Banking Supervision Annual Report 2016

Bank of Botswana

MISSION STATEMENT

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

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

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

In order to achieve these goals, the Bank

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

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

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

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

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

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

Banking Supervision
Annual Report 2016

Bank of Botswana

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BANK OF BOTSWANA: BANKING SUPERVISION

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LIST OF ACRONYMS

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ATA	Average Total Assets
ATMs	Automated Teller Machines
BancABC	African Banking Corporation of Botswana Limited
BAGL	Barclays Africa Group Limited
Banking Act	Banking Act (CAP. 46:04)
Bank Gaborone	Bank Gaborone Limited
Bank SBI	Bank SBI Botswana Limited
BNPS	Botswana National Payments System
Barclays	Barclays Bank of Botswana Limited
Baroda	Bank of Baroda (Botswana) Limited
BBS	Botswana Building Society
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
BIS	Bank for International Settlements
BOBA	Bank of Botswana Act (CAP. 55:01)
BoBCs	Bank of Botswana Certificates
BOI	Bank of India (Botswana) Limited
BSB	Botswana Savings Bank
BSE	Botswana Stock Exchange
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
Capital Bank	Capital Bank Limited
CA	Competition Authority
CBRs	Correspondent Banking Relationships
CET1	Common Equity Tier 1
CDS	Credit Default Swap
CIH	Capricorn Investment Holdings
CIRTs	Computer Incident Response Teams
CIUs	Collective Investment Undertakings
CRB	Credit Reference Bureau
EPS	Electronic Payment Services
EPSPs	Electronic Payment Services Providers
ESAAMLG	Eastern and Southern African Anti-Money Laundering Group
FATF	Financial Action Task Force
FIA	Financial Intelligence Agency
FNBB	First National Bank of Botswana Limited
FRPGA	Financial Ratio and Peer Group Analysis
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
IDs	Identity Documents
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IT	Information Technology
JWC	Joint Working Committee
KYC	Know-Your-Customer
LHS	Left Hand Scale
MAP	Making Access Possible
MER	Mutual Evaluation Report
MFED	Ministry of Finance and Economic Development
ML/TF	Money Laundering and Terrorist Financing
MLRO	Money Laundering Reporting Officer
MoU	Memorandum of Understanding
NDB	National Development Bank
NIM	Net Interest Margin
NPLs	Non-Performing Loans
ORS	Off-site Rating System
OSS	Off-site Surveillance System
PoS	Point of Sale
RAS	Risk Assessment System
RBA	Risk-Based Approach
RBS	Risk-Based Supervision
RCAP	Regulatory Consistency Assessment Programme
RHS	Right Hand Scale
ROAA	Return on Average Total Assets
ROE	Return on Equity
RSA	Rate Sensitive Assets
RSL	Rate Sensitive Liabilities
RWA	Risk-Weighted Assets
SMM	Standardised Measurement Method
Stanchart	Standard Chartered Bank Botswana Limited
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TSA	The Standardised Approach
UNHCR	United Nations High Commissioner for Refugees
USD	United States Dollar
VAT	Value Added Tax
ZAR	South African Rand

FOREWORD

This Annual Report provides information on banking regulation and supervision, including the structure and performance of the banking sector in 2016.

In 2016, the world economy was characterised by modest economic growth, low commodity prices, persistent excess capacity in some major economies and uncertain prospects. In the case of Botswana, the economy faced challenges, resulting in the closure of some mining companies. The debilitating drought situation experienced in 2015, continued in the early part of 2016. Real Gross Domestic Product (GDP) grew by 4.3 percent in the 12 months to December 2016, compared to a contraction of 1.7 percent in the prior year, mainly underpinned by growth in non-mining output.

There were no new banks licensed in 2016. Asset quality in the banking sector weakened, with the Non-Performing Loans (NPLs) to Total Loans and Advances ratio rising from 3.9 percent in 2015 to 4.9 percent in 2016, due to challenges in some sectors of the economy. However, in comparative terms, the majority of the financial soundness indicators improved during the year; an indication that the banking sector was safe and sound in 2016.

The downward trend in profitability in 2015 was reversed in 2016, with the banking sector recording significant growth in profitability. As a result, banks augmented their capital levels, strengthening the resilience of the banking sector to solvency risks.

The Bank implemented the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II) effective January 1, 2016. This followed a successful parallel run with the old capital framework (Basel I) in 2015. The transition to the new capital framework was smooth, with all banks that are on the new standard being compliant.

The Bank participated in supervisory college meetings for some of the banks operating in Botswana. The meetings are structures or mechanisms for collaboration, coordination and information sharing among the authorities responsible for the supervision of internationally active banking groups.

During the year under review, the banks were largely compliant with all regulatory prudential requirements, with any acts of non-compliance being subjected to the normal remedial processes. The annual consultative arrangements between the Bank and supervised entities continued in 2016, where issues of mutual interest were discussed.

Moses D Pelaelo
GOVERNOR

INTRODUCTION

The Bank continued to regulate and supervise commercial banks, bureaux de change and a deposit-taking microfinance institution, in accordance with the requirements of the Banking Act and the Bureaux de Change Regulations. There were no new banks licensed in 2016 and, therefore, the number of licensed commercial and statutory banks remained at 10 and three, respectively. Banks continued to restructure their operations, which led to an increase in branch networks and Automated Teller Machines (ATMs). In addition, banks embraced technology and innovation and, therefore, enhanced their service delivery through the introduction of new banking products and services.

Regulatory and supervisory activities were guided by a focus on ensuring good governance and appropriate risk-taking by regulated institutions. These included, inter-alia, on-site examinations and off-site monitoring of banks through the use of a Risk-Based Supervision (RBS) approach and Off-site Surveillance System (OSS).

The Bank continued to adopt best practices from the ongoing global regulatory reforms. Consequently, the Bank issued the Revised Directive on the International Convergence on Capital Measurement and Capital Standards for Botswana and related Guidelines for the banking industry, which came into effect on January 1, 2016. Basel II aims at further strengthening the resilience of banks to shocks through improving the quality, consistency and quantity of capital. The banking sector transitioned smoothly to the new capital requirements, with all banks on the new standard complying with the revised prudential minimum capital requirements.

Efforts to strengthen safeguards against threats of money laundering and terrorist financing (ML/TF) continued to be a key priority area for the Bank. In June 2016, the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) conducted a mutual evaluation assessment of Botswana's anti-money laundering and countering the financing of terrorism (AML/CFT) framework. The recommendations of the draft Mutual Evaluation Report (MER) were discussed at the ESAAMLG meeting held in April 2017. Drawing in part from the recommendations of the draft MER, the Banking Act and Banking AML/CFT Regulations are being reviewed to ensure compliance with the Financial Action Task Force (FATF) Recommendations.

As was the case in the prior year, five banks dominated the banking sector, accounting for 90 percent of total banking assets. There was a dilution of competitiveness, as measured by the Herfindahl-Hirschman Index (HHI), during the year. However, the banking sector remained moderately competitive. The pressure on banks to innovate, develop and improve their products and services, in order to maintain high profitability levels, is expected to enhance competitiveness.

The country's financial depth and development indicators improved marginally, with the ratios of Private Sector Credit and Banking Credit to GDP increasing from 31.6 percent and 32.4 percent in 2015, to 31.8 percent and 32.6 percent in 2016, respectively. However, the M2 to GDP ratio decreased from 45.7 percent in 2015 to 42.8 percent in 2016.

The banking sector's total assets increased by 5.3 percent from P76.6 billion in December 2015 to P80.6 billion. Loans and advances grew by 6.2 percent to P51.3 billion in December 2016, compared to growth of 7.1 percent in 2015.

INTRODUCTION (CONTINUED)

The Liquid Assets to Total Assets Ratio rose from 15.4 percent (2015) to 16.7 percent (2016), following an increase in liquid assets. Similarly, the ratio of NPLs to Total Loans and Advances increased from 3.9 percent in December 2015 to 4.9 percent in December 2016. The household sector accounted for 59 percent of total NPLs. The ratio of aggregate Large Exposures to Unimpaired Capital was much lower than the 800 percent maximum prudential limit set for banks in Botswana, implying satisfactory management of credit concentration risk.

In 2016, total customer deposits grew by 4.2 percent to P62.4 billion. Customer deposits constituted the largest proportion of liabilities at 77.4 percent and, as expected, the primary source of funding for the banking assets. Interbank balances and credit from institutions increased by 20.4 percent from P3.3 billion in 2015 to P4 billion in 2016, as banks accessed alternative sources of funding for asset growth. As a result, the Financial Intermediation Ratio (the ratio of Loans and Advances to Deposits) increased from 80.6 percent to 82.2 percent.

The banking sector was adequately capitalised and met the new regulatory capital requirements, with all banks reporting Capital Adequacy and Common Equity Tier 1 Capital Ratios in excess of the minimum prudential requirements of 15 percent and 4.5 percent, respectively. The banking industry's capital adequacy ratio was 19.6 percent in December 2016 (December 2015: 20.1 percent).

The banking sector's profitability improved in 2016, with income after-tax increasing by 29.3 percent from P1.1 billion in 2015 to P1.4 billion in December 2016. As a result, Return on Average Total Assets (ROAA) and Return on Equity (ROE) also increased from 1.5 percent and 13.3 percent to 1.8 percent and 14.4 percent, respectively. Overall, the banking sector complied with the minimum prudential and statutory thresholds as expected.

The Report is organised as follows: Chapter 1 highlights the structure of the financial sector, with particular emphasis on banks, while Chapter 2 assesses the financial performance of the banking sector in 2016; Chapter 3 reports on licensing and consumer protection issues; Chapter 4 highlights the recent global standards and guidelines issued by the Basel Committee on Banking Supervision based at the Bank for International Settlements (BIS); and Chapter 5 provides a summary of key issues arising from the on-site and off-site examination processes. Appendices are provided at the end of the Report.

CHAPTER 1
BOTSWANA FINANCIAL SYSTEM AND SELECTED INDICATORS

CHAPTER 1:

BOTSWANA FINANCIAL SYSTEM AND SELECTED INDICATORS

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

1.1 The Bank regulates and supervises commercial banks, bureaux de change and a deposit-taking microfinance institution, as shown in Diagram 1.1 (Appendix 1). There were 10 licensed commercial banks and three statutory banks as at December 31, 2016. During the year, four new bureaux de change were licensed, while three had their licences revoked. As a result, the total number of licensed bureaux de change increased from 58 in 2015 to 59 in 2016.

BANKING SECTOR: BRANCH NETWORK AND OTHER DELIVERY CHANNELS

1.2 Table 1.1 shows the number of bank branches and ATMs (2014 to 2016). Banks continued to restructure their operations, resulting in the closure of some branches and the opening of new ones during the year. Some banks increased their delivery channels by installing additional ATMs. Consequently, the total number of commercial bank branches increased from 114 in 2015 to 115 in 2016, while the total number of ATMs increased from 415 to 440 in the same period. Statutory banks' branches increased from 15 in 2015 to 18 in 2016.

1.3 Regarding the geographical distribution of branch network, the South East District which includes the capital city, Gaborone, had the highest concentration of branches at 52, as at December 31, 2016, followed by the Central District at 26 (Appendix 2).

Table 1.1: Banks, Branches and Other Delivery Channels: 2014 - 2016

		BRANCHES AND SUB-BRANCHES			ATMs		
		2014	2015	2016	2014	2015	2016
Commercial Banks	Barclays	41	38	36	116	117	118
	Stanchart	19	19	21	68	68	68
	FNBB	22	22	23	172	173	188
	Stanbic	11	11	11	26	29	30
	BancABC	8	8	8	10	10	15
	Baroda	3	3	3	6	6	6
	Bank Gaborone	7	7	7	18	8	9
	Capital	4	4	4	4	4	6
	BOI	1	1	1	-	-	-
	Bank SBI	1	1	1	-	-	-
	KBAL	1	-	-	-	-	-
Total (Commercial Banks)		118	114	115	420	415	440
Statutory Banks	BSB	2	2	5	-	-	3
	BBS	9	9	9	12	12	12
	NDB	4	4	4	-	-	-
Total (Statutory Banks)		15	15	18	12	12	15
Aggregate		133	129	133	432	427	455

1.4 Access to banking services, as measured by the ratio of Bank Accounts to Adult[1] Population, improved from 75.9 percent in 2015 to 76.5 percent in 2016. Notwithstanding the fact that an individual can have multiple accounts, the ratio of Bank Accounts to Adult Population provides a rough indicator of access to banking services. The aggregate number of bank accounts grew by 3 percent from 1.13 million in 2015 to 1.17 million in 2016, while the number of accounts held by the adult population grew by 2.7 percent from 1.49 million to 1.53 million.

BANKING SECTOR EMPLOYMENT TRENDS: 2015 - 2016

1.5 Table 1.2 shows the employment levels in the banking sector for 2015 and 2016. Employment levels increased by 0.5 percent from 5 030 in 2015 to 5 055 in 2016. The increase in employment levels was due to branch expansion. However, five banks recorded declines in their employment levels during the year under review due to branch rationalisation and automation.

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

Table 1.2: Employment Levels for Licensed Domestic Banks: 2015 - 2016

		2015			2016		
		CITIZENS	EXPATRIATES	TOTAL	CITIZENS	EXPATRIATES	TOTAL
Commercial Banks	Barclays	1 185	11	1 196	1 147	10	1 157
	Stanchart	811	4	815	752	10	762
	FNBB	1 218	4	1 222	1 275	3	1 278
	Stanbic	570	5	575	590	6	596
	BancABC	260	8	268	237	6	243
	Baroda	32	12	44	35	12	47
	Bank Gaborone	246	7	253	291	4	295
	Capital	87	8	95	113	8	121
	BOI	7	4	11	7	4	11
	Bank SBI	12	4	16	19	3	22
Total (Commercial Banks)		4 428	67	4 495	4 466	66	4 532
Statutory Banks	BSB	156	-	156	149	-	149
	BBS	200	2	202	200	2	202
	NDB	177	-	177	172	-	172
Total (Statutory Banks)		533	2	535	521	2	523
Aggregate		4 961	69	5 030	4 987	68	5 055

NEW BANKING PRODUCTS AND SERVICES

1.6 Banks continued to innovate and introduce new products and services, including Credit Default Swaps (CDS)[2] for institutional investors. CDS is an agreement where the buyer of the CDS makes a series of payments (the CDS "fee" or "spread") to the seller and, in exchange, receives a payoff if the loan defaults. Various savings accounts, such as target savings and offshore accounts, were also introduced.

1.7 To further enhance the existing service delivery channels, some banks upgraded the intelligent ATMs, among others, improving functionality with respect to cash and cheque deposits, withdrawal of foreign currency (e.g., South African rand (ZAR)), bill payments, and cardless services. Point of Sale (PoS) functionalities were also upgraded to permit acceptance of Union Pay International cards[3], as well as allowing local merchants and customers to pay in any currency of their choice, where feasible. Furthermore, PoS machines were enhanced to allow payment using earned cash-back points. In addition, the online banking platforms for small and medium enterprises were extended to include services such as payments to other bank accounts held in Botswana, bulk file payments for multiple beneficiaries and segregation of duties in the platform, according to an individual client's needs.

[2] Only one bank offered CDS in 2016.

[3] Union Pay International cards are China domestic card prints and operate in a similar way to VISA and MasterCard in terms of regulations and operations relating to ATMs and Point of Sale Machines.

BOX 1: INTRODUCTION OF ELECTRONIC PAYMENT SERVICES (EPS) REGULATIONS

As part of the reform and modernisation of the Botswana National Payments System (BNPS), the Bank has committed to implementing a strategic framework and legal environment to ensure provision of safe and secure electronic payment services. The legal basis for this framework is derived from Section 4 (1) (a) of the Bank of Botswana Act (CAP. 55:01), which requires the Bank, first and foremost, to promote and maintain monetary stability, an efficient payments mechanism and the liquidity, solvency and proper functioning of a soundly based monetary, credit and financial system in Botswana. This is expected to support the use of a wide variety of technology based payment services/systems and ensure that the rights and obligations of stakeholders are recognised, protected and enforceable. Respective services and infrastructure components not only require a properly structured legal and regulatory framework, but one that functions effectively, at all relevant levels. To this extent, the Bank, following extensive consultations with key stakeholders, is developing Electronic Payment Services (EPS) Regulations to address lack of specific guidelines with respect to electronic money and payment services. The EPS Regulations are part of the Bank's broader strategy to create an enabling regulatory environment for convenient, efficient and safe retail payments and funds transfer mechanisms.

The purpose of the EPS Regulations is to allow for the licensing and oversight of Electronic Payment Services Providers (EPSPs). EPSPs are, generally, organisations authorised by the Bank to provide electronic payment services to facilitate money transmission in a properly structured environment which conforms to best international standards by requiring comprehensive identification of the benefactor and beneficiary of the funds. Electronic payments are typically equated with transactions originated from a mobile phone or card, usually linked to an account, or prepaid card.

The EPS Regulations are expected to open up the electronic payments system business to non-bank players which, in turn, should reduce costs, stimulate competition and financial inclusion. The regulations are intended to streamline and strengthen licensing procedures, improve governance arrangements and oversight, engender consumer protection and tighten anti-money laundering procedures. The introduction of electronic payments products and services in the Botswana payments environment, including person to person payments, has made it imperative to recognise EPS as a means of driving the national financial inclusion agenda. This does not only extend the outreach of payment services, it also transforms the traditionally bank-dominated payments services landscape.

EPSPs operating in Botswana shall be subjected to all provisions of these Regulations. The Regulations create a licensing regime for providers of electronic payment services that are not licensed financial institutions or banks.

The Regulations do not apply to services based on specific payment instruments that can be used in a limited way, such as instruments allowing the holder to acquire goods and services only from the issuer or within a limited network of service providers under direct commercial agreement with the issuer; payment transactions carried out between payment service providers, their agents or branches for their own account; and technical support services for the provision of payments services.

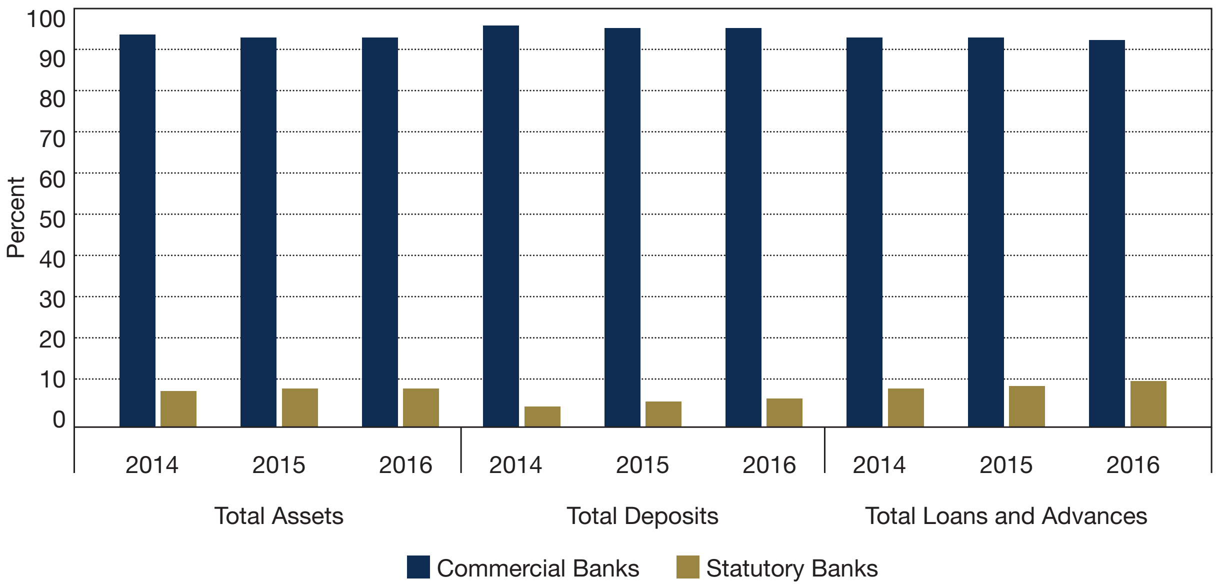
The framework for EPS is premised on principles of transaction safety and efficiency, transparency and consumer protection and conforms to international best practice.

BANKING SECTOR MARKET SHARE AND COMPETITION

MARKET SHARE

1.8 Chart 1.1 shows the banking sector market share of total assets, total deposits and total loans and advances. The banking sector was dominated by commercial banks, given the size of their total assets, total deposits and total loans and advances, relative to the statutory banks. The market share of statutory banks, in terms of total assets, decreased slightly from 7.3 percent in December 2015 to 6.9 percent in 2016. In terms of loans and advances, statutory banks' share increased from 8.1 percent in 2015 to 8.5 percent in 2016.

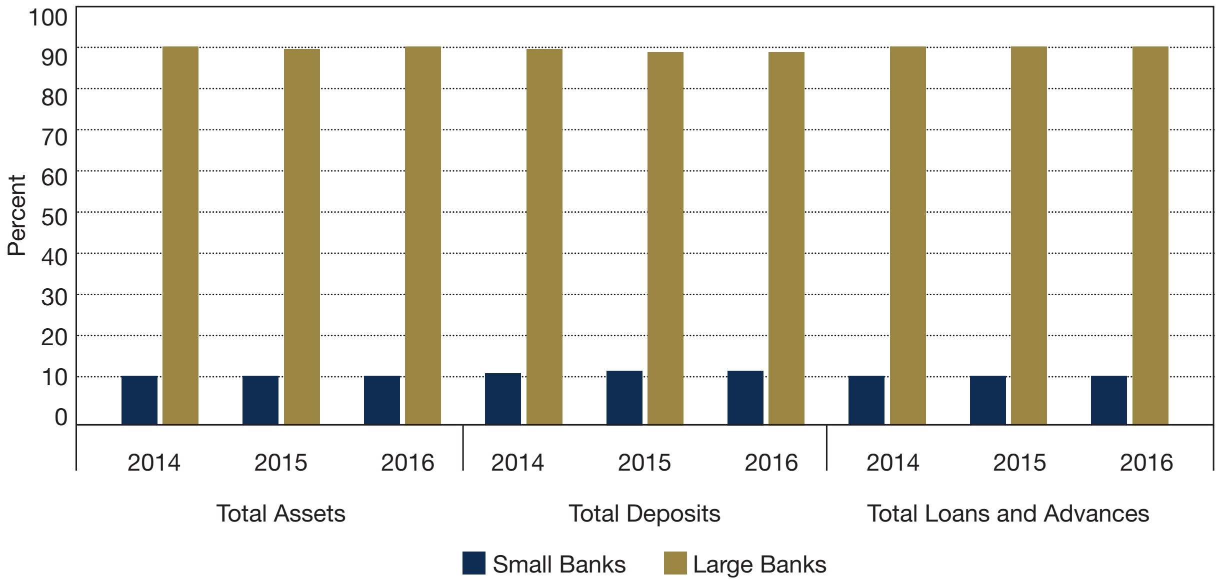
Chart 1.1: Banking Sector Market Share of Total Assets, Total Deposits and Total Loans and Advances*



*Figures revised to exclude one statutory bank (2014 - 2016)

1.9 The top five banks continued to dominate the banking sector and accounted for 90 percent of total assets, total deposits and total loans and advances in 2016 as in 2015.

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

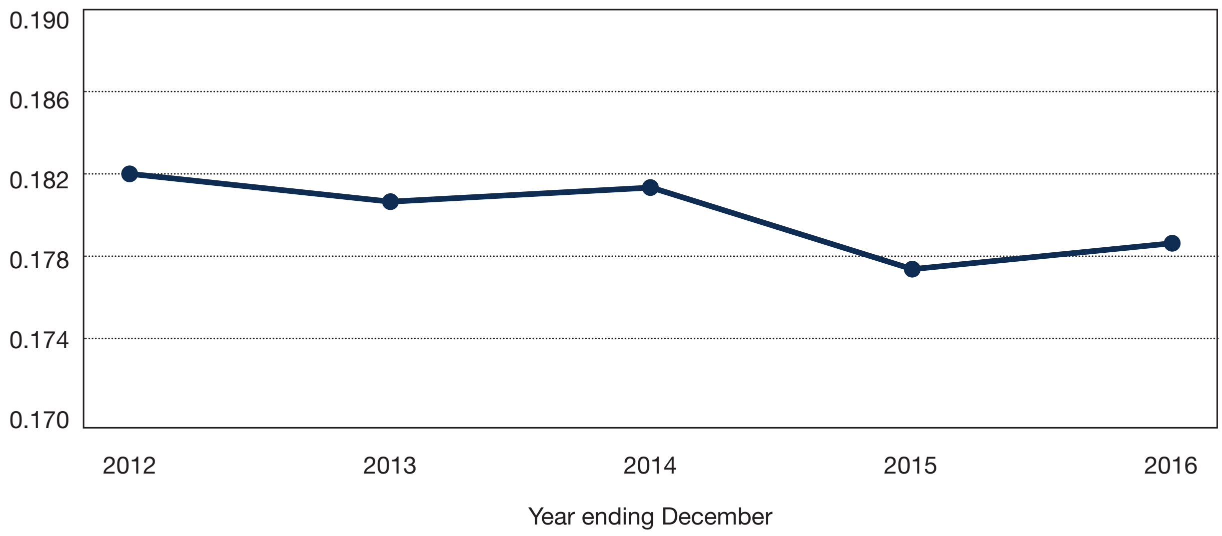


THE HERFINDAHL-HIRSCHMAN INDEX (HHI) OF COMPETITIVENESS

1.10 The Bank uses the HHI[4], a widely used measure of market concentration, to assess the degree of competition in the Botswana banking industry. The degree of competition during the year deteriorated slightly, as shown by the marginal increase in the HHI from 0.1774 in December 2015 to 0.1784 as at December 31, 2016 (Chart 1.3). By this measure, the banking sector in Botswana is highly concentrated. However, the modest differences in market shares for the top five banks suggest wider dispersion and competition at that level.

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

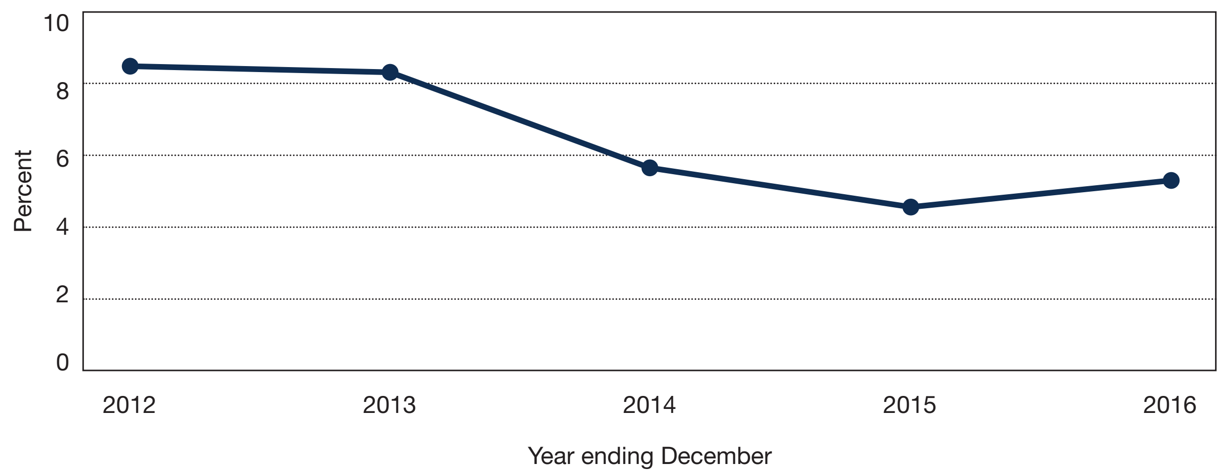
Chart 1.3: Herfindahl-Hirschman Index (HHI)



NET INTEREST MARGIN AS AN INDICATOR OF COMPETITION IN THE MARKET

1.11 The industry net interest margin (NIM) increased from 4.7 percent in 2015 to 5.4 percent in 2016, indicating a reduction in competition in the market, and thus reversing the downward trend observed over the past four years (Chart 1.4). In addition to competitive forces, the NIM can be driven by different factors, such as operating costs, loan quality and the macroeconomic environment, including inflation and interest rates. In this case, the indicator of weak competition in the market could be attributed to the fall in the average cost of deposits compared to 2015, where banks had to compete aggressively for deposits in response to tightening of liquidity in the market.

