Banking Supervision Annual Report 2017

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

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

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 safe and sound operation of banks;

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

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

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

Banking Supervision
Annual Report 2017

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
BAB	Bankers Association of Botswana
BACH	Botswana Automated Clearing House
BancABC	African Banking Corporation of Botswana Limited
Banking Act	Banking Act (CAP. 46:04)
Bank Gaborone	Bank Gaborone Limited
Bank SBI	Bank SBI Botswana Limited
Barclays	Barclays Bank of Botswana Limited
Baroda	Bank of Baroda (Botswana) Limited
BBS	Botswana Building Society
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
BIS	Bank for International Settlements
BISS	Botswana Interbank Settlement System
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
BURS	Botswana Unified Revenue Service
C	Compliant
CAR	Capital Adequacy Ratio
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
Capital Bank	Capital Bank Limited
CB	Central Bank
CET1	Common Equity Tier 1
CDD	Customer Due Diligence
CSDs	Central Securities Depositories
DTA	Deferred Tax Assets
ECLs	Expected Credit Losses
EFTs	Electronic Funds Transfers
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FATF	Financial Action Task Force
FIA	Financial Intelligence Agency
FMIs	Financial Market Infrastructures
FNBB	First National Bank of Botswana Limited
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IO	Immediate Outcome
IT	Information Technology
KYC	Know-Your-Customer
LAR	Liquid Asset Ratio
LC	Largely Compliant
LHS	Left-Hand Scale
MAP	Making Access Possible
MFED	Ministry of Finance and Economic Development
ML/TF	Money Laundering and Terrorist Financing
MoU	Memorandum of Understanding
NC	Not Compliant
NDB	National Development Bank
NIM	Net Interest Margin
NPLs	Non-Performing Loans
NSI	Net Settlement Instruction
N/A	Not Applicable
ORS	Off-site Rating System
OSS	Off-site Surveillance System
PC	Partially Compliant
PFMIs	Principles for Financial Market Infrastructures
RAS	Risk Assessment System
RBA	Risk-Based Approach
RBS	Risk-Based Supervision
RHS	Right-Hand Scale
ROAA	Return on Average Total Assets
ROE	Return on Equity
RTGS	Real Time Gross Settlement
RWAs	Risk-Weighted Assets
SARB	South African Reserve Bank
SMM	Standardised Measurement Method
Stanbic	Stanbic Bank Botswana Limited
Stanchart	Standard Chartered Bank Botswana Limited
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TSA	The Standardised Approach
USD	United States Dollar
VAT	Value Added Tax
ZAR	South African Rand

FOREWORD

The Annual Report presents information on banking regulation and supervision, including the structure and performance of the banking sector in 2017.

During 2017, the global economy strengthened, characterised by broad-based economic growth across regions and sectors, higher commodity prices, growing trade and investment, supportive financial conditions and firming up of aggregate growth in emerging markets and developing economies. Domestically, the impact of the closure of BCL and Tati Nickel mines lingered, although the non-mining sectors sustained output growth at slightly lower growth rates than in 2016. In the circumstances, real gross domestic product expanded by 2.4 percent in 2017 compared to growth of 4.3 percent in 2016.

No new bank licences were issued in 2017. Against the backdrop of moderation in annual credit growth in the year, asset quality, as reflected in non-performing loans, deteriorated. In this regard, the ratio of non-performing loans to gross total loans and advances increased from 4.9 percent in December 2016 to 5.3 percent in December 2017, reflecting financial stress in some sectors of the economy.

Given the slowdown in economic growth and adjustment to the fallout from the closure of some mines, the banking sector profitability fell in 2017 compared to the prior year, albeit the resultant diminution of capital levels for banks was not significant enough to pose insolvency risk to the banking system. Nevertheless, the banking system remained resilient, adequately capitalised, safe, liquid and sound.

In recognition of the crucial role of Pillar 3 disclosure in a well-functioning financial system, the Bank, following extensive consultations with banks, is at an advanced stage of preparations for the requirement of banks to commence public disclosure.

As on previous occasions, the Bank participated in supervisory college meetings for some cross-border banks with subsidiaries in Botswana. The meetings are a structure or mechanism for collaboration, coordination and information sharing among the authorities responsible for supervision of internationally active banking groups.

In 2017, banks were largely compliant with all regulatory prudential requirements, and in instances of non-compliance, normal supervisory actions, including remedial measures, were implemented. The annual consultative arrangements for the discussion of issues of mutual interest between the Bank and supervised institutions continued during 2017.

Moses D Pelaelo
GOVERNOR

INTRODUCTION

In accordance with the provisions of the Banking Act (CAP. 46:04) (Act) and the Bank of Botswana Act (CAP. 55:01) (Bureaux de Change Regulations), the Bank regulates and supervises banks, bureaux de change and one deposit-taking micro-finance institution. During the year under review, the number of licensed commercial and statutory banks remained at ten and three, respectively. As competition in the banking industry deepened, banks continued to improve products and service offerings to meet evolving customer needs, increase profits and remain relevant to the demands of the economy.

Total assets for the banking sector grew by 3.5 percent from P80.6 billion in December 2016 to P83.5 billion in 2017. The increase largely reflected a 5.6 percent growth in gross loans and advances from P51.3 billion in December 2016 to P54.2 billion in December 2017, albeit a lower rate of expansion compared to 6.2 percent increase in the prior year. The slower rate of expansion in credit was indicative of sluggish growth in economic activity and modest increase in personal incomes.

Customer deposits and shareholder funds remained the major sources of funding for asset growth. During 2017, customer deposits grew marginally by 1.8 percent to P63.6 billion, and constituted the largest proportion of liabilities at 76.2 percent. The financial intermediation ratio (the ratio of Loans and Advances to Deposits) increased from 82.2 percent in 2016 to 85.2 percent in 2017.

The banking sector remained adequately capitalised and complied with the regulatory capital requirements. The aggregate unimpaired capital for the industry increased by 5.2 percent to P10.8 billion in 2017 (2016: P10.2 billion). All banks reported capital adequacy and common equity Tier 1 capital ratios in excess of the 15 percent and 4.5 percent prudential and statutory minimum requirements, respectively.

Past due loans (arrears) increased by 11.7 percent from P3.6 billion in December 2016 to P4 billion in December 2017. On the other hand, non-performing loans (NPLs) increased by 13.6 percent from P2.5 billion to P2.9 billion in the same period. As a result, the ratio of NPLs to Gross Loans and Advances rose from 4.9 percent in December 2016 to 5.3 percent in December 2017. The ratio of Specific Provisions to NPLs increased from 50.2 percent in 2016 to 53.7 percent in 2017. The banks' Large Exposures to Unimpaired Capital ratio increased to 200 percent (2016: 195 percent), and was within the recommended 800 percent prudential limit due to a larger capital base for most banks. Generally, the banking sector's composite credit risk was considered to be high and is likely to increase over time.

Profitability of the banking sector was subdued in 2017 as aggregate net profit after-tax declined by 16 percent from P1.4 billion in 2016 to P1.2 billion in 2017. Consequently, efficiency and profitability indicators for the industry weakened. The return on equity (ROE) and return on average assets (ROAA) declined from 14.4 percent and 1.8 percent in 2016 to 12.6 percent and 1.4 percent, respectively. However, the profitability ratios remained strong and in line with international norms for banks of comparable size.

INTRODUCTION (CONTINUED)

The banking industry remained liquid, although there was a decline in liquid assets ratios due to a combination of slower growth in deposits and external net outflows. Statutory liquid assets fell by 15.5 percent to P11.4 billion in 2017 (December 2016: P13.5 billion). As a result, the banking sector's Liquid Assets to Total Deposit ratio (LAR) fell from 21.6 percent in 2016 to 17.9 percent in 2017, but remained above the 10 percent minimum prudential requirement.

The regulatory and supervisory activities of the Bank continued to focus on ensuring good governance and appropriate risk-taking by regulated institutions. These included on-site examinations and off-site monitoring of banks through the use of a risk-based supervision (RBS) approach and off-site surveillance (OSS) system.

In accordance with Section 24 of the Act, the Bank carried out full-scope and limited-scope on-site prudential and consumer compliance examinations of nine banks during 2017. Overall, the results indicated sound governance and operations and satisfactory market conduct, albeit with some areas of a consumer-complaints management nature requiring effective and timely response. There were also notable instances of violation of the Act and significant weak control environment. Banks were ordered to implement corrective actions to remedy all identified areas of weakness where required. In this regard, a monetary penalty fee was levied on banks that violated the Act.

The Bank continued to guide banks to strengthen safeguards against threats of money laundering and terrorist financing (ML/TF) as well as cyber crime. In this regard, measures were taken to address the shortcomings identified during the mutual evaluation exercise conducted by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) in June 2016. Partly drawing from the recommendations of the draft Mutual Evaluation Report, the Act and Banking AML/CFT Regulations are being reviewed to ensure compliance with the Financial Action Task Force (FATF) Recommendations.

This Report is organised as follows: Chapter 1 outlines the structure of the financial sector, with particular emphasis on banks, while Chapter 2 presents an assessment of the financial performance of the banking sector in 2017; Chapter 3 reports on licensing and consumer protection issues, and Chapter 4 highlights the recent global standards and guidelines issued by the Basel Committee on Banking Supervision; and Chapter 5 summarises key issues arising from the on-site and off-site examination processes. Appendices are provided at the end.

CHAPTER 1

BOTSWANA'S 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 micro-finance institution. As at December 31, 2017, there were ten licensed commercial banks and three statutory banks. During the year, four new bureaux de change were licensed, while two voluntarily surrendered their licences. As a result, the total number of licensed bureaux de change increased from 59 in 2016 to 61 in 2017.

BANKING SECTOR: BRANCH NETWORK AND OTHER DELIVERY CHANNELS

1.2 Table 1.1 presents the number of bank branches and automated teller machines (ATMs) (2015 to 2017). The restructuring of operations by banks resulted in the opening of five new branches. As a result, the number of bank branches increased from 140 to 145 in 2017. Statutory bank branches remained at 18, the same as in 2016. The number of ATMs grew from 455 to 473 during the year.

1.3 With respect to the geographical distribution of branch network, the South East District, which includes the capital city, Gaborone, continued to have the highest concentration of branches at 61, followed by the Central District at 32, as at December 31, 2017. Three districts, South East (8), Kweneng (1) and Kgalagadi (1) had an increase in branch network, while the other two districts had a reduction of one each (Southern and North East) (Appendix 2).

