Banking Supervision Annual Report 2011

Bank of Botswana

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Contents

Acronyms and Other Abbreviations

ABCB	African Banking Corporation of Botswana Limited
AML	Anti-Money Laundering
ATA	Average Total Assets
ATM	Automated Teller Machine
BARCLAYS	Barclays Bank of Botswana Limited
BARODA	Bank of Baroda (Botswana) Limited
BBS	Botswana Building Society
BG	Bank Gaborone Limited
BIS	Bank for International Settlements
BoBCs	Bank of Botswana Certificates
BSB	Botswana Savings Bank
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
CAR	Capital Adequacy Ratio
CBL	Capital Bank Limited
CFT	Combating the Financing of Terrorism
CIUs	Collective Investment Undertakings
DRS	Disaster Recovery Site
DSAs	Direct Sales Agents
FATF	Financial Action Task Force
FNBB	First National Bank of Botswana Limited
FSIs	Financial Soundness Indicators
GBP	British Pound Sterling
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
KYC	Know Your Customer
LHS	Left Hand Scale

NBFIRA	Non-Bank Financial Institutions Regulatory Authority
NDB	National Development Bank
NMD	Namibian dollar
OMO	Open Market Operations
PRR	Primary Reserve Requirement
PTY	Proprietary Limited Company
RHS	Right Hand Scale
ROAA	Return on Average Total Assets
ROE	Return on Equity
RWA	Risk-Weighted Assets
STANBIC	Stanbic Bank Botswana Limited
STANCHART	Standard Chartered Bank Botswana Limited
STR	Suspicious Transactions Reports
USD	United States dollar
ZAR	South African rand

FOREWORD

The growth of the banking sector, as indicated by the statement of financial position, slowed down in 2011, compared to 2010, and reflected the lingering challenges in the overall domestic and external economic environment. The ongoing sovereign debt crisis affecting some European Union countries continued to affect the country's export performance and related revenue sources from tourism and mining. In the circumstances, government spending was restrained throughout the year and although robust, the overall economy expanded at a slower rate of 4.1 percent compared to 7.2 percent in the previous year, due to a decline in mining output while non-mining performance rose at a faster rate of 6.8 percent.

The profitability of the banks, solvency and total industry credit rose at a faster rate compared to 2010. Similarly, the banking sector reported improvements in asset quality and consequently a decline in provisions for bad debts. In November 2011, the Bank took a decision to limit outstanding Bank of Botswana Certificates (BoBCs) to P10 billion in an effort to contain the cost of monetary operations as well as encourage banks to lend for productive purposes in support of economic diversification. The full effects of the initiative on BoBCs will unfold overtime and should be balanced against the risk of banking system soundness.

The number of banks was unchanged during the year and some bureaux de change were closed down due to non-compliance with regulatory requirements. Nevertheless, access to financial services increased further through the introduction of new products. This included e-money transactions which are available to previously unbanked sections of the population, particularly those in the rural areas. In addition, more branches were opened and automated teller machines (ATMs) were installed during the year.

The banking sector was generally compliant with all the statutory regulatory requirements; and the Bank continued to monitor the performance of the banking sector through on-site examinations, off-site surveillance and regular bilateral, trilateral and Banking Committee meetings.

The objective of this report is to inform the public and other stakeholders about the objectives, structure, form and process of banking supervision and, more importantly, about the performance of the banking industry during 2011.

Linah K Mohohlo

GOVERNOR

Introduction

The global economic recovery, which started in 2010, remained fragile in 2011 due to substantial sovereign debt in a number of advanced economies, especially in the Euro zone. The economic performance of these economies had financial implications for Botswana through the impact on tourism as well as exports of diamond and other products. As a result, the domestic economy slowed down to 4.1 percent in the twelve month period to September 2011, from 7.2 percent in 2010, due to the decline in mining output. Even so, non-mining activity rose by a robust 6.8 percent, led by construction and followed by the manufacturing and transport sectors. Overall, the banking sector growth was lower than the previous year.

Banking system total assets rose by 4 percent in 2011, which is a significant slowdown from the 12.6 percent expansion in 2010. However, the banking sector credit growth increased significantly by 26.3 percent, compared to 12.1 percent in the previous year, buoyed by a switch in asset composition from liquid assets to lending. Although it was reduced to 53 percent of the total, the share of bank lending to households continued to be the largest component of total banking sector credit. Nevertheless, as a reflection of higher non-mining activities, the quality of banking system assets improved as evidenced by a reduction in aggregate past due loans and provisioning, while deposits rose at a reduced rate of only 4 percent, thus reflecting an overall slowdown of the economy.

Banks remained well capitalised and complied with the minimum capital adequacy requirements. Banks' liquidity continued to be above the statutory threshold although the ratios trended downwards during the year. Moreover, large exposures were contained within the prudential limit of 800 percent of capital, which is an indication of prudent management of concentration risk. The outreach was extended further through additional branches, service centres, agencies and diversification of service delivery channels, including the introduction of cellular phone money transfer facilities that benefited the unbanked sections of society.

Work on the adoption of new global regulatory reforms was underway during the year. The key reform frameworks include proposals for adoption of the revised International Convergence of Capital Measurement and Capital Standards, commonly known as Basel II, the objective of which is to foster a more risk sensitive capital measurement framework.

This Banking Supervision Report is organised such that Chapter 1 highlights the structure of the banking sector. Chapter 2 provides an assessment of the operational performance of the sector in 2011, while summaries of statutory compliance and operational performance of non-bank financial institutions are in Chapter 3 and 4, respectively. International best practices on banking supervision are addressed in Chapter 5, and Chapter 6 deals with other banking system developments. The concluding remarks and overall summary are in Chapter 7.

The appendices provide a list of institutions licensed and supervised by the Bank, definitions of banking supervision terms, and approaches to regulation and supervision of banks in Botswana. Aggregate financial data and charts of key prudential and financial soundness indicators (FSIs) are also included.

Chapter 1: Banking Sector Overview

Structure of the Banking Industry and Other Supervised Financial Institutions

Commercial Banks, Statutory Banks and Other Entities

The structure of the Botswana financial sector remained unchanged in 2011 (Diagram 1). The Bank maintained supervisory responsibility for commercial banks, statutory banks, bureaux de change and deposit-taking micro-finance institutions, while the Non-Bank Financial Institutions Regulatory Authority (NBFIRA) supervised the non-bank financial sector, notably, the insurance industry, pension funds, stock exchange, fund management and other investment advisory services, as well as micro-lending businesses. The number of banks regulated by the Bank remained at 11 in 2011, while operational bureaux de change increased from 53 to 68.

Banking Business Distribution Channels

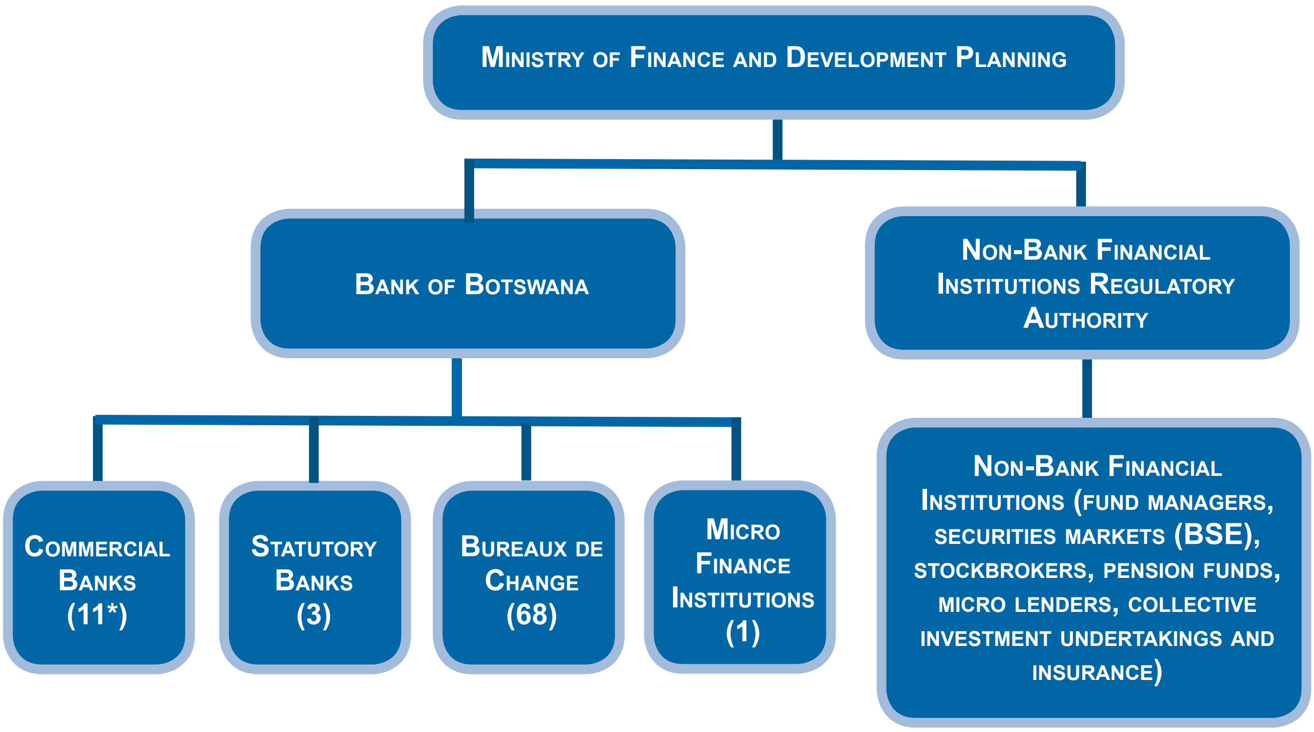
Banks continued to offer convenient services to customers through branches, service centres and agencies, as well as the internet. The service centres are for purposes of opening new bank accounts, issuing ATM cards, account balance enquiries and loan applications, which eased congestion at the banks' main branches.

Two new bank branches were opened and 38 new ATMs installed during 2011. This increased the number of operational bank branches to 96; ATMs reduced to 357. First National Bank of Botswana Limited (FNBB), which has the highest number of ATMs, discontinued 62 mini ATMs in 2011 (Table 1).

New Banking Products

In order to meet the changing needs of their customers, banks continued to be innovative by introducing new products and increased service delivery channels. Products such as salary advances and Small Medium

Diagram 1: The Structure of the Botswana Financial System/Sector



*Includes two offshore commercial banks

Table 1: Licensed Banks' Distribution Channels: 2009 – 2011*

	Branches and Sub-Branches			ATMs		
Bank**	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**
Barclays	40	40	40	100	99	103
Stanchart	13	13	14	43	46	54
FNBB	18	18	19	185	201	***157
Stanbic	9	11	10	16	18	18
Baroda	2	2	2	2	3	4
ABCB	2	3	4	0	0	4
BG	4	5	5	6	12	15
Capital	2	2	2	0	2	2
Total	**90**	**94**	**96**	**352**	**381**	**357**

* Botswana Savings Bank (BSB), Botswana Building Society (BBS) and National Development Bank (NDB) are not included in Table 1. If they are included, the total number of bank branches and ATMs are 110 and 367, respectively, as at December 31, 2011. BSB had 2 branches; BBS 9 branches and 10 ATMs; NDB 3 branches and 1 agency.

** This does not include ABN AMRO (domestic operation) as it did not have branches in 2010 and 2011.

*** Of the 157 ATMs, 123 are full ATMs and 34 are mini ATMs.

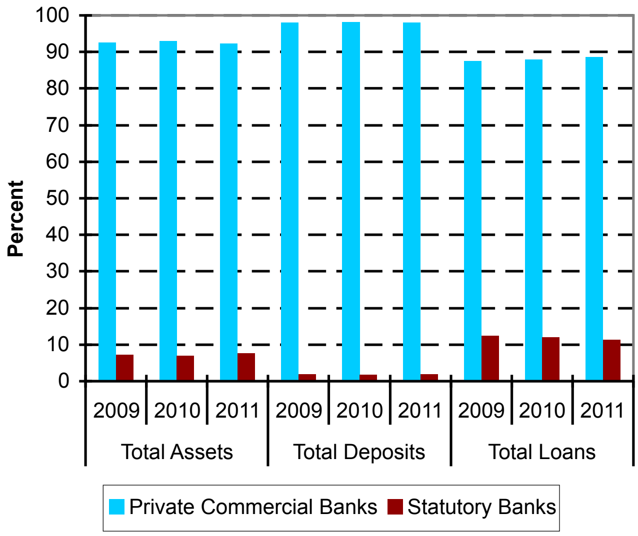
and Micro Enterprises (SMMEs) quick loans were launched during 2011. As a way of varying banking delivery channels, banks partnered with mobile telecommunication companies and insurance companies to conduct money transfer business and provide insurance products, respectively. The money transfer business allows customers to conduct banking without having to visit a bank, while at the same time lowering service delivery costs for banks.

The introduction of mobile money payment services, which has been successful in other African countries, is a welcome development in Botswana as it will enhance financial inclusion, including access to financial services by the unbanked population, especially in the rural areas. However, there are risks associated with this service delivery channel, such as the potential to compromise customer privacy and security, as well as identity theft and other forms of fraud. Notwithstanding the aforementioned risks, the Bank has been reassured that all the necessary risk mitigation strategies have been put in place, and will also closely monitor the uptake and the management of these products by banks.

Market Share

Consistent with the trend in the past five years, privately owned commercial banks held a larger share of total banking industry assets, deposits and loans and advances. Notably, even with new banking products and improved service delivery channels, the market shares of deposits remained unchanged for both commercial and statutory banks at 98 percent and 2 percent, respectively. On the other hand, commercial banks' market share of the industry loans and advances increased slightly by a percentage point, from 88 percent to 89 percent in 2011 (Chart 1(a)).

Chart 1 (a): Banking Industry Market Share of Total Assets, Total Deposits and Total Loans



The four largest banks[1] continued to dominate the private commercial bank market, even though the smaller banks have made marginal gains at the expense of the market share held by the large banks. Although not a significant change, the smaller banks' market share of total assets and loans and advances has been increasing since 2009 (Chart 1(b)).

1 A large bank, in this case, is a bank whose total assets constitute 10 percent or more of the aggregate industry balance sheet. These large banks are Barclays, FNBB, Stanbic and Stanchart; and the 'small banks' are Baroda, ABCB, BG and Capital Bank Limited (CBL).

CHART 1 (B): PRIVATE BANKS MARKET SHARE OF TOTAL ASSETS, TOTAL DEPOSITS AND TOTAL LOANS

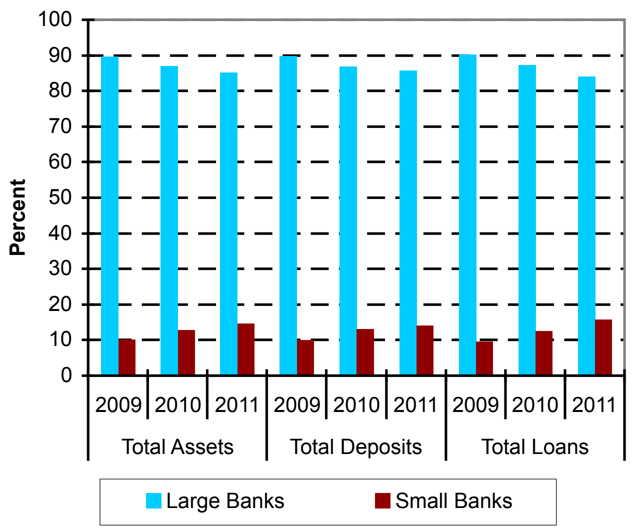
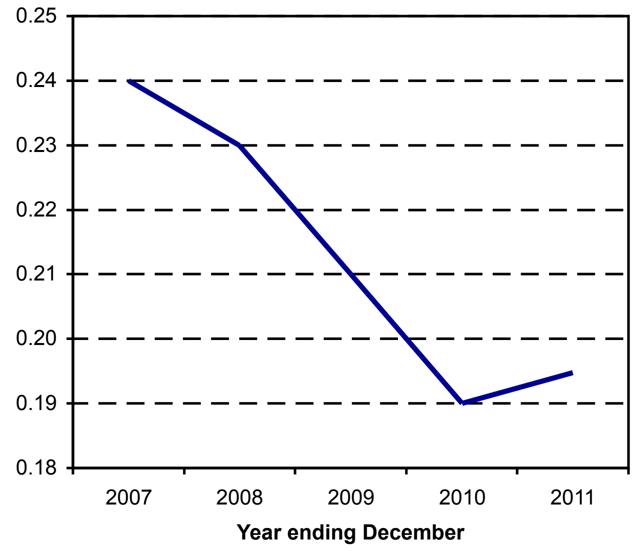


CHART 2: HERFINDAHL-HIRSCHMAN INDEX (HHI)



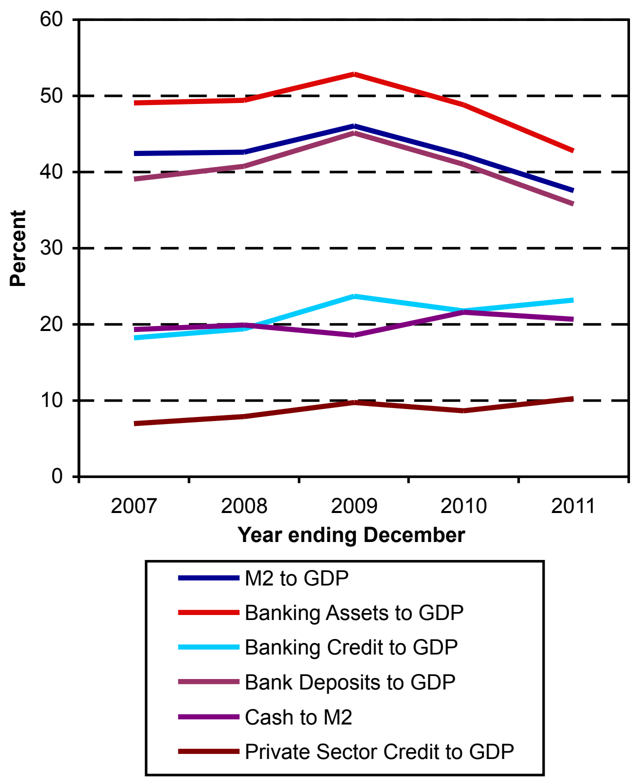
Competition

Increased competition in the banking sector is desirable as it is expected to spur institutional efficiency, innovation and superior service delivery. The Herfindahl-Hirschman Index (HHI) is a widely used measure to assess the degree of competition in an industry. It takes into account the relative size and distribution of firms in a market. The measure approaches zero when a market consists of a large number of firms of relatively equal size. Although the HHI for the banking sector has been trending downwards between 2007 and 2009, it has remained almost unchanged at 0.19 between 2010 and 2011, indicating little or no change in competitiveness in the banking industry (Chart 2). This trend is further corroborated by lack of change in the market share of total assets, deposits and loans and advances between large and small banks. The dominance of the four largest banks in the industry has given rise to an imperfectly competitive market structure.

