Banking Supervision Annual Report 2014

Bank of Botswana

Contents

Abbreviations

ALCO	Asset Liability Committee
ALM	Asset Liability Management
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ATA	Average Total Assets
ATMs	Automated Teller Machines
BAOA	Botswana Accountancy Oversight Authority
Banking Act	Banking Act (CAP. 46:04)
BancABC	African Banking Corporation of Botswana Limited
Barclays	Barclays Bank of Botswana Limited
Baroda	Bank of Baroda (Botswana) Limited
BBS	Botswana Building Society
BG	Bank Gaborone Limited
BIS	Bank for International Settlements
BoBCs	Bank of Botswana Certificates
BOI	Bank of India (Botswana) Limited
BSB	Botswana Savings Bank
BSE	Botswana Stock Exchange
CAELS	Capital, Asset Quality, Earnings, Liquidity and Sensitivity to Market Risk
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
CB	Central Bank
CBL	Capital Bank Limited
CIUs	Collective Investment Undertakings
D-SIBs	Domestic Systemically Important Banks
EU	European Union
FATF	Financial Action Task Force
FIA	Financial Intelligence Agency
FNBB	First National Bank of Botswana Limited
FRPGA	Financial Ratio and Peer Group Analysis
GDP	Gross Domestic Product
G-SIBs	Global Systemically Important Banks
HHI	Herfindahl–Hirschman Index
ICAAP	Internal Capital Adequacy Assessment Process
IT	Information Technology
IIP	Insitutional Impairment Portfolio
IRB	Internal Ratings-Based
KBAL	Kingdom Bank Africa Limited
KYC	Know Your Customer

LCs	Letters of Credit
LCR	Liquidity Coverage Ratio
LHS	Left Hand Scale
MFDP	Ministry of Finance and Development Planning
MIS	Management Information System
MoU	Memorandum of Understanding
NBFIRA	Non-Bank Financial Institutions Regulatory Authority
NDB	National Development Bank
NPLs	Non-Performing Loans
NSFR	Net Stable Funding Ratio
ORS	Off-site Rating System
OSS	Off-site Surveillance System
PEP	Politically Exposed Persons
RAS	Risk Assessment System
RBS	Risk-Based Supervision
RBZ	Reserve Bank of Zimbabwe
RCAP	Regulatory Consistency Assessment Programme
RHS	Right Hand Scale
ROAA	Return on Average Total Assets
ROE	Return on Equity
RWA	Risk-Weighted Assets
SBI	State Bank of India (Botswana) Limited
SIMS	Stanlib Investment Management Services
SMEs	Small and Medium Enterprises
SMs	Statistical Models
SREP	Supervisory Review and Evaluation Process
Stanbic	Stanbic Bank Botswana Limited
Stanchart	Standard Chartered Bank Botswana Limited
STR	Suspicious Transactions Report
SWIFT	Society for Worldwide Interbank Financial Telecommunication
USD	United States dollar
ZAR	South African rand

Foreword

The global economic recovery continued to be slow and fragile in 2014, thereby constraining economic growth prospects for Botswana. This, in turn, had a major negative impact on the performance of the banking sector in Botswana. The amount of excess liquidity in the banking system declined considerably as a result of a disproportionate increase in lending against sluggish growth in deposits. Consequently, the cost of funding increased markedly towards the end of 2014, as banks were competing aggressively for deposits, and this led to a decrease in interest margins which, historically, had been very high. As a result, the financial performance and profitability of the Botswana banking sector declined in 2014. There was also a marginal decline in asset quality during the year as banks experienced an increase in non-performing loans (NPLs). However, despite the challenging business environment, the profitability ratios for the banking sector remained strong and above international norms for comparable sized banks. Generally, the banking sector remained safe, sound and stable during 2014.

Access to banking services continued to expand, with banks introducing and improving banking technology and e-services.

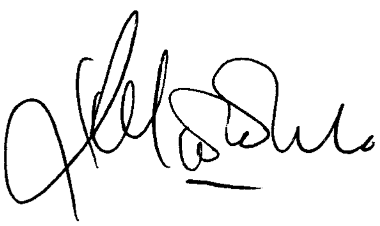
The Bank continued to monitor and take measures aimed at enhancing cost-effective access to financial services. In this respect, the Bank imposed a two-year moratorium on increasing bank charges/fees and commissions with effect from January 1, 2014, in response to public concerns about high level of bank charges relative to what is considered unsatisfactory quality of service. The moratorium was meant to provide an opportunity for the Bank to consult appropriately and chart a way forward in the best interests of all parties.

Following evaluation of the result of the parallel run of both Basel I and Basel II, the full implementation of the Basel II was deferred to January 1, 2016. This was to ensure accuracy and consistency of data reported by banks prior to full implementation. The Bank also introduced a risk based supervision (RBS) framework with effect from January 1, 2014, in order to better align the supervisory process with the manner in which banks manage risk and enhance supervisory process on the key risk areas of a particular institution. RBS seeks to address risk management in banks' operations.

The number of licensed banks declined from 13 in 2013 to 11 in 2014 following the voluntary surrender of a banking licence by ABN AMRO (Botswana) Limited and ABN AMRO (Botswana) OBU. Furthermore, towards the end of 2014, the Bank directed one of the offshore banks, Kingdom Bank Africa Limited (KBAL), to surrender the banking licence on account of failure to find a long-term solution to the viability of its operations. In the main, KBAL had failed to undertake, in a safe, sound and sustainable manner, the business for which it was licensed. The Bank had concluded that the medium to long-term "going concern" status of KBAL could no longer be guaranteed.

On February 16, 2015, the Bank assumed temporary management of KBAL with a view to finding a resolution to its unsound and deteriorating financial condition (see page 21).

Linah Mohohlo



GOVERNOR

Introduction

The banking sector remained safe, sound and stable during 2014, despite the fragile performance of the global economy. Total banking sector assets grew by 13.4 percent to P68 billion in 2014, compared to 3.5 percent growth recorded in the previous year. Loans and advances increased by 14.2 percent to P45.1 billion, while customer deposits went up by 6 percent to P51.5 billion, and this resulted in the intermediation ratio trending upwards to reach a high of 87.6 percent (December 2013: 81.3 percent). The household sector continued to account for a larger proportion of total loans and advances at 55.8 percent, and deposits remained highly concentrated in the private business sector. The Non-Performing Loans (NPLs) to Total Loans and Advances ratio remained constant at 3.6 percent as in 2013. The prudential ratio of aggregate banking sector Large Exposures to Unimpaired Capital increased from 148.2 percent in 2013 to 230 percent, and was within and significantly below the 800 percent prudential maximum limit, thus signifying that banks were prudently managing their credit concentration risk.

The banking sector profitability was subdued in 2014 with after-tax profits amounting to P1.5 billion, down from P1.8 billion recorded in 2013. Nevertheless, banks remained adequately capitalised and complied with the minimum capital requirements. The sector's liquid asset ratio of 14.5 percent continued on a downward trajectory as the amount of outstanding Bank of Botswana Certificates (BoBCs) held by banks declined; historically, BoBCs constituted a larger proportion of banks' liquid assets. The funds which used to be invested in BoBCs were channeled into lending and/or offshore investments, thereby exerting pressure on the liquid asset ratios of banks. Be that as it may, the industry liquid asset ratio remained above the 10 percent minimum statutory requirement.

It is evident that the Botswana banking sector is transitioning from a period of historically high levels of excess liquidity and high interest rates. The sector was characterised by rapid growth in bank balance sheets and high profits, against the backdrop of high interest margins. The situation has now changed to that of significant reduction in excess liquidity in a low interest rate environment and a more competitive market. This transition towards a normal banking environment is a welcome development as it is expected to spur banks into being more innovative and enhancing risk management systems in the process. In particular, banks are expected to adopt more prudent and effective liquidity and economic capital management policies and practices.

The number of commercial banks decreased by two to 11 in 2014, following the voluntary surrender of banking licences by ABN AMRO (Botswana) Limited and ABN AMRO (Botswana) OBU, as a result of the rationalisation of the group's global operations. On the whole, banks improved banking business delivery channels, such as mobile phones and internet-based banking services. In an effort to reach out to the unbanked population, banks also continued to strengthen their strategic partnerships with mobile network operators to provide financial services and this added the much needed impetus to reaching out to the unbanked members of society, thereby enhancing financial inclusion.

The Bank of Botswana (Bank) commissioned the parallel-run implementation of Basel I and Basel II effective January 1, 2014, the intention of which was to assess the likely impact and implications of the new capital rules on banks' capital and other financial soundness indicators. On the basis of the evaluation and extensive consultation with banks on the results of the parallel run, it was agreed to fully implement Basel II on January 1, 2016, in the best interests of accuracy and consistency of bank data. In a bid to foster cost-effectiveness of banking services, the Bank imposed a two-year freeze on upward adjustment of bank charges and fees with effect from January 1, 2014. This was in response to growing public concern about the high level of bank charges and fees, which are considered not commensurate with the quality of banking services and products. Consequently, the Bank commissioned a third party study to investigate whether banks were levying charges and fees that had been approved by the Bank, while banks too appointed a consultant to conduct a similar study to determine how bank charges in Botswana compared with those prevailing in countries in the region. The results of both studies will provide a basis for charting a way forward on bank charges and fees in general.

This Report is structured such that Chapter 1 outlines the structure of the financial sector. Chapter 2 covers an assessment of the operational performance of the banking sector in 2014. Licensing, financial inclusion and consumer protection, as well as international best practice on banking supervision are addressed in Chapters 3 and 4, respectively. Chapter 5 summarises key issues arising from the on-site examinations conducted during the year; this includes the results of the year's off-site surveillance and monitoring of banks. The last chapter (Chapter 6) highlights the performance of the Bureau de Change.

Chapter 1: Botswana Financial System and Selected Indicators

Structure of the Banking Sector and Other Supervised Financial Institutions

(Commercial Banks, Statutory Banks and Related Entities)

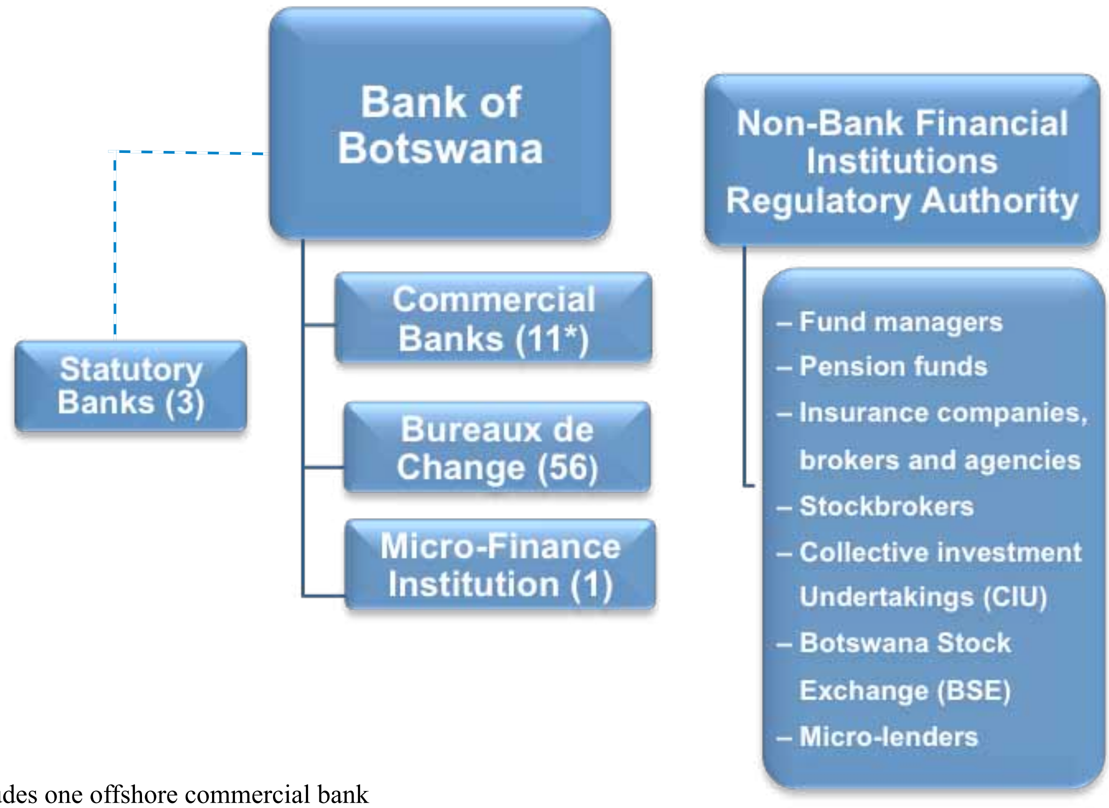
Diagram 1.1 shows the financial sector regulatory structure as at December 31, 2014. The Bank has regulatory and supervisory responsibility for commercial banks, bureaux de change and a deposit-taking microfinance institution, as well as supervisory responsibility for statutory banks. The Non-Bank Financial Institutions Regulatory Authority (NBFIRA) supervises the non-bank financial institutions, notably the insurance industry, pension funds, stock exchange, fund managers, other investment advisory service providers, and micro-lending businesses. The number of licensed commercial banks decreased by two to 11 in 2014, due to the surrender of banking licences by ABN AMRO (Botswana) Limited and ABN AMRO (Botswana) OBU. Statutory banks remained at three, while operational bureaux de change decreased marginally from 57 to 56 for the reporting period.

During the year under review, the Bank signed Memoranda of Understanding (MoUs) with the Competition Authority and the Botswana Accountancy Oversight Authority (BAOA) on June 6, 2014 and October 9, 2014, respectively. The MoUs are consistent with the spirit and principles enshrined in the mandates of the Bank of Botswana, the Competition Authority and BAOA, to enter into agreement with each other on policy matters of mutual interest. The main objectives of the MoUs are to:

Competition Authority

(a) foster supervisory cooperation between the Bank and the Competition Authority in the regulation of

Diagram 1.1: The Regulatory Architecture



*Includes one offshore commercial bank

anti-competitive behaviour in the banking and financial services sector;

(b) promote collaboration between the Bank and the Competition Authority in the investigation, analysis and combating of anti-competitive practices in the broader economy; and

(c) facilitate smooth functioning of the financial system infrastructure.

Botswana Accountancy Oversight Authority

(a) foster supervisory cooperation between the Bank and BAOA in the implementation of the Bank of Botswana Act (CAP. 55:01), Banking Act (CAP. 46:04) and Financial Reporting Act, 2010;

(b) recognise a need for cooperation in the efficient and effective regulation of auditors of public interest entities and enforcement of financial regulation laws, financial reporting, accounting and auditing professional standards, management of financial matters and mobilisation of resources and skills exchange;

(c) acknowledge the vital importance of developing financial reporting and improving the quality, standard and integrity of financial and non-financial information provided by public interest entities in Botswana; and

(d) facilitate the efficient functioning of the financial system infrastructure.

The MoUs were entered into in recognition of the respective mandates of the institutions. These MoUs neither affect the operational independence nor abrogate the powers, responsibilities and any legally binding obligations; they also do not supersede any laws and regulations governing the respective institutions.

Banking Business Distribution Channels

Banks continued to expand their delivery channels by way of automated teller machines (ATMs), service centres, internet and mobile money services. There was a marginal decrease in the branch network in 2014; one branch was opened while two were closed, thus resulting in the total number of commercial bank branches decreasing by one to 114. On the other hand, the number of commercial banks ATMs increased from 391 in 2013 to 420 in 2014; FNBB installed 31 additional ATMs countrywide. Table 1.1 below shows the distribution channels by the banks.

Employment Trends in the Banking Sector

The employment levels in the banking sector (including statutory banks), as presented in Table 1.2, registered an increase of 1 percent from 5 159 in 2013 to 5 205 in 2014. Four banks were the main contributors to the increase of staff complement. Marginal declines in the number of expatriate staff were noted during the period under review.

Table 1.1: Representation of Banks: 2012 – 2014

	Branches and Sub-Branches			ATMs		
Bank	2012	2013	2014	2012	2013	2014
ABN AMRO (On-shore & Off-Shore)	1	1	–	–	–	–
BancABC	6	8	8	7	10	10
Bank Gaborone	6	6	7	19	27	18*
Bank of India	–	1	1	–	–	–
Barclays	40	42	41	104	112	116
Baroda	2	3	3	4	6	6
Capital Bank	4	4	4	4	4	4
FNBB	21	22	22	159	141	172*
KBAL	1	1	1	–	–	–
Stanbic	11	11	11	25	26	26
Stanchart	15	15	15	57	65	68
State Bank of India	–	1	1	–	–	–
Total (Commercial banks)	**107**	**115**	**114**	**379**	**391**	**420**
BSB	2	2	2	–	–	–
BBS	9	10	9	10	10	12
NDB	4	4	4	–	–	–
Total (Industry)	**122**	**131**	**129**	**389**	**401**	**432**

* Of the 172 FNBB ATMs and 18 Bank Gaborone ATMs, 140 and 8 are full ATMs, whereas 32 and 10 are mini ATMs, respectively.