Table 1.1: Banks, Branches and Other Delivery Channels: 2015 - 2017

		Branches and Sub-branches			ATMs		
		2015	2016	2017	2015	2016	2017
Large Banks	Barclays	38	36	36	117	118	113
	Stanchart	19	21	21	68	68	67
	FNBB*	22	24	27	173	188	206
	Stanbic*	11	15	16	29	30	34
	BancABC*	8	9	9	10	15	15
	Sub-Total	**98**	**105**	**109**	**397**	**419**	**435**
Small Banks	Baroda	3	3	3	6	6	6
	Bank Gaborone*	7	8	9	8	9	11
	Capital	4	4	4	4	6	6
	BOI	1	1	1	-	-	-
	Bank SBI	1	1	1	-	-	-
	KBAL	-	-	-	-	-	-
	Sub-Total	**16**	**17**	**18**	**18**	**21**	**23**
Total (Commercial Banks)		**114**	**122**	**127**	**415**	**440**	**458**
Statutory Banks	BSB*	2	5	5	-	3	3
	BBS	9	9	9	12	12	12
	NDB	4	4	4	-	-	-
Total (Statutory Banks)		**15**	**18**	**18**	**12**	**15**	**15**
Aggregate		**129**	**140**	**145**	**427**	**455**	**473**

*2016 figures revised to include branches that were not reported.

1.4 Access to banking services, as measured by the ratio of Bank Accounts to Adult[1] Population, improved from 76.5 percent in 2016 to 84.4 percent in 2017. 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 12 percent from 1.17 million in 2016 to 1.32 million in 2017, while adult population increased by 2.2 percent from 1.53 million to 1.56 million.

BANKING SECTOR EMPLOYMENT TRENDS: 2016 - 2017

1.5 Employment levels in the banking sector for 2016 and 2017 are presented in Table 1.2. The number of people directly employed in the banking sector increased from 5 055 in 2016 to 5 176 in 2017, thus a 2.4 percent growth in employment. While there was an increase in employees for most banks, there was a decrease with respect to four banks. The number of expatriates employed by the banking industry declined marginally from 68 in 2016 to 66 in 2017. Overall, staff complement for small banks decreased by 2.2 percent, from 496 in 2016 to 485 in 2017; in contrast, the level of employment in large banks[2] rose by 2.5 percent from 4 036 in 2016 to 4 137 in 2017, mainly due to expansion in the branch network.

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

[2] In this context, a large bank refers to a bank with total assets amounting to at least 10 percent of the aggregate banking sector total assets as at December 31, 2017.

Table 1.2: Level of Employment by Domestic Banks: 2016 - 2017

		2016			2017		
		Citizens	Expatriates	Total	Citizens	Expatriates	Total
Large Banks	Barclays	1 147	10	1 157	1 150	7	1 157
	Stanchart	752	10	762	788	9	797
	FNBB	1 275	3	1 278	1 263	6	1 269
	Stanbic	590	6	596	596	4	600
	BancABC	237	6	243	309	5	314
	Sub-Total	4 001	35	4 036	4 106	31	4 137
Small Banks	Baroda	35	12	47	34	13	47
	Bank Gaborone	291	4	295	271	5	276
	Capital	113	8	121	126	7	133
	BOI	7	4	11	8	4	12
	Bank SBI	19	3	22	13	4	17
	Sub-Total	465	31	496	452	33	485
Total (Commercial Banks)		4 466	66	4 532	4 558	64	4 622
Statutory Banks	BSB	149	-	149	172	-	172
	BBS	200	2	202	215	2	217
	NDB	172	-	172	165	-	165
Total (Statutory Banks)		521	2	523	552	2	554
Aggregate		4 987	68	5 055	5 110	66	5 176

NEW BANKING PRODUCTS AND SERVICES

1.6 In response to competition, demand by customers and advancement in technology, banks continuously develop products and upgrade existing ones, including services to meet the evolving client needs, enhance profitability and remain relevant to developments in the economy. The Bank continued to assess fee and tariff proposals for products to ensure appropriateness and fairness, with revisions made accordingly where necessary, prior to implementation.

FINANCIAL MARKET INFRASTRUCTURES

1.7 Financial market infrastructures (FMIs) refer to payment systems, central securities depositories (CSDs), securities settlement systems, central counterparties and trade repositories. These infrastructures facilitate the clearing, settlement and recording of monetary and other financial transactions, such as payments, securities and derivative contracts. FMIs play a critical role in the financial system and the broader economy. These are channels through which virtually all financial transactions are cleared, settled and recorded. The FMIs facilitate transactions by consumers and firms in purchasing goods and services, making financial investments and the transferring of funds safe, secure and efficient.

1.8 The National Clearance and Settlement Systems (NCSS) Act (CAP 46:06) assigns the Bank powers and functions related to the regulation and oversight of FMIs. The NCSS Act became operational through the promulgation of the NCSS Regulations of 2005. The Bank also generally refers to internationally set standards for FMIs, as set out in the principles for financial market infrastructures (PFMIs), in order to align the country's systems with international best practice. The Bank, through the Payments and Settlement Department, is responsible for ensuring that the assigned powers and functions are exercised in a way that ensures safety, security and efficiency of FMIs in the country.

1.9 Overall, FMIs play an important role in facilitating economic activity and enhancing financial stability. However, there are risks associated with these systems, including systemic risk, credit risk, liquidity risk, operational risk, custody risk, investment risk and general business risk. The design and operation of payment systems, globally, are governed by PFMIs, the objective of which is to maintain financial stability through strong and resilient financial market infrastructures. Specifically, PFMIs prescribe responsibilities for central banks, market regulators and other relevant authorities involved in FMIs and the implementation modalities for the standards. The following four financial market infrastructures are recognised in Botswana, having been determined to satisfy the definition of an FMI.

(a) Botswana Interbank Settlement System

1.10 The Real Time Gross Settlement (RTGS) system in Botswana is known as the Botswana Interbank Settlement System (BISS). The BISS is used to settle payment instructions between settlement system participants. Payment instructions are routed via the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network and settled through settlement accounts of the paying and receiving participants held in the BISS. The main objective of the BISS is to facilitate safe and secure payments. The system provides faster high-value and time-critical payments on gross basis. However, to ensure optimal use of the system, low value payments have also been allowed to settle through the BISS. The BISS currently provides for direct participants and indirect participants. Direct participants are commercial banks regulated and supervised by the Bank and domiciled in Botswana, while indirect participants are the Botswana Unified Revenue Service (BURS) and the office of the Accountant General (OAG).

(b) Botswana Automated Clearing House

1.11 The Botswana Automated Clearing House (BACH) is a computer-based clearing facility established to process the exchange of transactions between participant banks operating in Botswana. The facility ensures timely, secure, accurate and efficient clearance and settlement of payment instructions. The BACH processes cheques and electronic funds transfer (EFT) transactions, and has enabled the banking industry to achieve the objective of reducing the cheque clearing cycle to two days. The BACH is owned and operated by the Bankers Association of Botswana (BAB), and participants in the BACH comprise all clearing banks whose systems are in direct interface with the BACH. The BACH also has an interface with the BISS, through which BACH payments settle in central bank money. To minimise settlement risk, BACH participants are required to set up security in the BISS to guarantee settlement of BACH net settlement instruction (NSI) for timely and secure settlement and improved liquidity in the BISS.

(c) Central Securities Depository

1.12 The CSD system is owned and operated by the Central Securities Depository Company of Botswana, a subsidiary of the Botswana Stock Exchange (BSE). This facility is used for the clearing and settlement of securities transactions carried out on the BSE. It ensures timely, secure, accurate and efficient clearance and settlement of securities' instructions. Participants in the CSD comprise brokers and custodian banks whose systems are in direct interface with the CSD system. As a measure to minimise settlement risk and ensure timely and secure settlement, CSD participants are required to guarantee settlement of the CSD net settlement instruction by crediting a liquidity account held at the settlement agent.

(d) SmartSwitch Botswana

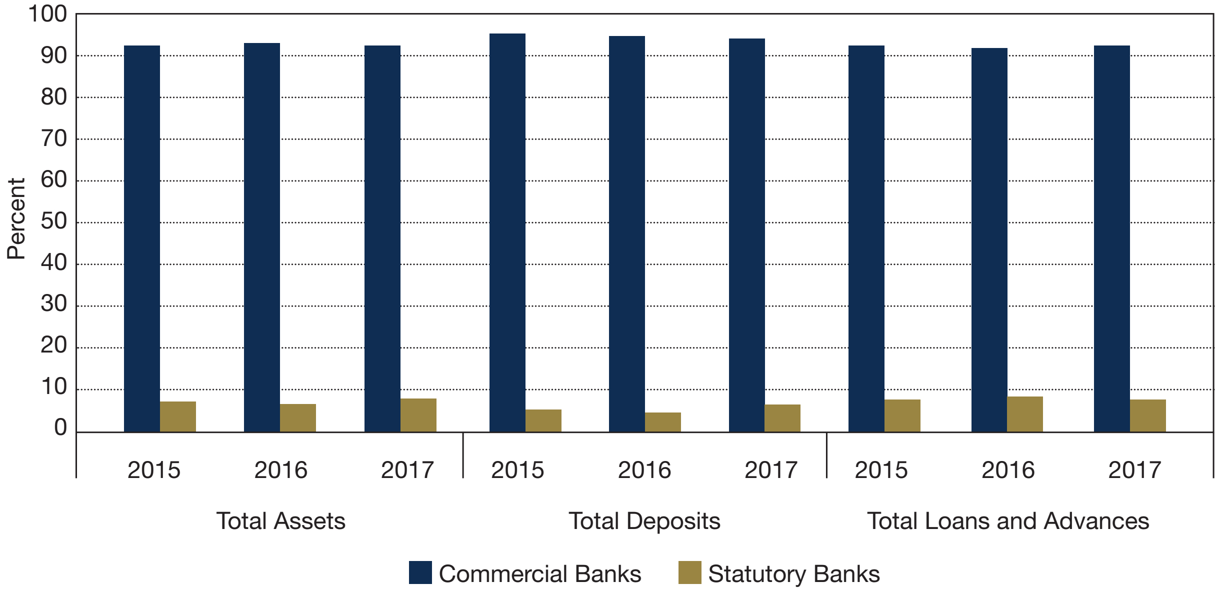
1.13 SmartSwitch Botswana provides a technology platform that accesses smart cards with biometric security. SmartSwitch operates through a network of point-of-sale devices held at participating retail merchants to provide related financial services. It handles payments for social services benefits to pensioners, destitutes and orphans.

BANKING SECTOR COMPETITION AND CONCENTRATION

MARKET SHARE

1.14 Commercial banks retain a dominant share of total banking industry assets, deposits and loans and advances, compared to statutory banks (Chart 1.1). However, statutory banks modestly gained market share of total assets and deposits of 7.5 percent and 6 percent in 2017, respectively, compared to 6.9 percent and 5.3 percent in the previous year. With respect to loans and advances, the share of statutory banks declined marginally from 8.5 percent in 2016 to 8.1 percent in 2017.

