

BANKING SUPERVISION
ANNUAL REPORT 2005

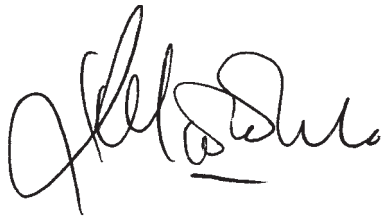
BANK OF BOTSWANA

FOREWORD

This Report is based on the 2005 statutory report submitted to the Minister of Finance and Development Planning, in accordance with the provisions of Section 28 of the Banking Act. The Report provides an overview of the banking industry structure, the industry's operational and financial performance and other developments which took place during the year ended December 31, 2005.

The banking industry¹ was stable in 2005 except for one offshore bank which was put under temporary management. 2005 was also a challenging year for the banking industry because of higher inflation, slower growth in the non-mining sector and sluggish domestic demand. Notwithstanding the unfavourable economic conditions, the overall financial performance of the industry improved compared to the previous year, despite a significant deceleration in the rate of growth of bank credit. All commercial banks were solvent, profitable, liquid and prudently managed; however, there were some operational performance problems for which the necessary interventions were made in respect of two small banking institutions. Furthermore, a deterioration in asset quality was noted in some banks.

A number of challenges face the industry; these include the need to continue to be competitive, adopt new technologies, be cost effective and uphold good corporate governance practices.



Linah K Mohohlo

GOVERNOR

¹Banks licensed under the Banking Act (CAP. 46.04)

STRUCTURE OF THE REPORT

The purpose of the Report is to disseminate information to the public about the structure and conduct of banking supervision in Botswana. It is based on the 2005 statutory report submitted to the Minister of Finance and Development Planning on the Bank's supervisory activities.

Chapter 1 provides an overview of the performance of the banking sector in 2005. Chapter 2 gives an update on the major operational activities of supervised institutions and other developments pertaining to the financial sector.

Also included in the Report are technical appendices relating to the institutions licensed and supervised by the Bank, definitions of technical banking supervision terms, and tables and charts on various statistical information on the banking industry.

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CHAPTER 1

INDUSTRY PERFORMANCE HIGHLIGHTS

1. BUSINESS LOCATIONS

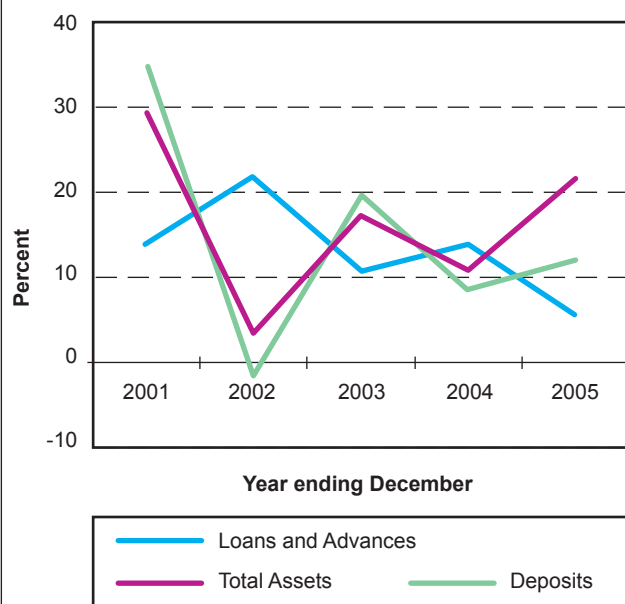
The representation and geographic distribution of banks' branches, agencies and encashment points in 2005 was almost unchanged from the previous year's structure. No new branch was opened during 2005. However, with the refurbishments and relocations that took place during the year, banks improved public access to banking facilities and services. The total number of automated teller machines (ATMs) increased by 7 to 181 as at December 31, 2005. The continued increase in the number of ATMs and mini-ATMs, as opposed to branch expansion, is indicative of the banks' preference for providing access to banking services through ATMs.

2. OPERATIONAL PERFORMANCE

The economic environment in which the banks operated during 2005 was characterised by slower growth of the non-mining non-government private sector compared to 2004, sluggish domestic demand, higher inflation and tight monetary conditions, all of which dampened growth in bank credit.

However, the overall performance of the industry was impressive relative to 2004. The banks' aggregate assets increased by 19 percent, from P15.5 billion to P18.5

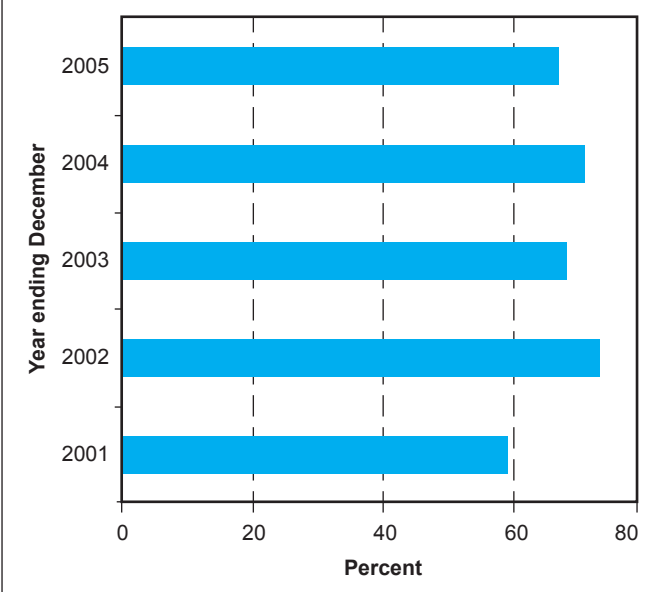
CHART 1: GROWTH RATES OF DEPOSITS, TOTAL ASSETS AND LOANS AND ADVANCES



billion, compared to 10 percent recorded in 2004. Credit grew at a slower rate of 6 percent (13 percent in 2004) to reach P9.3 billion and deposits rose at a faster rate of 12 percent to P14 billion. The changes in deposits, total assets and advances are illustrated in Chart 1.

The intermediation ratio for the banking industry declined to 67 percent in 2005 from 71 percent in 2004 (Chart 2), reflecting a slowdown in credit expansion. Smaller banks reported lower intermediation ratios while some of the major banks performed reasonably well.

CHART 2: ADVANCES TO DEPOSIT RATIO (INDUSTRY)



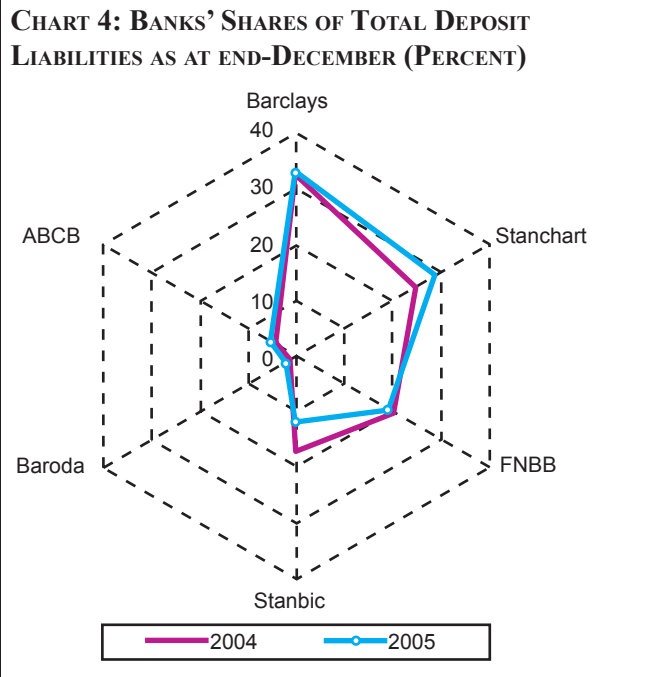
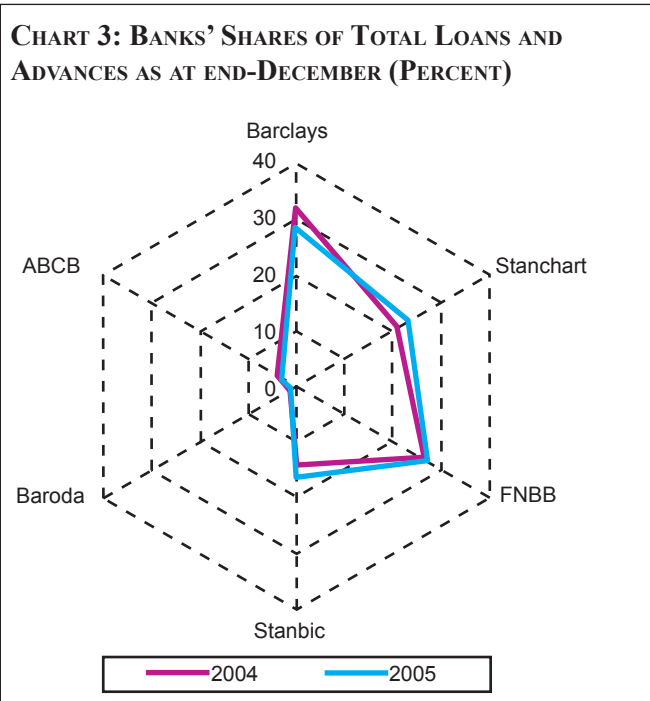
Charts 3 and 4, overleaf, show the changing composition of banks' shares in total loans and advances and total deposits.

3. CAPITAL ADEQUACY (SOLVENCY)

All banks operating in the domestic market met the regulatory minimum prudential capital requirements. Chart 5, overleaf, shows the ratios of core capital¹ to total capital, core capital to risk-weighted assets and unimpaired capital to risk-weighted assets (capital adequacy ratio) for the banking industry. The ratio of core capital to total capital for the industry was well above the 50 percent minimum statutory requirement,

¹ See page 19 for the method of calculation.

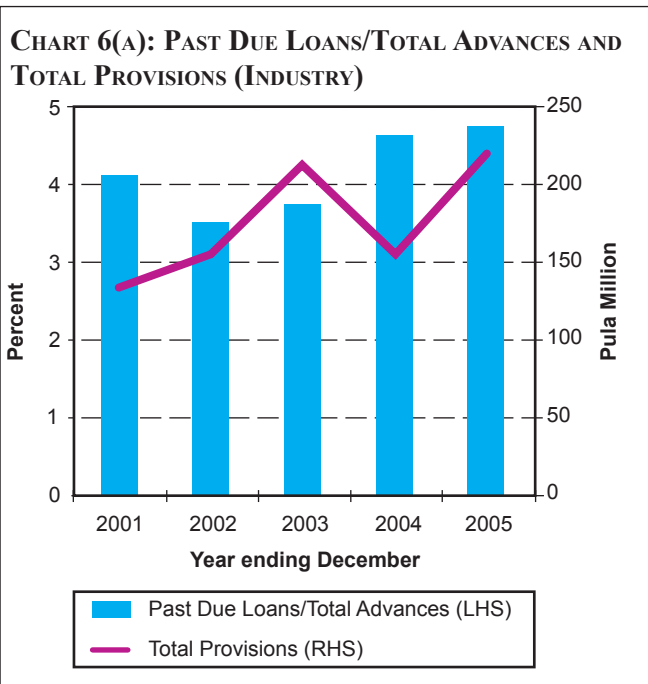
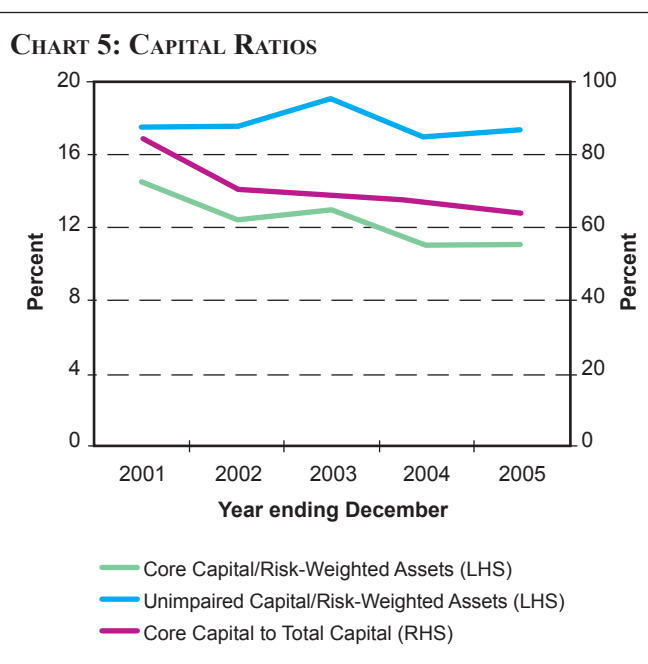
an indication of the existence of high quality capital. Similarly, capital adequacy ratios for all banks were above both the minimum statutory requirement of 8 percent and the 15 percent prescribed as a safe and prudent level for banks in Botswana.



4. NON-PERFORMING LOANS² AND ASSET CONCENTRATIONS

As shown in Chart 6(a), the banking industry's proportion of non-performing loans (NPL), measured by the ratio of Past Due Loans to Total Advances, was

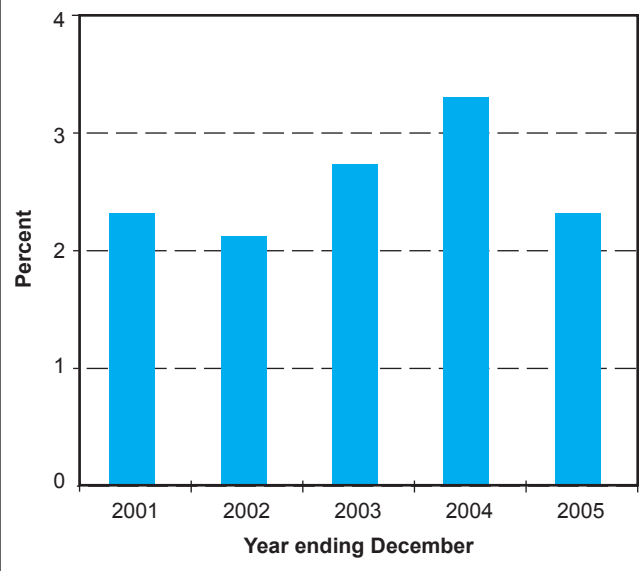
² Term loans that are 30 days or more in arrears.



slightly higher (4.7 percent) in 2005 compared to 2004 (4.6 percent). The rise in the ratio was accompanied by higher levels of provisions for bad and doubtful debts by banks, consistent with prudent accounting practices.

Chart 6(b), which gives another measure of asset quality (bad and doubtful debt provisions to advances), indicates a slight improvement in the asset quality of banks in 2005, compared to 2004, reflecting, inter alia, loan write-offs, improved risk management processes and intensified loan administration efforts. Banks operated within the stipulated regulatory asset concentration limits as measured by the industry's ratio of large exposures (i.e., more than 10 percent) to unimpaired

CHART 6(B): BAD AND DOUBTFUL DEBT PROVISIONS/ TOTAL ADVANCES



capital of 362 percent, which was well below the recommended 800 percent prudential maximum limit for banks in Botswana.

5. PROFITABILITY

While the deceleration in economic activity during 2005 had some negative effect on the quality of banks' asset portfolios, it had little or no adverse effect on the overall profitability of banks. The growth rate of profits for the banking industry maintained an upward trend for the second consecutive year (Chart 7). This was evident among most banks as they recorded higher after-tax profits driven by aggressive marketing strategies,

CHART 7: GROWTH RATES OF PROFIT BEFORE AND AFTER TAX



improved customer service and the attractiveness of new products, as well as a higher interest rate environment.

Tables 1(a) and 1(b) show additional key financial performance indicators on profitability. Interest income, mostly from loans and advances (at 77 percent of gross income), was the main source of earnings in 2005. Similarly, interest expense was a major cost component during the year. The largest component of the banks' non-interest expenses related to staff costs.

TABLE 1(A): BANKING INDUSTRY EARNINGS AND PROFITABILITY

	Amount (P million)		Growth (Percent)
	Dec 2004	Dec 2005	2004– 2005
Gross Interest Income	2 089.8	2 172.4	4.0
Interest Expense	982.2	1 094.0	11.4
Net Interest Income	937.4	1 078.4	15.0
Non-Interest Income	547.5	664.2	21.3
Operating Expense	713.6	785.5	10.1
Total Expense	1 695.8	1 879.5	10.8
Net Income before Tax	720.7	904.7	25.5
Net Income after Tax	597.9	756.6	26.5

TABLE 1(B): PERFORMANCE RATIOS (PERCENT)

	Dec 2004	Dec 2005
Return on Average Total Assets (ROAA)	4.0	4.5
Return on Equity (ROE)	43.3	53.4
Interest Income to Total Income	77.7	76.6
Non-Interest Income to Total Income	22.3	23.4
Interest Income to ATA	13.1	12.8
Non-Interest Income to ATA	3.7	3.9
Interest Expense/ATA	6.7	6.5
Interest Expense/Total Expense	57.9	58.2
Operating Expense/Total Expense	42.1	41.8
Non Interest Expense/ATA	4.8	4.6
Average Return on Advances	17.2	17.2
Net Interest Income/ATA	6.3	6.4
Average Cost of Deposits	7.5	7.4

Note: ATA = Average Total Assets

Banks deployed the resources at their disposal efficiently and productively to generate income. This is evident from the industry's higher Return on Average Total Assets (ROAA) and Return on Equity (ROE) ratios of 4.5 percent and 53.4 percent, respectively (Table 1(b)).

