Banking Supervision Annual Report 2018

BANK OF BOTSWANA

BANKA YA BOTSWANA

Bank of Botswana

MISSION STATEMENT

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

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

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

To achieve these goals, the Bank:

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

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

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

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

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

(f) monitors and investigates unlicensed or illegal deposit-taking activities and practices.

Banking Supervision Annual Report 2018

Bank of Botswana

CONTENTS

BANK OF BOTSWANA: BANKING SUPERVISION

CONTENTS

LIST OF ABBREVIATIONS

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ATA	Average Total Assets
ATM	Automated Teller Machine
BACH	Botswana Automated Clearing House
BancABC	African Banking Corporation of Botswana Limited
Banking Act	Banking Act (Cap. 46:04)
Bank Gaborone	Bank Gaborone Limited
Bank SBI	Bank SBI Botswana Limited
Barclays	Barclays Bank of Botswana Limited
Baroda	Bank of Baroda (Botswana) Limited
BBSL	BBS Limited
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
BIS	Bank for International Settlements
BISS	Botswana Interbank Settlement System
BMS	Building Material Suppliers
BoBA	Bank of Botswana Act (Cap. 55:01)
BoBCs	Bank of Botswana Certificates
BOI	Bank of India (Botswana) Limited
BSB	Botswana Savings Bank
BSEL	Botswana Stock Exchange Limited
BURS	Botswana Unified Revenue Service
CAR	Capital Adequacy Ratio
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
CB	Central Bank
CDD	Customer Due Diligence
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CSD	Central Securities Depository
DTA	Deferred Tax Assets
EFT	Electronic Funds Transfer
EPS	Electronic Payment Services
FATF	Financial Action Task Force
FCB	First Capital Bank Limited
FIA	Financial Intelligence Agency
Fintech	Financial Technology
FMIs	Financial Market Infrastructures
FNBB	First National Bank of Botswana Limited
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
ICAAP	Internal Capital Adequacy Assessment Process
IFRS 9	International Financial Reporting Standard 9
IMF	International Monetary Fund
IT	Information Technology
LAR	Liquid Asset Ratio
LHS	Left-Hand Scale
MD	Managing Director
MFED	Ministry of Finance and Economic Development
ML/TF	Money Laundering and Terrorist Financing
NCSS	National Clearance and Settlement System
NDB	National Development Bank
NIM	Net Interest Margin
NPLs	Non-performing Loans
NRA	National Risk Assessment
OSS	Off-site Surveillance
RAS	Risk Assessment System
RBS	Risk-Based Supervision
RHS	Right-Hand Scale
ROAA	Return on Average Assets
ROE	Return on Equity
RWA	Risk-weighted Asset
TSA	The Standardised Approach
SMM	Standardised Measurement Method
SMSW	SmartSwitch
Stanbic	Stanbic Bank Botswana Limited
Stanchart	Standard Chartered Bank Botswana Limited
SWIFT	Society for Worldwide Interbank Financial Telecommunication
UBO	Ultimate Beneficial Owner
USD	United States Dollar
VAT	Value Added Tax
ZAR	South African Rand

FOREWORD

This Annual Report presents information on banking regulation and supervision as well as the structure and performance of the banking sector in 2018.

The global economy weakened in 2018, reflecting mixed performance across countries and regions. Growth eased in most advanced countries against the backdrop of policy uncertainty, the adverse effect of pronouncements of protectionist trade policies and constraints on implementation of structural and policy reforms. Output expansion was higher in emerging market economies, albeit weakening marginally due to unfavourable market sentiment, trade tensions and policy uncertainty, restrained external demand and concerns about the Chinese economic outlook. In the domestic economic context, the increase in output accelerated from 2.9 percent in 2017 to 4.5 percent in 2018, underpinned by sustained growth in non-mining GDP and the recovery in mining activity.

No banking licence was issued in 2018. In an environment of faster annual growth in credit during the year, the banking asset quality, as measured by non-performing loans, deteriorated marginally. Specifically, the ratio of non-performing loans to gross total loans and advances increased from 5.3 percent in 2017 to 5.5 percent in 2018, reflecting, to a significant extent, financial distress in some segments of the business sector. In tandem with improving economic conditions during the year, credit growth accelerated, led by higher annual increase in lending to businesses. Similarly, deposit mobilisation gained traction, growing at a faster rate than loans and advances, while both the average cost of deposits and cost-to-income ratios were relatively low and increased only marginally. Consequently, banking sector profits increased in 2018 compared to the prior year.

Banks were generally compliant with Pillar 3 disclosure requirements, with only isolated cases of shortcomings in this regard. The Bank will continue to monitor compliance with the disclosure requirements to ensure improvement in the quality, consistency and comparability of financial disclosure across banks as well as compliance with regulatory requirements. The second phase of the implementation of Basel II began in September 2018 and the evaluation of internal capital adequacy assessment process reports of banks is in progress.

As it is the norm, statutory annual meetings for discussion of issues of mutual interest between the Bank and supervised institutions were held. The Bank participated in supervisory college meetings for international banking groups with subsidiaries in Botswana. The meetings provide a platform for collaboration, coordination and information sharing among the supervisory authorities for international banking groups and enhance effectiveness of group-wide supervision.

Both the banking sector size and access to banking services improved in 2018 as indicated by an increase in the ratios of banking assets to GDP and access to banking services from 46.3 percent and 64.6 percent in 2017 to 48.1 percent and 70 percent in 2018, respectively. The overall estimation is that the degree of financial sector development and depth has been largely static in the past five years.

During the course of 2018, banks were, in the main, compliant with statutory and prudential requirements, and in cases of non-compliance, appropriate supervisory actions, including remedial measures, were implemented consistent with established practice. Overall, the banking system remained safe, sound, profitable, adequately capitalised and liquid.

MOSES D PELAELO
GOVERNOR

INTRODUCTION

In accordance with the provisions of the Banking Act (Cap. 46:04) (Banking Act), Bank of Botswana Act (Cap. 55:01) and the Bank of Botswana (Bureaux de Change) Regulations, the Bank of Botswana (Bank) regulates and supervises banks, bureaux de change and one deposit-taking microfinance institution. The number of licensed commercial and statutory banks remained at 10 and three, respectively, in 2018, employing, in total, 5 270 people compared to 5 210 in 2017. Spurred by increased competition in the banking sector, along with evolving customer needs, banks continued to improve products and service offerings to remain relevant to the demands of the economy and sustain viable and profitable operations.

Total assets for the banking sector increased by 9.4 percent from P83.5 billion in 2017 to P91.3 billion in 2018, while customer deposits rose by 8.9 percent from P63.6 billion in 2017 to P69.3 billion in 2018, constituting 75.8 percent of liabilities. Similarly, loans and advances increased by 7.7 percent from P54.2 billion to P58.3 billion in the same period, faster than the 5.6 percent growth in the prior year. Consequently, the financial intermediation ratio eased from 85.2 percent in 2017 to 84.2 percent in 2018. Notwithstanding, core indicators of financial sector depth and development show that the country's banking sector is relatively small in relation to GDP.

The banking sector was adequately capitalised and complied with regulatory capital requirements. The aggregate unimpaired capital for the industry increased significantly by 12 percent to P12.1 billion in 2018 (2017: P10.8 billion). Banks largely reported capital adequacy and common equity Tier 1 capital ratios in excess of the respective 15 percent and 4.5 percent prudential and statutory minimum requirements. One bank, however, had a capital adequacy ratio (of 13.3 percent)1 below the prudential minimum requirement of 15 percent as at December 31, 2018.

Past due loans (accounts in arrears) increased by 1.2 percent between December 2017 and December 2018. Non-performing loans (NPLs) increased by 10.7 percent from P2.9 billion to P3.2 billion in the same period. As a result, the ratio of NPLs to gross loans and advances rose from 5.3 percent in December 2017 to 5.5 percent in December 2018, thus a slight deterioration in asset quality. The ratio of specific provisions to NPLs fell from 53.7 percent in 2017 to 42.7 percent in 2018, an erosion in the coverage of NPLs. But the credit-risk mitigation measures that banks have put in place are expected to absorb the residual risks. The banks' large exposures to unimpaired capital ratio increased to 209 percent (2017: 200 percent), and was within the 800 percent prudential limit for banks in Botswana. Generally, the composite credit risk for the banking sector was considered high and is expected to increase in the short- to medium-term due to the dominance in banks' loan books of the household sector credit, which is mostly unsecured. This makes the banking sector vulnerable to business restructuring and employment risks, particularly for state-owned entities.

Banking sector profitability rebounded in 2018 as aggregate after-tax profit increased significantly by 41.8 percent from P1.2 billion in 2017 to P1.7 billion in 2018. Consequently, efficiency and profitability indicators for the industry strengthened. The return on equity (ROE) and return on average assets (ROAA) increased from 12.6 percent and 1.4 percent in 2017 to 16.1 percent and 1.9 percent, respectively. Thus, profitability ratios were satisfactory and in line with international norms for banks of comparable size. The International Financial Reporting Standard (IFRS) 9 became mandatory from January 1, 2018; the transition from International Accounting Standard 39 to IFRS 9 was smooth, with no impact on banks' profitability and minimal effect on solvency.

[1] In order to comply with minimum prudential requirements, the bank was expected to be recapitalised through issuance of Tier 2 capital instruments.

INTRODUCTION (CONTINUED)

The banking industry remained liquid: statutory liquid assets rose by 15.7 percent to P13.2 billion in 2018 (December 2017: P11.4 billion). As a result, the liquid assets to total deposits ratio (LAR) for banks increased from 17.9 percent in 2017 to 19 percent in 2018, moderately above the required prudential minimum of 10 percent. The regulatory and supervisory oversight by the Bank continued to focus on ensuring good governance and appropriate risk-taking by regulated institutions. The oversight framework encompasses on-site examination and off-site monitoring of banks using a risk-based supervision (RBS) approach and off-site surveillance (OSS) system. In addition to the prudential assessment, the Bank monitored the business conduct of banks to ensure that their customers were treated in a fair, professional and transparent manner.

In accordance with Section 24 of the Banking Act, the Bank carried out full-scope and limited-scope on-site prudential and consumer compliance examinations of nine banks during 2018. Overall, the results indicated sound governance, internal controls and satisfactory market conduct. However, there were some areas relating to consumer complaints management that required improvement, particularly timely and sufficient response. Furthermore, some isolated instances of violation of the Banking Act and weak control environment were identified. The concerned banks were accordingly ordered to implement corrective actions in respect of the areas of deficiency and a total monetary penalty fee of P881 560 was levied on banks that violated the Banking Act. Banks continued to comply with the minimum public disclosure and statutory requirements on bank charges, by publishing monthly interest rates payable on deposits on their websites as well as in at least two newspapers widely circulating in Botswana. Large-value and longer-maturity deposits continued to earn relatively high deposit rates.

The Bank continued to guide banks on the requirements of the money laundering and terrorist financing (ML/TF) compliance regime to enhance effectiveness. Despite measures taken to improve compliance with the anti-money laundering and combating the financing of terrorism (AML/CFT) requirements, in October 2018, the Financial Action Task Force (FATF) concluded that progress made by Botswana to address the earlier identified strategic deficiencies was not adequate. Consequently, FATF placed the country under observation and issued a public statement pointing out the strategic AML/CFT deficiencies. The country has adopted an action plan, coordinated by the Financial Intelligence Agency, to remedy the identified deficiencies and also lay a strong legal foundation for a robust, effective and durable AML/CFT framework.

This report is organised as follows: Chapter 1 outlines the structure of the financial system, with particular emphasis on banks; while Chapter 2 presents an assessment of the financial performance of the banking sector in 2018; Chapter 3 reports on licensing and consumer protection issues; Chapter 4 highlights the recent global standards and guidelines issued by the Basel Committee on Banking Supervision (BCBS); and Chapter 5 summarises key issues arising from the on-site and off-site examination processes. Appendices are at the end of the report.

CHAPTER 1

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS

CHAPTER **1**:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS

Structure of the Financial Sector

1.1 The Bank continued to regulate and supervise commercial banks, bureaux de change and a deposit-taking microfinance institution (Women's Finance House). As at December 31, 2018, the number of licensed commercial and statutory banks was 10 and three, respectively, unchanged from the prior year. During 2018, five bureaux de change were licensed, while nine bureaux de change licences were revoked. As a result, the number of licensed bureaux de change decreased from 61 in 2017 to 57 in 2018.

Banking Sector: Branch Network and Other Delivery Channels

1.2 Table 1.1 shows the number of bank branches and automated teller machines (ATMs) in 2016, 2017 and 2018. The restructuring of operations by banks resulted in the opening of new branches and closure of some. As a result, bank branches increased from 143 to 147 in 2018. The number of ATMs increased from 473 to 523 during the year. Most of the new ATMs have more functions, including deposit-taking capabilities, thus improving convenient access to transactional banking services.

1.3 With respect to the geographical distribution of the branch network, the South East District, which includes the capital city, Gaborone, led the concentration of branches at 64, followed by the Central District at 33, as at December 31, 2018. Central district had an increase of 1 branch, while the branch network for the other districts was unchanged (Appendix 2).

Table 1.1: Bank Branches and Other Delivery Channels: 2016 – 2018

		Branches and Sub-branches			ATMs		
		2016	2017	2018	2016	2017	2018
Large Banks	Barclays*	36	34	34	118	113	113
	Stanchart	21	21	19	68	67	68
	FNBB*	24	27	29	188	206	226
	Stanbic*	15	16	16	30	34	53
	BancABC*	9	9	9	15	15	15
	Sub-Total	**105**	**107**	**107**	**419**	**435**	**475**
Small Banks	Baroda	3	3	3	6	6	6
	Bank Gaborone*	8	9	12	9	11	16
	FCB	4	4	4	6	6	6
	BOI	1	1	1	-	-	-
	Bank SBI	1	1	1	-	-	-
	Sub-Total	**17**	**18**	**21**	**21**	**23**	**28**
Total (Commercial Banks)		**122**	**125**	**128**	**440**	**458**	**503**
Statutory Banks	BSB*	5	5	5	3	3	8
	BBSL	9	9	10	12	12	12
	NDB	4	4	4	-	-	-
Total (Statutory Banks)		**18**	**18**	**19**	**15**	**15**	**20**
Aggregate		**140**	**143**	**147**	**455**	**473**	**523**

*2016 and 2017 figures were revised.

Source: Commercial and Statutory Banks (Statutory Returns submitted to the Bank).

Access Indicators

1.4 Access to banking services, as measured by the ratio of number of depositors[2] to adult[3] population, improved from 64.6 percent in 2017 to 70 percent in 2018. The number of depositors grew by 10.7 percent from 1 million in 2017 to 1.1 million in 2018, while the adult population increased by 2.1 percent from 1.56 million to 1.59 million.

1.5 The number of ATMs per 1 000 square kilometres and per 10 000 adults were one and three, respectively, in 2018, the same as in 2017, while there was one branch per 10 000 adults, and a statistical average of less than one branch per 1 000 square kilometres, indicative of the sparsely populated nature of the country.

[2] To calculate access to banking services, the number of depositors was used in 2018, compared to 2017 wherein the number of accounts was used.

[3] Adult refers to persons aged 15 and above. The population projection figures were obtained from the Botswana Statistics Projections 2011–2026 Report; medium scenario projections were used.

Banking Sector Employment Trends: 2017 and 2018

1.6 Employment levels in the banking sector for 2017 and 2018 are shown in Table 1.2. The number of people directly employed in the banking sector increased from 5 176 in 2017 to 5 270 in 2018, representing a 1.8 percent growth in employment, albeit a slower pace than the 2.4 percent increase in 2017 and was associated with the growth in the branch network. While there was an increase in staff complement for some banks, there was a decrease with respect to seven banks. The decline in employment at these banks was due to retrenchments, staff resignation and closure or merging of branches by some banks. The number of expatriates employed by the banking industry fell from 66 in 2017 to 60 in 2018. Overall, the staff complement for small banks increased by 3.1 percent, from 485 in 2017 to 500 in 2018; for the large banks[4], the level of employment rose by 2.2 percent from 4 137 in 2017 to 4 226 in 2018.

Table 1.2: Level of Employment by Domestic Banks: 2017 and 2018

		2017			2018		
		Citizens	Expatriates	Total	Citizens	Expatriates	Total
Large Banks	Barclays	1 150	7	1 157	1 152	4	1 156
	Stanchart	788	9	797	753	12	765
	FNBB	1 263	6	1 269	1 365	4	1 369
	Stanbic	596	4	600	589	3	592
	BancABC	309	5	314	342	2	344
	Sub-Total	4 106	31	4 137	4 201	25	4 226
Small Banks	Baroda	34	13	47	37	13	50
	Bank Gaborone	271	5	276	266	6	272
	FCB	126	7	133	145	7	152
	BOI	8	4	12	5	4	9
	Bank SBI	13	4	17	14	3	17
	Sub-Total	452	33	485	467	33	500
Total (Commercial Banks)		4 558	64	4 622	4 668	58	4 726
Statutory Banks	BSB	172	-	172	176	-	176
	BBSL	215	2	217	212	2	214
	NDB	165	-	165	154	-	154
Total (Statutory Banks)		552	2	554	542	2	544
Aggregate		5 110	66	5 176	5 210	60	5 270

Source: Commercial and Statutory Banks (Statutory Returns submitted to the Bank).

[4] In this context, a large bank refers to a bank with total assets amounting to at least 10 percent of the aggregate banking sector total assets as at December 31, 2018.

New Banking Sector Products and Services

1.7 Disclosure of key information about a product is fundamental to consumer protection as it enables customers to make informed decisions when selecting products and services offered in the market. Banks continued to diversify, develop and improve their products and services to meet evolving customer needs and to accommodate and harness industry and market innovation in areas of potential business growth.

1.8 During 2018, banks introduced 14 new products and services covering a wide range of banking services, namely, transactional accounts and mobile-banking services as well as group savings accounts, which target groups such as churches. A number of these products and services were designed to foster growth of customer base and retention of existing ones (thus financial inclusion), hence mainly featured enhancements and lower service fees.

Financial Market Infrastructures

1.9 The National Clearance and Settlement Systems (NCSS) Act (Cap. 46:06) assigns the Bank powers and functions related to the regulation and oversight of financial market infrastructures (FMIs), which are payment systems, central securities depositories (CSDs), securities settlement systems, central counterparties and trade repositories. These infrastructures facilitate the clearing, settlement and recording of monetary and other financial transactions such as payments, securities and derivative contracts. The four key financial market infrastructures that are recognised in Botswana, as highlighted below, remained stable in 2018.

Botswana Interbank Settlement System

1.10 The Botswana Interbank Settlement System (BISS) is used to settle payment instructions between settlement system participants in Botswana. The system is designed to settle high-value and time-critical payments, on a real-time, gross basis. To ensure optimal utilisation of the system, however, low-value payments are also allowed to settle through the BISS and it currently provides for direct and indirect participants. Direct participants are commercial banks regulated by the Bank, and indirect participants are the Botswana Unified Revenue Service (BURS) and Office of the Accountant General. Indirect participants are able to obtain information from BISS and upload to their back-end systems. This is to facilitate ease of reconciliation and prompt allocation of funds to the relevant accounts, particularly for BURS tax payers. The use of the BISS has increased over the years as bank customers and the business community in general became aware of the benefits of timeliness and security of payment transactions provided by the BISS.

Botswana Automated Clearing House

1.11 The Botswana Automated Clearing House (BACH) is a clearing facility established to process the exchange of transactions such as cheques and electronic funds transfers (EFTs) among participant banks operating in Botswana. The BACH is owned and operated by the Bankers Association of Botswana, and participants in the BACH comprise all clearing banks in Botswana.

Central Securities Depository

1.12 The central securities depository (CSD) system is operated by the Central Securities Depository Company of Botswana, a subsidiary of the Botswana Stock Exchange Limited (BSEL). The CSD facilitates the clearing and settlement of securities transactions carried out on the BSEL. Participants in the CSD include brokers and custodian banks whose systems have direct interface with the CSD system.

Smartswitch Botswana

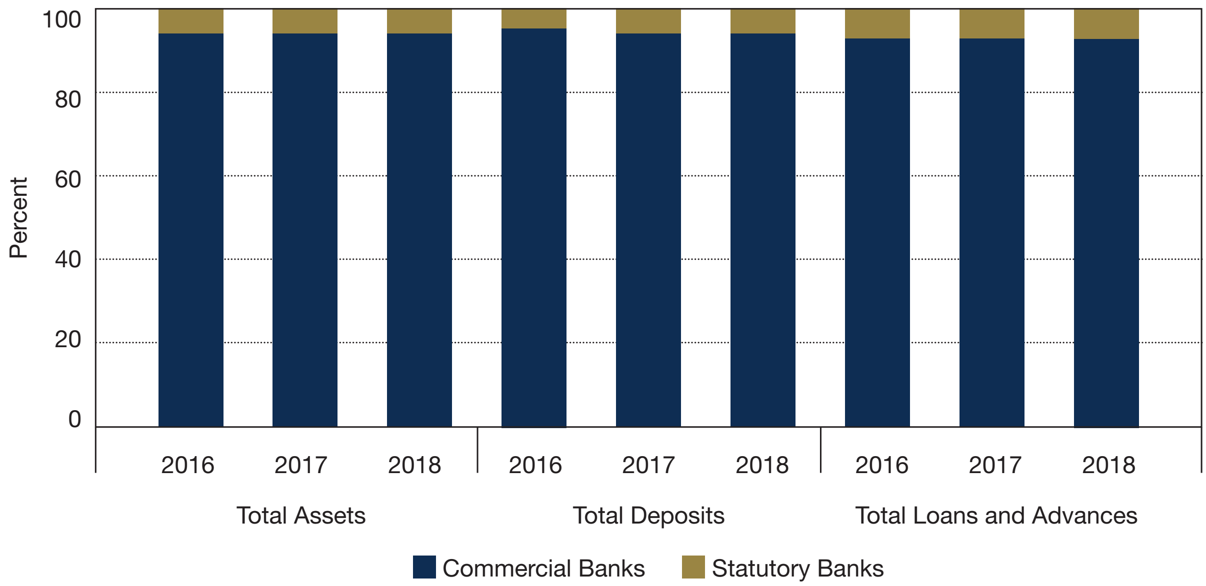
1.13 SmartSwitch Botswana (Proprietary) Limited is a recognised payment service provider licensed under the NCSS Act. The smartswitch (SMSW) system facilitates the use of smart cards, point-of-sale devices and accounts held with financial institutions. Currently, SMSW Botswana is contracted by the government of Botswana through the Ministry of Local Government and Rural Development to provide disbursement services to beneficiaries of social grants. But the system has capacity to offer a wide range of services. SMSW Botswana has a wide reach in Botswana, covering a network of 1 067 merchants in over 240 locations.

BANKING SECTOR COMPETITION AND CONCENTRATION

Market Share

1.14 Commercial banks maintained a dominant share of total banking industry assets, deposits, and loans and advances compared to statutory banks (Chart 1.1). On the other hand, the market share of statutory banks fell slightly with respect to total assets, deposits, and loans and advances, with 6.7 percent, 5.8 percent and 7.7 percent at the end of 2018, respectively, compared to 7.5 percent, 6 percent and 8.1 percent in 2017.

Chart 1.1: Banking Sector Market Share of Total Assets, Total Deposits and Total Loans and Advances*: 2016 – 2018 (Percent)

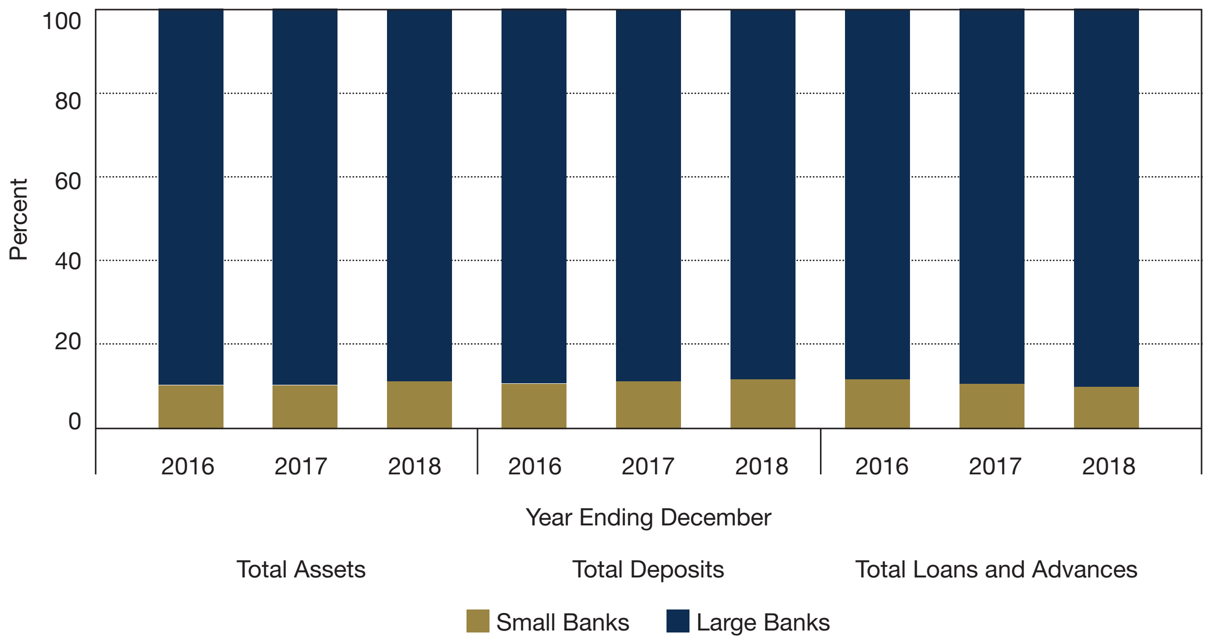


*Figures exclude one statutory bank.

Source: Commercial and Statutory Banks (Statutory Returns submitted to the Bank).

1.15 Five banks continued to dominate the banking sector and accounted for 88.7 percent, 87.9 percent and 87.8 percent of total assets, total deposits, and total loans and advances, respectively, in 2018, although slightly lower than the respective proportions of 89.5 percent, 88.5 percent and 88.7 percent reported in 2017.

Chart 1.2: Market Share of Total Assets, Total Deposits and Total Loans and Advances of Commercial Banks: 2016 – 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

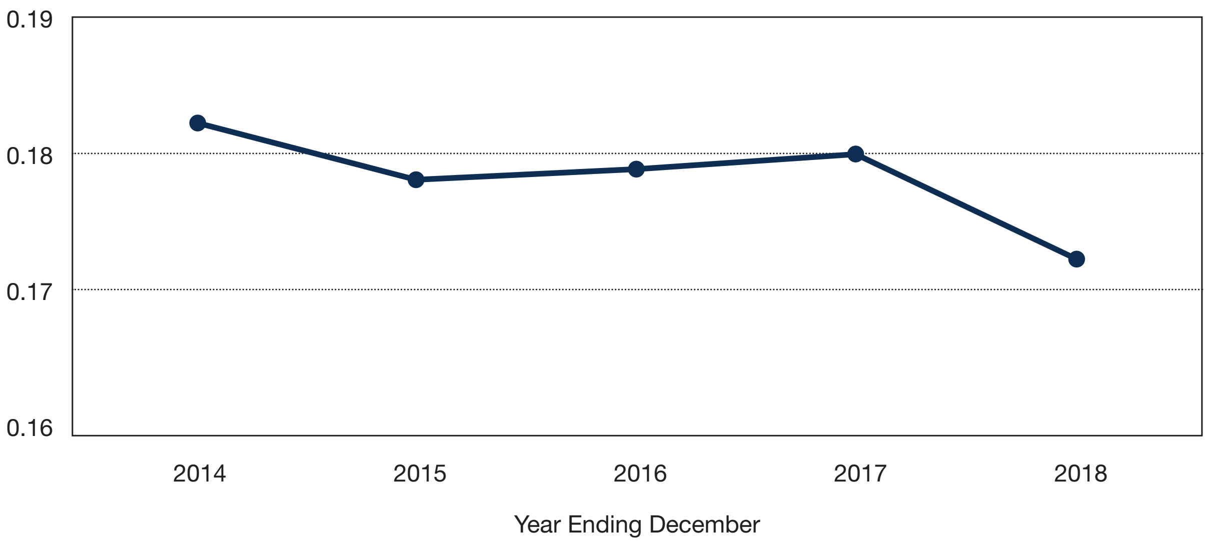
Market Competition Indicators

The Herfindahl-Hirschman Index (HHI) of Competitiveness

1.16 The Bank uses the Herfindahl-Hirschman Index[5] (HHI), a widely applied measure of market concentration, to assess the degree of competition in the Botswana banking industry. The HHI decreased from 0.1800 in 2017 to 0.1732 in 2018, indicating improvement in the degree of competition in the banking sector as small banks gained market share for assets, deposits, and loans and advances (Chart 1.3).

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

Chart 1.3: Herfindahl-Hirschman Index (HHI): 2014 – 2018



Source: Commercial Banks (Statutory Returns submitted to the Bank).