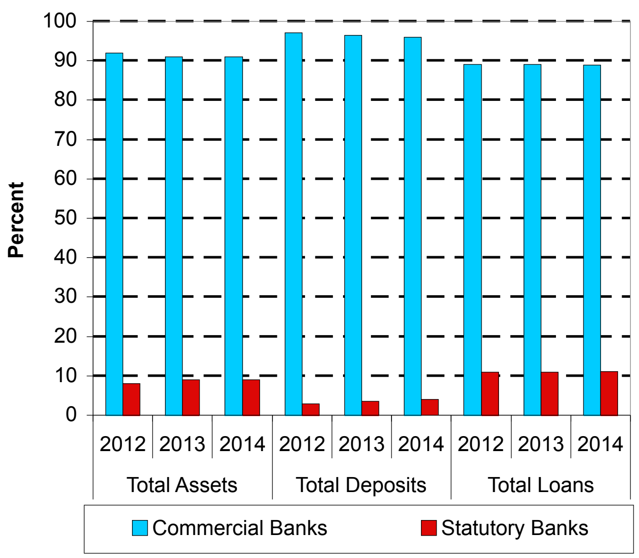
Table 1.2: Employment Levels for Licensed Domestic Banks: 2013 – 2014

Bank	2013			2014		
	Citizens	Expatriates	Total	Citizens	Expatriates	Total
Barclays	1 211	4	1 215	1 235	6	1 241
Stanchart	895	14	909	949	10	959
FNBB	1 137	7	1 144	1 134	6	1 140
Stanbic	600	5	605	583	4	587
Baroda	28	13	41	29	12	41
Bank Gaborone	268	8	276	276	9	285
BancABC	230	6	236	246	8	254
Capital	112	8	120	118	9	127
KBAL	11	7	18	11	7	18
Bank of India	6	3	9	6	3	9
State Bank of India	3	2	5	8	3	11
ABN AMRO	1	3	4	–	–	–
Total (Commercial banks)	**4 502**	**80**	**4 582**	**4 595**	**77**	**4 672**
BSB	198	–	198	145	–	145
BBS	198	1	199	200	2	202
NDB	180	–	180	186	–	186
Total (Industry)	**5 078**	**81**	**5 159**	**5126**	**79**	**5 205**

Market Share

The banking sector continued to be dominated by commercial banks, as measured by the share of total banking sector assets, deposits, loans and advances (Chart 1.1). Commercial banks' total assets, and total loans and advances market share remained almost unchanged at 91 percent and 89 percent, respectively. There was a small decrease in market share of total deposits from 96.5 percent in 2013 to 95.9 percent in 2014. Statutory banks continued to account for a small share of the industry assets, deposits and advances. The combined market share of total assets for the three statutory banks remained almost unchanged at 8.9 percent in 2014; it was 9 percent in 2013. Statutory banks' share of total deposits increased to 4.1 percent, compared to 3.5 percent in the previous year, while loans and advances remained constant at 11 percent.

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



While the four large banks[1] continued to dominate the commercial banks' market share, as shown in Chart 1.2, their share of total deposits declined slightly, from 80 percent in 2013 to 79 percent in 2014. Their share of total assets and total loans and advances remained unchanged at 81 percent.

Competition in the Banking Sector

The degree of competitiveness in the banking sector is determined by the size and structure of the sector. Competitiveness ranges from highly competitive market conditions, for many banks (of more or less the same size) to uncompetitive and monopolistic conditions where the sector is dominated by one bank. More often, however, markets are oligopolistic, the main feature of which is a few players in the market. A monopolistic market will have high concentration levels, which would result in an increase in market power, a factor that could lead to anti-competitive behaviour and con-

1 A large bank is one with total assets that constitute 10 percent or more of the aggregate banking sector total assets as at December 31, 2014. These large banks are Barclays Bank of Botswana Limited, First National Bank of Botswana Limited, Stanbic Bank Botswana Limited and Standard Chartered Bank Botswana Limited.

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

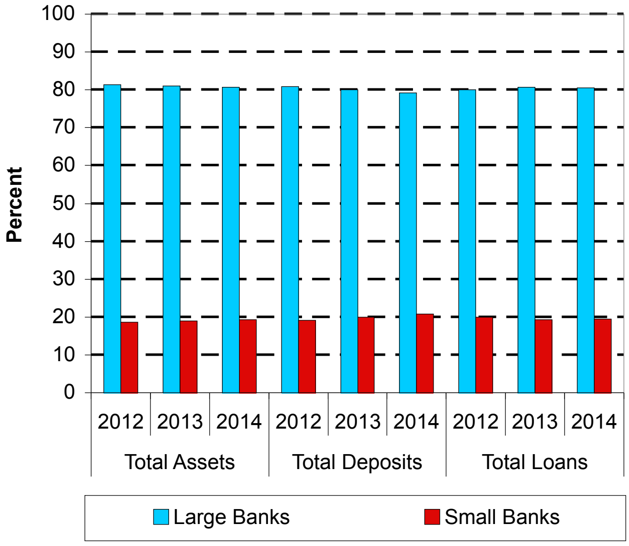
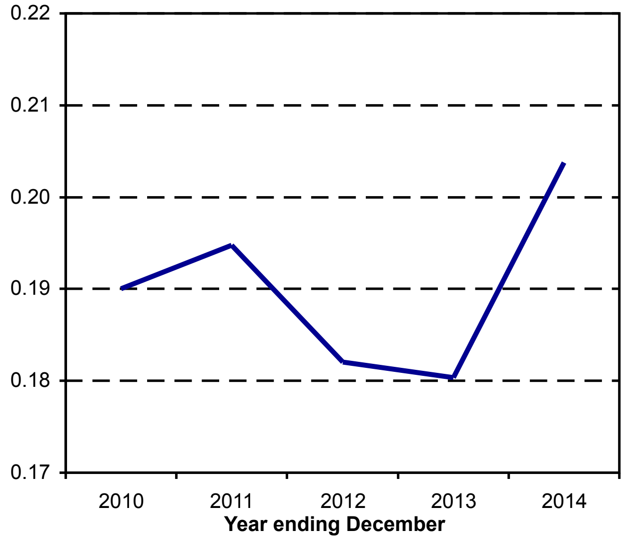


Chart 1.3: Herfindahl – Hirschman Index (HHI)



(Note: 2012 figures have been re-stated)

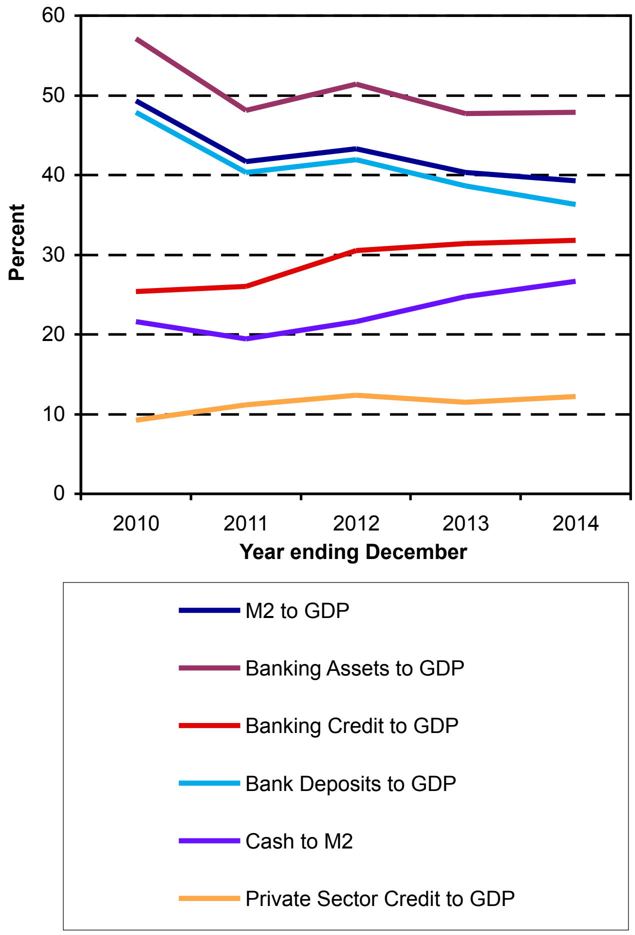
sequently higher cost of banking services for customers. In an oligopolistic situation, the market will also be highly concentrated in a few large banks, having substantial market control, although not to the same extent as in a monopolistic situation. In general, a higher number of banks of comparable size in the market ensures that banks price competitively, thus reducing the degree of market power and opportunities for collusion.

The Herfindahl–Hirschman Index[2] (HHI) measures the degree of competition in a market, and it takes into account the relative size and distribution of companies in a market. HHI approaches zero when a market consists of a large number of firms of relatively equal size. Chart 1.3 shows the movement of the index over the five-year period to 2014. The trend shows that the HHI remained above the theoretical threshold of 0.18 for high concentration during this period. The index increased from 0.18 in 2013 to 0.20 in 2014, thus indicating deterioration in the level of competitiveness in the banking sector.

Financial Deepening and Development

Chart 1.4 shows commonly used indicators that tend to adequately approximate financial deepening and de-

Chart 1.4: Financial Sector Deepening



Note: The Private Sector Credit figures (2010 – 2014) have been re-stated to exclude credit issued to Government; government agencies and public enterprises.

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

velopment. These are the ratios of Banking Assets to Gross Domestic Product (GDP);[3,4] Banking Credit to GDP; Bank Deposits to GDP; Cash[5] to M2 (measure of liquidity preference); Private Sector Credit to GDP;[6] and M2[7] to GDP.

Bank Deposits to GDP ratio declined from 39 percent in 2013 to 36 percent in 2014 while Banking Assets to GDP ratio remained constant at 48 percent. On the other hand, the Cash to M2 ratio, which is a measure of liquidity preference, increased from 25 percent in 2013 to 27 percent in 2014, thus implying that the public continued to have an increased preference to hold cash as opposed to savings at banks.

Financial depth and development, as approximated by the ratio of Private Sector Credit to GDP, remained unchanged at 12 percent. When benchmarked against the 67 percent average private sector credit to GDP ratios across countries (as reported by the World Bank's 2014 Global Financial Development Report), the Botswana banking system's financial depth remains shallow at 12 percent. The ratio was also well below the Sub-Saharan average of 17 percent; it has been found to have a strong statistical link to long-term economic growth.

The ratio of Banking Credit to GDP, which is the other proxy variable that determines the ability of banks to mobilise savings in the economy, increased slightly from 31 percent in 2013 to 32 percent in 2014, which translated into marginal improvement of the sector's financial depth. The M2 to GDP ratio (measure of the degree of intermediation-money supply-relative to the size of the economy) decreased marginally from 40 percent in 2013 to 39 percent in 2014 due to the slower growth rate of M2 (10 percent) in comparison to GDP (13 percent).

The above statistics show that the Botswana banking sector remains shallow relative to global benchmarks of financial depth. In deep financial markets, these ratios are usually more than 100 percent. Therefore, the banking sector remains small relative to the size of the economy.

3 GDP figures have been revised to GDP at current prices resulting in the inconsistencies between the 2013 and 2014 analysis.

4 GDP figure at current prices for 2014 was P141.9 billion.

5 Coins and notes in circulation and other money equivalents that are easily convertible into cash.

6 The Private Sector Credit to GDP ratio as defined by World Bank excludes credit issued to Government; government agencies; and public enterprises.

7 M2 (P55.7 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).

Chapter 2: Performance of the Banking Sector

Statement of Financial Position (Balance Sheet)

The banking sector statement of financial position strengthened and remained fundamentally robust and healthy as at December 31, 2014. This was shown by a 13.4 percent growth rate of total assets to P68 billion in December 2014, compared to the marginal increase of 3.5 percent recorded the prior year. All banks, with the exception of one small bank, recorded an increase in assets.

Placements with other banks, which increased by 50.3 percent to P9.6 billion in December 2014 (December 2013: P6.4 billion), was the largest contributor to the significant growth in total assets. A large amount (76 percent) of these funds were placements with foreign affiliated banks. Investment and trading securities decreased by 19.6 percent to P6.5 billion (December 2013: P8.1 billion), mainly due to decreased holdings of BoBCs. Gross loans and advances grew by 14.2 percent to end the year at P45.1 billion (December 2013: P39.5 billion).

The assets were mainly funded by customer deposits, which increased by 6 percent to P51.5 billion in December 2014 (December 2013: P48.6 billion). Customer deposits continued to constitute a significant portion of the liabilities at 75.7 percent. The banking sector balances due to other banks (vostro and domestic balances) increased significantly by 157 percent to P3.6 billion at year-end (December 2013: P1.4 billion). This could imply that some banks, increased their borrowing in the interbank and foreign markets to cover the shortfall in liquidity experienced in 2014. Shareholders' funds made 11.4 percent of total liabilities (P7.7 billion).

Charts 2.1 and 2.2 below show the composition of assets and liabilities at the end of 2013 and 2014, while Charts 2.3 and 2.4 show total assets, total deposits and total loans and advances as well as their growth rates over the past five years.

There was a marginal shift in the composition of deposits by maturity towards the longer term (time and savings) in 2014. Short-term deposits (call and current) declined to 48 percent from 51 percent recorded the prior year, while long term deposits increased to 52 percent, compared to 49 percent in 2013 (Chart 2.5). If the trend

Chart 2.1: Banking Sector Assets: 2013 – 2014 (Percent)

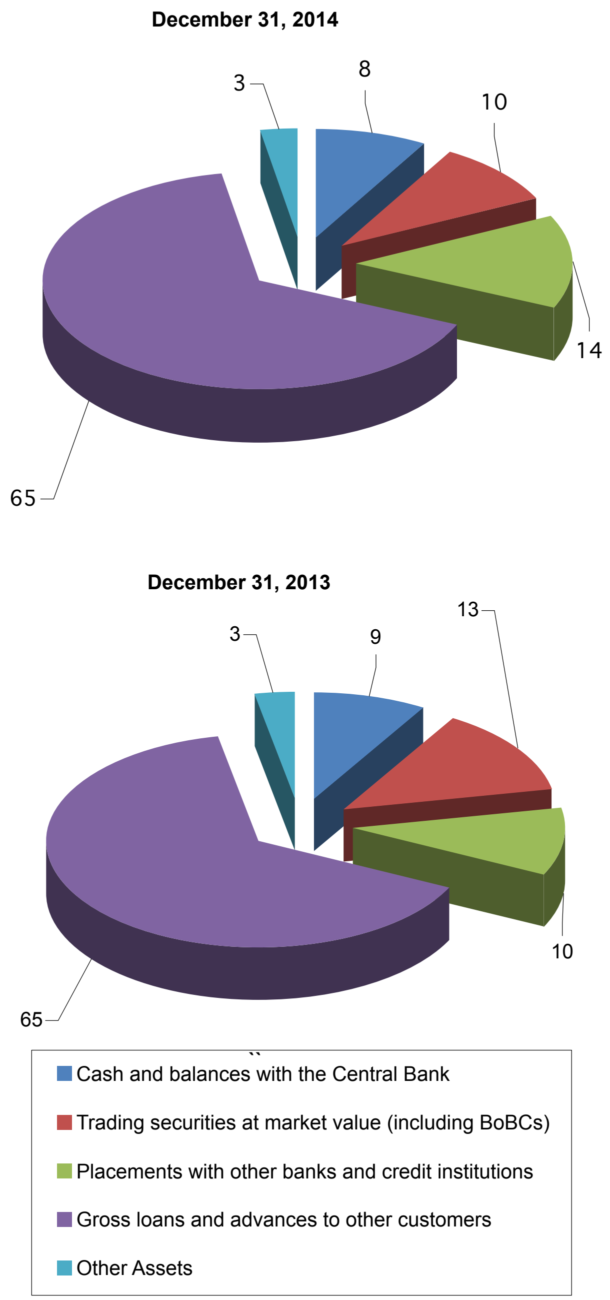
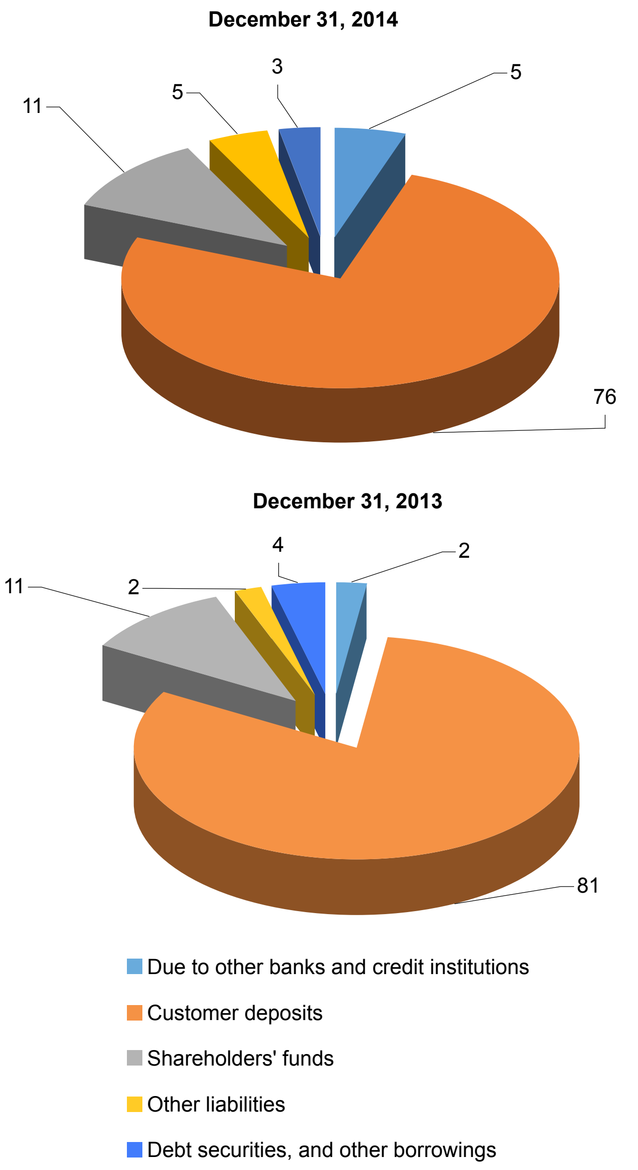


Chart 2.2: Banking Sector Liabilities: 2013 – 2014 (Percent)



is sustained, this could be a welcome development as it could address the excessive maturity mismatch between assets and liabilities of banks.

In the year under review, the value of deposits (Pula terms) by type, were almost the same as in 2013 for short term deposits, while the value of longer term deposits increased by 9.2 percent to P22.5 billion. Time deposits continued to account for a large proportion of total local currency deposits at P18.7 billion in 2014, compared to P17 billion in December 2013. The share of current, call, time and savings deposits (by value) are shown in Chart 2.6.