6. OPERATING EFFICIENCY

TABLE 2: BANKING INDUSTRY EFFICIENCY MEASURES

Performance Ratios (Percent)	2001	2002	2003	2004	2005
Net Spread	9.4	9.1	7.4	5.3	7.3
Net Interest Margin	6.8	7.0	6.7	6.3	6.4
Other Operating Income/Average Total Assets	3.6	3.9	3.7	3.7	3.9
Net Operating Margin	10.0	5.3	8.9	9.7	9.8
Net Income Per Employee (P'000)	170.0	204.4	214.7	235.0	282.0
Net Income To Employee Expense	192.4	194.8	181.1	190.8	222.2
Cost/Income	44.2	47.2	48.5	33.0	45.1
Staff Cost Per Employee (P'000)	70.8	105.0	118.6	123.2	126.9
Assets Per Employee (P'000)	4 805.1	4 798.0	5 564.6	6 102.1	6 911.1

Table 2 shows a five-year trend in operational and efficiency ratios for the banking industry. While by international standards banks continued to report relatively low cost to income ratios, the industry's operating efficiency ratios showed a slight decline.

The Cost to Income ratio rose in line with the increase in the staff complement, albeit remaining at relatively low levels by international standards. Other contributing factors were banks' efforts to improve staff welfare through, among others, HIV/AIDS assistance programmes and the provision of free Anti-Retroviral drugs (ARVs) to employees and dependants. However, as indicated in Table 2, most employee related ratios improved during the year, signifying improved productivity in the industry.

7. LIQUIDITY AND HOLDINGS OF BANK OF BOTSWANA CERTIFICATES (BoBCs)

The banking sector continued to experience high levels of liquidity, as shown in Chart 8. The industry's Liquid Assets to Deposits ratio of 38 percent (up from 30 percent in 2004) nearly quadrupled the required ratio of 10 percent. BoBCs constituted the largest portion of the banks' liquid assets.

The market value of total BoBCs held by banks on their own behalf increased substantially by 61 percent to over P4.8 billion. Chart 9 shows the level of BoBC holdings by the banking industry. In recent years the banks have been steadily increasing their share of BoBCs, reflecting the substantial rise in liquidity in the domestic money market and the absence of immediate lending opportunities.

CHART 8: LIQUID ASSETS TO DEPOSITS RATIO (INDUSTRY)

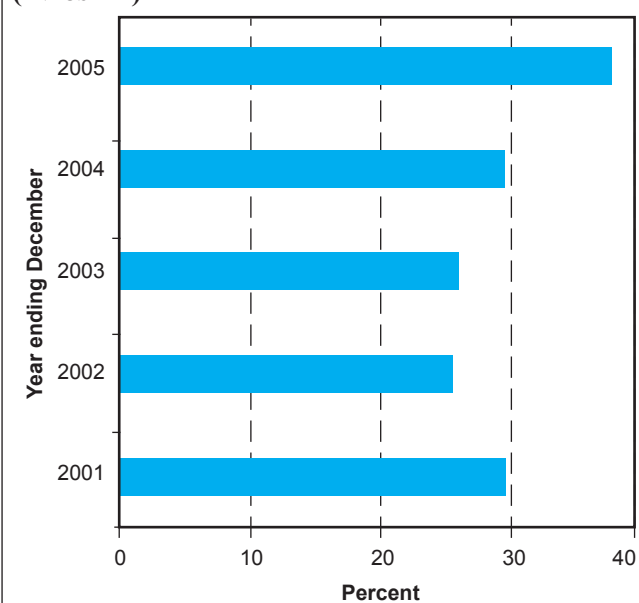
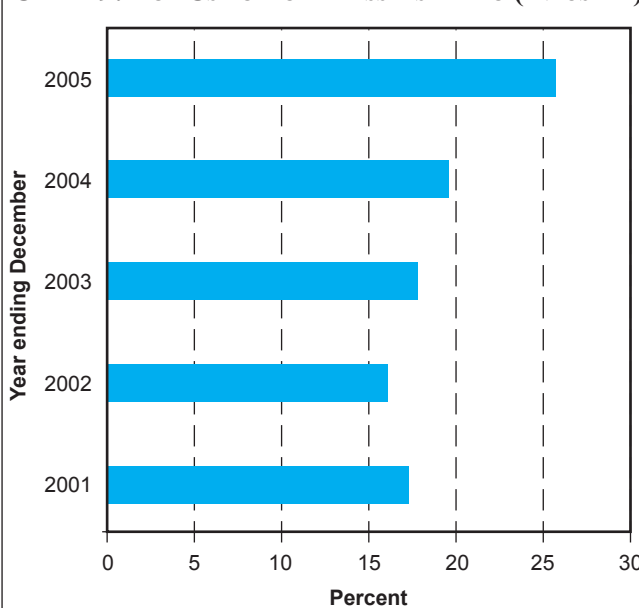


CHART 9: BoBCs TO TOTAL ASSETS RATIO (INDUSTRY)



CHAPTER 2

SUPERVISORY AND OTHER INDUSTRY ACTIVITIES IN 2005

This chapter covers the major banking supervision activities undertaken during 2005.

1. ON-SITE EXAMINATIONS OF LICENSED BANKS

The Bank conducted two full-scope on-site examinations of African Banking Corporation of Botswana Limited (ABCB) and National Development Bank (NDB), and a limited-scope examination of Bank of Baroda (Botswana) Limited (Baroda). The examinations focused on capital adequacy, profitability, liquidity, management and board oversight. The three institutions were generally found to be performing well and were profitable, solvent and liquid.

In addition to prudential examinations, proactive on-site examinations of banks for compliance with consumer protection and anti-money laundering laws were conducted at Botswana Savings Bank (BSB) and Botswana Building Society (BBS). These examinations focused on the implementation of the Policy on Disclosure of Bank Charges, administration of dormant accounts, electronic banking activities, anti-money laundering programmes and policies and procedures for handling consumer complaints. In general, the BSB examination revealed that the institution had documented policies and procedures on abandoned funds, bank charges and know-your-customer (KYC), while BBS's policies and procedures in the same areas were under development. Both institutions showed sufficient knowledge on applicable Anti-Money Laundering (AML) laws in Botswana but still had to fully put in place appropriate AML policies and procedures. The two banks were accordingly advised to remedy the weaknesses that were identified.

2. LICENSING OF NEW FINANCIAL INSTITUTIONS

The Bank approved an application for a commercial banking licence by Capricorn Investment Holdings (Botswana) (CIHB), trading as Bank Gaborone Limited on May 19, 2005. The bank started its operations on February 1, 2006 with limited products, i.e., home loans and treasury products. Bank Gaborone Limited is 100 percent owned by CIHB, which is in turn owned 88

percent by Capricorn Investment Holdings Ltd (Namibia) (CIHN). CIHN is a company incorporated in Namibia and holds a diversified asset portfolio in banking, insurance and asset management companies in Namibia. CIHN has a 100 percent shareholding in Bank Windhoek, the largest citizen-owned commercial bank in Namibia.

3. ESTABLISHMENT OF A CREDIT REFERENCE BUREAU

In May 2005, the Bank approved a request by the Bankers' Association of Botswana to set up a closed user credit reference bureau which would provide exclusive credit vetting services to banks in accordance with Section 43(2)(f) of the Banking Act. Preparations are at an advanced stage to establish the bureau, and the management of the bureau will be outsourced to a qualified independent service provider.

4. CONSULTATIVE MEETINGS WITH BANKS AND EXTERNAL AUDITORS

Several consultative meetings were held throughout the year in accordance with Section 22(8) of the Banking Act. The Bank held trilateral meetings with each supervised financial institution and its external auditors. These meetings covered issues pertaining to, inter alia, the review of the 2004 draft financial statements, accounting and provisioning policies, strategic plans for 2005 and risk management strategies for major risk areas. Pursuant to Section 22(9) of the Banking Act, bilateral meetings were also held with all external auditors of the supervised financial institutions. Two Banking Committee meetings were held during the year and the issues discussed included the Real Time Gross Settlement System and the crawling band exchange rate mechanism that was introduced in May 2005.

5. SUPERVISION OF STATUTORY BANKS: BOTSWANA BUILDING SOCIETY (BBS), BOTSWANA SAVINGS BANK (BSB) AND NATIONAL DEVELOPMENT BANK (NDB)

The combined assets of all statutory banks grew by 21 percent from P1.4 billion in 2004 to P1.7 billion in

2005, as a result of increases in both the volume and value of savings and investment accounts. By the end of the reporting period, statutory banks were largely in compliance, save for the AML and consumer protection inadequacies; there were violations of statutory requirements in some cases.

6. INTERNATIONAL FINANCIAL SERVICES CENTRE (IFSC) OPERATIONS

There was only one new entrant to the IFSC in 2005, namely, CB Richard Ellis (Pty) Limited, that was granted an Exemption Certificate to operate as a holding company responsible for consolidation and management of its real estate businesses in Africa. The Andisa Group of companies, which provided consolidated accounting, treasury and corporate finance services for regional subsidiaries, were deregistered for purposes of restructuring. This brought the total number of IFSC companies with regulatory approval from the Bank to 13 (with nine operating companies) as at December 31, 2005, down from 16 at the end of 2004.

The Bank assumed temporary management of Kingdom Bank Africa Limited (KBAL) in June 2005, consistent with Section 33 of the Banking Act, on account of undercapitalisation of the bank relative to the statutory minimum capital requirement. The temporary management was lifted in September 2005 after a successful recapitalisation by the shareholders of KBAL and the bank handed back to its management. The Bank continued to closely monitor developments at KBAL to ensure its viability (see box article opposite for details on the temporary management of KBAL).

7. COLLECTIVE INVESTMENT UNDERTAKINGS (CIUs) OPERATIONS

Table 3 below shows that, as at December 31, 2005, there were three management companies administering a total of 12 funds operating under the CIU Act. Orbis Investment Management Limited and Standard Chartered Bank Plc were authorised to market funds in Botswana during the year, while Hong Kong Shanghai Banking Corporation International-Capital Secured Growth Funds Plc (HSBC-CSGF) deregistered all its funds in Botswana in June 2005 due to weak demand for the Funds' services.

The total net asset value (NAV) of the funds (excluding

Summary of Developments Leading to the Temporary Management of Kingdom Bank Africa Limited by the Bank

Kingdom Bank Africa Limited (KBAL) was licensed and authorised to commence offshore banking operations in 2003. The bank was unprofitable from the first year of operation. Accumulated losses eroded its capital base which contracted to critical levels towards the end of 2004. KBAL engaged the Bank of Botswana (Bank) in discussions regarding its efforts to recapitalise. One of the outcomes of the discussions was a requirement that KBAL should, by the end of March 2005, inject adequate capital for it to be in compliance with the minimum statutory capital requirement of P5 million, and maintain it at or above that level at all times. Unfortunately, by the end of March 2005, KBAL had not recapitalised as required and was, therefore, in breach of the requirements of Section 13 of the Banking Act.

This led to the Bank assuming temporary management of KBAL on June 22, 2005, consistent with the requirements of Section 33 of the Banking Act. The objective was to facilitate the proper recapitalisation of the bank within three months and to ensure that depositor interests were safeguarded. During the temporary management period, KBAL was required to furnish the Bank with a business plan outlining how it intended to sustain the capital base at the new level, and generally, to ensure its viability in the future. KBAL duly complied with this requirement. Furthermore, the bank undertook a successful cost reduction programme, including relocation to cheaper premises.

During the period of temporary management, deposits and withdrawals were strictly controlled and monitored in order to facilitate a proper assessment of the capital level of KBAL. While the strict supervisory regime may have inadvertently inconvenienced the bank's customers, overall, the temporary management was considered a success. Both KBAL and the Bank maintained close contact with KBAL's depositors to avoid possible panic reactions. Following the recapitalisation of the bank to a level compliant with Section 13 of the Banking Act, the Bank lifted the temporary management of KBAL on September 1, 2005 and handed it back to its management and owners

TABLE 3: MANAGEMENT COMPANIES AND FUNDS

Management Company	Funds Managed
African Alliance Botswana Management Company (Pty) Limited	Botswana Global Allocation Fund Botswana Global Income Fund Botswana Value Fund Botswana Liquidity Fund African Alliance Private Equity Fund
African Alliance International (Pty) Limited	Global Managed Fund African Alliance Euro Fund African Alliance Dollar Fund Global Fixed Income Fund Global Equity Fund
Stanbic Investment Management Services (Pty) Limited	Stanbic Money Market Fund Stanbic Managed Fund

inward marketed funds) managed by the CIUs increased by 69 percent, from P2.6 billion in 2004 to P4.4 billion in 2005. The increase was mainly attributable to the entry into the market by Stanbic Investment Management Services (SIMS).

Two management companies were authorised in terms of Part VIII of the CIU Regulations to market their funds in Botswana (Table 4).

Chart 10, below, shows the total NAV of the funds (excluding inward marketed funds) managed by the CIUs for a four-year period, 2002-2005.

Chart 11, overleaf, shows that, of the P4.4 billion NAV recorded in December 2005, 63 percent was invested outside the country and 37 percent in the domestic market. The composition of CIU investments illustrated

CHART 10: NET ASSET VALUE OF LOCALLY REGULATED FUNDS

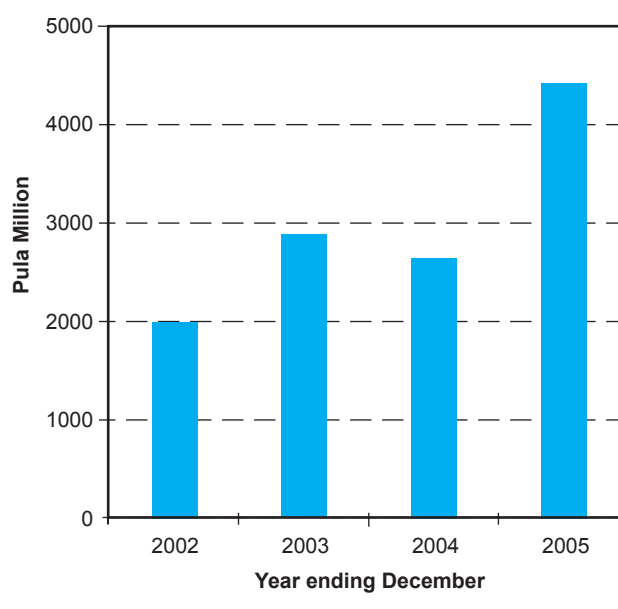
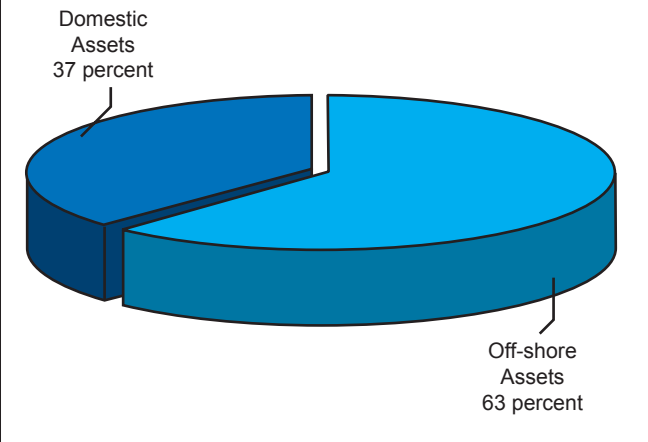


TABLE 4: EXTERNALLY LICENSED FUNDS MARKETED IN BOTSWANA

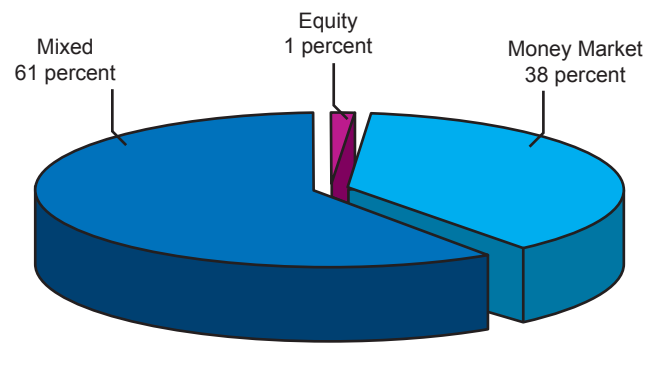
Management Company	Funds Managed
Orbis Investment Management Limited	Orbis Global Equity Fund Orbis Africa Equity Fund Orbis Japan Equity (US \$) Fund Orbis Optimal (EUR) Fund Orbis Optimal (US \$) Fund Orbis Leveraged (EUR) Fund Orbis Leveraged (US \$) Fund
Standard Chartered Bank London Plc	Standard Chartered (US \$) Liquidity Fund

CHART 11: OFF-SHORE AND DOMESTIC INVESTMENTS OF FUNDS



in Chart 12 indicates that CIUs invested 61 percent of their assets in mixed Funds (bonds and equities), 38 percent in Money Market Funds and one percent in Equity Funds.

CHART 12: CIU INVESTMENTS BY ASSET CLASS

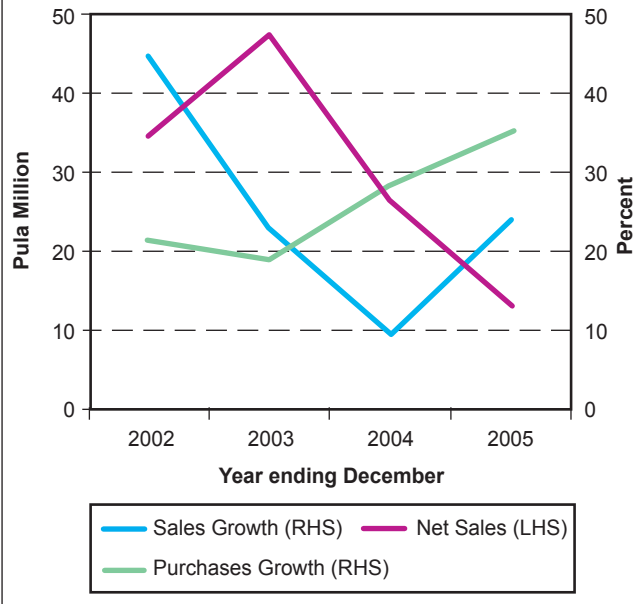


8. BUREAUX DE CHANGE AND MICRO-FINANCE ACTIVITIES

(a) Bureaux de Change

The value of foreign exchange transacted through bureaux de change continued to increase, with sales and purchases growing by 24 percent (from P202 million to P251 million) and 35 percent (from P176 million to P237 million), respectively, in 2005. This performance compares with slower growth rates of 10 percent (from P185 million to P202 million) and 28 percent (from P137 million to P176 million), respectively, in 2004 (Chart 13). The faster rate of increase in 2005 was partly due to additions to the number of bureaux de change operators, which expanded customer access to bureaux services and also possibly reflects that some bureaux

CHART 13: BUREAUX DE CHANGE FOREIGN EXCHANGE SALES AND PURCHASES



offered better rates compared to commercial banks and serviced their customers more efficiently.