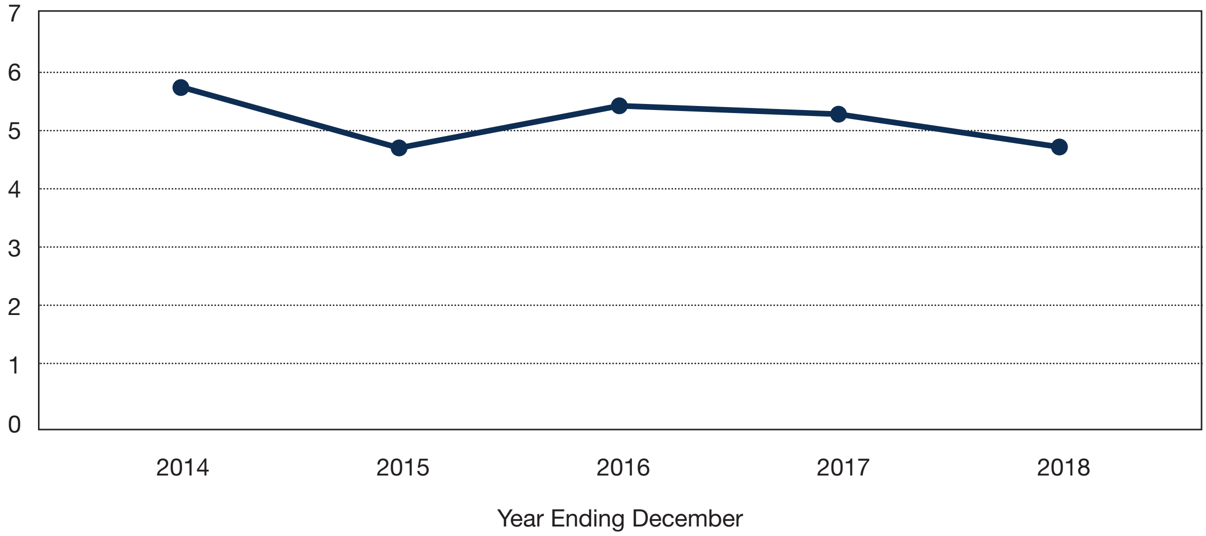
Net Interest Margin

1.17 The net interest margin (NIM) for the banking industry decreased from 5.4 percent in 2017 to 4.8 percent in 2018 (Chart 1.4), signalling enhanced competition and efficiency of the banking system in 2018. Notably, in addition to competitive forces, the NIM can be driven by factors such as operating costs, loan quality and the macroeconomic environment, including interest rates and demand (although aspects of these may be indirect facets of competition).

Lending-Deposit Spread and Operating Expenses to Total Assets Ratio

1.18 The lending-deposit spread for the banking sector decreased from 6.1 percent in 2017 to 5.2 percent in 2018, showing consistency with other measures that indicate improvement in the banking sector competition. The ratio of operating expenses to total assets declined from 4.6 percent to 4.4 percent in the same period, implying some degree of efficiency in generating banking assets.

Chart 1.4: Banking Sector Trend of Net Interest Margin (NIM): 2014 – 2018 (Percent)

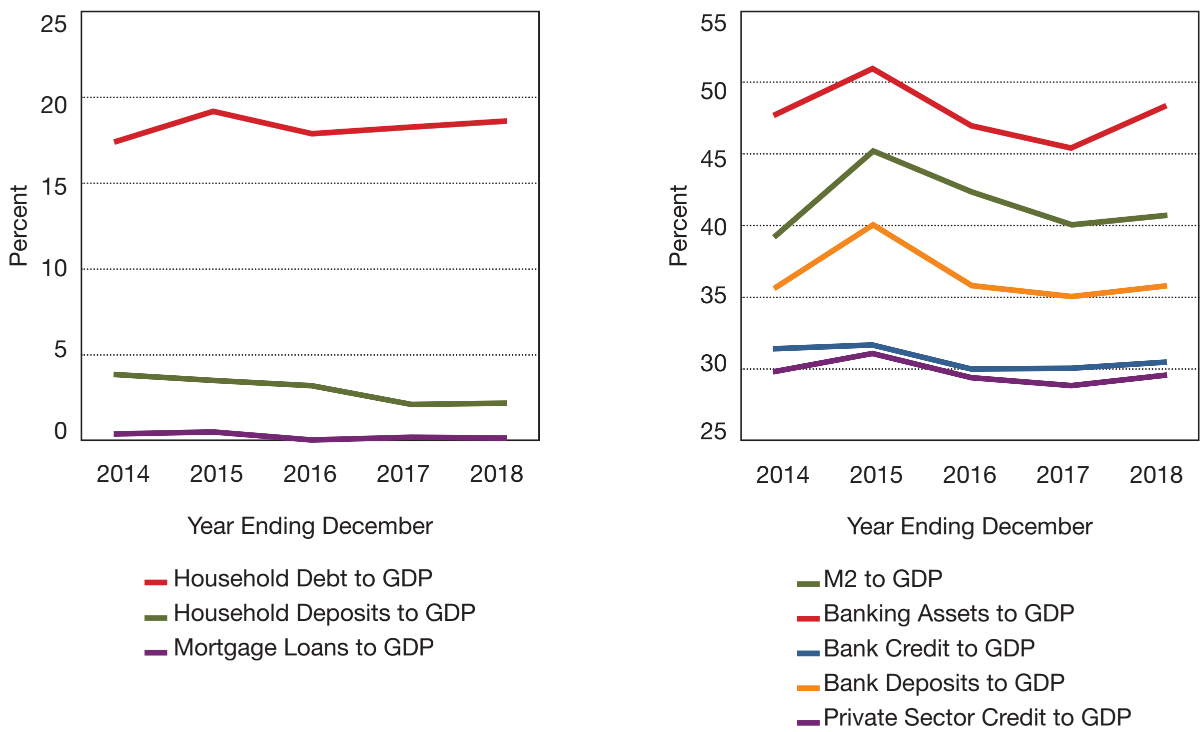


Source: Commercial Banks (Statutory Returns submitted to the Bank).

FINANCIAL DEEPENING AND DEVELOPMENT

1.19 Financial deepening refers to the increased use, relative to overall economic activity, of financial services, particularly broader choices with improved access by varied societal groups; thus greater and beneficial role of financial services in business activity, enhancement of living standards and economic performance, generally. Chart 1.5 shows several ratios commonly used in measuring financial deepening and development. Overall, the degree of financial sector development and depth has been largely static in the past five years or so, indicating scope for enhancement through policy review, structural transformation and strategic realignment by financial institutions in order for the financial sector to sustain meaningful support for economic activity.

Chart 1.5: Financial Sector Deepening Indicators: 2014 – 2018 (Percent)



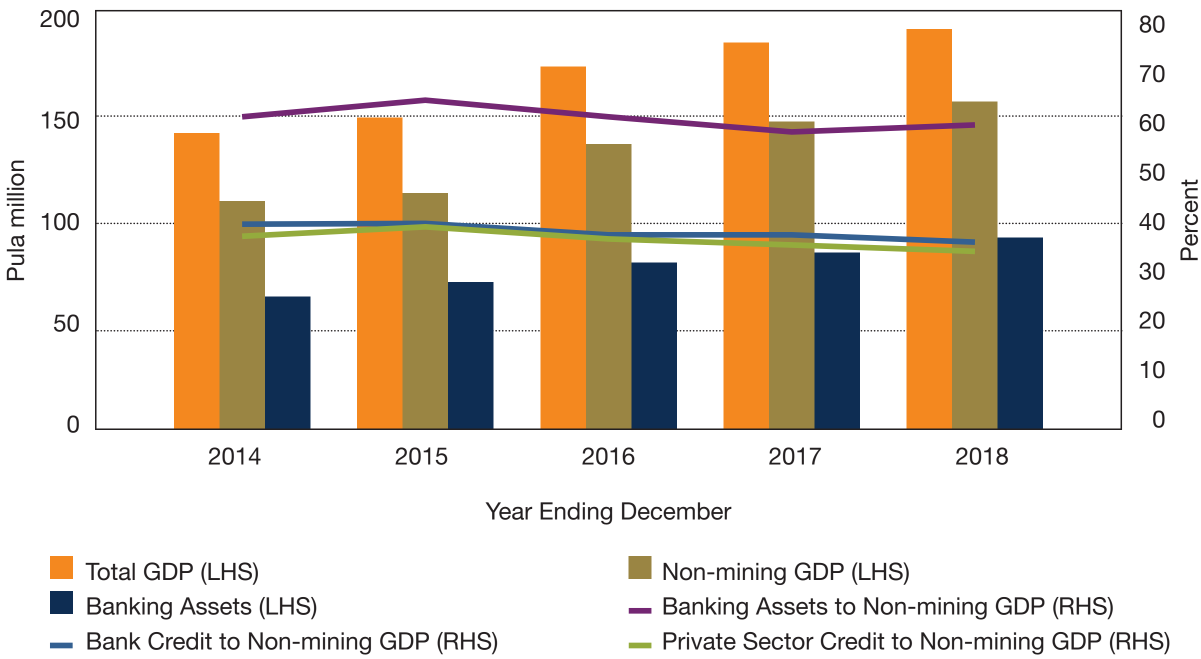
Source: Commercial Banks (Statutory Returns submitted to the Bank) and Statistics Botswana.

1.20 Financial depth and development, as estimated by the ratio of private sector credit to GDP[6], increased marginally from 28.5 percent in 2017 to 29 percent in 2018. In contrast, private sector credit, as a ratio of non-mining GDP, fell from 34.8 percent in 2017 to 34.6 percent in 2018. When benchmarked against the global average ratio of private sector credit to GDP of 51.4 percent (as reported by the World Bank's 2017/2018 Global Financial Development Report), the Botswana banking system is relatively small, suggesting scope for further growth under stable macroeconomic conditions and prudent credit expansion. It is noted, however, that the ratio was higher than the sub-Saharan African average of 21.3 percent.

1.21 The ratio of banking assets to GDP, a measure of financial sector size, increased to 48.1 percent in 2018 compared to 46.3 percent in 2017 (Chart 1.5). The ratio of banking assets to non-mining GDP increased from 56.6 percent in 2017 to 57.5 percent in 2018 (Chart 1.6). Bank credit, as a proportion of total GDP, grew from 30.1 percent in 2017 to 30.7 percent in 2018 (Chart 1.5).

[6] The private sector credit to GDP ratio, as defined by the World Bank, excludes credit issued to government, government agencies and public enterprises.

Chart 1.6: Financial Sector Size and Depth Indicators: 2014 – 2018



Source: Commercial Banks (Statutory Returns submitted to the Bank) and Statistics Botswana.

1.22 The M2[7] to GDP ratio, which estimates the degree of monetisation of an economy, increased from 40.2 percent in 2017 to 41.3 percent in 2018, indicating marginal improvement in financial depth. In the case of Botswana, a high M2 to GDP ratio would suggest that a significant part of economic activity was supported by the financial resources mobilised by the banking sector.

1.23 Total household debt as a proportion of GDP increased from 18.4 percent in 2017 to 18.5 percent in 2018. The commercial bank mortgage lending to GDP ratio remained unchanged at 5.1 percent in the same period; the broader ratio of mortgage loans to GDP, which includes statutory banks was 7.2 percent, an indication of meaningful contribution of statutory banks to mortgage financing. The household deposits to GDP ratio increased from 7.1 percent in 2017 to 7.3 percent in 2018.

[7] M2 (P77.7 billion) comprises all liabilities of financial corporations included in a country's definition of broad money. In the case of Botswana, M2 comprises currency outside depository corporations, transferable deposits (demand deposits) and other deposits included in broad money (time and fixed deposits).

1.24 The ratio of pension fund assets to GDP fell from 45.5 percent in 2017 to 41.6 percent in 2018, owing to a slight decrease of 3.7 percent in valuation of pension funds. As at December 31, 2018, the aggregate household savings in the banking sector and pension funds was P92.8 billion compared to the household borrowing of P35.1 billion. On this measure, the household sector was therefore a net saver[8] in the economy.

1.25 The value of electronic funds-transfer transactions (EFTs) relative to economic activity increased from 7.8 percent in 2017 to 8.6 percent in 2018, mainly reflecting growth of 15.9 percent in EFTs.

STOCK MARKET SIZE

1.26 In 2018, the market capitalisation[9] of BSEL was P413.2 billion, a decrease of 1.2 percent from P418.1 billion in 2017, as a result of which the ratio of market capitalisation to GDP fell to 217.6 percent from 232.2 percent in the same period. The market capitalisation to GDP ratio in excess of 100 percent (international benchmark) suggests that the country's stock market was overvalued. The overvaluation of the stock market is, however, not specific to the Botswana economy; for example, South Africa and Malaysia reported 352.3 percent and 144.9 percent, respectively, in 2017, while most African countries had market capitalisation ratios below 50 percent, indicating that stock markets for those countries are undervalued.

1.27 The ratio of the overall bond market[10] to GDP increased from 0.3 percent in 2017 to 1.2 percent in 2018 because of a significant rise in bonds issued during the review year. Despite the expansion, the bond market remains suboptimal in respect of effective support for the country's economic development, hence the significant scope for improvement, among others, through development of the related infrastructure and operations and a larger and frequent issuance by government, parastatals and private corporations. Similarly, the stock market turnover to GDP ratio rose from 1.7 percent in 2017 to 2.2 percent in 2018, indicating a slight increase in market liquidity, although remaining low from the investor participation perspective.

[8] Data used was from pension funds and commercial banks. Because of data limitations, the analysis does not include other financial institutions such as micro-lenders and insurance companies.

[9] Includes domestic and foreign companies.

[10] Includes government and corporate bonds.

BOX 1: FINANCIAL TECHNOLOGIES AND REGULATIONS

Financial technology (fintech) is a topical issue both in Botswana and across the globe. Fintech companies provide technologies that disrupt the traditional models for the provision of financial services, while benefitting financial institutions that embed them in their financial product offerings. In this respect, fintech potentially enables more efficient provision of financial services that are more widely distributed and at relatively low overhead costs, thus transforming the financial services landscape and creating opportunities for consumers and financial service providers. New and emerging technologies support the introduction of new services; drive efficiency gains in the financial sector; foster financial inclusion and financial deepening; and with a potential to deliver widespread economic and social benefits.

A new breed of non-bank payment providers has spurred exponential growth in payments innovation. These new players operate to facilitate payments, resulting in benefits such as speed, convenience, efficiency and multi-channel accessibility. The most significant changes occur in retail payments, and have stimulated the unbundling of a range of financial services. In recognition of the important role of fintech in the realm of payments, banks are paying greater attention to these developments and, in some instances, partnering with financial technology companies in order to expand their knowledge and understanding of potential developments, and also to incorporate the enhanced digital payments platforms and processes in their operations.

Sustained use of technology-based delivery of financial services depends on the efficiency, integrity and safety of the payments system. This requires proper management of risk and enabling regulatory framework that facilitates innovation, while also protecting stakeholder interests. The regulation of fintech operators and activities in Botswana is indirect in that it depends on various laws and regulations that govern financial institutions offering fintech services as enhancements to their core products, such as banking services, insurance and other financial products. Notably, as the main financial regulator in Botswana, the Bank ensures a consistent approach to the qualification and regulatory treatment of fintech operators. A diverse and dynamic fintech space has the potential to contribute significantly to the quality and competitiveness of the domestic financial sector. Therefore, the Bank continues to monitor and assess fintech developments with a view to identifying existing opportunities and threats in relation to the payments ecosystem.

In response to the market developments and, in order to maintain the integrity of the payments system, the Bank spearheaded the development of the Electronic Payment Services (EPS) Regulations (regulations) as part of its broader strategy to create an enabling regulatory environment for convenient, efficient and safe retail payments, and funds transfer mechanisms. The regulations, promulgated in January 2019, provide for the licensing and oversight of EPS providers, such as fintech companies and general provisions applicable to all EPS providers. EPS providers are, generally, organisations authorised by the Bank to provide electronic payment services to facilitate money transmission in a properly structured manner, which conforms to best international standards. These regulations will also ensure that payment services and infrastructure are provided in a secure and appropriate manner, within the context of an adequately responsive regulatory framework with a view to promoting both certainty for fintech companies and safety for consumers.

CHAPTER 2

PERFORMANCE OF THE BANKING INDUSTRY

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY

COMMERCIAL BANKS

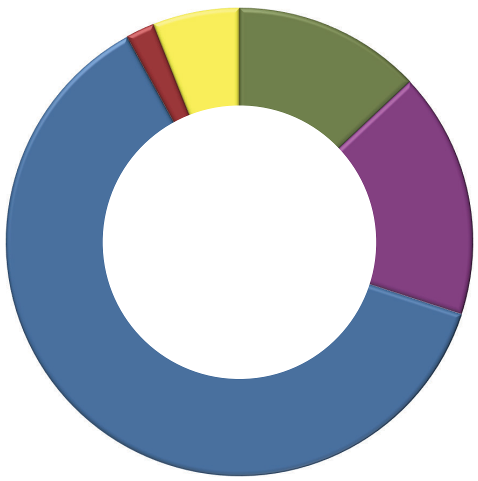
Statement of Financial Position: Balance Sheet

2.1 Total assets of the banking sector amounted to P91.3 billion at the end of 2018, a 9.4 percent increase from the P83.5 billion in 2017. Growth in assets of banks was underpinned by an increase in gross loans and advances (7.7 percent) from P54.2 billion to P58.3 billion in the same period. Net loans and advances constituted the largest proportion of total assets (62 percent) of the banking sector, followed by placement with other banks and credit institutions (17 percent), investment and trading securities (13 percent), cash and balances with the central bank (6 percent) and other assets (2 percent).

2.2 Total liabilities (excluding shareholder funds) of the banking sector grew by 9.2 percent from P74.1 billion in 2017 to P81 billion in 2018. Customer deposits, which are the main source of funding for banks, increased by 8.9 percent to P69.3 billion in 2018 (2017: P63.6 billion). Growth in deposits was supported by extensive deposit mobilisation efforts by commercial banks.

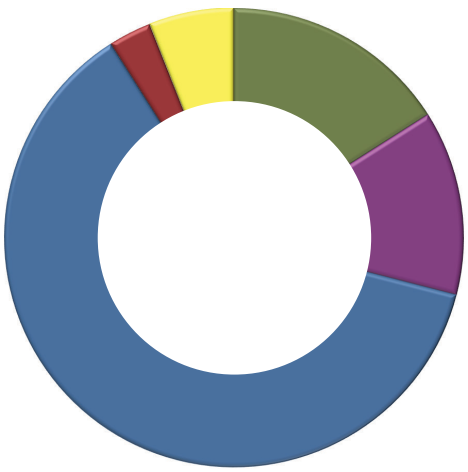
2.3 Charts 2.1 and 2.2 show the composition of assets and liabilities for 2017 and 2018, respectively. The proportions of both assets and liabilities remain largely unchanged, with only small variations between the two periods.

Chart 2.1: Commercial Banks: Composition of Assets: 2017 and 2018 (Percent)



December 31, 2018

Cash and balances with the central bank	6
Investment and trading securities	13
Placements with other banks and credit institutions	17
Net loans and advances	62
Other assets	2

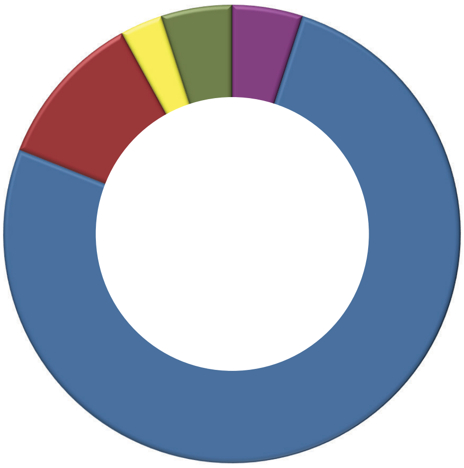


December 31, 2017

Cash and balances with the central bank	6
Investment and trading securities	16
Placements with other banks and credit institutions	13
Net loans and advances	62
Other assets	3

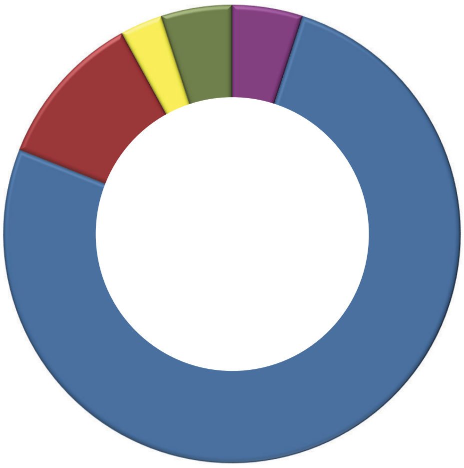
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Chart 2.2: Commercial Banks: Composition of Liabilities: 2017 and 2018 (Percent)



December 31, 2018

Due to Other Banks and Credit Institutions	5
Customer Deposits	76
Shareholder Funds	11
Other Liabilities	3
Debt Securities and Other Borrowing	5



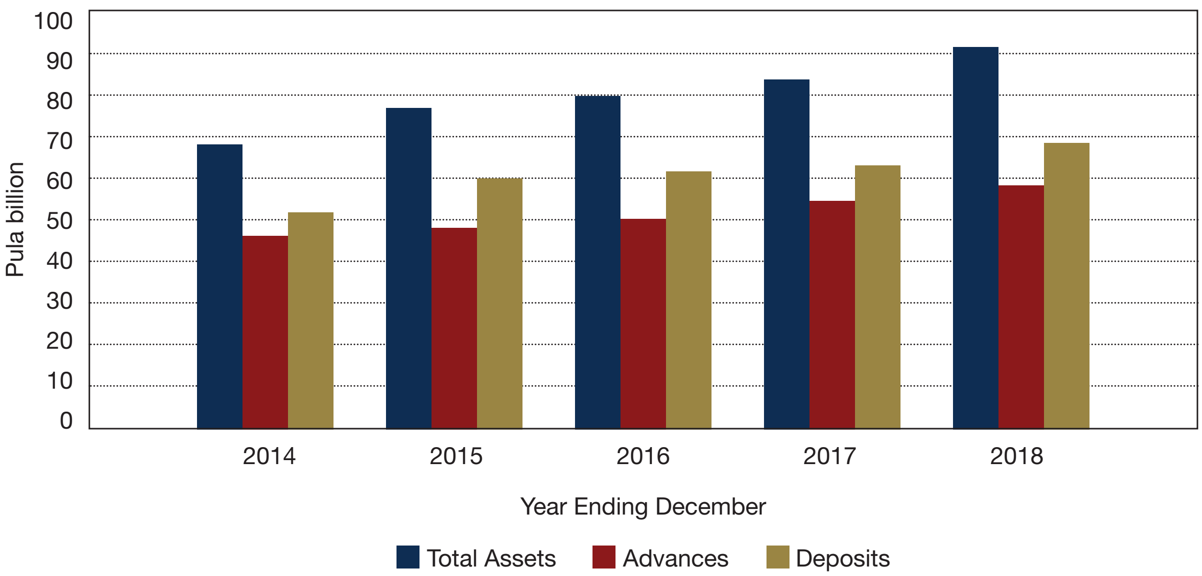
December 31, 2017

Due to Other Banks and Credit Institutions	4
Customer Deposits	78
Shareholder Funds	11
Other Liabilities	3
Debt Securities and Other Borrowing	4

Source: Commercial Banks (Statutory Returns submitted to the Bank).

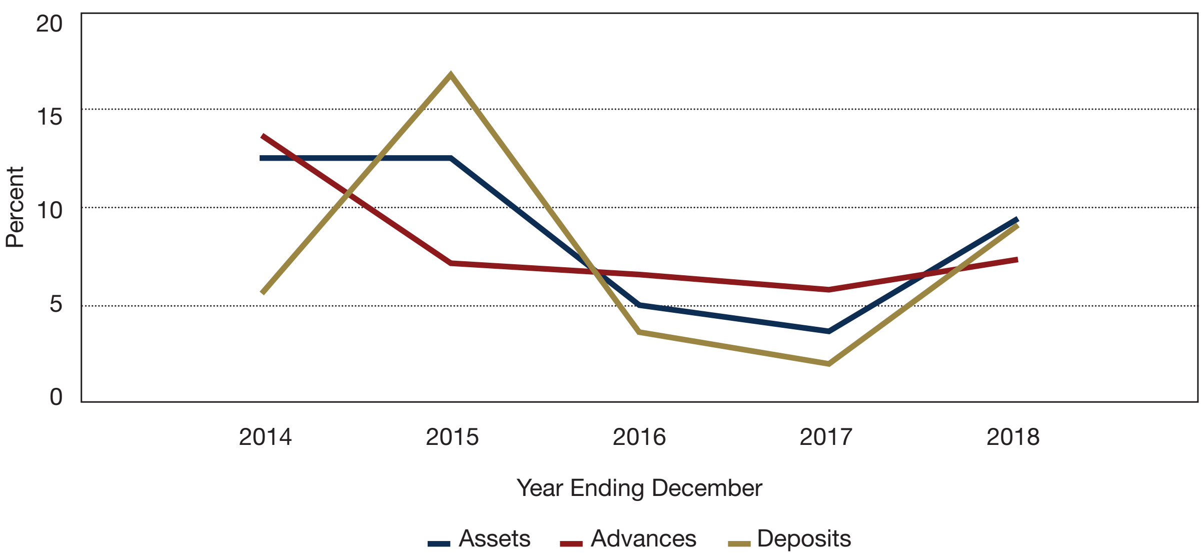
2.4 Chart 2.3 shows the levels of assets, deposits and loans and advances, while Chart 2.4 presents growth rates for assets, deposits and loans and advances, for the period 2014 to 2018, for which the trend of growth rates declines, demonstrating an adjustment from high levels.

Chart 2.3: Commercial Banks: Total Assets, Total Loans and Advances and Total Deposits: 2014 – 2018 (Pula billion)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Chart 2.4: Commercial Banks: Annual Growth Rates of Total Assets, Total Loans and Advances and Total Deposits: 2014 – 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Riskiness of On-Balance-Sheet Assets

2.5 Table 2.1 compares the riskiness of on-balance-sheet assets of banks as at December 31, 2017 and 2018. The risk profile of assets held by banks under the zero percent, 20 percent, 35 percent, 75 percent and 150 percent risk-weights declined in 2018. A larger share of the on-balance-sheet assets (24 percent) were risk-weighted at 75 percent.

2.6 Overall, 22.9 percent of the on-balance-sheet asset items were above the 75 percent risk-weight category in 2018 compared to 25.4 percent in 2017, indicating a modest decrease in the riskiness of banks' assets.

Table 2.1: Riskiness of Banks' Portfolios of On-balance-Sheet Assets in 2017 and 2018

Risk-Weights (Percent)	On-balance-sheet Assets (P' million)	Shares of On-balance-sheet Asset Items in Total On-balance-sheet Assets (Percent)	On-balance-sheet Assets (P' million)	Shares of On-balance-sheet Asset Items in Total On-balance-sheet Assets (Percent)
	December 2017		December 2018	
0	15 111	18.1	14 031	15.3
20	10 855	13.0	9 650	10.5
35	7 597	9.1	6 337	6.9
50	3 285	3.9	1 313	1.4
75	25 553	30.6	21 996	24
100	19 784	23.7	20 414	22.3
150	1 364	1.6	546	0.6
250	63	0.1	2	0.002
Total	83 612	100.0	91 342	100.0

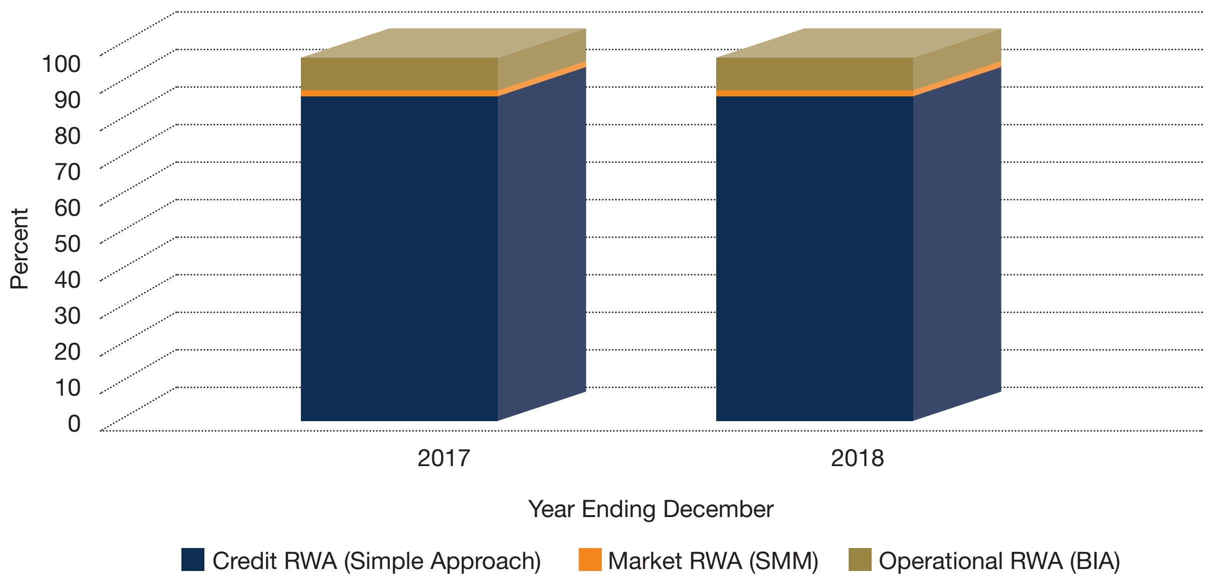
Source: Commercial Banks (Statutory Returns submitted to the Bank).

RISK ASSESSMENT

2.7 The prescribed methods of computing the minimum capital adequacy requirements for banks in Botswana are the standardised approach (SA) for credit risk, standardised measurement method (SMM) for market risk; and a choice between the basic indicator approach (BIA) and the standardised approach (TSA) for operational risk.