Financial Deepening and Development

Financial deepening indicators declined during the period under review in line with the difficult economic conditions alluded to earlier. The broad measure of money supply, M2[2] to GDP ratio, dropped from 42 percent in 2010 to reach 38 percent in 2011 due to a much slower growth of M2 compared to the increase in GDP. The ratio of Banking Assets to GDP also declined from 49 percent in 2010 to 43 percent in 2011. The reduction in these ratios is indicative of an overall decline in financial savings, possibly because of the low interest rates offered by banks (Chart 3). The Private Sector Credit to GDP ratio, which is a measure of the quantum of credit to the private sector and banking depth, increased during the year. This is a sign of improved intermediation by banks.

CHART 3: FINANCIAL SECTOR DEEPENING



Source: Botswana Financial Statistics and the December 2011 Statutory Returns

2 M2 comprises all liabilities of financial corporations included in a country's definition of broad money. In the case of Botswana, M2 comprises the following: currency outside depository corporations, transferable deposits (demand deposits) and other deposits included in broad money (time and fixed deposits).

These indicators of financial deepening and monetisation of the economy are low by international norms, and this suggests that the financial sector is still undeveloped.

Licensing of New Banks and Enquiries on Banking Licence Procedures

During 2011, no new bank was licensed, notwithstanding numerous enquiries on the licence application procedures and requirements by potential foreign and local investors. However, one application for a commercial banking licence submitted in 2010 was rejected in 2011, due to failure to meet the licensing requirements. Another application received during the year was still being processed.

Employment

The staff complement of the banking industry stood at 4 300[3] at the end of 2011; having grown by 5 percent from 4 097 in 2010. African Banking Corporation of Botswana Limited (ABCB) recorded the highest growth rate of 25 percent, due to the bank's entry into the retail market, which entailed extensive expansion of infrastructure and employment of additional personnel. This was followed by Standard Chartered Bank Botswana Limited (Stanchart) with 13 percent. The majority of banks recorded growth rates below 5 percent, with Kingdom Bank Africa Limited (KBAL) being the only bank to experience a decline of 24 percent in 2011 due to staff rationalisation measures. The number of expatriate staff employed by the banking industry decreased by 5 percent in 2011 from 88 to 84 (Table 2).

Table 2: Staffing Levels for Licensed Banks: 2010 – 2011

Bank	2010			2011		
	Citizens	Expatriates	Total	Citizens	Expatriates	Total
Barclays	1 326	12	1 338	1 374	9	1 383
Stanchart	670	15	685	758	16	774
FNBB	1 044	15	1 059	1 060	13	1 073
Stanbic	529	7	536	556	6	562
Baroda	24	9	33	24	10	34
ABCB	98	8	106	125	7	132
BG	216	9	225	229	8	237
CBL	69	5	74	69	4	73
KBAL	31	6	37	19	9	28
ABN AMRO	2	2	4	2	2	4
	4 009	**88**	**4 097**	**4 216**	**84**	**4 300**

3 The official statistics on staffing do not include Direct Sales Agents (DSAs); they are treated as temporary staff.

Box 1: Illegal Banking Activities under the Banking Act (CAP. 46:04) (Banking Act)

The Banking Act is the primary banking legislation in Botswana. Only institutions licensed under Section 3(1) of the Banking Act or exempted under Section 53(2) of the Banking Act are authorised to conduct banking business.[4] These institutions are licensed banks and statutory banks, which are established under their respective statutes.

Any business operations which contravene the aforementioned provisions of the Banking Act would be conducting illegal banking activities. For this reason, the Bank is empowered under Section 5(1) of the Banking Act to investigate any person or entity suspected to be advertising or conducting illegal deposit-taking business. If the investigations confirm the contravention, and subject to other interventions as the Bank may deem appropriate, the activities shall be suspended forthwith in accordance with Section 5(5) of the Banking Act. The Bank has carried out investigations in the past and effectively terminated such operations through issuance of "cease and desist" orders to such business operations.

Illegal operations are considered to be harmful, deceitful and their existence has the potential to undermine financial system soundness and stability, as well as the integrity of the country. It is against this background that it is a criminal offence, punishable by law, for any person(s) to operate an unauthorised deposit-taking activity in Botswana. Action taken by the Bank in respect of such illegal businesses is done in due consultation with the Minister of Finance and Development Planning, pursuant to Section 5(3) of the Banking Act. Furthermore, the Banking Act prescribes procedures to be followed to ensure the proper disposal of monies/assets in the possession of an unlicensed entity that were obtained while transacting the illegal business.

The most common form of illegal deposit-taking activities in the country has been those resembling pyramid schemes. Sources of information on suspected operations have been the media, Police and members of the public. As part of the public education effort, the Bank issued Press releases advising the public against participation in such illegal banking activities. If in doubt about the nature of operations offered by a business, the public should always contact the Banking Supervision Department of the Bank of Botswana.

4 (i) "the business of accepting deposits of money repayable on demand or after fixed periods or after notice, as the case may be, by cheque or otherwise"; and/or

(ii)"the employment of deposits in the making or giving of loans, advances, overdrafts or other similar facilities, and in the making of investments or engagement in other operations authorised by law or under customary banking practice, for the account of, and at the risk of the person or persons accepting such deposits, and includes the discounting of commercial paper, securities and other negotiable instruments for the purpose of extending loans or other credit facilities".

Chapter 2: Operational Performance of the Banking Industry

Composition of the Statement of Financial Position

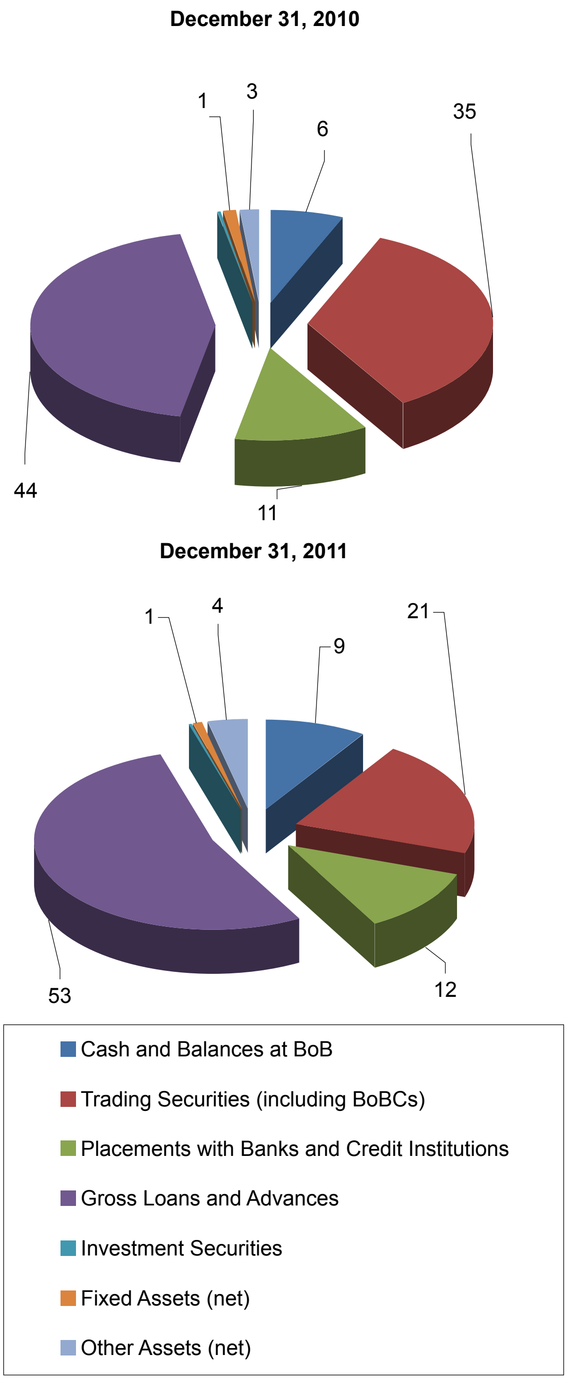
The aggregate banking sector statement of financial position continued to register growth, albeit at a slower pace than in the prior year. Total assets grew by 4 percent in 2011 compared to 12.6 percent in the previous year. The deceleration in statement of financial position growth was mainly due to the muted deposit growth. However, there was a significant increase in lending following the Bank's decision to reduce the issuance of BoBCs, in order to encourage banks to more aggressively seek out bankable projects that could promote economic growth and diversification. Consequently, trading securities at market value (including BoBCs), declined by 37 percent to reach a five-year low of P11.1 billion, down from P17.6 billion in 2010.

Excess liquidity that resulted from the reduction in BoBC holdings by banks during the year was, in part, channelled towards credit expansion and funding increased primary reserve requirement (PRR). Counterparty confidence in the banking sector was sustained in 2011, even though placements with other banks and credit institutions rose by only 7 percent, compared to a 43.5 percent growth in 2010. This was mainly due to a reduction in placements with other banks and credit institutions by two banks, which fell by 11.7 percent and 15.1 percent, respectively, between 2010 and 2011.

Excess liquidity and the low interest rate environment led to gross loans and advances increasing significantly by 26.3 percent, compared to 12.1 percent in 2010, marginally exceeding the pre-recession period average growth rate of 26.2 percent recorded between 2006 to 2008. This faster credit growth and the reduction in BoBC holdings resulted in improvement in the intermediation ratio which reached a five-year high of 65 percent.

The funding structure of the banking sector remained unchanged in 2011, with banking sector assets continuing to be primarily financed by customer deposits. Deposits constituted 84 percent of banking industry liabilities, while shareholders' funds accounted for 9.1 percent. On the other hand, the lack of deposit growth could be associated with the reluctance by banks to accept large deposits as they were sitting on excess funds from the limited issuance of BoBCs. The excess funds were evidently used by banks to finance credit growth

Chart 4: Composition of Assets: 2010 – 2011 (Percent)*



* Investment securities recorded an insignificant proportion (less than 1 percent) in 2010 and 2011.

rather than through acceptance of new deposits. Chart 4 (see previous page) and Chart 5 below show the composition of assets and liabilities between 2010 and 2011, while Chart 6 shows the growth rates for assets, loans and advances and deposits.

Chart 5: Composition of Liabilities: 2010 – 2011 (Percent)

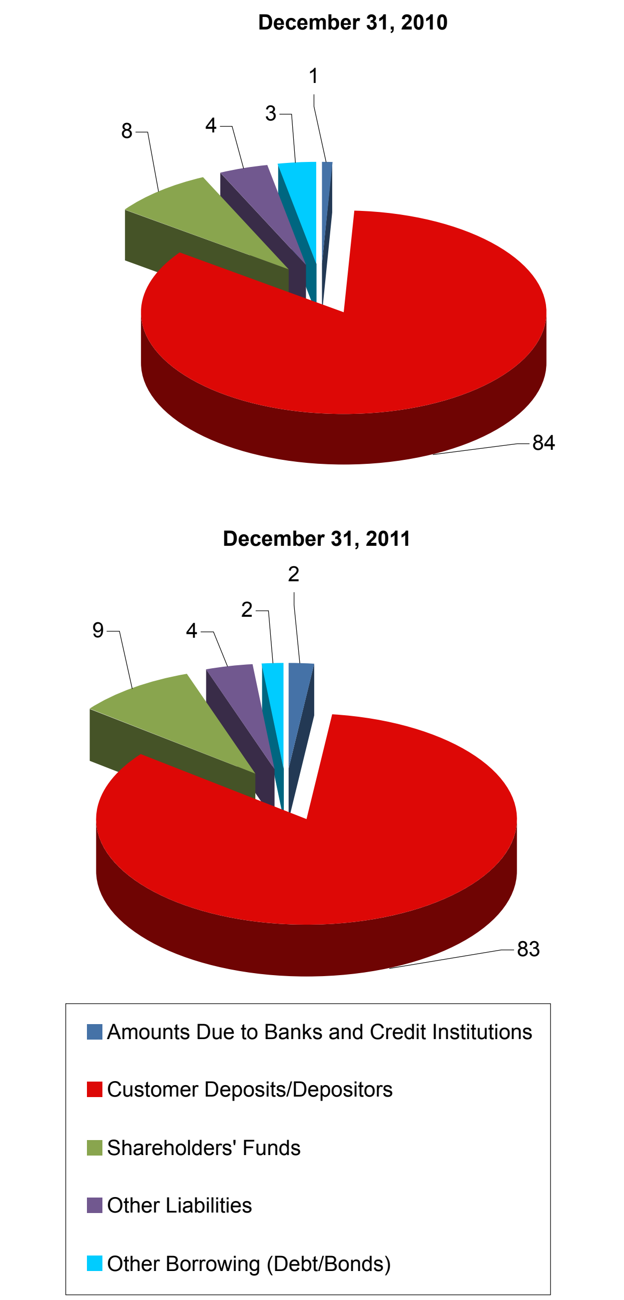


Chart 6: Annual Growth Rates of Deposits, Assets and Loans and Advances

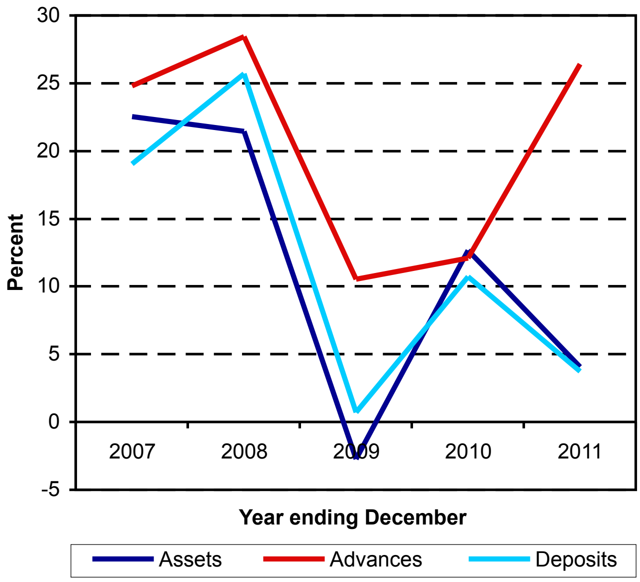
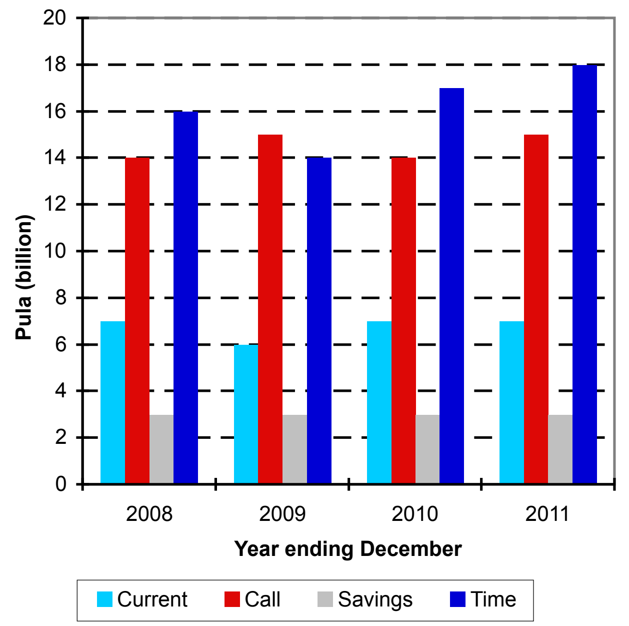


Chart 7: Value of Deposits by Type ('000)



The maturity structure of bank deposits, in value terms, was also unchanged from the previous year, almost equally split between short-term deposits (call and current) and long-term deposits (time and savings) at 51 percent (P22 billion) and 49 percent (P21.5 billion), respectively (Chart 7). Call accounts can expose the banking industry to greater volatility, leading to increased liquidity funding risk. The distribution of the share of the number of deposit accounts showed an increasing shift towards short-term deposits, especially current accounts (Chart 8). This was largely due to the increase in the number of current accounts at one bank, following aggressive marketing of its products upon commencement of retail commercial banking operations and probably the seemingly entrenched preference by customers to hold more funds in liquid form. Long-term deposit accounts constituted 38 percent of the total number of accounts, with the remaining 62 percent being short–term deposit accounts.

