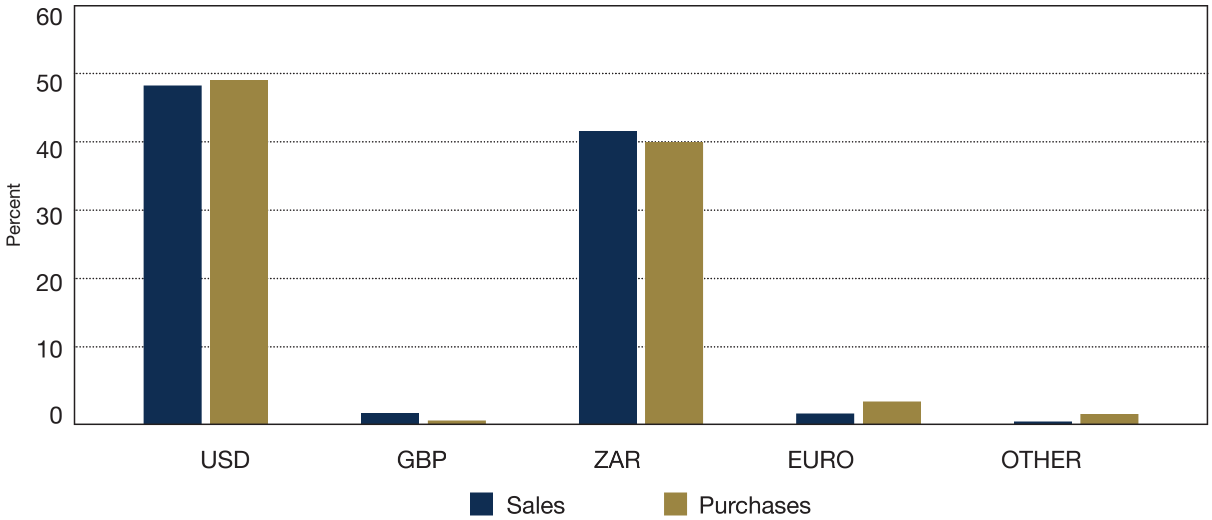



Chart 2.23: Bureaux de Change: Sales and Purchases of Foreign Currency for 2014

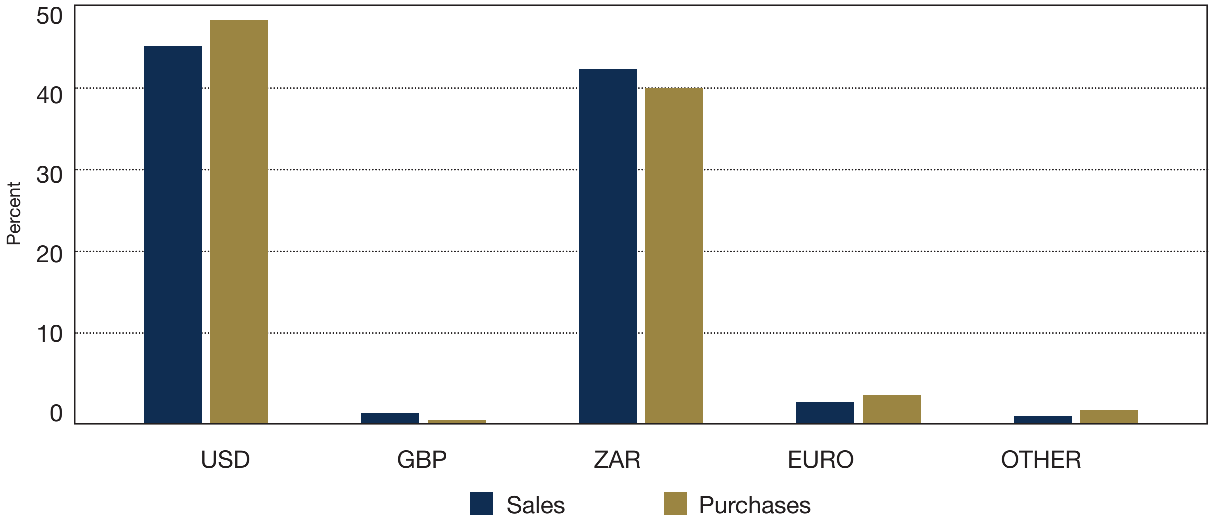
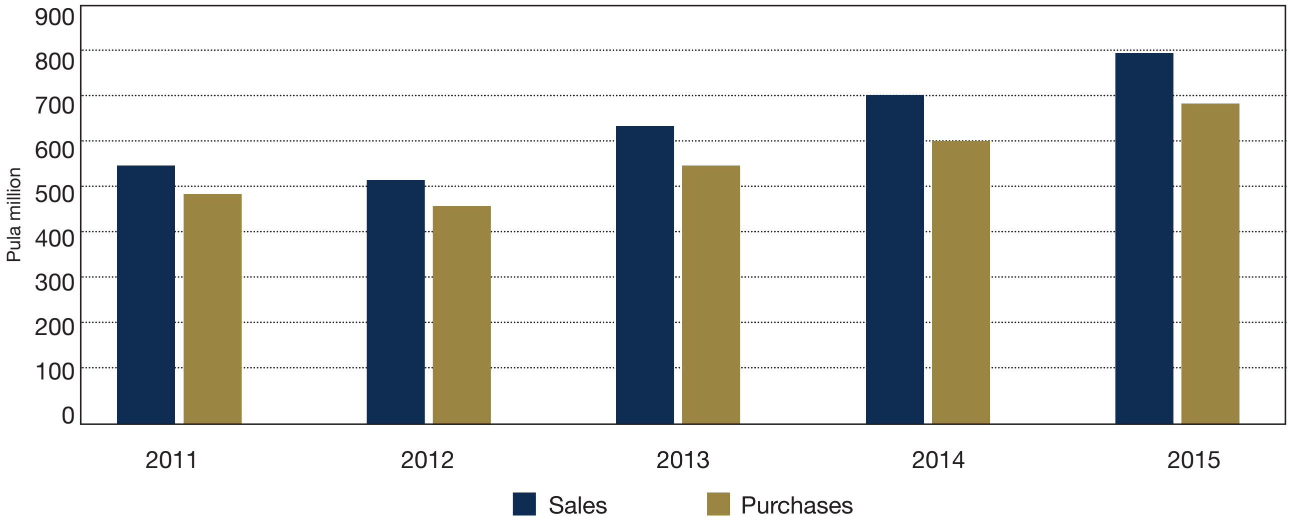


Chart 2.24: Bureaux de Change: Sales and Purchases of Foreign Currency, 2011 - 2015



# CHAPTER 3

## LICENSING, CONSUMER EDUCATION AND CONSUMER PROTECTION ISSUES

# CHAPTER **3**:

## LICENSING, CONSUMER EDUCATION AND CONSUMER PROTECTION ISSUES

### MARKET ENTRY ENQUIRIES AND LICENSING OF NEW BANKS

3.1 There were 10 banking licence enquiries in 2015. As at December 31, 2015, none of the promoters had formally submitted an application for a banking licence.

3.2 One banking licence application, which was rejected by the Bank in 2014, was appealed to the Minister in December 2015. The Minister upheld the Bank's decision. A conditional banking licence approval for one applicant which was granted in October 2014 was revoked on February 2015 due to lack of formal communication from the Central Bank of the applicant bank.

### REVOCATION OF BANKING LICENCE OF KINGDOM BANK AFRICA LIMITED (KBAL)

3.3 This section provides a brief background on the circumstances that led to the temporary management and subsequent closure of Kingdom Bank Africa Limited (KBAL).

3.4 KBAL was issued with an offshore investment banking licence on August 12, 2003, as a wholly owned subsidiary of a Zimbabwe-based bank, Kingdom Financial Holdings Limited which later became Afrasia Bank Zimbabwe Limited. It was licensed as an International Financial Services Centre (IFSC) investment bank, and was issued with an IFSC Certificate. Its operations were ring-fenced, therefore the bank's customers (depositors and borrowers), were non-residents predominantly based in Zimbabwe.

## OPERATIONAL AND FINANCIAL PERFORMANCE

3.5 In 2005, KBAL incurred losses, which eroded its capital base, leading to a breach of the statutory capital adequacy requirements. Bank of Botswana assumed temporary management of the bank on June 22, 2005, on account of the breach of the regulatory capital adequacy requirements. Consistent with Section 34 of the Banking Act (CAP. 46:04) (Act), KBAL was restored to the owners on September 1, 2005, following a successful recapitalisation of the bank by the shareholders.

3.6 KBAL continued to make losses despite the recapitalisation that was effected in 2005. The capital injection appeared to be solely to satisfy the bank's statutory and prudential capital adequacy requirements, and not to do the business for which it was licensed. Between 2005 and 2012, the Bank held a series of statutory and non-statutory meetings with senior management of KBAL and its parent bank (then Kingdom Financial Holdings Limited) in order to find a resolution to the bank's financial troubles. Ultimately, the bank developed a turn-around strategy and engaged several potential investors in 2013 and 2014, with a view to inject additional funds needed to execute the strategy. The strategy required substantial resources, as it entailed the bank entering new markets and introducing new products. All the efforts aimed at turning KBAL into a viable financial institution were not successful.

3.7 Failure of KBAL to find a long-term solution to the viability of its operations and its failure to honour deposit withdrawals created uncertainty relating to its "going concern" status. In November 2014, the Bank concluded that KBAL had failed to undertake the business for which it was licensed in a safe, sound and sustainable manner. The Bank gave KBAL up to January 31, 2015 to come up with an acceptable recapitalisation plan. KBAL failed to meet the set deadline.

## TEMPORARY MANAGEMENT

3.8 On January 28, 2015, KBAL was advised that it would be placed under temporary management pursuant to Section 33 of the Act, as its financial condition had not improved, and that the bank had, evidently, defaulted on requests for deposit withdrawals. The temporary management by the Bank, which came into effect on February 16, 2015, continued for 90 days to May 18, 2015. During the temporary management period, the Bank discontinued KBAL's business operations. Furthermore, the Bank evaluated various options for the resolution of the bank as set out in Section 34 of the Act. These included arranging for the sale of the bank, facilitating a compromise between the bank and its creditors and winding up the bank.

3.9 During the temporary management of KBAL, the Bank received an offer from a Consortium of potential investors to purchase 100 percent shareholding in KBAL. After a careful evaluation of the offer, the Bank declined the offer on account of weak financial strength, governance and ownership structure of the Consortium. At the conclusion of the temporary management period, it became apparent that the possibilities of selling the bank, restoring it to the current owners and/or proposing a compromise or some arrangement between KBAL and its creditors were no longer feasible.

### PETITION FOR WINDING UP

3.10 On May 12, 2015, the Bank successfully petitioned the High Court of Botswana to wind up the operations of KBAL in terms of Section 34(d) of the Act, and two co-liquidators were appointed. Accordingly, the Bank issued a public notice to inform depositors and other members of the public of this development. In accordance with Section 35(1) of the Act, the Bank effectively assumed the role of Master of the High Court and the preparations to start the liquidation process were underway. Therefore, KBAL ceased to be a licensed bank in Botswana effective June 19, 2015.

### LIQUIDATION

3.11 KBAL's liquidation process was on-going as at December 31, 2015. The first creditors meeting was held on July 28, 2015, and re-convened on November 10, 2015. The meeting was intended to, inter alia, prove claims against KBAL, adopt resolutions by KBAL's creditors/depositors, receive the summarised account of the Liquidator, approve the Liquidator's remuneration fee and authorise the disposal of KBAL's assets by the Liquidator. The second creditors' meeting was held on March 3, 2016 and the agenda of the meeting was the same as the one for the first meeting.

### LITIGATION BY DEPOSITORS

3.12 During the temporary management period, the Bank received letters from some Attorneys, representing aggrieved depositors, threatening legal action against both KBAL and the Bank in the event that their respective clients would not be reimbursed in full. One of these depositors, EBC Guernsey Limited (EBC), instituted a delictual claim against the Bank. On July 15, 2015, EBC, through its lawyers, Minchin & Kelly, sought and were granted a default judgement and writ of execution against the Bank, on the assertion that the Bank's Attorneys did not file notice of intention to defend the claim for damages instituted by EBC against the Bank on time. The Bank through its lawyers, Collins Newman & Co, argued for a rescission of the default judgement against it and on March 15, 2016, at the High Court of Botswana, the default judgement against the Bank was set aside. The judgement affords the Bank the opportunity to defend the matter in Court. The litigation of KBAL is ongoing.

### POLICY ON COMMERCIAL BANK CHARGES AND SELECTED AVERAGE CHARGES

3.13 The banking charges were unchanged due to the imposition of a freeze, which restricted upward adjustment of bank charges and fees for a period of two years, effective January 1, 2014 (Table 3.1).

3.14 In the two-year period, none of the banks submitted their tariff schedule for review, except one newly licensed bank, which submitted its initial tariff structure for approval in February 2015. Nevertheless, the Bank continued to receive applications for introduction of new products and services, including related charges. There were also instances in which banks introduced some improvements to existing products.

3.15 Banks continued to be largely compliant with the minimum public disclosure and statutory requirements on interest rates payable on deposits. The disclosures were shown on banks' respective websites, and published monthly in at least two newspapers widely circulated in Botswana (Table 3.2). Disclosures of key information about a product as well as alternative products helped to strengthen consumer protection standards and encouraged responsible business conduct by banks.