Chart 1.4: Banking Sector Trend of Net Interest Margin (NIM): 2012 - 2016

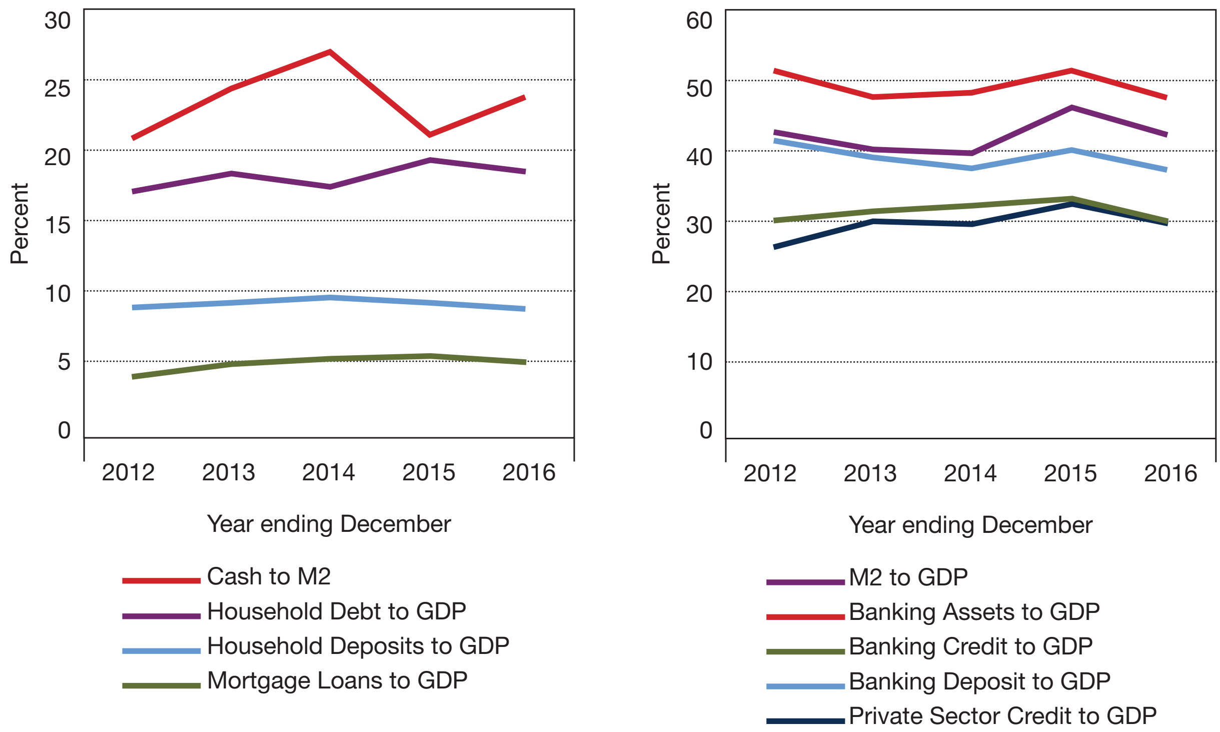


1.12 Hence, the two measures of competition (HHI and NIM) increased, indicating further room for improvement, in general terms, in the level of competition in the banking sector.

FINANCIAL DEEPENING AND DEVELOPMENT

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

Chart 1.5: Financial Sector Deepening Indicators



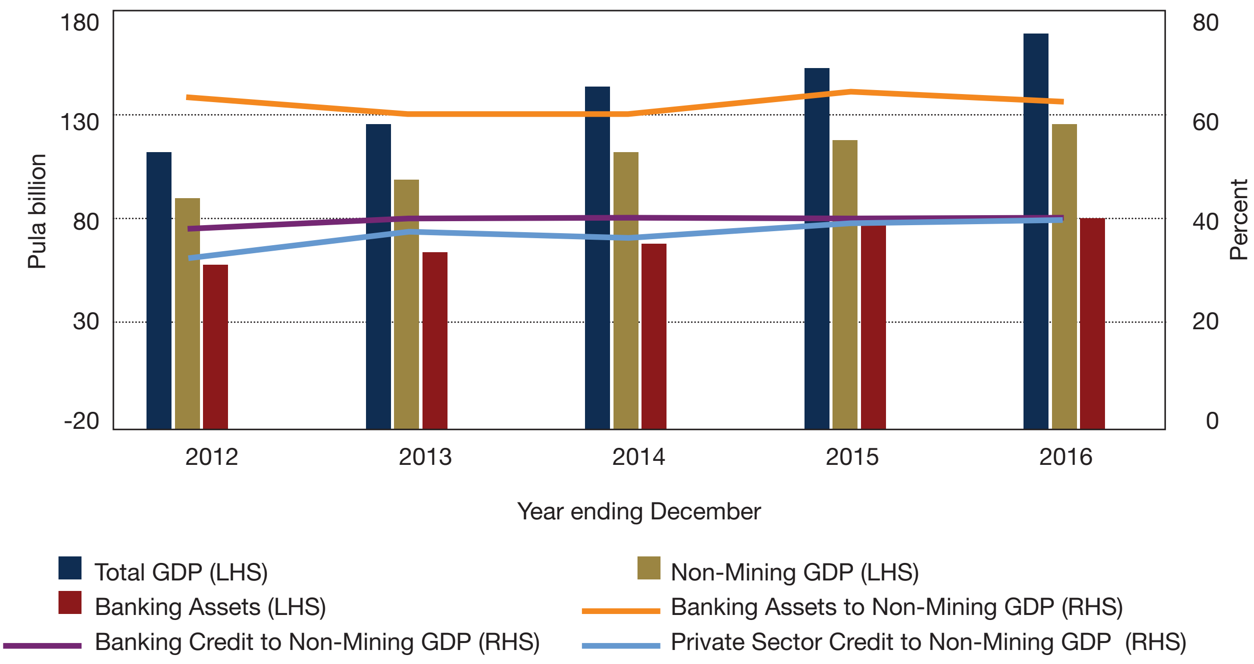
*Private Sector Credit to GDP figures revised in accordance with the World Bank definition of Private Sector Credit

1.14 Financial depth and development, as approximated by the ratio of Private Sector Credit to GDP[5], decreased slightly from 31.6 percent in 2015 to 29.5 percent in 2016. However, Private Sector Credit, as a proportion of Non-mining GDP, was higher at 39 percent in 2016. When benchmarked against the global average ratio of Private Sector Credit to GDP of 51.2 percent (as reported by the World Bank's 2015/2016 Global Financial Development Report), the Botswana banking system is relatively shallow.

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

1.15 The ratio of Banking Assets to GDP, a measure of financial sector size, decreased to 47.5 percent in 2016 (2015: 51.4 percent) (Chart 1.5). Similarly, the ratio of Banking Assets to Non-mining GDP decreased marginally from 63.8 percent in 2015 to 62.8 percent in 2016 (Chart 1.6). Over the two years to December 2015, the annual growth rate of banking assets exceeded that of total GDP because of contraction in mining. However, in 2016, banking assets growth rate (5.3 percent) trailed total GDP growth rate (13.8 percent). Banking Credit, as a proportion of total GDP, decreased slightly from 32.4 percent in 2015 to 30.2 percent in 2016 (Chart 1.5).

Chart 1.6: Financial Sector Size and Depth Indicators



1.16 On the other hand, M2 to GDP decreased from 45.7 percent in 2015 to 42.8 percent in 2016. This means that, relatively, the extent to which private agents store value decreased slightly. Liquidity preference, as measured by the Cash[6] to M2[7] ratio, increased from 21 percent in 2015 to 23.3 percent in 2016.

1.17 Household debt as a proportion of total GDP, decreased from 19.2 percent in 2015 to 18.2 percent in 2016. The Mortgage Loans to GDP Ratio also decreased from 5.5 percent in 2015 to 5.2 percent in 2016. When statutory banks are included, the Mortgage Loans to GDP Ratio decreased from 8.1 percent in 2015 to 7.5 percent in 2016. The Household Deposits to Total GDP Ratio declined from 8.9 percent in 2015 to 8.7 percent during the year under review. In broad terms, nominal GDP increased at a faster pace than the financial variables during the year, thus negating financial depth on a comparative basis.

[6] Coins and notes in circulation and other money equivalents that are easily convertible into cash.

[7] M2 (P72.7 billion) comprises all liabilities of financial corporations included in a country's definition of broad money. In the case of Botswana, M2 comprises currency outside depository corporations, transferable deposits (demand deposits) and other deposits included in broad money (time and fixed deposits).

1.18 The Pension Fund Assets to Total GDP ratio decreased from 50.6 percent in 2015 to 44.3 percent in 2016. In light of the fact that as at December 31, 2016, the aggregate household savings in the banking sector and pension funds was P90.3 billion, compared to household borrowings of P35.7 billion, the household sector was a net saver[8] in the economy. Meanwhile, the bulk of payments are done through electronic means, with the value of electronic funds transfer transactions relative to economic activity, increasing from 9.4 percent in 2015 to 10.7 percent in 2016.

1.19 Overall, compared to developed economies, where banking services account for very high proportions of total income generated in the economy (with ratios in excess of 100 percent), the banking sector in Botswana remained relatively small, vis-à-vis the size of the economy. Thus, there is considerable scope for the banking sector to expand, albeit in the context of proper prudential oversight and maintenance of financial stability.

[8] Data used was from pension funds, commercial and statutory banks. Due to data limitations, the analysis does not include other financial institutions such as micro lenders.

CHAPTER 2

PERFORMANCE OF THE BANKING INDUSTRY

CHAPTER 2:
PERFORMANCE OF THE BANKING INDUSTRY

COMMERCIAL BANKS

IMPLEMENTATION OF THE NEW CAPITAL MEASUREMENTS STANDARDS

2.1 In an effort to enhance and strengthen the resilience of the banking sector to economic and financial shocks, the Bank implemented the Basel II Capital framework which came into effect on January 1, 2016. In order to facilitate an orderly transition to the new capital regime, the Bank adopted a gradual approach to Basel II implementation, commencing with Pillar 1 (Simple Approaches) and Pillar 3 disclosure requirements. The implementation of Pillar 2 and the Advanced Approaches has been deferred to a later stage.

2.2 All the regulated and supervised banks, except one statutory bank, have adopted the Basel II standards and the transition to the new capital regime has had no adverse effects on the key financial soundness indicators.

2.3 The main features of the revised regulatory capital framework include:

(i) explicit computation of regulatory capital for market and operational risks, as well as a wider range of exposure categories and risk-weights. This is intended to enhance the risk sensitivity of a bank's capital. This is unlike Basel I, where only credit risk was considered in the computation of the regulatory capital of a bank; and

(ii) the gradual phasing-out of non-qualifying capital instruments over a period of five years (beginning January 1, 2016) in order to minimise shocks.

2.4 Overall, the minimum prudential Capital Adequacy Ratio (CAR) of 15 percent (Table 2.1 below) has been maintained.

Table 2.1: Capital Adequacy Requirements (All numbers in percent)

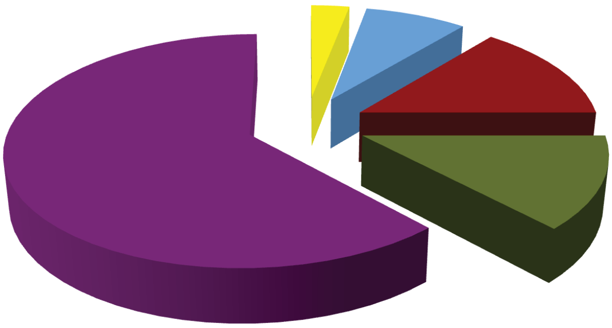
	Common Equity Tier 1 (CET 1) Capital	Additional Tier 1 Capital	Tier 1 Capital (CET 1 Capital + Additional Tier 1 Capital)	Tier 2 Capital	Total Capital
Minimum	4.5	3	7.5	7.5	15

STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

2.5 The banking sector's total assets increased by 5.3 percent in 2016 (December 2015: 12.7 percent) from P76.6 billion in December 2015 to P80.6 billion; mainly reflecting a 6.2 percent increase in gross loans and advances to P51.3 billion in December 2016. Net loans and advances constituted a larger proportion of total banking sector assets (62 percent), followed by investment and trading securities (14 percent).

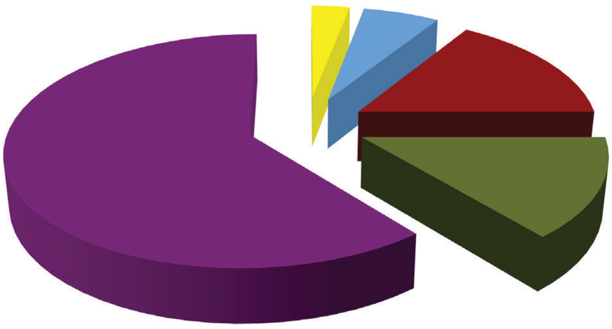
2.6 Charts 2.1 and 2.2 show the composition of assets and liabilities for 2015 and 2016, respectively. The proportions of both assets and liabilities for 2015 and 2016 have largely remained unchanged, with minimal variations between the two periods. From the two charts, it is evident that the major source of funding for commercial bank assets continues to be customer deposits. Subsequent paragraphs explain in some detail the funding structure and structure of loans and advances.

Chart 2.1: Commercial Banks: Composition of Assets: 2015 - 2016 (Percent)



December 31, 2016

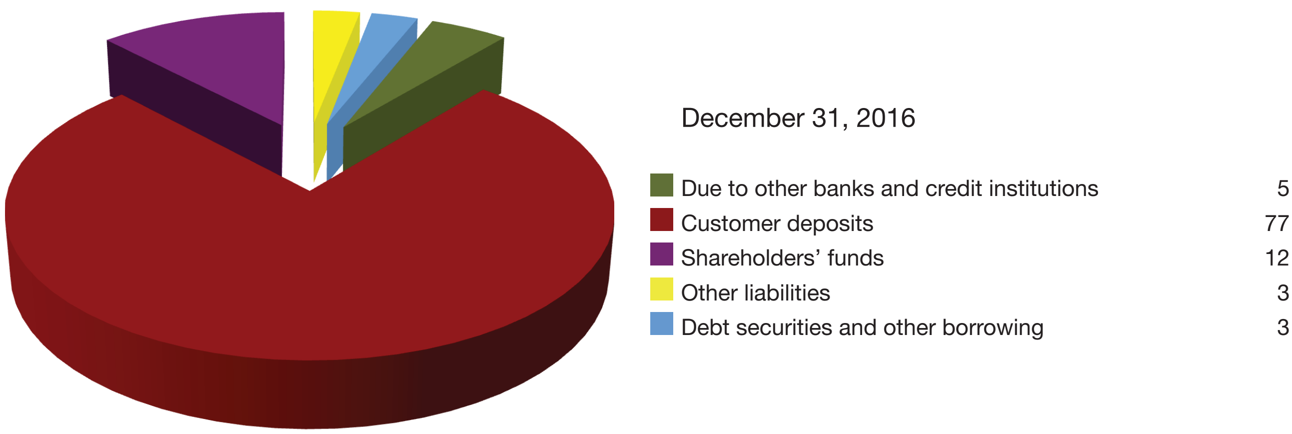
Cash and balances with the Central Bank	8
Investment and trading securities	14
Placements with other banks and credit institutions	13
Net loans and advances	62
Other assets	3

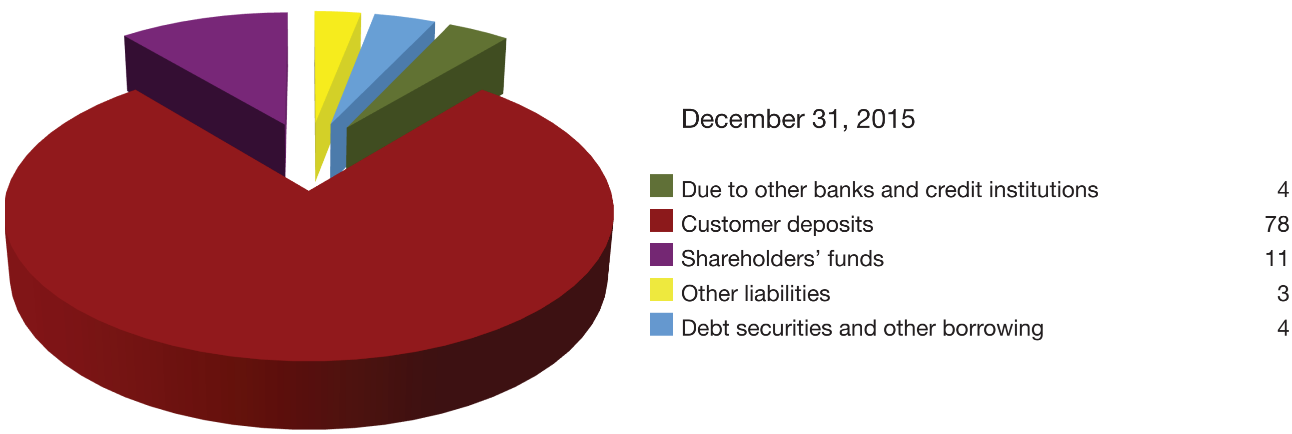


December 31, 2015

Cash and balances with the Central Bank	6
Investment and trading securities	16
Placements with other banks and credit institutions	14
Net loans and advances	61
Other assets	3

Chart 2.2: Commercial Banks: Composition of Liabilities: 2015 - 2016 (Percent)





2.7 Charts 2.3 and 2.4 show the level of total assets, total deposits and total loans and advances, as well as their growth rates, for the period 2012 - 2016.

Chart 2.3: Commercial Banks: Total Assets, Total Loans and Advances and Total Deposits: 2012 - 2016

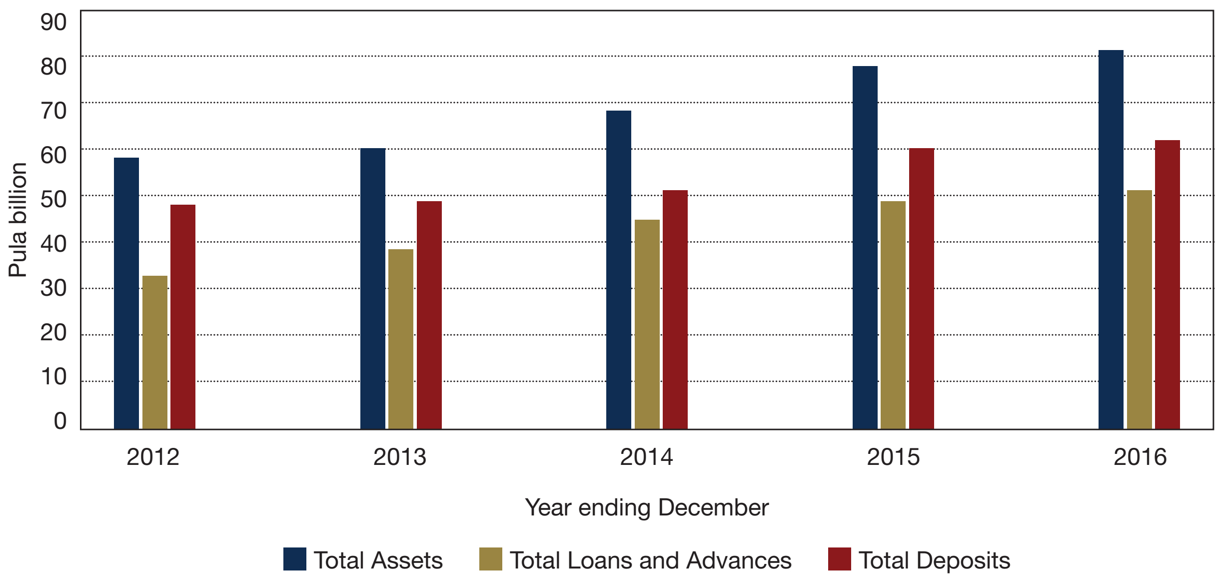
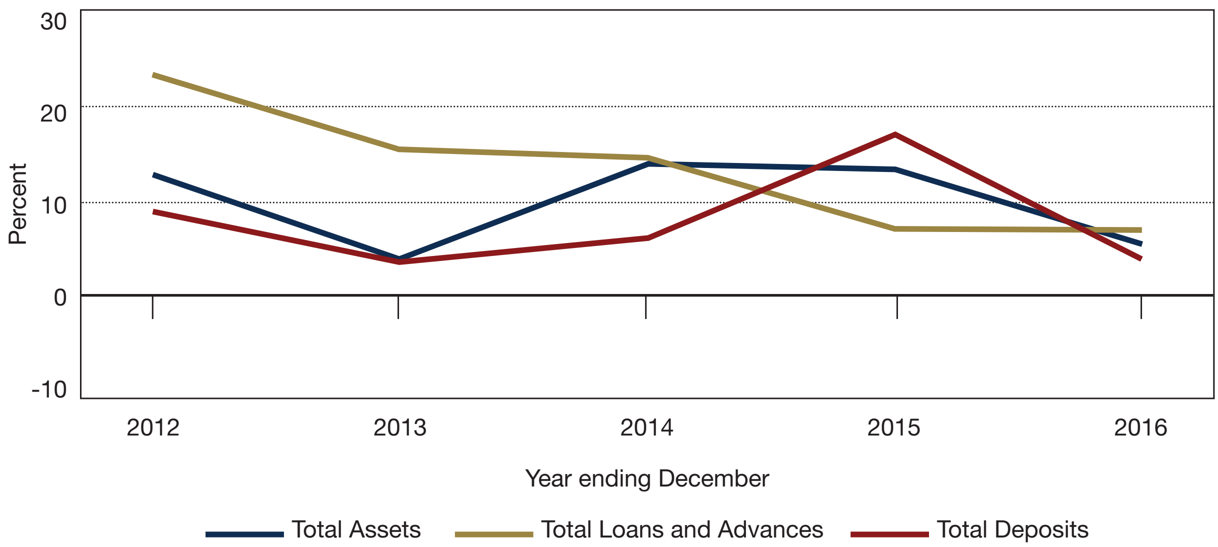


Chart 2.4: Commercial Banks: Annual Growth Rates of Total Assets, Total Loans and Advances and Total Deposits: 2012 - 2016



COMPARATIVE CHANGE IN THE RISKINESS OF ON-BALANCE SHEET ASSETS

2.8 Table 2.2 shows the comparative movements in the riskiness of banks' total on-balance sheet assets for the period ending December 2015 and 2016, following the implementation of Basel II in 2016. It is clear that there has been a downward shift in the risk profile of assets held by banks under the 20 percent, 50 percent, 100 percent and 150 percent risk-weights in 2016. In contrast, on-balance sheet assets risk-weighted zero percent increased marginally from 21.3 percent to 21.6 percent. Assets risk-weighted 35 percent, 75 percent and 250 percent accounted for 8 percent, 31.3 percent and 0.03 percent of total on-balance sheet assets, respectively.

2.9 Overall, 75 percent of the on-balance sheet asset items were below the 100 percent risk-weight category under Basel II, compared to 50.3 percent under Basel I (December 2015). This reflects the higher risk-sensitivity of the Basel II framework.

Table 2.2: Comparative Change in the Riskiness of Banks' Portfolios of On-Balance Sheet Assets

	DECEMBER 2015		DECEMBER 2016	
RISK-WEIGHTS (PERCENT)	ON-BALANCE SHEET ASSETS (P'MILLION)	PERCENTAGE TO TOTAL ON-BALANCE SHEET ASSETS	ON-BALANCE SHEET ASSETS (P'MILLION)	PERCENTAGE TO TOTAL ON-BALANCE SHEET ASSETS
0	16 336	21.3	17 452	21.6
20	13 007	17.0	8 639	10.7
35**	-	-	6 358	7.9
50	9 201	12.0	3 685	4.6
75*	-	-	25 220	31.3
100	36 678	47.9	18 725	23.2
150	1 382	1.8	539	0.7
250*	-	-	22	0.03
Total	**76 605**	**100**	**80 640**	**100**

* Retail portfolio which was risk-weighted 100 percent under Basel I

** Qualifying owner-occupied residential mortgage (or rented for residential purposes)

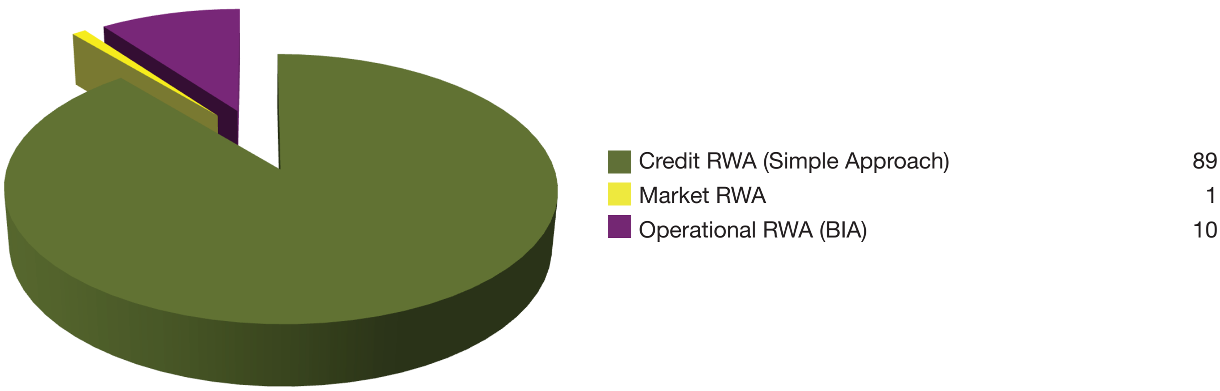
COMMERCIAL BANKS: RISK ASSESSMENT

INTRODUCTION

2.10 The prescribed methodologies for the computation of the minimum capital adequacy requirements for banks in Botswana are the Standardised Approach (SA) for Credit Risk and Standardised Measurement Method (SMM) for Market Risk; as well as a choice between the Basic Indicator Approach (BIA) and the Standardised Approach (TSA) to Operational Risk.