Chart 8: Deposit Accounts by Type ('000)

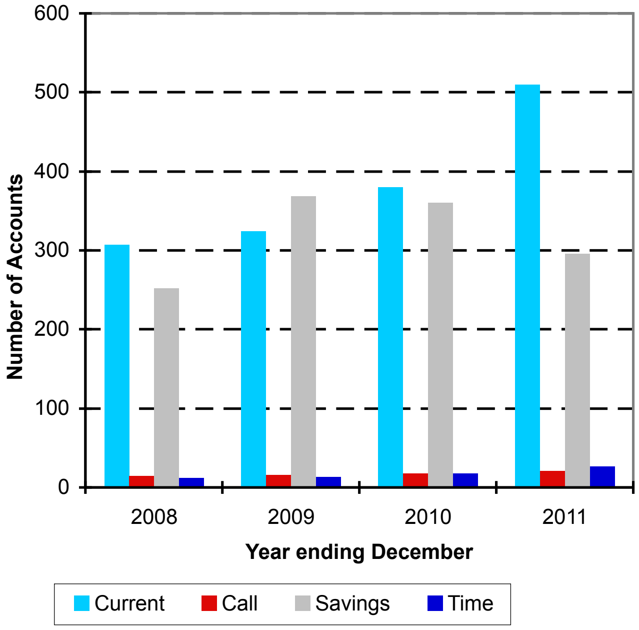
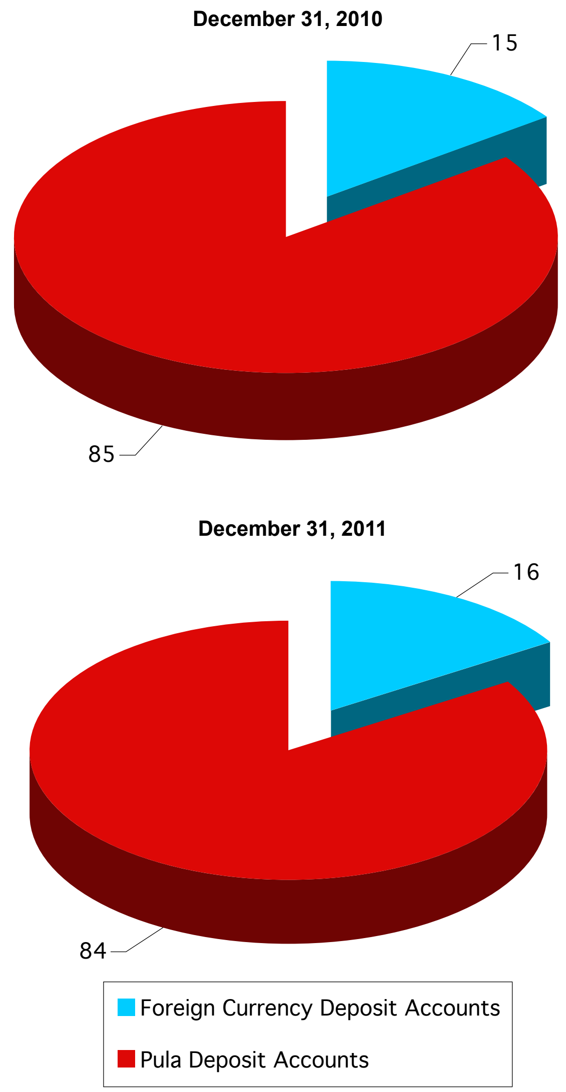


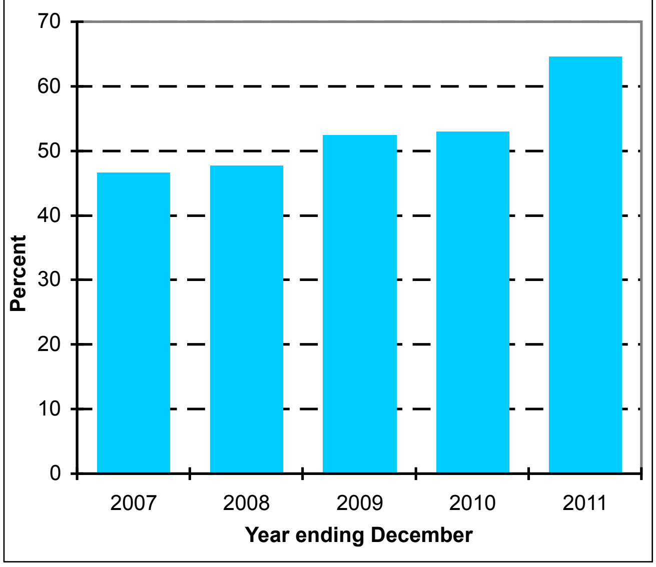
Chart 9: Share of Foreign Currency and Pula Denominated Deposits in Total Deposits (Percent)



The portfolio composition of Pula and foreign currency denominated accounts (FCAs) was almost unchanged, despite a marginal increase in the share of foreign currency denominated deposits, from 15 percent in 2010 to 16 percent in 2011 (Chart 9). As expected, deposits remained largely Pula denominated in 2011 (84 percent). There was a notable upward trend in the share of foreign currency denominated deposits which resulted from the depreciation of the Pula against major currencies [US dollar (14.4 percent), British Pound (14.2 percent) and Euro (11.6 percent)]. Foreign currency deposits grew by 14 percent (P6 billion in 2010) to P6.8 billion in 2011, compared to a 6.5 percent growth in Pula denominated deposits.

The Financial Intermediation Ratio continued to rise and was at 65 percent in 2011, which is a significant increase from 53 percent recorded in 2010 (Chart 10). This growth was due to a more than doubling in the growth rate of loans and advances in 2011 (26.3 percent) compared to 12.1 percent in 2010. On the other hand, the growth rate of deposits slowed down in 2011 as some corporate clients of banks withdrew some of their cash resources to finance expansion projects, in addition to the effect of the decision to reduce banks' BoBC holdings by the Bank.

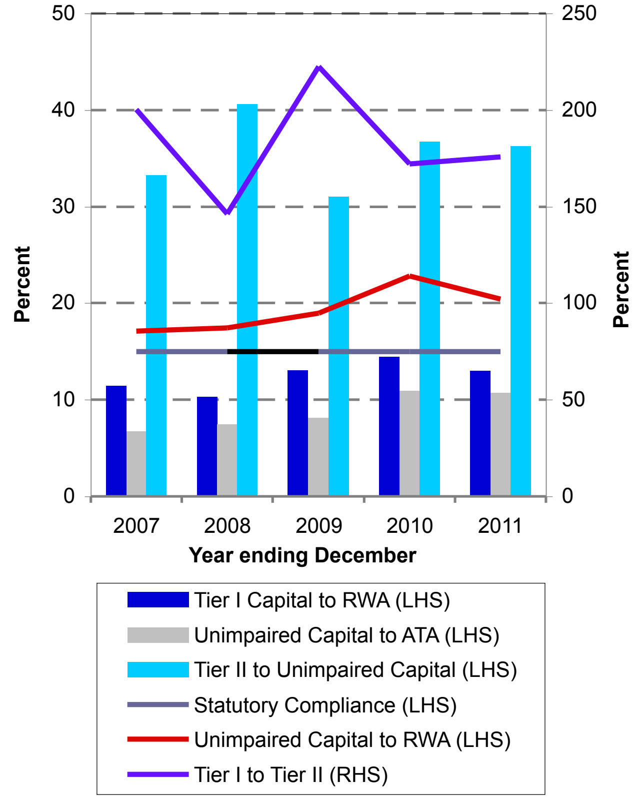
Chart 10: Industry Loans and Advances to Deposit Ratio (Financial Intermediation Ratio)



Capital Adequacy (Solvency): Levels, Quality and Trends

The banking sector remained well capitalised, with all banks reporting Capital Adequacy Ratios in excess of the 15 percent regulatory minimum requirement (Chart 11). The Core Capital to Risk-Weighted Assets Ratio declined from 15 percent in 2010 to 13 percent in 2011; and the Unimpaired Capital to Average Total Assets (ATA) Ratio was unchanged at 11 percent. The Core Capital to Unimpaired Capital Ratio continued to be above the prescribed 50 percent threshold, increasing marginally from 63 percent in 2010 to 64 percent in 2011. However, the Capital Adequacy Ratio of one bank has been barely above the regulatory minimum requirement, due to aggressive credit extension during 2011; the Bank is closely monitoring the bank.

CHART 11: CAPITAL ADEQUACY RATIOS

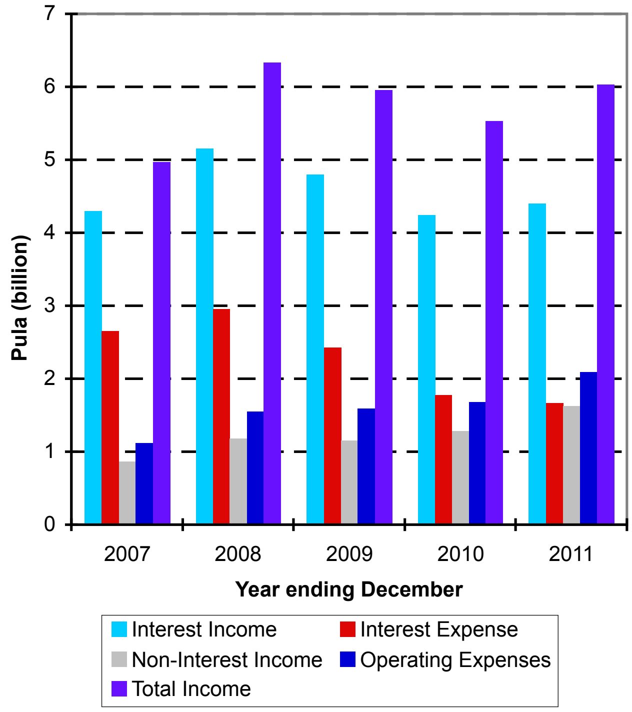


EARNINGS AND PROFITABILITY

Composition of Income and Expenses

For the first time in three years, the banking industry registered an increase in total income (interest income and non-interest income) with a growth rate of 9 percent to reach P6.03 billion from P5.53 billion in 2010. The significant growth in income of banks was boosted by the 26.6 percent and 3.8 percent increase in non-interest income and interest income, respectively. The increase in non-interest income in 2011 was mainly due to bank

CHART 12: COMPOSITION OF INCOME AND EXPENSES

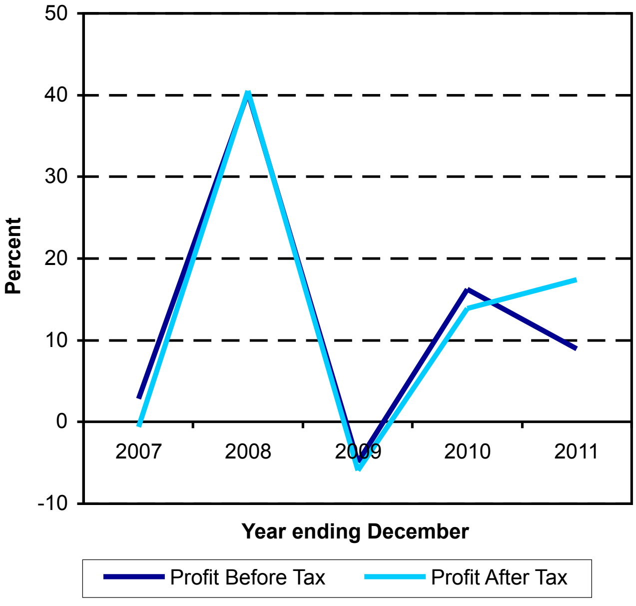


charges and related fees levied on customers against the backdrop of increased transaction volumes as well as the introduction of a diverse menu of new technological products. As reflected in Chart 12, in the past five years, non-interest income has trended upwards, while interest income has been showing a mixed growth trajectory. The sources of income were dominated by interest income from loans and advances and income from BoBCs at 75.2 percent and 19.5 percent of total interest income, respectively. Interest expenses have been declining since 2008, recording a slower growth rate of 6.5 percent in 2011, compared to a much bigger decline of 26.8 percent in 2010. This is consistent with a deceleration in the growth of the deposit base.

LEVELS AND TRENDS OF PROFITABILITY

The banking industry profitability improved in 2011, but at a slower pace than in 2010, as pre-tax profits only increased by 9 percent compared to 16.3 percent in 2010, from P1.8 billion in 2010 to P2 billion in 2011; after-tax profits grew at a faster rate of 17.4 percent compared to 13.9 percent in 2010 (Chart 13). The major contributor to the slow pace of growth in pre-tax profits was the 24.7 percent rise in operating costs during the year, largely due to staffing costs and new technological offerings, such as mobile money. The notable improvement in after-tax profits was due mainly to tax optimi-

Chart 13: Growth Rates of Profit, Before and After Tax

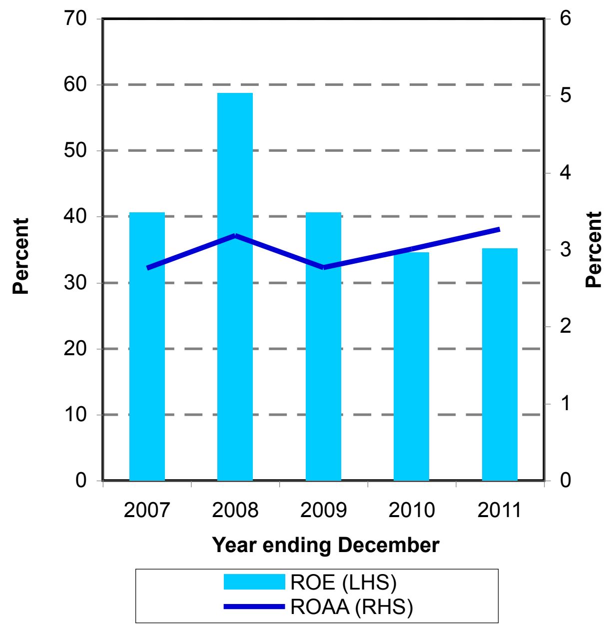


sation by banks following changes in the tax legislation during the year. Tax expenses declined by 21 percent from P395.6 million in 2010 to P312.7 million in 2011.

Profitability Indicators

Key profitability indicators improved during the period under review. Return on Equity (ROE), which has been falling since 2008, increased to 35.2 percent in 2011. Return on Average Total Assets (ROAA) also maintained the upward trend from 2.8 percent in 2009 to 3.3 percent in 2011 (Chart 14).

Chart 14: Profitability Indicators



Net Interest Income to Average Total Assets (ATA) ratio stagnated over the five-year period as reflected in Table 3; this suggests that the return on additional banking assets (mainly loans) had a marginal contribution to the banking industry's earnings capability. The growing reliance by banks on non-interest income to boost profitability is evidenced by a significant increase to 27 percent of the Non-Interest Income to Total Income Ratio, to reach a five-year peak.

Table 3: Other Performance Ratios (Percent)

Year	2007	2008	2009	2010	2011
Ratio					
Trading Income to Total Income	6.0	5.9	28.3	13.5	15.8
Non-Interest Income to Total Income	17.0	18.6	18.7	22.5	27.0
Return on Equity (ROE)	40.7	58.8	40.3	34.5	35.2
Return on Average Assets (ROAA)	2.8	3.2	2.7	3.0	3.3
Net Interest Income to ATA	4.8	5.3	5.3	5.3	5.4
Interest Income to Average Earnings Assets	15.8	16.0	13.6	11.2	11.4
Non-Interest Income to ATA	2.0	2.9	2.5	2.6	3.2
Interest Expense to ATA	7.9	7.2	5.4	3.8	3.3
Earnings Retention	40.6	42.0	60.1	56.5	48.0
Interest Income on Loans and Advances to ATA	12.7	12.5	10.8	9.1	8.7

Operating Efficiency Indicators

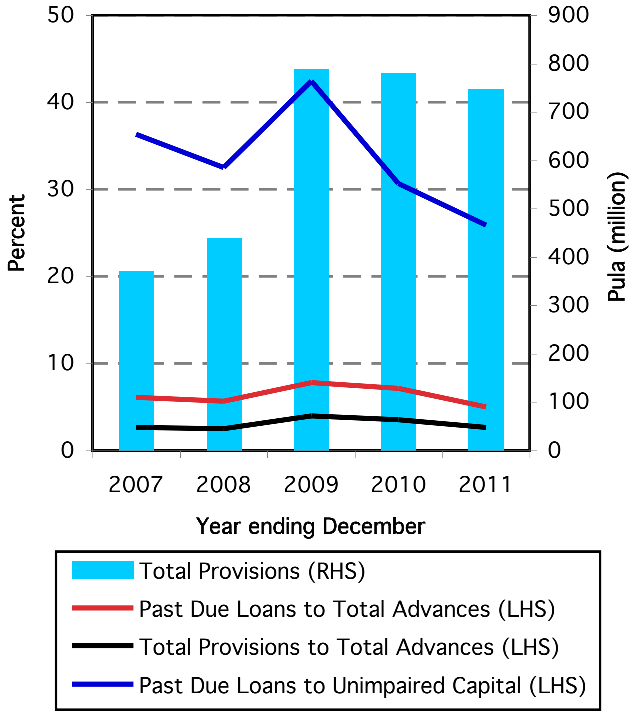
The core earnings capability of the banking industry weakened further for a second year in succession, as reflected by the decline in the net spread, from 9.6 percent in 2010 to 8.3 percent. The decline in the net spread is attributable to the prevailing low interest rate environment in Botswana. Net interest margin increased during 2011, following the growth in net interest income from 4.1 percent in 2010 to 10.4 percent in 2011. An increase was recorded in the Cost to Income Ratio from 44.8 percent to 47.9 percent in 2011, consistent with the infrastructure developments undertaken by some banks.