2.8 Chart 2.5 shows the aggregate risk-weighted assets (RWAs) of the banking sector in 2017 and 2018, as calculated under Pillar 1, Basel II. Total RWAs increased by 12.6 percent from P55.5 billion in 2017 to P62.5 billion in 2018. Proportions of RWAs were the same as in 2017, with credit RWAs constituting the bulk of the banking sector's RWAs at 89 percent, followed by operational RWAs at 10 percent and market RWAs at 1 percent.

Chart 2.5: Composition of Risk-weighted Assets: 2017 and 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Credit Risk

Regulatory Capital Requirements on Credit Risk

2.9 Credit RWAs increased by 12.5 percent from P49.3 billion in December 2017 to P55.5 billion in December 2018, indicative of the growth in credit during the year.

Asset Quality: Levels and Trends

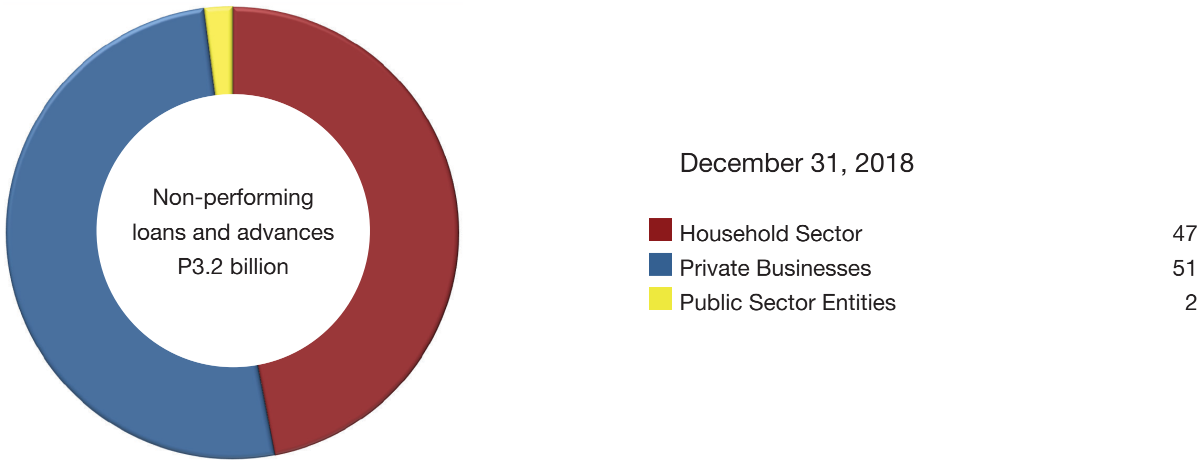
2.10 Gross loans and advances grew by 7.7 percent from P54.2 billion in 2017 to P58.3 billion in 2018, a faster increase than 5.6 percent in 2017. Growth in loans and advances occurred across the banking sector, except for two banks.

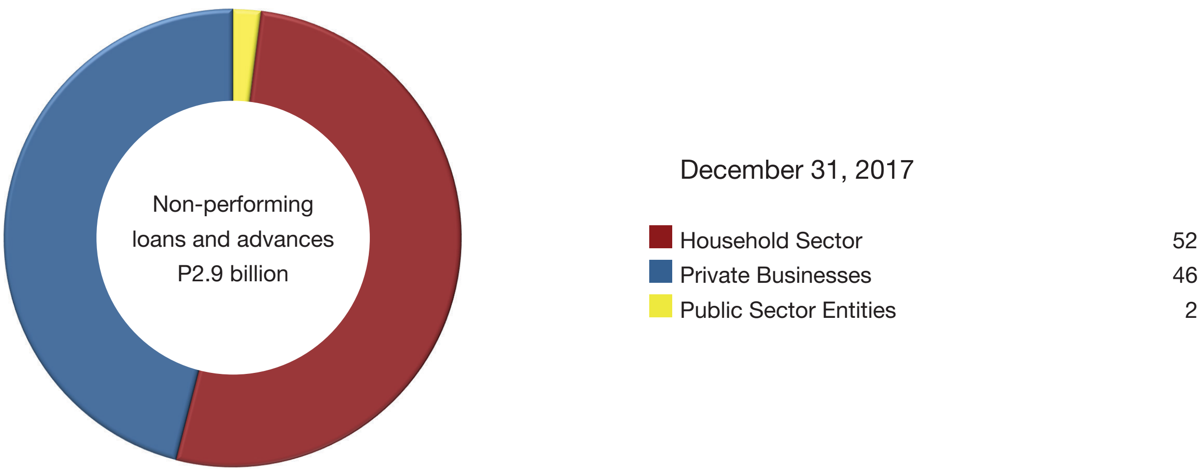
2.11 The asset quality of the banking sector deteriorated mildly as evidenced by the small increase in the ratio of non-performing loans (NPLs) to gross loans and advances from 5.3 percent in December 2017 to 5.5 percent in 2018. The ratio ranged between 1.3 percent and 10.4 percent for the banking sector.

2.12 Total past due loans (loans tainted with arrears) increased slightly by 1.2 percent to P4.02 billion in 2018 (2017: P4 billion), while NPLs (impaired loans) grew by 10.7 percent from P2.9 billion in 2017 to P3.2 billion.

2.13 The private businesses, household (predominantly unsecured loans) and public sector entities accounted for 51 percent, 47 percent and 2 percent of total NPLs in 2018, respectively. Chart 2.6 shows the sectoral distribution of NPLs between 2017 and 2018.

Chart 2.6: Sectoral Distribution of Non-performing Loans and Advances: 2017 and 2018 (Percent)





Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.14 Manufacturing and trade as well as restaurants and bars subsectors continued to dominate the private business NPLs in 2018, accounting for 29.5 percent and 17.2 percent of the private business NPLs, respectively. The increase in NPLs was mainly due to the default by a few large corporate clients of some banks. Table 2.2 shows sectoral distribution of private business NPLs, while Table 2.3 shows the levels and proportions of loans and advances, NPLs and specific provisions.

Table 2.2: Sectoral Distribution of Private Business Non-performing Loans and Advances: 2014 – 2018 (Percent)

Private Business Subsectors	2014	2015	2016	2017	2018
Agriculture, forestry and fishing	3	12.2	9.8	7.9	9.0
Mining and quarrying	5	3.6	0.1	0.0	2.5
Manufacturing	9	8.5	10.6	30.9	29.5
Construction	10	9.9	5.9	6.9	10.0
Commercial real estate	0	11.6	11.1	14.1	8.9
Electricity	0	1.2	0.0	1.4	0.7
Water	0.0	0.0	0.0	0.2	0.0
Telecommunications	0.3	0.0	0.4	0.0	0.0
Tourism and hotels	1	0.4	4.5	5.4	4.2
Transport	7	4.9	4.4	4.2	5.7
Trade, restaurants and bars	34	22.1	31.5	17.1	17.2
Business services	18	6.7	14.7	10.3	10.3
Other community, social and personal services	12	18.9	7.0	1.4	2.0

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 2.3: Levels and Proportions of Loans and Advances, Non-performing Loans and Advances and Specific Provisions: 2014 – 2018

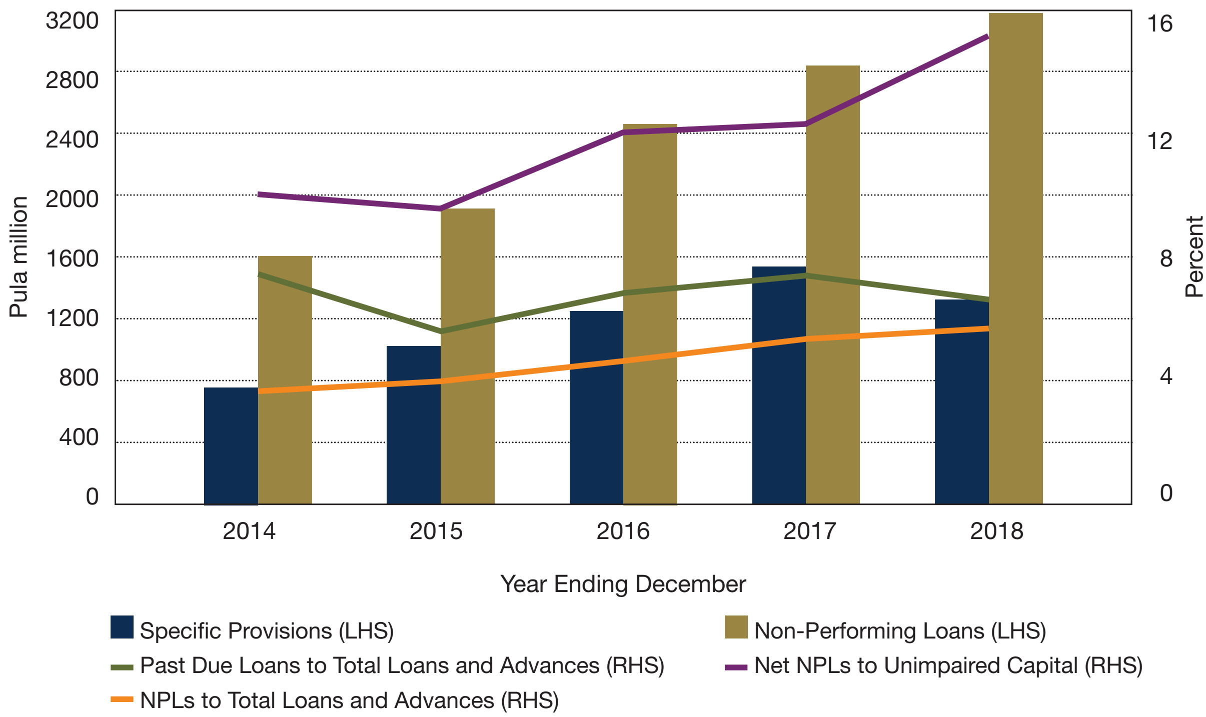
	2014	2015	2016	2017	2018
P'000					
Loans and advances	45 117	48 310	51 325	54 181	58 332
Non-performing loans (NPLs)	1 604	1 894	2 516	2 859	3 166
Specific provisions	771	1 009	1 270	1 536	1 352
Percent					
NPLs to Loans and Advances	3.6	3.9	4.9	5.3	5.5
Specific Provisions to NPLs	48.1	53.3	50.5	53.7	42.7

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.15 In 2018, specific provisions declined from P1.5 billion in 2017 to P1.4 billion. Consequently, the ratio of specific provisions to NPLs decreased from 53.7 percent in 2017 to 42.7 percent in 2018. Furthermore, the ratio of NPLs (net of specific provisions) to unimpaired capital increased from 12.3 percent to 15 percent in 2018. The credit risk mitigation measures that banks have in place are expected to absorb the residual credit risk.

2.16 Chart 2.7 shows trends in the commercial bank asset-quality indicators for the period 2014 to 2018, with an apparent trend increase in NPLs, which are, nevertheless, adequately covered by specific provisions and collateral, and remain low in comparison with other countries.

Chart 2.7: Commercial Banks: Asset Quality Indicators: 2014 – 2018



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Impact of International Financial Reporting Standard 9

2.17 Following the implementation of IFRS 9 on January 1, 2018, the Bank conducted a day-one impact assessment of the standard on the capital and profitability of commercial banks. It was noted that provisions by banks would increase by 34.1 percent from P2 billion (pre-IFRS 9 level) to the post-IFRS 9 amount of P2.7 billion, and thus reducing retained earnings of banks by the same amount. Consequently, the unimpaired capital for the industry would fall by 5.4 percent from P10.6 billion to P10 billion. Nevertheless, the capital adequacy ratio (CAR) of 18.1 percent and Tier 1 capital to risk-weighted assets ratio of 12.4 percent would remain above the prudential benchmarks of 15 percent and 7.5 percent, respectively.

2.18 All commercial banks would remain adequately capitalised except for one bank, which would have a capital adequacy ratio of 13.3 percent, while the CAR for two banks would be at borderline levels of 15.5 percent and 15 percent, respectively. With respect to profitability, no bank would be affected, save for three banks, which anticipated losses unrelated to the implementation of IFRS 9 in 2018[11].

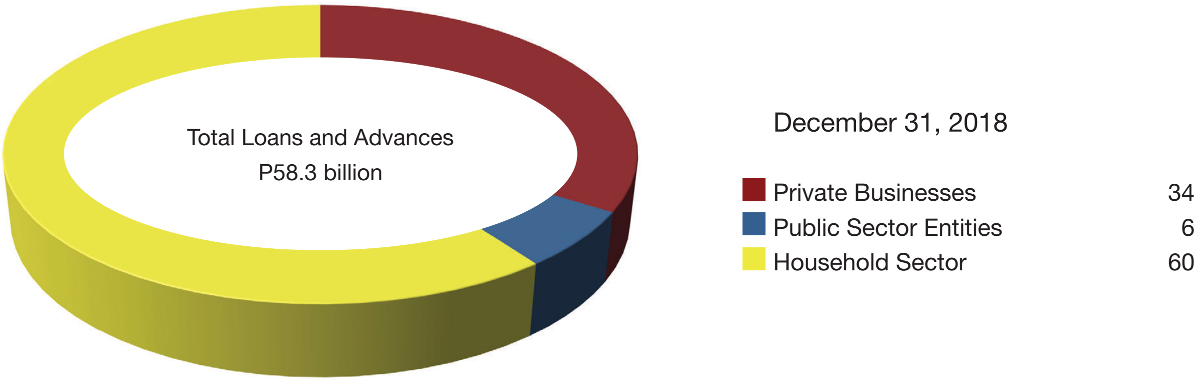
2.19 Therefore, overall, the transition from International Accounting Standard 39 to IFRS 9 was smooth, with no pressure on banks' profitability and with minimal effect on solvency.

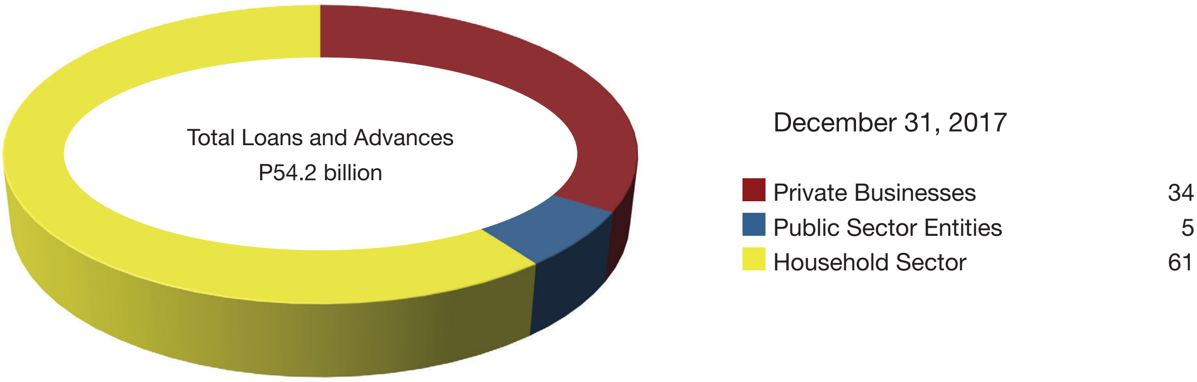
[11] Banks paid day-one provisions from retained earnings, which are a component of common equity Tier 1 capital.

Credit Concentration Risk and Sectoral Distribution of Commercial Bank Loans and Advances

2.20 The sectoral distribution of loans and advances in 2018 remained largely the same as in the previous period, with the household sector[12] accounting for the largest market share at 60 percent, falling marginally from 61 percent in December 2017. The market share for the private businesses was unchanged at 34 percent. Banks' loans and advances to the public sector entities (parastatals) increased from P2.8 billion to P3.4 billion, thus gaining a percentage point in market share. Chart 2.8 compares the sectoral distribution of loans and advances between 2017 and 2018.

Chart 2.8: Sectoral Distribution of Loans and Advances: 2017 and 2018 (Percent)





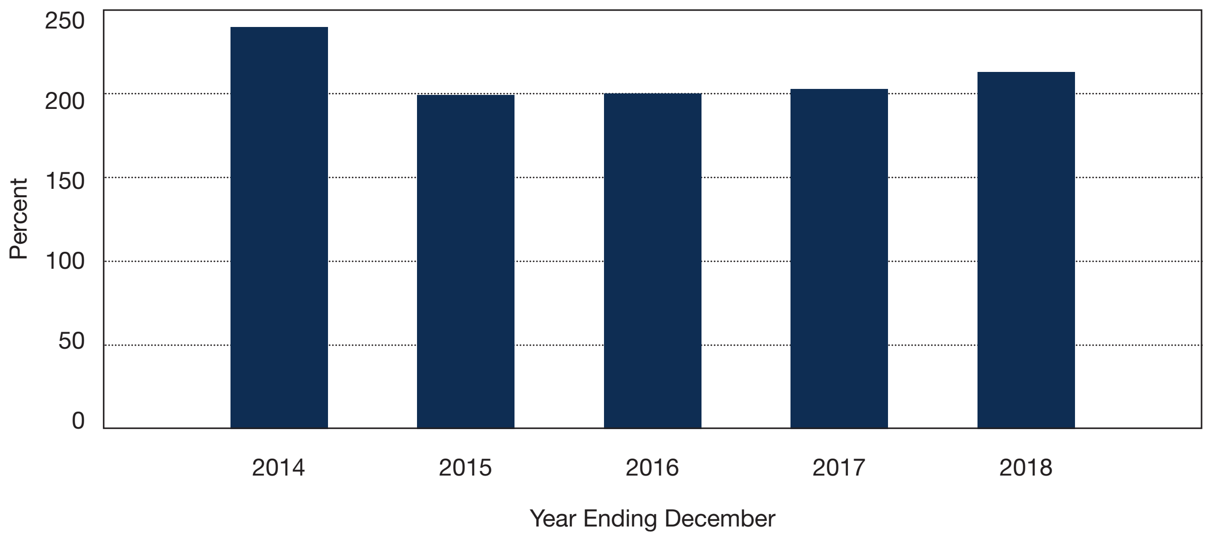
Source: Commercial Banks (Statutory Returns submitted to the Bank).

[12] In this classification, the household sector includes individuals and non-profit institutions that do not sell goods and services like non-governmental organisations, community development associations, sporting clubs and churches.

Large Exposures

2.21 Large exposures[13] for commercial banks increased from P21.5 billion in 2017 to P25.3 billion in 2018, and unimpaired capital increased by 12 percent to P12.1 billion (2017: P10.8 billion). Consequently, the banks' large exposures to unimpaired capital ratio increased from 200 percent in 2017 to 209 percent in 2018 (Chart 2.9). This ratio ranged from 55 percent to 458.4 percent for the banking industry. By proportion, 88 percent of the total large exposures was accounted for by large banks, while small banks shared the remainder. The ratio of large exposures to unimpaired capital was below the 800 percent prudential limit for banks in Botswana.

Chart 2.9: Commercial Banks: Large Exposures to Unimpaired Capital Ratio: 2014 – 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

The Structure of Private Business Loans and Advances

2.22 Table 2.4 shows a breakdown of the distribution of private business loans and advances for 2014 to 2018. The market share of four subsectors, namely, agriculture, forestry and fishing; manufacturing; construction; and commercial real estate increased during the review period. These developments in credit are broadly consistent with growth in sectoral non-mining nominal GDP (Table 2.5). Notably, the market share for trade, restaurants and bars declined from 35 percent to 26 percent in 2018, while the share of borrowing by all other subsectors was constant between 2017 and 2018.

[13] An exposure, direct or indirect, of the bank to any person or group of interrelated persons that equals or exceeds 10 percent of the unimpaired capital of the bank.

Table 2.4: Sectoral Distribution of Private Business Loans: 2014 – 2018 (Percent)

Distribution of Private Business Loans	2014	2015	2016	2017	2018
Agriculture, forestry and fishing	6	7.3	8	7	8
Mining and quarrying	4	5.5	2	2	2
Manufacturing	20	17.1	23	20	22
Construction	6	5.7	6	6	8
Commercial real estate	24	25	27	22	24
Electricity	1	0.7	1	1	1
Telecommunications	2	1.1	1	1	1
Tourism and hotels	1	1.7	4	5	5
Transport	4	3.8	4	3	3
Trade, restaurants and bars	33	32.2	24	35	26

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 2.5: Selected Sectoral Growth Rates and Shares in Non-mining Nominal GDP): 2014 – 2018 (Percent)

	2014	2015	2016	2017	2018
Agriculture, forestry and fishing					
Growth rate	5.9	5.6	8.7	2.5	5.9
Share in non-mining GDP	2.7	2.7	2.6	2.4	2.4
Manufacturing					
Growth rate	6.2	9.1	4.9	4.0	6.3
Share in non-mining GDP	6.8	7.0	6.5	6.2	6.2
Construction					
Growth rate	8.7	10.6	10.1	8.6	9.5
Share in non-mining GDP	7.7	8.0	7.8	7.8	7.9
Commercial real estate					
Growth rate	11.9	12.2	10.8	9.6	9.4
Share in non-mining GDP	1.5	1.6	1.6	1.6	1.6
Non-mining nominal GDP					
Growth rate	12.4	5.9	13.0	8.8	7.6

Source: Commercial Banks (Statutory Returns submitted to the Bank) and Statistics Botswana.

Loans to Directors and Related Parties

2.23 The exposure to related parties[14] was 0.9 percent of banks' unimpaired capital as at December 31, 2018, lower than1.3 percent as at December 31, 2017, thus posing minimal credit risk and/or insider abuse.

Foreign Currency-Denominated Loans and Liabilities

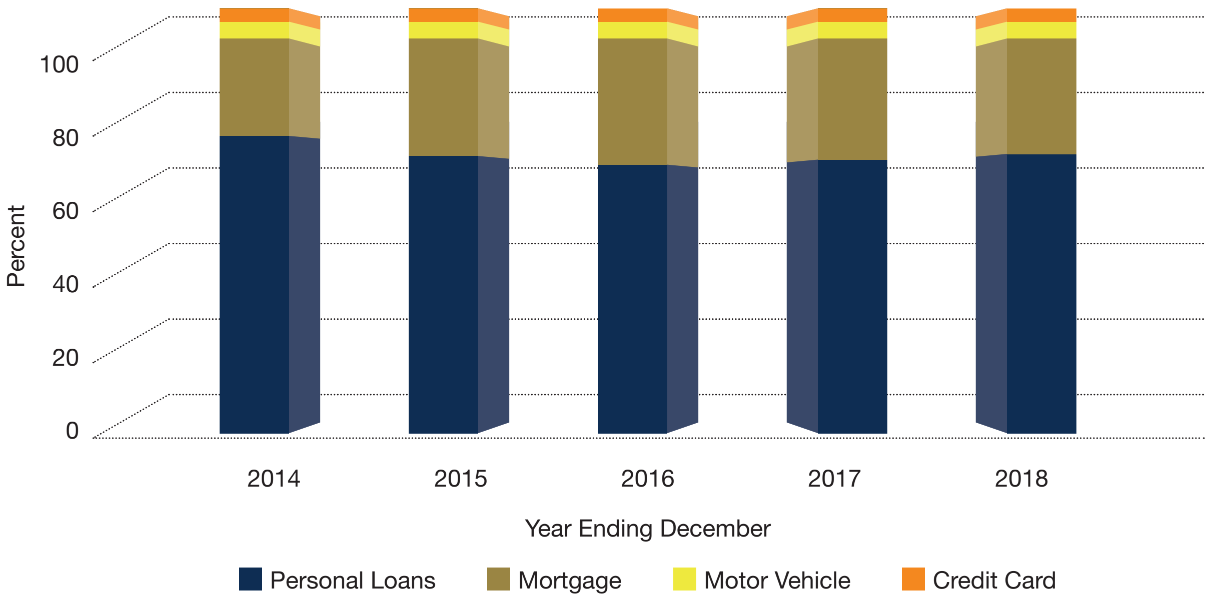
2.24 Foreign currency-denominated loans increased by 19.1 percent from P3.8 billion in 2017 to P4.5 billion in 2018. As a result, the ratio of foreign currency-denominated loans to gross loans and advances increased to 7.8 percent in 2018, while it was 7.1 percent in 2017. Similarly, vostro balances increased (39.6 percent) to P3.1 billion; thus, the proportion of vostro balances to total assets increased from 2.7 percent in 2017 to 3.4 percent in 2018. The ratio of foreign-currency loans to total foreign-currency deposits increased marginally from 37 percent to 38.9 percent in 2018. The ratio ranged between 1.2 percent and 242.6 percent for the banking industry.

Composition of Household Loans and Advances

2.25 Total credit to the household sector increased by 6.2 percent from P33.1 billion in 2017 to P35.1 billion in 2018. As shown in Chart 2.10, unsecured personal loans constituted the largest proportion of loans and advances to the household sector at 65 percent (December 2017: 64 percent). The share of mortgages declined to 27 percent in 2018 (December 2017: 28 percent), while the proportions for credit cards and motor vehicles were unchanged at 3 percent and 5 percent, respectively.

[14] Related persons include all of the following: significant shareholder; member of a board of directors or audit committee; principal officer and senior management officials; guarantor of a trust; a person who maintains a trust on behalf of an institution or its affiliate; any person who is related to such significant shareholder, member of a board of directors or audit committee, principal officer or family member or business interest; subsidiary of a bank; company or undertaking in which at least a 5 percent interest is held by a bank; parent company of a bank; company that is under common control with a bank; and a company that holds at least a 5 percent interest of another company in which a bank holds at least a 5 percent interest.

Chart 2.10: The Distribution of Household Loans and Advances: 2014 – 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

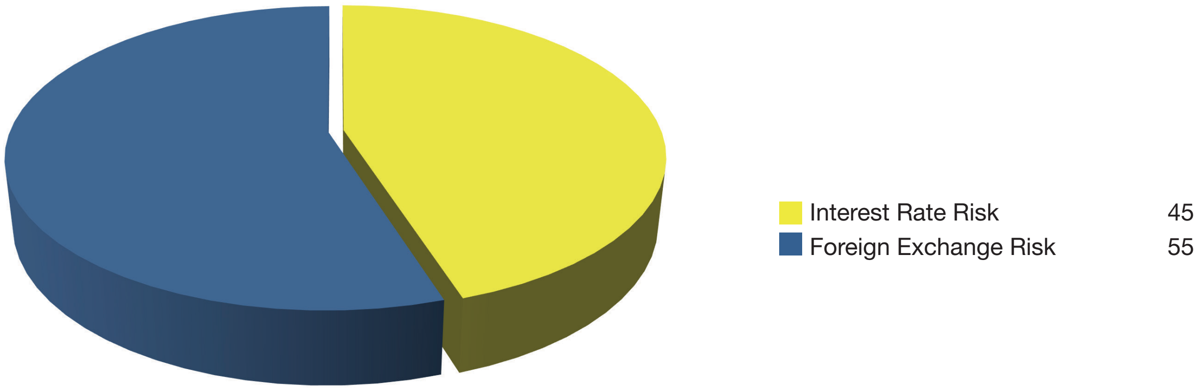
2.26 In general, the inherent credit risk for the banking sector was considered high. The risk management systems and controls of banks were satisfactory, but the residual risk remained high. The inherent credit risk is likely to increase over the next 12 months because of the dominance of the household sector credit, which is mostly unsecured, in banks' loan book.

Market Risk

Regulatory Capital Requirements on Market Risk

2.27 The market RWAs was P967 million (constituting 1 percent of total RWAs), an increase from P652 million in the prior year. The total regulatory capital requirement for market risk increased from P97.3 million (2017) to P144.3 million (2018). The market risk regulatory capital requirement comprised foreign exchange exposures, which amounted to P80 million or 55 percent, and interest rate exposure of P64.3 million or 45 percent of the total market-risk regulatory capital in December 2018 (Chart 2.11).

Chart 2.11: Composition of Market Risk Regulatory Capital: December 31, 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Foreign Exchange Risk Exposure

2.28 All banks complied with the Foreign Currency Exposure Directive No. BoBA 1/99 by maintaining foreign-exchange currency exposure to unimpaired capital ratios within the required 15 percent, 5 percent and 30 percent limits for major, minor and overall foreign currency exposures, respectively. The ratio of overall foreign-currency exposure to total unimpaired capital for the banking sector was 9.4 percent in December 2018, within the regulatory requirement of 30 percent. The banking sector had a fairly low exposure to foreign-exchange risk.

Interest Rate Risk Exposure

2.29 For all the time bands, except for the 1-to-3-month and 3-to-6-month categories (which had negative gaps of P552 million and P398 million, respectively), the gap between rate-sensitive assets and rate-sensitive liabilities for the banking sector was positive, implying that a banks' profits would improve in response to an increase in interest rates. With a negative gap, a decline in interest rates would result in liability repricing by banks at a low rate, thus raising earnings for the banking sector. In contrast, for prime rate-sensitive assets, a decline in interest rates would lower the banks' earnings, while an increase in interest rates would positively affect earnings and profitability and, by extension, economic capital.

Table 2.6: Interest Rate Risk Exposure: December 31, 2018 (P'million)

	Total Variable Rate Assets	Total Variable Rate Liabilities	Variable Gap
Up to 1 month	59 424	35 557	23 867
1 – 3 months	3 132	3 684	(552)
Over 3 – 6 months	1 094	1 492	(398)
Over 6 – 12 months	4 871	2 567	2 304
Over 12 months – 3 years	1 982	307	1 675
Over 3 – 5 years	989	484	505
Over 5 – 10 years	704	0	704
More than 10 years	570	0	570
Total	72 766	44 091	28 675

Note: Parentheses denote negative figures.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.30 Overall, market risk in the banking sector was considered low and the risk is expected to be stable in the next 12 months.

Operational Risk

Regulatory Capital Requirements on Operational Risk

2.31 RWAs relating to operational risk increased from P5.5 billion in 2017 to P6 billion in 2018. All banks calculated their operational-risk capital requirements using the BIA in 2018, with one bank conducting a trial-run of the standardised approach for operational risk.