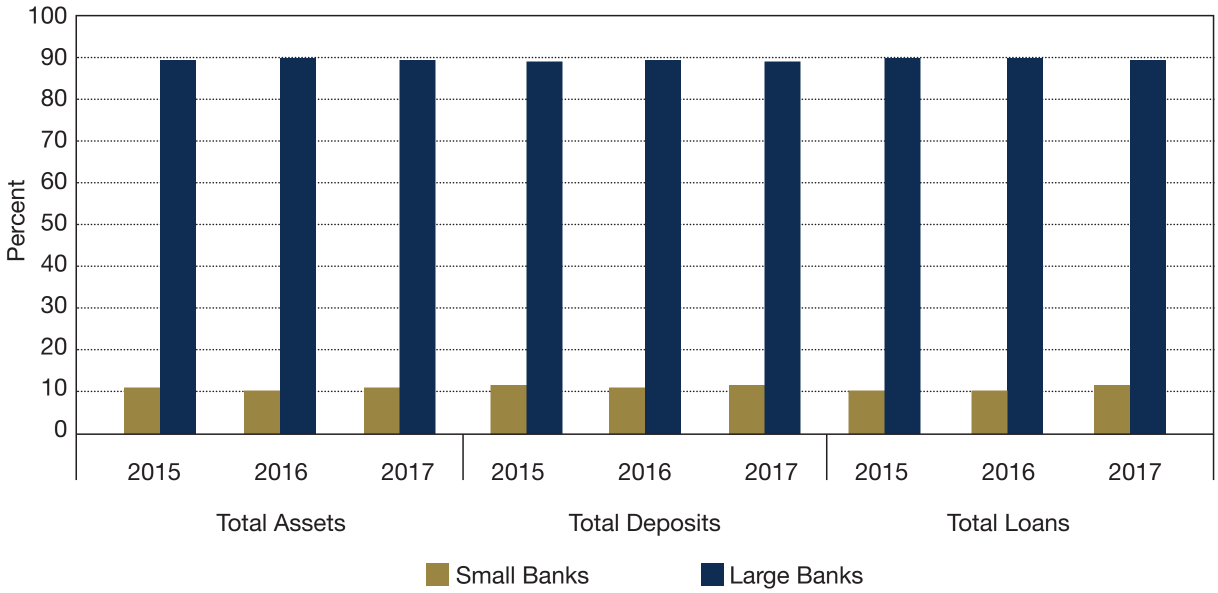
Chart 1.1: Banking Sector Market Share of Total Assets, Total Deposits and Total Loans and Advances*



*Figures exclude one statutory bank (2015 - 2017)

1.15 Five banks continued to dominate the banking sector and accounted for 89.5 percent, 88.5 percent and 88.7 percent of total assets, total deposits and total loans, respectively, in 2017, although slightly lower than the 90 percent in 2016, for all reviewed categories.

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

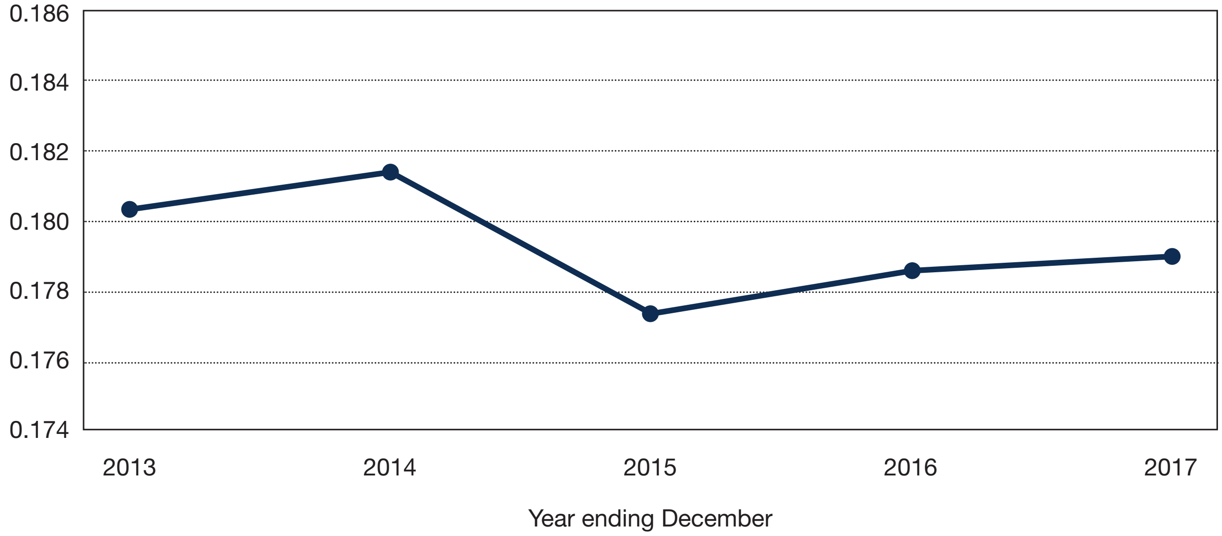


THE HERFINDAHL-HIRSCHMAN INDEX (HHI) OF COMPETITIVENESS

1.16 The Bank uses the Herfindah-Hirschman Index[3] (HHI), a widely applied measure of market concentration to assess the degree of competition in the Botswana banking industry. Evidence drawn from the HHI analysis between 2016 and 2017 shows a marginal increase in the index from 0.1784 in 2016 to 0.1800 in 2017 (Chart 1.3). Given the theoretical threshold of 0.1800 for moderate concentration, there continues to be scope for enhanced competitiveness.

[3] 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 moderately concentrated market; with a monopolist market condition, the HHI=1; with an industry of 100 equal size firms, the HHI=0.01.

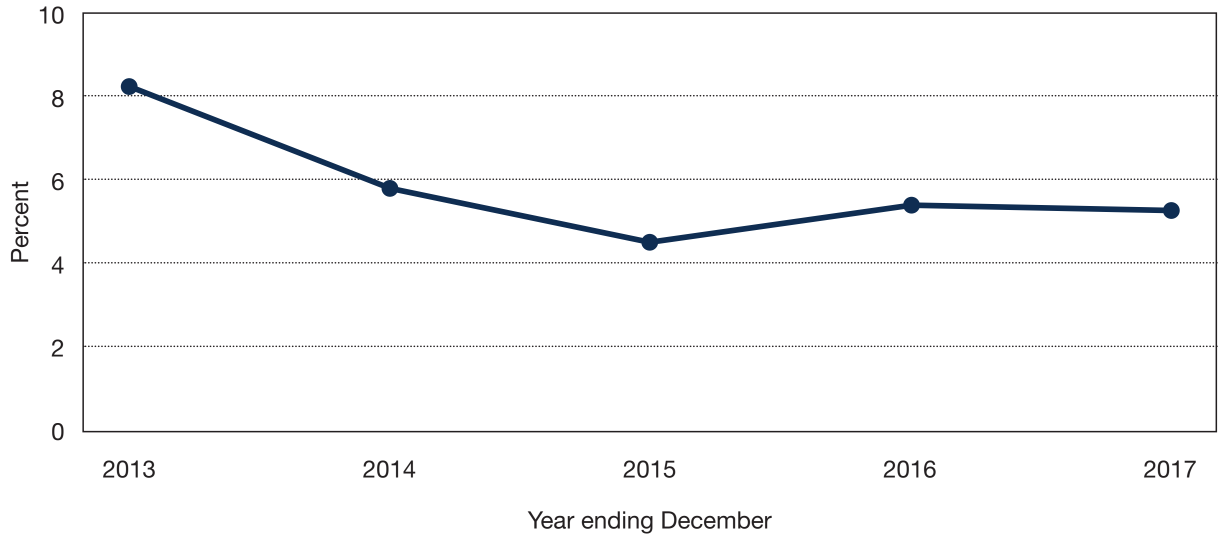
Chart 1.3: Herfindahl-Hirschman Index (HHI)



NET INTEREST MARGIN AS AN INDICATOR OF COMPETITION IN THE MARKET

1.17 The banking industry net interest margin (NIM) was unchanged at 5.4 percent between 2016 and 2017 (Chart 1.4). In addition to competitive forces, the NIM can be driven by factors such as operating costs, loan quality and the macroeconomic environment, including interest rates and demand. In general, a reduction in NIM indicates an increase in competition, hence efficiency of the banking system.

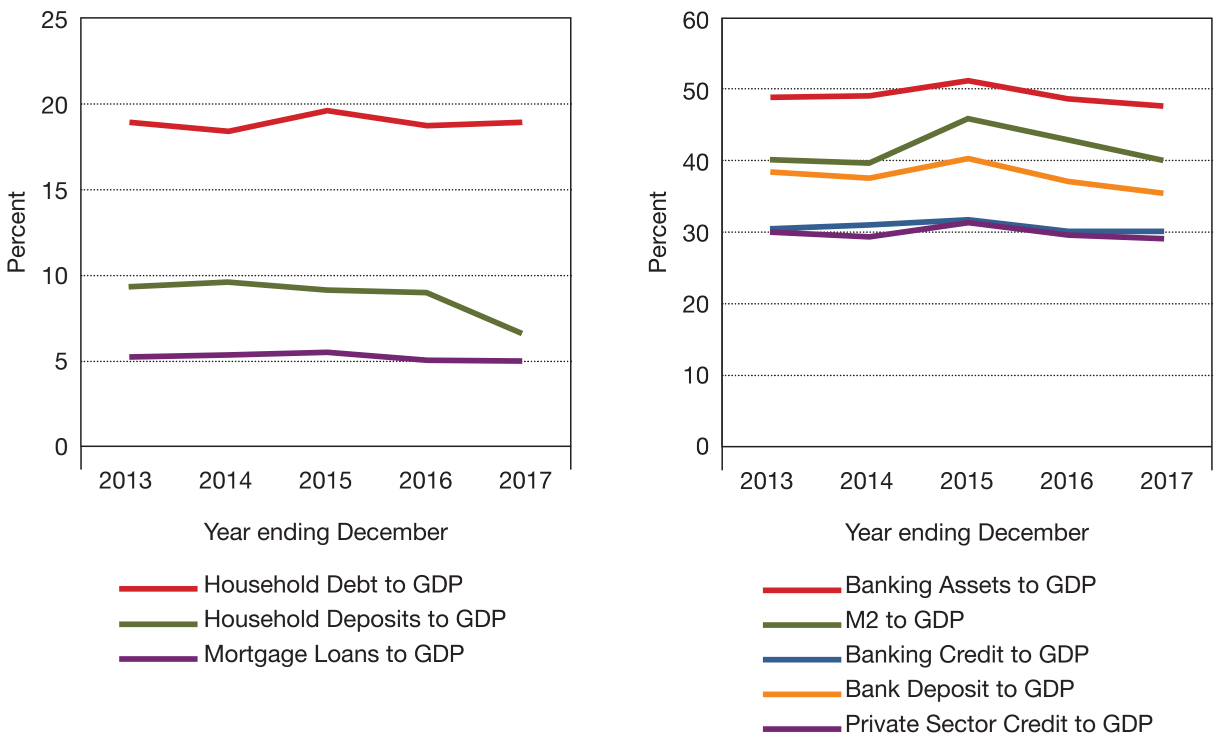
Chart 1.4: Banking Sector Trend of Net Interest Margin (NIM): 2013 - 2017



FINANCIAL DEEPENING AND DEVELOPMENT

1.18 Financial deepening refers to the extent of access to financial services, which enables meaningful participation in economic activity by a wide range of economic agents. Chart 1.5 shows several ratios, commonly used for measuring financial deepening and development.