Table 3.1: Selected Commercial Banks Average Charges: 2014 - 2015 (Pula)

| SERVICE CHARGE CATEGORY | AMOUNT |
|---|---|
| Accessibility Facilitation | |
| ATM Charges | |
| (i) Cash withdrawal (own account) | 2.17 |
| (ii) Lost card replacement | 59.86 |
| Internet Banking Charges | |
| (i) Monthly fees | 167.55 |
| (ii) Transfers | 3.48 |
| Investment/Intermediation | |
| (i) Personal loan - Arrangement fee (Max) | 2 345.54 |
| (ii) Vehicle/Asset finance - Arrangement fee | 652.91 |
| Trade Facilitation | |
| (i) Commission on purchase of foreign currency | 21.16 |
| (ii) International SWIFT transfer | 305.71 |
| (iii) Advisory fees on Letters of Credit | 216.96 |
| Payment and Clearing Charges | |
| (i) Bank cheque | 73.49 |
| (ii) Unpaid cheque due to lack of funds | 220.38 |

Table 3.2: Commercial Banks: Banking Sector Deposit Rates for December 2015

| DEPOSIT PRODUCT | DEPOSIT RATES (ANNUAL PERCENT) | |
|---|---|---|
| | Lowest | Highest |
| Ordinary Savings | 0.25 | 4.50 |
| Call | 0.05 | 2.96 |
| 91 days | 2.50 | 4.25 |
| 6 months | 0.50 | 4.50 |
| 12 months | 2.60 | 5.50 |
| 24 months | 2.70 | 5.50 |
| Prime Lending Rate | 7.50 | 7.50 |
| Bank Rate | 6.00 | 6.00 |

## CONSUMER COMPLAINTS MANAGEMENT

3.16 Five complaints were brought forward from the last quarter of 2014, of which three were resolved during the first quarter of 2015. The Bank engaged the concerned banks extensively on the remaining complaints. Given the legal complexity of the issues involved, the customers were advised to approach the Courts of Law. During the year under review, the Bank received and processed fifteen consumer complaints. Six complaints were successfully resolved; two customers were advised to approach the Courts of Law in the event they were not satisfied with the Bank's decision and one complaint was referred back to the Banking Adjudicator. Six complaints were being investigated as at December 31, 2015. The complaints included unauthorised ATM transactions; disputed loan tenure and balances; and failure by banks to reimburse insurance premiums for loans settled prior to their stipulated maturity period. Table 3.3 lists the nature of complaints received in 2015. The most recurring complaint across the banks was in respect of unauthorised ATM transactions. It was also observed that there was lack of consumer education, particularly in relation to access to calculation and amortisation of loans. Initiative was taken to enlighten the concerned customers on these aspects through the Bank's feedback.

Table 3.3: Consumer Complaints (2015)

| NATURE OF COMPLAINT RECEIVED | COMPLAINTS OUTSTANDING AS AT JANUARY 1, 2015 | TOTAL NUMBER RECEIVED IN 2015 | TOTAL NUMBER RESOLVED | CUSTOMER REFERRED TO BANK ADJUDICATOR OR COURT | TOTAL OUTSTANDING AS AT DECEMBER 31, 2015 |
|---|---|---|---|---|---|
| Unauthorised Transaction | 3 | 6 | 6 | - | 3 |
| Multiple Stop Orders | 2 | - | 1 | 1 | - |
| Lack of Financial Knowledge | - | 3 | 2 | - | 1 |
| Other | - | 6 | 2 | 2 | 2 |
| Total | 5 | 15 | 11 | 3 | 6 |

## ABANDONED FUNDS

3.17 The Bank continued to receive, process and administer abandoned funds from commercial banks, in accordance with Section 39 of the Banking Act. Table 3.4 shows that the balance of abandoned funds increased from P5.1 million in 2014 to P5.5 million in 2015.

Table 3.4: Total Abandoned Funds from Commercial Banks (Pula)

| | 2014 PULA | 2015 PULA |
|---|---|---|
| Balance Brought Forward | 8 151 262 | 5 052 907 |
| Funds Received | 1 066 895 | 2 335 297 |
| Claims Paid Out | (263 419) | (510 316) |
| Transfer to Guardian's Funds | (3 901 831) | (1 362 207) |
| Balance at Year-end | 5 052 907 | 5 515 681 |

## BOX 1: REPORT ON THE MORATORIUM ON INCREASING BANK CHARGES

The Bank of Botswana (Bank) imposed a two-year moratorium on upward adjustment of bank charges effective January 1, 2014. During the moratorium period, no bank was permitted to make upward adjustments on banking tariffs (bank charges, commissions, and other non-interest fees), with the exception of monetary policy or Bank Rate linked interest rate changes. Introduction of new product/service was subject to the Bank's prior approval. However, banks were advised that the related fee/charge would not exceed the fee(s) applicable for the existing similar products in the market. The Bank decided that during the moratorium period, an independent third party would be engaged at the expense of banks to investigate whether the fees and charges levied by banks were as approved and in accordance with published tariffs.

An investigation was conducted at eight banks and excluded the two new banks (BOI and Bank SBI). Four public accounting/audit firms were engaged by the Bank to determine, in the main, whether:

(a) banks had correctly levied charges as reflected in their respective approved tariff guides;

(b) there were other charges that may have been levied on customers which were not approved by the Bank, and whether banks had levied any charges that were not indicated in the tariff guides;

(c) all the provisions of the Disclosure of Bank Charges Notice No. 41 of 2001 were fully complied with; and

(d) banks had fully complied with all the provisions of Government Notice No. 111 of 2001 on the "Prescription of Notice Period and Early Settlement Penalties for Term Loans and Similar Credit Facilities".

The investigations revealed that all banks, except two, had not levied charges as approved by the Bank and as per their tariff guides. However, the level of transgressions differed from bank to bank. No evidence of violation was noted with respect to non-compliance with Disclosure of Bank Charges Notice No. 41 of 2001 and the Government Notice No. 111 of 2001 on the "Prescription of Notice Period and Early Settlement Penalties for Term Loans and Similar Credit Facilities". Consequently, the Bank decided that, in all cases where the violations had been noted, the concerned banks should identify and reimburse all the affected customers. The moratorium on bank charges was lifted in January 2016, on a case by case basis, subject to each bank fully normalising its violations. The Bank will make an assessment as to whether each bank has appropriately reimbursed its customers.

# CHAPTER 4

## OTHER SUPERVISORY ACTIVITIES

# CHAPTER **4**:

## OTHER SUPERVISORY ACTIVITIES

### UPDATE ON THE PARALLEL RUN OF BASEL I AND BASEL II - 2014/15

4.1 The Bank conducted a parallel-run of Basel I and the Revised International Convergence of Capital Measurement and Capital Standards (Basel II) over the twelve months from January 1 to December 31, 2014. In lieu of a detailed and comprehensive "Quantitative Impact Study (QIS)", the results of the parallel-run provided the basis for determining the likely impact of Basel II on individual banks and the resulting overall capital levels in the banking system. The parallel-run was mandatory for all banks and it required monthly submission of Basel I and Basel II statutory returns. During the parallel run period, the assessment and enforcement of compliance with the regulatory minimum prudential capital requirements were based on the Basel I capital ratios.

4.2 The Bank defined a satisfactory parallel-run as a period of at least 12 consecutive months, during which a bank complied fully with all of the qualification requirements of Basel II. Based on some unsatisfactory results obtained from the parallel-run, it was decided to defer the implementation of Basel II from January 1, 2015 to January 1, 2016. These deficiencies were addressed through a dedicated training workshop, which focused on providing guidance for the completion of the revised statutory returns.

### FINDINGS OF THE CAPITAL IMPACT ASSESSMENT

4.3 During the parallel run period, the Bank conducted a capital impact assessment on 8 commercial banks and 2 statutory banks. The results were that Basel II will not adversely impact either the capital levels of the banking sector or lending activities. Where there was a likely need to raise additional capital, affected banks had been proactive and voluntarily raised more capital funds either from the market or parent banks.

4.4 In view of the satisfactory parallel-run results, adequate preparations and consultations with key stakeholders, the Board of the Bank approved the adoption of Basel II as a basis for the determination of capital adequacy for banks; this will come into effect on January 1, 2016.

### ACTIVITIES OF THE BANK FOR INTERNATIONAL SETTLEMENTS (BIS)

4.5 The Basel Committee on Banking Supervision (the Committee) continued to issue and revise guidelines and standards that will, over the next few years, materially impact on the regulation and supervision of banks and banking groups. The following guidelines were issued in 2015:

(a) Revised Pillar 3 disclosure requirements - January 2015;
(b) Developments in credit risk management across sectors: current practices and recommendations - June 2015;
(c) Net Stable Funding Ratio disclosure standards - June 2015;
(d) Report on the impact and accountability of banking supervision - July 2015;
(e) Corporate governance principles for banks - July 2015;
(f) Progress report on implementation of principles for effective supervisory college - July 2015;
(g) Guidelines for identifying and dealing with weak banks - July 2015;
(h) Criteria for identifying simple, transparent and comparable securities - July 2015;
(i) Report on risk-weighted assets for counterparty credit risk (CCR) - October 2015;
(j) Making supervisory stress tests more macro-prudential: considering liquidity and solvency interactions and systemic risk - November 2015; and
(k) Guidance on credit risk and accounting for expected credit losses - December 2015.

4.6 In addition, the Committee was consulting on the following guidance and sound practice as at December 2015:

(a) Interest rate risk in the banking book;
(b) Review on the credit valuation adjustment risk framework;
(c) General guide to account opening;
(d) Revisions to the standardised approach for credit risk;
(e) Identification and measurement of step-in risk; and
(f) Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion.

## PARTICIPATION IN INTERNATIONAL AND DOMESTIC REGULATORY AND SUPERVISORY FORUMS

### PARTICIPATION IN SUPERVISORY COLLEGES

4.7 During 2015, the Bank participated in supervisory colleges[12] organised by Standard Bank Group in Pretoria (South Africa) and Standard Chartered Bank Group in London (United Kingdom). The Supervisory Colleges were held in compliance with Principle 13 of the Basel Core Principles for Effective Banking Supervision (Core Principles). The principle mandates home supervisors to establish bank-specific supervisory colleges for banking groups, and also requires host supervisors to be included in the colleges. The objective of the supervisory colleges was to discuss key supervisory issues and engage with senior management officials of banks. The meetings discussed different subject areas, among others, group financial performance, capital and liquidity management, board oversight, business conduct and risk management programmes, including financial crime risk.

### PARTICIPATION IN EASTERN AND SOUTHERN AFRICA ANTI-MONEY LAUNDERING GROUP (ESAAMLG) MEETINGS AND THE NATIONAL RISK ASSESSMENT PROJECT ON MONEY LAUNDERING AND TERRORIST FINANCING FOR BOTSWANA

4.8 The Bank participated in meetings of the National Coordinating Committee on Financial Intelligence (NCCFI), the objective of which was to reinforce mechanisms for combating money laundering and terrorist financing and proliferation. Furthermore, during 2015, the Bank attended the 29th and 30th Task Force of Senior Officials meetings for the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), which were held, respectively, in Arusha (Tanzania) and Johannesburg (South Africa).

4.9 The Bank also participated in the National Risk Assessment (NRA) project on money laundering and terrorism financing, which commenced in December 2014 and was expected to be completed in November 2015. The exercise was conducted by the Ministry of Finance and Development Planning and the Financial Intelligence Agency (FIA), in partnership with the World Bank. The project was carried out to fulfill the requirements of the Financial Action Task Force (FATF) recommendations on international standards on anti-money laundering and combating the financing of terrorism (AML/CFT). The FATF standards, in particular Recommendation 1, requires, among others, that countries and financial institutions identify, assess and understand the money laundering and terrorist financing risks for the country. Based on the assessment, countries are required to apply a risk-based approach to ensure that measures to prevent or mitigate money laundering and terrorism financing are commensurate with risks identified. This approach will be an essential foundation to the efficient allocation of resources across the AML/CFT regime and the implementation of risk-based measures throughout the FATF Recommendations.

[12] Supervisory Colleges are working groups of supervisors formed to enhance the consolidated supervision of banking groups.

## MEMORANDUM OF UNDERSTANDING

4.10 During the year under review, the Bank finalised and signed Memoranda of Understanding (MoUs) with the Reserve Banks of India and Malawi on September 15, 2015 and June 24, 2015, respectively. The main purpose of the MoUs is to determine parameters within which mutual assistance, cooperation and exchange of supervisory information would be handled between Bank of Botswana and the two supervisory authorities. The MoUs are consistent with Principle 13 of the Basel Core Principles for Effective Banking Supervision, which requires home and host supervisors of cross-border banking groups to share information and cooperate for effective supervision of the group and group entities, and for effective handling of crisis situations.

## BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION: ASSESSMENT OF OBSERVANCE FOR BOTSWANA

4.11 The Bank, like other supervisory authorities, is guided in its supervisory approach by the Basel Core Principles for Effective Banking Supervision (Core Principles). These Core Principles are the de facto international standards for the supervision of banks. They serve as a benchmark for sound supervisory practices and are used by the IMF and World Bank in the context of the Financial Sector Assessment Programme (FSAP) to assess the effectiveness of banking supervision. They were first published in September 1997 and revised in October 2006 and, more recently, in September 2012 to, among others, reflect the main lessons from the recent global financial crisis.

4.12 The last assessment of the Bank of Botswana's compliance with the Core Principles by the IMF and World Bank was conducted in March 2007, as part of the FSAP. The assessment was based on the 2006 methodology. During 2015, the Bank conducted a self-assessment of the Core Principles using the 2012 Core Principles Assessment Methodology. The objective of the exercise was to assess the Bank's supervisory systems and identify areas for improvement. The results of the self-assessment exercise are presented in Table 4.1.