The Net Income to Employee Costs Ratio continued to fall for the fifth consecutive year, declining from 178 percent in 2010 to 175 percent in 2011, due to staff development costs and salary increments which are directed at retaining the best expertise in the market (Table 4). The decline in the Average Cost of Deposits and Return on Loans and Advances Ratios is reflective of the low interest rate environment and the use of deposits to fund development by corporate clients of banks.

Table 4: Banking Industry Efficiency Measures

Measure	2007	2008	2009	2010	2011
Average Cost of Deposits	8.0	6.1	5.0	3.5	3.4
Return on Loans and Advances	19.1	19.1	17.7	13.9	13.4
Net Interest Margin	6.0	6.8	6.7	6.5	7.1
Net Spread	8.8	10.4	11.3	9.6	8.3
Cost to Income	49.4	45.6	45.2	44.8	47.9
Net Income to Employee Costs	201.4	195.1	184.2	178.1	168.7
Net Income Per Employee (P'000)	310.2	342.3	313.3	346.9	387.0
Staff Cost Per Employee (P'000)	154.0	175.5	170.1	194.8	229.4
Asset Per Employee (P'000)	12 389	11 793	11 162	12 226	12 090

Chart 15: Asset Quality Measures



Analysis of Risk Categories

Credit Risk

Asset Quality: Levels and Trends

An improvement in asset quality was observed in the banking industry during the year as aggregate past due loans declined by 10.5 percent, from P1.6 billion in 2010 to P1.4 billion in 2011. This was evidenced by a decline in the Past Due Loans to Total Advances Ratio and the Past Due Loans to Unimpaired Capital Ratio by 5 percent (7.1 percent in 2010) and 25.9 percent (30.5 percent in 2010), respectively. Consistent with improvement in asset quality, total provisions declined by 4.2 percent to reach P0.75 billion in 2011 from P0.78 billion in 2010 (Chart 15). Past due loans continued to be concentrated in the household sector despite a drop in the sector's share to 61.6 percent of total industry past dues (80.1 percent in 2010). This improvement was due to increased collections and robust underwriting standards by banks.

Liquidity Risk

The funding structure of banks remained largely the same with deposits continuing to be dominant, despite flat year–on-year growth in the share of total funding. As has been the case in past years, shareholders increased their funding contribution to account for 9.1 percent of the banking industry funding. As indicated in Table 5, other borrowings was the least preferred source of funding in 2011, with a 1.8 percent share and a decline from the 2.9 percent share in 2010. Failure to grow the long-term fixed deposit category could lead to maturity mismatches as a significant share of advances have a relatively longer maturity. In order to address these liquidity risks and sustain growth momentum, banks must redouble efforts towards mobilising deposits, especially at the longer end of the spectrum.

Chart 16 shows that the banking industry deposit mix was maintained in 2011, with the private sector continuing its dominance, despite a drop in its share to 58 percent (P25.6 billion). The public sector, predominantly parastatal deposit holdings, slightly increased as a proportion of total deposits, to 22 percent (P9.8 billion) in 2011 compared to 20 percent in 2010. The portion of deposits held by the household sector dropped to 20 percent (P8.9 billion) in 2011 from 21 percent in 2010, and this indicates persistent income pressures on households. The fifteen largest depositors' share of bank deposits remained at 43 percent (P18.7 billion).

The industry liquidity ratios declined, as measured by the Liquid Assets to Deposits and Liquid Assets to Total Assets ratios. The decline in the Liquid Assets to Deposits ratio, for a fourth consecutive year, from 41

Table 5: Banking Industry Funding Trends (Percent)

Category	2007	2008	2009	2010	2011
Deposits (P' million)	29 695	37 329	37 590	41 628	43 178
Growth Rate	19.1	25.7	0.7	10.7	3.7
Share of Total Funding	79.7	82.5	85.4	83.9	83.7
Other Liabilities* (P' million)	2 881	2 877	1 099	1 977	1 827
Growth Rate	36.4	(0.1)	(61.8)	79.9	(7.6)
Share of Total Funding	7.7	6.4	2.5	4.0	3.5
Share Capital (P' million)	1 883	2 420	3 035	4 069	4 696
Growth Rate	13.7	28.5	25.4	34.1	15.4
Share of Total Funding	5.1	5.3	6.9	8.2	9.1
Owed to Govt. Institutions (P' million)	100	0	0	0	0
Growth Rate	100.6	(100)	0	1	2.0
Share of Total Funding	0.3	0	0	0	0
Due to other Banks (P' million)	1 224	1 058	680	460	990
Growth Rate	(25.9)	(13.6)	(35.8)	(32.3)	115.4
Share of Total Funding	3.3	2.3	1.5	0.9	1.9
Other Borrowings (P' million)	1 481	1 566	1 621	1 457	908
Growth Rate	0	5.7	3.5	(10.1)	(37.7)
Share of Total Funding	4.0	3.5	3.7	2.9	1.8
Total Funding (P' million)	**37 265**	**45 251**	**44 023**	**49 590**	**51 600**

*Includes: Taxes and dividends payable and accrued expenses

percent in 2010 to 24 percent in 2011, is trending towards the regulatory requirement of 10 percent (Chart 17 overleaf). The Liquid Assets to Total Assets Ratio also dropped to 20 percent compared to 35 percent in 2010. Evidently, the two ratios were negatively impacted by a significant decline of 43 percent in statutory liquid assets to reach a five-year low of P9.8 billion. The fall in the liquidity ratios, is a result of the decline in BoBC holdings (Chart 18 overleaf) by banks as well as a disproportionate increase in loans and advances of 26 percent vis-à-vis a 4 percent increase in deposit liabilities. Despite the decline in holdings by banks, BoBCs still accounted for a larger portion of the banking sector liquid assets at 79.4 percent compared to 98.6 percent in 2010.

Concentration Risk

Sectoral Distribution of Loans and Advances

The sectoral distribution of loans and advances in 2011 showed a continued revival of both the private and public sectors as reflected by their increased shares (Chart 19 overleaf). While the household sector continued to account for the largest proportion of loans and advances at 53 percent (P15 billion), there was a slight shift in favour of corporate and parastatal lending. This shift could be due to the continuing deterioration of household disposable incomes and reclassification of some business loans to their relevant sectors, following the adoption of the revised statutory returns in January 2011. Loans to the private and public sectors, as a

Chart 16: Sectoral Distribution of Deposits: 2010 – 2011 (Percent)

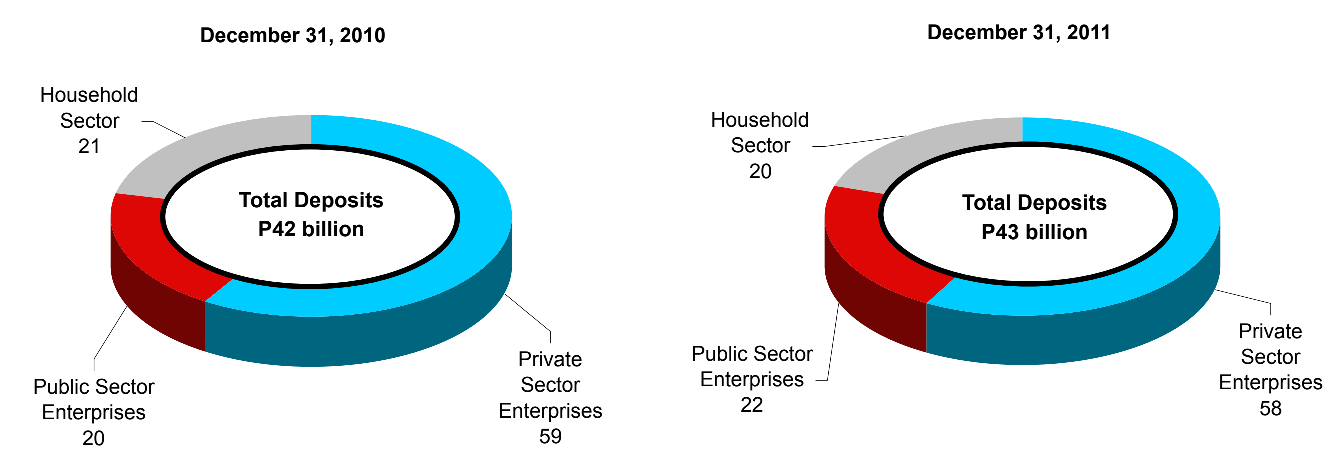


Chart 17: Liquidity Ratios

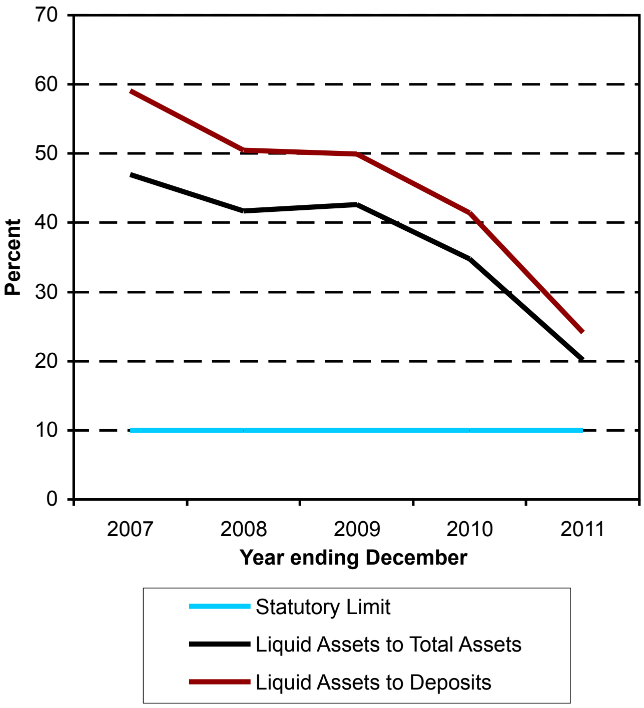
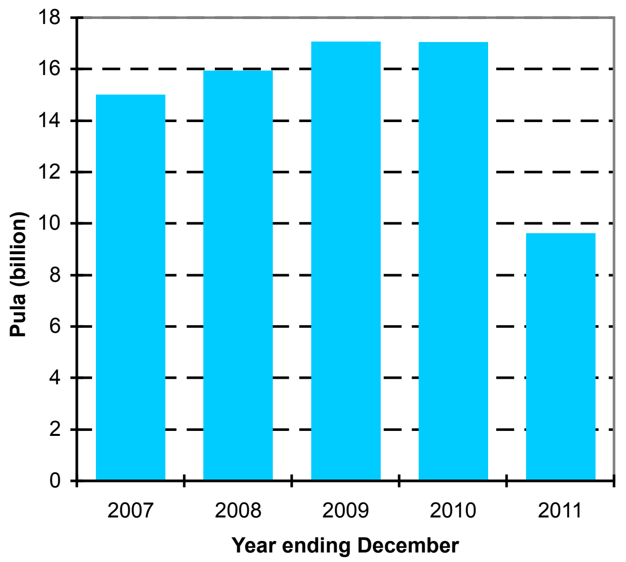


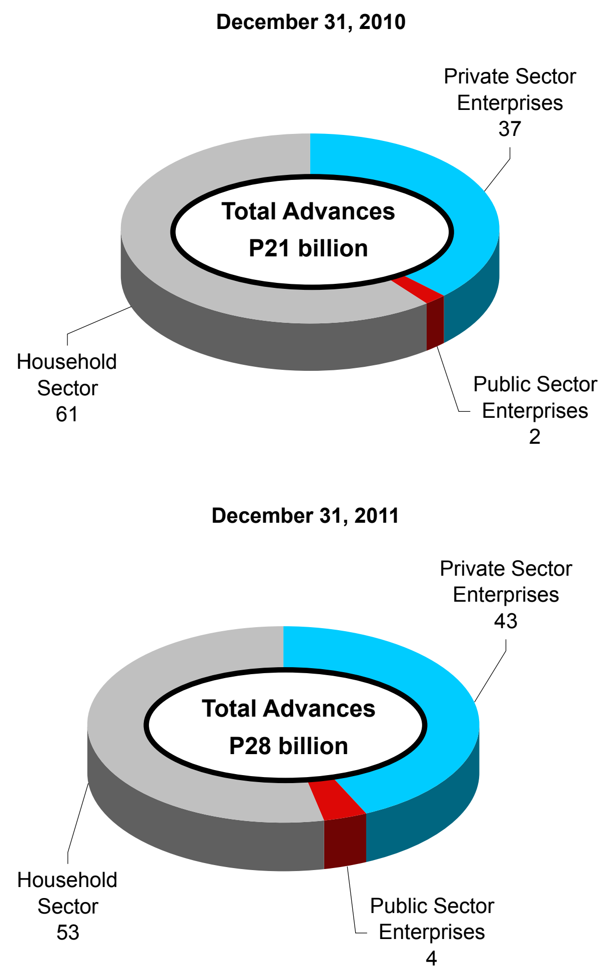
Chart 18: Outstanding Market Value of BoBCs Held by Banks



share of total advances, increased to 43 percent (P12 billion) and 4 percent (P1 billion), respectively, during 2011.

Banks continued to have well diversified loan portfolios as shown by the Large Exposures to Unimpaired Capital Ratio, which stood at 196 percent in 2011 (Chart 20). This was within the 800 percent prudential limit. However, despite this positive industry wide picture, two banks need close monitoring as their Large Exposures to Unimpaired Capital Ratios increased to 462 percent and 526.5 percent, respectively, in 2011.

Chart 19: Sectoral Distribution of Loans and Advances: 2010 – 2011 (Percent)



In order to mitigate the potential destabilising effects of systemic risk, banks continued to diversify their exposures to different sectors of the economy (Chart 21).

Chart 20: Aggregate Large Exposures to Unimpaired Capital

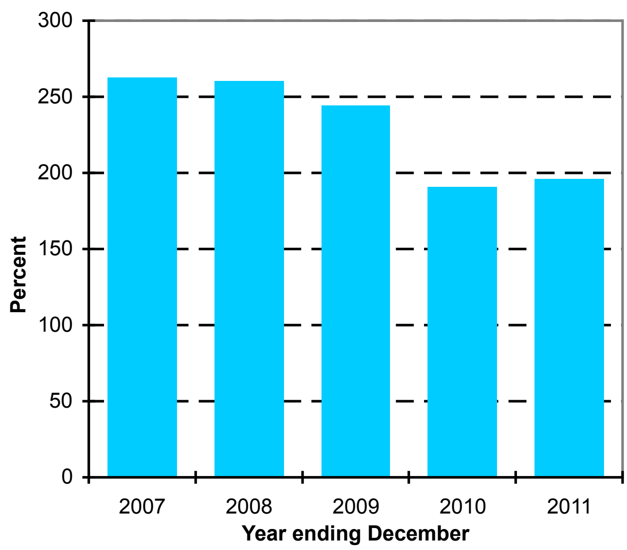
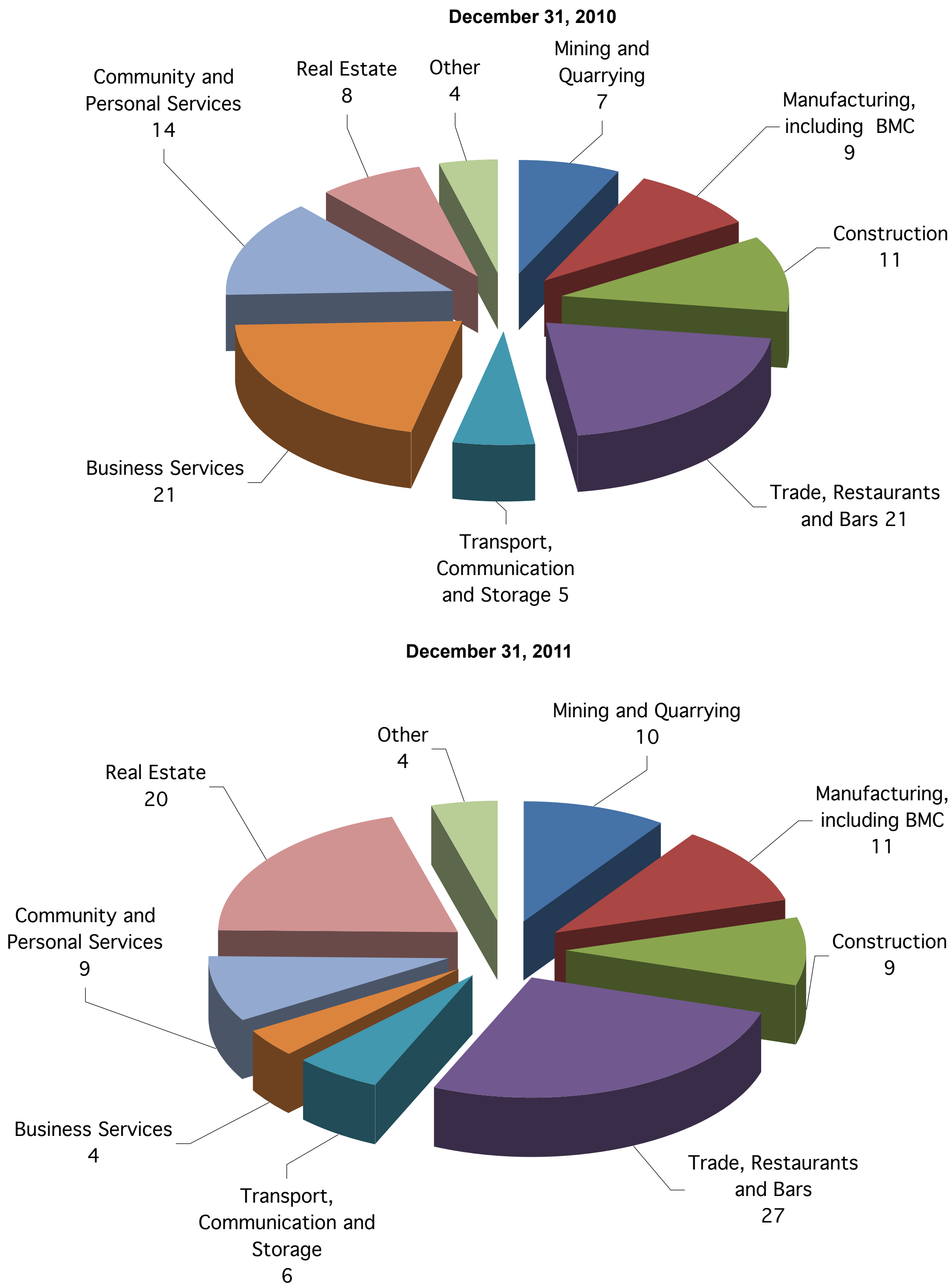