Customer deposits continued to be largely Pula denominated in 2014. However, the proportion of Pula

Chart 2.3: Levels of Total Assets, Total Loans and Advances and Total Deposits

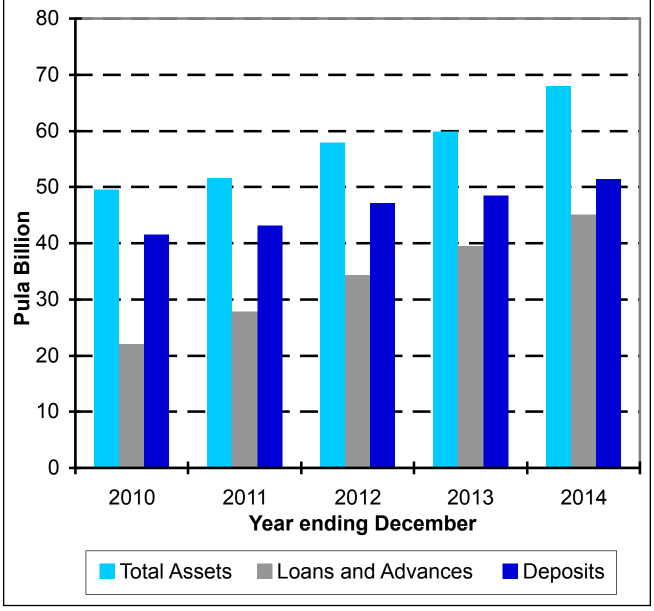
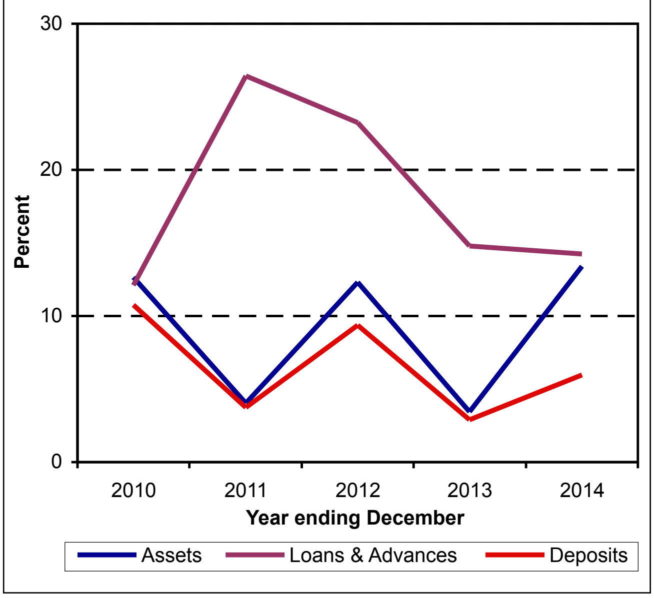


Chart 2.4: Growth Rates of Total Assets, Total Loans and Advances and Total Deposits



denominated deposits as a percentage of total deposits decreased to 84.1 percent (P43.5 billion), compared to the 87 percent (P42.4 billion) recorded in the previous year (Chart 2.7). The foreign currency deposits amounted to P8 billion in December 2014, which is an increase of 48.1 percent over the P5.4 billion recorded in December 2013. The United States dollar (USD) and South African rand (ZAR) continued to dominate foreign currency deposits, mainly due to the relative importance of these two currencies in the country's trade relations.

Chart 2.5: Deposits Type by Maturity (Percent)

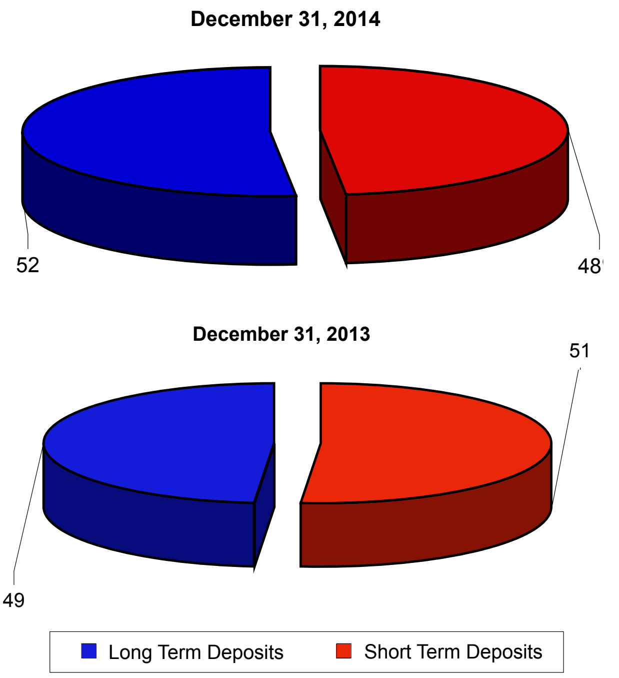
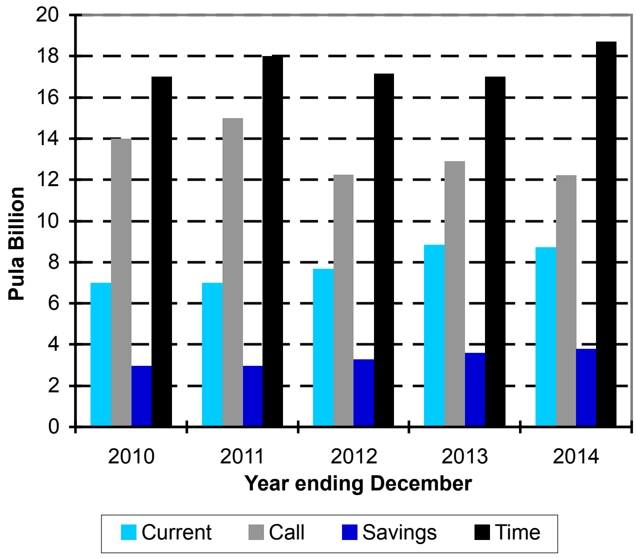


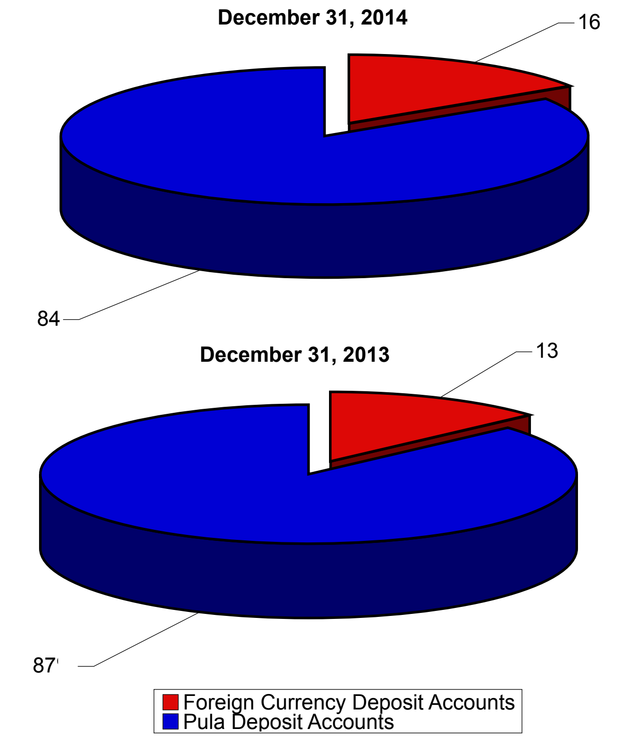
Chart 2.6: Share of Value of Deposits by Type



Capital Adequacy (Solvency): Levels, Quality and Trends

The banking sector remained adequately capitalised and all banks complied with the minimum statutory and prudential capital requirements; banking industry average capital adequacy ratio stood at 18.9 percent. The banking sector total unimpaired capital increased by 11.5 percent to P8.4 billion in December 2014 (December

Chart 2.7: Foreign Currency and Pula Denominated Deposits to Total Deposits (Percent)



2013: P7.5 billion). The increase was mainly due to a 12.2 percent rise in the stated capital, which was contributed by two newly licensed banks. The two banks commenced operations in the second half of 2013. The other contributing factor was the 22.5 percent rise in the eligible subordinated debt to P1 billion in December 2014. Overall, the banking sector capital was of high quality as Tier I capital components constituted 70.4 percent of total unimpaired capital, which was mostly from retained earnings and stated capital. Total Tier II capital stood at P2.5 billion, with subordinated debt comprising 41.9 percent of the total amount, and unpublished profits for 2014 at P970.8 million or 39.3 percent of Tier II capital. Chart 2.8 shows the industry capital adequacy ratios.

Composition of Statement of Comprehensive Income (Industry Income Statement)

The banking sector total annual income (net-interest and non-interest income) decreased by 2.5 percent from P5.6 billion in 2013 to P5.4 billion in 2014. This decrease was mainly due to the 7.4 percent drop in net interest income on account of income received from trading and investment securities, having gone down by

Chart 2.8: Capital Adequacy Ratios

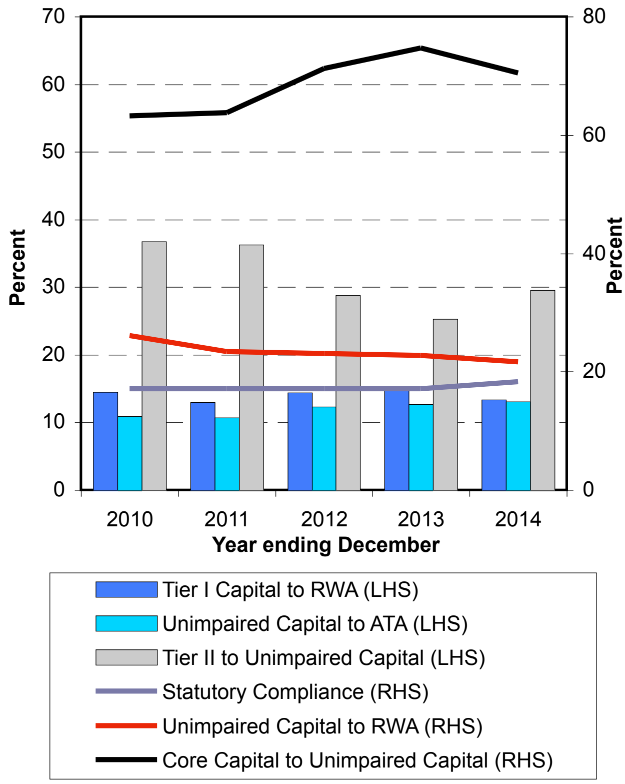
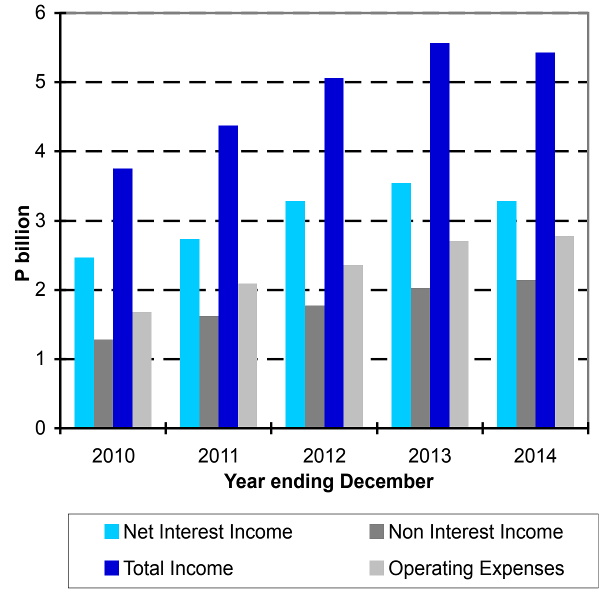


Chart 2.9: Composition of Income and Expenses



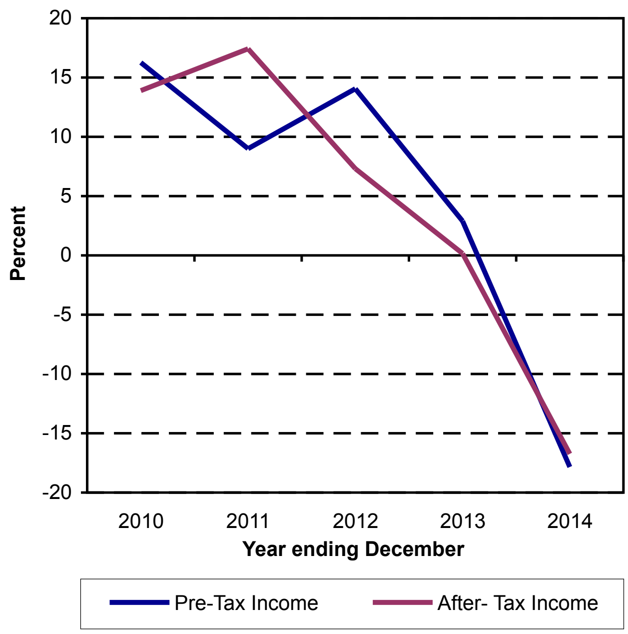
more than half to P261.9 million in 2014 and interest income from loans and advances having decreased by 3.2 percent. On the other hand, non-interest income increased by 6 percent to P2.2 billion in December 2014 (December 2013: P2 billion), with the bulk of the non-funded income derived from fees on foreign exchange trading. The increase in non-interest income was, however, lower than the 14.2 percent growth recorded between 2013 and 2012, mainly due to the effects of the two-year freeze on upward adjustment of bank charges and fees effective January 1, 2014. Furthermore, net interest income, as a proportion of total income, maintained a five-year downward trend to a low of 60.4 percent in December 2014 (Table 2.1). On the other hand, the banking sector Cost to Income ratio increased to 51.2 percent in December 2014 (December 2013: 48.6 percent) due, in the main, to subdued income. Chart 2.9 shows the trends and composition of income and expenses for the banking sector over the five-year period.

Levels and Trends of Profitability

The banking sector after-tax profit decreased by 16.7 percent to P1.5 billion for the period ended December 31, 2014 (December 2013: P1.8 billion). This contrasted with a positive growth rate of 0.1 percent in 2013.

Chart 2.10 shows the industry growth rate of pre-tax and after-tax profit.

Chart 2.10: Industry Growth Rates of Pre-Tax and After-Tax Profit



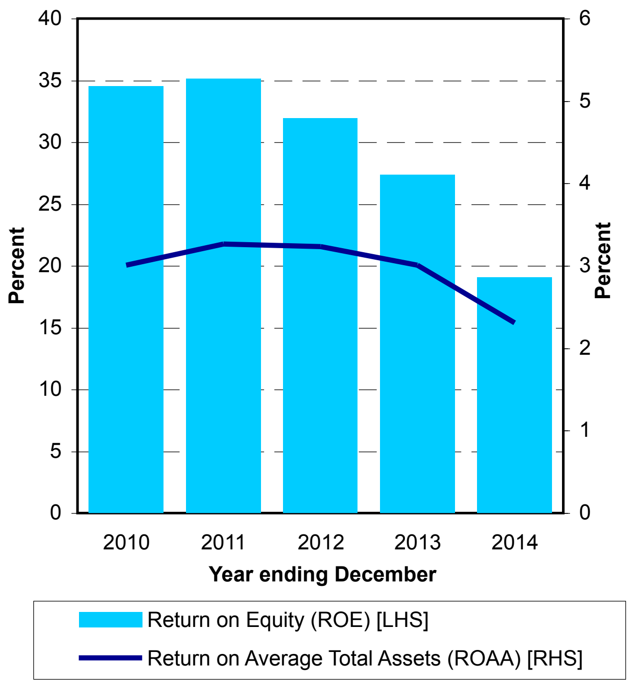
The prevailing low interest rate environment in the country coupled with a 31.2 percent increase in the total provisions charge for loan impairments to P760 million in December 2014 compared to P579.4 million in 2013, contributed to the decline in profits.

Profitability and Operating Efficiency Indicators

Profitability Indicators

The profitability of banks, as measured by Return on Equity (ROE) and Return on Average Total Assets (ROAA) - (Chart 2.11 below), experienced a downward trend, partly due to a 16.7 percent decline in net profit after tax. ROE, which is a measure of the efficient use of shareholders' funds, decreased from 27.4 percent in 2013 to 19.1 percent in 2014. ROAA decreased to 2.3 percent in December 2014 (December 2013: 3 percent). These profitability ratios remained strong and above international norms for comparable sized banks, despite their downtrend.

Chart 2.11: Profitability Indicators



The Net Interest Income to Average Total Assets (ATA) ratio decreased to 5.1 percent in December 2014, from 6 percent in December 2013, which reflects the banking sector's declining efficiency in the employment of banks' assets to generate income. The Non-Interest Income to Total Income ratio increased to 39.6 percent in 2014 from the previous year's 36.4 percent.

Operating Efficiency Indicators

Table 2.2 shows a five-year trend of operational and allocative efficiency ratios for the banking sector. Net interest margin was 5.8 percent in 2014, down from 8.2 percent recorded in 2012 and 2013. The net spread also decreased to 6.2 percent in the year under review, compared to 7.9 percent in 2013. The decline in net spread was due to the 3.2 percent reduction in interest on loans and advances, compared to a 3.9 percent increase in interest paid on deposits. The Net Income to Employee Costs ratio also declined from 142.2 percent in 2013 to 107.9 percent in 2014, largely due to an increase in staff salaries and recruitment**.** Net income generated by each staff member also decreased to P317 600 in December 2014 (December 2013: P390 400).