In 2005, five new bureaux de change were licensed while two closed down, bringing the total number to 37. Existing bureaux de change also expanded their operations by opening new branches; Business Towers Bureaux de Change opened four new branches in Gaborone and Maun, while Sunny Bureaux de Change opened two new branches in Maun.

Charts 14 and 15 below show the composition of foreign exchange sales and purchases by bureaux de

CHART 14: BUREAUX DE CHANGE SALES OF FOREIGN CURRENCY: 2004-2005

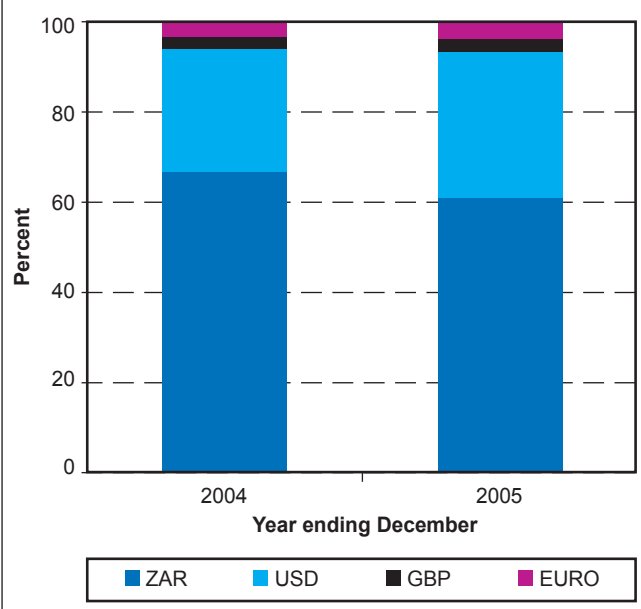
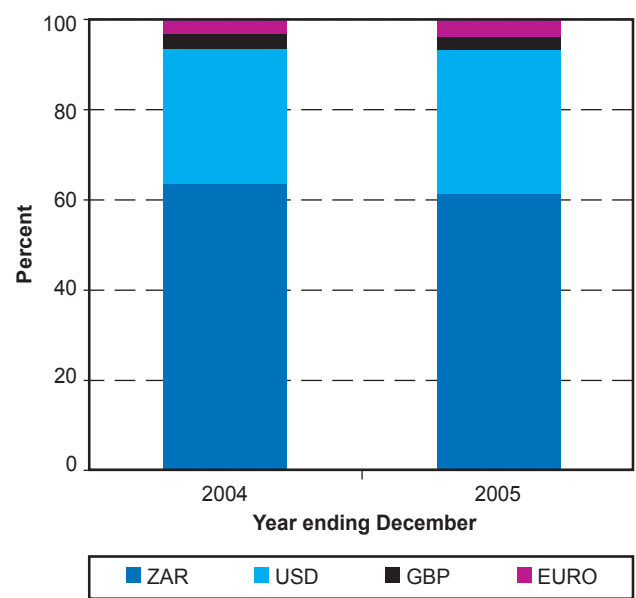


CHART 15: BUREAUX DE CHANGE PURCHASES OF FOREIGN CURRENCY: 2004-2005

change during 2005. As in the previous year, the South African rand continued to dominate foreign exchange transactions of bureaux de change, despite a slight drop in its share of both sales and purchases. The US dollar, was the second most traded currency in bureaux de change transactions. Other currencies, such as the British pound and the euro, accounted for a small proportion of bureaux de change business.

(b) Micro-Finance Institutions (MFI's) Activities

Women's Finance House Botswana (WFHB) is the only MFI operating in Botswana. The organisation is dedicated to assisting economically active low income women, particularly those who do not have access to financial institutions credit and savings facilities. The audited annual financial statements of WFHB for the year ended 2004/05 showed that high operating costs led to the institution realising a loss. However, WFHB's assets grew by 94 percent, from P2 million in 2003/4 to P4 million in 2004/5.

(c) Money-Lending Business

The Bank received 86 enquiries/applications for money-lending businesses in 2005 compared to 247 in 2004. With the coming into force of the Consumer Protection (Money-Lending) Regulations, 2005, this regulatory function is expected to be assumed by the Ministry of Trade and Industry.

9. ABANDONED FUNDS

In accordance with Section 39 of the Banking Act, the Bank received, processed and maintained abandoned funds submissions from commercial banks during 2005. The total funds received and claims processed for the period are summarised in Table 5 below. Accordingly, the Bank informed the public about the existence of these funds by placing notices in local newspapers and the Government Gazette. However, the public response was low as evidenced by the fact that less than a quarter of the funds received during the year were claimed. The closing balance of unclaimed funds as at December 31, 2005 was P4.3 million.

TABLE 5: SUMMARY OF ABANDONED FUNDS BALANCES (PULA)

	Total
Balance brought forward	3 585 344
Funds received in 2005	887 612
Claims paid out in 2005	(204 004)
	683 608
Balance at year-end 2005	4 268 952

10. BANK CHARGES

The Bank continued to encourage banks to improve access to banking services at affordable prices and, in this respect, the Bank maintained an active dialogue with the banks on the cost and quality of banking services, including the need to review banking tariffs. In response to the those efforts some positive developments were noted, with some banks adopting pricing models that support public policy objectives of financial intermediation, economic diversification and savings mobilisation.

Table 6 below shows a summary of the commonly applied bank charges (industry averages) during 2005. Financial intermediation charges were the highest in the banking industry in 2005 while other fees, such as international trade and foreign exchange commission and account maintenance fees, were deemed reasonable. The banks were advised to continue observing and ensuring compliance with the provisions of the Disclosure of Bank Charges Notice of 2001.

**TABLE 6: CLASSIFICATION OF BANK CHARGES – 2005
(INDUSTRY AVERAGES)**

Behavioural Deterrent		International Trade & Foreign Exchange		Savings Mobilisation		Financial Intermediation	
Service	Fee (P)	Service	Fee (P)	Service	Fee (P)	Service	Fee (P)
Special Clearance of Cheques	87.00	Advisory on letters of credit	301.00	–	–	Vehicle/asset finance loan arrangement	480.00
Bounced Cheques*	203.00	Travellers Cheques	388.00	Maintenance on savings accounts	19.20	Other loans arrangement	420.00
ATM withdrawal	1.54	Commission on Purchase of Foreign Currency	14.75	Transaction on savings accounts	7.00	–	–
Over-the-counter withdrawal	16.54	Inter-bank transfer fee/ SWIFT	179.00	–	–	–	–

Note: – means not applicable

* ‘refer to drawer’ cheques when there are insufficient funds in the account.

11. ANTI-MONEY LAUNDERING (AML) AND THE COMBATING OF THE FINANCING OF TERRORISM (CFT)

Botswana continues to play an active role in regional and international fora aimed at combating money laundering and the financing of terrorism. In addition to on-going efforts to enhance institutional capacity for effective enforcement, initiatives are at an advanced stage for a comprehensive review of the country’s legislative framework on AML and CFT, consistent with UN Conventions and Financial Action Task Force (FATF) recommendations.

12. INTERNATIONAL SUPERVISORY ISSUES

In November 2005, the Basel Committee on Banking Supervision issued an updated version of its publication, the “*International Convergence of Capital Measurement and Capital Standards: a Revised Basel II Framework*”, and an updated version of the amendment to the Capital Accord which incorporated market risks. The targeted Basel II implementation date for the G10 countries and SADC countries remains end-2007 and 2010, respectively. Member countries of the Macroeconomic and Financial Management Institute (MEFMI) have agreed, in principle, on the end-2010 target date. It

is important to point out that each jurisdiction has discretion in the timing, scope and pace of Basel II implementation.

SADC central banks and supervisory authorities continue to forge closer links with a view to achieving greater collaboration and cooperation on matters relating to banking regulation and supervision. In June 2005, the SADC Sub-committee of Banking Supervisors met in Lilongwe (Malawi) to consider a revised Memorandum of Understanding to be submitted to the SADC Committee for Central Bank Governors.

APPENDICES

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APPENDIX 1: SUPERVISED FINANCIAL INSTITUTIONS AS AT DECEMBER 31, 2005

(A) BANKS AND OTHER DEPOSIT-TAKING INSTITUTIONS

Institution	Postal Address	Business Locations*	External Auditors
COMMERCIAL BANKS			
Barclays Bank of Botswana Limited	P O Box 478, Gaborone	33	PricewaterhouseCoopers
Standard Chartered Bank Botswana Limited	P O Box 496, Gaborone	17	KPMG
First National Bank of Botswana Limited	P O Box 1552, Gaborone	12	Deloitte & Touche
Stanbic Bank Botswana Limited	P/Bag 00168, Gaborone	8	KPMG
Bank of Baroda (Botswana) Limited	P O Box 21559, Gaborone	1	Grant Thornton Acumen
Bank Gaborone Limited	P O Box 47144, Gaborone	1	PricewaterhouseCoopers
MERCHANT BANKS			
African Banking Corporation of Botswana Limited	P/Bag 00303, Gaborone	2	KPMG
STATUTORY BANKS			
Botswana Savings Bank ¹	P O Box 1150, Gaborone		PricewaterhouseCoopers
National Development Bank	P O Box 225, Gaborone	4	Deloitte & Touche
BUILDING SOCIETIES			
Botswana Building Society	P O Box 40029, Gaborone	9	PricewaterhouseCoopers

¹ The Botswana Savings Bank uses Post Offices as its agencies for provision of services to the public.

(B) BUREAUX DE CHANGE

Name	Postal Address	Business Locations
Universal Bureau de Change	P O Box 2444, Gaborone	2
Garona Bureau de Change	P O Box 408, Gaborone	4
Kasane Bureau de Change	P O Box 55, Kasane	1
Sunny Bureau de Change	P O Box 370, Maun	3
Exim Bureau de Change	P O Box 1020, Gaborone	1
ASA Bureau de Change	P O Box 2, Lobatse	3
Prosper Bureau de Change	P/Bag BO7, Gaborone	3
Kwanokeng Bureau de Change	P O Box 10, Sherwood	1
Proxy Bureau de Change	P O Box 404108, Gaborone	2
Edcom Bureau de Change	P O Box 502429, Gaborone	2
Thari Bureau de Change	P O Box 40074, Gaborone	1
Sherwood Ranch Bureau de Change	P O Box 1, Sherwood	2
Madikwe Bureau de Change	P O Box 402885, Gaborone	1
Aldaph Bureau de Change	P O Box 41436, Gaborone	2
Counter Bureau de Change	P/Bag F388, Francistown	1
Kalahari Bureau de Change	P O Box 1116, Gaborone	1
Maeto Bureau de Change	P O Box 22, Mahalapye	1
Bellagio Bureau de Change	P/Bag BR 321, Gaborone	2
SMI Bureau de Change	P O Box 201641, Gaborone	1
American Express Bureau de Change	P O Box 45140, Gaborone	1
Star Bureau de Change	P O Box 80491, Gaborone	1
Unity Bureau de Change	P O Box 1586, Francistown	1
Open Door Bureau de Change	P O Box 839, Maun	1
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Royalty Bureau de change	Private Bag BO 259 Gaborone	1
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
Blondie Bureau de Change	P O Box 21712, Gaborone	1
FX Africa Bureau de Change	P O Box 20537, Gaborone	1
Cape to Cairo Bureau de Change	P O Box 5, Kasane	1
Business Towers Bureau de Change	P O Box 40943, Gaborone	5
Nsundano Bureau de Change	P O Box 243, Kasane	1
Theo Bureau de Change	P O Box 20918, Maun	1
Limpopo Bureau de Change	P O Box 8, Sherwood	1
Palapye Bureau de Change	P O Box 10408, Palapye	1
Rennies Bureau de Change	P O Box 2482, Gaborone	1
Investors View Bureau de Change	P O Box 266, Nata	1
Crystal Diamond Bureau de Change	P O Box 20554, Gaborone	1

(C) COLLECTIVE INVESTMENT UNDERTAKINGS

Name	Postal Address
African Alliance Botswana Management Company (Pty) Ltd	P O Box 2770, Gaborone
African Alliance International Limited	P O Box 2770, Gaborone
Stanbic Investment Management Services (Pty) Limited	Private Bag 00168, Gaborone

(D) ORGANISATIONS ISSUED WITH EITHER A BANKING LICENCE OR EXEMPTION CERTIFICATE UNDER THE INTERNATIONAL FINANCIAL SERVICES CENTRE

Name	Postal Address
Seedco. International Limited	P O Box 478143, Gaborone
ABC (International) Limited	Private Bag 00303, Gaborone
African Alliance International Limited	P O Box 2770, Gaborone
ABC Holdings Limited	Private Bag 00303, Gaborone
RPC Data International Limited	Private Bag BR 42, Gaborone
Kingdom Bank Africa Limited	P O Box 45078, Gaborone
Nugen (Pty) Limited	P O Box 408, Gaborone
Imara Holdings Limited	Private Bag 00186, Gaborone
AON Risk Management	P O Box 624, Gaborone
Wilderness Safaris Botswana (Pty) Limited	Private Bag 14, Maun
Cherubin Ventures (Pty) Limited	P O Box 1444, Gaborone
Enterprise Banking Group (Pty) Limited	Private Bag 351, Gaborone
CBRE (Pty) Limited	P O Box 3983, Harare, Zimbabwe

(E) MICRO-FINANCE INSTITUTIONS

Name	Postal Address
Women's Finance House Botswana	Private Bag 124, Gaborone

APPENDIX 2: CAPITAL ELEMENTS, RISK WEIGHTS AND DEFINITIONS OF TERMS

1. CAPITAL ELEMENTS

CORE CAPITAL+ SUPPLEMENTARY CAPITAL LESS IMPAIRMENTS OF CAPITAL = UNIMPAIRED CAPITAL

(a) Tier 1 [Core Capital = Sum of (a)(i) to (a)(v) less (a)(vi) to (a)(viii)]

- (i) Ordinary shares (issued and paid-up)
 - (ii) Perpetual (non-redeemable) non-cumulative preferred shares
 - (iii) Disclosed prior years' reserves (audited)
 - Share premium
 - General reserves
 - Accumulated retained earnings
 - (iv) Published current year's retained earnings
 - (v) Minority interests
- less*
- (vi) Current year's unpublished losses
 - (vii) Goodwill and other intangible assets
 - (viii) Shareholders' equity funded through the capitalisation of unrealized gains arising from property revaluation

(b) Tier 2 Capital [Supplementary Capital = Sum of (b)(i) to (b)(vii)]

- (i) Current year's unpublished profits
- (ii) 50% of fixed asset revaluation reserves
- (iii) Unencumbered general provisions not to exceed 1.25% of Risk Weighted Assets
- (iv) Hybrid (debt/equity) capital instruments (eligible for inclusion)
- (v) Subordinated term debt (eligible for inclusion)
- (vi) Minority interests (in Tier 2 preference shares)
- (vii) Shareholders' equity funded through the capitalisation of property revaluation reserves

(c) Impairments of Capital = Sum of (c)(i) to (c)(iv)

- (i) Investments in unconsolidated subsidiaries and associated companies
- (ii) Connected lending of a capital nature, including unlawful lending to directors, owners or their indirect interests
- (iii) Capitalised establishment costs/pre-incorporating expenses
- (iv) Underwriting commission

(d) Total Capital Funds = Sum of (a) and (b)

(e) Total Unimpaired Capital: (d) minus (c)

2. RISK WEIGHTS

TYPE	RISK FACTOR (percent)
On-Balance Sheet Items	
Cash (Pula notes)	0
Balances of accounts held at Bank of Botswana	0
Loans, advances and other credit facilities to the Government of Botswana or fully and unconditionally guaranteed by the Government of Botswana	0
Assets secured by a lien or pledge over fixed/notice or savings deposits (cash) held by the (same) bank	0
Central Bank Securities (BoBCs)	0
Advances collateralised by BoBCs or any securities issued by the Government of Botswana	0
Foreign currency notes	20
Advances to Local Government Authorities	20
Cash items in the process (course) of collection	20
Assets secured by cash investments held at another domestic bank/local financial institution	20
Due from other banks - demand or maturity under 1 year	20
Loans and other advances secured by first class bank guarantees acceptable to the Bank of Botswana	20
Loans secured by recognised multilateral development financial institutions (e.g., IBRD, ADB, etc.)	20
Claims to or credit facilities guaranteed by Statutory Corporations (Parastatals)	20
Claims to or credit facilities guaranteed by Debswana	20
Assets due from or guaranteed by other domestic public sector entities	50
Loans secured by owner occupied residential property	50
Loans secured by commercial and industrial property	100
Due from other banks maturing over 1 year	100
Credit facilities to subsidiaries of parastatals (claims on commercial companies owned by public sector entities (e.g., BDC subsidiaries)	100
Eligible equity investments	100
All other private sector advances	100
All other assets	100
Off-Balance Sheet Items	
Direct credit substitutes (guarantees, Standby Letters of Credit, Bankers Acceptances)	100
Assets securitised with recourse	100
Transaction-related contingent items (performance bonds, bid bonds, etc.)	50
Formal commitments, credit lines (original maturity over 1 year-undrawn commitments) and underwriting and note-issuance facilities	50
Short-term self-liquidating, trade-related contingencies (documentary credits secured by shipment)	20
Forward foreign exchange contracts (over 1 year)	5
Forward foreign exchange contracts (under 1 year)	1
Undrawn commitments, original maturity under 1 year or less or can be cancelled	0
Currency Swaps	0
BoBCs held on behalf of customers	0

3. DEFINITIONS OF BANKING SUPERVISION TERMS

- (a) **Asset Concentration:** Measures aggregate exposure to one borrower, an affiliated group of borrowers, or borrowers with a common controlling interest, common management, cross guarantees or financial interdependency which cannot be substituted in the short term. This exposure is usually expressed as a percentage of the bank's unimpaired capital and its various thresholds are subjected to prudential regulatory requirements. In terms of the Banking Act, exposure in excess of 10 percent of the bank's unimpaired capital is deemed an asset concentration requiring prior approval of the Board of Directors of the lending financial institution. Exposure in excess of 30 percent of the bank's unimpaired capital requires prior Bank of Botswana approval.
- (b) **Asset Quality:** A relative measure of the performance of the bank's loan portfolio based on the appraisal of the asset, concerning the degree of risk and the likelihood of recovery, adherence to the terms of contracts and orderly liquidation of the account. Good quality asset means the loan, advance, or investment is producing cash flow as was expected and/or agreed upon.
- (c) **Adverse Classifications:**
- (i) **"Substandard" Assets** - A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well defined weakness or weaknesses that jeopardise the liquidation of the debt. They are characterised by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.
 - (ii) **"Doubtful" Assets** - An asset classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristics 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 assets, its classification as an estimated loss is deferred until its more exact status can be determined.
 - (iii) **"Loss" Assets** - Assets classified as losses are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this potentially worthless asset even though partial recovery may be effected in future.
- (d) **Core Capital:** an aggregate of share capital, share premium, general reserve and retained earnings, also called Tier 1 capital. It represents the most stable and permanent form of capital for supporting a bank's operations. (See Appendix 2 for computations).
- (e) **Total Risk Weighted Assets:** An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk weighting are presented on page 20.
- (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 or other creditors in the event of the liquidation or dissolution of the bank, and the absence of any condition or arrangement which would, in the opinion of the Central Bank, diminish the value of the whole or any portion of the capital of the bank. An outline of capital elements used to compute unimpaired capital is presented on page 19.
- (g) **Weighted Classifications:** represents an aggregate of 20 percent of the value of accounts classified "Substandard", 50 percent of the value of accounts classified "Doubtful" and a total of the value of accounts classified "Loss".