2.11 Charts 2.5 shows the aggregate Risk-Weighted Assets (RWA) of the banking sector as at December 31, 2016, calculated under Pillar 1 of Basel II. In addition to credit RWA used in the computation of risk capital under Basel I, Basel II introduced capital charges for operational risk and market risk, which increased individual bank's RWA. The credit RWA constituted the bulk of the banking sector's total RWA at 89 percent, followed by operational RWA at 10 percent and market RWA at 1 percent.

Chart 2.5: Composition of Risk-Weighted Assets (Percent)



2.12 Six banks made notable capital savings resulting from reduced credit RWA. These were banks with predominantly retail loan books. The capital savings derived from these reduced risk-weights were offset by increases in risk-weights of certain asset categories that migrated to higher risk-weights, as well as additional RWA (emanating from operational and market risk capital charges).

CREDIT RISK

REGULATORY CAPITAL REQUIREMENTS ON CREDIT RISK

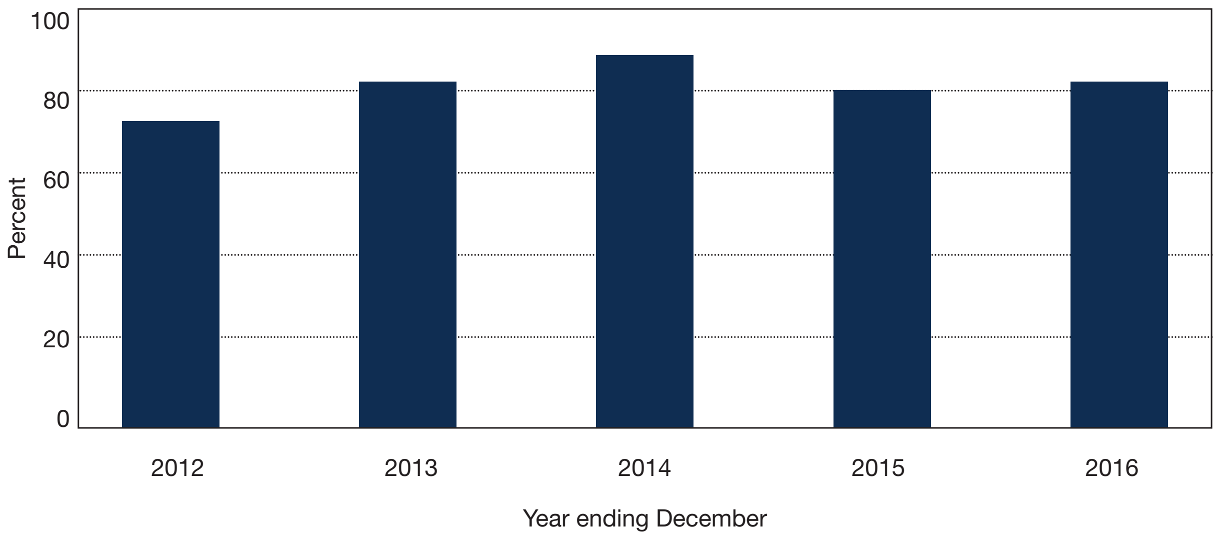
2.13 Credit risk regulatory capital requirements (as measured by credit RWA) increased from P45.9 billion to P46.5 billion in December 2016. This increase resulted from the migration of some risk exposures (under Basel I) to different risk-weight categories (under Basel II). In particular, qualifying retail and residential mortgage exposures were risk-weighted at lower values of 75 percent and 35 percent, respectively, compared to 100 percent and 50 percent (under Basel I), respectively. The two exposure categories (combined) constituted 39.1 percent of the industry aggregate loan book.

ASSET QUALITY: LEVELS AND TRENDS

2.14 Gross loans and advances grew by 6.2 percent, from P48.3 billion in 2015 to P51.3 billion in December 2016. The relatively slower rate of credit growth than in the prior year at 7.1 percent, was a result of the adoption of a more stringent approach to lending. This was in light of moderate economic growth, restructuring of balance sheets by banks, and reduced marginal capacity for additional borrowing by public sector employees, in particular, as salary increments had been modest; this has meant limited headroom for increased borrowing from banks.

2.15 The Financial Intermediation Ratio (the ratio of Loans and Advances to Deposits) increased from 80.6 percent in December 2015 to 82.2 percent in December 2016, and thus was outside the upper end of the recommended prudential range of 50 - 80 percent for the Botswana banking sector (Chart 2.6). This indicates that banks in Botswana are expanding their sources of funding beyond deposit liabilities.

Chart 2.6: Commercial Banks: Loans and Advances to Deposits Ratio (Financial Intermediation)

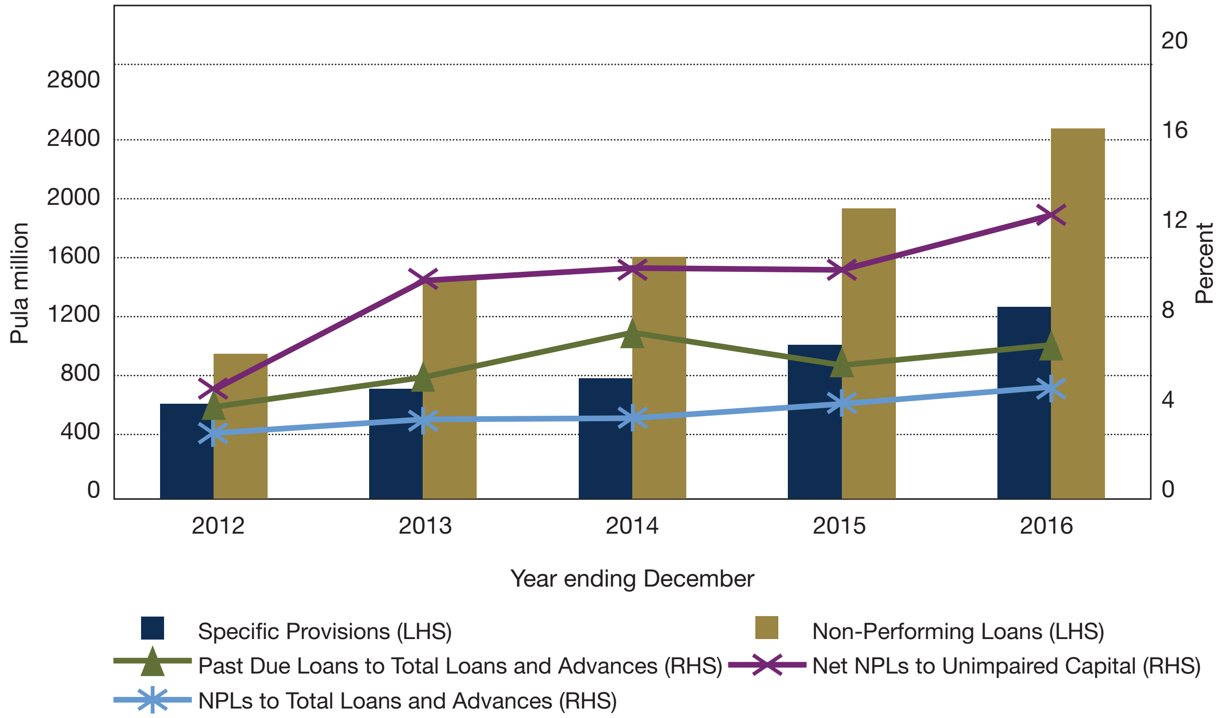


2.16 The banking sector's asset quality deteriorated somewhat, as the NPLs to Total Loans and Advances Ratio increased from 3.9 percent in December 2015 to 4.9 percent in December 2016. The growth in NPLs followed job losses and the closure of some mines e.g., BCL and Tati Nickel.

2.17 Total past due loans (i.e., loans tainted by arrears) increased significantly by 32.7 percent to P3.6 billion in December 2016 (December 2015: P2.7 billion), while NPLs (i.e., impaired loans) increased by 32.8 percent to P2.5 billion. The household sector (predominantly comprising unsecured loans) accounted for 59 percent of total NPLs in 2016 (December 2015: 52 percent).

2.18 The ratio of NPLs to Total Loans and Advances varied substantially among individual banks, ranging from 0.8 percent to 8.5 percent. The banking sector's specific provisions increased from P1 billion in 2015 to P1.3 billion in 2016, providing a 51 percent cover of NPLs as at December 2016. Furthermore, the ratio of NPLs (net of specific provisions) to Unimpaired Capital increased to 12.2 percent as at December 31, 2016 (December 2015: 9 percent). However, the credit risk mitigation measures that banks have in place are expected to absorb any residual credit risk. Chart 2.7 shows trends in commercial bank asset quality indicators for the period 2012 - 2016.

Chart 2.7: Commercial Banks: Asset Quality Indicators: 2012 - 2016

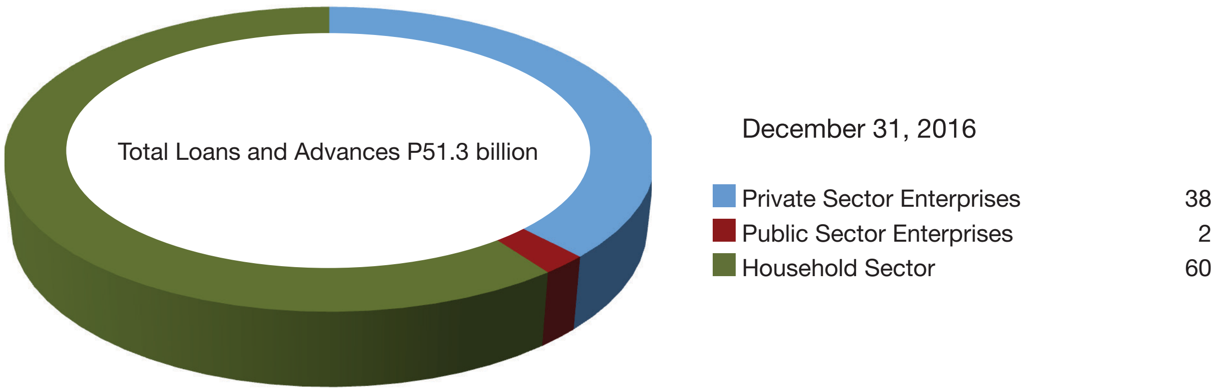


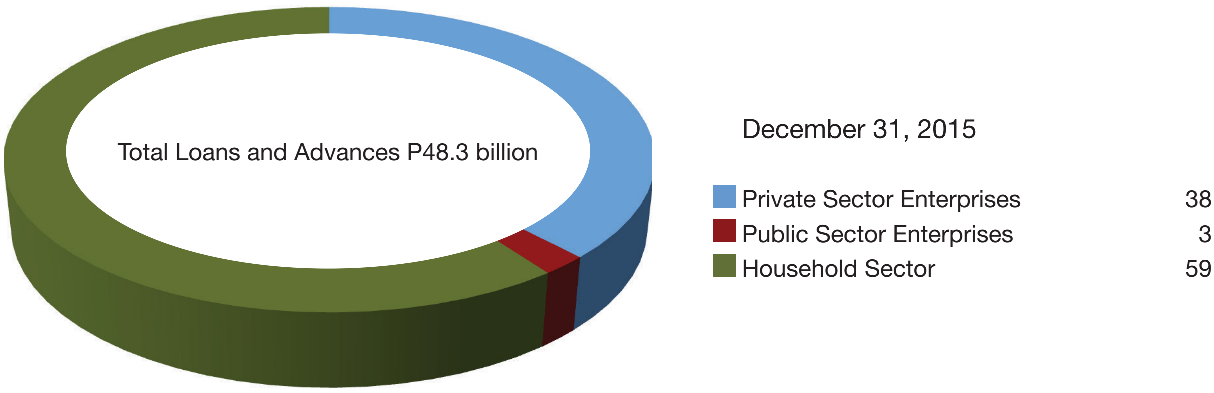
CREDIT CONCENTRATION RISK

SECTORAL DISTRIBUTION OF COMMERCIAL BANK LOANS AND ADVANCES

2.19 Chart 2.8 compares the sectoral distribution of loans and advances between 2015 and 2016. Household loans and advances increased by 7.6 percent to P30.8 billion and accounted for the largest share of loans and advances (60.1 percent) provided by the banking sector. Private sector enterprises' loans and advances also increased (4.7 percent) to P19.2 billion and accounted for 38 percent of total loans and advances. The increase was driven mainly by more credit facilities granted to the manufacturing, commercial real estate, tourism and hotels, and agriculture sectors (Chart 2.10).

Chart 2.8: Sectoral Distribution of Loans and Advances: 2015 - 2016 (Percent)



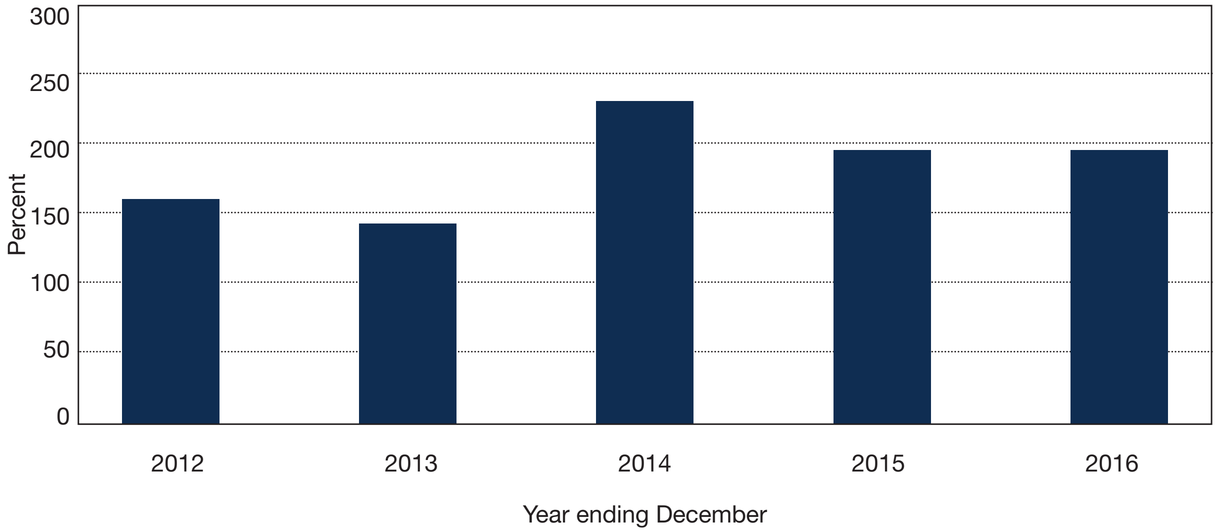


LARGE EXPOSURES

2.20 The commercial banks' Large Exposures[9] to Unimpaired Capital Ratio increased to 195 percent (2015: 194 percent) (Chart 2.9). This ratio differed considerably among individual banks, ranging from 65.5 percent to 484.1 percent. The large exposures increased from P18.2 billion in 2015 to P20 billion in 2016, while unimpaired capital increased to P10.2 billion in 2016 (2015: P9.4 billion). The Large Exposures to Total Loans and Advances Ratio was 38.9 percent (2015: 37.7 percent). All banks maintained Large Exposures to Unimpaired Capital Ratios within the recommended 800 percent prudential limit.

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

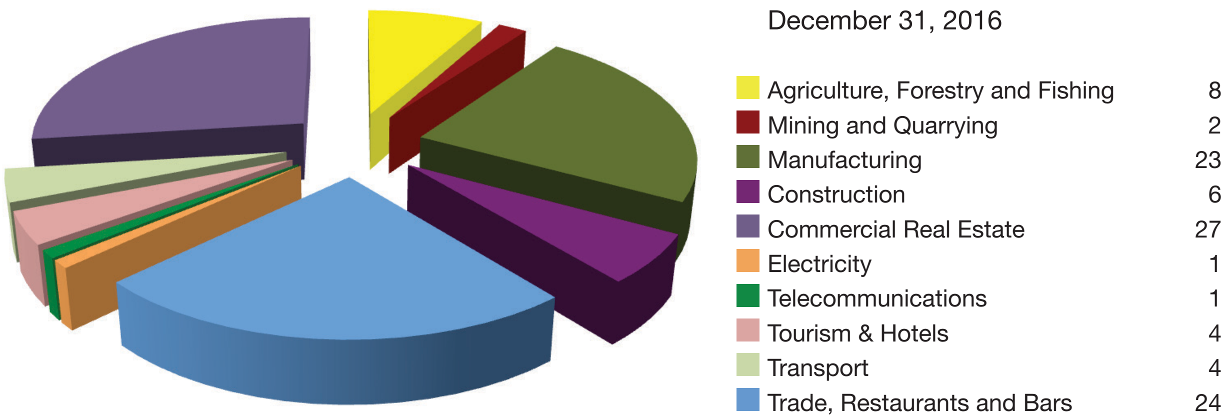
Chart 2.9: Commercial Banks: Large Exposures to Unimpaired Capital Ratio: 2012 - 2016

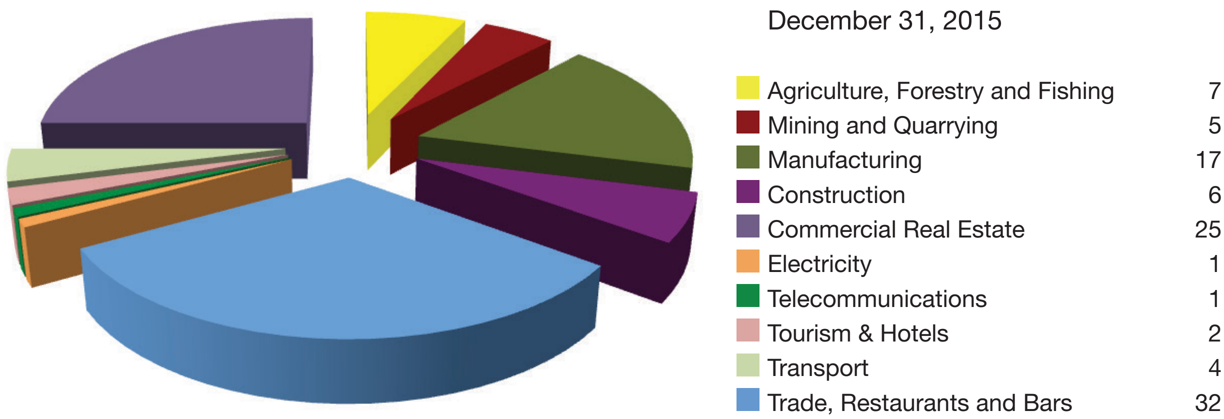


THE STRUCTURE OF PRIVATE SECTOR ENTERPRISES LOANS AND ADVANCES

2.21 Commercial banks maintained a diversified exposure to different sectors of the economy (Chart 2.10). During 2016, loans and advances to six sectors, namely, agriculture, forestry and fishing, manufacturing, construction, commercial real estate, and tourism and hotels, grew by different rates ranging from 0.7 percent to 6.1 percent. In contrast, loans and advances to the trade, restaurants and bars sectors fell by 8.2 percent, while to the mining and quarrying sector, the decline was 3.4 percent.

Chart 2.10: Sectoral Distribution of Private Sector Enterprise Loans: 2015 - 2016 (Percent)





LOANS TO DIRECTORS AND RELATED PARTIES

2.22 As at December 2016, total loans and advances extended to related parties constituted 1.8 percent of banks' unimpaired capital, thus posing minimal credit risk in the banking sector.

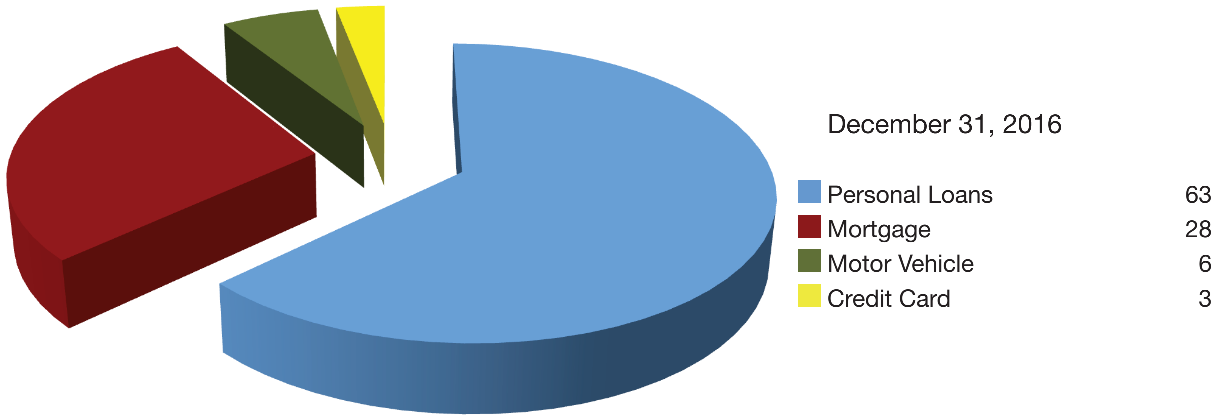
FOREIGN CURRENCY DENOMINATED LOANS AND LIABILITIES

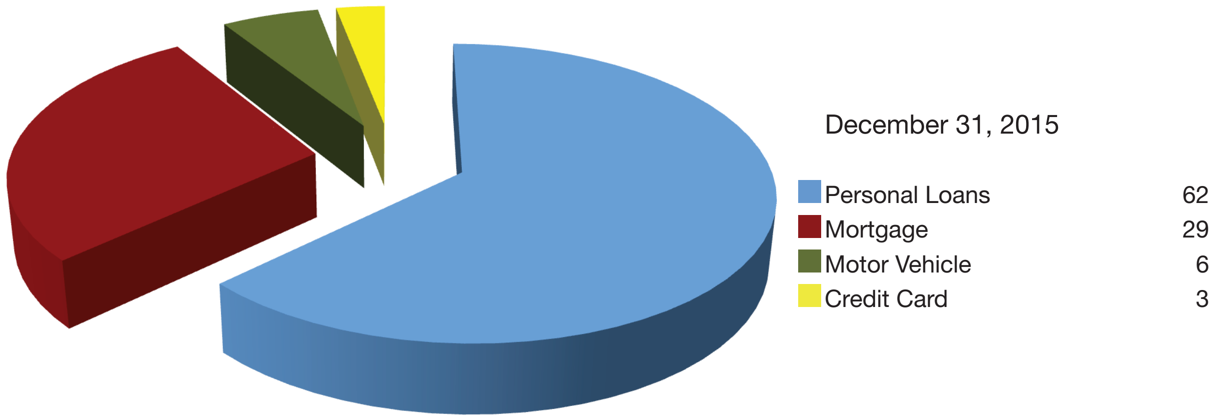
2.23 The ratio of Foreign Currency Denominated Loans to Total Loans and Advances and Foreign Currency Denominated Liabilities to Total Assets were 7.5 percent and 10.5 percent, respectively. This indicated that adverse movements in foreign exchange rates had a relatively modest impact on the earnings and capital of the banking sector. The ratio of Foreign Currency Loans to Total Foreign Currency Deposits was 36.5 percent in 2016. The ratio ranged between 2.4 percent and 111 percent, implying that banks' foreign currency lending was not solely funded by foreign currency deposits.

THE COMPOSITION OF HOUSEHOLD LOANS AND ADVANCES

2.24 The composition of loans and advances to households was almost unchanged in 2016, compared to 2015 (Chart 2.11). Total credit to the household sector increased from P28.7 billion in December 2015 to P30.8 billion in 2016. The growth was driven by a 9.1 percent increase in personal loans, which constituted the largest proportion of household loans at 63 percent. Mortgage loans increased by 6.3 percent to P8.8 billion, although its share, as a proportion of total retail lending, was almost unchanged at 28 percent (December 2015: 29 percent). The motor vehicle and credit card segments had shares of 6 percent and 3 percent, respectively.

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





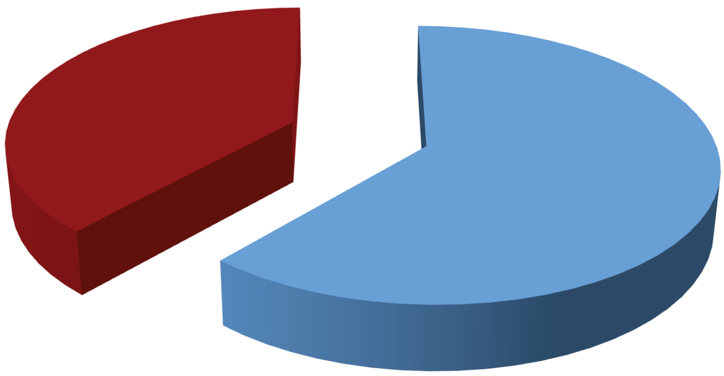
2.25 In general, the banking sector's inherent credit risk was considered high. However, measures in place, including collateral and stringent loan approval processes for unsecured loans, have adequately mitigated the risk, resulting in a moderate residual risk.

MARKET RISK

REGULATORY CAPITAL REQUIREMENTS ON MARKET RISK

2.26 The total market RWA was P456.5 million (constituting 1 percent of total RWA), while the total regulatory capital requirement for market risk was P68.1 million. This was indicative of the industry's low exposure to market risk. The majority of the market risk regulatory capital requirement relates to interest rate exposures, which amounted to P41.9 million or 61.5 percent of the total regulatory capital requirement for market risk in December 2016. The capital charge for exposure to foreign exchange risk was 38.5 percent of the total market risk regulatory capital requirement (Chart 2.12).

Chart 2.12: Composition of Market Risk Regulatory Capital Requirement (Percent)



FOREIGN EXCHANGE RISK EXPOSURE

2.27 All banks complied with the Foreign Currency Exposure Directive No. BoBA 1/99, by maintaining Foreign Exchange Currency Exposure to Unimpaired Capital Ratios within the required 15 percent, 5 percent and 30 percent limits[10] for major, minor and overall currency exposures, respectively. This indicates that the banking sector had relatively low net exposure to foreign exchange risk.

INTEREST RATE RISK EXPOSURE

2.28 The banking sector gap between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) was positive in each time band, except for the "6 to 12 months" time band, which recorded a negative gap of P189 million (Table 2.3). This negative gap shows that a decline in interest rates will result in liabilities repricing at a lower rate, thus, increasing the banks' earnings. Similarly, on rate sensitive assets, a decline in interest rates would lower the sector's earnings, while an increase in interest rates will positively impact earnings and profitability and, by extension, economic capital.

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

Table 2.3: Interest Rate Risk Exposure

	TOTAL VARIABLE RATE ASSETS (P'MILLION)	TOTAL VARIABLE RATE LIABILITIES (P'MILLION)	VARIABLE GAP (P'MILLION)
Up to 1 month	51 609	30 842	20 767
1 - 3 months	2 708	1 392	1 316
Over 3 - 6 months	384	13	371
Over 6 - 12 months	832	1 021	(189)
Over 12 months - 3 years	1 472	2	1 470
Over 3 - 5 years	1 543	457	1 086
Over 5 - 10 years	2 324	307	2 017
More than 10 years	2 105	46	2 059
Total	62 977	34 080	28 897

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

OPERATIONAL RISK

REGULATORY CAPITAL REQUIREMENTS ON OPERATIONAL RISK

2.30 The risk-weighted assets for operational risk was P5.3 billion, constituting 10.1 percent of the total RWAs in December 2016. On the other hand, the total regulatory capital requirement for operational risk was P787 million as at December 31, 2016. All banks computed their operational risk capital requirements using the Basic Indicator Approach (BIA), except one bank, which used both the BIA and the Standardised Approach for Operational Risk (TSA), since it was conducting a TSA trial-run.