Operational Risk Exposure

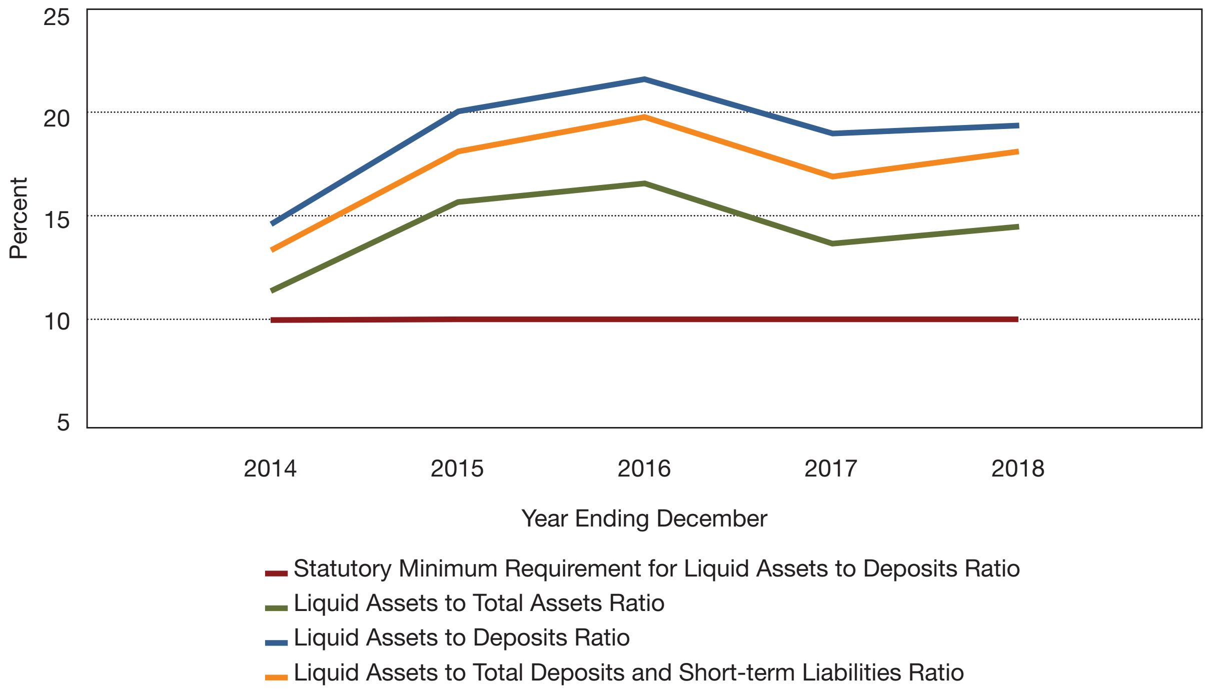
2.32 The most common operational risk management weaknesses among banks in 2018 related to a lack of segregation of duties in some functions, inadequate staff complement, information technology policies that are not comprehensive, compromised lines of defence in risk management, weak management of suspense accounts, and failure to reconcile items that were outstanding for a long time.

2.33 The banking sector composite operational risk remained high as risk management measures in place were unsatisfactory. Operational risk is expected to increase in the next 12 months as a result of a likely increase in ATM fraud, movement by banks from brick and mortar to virtual banking, outsourcing of some functions and significant internal control lapses identified at some banks.

Liquidity and Funding Risk

2.34 Liquid assets for the banking sector comprised Bank of Botswana Certificates (BoBCs) (55 percent), cash and balances with Bank of Botswana (28 percent) and other liquid assets (17 percent). Statutory liquid assets for the industry increased by 15.7 percent from P11.4 billion in the prior year to P13.2 billion in 2018. Consequently, the liquid assets to total deposit ratio (LAR) rose slightly from 17.9 percent in December 2017 to 19 percent in December 2018, above the 10 percent prudential minimum. Two banks reported the lowest LARs of 11.5 percent and 12.7 percent, respectively. The proportion of liquid assets to total assets also increased from 13.6 percent in 2017 to 14.4 percent in 2018 (Chart 2.12).

Chart 2.12: Commercial Banks: Liquidity Ratios: 2014 – 2018 (Percent)

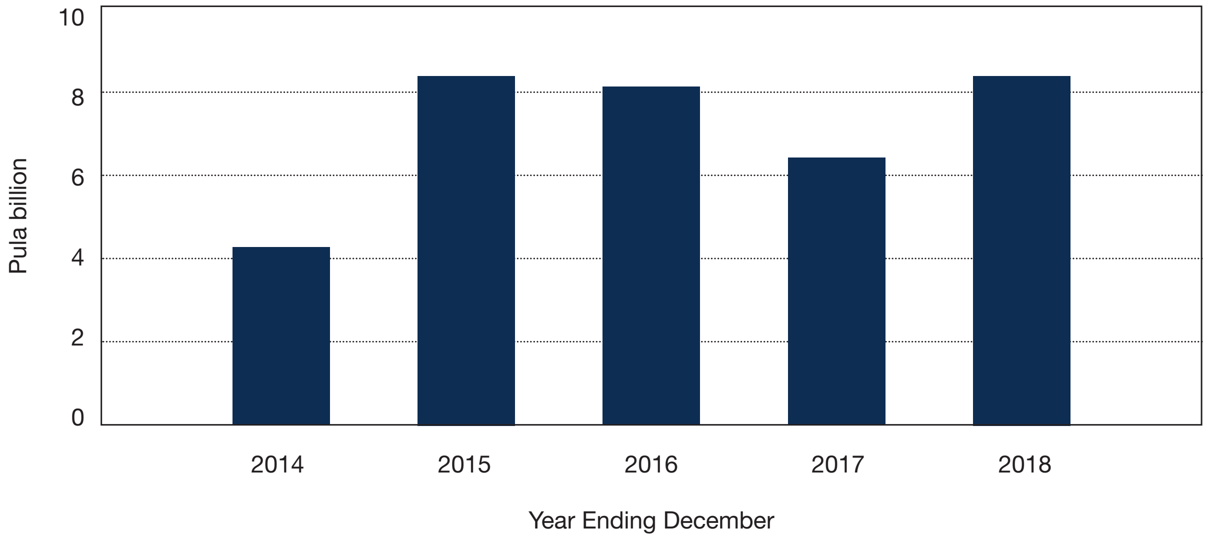


Source: Bank's Calculations.

2.35 BoBCs increased by 30.2 percent from P6.3 billion in 2017 to P8.2 billion in 2018 (Chart 2.13). Banks' nostro balances (which do not qualify as liquid assets) grew from P11 billion in 2017 to P13.3 billion in 2018. Considering the vostro balances, the respective net nostro amounts were P8.8 billion in 2017 and P10.2 billion in 2018. The nostro amounts constituted 13.2 percent and 20.5 percent of total assets for 2017 and 2018, respectively.

2.36 The banking sector inherent liquidity risk was considered to be moderate. The satisfactory risk management measures in place mitigated the risk. Therefore, the residual liquidity risk remained moderate, with an increasing trend due to the intense competition for stable deposits by banks in the market.

Chart 2.13: Commercial Banks: Market Value of Outstanding BoBCs Holdings: 2014 – 2018 (Pula billion)

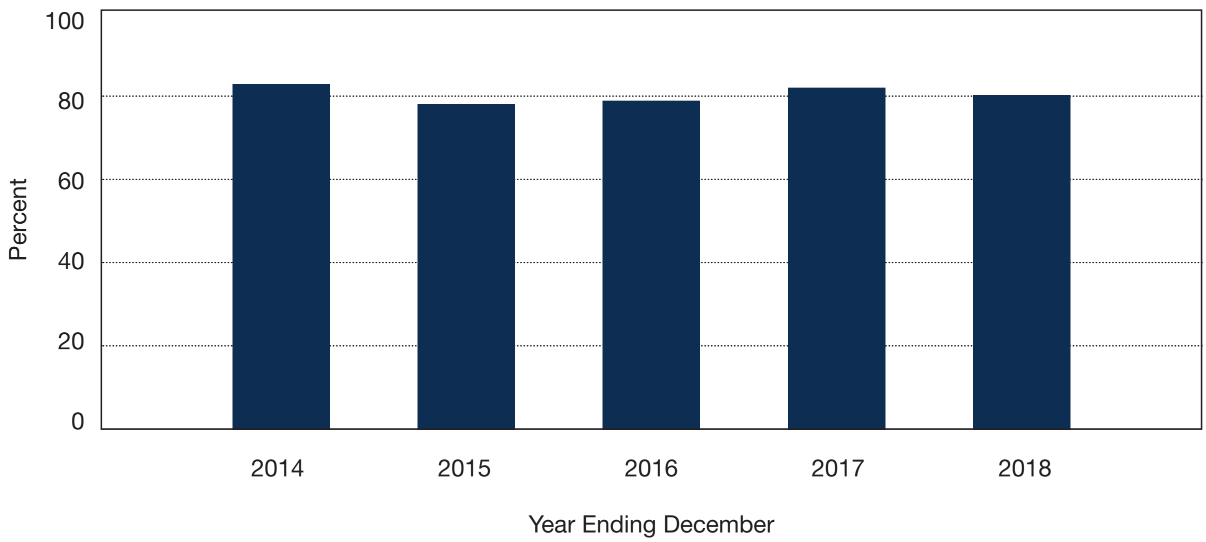


Source: Commercial Banks (Statutory Returns submitted to the Bank).

Financial Intermediation

2.37 The average financial intermediation ratio (loans and advances to deposits) eased marginally from 85.2 percent in December 2017 to 84.2 percent in December 2018 (Chart 2.14). The intermediation ratio ranged from 62.8 percent to 166.8 percent for the banking industry, in the same period.

Chart 2.14: Commercial Banks: Loans and Advances to Deposits Ratio (Financial Intermediation): 2014 – 2018 (Percent)



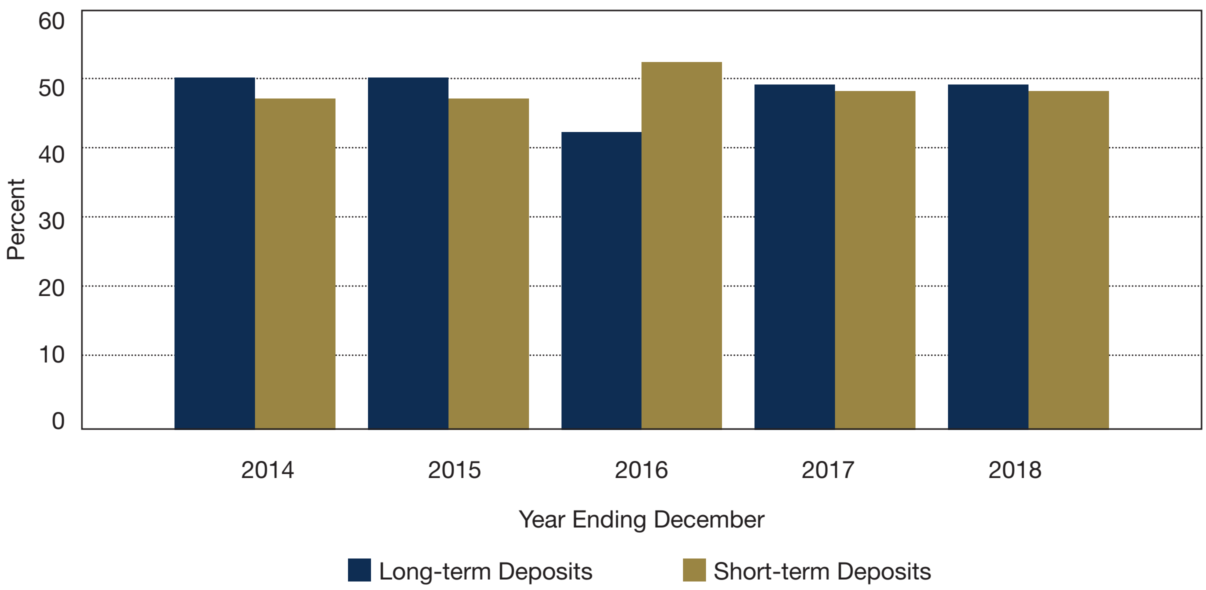
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Liabilities and Funding Structure

2.38 The sources of funding (customer deposits, equity and debt securities, interbank balances and borrowings)for asset growth increased between 2017 and 2018. Customer deposits, which are the main source of funding for the banking industry grew by 8.9 percent from P63.6 billion in 2017 to P69.3 billion in 2018 and constituted 75.8 percent of liabilities. Equity, which amounted to 11.4 percent of liabilities, increased by 10.7 percent from P9.4 billion to P10.4 billion in the same period. Interbank balances and credit from other institutions increased by 11.4 percent from P4.3 billion in 2017 to P4.7 billion in 2018. Debt securities and other borrowings increased by 16.8 percent from P4.1 billion in 2017 to P4.7 billion in 2018. The increase in equity and borrowings was attributable to additional capital injection by commercial banks in order to meet capital adequacy requirements and to leverage business opportunities.

2.39 The relative shares of deposits by maturity were unchanged between 2017 and 2018. Long-term deposits (time and savings) amounted to 51 percent in 2018, while short-term deposits (call and current) accounted for 49 percent (Chart 2.15). If this trend is sustained, maturity mismatch risks, which have characterised the Botswana banking sector over the years, will decrease.

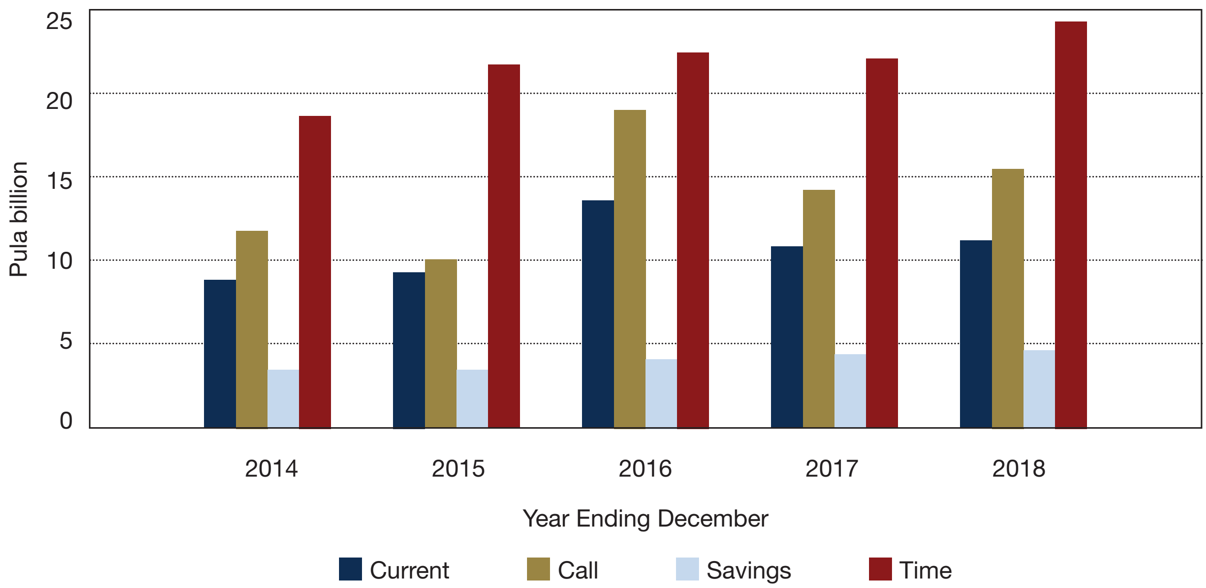
Chart 2.15: Commercial Banks: Deposits Type by Maturity: 2014 – 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.40 Chart 2.16 shows the value of Pula-denominated deposits by type for 2014 to 2018, in which all deposit types increased between 2017 and 2018. Call, time, current and savings deposits grew by 10.3 percent, 9.3 percent, 6.3 percent and 2.1 percent, respectively, during the review period. At P24.5 billion, time deposits constituted the largest proportion of total deposits (42.5 percent), followed by call deposits (27.7 percent), current deposits (21.5 percent) and savings deposits (8.3 percent).

Chart 2.16: Commercial Banks: Share of Pula-Denominated Deposits by Type: 2014 – 2018 (Pula billion)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.41 Foreign currency-denominated deposits amounted to P11.6 billion as at the end of 2018, representing a growth of 13.3 percent from P10.3 billion in the corresponding period in 2017. Foreign currency-denominated deposits accounted for 16.8 percent of total deposits in 2018, a modest increase from 16 percent in 2017. The level of Pula-denominated deposits as a proportion of total deposits was 83.2 percent in 2018 from 84 percent in 2017 (Chart 2.17).

Chart 2.17: Commercial Banks: Share of Foreign Currency and Pula-Denominated Deposits to Total Deposits: 2017 and 2018 (Percent)

December 31, 2018		December 31, 2017	
Foreign Currency Deposit Accounts	17	Foreign Currency Deposit Accounts	16
Pula Deposit Accounts	83	Pula Deposit Accounts	84

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.42 Private businesses maintained the highest share of total deposits of 71 percent in 2018, the same as in 2017. The shares of deposits for the public (government and parastatals) and household sectors remained at 9 percent and 20 percent, respectively, in the same period.

Chart 2.18: Commercial Banks: Sectoral Distribution of Deposits: 2017 and 2018 (Percent)

December 31, 2018		December 31, 2017	
Private Businesses	71	Private Businesses	71
Public Sector	9	Public Sector	9
Household Sector	20	Household Sector	20

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.43 Other sources of funding (balances due to other banks, debt securities and other borrowings) contributed 5.2 percent each to total funding in 2018. Table 2.7 shows the sources of funding for the banking sector from 2014 to 2018.

Table 2.7: Main Sources of Funding: 2014 – 2018 (Pula million)

Category	2014	2015	2016	2017	2018
Deposits	51 492	59 940	62 438	63 581	69 270
Annual Growth Rate (Percent)	6.0	16.4	4.2	1.8	8.9
Share of Total Funding	75.7	78.2	77.4	76.2	75.8
Other Liabilities	3 109	1 999	1 828	2 196	2 199
Annual Growth Rate (Percent)	157.8	(35.5)	(9)	19.4	1.4
Share of Total Funding	4.6	2.6	2.3	2.6	2.4
Share Capital	7 724	8 195	9 748	9 383	10 390
Annual Growth Rate (Percent)	19.2	6.1	19	(3.7)	10.7
Share of Total Funding	11.4	10.7	12.1	11.2	11.4
Due to other Banks	3 581	3 308	3 984	4 250	4 735
Annual Growth Rate (Percent)	157.0	(7.6)	20.4	6.7	11.4
Share of Total Funding	5.3	4.3	4.9	5.1	5.2
Debt Securities and Other Borrowing	2 088	3 163	2 642	4 065	4 747
Annual Growth Rate (Percent)	(8.9)	51.5	(16.5)	53.9	16.8
Share of Total Funding	3.1	4.1	3.3	4.9	5.2
Total Funding	67 994	76 605	80 640	83 475	91 341

Note: Parentheses denote negative figures.

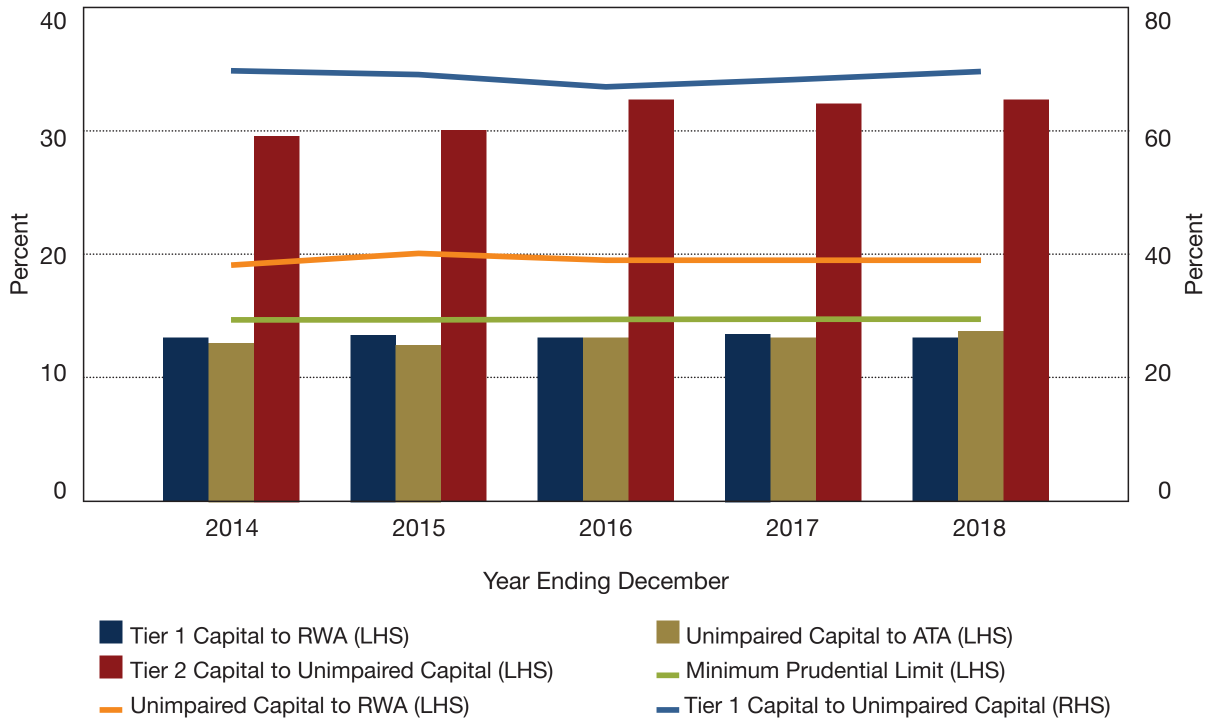
Source: Commercial Banks (Statutory Returns submitted to the Bank).

CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

2.44 The banking sector remained adequately capitalised and complied with the minimum thresholds for regulatory capital-adequacy standards. Banks reported capital adequacy and common equity Tier 1 capital ratios in excess of the 15 percent and 4.5 percent prudential and statutory minimums, respectively. Only one bank had a capital adequacy ratio (13.3 percent)[15] below the prudential minimum of 15 percent as at December 31, 2018. Total risk-weighted assets for banks grew by 12.7 percent from P55.5 billion in 2017 to P62.5 billion in 2018. Meanwhile, the banks' CAR fell marginally from 19.4 percent in December 2017 to 19.3 percent in December 2018. Chart 2.19 shows the CAR over a five-year period (2014 – 2018).

[15] On engagement, the concerned bank indicated that it was remedying the deficiency to achieve compliance with minimum prudential requirements; recapitalisation was to be ensured through the issuance of Tier 2 capital instruments.

Chart 2.19: Commercial Banks: Capital Ratios: 2014 – 2018



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.45 The unimpaired capital for the banking industry rose by 12.1 percent from P10.8 billion in 2017 to P12.1 billion in 2018. All banks, except one that made a loss, reported an increase in unimpaired capital. Retained earnings increased by 9.5 percent from P5.9 billion in 2017 to P6.4 billion in 2018. Three banks injected additional capital, while four banks paid dividends.

2.46 Total Tier 1 capital, which accounted for 69.8 percent of total unimpaired capital, increased from P7.4 billion in 2017 to P8.4 billion in 2018. The main component of capital, retained earnings, constituted 76.2 percent of Tier 1 capital. Moreover, there was an increase in the ratio of Tier 1 capital to average total assets, to 9.6 percent (December 2017: 9 percent), indicating improvement in the quality of capital. The ratio of Tier 1 capital to risk-weighted assets increased marginally from 13.3 percent to 13.5 percent in the same period.

2.47 Tier 2 capital was P3.6 billion in 2018 (December 2017: P3.4 billion), comprising mainly subordinated term debt (50.8 percent), unpublished current year profits (27.1 percent), general loan reserves (18.6 percent), Tier 2 capital instruments subject to gradual phase-out treatment (3.8 percent) and regulatory adjustments (0.3 percent). Tier 2 capital to unimpaired capital ratio for 2018 was 30.2 percent, down from the 31.7 percent of the previous year. Non-qualifying Tier 2 capital decreased from P214 million in 2017 to P140 million in 2018, and accounted for 3.8 percent of Tier 2 capital. Two banks had non-qualifying Tier 2 capital, which will be phased out by 2020.

COMMERCIAL BANKS' STATEMENT OF COMPREHENSIVE INCOME AND EXPENSES

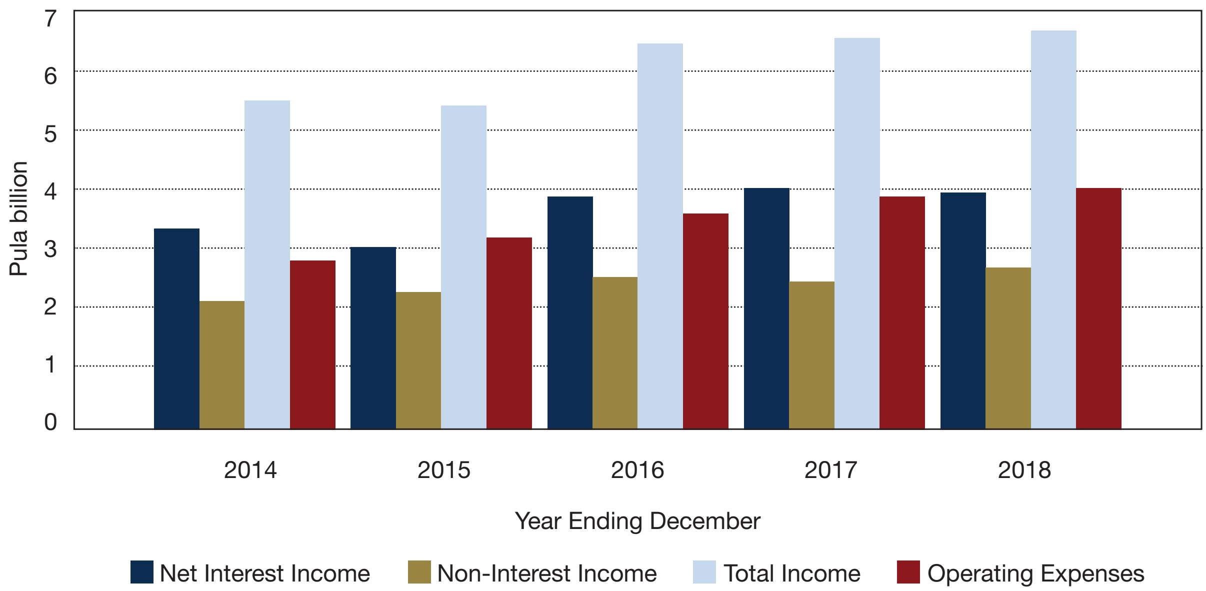
Income

2.48 Total income (net interest income and non-interest income) of commercial banks increased by 1.5 percent from P6.5 billion in 2017 to P6.6 billion in 2018. Net interest income fell by 1.7 percent from P4 billion to P3.9 billion, while operating income (non-interest income) increased by 6.7 percent to P2.7 billion, from P2.5 billion in the same period. The main source of interest income for the banking sector was lending, with income from loans and advances contributing 88.1 percent of the total interest income for commercial banks; the rest of the interest income was from balances with other banks, and investment and trading securities. Interest earned on loans and advances amounted to 59.6 percent of banks' income in 2018 (December 2017: 61.5 percent), while the contribution of non-interest sources (banking fees, charges and commissions) rose from 38.5 percent in 2017 to 40.4 percent in 2018.

Expenses

2.49 Regarding expenditure, operating expenses amounted to 68.8 percent of commercial banks' total expenses, while interest expenses contributed 31.2 percent. Operating expenses grew by 2.9 percent from P3.9 billion in 2017 to P4 billion in 2018, the bulk of which was staff costs at 45 percent, followed by administration and other expenditures at 37 percent, legal and management fees at 14 percent; and other expenses (audit and consulting fees, and occupancy and depreciation) at 4 percent. Chart 2.20 shows trends and composition of income and expenses for commercial banks for the period 2014 to 2018.

Chart 2.20: Commercial Banks: Composition of Income and Expenses: 2014 – 2018 (Pula billion)

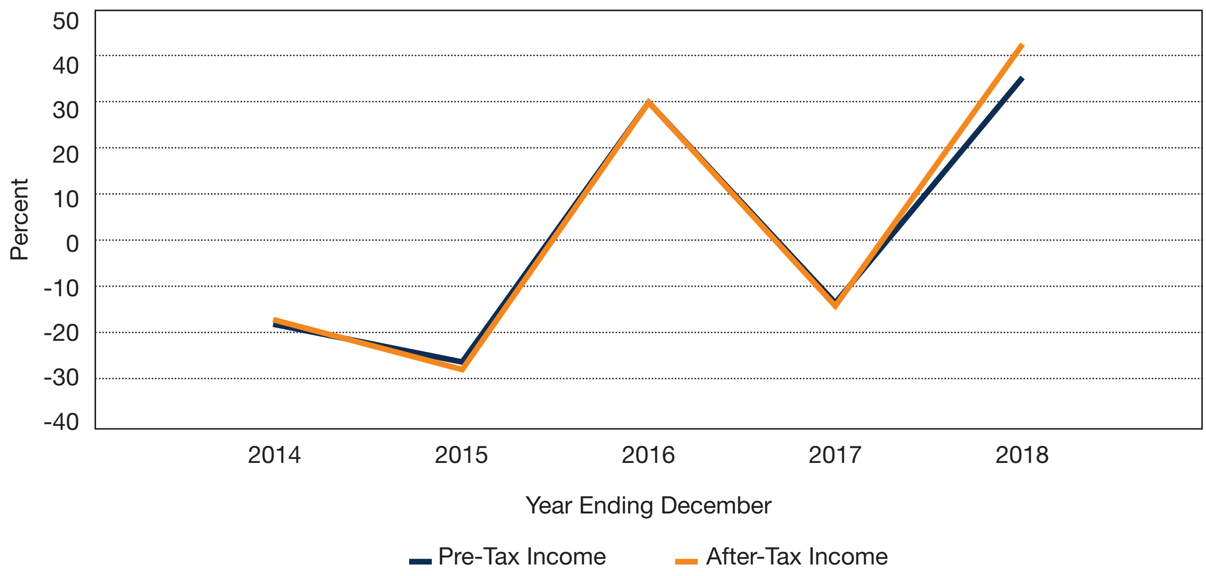


Source: Commercial Banks (Statutory Returns submitted to the Bank).