APPENDIX 3: AGGREGATE FINANCIAL STATEMENTS OF LICENSED BANKS: 2001–2005

TABLE 3.1: AGGREGATE BALANCE SHEET OF LICENSED BANKS: 2001–2005 (PULA MILLION)

Total Assets in Local Currency	2001	2002	2003	2004	2005
1. Cash and balances with the Central Bank	471.6	628.2	776.3	843.0	722.2
a. Currency	258.7	327.8	316.7	314.1	375.2
aa. Hard currency and gold bullion	38.0	33.7	32.5	35.1	29.3
ab. Local currency	220.7	294.1	284.2	279.0	345.9
b. Balances with the Central Bank	212.9	287.7	417.7	432.1	347.0
c. Other	0.0	17.4	248.5	254.6	51.5
2. Trading securities at market value (BoBCs)	2 015.0	1 946.9	2 517.7	3 046.3	4 771.1
3. Placements with other banks and credit institutions	2 997.2	1 959.7	2 004.5	1 957.3	3 002.2
4. Loans and advances to other customers (net of specific provisions)	5 608.6	6 862.9	7 609.2	8 680.7	9 129.5
5. Investment securities	78.4	82.9	532.6	385.6	189.6
6. Fixed assets net of depreciation	178.0	197.8	208.8	212.2	199.8
7. Other assets (net)	274.8	368.5	429.5	408.7	527.9
Total Assets	11 623.6	12 046.9	14 078.6	15 533.8	18 542.4
Liabilities in Local Currency					
1. Amounts owed to government institutions	117.9	113.6	108.8	104.2	104.2
a. Central Bank accounts	0.0	0.0	0.0	0.0	0.0
b. Direct Government credits (CB or MoF)	117.9	113.6	108.8	104.2	104.8
c. Other	0.0	0.0	0.0	0.0	0.0
2. Due to other banks and credit institutions	229.0	244.2	254.4	410.4	1459.9
3. Securities sold under repurchase agreements	0.0	0.0	0.0	0.0	0.0
4. Due to other customers/depositors	9 718.4	9 701.3	11 488.4	12 568.7	14 019.4
5. Shareholders funds	1 014.3	1 219.7	1 436.4	1 233.8	1 417.8
6. Other liabilities	544.0	719.5	790.6	900.3	1 301.1
a. Taxes payable	116.7	126.4	61.7	102.9	118.2
b. Dividends payable	184.6	219.4	53.2	118.3	33.3
c. Accrued expenses	41.1	82.0	135.0	30.6	15.3
d. Other	201.6	291.7	540.7	648.4	1 134.4
7. Other borrowing including international lending agencies	0.0	48.5	0.0	316.5	239.3
Total Liabilities	11 623.6	12 046.9	14 078.6	15 533.8	18 542.4

TABLE 3.2: AGGREGATE INCOME STATEMENT OF LICENSED BANKS: 2001–2005 (PULA MILLION)

	2001	2002	2003	2004	2005
1. Interest and similar income	1 320.2	1 544.8	1 790.7	1 903.6	2 172.4
2. Interest expense	676.9	779.4	914.9	970.8	1 094.0
3. Net interest income [1-2]	643.3	765.4	875.7	932.8	1 078.4
4. Other operating income	367.5	452.2	487.9	545.6	666.2
5. Gross operating income/(loss) [3+4]	1 010.8	1 217.6	1 363.6	1 478.4	1 744.6
6. Bad and Doubtful Debts Provisions	44.0	46.5	74.7	50.2	53.5
a) Specific loss provision expenses	43.9	61.9	88.9	94.0	66.1
b) General loss provision	7.3	8.3	8.9	(22.6)	5.9
c) Releases and Recoveries of bad debts previously written off	(7.2)	(23.8)	(23.1)	(21.2)	(18.4)
7. Operating income/(loss) net of specific loss provisions	966.8	1 171.1	1 288.9	1 428.2	1 691.0
8. Operating expenses	446.8	574.2	661.2	707.8	785.5
a) Salaries and employee benefits	213.0	262.4	300.0	313.1	340.5
b) Administrative expenses	16.6	22.2	0.0	97.4	21.7
c) Auditing and consulting expenses	3.4	6.9	0.4	25.5	1.2
d) Rents paid	6.6	9.3	22.2	32.9	16.6
e) Depreciation and amortization	30.7	30.0	38.5	38.4	9.9
f) Other	176.5	243.4	300.2	200.5	395.6
9. Other provisions and write-offs	0.0	0.0	0.0	0.0	0.8
a) Investments	0.0	0.0	0.0	0.0	0.8
b) Other balance sheet items	0.0	0.0	0.0	0.0	0.0
c) Off-balance sheet items	0.0	0.0	0.0	0.0	0.0
10. Net operating income/(loss) [7-8-9]	520.0	596.8	627.7	720.3	904.7
11. Extraordinary Gains/(Losses)	0.0	(2.0)	(0.4)	(2.1)	0.0
a) Gains/Losses on revaluation of assets (Net)	0.0	(2.0)	0.0	0.0	0.0
b) Translation Gains/Losses (Net)	0.0	0.0	0.0	0.0	0.0
c) Other Gains/Losses	0.0	0.0	(0.4)	(2.1)	0.0
12. Net income/(loss) before tax [10+11]	520.0	594.9	627.3	718.2	904.7
13. Income tax	87.6	83.7	84.0	119.1	148.2
14. Net income/(loss) after tax [12-13]	432.4	511.2	543.3	599.2	756.6
15. Transfers from revaluation/to general provisions	(0.9)	(0.8)	0.0	(0.3)	0.0
16. Dividends declared (paid & proposed)	294.6	489.7	399.0	476.9	525.9
17. Retained earnings for the year [14-15-16]	138.8	22.3	144.3	122.5	230.6
18. Retained earnings at the beginning of the year	497.1	635.9	658.2	774.5	897.0
19. Retained earnings at the end of the year [17+18]	635.9	658.2	802.4	897.0	1 127.7

APPENDIX 4: CHARTS OF KEY PRUDENTIAL AND OTHER FINANCIAL INDICATORS

CHART 4.1: UNIMPAIRED CAPITAL

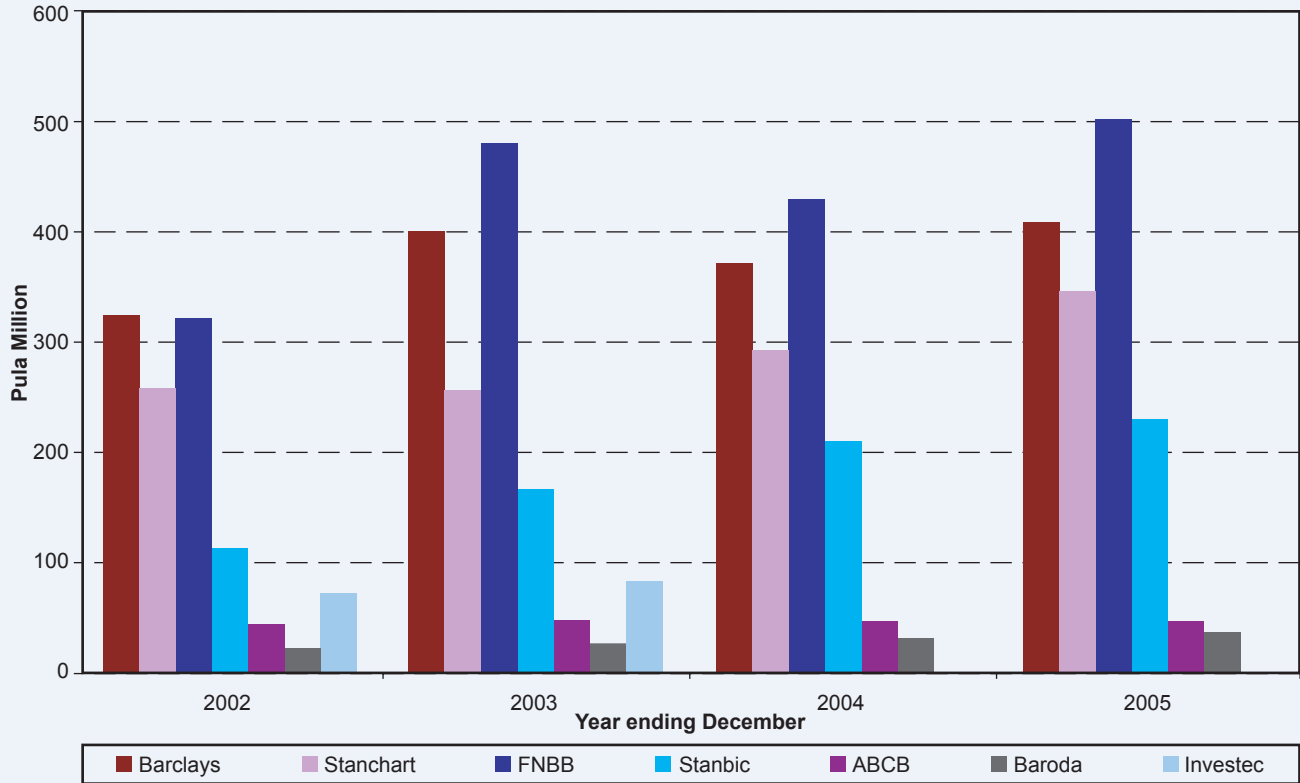


CHART 4.2: CORE CAPITAL TO TOTAL CAPITAL

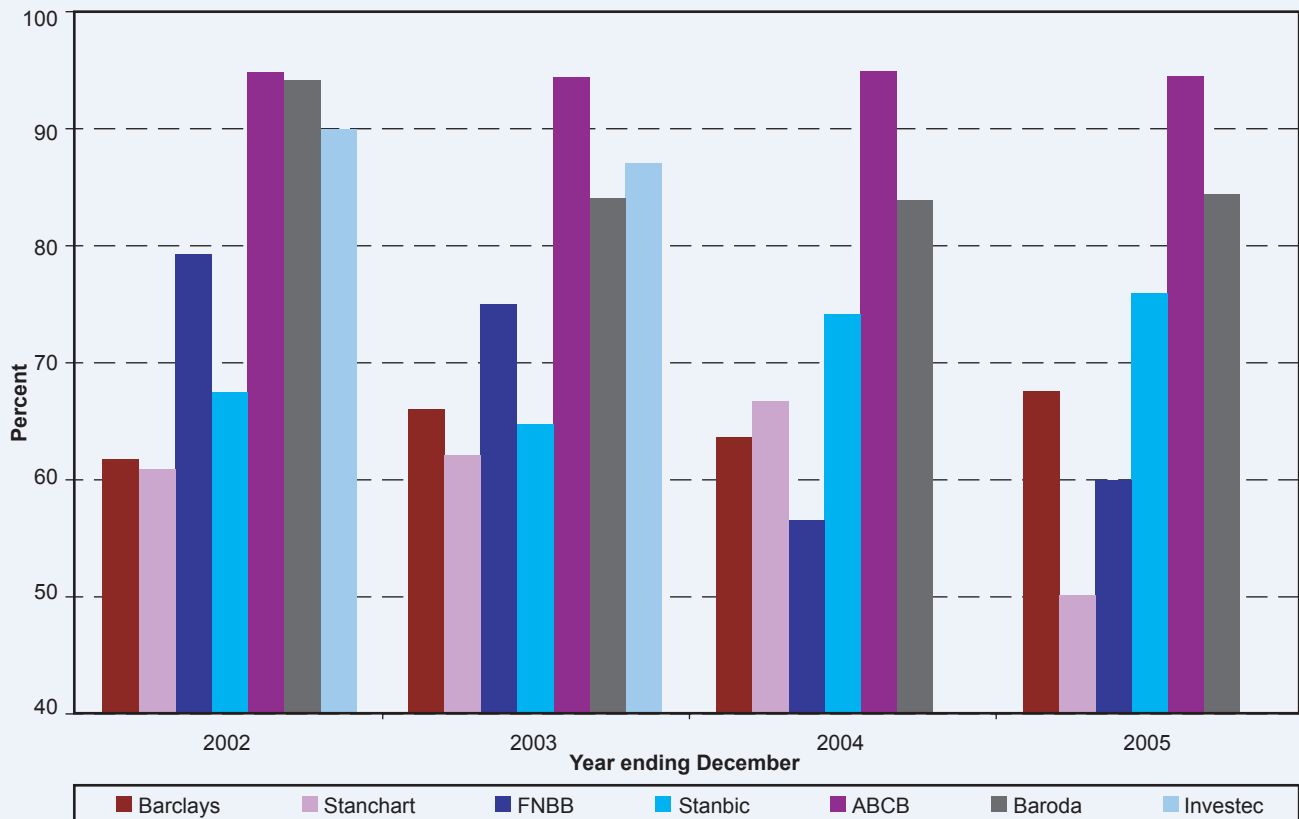


CHART 4.3: CORE CAPITAL TO RISK-WEIGHTED ASSETS

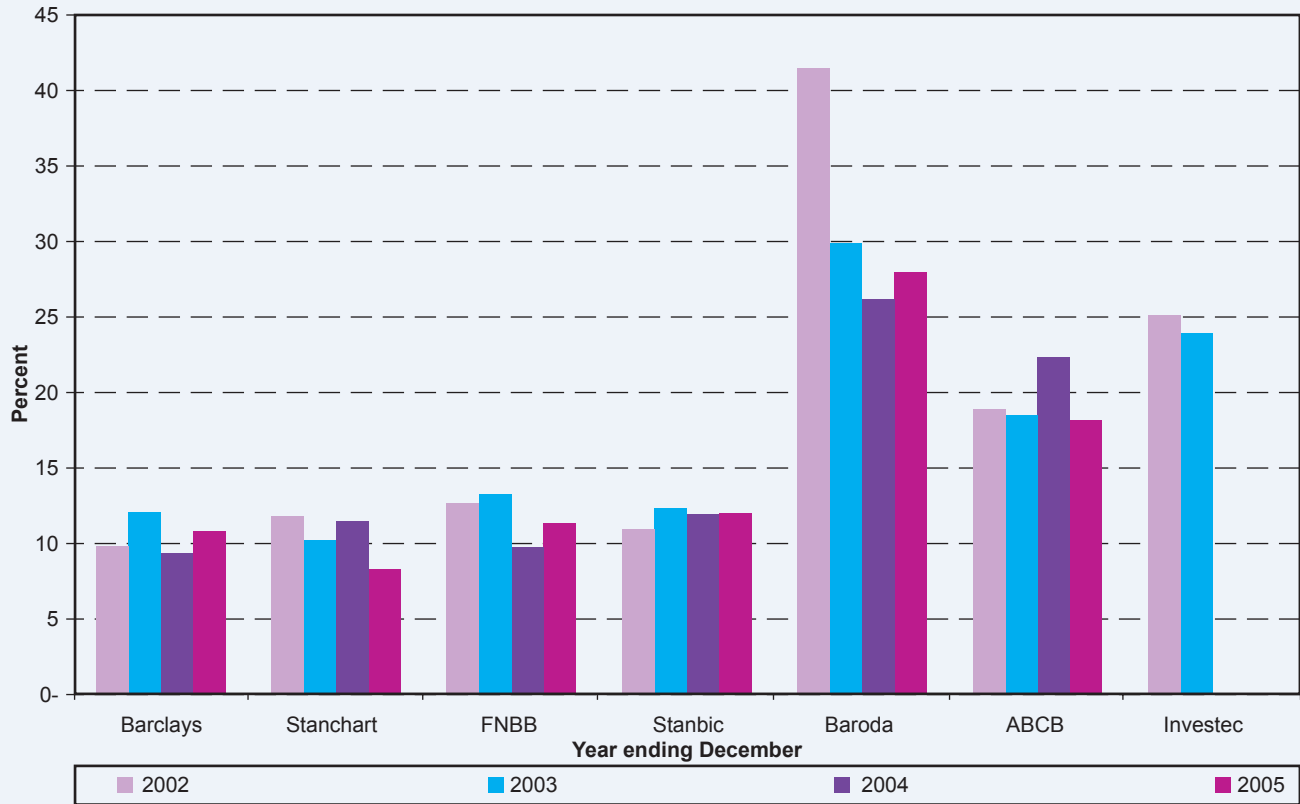


CHART 4.4: UNIMPAIRED CAPITAL TO RISK-WEIGHTED ASSETS (CAPITAL ADEQUACY)