OPERATIONAL RISK EXPOSURE

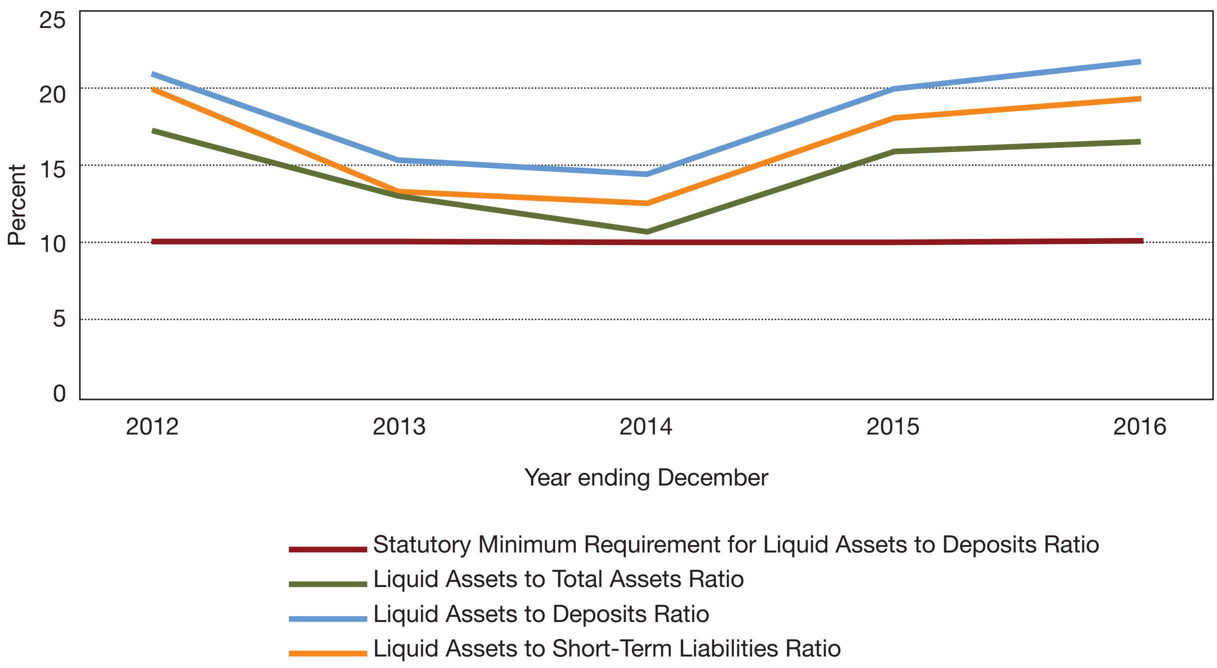
2.31 A review of banks' internal controls by the external auditors highlighted incidences of internal control deficiencies, which included outstanding items in the suspense accounts (indicating delays in reconciliations), credit card impairment model with no access rights, incorrect interest rates on staff loans, missing customer loan files, as well as lack of withholding tax on payments made to VISA. On IT-related matters, on-site examinations revealed that some banks had neither conducted penetration tests that ensure security of the IT infrastructure nor had their core banking systems replicated in Botswana, to enable timely intervention.

2.32 In the circumstances, the banking sector composite operational risk was considered moderate, in light of satisfactory risk management measures in place to mitigate the risk.

LIQUIDITY AND FUNDING RISK

2.33 The banking sector's Liquid Assets to Total Deposit Ratio increased from 19.7 percent in 2015 to 21.6 percent in 2016, which was significantly above the 10 percent minimum prudential requirement. Similarly, the Liquid Assets to Total Assets Ratio increased from 15.4 percent in 2015, to 16.7 percent in 2016, following an increase in liquid assets (Chart 2.13). Overall, the total liquid assets held in the banking sector increased to P13.5 billion as at December 31, 2016 (December 2015: P11.8 billion).

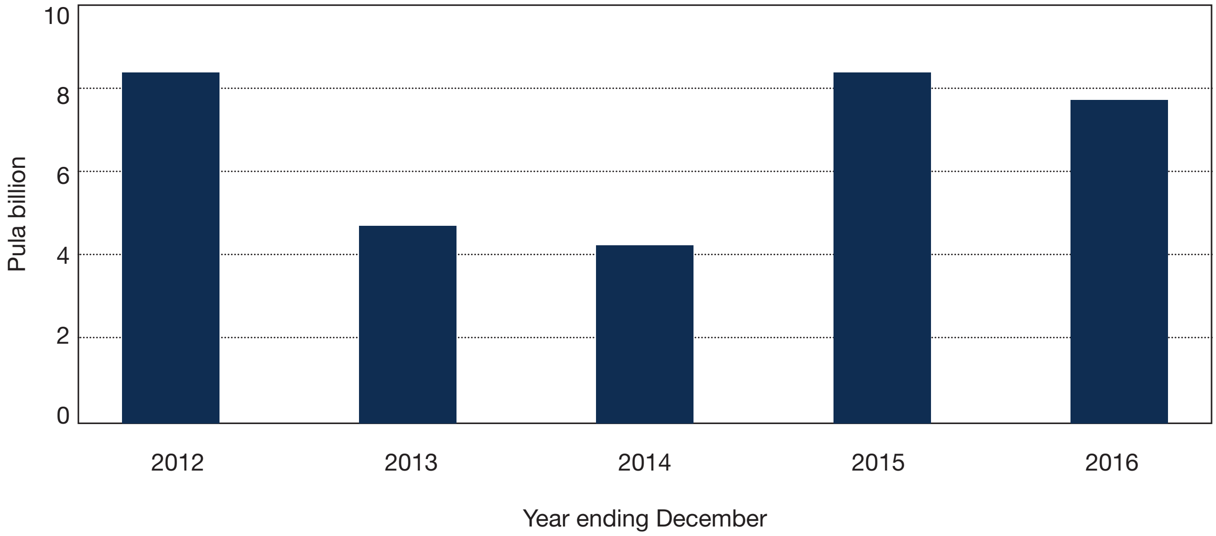
Chart 2.13: Commercial Banks: Liquidity Ratios: 2012 - 2016



2.34 The banks' aggregate cash and balances with the Bank increased by 38.2 percent from P4.6 billion in 2015 to P6.3 billion in 2016. Commercial banks' placements with other banks and credit institutions increased by 3.9 percent from P10.5 billion in 2015 to P11 billion in 2016. Chart 2.14 shows Bank of Botswana Certificates (BoBCs) holdings by banks for the period 2012 - 2016. There was a slight decrease in BoBCs holdings to P7.9 billion during 2016 (December 2015: P8.2 billion).

2.35 Overall, the liquidity indicators show an improved liquidity condition in 2016.

Chart 2.14: Commercial Banks: Market Value of Outstanding BoBCs Holdings

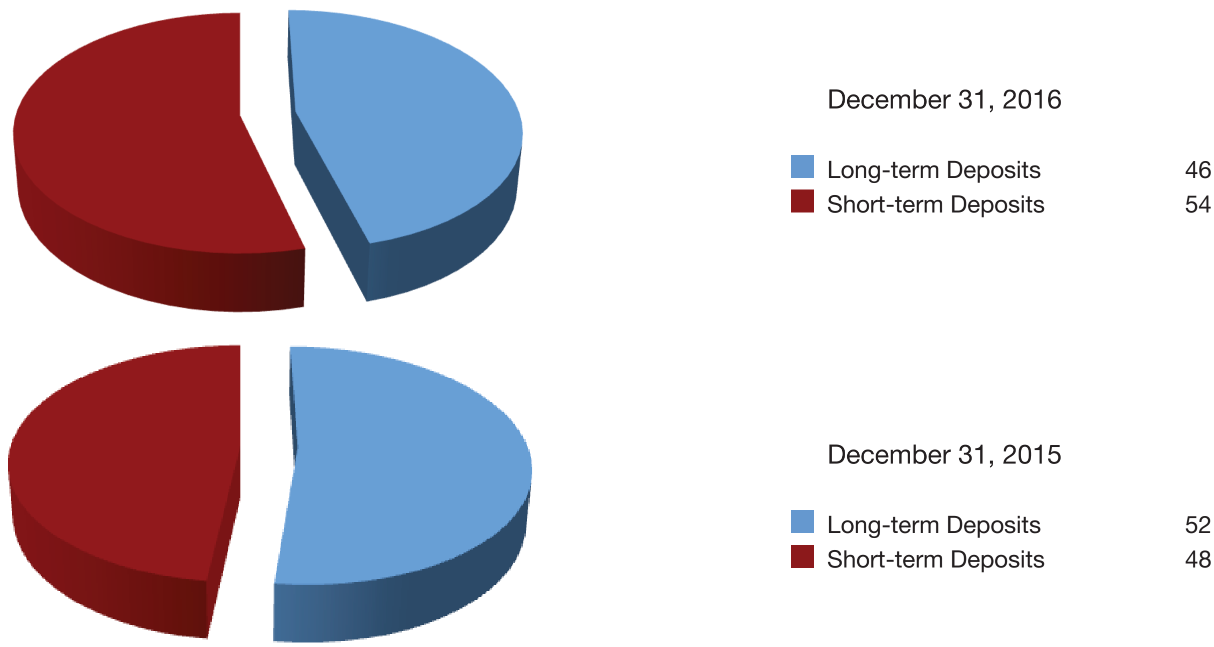


LIABILITIES AND FUNDING STRUCTURE

2.36 The main sources of funding (total deposits and shareholders' funds) increased marginally in 2016. Total customer deposits increased (4.2 percent) from P60 billion in 2015 to P62.4 billion in 2016, and constituted the largest proportion of liabilities at 77.4 percent and, as expected, were the primary source of funding for asset growth and other aspects of the banks' operations. Interbank balances and credit from institutions increased by 20.4 percent from P3.3 billion in 2015 to P4 billion in 2016, as banks accessed alternative sources of funding for asset growth. Debt securities decreased by 16.5 percent from P3.2 billion in 2015 to P2.6 billion, which weakened balance sheet funding.

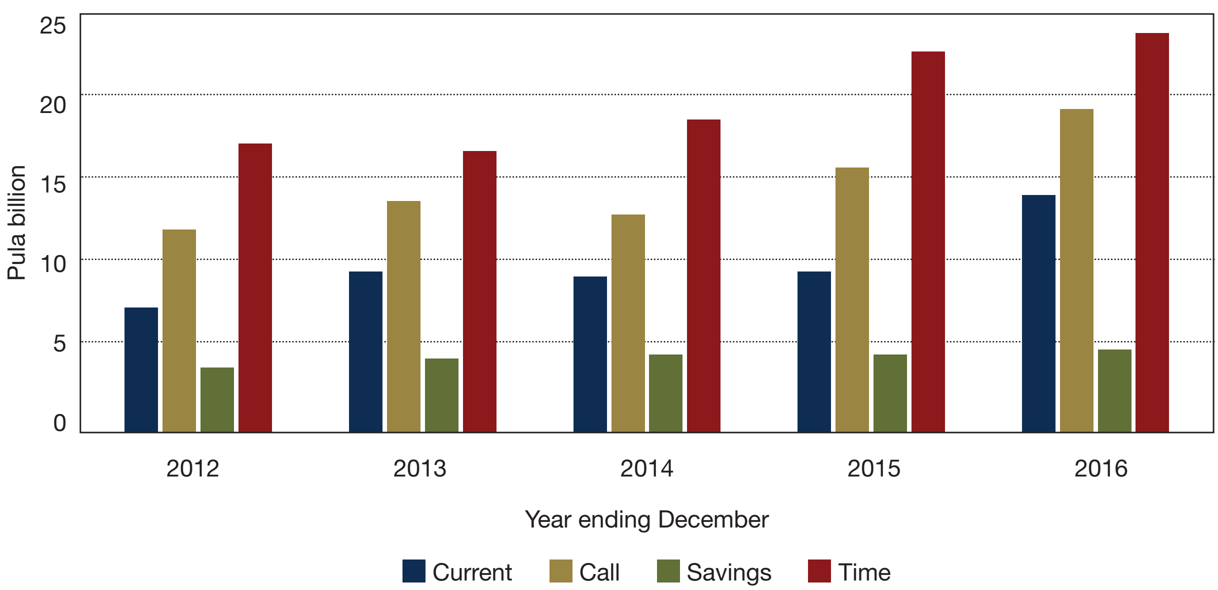
2.37 The relative share of deposits by maturity changed significantly between 2015 and 2016. The share of long-term deposits (time and savings) decreased from 52 percent in 2015 to 46 percent in 2016, while that of short-term deposits (call and current) increased from 48 percent to 54 percent (Chart 2.15). This exacerbates the problem of funding long-term assets with short-term liabilities.

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



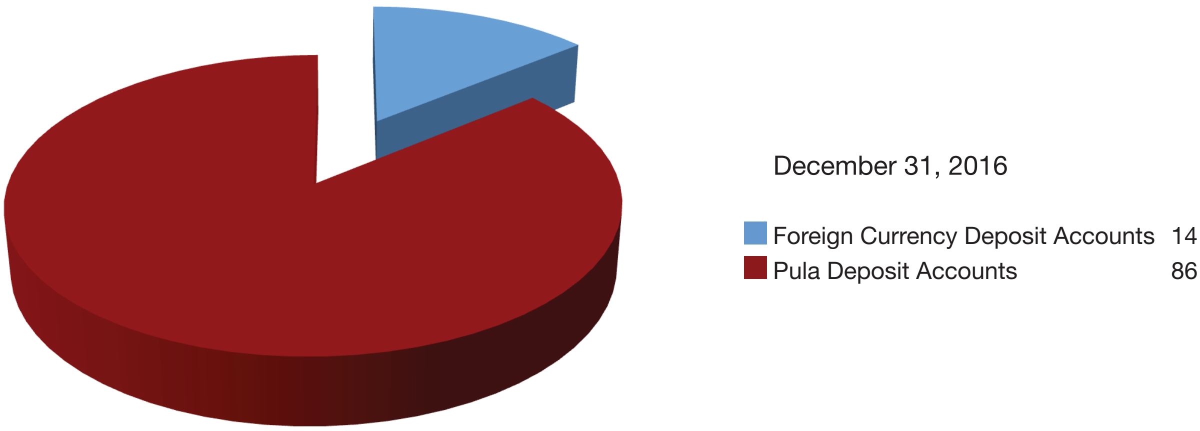
2.38 Chart 2.16 shows the value of Pula denominated deposits by type, for the period 2012 to 2016. As at December 31, 2016, time deposits (fixed and notice) amounted to P23.2 billion (December 2015: P22.4 billion), and accounted for the largest proportion of total deposits at 38.2 percent. In contrast, savings deposits constituted the smallest proportion of total deposits (7.3 percent).

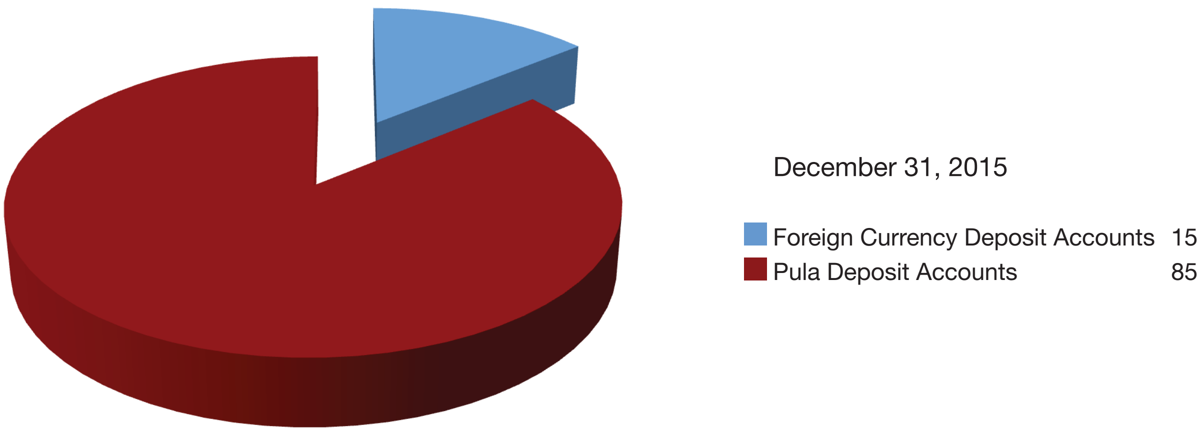
Chart 2.16: Commercial Banks: Share of Value of Pula Denominated Deposits by Type: 2012 - 2016



2.39 Foreign currency deposits amounted to P8.7 billion as at December 31, 2016 (December 2015: P9 billion). Chart 2.17 shows that the proportion of Foreign Currency Deposits to Total Deposits decreased marginally from 15 percent in December 2015 to 14 percent in December 2016. The United States dollar (USD) and South African rand (ZAR) dominated foreign currency deposits, mainly due to the relative importance of these two currencies in the country's trade transactions. However, most of the deposits (85.6 percent) were Pula denominated.

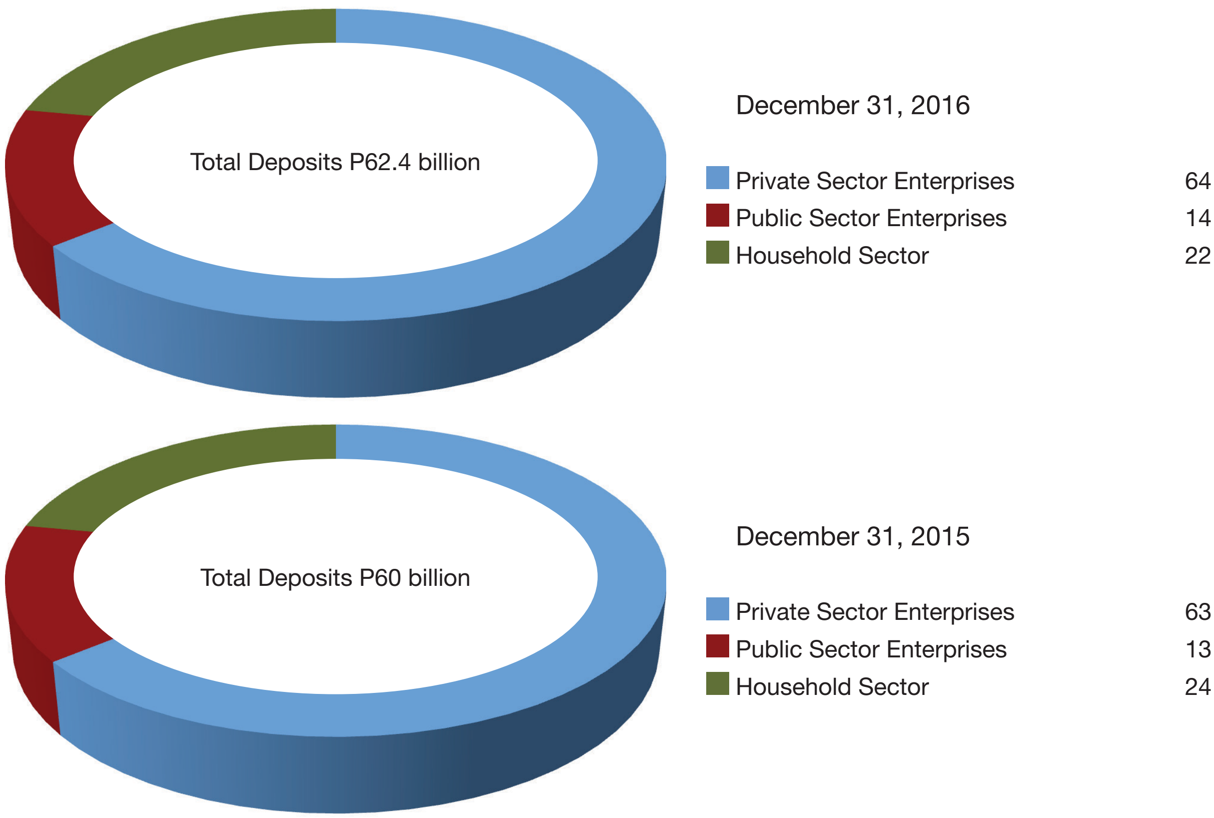
Chart 2.17: Commercial Banks: Share of Foreign Currency and Pula Denominated Deposits to Total Deposits (Percent)





2.40 The bulk of deposits were mainly held by private sector enterprises (64 percent) in December 2016. The share of deposits for the household sector decreased slightly from 24 percent in December 2015 to 22 percent in December 2016, while the public sector deposits increased marginally to 14 percent (December 2015: 13 percent). Chart 2.18 shows the sectoral distribution of deposits in 2015 and 2016.

Chart 2.18: Commercial Banks: Sectoral Distribution of Deposits: 2015 - 2016 (Percent)



2.41 Other sources of funding (share capital, balances due to other banks, debt securities and other borrowings) comprised 12.1 percent, 4.9 percent and 3.3 percent of total funding, respectively, in 2016. Table 2.4 shows the sources of funding for the banking sector from 2012 to 2016.

Table 2.4: Main Sources of Funding (Pula Million)

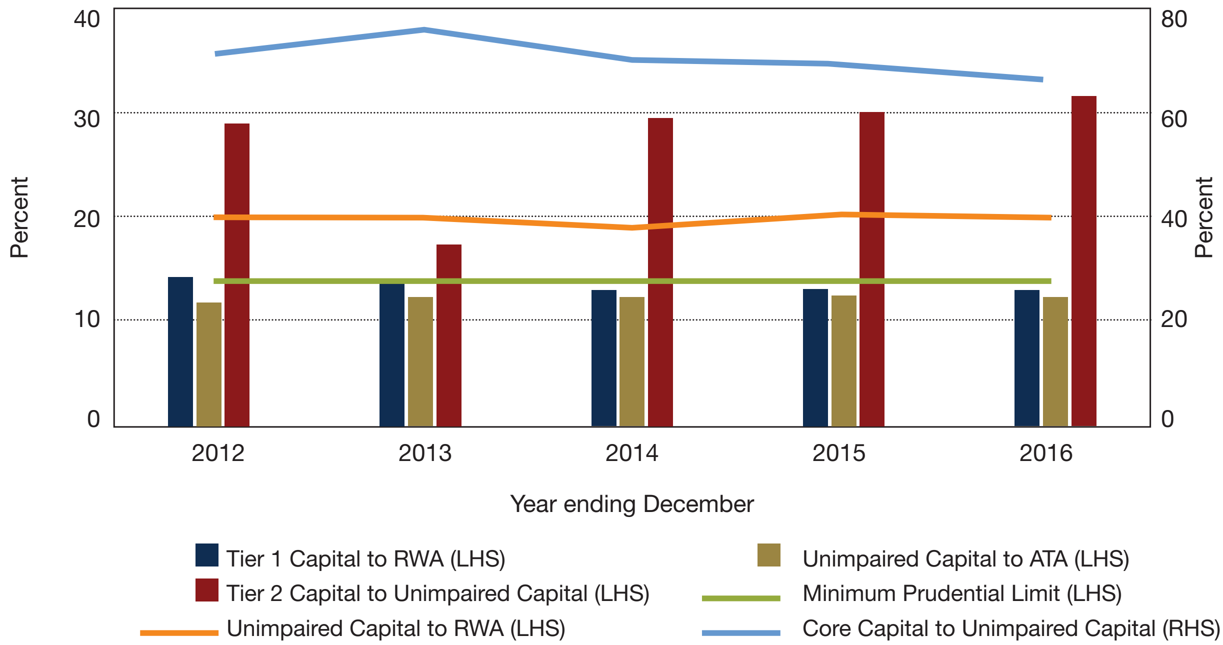
CATEGORY	2012	2013	2014	2015	2016
Deposits	47 219	48 589	51 492	59 940	62 438
Growth Rate (Percent)	9.4	2.9	6.0	16.4	4.2
Share of Total Funding	81.5	81.0	75.7	78.2	77.4
Other Liabilities	2 925	1 207	3 109	1 999	1 817
Growth Rate (Percent)	60.1	(58.9)	157.8	(35.5)	(9)
Share of Total Funding	5.0	2.0	4.6	2.6	2.3
Share Capital	5 548	6 479	7 724	8 195	9 748
Growth Rate (Percent)	18.1	16.8	19.2	6.1	19
Share of Total Funding	9.6	10.8	11.4	10.7	12.1
Due to other Banks	1 320	1 394	3 581	3 308	3 984
Growth Rate (Percent)	33.3	5.6	157.0	(7.6)	20.4
Share of Total Funding	2.3	2.3	5.3	4.3	4.9
Debt Securities and Other Borrowings	942	2 292	2 088	3 163	2 642
Growth Rate (Percent)	3.7	143.5	(8.9)	51.5	(16.5)
Share of Total Funding	1.6	3.8	3.1	4.1	3.3
Total Funding	57 954	59 962	67 994	76 605	80 640

Note: Parenthesis denotes negative figures

CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

2.42 The banking sector was adequately capitalised and complied with the new regulatory capital requirements, with all banks on the new standard reporting Capital Adequacy and Common Equity Tier 1 Capital ratios in excess of the 15 percent and 4.5 percent prudential minimum requirements, respectively. Nevertheless, commercial banks' Capital Adequacy Ratios declined marginally from 20.1 percent in December 2015 to 19.6 percent in December 2016. This was partly a result of the 12.1 percent growth in RWAs to P52.3 billion in December 2016 (December 2015: P46.7 billion). Chart 2.19 shows the capital adequacy ratios over a five-year period (2012 - 2016).

Chart 2.19: Commercial Banks: Capital Ratios: 2012 - 2016



2.43 The banking industry's unimpaired capital increased by 9.2 percent from P9.4 billion in 2015 to P10.2 billion in 2016, due to an increase in retained earnings of 4.1 percent (2015: 11.5 percent) and Tier 2 capital instruments (5.8 percent). Four banks voluntarily injected additional Tier 2 capital amounting to P240 million. In addition, increases in banks' capital levels can also be attributed to increases in RWA, as banks grew their loan books. All banks, with the exception of two banks, which paid out dividends, recorded increases in their unimpaired capital.

2.44 Total qualifying Tier 1 capital accounted for 67.8 percent of total unimpaired capital. The movement from Basel I to Basel II shows notable increments in the commercial banks' unimpaired capital, mainly for the reasons given at paragraph 2.43.

2.45 Total Tier 2 capital was P3.3 billion (December 2015: P2.8 billion), comprising mainly subordinated term debt (55.2 percent), unpublished current year's profits (31.6 percent) and general loan reserves (13.2 percent). Qualifying subordinated term debt constituted 90.3 percent of total subordinated term debt.