Levels, Sources and Trends of Profitability

2.50 The banking sector remained profitable in 2018, with after-tax profit increasing by 41.8 percent from P1.2 billion in 2017 to P1.7 billion in 2018. Growth in profit was due to a 6.7 percent increase in non-interest income and the reduction in provisions by banks. Provisions charged to the statement of comprehensive income and expenses declined from P1 billion in 2017 to P429 million in 2018. All banks, except one, made profit during the review period. The bank continued to make losses mainly owing to its high level of operating expenses relative to the low levels of income and an increase in impairment charges. Chart 2.21 shows pre- and after-tax profit growth rates for commercial banks over a five-year period.

Chart 2.21: Commercial Banks: Growth Rates of Pre- and After-Tax Profit: 2014 – 2018 (Percent)



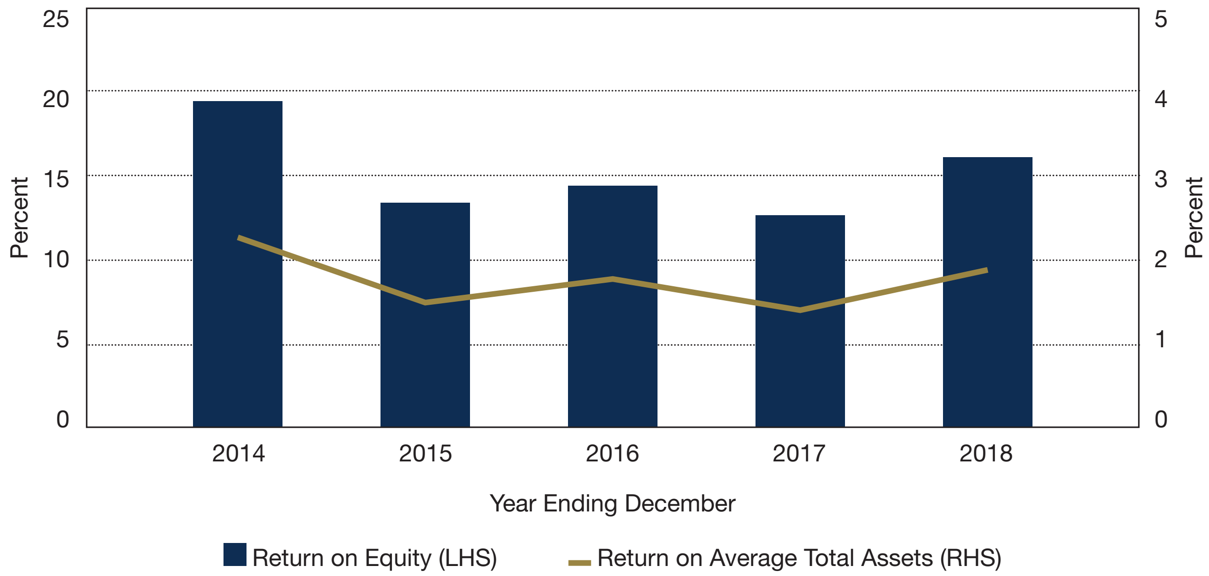
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Profitability and Operating Efficiency Indicators

Profitability Indicators

2.51 As a result of the relatively strong financial performance by all banks, except one, profitability indicators showed improvement. The aggregate return on equity (ROE) and return on average assets (ROAA) ratios (Chart 2.22) increased to 16.1 percent and 1.9 percent in 2018, from 12.6 percent and 1.4 percent in 2017, respectively.

Chart 2.22: Commercial Banks: Profitability Indicators: 2014 – 2018 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.52 Table 2.8 provides data on financial performance indicators for the banking sector for 2014 – 2018.

Table 2.8: Financial Performance Ratios: 2014 – 2018 (Percent)

Financial Performance Ratios	2014	2015	2016	2017	2018
Income on Investments and Securities to Total Income	4.5	4.3	3.0	3.8	3.8
Non-Interest Income to Total Income	39.6	43.2	39.2	38.5	40.4
Net Interest Income to Total Income	60.4	56.8	60.8	61.5	59.6
Return on Equity	19.1	13.3	14.4	12.6	16.1
Return on Average Assets	2.3	1.5	1.8	1.4	1.9
Net Interest Income to Average Total Assets	5.1	4.2	4.9	3.0	4.5
Interest Income to Average Earning Assets	8.8	7.9	7.4	8.7	8.0
Non-Interest Income to Average Total Assets	3.4	3.2	3.2	3.0	3.0
Interest Expense to Average Total Assets	2.6	2.9	1.8	1.8	2.1
Earnings Retention	70.1	37.6	80.0	67.7	73.9
Interest Income on Loans to Average Total Assets	6.9	6.3	6.0	5.9	5.8
Non-Interest Expense to Average Total Assets	4.3	4.5	4.6	4.7	4.6
Gross Interest Income to Average Total Assets	7.7	7.1	6.7	7.9	7.5

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Operating Efficiency Indicators

2.53 The cost-to-income ratio rose to 60.7 percent during 2018 from 59.9 percent in 2017. Table 2.9 presents trends in efficiency measures for commercial banks for 2014 – 2018.

Table 2.9: Commercial Banks: Other Efficiency Measures: 2014 – 2018

	2014	2015	2016	2017	2018
Percent					
Average Cost of Deposits	2.9	3.1	1.7	1.7	1.8
Return on Loans and Advances	10.4	9.7	9.5	9.2	9.0
Net Interest Margin	5.8	4.7	5.4	5.4	4.8
Net Spread	6.2	4.0	4.8	6.1	5.2
Cost to Income	51.2	60.6	57.0	59.9	60.7
Net Income to Employee Costs	107.9	80.7	91.2	68.3	94.1
P’ 000					
Net Income per Employee	317.6	233.9	310.5	255.8	354.7
Staff Costs per Employee	294.4	289.9	340.5	374.6	376.8
Assets per Employee	14 610	16 460	17 793	18 060	19 327

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.54 The core earning capability of commercial banks deteriorated moderately as shown by a decrease in the net spread and return on loans and advances ratios. The net spread fell from 6.1 percent in 2017 to 5.2 percent in 2018, while the return on loans and advances ratio declined from 9.2 percent to 9 percent in the same period. The cost of deposits ratio increased slightly from 1.7 percent in 2017 to 1.8 percent in 2018. Owing to the larger profits of banks, net income per employee increased from 255 800 to 354 700 in the same period, while the proportion of net income to employee costs also increased from 68.3 percent in the previous year to 94.1 percent in 2018. Similarly, assets per employee increased from P18 million in 2017 to P19.3 million in 2018.

ASSESSMENT OF THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS: OFF-SITE SURVEILLANCE SYSTEM RESULTS

2.55 The Bank’s off-site surveillance (OSS)[16] results and the annual risk assessment review indicated that, during 2018, the financial performance of commercial banks was sound and stable. The strongest components for banks were capital adequacy and sensitivity to market risk. On the other hand, asset quality, liquidity, and earnings and profitability were rated adequate, with industry average scores of 2.03, 2.42 and 2.45, respectively.

[16] This is a quarterly monitoring tool that rates performance of banks with respect to capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk (CAMELS); it rates and ranks banks using an assessment of key financial soundness indicators. The ratings range from strong (1) to weak (4.5).

2.56 Table 2.10 provides a summary of OSS ratings for commercial banks included in this framework.

Table 2.10: OSS Results as at December 31, 2018

BANK	Capital Adequacy	Asset Quality	Earnings	Liquidity	Market Sensitivity	Overall Score
Banking Sector Average	1.87	2.03	2.45	2.42	1.30	2.01

Source: Bank of Botswana.

Definition of the Colour Codes:

	Rating	Strong		Adequate		Partially Adequate		Weak	
Camels	Category	Band 1		Band 2		Band 3		Band 4	
	Sub Category	B1-Upper	B1-Lower	B2-Upper	B2-Lower	B3-Upper	B3-Lower	B4-Upper	B4-Lower
	Score	1.0	1.5	2	2.5	3	3.5	4	4.5
Risk Assessment Summary	Risk Rating	Low		Medium		Medium High		High	

Source: Bank of Botswana.

STATUTORY BANKS[17]

Statement of Financial Position (Balance Sheet)

2.57 Total assets for the two statutory banks[18] declined by 3.4 percent from P6.8 billion in December 2017 to P6.5 billion in 2018. With respect to market share, the two banks accounted for 6.7 percent, 7.7 percent and 5.8 percent of the total banking sector assets, gross loans and advances and deposits, respectively. This confirms that the Botswana banking sector continues to be dominated by privately owned commercial banks.

Liquidity Risk

2.58 The total liquid assets of the two statutory banks comprised cash and balances due from domestic banks. Liquid assets decreased by 4 percent to P1.5 billion in 2018 from P1.6 billion in 2017. The LAR decreased from 39.5 percent to 36.1 percent in the same period, but remained above the statutory limit of 10 percent. Furthermore, the liquid assets to total assets and liquid assets to gross loans and advances ratios fell from 23.6 percent and 33.3 percent in 2017 to 23.4 percent and 31.4 percent in 2018, respectively.

Loans and Advances, Credit Risk and Asset Quality

2.59 The loan book of the two statutory banks grew by 2.1 percent from P4.8 billion in 2017 to P4.9 billion in 2018. On the other hand, placements with other banks declined by 21.7 percent to P1.4 billion in 2018 from P1.8 billion in 2017. NPLs increased by 24.3 percent to P412 million from P331.3 million in 2017. Accordingly, specific provisions increased by 60 percent from P59.3 million in 2017 to P94.9 percent in 2018 to support the increase in NPLs, resulting in the ratio of specific provisions to NPLs rising to 23 percent from 17.9 percent in 2017. One statutory bank had a larger share of specific provisions (61 percent). As a result of the increase in NPLs, the ratio of NPLs to total loans and advances for the banks was 8 percent in 2018 (2017: 7 percent).

Composition of Liabilities and Funding Structure of Statutory Banks

2.60 Funding of the assets of the two banks was mainly through deposits, which increased by 5 percent to P4.2 billion from P4 billion in 2017, and constituted 64.9 percent of total liabilities. Other funding sources were borrowings and equity at 20.2 percent and 11.3 percent of total liabilities, respectively.

[17] The analysis excludes one statutory bank, which reports under Basel I, while other banks report under Basel II.

[18] Banks established by specific statutes.

Solvency (Capital Adequacy): Levels, Quality and Trends

2.61 The two statutory banks were adequately capitalised as at December 31, 2018, and complied with statutory minimum and prudential capital adequacy requirements. The CAR remained above 15 percent, at 28.5 percent, in December 2018 (December 2017: 43 percent), albeit with a significant decline due to a fall in profits. Tier 1 capital to unimpaired capital ratio amounted to 85.7 percent, indicative of high-quality capital levels of the statutory banks.

Statement of Comprehensive Income

2.62 The aggregate net profit of the two statutory banks fell sharply to P0.2 million in 2018, from P37 million in 2017. The decrease was on account of impairments, which rose markedly by 33.3 percent, from P24 million in 2017 to P32 million in 2018 as well as high interest expense, which increased by 15.2 percent.

2.63 ROAA and ROE declined from 0.6 percent and 2.8 percent in 2017 to 0.003 percent and 0.023 percent in 2018, respectively. The cost-to-income ratio increased from 74.3 percent in December 2017 to 85.5 percent in December 2018 owing to low income growth. Table 2.11 shows key performance indicators for statutory banks from 2014 to 2018.

Table 2.11: Statutory Banks: Financial Performance Indicators: 2014 – 2018

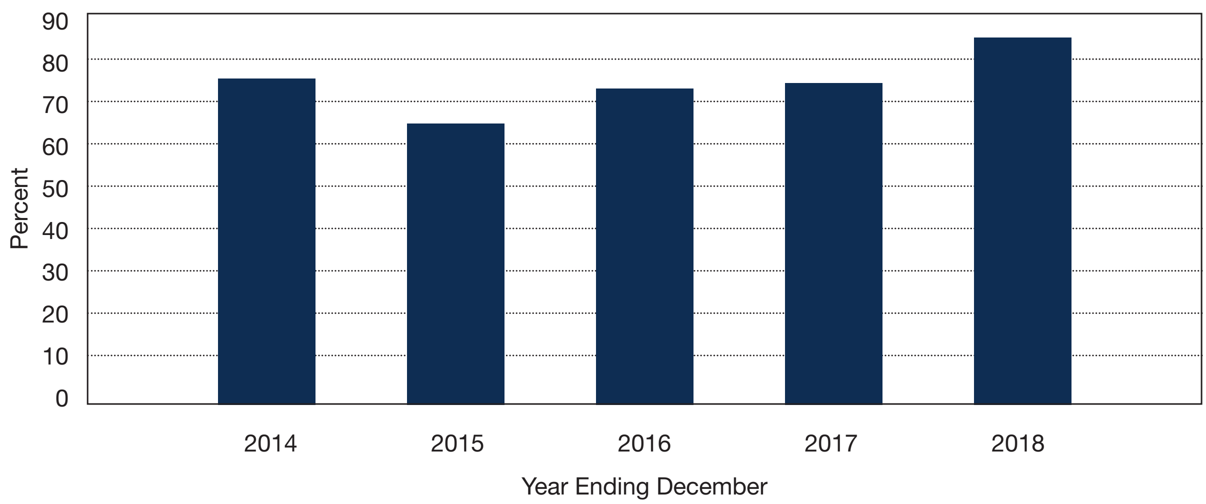
Indicator	2014	2015	2016	2017	2018
P’000					
Net Income	60	96	65	37	0.2
Interest Income	370	475	482	265	441
Net Interest Income	197	242	251	234	213
Non-Interest Expense	174	189	214	197	212
Total Assets	4 834	6 031	5 982	6 777	6 544
Average Total Assets	4 584	5 432	6 006	6 379	6 660
Average Earning Assets	1 636	1 890	2 120	6 111	6 307
Unimpaired Capital	1 205	1 325	1 297	1 316	880
Risk-Weighted Assets	2 700	2 943	2 878	3 060	3 092
Percent					
Net Income Growth Rate	(12.8)	60.3	(31.7)	(43.5)	(89.2)
Interest Income to Average Total Assets	8.1	8.7	8.0	4.1	3.7
Cost-to-Income	74.7	64.3	72.1	74.3	85.5
Return on Average Assets	1.3	1.8	1.1	0.6	0.0
Return on Equity	3.6	7.6	5.0	2.8	0.0
Return on Advances	8.9	9.9	9.5	8.0	7.8
Average Cost of Deposits	5.5	4.7	3.9	3.4	3.8

Notes: 1. Parentheses denote negative figures.
2. All figures in the table exclude one statutory bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

2.64 Chart 2.23 presents the trend of the cost-to-income ratio for statutory banks over the five-year period (2014 – 2018).

Chart 2.23: Statutory Banks: Cost-to-Income Ratio: 2014 – 2018 (Percent)



Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

Operational Risk

Regulatory Capital Requirements in Respect of Operational Risk

2.65 The total risk-weighted assets for operational risk of the two statutory banks increased by 1 percent from P277.1 million in 2017 to P279 million in 2018 and constituted 9 percent of the total risk-weighted assets of statutory banks.

OVERVIEW OF PILLAR 3 DISCLOSURE REQUIREMENTS

2.66 Banks in Botswana are required to publish on a regular basis, information on their financial health, risk management systems, risk profile, corporate governance and internal controls on their publicly accessible websites and through published financial statements. The disclosures should be in accordance with the requirements of the Basel II Directive and Circular on Implementation of Pillar 3 Disclosure Requirements (Pillar 3 Circular).

2.67 During 2018, banks addressed most of the deficiencies that were noted in their Pillar 3 disclosures, which included inconsistency in reporting, gaps in disclosure policies, and failure to submit board-approved disclosure policies. Late publication of Pillar 3 disclosure reports remained a challenge for the majority of banks. Reports posted on websites were up to the third quarter of 2018 for most banks. Overall, improvement was observed in the quality of Pillar 3 disclosure reports. Banks were generally compliant with the requirements of the Basel II Directive and Pillar 3 Circular, with minor shortcomings noted in a few banks. The Bank continues to monitor the compliance of banks with the disclosure requirements to ensure improvement in the quality, consistency and comparability of disclosures across banks and compliance with regulatory requirements.

NON-BANK FINANCIAL INSTITUTIONS

Bureaux De Change Activities

Market Entry and Exit

2.68 The Bank licensed five bureaux de change and revoked nine licences, bringing the total number of operating entities to 57 as at the end of 2018.

On-Site Examination of Bureaux De Change

2.69 The Bank conducted on-site examination of 10 bureaux de change to assess their compliance with the Bank of Botswana (Bureaux de Change Regulations) (regulations), Financial Intelligence Act and Financial Intelligence Regulations during 2018. The on-site examination indicated that one bureau de change complied with all the provisions of the regulations, while all others violated various aspects of the provisions of the regulations. Six bureaux de change were fined a total of P12 320 (VAT inclusive) for violating the regulations. Two bureaux de change were cautioned for non-compliance, while another had its licence suspended for three months. The suspended bureau de change subsequently ceased operation and voluntarily surrendered its licence.

2.70 In 2018, the most recurring violations by bureaux de change related to failure to take reasonable measures to obtain information about the true identity of persons on whose behalf financial transactions were conducted; and failure to continually train employees on AML/CFT issues as indicated in Table 2.12.

Table 2.12: Violation of the Provisions of the Bank of Botswana (Bureaux de Change) Regulations in 2018

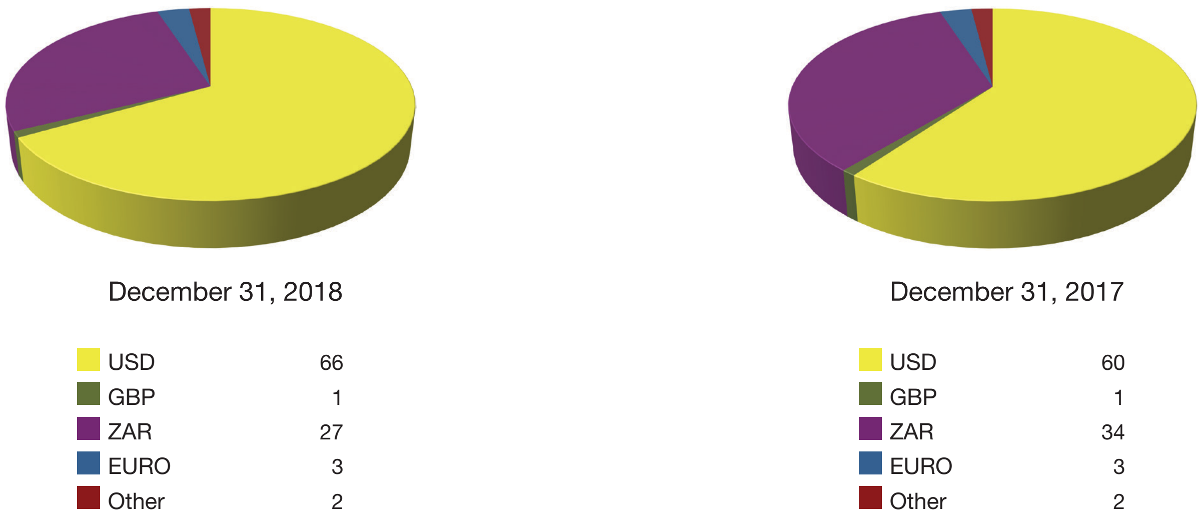
Regulation Violated	Details of the Provisions of the Regulations	Number of Bureaux de Change
3(d)	Failure to appoint a principal officer	1
5(2)(c)	Failure to maintain a minimum balance in a deposit account	3
5(2)(e)	Effecting change in the composition of shareholders or principal officers without the prior approval of the Bank	2
6(d)	Failure to operate within the set hours	1
6(f)(iii)	Failure to display commission charges in a conspicuous place at the licensed premises	1
12(2)(a)	Failure to take reasonable measures to obtain information about the true identity of a person on whose behalf a transaction is conducted	5
12(2)(c)	Failure to identify suspicious transactions and raise related reports with the Financial Intelligence Agency	2
12(2)(d)(vi)	Failure to continually train employees on AML/CFT issues	5
13(1)	Failure to observe the prescribed cash amount transaction limit of P10 000 per person per day	1
14(2)	Failure to keep duplicate copies of each sale and purchase receipts issued to customers	1
16	Submission of inaccurate statutory returns to the Bank	2
18 (1)	Failure to keep and maintain proper books of accounts	1
18(2)	Failure to conduct an audit of the accounts	1
18(5)	Failure to submit auditor's report and audited accounts	2
21(1)	Failure to display the original licence	1

Source: Bank of Botswana.

Off-Site Surveillance of Bureaux De Change

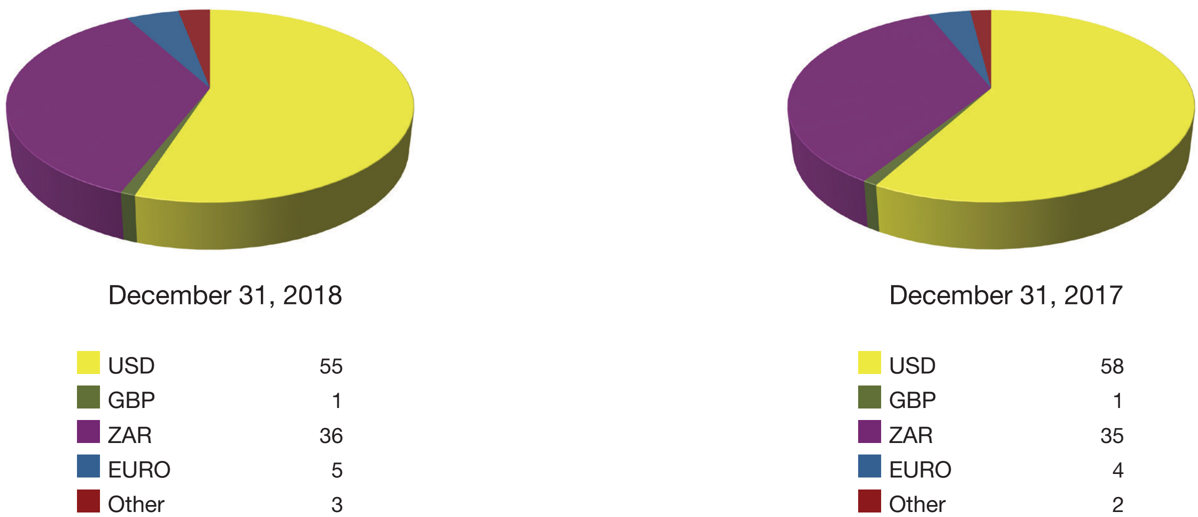
2.71 The value of foreign-currency sales by bureaux de change increased by 8.8 percent in 2018 compared to 20.4 percent reported in the prior year. In contrast, the value of purchases declined by 10.5 percent in 2018 compared to an increase of 18.1 percent in 2017. The United States Dollar (USD) and South African Rand (ZAR) dominated bureaux de change foreign-exchange transactions during 2018.

Chart 2.24: Bureaux de Change: Sale Shares of Foreign Currency in 2017 and 2018 (Percent)



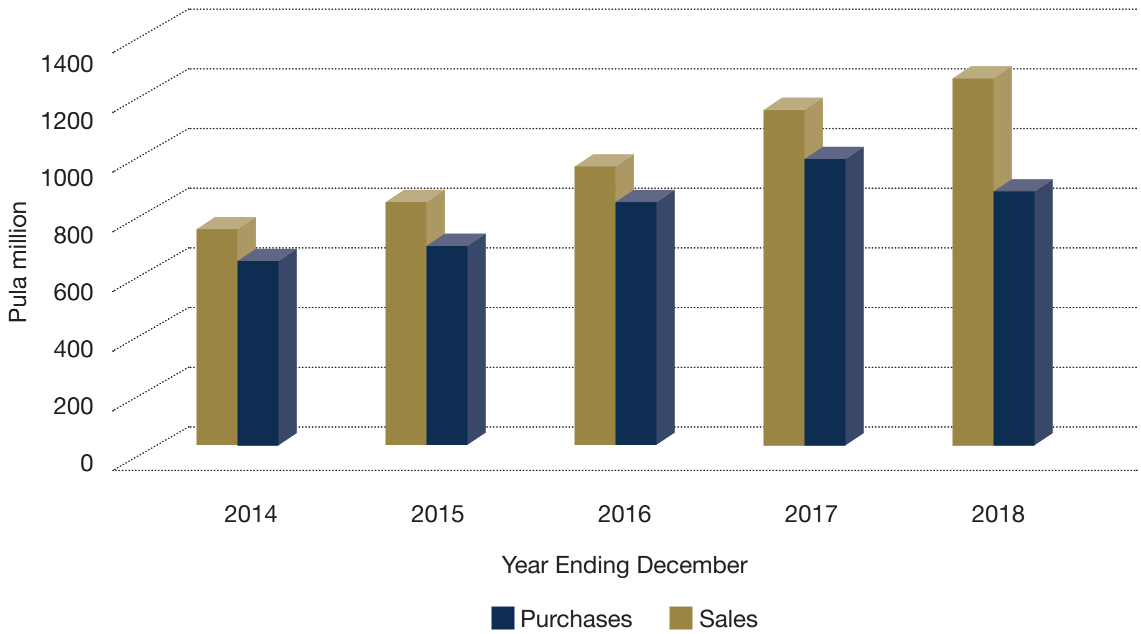
Source: Bureaux de Change (Statutory Returns submitted to the Bank).

Chart 2.25: Bureaux de Change: Purchase Shares of Foreign Currency in 2017 and 2018 (Percent)



Source: Bureaux de Change (Statutory Returns submitted to the Bank).

Chart 2.26: Bureaux de Change: Sale and Purchase Shares of Foreign Currency: 2014 – 2018 (Value)



Source: Bureaux de Change (Statutory Returns submitted to the Bank).

CHAPTER 3

LICENSING AND CONSUMER PROTECTION ISSUES

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION ISSUES

MARKET ENTRY ENQUIRIES AND LICENSING OF NEW BANKS

3.1 During the year, the Bank received four banking licence enquiries and one application for a commercial banking licence. None of the enquiries resulted in submission of a licence application, while one licence application was processed to a point of recommendation to the Board of the Bank.

ILLEGAL DEPOSIT TAKING

3.2 The Bank investigated Aquapanel (Pty) Limited (Aquapanel), a company suspected of conducting illegal deposit-taking activities. Aquapanel operated on rented premises at Grand Park, Unit B4/S11, Block 5 in Gaborone. Investigations found that the company was advertising and soliciting deposits from members of the public and investing them in off-shore foreign-exchange markets. It was concluded that the activities of the company were in violation of Section 3(1) of the Banking Act. The company was accordingly ordered to "cease and desist" from all activities involving the acceptance of money from the public in line with Section 5(5) of the Banking Act. Aquapanel was further ordered to return the funds it had collected from the public and report details of the reimbursement to the Bank.

3.3 On the basis of the investigation findings, the Bank issued a press release warning the public about illegal deposit-taking activities and to desist from participating in unlicensed schemes. Members of the public were particularly urged to be vigilant when making investment decisions, not least through use of online platforms, given the complexity of conducting due diligence with respect to such activities.

3.4 The Bank also conducted an investigation of alleged deposit-taking activities of building material suppliers (BMS), the conclusion of which was that the reverse credit purchase arrangement that BMS have with their customers does not violate the Banking Act as it does not constitute banking business.

POLICY ON COMMERCIAL BANK CHARGES AND SELECTED AVERAGE CHARGES

3.5 During 2018, three banks submitted tariff proposals for review; two of which were granted selective approval. In instances where the fees were considered excessive relative to the market, approval was granted subject to the banks reducing the proposed tariffs. Assessment of tariff proposals by one bank was in progress as at December 31, 2018 and subsequently approved in March 2019.

3.6 Table 3.1 shows commercial bank deposit interest rates for various products during 2018. Banks continued to comply with the minimum public disclosure and statutory requirements on bank charges, by publishing monthly interest rates payable on deposits on their websites as well as in at least two newspapers widely circulating in Botswana.

3.7 Table 3.2 shows average lending interest rates of commercial banks for various products in 2018. The differential between the lowest and highest interest rates charged was substantial with respect to some products. Broadly, large-value and longer-maturity deposits attract higher deposit rates, while lower lending rates are charged for loans to more creditworthy clients. Furthermore, commercial banks deem scheme loans to be low risk because repayment is deducted directly from the income source and thus attract lower lending rates compared to non-scheme loans.