Credit Risk Assessment and Asset Quality

Asset Quality: Levels and Trends

The banking sector gross loans and advances increased by 14.2 percent to P45.1 billion, as at December 31, 2014 (December 2013: P39.5 billion), while total industry deposits increased at a slower rate (6 percent). Consequently, the financial intermediation ratio (Loans to Deposits Ratio) reached a high of 87.6 percent in

Table 2.1: Financial Performance Ratios (Percent)

	2010	2011	2012	2013	2014
Income on Investments and Securities to Total Income	25.6	21.8	8.3	11.3	4.5
Non-Interest Income to Total Income	34.3	37.3	35.1	36.4	39.6
Net Interest to Total Income	65.7	62.7	64.9	63.6	60.4
Return on Equity (ROE)	34.6	35.2	31.9	27.4	19.1
Return on Average Total Assets (ROAA)	3.0	3.3	3.2	3.0	2.3
Net Interest Income to Average Total Assets	5.3	5.4	6.0	6.0	5.1
Interest Income to Average Earning Assets	11.2	11.5	11.9	11.8	8.8
Non-Interest Income to Average Total Assets	2.8	3.2	3.2	3.4	3.4
Interest Expense to Average Total Assets	3.8	3.3	2.7	2.7	2.6
Earnings Retention	57.1	48.0	92.8	69.9	70.1
Interest Income on Loans to Average Total Assets	6.2	6.6	7.5	7.7	6.9
Non-Interest Expense to Average Total Assets	3.6	4.1	4.3	4.6	4.3
Gross Interest Income to Average Total Assets	9.1	8.7	8.7	8.7	7.7

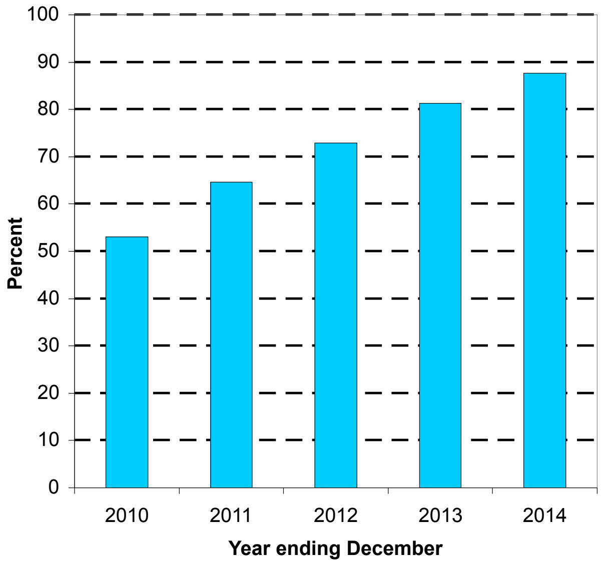
Table 2.2: Other Banking Sector Efficiency Measures

	2010	2011	2012	2013	2014
Average Cost of Deposits*	3.5	3.4	3.0	3.0	2.9
Return on Loans and Advances*	13.9	13.4	13.3	12.4	10.4
Net Interest Margin*	6.5	7.2	8.2	8.2	5.8
Net Spread*	9.6	8.3	8.6	7.9	6.2
Cost to Income*	44.8	47.9	46.7	48.6	51.2
Net Income to Employee Costs*	178.1	168.7	156.4	142.2	107.9
Net Income Per Employee (P'000)	346.9	387.0	404.9	390.4	317.6
Staff Cost Per Employee (P'000)	194.8	229.4	258.8	274.5	294.4
Asset Per Employee (P'000)	12,226	12,090	13,238	13,190	14,610

* Percent

December 2014 (December 2013: 81.3 percent), as shown in Chart 2.12. The ratio remained above the 50-80 percent range recommended for banks operating in Botswana and precipitated short-term liquidity pressures in the market.

Chart 2.12: Industry Loans and Advances to Deposits Ratio (Financial Intermediation)

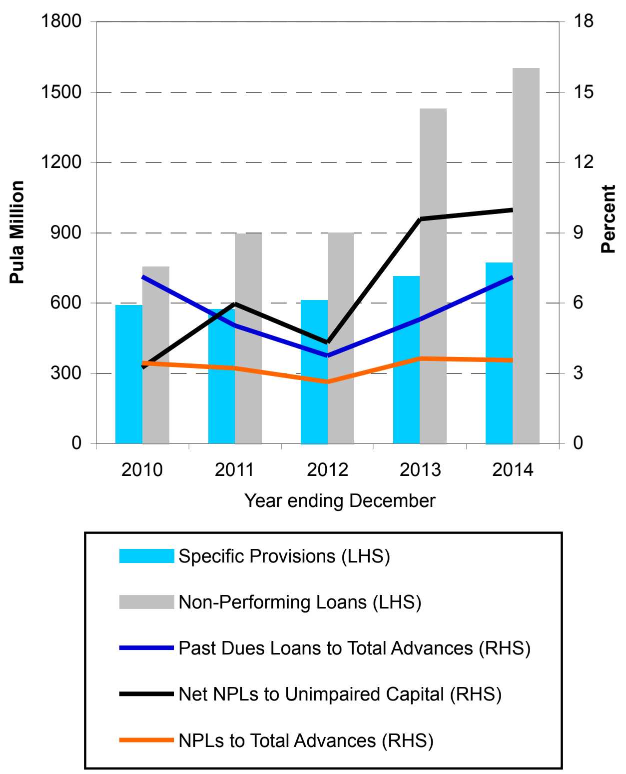


There was an upward trend in both the level of total past due loans and non-performing loans (NPLs).

The rise in the NPLs negatively impacted on the profitability of the banking sector, as banks had to provide for these impaired loans and advances, and thus contributed to the decrease in the banking sector's overall net profit after tax. Total past due loans (loans tainted by arrears) increased significantly by 52.9 percent to P3.2 billion in December 2014 (December 2013: P2.1 billion). NPLs also grew significantly by 12.1 percent to P1.6 billion as at December 31, 2014 (December 2013: P1.4 billion). The household sector continued to dominate the NPLs as they accounted for 51.3 percent of total NPLs.

The NPLs to Total Loans and Advances ratio ranged between 0.6 percent and 11.8 percent, while the average industry ratio remained constant at 3.6 percent in December 2014 as in 2013. The banking sector's specific provisions stood at P771.5 million as at December 31, 2014 and were inadequate as they could only cover 48.1 percent of NPLs. Furthermore, the NPLs (net of specific provisions) to unimpaired capital ratio increased to 10 percent in December 2014 from the 9.6 percent registered the prior year, which is an indication that the rising NPLs could adversely affect the capital levels of the banking sector. Chart 2.13 presents industry asset quality measures for the past five years.

Chart 2.13: Asset Quality Measures

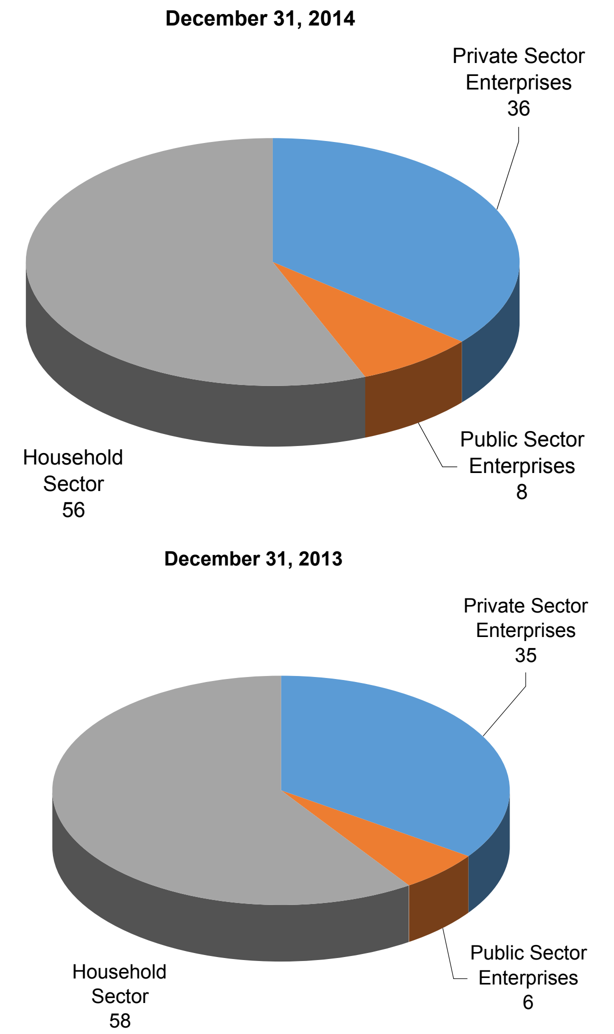


Concentration Risk

Sectoral Distribution of Loans and Advances

Chart 2.14 compares the sectoral distribution of loans and advances between 2013 and 2014. The sectoral distribution of loans and advances remained almost the same in 2014 as in the previous years, with the household sector accounting for the largest market share of 55.8 percent (P25.2 billion), albeit at decreased levels compared to 59.3 percent in 2013. Most banks' credit strategies were revised to reduce lending to the household sector and increase private sector loans and advances. As a result, the share of credit to the private and public sectors increased to 36 percent and 7.8 percent in 2014 (P16.2 billion and P3.5 billion), compared to 34.7 percent and 5.9 percent (P13.4 billion and P2.3 billion), respectively, in 2013.

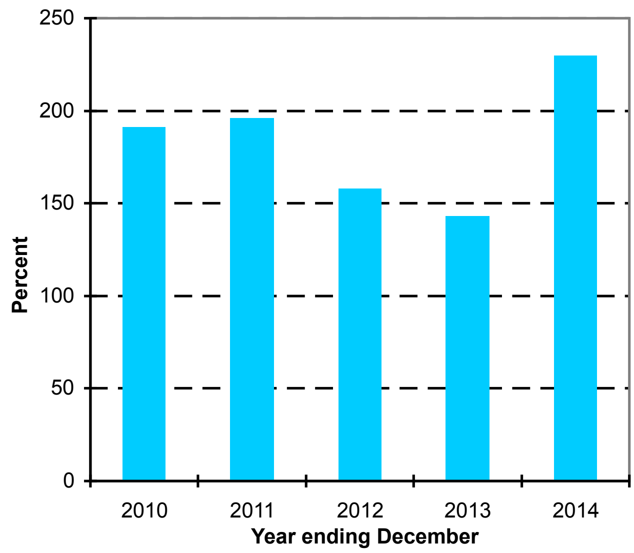
Chart 2.14: Sectoral Distribution of Loans and Advances: 2013 – 2014 (Percent)



The banking sector Large Exposures[8] to Unimpaired Capital ratio increased to 230 percent, thus reversing the decreasing trend which prevailed over the past two years (Chart 2.15). This increase was due to the significant increase of 79 percent in large exposures. All banks maintained their Large Exposures to Unimpaired Capital ratios within the recommended 800 percent prudential limit.

Chart 2.16 below shows a breakdown of the distribution of private sector enterprises loans and advances. The market share of five of the categories, namely; Real Estate, Construction, Mining and Quarrying; Tourism and Hotels; and Telecommunications; declined marginally. Manufacturing, Trade, Restaurants and Bars increased, while the other sectors' market share remained constant in 2014, compared to the previous year.

Chart 2.15: Industry Large Exposures to Unimpaired Capital Ratio

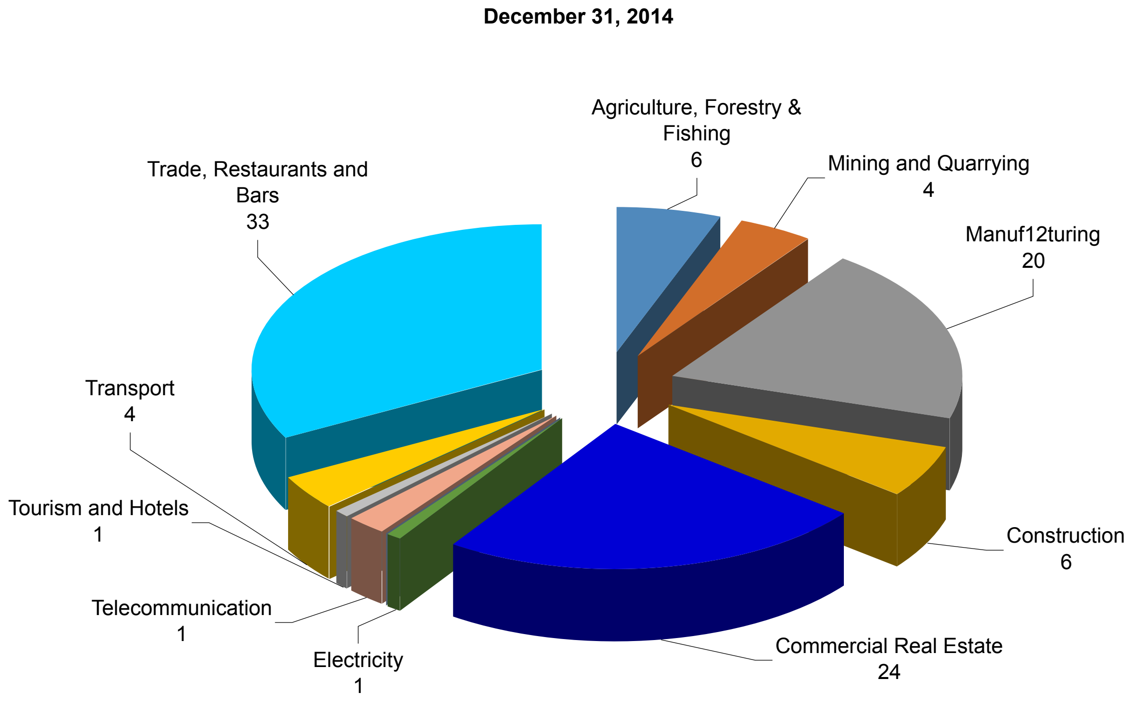


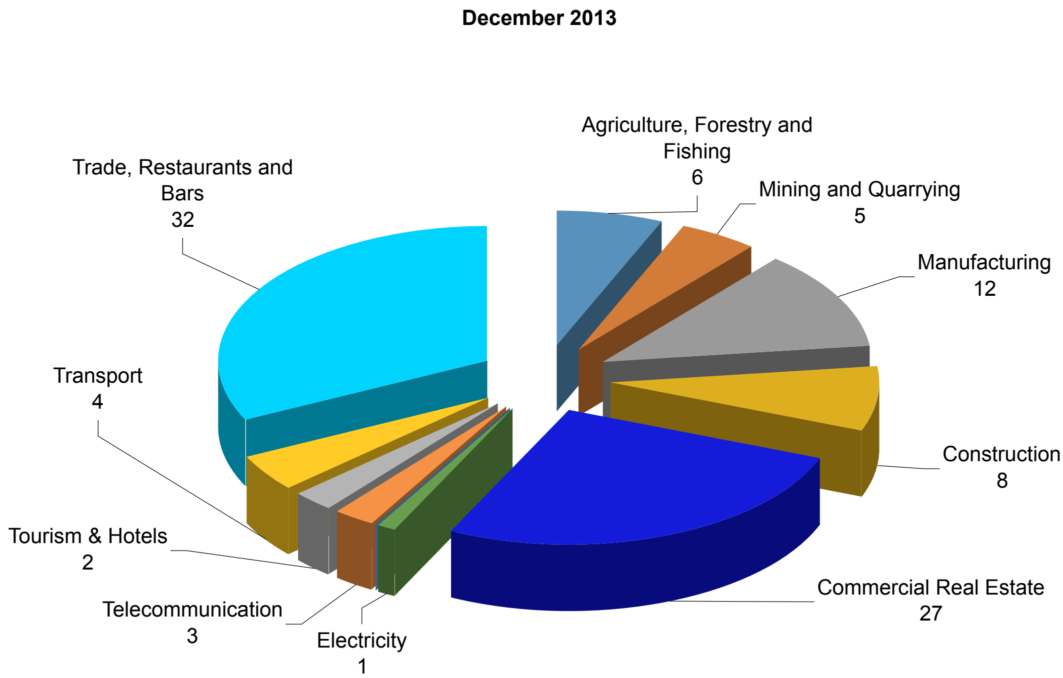
The Structure of Household Loans and Advances

Total credit to the household sector stood at P25.2 billion, which represented 55.8 percent of total loans and advances. As shown in Chart 2.17 below, the unsecured personal loans constituted the largest proportion of loans to the household sector, at 60.4 percent in December 2014; down from 62 percent in December 2013. This was followed by mortgage and motor vehicle loans at 30.5 percent and 5.7 percent, respectively.

8 These are loans and advances of 10 percent and above of a bank's unimpaired capital

Chart 2.16: Distribution of Private Sector Enterprise Loans: 2013 – 2014 (Percent)





Liquidity and Funding Risk

The banking sector total statutory liquid assets were almost constant at P7.4 billion for the period under review. Liquid assets comprised cash, BoBCs and current account balances with domestic banks. The Liquid Assets to Total Deposits ratio continued to be on a downward trajectory, reaching a low of 14.5 percent as at December 31, 2014. The ratio was, however, above the statutory minimum limit of 10 percent. Similarly, the Liquid Assets to Total Assets and Liquid Assets to Short Term Liabilities ratios maintained the downward trajectory. The decrease in these ratios was due to the continued decline in BoBC holdings by banks, which historically constituted a large proportion of banks' liquid assets. As a result, funds initially invested in BoBCs were channeled to loans and advances and other investment assets (mainly placements with foreign banks), which do not qualify as liquid assets. Charts 2.18 and 2.19 show the liquidity ratios and the level of BoBCs in the past five years.