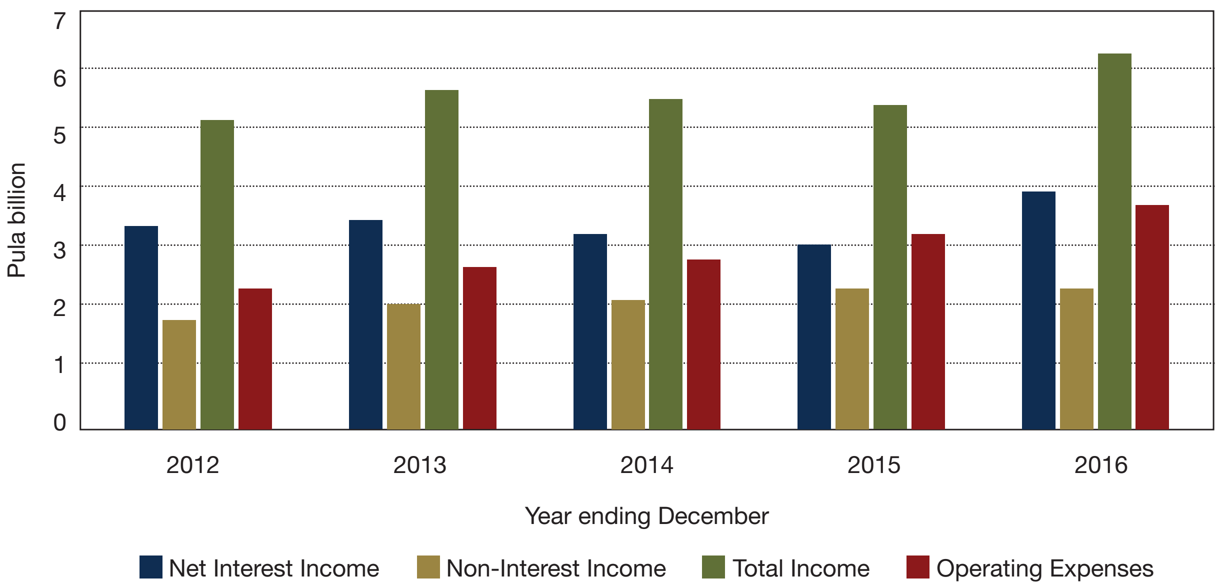
COMPOSITION OF THE STATEMENT OF COMPREHENSIVE INCOME (COMMERCIAL BANKS' INCOME STATEMENT)

2.46 The total income for commercial banks (net-interest and non-interest income), increased by 18.2 percent (1.6 percent in 2015) from P5.3 billion in 2015 to P6.3 billion in 2016. Net-interest income increased by 26.7 percent from P3 billion in 2015 to P3.8 billion in 2016 partly reflecting a 31.9 percent decline in interest expenses. Non-interest income increased by 7.1 percent from P2.3 billion in 2015 to P2.5 billion in 2016. The share of Non-Interest Income to Total Income declined to 39.2 percent in 2016 (2015: 43.2 percent), while the ratio of Net Interest Income to Total Income increased from 56.8 percent in 2015 to 60.8 percent in 2016.

2.47 Operating expenses have been on a five-year upward trend for several reasons, including increasing staff costs, rental costs as banks expanded branch networks and due to a rise in specific impairments.

2.48 The Cost to Income Ratio declined from 60.6 percent in 2015 to 57 percent in 2016, and thus was within the 55 - 60 preferred range. The decline was attributable to faster growth in income than expenses, implying relatively satisfactory non-interest expense management. Chart 2.20 shows the trends and composition of income and expenses for commercial banks for the period 2012 - 2016.

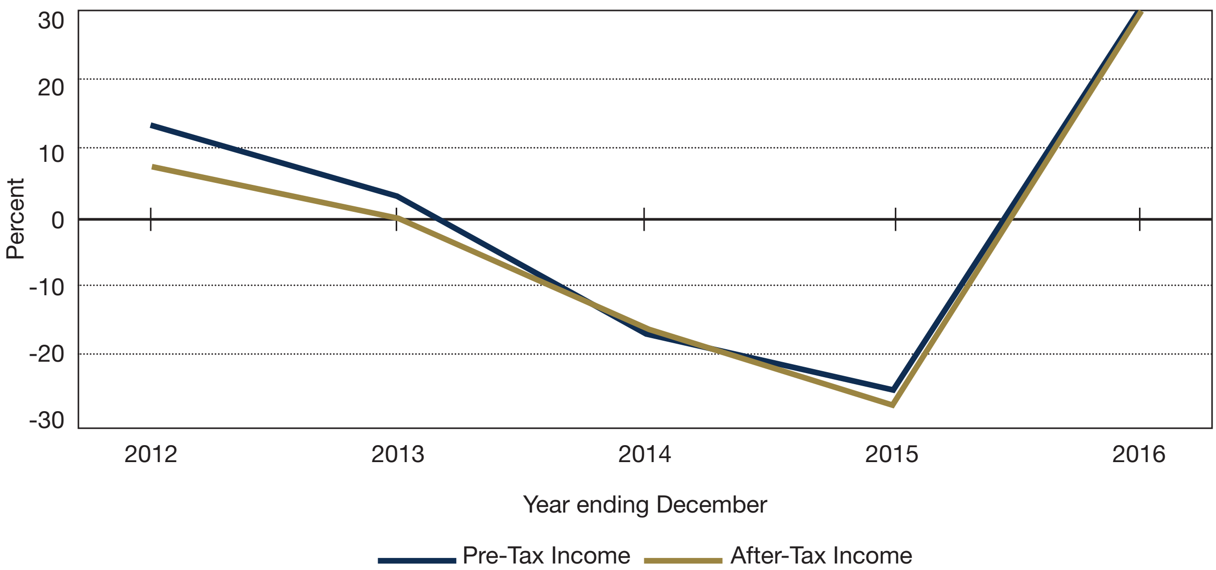
Chart 2.20: Commercial Banks: Composition of Income and Expenses: 2012 - 2016



LEVELS, SOURCES AND TRENDS OF PROFITABILITY

2.49 Most banks reported net profit for the period ended December 31, 2016. The banking sector net income after-tax improved and increased by 29.3 percent from P1.1 billion to P1.4 billion in December 2016. Chart 2.21 shows commercial banks' pre- and after-tax profit growth rates over a five-year period.

Chart 2.21: Commercial Banks: Growth Rates of Pre- and After-Tax Profits: 2012 - 2016

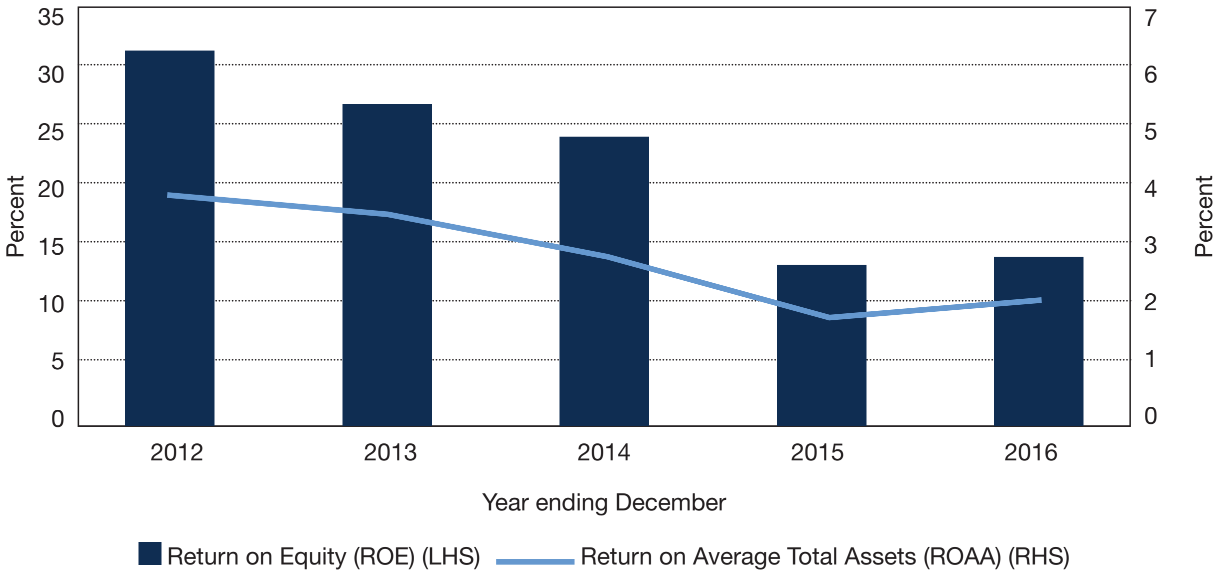


PROFITABILITY AND OPERATING EFFICIENCY INDICATORS

PROFITABILITY INDICATORS

2.50 Key profitability indicators improved in December 2016. The Return on Equity (ROE) ratio increased from 13.3 percent in 2015 to 14.4 percent in 2016. Likewise, the Return on Average Assets (ROAA) Ratio increased from 1.5 percent in 2015 to 1.8 percent in 2016 (Chart 2.22). The higher ratios were mainly due to an increase in commercial banks' profitability, arising out of an improvement in net interest income and non-interest revenue.

Chart 2.22: Commercial Banks: Profitability Indicators for Commercial Banks, 2012 - 2016



2.51 The Net Interest Income to Average Total Assets (ATA) Ratio increased from 4.2 percent in 2015 to 4.9 percent in 2016 (Table 2.5). The Non-Interest Income to Total Income Ratio declined from 42.7 percent to 39.2 percent, signaling reduced reliance by banks on non-interest income to augment profits. Table 2.5 provides data on key financial performance indicators for the banking sector, from 2012 - 2016.

Table 2.5: Financial Performance Ratios (Percent)

FINANCIAL PERFORMANCE RATIOS	2012	2013	2014	2015	2016
Income on Investments and Securities to Total Income	8.3	11.3	4.5	4.3	3.0
Non-Interest Income to Total Income	35.1	36.4	39.6	43.2	39.2
Net Interest Income to Total Income	64.9	63.6	60.4	56.8	60.8
Return on Equity	31.9	27.4	19.1	13.3	14.4
Return on Average Total Assets	3.2	3.0	2.3	1.5	1.8
Net Interest Income to Average Total Assets	6.0	6.0	5.1	4.2	4.9
Interest Income to Average Earnings Assets	11.9	11.8	8.8	7.9	7.4
Non-Interest Income to Average Total Assets	3.2	3.4	3.4	3.2	3.1
Interest Expense to Average Total Assets	2.7	2.7	2.6	2.9	1.8
Earnings Retention	92.8	69.9	70.1	37.6	80.0
Interest Income on Loans to Average Total Assets	7.5	7.7	6.9	6.3	6.0
Non-Interest Expense to Average Total Assets	4.3	4.6	4.3	4.5	4.6
Gross Interest Income to Average Total Assets	8.7	8.7	7.7	7.1	6.7

OPERATING EFFICIENCY INDICATORS

2.52 Table 2.6 shows the trend in commercial banks' efficiency measures for the period 2012 - 2016. Net Income per Employee increased to P310 500 in 2016 (2015: P233 900), while Net Income to Employee Costs increased from 81.5 percent to 91.2 percent in 2016.

2.53 The core earning capability of commercial banks improved in 2016, as indicated by the increase in the net spread from 4 percent in 2015 to 4.8 percent in 2016. Net Interest Margin also increased to 5.4 percent in 2016 (2015: 4.7 percent). On the other hand, the Average Cost of Deposits Ratio declined from 3.1 percent in 2015 to 1.7 percent in 2016, while the Return on Loans and Advances Ratio decreased to 9.5 percent in 2016 (2015: 9.7 percent).

Table 2.6: Commercial Banks: Other Efficiency Measures: 2012 - 2016

	2012	2013	2014	2015	2016
Average Cost of Deposits (Percent)	3.0	3.0	2.9	3.1	1.7
Return on Loans and Advances (Percent)	13.3	12.4	10.4	9.7	9.5
Net Interest Margin (Percent)	8.2	8.2	5.8	4.7	5.4
Net Spread (Percent)	8.6	7.9	6.2	4.0	4.8
Cost to Income (Percent)	46.7	48.6	51.2	60.6	57.0
Net Income to Employee Costs (Percent)	156.4	142.2	107.9	81.5	91.2
Net Income per Employee (P'000)	404.9	390.4	317.6	233.9	310.5
Staff Cost per Employee (P'000)	258.8	274.5	294.4	289.9	340.5
Asset per Employee (P'000)	13 238	13 190	14 610	16 460	17 793

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

2.54 The Bank's Off-site Surveillance System (OSS)[11] and the annual risk assessment review showed that, as at the end of 2016, commercial banks were sound and stable. The solvency of banks, as measured by the Capital Adequacy Ratios had an average rating of 1.3. On the other hand, the asset quality was unsatisfactory, as it was partially adequate with scores ranging between 3 and 3.5. This was attributed to the high NPLs. The liquidity position of banks was satisfactory and had an average score of 2.5.

2.55 Commercial banks' sensitivity to market risk had an average rating of 2, with scores ranging between 1.5 and 2.5. Consequently, the management[12] was rated 3.5, which was the highest ranking assigned to the CAMELS components. Table 2.7 below provides a summary of OSS ratings for the eight banks included in this framework.

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

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

Table 2.7: Banking Sector OSS Results as at December 31, 2016

	CAPITAL ADEQUACY	ASSET QUALITY	MANAGEMENT	EARNINGS	LIQUIDITY	SENSITIVITY TO MARKET RISK	OVERALL SCORE
BANKING SECTOR AVERAGE							

Meaning of the Colour Codes

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

STATUTORY BANKS

STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

2.56 The financial position of two statutory banks was unchanged at P6 billion at the end of both 2015 and 2016[13]. Total assets and deposits of the statutory banks were lower than those of all banks in general and small banks in particular.

LIQUID ASSETS AND LIQUIDITY RISK

2.57 Statutory banks' liquid assets fell by 33.9 percent from P1.5 billion in 2015 to P1 billion in 2016 and these comprised mainly of placements with domestic banks. Placements with other banks declined by 35.2 percent to P1 billion (2015: P1.6 billion). As a result, the Liquid Assets to Total Deposits Ratio declined from 45 percent in 2015 to 28.4 percent in 2016. However, the ratio still remained within the prudential minimum limit of 10 percent. Likewise, the Liquid Assets to Total Assets and Liquid Assets to Advances Ratios, declined to 16.6 percent and 20.8 percent, respectively (December 2015: 24.9 percent and 35.1 percent, respectively).

LOANS AND ADVANCES, CREDIT RISK AND ASSET QUALITY

2.58 Lending by the statutory banks increased by 11.5 percent in 2016 to P4.8 billion (2015: P4.3 billion). NPLs declined by 18 percent to P215 million in 2016, compared to P262 million in 2015. As a result, the ratio of NPLs to Total Loans and Advances decreased from 6.1 percent in 2015 to 5 percent in 2016. However, past due and specific provisions increased in 2016 to P450 million and P28 million, respectively (December 2015: P369 million and P22 million, respectively). To mitigate the credit risk, the two banks had some of their loans and advances secured by qualifying real estate or guaranteed by Government.

2.59 During the period under review, the regulatory capital requirements of the statutory banks, in terms of credit risk-weighted assets, declined from P2.9 billion in 2015 to P2.4 billion in 2016. The decline resulted from the migration of some risk exposures under Basel I to lower risk-weighted categories under Basel II. These credit risk-weighted assets constituted 84.9 percent of the total risk-weighted assets.

COMPOSITION OF LIABILITIES AND FUNDING STRUCTURE OF STATUTORY BANKS

2.60 The assets of statutory banks were funded by customer deposits (58.4 percent), shareholders' funds (21.8 percent) and borrowings from international lending agencies (16.5 percent). Deposits increased by 5 percent to P3.5 billion (2015: P3.3 billion). The Loans to Deposits Ratio increased to 136.6 percent in 2016 (2015: 128.1 percent). This relatively high ratio reflects the fact that statutory banks rely more on capital and other funding sources, and not on customer deposits.

CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

2.61 Statutory banks were adequately capitalised and met the new regulatory capital requirements. Capital Adequacy and Common Tier 1 Capital ratios were in excess of the 15 percent and 4.5 percent minimum prudential requirements, respectively. The Unimpaired Capital to Risk-Weighted Assets Ratio was virtually unchanged at 45.1 percent (December 2015: 45 percent), due to the marginal decline in risk-weighted assets, while capital remained the same. Core Capital to Total Capital Ratio remained above 50 percent, at 94.8 percent in 2016, an improvement from 92.8 percent in 2015. One statutory bank was the main contributor to the increase in the ratios.

[13] The analysis of statutory banks excludes one statutory bank because it was given a waiver not to report under the Basel II Reporting structure until further notice.

STATEMENT OF COMPREHENSIVE INCOME

2.62 The aggregate net income of the statutory banks fell by 31.7 percent to P65 billion in 2016. The primary driver for the decrease in net income was loan impairments (trading losses), which doubled to P18 million from P9 million in 2015. As a result, ROAA and ROE ratios declined in 2016 to 1.1 percent and 5 percent, respectively (2015: 1.8 percent and 7.6 percent, respectively). However, interest income increased by 1.5 percent to P482 million in 2016 (2015: P475 million). The Interest Income to ATA Ratio declined to 8 percent in 2016, from 8.7 percent in 2015. Table 2.8 shows key performance indicators for statutory banks during 2012 - 2016.

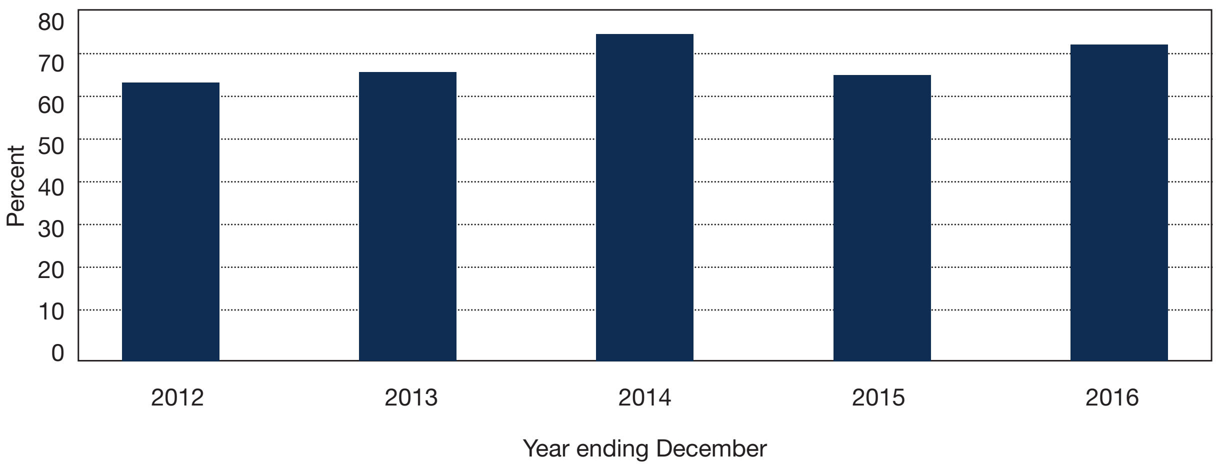
Table 2.8: Statutory Banks: Financial Performance Indicators: 2012 - 2016

INDICATOR	2012	2013	2014	2015	2016
Net Income (P' million)	81	68	60	96	65
Net Income Growth Rate (Percent)	(5.9)	(15.4)	(12.8)	60.3	(31.7)
Interest Income (P' million)	310	352	370	475	482
Net Interest Income (P' million)	175	192	197	242	251
Non-Interest Expense (P' million)	132	151	174	189	214
Total Assets (P' million)	3 894	4 333	4 834	6 031	5 982
Average Total Assets (P' million)	4 087	4 114	4 584	5 432	6 006
Average Earning Assets (P' million)	1 722	1 443	1 636	1 890	2 120
Unimpaired Capital (P' million)	1 634	1 062	1 205	1 325	1 297
Risk-Weighted Assets (P' million)	3 167	2 171	2 700	2 943	2 878
Interest Income to ATA (Percent)	7.6	8.6	8.1	8.7	8.0
Interest Income to Average Earnings (Percent)	18.0	24.4	22.6	25.1	22.7
Cost to Income (Percent)	62.5	65.7	74.7	64.3	72.1
ROAA (Percent)	2.0	1.7	1.3	1.8	1.1
ROE (Percent)	5.7	2.8	3.6	7.6	5.0

Notes: 1. Parenthesis denotes negative figures
2. All figures in the table exclude one statutory bank

2.63 Chart 2.23 depicts the trend in the Cost to Income Ratio over the five-year period (2012 - 2016) for statutory banks. The Cost to Income Ratio increased sharply to 72.1 percent in 2016 (2015: 64.3 percent), reflecting the decline in income and increasing costs, partly because of expenses on infrastructure and systems associated with the preparation for conversion to a commercial orientation. The relatively lower Cost to Income Ratio in 2015 was attributable to a faster growth in income compared to expenses.

Chart 2.23: Statutory Banks: Cost to Income Ratio: 2012 - 2016



OPERATIONAL RISK

REGULATORY CAPITAL REQUIREMENTS IN RESPECT OF OPERATIONAL RISK

2.64 As at December 31, 2016, the risk-weighted assets for operational risk was P434.9 million, constituting 15.1 percent of the total risk-weighted assets of statutory banks. The total regulatory capital requirement for operational risk was P64.9 million. The two statutory banks computed their operational risk capital requirements using the BIA, which is an operational risk measurement technique proposed under Basel II.

2.65 The on-site examination of one statutory bank conducted in 2016 revealed that, in general, the bank complied with the statutory and prudential requirements on capital adequacy, earnings and profitability, as well as liquidity. However, deficiencies in the control environment, cash management and security measures were noted. Furthermore, the bank's core banking system did not interface with other business units' IT systems. These deficiencies were judged to pose high operational risk.

OVERVIEW OF PILLAR 3 DISCLOSURE REQUIREMENTS

2.66 The implementation of Pillar 3 under Basel II commenced on January 1, 2016. As a result, all banks were required to have in place Board approved Disclosure Policies by June 30, 2016, prior to publishing the disclosures. Furthermore, a Circular on Pillar 3 Market Disclosure was issued to banks in March 2016, to augment and provide clarification on the implementation of Pillar 3 Disclosure Requirements.

2.67 The Bank has since determined that further guidance is required for banks to fully comply with the Disclosure Requirements. As a result, the Bank will organise training in 2017 to assist banks accordingly. However, it is expected that the country's disclosure requirements will provide banks' customers and other relevant stakeholders with information on the level, structure and quality of banks' capital.

BOX 2: CYBER-CRIME PREVALENCE IN THE BANKING SECTOR

INTRODUCTION

The dependence of banks on Information Technology (IT) continues to increase as a result of rapid innovation around information and communications technologies as well as improvements in the quality, performance and efficiency in delivery of services. However, this evolution has unintended consequences, including vulnerability to cyber-crime risk. According to Roux (2015)[14], "Cyber risk is a growing risk, which has serious implications for prudential supervision, consumer protection and financial stability".

While there is no globally accepted definition of cyber-crime, it is associated with any criminal activity emanating from the use of electronic data and its transmission. Given the extensive interlinkages and interdependency of financial systems, cyber-attacks can be perpetrated on banks, customers, linked financial institutions and service providers. Broadly, this involves criminal and other malicious cyber-attacks/crimes carried out by perpetrators seeking financial gains or even competitors seeking to steal intellectual property or trade secrets. Insider threat from disgruntled or careless employees can be another avenue for cyber-attacks. Financial Technology (FinTech) innovations and digital channels and/or services may also act as vehicles of cyber-crime.

The Global Economic Crime Survey of 2016[15] indicated that incidences of cyber-crime were the second highest reported form of economic crime, globally. The financial sector is particularly targeted because of the unique and critical economic function it performs, the nature and value of its assets, as well as the significance of potential financial gains.

POTENTIAL IMPACT OF CYBER-CRIMES

Cyber-crime has the potential to undermine proper functioning of financial systems. If the world's financial systems fail to put in place cyber risk mitigation measures, the consequences could be far-reaching with adverse implications, including:

i. loss or corruption of confidential and sensitive data;

ii. financial loss; either direct loss of revenue or indirectly through litigation and other legal costs, fines, reputational damage; and

iii. loss of business due to weakened confidence, material loss of shareholder value, and business disruptions due to compromised IT systems. For banks, this could result in depositors being unable to access their funds on demand, creating mass panic and bank runs, thus threatening the existence of financial institutions and systems.

[14] Adopted from an Address by Cyril Roux, Deputy Governor (Financial Regulation) of the Central Bank of Ireland, to the Society of Actuaries in Ireland Risk Management Conference "Cybersecurity and cyber risk", Dublin, September 30, 2015.

[15] Global Economic Crime Survey 2016; Adjusting the lens on economic crime: Preparation brings opportunity back into focus by PricewaterhouseCoopers

THE WAY FORWARD

The management and mitigation of cyber risk is a major challenge and requires significant financial, human and other resources. However, given the various consequences of cyber-crime, efforts must be made to tackle it, including:

i. enhanced risk awareness by the Board and Executive Management;

ii. strengthening of Board oversight over cyber security risks. In addition, there should be an on-going dialogue about emerging trends and vulnerabilities;

iii. adequate investment in cyber security infrastructure systems and procedures. The resources allocated to cyber security should be commensurate with the nature and complexity of an institution's business activities and its strategic direction;

iv. there is need to engage cyber risk specialists that can develop timely and customised solutions on the institution's operating systems, business needs and organisational culture; and

v. sectoral and regulatory collaboration and information sharing on cyber-crime risks and threats.

Furthermore, it is crucial for the financial sector to work more closely with the telecommunications firms, internet service providers and other vendors in tackling cyber-crime.

The Bank is updating regulatory and supervisory frameworks aimed at addressing the cyber security threats. Banks are equally expected to clearly outline key areas of vulnerability. In the meantime, the Bank has urged banks to proceed as follows:

i. develop cyber-crime risk policy to strengthen the Board's oversight role of this type of risk;

ii. establish Computer Incident Response Teams (CIRTs) to monitor, detect, analyse and investigate cyber threats and cyber incidents;

iii. ensure that appropriate reporting channels are made available to facilitate the reporting of incidents related to cyber-crime to the Bank, other licensed banks and relevant law enforcement authorities in a timely manner;

iv. each bank to have a system in place for recording, production and provision of statistical data on cyber-crime and other related criminal activities to the Bank and relevant law enforcement authorities; and

v. domestic financial institutions to establish mechanisms to facilitate collaboration and work more closely with each other, the telecommunications industry, internet service providers and other vendors, so as to increase awareness of cyber-crime.

CONCLUSION

In view of the serious threats posed by cyber-crime, the Bank will continue to closely monitor developments in this area, and regularly engage the banking sector, as necessary.

REFERENCES

1. Address by Cyril Roux, Deputy Governor (Financial Regulation) of the Central Bank of Ireland, to the Society of Actuaries in Ireland Risk Management Conference “Cybersecurity and cyber risk”, Dublin, September 30, 2015.

2. Global Economic Crime Survey 2016; “Adjusting the lens on economic crime: Preparation brings opportunity back into focus” by PricewaterhouseCoopers.

3. “Guidance on Cyber Resilience for Financial Market Infrastructures”, June 2016, Bank for International Settlements.

4. “Cyber Risk - Nature of Risk” by Financial Stability Institute, January 2017.

NON-BANK FINANCIAL INSTITUTIONS

BUREAUX DE CHANGE ACTIVITIES

MARKET ENTRY AND EXIT

2.68 In 2016, the Bank licensed four bureaux de change and revoked three licences. The licence revocations were mainly due to failure to comply with the Bank of Botswana (Bureaux de Change) Regulations, 2004 (Regulations). Overall, there were 59 bureaux de change in operation as at December 31, 2016.