Chart 1.5: Financial Sector Deepening Indicators

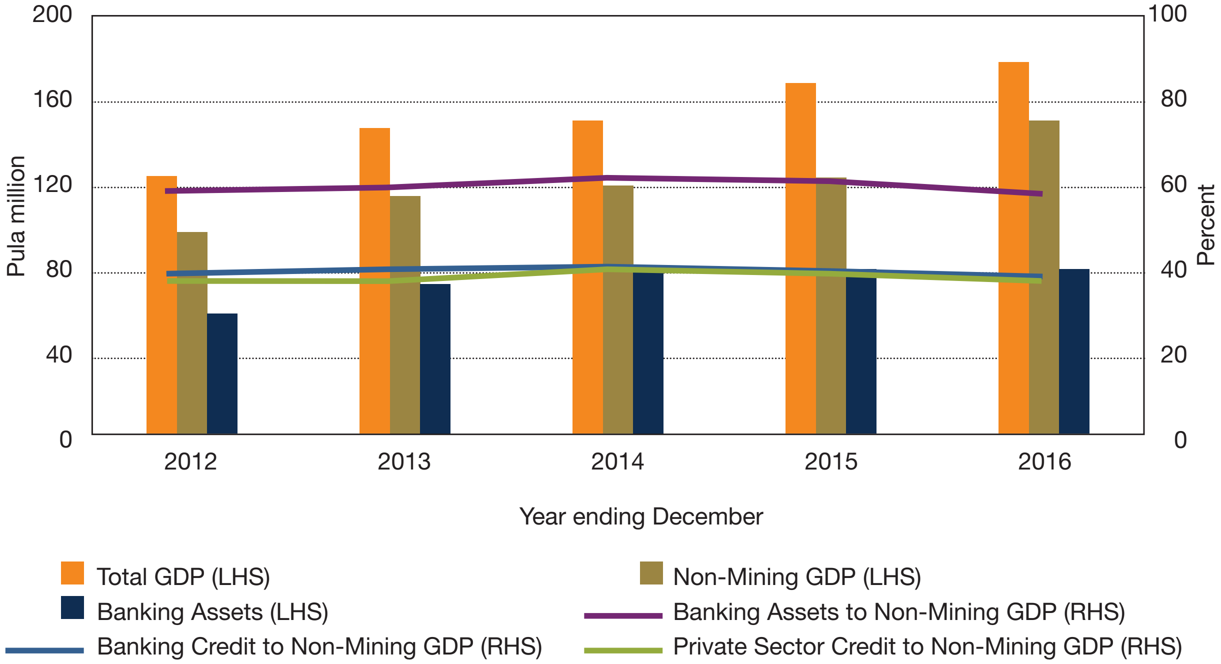


1.19 Financial depth and development, as approximated by the ratio of private sector credit to GDP[4], declined marginally from 29.4 percent in 2016 to 28.5 percent in 2017. This indicates a slower rate of increase in credit compared to overall economic growth. Similarly, private sector credit, as a proportion of non-mining GDP, fell from 36.9 percent in 2016 to 34.8 percent in 2017. When benchmarked against the global average ratio of private sector credit to GDP of 51.4 percent (as reported by the World Bank's 2017/2018 Global Financial Development Report), the Botswana banking system is relatively shallow and there is scope for growth under stable conditions and sound credit extension.

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

1.20 The ratio of banking assets to GDP, a measure of financial sector size, declined further to 46.3 percent in 2017 compared to 47.3 percent in 2016 (Chart 1.5). Correspondingly, the ratio of banking assets to non-mining GDP decreased from 59.4 percent in 2016 to 56.6 percent in 2017 (Chart 1.6). This was mainly on account of slower growth in the banking industry, compared to the recent past, and faster expansion of other sectors in relation to total GDP: nominal GDP and non-mining GDP increased by 5.6 percent and 8.8 percent, respectively, against a slower growth rate of 3.5 percent in total banking assets. Banking credit, as a proportion of total GDP, was unchanged at 30.1 percent (Chart 1.5). Considering a longer time perspective, over the five-year period, the trend is generally downwards for all the financial sector depth indicators, suggesting that the pace of growth of the financial sector has been slower than that of the country's GDP.

Chart 1.6: Financial Sector Size and Depth Indicators



1.21 M2[5] to GDP decreased from 42.6 percent in 2016 to 40.2 percent in 2017. This implied that, relative to growth of the economy, the increase in cash and deposits at banks was smaller, suggesting client preference for alternative forms of wealth holding.

1.22 Household debt relative to GDP was virtually constant. Total household debt as a proportion of total GDP increased marginally from 18.1 percent in 2016 to 18.4 percent in 2017. Mortgage to GDP ratio was unchanged at 5.1 percent. When statutory banks are included, the mortgage to GDP ratio also remains unchanged at 7.5 percent between 2016 and 2017. The household deposits to total GDP ratio declined from 8.7 percent in 2016 to 7.1 percent as at the end of 2017, indicative of relative modest growth in incomes and net external financial outflows.

[5] M2 (P72.5 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).

1.23 The pension fund assets to total GDP ratio rose from 44.3 percent in 2016 to 45.5 percent in 2017. In the light of the fact that, as at December 31, 2017, the aggregate household savings in the banking sector and pension funds was P94.8 billion compared to household borrowing of P33.1 billion, the household sector was a net saver[6] in the economy. This should, however, not be interpreted to mean that the household sector is not over-leveraged because the bulk of the household savings are non-discretionary, representing future cashflows.

1.24 The value of electronic funds transfer transactions (EFTs) relative to economic activity decreased from 10.7 percent in 2016 to 7.8 percent in 2017. This is attributable to a 22 percent decline in EFTs relative to a 6.1 percent growth in nominal GDP.

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

BOX 1: UPDATE ON PYRAMID SCHEMES AND ILLEGAL DEPOSIT-TAKING IN BOTSWANA

INTRODUCTION

A pyramid scheme is an arrangement, agreement or practice in which participants in the scheme receive compensation derived primarily from their respective recruitment of other persons as participants, rather than from the sale of any goods or services (Consumer Protection Act (CAP. 27:01) of 2018). The benefits received depend on the number of new members an individual recruits. Illegal deposit-taking, on the other hand, refers to an act of receiving, taking or accepting deposits from members of the public without a valid licence, which contravenes Section 3(1) of the Banking Act (CAP. 46:04) (Act). The Act restricts transacting banking business and/or soliciting deposits of money from the public to licensed banks. Therefore, any person peddling a pyramid scheme and/or participating in such an arrangement is committing a crime/offence.

There has been instances of illegal deposit-taking and/or solicitation of deposits of money from members of the public by unlicensed operators in Botswana. Such cases have increased recently. In these instances, members of the public are promised substantially high returns on their “investments”; the latest trend involves internet-based transacting. The observation is that this activity resembles pyramid schemes, which are illegal and not permissible in Botswana.

MODE OF OPERATION AND RELATED CHALLENGES

As an incentive and strategy to attract members of the public (credulous individuals), these schemes offer inordinately high deposit interest rates compared to commercial banks and other financial institutions. At the nascent stages of the scheme, money deposited by “investors” is channelled to operators as returns for the business. As an incentive to attract more “investors”, the operators will distribute part of these “returns” to existing members, which tends to give the “investors” a false sense of sustainability, which lures them to place more funds into the scheme. In theory, if the scheme continues to attract new “investors”, it would continue operating for an indefinite period. However, in practice, such scheme will inevitably collapse as the stream of new “investors” that keeps the scheme going runs dry. It is important to note that these operations are not sustainable in that at a certain point the scheme will collapse. This usually happens at a point where operators realise that they have amassed enough capital to discontinue the swindling project and disappear with the remainder of the funds collected. Since the operators are aware of the unsustainability of the schemes, they tend to abscond just on the brink of the collapse of the scheme, leaving “investors” with large financial losses, both capital contributions and promised returns.

Another variety of these schemes is that of businesses offering certain non-proscribed products as a cover-up for illegal deposit-taking. In this case, it appears as if the payments are taken in exchange for such products. However, the unsustainability of such ventures is revealed when the schemes collapse and investors lose their money and seek the intervention of the Bank.

CURRENT SITUATION

The current challenge relates to cyber-based operations, with no local or cross-border physical location, as the Bank is constrained in taking any action against operations based outside its jurisdiction. During 2017, the Bank investigated two such operations: one originated from Botswana, while the other was web-based and originated from the Republic of South Africa. In order to deal with the challenges of investigating those outside Botswana, the Bank usually seeks assistance from central banks in countries from which the schemes are suspected to originate.

LEGALITY OF THE SCHEMES IN BOTSWANA

The Act stipulates that the business of taking deposits of money from members of the public is the preserve of licensed banks since this part constitutes banking business. Banking business, as defined in Section 2 of the Act, refers to "the business of accepting deposits of money repayable on demand or after fixed periods or after notice, as the case may be, by cheque or otherwise." In view of the above, it follows that deposit-taking, through unlicensed banking activities and pyramid schemes, is illegal in Botswana. Soliciting deposits from the general public by unlicensed entities contravenes Section 3(1) of the Act, which stipulates that "no person shall transact banking business in Botswana without a valid licence issued by the central bank." If the perpetrators are found guilty, they are liable to a fine of P2 500 for each day on which the offence occurs, and/or imprisonment for five years, in accordance with Section 3(4) of the Act.

Furthermore, it is a criminal offence, punishable by law, for any person to promote the aforementioned illegal activities in Botswana. Section 5(1) of the Act empowers the Bank to investigate a person or entity suspected to be conducting unlicensed banking business and/or illegal deposit-taking activities. In terms of Section 5(5) of the Act, if such investigations confirm the contravention, the activities shall be suspended forthwith. In accordance with Section 5(6) of the Act, any person who contravenes any order of suspension given pursuant to subsection 5, shall be guilty of an offence and liable to a fine of P2 000 for each day on which the contravention occurs or continues to occur and to imprisonment for three years.