Table 4.1: A Comparison of the 2015 Self-Assessment Rating with the 2007 IMF and World Bank FSAP Ratings

| | 2012 CORE PRINCIPLE[13] | 2006 STRUCTURE | IMF/WORLD BANK AUGUST 2007 RATING | 2015 SELF-ASSESSMENT RATING |
|---|---|---|---|---|
| 1. | Responsibilities, objectives and powers | CP 1 | LC | LC |
| 2. | Independence, accountability, resourcing and legal protection for supervisors | CP 1 | MNC | LC |
| 3. | Cooperation and collaboration | CP 1 | LC | LC |
| 4. | Permissible activities | CP 2 | MNC | MNC |
| 5. | Licensing criteria | CP 3 | LC | LC |
| 6. | Transfer of significant ownership | CP 4 | MNC | MNC |
| 7. | Major acquisitions | CP 5 | LC | LC |
| 8. | Supervisory approach | CP 19 | LC | LC |
| 9. | Supervisory techniques and tools | CP 20 | LC | C |
| 10. | Supervisory reporting | CP 21 | C | C |
| 11. | Corrective and sanctioning powers of supervisors | CP 23 | LC | LC |
| 12. | Consolidated supervision | CP 24 | MNC | NC |
| 13. | Home-host relationships | CP 25 | LC | LC |
| 14. | Corporate governance | | LC | LC |
| 15. | Risk management Process | CP 7 | LC | LC |
| 16. | Capital Adequacy | CP 6 | LC | LC |
| 17. | Credit risk | CP 8 | LC | LC |
| 18. | Problem assets, provisions and reserves | CP 9 | C | C |
| 19. | Concentration risk and large exposure Limits | CP 10 | LC | C |
| 20. | Transactions with related parties | CP 11 | LC | LC |
| 21. | Country and transfer risks | CP 12 | LC | LC |
| 22. | Market risk | CP 13 | LC | LC |
| 23. | Interest rate risk in the banking book | CP 16 | LC | NC |
| 24. | Liquidity risk | CP 14 | MNC | LC |
| 25. | Operational risk | CP 15 | LC | MNC |
| 26. | Internal controls and audit | CP 17 | N/A | LC |
| 27. | Financial reporting and external audits | CP 22 | N/A | C |
| 28. | Disclosures and transparency | CP 22 | N/A | LC |
| 29. | Abuse of financial services | CP 18 | N/A | LC |

*LC-Largely Compliant, MNC-Materially Non-Compliant, C-Compliant, CP-Core Principles.

[13] The Core Principles for Effective Banking Supervision (Core Principles) are the de facto minimum standard for sound prudential regulation and supervision of banks and banking systems. Originally issued by the Basel Committee on Banking Supervision (the Committee) in 1997, they are used by countries as a benchmark for assessing the quality of their supervisory systems and for identifying future work to achieve a baseline level of sound supervisory practices. The Committee last reviewed and updated the Core Principles in 2012.

# CHAPTER 5

## SUMMARY OF KEY ISSUES ARISING FROM ON-SITE EXAMINATIONS AND PRUDENTIAL MEETINGS

# CHAPTER 5:

## SUMMARY OF KEY ISSUES ARISING FROM ON-SITE EXAMINATIONS AND PRUDENTIAL MEETINGS

### COMMERCIAL BANKS' EXAMINATIONS

5.1 The Bank carried out a full-scope on-site examination of one bank and limited scope on-site examinations of two banks. One limited on-site examination focused on the evaluation of the bank's level of liquidity risk and the effectiveness of risk management and internal control systems, credit risk, operational risk and strategic risk, while the other targeted earnings and profitability, liquidity and funding risks. All the three examinations were conducted using the Risk Based Supervision (RBS) approach commissioned in 2014, which is aimed at enhancing the timely identification, measurement, monitoring and control of key risks inherent in a bank's business activities and the traditional CAMELS methodology. These on-site examinations were complemented by information obtained during both the bilateral and trilateral meetings, monthly early warning reports and quarterly off-site surveillance (OSS) results. Furthermore, limited scope consumer compliance on-site examinations focusing on the implementation of the monetary policy decision of February 18, 2015[14], were undertaken at all commercial banks, during 2015.

5.2 The full scope examination revealed that the financial condition and performance of the bank in question were sound. However, there were some issues of supervisory concern, which required remedial action within a specified period. The most notable deficiency at the bank was in the capital management framework, which lacked contingency funding support from the Group (the Parent); this was a deviation from the licensing requirement, which mandates a parent banking group to undertake to be a source of financial strength, provide liquidity and capital support to the subsidiary, as necessary.

5.3 The loan book of the bank in question had no material performance problems, as non-performing loans were minimal. However, the credit review method adopted by the bank needed to be improved and some of the indicated collateral values were deemed inadequate to generate the cash flow for the impaired loans. Consequently, the bank was instructed to avail additional provisions to cover for the likely losses that might occur due to non-performing loans.

[14] The examinations were intended to establish whether or not banks were transmitting monetary policy signals in line with the Bank's policy easing of that date, that is, the Bank Rate reduction by one percentage point (See paragraph 5.10).

5.4 Furthermore, credit risk management at the bank was deemed inadequate because the credit management systems could not aggregate related party exposures. This inability to consolidate same client loan accounts resulted in the bank failing to assess and accurately report client credit concentration.

5.5 The controls around operational risk management were deemed insufficient due to inadequate staffing levels, poor records management, lack of business continuity, and over-reliance on the Group Internal Audit processes.

5.6 One of the two banks subjected to limited scope examinations had significant intra-group placements deployed in a manner that could compromise the liquidity of the bank and, in general, safety and soundness of its operations.

5.7 However, it was observed that the liquidity problems at the bank were mainly a result of ambitious growth strategies, as evidenced by rapid growth of the loan book, far in excess of the funding sources, as well as over-reliance on high-cost volatile wholesale deposits as the main source of funding.

5.8 With respect to the other bank at which a limited scope examination was conducted, inherent liquidity risk was found to be high because of over-reliance on volatile deposits, and this led to violation of the Liquid Asset Ratio (LAR) on two occasions for which a monetary fine was levied. However, the quality of risk management systems was satisfactory. Consequently, liquidity risk was rated high (4) under CAMELS.

5.9 All the three banks examined were ordered to implement corrective actions to remedy all areas of weaknesses. They were also required to update the Bank on progress made in rectifying the anomalies on a quarterly basis.

## CONSUMER COMPLIANCE ON-SITE EXAMINATIONS

5.10 Regarding consumer compliance issues, the Bank conducted limited scope on-site examinations of all commercial banks in the month of April 2015, on the implementation of the monetary policy decision of February 18, 2015. The objective of the examination was to assess whether banks had adjusted the lending and deposits interest rates in line with the adjustment on the Bank Rate. It was found that four banks complied fully with the decision, two were partially compliant while two other banks did not comply.

5.11 Consequently, follow-up on-site examinations were conducted at the banks that were not compliant, by which time it was found that all the necessary interest rate changes had been made and back-dated to February 19, 2015.

## CONSULTATIVE AND PRUDENTIAL MEETINGS

5.12 The two semi-annual Banking Committee meetings scheduled for 2015 were held accordingly and the discussions focused mainly on the role of commercial banks in the transmission of the Bank's monetary policy decisions, as well as the impact of liquidity pressures in the market and lackluster credit growth.

5.13 Similarly, prudential bilateral and statutory trilateral meetings were held in 2015, during which banks outlined their business strategies for the previous year(s) and the period ahead, as well as presenting their financial year-end results. Furthermore, statutory bilateral meetings were held with external auditors to discuss audit plans for the respective banks.

5.14 One statutory bank did not submit the 2015 audited financial statements, and this was a violation of Section 53(2) of the Banking Act. In line with Section 22(7) of the Banking Act, the Bank held a bilateral meeting with the external auditors of the concerned bank in July 2015, where the auditors were requested to explain the causes of the delay in the submission of the audited financial statements, and any other problem related to the operation of the bank. The auditors stated that the main problems identified at the bank emanated from the following:

(a) challenges with IT systems interface, which resulted in slow accounts reconciliation and limited understanding of the new banking system by staff;
(b) insufficient knowledge base and experience on banking matters which negatively impacted on the operations of the bank; and
(c) deteriorating liquidity status at the bank.

5.15 Subsequently, the concerned statutory bank was advised to work on producing audited accounts on time, resolve information technology system problems and redress the staff shortage in critical areas.

## VIOLATIONS OF THE BANKING ACT

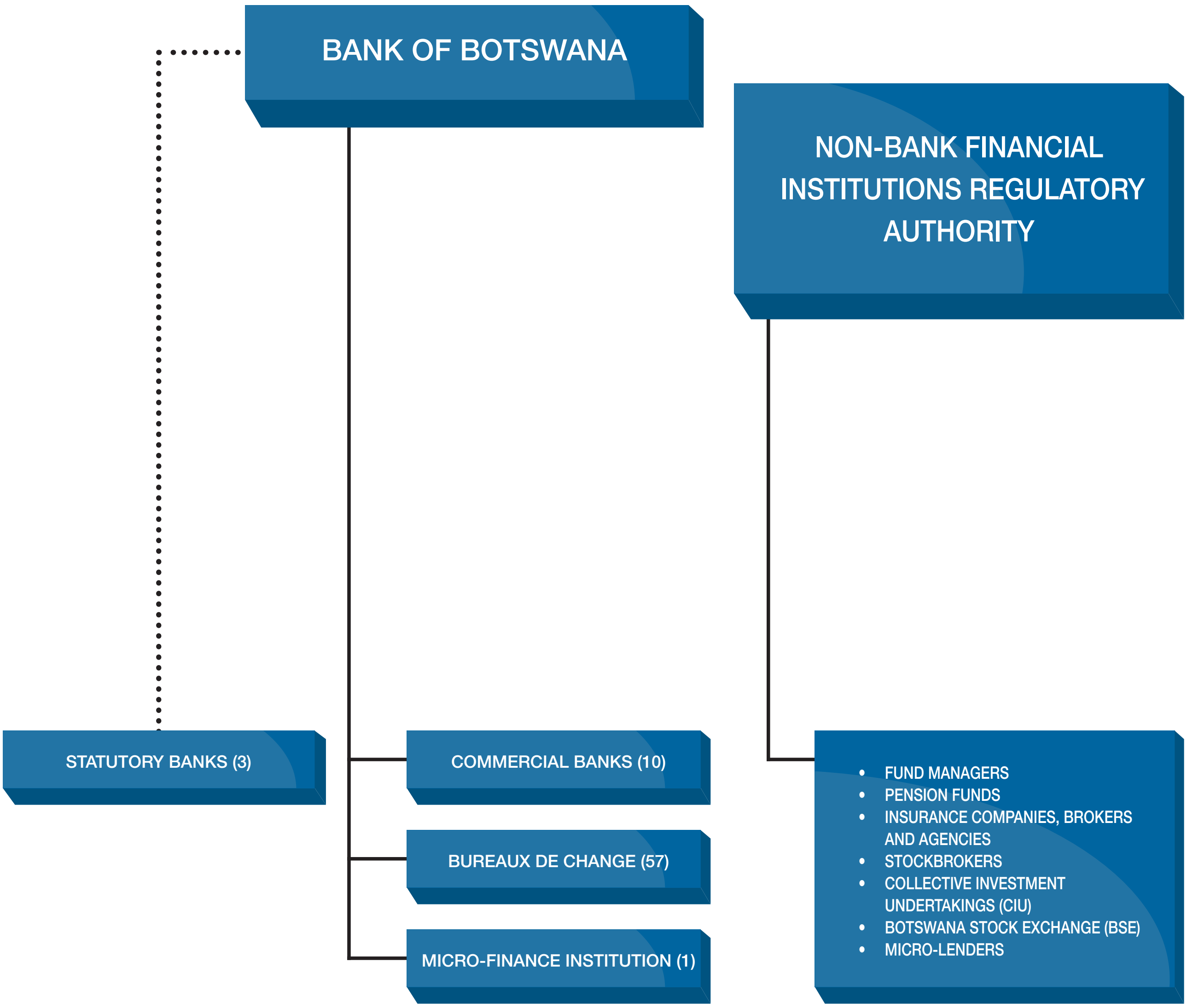
5.16 Two banks violated various sections of the Banking Act during 2015 ranging from submission of incorrect and misleading data and granting employees unsecured facilities in excess of annual gross emoluments. Monetary penalties were levied for these violations.