Chart 21: Distribution of Private Sector Enterprise Loans: 2010 – 2011 (Percent)



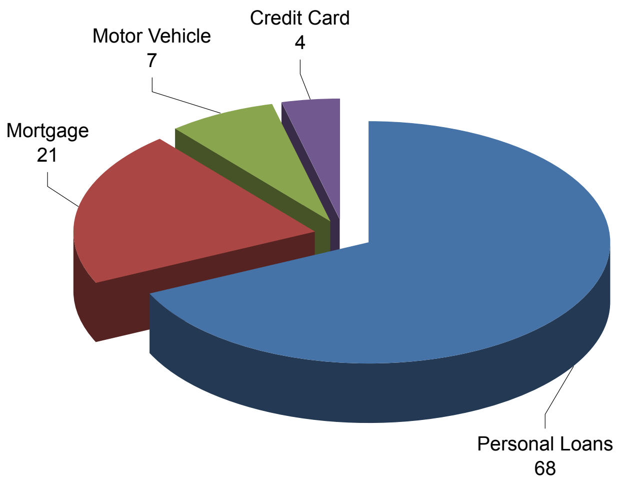
Note: The "Other" category includes the agriculture, electricity and water, tourism and hotels, and insurance sectors.

Most sectors showed growth, led by the real estate sector with a 12 percent increase in the share of total loans, while the rest of the sectors gained between 1 percent and 6 percent. However, the relative share of loans to the "business services" and "community and personal services" sectors declined by 17 percent and 5 percent, respectively. The growing lending appetite for both commercial real estate loans and owner-occupied residential mortgages, whose shares more than doubled from 8 percent in 2010 to 20 percent in 2011, needs to be closely monitored given the potential for the build-up of an asset price bubble.

Structure of Household Loans and Advances

Chart 22 below shows the structure of household loans and advances. Despite the high cost, personal loans represented the largest share at 68 percent of total household loans and advances, followed by mortgage loans at 21 percent. The proportion of Unsecured Household Credit to GDP and to Total Capital (Unimpaired) was 8 percent and 184.9 percent, respectively, in 2011. In the same period, the proportion of Mortgage Loans to GDP and to Total Capital (Unimpaired) was 2.5 percent and 56.3 percent, respectively. These unsecured personal loans,[5] which attract a high risk premium, are easily accessible. In the period under review, total household past due loans constituted 60.9 percent and 3.1 percent of the total industry past due loans and total loans and advances, respectively. The Bank will continue to closely monitor household debt accumulation in the context of the prevailing difficult economic conditions.

Chart 22: Structure of household loans and advances (percent)



Foreign Exchange Risk

All banks, except one, complied with the prescribed foreign exchange limits. One bank violated the Foreign Currency Exposure Directive BOBA 1/99 by exceeding the USD currency exposure limit of 15 percent. The bank has been holding increased amounts of foreign currency denominated guarantees on behalf of some public sector institutional clients, which has led to the violation. The Bank is in consultation with the bank with a view to regularise its foreign exchange positions and be in full compliance with foreign currency prudential limits.

Operational Risk

Internal Control Environment

The full scope and limited scope on-site examinations carried out at two commercial banks and one statutory bank in 2011 revealed that the internal control environment at the commercial banks were satisfactory. Nevertheless, there were some important internal control shortcomings at the statutory bank, which required rectification.

IT Infrastructure

One statutory bank did not have the necessary policies required to enforce security and ensure the safe operation of its IT resources. The Security Policy, which was too voluminous and cumbersome to apply, was in place. Furthermore, the bank's Disaster Recovery Site (DRS) facility was found to be inadequate in that, amongst others, it was too restrictive in the frequency of allowing users to test their systems, thus exposing the bank to the risk of remaining inoperative for an extended period of time in the case of disaster. The statutory bank was urged to give priority to the conversion of its warehouse into a fully-fledged DRS.

IT systems at one commercial bank needed to be enhanced to avoid compromising data integrity. As a consequence of the systems' problems, some relevant committees were unable to meaningfully discuss statement of financial position due to integrity problems of available data.

Fraud and Crime

The examination exercises did not reveal any incidences of fraud or crime at the examined banks. However, outside of the examination cut-off periods, there were reported incidents of armed robberies at two commercial banks during 2011, which occurred in Francistown, Gaborone and Palapye; two robberies were for one commercial bank. The Bank's security division has maintained liaison with the relevant law enforcement agencies, to devise better security measures at bank branches to reduce crime.

5 However, banks require insurance protection against death and permanent disability for these unsecured loans.

PERFORMANCE OF STATUTORY BANKS

Statement of Financial Position Structure

The performance of statutory banks displayed the highest statement of financial position growth in three years; total assets trended upwards by 13 percent (9 percent in 2010) from P3.8 billion in 2010 to P4.3 billion in 2011. The major contributor to the statement of financial position growth was loans and advances, which recorded a growth rate of 17 percent from P3.1 billion to P3.6 billion in 2011. The growth in assets was largely funded by customer deposits and other borrowings (debt instruments), which individually grew by 16 percent and 31 percent, respectively. The increases in the statement of financial position components of statutory banks reflect the continued recovery of the economy during the year.

Profitability

After-tax profits of statutory banks declined by 17 percent to P85.8 million in 2011, following an increase of 2 percent in 2010, which was preceded by a 13 percent decline in 2009. Poor profitability was caused by the 6.4 percent drop in interest income and 4.3 percent increase in interest expenses. Key profitability ratios also trended downwards with the ROE and ROAA ratios dropping to 4.7 percent and 2.1 percent, respectively (Table 6). Interest Income to Average Total Assets (ATA) also recorded a drop from 11.1 percent to 9.4 percent in 2011, on account of negative growth (6.4 percent decline) of interest income compared to faster growth of ATA (10.9 percent).

The Cost to Income ratio of statutory banks has been increasing in the past five years, reaching a peak of 57.8 percent in 2011, thus indicating failure to contain operating costs as they responded to competition from commercial banks, which, comparatively, have been more efficient in their operations (Chart 23). This is further evidenced by a five year average for the Cost to Income ratios of 46.6 percent and 51.9 percent for commercial banks and statutory banks, respectively.

CHART 23: COST TO INCOME RATIOS

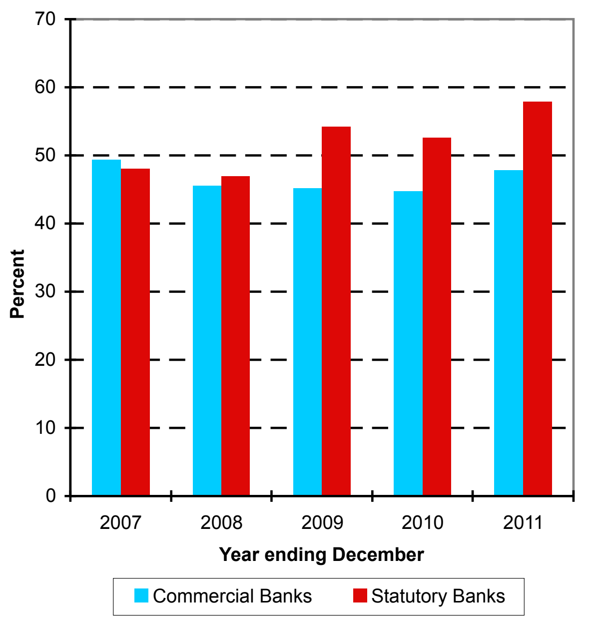


TABLE 6: PERFORMANCE INDICATORS FOR STATUTORY BANKS

Indicator	2007	2008	2009	2010	2011
ROAA (Percent)	2.0	4.0	3.1	2.9	2.1
ROE (Percent)	3.2	5.5	5.6	5.7	4.7
Interest Income to ATA (Percent)	11.6	13.4	12.5	11.1	9.4
Interest Income to Average Earnings (Percent)	34.6	40.9	33.3	29.8	25.6
Cost to Income (Percent)	48.0	47.0	54.2	52.7	57.8
Average Total Assets (P' million)	2 517	2 925	3 303	3 613	4 007
Unimpaired Capital (P' million)	1 557	2 114	1 815	1 461	1 815
Interest Income (P' million)	293	392	413	402	377
Average Earning Assets (P' million)	846	959	1 239	1 350	1 470
Net Income (P' million)	50	117	102	103	86

Chapter 3: Statutory Compliance

Examination of Commercial Banks

The Bank carried out on-site examinations at two statutory banks in 2011. The examination included appraisal of the assets and an assessment of the banks' compliance with prudential and regulatory standards as per the provisions of the Banking Act. Consistent with established banking supervisory practice, formal audit procedures, including verification of existence of assets, were not carried out; reliance was placed on the integrity of the financial records as vouched for by bank management and/or external auditors.

Overall, the banks' compliance with all the CAMELS[6] components was considered satisfactory. Nevertheless, there were some inadequacies evident in the managements' seeming reluctance to implement board decisions promptly. There was also non-compliance with the Guideline on the Appointment of New Directors and Senior Management Officials of Banks, given that executive directors were more than non-executive directors. The Board and senior management of both examined banks were urged to address all identified weaknesses fully and report progress to the Bank.

Spot on-site examinations were conducted on all commercial banks. Examinations intended to establish compliance with the Regulatory Guideline RG 01/09/2009 on Disclosure Framework for Deposit and Lending Interest Rates (Guideline). The examination revealed that all banks (except one) had fully complied with the guideline as all the sampled 91-day fixed deposit accounts attracted the benchmark interest rate of at least 5.5 percent. The Asset-Liability Committee (ALCO) minutes of respective banks did not reflect changes to the interest rate structures following the increase of the PRR. This is with the exception of one bank which had explored the possibility of increasing the minimum threshold. All, but three banks, had also complied with the minimum public disclosure and statutory requirements as prescribed by the Guideline.

6 CAMELS is acronym for a banking supervision approach/method which reviews the banks' Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk.

Examination of Statutory Banks

The Bank carried out on-site examinations at two banks in 2011. Overall, there was compliance with the CAMELS requirements, except for violations of Section 17(8) of the Banking Act; non-compliance with some corporate governance issues and liquidity contingency planning issues. The two statutory banks were advised to implement the recommended remedial measures to address the identified weaknesses.

Corporate Governance Issues

In general, board members of banks were found to have the necessary skills and experience to exercise effective oversight roles over the operations of banks. Board size and diversity were found to be satisfactory at the examined institutions and, in general, Board members had relevant qualifications ranging from accounting, law, economics and general business experience. Loans extended to directors in all the examined banks complied with the relevant sections of the Banking Act.

Despite the foregoing, there were areas that needed improvement in the governance framework at one bank, in particular:

(a) inadequate review of the credit policy in line with the changing nature of the bank's product offerings;
(b) absence of formal arrangements to undertake a formal and rigorous evaluation of the Board's performance on a regular basis; and
(c) the need to take action against some individual board members who, apparently, were not attending meetings on a regular basis.

A special examination exercise to evaluate corporate governance practices at one bank during 2011 revealed that the bank's corporate governance framework, practices and procedures required enhancement. These included; the need for security vetting and financial probity of senior management and board members as an additional fit and proper test; Board approval of the management succession plan into a formal policy document; need for the development and implementation of the Board evaluation tools; and the need to develop a liquidity contingency funding plan that should include a clear description of a diversified set of viable funding options readily available in various adverse conditions.

Consultative and Prudential Meetings

All bilateral, trilateral (13 each) and Banking Committee (2) meetings scheduled for 2011 were duly held. While there were initial concerns that the civil servants' industrial action in 2011 could have an adverse impact on the financial condition and performance of banks, in the end, the financial soundness indicator for banks were largely unaffected. Nevertheless, two banks showed signs of a build-up of asset quality problems evident in creeping non-performing loans.

BUREAU DE CHANGE ACTIVITIES

During the year under review, eleven bureaux de change were licensed and commenced business. Out of the eleven licensed bureaux, eight were located in Gaborone and surrounding areas. The Bank revoked five licenses due to violations of the provisions of the Bank of Botswana (Bureaux de Change) Regulations, 2004. The net effect of the changes brought the number of operational bureaux to 68 in 2011, compared to 63 in 2010.

The South African rand (ZAR) and United States dollar (USD) continued to dominate foreign currency transactions in the bureaux industry. A slight improvement in transaction activity for both sales and purchases was recorded in 2011 compared to 2009 and 2010, as shown by Charts 24 and 25. Total foreign currency sales increased by 8.2 percent in 2011, compared to declines of 14.2 percent and 20.8 percent registered in 2009 and 2010, respectively. Foreign currency purchases increased by 5.3 percent in 2011, while declines of 28.7 percent and 9.1 percent were registered in 2009 and 2010, respectively.

CHART 24: COMPOSITION OF BUREAUX DE CHANGE SALES OF FOREIGN CURRENCY (PERCENT)

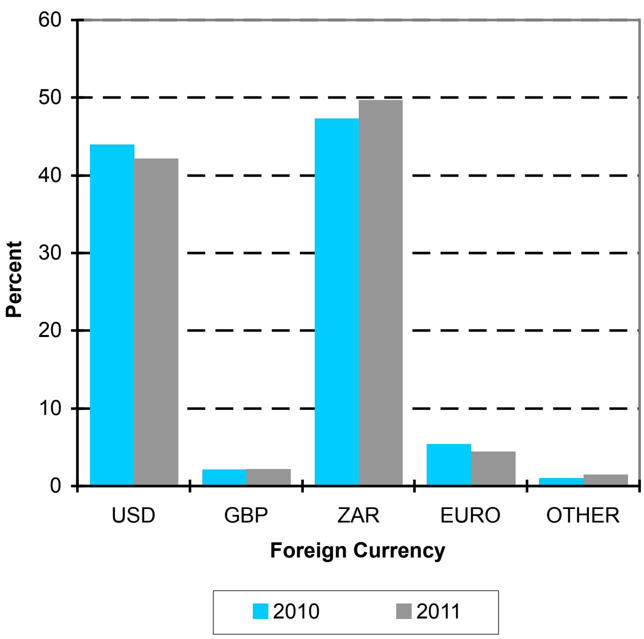


CHART 25: COMPOSITION OF BUREAUX DE CHANGE PURCHASES OF FOREIGN CURRENCY (PERCENT)

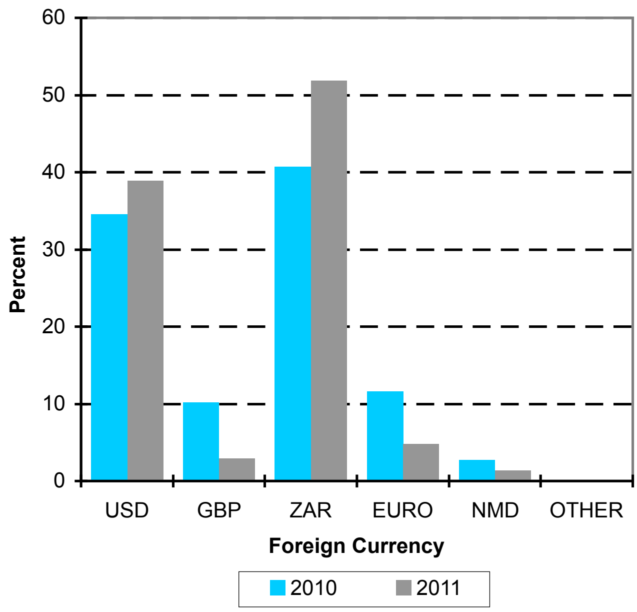
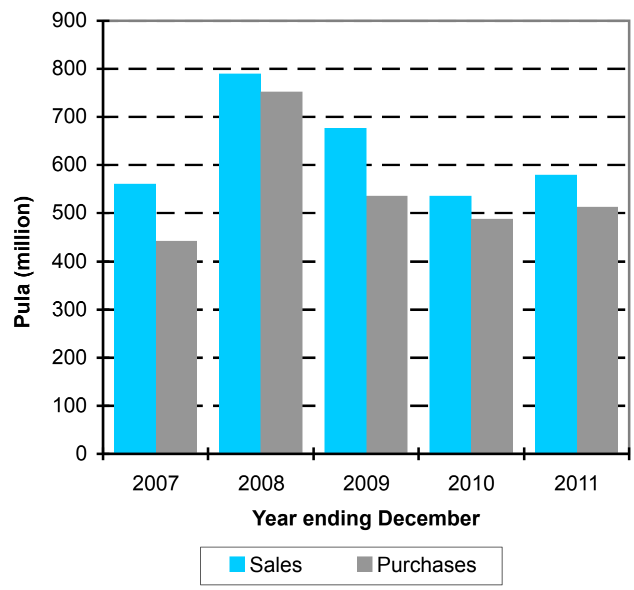


CHART 26: AGGREGATE BUREAUX DE CHANGE SALES AND PURCHASES OF FOREIGN CURRENCY



ON-SITE EXAMINATIONS

On-site examinations of seven bureaux were carried out in 2011 and the findings of the examinations were generally satisfactory, except for contravention of some provisions of the Bureaux de Change Regulations, 2004. The contraventions related to Regulation 12 on anti-money laundering; Regulation 14 on receipts of transactions; Regulation 16 on timely submission of accurate statutory returns; and Regulation 18 on auditing of books. Bureaux operators continued to raise concerns relating to illegal activities (parallel marketing), which have driven some operations out of business. Pressure was also mounting from acceptance of foreign exchange by local businesses for the payment of goods and services rendered. The former remains a challenge for law enforcement agencies, whilst the latter will be addressed through the on-going review of legislation.