BOX 2: BANKS' CONSUMER COMPLAINTS RESOLUTION PROCEDURE

One of the key mandates of the Bank of Botswana is to safeguard depositor funds and financial stability by ensuring that banks prudently conduct their businesses in a fair and transparent manner. The safety of deposits underpins public confidence in the banking system and consequently the effectiveness of the key role of intermediation between lenders and borrowers. The need for prudent banking practice is meant to foster stability and soundness of the banking system and, in turn, improve the welfare of economic agents through effective and beneficial financial products and services. But the intermediation and other services provided by banks should be in the context of good conduct and fair treatment of customers by banks; hence the existence of guidelines for handling customer queries and complaints. To ensure a common approach to addressing consumer queries, banks have designed a standard procedure for resolving consumer complaints.

The Bank has observed that customer complaints directed at banks take a long time to resolve owing to lack of understanding of the appropriate complaint resolution procedure. In several cases, bank customers do not follow the required sequence when lodging a complaint.

Below is a guide on the established procedure that banking service consumers should follow in lodging complaints against banks.

The complaint process progresses upwards sequentially through an individual bank's structures, banking adjudicator, the Bank of Botswana structures and, ultimately, recourse to the courts of law in the event of dissatisfaction after exhausting the channels of the complaint process. It should be noted that the sequencing of the complaints procedure assumes that the complaint relates to business conduct and not of a criminal nature, such as forgery of customer signature or documents to access banking services. In cases of criminal activity, the matter should be reported to the law enforcement officers responsible for investigation of criminal matters.

When bank customers have a complaint against a bank, they should first approach the concerned bank. In this regard, the proper complaints-lodging procedure involves an aggrieved customer taking up a case with the branch manager of a bank, and if not satisfied, the customer is free to escalate the case to the head office of a bank. The chief executive officer of a bank is the arbiter of a complaint at bank level, following which an unsatisfied customer may take the matter up with the banking adjudicator, beyond whom it may be referred to the Bank. Thus, for the information of the public, each bank is required to have a complaints-escalation procedure displayed conspicuously in its banking hall.

To reduce complaints, banks are encouraged to disclose all pertinent information relating to their product offerings to minimise surprise discoveries by customers at a later stage. This complaint procedure must be brought to the attention of the customer on opening account(s) and regular notices through various platforms. In most cases, matters that tend to be a source of customer grievances are alleged unauthorised transactions, contested loan balances and charges that could not be reconciled with the narrations in tariff guides of banks. In general, the Bank's approach to consumer-complaints resolution seeks to balance fair treatment of customers with banks' needs for shareholder value maximisation. The goal is that the relationship between banks and their customers should be cordial and mutually fulfilling.

Table 3.1: Commercial Banks: Deposit Rates for December 2018

Deposit Product	Deposit Rates (Annual Percent)	
	Lowest	Highest
Savings	0.00	4.25
Call	0.00	2.47
91 days	1.50	3.00
6 months	1.50	4.25
12 months	1.60	4.50
24 months	2.10	5.00

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 3.2: Commercial Banks: Lending Rates for December 2018

Lending Product	Lending Rates (Annual Percent)	
	Lowest	Highest
Mortgage (property loans)	5.85	12.50
Overdraft (revolving credit lines)	3.50	22.50
Credit Card	18.27	36.00
Lease Loans	6.50	23.50
Personal Loans (excluding overdrafts, mortgage and credit cards)	9.97	25.50
Other Long-term Loans (including purchase order financing)	3.50	84.00
Prime Lending Rate	6.50	6.50

Source: Commercial Banks (Statutory Returns submitted to the Bank).

3.8 Table 3.3 presents average charges for selected banking industry services in 2018. The structure is based on four broad categories of frequently applied charges, namely, access facilitation, investment/intermediation, trade facilitation, and payments and clearing charges. The data shows that the cost of financial services was generally higher in 2018 compared to 2017.

Table 3.3: Selected Commercial Banks Average Charges: 2017 – 2018 (Pula)

Service Charge Category (Pula)		2017	2018	Growth Rate (Percent)
Access Facilitation				
(i)	Cash withdrawal (own bank)	2.62	2.90	10.69
(ii)	Lost ATM card replacement	62.73	66.08	5.34
(iii)	Point of sale	0.76	1.00	31.58
Internet Banking Charges				
(i)	Monthly fees	206.92	208.11	0.58
(ii)	Transfers (third party within bank)	2.75	2.38	(13.45)
Mobile Banking Charges				
(i)	Utility bill payments	3.16	3.00	(5.06)
(ii)	Payment to third party accounts	2.66	2.98	12.03
(iii)	Buy pre-paid airtime	0.27	0.31	14.81
(vi)	Cash send/e-wallet/instant money	9.46	9.67	2.22
Investment/Intermediation				
(i)	Personal loan – arrangement fee (min)	405.01	405.84	0.21
(ii)	Vehicle/asset finance – arrangement fee (min)	668.25	671.85	0.54
(iii)	Mortgage – arrangement fee (min)	630.57	698.49	10.77
Trade Facilitation				
(i)	Purchase of foreign currency (min)	22.21	27.67	24.58
(ii)	International SWIFT transfer (max)	319.09	343.98	7.80
(iii)	Advising commission on letters of credit	221.16	220.77	(0.18)
(iv)	Real Time Gross Settlement	202.88	218.21	7.55
(v)	Transfer to accounts at foreign banks (max)	342.35	365.75	6.84
Payment and Clearing Charges				
(i)	Standard cheque book (20 – 50 pages)	36.26*	35.74	(1.43)
(ii)	Unpaid cheque due to lack of funds	200.73	222.28	10.74

Note: 1. Parentheses denote negative figures.
2. *The 100 pages standard cheque book used in the 2017 report was replaced with the 20 – 50 pages cheque book.

Source: Commercial Banks.

CONSUMER COMPLAINTS MANAGEMENT

3.9 The Bank received and processed 13 new complaints during the year, 11 of which were successfully resolved, while two were in progress. Most complaints related to unfair handling of customer loans as illustrated in Table 3.4.

Table 3.4: Commercial Banks' Consumer Complaints in 2018

Nature of Complaint Received	Total Number Received	Total Number Resolved	Total Outstanding as at December 31, 2018
Unsatisfactory service	3	3	-
Unfair handling of loans	6	4	2
Fraudulent transactions	3	3	-
Other	1	1	-
Total	13	11	2

Source: Bank of Botswana.

ABANDONED FUNDS

3.10 In accordance with Section 39 of the Banking Act, the Bank continued to administer abandoned funds from commercial banks. As indicated in Table 3.5, the balance of abandoned funds increased by 42 percent from P10.6 million in 2017 to P15.1 million in 2018.

Table 3.5: Total Abandoned Funds from Commercial Banks in 2018 (Pula)

	2017	2018
	Pula	Pula
Balance brought forward	6 918 216	10 618 671
Funds received	7 059 644	6 184 744
Claims paid out	(2 913 227)	(423 292)
Transfer to Guardian Fund	(445 962)	(1 303 090)
Balance at year-end	10 618 671	15 077 033

Note: Parentheses denote negative figures.

Source: Commercial Banks.

CORPORATE GOVERNANCE

3.11 During 2018, consistent with the requirements of Section 29 of the Banking Act, relevant guidelines and international best practice, banks continued to appoint board and senior management officials who were deemed to satisfy the requisite competence, fitness and propriety test to manage banks. The Bank received 15 applications for appointments to boards of banks and 38 applications for senior management positions. All the board appointments were approved, while one senior management applicant was rejected as the person was employed by another bank, which would have contravened Clause 4.13 of the Guidelines on Appointment of New Directors and Senior Management Officials of Banks. The majority of approved appointments were of Botswana nationals, who accounted for 67.9 percent of the board and senior management officials.

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

3.12 The October 2018 meeting of the Financial Action Task Force (FATF) on AML/CFT determined that progress made by Botswana was not adequate to address identified strategic deficiencies. Therefore, the country was placed under observation by the FATF. Subsequently, a public statement was issued on Botswana, pointing out the strategic AML/CFT deficiencies and an action plan developed for the country to adopt. The FATF was to closely monitor the implementation of the action plan. Once a determination is made that Botswana has substantially addressed all the deficiencies, an on-site visit will be organised to confirm implementation of the necessary legal, regulatory and/or operational reforms.

BOX 3: AML/CFT NATIONAL RISK ASSESSMENT CONDUCTED IN 2017 AND ITS IMPLICATION FOR THE BANKS' AML/CFT RISK

INTRODUCTION

Following the mutual evaluation of Botswana by the Eastern and Southern Africa Anti-Money Laundering Group in 2017, Botswana was directed to formulate a national risk assessment (NRA) against which identification and assessment of threats and vulnerabilities for money laundering and terrorist financing (ML/TF) and proliferation could be undertaken. As a result, Botswana conducted the NRA with the technical assistance of the World Bank in 2017. Specifically, the World Bank provided a tool through which threats and vulnerabilities in the various sectors in the domestic economy could be evaluated and gave guidance on its use. In addition, the World Bank provided feedback on the draft reports of the sectors covered in the NRA.

This note highlights threats and vulnerabilities in the banking sector and the corrective or mitigating measures implemented to regularise identified anomalies. The mitigating measures emphasise the need for adoption of a risk-based approach in the combating of ML/TF activities. That is, financial institutions are required to allocate resources towards anti-money laundering and combating the financing of terrorism (AML/CFT) in a manner proportionate to the threats and vulnerabilities associated with the scale of their business activities.

IDENTIFIED ML/TF RISKS AND REMEDY

Following the completion of the NRA, Botswana initiated formulation of the national strategy on AML/CFT with a view to having coordinated efforts to remedy deficiencies identified in the NRA. In order to address the weaknesses identified during the NRA, 25 legislations were enacted by parliament in 2018.

Meanwhile, to ensure compliance with the Financial Action Task Force (FATF) recommendations, all banks in Botswana are required to prioritise identification and assessment of ML/TF risks in all their business activities and take appropriate remedial action. The need for AML/CFT compliance is paramount, given the adverse consequences associated with ML/TF risks. Failure to comply with FATF recommendations could result in reluctance by international businesses to trade with domestic entities and termination by international banks and other global financial service providers of business relationships with domestic entities. Overall, the banking sector vulnerability to ML/TF was rated medium high on account of the large volumes of transactions and high levels of cash activity in the banking system.

Botswana's AML/CFT legal framework was also assessed for comprehensiveness. Banks in Botswana are licensed and regulated by Bank of Botswana under Section 3 of the Banking Act (Cap. 46:04). The Bank uses the Financial Intelligence Act (Cap. 08:07), and the Financial Intelligence Regulations to regulate institutions for AML/CFT compliance. The key features in the legal framework for AML/CFT compliance relate to the following:

(a) Record-keeping for at least five years;
(b) Designation of compliance officers at management level, who shall be in charge of the implementation of internal programmes and procedures;

(c) Implementation and maintenance of an AML/CFT-compliance programme;
(d) Ensuring regular staff training and formulation of procedures for high employee integrity;
(e) Reporting suspicious transactions to the Financial Intelligence Agency; and
(f) Conducting independent audit of the AML/CFT-compliance programme.

Although the banking sector was found to be relatively well regulated, it was concluded that the laws did not adequately address some AML/CFT issues and had to be amended to address the deficiencies. As a result, the enabling laws were amended in 2018. In general, the NRA identified areas that required improvement, including the following:

(a) There was no statutory requirement for banks to conduct enhanced due diligence for high-risk customers, including politically influential persons. In spite of this deficiency, banks operating in Botswana have always followed their internal policies, which are informed by the guidance from their parent banks that are modelled on international best practices. Nonetheless, the Bank of Botswana directed all banks to immediately adopt a risk-based assessment of their customers so that the institutions could adequately identify and assess the inherent risks and apply appropriate AML/CFT controls in their internal processes;
(b) The AML/CFT-control environment was found to be inadequate due to the lack of a centralised customer-identification infrastructure, which was deemed to potentially hamper identification of beneficial ownership information;
(c) Overall, the banking sector was rated medium high risk in the effectiveness of its supervisory regime on account of a lack of statutory requirement for a risk-based AML/CFT oversight. Consequently, to address these deficiencies, the Bank of Botswana adopted a risk-centric examination of institutions for AML/CFT compliance in 2017. Following that, the Bank initiated the establishment of a unit dedicated to the supervision of institutions for AML/CFT compliance. Thus, banks were directed to submit their internal AML/CFT-risk assessments through which the institutions could evaluate the robustness of their AML/CFT policies and procedures. Furthermore, the Bank updated its risk-based AML/CFT manual.
(d) Banks, like other institutions, were directed to update information on ultimate beneficial owners (UBOs). In particular, this related to trusts, societies, and other legal arrangements such as partnerships. Consequent to this, banks commenced remedying this deficiency by updating information on UBOs in all affected accounts; and
(e) It was indicated that, although most banks conduct customer due diligence (CDD) at on-boarding stage, some banks did not do so. This deficiency was attributed to a lack of access by banks to the national identification database for verification of national identity documents. In an effort to have the weaknesses remedied, banks were directed to regularly review CDD, and on-site inspection was conducted to assess the compliance status of banks.

CONCLUSION

Overall, the NRA served as a template through which both the central bank and banks have a common understanding of threats and vulnerabilities in the banking sector and the possible control measures to be implemented. Also, the NRA provided a basis on which the Bank implements a programme through which banks are sensitised on the threats and vulnerabilities in the banking sector.

CHAPTER 4

OTHER SUPERVISORY ACTIVITIES

CHAPTER 4:

OTHER SUPERVISORY ACTIVITIES

RECENT GLOBAL STANDARDS AND GUIDELINES ISSUED BY THE BASEL COMMITTEE ON BANKING SUPERVISION AT THE BANK FOR INTERNATIONAL SETTLEMENTS

4.1 The Basel Committee on Banking Supervision (BCBS) issued new and revised guidelines and standards that materially affect the regulation and supervision of banks and banking groups. The following guidelines/standards and reports were issued in 2018:

(a) Implications of Fintech Developments for Banks and Bank Supervisors – February 2018;
(b) Capital Treatment for Simple, Transparent and Comparable Short-Term Securitisations – May 2018;
(c) Treatment of the Extraordinary Monetary Policy Operations in the Net Stable Funding Ratio – June 2018;
(d) Globally Systemically Important Banks: Revised Assessment Methodology and the Higher Loss Absorbency Requirement – June 2018;
(e) Pillar 3 Disclosure Requirements: Regulatory Treatment of Accounting Provisions – August 2018;
(f) Stress Testing Principles – October 2018;
(g) Pillar 3 Disclosure Requirements: Updated Framework – December 2018; and
(h) Cyber-Resilience: Range of Practices – December 2018.

4.2 In addition, the BCBS issued, for consultation, the following standards during 2018:

(a) Revisions to the minimum capital requirements for market risk;
(b) Criteria for identifying simple, transparent and comparable short-term securitisations;
(c) Leverage ratio treatment of client cleared derivatives; and
(d) Revisions to the leverage ratio disclosure requirements.

4.3 The Bank has implemented Pillar 3 disclosure requirements and selected enhancements. It is expected that the net stable funding ratio, leverage ratio and liquidity coverage ratio frameworks will be implemented fully in 2019/2020. The Bank issued Guidelines on Risk Management and a Circular on Regulatory Treatment of Accounting Provisions - Interim Approach and Transitional Arrangements to the banking industry.

[19] Supervisory colleges are working groups of supervisors formed to enhance the consolidated supervision of internationally active banking groups.

PARTICIPATION IN INTERNATIONAL AND DOMESTIC REGULATORY AND SUPERVISORY FORA

Supervisory Colleges

4.4 During 2018, the Bank attended supervisory college[19] meetings organised by home supervisors of parent banks of banking groups with subsidiaries in Botswana, namely, Capricorn Investment Group Limited in Windhoek, Namibia; two for Barclays Africa Group Limited in Pretoria, South Africa; and Standard Chartered PLC Group in Zanzibar (for African subsidiaries) and in London for the whole Group.

4.5 The supervisory college meetings were held in compliance with principle 13 of the Basel Core Principles for Effective Banking Supervision (core principles). The principle requires home supervisors to establish bank-specific supervisory college meetings for banking groups and host supervisors to be included in the colleges. The objective of the supervisory college meetings was to discuss key supervisory issues and engage with senior management officials of banks with a view to enhancing supervision of the respective international banking groups. Issues discussed include group financial performance, capital and liquidity management, business conduct and risk management programmes, and oversight by the boards of these banks.

OTHER SUPERVISORY MATTERS

4.6 Consistent with the spirit and principles of best international practice on cooperation and collaboration with other regulatory authorities, the Bank and Competition Authority Joint Working Committee held two meetings during the year.

4.7 In accordance with the Basel II Directive, banks submitted their internal capital adequacy assessment process (ICAAP) reports. The Bank reviewed ICAAP reports for five banks and, subsequently, meetings were held with the respective banks for presentation of their ICAAP reports. Following the presentations, the Bank provided the respective banks with feedback on the preliminary assessment.

4.8 All banks adopted IFRS 9 in 2018. But due to lack of comprehensive data, most banks were at the stage of impact assessment.

4.9 As a way to address the shortcomings identified by the country's AML/CFT mutual evaluation report, the Banking Act was amended. The amendment removed, in particular, dual reporting of suspicious transactions to the Bank and FIA, by deleting Section 21(d). Section 43 was also amended to allow banks to share customer information with FIA. For assessing compliance of banks with AML/CFT requirements, the Bank uses the Financial Intelligence Act (Cap.08:07) and Financial Intelligence Regulations.

4.10 The Bank continued to compile and disseminate financial soundness indicators to different stakeholders through posting on the Bank of Botswana and International Monetary Fund websites; as well as the African Development Bank's Open Data Platform website.

CROSS-BORDER SUPERVISION

4.11 Consistent with principle 12 of the core principles, the Bank held a teleconference supervisory interaction meeting with the South African Reserve Bank in respect of one commercial bank. The meeting was a follow-up to the supervisory-college meeting held on October 18 to 20, 2017. During this meeting, a recommendation was made to establish regular lines of communication, enhance transparency and cooperation as well as timely sharing of information among supervisors of the group and its subsidiaries. Issues discussed at the meeting include the bank's corporate governance, risk management, AML/CFT issues and recovery and resolution planning.

4.12 The collaboration ensured that the banking group was supervised on a consolidated basis, adequately monitored and that prudential standards would be applied to all aspects of the business conducted by the banking group across countries.

SELF-ASSESSMENT OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

4.13 The Bank continued to conduct self-assessment of the core principles towards compliance with specified criteria thereof. The results of the self-assessment process inform supervisory priorities and feed into the preparation of the annual work programme of the Banking Supervision Department.

CHAPTER 5

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

CHAPTER **5**:

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

EXAMINATION OF COMMERCIAL BANKS

5.1 The Bank conducted limited on-site examination of three commercial banks. The focus of the examination was an assessment of credit risk, strategic/governance and AML/CFT risk at one bank. Examination of the second bank focussed on assessing the board and senior management oversight (strategic/governance risk), asset quality (credit risk) and operational risk. Similarly, the examination at the third bank included appraisal of oversight effectiveness of the bank's board and senior management, and assessment of asset quality as well as operational risk.

5.2 For the first bank, the examination indicated unsatisfactory financial condition and performance. There were notable deficiencies relating to board and senior management oversight: absence of a board charter; no induction or training for new board members; lack of board self-assessment; no succession plan; appointment of the managing director by the parent bank without involvement of the local board; and no leadership continuity as senior and middle management staff were rotated every three years.

5.3 At the second bank, it was determined through the examination that the financial condition and performance were satisfactory. But weaknesses relating to governance were identified: these included inadequate composition of the board and some board sub-committees; lack of customisation of some policies and frameworks to suit the in-country business operations; and failure to conduct performance evaluation for board members. The bank's strategic risk had increased as a result of the change in leadership at the inception of a new strategy. Inadequacies were also noted in segregation of duties in the risk-management function. The bank's IT security was compromised as the IT policy did not specify the frequency of penetration tests.

5.4 The third examined bank had a related-party representation of 40 percent, which violated the requirement of the Guidelines on the Appointment of New Directors and Senior Management Officials of Banks that prescribes a ratio of 33.3 percent at the most. Asset quality had deteriorated as evidenced by an upward trend in NPLs. Collateral management at the bank was considered inadequate, given that some residential properties held as security were not valued once every three years; some security documents for customer facilities were not in the bank's custody; and some vehicle insurance covers had expired. The bank violated Section 20 (3) of the Banking Act by not reporting some large credit exposures to the Bank on a quarterly basis. Supervisory action was taken against the bank for the violation. In addition, there were inconsistencies between information provided through statutory returns and that availed during the examination.

5.5 Regarding operational risk, the following issues of concern were raised: lack of documented procedures for the bank's processes and definite timelines for completion of ongoing projects; no contracts for some outsourced services; late submission of statutory returns; and unresolved audit findings. Furthermore, some staff members were not trained on AML/CFT issues.

5.6 A limited-scope AML/CFT on-site examination was also conducted at one commercial bank, focussing on an assessment of the bank's exposure to money laundering and terrorist financing risks; adequacy of policies, procedures and internal controls in addressing these risks; and implementation of AML/CFT requirements. The findings revealed that the know-your-customer (KYC) documents collected by the bank for corporate accounts were insufficient. The bank's vulnerability to inherent ML/TF risk was rated moderate; the AML/CFT risk-management practices and controls were considered moderately effective. Overall, the bank's residual ML/TF risk was rated moderate.

EXAMINATION OF STATUTORY BANKS

5.7 The Bank carried out a full-scope on-site examination of one statutory bank, comprising a review of capital adequacy; asset quality; management and effectiveness of board oversight; earnings and profitability; liquidity; and sensitivity to market risk (CAMELS). The assessment included the following risk areas under the risk-based supervision (RBS) approach: strategic/governance risk, credit risk, liquidity risk, market risk, operational risk and money laundering and terrorism financing risk.

5.8 The findings indicated that the bank's financial condition was unsatisfactory. Supervisory concerns relating to the board and senior management oversight were noted. The operational risk environment at the statutory bank was unsatisfactory as indicated by an increasing staff turnover at the bank, particularly in management; absence of a succession plan for critical roles; inability of the core banking system to integrate with other systems; and a weak internal-control environment.

5.9 The bank's money laundering and financing of terrorism (ML/TF) risk-management framework was unsatisfactory. It was noted that the bank's customers were not assessed for vulnerability to ML/TF risks; customer due diligence procedures and controls were ineffective; and identification and reporting of suspicious transactions were not carried out.

CONSUMER COMPLIANCE ON-SITE EXAMINATIONS

5.10 The Bank conducted full-scope consumer compliance on-site examination of four commercial banks in 2018. The examination revealed that banks had comprehensive policies and procedures in place. Furthermore, the banks complied satisfactorily with most consumer issues, except for the violations shown in Table 5.1.

Table 5.1: Violation of Consumer Compliance Standards (2018)

Violated Sections	Description
Disclosure of Bank Charges Government Notice No. 41 of 2001, Section 5(b)	Some charges for three commercial banks were wrongly narrated in the bank statements and did not conform to those in the approved tariff guides.
Disclosure of Bank Charges Government Notice No. 41 of 2001	Two banks did not accurately compute and disclose the average percentage rate in all facility letters. Furthermore, the banks did not levy some charges as approved by the Bank.
Section 39(1) of the Banking Act (Cap. 46.04)	One bank's guideline on dormant accounts did not clearly state the period in which the accounts were declared dormant.

Source: Bank of Botswana Compilation.

CONSULTATIVE AND PRUDENTIAL MEETINGS

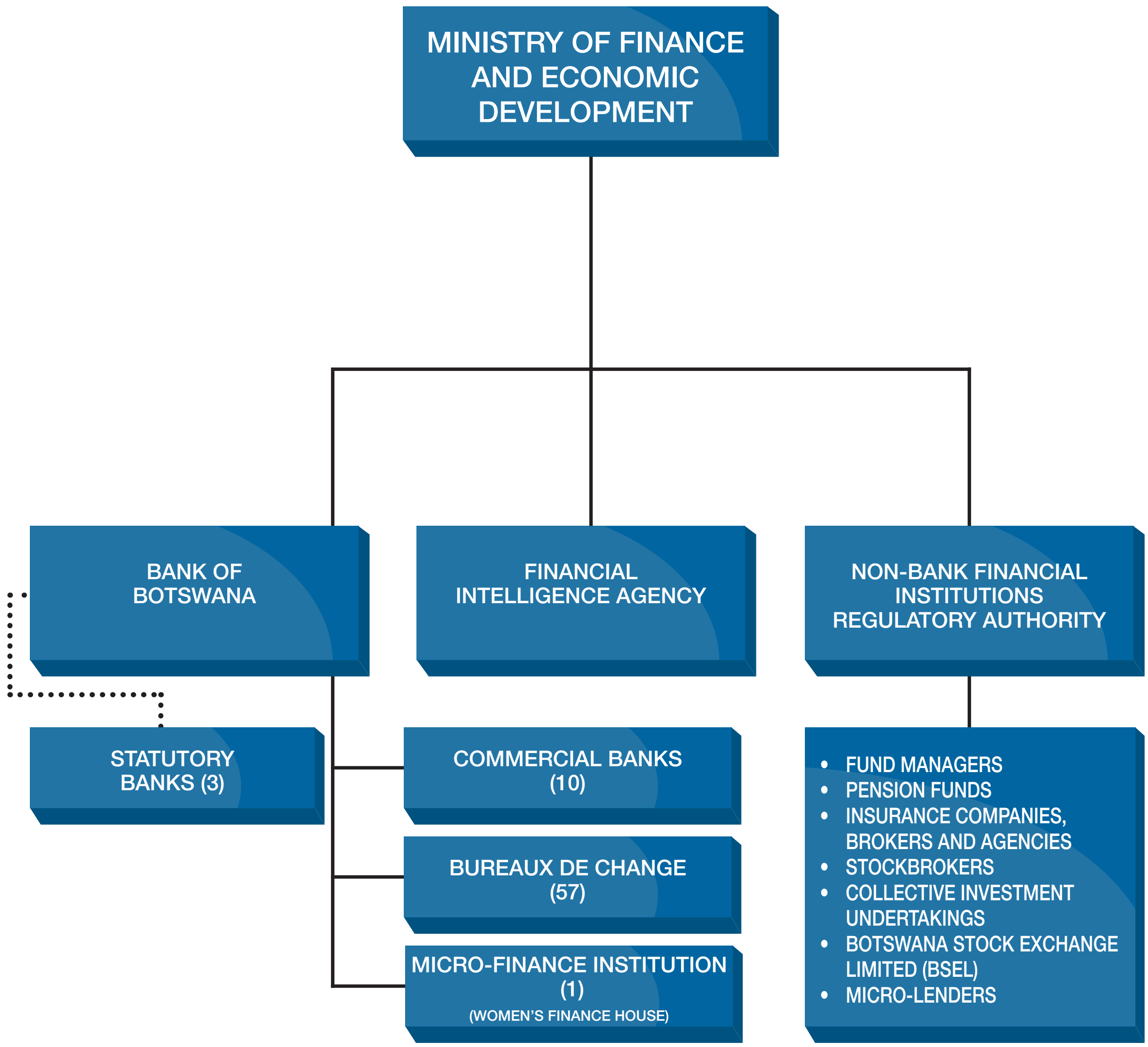
5.11 Prudential bilateral and statutory trilateral meetings were held in 2018, during which banks presented a review of their business strategies for the previous year(s) and strategic plans for the ensuing period as well as their financial year-end results. In addition, statutory bilateral meetings were held with external auditors to discuss audit strategies for the respective banks.

APPENDICES

APPENDICES

APPENDIX 1

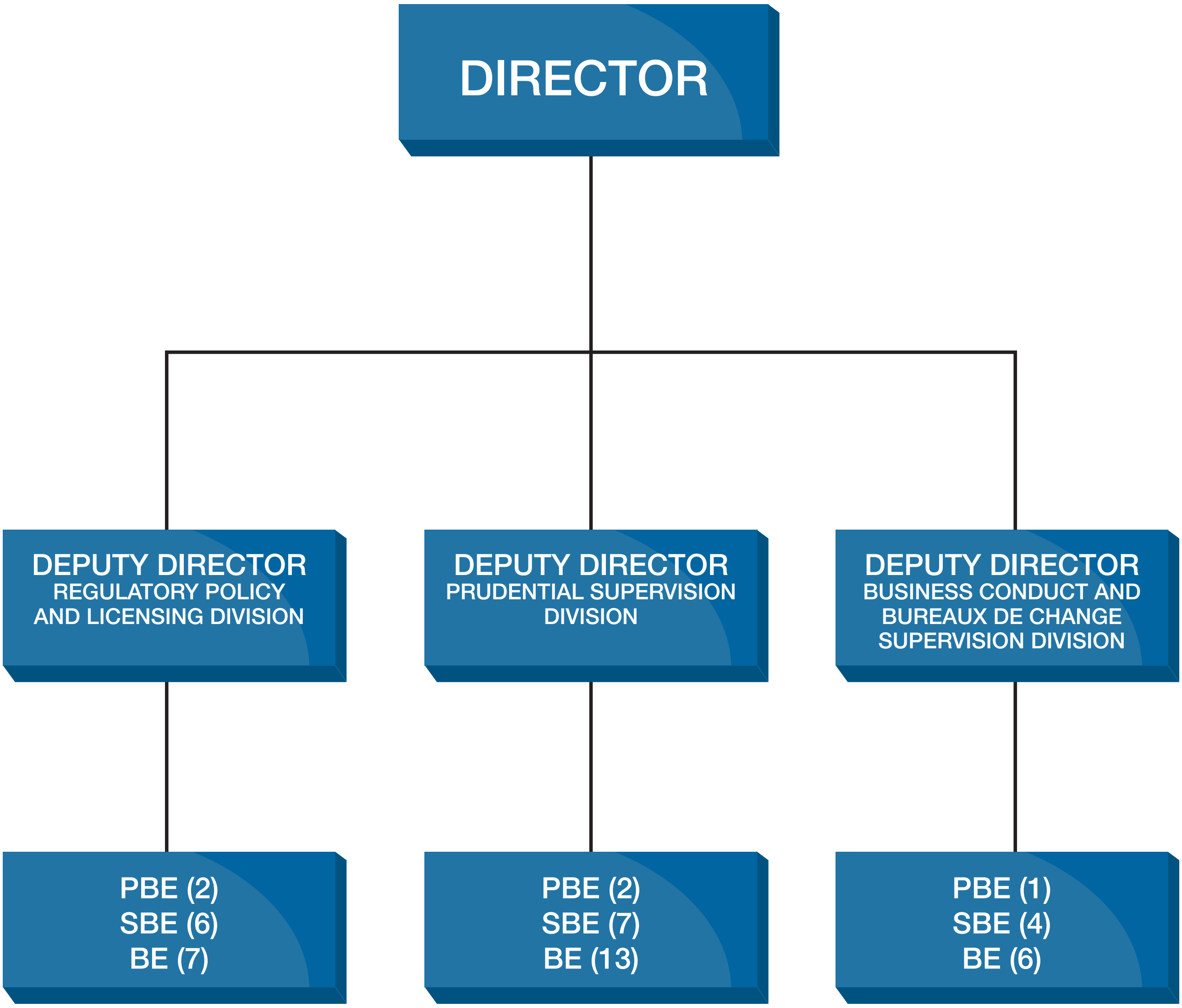
DIAGRAM 1.1: THE REGULATORY ARCHITECTURE OF THE DOMESTIC FINANCIAL SYSTEM



Source: Bank of Botswana.