# APPENDICES

# APPENDICES

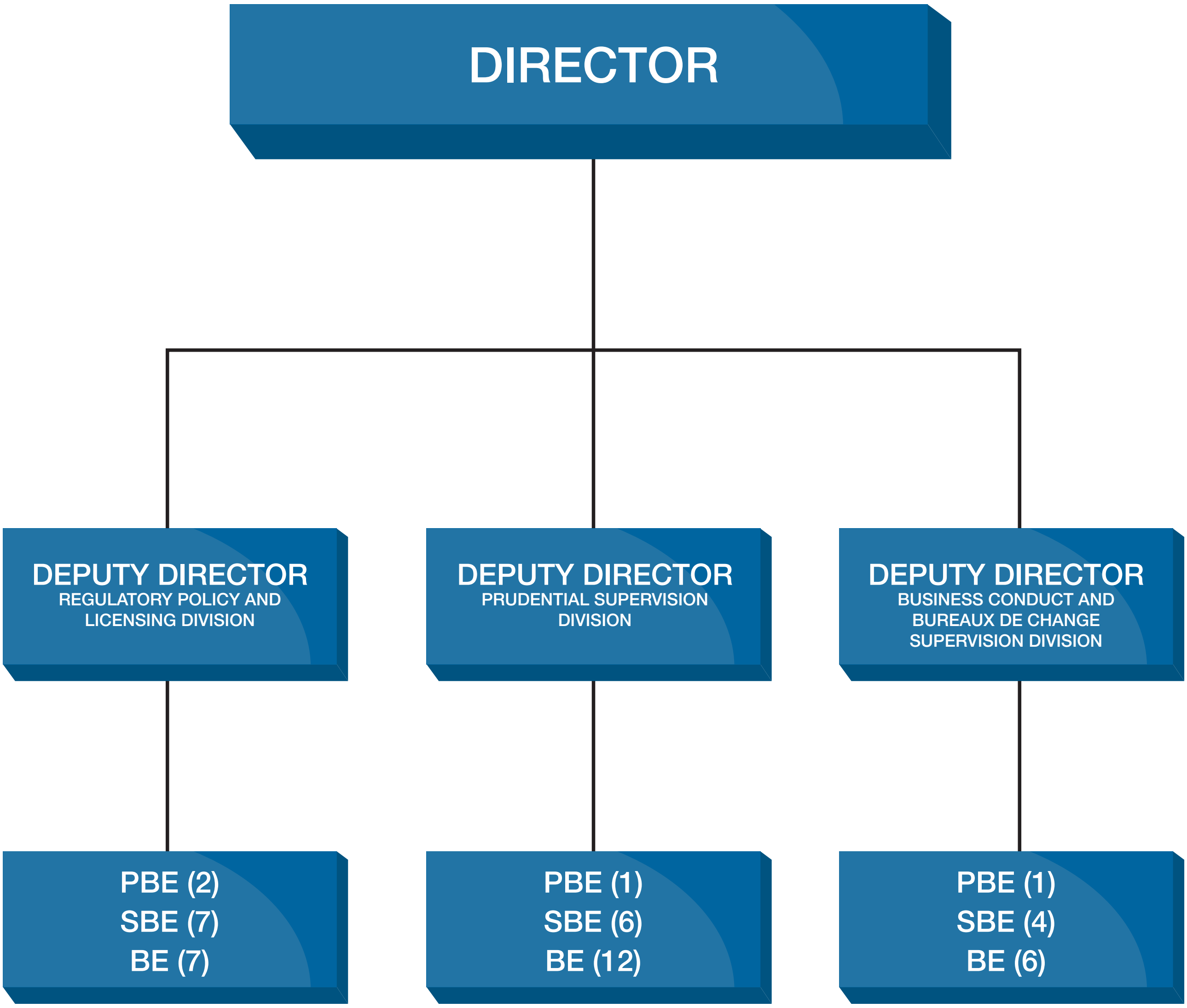
# APPENDIX **1**

Diagram 1.1: The Regulatory Architecture of the Domestic Financial System



# APPENDIX 1

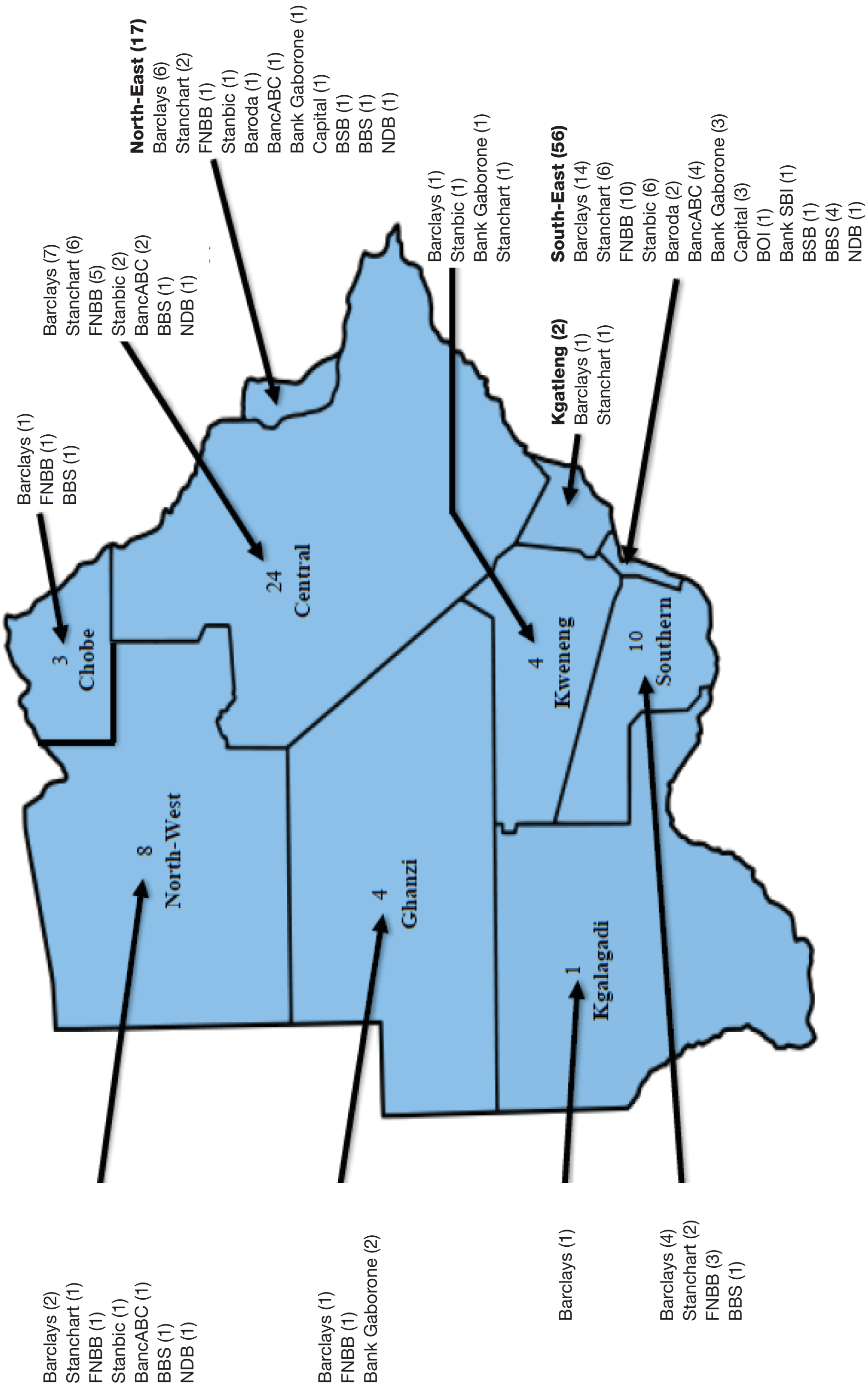
Diagram 1.2: Banking Supervision Department Organisational Structure




Key: PBE; Principal Bank Examiner
SBE; Senior Bank Examiner
BE; Bank Examiner

# APPENDIX **2**

Chart 1: Bank Branch Distribution Network by District as at December 31, 2015



# APPENDIX **3**

**APPROACHES TO REGULATION AND SUPERVISION OF BANKS IN BOTSWANA**

## 1. INTRODUCTION

1.1 This Appendix outlines the basic elements of the framework, standards and processes for banking supervision in Botswana. The Bank is committed to the development of a sound, stable and competitive banking system which promotes savings mobilisation while responding, in a prudent and sustainable manner, to the credit requirements of the economy. The Bank also seeks to adhere to best international practice as enshrined in the Basel Committee's 29 Core Principles for Effective Banking Supervision.

## 2. LEGAL FRAMEWORK

2.1 In general, it is considered that, to be effective, a regulatory framework must have sufficient authority established by law, a high degree of independence or operational autonomy and adequate human and financial resources. In Botswana, the primary legislation covering the supervision and regulation of licensed financial institutions is the Banking Act (CAP. 46:04) (Banking Act). Important elements of the Banking Act are: explicit provisions for licensing and authorisation processes, which give the Bank powers to regulate market entry; power to establish minimum prudential supervisory standards and policies with respect to capital adequacy, liquidity, restrictions on large exposures, loans to insiders and quality of management; rules governing accounting, auditing and disclosure of information; and guidelines for the management and/or restructuring of banks in distress.

2.2 The banking law also covers matters of governance, market discipline within the banking system, and prudential supervision of the banking system. It is recognised that, primarily, the responsibility for banking soundness lies with owners (shareholders) and managers, who have a commercial incentive to operate banks prudently. Market discipline, which is underpinned by minimum disclosure requirements, provides an incentive for good internal governance and imposes sanctions for failures, particularly for institutions listed on the stock exchange. Prudential supervision is essential to provide external incentives for management and owners of banks to rectify inadequacies in governance and impose the appropriate level of control where market behaviour could lead to imprudent conduct, which could have adverse systemic repercussions. Thus, the continuing safety, soundness and stability of the banking system and the extent to which it is effective in facilitating financial intermediation between savers and borrowers, as well as operating the payment system, is a reflection of efficiency in all these three areas.

## 3. AUTHORITY FOR LICENSING BANKS

3.1 A central feature of banking supervision is establishing criteria for licensing of banks. Banking is a regulated industry because banks take deposits from the public, and play a critical role in the country's payments system. As a result, there are regulatory barriers to entry that importantly influence the structure of the banking sector in terms of the number, size and ownership of banks in the country. These market entry requirements must be carefully balanced with the public policy objective of a competitive and efficient banking system.

3.2 The responsibility for licensing banks is exclusively conferred on the Bank by Section 3 of the Banking Act. This section covers licensing of commercial banks, merchant/investment banks, credit institutions and discount houses.

# APPENDIX **3**

## 4. LICENSING POLICY AND PROCEDURES FOR ESTABLISHING A BANK

4.1 The licensing requirements and procedures for establishing a bank in Botswana are set out in Sections 6(1) and 8 of the Banking Act, and detailed in Banking Regulations 3, 4 and 5.

4.2 In order to be licensed as a bank in Botswana, an applicant must satisfy the following requirements:

(a) The company must be locally incorporated in Botswana (branch banking is not permitted).

(b) The proposed banking establishment must have the prescribed initial minimum capital (currently P5 million) and the owners must demonstrate willingness and ability to provide additional financial support as and when required. In case of applicants that are majority owned by holding companies or a part of a financial conglomerate, the parent entity should demonstrate capacity to be a source of financial strength to the applicant.

(c) The applicant must have adequate managerial capacity, which includes the appointment of "fit and proper" persons, as well as sound risk management and other governance structures.

(d) In the case of foreign banks, the parent bank must be subject to adequate home supervision, and documentary evidence of consent by the parent supervisor to operate in Botswana must be provided.

(e) The proposed ownership and organisational structure must be acceptable to the Bank, and the structure must be such that it does not deter effective supervision, or, where necessary and appropriate, consolidated supervision.

(f) The promoter must submit a business plan and five-year financial projections showing the establishment of a branch network, products to be provided, and demonstrate the ability to enhance effective competition.

## 5. CORE PRUDENTIAL REQUIREMENTS

5.1 Among the most significant prudential regulations on banks are capital adequacy requirements, statutory primary reserve requirements, liquid asset requirements, large exposure limits, insider loans and asset quality requirements. Each of these is described briefly below.

### CAPITAL ADEQUACY REQUIREMENTS

5.2 A bank must maintain a minimum capital adequacy (solvency) ratio of at least 8 percent, calculated as the ratio of Unimpaired Capital to Total Risk-Weighted Assets. The 8 percent is regarded as the statutory floor. Banks in Botswana are required to maintain a capital adequacy ratio at or above 15 percent, which, in the context of the current macroeconomic and financial environment, is regarded as a safe and prudent level. The key issue is that a bank must maintain sufficient capital and other financial resources at a level that is considered to be commensurate with the nature and scale of its operations and the risks associated with them. The availability and adequacy of high quality capital determines the degree of resilience of a bank to withstand shocks to its financial position.

# APPENDIX **3**

## RESERVE REQUIREMENTS

5.3 Section 40 of the Bank of Botswana Act (CAP. 55:01) empowers the Bank of Botswana to require financial institutions to hold primary reserves, including marginal primary reserves, in the form of cash holdings or deposits with the Bank or both, against such deposits and similar liabilities as may be specified by the Bank. In April 2015, the primary reserve requirement ratio was reduced from 10 percent to 5 percent of Pula denominated deposits held in a non-interest bearing account of the Bank. This is primarily a monetary policy tool intended to regulate the ability of a bank to use deposit liabilities for lending purposes.

## LIQUID ASSETS REQUIREMENTS

5.4 Section 16(2) of the Banking Act stipulates that every bank must maintain in Botswana, on a daily basis, specified eligible liquid assets as a percentage of its deposit liabilities currently equal to 10 percent and 3 percent for commercial banks and credit institutions, respectively.

5.5 In general, a licensed financial institution should establish appropriate and prudent policies for the management of liquidity risk. It should ensure, to the satisfaction of the Bank, that adequate internal risk management systems exist to monitor and control maturity mismatches between its assets and liabilities; that the bank has the capacity to meet maturing obligations and/or fund expansion of its statement of financial position in a sound and effective manner; that the level, trend and quality of bank funding sources, including cash flow from earning assets, are supportive of the bank's growth strategy.

## ASSET QUALITY

## ASSET CONCENTRATIONS (LARGE EXPOSURES)

5.6 Section 17 of the Banking Act, read together with Regulation 9, restricts a bank from granting facilities that are in excess of 10 percent of a bank's unimpaired capital to a single customer or group of related customers without the specific approval of a bank's entire board of directors. Further, a bank is required to seek prior approval of the Bank before granting loans and other credit facilities to a single entity or group of related companies which, in aggregate, are in excess of 30 percent of a bank's unimpaired capital. This is an asset quality ratio intended to avoid vulnerabilities arising from excessive concentration of credit risk, or, put more positively, to encourage diversification of the loan portfolio of a bank.

## INSIDER LENDING

5.7 Section 17 of the Banking Act, read together with Banking Regulation 9, also restricts banks from granting credit facilities to directors and their related interests in excess of the higher of P50 000 or 1 percent of a bank's core capital without the approval of the bank's entire board of directors. In addition, no bank may grant facilities, direct or indirect, to a member of its board of directors in excess of 25 percent of its unimpaired capital. This provision seeks to avoid possibilities of insider abuse, self-dealing or over-reliance on related party business. Any lending in violation of this requirement is deemed to be a withdrawal of capital and, therefore, deducted from the unimpaired capital in computing the capital adequacy ratio of a bank.

# APPENDIX **3**

### NON-PERFORMING LOANS AND PROVISIONS

5.8 Section 14 of the Banking Act deals with certain items, which should be provided for; that is, reserves to be made to take into account potential losses when determining a bank's capital adequacy. It establishes the legal framework for the Bank to assess adequacy of the provisions for non-performing assets. Accordingly, the Bank has statutory power to assess, in consultation with the bank's independent statutory auditors, the level of impairments in a bank's loan portfolio and the amount of charges to the bank's profit and loss as an expense for non-performing assets.

## 6. MAIN SUPERVISORY APPROACHES

### ON-SITE EXAMINATIONS

6.1 The Bank conducts regular on-site examinations of banks pursuant to Section 24(1) of the Banking Act. The Bank may also conduct an examination of a bank if so petitioned by one fifth of depositors as provided for under Section 24(3) of the Banking Act.