Chapter 5: International Best Practices on Banking Supervision

Basel II Implementation Strategy

The Bank has adopted a phased Basel II National Implementation Strategy. The strategy will commence with a parallel run of Basel I and Basel II Simple Approaches in 2014, culminating in the adoption of the Advanced Approaches by qualifying banks in 2017 (Table 7). The Bank had also drafted and circulated to the market for comments, the Draft Consultative Paper on Basel II Implementation in Botswana.

Revised Core Principles for Effective Banking Supervision

In an effort to enhance supervisory effectiveness and risk management, which was prompted by lessons from the recent global financial crisis, the Basel Committee on Banking Supervision (BCBS) has issued the revised Banking Supervision Core Principles for Effective Banking Supervision (BCPs). The consultative paper updates the 2006 BCPs and the associated assessment methodology. The revised BCPs are aimed at strengthening the supervisory requirements, approaches to supervision and supervisors' expectations of banks. The review of the BCPs took into account several key trends and developments that emerged in the last few years of market turmoil. These included the need for greater intensity and resources to deal effectively with systemically important banks; and the importance of applying a system-wide, macro perspective to the microprudential supervision of banks. This will, in turn, assist in identifying, analysing and taking pre-emptive action to address systemic risk, increasing focus on effective crisis management, recovery and resolution measures in reducing both the probability and impact of bank failures.

As a result of this review, the number of BCPs has increased from 25 to 29. There are a total of 36 new assessment criteria, comprising 31 new essential criteria and 5 new additional criteria (Appendix 7).

Anti-Money Laundering, Suspicious Transaction Reporting, Combating the Financing of Terrorism and Other International Supervisory Issues

One statutory bank did not adhere to Regulation 9 of the Banking (Anti-Money Laundering) Regulations, 2003, as it opened customer accounts without the requisite Know-Your-Customer (KYC) documentation during 2003-2010. This violation was subsequently regularised.

The examination of one commercial bank showed commitment to combating money laundering and the financing of terrorism through the continuous recognition and reporting of suspicious transactions to the Directorate on Corruption and Economic Crime (DCEC) and the Bank. Procedures for opening accounts were considered satisfactory and were conducted in compliance with the Banking (AML) Regulations, 2003. However, it was noted from a sampling of trust accounts that the majority of them had no traceable records confirming the true or lawful sources of funds, which should be either in the form of a letter of undertaking from donors or in the form of copies of audited financial statements. The bank was strongly advised to make the provision of sufficient information about account-holders a prerequisite to opening an account; and, furthermore, it was advised to obtain the missing information, as a matter of priority.

Table 7: Basel II Implementation Timelines

ACTIVITY/ACTION	DATE
Preparatory and Consultative Process	January 1, 2012 – December 31, 2013
Parallel Run: Basel I and II	January 1 – December 31, 2014
Adoption of Basel II Simple Approaches as mandatory capital measurement and standard	December 31, 2014
Processing Applications by banks for the Advanced Approaches	January 1 – March 31, 2015
Parallel Run: Banks approved to adopt Advanced Approaches	January 1 – December 31, 2016
Full implementation of Advanced Approaches	January 1, 2017

Box 2: Financial Soundness Indicators: A Useful Supervisory Toolkit

Introduction

Financial soundness indicators (FSIs) are a quantitative measure of the financial soundness and/or strength of the financial system. FSIs help detect nascent risks in the financial system. Typically, regulators prescribe thresholds of FSIs, below or above which, supervisory action will need to be taken. The methodology and concepts for the development of FSIs have been compiled by the International Monetary Fund (IMF) with the assistance of the multilateral agencies such as the Bank for International Settlements (BIS) and IMF member countries. To assist countries compile FSIs, the IMF published a book entitled *Compilation Guide: Financial Soundness Indicators* in 2006, which was followed by a separate document in 2007 entitled *Amendments to the Financial Soundness Indicators: Compilation Guide.*

The IMF segregates the FSIs into a core set for deposit taking institutions and an encouraged set for other financial corporations, the non-financial corporate sector, households and real estate markets. While the "encouraged set" of FSIs is important to some degree, for the purpose of this article, the focus shall be on the core (mandatory) set of FSIs.[7] Table 1 lists the core set of FSIs.

Table 1: Core Set of Financial Soundness Indicators for Deposit Takers

Capital adequacy	Regulatory Tier 1 Capital to Risk-Weighted Assets
	Regulatory Capital to Risk-Weighted Assets
	Non-performing Loans net of Provisions to Capital
Asset quality	Non-performing Loans to Total Gross Loans
	Sectoral Distribution of Loans to Total Loans
Earnings and profitability	Return on Assets
	Return on Equity
	Interest Margin to Gross Income
	Non-interest Expenses to Gross Income
Liquidity	Liquid Assets to Total Assets (liquid asset ratio)
	Liquid Assets to Short-term Liabilities
Sensitivity to market risk	Net Open Position in Foreign Exchange to Capital

Source: *Financial Soundness Indicators: Compilation Guide,* Washington DC, International Monetary Fund, 2006

Rationale for Monitoring FSIs

Table 1 shows that, in the case of deposit taking institutions, FSIs track the CAMELS supervisory framework's components developed by the United States of America. It is critically important to monitor the measures of capital adequacy as they determine the solvency of a deposit taker or its ability to absorb potential losses. By contrast, poor performance of the loan portfolio and/or lack of diversification of the loan portfolio, i.e., credit concentration in any one sector, are either indications of poor asset quality in the case of the former or show potential for asset quality to deteriorate in the case of the latter, if the sector experiences problems, and ultimately affect the solvency of the deposit taking institution.

The 'going concern' status of a deposit taking institution is in serious doubt if it makes losses on a continuous basis. This is partly the reason why it is important to monitor earnings and profitability performance using, for example, the return on assets indicator, quality of earnings and sources of earnings.

Liquidity indicators measure the degree to which a deposit taking entity is able to fulfill liquidity demands

7 This article deals primarily with the rationale for monitoring FSIs. Details on the concepts, definitions of FSIs and the accounting standard to follow in the compilation of FSIs can be found in the *Compilation Guide: Financial Soundness Indicators* and *Amendments to the Financial Soundness Indicators: Compilation Guide.*

without running into cash or near cash shortages. Inability of a bank to meet liquidity demands runs the risk of triggering a bank run.

Treasury operations, in particular, large open positions in foreign exchange activities, potentially predisposes a deposit taking institution to foreign exchange risk, and this could result in possible deleterious effects on capital. This provides a rationale for tracking the sensitivity to market risk indicator, i.e., net open position in foreign exchange to capital.

Conclusion

Overall, prudential supervision is concerned with preserving the safety of depositors' funds and, ultimately, financial system safety soundness and stability. Consequently, FSIs for banks in particular, provide a mechanism for monitoring the sustainability of risks the management of banks is taking. In other words, FSIs provide signals for proactive and corrective supervisory action to be taken as necessary.

References

1 *Amendments to the Financial Soundness Indicators: Compilation Guide* available at http//www.imf.org/external/pubs/ft/fsi/guide/2008/pdf/071408.pdf

2 *Financial Soundness Indicators: Compilation Guide,* Washington DC, International Monetary Fund, 2006.

3 Jose, A. S., and A. Georgiou, *Financial Soundness Indicators (FSIs): framework and implementation* available at www.bis.org/ifc/publ/ifcb3iv.pdf.

4 Moorhouse, A., *An introduction to Financial Soundness Indicators* available at www.bankofengland.co.uk/statistics/documents.

5 *Macroprudential Indicators of Financial System Soundness,* Occasional Paper 192, International Monetary Fund, Washington D.C., 2000.

Chapter 6: Other Banking System Developments

Abandoned Funds

In accordance with Section 39 of the Banking Act, the Bank received abandoned funds from banks amounting to P0.6 million in 2011, compared to P1.6 million in 2010. A total of P0.4 million was transferred to the Guardian's Fund in 2011; this compares with P0.7 million of 2010. These are funds that were held by the Bank and remained unclaimed for a period of five years. The closing balance of abandoned funds remained at P9.8 million for 2011 (Table 8).

Table 8: Abandoned Funds (Pula): 2010 – 2011

	2010	2011
Balance brought forward	9 176 940	9 761 587
Funds received	1 624 747	629 340
Claims paid out	(344 625)	(250 835)
Transfer to Guardian's Fund	(697 679)	(364 018)
Balance at year-end	**9 761 578**	**9 776 074**

Structure of Banking Tariffs and Cost of Financial Services

Banks levy a variety of fees for services and products offered to customers. In 2011, the Bank introduced, in consultation with supervised banks, a standardised format classifying charges into groups of similar services/ products offered by banks. The purpose of the standardised template was to expedite the review process by the Bank and facilitate comparative analysis of charges across the banking industry. Banks continued to make proposals for a review of tariffs, citing the increase in the cost of providing banking services and inflation as the main reasons for annual reviews of banking tariffs. Tariff proposals for four banks were assessed and approved in 2011; the fees/tariff increases were approved selectively, following consideration of justifications provided for such fee increases or introduction of new fees. In line with other regulatory authorities globally, the Bank's intervention was necessitated by the widely held perception that the cost of banking is not commensurate with the quality of banking services and the increasing public complaints.

The tariff assessment is based on the following four categories: accessibility facilitation, investment/intermediation, trade facilitation and payments and clearing charges. The selected banking industry average charges indicate that the cost of financial services has, on average, increased (Table 9).

Handling of Consumer Complaints

The Bank received and processed various consumer complaints during the year; these related to unauthorised ATM transactions, account closure without valid reasons and disagreements regarding settlement of loan facilities by customers. Some of the complaints were referred to the Banking Adjudicator while others had to be reviewed further by the concerned banks.

Table 9: Banking Industry Average Charges – 2010 and 2011 (Pula)

Service Charge Category		2010	2011
Accessibility Facilitation			
ATM Charges			
(i)	Cash withdrawal (own account)	1.59	1.80
(ii)	Lost card replacement	40.70	49.65
Internet Banking Charges			
(i)	Monthly fees	42.61	63.29
(ii)	Transfers	2.01	2.41
Investment/ Intermediation			
(i)	Personal Loan – Arrangement fee	528.19	918.44
(ii)	Vehicle /Asset Finance – Arrangement fee	979.21	1 083.52
Trade Facilitation			
(i)	Commission on purchase of foreign currency	16.64	16.94
(ii)	International SWIFT transfer	261.50	266.34
(iii)	Advisory fees on Letters of Credit	193.81	269.79
Payment and Clearing Charges			
(i)	Bank Cheque	44.03	44.09
(ii)	Unpaid Cheque due to lack of funds	196.13	223.79

Box 3: Bank Charges – Domestic and International Practice

Definition

A bank charge/tariff is a payment, other than interest, by a customer, for a service rendered or product offered by a bank. Banks invest heavily in information technology infrastructure for record keeping, payments facilitation and remittances, as well as the use of electronic banking services such as ATMs, internet and mobile banking. Other costs relate to system maintenance and security of customer funds. In addition, banks are expected to provide, at additional expense, some form of financial education to staff and customers for them to appreciate and optimally utilise the services and products. It is, therefore, an acceptable banking practice that some of these costs could be factored into the computation of charges levied by banks, as part of a wider pricing strategy.

Legal Authority

The Bank is empowered by Section 41(1)(c) of the Bank of Botswana Act to review or assess the levels, methods of computation and publicly disclose charges levied by licensed banks. Furthermore, and consistent with Clause 15 of the Disclosure of the Bank Charges Notice, 2001, banks are required to submit their proposed tariff guides to the Bank for consideration prior to implementation. This requirement is in recognition of the growing public concerns regarding the perceived onerous bank charges vis-à-vis the poor quality of banking services in Botswana. The Bank has an obligation, given its primary mandate of price stability and as a regulatory authority, to monitor bank charges, which have been widely viewed as a disincentive to save. The emphasis is on disclosure of bank charges and this is aimed at promoting transparency and giving consumers essential information on which to make informed decisions.

The Bank's Intervention

In reviewing the proposed charges, the Bank takes into account the prevailing economic conditions as well as the quantum of industry bank charges. Specifically, the assessment considers a range of fees across the banking industry; and the justification provided by a bank for the proposed charge. For example, if a bank proposes to introduce a new fee that has no comparable charge in the industry, it is assessed on the basis of reasonableness, taking into account the bank's justification and a breakdown of costs it will incur were the service/product be provided. Similarly, banks have also collectively undertaken to avail details of charges and fees for banking services.[8]

International Practice

Some regional regulatory authorities employ various approaches to handling bank charges. The approaches include full, limited and minimal intervention by the central bank. Some of the regulatory authorities follow similar approaches to the Bank, while the majority of those contacted did not regulate bank charges, but rather required banks to submit tariff guides on a regular basis, while the charges were market determined.

While there are varied approaches to handling bank charges, there appears to be a concerted campaign in most jurisdictions to ensure disclosure of bank charges. Furthermore, there has been growing pressure for regulatory intervention as necessitated by perceived exorbitant charges that are deemed to be out of line with the cost and quality of the banking services.

8 *Code of Conduct – Bankers' Association of Botswana, Sections 4.5 and 4.6*

Chapter 7: Conclusion

Although the global economic recovery remained weak and domestic fiscal consolidation continued in 2011, the banking sector posted satisfactory results, although they were lower than those of 2010. However, credit risk continued to be a dominant factor especially with respect to the significant share of lending being to the household sector. In contrast, the corporate sector remained the net major contributor to banks' loanable funds.

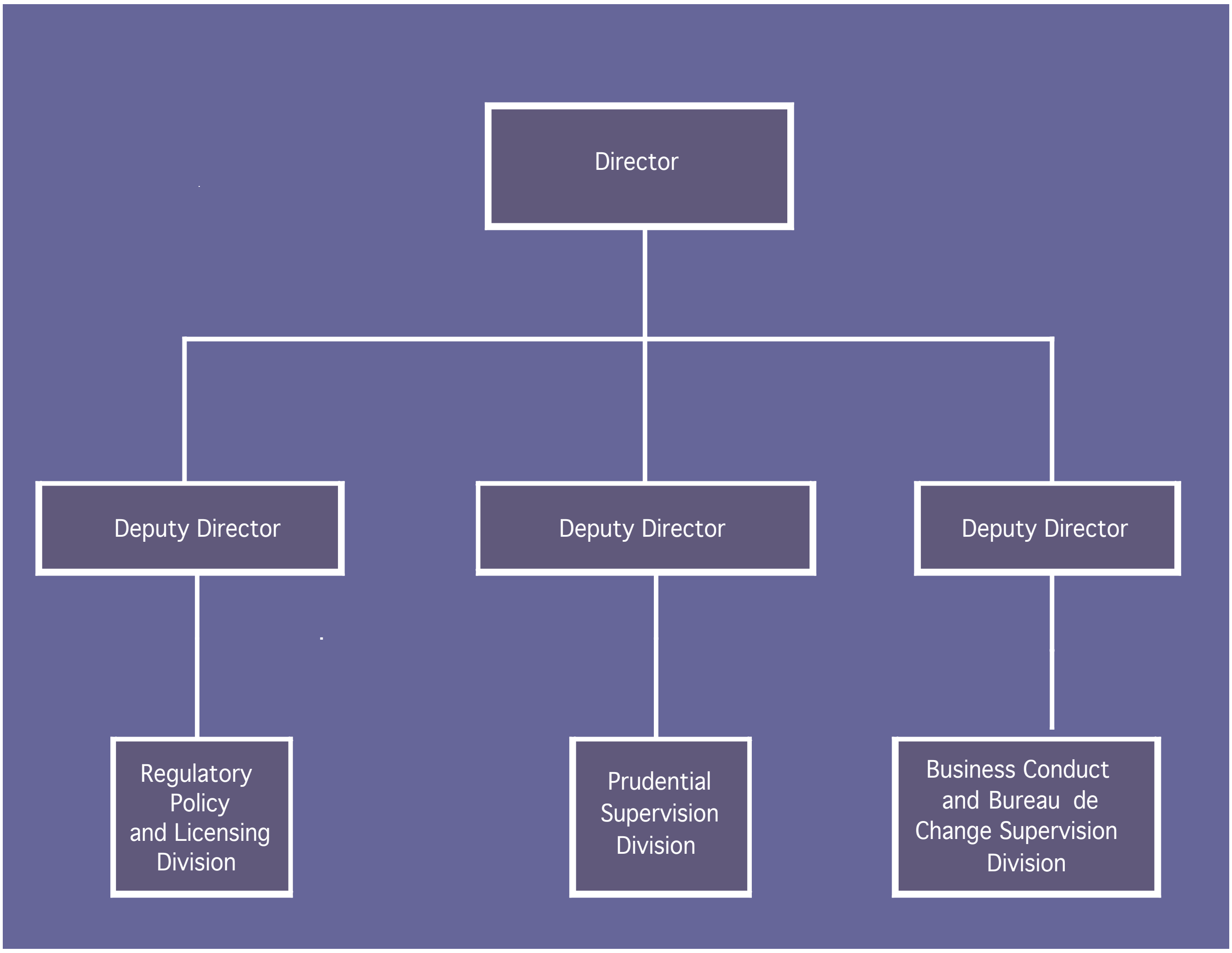
A number of potential investors continued to make enquiries about bank licence application procedures. The result is that one application for a banking licence was at an advanced stage at year-end.