Parliament has promulgated the Consumer Protection Act which, inter alia, prescribes the multiplication, pyramid, chain letter schemes and other related activities as illegal ventures. To deter participation in such schemes, Section 9(4) of the Consumer Protection Act provides that "a person who participates in an arrangement, agreement, practice or scheme under subsection (2) commits an offence and shall be liable, upon conviction, to a fine not exceeding P100 000 or to imprisonment for a term not exceeding five years, or to both."

PUBLIC AWARENESS

The Bank and other financial institutions need to sustain the consumer education and public awareness campaign to alert and warn the public to refrain from participating in these schemes. The public is encouraged to consider the following before investing money:

(a) seek guidance from the relevant regulators and licensed financial advisors before placing deposits and investing;

(b) deal only with licensed financial institutions and authorised dealers;

(c) be cautious of opportunities that promise to generate substantial wealth in a short period, especially that is excessively higher than general interest rate level, returns on the stock market and nominal growth of the economy (GDP);

(d) avoid being pressured or rushed to invest;

(e) be extra careful with investments on the internet; and

(f) in case an investment has been made, keep copies of all the investment documentation and communication.

CONCLUSION

Growth in illegal deposit-taking in Botswana is a concern to the Bank as it has an adverse impact on the financial system and, by extension, the domestic economy. To avoid financial loss and possible criminal liability, the public should not participate in illegal schemes and should cooperate in closure and liquidation of such ventures. The public is further reminded that there are strict rules and regulations governing investments with licensed institutions, whereas unregulated and unsupervised persons, groups or companies do not follow these rules; therefore, money invested with them is at the greatest risk of loss.

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http:site.giatmoney.com/main/3000/index.asp?pageid=170123&t=what-is-illegal-deposit-taking

CHAPTER 2

PERFORMANCE OF THE BANKING INDUSTRY

CHAPTER **2**:

PERFORMANCE OF THE BANKING INDUSTRY

COMMERCIAL BANKS

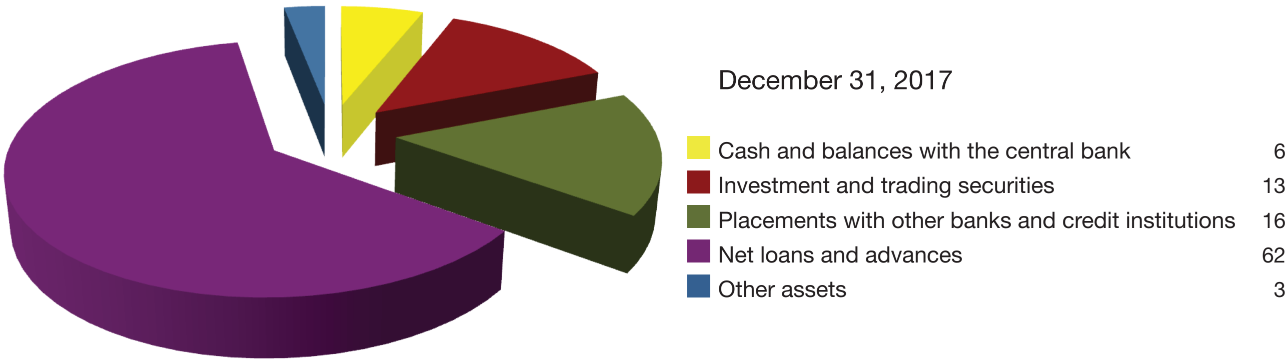
STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

2.1 The banking sector's total assets increased by 3.5 percent (5.3 percent in 2016) from P80.6 billion in December 2016 to P83.5 billion in 2017. Gross loans and advances grew by 5.6 percent to P54.2 billion in December 2017. Net loans and advances constituted the largest proportion of total banking sector assets (62 percent), followed by placement with other banks and credit institutions (16 percent), investment and trading securities (13 percent), cash and balances with the central bank (6 percent) and other assets (3 percent).

2.2 As at December 31, 2017, total deposit liabilities of the banking system amounted to P63.6 billion, a marginal increase of 1.8 percent compared to the P62.4 billion in 2016. Accordingly, at 76 percent and 11 percent of total banking sector liabilities, respectively, customer deposits and shareholder funds remained the primary source of funding for asset growth. Other sources of funds comprised balances due to other banks and credit institutions (5 percent), debt securities and other borrowing (5 percent), and other liabilities (3 percent).

2.3 Charts 2.1 and 2.2 show the composition of assets and liabilities for 2016 and 2017, respectively. The proportions of both assets and liabilities remain largely unchanged, with only small 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.

Chart 2.1: Commercial Banks: Composition of Assets: 2016 - 2017 (Percent)



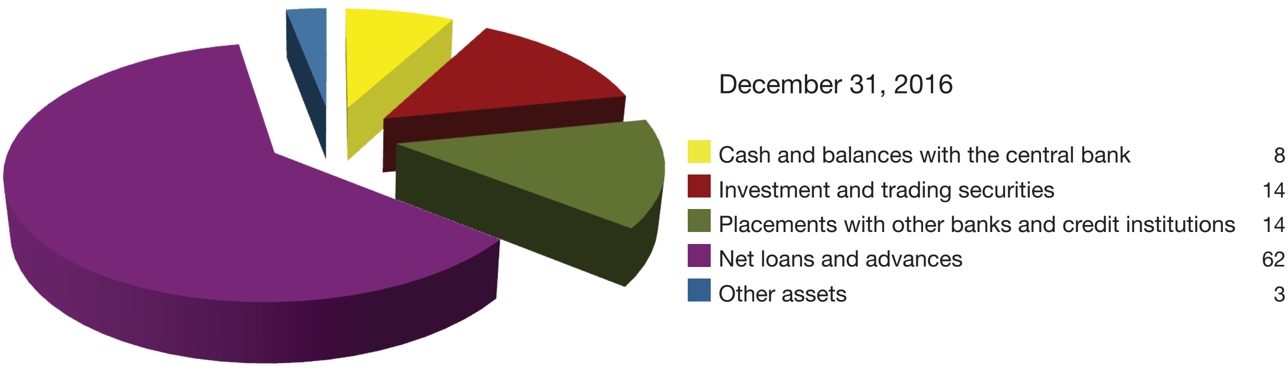
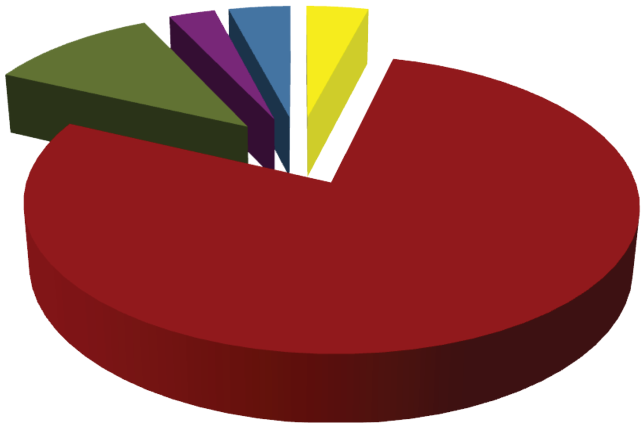
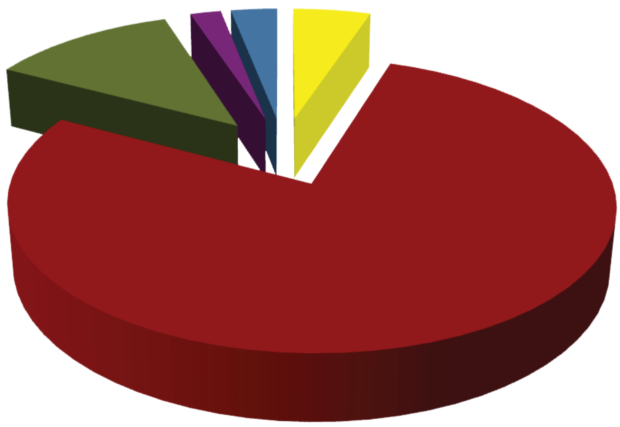


Chart 2.2: Commercial Banks: Composition of Liabilities: 2016 - 2017 (Percent)



December 31, 2017

Due to other banks and credit institutions	5
Customer deposits	76
Shareholder funds	11
Other liabilities	3
Debt securities and other borrowing	5



December 31, 2016

Due to other banks and credit institutions	5
Customer deposits	77
Shareholder funds	12
Other liabilities	2
Debt securities and other borrowing	3

2.4 Charts 2.3 shows the level of total assets, total deposits and total loans and advances, while Chart 2.4 presents growth rates for total assets, total deposits and total loans and advances, for the period 2013 - 2017.

Chart 2.3: Commercial Banks: Total Assets, Total Loans and Advances and Total Deposits: 2013 - 2017