ON-SITE EXAMINATIONS OF BUREAUX DE CHANGE

2.69 The Bank conducted 13 on-site examinations during the year to check compliance with the Regulations. The on-site examinations revealed that only one bureau de change complied fully with the provisions of the Regulations, and that others violated various provisions of the Regulations. As a result, one bureau de change was cautioned and 11 were fined a total of P29 120 (VAT inclusive) for non-compliance.

2.70 Maintenance of minimum balance was a requirement that was not complied with by the largest number of the bureaux de change (Table 2.10).

Table 2.10: Violations of the Provisions of the Bank of Botswana (Bureaux de Change) Regulations

REGULATION VIOLATED	DETAILS OF THE PROVISIONS OF THE REGULATIONS	NUMBER OF BUREAUX DE CHANGE
3(d)	Failure to appoint a Principal Officer	1
5(2)(a)	Failure to operate from premises approved by the Bank	1
5(2)(b)	Change of premises without prior written approval by the Bank	1
5(2)(c)	Maintenance of minimum cash balance	5
5(2)(e)	Effecting change in the composition of shareholders or principal officers without the approval of the Bank	3
6(f)(i)	Failure to display operating hours of business	2
6(f)(ii)	Failure to display the buying and selling rate of the Pula against other currencies	1
6(f)(iii)	Failure to display commission charges in a conspicuous place on the licensed premises	1
12(2)(a)	Failure to take reasonable measures to obtain information about the true identity of a person on whose behalf a transaction is conducted	4
12(2)(d)(i)	Failure to identify and capture customer addresses	3
12(2)(d)(vi)	Failure to continuously train employees on anti-money laundering measures	3
13(1)	Transactions, per person per day, of cash amount exceeding P10 000	2
16	Failure to submit a monthly consolidated purchase and sales return	1
17	Maintaining a financial year not ending 31st of March	1
18	Failure to keep and maintain proper books of accounts	1
18(5)	Failure to submit auditor's report (audited accounts)	3

OFF-SITE SURVEILLANCE OF BUREAUX DE CHANGE

2.71 The value of sales and purchases of foreign currency at bureaux de change maintained an upward trend, as they both increased from 12.4 percent and 11.4 percent, respectively, in 2015, to 14.9 percent and 16.7 percent, respectively, in 2016. The United States dollar (USD) and South African rand (ZAR) dominated the bureaux de change foreign exchange transactions by value, during 2016 (Chart 2.24).

Chart 2.24: Bureaux de Change: Shares of Sales and Purchases of Foreign Currency in 2016 (by Value)

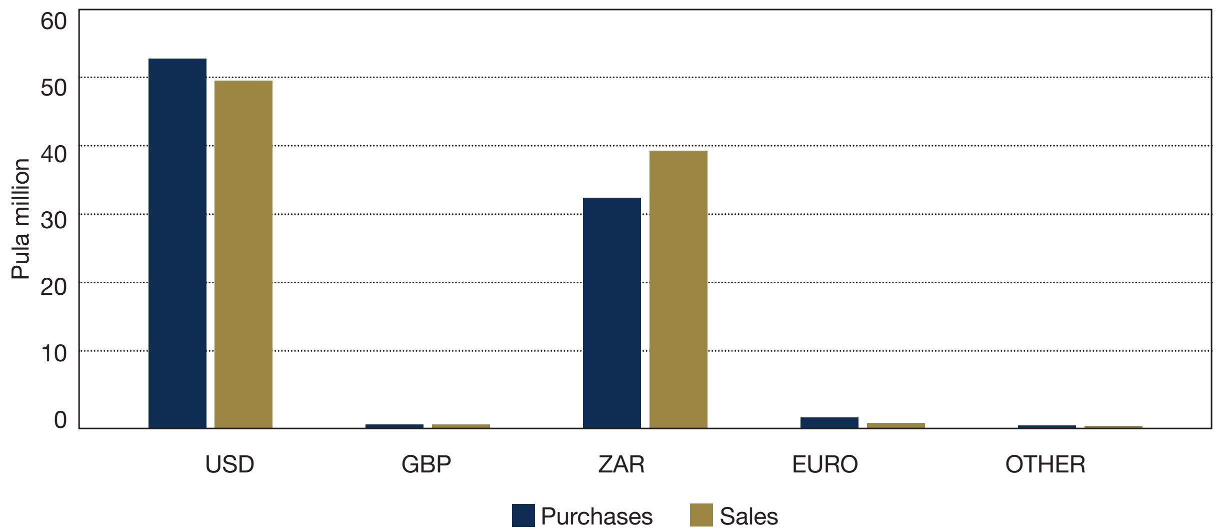


Chart 2.25: Bureaux de Change: Shares of Sales and Purchases of Foreign Currency in 2015 (by Value)

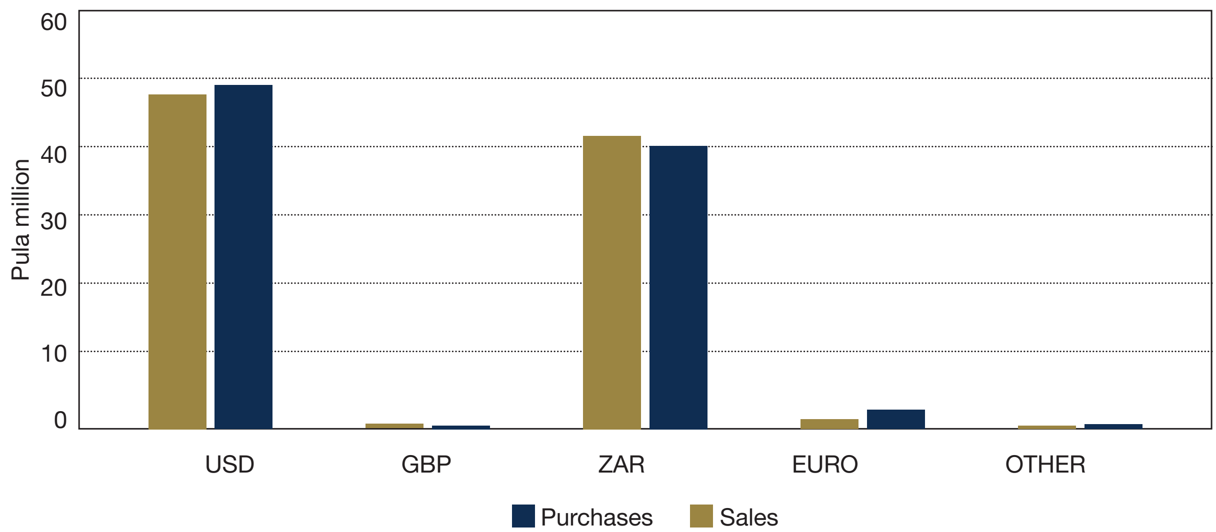
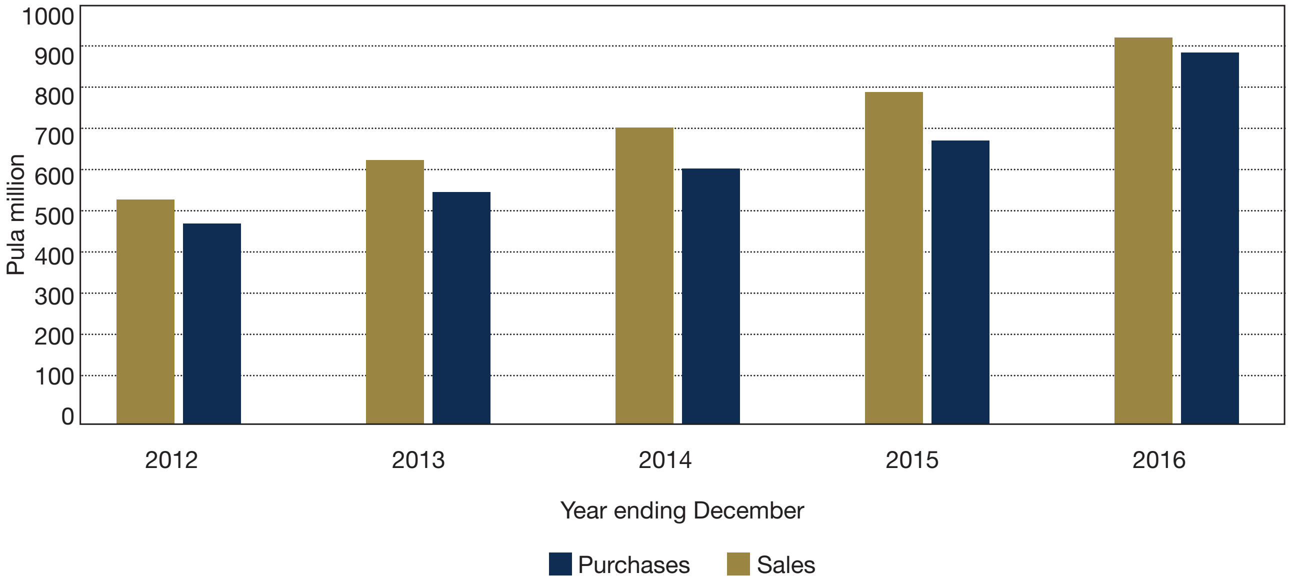


Chart 2.26: Bureaux de Change: Shares of Sales and Purchases of Foreign Currency: 2012 - 2016 (by Value)



CHAPTER 3

LICENSING AND CONSUMER PROTECTION ISSUES

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION ISSUES

MARKET ENTRY ENQUIRIES AND LICENSING OF NEW BANKS

3.1 Seven banking licence enquiries were made in 2016. However, none of the promoters formally submitted an application for a banking licence.

FINANCIAL INCLUSION INITIATIVES

3.2 Financial inclusion initiatives refer to a deliberate effort by authorities and financial services providers to devise and design ways and means that enable sections of the society that would otherwise be excluded from accessing financial services, to have cost-effective access to financial products and services. Crucially, one of the key tenets for economic development is access to finance by the low-income and non-salaried cohorts, as well as other disadvantaged segments of the society, such as women. It is also recognised that financial inclusion is also necessary to broaden coverage of transmission of macroeconomic policies and efficient provision of social services. According to the FinScope Survey of 2014, approximately 68 percent of adults in Botswana had access to formal financial services, with 8 percent depending on the informal financial services. Hence, 24 percent of the population had no access to either formal or informal financial services.

3.3 In recognition of the critical role of financial inclusion to socio-economic development, Botswana devised a six-year financial inclusion strategy, effective 2014, called Making Access Possible (MAP). MAP represents a partnership between Government and cooperating multilateral institutions that are tasked with the promotion of financial inclusion globally. Furthermore, the critical importance of financial inclusion in bolstering socio-economic development had been underscored in the Botswana Financial Sector Development Strategy of 2012 - 2016. The Strategy highlighted the need for broad-based access to financial services, also took cognisance of the fact that the more informed and knowledgeable consumers are, the better their financial decision making.

3.4 The national strategy to bolster financial inclusion covers the demand-side, supply-side and assessment of the regulatory environment. The supply-side assessment covers payments, savings, credit and insurance, and, therefore, provides an understanding of financial inclusion in a broader context. On the other hand, the demand side entails the assessment of access, usage, perceptions and attitudes of the identified target groups.

3.5 Domestic banks continue to introduce financial inclusion products and services, in order to serve the unbanked or underbanked sections of the society. For the year under review, financial inclusion products in the market included low threshold transactional accounts, group savings schemes (Motshelo accounts), mobile funds transfer services and savings accounts for minors.

3.6 In most cases, these products and services were either offered without charges, charged a minimal fee or required low amounts for activation at account opening stage. As in all cases relating to the review of the proposed new products, and in line with the MAP strategy, the Bank assessed fees associated with financial inclusion products and, where the fees were considered onerous, the Bank instructed the concerned banks to reduce such fees to reasonable levels.

POLICY ON COMMERCIAL BANK CHARGES AND SELECTED AVERAGE CHARGES

3.7 Following the expiry of the two-year moratorium on the upward adjustment of bank charges effective January 2016, most banks, except one bank, sought regulatory approval to adjust tariff structures in 2016, in accordance with Clause 15 of the Disclosure of Bank Charges Notice.

3.8 The proposed charges varied across banks in terms of magnitude and category, and were ascribed to higher banking costs, including increased systems support expenses, cost of labour and enhancements of product quality. The proposed fee increases were benchmarked against charges levied by peer banks on comparable products and services in the industry. Where banks were found to be offering the highest charge/fee in the market, the proposed fee increases were rejected by the Bank. In general, banks were encouraged to consider fee increases which were in line with the level of inflation.

3.9 Banks continued to be largely compliant with the minimum public disclosure 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 (Table 3.1). This arrangement is meant to enhance information dissemination, transparency and promotion of public awareness on the cost of banking services in Botswana. Bank customers are expected to use the information to negotiate for better rates and/or lower cost of their banking activities.

Table 3.1: Commercial Banks: Banking Sector Deposit Rates for December 2016

DEPOSIT PRODUCT	DEPOSIT RATES (ANNUAL PERCENT)	
	Lowest	Highest
Ordinary Savings	0.20	4.25
Call	0.03	2.96
91 days	2.00	2.75
6 months	2.00	3.25
12 months	2.10	4.25
24 months	2.50	4.70

3.10 Table 3.2 below provides selected banking industry average charges applied during 2016. The structure is based on four broad categories of frequently applied charges, namely, accessibility facilitation, investment/intermediation, trade facilitation and payments and clearing charges. The selected banking industry average charges indicate that the cost of financial services has increased.

Table 3.2: Selected Commercial Banks Average Charges: 2015 - 2016 (Pula)

SERVICE CHARGE CATEGORY (PULA)	2015*	2016	GROWTH RATE (PERCENT)
Accessibility Facilitation			
ATM Charges			
(i) Cash withdrawal (Own Bank)	1.93	2.09	8.09
(ii) Lost ATM Card replacement	59.79	60.99	2.00
Internet Banking Charges			
(i) Monthly fees	172.69	174.27	0.91
(ii) Transfers (third party within Bank)	2.93	3.12	6.34
Investment/Intermediation			
(i) Personal loan - Arrangement Fee (Min)	387.09	391.20	1.06
(ii) Vehicle/Asset Finance - Arrangement Fee (Min)	593.76	633.82	6.75
Trade Facilitation			
(i) Purchase of foreign notes (Min)	21.64	21.86	1.01
(ii) International SWIFT transfer (Max)	342.50	344.36	0.54
(iii) Advising commission on Letters of Credit	214.54	216.84	1.07
Payment and Clearing Charges			
(i) Bank cheque (Standard 100 pages)	58.65	59.39	1.25
(ii) Unpaid cheque due to lack of funds	194.16	197.80	1.87
E-Banking/Mobile-Banking			
(i) Utility bill payment	3.07	3.10	0.88
(ii) Payment to third party accounts	2.56	2.62	2.27
(iii) Buy Pre-paid airtime	0.21	0.22	1.89
(iv) Cash Send/E-wallet/Instant Money	9.43	9.43	0.00

*Figures vary from the figures reported in the previous year because the fees for the newly licensed banks have been included.

CONSUMER COMPLAINTS MANAGEMENT

3.11 During the year under review, the Bank received and processed 18 consumer complaints, of which 15 were successfully resolved, while three were still being investigated, as at December 31, 2016. The complaints mainly related to disputed mortgage loan arrears and balances, unauthorised ATM withdrawals and internet transactions, unsatisfactory service and disputed listing on Credit Reference Bureau Collection Africa (CRB). It was observed that there was lack of consumer education, particularly on the procedures to be followed in lodging complaints (Table 3.3).

Table 3.3: Consumer Complaints (2016)

NATURE OF COMPLAINT RECEIVED	COMPLAINTS OUTSTANDING AS AT JANUARY 1, 2016	TOTAL NUMBER RECEIVED IN 2016	TOTAL NUMBER RESOLVED	TOTAL OUTSTANDING AS AT DECEMBER 31, 2016
Unauthorised Transactions	3	4	6	1
CRB Disputed Listings	-	2	2	-
Disputed Mortgage Loan Arrears and Balances	-	4	4	-
Unsatisfactory Service	-	4	3	1
Other	3	4	6	1
Total	6	18	21	3

ABANDONED FUNDS

3.12 In accordance with Section 39 of the Banking Act, the Bank continued to administer abandoned funds from commercial banks. Table 3.4 below, shows that the balance of abandoned funds increased to P6.9 million as at December 2016 (December 2015: P5.5 million).

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

	2015	2016
	PULA	PULA
Balance Brought forward	5 052 907	5 515 681
Funds Received	2 335 297	2 321 882
Claims Paid Out	(510 316)	(372 291)
Transfer to Guardian's Funds	(1 362 207)	(547 055)
Balance at Year-end	5 515 681	6 918 217

Note: Parenthesis denotes negative figures

CORPORATE GOVERNANCE

3.13 Commercial banks appointed senior management officials who were considered “fit and proper”, as per the requirements of the Banking Act, relevant guidelines and international best practice. During 2016, the Bank received 19 applications for appointments to banks’ Boards and 34 to senior management positions, all of which were approved. Out of the total appointments, eight Botswana citizens were appointed to Boards and 15 to senior management positions. This represented a 7 percent decline on the number of citizen appointments reported in 2015.

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

3.14 The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) conducted an on-site assessment of Botswana’s compliance with the Financial Action Task Force (FATF) recommendations on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) from June 13 - 24, 2016. The draft MER has since been submitted to the Bank, Financial Intelligence Agency (FIA) and Ministry of Finance and Economic Development (MFED), and the findings thereof were discussed at the ESAAMLG meeting held in April 2017 in Arusha, Tanzania.

3.15 The Bank continued to ensure that the legal framework for the regulation and supervision of banks remained relevant and current. Ideally, the legal framework pertaining to banking regulation has to reflect local and international supervisory developments, and comply with best practice, including compliance with the FATF Recommendations. The Bank will continue to review and amend the Banking Act and Banking AML/CFT Regulations, to ensure compliance with the FATF Recommendations.

BOX 3: THE DE-RISKING PHENOMENON FROM A BANKING PERSPECTIVE

INTRODUCTION

De-risking from a banking industry perspective refers to the process whereby a bank reduces or terminates relationships with other banks or other financial institutions to reduce the level of counter-party risks and/or multiple banking relationship risks. This often occurs when the bank views another client in the relationship as non-compliant with some regulatory and supervisory requirements/standards. Recently, de-risking has occurred in the form of either restriction or outright termination of Correspondent Banking Relationships (CBRs). The CBRs are meant to facilitate cross-border payments and settlement and, therefore, international trade.

COMMONEST DRIVERS OF DE-RISKING

Given the importance of banks in the economy, supervisory authorities are increasingly demanding that they should be more prudent when they establish inter-jurisdictional banking relationships. The compliance requirements which banks should meet have resulted in the re-assessment of CBRs by international banks. In most cases, a bank terminates a relationship with its counterparty when it realises that the other party does not comply with best international practices. The most common instances of non-compliance are failure to conduct Know-Your-Customer (KYC) and non-disclosure of either source, purpose or intended beneficiary of money transfer services.

International banks state that they de-risk in order to comply with the anti-money laundering and combating the financing of terrorism (AML/CFT) requirements/standards. However, the Financial Action Task-Force (FATF), the inter-governmental body that develops and promotes policies to safeguard the global financial system against money laundering, financing of terrorism (ML/FT) and proliferation of weapons of mass destruction, recommends that banks should adopt a risk-based approach and only de-risk on a case-by-case basis and terminate relationships where ML/FT risk could not be mitigated. In other words, de-risking is not meant to be a risk management tool.

THE EFFECTS OF DE-RISKING

De-risking undermines payment and settlement systems, thus constraining international trade in the process. As most of the de-risking is imposed on banking clients from developing countries, this inhibits financial inclusion in those countries. This is because in order to comply with the stringent requirements set by their CBR counterparts, local banks require their local clients to meet certain stringent conditions, prior to accessing banking services. Other effects include constraining remittances.

According to the World Bank Survey (WB Survey) of 2015, approximately 75 percent of the international banks covered in the survey had reduced their CBRs. In the Southern African region, Angola, Mauritius and South Africa had been the most affected, as their international banking networks declined by 37 percent, 16 percent and 10 percent, respectively, between 2013 and 2015. The end result is that these reductions led to contraction in access to financial services by some banking clients in these countries. One of the shortcomings of de-risking is the lack of a binding obligation on international banks to advance reasons for terminating banking relationships.

This has resulted in the international banks taking unilateral decisions based on inconsistent or unwarranted grounds for de-risking.

There have been instances in which some customers who are barred from accessing the banking system for money transfer service, end up shifting to alternative service providers that do not comply with best standards for AML/CFT compliance. Paradoxically, therefore, rather than mitigating ML/TF activities altogether, de-risking merely shifts them from one service provider to the other.

DE-RISKING IN THE BANKING ENVIRONMENT IN BOTSWANA

De-risking in Botswana has been very minimal as the banking environment is dominated by subsidiaries of foreign banks, with wide global networks. Also, all banks are subjected to an acceptable level of AML/CFT compliance regime. For example, the Bank requires every bank to institute a comprehensive AML programme, which entails having an AML related training programme for bank employees and the appointment of a Money Laundering Reporting Officer. Compliance with best international standards is assessed from time to time and, where necessary, remedial action is enforced.

Notwithstanding the foregoing, some local banks have experienced CBR termination. The following reasons were advanced:

i. group-wide termination of correspondent banking services for euro payments to 53 countries, including in Africa, Caribbean and Channel Islands;

ii. avoiding reputational risk as the local banks had bureaux de change and money remitters as their clients; and

iii. risks associated with the African clientele.

CONCLUSION

It is clear from the reasons advanced by international banks that the decision to de-risk is based on a blanket policy and not a risk-centric assessment of the likelihood of risk that each relationship could present. Also, it is apparent that the decision to restrict or terminate respondent banks' customers are often unilaterally initiated by the international banks, without taking cognisance of the AML/CFT measures deployed by such banks.

Given the adverse impact that de-risking could have on the banking system and, consequently, the domestic economy, the Bank of Botswana shall continue to require all the banks and other entities falling under its purview to strictly comply with the best standards as prescribed by the FATF.

In general, de-risking needs to be addressed urgently as it has the potential to negatively affect development efforts in lower income countries.

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Financial Market Integrity: World Bank Survey, 2015

Tracey Durner and Liat Shetret (2015). “Understanding Bank De-Risking and Its Effects on Financial Inclusion”.

Third Public and Private Sector Dialogue (2016): Eastern and Southern African Anti-Money Laundering Group, 2016.

CHAPTER 4

OTHER SUPERVISORY ACTIVITIES

CHAPTER **4**:
OTHER SUPERVISORY ACTIVITIES

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

4.1 The Basel Committee on Banking Supervision (BCBS) continued to issue and revise guidelines and standards that will, over the next few years, materially impact on the regulation and supervision of banks and banking groups. The following guidelines/standards and reports were issued in 2016:

a. Revised Framework for Market Risk Capital Requirements - January 2016;
b. Guideline on Sound Management of Risk Related to Money Laundering and Financing of Terrorism - February 2016;
c. Guidelines on Anti-Money Laundering and Countering Financing of Terrorism with a "General Guide to Account Opening" - February 2016;
d. Standard on the Interest Rate Risk in the Banking Book - April 2016;
e. Report on Regulatory Consistency Assessment Programme (RCAP) - Analysis of Risk-Weighted Assets for Credit Risk in the Banking Book - April 2016;
f. Tenth Report on the Adoption of the Basel Regulatory Framework - April 2016;
g. Guidance on the Application of the Core Principles for Effective Banking Supervision to the Regulation and Supervision of Institutions Relevant to Financial Inclusion - September 2016;
h. Final Standard on Total Loss Absorbing Capacity for Global Systemically Important Banks - October 2016; and
i. Eleventh Progress Report on the Adoption of the Basel Regulatory Framework - October 2016.

4.2 In addition, the BCBS had issued, for consultation, the following Standards as at December 2016:

a. Revisions to the Annex on Correspondent Banking;
b. Standardised Measurement Approach for Operational Risk;
c. Reducing Variation in Credit Risk-Weighted Assets - Constraints on the Use of the Internal Models Approaches;
d. Revisions to the Basel III Leverage Ratio Framework; and
e. Prudential Treatment of Problem Assets - Definitions of Non-Performing Exposures and Forbearance.

PARTICIPATION IN INTERNATIONAL AND DOMESTIC REGULATORY AND SUPERVISORY FORUMS

PARTICIPATION IN SUPERVISORY COLLEGES

4.3 During 2016, the Bank attended supervisory colleges[16] meetings organised by the parent banks of the banking groups, which have subsidiaries in Botswana. These included the following: Capricorn Investment Holdings Group (CIH) in Windhoek, Namibia; two Supervisory College meetings for Barclays Africa Group Limited (BAGL) in Pretoria, South Africa; Supervisory College Meeting for Bank of Baroda Limited and Bank of India Limited in Mumbai, India, and Supervisory College for Standard Chartered Bank Limited in Kampala, Uganda.

4.4 Supervisory Colleges were held in compliance with Principle 13 of the Basel Core Principles for Effective Banking Supervision (Core Principles). The Principle mandates home supervisors to establish bank-specific supervisory college meetings for banking groups, and also requires host supervisors to be included in the colleges. The objective of the supervisory colleges was to discuss key supervisory issues and engage with senior management officials of banks, with a view to enhancing supervision of the respective international banking groups. The subject matters discussed included, among others, group financial performance, capital and liquidity management, business conduct and risk management programmes, and oversight by the Boards of these banks.

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

OTHER SUPERVISORY MATTERS

4.5 Following the signing of the Memorandum of Understanding (MoU) between the Bank and the Competition Authority (CA), the two authorities constituted a Joint Working Committee (JWC), the objectives of which are to:

(i) manage and facilitate meetings, cooperation and consultation in respect of matters dealt with by each party in terms of the MoU;
(ii) propose, when necessary, any amendment of, or supplementation to the MoU;
(iii) advise senior management of the Bank and CA on issues affecting the efficient and effective cooperation and implementation of the MoU and solutions thereto; and
(iv) address any matter connected to or incidental to the MoU.

4.6 The Bank received a request from commercial banks seeking authorisation to use the United Nations High Commissioner for Refugees (UNHCR) issued Identity Documents (IDs) for on-boarding of refugee bank customers. The Bank, in consultation with FIA, allowed the banks to accept such a document, as a form of identity when refugees do business with the banks. However, banks were advised to continuously conduct the normal customer due diligence.

CROSS BORDER SUPERVISION

JOINT EXAMINATIONS

4.7 The Bank, FIA and the home supervisor of one bank conducted a joint AML/CFT on-site examination of the bank in April 2016. The examination was undertaken in line with Principle 12 of the Core Principles. The examination revealed that the bank required enhanced focus on, and commitment to, strengthening its controls in relation to the combating of money laundering and the financing of terrorism in various areas. However, the progress update submitted by one bank, regarding the findings of the examination, showed that most of the supervisory concerns were being addressed.