All banks were profitable, liquid, adequately capitalised and in compliance with the minimum prudential requirements. In an effort to encourage the market to actively seek bankable projects, the Bank reduced its BoBC offerings, a development which led to a significant decline in the average cost of deposits, and also an increase in the financial intermediation ratios of most banks. It is hoped that the growth in loans and advances will be sustainable, supported by sound credit risk management and other prudential banking practices. Access to banking and other financial services improved, in part, due to the increased usage of mobile banking technology, which has facilitated access to banking services by the unbanked population.

In the period ahead, the Bank will continue to monitor the performance of the banking sector and enhance collaboration with the NBFIRA, as well as foreign regulators, to ensure a stable and efficient financial system. The Bank has, in consultation with the banking industry, decided to adopt Basel II and III on a phased basis, commencing with a parallel run of both Basel I and Basel II in 2013 – 2014.

APPENDICES

Appendix 1: Banking Supervision Department Organisation Chart



Appendix 2: Approaches to Regulation and Supervision of Banks in Botswana

1. Introduction

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 practices as enshrined in the Basel Committee's 25 Core Principles for Effective Banking Supervision.

2. Legal Framework

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). This legislation has undergone various phases of development since it was first promulgated as the Financial Institutions Act, in 1975. Important elements of the Banking Act are: explicit provisions for licensing and authorisation processes, which give the Bank powers to regulate market entry; the power to establish 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.

The banking law also extensively covers matters of governance, market discipline within the banking system, and official supervision of the banking system. It is recognised that, primarily, the responsibility for banking soundness lies with owners and managers who have a commercial incentive to operate banks prudently. Market discipline provides further pressure and incentives for good internal governance and imposes sanctions for failures, particularly for institutions listed on the stock exchange. Official supervision is essential to provide external incentives for management and owners of banks to rectify inadequacies in governance and impose appropriate level of control where market behaviour could lead to imprudent conduct, which could have adverse systemic repercussions. These three aspects are subsumed within the legislation and prudential requirements. 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

A central feature of banking supervision is establishing criteria for licensing of banks. Banking is a heavily regulated industry because banks take deposits from the public, play a critical role in the country's payments system and, related to both of these functions, have the potential to introduce systemic risk in the event of banking problems. There are, as a result, regulatory barriers to entry that importantly influence the structure of the banking industry 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.

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.

4. Licensing Policy and Procedures for Establishing a Bank

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 Act Regulations 3, 4 and 5.

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

(a) The enterprise must be locally incorporated in Botswana (branch banking is not permitted).
(b) It 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.
(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 allows effective consolidated supervision, if necessary.
(f) The promoter must submit a business plan and five-year financial projections showing the establishment of branch network, products to be provided, and demonstrate ability to enhance effective competition.

5. Core Prudential Standards

Among the most significant prudential regulations on banks are capital adequacy requirements, statutory reserve, liquid asset requirements, legal lending or large exposure limits, and asset quality requirements. Each of these are described briefly below:

Capital Adequacy Requirements

A bank must maintain a minimum capital adequacy (solvency) ratio of at least 8 percent, calculated as Unimpaired Capital divided by Total Risk-weighted Assets. However, 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 to be commensurate with the nature and scale of its operations and the risks associated with them.

Reserve Requirements

Section 39 of the Bank of Botswana Act 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. The current primary reserve requirement ratio is 10 percent of Pula denominated deposits.

Liquid Assets Requirements

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

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 of Botswana, 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 the 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)

Section 17 of the Banking Act restricts a bank from granting facilities that are in excess of 10 percent of a bank's unimpaired capital to a single 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 from the Bank of Botswana 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.

Insider Lending

Section 17 of the Banking Act 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 a 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.

Non-Performing Loans and Provisions

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 of Botswana to assess adequacy of the provisions for non-performing assets. Accordingly, the Bank of Botswana 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

The Bank of Botswana 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.

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

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.

The evaluation of the financial soundness of the institution is achieved by assessing Capital Adequacy (C), Asset Quality (A), Management (M), Earnings and Profitability (E), Liquidity (L) and Sensitivity to Market Risk (S) components (referred to as CAMELS), and adherence to statutory and prudential limits in each of these areas.

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

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, the adoption and implementation of issues that may adversely affect the performance of a bank for which they are responsible.

Bilateral and Trilateral Meetings

Bilateral meetings are held once a year with all supervised financial institutions. These meetings provide a forum for exchange of views on matters affecting the supervised institution and serve to improve communication and information flow between the Bank and the supervised financial institutions.

In addition to the separate bilateral meetings with both external auditors and the respective licensed financial institutions, 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 income statement. 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.

It is also at such meetings that the Bank of Botswana takes the opportunity to discuss with auditors their expectations regarding the scope of statutory audits and other general issues of a prudential nature.

7. Accounting, Auditing and Disclosure Standards

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 3: Supervised Financial Institutions as at December 31, 2011

Banks and Other Supervised Financial Institutions

Institution	Postal Address	Business Locations	External Auditors
Commercial Banks			
Barclays Bank of Botswana Limited	P O Box 478, Gaborone	54*	PricewaterhouseCoopers
Standard Chartered Bank Botswana Limited	P O Box 496, Gaborone	17**	KPMG
First National Bank of Botswana Limited	P O Box 1552, Gaborone	19	Delloitte & Touche
Stanbic Bank Botswana Limited	P/Bag 00168, Gaborone	10	KPMG
Bank of Baroda (Botswana) Limited	P O Box 21559, Gaborone	2	Grant Thornton
Bank Gaborone Limited	P/Bag 00325, Gaborone	5	PricewaterhouseCoopers
Capital Bank Limited	P O Box 5548, Gaborone	2	KPMG
African Banking Corporation of Botswana Limited	P/Bag 00303, Gaborone	4	PricewaterhouseCoopers
ABN AMRO Bank (Botswana) Limited	P/Bag 254, Gaborone	1	KPMG
Kingdom Bank Africa Limited	P O Box 45078, Gaborone	1	KPMG
Statutory Banks			
Botswana Savings Bank	P O Box 1150, Gaborone	2	KPMG
National Development Bank	P O Box 225, Gaborone	4	KPMG
Building Society			
Botswana Building Society	P O Box 40029, Gaborone	9	KPMG

* Includes 14 service centres

** Includes 14 branches and 3 agencies.

Appendix 4: Definition of Banking Supervision Terminology as Used in the Report

Definition of Banking Supervision Terms

(a) **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 the Banking Act (CAP. 46:04), 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. Exposure in excess of 30 percent of the bank's unimpaired capital requires prior Bank of Botswana approval.

(b) **Asset Quality:** A relative measure of the performance of the bank's loan portfolio based on the appraisal of the asset, concerning the degree of risk and the likelihood of recovery, adherence to the terms of contracts and orderly liquidation of the account. Good quality asset means the loan, advance or investment is producing cashflow as was expected and/or agreed upon.

(c) **Adverse Classifications:**

(i) **"Substandard" Assets** – A substandard 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.

(ii) **"Doubtful"Assets** – An asset classified doubtful has all the weaknesses inherent in one classified substandard, 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.

(iii) **"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 future.

(d) **Core Capital:** An aggregate of share capital, share premium, general 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 Page 48 for computations)

(e) **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 on page 46.

(f) **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 on Page 48.

(g) **Weighted Classifications:** Represents an aggregate of 20 percent, 50 percent and 100 percent of the value of accounts classified "Sub-standard", "Doubtful" and "Loss", respectively.

Prudential Ratios

(a) **Return on Equity (ROE):** The ratio measures the after-tax profit against shareholders' funds. The ratio, however, tends to favour high 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.

(b) **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 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.

(c) **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 than for banking supervision. It is the inverse of this ratio, profit retention ratio that is of greater interest 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.

(d) **Capital Growth:** This ratio measures the impact of retained income and other capitalised funds on the capital base of a bank. Ideally, the bank's rate of income retention must keep pace with its asset growth, or risk exposure. Where there is a disparity in growth, especially with acceleration of the latter, the bank's solvency will be weakened.

(e) **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. 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 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 off-statement of financial position transactions, its foreign exchange dealing operations and all other risks associated with its business.

(f) **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.

(g) **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.

(h) **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.

(i) **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.

(j) **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.

(k) **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.

(l) **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.

(m) **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.

Risk-Weights Applied on Various Assets Exposures for Purposes of Capital Adequacy Measurement

ASSETS	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 sovereigns	**0**
8. Treasury Bills	**0**
9. Other Government 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 notes	**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**

	Credit Conversion* Factor	Risk Factor (%)**
25. Total Off-Balance Sheet Items (sum of lines 26 to 37)		
26. Commitments under 1 year or can be cancelled	**0**	
27. Guarantees/performance bonds secured by cash	**0**	
28. Forward foreign exchange contracts (over 7 days and under 1 year)	**1**	
29. LC's and guarantees to public financial and non-financial corporations	**20**	
30. Guarantees and bonds secured by first class banks	**20**	
31. Self-liquidating-trade related LCS (commercial LCs)	**20**	
32. Securities underwriting	**50**	
33. Formal commitments, credit lines and bills endorsed (includes promissory notes original maturity over 1 year)	**50**	
34. Other unsecured performance bonds, etc. (transaction related)	**50**	
35. Other off-statement of financial position exposure (specify)	**100**	
36. Assets securitisation with recourse	**100**	
37. Other standby letters of credit and other guarantees	**100**	

Maturity***	Conversion Factors – Interest Rate Contracts	Risk Factor (%)**
38. Forwards, Swaps, Purchased Options and Similar Derivatives Contracts (sum of lines 39 to 44)		
39. One Year or Less	0.50%	
40. Over One Year to Two Years	1.00%	
41. For each Additional Year	1.00%	

	Exchange Rate Contracts and Gold	Risk Factor (%)**
42. One Year or Less	2.00%	
43. Over One Year to Two Years	5.00%	
44. For each Additional Year	3.00%	
45. TOTAL RISK-WEIGHTED ASSETS AND OFF-BALANCE SHEET ITEMS (SUM OF LINES 1, 25 AND 38)		

* 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%, Multilateral Banks and public financial and non-financial corporations – 20%, and private Sector – 100%.

** 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.

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% 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 5: Aggregate Financial Statements of Licensed Banks: 2007 – 2011

Table 5.1: Aggregate Statement of Financial Position of Licensed Commercial Banks (P'million)

Total Assets in Local Currency	2007	2008	2009*	2010	2011
1. Cash and balances with the Central Bank	1 851	2 125	2 238	3 269	4 766
a. Currency	496	593	595	707	721
aa. Hard currency	123	137	174	56	76
ab. Local currency	373	456	421	651	645
b. Balances with Central Bank	1 339	1 399	1 638	2 562	4 045
c. Other	16	133	5	0	0
2. Trading securities at market value (BoBCs)	15 013	15 654	17 415	17 617	11 083
3. Placements with other banks and credit institutions	3 751	5 894	4 028	5 778	6 187
4. Gross loans and advances	13 878	17 823	19 700	22 087	27 920
4.1 Specific provisions	291	326	649	720	574
4.2 Interest in suspense				43	213
5. Net loans and advances	13 587	17 497	19 051	21 324	27 133
6. Investment securities	1 609	2 406	311	210	38
7. Fixed assets net of depreciation	295	364	399	492	482
8. Other assets (net)	1 159	1 311	580	900	1 911
Total Assets	**37 265**	**45 251**	**44 023**	**49 590**	**51 600**
Liabilities in Local Currency					
1. Amounts owed to government institutions	100	0	0	0	0
a. Central Bank accounts	100	0	0	0	0
b. Direct Government credits (CB or MFDP)	0	0	0	0	0
c. Other	0	0	0	0	0
2. Amounts due to other banks and credit institutions	1 224	1 058	680	460	990
3. Securities sold under repurchase agreements	0	0	0	0	0
4. Amounts due to other customers/depositors	29 695	37 329	37 590	41 628	43 178
5. Shareholders' funds	1 883	2 420	3 035	4 069	4 696
6. Other liabilities	2 881	2 877	199	1 977	1 827
a. Taxes payable	89	94	213	168	156
b. Dividends payable	0	115	0	0	0
c. Accrued expenses	28	27	2	42	243
d. Other	2 764	2 642	884	1 767	1 429
7. Other borrowing, including international lending agencies	1 481	1 566	1 621	1 457	909
Total Liabilities	**37 265**	**45 251**	**44 023**	**49 590**	**51 600**

* Figures restated

Table 5.2: Aggregate Income Statement of Licensed Commercial Banks (P'million)

	2007	2008	2009*	2010	2011
1. Interest and similar income	4 295	5 154	4 796	4 244	4 407
2. Interest expense	2 660	2 954	2 427	1 778	1 663
3. Net interest income [1-2]	1 635	2 200	2 369	2 466	2 745
4. Other operating income	868	1 180	1 156	1 288	1 631
5. Gross operating income/(loss) [3+4]	**2 503**	**3 379**	**3 525**	**3 754**	**4 376**
6. Bad and doubtful debts provisions	218	193	384	272	301
(a) Specific loss provision expenses	236	202	414	318	305
(b) General loss provision	11	23	20	8	37
(c) Releases and recoveries of bad debts previously written off	(29)	(32)	(50)	(54)	(41)
7. Operating income/(loss) net of specific loss provisions	**2 285**	**3 186**	**3 141**	**3 482**	**4 075**
8. Operating expenses	1 124	1 553	1 594	1 681	2 096
(a) Salaries and employee benefits	464	673	671	790	979
(b) Administrative expenses	0	260	0	0	0
(c) Auditing and consulting expenses	3	9	13	12	33
(d) Rental/lease expenses	43	59	65	53	84
(e) Depreciation and amortisation	43	76	77	69	110
(f) Other	570	476	768	756	890
9. Other provisions and write-offs	0	0	0	0	14
(a) Investments	0	0	0	0	0
(b) Other statement of financial position items	0	0	0	0	14
(c) Off-statement of financial position items	0	0	0	0	0
10. Net operating income/(loss) [7-8-9]	1 161	1 633	1 547	1 801	1 964
11. Extraordinary gains/(losses)	1	(2)	3	1	0
(a) Gains/Losses on revaluation of assets (net)	0	0	0	0	0
(b) Translation gains/losses (net)	0	0	0	0	0
(c) Other gains/losses	1	(2)	3	1	0
12. Net income/(loss) before tax [10+11]	**1 162**	**1 631**	**1550**	**1 802**	**1 964**
13. Income tax	228	317	315	396	313
14. Net income/(loss) after tax [12-13]	935	1 313	1 236	1 407	1 652
15. Proceeds from discontinued operations	0	0	4	80	13
16. Transfers from revaluation to general provisions	0	0	8	(14)	16
17. Dividends declared (paid and proposed)	555	762	480	603	858
18. Retained earnings for the year [14-15-16-17]	387	551	748	898	790
19. Retained earnings at the beginning of the year	1 388	1 380	1 349	2 796	3 035
20. Retained earnings at the end of the year [18+19]	**1 775**	**1 932**	**2 097**	**3 694**	**3 825**

*Figures restated

Table 5.3: Aggregate Statement of Financial Position of Statutory Banks (P'million)

Total Assets in Local Currency	2007	2008	2009	2010	2011
1. Cash and balances with the Central Bank	2	3	5	10	14
a. Currency	2	3	2	7	20
aa. Hard currency	0	0	0	0	0
ab. Local currency	2	3	2	7	20
b. Balances with Central Bank	0	0	4	3	(7)
c. Other	0	0	0	0	0
2. Trading securities at market value (BoBCs)	0	0	0	0	0
3. Placements with other banks and credit institutions	650	482	574	613	579
4. Gross loans and advances to other customers			2 813	3 052	3 573
5. Specific provisions			113	112	129
6. Loans and advances to other customers (net of specific provisions)	1 917	2 479	2 701	2 940	3 445
7. Investment securities	0	0	0	0	27
8. Fixed assets net of depreciation	109	153	150	157	176
9. Other assets (net)	28	26	33	42	11
Total Assets	**2 706**	**3 143**	**3 463**	**3 762**	**4 252**
Liabilities in Local Currency					
1. Amounts owed to government institutions	0	3	0	0	0
a. Central Bank accounts	0	3	0	0	0
b. Direct government credits (CB or MFDP)	0	0	0	0	0
c. Other	0	0	0	0	0
2. Amount due to other banks and credit institutions	0	0	0	0	0
3. Securities sold under repurchase agreements	0	0	0	0	0
4. Amount due to other customers/depositors	517	618	720	756	879
5. Shareholders' funds	1 513	1 674	1 819	1 957	2 031
6. Other liabilities	63	27	55	90	89
a. Taxes payable	0	0	0	0	0
b. Dividends payable	6	0	13	14	12
c. Accrued expenses	0	0	0	0	0
d. Other	58	27	42	76	77
7. Other borrowing incl. international lending agencies	613	821	869	960	1 253
Total Liabilities	**2 706**	**3 143**	**3 463**	**3 762**	**4 252**