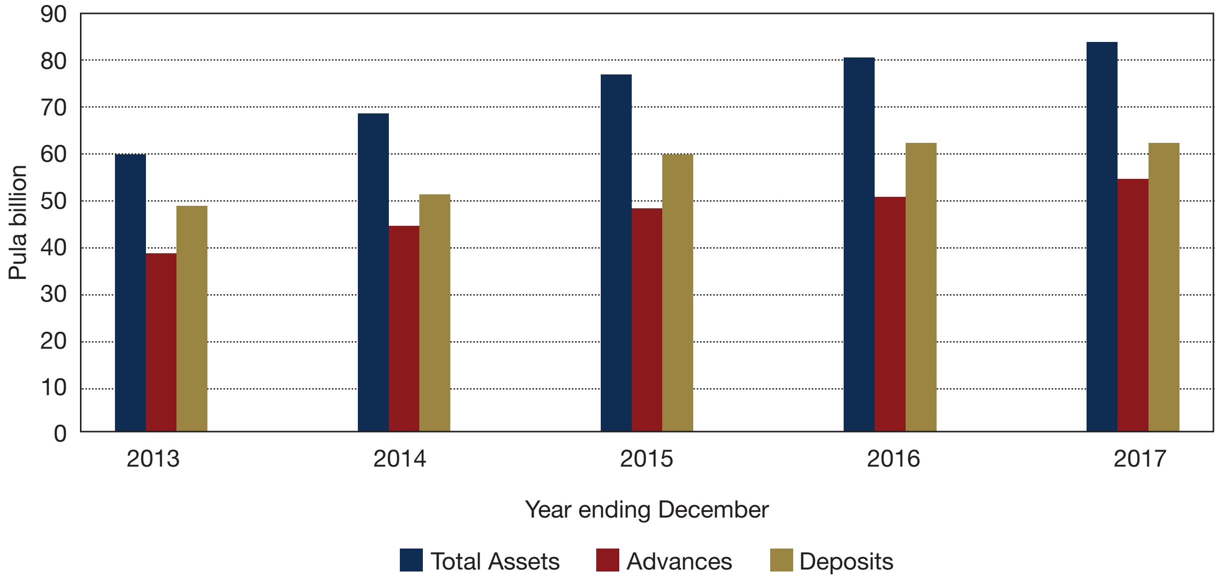
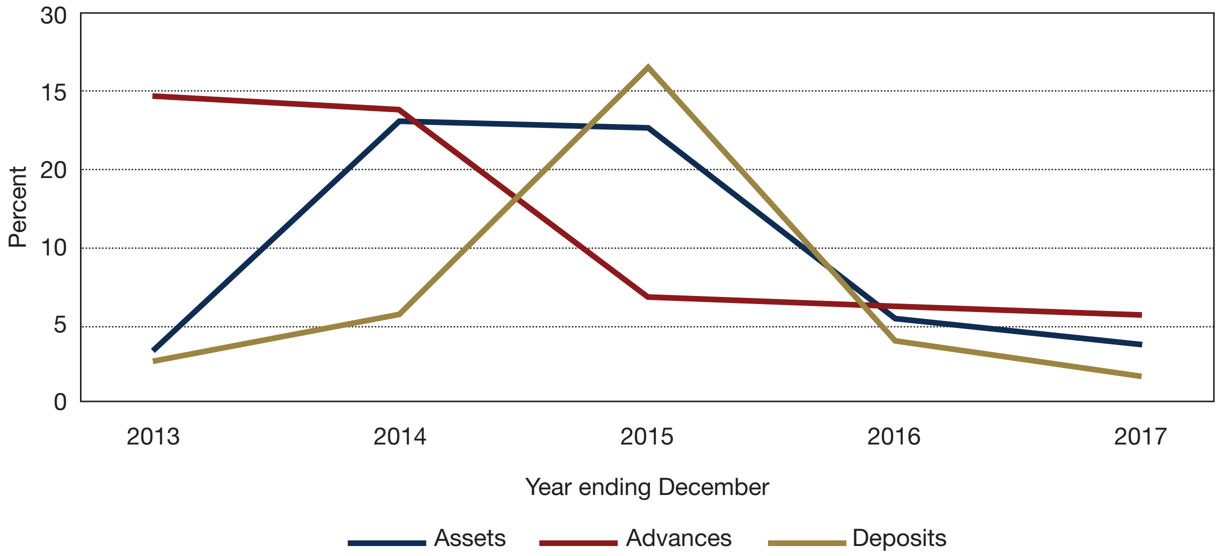


Chart 2.4: Commercial Banks: Annual Growth Rates of Total Assets, Total Loans and Advances and Total Deposits: 2013 - 2017



COMPARATIVE CHANGE IN THE RISKINESS OF ON-BALANCE SHEET ASSETS

2.5 Table 2.1 shows the comparative riskiness of total on-balance sheet assets of banks as at December 2016 and 2017. There was a slight upward shift in the risk profile of assets held by banks under the 20 percent, 35 percent, 100 percent and 150 percent risk-weights in 2017. On-balance sheet assets risk-weighted zero percent and 50 percent decreased moderately from 21.6 percent and 4.6 percent to 18.1 percent and 3.9 percent, respectively. A larger share of the on-balance sheet assets (30.6 percent) were risk-weighted at 75 percent.

2.6 Overall, 25.4 percent of the on-balance sheet asset items were above the 75 percent risk-weight category in 2017 compared to 23.9 percent in 2016, indicating a modest increase in the riskiness of banks' assets.

Table 2.1: Comparative Change in the Riskiness of Banks' Portfolios of On-balance Sheet Assets

Risk-Weights (Percent)	On-balance Sheet Assets (P'million)	On-balance Sheet Assets to Total On-balance Sheet Assets (Percent)	On-balance Sheet Assets (P'million)	On-balance Sheet Assets to Total On-balance Sheet Assets (Percent)
	December 2016		December 2017	
0	17 452	21.6	15 111	18.1
20	8 639	10.7	10 855	13.0
35	6 358	7.9	7 597	9.1
50	3 685	4.6	3 285	3.9
75	25 220	31.3	25 553	30.6
100	18 726	23.2	19 784	23.7
150	539	0.7	1 364	1.6
250	22	0.03	63	0.1
Total	80 640	100	83 612	100

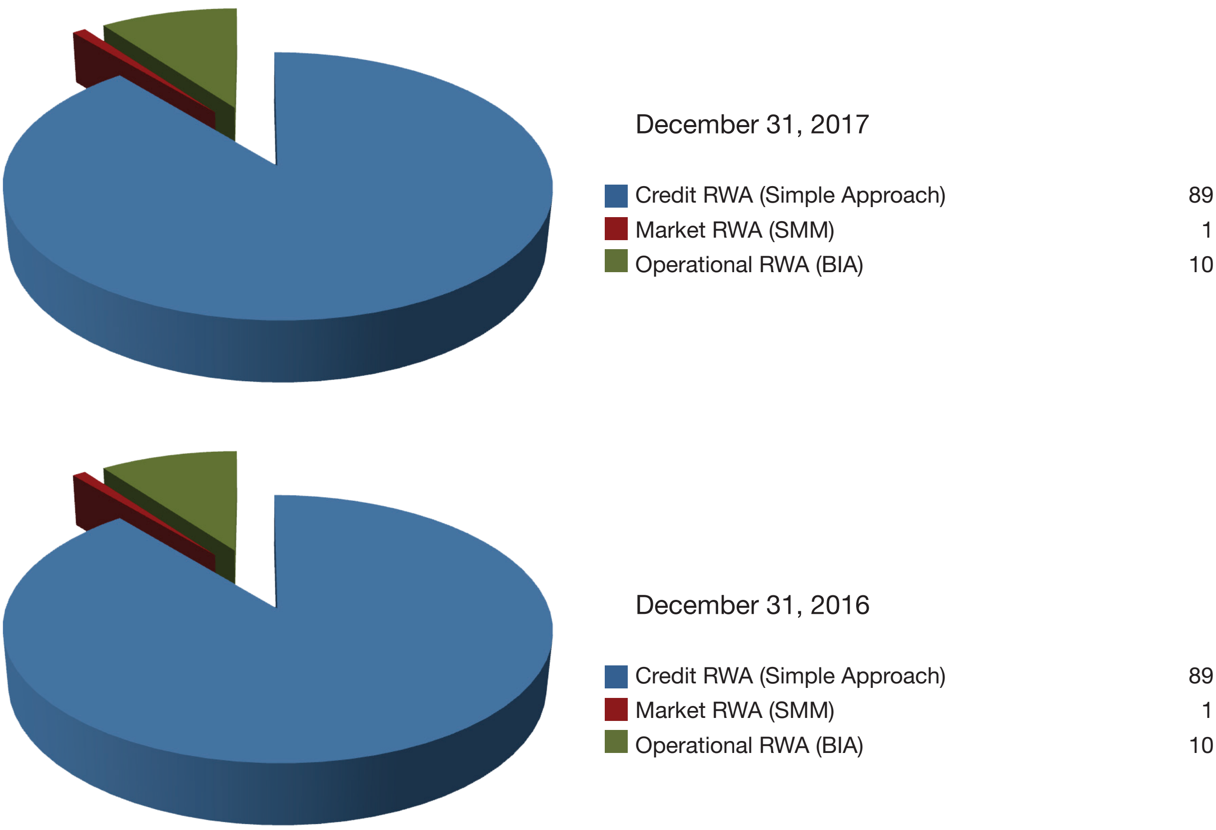
COMMERCIAL BANKS: RISK ASSESSMENT

INTRODUCTION

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

2.8 Chart 2.5 shows the aggregate risk-weighted assets (RWA) of the banking sector in 2016 and 2017, as calculated under Pillar 1 of Basel II. Total RWA increased by 6.1 percent to P55.5 billion in 2017 (December 2016: P52.3 billion). The proportions of RWA were the same as in 2016, with credit RWA constituting 89 percent of the banking sector's total RWA, followed by operational RWA at 10 percent and market RWA at 1 percent.

Chart 2.5: Composition of Risk-Weighted Assets (Percent): 2016 - 2017



CREDIT RISK

REGULATORY CAPITAL REQUIREMENTS ON CREDIT RISK

2.9 Credit risk-weighted assets increased by 6.2 percent from P46.5 billion in December 2016 to P49.3 billion in December 2017. This increase resulted from the migration of some risk exposures from low risk-weight categories (zero and 50 percent) to higher risk-weight categories (100 percent and 150 percent).

ASSET QUALITY: LEVELS AND TRENDS

2.10 Gross loans and advances grew by 5.6 percent, from P51.3 billion in December 2016 to P54.2 billion in December 2017. Credit growth, nevertheless, continued to be slow, decreasing from 6.2 percent in 2016 to 5.6 percent in 2017. The slow growth in credit was indicative of moderate economic growth as well as the modest increase in personal incomes.

2.11 The asset quality of the banking sector deteriorated as shown by an increase in the ratio of NPLs to Gross Loans and Advances from 4.9 percent in December 2016 to 5.3 percent in December 2017. However, most banks reported ratios below the banking sector average, with larger NPLs ratios attributable to three banks.