MEMORANDA OF UNDERSTANDING

4.8 During 2016, the Bank finalised and signed MoUs with the SARB and the Reserve Bank of Zimbabwe, on April 10, 2016 and April 24, 2016, respectively. The MoU between the Bank and FIA was submitted to FIA for counter-signing on December 19, 2016. The main purpose of the MoUs is to determine parameters within which mutual assistance, cooperation and exchange of supervisory information would be handled between the Bank and other supervisory authorities. The MoUs signed with external supervisors are consistent with Principle 13 of the Core Principles, which requires home and host supervisors of cross-border banking groups to share information and cooperate for the effective supervision of the group and group entities, and for the efficient and effective handling of crisis situations.

CHAPTER 5

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

CHAPTER 5:

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

COMMERCIAL BANKS' EXAMINATIONS

5.1 The Bank carried out full-scope on-site examinations of one commercial bank and one statutory bank, and limited scope (AML/CFT) on-site examinations of two commercial banks. The full-scope on-site examination of two banks included a review of capital adequacy; asset quality; management and effectiveness of Board oversight; earnings and profitability; liquidity; and sensitivity to market risk (CAMELS). The review also included the assessment of operational risk, legal and compliance risk. The full-scope on-site examination of one bank, was a joint on-site examination with the bank's home supervisor. The joint AML/CFT on-site examinations were carried out in collaboration with FIA and the bank's home supervisor. All the four banks examined were ordered to implement corrective actions to remedy all areas of weakness.

5.2 The full-scope examination of the commercial bank revealed that its financial condition and performance were sound. However, some issues of supervisory concern were brought to the attention of the Board, namely, unsatisfactory management of credit risk, in light of the concentration in unsecured retail scheme loans; violations of the bank's Credit Policy, evident in collateral management and inability of the bank to periodically review credit facilities.

5.3 The bank's liquidity position had improved. However, deposit concentration risk was an issue of concern and the bank was reliant on volatile wholesale deposits to fund its lending activities.

5.4 The bank's operational risk was considered high, on account of significant manual interventions in the IT systems and poor record management. Furthermore, the bank did not have robust policies and processes for the monitoring and detection of unusual or suspicious transactions.

5.5 The quality of the statutory bank's risk management systems and controls on strategic risk was found to have material shortcomings partly because: Board members did not evaluate each other, resulting in failure to establish the performance and effectiveness of individual Board members; and the bank did not have a succession plan to identify and develop staff in order to timely fill key positions, when they become vacant.

5.6 It was established that there was need to improve the quality of credit risk management processes, given the lack of a robust loan classification methodology; and inadequate computation of the general impairments.

5.7 With respect to the limited scope on-site examinations, the management of AML/CFT processes and procedures was considered inadequate at both banks. The banks did not regularly review their existing customers against sanction lists to ensure that the information was up-to-date.

5.8 In addition, the banks did not conduct ML/TF risk assessments on their customers, geographic areas, products and services, transactions and/or delivery channels. Consequently, it was determined that these banks did not have a thorough understanding of ML/TF to determine the level of their overall inherent risk and type of mitigation strategies to be applied.

CONSUMER COMPLIANCE ON-SITE EXAMINATIONS

5.9 The Bank conducted full scope consumer compliance on-site examinations of two banks during the year under review. The examinations revealed that the two banks had comprehensive policies and procedures in place. Furthermore, the banks complied satisfactorily with most consumer issues, except for the violations shown in Table 5.1.

Table 5.1: Violations of Consumer Compliance Standards

VIOLATION	DESCRIPTION
Section 39(1) of the Banking Act (CAP. 46:04)	One bank did not have a standard policy on abandoned funds, which details how such funds are to be transferred to the Bank, as mandated by Section 39(1) of the Banking Act (CAP. 46:04).
Disclosure of Bank Charges Notice (Government Notice No. 41 of 2001)	Both banks did not compute and disclose the Annual Percentage Rate (APR) for all credit facilities.
Disclosure Framework for Deposit and Lending Interest Rates, Regulatory Guideline No. RG 01/09/2009	One bank used the Simple Interest Rate method to calculate the interest payable on longer-dated deposits, instead of the Compounding Interest Rate method cited in the customers' certificates, resulting in shortfalls in the interest amounts payable to customers.
Government Notice No. 111 of 2011, on the Prescription of Notice Period and Early Settlement Penalties for Term Loans and Similar Credit Facilities (Notice).	The early settlement clause in one bank's loan application forms required customers to give at least 90 days' notice, contrary to the 45 days prescribed by the Notice.

CONSULTATIVE AND PRUDENTIAL MEETINGS

5.10 Prudential bilateral and statutory trilateral meetings were held in 2016, during which banks reviewed their business strategies for the previous year(s) and presented plans for the period ahead, as well as financial year-end results. Furthermore, statutory bilateral meetings were held with external auditors to discuss audit strategies for the respective banks. The biannual Banking Committee meetings were held as planned. These meetings serve as a consultative forum and advisory body on broad parameters of monetary and financial sector policies of the Bank.

VIOLATIONS OF THE BANKING ACT

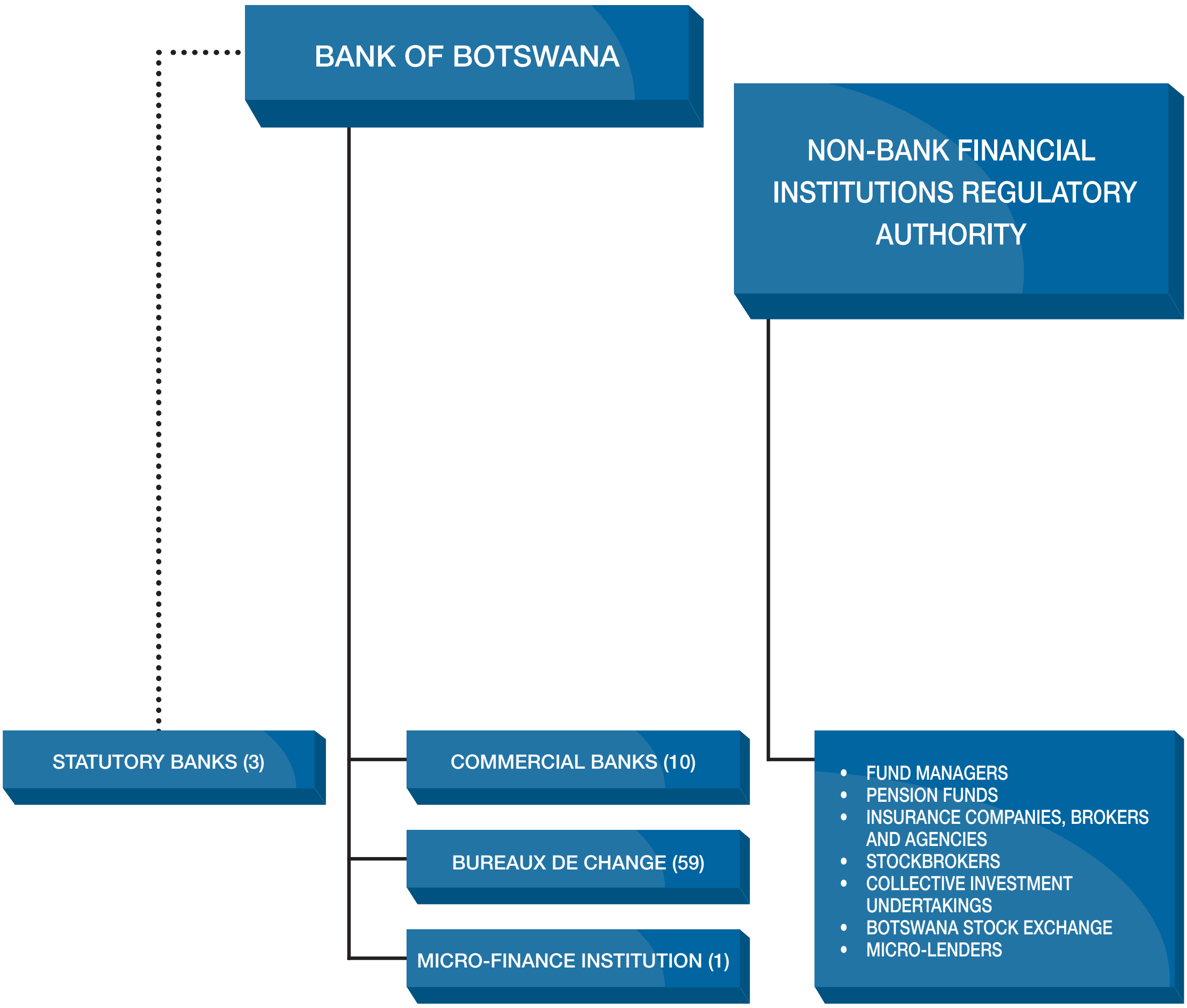
5.11 Two banks violated various sections of the Banking Act during 2016. These included the submission of incorrect and misleading data. Consequently, a monetary penalty fee was levied on such banks.

APPENDICES

APPENDICES

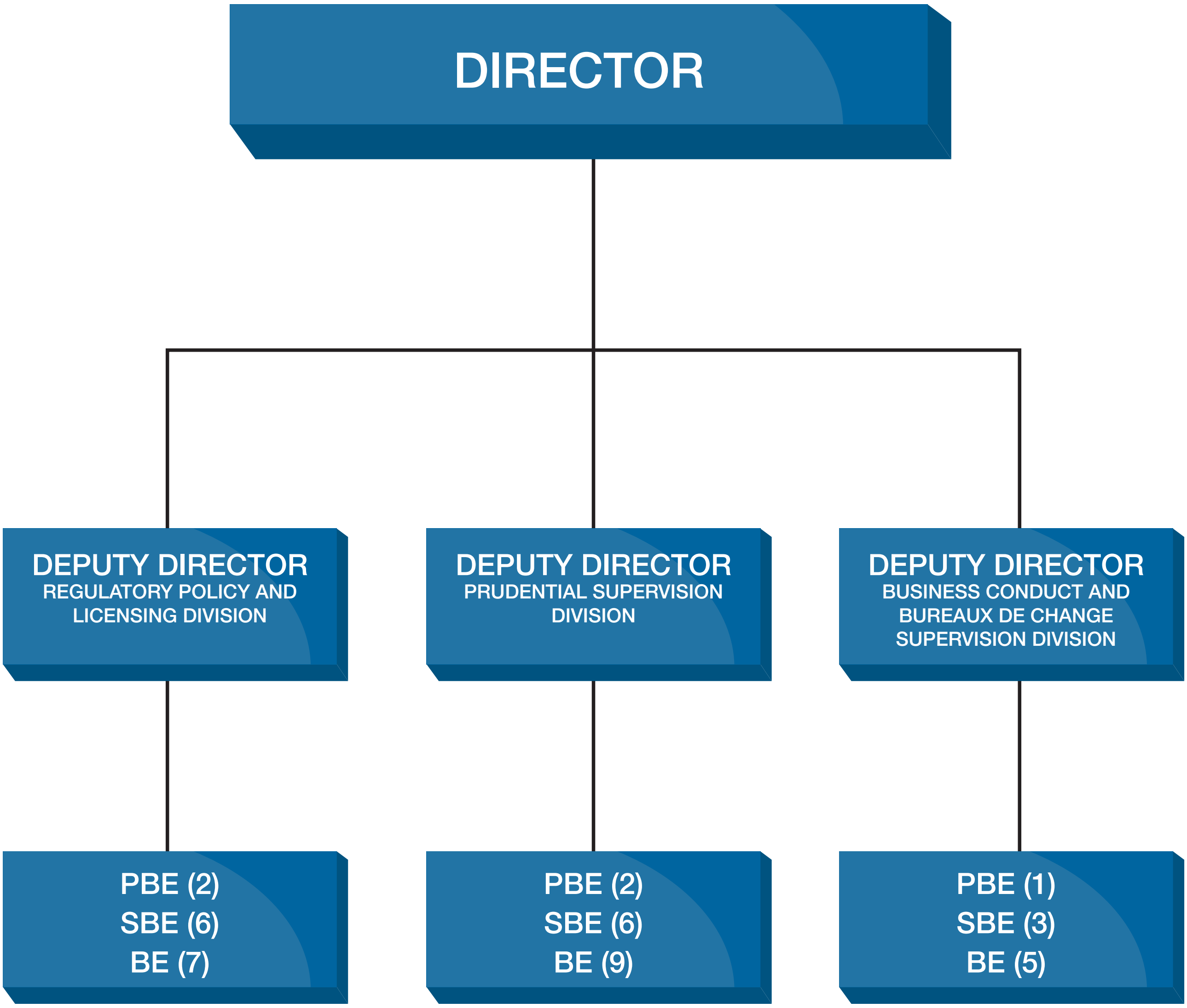
APPENDIX 1

DIAGRAM 1.1: THE REGULATORY ARCHITECTURE OF THE DOMESTIC FINANCIAL SYSTEM



APPENDIX 1

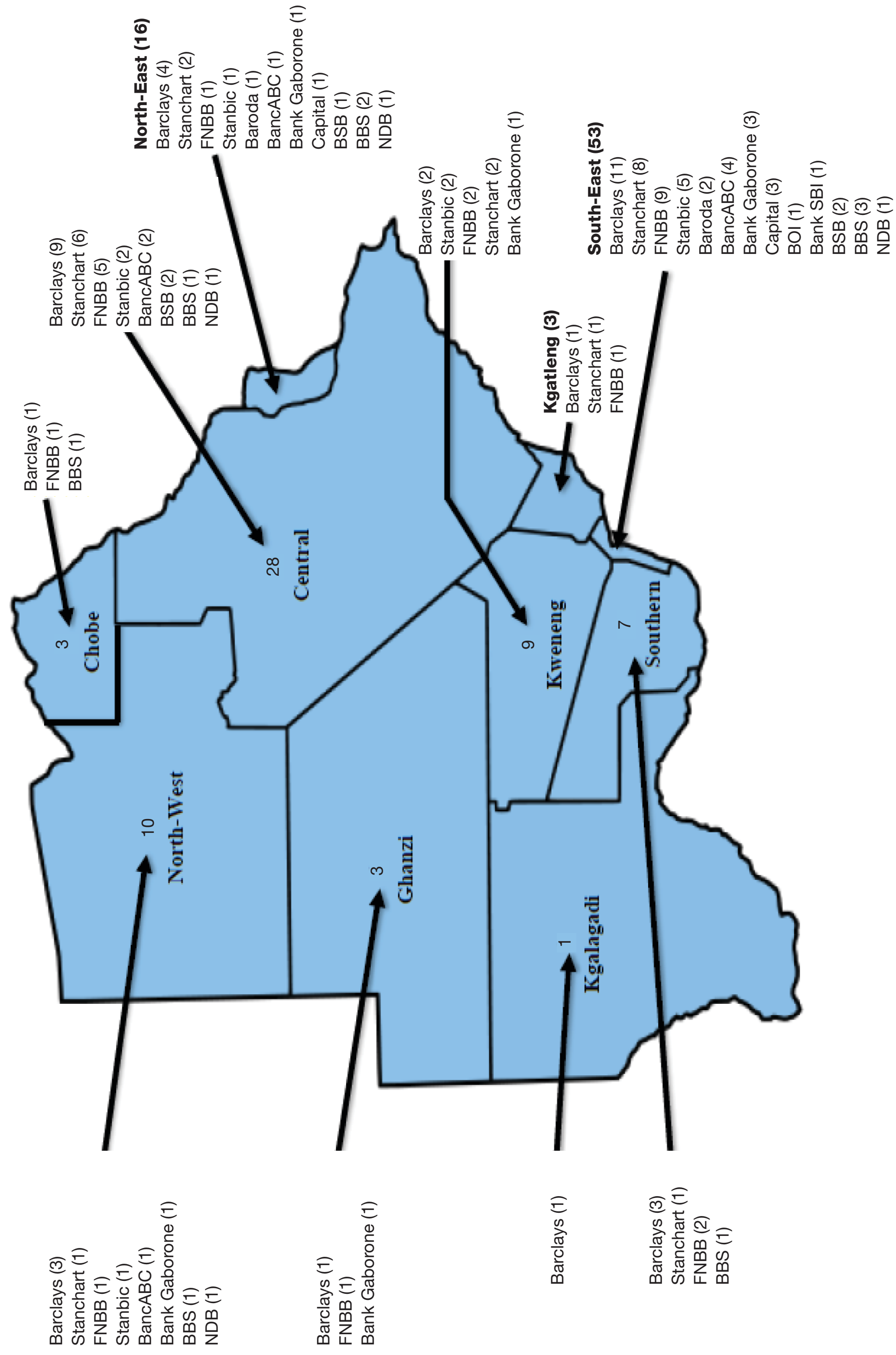
DIAGRAM 1.2: BANKING SUPERVISION DEPARTMENT ORGANISATIONAL STRUCTURE



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

APPENDIX 2

BANK BRANCH DISTRIBUTION NETWORK BY DISTRICT AS AT DECEMBER 31, 2016



APPENDIX **3**

APPROACHES TO REGULATION AND SUPERVISION OF BANKS IN BOTSWANA

1. INTRODUCTION

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

2. LEGAL FRAMEWORK

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

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

3. AUTHORITY FOR LICENSING BANKS

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

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

APPENDIX **3**

4. LICENSING POLICY AND PROCEDURES FOR ESTABLISHING A BANK

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

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

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

5. CORE PRUDENTIAL REQUIREMENTS

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

CAPITAL ADEQUACY REQUIREMENTS

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

RESERVE REQUIREMENTS

5.3 Section 40 of the Bank of Botswana Act (CAP. 55:01) empowers the Bank of Botswana to require financial institutions to hold primary reserves, including marginal primary reserves, in the form of cash holdings or deposits with the Bank or both, against such deposits and similar liabilities as may be specified by the Bank.

APPENDIX **3**

LIQUID ASSETS REQUIREMENTS

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

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

ASSET QUALITY

ASSET CONCENTRATIONS (LARGE EXPOSURES)

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

INSIDER LENDING

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

NON-PERFORMING LOANS AND PROVISIONS

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

APPENDIX **3**

6. MAIN SUPERVISORY APPROACHES

ON-SITE EXAMINATIONS

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

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

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

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

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

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

APPENDIX **3**

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

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

BILATERAL AND TRILATERAL MEETINGS

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

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

APPENDIX **3**

OFF-SITE MONITORING AND SURVEILLANCE

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

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

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

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

7. ACCOUNTING, AUDITING AND DISCLOSURE STANDARDS

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

APPENDIX **4**

SUPERVISED FINANCIAL INSTITUTIONS AS AT DECEMBER 31, 2016

INSTITUTION	TOTAL ASSETS (P' MILLION)	POSTAL ADDRESS	BUSINESS LOCATIONS	AUDITORS
Commercial Banks				
African Banking Corporation of Botswana Limited	8 386	Private Bag 00303 Gaborone	8	KPMG
Bank of Baroda (Botswana) Limited	1 617	P O Box 216 ADD Gaborone	3	KPMG
Bank of India (Botswana) Limited	200	Private Bag 00111 Gaborone	1	Grant Thornton
Bank Gaborone Limited	4 354	Private Bag 00325 Gaborone	7	Pricewaterhouse-Coopers
Barclays Bank of Botswana Limited	15 410	P O Box 478 Gaborone	36	Pricewaterhouse-Coopers
Capital Bank Limited	1 619	P O Box 5548 Gaborone	4	KPMG
Bank SBI Botswana Limited	454	P O Box 505243 Gaborone	1	Grant Thornton
First National Bank of Botswana Limited	22 516	P O Box 1552 Gaborone	23	Deloitte
Stanbic Bank Botswana Limited	12 220	Private Bag 00168 Gaborone	11	KPMG
Standard Chartered Bank Botswana Limited	13 862	P O Box 496 Gaborone	21	KPMG
Statutory Banks				
Botswana Savings Bank	2 217	P O Box 1150 Gaborone	5	KPMG
National Development Bank	1 654	P O Box 225 Gaborone	4	Pricewaterhouse-Coopers
Building Society				
Botswana Building Society	3 765	P O Box 40029 Gaborone	9	KPMG

APPENDIX **4**

BUREAUX DE CHANGE AS AT DECEMBER 31, 2016

NAME	POSTAL ADDRESS	BUSINESS LOCATION
4Corners Bureau de Change	P O Box 848, Ghanzi	1
Aldaph Bureau de Change	P O Box 404845, Gaborone	2
American Express Bureau de Change	P O Box 45140, Gaborone	2
Andy and Esi Bureau de Change	P O Box 504125, Gaborone	1
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	Private Bag BR 321, Gaborone	1
Beni Fame Bureau de Change	P O Box 2143 AAD, Gaborone	4
Berry-Pee Bureau de Change	P O Box 20051, Gaborone	1
Boitekanelo Bureau de Change	P O Box 2768, Gaborone	1
BT Bureau de Change	P O Box 601369, Gaborone	2
Cape to Cairo Bureau de Change	P O Box 799, Kasane	2
City Exchange Bureau de Change	Private Bag F199, Francistown	1
Crystal Diamond Bureau de Change	P O Box 20554, Gaborone	1
CSS Bureau de Change	P O Box 45168, Gaborone	3
Dollar Wave Bureau de Change	P O Box 10784, Palapye	1
Eagle Sight Bureau de Change	P O Box 10654, Palapye	1
Earthmark Bureau de Change	P O Box 242, Digawana	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
Galaxy Bureau de Change	P O Box 501055, Gaborone	1
Garona Bureau de Change	P O Box 408, Gaborone	5
Genesis Bureau de Change	Private Bag BR 225, Gaborone	1
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Hi-Rated Bureau de Change	P O Box 3299, Gaborone	1
*Investors View Bureau de Change	P O Box 2381, Francistown	1
Kaycy Bureau de Change	P O Box 1693, Lobatse	2
Kwanokeng Bureau de Change	P O Box 10, Sherwood	2
Limpopo Bureau de Change	P O Box 8, Sherwood	2
Macheng Bureau de Change	P O Box 60474, Gaborone	1
Madikwe Bureau de Change	P O Box 268, Sikwane	1
Maeto Bureau de Change	P O Box 22, Mahalapye	1
Mochudi Bureau de Change	P O Box 202147, Gaborone	2
Monty Cristo Bureau de Change	Private Bag 00254, Gaborone	1

APPENDIX **4**

BUREAUX DE CHANGE AS AT DECEMBER 31, 2016

NAME	POSTAL ADDRESS	BUSINESS LOCATION
Okavari Bureau de Change	P O Box 44, Karakubis	1
Open Door Bureau de Change	P O Box 839, Maun	6
Ozair Bureau de Change	P O Box 4862, Gaborone	2
Proxy Bureau de Change	P O Box 404108, Gaborone	3
Regash Bureau de Change	P O Box 45144, Gaborone	1
Rennies Bureau de Change	P O Box 2482, Gaborone	1
River Ride Bureau de Change	P O Box 301106, Francistown	4
Rose of Sharon Bureau de Change	P O Box 404338, Gaborone	1
Royalty Bureau de Change	Private Bag BO 259, Gaborone	2
Sherwood Ranch Bureau de Change	P O Box 1, Sherwood	1
Simple Forex Bureau de Change	P O Box 81384, Gaborone	1
SMH Bureau de Change	P O Box AD 148 ADD, Gaborone	3
Sunny Bureau de Change	P O Box 370, Maun	2
Tlhokomelo Bureau de Change	P O Box 2033, Molepolole	1
Thari Bureau de Change	P O Box 40074, Gaborone	2
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
Trans Frontier Bureau de Change	P O Box 183, Pitsane	2
Travellers' Bureau de Change	P O Box 20909, Maun	2
Travellers' Choice Bureau de Change	P O Box 26725, Gaborone	2
TRL Money Link Bureau de Change	Private Bag F333, Francistown	1
Tshilong Bureau de Change	P O Box 40418, Gaborone	1
Toluca Bureau de Change	P O Box 402026, Gaborone	1
UAE Xchange Bureau de Change	P O Box AD 749 ADD, Gaborone	4
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	59	104

* Ceased operations on December 31, 2016

MICROFINANCE INSTITUTION

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

APPENDIX **5**

LIST OF GUIDELINES ISSUED AND OTHER STATUTORY AMENDMENTS

The Circular on the Implementation of Pillar 3 Disclosure Requirements was issued to all banks in March 2016, to provide clarification on the implementation of Pillar 3 market disclosure.

APPENDIX **6**

DEFINITIONS OF BANKING SUPERVISION TERMS

ASSET CONCENTRATION

Measures aggregate exposure to one borrower, an affiliated group of borrowers, or borrowers with a common controlling interest, common management, cross-guarantees or financial interdependency 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, an exposure in excess of 10 percent of the bank's unimpaired capital is deemed an asset concentration requiring prior approval of the Board of Directors of the lending financial institution. Exposures in excess of 30 percent of the bank's unimpaired capital require the Bank's approval.

ASSET QUALITY

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

LOAN CLASSIFICATIONS

(i) **"Pass" Assets** - Assets under the "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. These assets (loans, investments or other credit facilities) 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 neither practical nor desirable to defer writing off this potentially worthless asset even though partial recovery may be effected in the future.

APPENDIX 6

CORE CAPITAL

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

TOTAL RISK-WEIGHTED ASSETS

An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk-weighting are presented at Appendix 6 (Table 1(a) and 1(b)).

UNIMPAIRED CAPITAL

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

PRUDENTIAL RATIOS

RETURN ON EQUITY (ROE)

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

RETURN ON AVERAGE TOTAL ASSETS (ROAA)

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

APPENDIX **6**

DIVIDEND PAY-OUT

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

RISK-BASED CAPITAL

On January 1, 2016, the Bank implemented Basel II. This new framework augments the risk sensitivity of Basel I. In terms of the Basel II framework, in addition to credit risk, a separate and explicit computation of the regulatory capital for market risk and operational risk is introduced. Therefore, the minimum amount of regulatory capital (the ratio of Unimpaired Capital to Risk-Weighted Assets) is derived from the summation of capital charges for credit risk, operational risk and market risk. The move to this method of capital adequacy measurement has alerted banks to the type of assets they hold and the associated risk profiles. The intention is to strengthen the resilience of banks. In the process, some existing capital instruments held by banks and fixed revaluation reserves were disqualified as part of Tier II Capital. Also excluded are any elements that are likely to impair a bank's capital, such as investment in unconsolidated subsidiaries and associated companies, and connected lending of a capital nature. 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 implies that adequate funds are available to absorb risks inherent in the types of assets held by a bank, its foreign exchange dealing operations and all other risks associated with the business.

NET SPREAD (PERCENT)

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

NET INTEREST MARGIN (PERCENT)

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

APPENDIX **6**

OTHER OPERATING INCOME TO TOTAL ASSETS (PERCENT)

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

NET OPERATING (OR INTERMEDIATION) MARGIN (PERCENT)

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

NET INCOME PER STAFF

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

NET INCOME TO STAFF EXPENSE

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

COST TO INCOME

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

AVERAGE COST OF DEPOSITS

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

APPENDIX **6**

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

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

	CREDIT RATE						
CLAIMS ON EXPOSURE	AAA TO AA-	A+ TO A-	BBB+ TO BBB-	BBB+ TO B-	BELOW B-/BB	UNRATED	RISK-WEIGHT/CCF PERCENTAGE
Government of Botswana and Bank of Botswana							0
Cash							0
Cash items in the process of collection							20
Sovereigns and Central Banks	0	20	50	100	150	100	
BIS, IMF							0
Domestic PSEs							20
PSEs	20	50	100	100	150	100	
Domestic Banks							20
Foreign Banks	20	50	100	100	150	100	
Security Firms	20	50	100	100	150	100	
Eligible Retail							75
Other Retail							100
Mortgages[17]							35
Corporates/Insurance Companies	20	50	100	100	150	100	100
MDBs	20	50	50	100	150	50	0/100
Commercial Real Estate	100	100	100	100	100	100	100
Other Assets[18]							100
Past Due Items							100(20); 100(20); 150(20)
Other Non-Qualifying Residential Property							75
Significant investments in equity and regulatory capital instruments issued by unconsolidated financial institutions							250
Mortgage Servicing Rights							250
DTAs							250
Investments in commercial entities							1 250
Non-payment/delivery on non-DvP and non-PvP transactions							1 250
Venture capital and private equity investment							150

[17] Owner occupied or rented by the borrower to a third party, but used for residential purposes.