Table 5.4: Aggregate Income Statement of Statutory Banks (P'million)

Statutory Banks	2007	2008	2009	2010	2011
1. Interest and similar income	293	392	413	402	377
2. Interest expense	95	126	150	132	137
3. Net interest income [1-2]	198	266	263	271	239
4. Other operating income	31	32	44	43	50
5. Gross operating income/(loss) [3+4]	**229**	**298**	**306**	**313**	**289**
6. Bad and doubtful debts provisions	74	37	33	45	36
(a) Specific loss provision expenses	17	33	33	43	36
(b) General loss provision	57	4	0	2	0
(c) Releases and recoveries of bad debts previously written off	0	0	0	0	0
7. Operating income/(loss) net of specific loss provisions	**155**	**261**	**274**	**268**	**253**
8. Operating expenses	110	140	166	165	167
(a) Salaries and employee benefits	52	73	80	88	88
(b) Administrative expenses	0	0	0	0	0
(c) Auditing and consulting expenses	0	0	0	0	0
(d) Rental/lease expenses	0	0	0	0	0
(e) Depreciation and amortisation	6	6	6	10	6
(f) Other	52	60	79	68	73
9. Other provisions and write-offs	0	0	0	0	0
(a) Investments	0	0	0	0	0
(b) Other statement of financial position items	0	0	0	0	0
(c) Off-statement of financial position items	0	0	0	0	0
10. Net operating income/(loss) [7-8-9]	**45**	**122**	**108**	**103**	**86**
11. Extraordinary gains/(losses)	5	(5)	6	0	0
(a) Gains/losses on revaluation of assets (net)	0	0	0	0	0
(b) Translation gains/losses (net)	0	0	0	0	0
(c) Other gains/losses	0	(5)	0	0	0
12. Net income/(loss) before tax [10+11]	**50**	**117**	**102**	**103**	**86**
13. Income tax	0	0	0	0	0
14. Net income/(loss) after tax [12-13]	50	117	102	103	86
15. Transfers from revaluation to general provisions	0	0	0	5	0
16. Dividends declared (paid and proposed)	33	27	37	37	42
17. Retained earnings for the year [14-15-16]	17	90	65	146	128
18. Retained earnings at the beginning of the year	0	0	90	61	44
19. Retained earnings at the end of the year [17+18]	**17**	**90**	**155**	**207**	**172**

TABLE 5.5: AGGREGATE* CAPITAL STRUCTURE - TIER 1 CAPITAL, TIER 2 CAPITAL AND TOTAL CAPITAL (P'MILLION)

Tier 1	Capital Elements	2007	2008	2009***	2010	2011
1	Stated capital**	236	314	352	583	712
2	Preference (non-redeemable) non-cumulative shares	0	0	0	229	255
3	General reserves	58	3	355	105	70
4	Undivided profits (audited current year retained earnings/loss)	1 292	1 559	1 837	2 463	2 558
5	Minority interests	0	0	0	0	0
6	Less					
	(a) Goodwill and other intangible assets	41	41	(41)	(144)	(134)
	(b) Shareholders' equity funded through the capitalisation of unrealised gains arising from property revaluation	13	0	0	0	0
7	**Total Tier 1 Capital (Sum of lines 1-5 less lines 6 (a) and (b)**	**1 532**	**1 835**	**2 503**	**3 236**	**3 461**
Tier 2						
8	Current year's unpublished profits	172	479	127	875	976
9	Fifty percent of fixed asset revaluation reserves	17	18	16	30	36
10	Unencumbered general provisions not to exceed 1.25 percent of risk weighted assets	96	114	166	181	202
11	Hybrid (debt/equity) capital instruments eligible for inclusion	0	1	0	1	37
12	Subordinated term debt eligible for inclusion	480	645	815	793	715
13	Minority interest in Tier 2 preference shares	0	0	0	0	1
14	Shareholders' equity funded through the capitalisation of property revaluation reserves	0	0	0	0	0
15	**Total Tier 2 Capital (sum of lines 8 to 14)**	**764**	**1 257**	**1 125**	**1 879**	**1 969**
16	**Total Capital (sum of lines 7 and 15)**	**2 295**	**3 093**	**3 627**	**5 115**	**5 429**
	Impairments					
17	Investments in unconsolidated subsidiaries and associated companies	1	1	(1)	0	0
	Total impairments of capital	1	1	(1)	0	0
	Total unimpaired capital	**2 294**	**3 092**	**3 627**	**5 115**	**5 429**

* Excluding statutory banks
** Ordinary shares (issued and paid up) plus surplus-share premium
*** Figures restated

Appendix 6: Charts of Key Prudential and Other Financial Indicators

Chart 6.1: Average Cost of Deposits

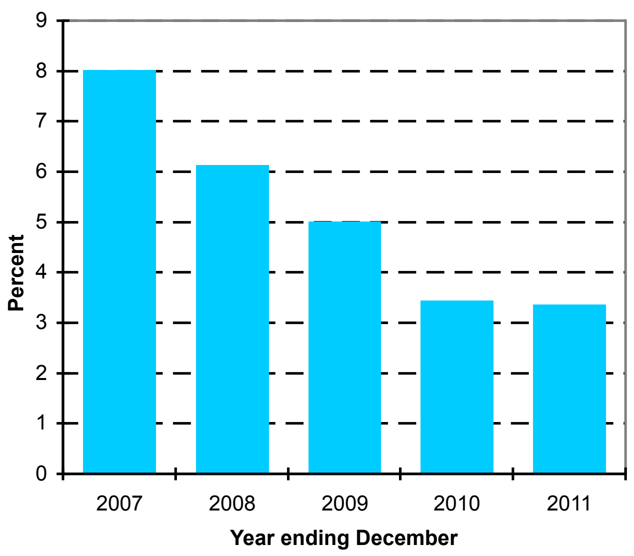


Chart 6.2: Return on Advances

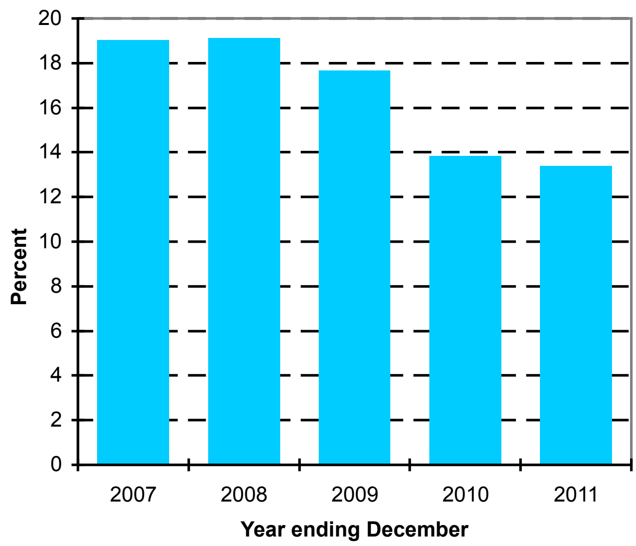


Chart 6.3: Residential Real Estate Loans to Gross Loans

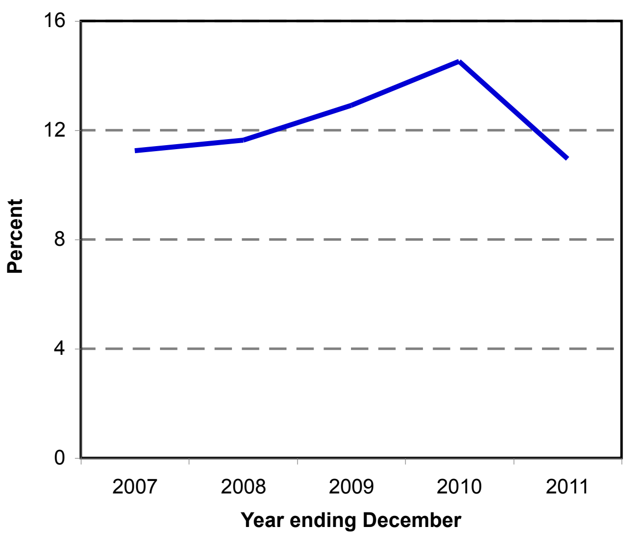


Chart 6.4: Household Loans to Gross Loans

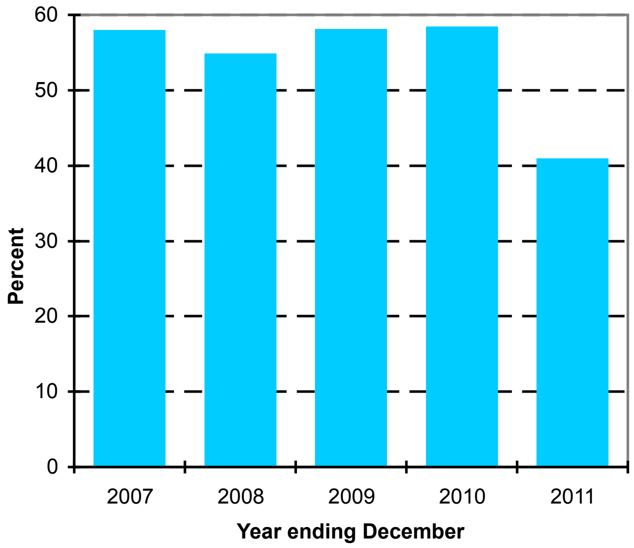


Chart 6.5: Past Due Loans Growth Rate

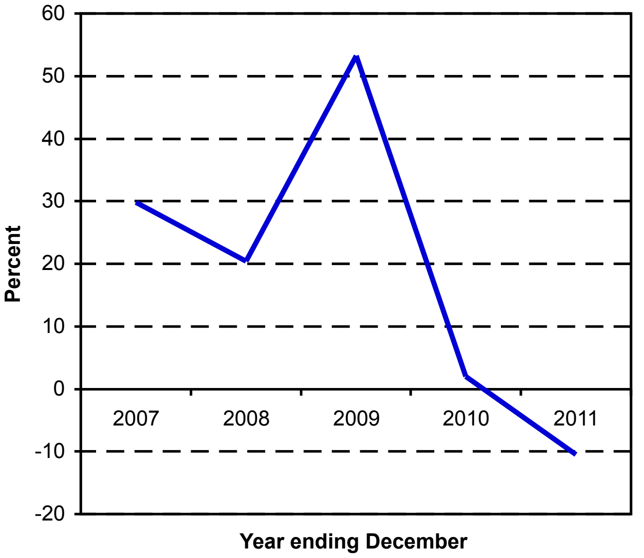


Chart 6.6: Share of Value of Total Deposits by Type (including FCAs)

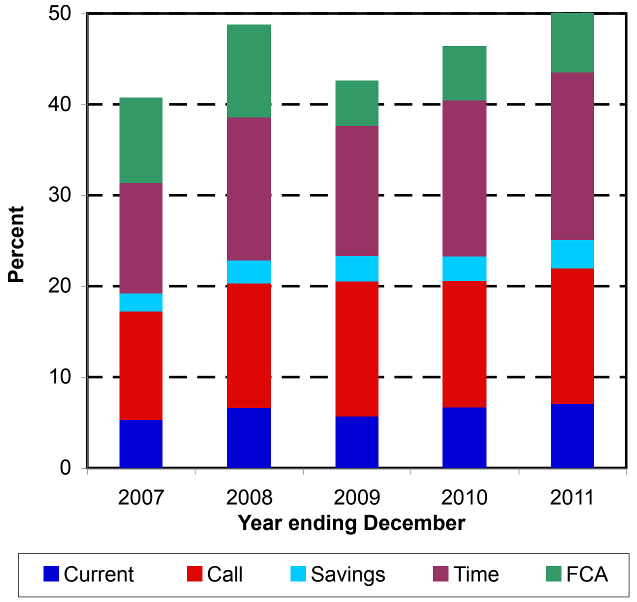


Chart 6.7: Growth Rate of Foreign Currency Accounts

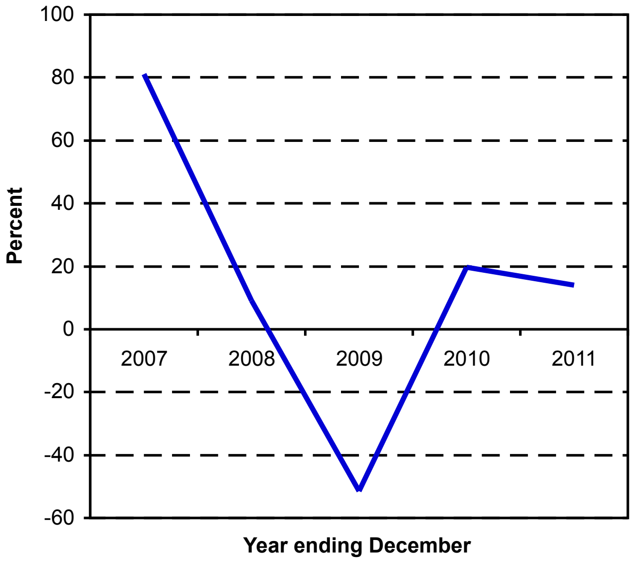
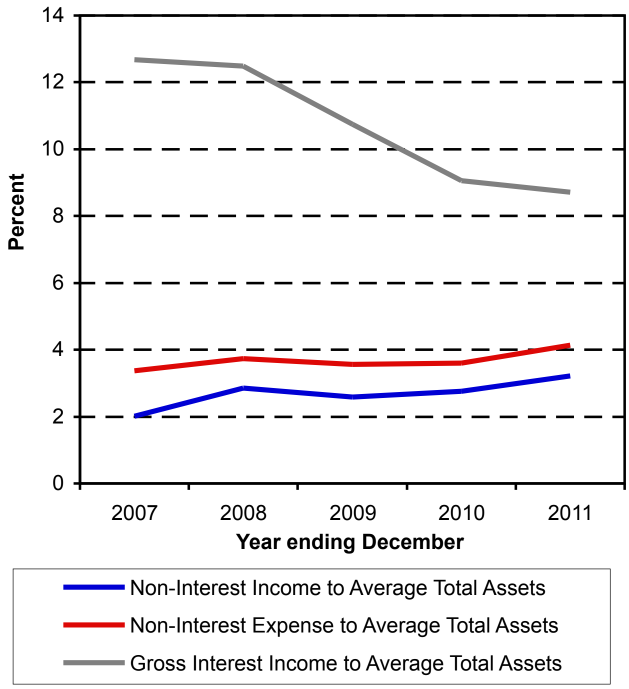


Chart 6.8: Gross Interest Income to ATA, Non-Interest Income to ATA and Non-Interest Expense to ATA



Appendix 7: Comparison between the Revised and 2006 Versions of the Core Principles

Revised structure	2006 structure
CP 1: Responsibilities, objectives and powers CP 2: Independence, accountability, resourcing and legal protection for supervisors CP 3: Cooperation and collaboration	CP 1: Objectives, independence, powers, transparency and cooperation
CP 4: Permissible activities	CP 2: Permissible activities
CP 5: Licensing criteria	CP 3: Licensing criteria
CP 6: Transfer of significant ownership	CP 4: Transfer of significant ownership
CP 7: Major acquisitions	CP 5: Major acquisitions
CP 8: Supervisory approach	CP 19: Supervisory approach
CP 9: Supervisory techniques and tools	CP 20: Supervisory techniques
CP 10: Supervisory reporting	CP 21: Supervisory reporting
CP 11: Corrective and sanctioning powers of supervisors	CP 23: Corrective and remedial powers of supervisors
CP 12: Consolidated supervision	CP 24: Consolidated supervision
CP 13: Home-host relationships	CP 25: Home-host relationships
Prudential Regulations and Requirements	
CP 14: Corporate governance	
CP 15: Risk management process	CP 7: Risk management process
CP 16: Capital adequacy	CP 6: Capital adequacy
CP 17: Credit risk	CP 8: Credit risk
CP 18: Problem assets, provisions and reserves	CP 9: Problem assets, provisions and reserves
CP 19: Concentration risk and large exposure limits	CP 10: Large exposure limits
CP 20: Transactions with related parties	CP 11: Exposures to related parties
CP 21: Country and transfer risks	CP 12: Country and transfer risks
CP 22: Market risk	CP 13: Market risk
CP 23: Interest rate risk in the banking book	CP 16: Interest rate risk in the banking book
CP 24: Liquidity risk	CP 14: Liquidity risk
CP 25: Operational risk	CP 15: Operational risk
CP 26: Internal control and audit	CP 17: Internal control and audit
CP 27: Financial reporting and external audit CP 28: Disclosure and transparency	CP 22: Accounting and disclosure
CP 29: Abuse of financial services	CP 18: Abuse of financial services