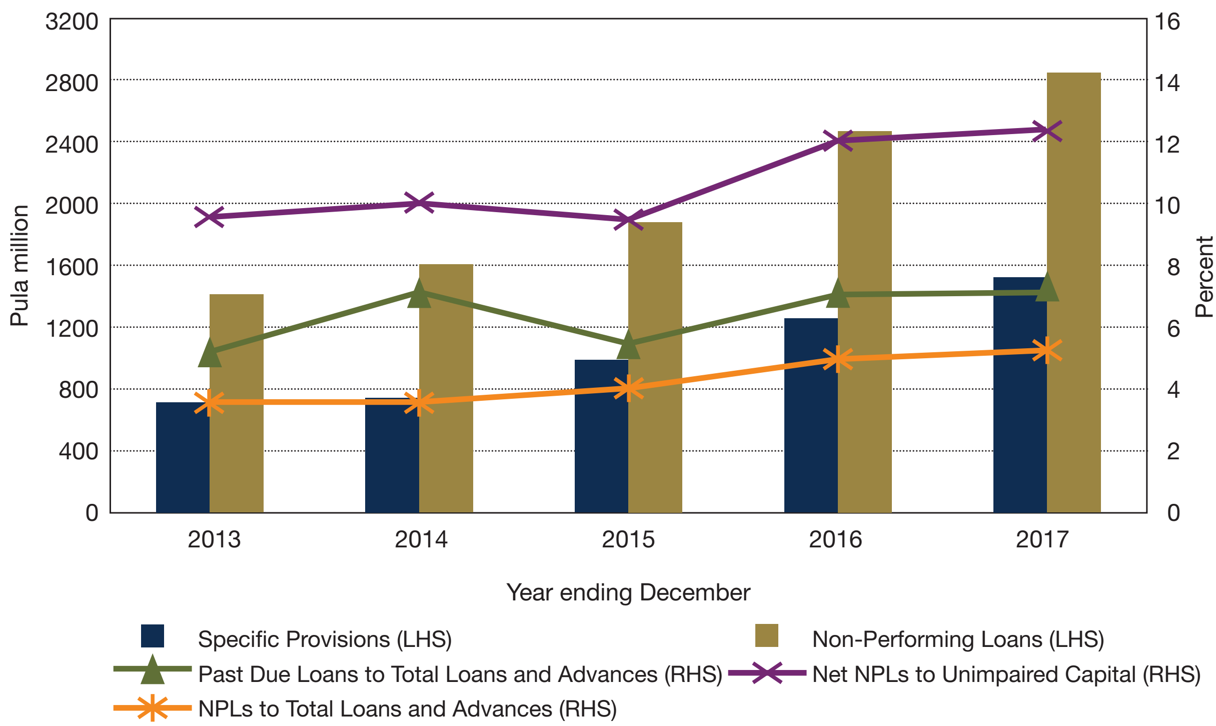
2.12 Past due loans (that is, loans tainted by arrears) increased by 11.7 percent to P4 billion in 2017 (December 2016: P3.6 billion). On the other hand, non-performing loans (NPLs) (i.e., impaired loans) increased by 13.6 percent to P2.9 billion (December 2016: P2.5 billion). The household (predominantly unsecured loans) and private business sectors accounted for 52 percent and 48 percent of total NPLs in 2017, respectively.

2.13 Within the private business sector, manufacturing and trade, restaurants and bars sectors had the highest proportion of NPLs at 30.9 percent and 17.1 percent, respectively. Growth in NPLs followed the closure of some mines, for example, BCL and Tati Nickel, some diamond sightholder businesses and related job losses, and, to a lesser extent, the increase in the cost of living. The increase in commercial real estate NPLs could be attributable to the dependence of the borrower's source of repayments on the cash flows generated by the commercial real estate, which were constrained in a relatively subdued property market.

2.14 Banks increased their specific provisions from P1.3 billion in 2016 to P1.5 billion in 2017, providing a 53.7 percent cover of NPLs as at December 31, 2017. Furthermore, the ratio of NPLs (net of specific provisions) to Unimpaired Capital increased slightly to 12.3 percent as at December 31, 2017 (December 2016: 12.2 percent). The credit risk-mitigation measures that banks have in place are expected to absorb any residual credit risk.

2.15 Chart 2.6 shows trends in the commercial bank assets quality indicators for the period 2013 - 2017.

Chart 2.6: Commercial Banks: Asset Quality Indicators: 2013 - 2017

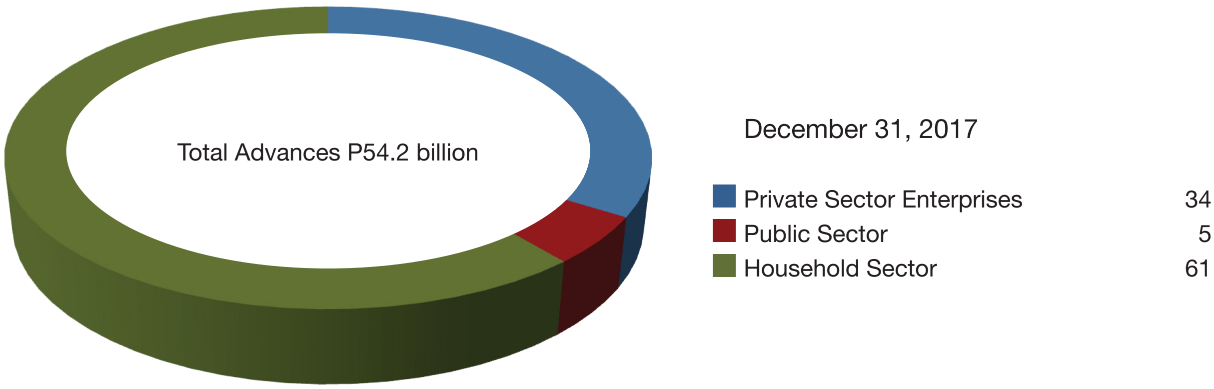


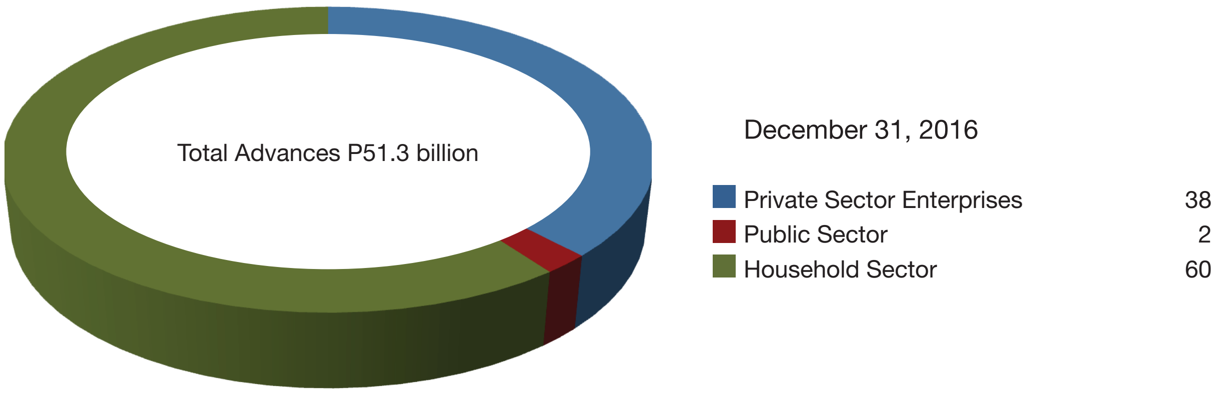
CREDIT CONCENTRATION RISK

SECTORAL DISTRIBUTION OF COMMERCIAL BANK LOANS AND ADVANCES

2.16 Chart 2.7 compares the sectoral distribution of loans and advances between 2016 and 2017. Household loans and advances continue to account for the largest share of the industry's loans and advances, which was 61 percent as at December 31, 2017. Loans and advances to private sector enterprises declined by 5 percent from P19.2 billion in 2016 to P18.3 billion in 2017. Consequently, the share of private sector enterprises loans decreased to 34 percent in 2017 (December 2016: 38 percent). On the other hand, public sector loans and advances accounted for 5 percent of total loans and advances.

Chart 2.7: Sectoral Distribution of Loans and Advances: 2016 - 2017 (Percent)



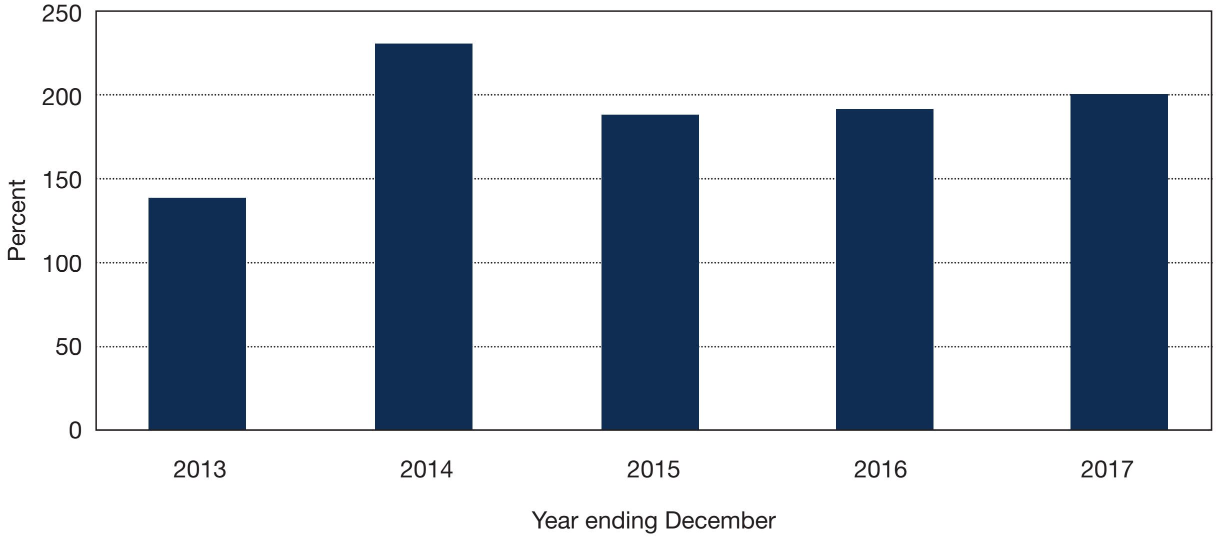


LARGE EXPOSURES

2.17 Commercial banks' large exposures[7] increased marginally from P20 billion in 2016 to P21.5 billion in 2017, and unimpaired capital increased by 5.2 percent to P10.8 billion in 2017 (2016: P10.2 billion). Consequently, the banks' Large Exposures to Unimpaired Capital ratio increased to 200 percent (2016: 195 percent) (Chart 2.8). The ratio ranged from 60.8 percent to 637.4 percent for the banking industry. The ratio was, however, below the recommended 800 percent prudential limit for the banks in Botswana.

[7] An exposure, direct or indirect, of a bank to any person or group of inter-related persons that equals or exceeds 10 percent of the unimpaired capital of the bank.