Towards the end of 2014, some banks experienced sig-

CHART 2.17: THE STRUCTURE OF HOUSEHOLD LOANS AND ADVANCES: 2013 – 2014 (PERCENT)

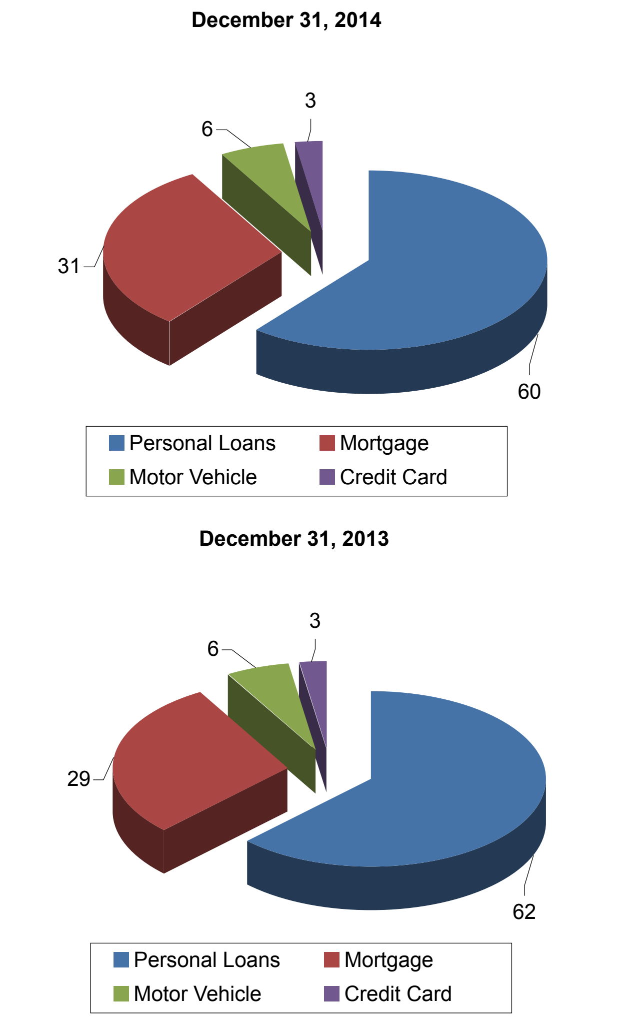


CHART 2.18: INDUSTRY LIQUIDITY RATIOS

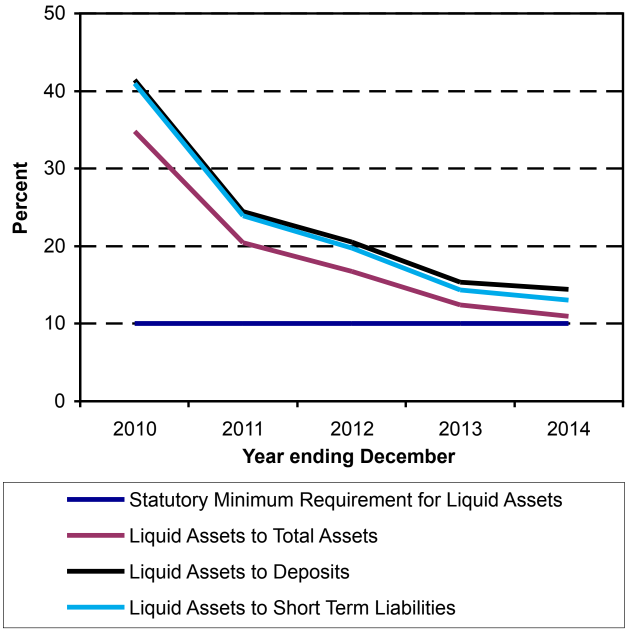
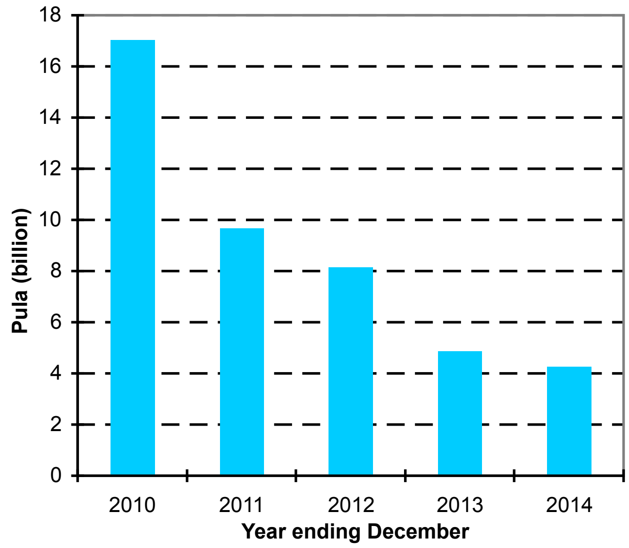


CHART 2.19: OUTSTANDING MARKET VALUE OF BOBCS HELD BY BANKS



nificant short-term liquidity shortages, to the extent that their Liquid Assets to Total Deposits ratio fell below the statutory prescribed limit of 10 percent. Consistent with Section 16(2) of the Banking Act, a monetary penalty fee of P892 263 was levied on all non-compliant banks.

The funding structure of the banking sector remained unchanged in the past five years. Customer deposits continued to be the main source of funding, as shown in Table 2.3. Customer deposits increased by 6 percent to P51.5 billion in December 2014 (December 2013: P48.6 billion); and decreased in terms of the share of total funding to 75.7 percent in 2014 compared to 81 percent in the previous year. Shareholders' funds increased by 19.2 percent to P7.7 billion in December 2014 (11.4 percent of total liabilities). The industry balances due to other banks (vostro and domestic balances) as an alternative source of funding registered a notable growth rate of 157 percent in contrast to a growth rate of 5.6 percent in 2013.

The sectoral distribution of total deposits remained highly concentrated in the private sector; its share increased from 59 percent in 2013 to 62 percent in 2014 (Chart 2.20). Similarly, the household sector gained a marginal increase in market share of total deposits from 24 percent in 2013 to 25 percent in 2014. The public sector enterprises market share of total deposits decreased to 13 percent in the year under review (December 2013: 17 percent).

Foreign Exchange Risk

Overall, all banks observed the prescribed limit of the

Table 2.3: Main Sources of Funding (P' million)

Category	2010	2011	2012	2013	2014
Deposits	41 628	43 178	47 219	48 589	51 492
Growth Rate (Percent)	10.7	3.7	9.4	2.9	6.0
Share of Total Funding	83.9	83.7	81.5	81.0	75.7
Other Liabilities	1 977	1 827	2 925	1 207	3 109
Growth Rate (Percent)	79.9	(7.6)	60.1	(58.9)	157.8
Share of Total Funding	4.0	3.5	5.0	2.0	4.6
Share Capital	4 069	4 696	5 548	6 479	7 724
Growth Rate (Percent)	34.1	15.4	18.1	16.8	19.2
Share of Total Funding	8.2	9.1	9.6	10.8	11.4
Due to other Banks	460	990	1 320	1 394	3 581
Growth Rate (Percent)	(32.3)	115.4	33.3	5.6	157.0
Share of Total Funding	0.9	1.9	2.3	2.3	5.3
Debt Securities and Other Borrowings	1 457	908	942	2 292	2 088
Growth Rate (Percent)	(10.1)	(37.7)	(53.5)	(21.2)	(8.9)
Share of Total Funding	2.9	1.8	0.7	0.6	3.1
Total Funding	**49 590**	**51 600**	**57 954**	**59 962**	**67 994**

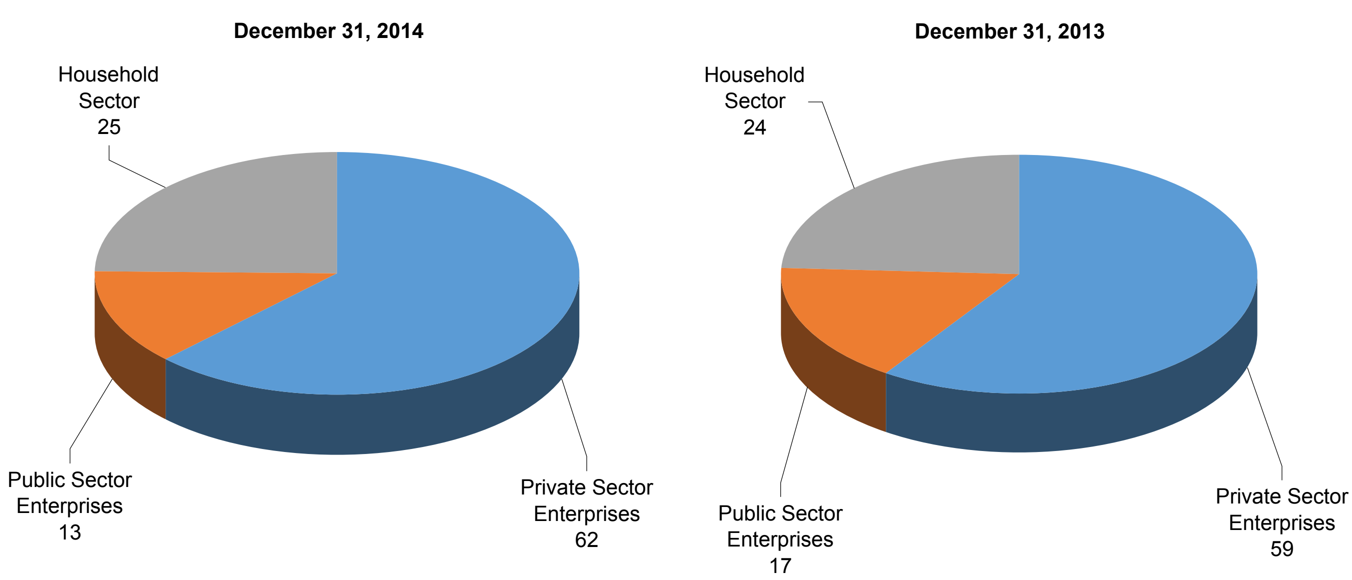
foreign Net Open Position to Unimpaired Capital ratio of 30 percent, with an aggregate industry ratio of 14.5 percent as at December 31, 2014, with one large bank having the largest Overall Net Open Position to Unimpaired ratio of 21.9 percent (December 2013: 24.3). All dealings in major and minor currencies were within the prescribed maximum limits of 15 percent and 5 percent of unimpaired capital, respectively. The USD dominated the foreign currency positions as at December 31, 2014.

Operational Risk

Internal controls

A review of the banks' internal controls by the external auditors, as highlighted in the management reports,

Chart 2.20: Sectoral Distribution of Deposits: 2013 – 2014 (Percent)



indicated that there were noted incidences of internal control deficiencies at banks. The deficiencies noted across the banks generally included reconciliations not performed in a timely manner, thereby resulting in long outstanding items in banks' books, which could lead to misstatements in banks' reports. There could also be incorrect recording of interest rates and charges for some customer accounts, thereby leading to over-charging customers; and non-deactivation of user profiles of some staff members who had left the banks, and this could lead to irregular or unauthorised transactions.

Fraud and Other Criminal Activities Prevalent in the Banking Sector

Incidents of fraud were reported across the banking sector. Most of the cases related to presentation of falsified documents by fraudsters and customers withdrawing funds against uncleared cheques, against accounts with insufficient funds. The increasing cases of identity cards theft and card fraud as well as falsification of documents in support of application for loans continues to be worrisome. Banks have been implored to enhance operational risk mitigation strategies to ensure safety of customer funds.

Performance of Statutory Banks

Statement of Financial Position Structure

The financial position of three statutory banks continued to trend upwards, as shown by a 12.6 percent increase in total assets from P5.9 billion in 2013 to P6.7 billion in 2014. The asset growth was primarily funded by deposits, which grew by 25.3 percent to P2.2 billion in 2014 (December 2013: P1.7 billion). The other funding source was borrowing from international lending agencies which increased by 13.4 percent to P1.1 billion (December 2013: P0.9 billion). Credit growth for statutory banks continued to be rapid in the past 5 years, and reflecting the 15.2 percent annual rate of growth, from P4.9 billion in 2013 to P5.6 billion in 2014.

Notwithstanding the above, statutory banks remain small compared to smaller commercial banks.

Earnings and Profitability

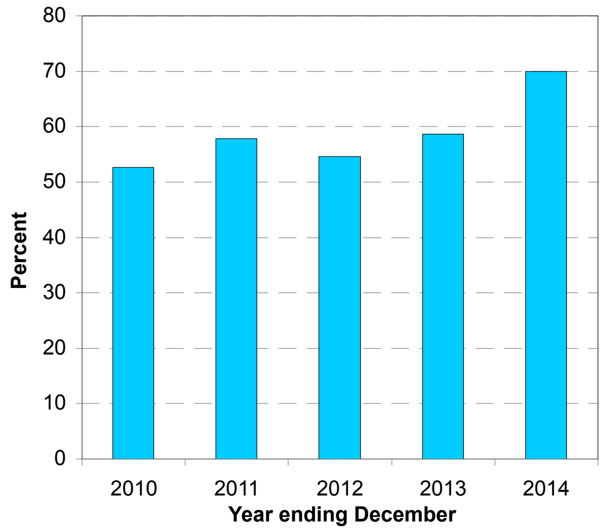
The aggregate net profit of the statutory banks in the five-year period had been fluctuating. In the year under review, it decreased to a low of P82 million (December 2013: P121 million). The decrease was on account of rising operating expenses and interest expenses, which increased by 3.4 percent and 7.1 percent, respectively. Statutory banks recorded a decline in interest income to P525 million compared to P561 million the previous year. Key profitability ratios declined to 1.3 percent for ROAA and 4.4 percent for ROE (December 2013: 2.2 percent and 6.5 percent, respectively). The Interest Income to ATA ratio also declined to 8.3 percent from 10.2 percent in 2013. Table 2.4 shows key performance indicators for statutory banks in the period 2010-2014.

The Cost to Income ratio of statutory banks increased significantly to 70 percent, compared to previous years when it was fluctuating between 50 percent and 60 per-

Table 2.4: Financial Performance Indicators for Statutory Banks

Indicator	2010	2011	2012	2013	2014
Net Income growth (Percent)	1.5	(17.0)	41.4	(0.2)	(32.6)
ROAA (Percent)	2.9	2.1	2.6	2.2	1.3
ROE (Percent)	7.1	4.7	7.4	6.5	4.4
Interest Income to ATA (Percent)	11.1	9.4	9.7	10.2	8.3
Interest Income to Average Earnings (Percent)	29.8	25.6	26.4	27.9	22.7
Cost to Income (Percent)	52.7	57.8	54.7	58.6	70.0
Total Assets (P' million)	3 762	4 252	5 099	5 938	6 689
Average Total Assets (P' million)	3 613	4 007	4 675	5 518	6 313
Unimpaired Capital (P' million)	1 461	1 815	1 634	1 860	1 860
Interest income (P' million)	402	377	455	561	525
Average Earning Assets (P' million)	1 350	1 470	1 722	2 007	2 316
Net Income (P' million)	103	86	121	121	82

Chart 2.21: Cost to Income Ratio



cent. The sharp increase of the ratio indicates that the banks' expenses increased by a wider margin compared to income growth in the period under review, as reflected in Chart 2.21.

An increase in Cost to Income ratios could mean a number of things, each presenting a different challenge or opportunity. For example, a significant increase of investment in infrastructure, such as branch network, technology, risk management systems and staff training and welfare could hike the Cost to Income ratio in the early years of the investment; it could be a future benefit. Conversely, failure to control operating costs, such as administrative expenses, could harm a bank's profitability. A reduction of income, as earnings capacity decrease, could also lead to an increase in Cost to Income ratio.

In each of the above scenarios, a careful assessment of the major drivers of an increasing Cost to Income ratio is necessary, in order to ensure that any efficiency in operations does not compromise sustainability of any of the banks.

Box 1: Update on Kingdom Bank Africa Limited (KBAL)

Introduction

The objective of this article is to provide a brief background on the circumstances that led to the temporary management and subsequent closure of Kingdom Bank Africa Limited (KBAL).

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

Operational and Financial Performance

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

KBAL continued to make losses despite the recapitalisation that was effected in 2005. The bank developed a turnaround strategy and engaged several potential external investors in 2013 and 2014, with a view to inject additional funds needed to execute the strategy. All the efforts aimed at turning KBAL into a viable financial institution were not successful. The failure of KBAL to find a long-term solution to the viability of its operations and its failure to honour deposit withdrawals created an uncertainty relating to its "going concern" status. In November 2014, the Bank concluded that KBAL had failed to undertake the business for which it was licensed in a safe, sound and sustainable manner. A letter was issued to the Chairman of the Board of KBAL on November 6, 2014, requesting a surrender of the banking licence, pursuant to Section 11(2) of the Banking Act (CAP: 46:04). KBAL declined the offer to surrender the licence, indicating that it was negotiating a transaction with identified potential investors based in South Africa. The Bank gave KBAL up to January 31, 2015 to come up with an acceptable recapitalisation plan. KBAL failed to meet the set deadline.

Temporary Management

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

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

Petition for Winding Up

On May 12, 2015, the Bank successfully petitioned the Lobatse High Court to wind up the operations of KBAL in terms of Section 34(d) of the Act, and two co-liquidators were appointed. Accordingly, the Bank has issued a public notice to inform depositors and other members of the public of this development. In accordance with Section 35(1) of the Act, the Bank has effectively assumed the role of Master of the High Court and the preparations to start the liquidation process were underway. KBAL has, therefore ceased to be a licensed bank in Botswana effective May 18, 2015.

Chapter 3: Licensing, Financial Inclusion and Consumer Protection Issues

Market Entry Enquiries and Licensing of New Banks

In the year under review, the Bank received six licensing enquiries and four licence applications from potential investors to establish banking business in Botswana.

One application was returned at the initial stage due to incomplete information, while three were processed and presented to the Bank's Board. Regarding the three applications, one was granted conditional approval[9], while the other two were found to be materially deficient and, therefore, declined at the Board meetings of February 20, 2014 and October 23, 2014.

Electronic Money and Financial Inclusion

Banks continued to introduce new products and enhance the quality of the services offered. These developments seem to indicate intensifying competition and efforts undertaken by banks to take advantage of the market and advancement in technology. The developments could also be attributable to the imposition of the freeze which restricted upward adjustment of bank charges and fees for a period of two years to end-2015, thus inevitably encouraging banks to be innovative. Some enhancements resulted in improved ATM card security features, introduction of ATM cash deposits functionality, as well as upgrading of internet banking which facilitated, inter alia, on-line account opening, payment of utilities and the purchase of electronic money vouchers. For the purpose of promoting the use of electronic banking, some banks introduced funding facilities for purchase of smart devices.

To guard against unreasonable pricing by banks, the Bank reviewed the fees associated with new products and services, prior to approval.

Table 3.1: Banking Sector Average Charges: 2013 – 2014 (Pula)

Service Charge Category	2013	2014
Accessibility Facilitation		
ATM Charges		
(i) Cash withdrawal (own account)	2.17	2.17
(ii) Lost card replacement	59.86	59.86
Internet Banking Charges		
(i) Monthly fees	167.55	167.55
(ii) Transfers	3.48	3.48
Investment/Intermediation		
(i) Personal loan – Arrangement fee (Max)	2345.54	2345.54
(ii) Vehicle/Asset finance – Arrangement fee	652.91	652.91
Trade Facilitation		
(i) Commission on purchase of foreign currency	21.16	21.16
(ii) International SWIFT transfer	305.71	305.71
(iii) Advisory fees on Letters of Credit	216.96	216.96
Payment and Clearing Charges		
(i) Bank cheque	73.49	73.49
(ii) Unpaid cheque due to lack of funds	220.38	220.38

9 The conditional approval was revoked due to lack of formal communication from the Central bank of the applicant.

Policy on Bank Charges and Selected Banking Sector Average Charges

In compliance with a two-year freeze on upward adjustment of bank charges which began in January 2014, no bank submitted any tariff schedule for review, save one newly licensed bank that submitted its initial tariff structure for approval in April 2014. However, banks were allowed to introduce new products and services and their specific charges were reviewed and approved. Banks continued to be largely compliant with the minimum public disclosure and statutory requirements on bank charges by publishing, on a monthly basis, interest rates payable on deposits on their websites, as well as in at least two newspapers widely circulating in Botswana. This arrangement is intended to assist customers in making informed decisions, as they will have access to information on the cost of banking services in Botswana. As shown in Table 3.1 below, the selected average banking charges remained unchanged in 2014.

Consumer Complaints Management

The Bank received and processed 14 consumer complaints during 2014. Five complaints were successfully resolved, while one was referred to the Banking Adjudicator, three required legal intervention. The remaining five which were being processed by the Bank as at December 31, 2014, have since been completed except for one. The complaints related to, inter alia, unauthorised ATM transactions, multiple loan installment deductions and irregularities in clients' accounts that led to loss of funds. The most recurring complaints across the sector were in respect of unauthorised ATM transactions.