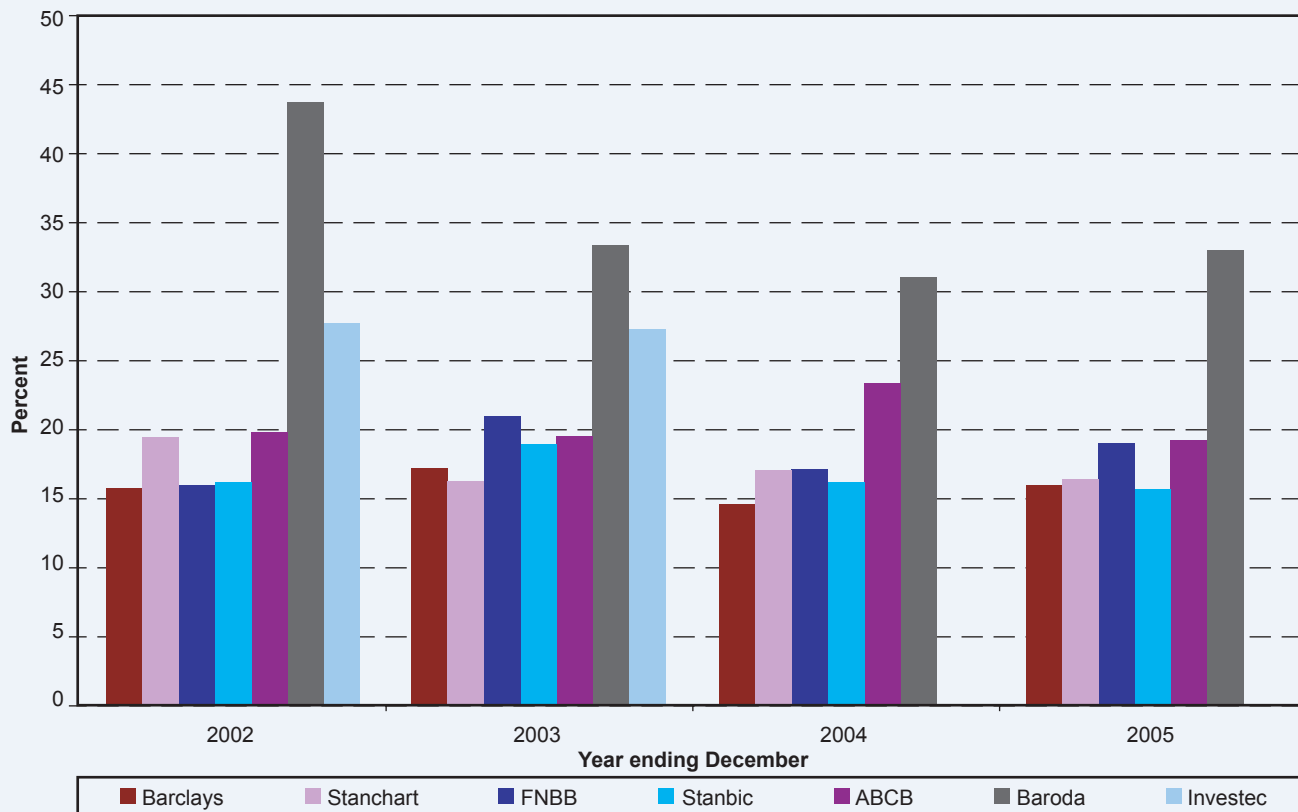


CHART 4.5: LEVEL AND GROWTH OF NET INCOME AFTER-TAX

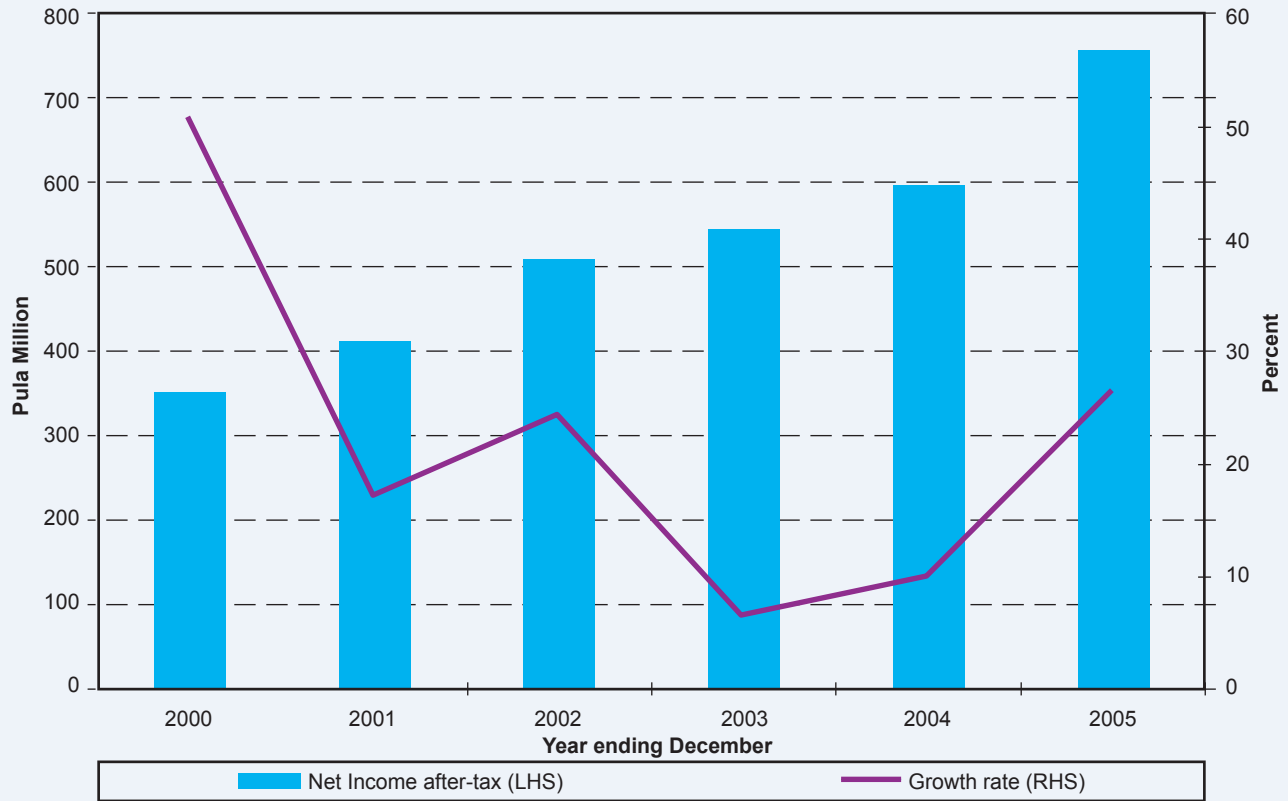


CHART 4.6: RETURN ON AVERAGE TOTAL ASSETS

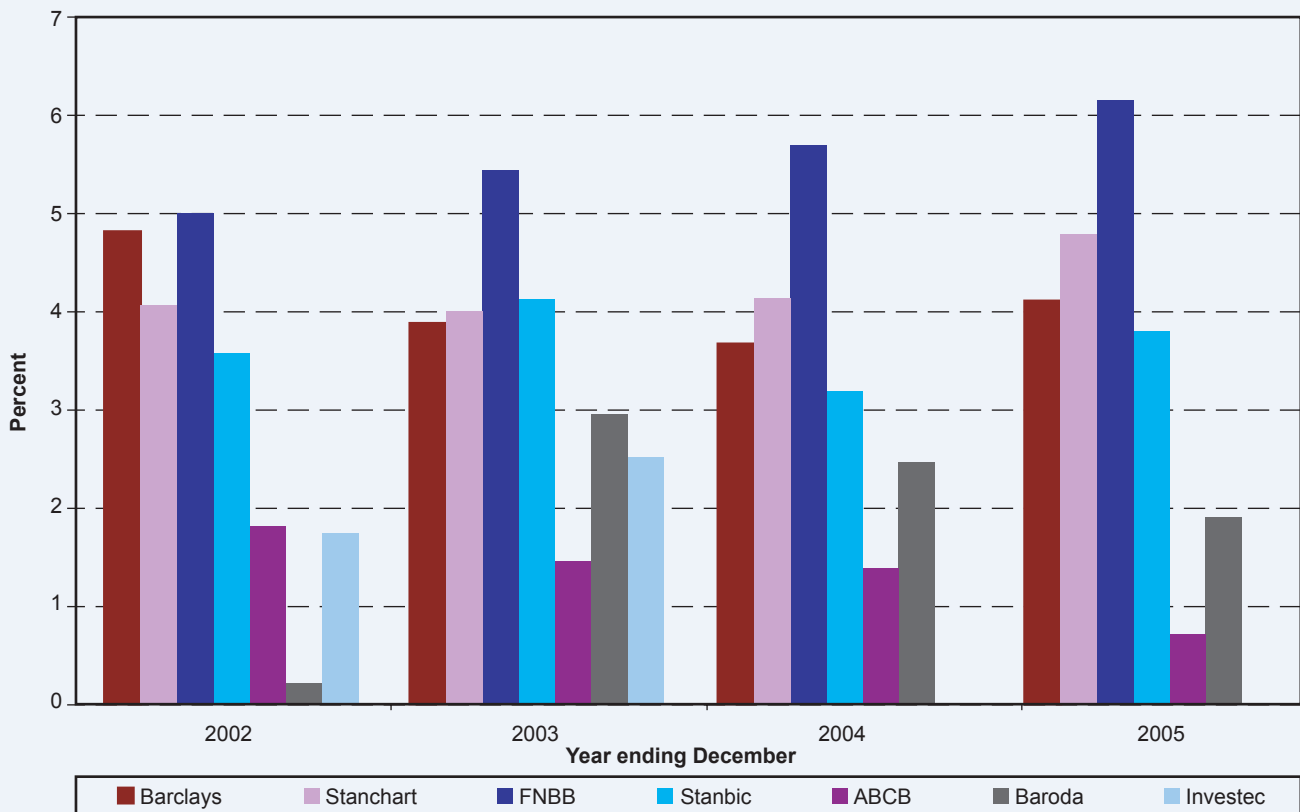


CHART 4.7: RETURN ON EQUITY

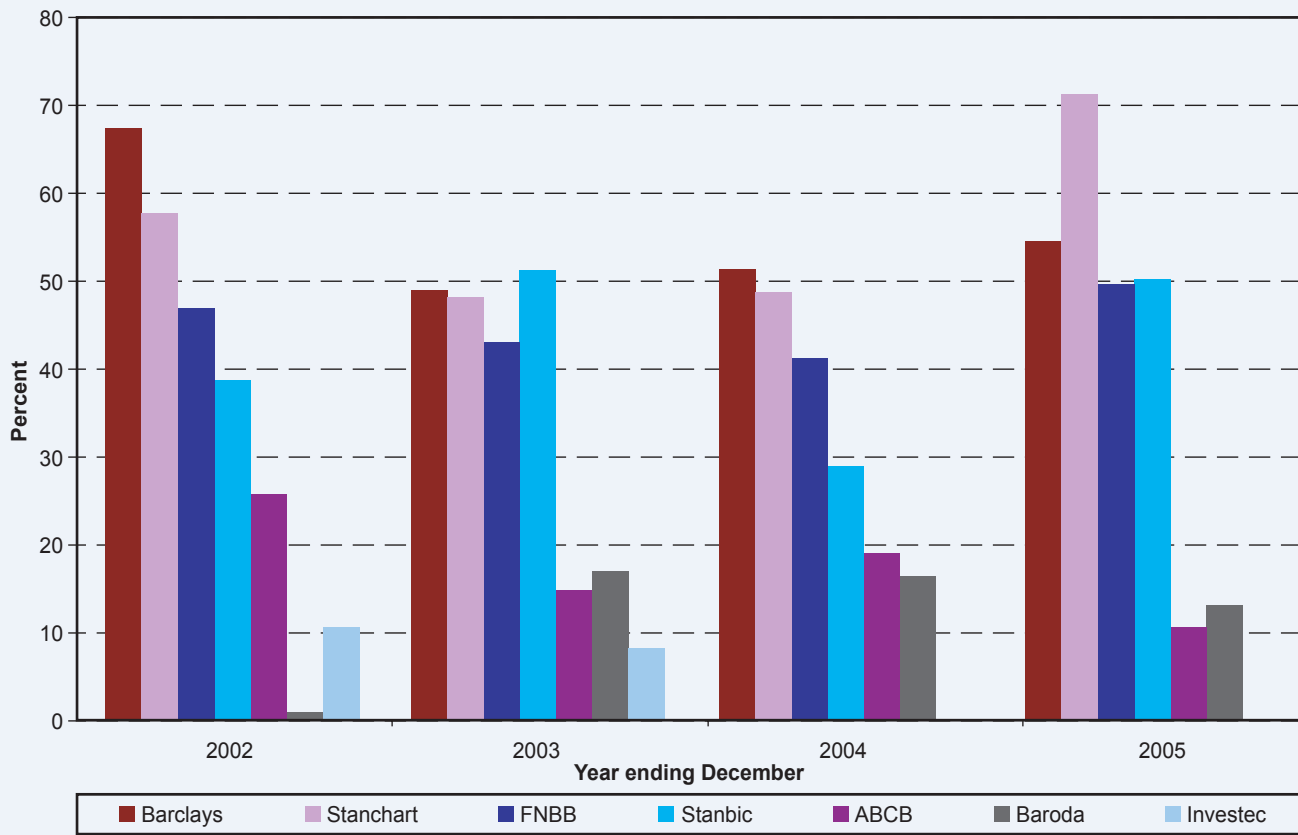


CHART 4.8: NON-INTEREST INCOME TO GROSS INCOME

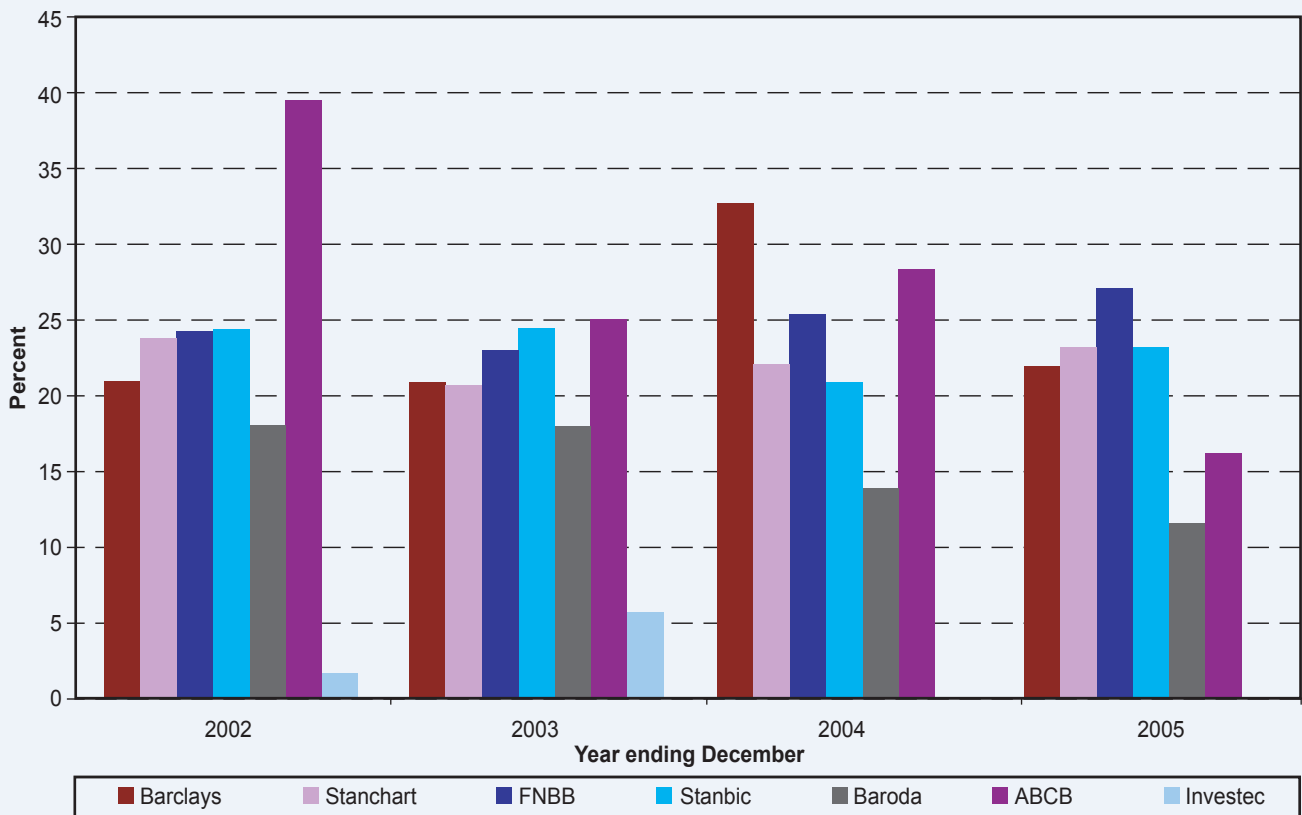