APPENDIX 1

DIAGRAM 1.2: BANKING SUPERVISION DEPARTMENT ORGANISATIONAL STRUCTURE AS AT DECEMBER 31, 2018



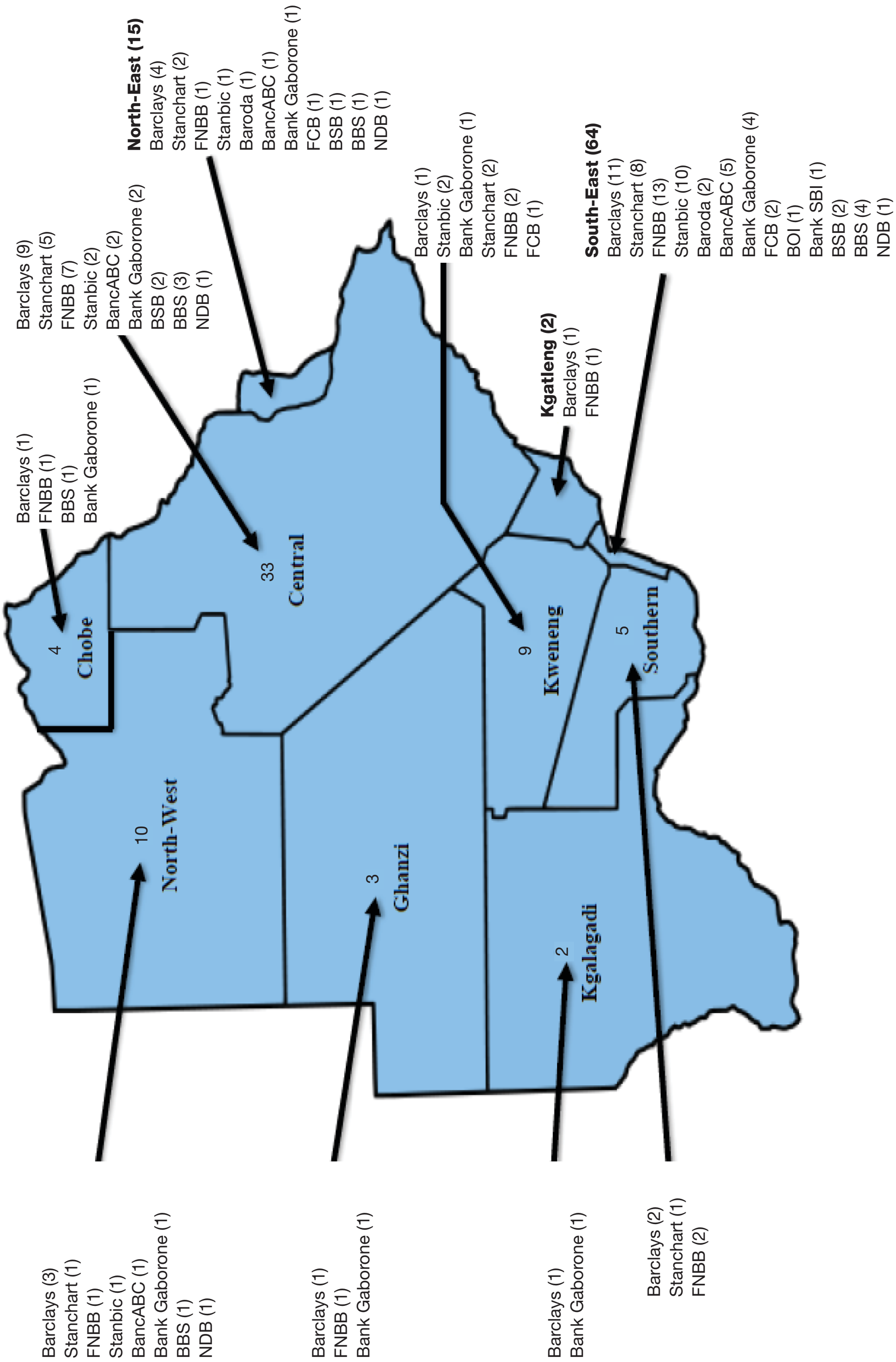
Key:

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

Source: Bank of Botswana.

APPENDIX **2**

BANK BRANCH DISTRIBUTION NETWORK BY DISTRICT AS AT DECEMBER 31, 2018



APPENDIX **3**

APPROACHES TO REGULATION AND SUPERVISION OF BANKS IN BOTSWANA

1. INTRODUCTION

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

2. LEGAL FRAMEWORK

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

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

3. AUTHORITY FOR LICENSING BANKS

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

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

APPENDIX 3

4. LICENSING POLICY AND PROCEDURES FOR ESTABLISHING A BANK

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

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

(a) The company must be locally incorporated in Botswana (branch banking is not permitted);
(b) The proposed banking establishment must have the prescribed initial minimum capital (currently P5 million) and the owners must demonstrate willingness and ability to provide additional financial support as and when required. In case of applicants that are majority owned by holding companies or a part of a financial conglomerate, the parent entity should demonstrate capacity to be a source of financial strength to the applicant;
(c) The applicant must have adequate managerial capacity, which includes the appointment of "fit and proper" persons, as well as sound risk-management and governance structures;
(d) In the case of foreign banks, the parent bank must be subject to adequate home supervision, and documentary evidence of consent by the parent supervisor to operate in Botswana must be provided;
(e) The proposed ownership and organisational structure must be acceptable to the Bank, and the structure must be such that it does not deter effective supervision, or, where necessary and appropriate, consolidated supervision; and
(f) The promoter must submit a business plan and five-year financial projections showing the establishment of a branch network, products to be provided, and demonstrate the ability to enhance effective competition, and effectively provide products and services to meet legitimate financial needs of the public in a prudent and safe manner.

5. CORE PRUDENTIAL REQUIREMENTS

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

Capital Adequacy Requirements

5.2 A bank must maintain a minimum capital adequacy (solvency) ratio of at least 8 percent, a statutory floor, calculated as the ratio of unimpaired capital to total risk-weighted assets. Banks in Botswana are required to maintain a capital adequacy ratio at or above 15 percent, which, in the context of the structure of the economy, prevailing macroeconomic and financial environment, is regarded as a safe and prudent level. The key issue is that a bank must maintain sufficient capital and other financial resources at a level that is commensurate with the nature and scale of its operations and the risks associated with them. The availability and adequacy of high-quality capital determines the degree of resilience of a bank to shocks to its financial position.

APPENDIX **3**

Liquid Assets Requirements

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

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

Asset Quality

Asset Concentrations (Large Exposures)

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

Insider Lending

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

Non-Performing Loans and Provisions

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

APPENDIX **3**

6. MAIN SUPERVISORY APPROACHES

On-Site Examination

6.1 The Bank conducts regular on-site examination 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 the total number of depositors as provided for under Section 24(3) of the Banking Act.

6.2 A full-scope prudential on-site examination is one that is sufficient in scope to assess an institution's capital adequacy (C), asset quality (A), management and effectiveness of board oversight (M), earnings and profitability (E), liquidity (L) and sensitivity to market risk (S) components (referred to as CAMELS) and the risk-management systems and make a conclusion about the institution's safety and soundness. A full-scope on-site examination should be conducted at least every 18 months. A limited-scope examination is an on-site examination that does not cover all components of the CAMELS, but rather focuses on a specific product, area, or risk, for example, consumer loans, treasury or operational risk. An ad hoc on-site examination is usually a limited-scope examination designed to test a specific area of supervisory concern, for instance, compliance with laws and regulations, liquidity, capital adequacy, among others. A full-scope business-conduct supervision examination focuses on the entire business conduct of an institution and how it relates to customers (consumer protection).

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

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

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

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

APPENDIX **3**

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

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

Bilateral and Trilateral Meetings

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

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

APPENDIX **3**

Off-Site Monitoring and Surveillance

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

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

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

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

7. ACCOUNTING, AUDITING AND DISCLOSURE STANDARDS

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

APPENDIX **4**

SUPERVISED FINANCIAL INSTITUTIONS AS AT DECEMBER 31, 2018

A. COMMERCIAL AND STATUTORY BANKS

Institution	Total Assets (P' million)	Postal Address	Business Locations	Auditors
Commercial Banks				
African Banking Corporation of Botswana Limited	9 227	Private Bag 00303 Gaborone	9	KPMG
Bank of Baroda (Botswana) Limited	1 606	P O Box 216 ADD Gaborone	3	Grant Thornton
Bank of India (Botswana) Limited	137	Private Bag 00111 Gaborone	1	Grant Thornton
Bank Gaborone Limited	5 370	Private Bag 00325 Gaborone	12	PricewaterhouseCoopers
Barclays Bank of Botswana Limited	17 228	P O Box 478 Gaborone	34	KPMG
First Capital Bank Limited	2 802	P O Box 5548 Gaborone	4	KPMG
Bank SBI Botswana Limited	416	P O Box 505243 Gaborone	1	Grant Thornton
First National Bank of Botswana Limited	24 776	P O Box 1552 Gaborone	29	Deloitte
Stanbic Bank Botswana Limited	14 523	Private Bag 00168 Gaborone	16	KPMG
Standard Chartered Bank Botswana Limited	15 257	P O Box 496 Gaborone	19	KPMG
Statutory Banks				
Botswana Savings Bank	2 527	P O Box 1150 Gaborone	5	PricewaterhouseCoopers
National Development Bank	939	P O Box 225 Gaborone	4	PricewaterhouseCoopers
Building Society				
BBS Limited	4 017	P O Box 40029 Gaborone	10	KPMG

Source: Commercial and Statutory Banks Returns submitted to the Bank.

APPENDIX 4

B. BUREAUX DE CHANGE AS AT DECEMBER 31, 2018

Name	Postal Address	Business Location
4Corners Bureau de Change	P O Box 848, Ghanzi	1
Aldaph Bureau de Change	P O Box 404845, Gaborone	1
American Express Bureau de Change	P O Box 45140, Gaborone	1
Andy and Esi Bureau de Change	P O Box 504125, Gaborone	1
Apijoe Bureau de Change	P O Box 458, Mogoditshane	2
Arpanet Bureau de Change	P O Box 2241 ABG, Gaborone	2
Ban Mo Bureau de Change	P O Box 99, Sherwood	1
Bellagio Bureau de Change	Private Bag BR 321, Gaborone	1
Beni Fame Bureau de Change	P O Box 2143 AAD, Gaborone	5
Berry-Pee Bureau de Change	P O Box 21409, Gaborone	1
Boitekanelo Bureau de Change	P O Box 2768, Gaborone	1
City Exchange Bureau de Change	P O Box 50282, Gaborone	1
CSS Bureau de Change	P O Box 45168, Gaborone	3
Exim Bureau de Change	P O Box 1020, Gaborone	1
Fanz Bureau de Change	P O Box 617, Lobatse	1
Fundex Bureau de Change	P O Box 401547, Gaborone	3
Galaxy Bureau de Change	P O Box 501055, Gaborone	2
Garona Bureau de Change	P O Box 408, Gaborone	4
Genesis Bureau de Change	P O Box 465 AAH, Gaborone	1
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Hi-Rated Bureau de Change	P O Box 3299, Gaborone	1
Kabona Bureau de Change	P O Box 455 ADD, Tlokweng	1
Kaycy Bureau de Change	P O Box 1693, Lobatse	2
Kwanokeng Bureau de Change	P O Box 10, Sherwood	2
Limpopo Bureau de Change	P O Box 8, Sherwood	2
Macheng Bureau de Change	P O Box 60474, Gaborone	1
Madikwe Bureau de Change	P O Box 268, Sikwane	1
Master Bureau de Change	Private Bag F199, Francistown	1
Mochudi Bureau de Change	P O Box 202147, Gaborone	1
Monty Cristo Bureau de Change	Private Bag 00254, Gaborone	1
Mukuru Bureau de Change	P O Box AD 148 ADD, Gaborone	4
Murhivudzo Bureau de Change	P O Box 799, Orapa	1

APPENDIX 4

BUREAUX DE CHANGE AS AT DECEMBER 31, 2018

Name	Postal Address	Business Location
Ngami Bureau de Change	P O Box 44, Maun	1
Okavari Bureau de Change	P O Box 278, Charleshill	1
Open Door Bureau de Change	P O Box 839, Maun	8
Ozair Bureau de Change	P O Box 4862, Gaborone	2
Palm Bureau de Change	P O Box 502359, Gaborone	1
Prime Ex Bureau de Change	P O Box 686, Moshupa	1
Proxy Bureau de Change	P O Box 404108, Gaborone	2
Regash Bureau de Change	P O Box 45144, Gaborone	1
Rennies Bureau de Change	P O Box 2482, Gaborone	1
River Ride Bureau de Change	P O Box 301106, Francistown	1
Royalty Bureau de Change	Private Bag BO 259, Gaborone	2
Sherwood Ranch Bureau de Change	P O Box 1, Sherwood	1
Sunny Bureau de Change	P O Box 370, Maun	2
Thari Bureau de Change	P O Box 40074, Gaborone	2
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
Titanium Treasury Bureau de Change	P O Box 1890 ABG, Gaborone	1
Trans Fronter Bureau de Change	P O Box 183, Pitsane	2
Travelex Bureau de Change	P O Box 80981, Gaborone	1
Travellers' Choice Bureau de Change	P O Box 26725, Gaborone	1
TRL Money Link Bureau de Change	Private Bag F333, Francistown	1
Tshilong Bureau de Change	P O Box 40418, Gaborone	2
Toluca Bureau de Change	P O Box 402026, Gaborone	1
UAE Exchange Bureau de Change	P O Box AD 749 ADD, Gaborone	8
Unity Bureau de Change	P O Box 1586, Francistown	1
West Bureau de Change	P O Box 40854, Gaborone	1
Total	57	98

Source: Bureaux de Change (Statutory Returns submitted to the Bank).

C. MICROFINANCE INSTITUTION

Institution	Postal Address	Business Locations	Auditors
Women's Finance House	Private Bag 124, Gaborone	1	Sharma & Associates

Source: Women's Finance House.

APPENDIX **5**

DEFINITION OF BANKING SUPERVISION TERMS

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 that 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. According to Section 17 of the Banking Act, an exposure in excess of 10 percent of a bank's unimpaired capital is deemed an asset concentration requiring prior approval of the board of directors of the lending financial institution. Exposures in excess of 30 percent of the bank's unimpaired capital require the Bank's approval.

Asset Quality

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

Loan Classifications

(i) "Pass" Assets

A credit is in the "pass/standard category if there are no material or significant performance problems (the credit is current and the borrower is complying, and is expected to continue to comply with all terms of the contract); or there are no technical and/or legal documentation deficiencies.

(ii) "Special Mention" Assets

A credit should be in the "special mention" or watch category if it is currently protected, but potentially weak. That is, assets with potential weaknesses that may, if not checked or corrected, weaken the asset as a whole or potentially jeopardise a borrower's repayment capacity in the future. This would, for example, include credit given through inadequate loan agreement or covenants, a lack of control over collateral, or incomplete or inadequate documentation, as well as adverse trends which are not yet serious enough for a classification of substandard.

(iii) "Sub-standard" Assets

A credit should be classified as "substandard" if it has one or more well-defined weaknesses that make the full collection of principal and interest questionable. This would include, for example,

(i) deterioration of the borrower's financial condition, including net worth and/or repayment capacity;
(ii) the pledged collateral (if any) is undocumented, insufficient, or deteriorating;
(iii) the borrower's financial information is absent or unsatisfactory;
(iv) other adverse factors exist, which cause concern regarding the ability of the borrower to repay the credit in accordance with the existing repayment terms, such as delinquency of 90 days, significant deviation from original source of repayment or carryover debt; and/or
(v) an actual breach of the contract has occurred.

APPENDIX **5**

(iv) “Doubtful” Assets

A credit shall be classified as “doubtful” when weaknesses exist that make collection or repayment in full highly questionable and improbable based upon current circumstances, conditions and the estimated recoverable amount of the pledged collateral (if any). Such credits generally display high levels of delinquency and the possibility of loss is very high. However, because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the credit, classification of the credit as “loss” is deferred until its more exact status is determined. Pending factors may include a merger/acquisition and capital injection.

(v) “Loss” Assets

At the time of classification, the credit is deemed uncollectable and of such little value that it should not continue to be included in the accounts and financial statements of the bank. The classification of credit as loss does not mean that the credit has no recovery or salvage value, but that the bank should not defer writing it off even though at least part of the value could be recovered in the future. Such classification does not cancel the borrower's obligation to repay, nor does it mean that the bank should not continue to exercise its full legal right to collection or payment. Loans classified as loss may have severe delinquency, unsecured and/or not well secured and not in the process of collection. Overdrafts considered loss may be hardcore, stagnant for a long period of time and unsecured or not well secured.

Core Capital

An aggregate of share capital, share premium, general revenue reserve and retained earnings, also called Tier 1 capital. It represents the most stable and permanent form of capital for supporting a bank's operations. (See Appendix 6 (d) for computations).

Total Risk-Weighted Assets

An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk-weighting is presented at Appendix 6 (c) attached. The amount of the risk-weighted assets for both operational risk and market risk shall be determined by multiplying the respective capital requirements by 6.7, the result of which is added to the risk-weighted assets for credit risk to come up with the total risk-weighted assets for a bank.

Unimpaired Capital

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

APPENDIX **5**

PRUDENTIAL RATIOS

Return On Equity (ROE)

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

Return On Average Total Assets (ROAA)

The ratio measures after-tax profits as a percentage of average total assets. This ratio is widely used by both banking supervisors and market analysts, since banking assets are the base from which earnings are primarily derived. The ratio measures the earnings capacity of the assets of a 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.

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 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, for example, the core and unimpaired capital to risk-weighted assets ratio. The rationale is that owners of banks must have sufficient own funds in a bank, though it is recognised that unnecessarily high capital levels could result in economic inefficiencies, if not employed productively. However, for commercial and other strategic reasons, most banks will retain some or a portion of their income to build greater capacity by way of a larger capital base in order to take advantage of lending and/or investment opportunities in large projects, or to support organic growth of the bank.

Risk-Based Capital

On January 1, 2016, the Bank implemented the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II). This new framework augments the risk sensitivity of the Basel Committee Capital Accord (Basel I). In terms of the Basel II framework, in addition to credit risk, a separate and explicit computation of the regulatory capital for market risk and operational risk is introduced. Therefore, the minimum amount of regulatory capital (the ratio of unimpaired capital to risk-weighted assets) is derived from the summation of capital charges for credit risk, operational risk and market risk. The move to this method of capital adequacy measurement has alerted banks to the types of assets they hold and the associated risk profiles. The intention is to strengthen the resilience of banks. In the process, some existing capital instruments held by banks and fixed revaluation reserves were disqualified from being part of Tier 2 capital. Also excluded are 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.

APPENDIX **5**

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 to expand its business by lending to more borrowers, if opportunities arise. A good capital base implies that adequate funds are available to absorb risks inherent in the types of assets held by a bank, its foreign exchange dealing operations and all other risks associated with the business.

Net Spread

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

Net Interest Margin

This is net interest income as a percentage of average total earning assets. The ratio identifies the core earnings capability of a bank.

Other Operating Income to Total Assets

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

Net Operating (or Intermediation) Margin

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 incurred by the banking system for intermediating between the providers and the users of funds.

Net Income Per Employee

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

Net Income to Employee Costs

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

APPENDIX 5

Cost-to-Income

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

Average Cost of Deposits (Interest Paid on Deposits to Total Average Deposits)

The ratio measures interest paid on deposits as a percentage of total average 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 begin to engage in aggressive marketing for deposits, either due to liquidity concerns and/or to fund expansion of their lending business, will have a high average cost of deposits.

APPENDIX **5**

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

Table 1 (a): Summary of Risk-Weights under the Standardised Approach for Credit Risk

	Credit Rate						
Claims on Exposure	AAA to AA-	A+ to A-	BBB+ to BBB-	BBB+ to B-	Below B-/BB	Unrated	Risk-Weight/ Credit Conversion Factor Percentage
Government of Botswana and Bank of Botswana							0
Cash							0
Cash items in the process of collection							20
Sovereigns and central banks	0	20	50	100	150	100	
BIS, IMF							0
Domestic public sector entities							20
Public sector entities	20	50	100	100	150	100	
Domestic banks							20
Foreign banks	20	50	100	100	150	100	
Security firms	20	50	100	100	150	100	
Eligible retail							75
Other retail							100
Mortgages[1]							35
Corporates/insurance companies	20	50	100	100	150	100	100
Multilateral development banks	20	50	50	100	150	50	0/100
Commercial real estate	100	100	100	100	100	100	100
Other assets[2]							100
Past due items **							100(20); 100(20-50); 150(20)
Other non-qualifying residential property							75
Significant investments in equity and regulatory capital instruments issued by unconsolidated financial institutions							250
Mortgage servicing rights							250
Deferred tax assets							250
Investments in commercial entities							1 250
Non-payment/delivery on non-delivery-versus-payment and non-payment-versus-payment transactions							1 250
Venture capital and private equity investment							150

Notes: ** Treatment of past due loans (non-performing loans net of specific provisions)

1 Owner-occupied or rented by the borrower to a third party, but used for residential purposes.

2 Excludes cash items in the process of collection.

Source: Bank of Botswana.

APPENDIX **5**

Specific Provision (SP)	Risk-Weight (Percent)
SP < 20 percent of outstanding loan amount	150
SP between 20 percent and 50 percent of outstanding loan amount	100
For loans secured by residential property, where such loans are past due for more than 90 days, and their SP < 20 percent	100

APPENDIX **5**

Table 1 (b): Credit Conversion Factors: Off-Balance Sheet Items

Maturity/Commitment	Credit Conversion Factor (CCF) Percentage
Commitments:	
• Original maturity up to 1 year	20
• Original maturity over 1 year	50
• Unconditionally cancellable commitments without notice	0
Direct credit substitutes:	
• Acceptances and endorsements	100
• Guarantees on behalf of customers	100
• Letter of credit issued by the bank with no title to underlying shipment	100
• Letter of credit confirmed by the bank and standby letters of credit serving as financial guarantee	100
Repo style transactions:	
• Sales and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank	100
Lending of banks securities or posting of securities as collateral:	
• Repurchase/reverse repurchase agreements and securities/borrowing transactions	100
Forward asset purchases:	
• Commitment to purchase at a specified future date on prearranged terms, a loan, security or other asset from another party, including written put options on specified assets with the character or a credit enhancement	100
Placements of forward deposits:	
• An agreement between a bank and another party where the bank will place a deposit at an agreed rate of interest at a predetermined future date	100
Partly paid shares and securities:	
• Amounts owing on the uncalled portion of partly paid shares and securities held by a bank representing commitments with certain draw down conditions by the issuer at a future date	100
Certain transaction-related contingent items:	
• Performance bonds, warranties and indemnities	50
• Bid or tender bonds	50
• Advance payment guarantees	50
• Customs and excise bonds	50
• Standby letter of credit related to particular contracts and non-financial transactions	50
Note issuance facilities and revolving underwriting securities:	
• An arrangement whereby a borrower may draw down funds up to a prescribed limit over a predetermined period by making repeated note issues to the market. If the issue is unable to be placed in the market, the unplaced amount is to be taken up or funds made available by a bank being committed as an underwriter of the facility	50
Short-term self-liquidating trade LCs/trade related contingent items with an original maturity below 6 months:	
• These are contingent liabilities arising from trade-related obligations, secured against an underlying shipment of goods for both issuing and confirming bank	20

Source: Bank of Botswana.

APPENDIX **5**

CAPITAL ELEMENTS

	COMMON EQUITY TIER 1 (CET1) CAPITAL
Line	Item
1.	Common shares
2.	Share premium resulting from the issue of common shares
3.	Retained earnings: Retained earnings brought forward from the previous financial year Add: interim profits (audited by external auditor) Less: dividend declared Less: dividend paid in the current financial year
4.	Accumulated other comprehensive income and other disclosed reserves: a. Statutory credit risk reserve b. Capital buffer c. Statutory reserves d. Other (specify)
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)
6.	Regulatory adjustments applied in the calculation of CET1 capital
7.	**Common Equity Tier 1 Capital Lines (1+2+3+4+5-6)**
	ADDITIONAL TIER 1 CAPITAL
8.	Instruments issued by the bank that meet the criteria for inclusion in additional Tier 1 capital as per paragraph 4.9 of the Capital Directive
9.	Stock surplus (Share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in additional Tier 1 capital and are not included in CET1 subject to terms and conditions in paragraph 3.5 of the Basel II Guidelines
11.	Regulatory adjustments applied in the calculation of additional Tier 1 capital
12.	**Additional Tier 1 Capital Lines (8+9+10-11)**
13.	**Total Tier 1 Capital Lines (7+12)**
	TIER 2 CAPITAL
14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital
16.	Unpublished current year's profits
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach
20.	Regulatory adjustments applied in the calculation of Tier 2 capital
21.	**Total Tier 2 Capital Lines (14+15+16+17+18+19-20)**
22.	**Total Unimpaired Capital Lines (13+21)**

Source: Bank of Botswana.

APPENDIX **5**

Table 3 (b): Regulatory Adjustments Applied In the Calculation of Capital

1. REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF CET1 CAPITAL	
A. Full deductions	
Line	**Item**
22	Goodwill and other intangible assets
23	Advances of a capital nature granted to connected persons
24	Deferred tax assets (DTA) that rely on future profitability to be realised
25	Investments in own shares, whether directly or indirectly
26	Unrealised revaluation losses on investments in securities
27	Defined benefit pension fund assets
28	Reciprocal holdings in the capital of banking, financial and insurance entities
29	Cash flow hedge reserve
30	Gain on sale related to securitisation transactions
31	Regulatory adjustments applied to CET1 capital due to insufficient additional Tier 1 and Tier 2 capital
32	**Full deductions applied to the calculation of CET1 capital line (22+23+24+25+26+27+28+29+30+31)**
B. Threshold deductions	*(Recognition capped at 10 percent of the bank's common equity (after the application of all regulatory adjustments set out under paragraph 4.6 of the Basel II Directive)*
Line	**Item**
33	Significant investments in the common shares of unconsolidated financial institutions, where a bank or its subsidiary owns more than 10 percent common shares of the issuing entity (banks, insurance and other financial entities) - instead of full deduction, only deduct the excess above the 10 percent threshold, the remaining balance below thresholds shall be treated as other assets (paragraph 3.16 – 3.18 Basel II Guidelines)
34	Deferred tax assets that arise from temporary differences
35	Mortgage servicing rights
36	Aggregate non-significant investments by the bank or its subsidiary in the equity of other banks and financial institutions, where the aggregate investment is equal to or greater than 10 percent of the capital of the institution in which the investment is made - instead of full deduction, only deduct the excess over the 10 percent threshold, the remaining amount below the 10 percent threshold shall be treated as other assets
37	**Threshold deductions applied to the calculation of CET1 capital line (33+34+35+36)**
38	**Total regulatory adjustments applied to the calculation of CET1 capital lines (32+37)**
2. REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF ADDITIONAL TIER 1 CAPITAL	
A. Full Deductions	
39	Direct investments in own additional Tier 1 capital, net of any short positions, if the short positions involve no counterparty risk
40	Indirect investments in own additional Tier 1 capital (e.g., through holdings of index securities in which the bank itself is a constituent), net of any short positions
41	Any own additional Tier 1 capital which the bank could be contractually obliged to purchase
42	Reciprocal cross holdings and the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation
43	Significant investments in the common shares of unconsolidated financial institutions, where a bank or its subsidiary owns more than 10 percent common shares of the issuing entity (banks, insurance and other financial entities)
44	**Full deductions applied to the calculation of additional Tier 1 capital line (39+40+41+42+43)**

APPENDIX **5**

	Line	Item
B.	Threshold deductions	*Recognition capped at 10 percent of the bank's common equity (after the application of all regulatory adjustments set out under paragraph 4.10 of the Basel II Directive)*
	45	Aggregate non-significant investments by the bank or its subsidiary in the equity of other banks and financial institutions, where the aggregate investment is equal to or greater than 10 percent of the capital of the institution in which the investment is made - instead of full deduction, only deduct the excess over the 10 percent threshold, the remaining amount below the 10 percent threshold shall be treated as other assets
	46	Total threshold deductions applied to the calculation of additional Tier 1 capital
	47	Total regulatory adjustments applied to the calculation of additional Tier1 capital line (44+46)
3.	REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF TIER 2 CAPITAL	
A.	Full deductions	
	48	Direct investments in own Tier 2 capital, net of any short positions, if the short positions involve no counterparty risk
	49	Indirect investments in own Tier 2 capital (e.g., through holdings of index securities in which the bank itself is a constituent), net of any short positions
	50	Any own Tier 2 capital which the group could be contractually obliged to purchase
	51	Reciprocal cross holdings and the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation
	52	Significant investments in the common shares of unconsolidated financial institutions, where a bank or its subsidiary owns more than 10 percent common shares of the issuing entity (banks, insurance and other financial entities)
	53	Full deductions applied to the calculation of Tier 2 capital line (48+49+50+51+52)
B.	Threshold deductions	*Recognition capped at 10 percent of the bank's common equity (after the application of all regulatory adjustments set out under paragraph 4.15 of the Basel II Directive)*
	54	Aggregate non-significant investments by the bank or its subsidiary in the equity of other banks and financial institutions, where the aggregate investment is equal to or greater than 10 percent of the capital of the institution in which the investment is made - instead of full deduction, only deduct the excess over the 10 percent threshold, the remaining amount below the 10 percent threshold shall be treated as other assets
	55	Total threshold deductions applied to the calculation of Tier 2 capital
	56	Total regulatory adjustments applied to the calculation of Tier 2 capital line (53+55)

Note:
1. The amount of the three items (33, 34, 35) not deducted (threshold amounts) in the calculation of CET1 is treated as other assets and risk-weighted at 250 percent.
2. Line 36: The amount above the 10 percent threshold shall be deducted from CET1, and the amount at or below threshold shall be risk-weighted as appropriate as per the Monthly Schedule M- SRWA 12a (CRM.1): Credit Risk Mitigation (Simple Approach) or Monthly Schedule M- SRWA 12b (CRM.2): Credit Risk Mitigation (Comprehensive Approach).