6.2 A full scope prudential on-site examination is one that is sufficient in scope to assess an institution's Capital Adequacy (C), Asset Quality (A), Management and Effectiveness of Board Oversight (M), Earnings and Profitability (E), Liquidity (L) and Sensitivity to Market Risk (S) components (referred to as CAMELS) and the risk management systems and make a conclusion about its safety and soundness. Full scope on-site examinations should be conducted at least every 18 months. A limited scope examination is an on-site examination which does not cover all the CAMELS components, but rather focuses on a specific product, area, or risk, e.g., consumer loans, treasury or operational risk. An ad hoc on-site examination is usually a limited scope examination designed to test a specific area of supervisory concern; e.g., compliance with laws and regulations, liquidity, capital adequacy, etc. A full scope business conduct supervision examination focuses on the entire business conduct of an institution and how it relates to customers (consumer protection).

6.3 The objectives of on-site examinations are to assess and evaluate the overall condition and financial soundness/ health of a bank, compliance with applicable laws and regulations, the quality and effectiveness of governance structures, including the internal control environment, as well as to check the accuracy of statutory reports submitted to the Bank.

6.4 During an on-site examination, examiners have direct access to the books and records of the financial institution being examined. This enables examiners to make a fair and realistic assessment of the condition of the institution in various risk areas.

6.5 The evaluation of the financial soundness of the institution is achieved by assessing CAMELS, and the Risk Assessment Systems (RAS) rating. CAMELS and RAS ratings were awarded on a scale of 1 to 5. A rating of 1 indicates strong performance and strong risk management practices, while a rating of 5 represents weak performance and inadequate risk management practices. Consistent with the Risk-Based Supervision (RBS) methodology applied by the Bank, CAMELS ratings are used as a guide to determine, inter alia, the frequency of on-site examinations and intensity of supervisory programmes for each bank. A CAMELS rating of 1 (sound/ strong bank) requires a bank to be examined within 24 months; a CAMELS rating of 2 within 18 months; a CAMELS rating of 3 within 12 months; and CAMELS ratings of 4 and 5, represent poor risk management and/ or unsound banking operation, thus requiring a bank to be examined within six (6) months.

# APPENDIX **3**

6.6 In order to ascertain the soundness and prudence of the bank's practices and procedures, an assessment is made of its inherent risks, and the adequacy of its risk management systems and controls. The practices and procedures adopted would reveal the extent to which the financial institution is employing adequate measures to protect depositors' funds, shareholders' interests, deployment of resources and effective measurement and control of risks that are inherent in any banking operation.

6.7 The internal control systems are also assessed to determine their effectiveness and the role of the internal audit function. Effective running of operations depends on the adequacy of records maintained and the adoption and implementation of issues that may adversely affect the performance of a bank for which they are responsible.

6.8 To enhance the traditional supervisory process, the Bank adopted the Risk-Based Supervision (RBS) framework in 2014. This framework places strong emphasis on understanding and assessing the adequacy of each financial institution's risk management systems. It also stresses the process of risk identification, measurement, monitoring and control on an on-going basis. As a result, the use of RBS assists supervisors to identify banks in which risks are greatest, identify within a bank those areas or activities in which risks are high and apply supervisory resources to assessing and measuring those risks. Therefore, it enables the supervisor to prioritise efforts and focus on significant risks by channelling available resources to banks where the risk profile warrants greater attention. The major output of RBS is a bank's supervisory plan which outlines the planned supervisory activities for a bank over a given period of time. The supervisory plan is established every year with results obtained from OSS and CAMELS and RAS assigned to a bank during the previous on-site examinations.

## BILATERAL AND TRILATERAL MEETINGS

6.9 Bilateral meetings are held once a year with each supervised bank. Prudential meetings with the institution's management are meant to discuss its financial performance, risk profile, strategies, the market in which it operates, and/or any other issues of supervisory concern. These meetings provide a forum for exchange of views on matters affecting the supervised banks and serve to improve communication and information flow between the Bank and the supervised banks. Bilateral meetings are also held once a year with auditing firms engaged by supervised banks. The meetings are arranged to discuss supervisory issues that might need attention of both the external auditor and the supervisor. It is also at such meetings that the Bank takes the opportunity to discuss with auditors their expectations regarding the scope of statutory audits and other general issues of a prudential nature.

6.10 In addition to the separate bilateral meetings with both external auditors and the respective supervised banks, the Bank, pursuant to Section 22(8) of the Banking Act, arranges tripartite meetings with each financial institution and its external auditors. These trilateral meetings are convened to discuss matters relevant to the Bank's supervisory responsibilities that may have arisen in the course of a statutory audit of a bank's business, its accounting and internal control systems, and its draft audited annual statement of financial position and statement of comprehensive income. The forum is also used to share information on the critical risk areas and/or any new developments in accounting and regulatory standards. Trilateral meetings have an added advantage of fostering effective collaboration and communication between the Bank (as regulatory authority) and external auditors of banks in the application of accounting standards and ensuring effective disclosure in financial statements and related reports of material risks in a bank's statement of financial position.

# APPENDIX **3**

## OFF-SITE MONITORING AND SURVEILLANCE

6.11 Off-site surveillance involves off-site monitoring of the supervised institution regarding its performance and condition, together with an assessment of progress made regarding implementation of various directives and/or recommendations from the supervisor. All banks are required to submit statutory returns as prescribed under Section 20 of the Banking Act. The foreign exchange statutory return, which shows the bank's net foreign exchange position, is submitted every week to the Bank. The monthly and quarterly statutory returns should be submitted on the 10th day of the month following the reporting month. Instructions on how to complete the returns are contained in the statutory returns availed to each bank upon being granted a licence.

6.12 The Banking Supervision Department analyses financial data from banks continuously to determine their financial conditions, soundness and viability. The specific objectives of the analysis are to determine the levels, trends and sources of banks' profits; compare each bank's performance for the period with that of prior periods, and against that of other banks; note changes in the banks' capital accounts and the causes thereof (monthly, quarterly and annual performance review); determine whether the banks have complied with the Banking Act, Banking Regulations, Directives, Circulars and Guidelines pertaining to prudential requirements.

6.13 The outcome of the off-site analysis is used for preparing early warning reports, which also serve as an input to the on-site examination work, including planning, scope of on-site examination work and resourcing of the on-site examination teams. Furthermore, this regular off-site monitoring, surveillance and analysis serves an important function of risk profiling of banks, continuous engagement with bank management and, as may be necessary, any targeted supervisory interventions.

6.14 To enhance the off-site monitoring process, in 2015 the Bank adopted the use of an OSS quarterly monitoring tool. The OSS is a hybrid of the Off-site Rating System (ORS) and the Financial Ratio and Peer Group Analysis (FRPGA) monitoring tools that are used by regulators worldwide. The OSS rates and ranks banks based on an assessment of 32 financial soundness indicators or ratios. It is the adaptation of the traditional CAMELS ratings system and weighs the components, relative to their current industry importance to financial soundness. The OSS scoring places banks within four broad categories of strong, adequate, partially adequate and weak, with a rating scale of 1 to 4.5, where 1 is strong and 4.5 is weak. This rating methodology was developed based on the Botswana banking sector data and, therefore, factored in the country-and-sector-specific variables affecting local banking business. It is expected that this system will bring a wealth of benefits in terms of tracking financial soundness and, accordingly, trigger appropriate supervisory reactions to systemic and idiosyncratic conditions.

## 7. ACCOUNTING, AUDITING AND DISCLOSURE STANDARDS

7.1 Section 22 of the Banking Act requires banks to annually appoint independent external auditors acceptable to the Bank. Statutory audits are conducted annually, usually at financial year-end, except that when a bank intends to capitalise half-year interim profits, it must call for an audit of the accounts. Change of external auditors or the financial year-end requires prior approval of the Bank.

# APPENDIX 4

Supervised Financial Institutions as at December 31, 2015

| INSTITUTION | POSTAL ADDRESS | BUSINESS LOCATIONS | AUDITORS |
|---|---|---|---|
| Commercial Banks | | | |
| African Banking Corporation of Botswana Limited | Private Bag 00303 Gaborone | 8 | KPMG |
| Bank of Baroda (Botswana) Limited | P.O Box 216 ADD Gaborone | 3 | KPMG |
| Bank of India (Botswana) Limited | Private Bag 00111 Gaborone | 1 | Grant Thornton |
| Bank Gaborone Limited | Private Bag 00325 Gaborone | 7 | PriceWaterHouse Coopers |
| Barclays Bank of Botswana Limited | P.O Box 478 Gaborone | 38 | PriceWaterHouse Coopers |
| Capital Bank Limited | P.O Box 5548 Gaborone | 4 | KPMG |
| First National Bank of Botswana Limited | P.O Box 1552 Gaborone | 22 | Deloitte & Touché |
| Stanbic Bank Botswana Limited | Private Bag 00168 Gaborone | 11 | KPMG |
| Standard Chartered Bank Botswana Limited | P.O Box 496 Gaborone | 19 | KPMG |
| Bank SBI Botswana Limited | P.O Box 505243 Gaborone | 1 | Grant Thornton |
| Statutory Banks | | | |
| Botswana Savings Bank | P.O Box 1150 Gaborone | 2 | KPMG |
| National Development Bank | P.O Box 225 Gaborone | 4 | PriceWaterHouse Coopers |
| Building Society | | | |
| Botswana Building Society | P.O Box 40029 Gaborone | 9 | KPMG |

# APPENDIX **4**

Bureaux de Change as at December 31, 2015

| NAME | POSTAL ADDRESS | BUSINESS LOCATION |
|---|---|---|
| 4Corners Bureau de change | P.O Box 848, Ghanzi | 1 |
| Aldaph Bureau de Change | P.O Box 404845, Gaborone | 1 |
| American Express Bureau de Change | P.O Box 45140, Gaborone | 3 |
| Apijoe Bureau de Change | P.O Box 458, Mogoditshane | 1 |
| Ban Mo Bureau de Change | P.O Box 99, Sherwood | 1 |
| Bellagio Bureau de Change | Private Bag BR 321, Gaborone | 1 |
| Beni Fame Bureau de Change | P.O Box 2143 AAD, Gaborone | 3 |
| Berry-Pee Bureau de Change | P.O Box 20051, Gaborone | 1 |
| Boitekanelo Bureau de Change | P.O Box 27698, Gaborone | 1 |
| Cape to Cairo Bureau de Change | P.O Box 799, Kasane | 2 |
| Crystal Diamond Bureau de Change | P.O Box 20554, Gaborone | 1 |
| CSS Bureau de Change | P.O Box 45168, Gaborone | 3 |
| Dollar Wave Bureau de Change | P.O Box 10784, Palapye | 1 |
| Elite Bureau de Change | Private Bag 0028, Mogoditshane | 1 |
| Exim Bureau de Change | P.O Box 1020, Gaborone | 1 |
| Fanz Bureau de Change | P.O Box 617, Lobatse | 1 |
| Fundex Bureau de Change | P.O Box 401547, Gaborone | 3 |
| FX Africa Bureau de Change | P.O Box 20537, Gaborone | 4 |
| Galaxy Bureau de Change | P.O Box 501055, Gaborone | 1 |
| Garona Bureau de Change | P.O Box 408, Gaborone | 5 |
| Genesis Bureau de Change | Private Bag BR 225, Gaborone | 1 |
| Gorogang Bureau de Change | P.O Box 46785, Gaborone | 1 |
| Hi-Rated Beruau de Change | P.O Box 1693, Selibe-Phikwe | 1 |
| Investors View Bureau de Change | P.O Box 2381, Francistown | 1 |
| Kalahari Bureau de Change | P.O Box 1116, Gaborone | 1 |
| Kaycy Bureau de Change | P.O Box 1693, Lobatse | 1 |
| Kwanokeng Bureau de Change | P.O Box 10, Sherwood | 2 |
| Limpopo Bureau de Change | P.O Box 8, Sherwood | 2 |
| Madikwe Bureau de Change | P.O Box 268, Sikwane | 1 |
| Maeto Bureau de Change | P.O Box 22, Mahalapye | 1 |
| Master Bureau de Change | Private Bag F199, Francistown | 1 |
| Mochudi Bureau de Change | P.O Box 202147, Mochudi | 1 |

# APPENDIX **4**

## Bureaux de Change as at December 31, 2015

| NAME | POSTAL ADDRESS | BUSINESS LOCATION |
|---|---|---|
| Monty Cristo Bureau de Change | Private Bag 00254, Gaborone | 1 |
| Okavari Bureau de Change | P.O Box 44, Karakubis | 1 |
| Open Door Bureau de Change | P.O Box 839, Maun | 4 |
| Ozair Bureau de Change | P.O Box 4862, Gaborone | 2 |
| Proxy Bureau de Change | P.O Box 404108, Gaborone | 3 |
| Rennies Bureau de Change | P.O Box 2482, Gaborone | 1 |
| River Ride Bureau de Change | P.O Box 301106, Francistown | 4 |
| Rose of Sharon Bureau de Change | P.O Box 404338, Gaborone | 1 |
| Royalty Bureau de change | Private Bag BO 259, Gaborone | 2 |
| Sherwood Ranch Bureau de Change | P.O Box 1, Sherwood | 1 |
| Simple Forex Bureau de Change | P.O Box 81384, Gaborone | 1 |
| SMH Bureau de Change | P.O Box AD 148 ADD, Gaborone | 3 |
| Sunny Bureau de Change | P.O Box 370, Maun | 2 |
| Thari Bureau de Change | P.O Box 40074, Gaborone | 2 |
| The Silver Bureau de Change | P.O Box 1894, Ramotswa | 1 |
| Trans Fronter Bureau de Change | P.O Box 183, Pitsane | 1 |
| Travellers Bureau de Change | P.O Box 20909, Maun | 2 |
| Travellers' Choice Bureau de Change | P.O Box 26725, Gaborone | 2 |
| TRL Money Link Bureau de Change | Private Bag F333, Francistown | 1 |
| Tshilong Bureau de Change | P.O Box 40418, Gaborone | 1 |
| Toluca Bureau de Change | P.O Box 402026, Gaborone | 1 |
| UAE Exchange Bureau de Change | P.O Box AD 749 ADD, Gaborone | 2 |
| Unity Bureau de Change | P.O Box 1586, Francistown | 1 |
| Universal Bureau de Change | P.O Box 2444, Gaborone | 1 |
| West Bureau de Change | P.O Box 40854, Gaborone | 1 |
| Total | 57 | 92 |

## Microfinance Institutions

| INSTITUTION | POSTAL ADDRESS | BUSINESS LOCATIONS | AUDITORS |
|---|---|---|---|
| Women's Finance House | Private Bag 124, Gaborone | 1 | Sharma & Associates |

# APPENDIX **5**

## GUIDELINES ISSUED

The Capital Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II) and the related guidelines, statutory returns template, together with the instructions, were finalised and issued to the banking sector, for adoption by all banks operating in Botswana effective January 1, 2016.