CHART 4.9: INTEREST INCOME TO AVERAGE TOTAL ASSETS

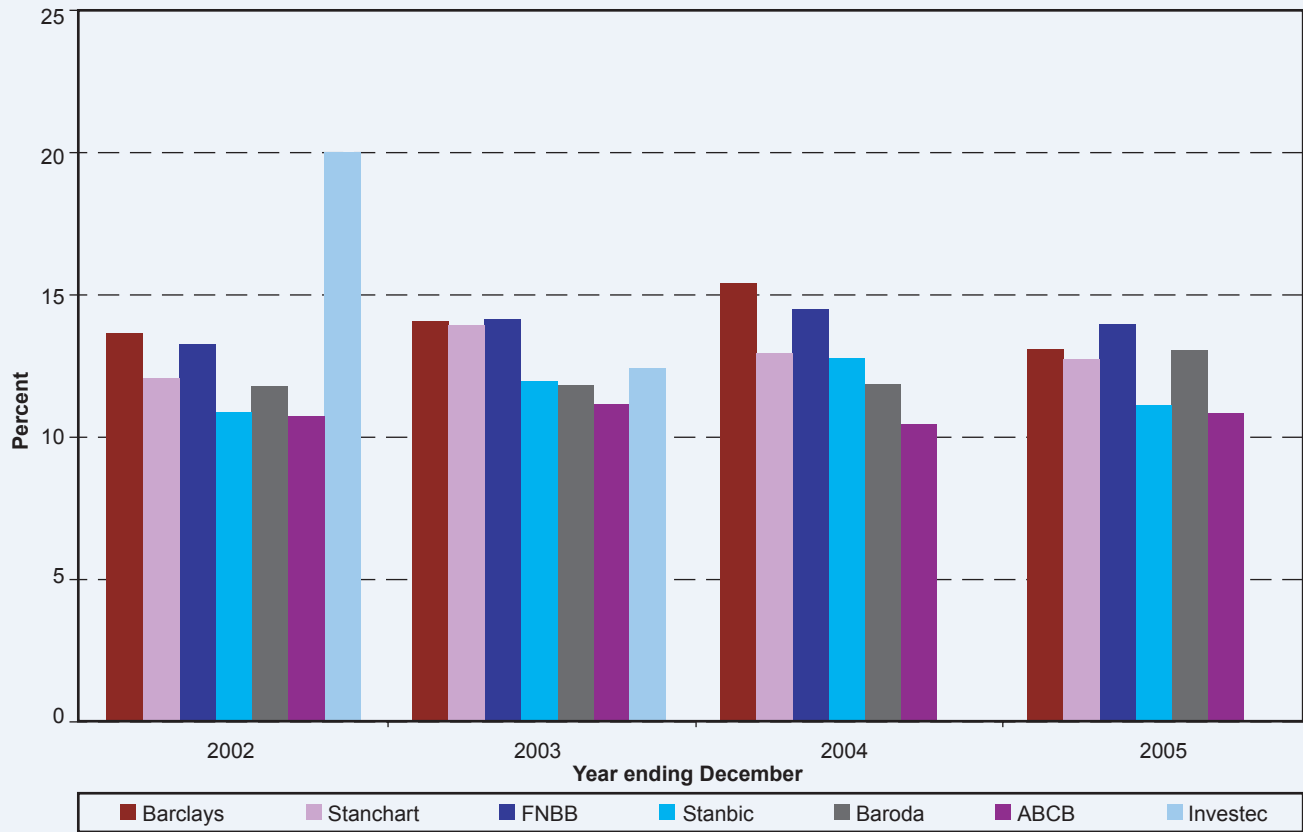


CHART 4.10: NON-INTEREST INCOME TO AVERAGE TOTAL ASSETS

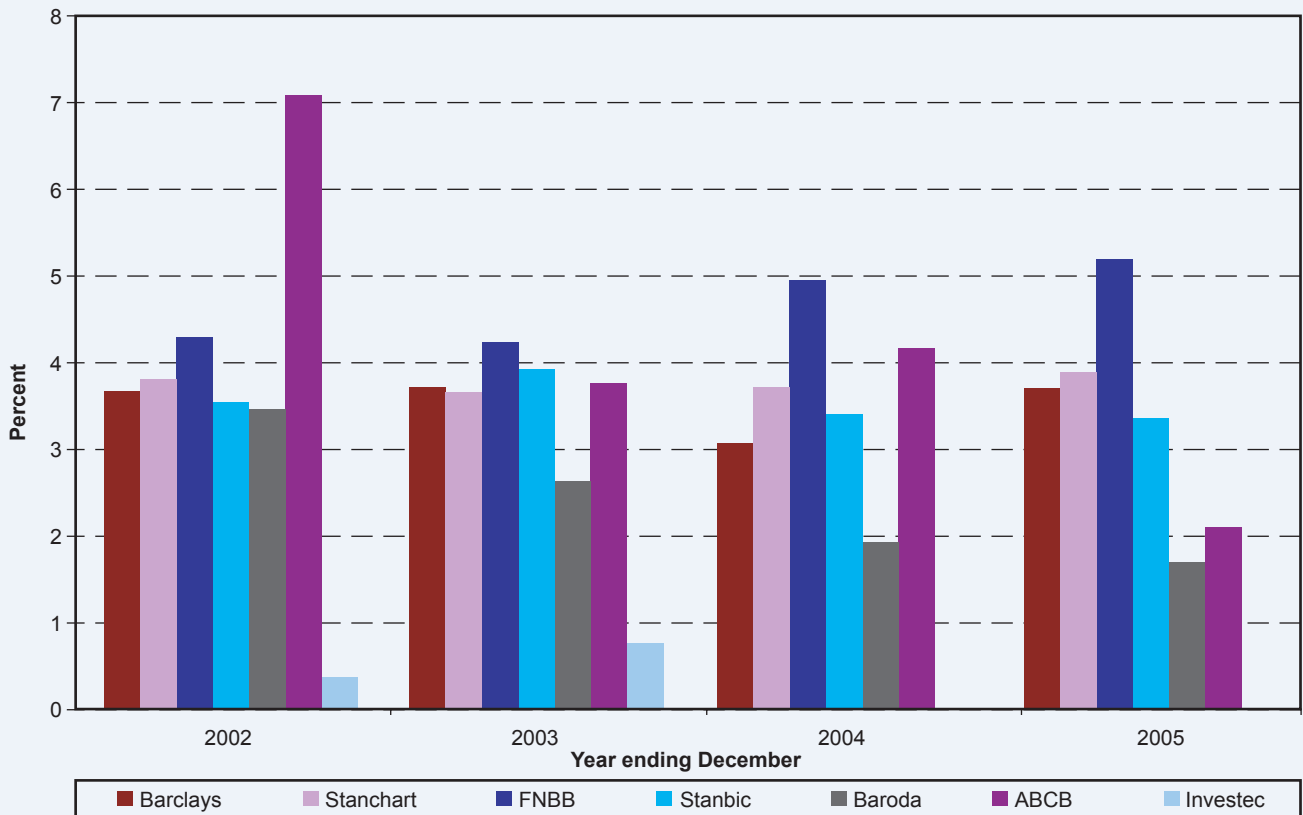


CHART 4.11: NON-INTEREST EXPENSE TO AVERAGE TOTAL ASSETS

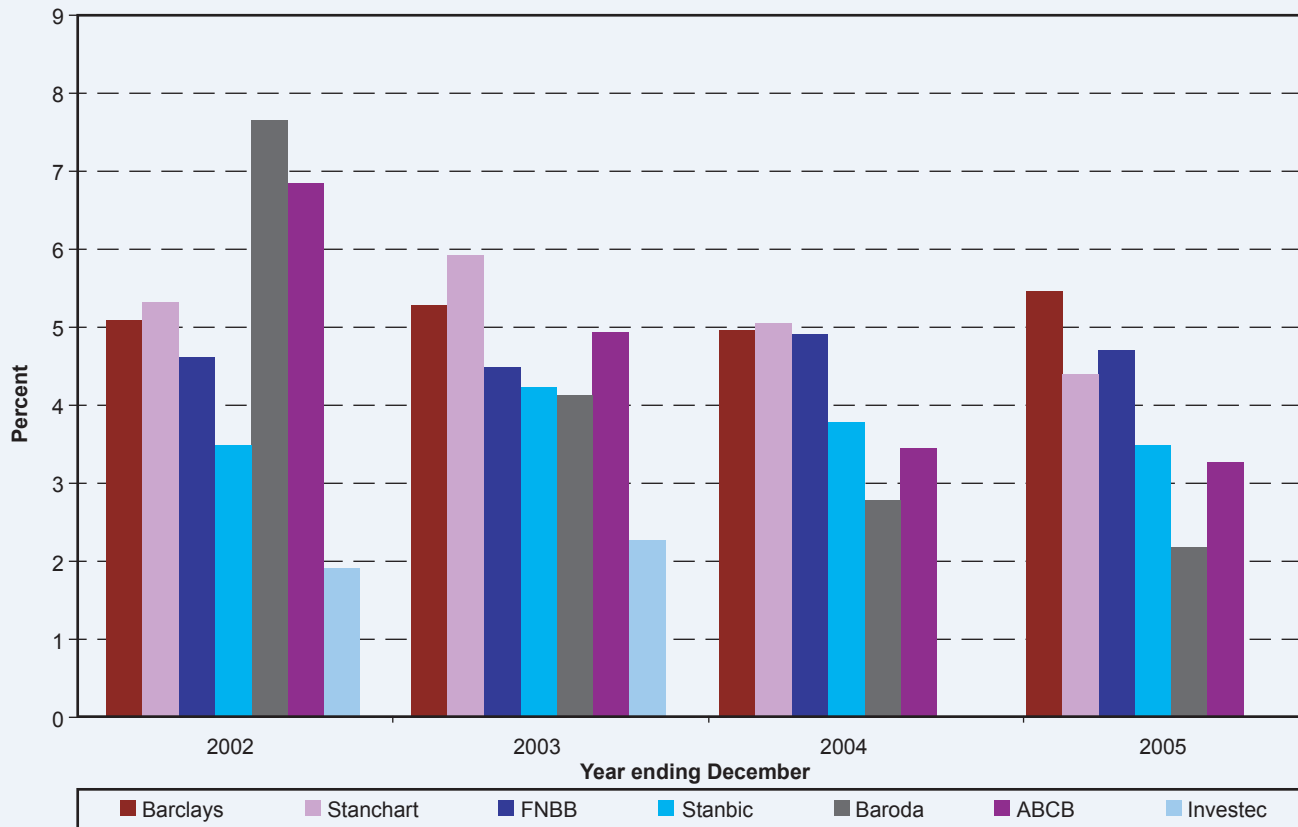


CHART 4.12: COST TO INCOME RATIO

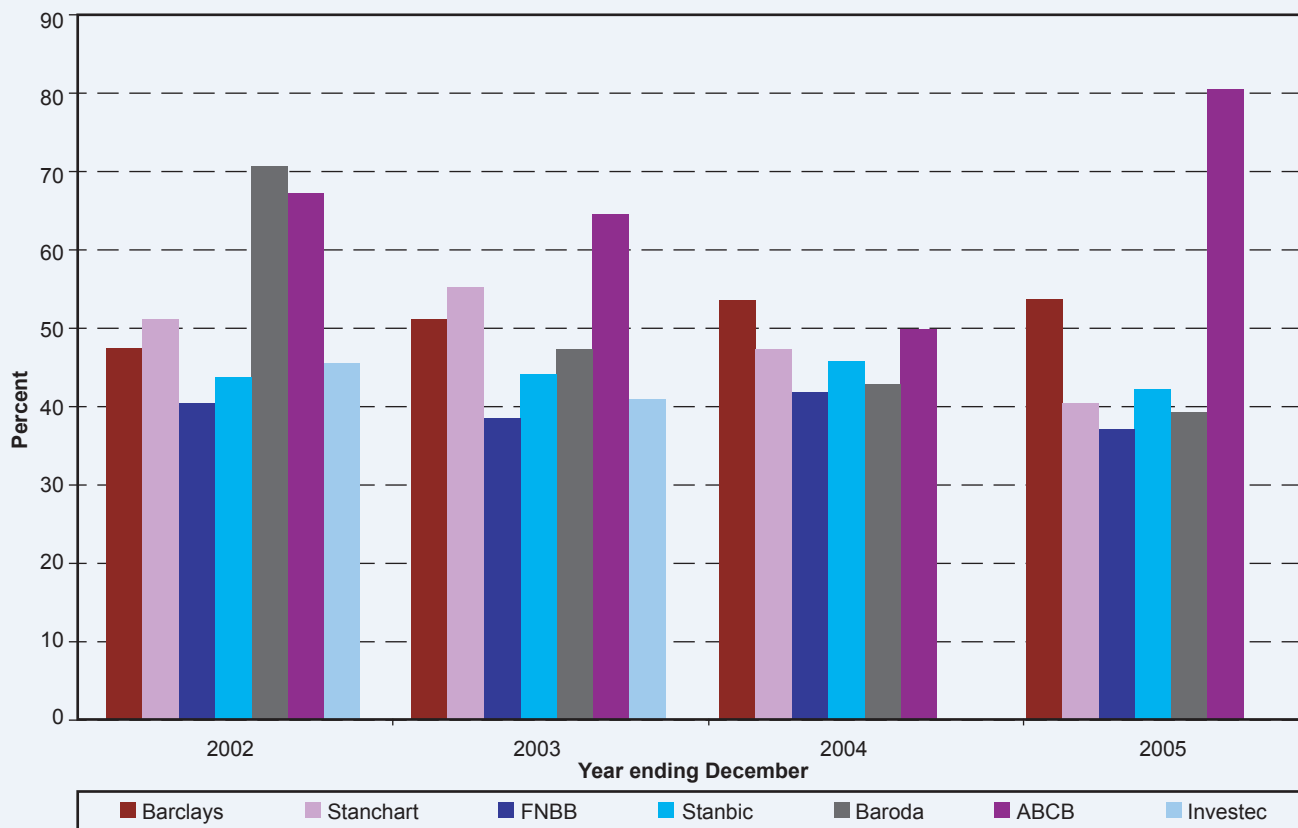


CHART 4.13: AVERAGE COST OF DEPOSIT