Abandoned Funds

The Bank continued to receive, process and administer abandoned funds from commercial banks in accordance with Section 39 of the Banking Act. As shown in Table 3.2 below, the balance of abandoned funds amounted to P5 052 907 in 2014, compared to P8 151 262 in 2013. The substantial decrease in the balance followed the transfer of abandoned funds to the Guardian Fund in terms of Section 39 of the Banking Act which increased sharply by 184 percent to P3 901 831 in 2014 (December 2013: P1 371 515). Abandoned funds received from commercial banks decreased by 31 percent from P1 547 175 in 2013 to P1 066 895 in 2014. On the other hand, abandoned funds claims increased marginally by 0.3 percent from P262 652 to P263 419 in the period under review.

Table 3.2: Abandoned Funds (Pula)

	2013 Pula	2014 Pula
Balance Brought forward	8 238 254	8 151 262
Funds Received	1 547 175	1 066 895
Claims Paid Out	(262 652)	(263 419)
Transfer to Guardian's Funds	(1 371 515)	(3 901 831)
Balance at Year-end	**8 151 262**	**5 052 907**

Chapter 4: International Best Practices on Banking Supervision

A. Basel II Implementation: Basel I and Basel II Parallel-Run

The parallel-run of Basel I and Basel II standardised approaches commenced on January 1, 2014, as planned. The intention of the parallel-run was to assess the likely impact and implications of the new capital rules on banks' capital and other financial soundness indicators. The full implementation of Basel II, which was initially planned to commence on January 1, 2015, was postponed to January 1, 2016. The postponement was intended to ensure accuracy and consistency of data reported by banks prior to full implementation.

Bilateral meetings with individual banks and workshops on Basel II related issues continued to be held with banks during the year, in an effort to prepare the banking sector for full implementation of the new capital rules.

B. Developments at the Bank for International Settlement (BIS)[10]

Following the introduction of the Basel III capital standards, the focus of the Basel Committee on Banking Supervision (Committee) has been on establishing the effectiveness and consistency of application of these post-crisis regulatory reforms across jurisdictions. As such, the Committee's main agenda has been to assess whether the Basel III reforms were achieving their intended objective to strengthen regulation and practices of banks worldwide and enhancement of financial stability, promotion of public confidence in regulatory capital ratios, as well as encouragement of a level playing field for internationally active banks.

The process started in 2012, when the Group of Twenty (G20)[11] endorsed the Committee's adoption of a comprehensive Regulatory Consistency Assessment Programme (RCAP) to assess the implementation of the Basel framework across jurisdictions.

Through the RCAP, the Committee conducts studies, the findings of which inform on areas that have deficiencies, hence the Committee's on-going review of the regulatory standards. By the end of 2014, the Committee had made several reviews on existing regulatory standards and was consulting on other areas of regulation that needed strengthening.

By December 2014, the Committee was consulting on the following:

(a) the design of a capital floor framework based on the Basel II standardised approaches. This framework will replace the current transitional capital floor used in Internal Ratings-Based (IRB) models, which is based on Basel I standards;

(b) revisions to the standardised approach to credit risk; the proposal seeks to reduce reliance on external credit ratings, increase granularity, strengthen the link between the standardised and IRB approaches, and enhance comparability of capital requirements across banks;

(c) fundamental review of the trading book: outstanding issues; a limited set of revisions to the Committee's revised market risk framework, which was published in October 2013;

(d) proposed criteria for identifying simple, transparent and comparable securitisations;

(e) ongoing consultation on revisions to the simpler approaches for measuring operational risk capital requirements. The revised standardised approach will replace the current Basic Indicator Approach, the Standardised Approach and the Alternative Standardised Approach for measuring operational risk;

(f) Net Stable Funding Ratio (NSFR) Disclosure Standards; and

(g) proposed changes to the Pillar 3 disclosure requirements.

The Committee also finalised the following additional regulatory standards in the reporting period:

10 Source: www.bis.org

11 G20 is an international forum for the governments and central banks governors from 20 major economies. The members include 19 individual countries—Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States—along with the European Union (EU). The EU is represented by the European Commission and by the European Central Bank.

(a) the capital frameworks for global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs);

(b) capital requirements for bank exposures to central counterparties;

(c) a supervisory framework for measuring and controlling large exposures;

(d) the leverage ratio disclosure requirements;

(e) liquidity coverage ratio (LCR) disclosure standards;

(f) the Standardised Approach for measuring counterparty credit risk exposures, which replaces both the current exposure method and the standardised method;

(g) revisions to the securitisation framework;

(h) the Net Stable Funding Ratio (NSFR); and

(i) restricted-use committed liquidity facilities.

During 2014, the Committee issued guidance for supervisors on:

(a) sound management of risks related to money laundering and financing of terrorism;
(b) principles for effective supervisory colleges;
(c) fundamental elements of a sound capital planning process;
(d) guidelines for external audit of banks;
(e) proposed revisions to supervisory guidelines for identifying and dealing with weak banks;
(f) review of the principles for the sound management of operational risk; and
(g) proposed revisions to the corporate governance principles for banks.

Overall, by the end of 2014, the Committee had largely completed its post-crisis reform agenda. Finalising these standards and guidance are an important step for the Committee in completing its crisis-related reforms which, once implemented, will establish a stronger and more resilient banking system. In addition, once the post-crisis agenda is completed, individual countries would be able to focus on monitoring the implementation of these reforms, which is one of the key priority areas of the Committee.

BOX 2: ENHANCING OFF-SITE SURVEILLANCE – BOTSWANA PERSPECTIVE

The Bank uses an array of supervisory techniques, including on-site examinations and off-site monitoring. On-site examination involves a comprehensive review of a bank's operations by Bank Examiners at the bank premises. The Examiners evaluate financial reporting and internal controls, asset quality and risk management practices at a bank; management and management information systems. Off-site monitoring complements on-site examinations by continually providing updated information on the condition of a bank, based on monthly and quarterly submissions to the Bank of Botswana of statutory returns (balance sheet and comprehensive income statements). Globally, bank regulators have come up with supervisory tools that enhance their off-site examination process, commonly known as off-site surveillance systems. There are three tiers of these systems, namely, Off-site Rating System (ORS), Financial Ratio and Peer Group Analysis (FRPGA) and Statistical Models (SMs), in descending order of their complexity. The ORS provides a weighted rating for a bank using a few indicators of financial soundness. The FRPGA employs, on average, 50 indicators to assess the financial soundness of an institution. It basically identifies outliers and makes a comparison of a bank's condition to its past performance (trend), other banks (peer review) and to the established benchmarks and thresholds (level). These two systems are mostly adapted from the common CAEL system adopted in US in the early 1980s.[12] The third tool is statistically advanced and uses quantitative techniques to predict a bank's condition. Of these, the Bank of Botswana has chosen a hybrid of the ORS and FRPGA tools to improve its off-site monitoring process.

The Bank's off-site surveillance system (OSS) is a quarterly monitoring tool that rates and ranks banks based on an assessment of 32 financial soundness indicators or ratios. It is an adaptation of the traditional CAMELS rating system and weighs the components, relative to their current industry importance to financial soundness.[13] Within the OSS, market risk and earnings components attract the least weights of 10 percent and 15 percent, respectively, while the other three components each weigh 25 percent of the overall OSS score. Presently, the industry's exposure to market risk is considered insignificant, while earnings are perceived to be a function of asset quality, hence the respective lower weights on these components.

FIGURE 1: OSS RATING CATEGORIES

Rating Category	Rating Interpretation
Strong (Band 1)	Strong performance. Sound Management. No cause for supervisory concern
Adequate (Band 2)	Fundamentally sound. Compliance with regulations. Stable. Limited supervisory needs.
Partially Adequate (Band 3)	Weaknesses in one or more components, unsatisfactory practices, weak performance but limited concern for failure.
Weak (Band 4)	Serious financial and managerial deficiencies. Unsound practices. Need for close supervision and remedial action.

Rating	Strong		Adequate		Partially Adequate		Weak	
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	2.0	2.5	3.0	3.5	4.0	4.5

12 CAEL stands for Capital, Asset quality, Earnings and Liquidity. The framework quantitatively assesses a bank's financial soundness based on periodic data submitted to the regulators.

13 The OSS is dynamic and would be appropriately adjusted as and when industry conditions change.

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 (see illustration above). This rating methodology was developed based on the Botswana banking sector data and, therefore, factored in the country and sector-specific variables affecting local banking business.

Overall, the system provides bank ratings, rankings (peer analysis), trend (compares bank ratio with past) and level (compares a ratio to the prudential or statutory benchmark). It is expected that this system will bring a wealth of benefits in terms of tracking financial soundness and, accordingly, trigger appropriate supervisory reaction to systemic and idiosyncratic conditions. In particular, the OSS results will feed into preparations for the annual statutory meetings with banks and external auditors. It is also expected to easily blend with other supervisory approaches within the Department, especially risk-based supervision.

Chapter 5: Summary of Key Issues Arising from On-Site Examinations and Off-Site Surveillance Activities

A. Examinations of Commercial Banks

The Bank carried out pilot full-scope risk-based supervision on-site examinations at two banks during the year ended December 31, 2014. In addition, follow-up examinations were conducted at two other banks. The scope of the examinations covered those areas that were considered to present the greatest risk to the banks, and compliance with Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) requirements.

The banks ceased submitting Suspicious Transactions Reports (STRs) to the Bank, and instead began to avail the reports to the Financial Intelligence Agency (FIA) in 2014. The cessation of submitting STRs to the Bank is in accordance with best international practice and Recommendation 29 of the Financial Action Task Force of February 2012, which stipulates that such reports should be filed with the country's Financial Intelligence Unit. FIA shall be the central unit responsible for requesting, receiving, analysing and disseminating to an investigatory authority, supervisory authority or comparable body, disclosures of financial information concerning suspicious transactions.

The full-scope examinations revealed that the two banks had effective internal controls. However, it was observed that they both had matrix reporting structures and these arrangements could marginalise both the local Boards and the Chief Executive Officer/Managing Director in the decision-making processes. Furthermore, it was observed that governance structures were characterised by cross-membership in the two banks' Board committees. The Bank concluded that having the same people sitting in all Board committees compromises independence and credible checks and balances for effective oversight of the concerned banks. The banks were directed to correct this anomaly.

In addition, the on-site examinations revealed that there was no individual assessment of Board members at the two banks. Instead, performance appraisals were conducted holistically, and this could hinder effective assessment of each member's level of contribution to Board affairs. Also, the examination revealed that the Head of the Internal Audit position at one of the large banks had been vacant for a protracted period of time, and this compromised the effectiveness of the internal audit function.

One large bank experienced numerous operational challenges following the roll-out of a new core banking IT system, in 2013. These problems, which resulted in increased customer complaints in 2014, included duplication of payments, indecipherable narration of transactions, disputed balances, failed payments and erroneous calculation of interest. In addition, on-site visits at the various branches revealed that there were no business continuity contingency plans at two of its branches.

With respect to another large bank, it was observed that, although its core banking system was considered satisfactory, there was concern that the continued location of the Disaster Recovery Centre outside the country could expose the bank to undue geo-political risks. The bank's branch network connectivity experienced disruptions whenever there were problems with the national telecommunications network. In addition, the system tended to be slow during peak periods, thus resulting in long queues at branches. Most of the customer complaints at this large bank related to unreconciled deductions from ATMs transactions and stop-order deductions effected even when customer loans had been cleared.

The two banks had AML/CFT policies which were duly approved by the respective Boards. The two banks' AML/CFT policies adequately covered customer due diligence matters, record-keeping and reporting of STRs.

These banks also had AML/CFT training programmes, which were implemented at all the branches. The employees of the two banks could enroll for on-line based training modules to enhance their awareness on AML/CFT issues.

B. Consultative and Prudential Meetings and Salient Features from Off-Site Monitoring

The two semi-annual Banking Committee meetings scheduled for 2014 were duly held and discussions centred mainly on fraud relating to the falsification of documents to obtain loans, which could lead to legal cases. Also, there was concern regarding wide interest rate spreads and low deposit interest rates in the market, which are detrimental to depositors, as well as adversely affecting deposit mobilisation. Banks also made a joint representation on tight liquidity conditions.

All statutory bilateral audit plans and trilateral meetings were held in 2014, where banks outlined their business strategies and presented their financial year-end results. Furthermore, consultative meetings were held with banks with the aim of gauging their preparedness for Basel II implementation in 2016.

The Bank participated in two supervisory colleges for African Banking Corporation Holdings Limited (ABCH) and Barclays Africa Group Limited in Harare (Zimbabwe) and Pretoria (South Africa), respectively, and discussed the two banks' compliance with supervisory and regulatory requirements in their respective supervisory jurisdictions.

The Banking Supervision Department continued to monitor the performance of the banking sector through statutory returns that are submitted on a weekly, monthly and quarterly basis. Overall, banks were found to be financially sound and well managed, except for Kingdom Bank Africa Limited, whose financial condition had deteriorated; its "going concern" status could no longer be guaranteed in the short to medium term. In accordance with Section 35(1) of the Act, the Bank assumed the role of Master of High Court and the preparations to start the liquidation process of KBAL were underway. KBAL has, therefore, ceased to be a licensed bank in Botswana effective May 18, 2015.

Box 3: Implementation of Risk-Based Supervision (RBS) in Botswana

Changes in the environment within which banking institutions operate is increasingly becoming more complex and dynamic, and it impacts on the way banking institutions conduct their business. In addition, technological advances and introduction of new banking products, which normally characterise the complexity and dynamism of financial markets, bring about changes in the risk profiles of these institutions which, in turn, call for improved risk management systems by these institutions as well as enhanced prudential supervision methods. Banks need to understand the risks associated with the technological advances and product innovations they are adopting and devise ways to effectively manage risks. Equally, supervisors should continually enhance the traditional supervisory process to ensure that it effectively incorporates supervision of risk management systems in banking institutions.

The adoption of RBS has a number of benefits. RBS places strong emphasis on understanding and assessing the adequacy of each financial institution's risk management systems. It also stresses the process of risk identification, measurement, monitoring and control on an on-going basis. As a result, a supervisor following RBS will identify banks in which risks are greatest, identify within each bank those areas or activities in which risks are high and apply supervisory resources to assessing and measuring those risks. In this regard, RBS emphasises the development of a customised supervisory programme for each bank and focuses much attention on banks that are considered to have potentially high systemic risk. Therefore, it enables the supervisor to prioritise efforts and focus on significant risks by channeling available resources to banks where risk profile warrants greater attention. RBS results in an effective and efficient process for monitoring and assessing, on an on-going basis, the safety and soundness of banks.

The basic framework for RBS as adopted by the Bank includes:

(a) understanding the financial institution – (institutional profile);

(b) assessing the financial institution's risk profile – (risk matrix and risk assessment narrative);

(c) planning and scheduling supervisory activities – (supervisory plan);

(d) defining examination activities – (scope memorandum);

(e) performing on-site examination – (on-site examination);

(f) determining and communicating the supervisory findings – (examination report); and

(g) conducting off-site supervision – (off-site reports and update institutional profile).

The approach is anchored on evaluating the following key elements of an effective risk management framework:

(a) active board and senior management oversight;

(b) adequate policies, procedures and limits;

(c) adequate risk monitoring and management information systems; and

(d) comprehensive internal control systems.

A risk-based supervision framework is in line with the Basel Core Principles for Effective Banking Supervision and the Supervisory Review and Evaluation Process (SREP) in Basel II, which require the supervisory authority to be satisfied that financial institutions have in place a comprehensive risk management process, to be able to identify, measure, monitor and control all material risks and, where appropriate, to hold adequate capital against such risks.

The goal of RBS is not to attempt to limit risk-taking by financial institutions, but rather to ensure that institutions understand and control the types and levels of risks they assume. The assessment of risk incorporates both a current and prospective view of the institution's risk profile. The specific objectives for the RBS approach are:

(a) to promote a safe and sound financial system by assessing how well financial institutions manage risk;

(b) to focus on qualifying problems by identifying system flaws and poor management practices that cause both current and potential problems;

(c) to enable examiners to identify problems and their root causes and carry out a proper evaluation of the institution's risk management; and

(d) to develop a common framework and terminology for practicing and communicating assessment of risks in the financial system.

The major output of RBS is a bank's supervisory plan which outlines the planned supervisory activities for a bank over a given period of time. The supervisory plan identifies significant risks, issues of supervisory concern, and the activities to be conducted at a bank during a given period of time. The supervisory plan is established every year with results obtained from the off-site surveillance (OSS) and CAMELS and risk assessment rating systems (RAS) assigned to a bank during the previous on-site examination. The Table below shows the frequency of the bank's prudential meetings and/or on-site examinations, which is based on the bank's assigned CAMELS rating.

To ensure that all banks are able to identify, measure, monitor and control risks effectively on an on-going

On-site and Off-site Composite CAMELS Ratings	Frequency of Prudential Meetings	Frequency of On-site Examinations
Strong "1"	Yearly	Within 24 months
Satisfactory "2"	Half-yearly	Within 18 months
Fair "3"	Quarterly	Within 12 months
Weak "4"	Quarterly	Within 6 months
Critical "5"	Quarterly	Within 6 months

basis in 2015, the Bank will develop and issue to the banking sector draft risk management guidelines covering material banking risks; namely, strategic, compliance, credit, liquidity, interest rate, foreign exchange and operational risks.

Chapter 6: Performance of Non-Bank Financial Institutions

A. Bureaux de Change Activities

In the year under review, three bureaux de change were licensed and commenced operations. The Bank revoked the licences of four bureaux de change; for three of them due to violations of the provisions of the Bank of Botswana (Bureaux de Change) Regulations, 2004; while for one, it was failing to commence operations after being granted permission to temporarily close the operations. These changes resulted in the number of bureaux decreasing marginally to 56 in 2014, compared to 57 in 2013.

B. On-site Examinations of Bureaux de Change

On-site examinations of seven bureaux de change were carried out in 2014. The examinations revealed that the bureaux de change violated some provisions of the Bank of Botswana (Bureaux de Change) Regulations, 2004. These violations included, among others, breaches of Regulations 5(2)(c) and (d) (maintenance of minimum balances); Regulation 5(2)(e) (composition of shareholders or principal officers); Regulations 12(2)(a), (d) and (e), which relate to Anti-money Laundering measures; Regulation 13 relating to transaction limits; Regulation 16, which deals with submission of accurate consolidated monthly purchases and returns; and Regulation 18(5), which requires auditing of books of accounts and submitting them to the Bank.