# APPENDIX **6**

## DEFINITION OF BANKING SUPERVISION TERMINOLOGY AS USED IN THE REPORT

### ASSET CONCENTRATION

Measures aggregate exposure to one borrower, an affiliated group of borrowers, or borrowers with a common controlling interest, common management, cross-guarantees or financial interdependency which cannot be substituted in the short term. This exposure is usually expressed as a percentage of the bank's unimpaired capital and its various thresholds are subjected to prudential regulatory requirements. In terms of Section 17 of the Banking Act (CAP. 46:04), an exposure in excess of 10 percent of the bank's unimpaired capital is deemed an asset concentration requiring prior approval of the Board of Directors of the lending financial institution. Exposures in excess of 30 percent of the bank's unimpaired capital require the Bank's approval.

### ASSET QUALITY

A relative measure of the performance of the bank's loan portfolio based on the appraisal of the asset, in terms of the degree of risk and the likelihood of recovery, adherence to the terms of contracts and orderly liquidation of the account. A good quality asset means the loan, advance or investment is producing cash flows as was expected and/or agreed upon. A non-performing asset or loan is a loan where payment of interest and principal are past due by 90 days or more.

### LOAN CLASSIFICATIONS

(i) **"Pass" Assets** - Assets under "Pass" category are those that are found to have no material or significant performance problems, or technical and/or legal documentation deficiencies.

(ii) **"Special" Mention Assets** - Advances in this category are currently performing well but are potentially weak. These advances constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of sub-standard. The credit risk may be relatively minor, yet it may constitute an unwarranted risk in the light of the circumstances surrounding a specific advance. Special mention rating is not a classification, and should not be used as a compromise between a "Pass" and "Sub-standard".

(iii) **"Sub-standard" Assets** - A sub-standard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardise the liquidation of the debt. They are characterised by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

(iv) **"Doubtful" Assets** - An asset classified doubtful has all the weaknesses inherent in one classified sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status can be determined.

# APPENDIX **6**

(v) **"Loss" Assets** - Assets classified as losses are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this potentially worthless asset even though partial recovery may be effected in the future.

## CORE CAPITAL

An aggregate of share capital, share premium, general revenue reserve and retained earnings, also called Tier 1 capital. It represents the most stable and permanent form of capital for supporting a bank's operations. (See Appendix 7 (5) for computations).

## TOTAL RISK-WEIGHTED ASSETS

An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk-weighting are presented at Appendix 6 (2) attached.

## UNIMPAIRED CAPITAL

Unimpaired in relation to the capital of a bank means the absence of any legal or technical covenant, term, restriction or encumbrance, which would otherwise render such capital not to be freely available for distribution to depositors and/or other creditors in the event of the liquidation or dissolution of the bank, and the absence of any condition or arrangement which would, in the opinion of the central bank, diminish the value of the whole or any portion of the capital of the bank. An outline of capital elements used to compute unimpaired capital is presented at Appendix 6 (3) attached.

## PRUDENTIAL RATIOS

### RETURN ON EQUITY (ROE)

The ratio measures the after-tax profit against shareholders' funds. The ratio, however, tends to favour highly leveraged banks in that the ratio tends to be higher for low capitalised banks than for large capitalised banks. It is of major interest to the shareholders of the bank, and less so for banking supervisory authorities.

### RETURN ON AVERAGE TOTAL ASSETS (ROAA)

The ratio measures after-tax profits as a percentage of average total assets. This ratio is widely used by both banking supervisors and market analysts since banking assets are the base from which earnings are primarily derived. The ratio measures the earnings capacity of the assets of the financial institution. It measures profit earned against the amount invested in assets and is the key to profitability measurement as it shows how efficiently a financial institution's assets are employed. It is also used to measure the effectiveness of management's decisions with respect to resource utilisation. The higher the ratio, the more efficient the management is in its asset allocation decisions.

# APPENDIX **6**

## DIVIDEND PAY-OUT

The ratio measures the proportion of the after-tax income that is paid out to shareholders. This ratio is of greater interest to investors and for prudential supervision. Emphasis is on the adequacy of capital with reference to the quality of capital funds in relation to the statement of financial position risk profile, i.e., the core and unimpaired capital to risk weighted assets ratio. The rationale is that owners of banks must have sufficient own funds in a bank, though it is recognised that unnecessarily high capital levels could result in economic inefficiencies, if not employed productively. However, for commercial and other strategic reasons, most banks will retain some or a portion of their income to build greater capacity by way of a larger capital base, in order to take advantage of lending and/or investment opportunities in large projects, or to support organic growth of the bank.

## RISK-BASED CAPITAL

In November 1995, the Bank adopted the internationally recommended framework on capital adequacy measurement and standards for banks, commonly known as the Basel Committee Capital Accord (Basel I). In terms of this framework, capital adequacy is measured by the ratio of Unimpaired Capital to Risk-Weighted Assets. The move to this method of capital adequacy measurement has sensitised banks to the type of assets they hold and the statement of financial position risk profiles. It has also broadened and standardised the acceptable supplementary capital items such as unencumbered general provisions, fixed assets revaluation reserves (adjusted by a 50 percent factor) and interim profits (provided an audit had been carried out). It excludes, however, any elements that are likely to impair a bank's capital, such as investment in unconsolidated subsidiaries and associated companies, and connected lending of a capital nature. The use of risk-weighted assets is intended to take into account the risk inherent in the different types of assets. If two banks with exactly the same size of assets and capital base are to be compared, their unadjusted capital ratio will be the same. However, if the inherent risk of the statement of financial position is taken into consideration, the bank with less risky assets will enjoy a higher capital adequacy ratio and is better able, therefore, to expand its business by lending to large borrowers, if opportunities arise. A good capital base ensures that adequate funds are freely available on a permanent basis to absorb risks inherent in the types of assets held by a bank, its foreign exchange dealing operations and all other risks associated with its business.

## NET SPREAD (PERCENT)

This ratio covers only those assets and liabilities that have an interest rate attached to them. Thus, it excludes the impact of non-interest-bearing demand deposits, capital and non-remunerated reserve requirements on net interest earned and thus on bank profits. This is helpful in that it isolates the effect of interest rates on bank profits and thereby enables a better understanding of the sources of bank profitability and, consequently, of the vulnerability of bank earnings.

## NET INTEREST MARGIN (PERCENT)

This ratio identifies the core earnings capability of the bank - its interest differential income as a percentage of average total earning assets.

# APPENDIX **6**

## OTHER OPERATING INCOME TO TOTAL ASSETS (PERCENT)

The ratio shows the dependence on “non-traditional” income. Growth in this ratio can indicate diversification into fee-based financial services or a reaching for speculative profits to make up for deficiencies in the bank’s core interest differential income.

## NET OPERATING (OR INTERMEDIATION) MARGIN (PERCENT)

The intermediation margin can be defined as the differential between the cost of funds and the yield on earning assets plus related fee income. The differential quantifies the cost extracted by the banking system for intermediating between the providers and the users of funds.

## NET INCOME PER STAFF

The ratio measures the average income generated by each staff member. Note that this ratio will be significantly different for a wholesale (investment) bank with relatively few, but highly paid staff compared to a retail bank with a large branch network and many less highly paid clerical staff.

## NET INCOME TO STAFF EXPENSE

Measures the return on investment in staffing costs. This ratio is probably a better measure than net income per staff since it enables institutions of a different type to be compared to some degree. It looks at the effect of staffing decisions, regardless of whether these are low cost, low expertise clerical staff, or high cost, high qualified professionals.

## COST TO INCOME

The ratio measures the non-interest expenses as a percentage of net interest income plus non-interest income (total operating income). It shows how well the non-interest expenses are managed by the institution relative to the level of total operating income.

## AVERAGE COST OF DEPOSITS

The ratio measures interest paid on deposits as a percentage of total average deposits. It shows the average cost of deposits. Institutions with a large customer base of operating transaction accounts (demand deposits) relative to interest earning savings accounts tend to report low average cost of deposits. In turn, banks that tend to rely on wholesale deposits (call and other highly volatile money) for funding will have relatively high average cost of deposits. Similarly, banks that start to engage in aggressive marketing for deposits, either due to liquidity concerns and/or to fund expansion of their lending business, will exhibit a high average cost of deposits.

# APPENDIX **6**

## RISK-WEIGHTS APPLIED ON VARIOUS ASSET EXPOSURES FOR PURPOSES OF CAPITAL ADEQUACY MEASUREMENT

| | ASSETS | AMOUNT<br>RISK FACTOR (%) |
|---|---|---|
| 1. | Total Assets (Sum of lines 2 to 24) | |
| 2. | Cash (Pula) | 0 |
| 3. | Due from Bank of Botswana (current) | 0 |
| 4. | Bank of Botswana Certificates | 0 |
| 5. | Loans and Advances Secured by Cash | 0 |
| 6. | Loans and Advances guaranteed by Government of Botswana | 0 |
| 7. | Loans and advances guaranteed by other sovereign states | 0 |
| 8. | Treasury Bills | 0 |
| 9. | Other Government of Botswana obligations | 0 |
| 10. | Due from domestic banks (under 1 year) | 20 |
| 11. | Local Government | 20 |
| 12. | Due from foreign banks (under 1 year) | 20 |
| 13. | Foreign banknotes (cash) | 20 |
| 14. | Cash items in process of collection | 20 |
| 15. | Loans and advances rated AAA to AA - (Fitch Rating) | 20 |
| 16. | Loans and advances to public financial and non-financial corporations | 20 |
| 17. | Real estate (residential-owner occupied) | 50 |
| 18. | Due from domestic banks (over 1 year) | 100 |
| 19. | Private sector advances (loans and overdrafts) | 100 |
| 20. | Due from foreign banks (over 1 year): sum of lines (a) to (d): | |
| a. | Rated AAA to AA (-) | 20 |
| b. | Rated A to A (-) | 50 |
| c. | Rated less than A (-) and non-rated | 100 |
| d. | Rated BBB | 150 |
| 21. | Bank premises | 100 |
| 22. | Other real estate | 50 |
| 23. | Other assets | 100 |
| 24. | Past Due Loans (in line 15 to 20) | 150 |

# APPENDIX **6**

| | | CREDIT CONVERSION* FACTOR | RISK FACTOR (%)** |
|---|---|---|---|
| **25.** | **Total Off-Balance Sheet Items (sum of lines 26 to 36)** | | |
| 26. | Commitments under 1 year or can be cancelled | 0 | - |
| 27. | Guarantees/performance bonds secured by cash | 0 | - |
| 28. | LCs and guarantees to public financial and non-financial corporations | 20 | - |
| 29. | Guarantees and bonds secured by first class banks | 20 | - |
| 30. | Self-liquidating-trade related LCs (commercial LCs) | 20 | - |
| 31. | Securities underwriting | 50 | - |
| 32. | Formal commitments, credit lines and bills endorsed (includes promissory notes with original maturity over 1 year) | 50 | - |
| 33. | Other unsecured performance bonds, etc. (transaction related) | 50 | - |
| 34. | Other off-statement of financial position exposure (specify) | 100 | - |
| 35. | Assets securitisation with recourse | 100 | - |
| 36. | Other standby letters of credit and other guarantees | 100 | - |

| | MATURITY*** | CONVERSION FACTORS - INTEREST RATE CONTRACTS (%) | RISK FACTOR (%)** |
|---|---|---|---|
| **37.** | **Forwards, Swaps, Purchased Options and Similar Derivatives Contracts (sum of lines 39 to 43)** | | |
| 38. | One Year or Less | 0.50 | - |
| 39. | Over One Year to Two Years | 1.00 | - |
| 40. | For Each Additional Year | 1.00 | - |
| | | **EXCHANGE RATE CONTRACTS AND GOLD (%)** | **RISK FACTOR (%)**** |
| 41. | One Year or Less | 2.00 | - |
| 42. | Over One Year to Two Years | 5.00 | - |
| 43. | For each Additional Year | 3.00 | - |
| **44.** | **Total Risk-Weighted Assets and Off-Balance Sheet Items (Sum of Lines 1, 25 and 37)** | | |

* The credit conversion factor converts the off-statement of financial position items to their on-statement of financial position equivalence, before they can be risk-weighted by the weights applicable to the category of counter party, i.e., Government - 0 percent, Multilateral Banks and Public Financial and Non-Financial Corporations - 20 percent and Private Sector - 100 percent.

** For the purposes of calculating RWA, the exposure amount should be such that it is no less than the amount by which the bank's regulatory capital would be reduced if the exposure were to be written-off.