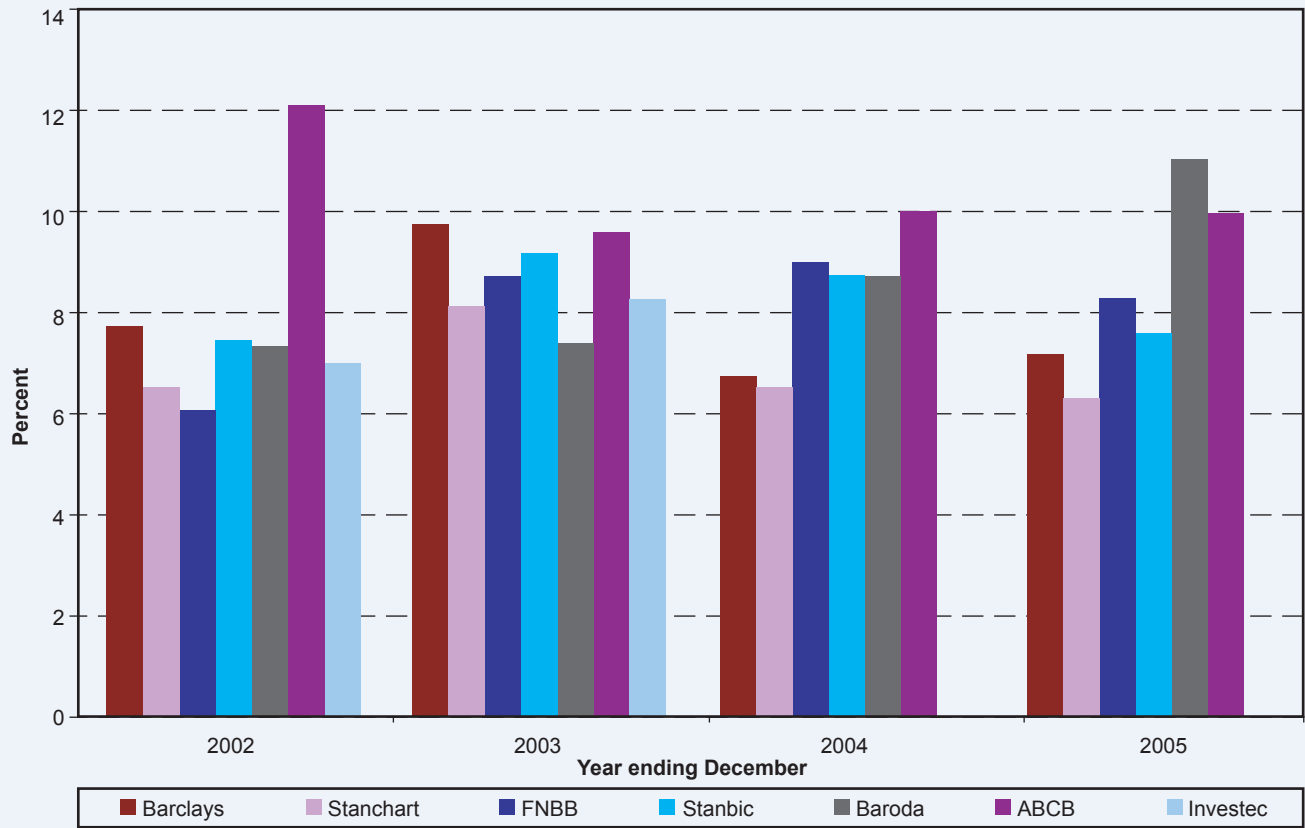


CHART 4.14: TOTAL PROVISIONS FOR BAD DEBTS

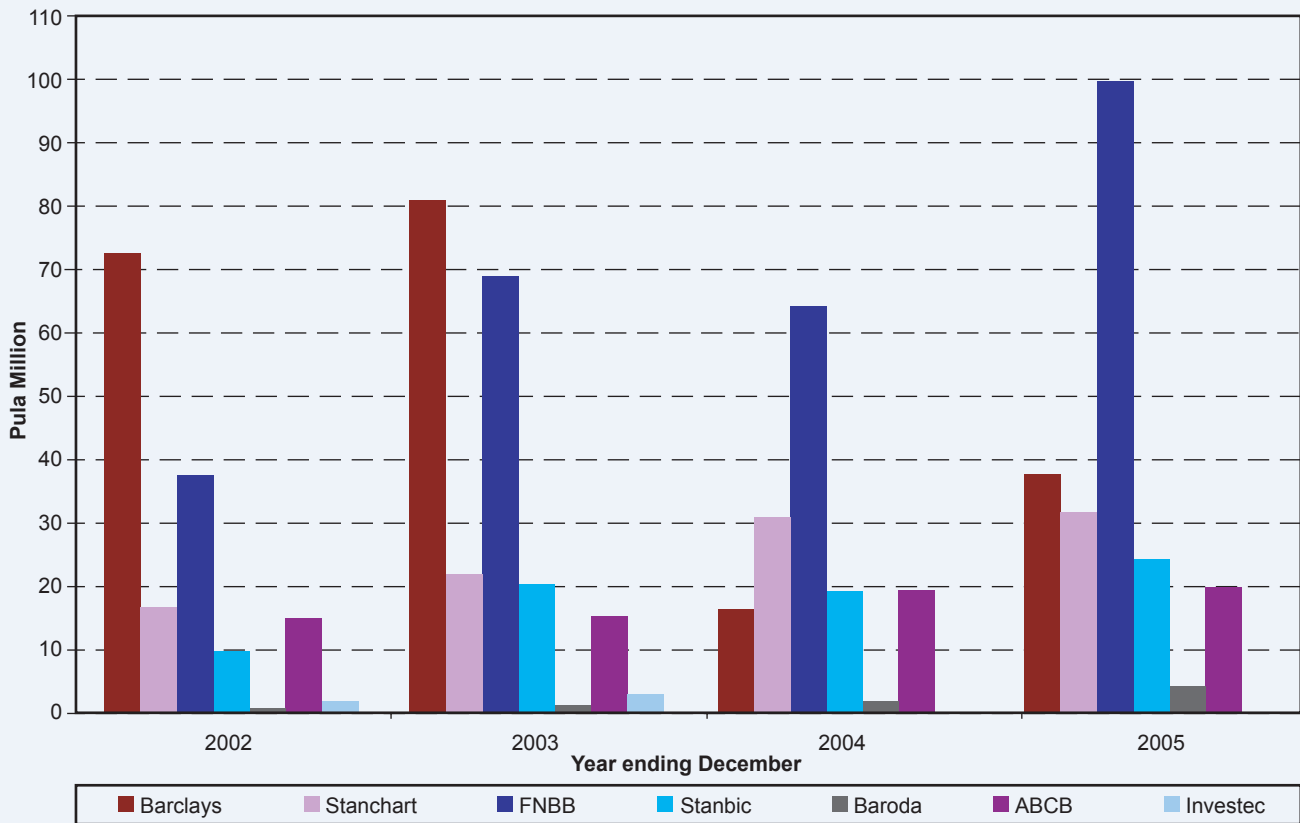


CHART 4.15: ADVANCES TO DEPOSITS RATIO

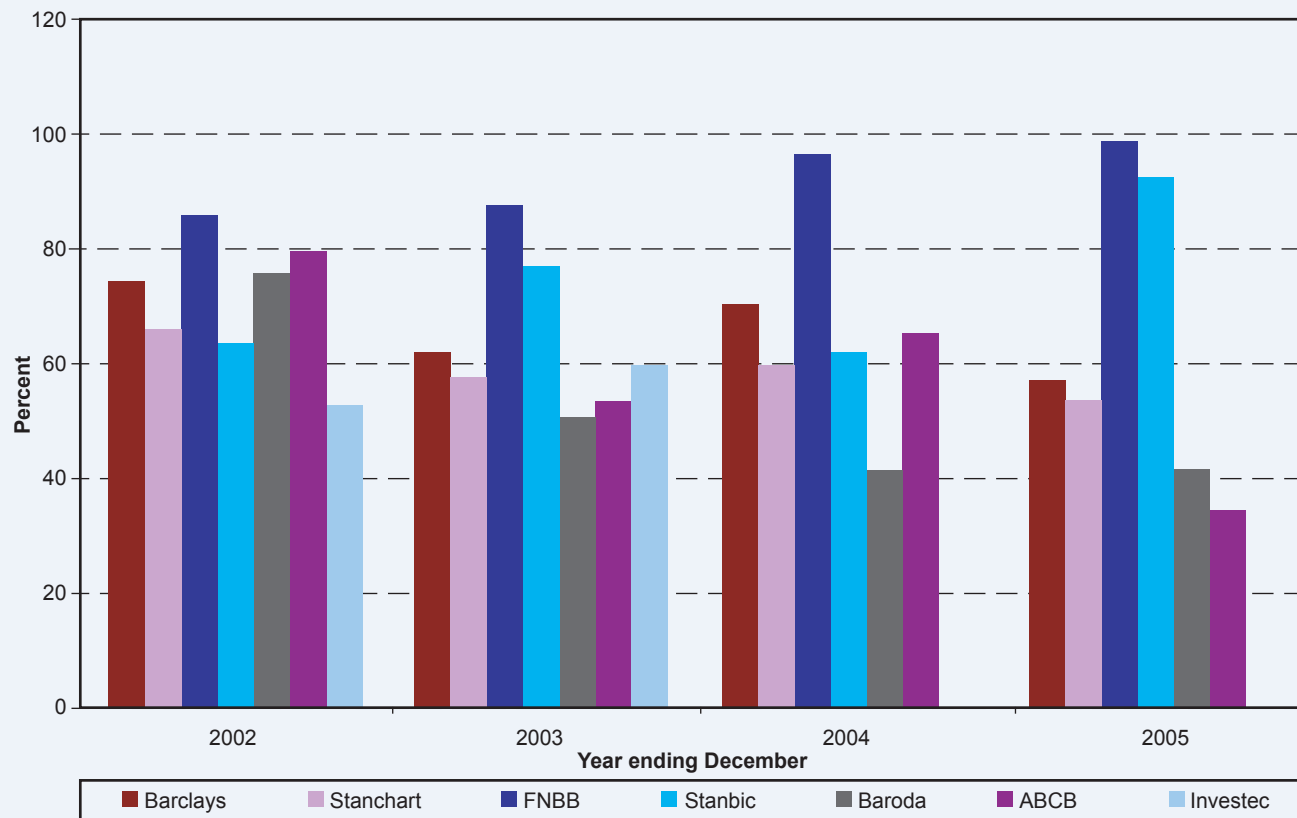


CHART 4.16: NUMBER OF DEPOSIT ACCOUNTS

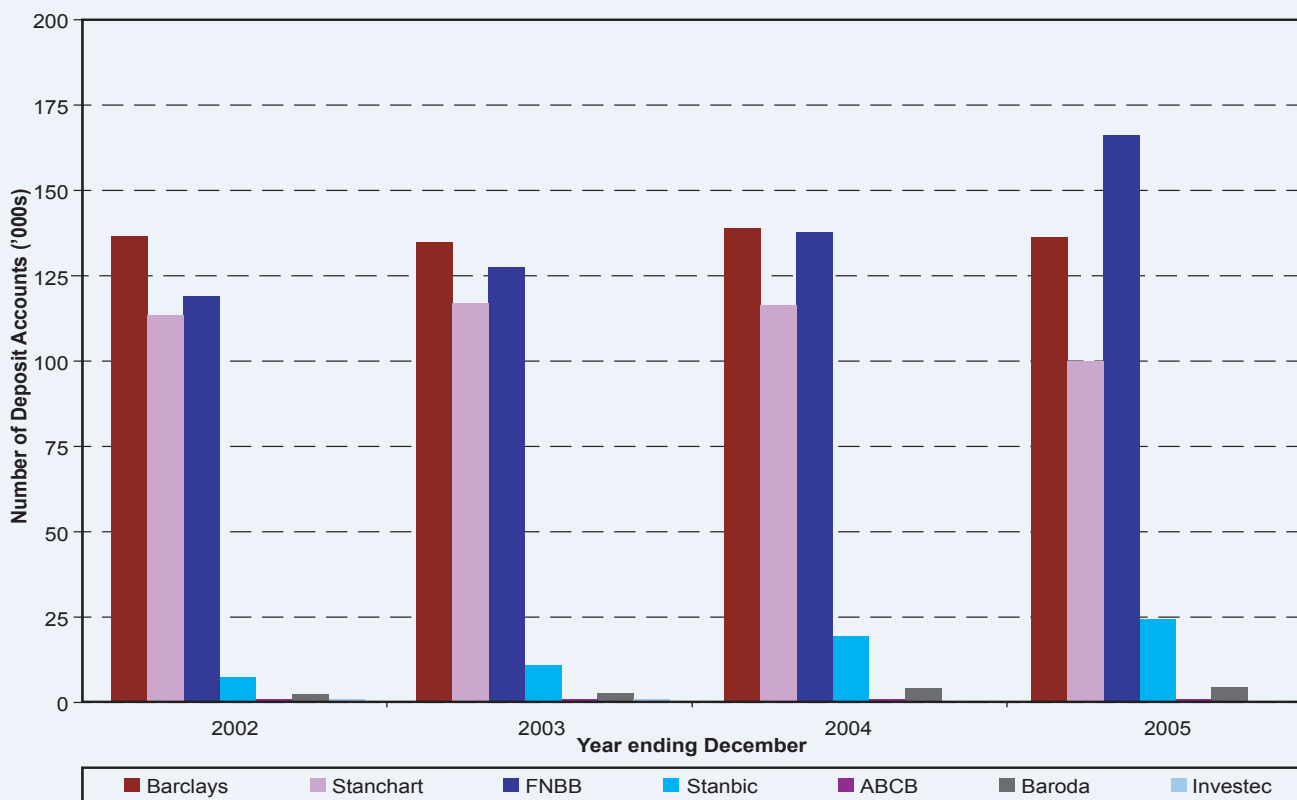


CHART 4.17: VALUE OF CURRENT ACCOUNTS

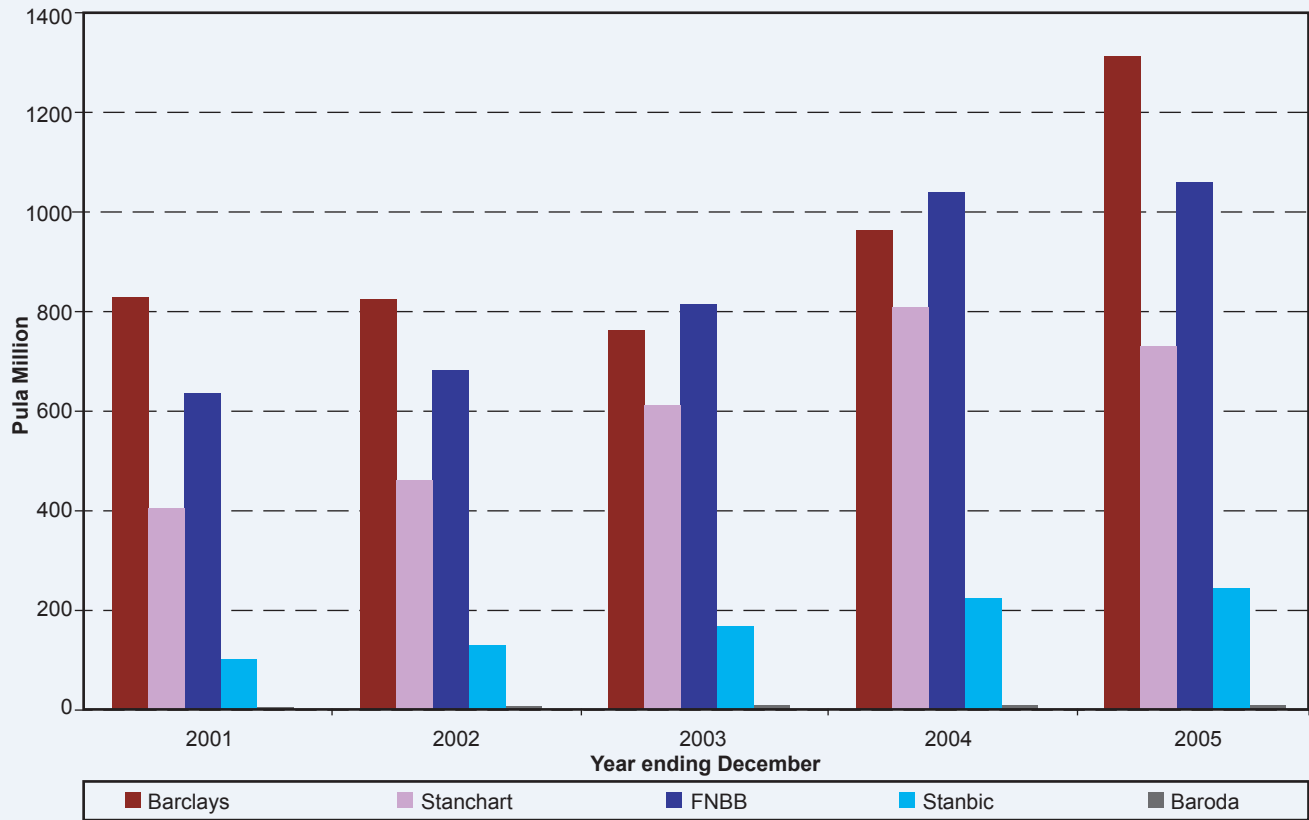
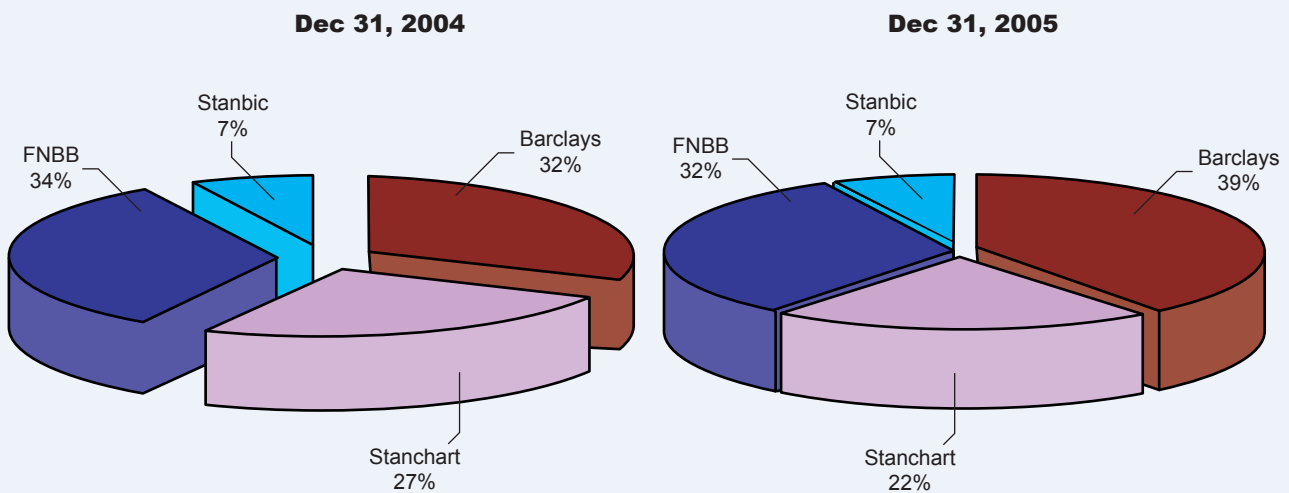