C. Off-site Examinations of Bureaux de Change

As shown in Charts 6.1 and 6.2, the South African rand (ZAR) and United States dollar (USD) continued to dominate the bureaux de change foreign currency transactions. An upward trend in sales and purchases at bureaux de change has also been noted in 2014 (Chart 6.3). Total foreign currency sales and purchases at bureaux de change increased by 9.9 percent and 9.3 percent, respectively, in 2014, compared to the increase of 18.6 percent and 17.3 percent, respectively, reported in 2013.

Chart 6.1: Bureaux de Change Sales of Foreign Currency

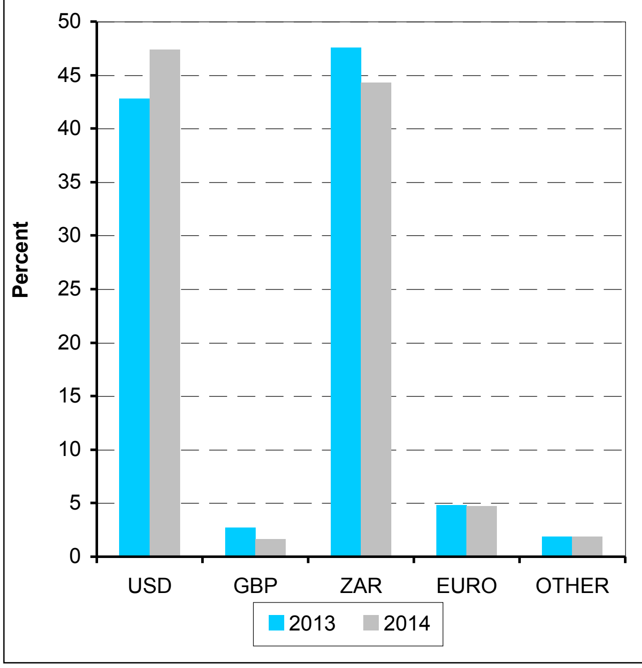


Chart 6.2: Bureaux de Change Purchases of Foreign Currency

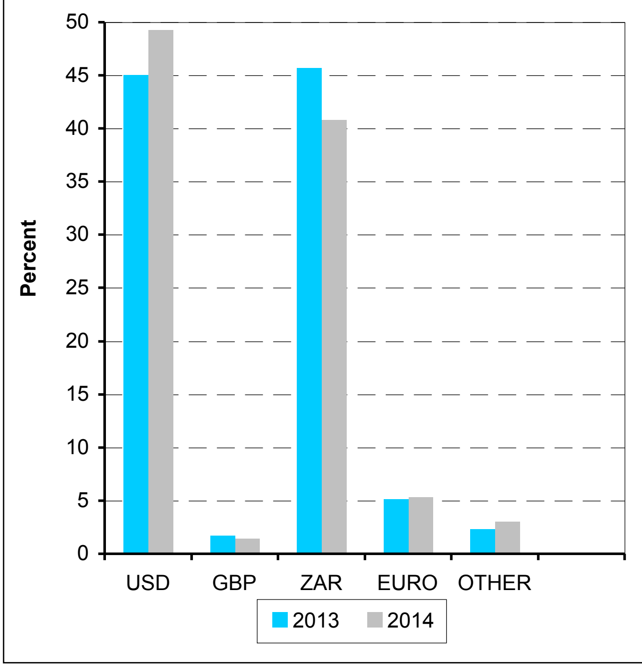
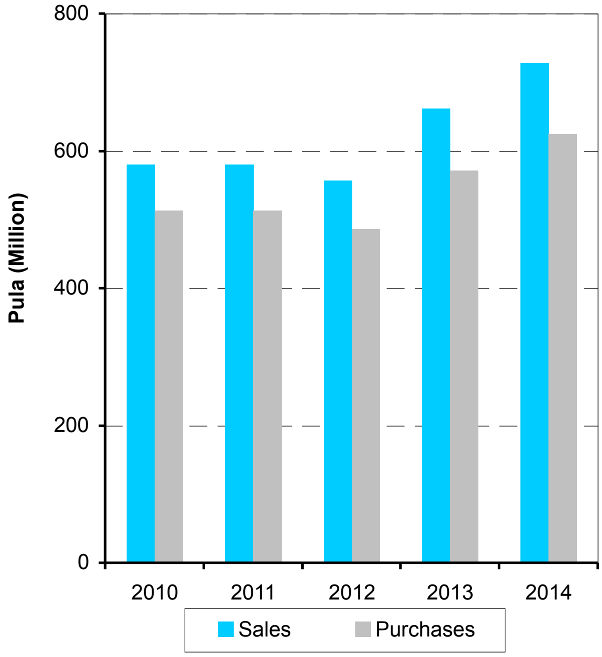


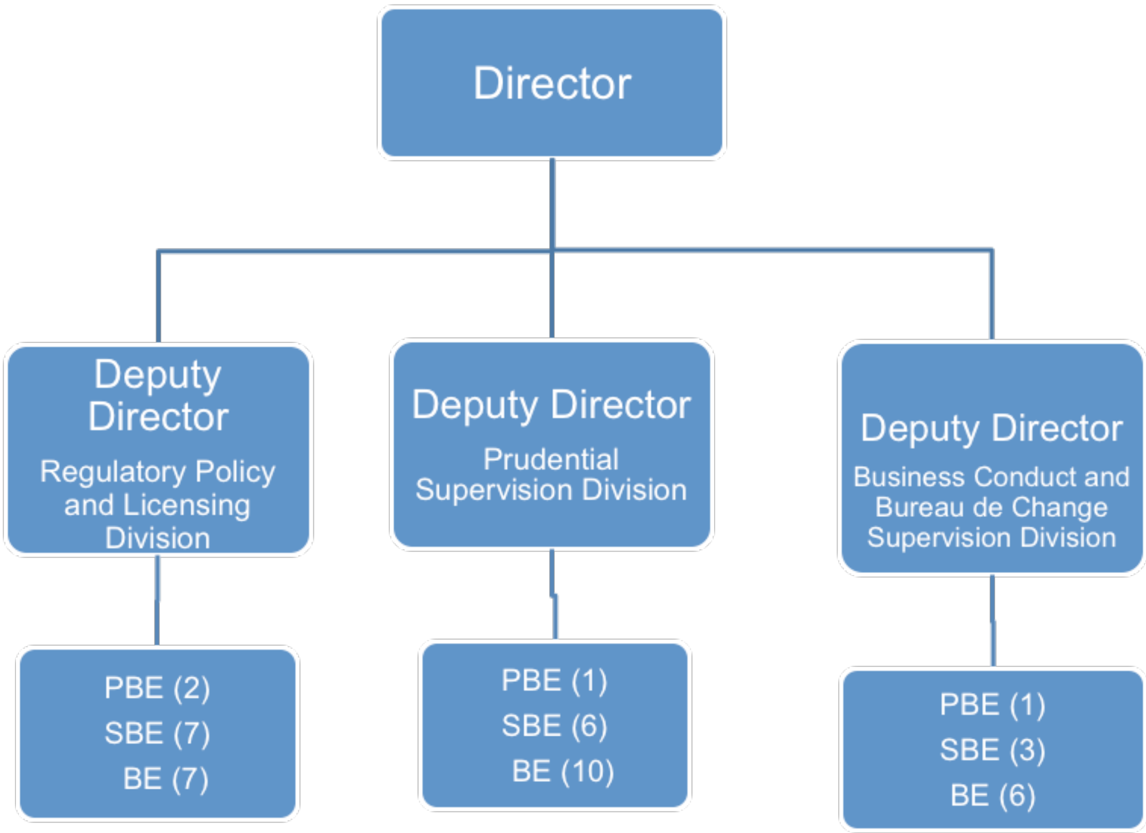
Chart 6.3: Bureaux de Change Sales and Purchases of Foreign Currency



Appendices

Appendix Contents

Appendix 1: Banking Supervision Department Organisational Chart



Key:

PBE: Principal Bank Examiner

SBE: Senior Bank Examiner

BE: Bank Examiner

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

1. Introduction

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

2. Legal Framework

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

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

3. Authority for Licensing Banks

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

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

4. Licensing Policy and Procedures for Establishing a Bank

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

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

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

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

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

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

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

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

5. Core Prudential Requirements

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

Capital Adequacy Requirements

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

Reserve Requirements

Section 40 of the Bank of Botswana Act (CAP. 55:01) empowers the Bank of Botswana to require financial institutions to hold primary reserves, including marginal primary reserves, in the form of cash holdings or deposits with the Bank or both, against such deposits and similar liabilities as may be specified by the Bank. During 2014, the primary reserve requirement ratio was 10 percent of Pula denominated deposits, held in a non-interest bearing account of the Bank. This is primarily a monetary policy tool intended to regulate the ability of a bank to use deposit liabilities for lending purposes.

Liquid Assets Requirements

Section 16(2) of the Banking Act stipulates that every bank must maintain in Botswana, on a daily basis, specified eligible liquid assets as a percentage of its deposit liabilities. During 2014, this ratio was equal to 10 percent and 3 percent for commercial banks and credit institutions, respectively.

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

Asset Quality

Asset Concentrations (Large Exposures)

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

Insider Lending

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

Non-Performing Loans and Provisions

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

6. Main Supervisory Approaches

On-Site Examinations

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

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

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

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

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

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

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

Bilateral and Trilateral Meetings

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 each of the four (4) auditing firms engaged by the supervised banks. The meetings are arranged to discuss supervisory issues that might need attention of both the external auditor and the supervisor. It is also at such meetings that the Bank takes the opportunity to discuss with auditors their expectations regarding the scope of statutory audits and other general issues of a prudential nature.

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

Off-Site Monitoring and Surveillance

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

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

The outcome of the off-site analysis is used for preparing early warning reports, which also serve as an input into 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.

7. Accounting, Auditing and Disclosure Standards

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

Appendix 3: Supervised Financial Institutions as at December 31, 2014

A. Commercial and Statutory banks

Institution	Postal Address	Business Locations	Auditors
Commercial Banks			
African Banking Corporation of Botswana Limited	P/Bag 00303, Gaborone	8	KPMG
Bank of Baroda (Botswana) Limited	P O Box 21559, Gaborone	3	Grant Thornton
Bank of India (Botswana) Limited	P/Bag 00111,Gaborone	1	Grant Thornton
Bank Gaborone Limited	P/Bag 00325, Gaborone	7	Pricewaterhouse Coopers
Barclays Bank of Botswana Limited	P O Box 478, Gaborone	41	Pricewaterhouse Coopers
Capital Bank Botswana Limited	P O Box 5548, Gaborone	4	KPMG
First National Bank of Botswana Limited	P O Box 1552, Gaborone	22	Deloitte & Touché
Stanbic Bank Limited	P/Bag 00168, Gaborone	11	KPMG
Standard Chartered Bank of Botswana Limited	P O Box 496, Gaborone	15	KPMG
State Bank of India (Botswana) Limited	P O Box 505243, Gaborone	1	Grant Thornton
Off-shore Banks			
Kingdom Bank Africa Limited	P O Box 45078, Gaborone	1	KPMG
Statutory Banks			
Botswana Savings Bank	P O Box 1150, Gaborone	2	KPMG
National Development Bank	P O Box 225, Gaborone	4	Pricewaterhouse Coopers
Building Society			
Botswana Building Society	P O Box 40029, Gaborone	10	KPMG

B. Bureaux de Change as at December 31, 2014

Name	Postal Address	Business Locations
Aldaph Bureau de Change	P O Box 404845, Gaborone	1
American Express Bureau de Change	P O Box 45140, Gaborone	3
Apijoe Bureau de Change	P O Box 458, Mogoditshane	2
Ban Mo Bureau de Change	P O Box 99, Sherwood	1
Bellagio Bureau de Change	P/Bag BR 321, Gaborone	1
Beni Fame Bureau de Change	P O Box 2143 AAD, Gaborone	3
Boitekanelo Bureau de Change	P O Box 27698, Gaborone	1
Cape to Cairo Bureau de Change	P O Box 799, Kasane	2
Crystal Diamond Bureau de Change	P O Box 20554, Gaborone	1
CSS Bureau de Change	P O Box 45168, Gaborone	3
Currency Exchange Bureau de Change	P O Box 80981, Gaborone	1
Dollar Wave Bureau de Change	P O Box 1054, Bobonong	1
Elite Bureau de Change	P/Bag 0028, Mogoditshane	1
Exim Bureau de Change	P O Box 1020, Gaborone	1
Fanz Bureau de Change	P O Box 617, Lobatse	1
Fundex Bureau de Change	P O Box 401547, Gaborone	3
FX Africa Bureau de Change	P O box 20537, Gaborone	4
Garona Bureau de Change	P O Box 408 , Gaborone	4
Genesis Bureau de Change	P/Bag BR 225, Gaborone	1
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Hyper Bureau de Change	P O Box AE 27 AEH, Gaborone	1
Investors View Bureau de Change	P O Box 2381, Francistown	1
Kalahari Bureau de Change	P O Box 1116, Gaborone	1
Kaycy Bureau de Change	P O Box 1693, Lobatse	1
Kwanokeng Bureau de Change	P O Box 10, Sherwood	2
Limpopo Bureau de Change	P O Box 8, Sherwood	2
Madikwe Bureau de Change	P O Box 268, Sikwane	1
Maeto Bureau de Change	P O Box 22, Mahalapye	1
Master Bureau de Change	P/Bag F199, Francistown	1
Min-C Bureau de Change	P O Box 26513, Gaborone	1
Mochudi Bureau de Change	P O Box 202147, Mochudi	1
Monty Cristo Bureau de Change	Private Bag 00254, Gaborone	1

Open Door Bureau de Change	P O Box 839, Maun	4
Ozair Bureau de Change	P O Box 4862, Gaborone	2
Prosper Bureau de Change	P/Bag B O7, Gaborone	1
Proxy Bureau de Change	P O Box 404108, Gaborone	2
Rennies Bureau de Change	P O Box 2482, Gaborone	1
River Ride Bureau de Change	P O Box 301106, Francistown	4
Rose of Sharon Bureau de Change	P O Box 404338, Gaborone	1
Royalty Bureau de change	Private Bag BO 259 , Gaborone	2
Sherwood Bureau de Change	P O Box 1 , Sherwood	1
SMH Bureau de Change	P O Box AD 148 ADD, Gaborone	3
Simple Forex Bureau de Change	P O Box 81384, Gaborone	1
Sunny Bureau de Change	P O Box 370, Maun	2
Thari Bureau de Change	P O Box 40074, Gaborone	2
Thafelo Bureau de Change	P O Box 50343, Tlokweng	1
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
Trans Fronter Bureau de Change	P O Box 183, Pitsane	1
Travellers Bureau de Change	P O Box 20909, Maun	2
Travellers' Choice Bureau de Change	P O Box 26725, Gaborone	2
TRL Money Link Bureau de Change	Private Bag F333, Francistown	1
Tshilong Bureau de Change	P O Box 40418, Gaborone	1
UAE Exchange Bureau de Change	P O Box AD 749 ADD, Gaborone	2
Unity Bureau de Change	P O Box 1586, Francistown	1
Universal Bureau de Change	P O Box 2444, Gaborone	1
West Bureau de Change	P O Box 40854, Gaborone	1
Total	**56**	**90**

C. MICROFINANCE INSTITUTIONS

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

Appendix 4: Definition of Banking Supervision Terms

(1) Definition of Banking Supervision Terminology as used in the Report

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

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

(c) **Loan Classifications:**

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

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

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

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

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

(d) **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 5 for computations).

(e) **Total Risk-Weighted Assets:** An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk-weighting are presented at Appendix 5 (2) attached.

(f) **Unimpaired Capital:** Unimpaired in relation to the capital of a bank means the absence of any legal or technical covenant, term, restriction or encumbrance, which would otherwise render such capital not to be freely available for distribution to depositors and/or other creditors in the event of the liquidation or dissolution of the bank, and the absence of any condition or arrangement which would, in the opinion of the central bank, diminish the value of the whole or any portion of the capital of the bank. An outline of capital elements used to compute unimpaired capital is presented at Appendix 5 (3) attached.

Prudential Ratios

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

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

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

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

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

(f) **Net Interest Margin (Percent):** This ratio identifies the core earnings capability of the bank – its interest differential income as a percentage of average total earning assets.

(g) **Other Operating Income to Total Assets (Percent):** The ratio shows the dependence on "non-traditional" income. Growth in this ratio can indicate diversification into fee-based financial services or a reaching for speculative profits to make up for deficiencies in the bank's core interest differential income.

(h) **Net Operating (or Intermediation) Margin (Percent):** The intermediation margin can be defined as the differential between the cost of funds and the yield on earning assets plus related fee income. The differential quantifies the cost extracted by the banking system for intermediating between the providers and the users of funds.

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

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

(k) **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.