Source: Bank of Botswana.

APPENDIX **6**

AGGREGATE FINANCIAL STATEMENTS OF LICENSED BANKS: 2014 – 2018

Table 1: Aggregate Statement of Financial Position of Licensed Commercial Banks: 2014 – 2018 (P' million) as at December 31st

	TOTAL ASSETS IN LOCAL CURRENCY	2014	2015	2016	2017	2018
1.	Cash and balances with the central bank	5 838	4 584	6 333	4 597	5 364
	1.1. Currency	1 374	1 544	1 433	1 608	1 901
	a. Foreign currency	463	532	363	382	607
	b. Local currency	911	1 013	1 070	1 226	1 294
	1.2. Balances with central bank	4 419	2 982	4 900	2 989	3 462
	1.3. Other	45	58	-	-	-
2.	Investment and trading securities	6 482	12 537	11 425	10 811	12 142
3.	Placements with other banks and credit institutions	9 636	10 539	10 951	13 590	15 467
4.	Gross loans and advances to other customers	45 117	48 307	51 325	54 181	58 332
	4.1. Impairments-specific	771	1 007	1 270	1 536	1 352
	4.2. Interest in suspense	218	340	184	259	492
	4.3. Impairments portfolio	-	132	182	239	303
5.	Loans and advances to other customers (net of specific provisions)	44 075	46 875	49 690	52 147	56 185
6.	Fixed assets net of depreciation	910	968	908	926	956
7.	Other assets (net)	1 054	1 106	1 333	1 402	1 227
	Total Assets	67 994	76 605	80 640	83 475	91 341
	TOTAL LIABILITIES IN LOCAL CURRENCY					
1.	Amounts owed to government institutions	12	2	12	27	-
	a. Central bank accounts	12	2	12	27	-
	b. Direct government credits (CB or MFED)	-	-	-	-	-
2.	Due to other banks and credit institutions	3 581	3 308	3 984	4 250	4 735
3.	Debt securities and other borrowing	2 088	3 163	2 642	4 065	4 747
4.	Due to other customers/depositors	51 491	59 940	62 438	63 581	69 270
5.	Shareholder funds	7 724	8 204	9 748	9 383	10 390
6.	Other liabilities	3 097	1 997	1 817	2 169	2 199
	a. Taxes payable	133	252	195	246	185
	b. Dividends payable	4	7	-	-	-
	c. Accrued expenses	1 167	-	7	551	-
	d. Other	1 794	1 715	1 615	1 372	2 013
	Total Liabilities	67 994	76 605	80 640	83 475	91 341

Source: Commercial Banks (Statutory Returns submitted to the Bank).

APPENDIX 6

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

		2014	2015	2016	2017	2018
1.	1. Total interest and fee income from loans and advances	4 953	5 129	5 271	5 449	5 728
2.	2. Interest expense	1 670	2 093	1 425	1 466	1 811
3.	3. Net interest income [1-2]	3 284	3 036	3 847	3 983	3 916
4.	4. Total non-interest income	2 150	2 312	2 477	2 490	2 657
5.	**Gross operating income/(loss) [3+4]**	**5 434**	**5 348**	**6 323**	**6 473**	**6 573**
6.	Total Impairments	760	668	855	1 003	429
	a. Impairment of loans and advances – specific	545	587	685	994	344
	b. Impairment of loans and advances – portfolio	216	83	172	9	85
	c. Impairment on other financial assets	(1)	(2)	(2)	-	-
7.	**Operating income/(loss) net of bad and doubtful debts**	**4 674**	**4 680**	**5 469**	**5 470**	**6 144**
8.	Total non-interest expense	2 782	3 242	3 607	3 876	3 988
	a. Salaries and employee benefits	1 370	1 335	1 543	1 731	1 781
	b. Auditing and consulting expenses	49	49	173	299	15
	c. Rents paid	187	195	198	207	227
	d. Depreciation and amortisation	135	148	159	158	174
	e. Other	1 089	1 565	1 533	1 481	1 791
9.	Other provisions and write-offs	-	-		-	-
	a. Investments	-	-		-	-
	b. Other balance sheet items	-	-		-	-
	c. Off-balance sheet items	-	-		-	-
10.	**Net operating income/(loss) [7-8-9]**	**1 893**	**1 438**	**1 862**	**1 595**	**2 156**
11.	Extraordinary gains/(losses)	-	-	-	-	-
	a. Gains/losses on revaluation of assets (NET)	-	-	-	-	-
	b. Translation gains/losses (NET)	-	-	-	-	-
	c. Other gains/losses	-	-	-	-	-
12.	**Net income/(loss) before tax [10+11]**	**1 893**	**1 438**	**1 862**	**1 595**	**2 156**
13.	Income tax	415	349	455	412	480
14.	**Net income/(loss) after tax [12-13]**	**1 478**	**1 088**	**1 407**	**1 182**	**1 676**

Source: Commercial Banks (Statutory Returns submitted to the Bank).

APPENDIX **6**

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

	TOTAL ASSETS IN LOCAL CURRENCY	2013	2014	2015	2016	2017
1.	Cash and balances with the central bank	8	9	23	70	177
	a. Currency	6	8	21	18	171
	aa. Foreign currency	-	-	-	-	-
	ab. Local currency	6	8	21	18	171
	b. Balances with central bank	2	1	2	52	6
	c. Other	-	-	-	-	-
2.	Investment and trading securities	-	-	-	-	-
3.	Placements with other banks and credit institutions	854	1 580	1 025	1 777	1 391
4.	Gross loans and advances to customers	3 823	4 278	4 769	4 792	4 891
5.	Specific provisions	20	22	28	93	95
6.	Net loans and advances to customers	3 781	4 240	4 722	4 699	4 745
7.	Fixed assets net of depreciation	121	131	151	152	146
8.	Other assets (net)	70	71	62	79	82
	Total Assets	4 834	6 031	5 983	6 777	6 544
	LIABILITIES IN LOCAL CURRENCY					
1.	Amounts owed to government institutions	-	-	-	-	-
	a. Central bank accounts	-	-	-	-	-
	b. Direct government credits (CB** or MFED)	-	-	-	-	-
	c. Other	-	-	-	-	-
2.	Borrowing from other banks, credit institutions and international lending agencies	855	1 271	987	1 235	1 325
3.	Due to customers/depositors	2 180	3 340	3 493	4 042	4 244
4.	Shareholder funds	1 664	1 263	1 303	1 306	775
5.	Other liabilities	136	157	200	193	200
	a. Taxes payable	1	1	1	1	2
	b. Dividends payable	-	-	4	-	-
	c. Accrued expenses	-	-	-	-	-
	d. Other	135	156	195	192	198
	Total Liabilities	4 834	6 031	5 983	6 777	6 544

* 2014 – 2015 figures revised to exclude one statutory bank

** CB denotes central bank

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

APPENDIX **6**

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

		2014	2015	2016	2017	2018
1.	Total interest and fee income from loans and advances	370	475	482	433	441
2.	Interest expense	173	233	231	198	228
3.	Net interest income [1-2]	197	242	251	234	213
4.	Total non-interest income	35	51	46	30	35
5.	**Gross operating income/(loss) [3+4]**	**232**	**294**	**297**	**265**	**248**
6.	6. Total Impairments	(1)	9	18	24	32
	a. Impairment of loans and advances – specific	-	-	-	-	18
	b. Impairment of loans and advances – portfolio	-	-	-	-	6
	c. Releases and recoveries of bad debts previously written off	-	-	-	-	2
7.	**Operating income/(loss) net of specific loss provisions**	**233**	**284**	**279**	**241**	**216**
8.	Total non-interest expense	174	189	214	197	212
	a. Salaries and employee benefits	74	94	106	91	97
	b. Administrative expenses	-	-	-	-	-
	c. Auditing and consulting expenses	-	-	-	-	1
	d. Rents paid	-	-	-	-	2
	e. Depreciation and amortisation	9	13	10	16	19
	f. Other	90	81	98	88	93
9.	Other provisions and write-offs	-	-	-	-	-
	a. Investments	-	-	-	-	-
	b. Other balance sheet items	-	-	-	-	-
	c. Off-balance sheet items	-	-	-	-	-
10.	**Net operating income/(loss) [7-8-9]**	**60**	**96**	**65**	**44**	**4**
11.	Extraordinary gains/(losses)	-	-	-	-	-
	a. Gains/losses on revaluation of assets (NET)	-	-	-	-	-
	b. Translation gains/losses (NET)	-	-	-	-	-
	c. Other gains/losses	-	-	-	-	-
12.	**Net income/(loss) [10+11]**	**60**	**96**	**65**	**44**	**0.18**

*2014 – 2015 figures revised to exclude one statutory bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

APPENDIX **6**

Table 5 (a): Aggregate Capital Structure of Commercial Banks (under Basel I) (P' million) as at December 31st

	TIER 1	2014	2015
1.	Stated capital	1 097	1 381
2.	Preference (non-redeemable) non-cumulative shares	229	-
3.	General reserves	67	148
4.	Retained earnings	4 589	5 116
5.	Minority interests	-	-
6.	Less	(91)	(86)
	a. Goodwill and other intangible assets	(89)	(82)
	b. Shareholder equity funded through the capitalisation of unrealised gains arising from property revaluation	-	-
	c. Current year's unpublished losses	(2)	(4)
7.	**Total Tier 1 Capital (Sum of lines 1 - 5 less lines 6(a) - (c)**	**5 891**	**6 559**
	TIER 2		
8.	Current year's unpublished profits	971	780
9.	Fifty percent of fixed asset revaluation reserves	35	34
10.	Unrealised gains on available for sale revaluations	-	9
11.	Unencumbered general provisions not to exceed 1.25 percent of risk-weighted assets	310	332
12.	Hybrid (debt/equity) capital instruments eligible for inclusion	-	8
13.	Subordinated term debt eligible for inclusion	1 036	1 551
14.	Minority interest in Tier 2 preference shares	100	100
15.	Shareholders equity funded through the capitalisation of property revaluation reserves	-	-
16.	**Total Tier 2 Capital (sum of lines 8 - 14)**	**2 472**	**2 814**
17.	**Total Capital (sum of lines 7 and 15)**	**8 363**	**9 373**
	Impairments	**-**	**-**
18.	Investments in unconsolidated subsidiaries and associated companies	-	-
19.	Total Impairments of capital	-	-
20.	**Total Unimpaired Capital**	**8 363**	**9 373**

Source: Commercial Banks (Statutory Returns submitted to the Bank).

APPENDIX **6**

Table 5 (b): The Revised Aggregate Capital Structure of Commercial Banks (Basel II) (P' million) as at December 31st

	COMMON EQUITY TIER 1 (CET1) CAPITAL	2016	2017	2018
1.	Common shares	1 165	1 265	1 265
2.	Share premium resulting from the issue of common shares	271	271	271
3.	Retained Earnings:	5 479	5 867	6 422
	Retained earnings brought forward from the previous financial year	5 325	6 404	6 700
	Add: interim profits (audited by external auditor)	506	(196)	63
	Less: dividend declared	-	6	160
	Less: dividend paid in the current financial year	352	335	180
4.	Accumulated other Comprehensive income and other disclosed reserves	156	207	289
	a. Statutory credit risk reserve	25	79	137
	b. Capital buffer	-	-	-
	c. Statutory reserves	2	2	2
	d. Other (specify)	129	126	150
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)	-		-
6.	Regulatory adjustments applied in the calculation of CET1 Capital[1]	123	249	275
	a. Transitional adjustment amount added back to CET1	-	-	390
7.	CET1 Capital (Lines (1+2+3+4+5-6))	6 948	7 361	8 029
	ADDITIONAL TIER 1 CAPITAL			
8.	Instruments issued by the bank that meet the criteria for inclusion in additional Tier 1 capital as per paragraph 4.9 of the Basel II Directive	-	-	400
9.	Stock surplus (share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-	-	-
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in additional Tier 1 capital and are not included in CET 1 subject to terms and conditions in paragraph 3.5 of the Basel II Guidelines	-	-	-
11.	Regulatory adjustments applied in the calculation of additional Tier 1 capital	-	-	-
12.	Additional Tier 1 Capital (Lines (9+10+11-12))	-	-	400
13.	Total Tier 1 Capital (Lines (7+13))	6 948	7 361	8 429

APPENDIX **6**

	TIER 2 CAPITAL			
14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital);	1 641	1 683	1 853
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;	-	-	-
16.	Unpublished current year's profits	1 041	1 124	987
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	176	214	140
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)	-	-	-
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	432	391	678
20.	Regulatory adjustments applied in the calculation of Tier 2 capital	-	-	(11)
21.	**Total Tier 2 Capital (Lines (16+17+18+19+20+21-22))**	**3 293**	**3 412**	**3 648**
22.	**Total Unimpaired Capital (Lines (14+23))**	**10 241**	**10 774**	**12 077**

Note: 1. Comprises goodwill and other intangible assets.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 5 (c): Listing of the Key Components of the Capital Structure of Commercial Banks (Summary) (P' million) as at December 31st

		2014	2015	2016	2017	2018
1	Stated capital*	1 097	1 381	1 165	1 265	1 265
2	Share premium	-	-	271	271	271
3	Retained earnings	4 589	5 116	5 479	5 867	6 422
4	**Total Tier 1 Capital**	**5 891**	**6 560**	**6 948**	**7 361**	**8 429**
5	Subordinated term debt	1 036	1 551	1 817	1 897	1 993
6	Current year's unpublished profits	971	780	1 041	1 124	987
7	**Total Tier 2 Capital**	**2 472**	**2 814**	**3 293**	**3 412**	**3 648**
8	**Total Unimpaired Capital (sum of Line 4 and 7)**	**8 363**	**9 374**	**10 241**	**10 774**	**12 077**

* Stated capital for period 2014 – 2015 included share premium.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

APPENDIX 6

Table 6 (a): Aggregate Capital Structure of Statutory Banks (Basel I) (P' million) as at December 31st

	TIER 1	2014	2015
1.	Stated capital	809	878
2.	Preference (non-redeemable) non cumulative shares	-	-
3.	General reserves	224	228
4.	Retained earnings	121	130
5.	Minority interests	-	-
6.	Less	-	7
	a. Goodwill and other intangible assets	-	7
	b. Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation	-	-
	c. Current year's unpublished losses	-	-
7.	**Total Tier 1 Capital (Sum of lines 1 - 5 less lines 6(a) and 6(b)**	**1 153**	**1 229**
	TIER 2		
8.	Current year's unpublished profits	51	90
9.	50 percent of fixed asset revaluation reserves	-	-
10.	Unrealised gains on available for sale revaluations	-	-
	a. Unemcumbered general provisions not to exceed 1.25 percent of risk-weighted assets	4	5
	b. Statutory credit risk reserve	-	-
11.	Subordinated term debt eligible for inclusion	-	-
12.	Minority interest in Tier 2 preference shares	-	-
13.	Shareholders equity funded through the capitalisation of property revaluation reserves	-	-
14.	**Total Tier 2 Capital (sum of lines 8 - 14)**	**55**	**95**
15.	**Total Capital (sum of lines 7 and 15)**	**1 208**	**1 324**
	Impairments		
16.	Investments in unconsolidated subsidiaries and associated companies	-	-
17.	Connected lending of a capital nature	4	-
18.	Total impairments of capital	4	-
19.	**Total Unimpaired Capital**	**1 208**	**1 324**

*2014 – 2015 figures revised to exclude one statutory bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

APPENDIX **6**

Table 6 (b): The Revised Aggregate Capital Structure of Statutory Banks (Basel II) (P' million) as at December 31st

	COMMON EQUITY TIER 1 (CET1) CAPITAL	2016	2017	2018
1.	Common shares	922	952	507
2.	Share premium resulting from the issue of common shares	-	-	-
3.	Retained Earnings:	97	85	119
	Retained earnings brought forward from the previous financial year	157	132	119
	Add: interim profits (audited by external auditor)	-	-	-
	Less: dividend declared	-	-	-
	Less: transfer during the year	-	3	-
	Less: dividend paid in the current financial year	60	44	-
4.	Accumulated other Comprehensive income and other disclosed reserves	64	230	145
	a. Statutory credit risk reserve	-	-	(14)
	b. Capital buffer	-	-	-
	c. Statutory reserves	-	166	159
	d. Other (specify)	64	64	-
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)	-	-	-
6.	Regulatory adjustments applied in the calculation of CET1 capital	-	-	17
7.	CET1 Capital (Lines (1+2+3+4+5-6))	1 083	1 259	754
	ADDITIONAL TIER 1			
8.	Instruments issued by the bank that meet the criteria for inclusion in additional Tier 1 capital as per paragraph 4.9 of the Basel II Directive	-	-	-
9.	Stock surplus (share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-	-	-
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in additional Tier 1 capital and are not included in CET 1 capital subject to terms and conditions in paragraph 3.5 of Basel II Guidelines	-	-	-
11.	Regulatory adjustments applied in the calculation of additional Tier 1 capital	-	-	-
12.	Additional Tier 1 Capital (Lines (9+10+11-12))	-	-	-
13.	Total Tier 1 Capital (Lines (7+13))	1 083	1 259	754
	TIER 2 CAPITAL			

APPENDIX 6

14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)	-	-	102
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	-	-	-
16.	Unpublished current year's profits	67	40	4
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	-	-	-
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)	-	-	-
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2 capital, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	-	17	19
20.	Regulatory adjustments applied in the calculation of Tier 2 capital	-	-	-
21.	**Total Tier 2 Capital (Lines (16+17+18+19+20+21-22))**	**67**	**57**	**126**
22.	**Total Unimpaired Capital (Lines (14+23))**	**1 150**	**1 316**	**880**

*Figures excludes one statutory bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

Table 6 (c): Listing of the Key Components of the Capital Structure of Statutory Bank (Summary) (P' million) as at December 31st

		2014	2015	2016	2017	2018
1.	Stated capital	809	878	922	952	507
2.	Retained earnings	224	228	97	85	119
3.	**Total Tier 1 Capital**	**1 153**	**1 229**	**1 083**	**1 259**	**754**
4.	Current year's unpublished profits	51	90	67	40	4
5.	**Total Tier 2 Capital**	**55**	**95**	**67**	**57**	**126**
6.	**Total Unimpaired Capital (sum of line 3 and 5 less impairments)**	**1 205**	**1 325**	**1 150**	**1 316**	**880**

*Figures excludes one statutory bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

APPENDIX **7**

CHARTS AND TABLES OF KEY PRUDENTIAL AND OTHER FINANCIAL SOUNDNESS INDICATORS

Chart 7.1: Average Cost of Deposits

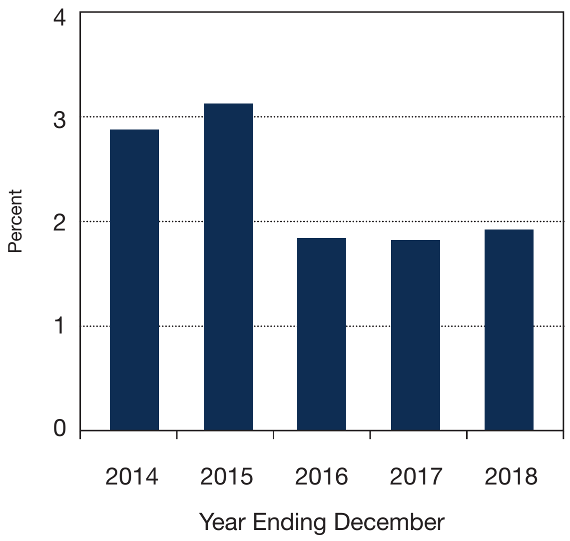


Chart 7.2: Return on Loans and Advances

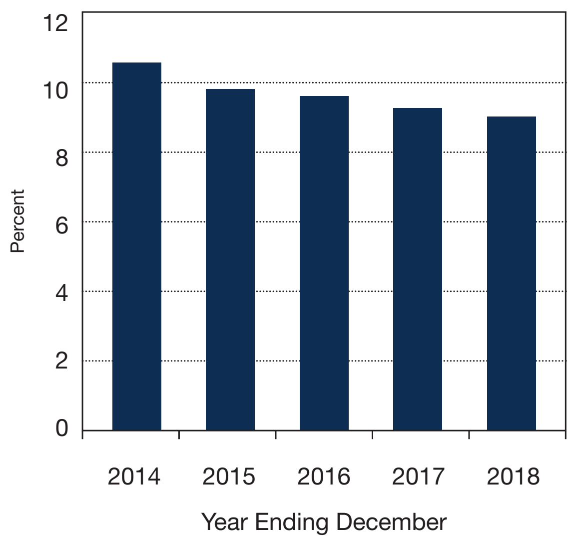


Chart 7.3: Residential Real Estate Loans to Gross Loans and Advances

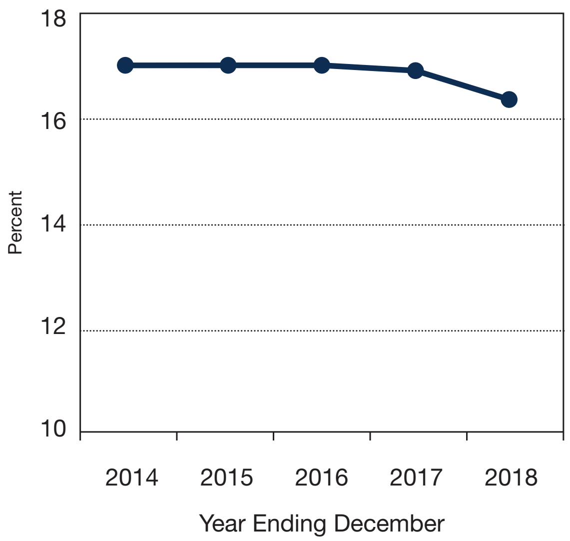
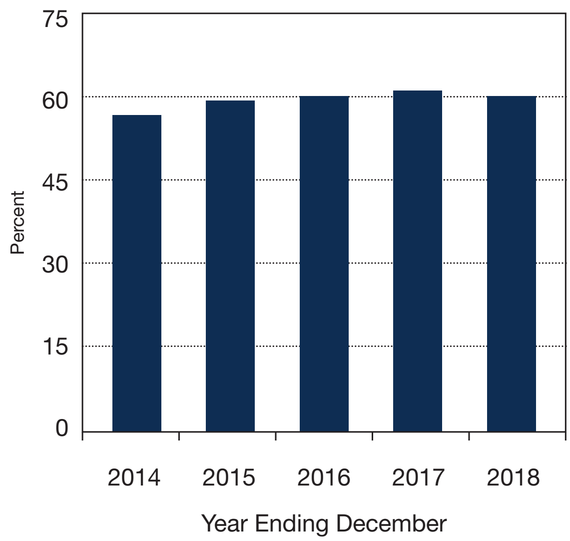


Chart 7.4: Household Loans to Gross Loans and Advances



Source: Commercial Banks (Statutory Returns submitted to the Bank).

APPENDIX 7

CHARTS AND TABLES OF KEY PRUDENTIAL AND OTHER FINANCIAL SOUNDNESS INDICATORS

Chart 7.5: Non-performing Loans Growth Rate

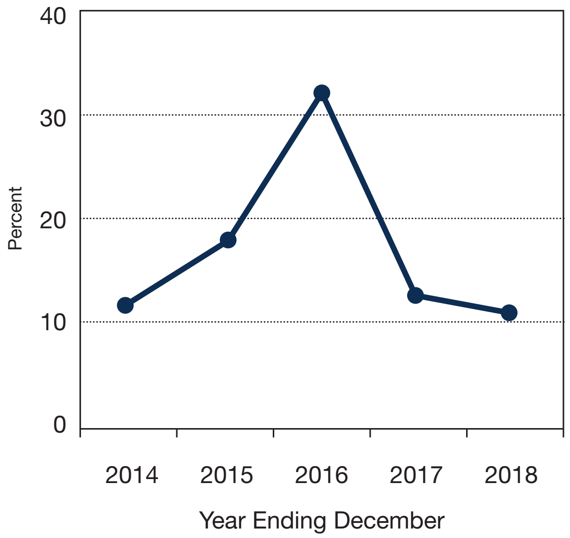


Chart 7.6: Share of Value of Total Deposits by Type (including FCAs)

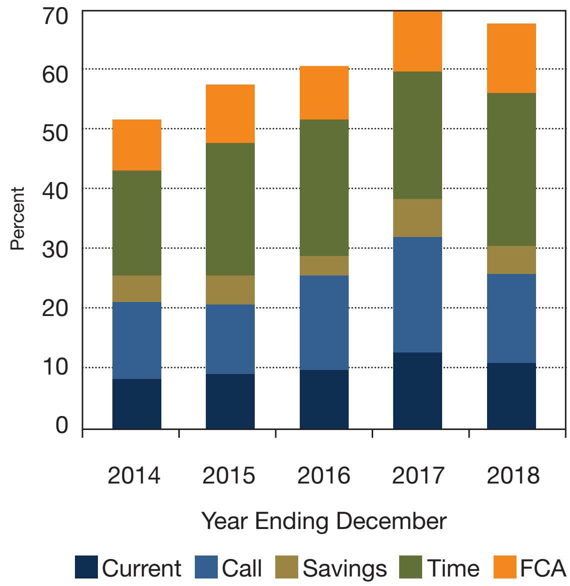


Chart 7.7: Growth Rate of Foreign Currency Accounts

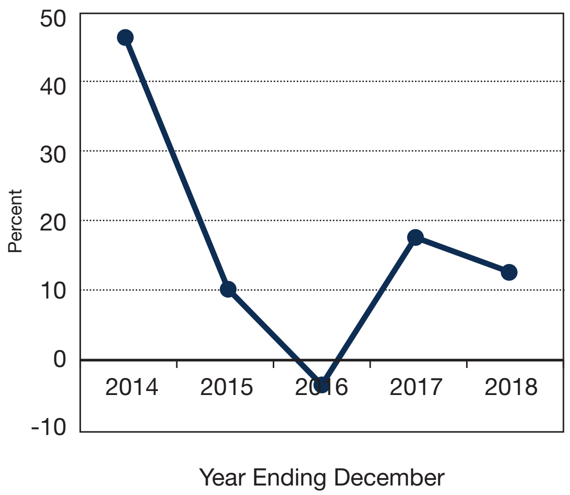
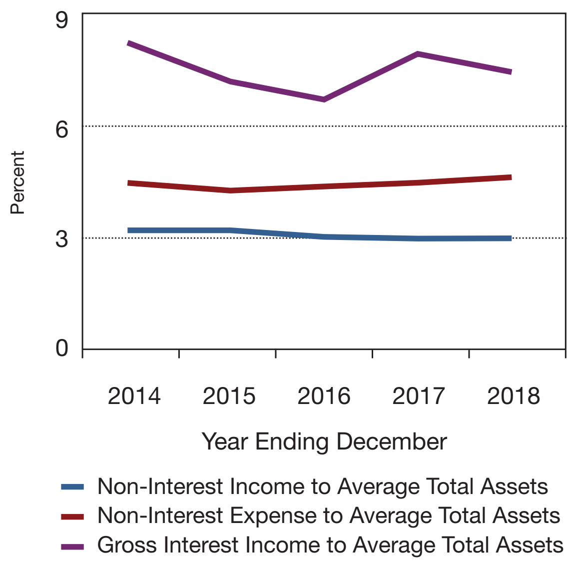


Chart 7.8: Efficiency Ratios



Source: Commercial Banks (Statutory Returns submitted to the Bank).

NOTES

NOTES

NOTES