CHART 4.18: MARKET SHARE OF VALUE OF CURRENT ACCOUNTS



Note: ABCB has no current accounts

CHART 4.19: VALUE OF CALL ACCOUNTS

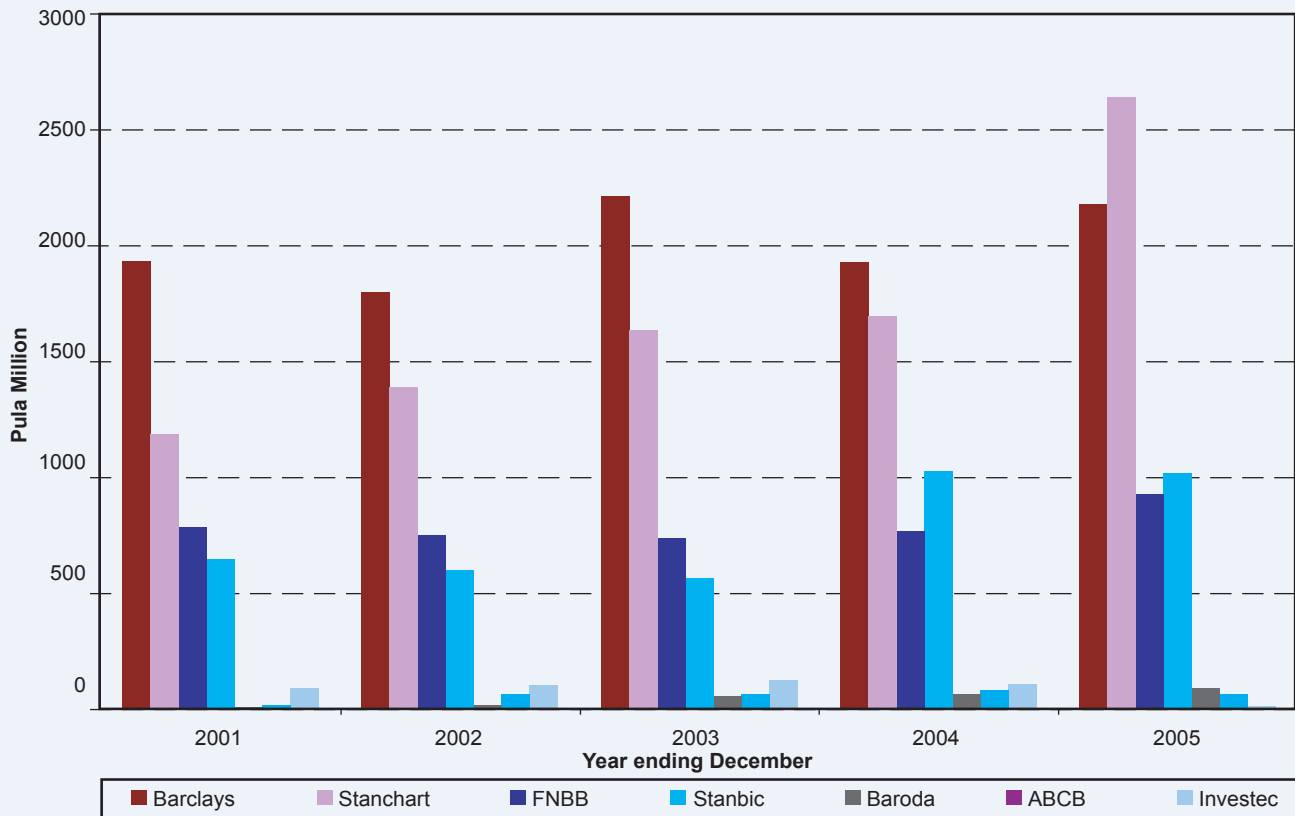


CHART 4.20: MARKET SHARE OF VALUE OF CALL ACCOUNTS

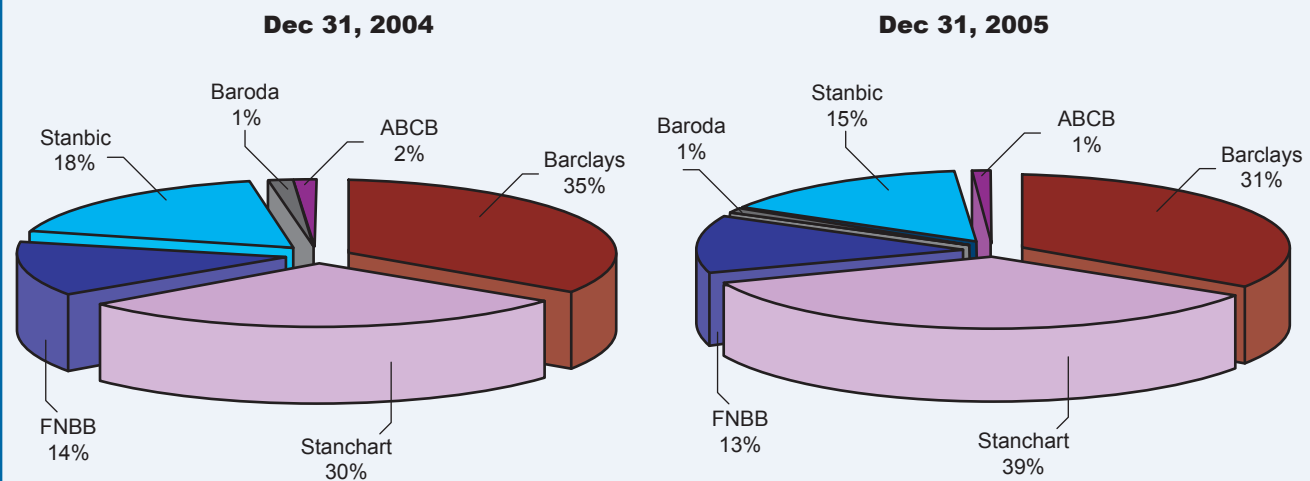


CHART 4.21: VALUE OF SAVINGS ACCOUNTS

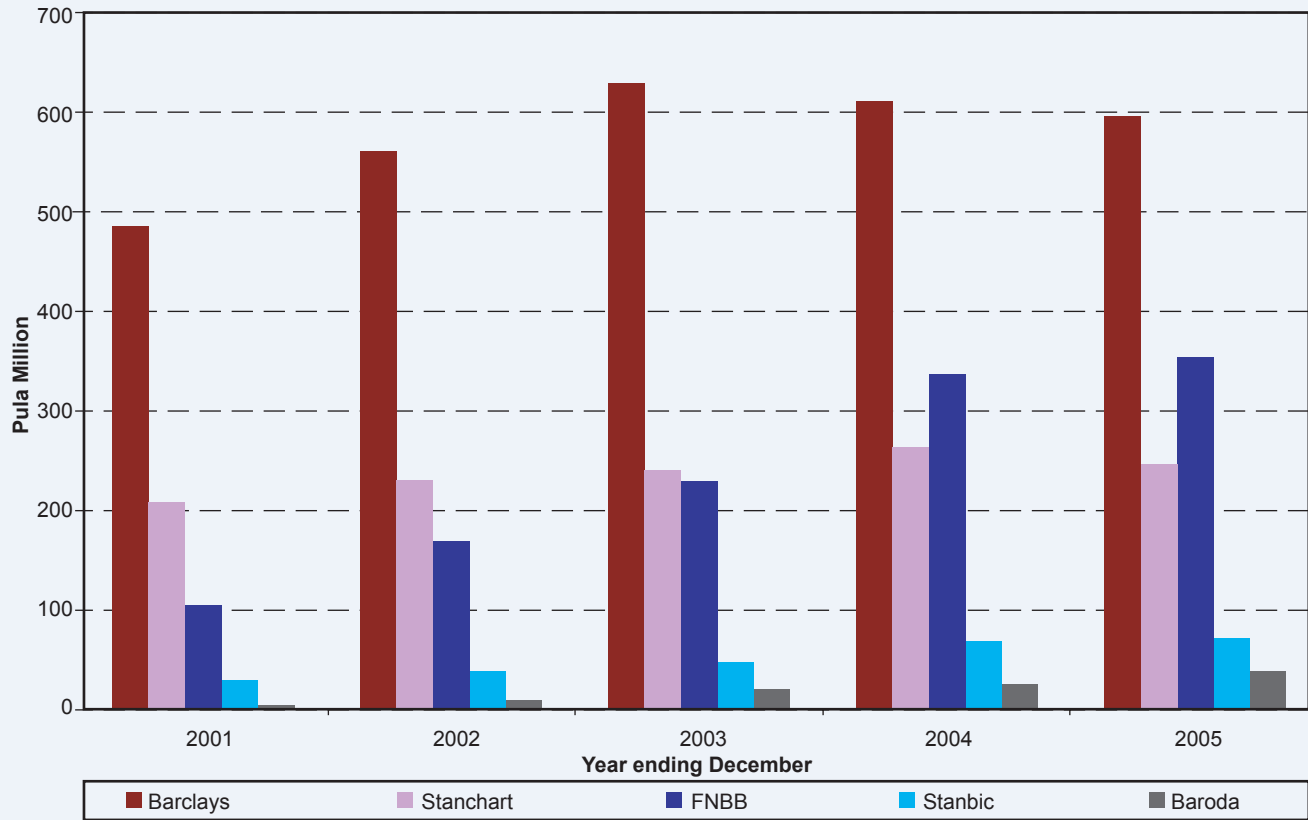


CHART 4.22: MARKET SHARE OF VALUE OF SAVINGS ACCOUNTS

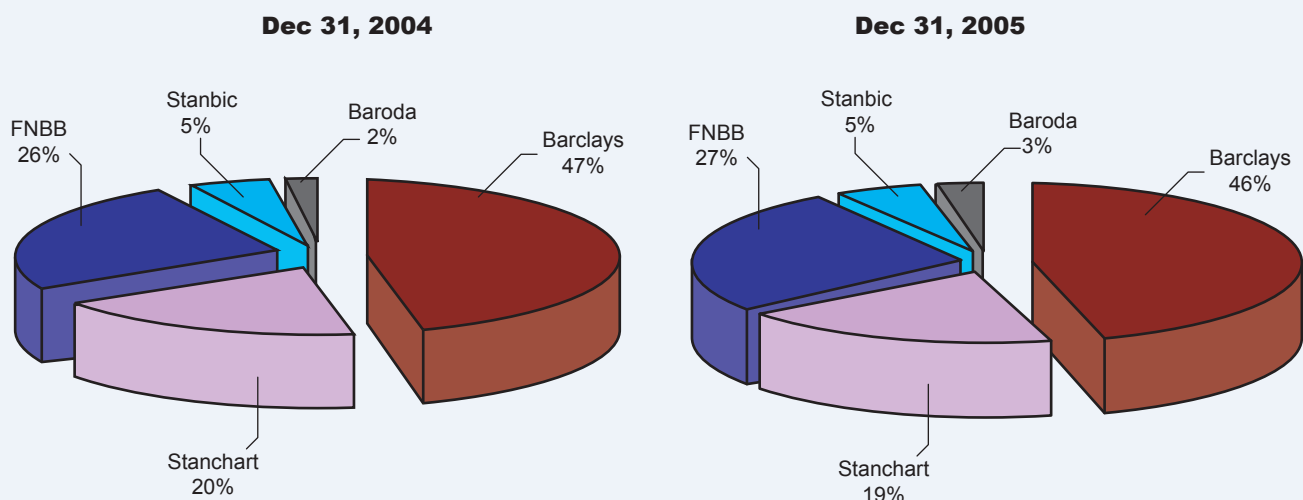


CHART 4.23: VALUE OF TIME DEPOSIT ACCOUNTS

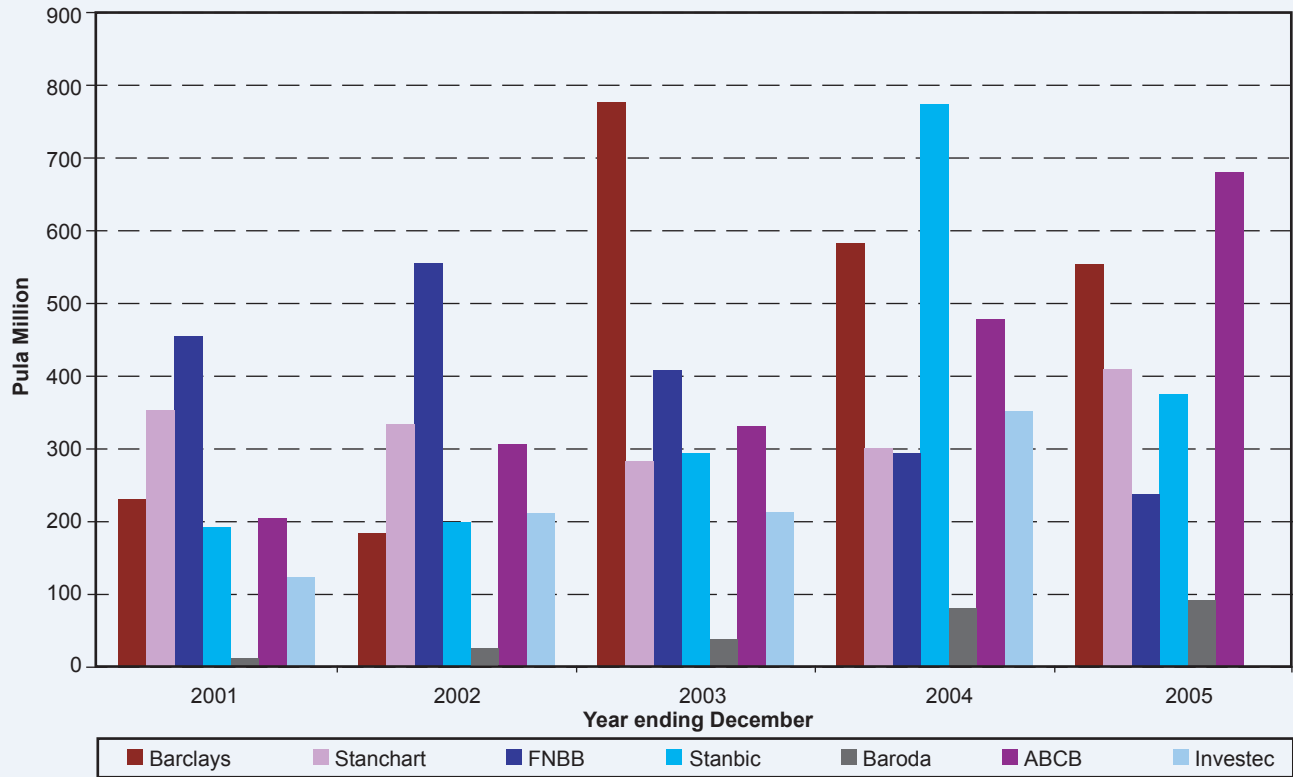


CHART 4.24: MARKET SHARE OF VALUE OF TIME DEPOSITS

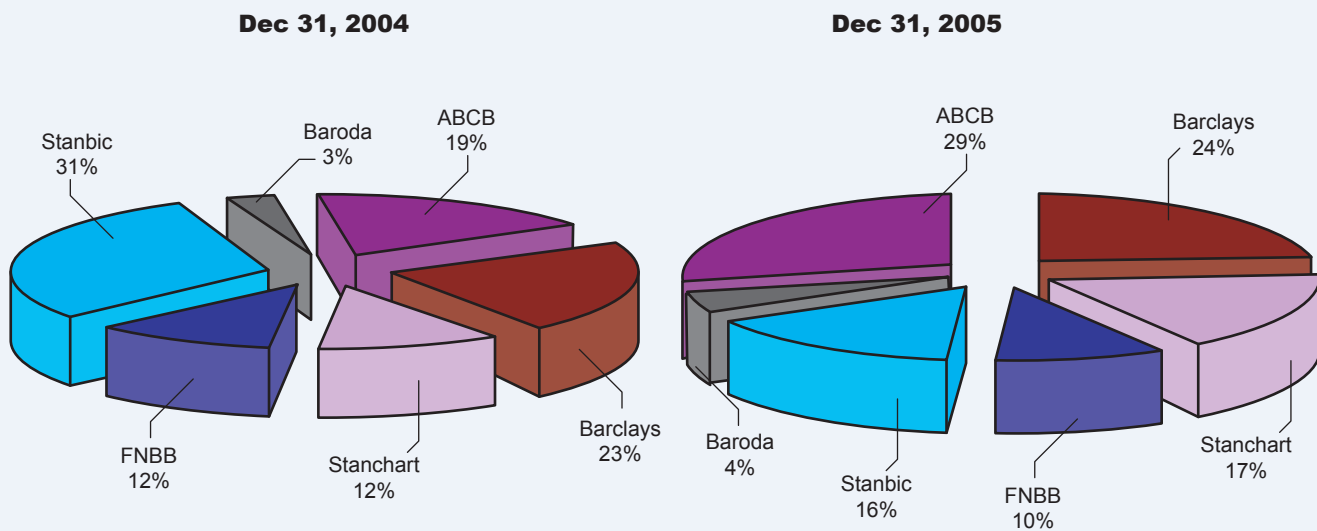


CHART 4.25: VALUE OF FOREIGN CURRENCY ACCOUNTS

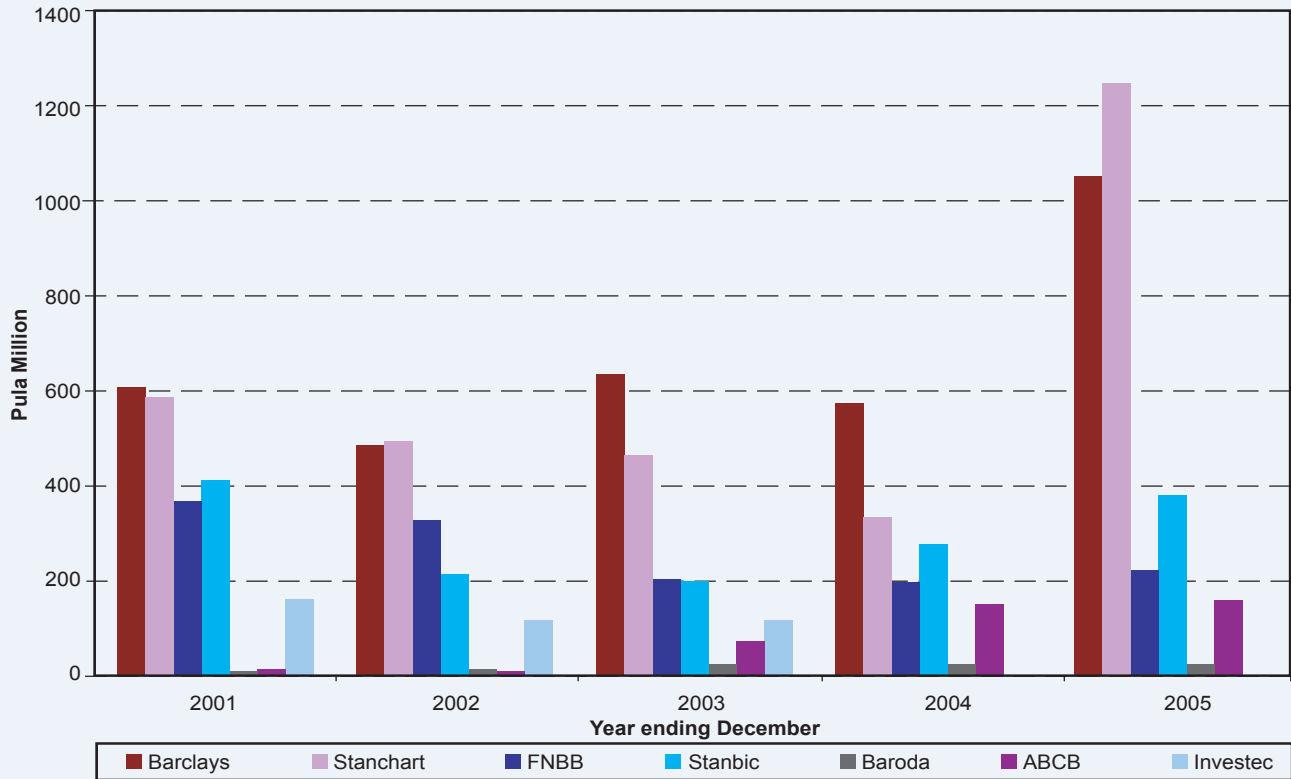


CHART 4.26: MARKET SHARE OF VALUE OF FOREIGN CURRENCY ACCOUNTS