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

(2) Risk-Weights Schedule

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

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

35. Assets securitisation with recourse	100	
36. Other standby letters of credit and other guarantees	100	
Maturity* **	**Conversion Factors – Interest Rate Contracts (%)**	**Risk Factor (%)****
37. Forwards, Swaps, Purchased Options and Similar Derivatives Contracts (sum of lines 38 to 43)		
38. One Year or Less	0.50	
39. Over One Year to Two Years	1.00	
40. For Each Additional Year	1.00	
	Exchange Rate Contracts and Gold (%)	**Risk Factor (%)****
41. One Year or Less	2.00	
42. Over One Year to Two Years	5.00	
43. For each Additional Year	3.00	
44. TOTAL RISK-WEIGHTED ASSETS AND OFF-BALANCE SHEET ITEMS (SUM OF LINES 1, 25 AND 37)		

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

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

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

(3) Capital Elements

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

Appendix 5: Aggregate Financial Statements of Licensed Banks 2010–2014

Table 1: Aggregate Statement of Financial Position for Licensed Commercial Banks: 2010 – 2014 (P' million) as at December 31st

Total Assets in Local Currency	2010	2011	2012	2013	2014
1. Cash and balances with the Central Bank	3 269	4 766	4 933	5 268	5 838
a. Currency	707	721	824	976	1 374
aa) Foreign currency	56	76	86	159	463
ab) Local currency	651	645	738	816	911
b. Balances with Central Bank	2 562	4 045	4 109	4 292	4 419
c. Other	–	–	–	–	45
2. Investment and Trading Securities	17 827	11 121	10 199	8 059	6 482
3. Placements with other banks and credit institutions	5 778	6 187	7 407	6 410	9 636
4. Gross Loans and advances to other customers	22 087	27 920	34 410	39 499	45 117
4.1 Impairments- Specific	720	574	617	718	771
4.2 Interest in suspense	43	213	257	339	218
4.3 Impairments-Portfolio	–	–	–	–	53
5. Loans and advances to other customers (net of Impairments)	21 324	27 133	33 537	38 442	44 075
6. Fixed assets net of depreciation	492	482	665	872	910
7. Other assets (net)	900	1 911	1 213	911	1 054
Total Assets	**49 590**	**51 600**	**57 954**	**59 962**	**67 994**

Total Liabilities in Local Currency					
1. Amounts owed to government institutions	–	–	–	6	12
a. Central Bank accounts	–	–	–	6	12
b. Direct Government credits (CB or MFDP)	–	–	–	–	–
2. Due to other banks and credit institutions	460	990	45	1 394	3 581
3. Debt Securities and Other Borrowing	1 457	908	942	2 292	2 088
4. Due to other customers/depositors	41 628	43 178	47 219	48 589	51 491
5. Shareholders funds	4 069	4 696	5 548	6 479	7 724
6. Other liabilities	1 977	1 827	2 925	1 202	3 097
a. Taxes payable	168	156	132	177	133
b. Dividends payable	–	–	20		4
c. Accrued expenses	42	243			1 167
d. Other	1 767	1 429	2 774	1 025	1 794
Total Liabilities	**49 590**	**51 600**	**57 954**	**59 962**	**67 994**

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

	2010	2011	2012	2013	2014
1. Interest and similar income	4 244	4 407	4 784	5 146	4 953
2. Interest expense	1 778	1 662	1 502	1 600	1 670
3. Net interest income [1–2]	2 466	2 745	3 282	3 546	3 284
4. Other operating income	1 288	1 631	1 777	2 028	2 150
5. Gross operating income/(loss) [3+4]	3 754	4 376	5 059	5 575	5 434
6. Total Impairments	272	301	455	579	760
a) Impairment of loans and advances – Specific	318	305	445	588	545
b) Impairment of loans and advances – Portfolio	8	37	55	445	216
c) Impairment on other financial assets	(54)	(41)	(46)	(53)	(1)
7. Operating income/(loss) net of Impairments	**3 482**	**4 075**	**4 604**	**4 995**	**4 674**
8. Operating expenses	1 681	2 096	2 364	2 709	2 782
a) Salaries and employee benefits	790	979	1 133	1 248	1 370
b) Auditing and consulting expenses	12	33	6	17	0.5
c) Rents paid	53	84	129	105	187
d) Depreciation and amortization	69	110	107	152	135
e) Other	756	890	989	1 186	1 089
9. Other provisions and write-offs	0	14	0	0	0
a) Investments	0	0	0	0	0
b) Other balance sheet items	0	14	0	0	0
c) Off-balance sheet items	0	0	0	0	0
10. Net operating income/(loss) [7–8–9]	**1 801**	**1 964**	**2 240**	**2 287**	**1 893**
11. Extraordinary Gains/(Losses)	1	0	0	18	0
a) Gains/Losses on revaluation of assets (NET)	0	0	0	18	0
b) Translation Gains/Losses (NET)	0	0	0	0	0
c) Other Gains/Losses	1	0	0	0	0
12. Net income/(loss) before tax [10+11]	1 803	1 964	2 240	2 305	1 893
13. Income tax	396	313	468	530	415
14. Net income/(loss) after tax [12–13]	**1 407**	**1 652**	**1 772**	**1 775**	**1 478**
15. Proceeds from Discontinued Operations	80	13	0	0	0
16. Transfers from revaluation/to general provisions	(14)	16	0	0	0
17. Dividends declared (Paid and Proposed)	603	858	128	535	441
18. Retained earnings for the year [14–15–16]	898	790	1 645	1 240	1 037
19. Retained earnings at the beginning of the year	2 796	3 035	3 830	5 474	6 715
20. Retained earnings at the end of the year [17+18]	**3 694**	**3 825**	**5 474**	**6 715**	**7 752**

TABLE 3: AGGREGATE STATEMENT OF FINANCIAL POSITION FOR STATUTORY BANKS IN BOTSWANA (P' MILLION) AS AT DECEMBER 31ST

Total Assets in Local Currency	2010	2011	2012	2013	2014
1. Cash and balances with the Central Bank	10	14	(20)	19	8
a. Currency	7	20	(21)	15	6
aa. Foreign currency	–	–	–	–	–
ab. Local currency	7	20	(21)	15	6
b. Balances with Central Bank (CB)	3	(7)	1	3	2
2. Trading securities at market value (BoBCs)	–	–	–	–	–
3. Placements with other banks and credit institutions	613	579	874	948	877
4. Gross Loans and advances to customers	3 052	3 573	4 214	4 873	5 612
5. Impairments	112	129	199	242	254
6. Net Loans and advances to customers	2 940	3 445	4 015	4 631	5 359
7. Investment securities	–	27	–	–	–
8. Fixed assets net of depreciation	157	176	184	217	246
9. Other assets (net)	42	11	46	124	200
Total Assets	**3 762**	**4 252**	**5 099**	**5 938**	**6 689**

Liabilities in Local Currency					
1. Amounts owed to government institutions	–	–	58	75	160
a. Central Bank accounts	–	–	–	–	–
b. Direct Government credits (CB or MoF)	–	–	–	–	–
2. Due to other banks and credit institutions	–	–	–	–	–
3. Securities sold under repurchase agreements	–	–	–	650	644
4. Due to customers/depositors	756	879	1,430	1 740	2 180
5. Shareholders funds	1 957	2 031	2 162	2 350	2 464
6. Other liabilities	90	744	758	177	168
a. Taxes payable	–	–	–	1	1
b. Dividends payable	14	12	1	–	–
c. Accrued expenses	–	13	–	–	–
d. Other	76	719	757	176	168
7. Other borrowing including international lending agencies	960	598	691	946	1,073
Total Liabilities	**3 762**	**4 252**	**5 099**	**5 938**	**6 689**

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

	2010	2011	2012	2013	2014
1. Interest and similar income	402	377	455	561	525
2. Interest expense	132	137	167	211	226
3. Net interest income [1–2]	271	239	288	350	299
4. Other operating income	43	50	47	51	48
5. Gross operating income/(loss) [3+4]	**313**	**289**	**335**	**401**	**347**
6. Total Impairments	45	36	31	45	23
a) Impairment on loans and advances – Specific	43	36	29	–	–
b) Impairment on loans and advances – Portfolio	2	–	2	–	–
c) Releases and Recoveries of bad debts previously written off	–	–	–	–	–
7. Operating income/(loss) net of total impairments	**268**	**253**	**305**	**356**	**324**
8. Operating expenses	165	167	183	235	243
a) Salaries and employee benefits	88	88	95	126	121
b) Administrative expenses	–	–	–	–	–
c) Auditing and consulting expenses	–	–	–	–	–
d) Rents paid	–	–	–	–	–
e) Depreciation and amortisation	10	6	7	9	9
f) Other	68	73	81	100	113
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]	**103**	**86**	**121**	**121**	**82**
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]	**103**	**86**	**121**	**121**	**82**
13. Transfers from revaluation/to general provisions	5	–	–	–	–
14. Dividends declared (Paid and Proposed)	37	42	44	44	45
15. Retained earnings for the year [12–13–14]	61	44	77	77	37
16. Retained earnings at the beginning of the year	294	354	398	476	552
17. Retained earnings at the end of the year [15+16]	**354**	**398**	**476**	**552**	**589**

TABLE 5: AGGREGATE CAPITAL STRUCTURE OF COMMERCIAL BANKS IN BOTSWANA (TIER 1 CAPITAL, TIER 2 CAPITAL AND TOTAL CAPITAL) (P' MILLION) AS AT DECEMBER 31ST

TIER 1		2010	2011	2012	2013	2014
1	Stated Capital	583	712	977	977	1,097
2	Preference (non-redeemable) non-cumulative shares	229	255	229	229	229
3	General Reserves	105	70	225	377	67
4	Retained Earnings	2 463	2 558	3 468	4 112	4 589
5	Minority Interests	–	–	–	–	–
6	Less	(144)	(134)	(104)	(92)	(91)
	(a) Goodwill and other intangible assets	(144)	(134)	(104)	(92)	(89)
	(b) Shareholders' equity funded through the capitalisation of unrealised gains arising from property revaluation	–	–	–	–	–
	(c) Current year's unpublished losses	–	–	–	–	(2)
7	**Total Tier 1 Capital (Sum of lines 1-5 less lines 6(a), (b) and (c)**	**3 236**	**3 461**	**4 796**	**5 603**	**5 891**
TIER 2						
8	Current year's unpublished profits	875	976	472	634	982
9	Fifty percent of fixed asset revaluation reserves	30	37	32	57	35
10	Unemcumbered general provisions not to exceed 1.25 percent of risk weighted assets	181	202	345	359	319
11	Hybrid (debt/equity) capital instruments eligible for inclusion	805	–	–	–	–
12	Subordinated term debt eligible for inclusion	793	753	1 088	846	1 036
13	Tier 2 preference shares		1	–	–	100
14	Shareholders' equity funded through the capitalisation of property revaluation reserves	–	–	–	–	–
15	**Total Tier 2 Capital (sum of lines 8-14)**	**1 879**	**1 969**	**1 937**	**1 896**	**2 472**
16	**Total Capital (sum of lines 7 and 15)**	**5 115**	**5 430**	**6 733**	**7 499**	**8 363**
	Impairments	–	–	–	–	–
17	Investments in unconsolidated subsidiaries and associated companies	–	–	–	–	30
18	Total Impairments of Capital	–	–	–	–	30
19	**Total Unimpaired Capital**	**5 115**	**5 430**	**6 733**	**7 499**	**8 333**

Appendix 6: Charts of Key Prudential and Other Financial Indicators

Chart 6.1: Average Cost of Deposits

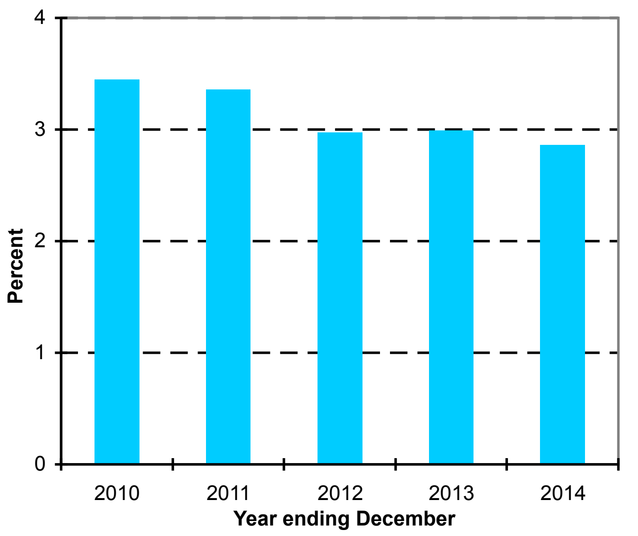


Chart 6.2: Return on Loans and Advances

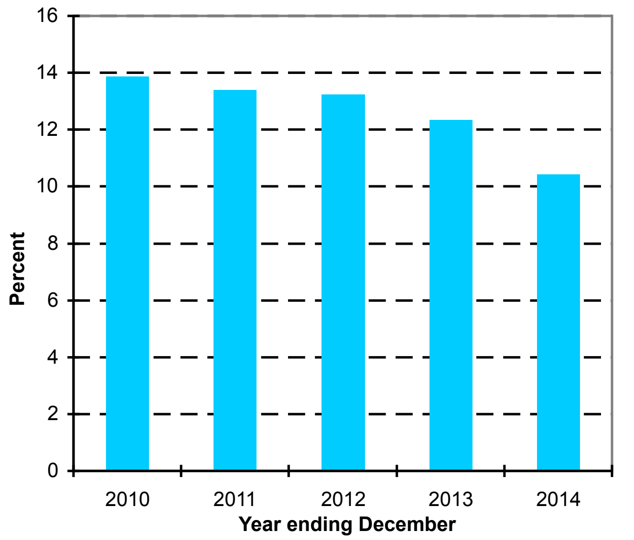


Chart 6.3: Residential Real Estate Loans to Gross Loans

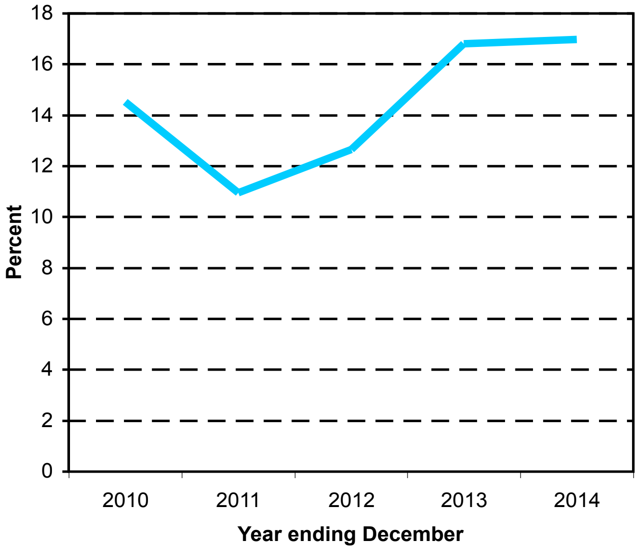


Chart 6.4: Household Loans to Total Loans

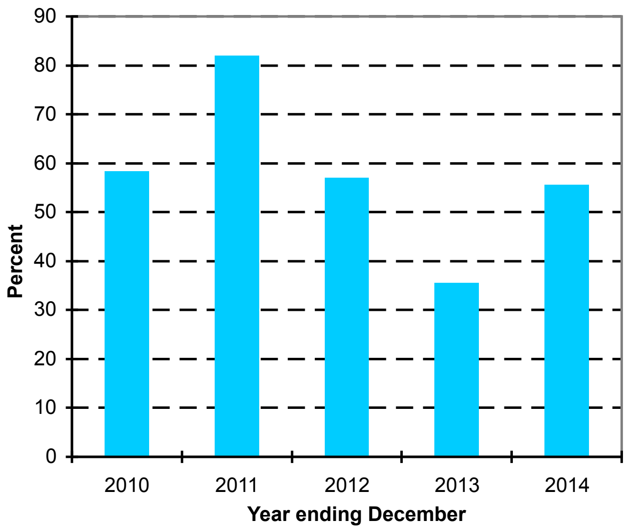


Chart 6.5: Non-Performing Loans Growth Rate

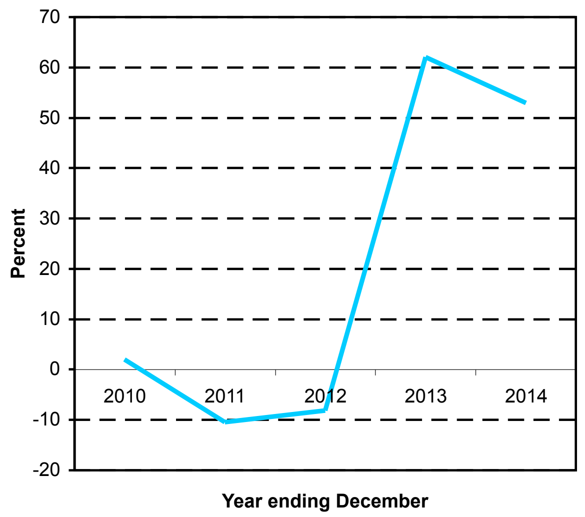


Chart 6.6: Share of Value of Total Deposits by Type (including FCAs)

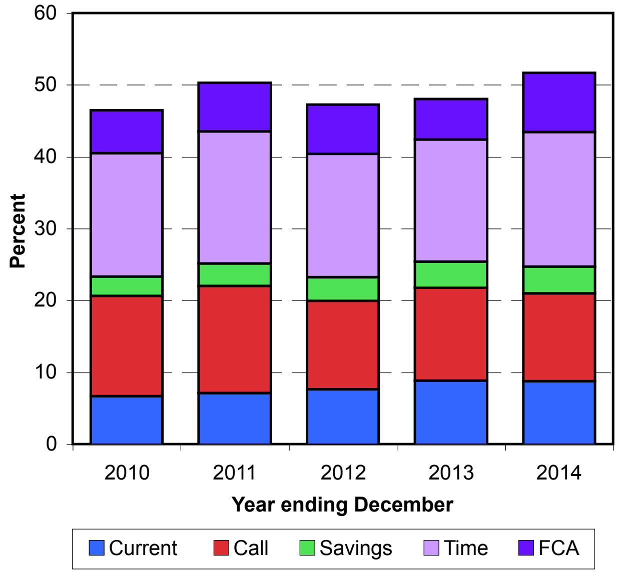


Chart 6.7: Growth Rate of Foreign Currency Accounts

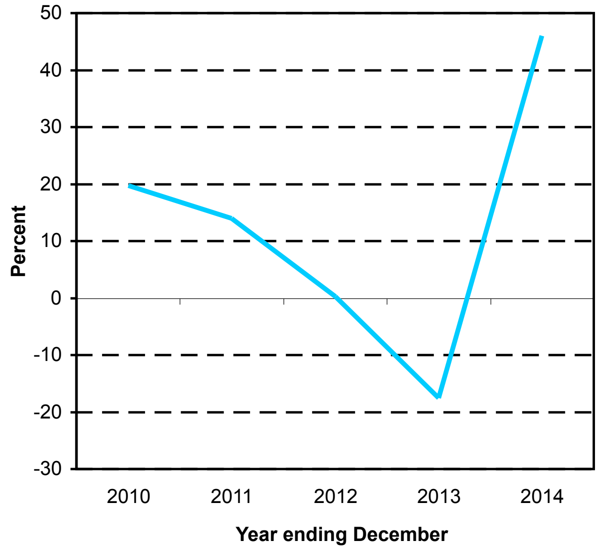


Chart 6.8: Industry Efficiency Ratios