***Use residual maturity for interest rate contracts and original maturity for exchange rate contracts.

# APPENDIX **6**

## CAPITAL ELEMENTS

| | |
|---|---|
| **1.** | **Total Tier 1 Capital (sum of lines 2 to 7, less line 8(a) to (f)):** |
| 2. | Stated capital |
| 3. | Perpetual (non-redeemable) non-cumulative preferred shares |
| 4. | General reserves |
| 5. | Retained earnings |
| 6. | Minority interests |
| 7. | Buffer capital |
| 8. | Less: |
| a. | Goodwill and other intangible assets |
| b. | Cumulative losses below original cost of own use investment properties |
| c. | Shareholders' equity funded through the capitalisation of unrealised gains arising from revaluations |
| d. | Current year unpublished loss |
| e. | Impairment losses (including those resulting on available for sale) |
| f. | Supervisory capital charges |
| **9.** | **Total Tier 2 Capital (sum of lines 10 and 18)** |
| **10.** | **Upper Tier 2 (sum of lines 11 to 17)** |
| 11. | Current year's unpublished profits |
| 12. | 50 percent of fixed asset revaluation reserves |
| 13. | 50 percent of unrealised gains on available for sale revaluations |
| 14. | Unencumbered collectively assessed (General) allowances not to exceed 1.25 percent of risk-weighted assets |
| 15. | Hybrid (debt/equity) capital instruments eligible for inclusion in Tier 2 |
| 16. | Minority interests in Tier 2 preference shares |
| 17. | Shareholders' equity funded through the capitalisation of property revaluations |
| **18.** | **Lower Tier 2 (sum of lines 19 and 20)** |
| 19. | Subordinated term debt eligible for inclusion (not exceeding 50 percent of Core Capital) |
| 20. | Other dated capital instruments eligible for inclusion in Tier 2 |
| **21.** | **Total Capital (sum of lines 1 and 9)** |
| **22.** | **Total Impairments of Capital (sum of lines 23 to 30)** |
| 23. | Investments in unconsolidated subsidiaries and associated companies |
| 24. | Connected lending of a capital nature, including unlawful lending to directors, owners or their indirect interest |
| 25. | Capitalised establishment costs/pre-incorporating expenses |
| 26. | Underwriting commission |
| 27. | Shortfalls in provisions for losses |
| 28. | Pre-paid expenses |
| 29. | Deferred charges |
| 30. | Leasehold rights |
| **31.** | **TOTAL UNIMPAIRED CAPITAL FUNDS (LINE 21 LESS 22)** |

# APPENDIX **7**

## AGGREGATE FINANCIAL STATEMENT OF LICENSED BANKS: 2011 - 2015

Table 1: Aggregate Statement of Financial Position of Licensed Commercial Banks: 2011 - 2015 (P' million) as at December 31st

| | TOTAL ASSETS IN LOCAL CURRENCY | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| 1. | Cash and balances with the Central Bank | 4 766 | 4 933 | 5 268 | 5 838 | 4 584 |
| a. | Currency | 721 | 824 | 976 | 1 374 | 1 544 |
| aa. | Foreign currency | 76 | 86 | 159 | 463 | 532 |
| ab. | Local currency | 645 | 738 | 816 | 911 | 1 013 |
| b. | Balances with Central Bank | 4 045 | 4 109 | 4 292 | 4 419 | 2 982 |
| c. | Other | - | - | - | 45 | 58 |
| 2. | Investment and Trading Securities | 11 121 | 10 199 | 8 059 | 6 482 | 12 537 |
| 3. | Placements with other banks and credit institutions | 6 187 | 7 407 | 6 410 | 9 636 | 10 539 |
| 4. | Gross Loans and advances to other customers | 27 920 | 34 410 | 39 499 | 45 117 | 48 307 |
| 4.1. | Impairments-Specific | 574 | 617 | 718 | 771 | 1 007 |
| 4.2. | Interest in suspense | 213 | 257 | 339 | 218 | 340 |
| 4.3. | Impairments Portfolio | - | - | - | - | 132 |
| 5. | Loans and advances to other customers (net of specific provisions) | 27 133 | 33 537 | 38 442 | 44 075 | 46 829 |
| 6. | Fixed assets net of depreciation | 482 | 665 | 872 | 910 | 968 |
| 7. | Other assets (net) | 1 911 | 1 213 | 911 | 1 054 | 1 109 |
| | Total Assets | 51 600 | 57 954 | 59 962 | 67 994 | 76 605 |
| | TOTAL LIABILITIES IN LOCAL CURRENCY | | | | | |
| 1. | Amounts owed to government institutions | - | - | 6 | 12 | 2 |
| a. | Central Bank accounts | - | - | 6 | 12 | 2 |
| b. | Direct Government credits (CB or MFDP) | - | - | - | - | - |
| 2. | Due to other banks and credit institutions | 990 | 1 320 | 1 394 | 3 581 | 3 308 |
| 3. | Debt Securities and Other Borrowing | 908 | 942 | 2 292 | 2 088 | 3 163 |
| 4. | Due to other customers/depositors | 43 178 | 47 219 | 48 589 | 51 491 | 59 940 |
| 5. | Shareholders' funds | 4 696 | 5 548 | 6 479 | 7 724 | 8 204 |
| 6. | Other liabilities | 1 827 | 2 925 | 1 202 | 3 097 | 1 997 |
| a. | Taxes payable | 156 | 132 | 177 | 133 | 252 |
| b. | Dividends payable | - | 20 | - | 4 | 7 |
| c. | Accrued expenses | 243 | - | - | 1 167 | - |
| d. | Other | 1 429 | 2 774 | 1 025 | 1 794 | 1 715 |
| | Total Liabilities | 51 600 | 57 954 | 59 962 | 67 994 | 76 605 |

# APPENDIX **7**

Table 2: Aggregate Statement of Comprehensive Income of Licensed Commercial Banks (P' million) for the period ended December 31st

| | | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| 1. | Interest and similar income | 4 407 | 4 784 | 5 146 | 4 953 | 5 129 |
| 2. | Interest expense | 1 662 | 1 502 | 1 600 | 1 670 | 2 093 |
| 3. | Net interest income [1-2] | 2 745 | 3 282 | 3 546 | 3 284 | 3 036 |
| 4. | Other operating income | 1 631 | 1 777 | 2 028 | 2 150 | 2 312 |
| **5.** | **Gross operating income/(loss) [3+4]** | **4 376** | **5 059** | **5 575** | **5 434** | **5 348** |
| 6. | Total Impairments | 301 | 455 | 579 | 760 | 668 |
| a. | Impairment of loans and advances-Specific | 305 | 445 | 588 | 545 | 587 |
| b. | Impairment of loans and advances-Portfolio | 37 | 55 | 45 | 216 | 83 |
| c. | Impairment on other financial assets | (41) | (46) | (53) | (1) | (2) |
| **7.** | **Operating income/(loss) net of bad and doubtful debts** | **4 075** | **4 604** | **4 995** | **4 674** | **4 680** |
| 8. | Operating expenses | 2 096 | 2 364 | 2 709 | 2 782 | 3 242 |
| a. | Salaries and employee benefits | 979 | 1 133 | 1 248 | 1 370 | 1 335 |
| b. | Auditing and consulting expenses | 33 | 6 | 17 | 49 | 49 |
| c. | Rents paid | 84 | 129 | 105 | 187 | 195 |
| d. | Depreciation and amortization | 110 | 107 | 152 | 135 | 148 |
| e. | Other | 890 | 989 | 1 186 | 1 089 | 1 565 |
| 9. | Other provisions and write-offs | 14 | - | - | - | - |
| a. | Investments | - | - | - | - | - |
| b. | Other balance sheet items | 14 | - | - | - | - |
| c. | Off-balance sheet items | - | - | - | - | - |
| **10.** | **Net operating income/(loss) [7-8-9]** | **1 964** | **2 240** | **2 287** | **1 893** | **1 438** |
| 11. | Extraordinary Gains/(Losses) | - | - | 18 | - | - |
| a. | Gains/Losses on revaluation of assets (NET) | - | - | 18 | - | - |
| b. | Translation Gains/Losses (NET) | - | - | - | - | - |
| c. | Other Gains/Losses | - | - | - | - | - |
| **12.** | **Net income/(loss) before tax [10+11]** | **1 964** | **2 240** | **2 305** | **1 893** | **1 438** |
| 13. | Income tax | 313 | 468 | 530 | 415 | 349 |
| **14.** | **Net income/(loss) after tax [12-13]** | **1 652** | **1 772** | **1 775** | **1 478** | **1 088** |

# APPENDIX **7**

Table 3: Aggregate Statement of Financial Position for Statutory Banks in Botswana (P' million) as at December 31st

| | TOTAL ASSETS IN LOCAL CURRENCY | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| 1. | Cash and balances with the Central Bank | 14 | (20) | 19 | 8 | 9 |
| a. | Currency | 20 | (21) | 15 | 6 | 8 |
| aa. | Foreign currency | - | - | - | - | - |
| ab. | Local currency | 20 | (21) | 15 | 6 | 8 |
| b. | Balances with Central Bank | (7) | 1 | 3 | 2 | 1 |
| c. | Other | - | - | - | - | - |
| 2. | Investment and Trading securities | 27 | - | - | - | - |
| 3. | Placements with other banks and credit institutions | 579 | 874 | 948 | 877 | 1 610 |
| 4. | Gross Loans and advances to customers | 3 573 | 4 214 | 4 873 | 5 612 | 5 933 |
| 5. | Specific Provisions | 129 | 199 | 242 | 254 | 418 |
| 6. | Net Loans and advances to customers | 3 445 | 4 015 | 4 631 | 5 359 | 5 515 |
| 8. | Fixed assets net of depreciation | 176 | 184 | 217 | 246 | 261 |
| 9. | Other assets (net) | 11 | 46 | 124 | 200 | 99 |
| | Total Assets | 4 279 | 5 099 | 5 938 | 6 689 | 7 492 |
| | Liabilities in Local Currency | | | | | |
| 1. | Amounts owed to government institutions | - | - | - | - | - |
| a. | Central Bank accounts | - | - | - | - | - |
| b. | Direct Government credits (CB or MFDP) | - | - | - | - | - |
| c. | Other | - | - | - | - | - |
| 2. | Borrowings from Other Banks, Credit Institutions and International Lending Agencies | 626 | 749 | 1 671 | 1 877 | 2 073 |
| 3. | Due to customers/depositors | 879 | 1 430 | 1 740 | 2 180 | 3 340 |
| 4. | Shareholders' funds | 2 031 | 2 162 | 2 350 | 2 464 | 1 888 |
| 5. | Other liabilities | 744 | 758 | 177 | 168 | 191 |
| a. | Taxes payable | - | - | 1 | 1 | 1 |
| b. | Dividends payable | 12 | 1 | - | - | - |
| c. | Accrued expenses | 13 | - | - | - | - |
| d. | Other | 719 | 757 | 176 | 168 | 190 |
| | Total Liabilities | 4 279 | 5 099 | 5 938 | 6 689 | 7 492 |

# APPENDIX **7**

Table 4: Aggregate Statement of Comprehensive Income of Statutory Banks (P' million) for the period ended December 31st

| | | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| 1. | Interest and similar income | 377 | 455 | 561 | 525 | 639 |
| 2. | Interest expense | 137 | 167 | 211 | 226 | 288 |
| 3. | Net interest income [1-2] | 239 | 288 | 350 | 299 | 351 |
| 4. | Other operating income | 50 | 47 | 51 | 48 | 58 |
| **5.** | **Gross operating income/(loss) [3+4]** | **289** | **335** | **401** | **347** | **409** |
| 6. | Bad and Doubtful Debts Provisions | 36 | 31 | 45 | 23 | 51 |
| a. | Specific loss provision expenses | 36 | 29 | - | - | - |
| b. | General loss provision | - | 2 | - | - | - |
| c. | Releases and Recoveries of bad debts previously written off | - | - | - | - | - |
| **7.** | **Operating income/(loss) net of specific loss provisions** | **253** | **305** | **356** | **324** | **358** |
| 8. | Operating expenses | 167 | 183 | 235 | 243 | 258 |
| a. | Salaries and employee benefits | 88 | 95 | 126 | 121 | 140 |
| b. | Administrative expenses | - | - | - | - | - |
| c. | Auditing and consulting expenses | - | - | - | - | - |
| d. | Rents paid | - | - | - | - | - |
| e. | Depreciation and amortization | 6 | 7 | 9 | 9 | 13 |
| f. | Other | 73 | 81 | 100 | 113 | 105 |
| 9. | Other provisions and write-offs | - | - | - | - | - |
| a. | Investments | - | - | - | - | - |
| b. | Other balance sheet items | - | - | - | - | - |
| c. | Off-balance sheet items | - | - | - | - | - |
| **10.** | **Net operating income/(loss) [7-8-9]** | **86** | **121** | **121** | **82** | **100** |
| 11. | Extraordinary Gains/(Losses) | - | - | - | - | - |
| a. | Gains/Losses on revaluation of assets (NET) | - | - | - | - | - |
| b. | Translation Gains/Losses (NET) | - | - | - | - | - |
| c. | Other Gains/Losses | - | - | - | - | - |
| **12.** | **Net income/(loss) [10+11]** | **86** | **121** | **121** | **82** | **100** |

# APPENDIX **7**

Table 5: Aggregate Capital Structure of Commercial Banks in Botswana (Tier 1 Capital, Tier 2 Capital and Total Capital) (P' million) as at December 31st

| | TIER 1 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| 1. | Stated Capital | 712 | 977 | 977 | 1 097 | 1 381 |
| 2. | Preference (non-redeemable) non-cumulative shares | 255 | 229 | 229 | 229 | - |
| 3. | General Reserves | 70 | 225 | 377 | 67 | 148 |
| 4. | Retained Earnings | 2 558 | 3 468 | 4 112 | 4 589 | 5 116 |
| 5. | Minority Interests | - | - | - | - | - |
| 6. | Less | (134) | (104) | (92) | (91) | (86) |
| a. | Goodwill and other intangible assets | (134) | (104) | (92) | (89) | (82) |
| b. | Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation | - | - | - | - | - |
| c. | Current year's unpublished losses | - | - | - | (2) | (4) |
| 7. | Total Tier 1 Capital (Sum of lines 1-5 less lines 6(a) - (c) | 3 461 | 4 796 | 5 603 | 5 891 | 6 560 |
| | TIER 2 | | | | | |
| 8. | Current year's unpublished profits | 976 | 472 | 634 | 971 | 780 |
| 9. | Fifty percent of fixed asset revaluation reserves | 37 | 32 | 57 | 35 | 34 |
| | Unrealised gains on available for sale revaluations | - | - | - | - | 9 |
| 10. | Unencumbered general provisions not to exceed 1.25 percent of risk weighted assets | 202 | 345 | 359 | 310 | 332 |
| 11. | Hybrid (debt/equity) capital instruments eligible for inclusion | - | - | - | - | 8 |
| 12. | Subordinated term debt eligible for inclusion | 753 | 1 088 | 846 | 1 036 | 1 551 |
| 13. | Minority interest in Tier 2 preference shares | 1 | - | - | 100 | 100 |
| 14. | Shareholders equity funded through the capitalisation of property revaluation reserves | - | - | - | - | - |
| 15. | Total Tier 2 Capital (sum of lines 8-14) | 1 969 | 1 937 | 1 896 | 2 472 | 2 814 |
| 16. | Total Capital (sum of lines 7 and 15) | 5 430 | 6 733 | 7 499 | 8 363 | 9 374 |
| | Impairments | | | | | |
| 17. | Investments in unconsolidated subsidiaries and associated companies | - | - | - | - | - |
| 18. | Total Impairments of Capital | - | - | - | - | - |
| 19. | Total Unimpaired Capital (line 16 less line 18) | 5 430 | 6 733 | 7 499 | 8 363 | 9 374 |