[18] Excludes cash items in the process of collection

APPENDIX **6**

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

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

APPENDIX **6**

CAPITAL ELEMENTS

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

APPENDIX 6

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

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

APPENDIX **6**

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

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

Important note

1. The amount of the three items (33, 34, 35) not deducted (threshold amounts) in the calculation of CET1 will be treated as other assets and risk-weighted at 250 percent.

2. Line 36: The amount above the 10 percent threshold shall be deducted from CET1, and the amount at below threshold shall be risk-weighted as appropriate as per Schedule M-SRWA.

APPENDIX **7**

AGGREGATE FINANCIAL STATEMENTS OF LICENSED BANKS: 2012 - 2016

Table 1: Aggregate Statement of Financial Position of Licensed Commercial Banks: 2012 - 2016 (P' million) as at December 31st

	TOTAL ASSETS IN LOCAL CURRENCY	2012	2013	2014	2015	2016
1.	Cash and balances with the Central Bank	4 933	5 268	5 838	4 584	6 333
	1.1. Currency	824	976	1 374	1 544	1 433
	a. Foreign Currency	86	159	463	532	363
	b. Local Currency	738	816	911	1 013	1 070
	1.2. Balances with Central Bank	4 109	4 292	4 419	2 982	4 900
	1.3 Other	-	-	45	58	-
2.	Investment and Trading Securities	10 199	8 059	6 482	12 537	11 425
3.	Placements with Other Banks and Credit Institutions	7 407	6 410	9 636	10 539	10 951
4.	Gross Loans and Advances to Other Customers	34 410	39 499	45 117	48 307	51 325
	4.1. Impairments-Specific	617	718	771	1 007	1 270
	4.2. Interest in Suspense	257	339	218	340	184
	4.3. Impairments Portfolio	-	-	-	132	182
5.	Loans and Advances to Other Customers (Net of Specific Provisions)	33 537	38 442	44 075	46 875	49 690
6.	Fixed Assets Net of Depreciation	665	872	910	968	908
7.	Other Assets (net)	1 213	911	1 054	1 106	1 333
	Total Assets	**57 954**	**59 962**	**67 994**	**76 605**	**80 640**
	TOTAL LIABILITIES IN LOCAL CURRENCY					
1.	Amounts Owed to Government Institutions	-	6	12	2	12
	a. Central Bank Accounts	-	6	12	2	12
	b. Direct Government Credits (CB or MFED)	-	-	-	-	-
2.	Due to Other Banks and Credit Institutions	1 320	1 394	3 581	3 308	3 984
3.	Debt Securities and Other Borrowing	942	2 292	2 088	3 163	2 642
4.	Due to Other Customers/Depositors	47 219	48 589	51 491	59 940	62 438
5.	Shareholders' Funds	5 548	6 479	7 724	8 204	9 748
6.	Other Liabilities	2 925	1 202	3 097	1 997	1 817
	a. Taxes Payable	132	177	133	252	195
	b. Dividends Payable	20	-	4	7	-
	c. Accrued Expenses	-	-	1 167	-	7
	d. Other	2 774	1 025	1 794	1 715	1 615
	Total Liabilities	**57 954**	**59 962**	**67 994**	**76 605**	**80 640**

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Table 2: Aggregate Statement of Comprehensive Income of Licensed Commercial Banks (P' million) for the period ended December 31, 2016

		2012	2013	2014	2015	2016
1.	Interest and similar income	4 784	5 146	4 953	5 129	5 271
2.	Interest expense	1 502	1 600	1 670	2 093	1 425
3.	Net interest income [1-2]	3 282	3 546	3 284	3 036	3 847
4.	Other operating income	1 777	2 028	2 150	2 312	2 477
5.	**Gross operating income/(loss) [3+4]**	**5 059**	**5 575**	**5 434**	**5 348**	**6 323**
6.	Total Impairments	455	579	760	668	855
	a. Impairment of loans and advances - Specific	445	588	545	587	685
	b. Impairment of loans and advances - Portfolio	55	45	216	83	172
	c. Impairment on other financial assets	(46)	(53)	(1)	(2)	(2)
7.	**Operating income/(loss) net of bad and doubtful debts**	**4 604**	**4 995**	**4 674**	**4 680**	**5 469**
8.	Operating expenses	2 364	2 709	2 782	3 242	3 607
	a. Salaries and employee benefits	1 133	1 248	1 370	1 335	1 543
	b. Auditing and consulting expenses	6	17	49	49	173
	c. Rents paid	129	105	187	195	198
	d. Depreciation and amortisation	107	152	135	148	159
	e. Other	989	1 186	1 089	1 565	1 533
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]**	**2 240**	**2 287**	**1 893**	**1 438**	**1 862**
11.	Extraordinary Gains/(Losses)	-	18	-	-	-
	a. Gains/Losses on revaluation of assets (NET)	-	18	-	-	-
	b. Translation Gains/Losses (NET)	-	-	-	-	-
	c. Other Gains/Losses	-	-	-	-	-
12.	**Net income/(loss) before tax [10+11]**	**2 240**	**2 305**	**1 893**	**1 438**	**1 862**
13.	Income tax	468	530	415	349	455
14.	**Net income/(loss) after tax [12-13]**	**1 772**	**1 775**	**1 478**	**1 088**	**1 407**

APPENDIX 7

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

	TOTAL ASSETS IN LOCAL CURRENCY	2012	2013	2014	2015	2016
1.	Cash and balances with the Central Bank	(20)	19	8	9	23
	a. Currency	(21)	5	6	8	21
	aa. Foreign currency	-	-	-	-	-
	ab. Local currency	(21)	15	6	8	21
	b. Balances with Central Bank	1	3	2	1	2
	c. Other	-	-	-	-	-
2.	Investment and Trading securities	-	-	-	-	-
3.	Placements with other banks and credit institutions	859	856	854	1 580	1 025
4.	Gross Loans and Advances to Customers	2 927	3 316	3 823	4 278	4 769
5.	Specific Provisions	-	25	20	22	28
6.	Net Loans and Advances to Customers	2 886	3 273	3 781	4 240	4 722
7.	Fixed assets net of depreciation	126	129	121	131	151
8.	Other assets (net)	43	57	70	71	62
	Total Assets	3 894	4 333	4 834	6 031	5 983
	Liabilities in Local Currency					
1.	Amounts owed to government institutions	-	-	-	-	-
	a. Central Bank accounts	-	-	-	-	-
	b. Direct Government credits (CB** or MFED)	-	-	-	-	-
	c. Other	-	-	-	-	-
2.	Borrowings from Other Banks, Credit Institutions and International Lending Agencies	468	918	855	1 271	987
3.	Due to customers/depositors	1 430	1 740	2 180	3 340	3 493
4.	Shareholders' funds	1 426	1 564	1 664	1 263	1 303
5.	Other liabilities	570	111	136	157	200
	a. Taxes payable	-	1	1	1	1
	b. Dividends payable	-	-	-	-	4
	c. Accrued expenses	-	-	-	-	-
	d. Other	570	110	135	156	195
	Total Liabilities	3 894	4 333	4 834	6 031	5 983

* 2012 - 2015 figures revised to exclude one statutory bank

** CB denotes Central Bank

APPENDIX 7

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

		2012	2013	2014	2015	2016
1.	Interest and similar income	310	352	370	475	482
2.	Interest expense	135	160	173	233	231
3.	Net interest income [1-2]	175	192	197	242	251
4.	Other operating income	36	38	35	51	46
5.	**Gross operating income/(loss) [3+4]**	**211**	**230**	**232**	**294**	**297**
6.	Bad and Doubtful Debts Provisions	(2)	11	(1)	9	18
	a. Specific loss provision expenses	(3)	-	-	-	-
	b. General loss provision	2	-	-	-	-
	c. Releases and Recoveries of bad debts previously written off	-	-	-	-	-
7.	**Operating income/(loss) net of specific loss provisions**	**213**	**220**	**233**	**284**	**279**
8.	Operating expenses	132	151	174	189	214
	a. Salaries and employee benefits	70	76	74	94	106
	b. Administrative expenses	-	-	-	-	-
	c. Auditing and consulting expenses	-	-	-	-	-
	d. Rents paid	-	-	-	-	-
	e. Depreciation and amortization	7	9	9	13	10
	f. Other	55	66	90	81	98
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]**	**81**	**68**	**60**	**96**	**65**
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]**	**81**	**68**	**60**	**96**	**65**

*2012 - 2015 figures revised to exclude one statutory bank

APPENDIX **7**

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

	TIER 1	2011	2012	2013	2014	2015
1.	Stated Capital	712	977	977	1 097	1 381
2.	Preference (non-redeemable) non-cumulative shares	255	229	229	229	-
3.	General Reserves	70	225	377	67	148
4.	Retained Earnings	2 558	3 468	4 112	4 589	5 116
5.	Minority Interests	-	-	-	-	-
6.	Less	(134)	(104)	(92)	(91)	(86)
	a. Goodwill and other intangible assets	(134)	(104)	(92)	(89)	(82)
	b. Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation	-	-	-	-	-
	c. Current year's unpublished losses	-	-	-	(2)	(4)
7.	Total Tier 1 Capital (Sum of lines 1-5 less lines 6(a) - (c)	3 461	4 796	5 603	5 891	6 559
	TIER 2					
8.	Current year's unpublished profits	976	472	634	971	780
9.	Fifty percent of fixed asset revaluation reserves	37	32	57	35	34
	Unrealised gains on available for sale revaluations					9
10.	Unencumbered general provisions not to exceed 1.25 percent of risk-weighted assets	202	345	359	310	332
11.	Hybrid (debt/equity) capital instruments eligible for inclusion	-	-	-	-	8
12.	Subordinated term debt eligible for inclusion	753	1 088	846	1 036	1 551
13.	Minority interest in Tier 2 preference shares	1	-	-	100	100
14.	Shareholders equity funded through the capitalisation of property revaluation reserves	-	-	-	-	-
15.	**Total Tier 2 Capital (sum of lines 8 - 14)**	**1 969**	**1 937**	**1 896**	**2 472**	**2 814**
16.	**Total Capital (sum of lines 7 and 15)**	**5 430**	**6 733**	**7 499**	**8 363**	**9 373**
	Impairments	**-**	**-**	**-**	**-**	**-**
17.	Investments in unconsolidated subsidiaries and associated companies	-	-	-	-	-
18.	Total Impairments of Capital	-	-	-	-	-
19.	**Total Unimpaired Capital**	**5 430**	**6 733**	**7 499**	**8 363**	**9 373**

APPENDIX 7

Table 5 (b): The Revised Aggregate Capital Structure of Commercial Banks in Botswana (Basel II) (P' million) as at December 31, 2016

	COMMON EQUITY TIER 1 (CET1) CAPITAL	
1.	Common shares	1 165
2.	Share premium resulting from the issue of common shares	271
3.	Retained Earnings:	5 479
	Retained Earnings brought forward from the previous financial year	5 325
	Add: Interim profits (audited by external auditor)	506
	Less: Dividend declared	-
	Less: Dividend paid in the current financial year	352
4.	Accumulated other Comprehensive income and other disclosed reserves	156
	a. Statutory Credit Risk Reserve	25
	b. Capital Buffer	-
	c. Statutory Reserves	2
	d. Other (specify)	129
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (Minority Interest)	-
6.	Regulatory adjustments applied in the calculation of CET1 Capital[19]	123
7.	CET1 Capital (Lines (1+2+3+4+5-6))	6 948
	ADDITIONAL TIER 1	
8.	Instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital as per paragraph 4.9 of the Capital Directive	-
9.	Stock surplus (Share premium) resulting from the issue of Additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Additional Tier 1 capital and are not included in CET 1 subject to terms and conditions in 3.5	-
11.	Regulatory adjustments applied in the calculation of Additional Tier 1 Capital	-
12.	Additional Tier 1 Capital (Lines (9+10+11-12))	-
13.	Total Tier 1 Capital (Lines (7+13))	6 948
	TIER 2 CAPITAL	
14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital);	1 641
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;	-
16.	Unpublished Current Year's Profits	1 041
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	176
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)	-
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	435
20.	Regulatory adjustments applied in the calculation of Tier 2 Capital	-
21.	Total Tier 2 Capital (Lines (15+15+16+17+18+19-20))	3 293
22.	Total Unimpaired Capital (Lines (13+21))	10 241

[19] Comprises of Goodwill and other intangible assets

APPENDIX **7**

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

		2012	2013	2014	2015	2016
1	Stated Capital*	977	977	1 097	1 381	1 165
2	Share Premium	-	-	-	-	271
3	Retained Earnings	3 468	4 112	4 589	5 116	5 479
4	Total Tier 1 Capital	4 796	5 603	5 891	6 560	6 948
5	Subordinated Term Debt	753	1 088	1 036	1 551	1 817
6	Current year's unpublished profits	472	634	971	780	1 041
7	Total Tier 2 Capital	1 937	1 896	2 472	2 814	3 293
8	Total Unimpaired Capital (sum of Line 4 and 7)	6 733	7 499	8 363	9 374	10 241

* Stated Capital for period 2012 - 2015 included share premium.

APPENDIX **7**

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

	TIER 1	2011	2012	2013	2014	2015
1.	Stated Capital	560	601	712	809	878
2.	Preference (non-redeemable) non cumulative shares	-	-	-	-	-
3.	General Reserves	194	197	214	224	228
4.	Retained Earnings	89	101	97	121	130
5.	Minority Interests	-	-	-	-	-
6.	Less	-	-	-	-	7
	a. Goodwill and other intangible assets	-	-	-	-	7
	b. Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation	-	-	-	-	-
	c. Current year's unpublished losses	-	-	-	-	-
7.	**Total Tier 1 Capital (Sum of lines 1 - 5 less lines 6(a) and (b)**	**843**	**900**	**1 023**	**1 153**	**1 229**
	TIER 2					
8.	Current year's unpublished profits	54	32	36	51	90
9.	50 percent of fixed asset revaluation reserves	-	-	-	-	-
10.	Unrealised gains on available for sale revaluations	-	-	-	-	-
	a. Unemcumbered general provisions not to exceed 1.25 percent of risk weighted assets	-	3	3	4	5
	b. Statutory Credit Risk Reserve	-	-	-	-	-
11.	Subordinated term debt eligible for inclusion	3	-	-	-	-
12.	Minority interest in Tier 2 preference shares	-	-	-	-	-
13.	Shareholders equity funded through the capitalisation of property revaluation reserves	-	-	-	-	-
14.	**Total Tier 2 Capital (sum of lines 8 - 13)**	**57**	**35**	**39**	**55**	**95**
15.	**Total Capital (sum of lines 7 and 14)**	**900**	**935**	**1 062**	**1 208**	**1 324**
	Impairments					
16.	Investments in unconsolidated subsidiaries and associated companies	-	-	-	-	-
17.	Connected Lending of a Capital Nature	15	38	-	4	-
18.	Total Impairments of Capital	15	38	-	4	-
19.	**Total Unimpaired Capital**	**885**	**897**	**1 062**	**1 208**	**1 324**

*2013 - 2015 figures revised to exclude one statutory bank

APPENDIX **7**

Table 6 (b): The Revised Aggregate Capital Structure of Statutory Banks in Botswana (Basel II) (P' million) as at December 31, 2016

	COMMON EQUITY TIER 1 (CET1) CAPITAL	2016
1.	Common shares	922
2.	Share premium resulting from the issue of common shares	-
3.	Retained Earnings:	97
	Retained Earnings brought forward from the previous financial year	157
	Add: Interim profits (audited by external auditor)	-
	Less: Dividend declared	-
	Less: Transfer during the year	-
	Less: Dividend paid in the current financial year	60
4.	Accumulated other Comprehensive income and other disclosed reserves	64
	a. Statutory Credit Risk Reserve	-
	b. Capital Buffer	-
	c. Statutory Reserves	-
	d. Other (specify)	64
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (Minority Interest)	
6.	Regulatory adjustments applied in the calculation of CET1 Capital	-
7.	CET1 Capital (Lines (1+2+3+4+5-6))	1 083
	ADDITIONAL TIER 1	
8.	Instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital as per paragraph 4.9 of the Capital Directive	-
9.	Stock surplus (Share premium) resulting from the issue of Additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Additional Tier 1 capital and are not included in CET 1 subject to terms and conditions in 3.5	-
11.	Regulatory adjustments applied in the calculation of Additional Tier 1 Capital	-
12.	Additional Tier 1 Capital (Lines (8+9+10-11))	-
13.	Total Tier 1 Capital (Lines (7+12))	1 083
	TIER 2 CAPITAL	
14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)	
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	
16.	Unpublished Current Year's Profits	67
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	-
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)	-
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	-
20.	Regulatory adjustments applied in the calculation of Tier 2 Capital	-
21.	Total Tier 2 Capital (Lines (14+15+16+17+18+19-20))	67
22.	Total Unimpaired Capital (Lines (13+21))	1 150

*Figures excludes one statutory bank

APPENDIX 7

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

		2012	2013	2014	2015	2016
1.	Stated Capital	601	712	809	878	922
2.	Retained Earnings	101	97	224	228	97
3.	**Total Tier 1 Capital**	**900**	**1 023**	**1 153**	**1 229**	**1 083**
4.	Current year's unpublished profits	32	36	51	90	67
5.	**Total Tier 2 Capital**	**35**	**39**	**55**	**95**	**67**
6.	**Total Unimpaired Capital (sum of line 3 and 5 less impairments)**	**897**	**1 062**	**1 205**	**1 325**	**1 150**

*Figures excludes one statutory bank

APPENDIX **8**

CHARTS AND TABLES OF KEY PRUDENTIAL AND OTHER FINANCIAL SOUNDNESS INDICATORS

Chart 8.1: Average Cost of Deposits

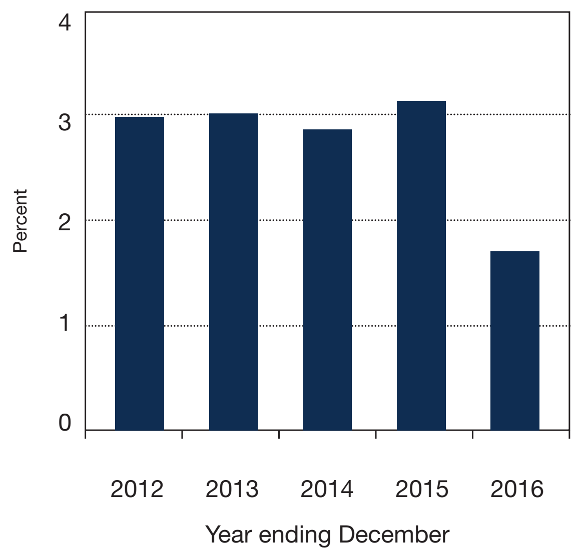


Chart 8.2: Return on Loans and Advances

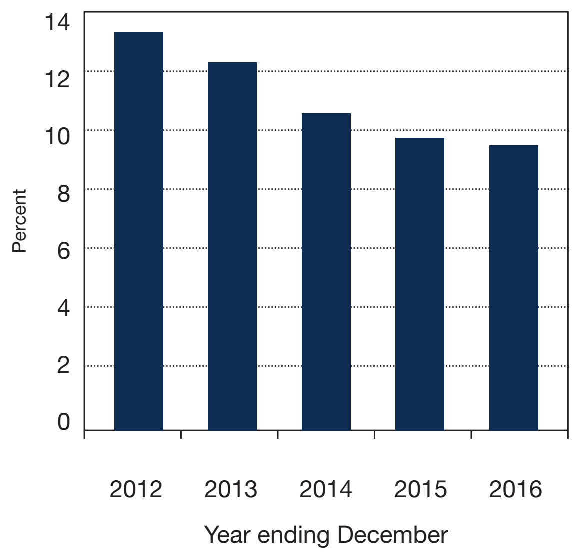


Chart 8.3: Residential Real Estate Loans to Gross loans

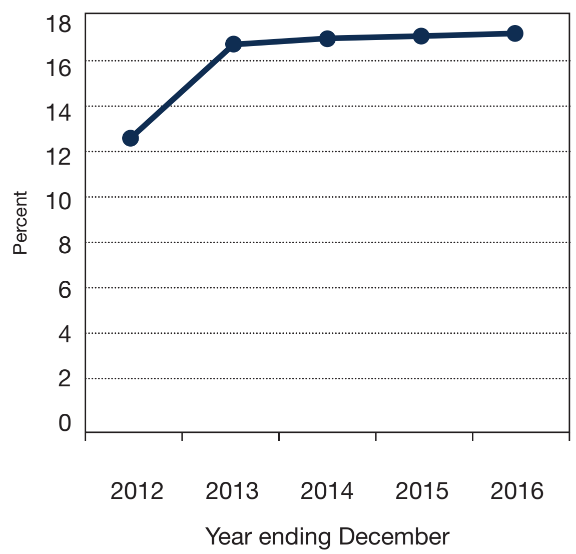
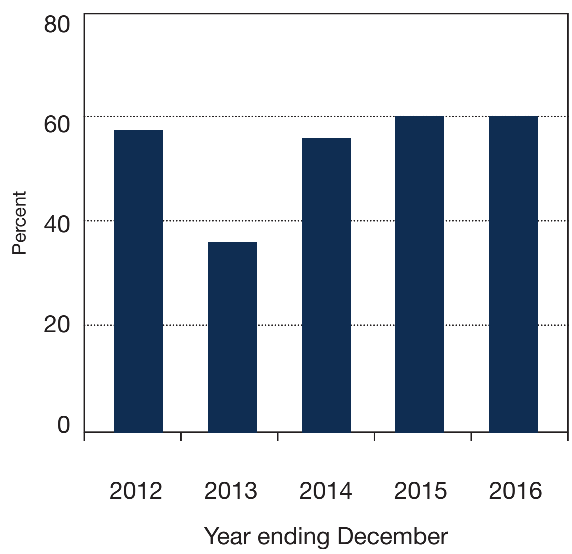


Chart 8.4: Household Loans to Gross Loans



APPENDIX 8

CHARTS OF KEY PRUDENTIAL AND OTHER FINANCIAL INDICATORS

Chart 8.5: Non-Performing Loans Growth Rate

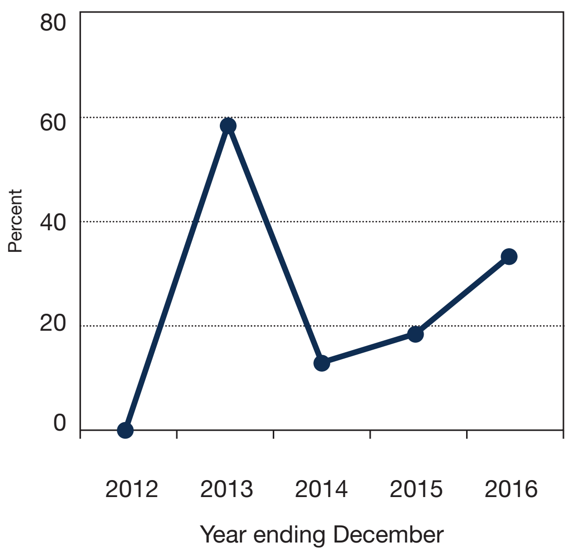


Chart 8.6: Share of Value of Total Deposits by Type (including FCAs)

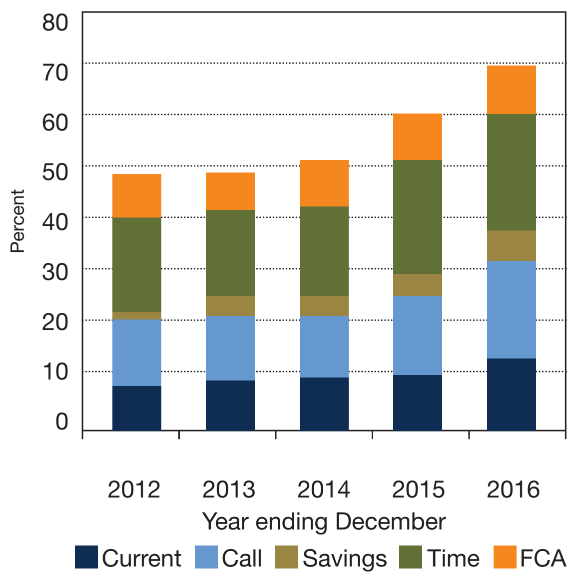


Chart 8.7: Growth Rate of Foreign Currency Accounts

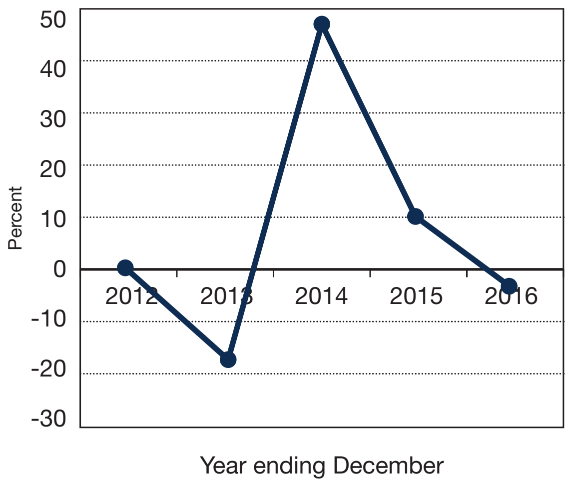
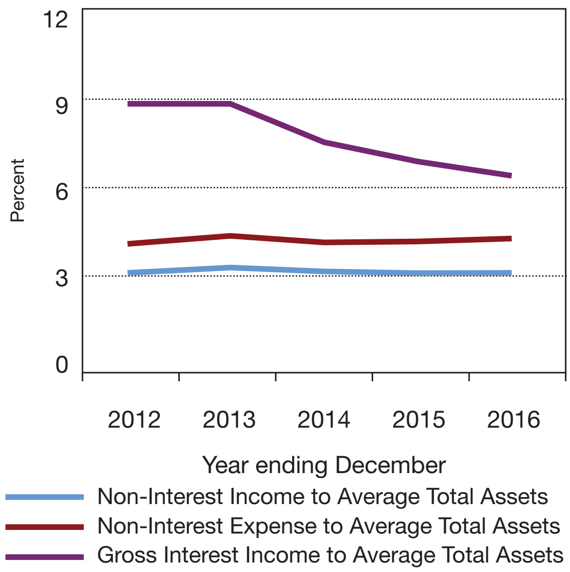


Chart 8.8: Efficiency Ratios



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