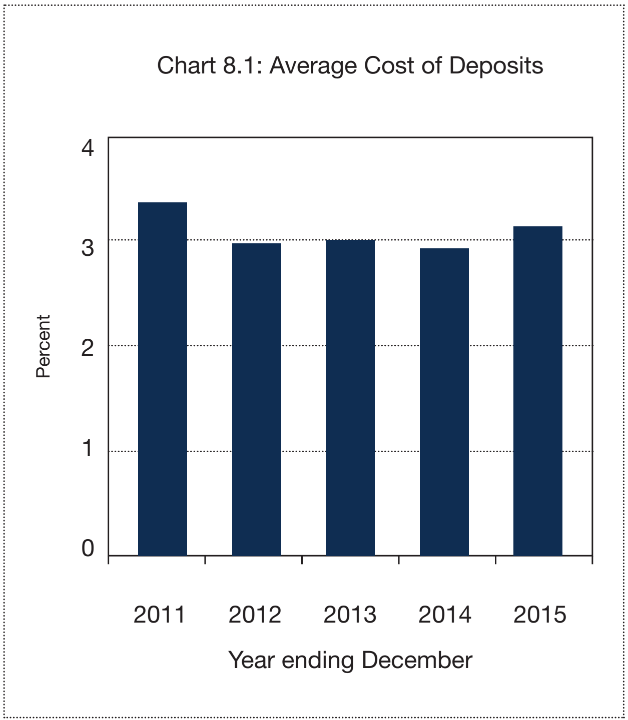
# APPENDIX **7**

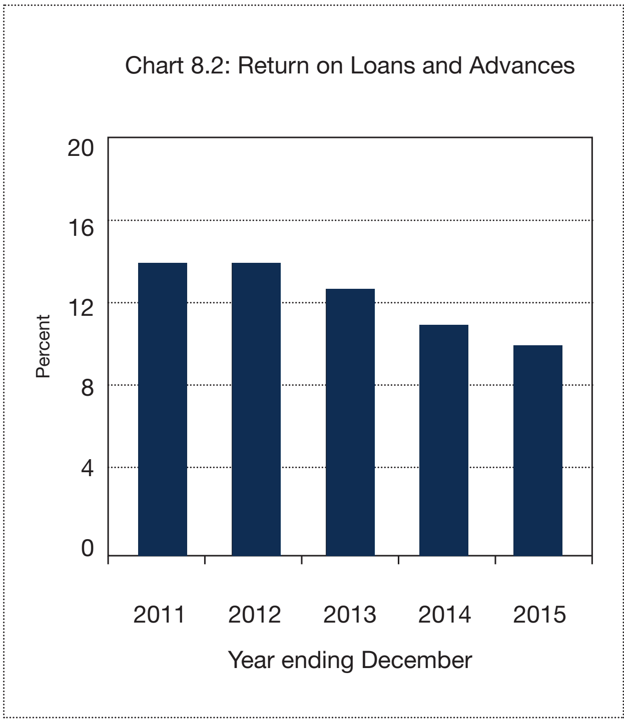
Table 6: Aggregate Capital Structure of Statutory Banks in Botswana (Tier 1, Tier 2 and Total Capital) (P' million) as at December 31st

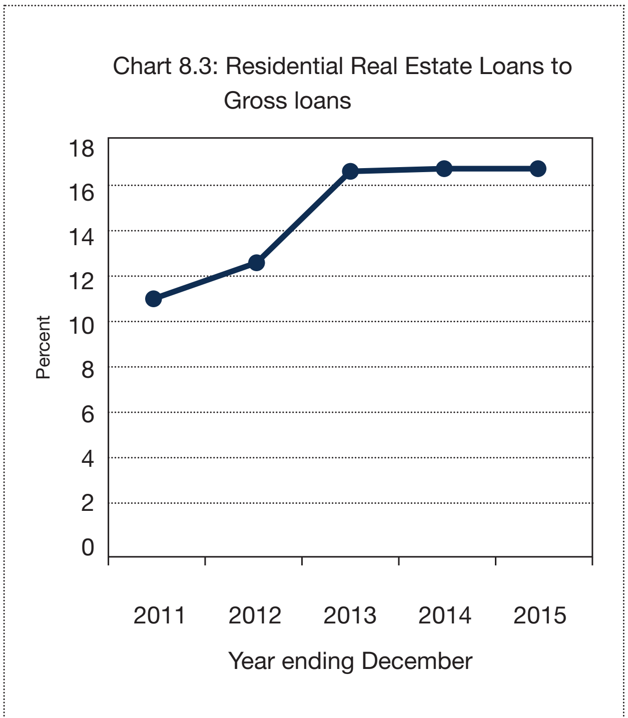
| | TIER 1 | 2013 | 2014 | 2015 |
|---|---|---|---|---|
| 1. | Stated Capital | 790 | 886 | 956 |
| 2. | Preference (non-redeemable) non-cumulative shares | - | - | - |
| 3. | General Reserves | 223 | 233 | 238 |
| 4. | Retained Earnings | 717 | 767 | 617 |
| 5. | Minority Interests | - | - | - |
| 6. | Less | - | - | 7 |
| a. | Goodwill and other intangible assets | - | - | 7 |
| b. | Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation | - | - | - |
| | Current year's unpublished losses | - | - | - |
| **7.** | **Total Tier 1 Capital (Sum of lines 1-5 less lines 6(a) and (b)** | **1 730** | **1 887** | **1 805** |
| | TIER 2 | | | |
| 8. | Current year's unpublished profits | 89 | 72 | 94 |
| 9. | 50 percent of fixed asset revaluation reserves | 13 | 22 | 23 |
| 10. | Unrealised gains on available for sale revaluations | - | - | - |
| a. | Unencumbered general provisions not to exceed 1.25 percent of risk weighted assets | 29 | 36 | 23 |
| b. | Statutory Credit Risk Reserve | - | - | - |
| 11. | Subordinated term debt eligible for inclusion | - | - | - |
| 12. | Minority interest in Tier 2 preference shares | - | - | - |
| 13. | Shareholders equity funded through the capitalisation of property revaluation reserves | - | - | - |
| **14.** | **Total Tier 2 Capital (sum of lines 8-14)** | **131** | **130** | **140** |
| **15.** | **Total Capital (sum of lines 7 and 14)** | **1 861** | **2 017** | **1 945** |
| | Impairments | | | |
| 16. | Investments in unconsolidated subsidiaries and associated companies | 1 | 1 | 1 |
| 17. | Connected lending of a Capital Nature | - | 4 | - |
| 18. | Total Impairments of Capital | 1 | 5 | 1 |
| **19.** | **Total Unimpaired Capital (line 15 less line 18)** | **1 860** | **2 012** | **1 944** |

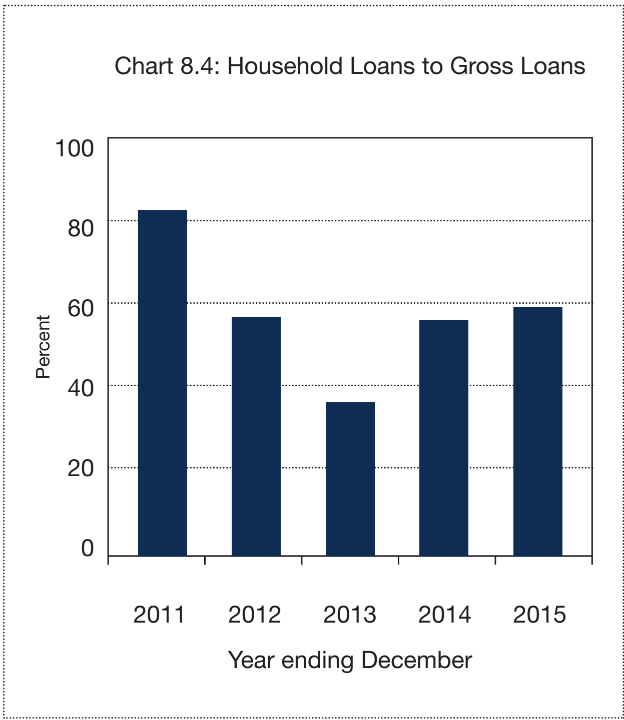
# APPENDIX **8**

## CHARTS OF KEY PRUDENTIAL AND OTHER FINANCIAL INDICATORS



# APPENDIX **8**

## CHARTS OF KEY PRUDENTIAL AND OTHER FINANCIAL INDICATORS

Chart 8.5: Non-Performing Loans Growth Rate

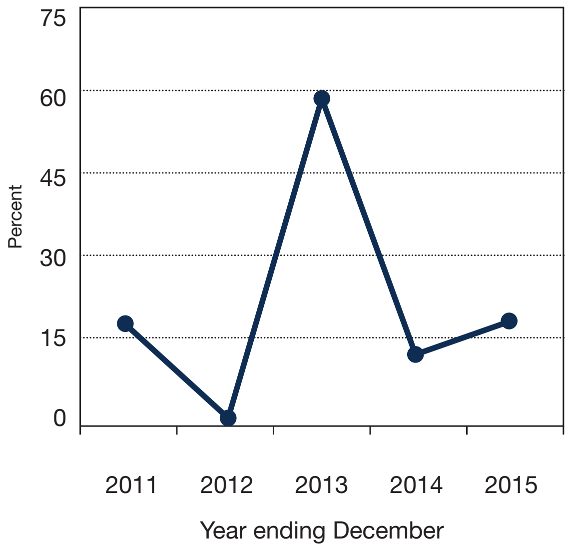



Chart 8.6: Share of Value of Total Deposits by Type (including FCAs)

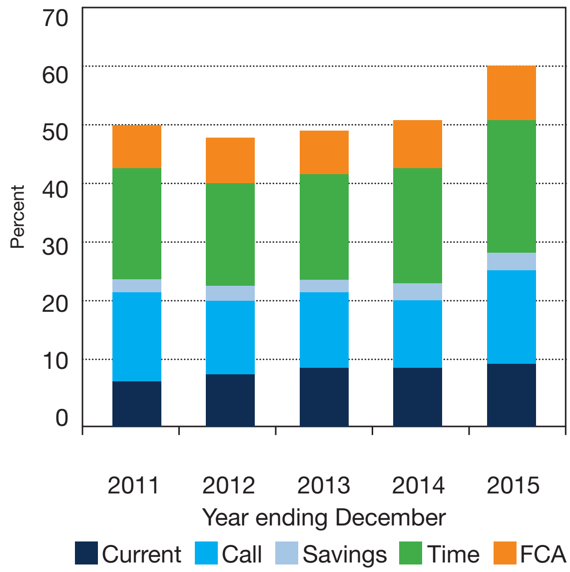



Chart 8.7: Growth Rate of Foreign Currency Accounts

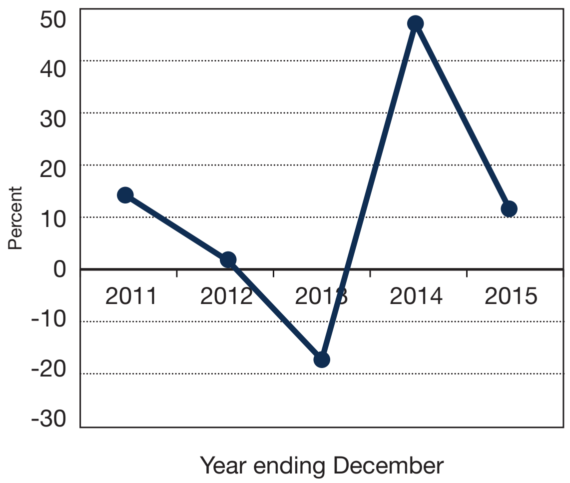
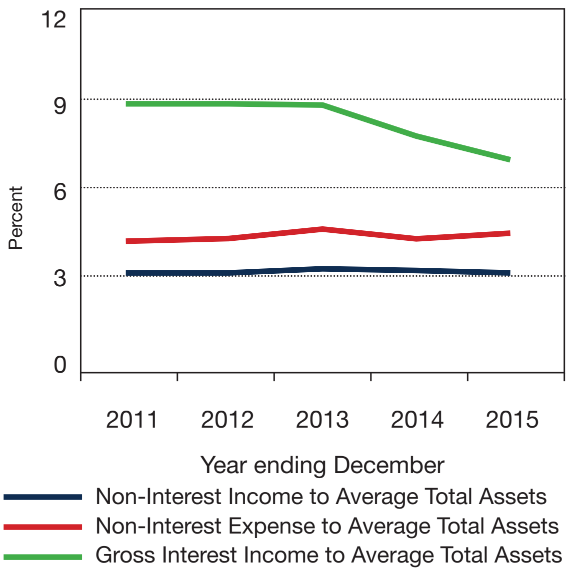



Chart 8.8: Efficiency Ratios



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