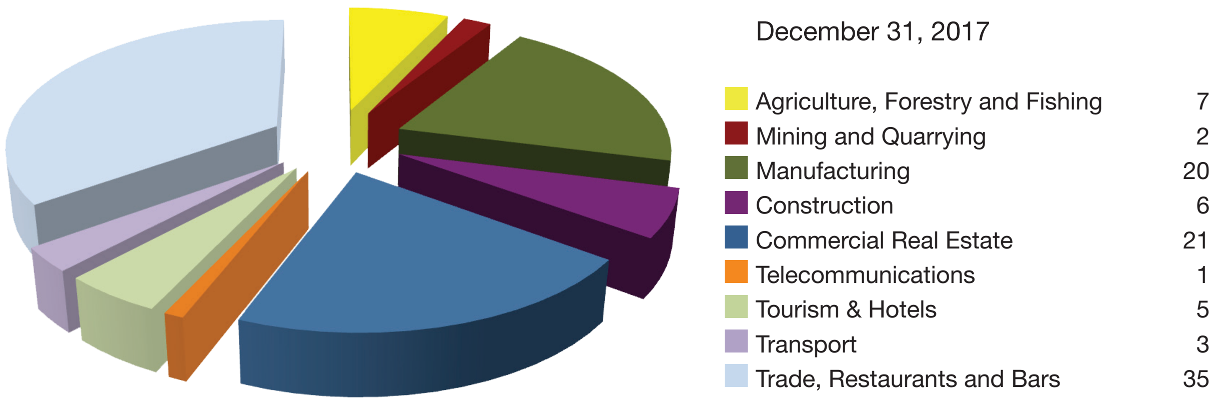
Chart 2.8: Commercial Banks: Large Exposures to Unimpaired Capital Ratio: 2013 - 2017

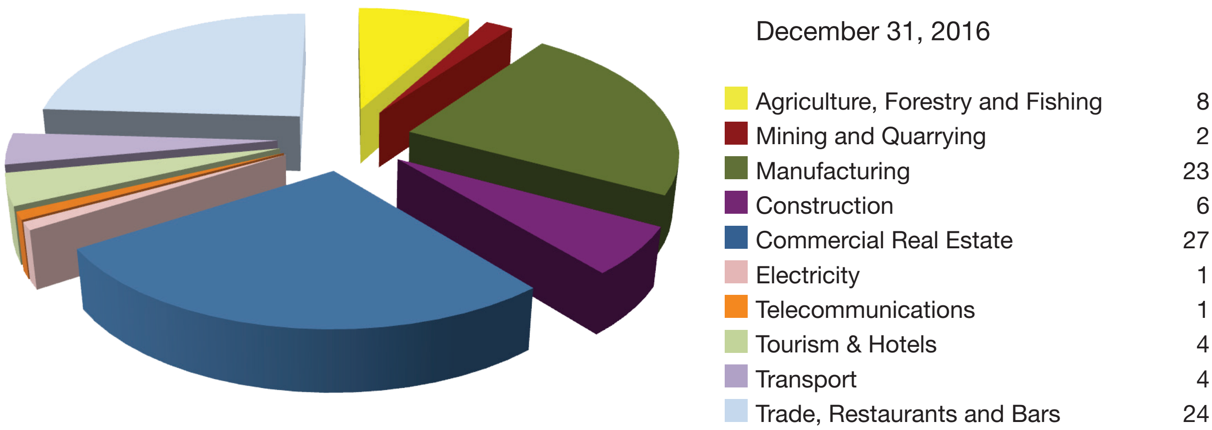


THE STRUCTURE OF PRIVATE SECTOR ENTERPRISES LOANS AND ADVANCES

2.18 Commercial banks maintained a diversified exposure to different sectors of the economy (Chart 2.9) except for the overall larger share of households. The share of loans and advances to six sectors in total private sector credit, namely, mining and quarrying, electricity, construction, telecommunications, tourism and hotels, and transport, was generally unchanged between 2016 and 2017. However, due to a 78.5 percent increase in loans and advances to the trade, restaurants and bars sector, its share rose to 35 percent in 2017 compared to 24 percent in 2016. At the same time, there was a notable reduction in the proportion of lending to commercial real estate sector, reflecting slow economic activity in the sector. The share of credit to the manufacturing sector also declined in the context of a cautious lending approach to the sector, given its poor performance in recent years.

Chart 2.9: Sectoral Distribution of Private Sector Enterprise Loans: 2016 - 2017 (Percent)





LOANS TO DIRECTORS AND RELATED PARTIES

2.19 The exposure to related parties (gross loans and advances extended to related parties) was 1.3 percent of banks' unimpaired capital as at December 31, 2017 (December 2016: 1.8 percent), thus posing minimal credit risk from related parties in the banking sector.

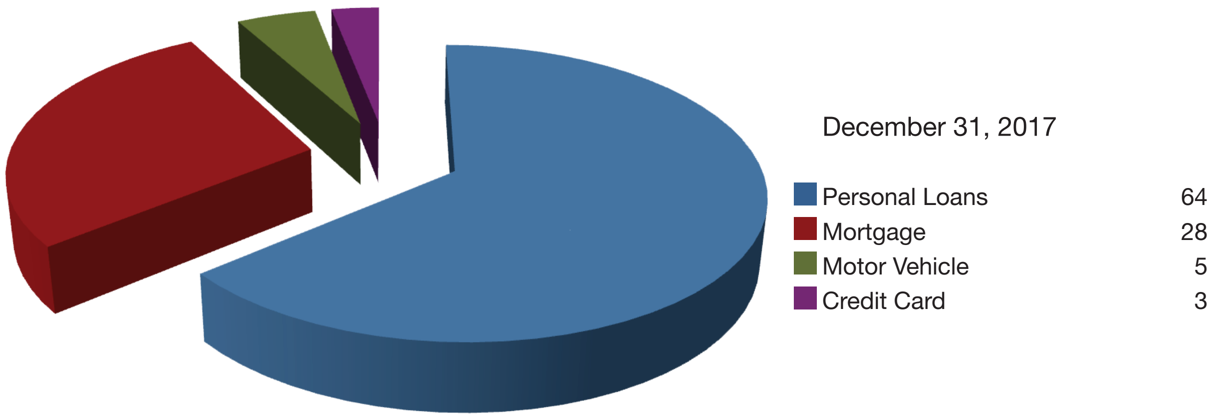
FOREIGN CURRENCY DENOMINATED LOANS AND LIABILITIES

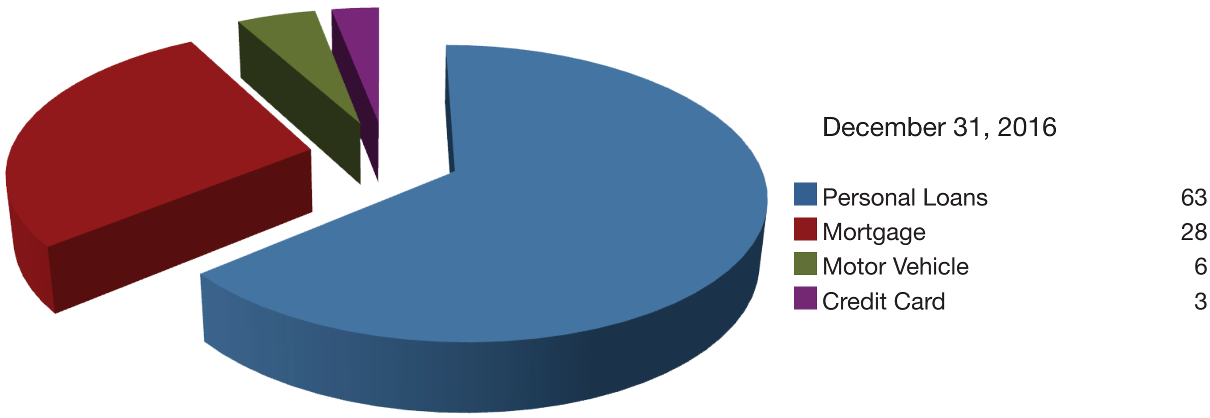
2.20 Foreign currency-denominated loans decreased marginally by 1.5 percent from P3.9 billion in 2016 to P3.8 billion in 2017. Consequently, the ratio of Foreign Currency-Denominated Loans to Gross Loans and Advances fell from 7.5 percent in 2016 to 7.1 percent in 2017. Likewise, vostro balances decreased marginally (1.3 percent) to P2.2 billion; thus, the ratio of Vostro Balances to Total Assets also decreased to 2.7 percent (2016: 2.8 percent). The ratio of Foreign Currency Loans to Total Foreign Currency Deposits was 37 percent in 2017 (December 2016: 36.5).

THE COMPOSITION OF HOUSEHOLD LOANS AND ADVANCES

2.21 The share of household lending in total credit was virtually unchanged between 2016 and 2017 (Chart 2.11). Total loans and advances to the household sector increased from P30.8 billion in December 2016 to P33.1 billion in December 2017. The growth in credit to households was driven by an increase in the unsecured personal loans and credit cards, from P20.1 billion in 2016 to P21.9 billion in 2017. Mortgages increased by 4.8 percent to P9.2 billion, although their share in total retail lending was unchanged at 28 percent from the prior year.

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





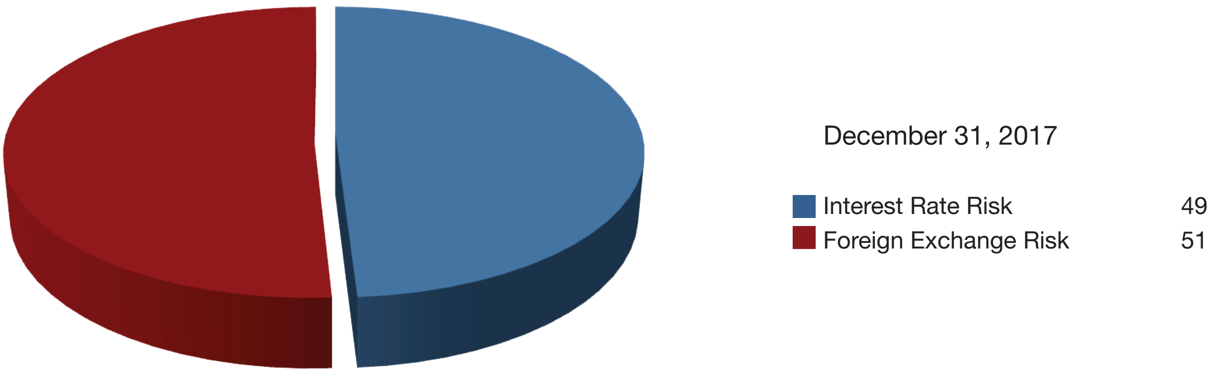
2.22 In general, the inherent credit risk of the banking sector was considered to be high. The existing risk-management systems of banks were satisfactory, but the residual risk remained high and likely to increase over time, hence requiring continuous close monitoring.

MARKET RISK

REGULATORY CAPITAL REQUIREMENTS ON MARKET RISK

2.23 The total market RWA was P652 million (constituting 1 percent of total RWA), while the total regulatory capital requirement for market risk was P97.3 million. This indicated the industry's low exposure to market risk. The bulk of the market-risk regulatory capital requirement relates to foreign exchange exposures, which amounted to P50 million or 51.3 percent of the total regulatory capital requirement for market risk in December 2017. The capital charge for exposure to interest rate risk was 48.7 percent of the total market-risk regulatory capital requirement (Chart 2.11).

Chart 2.11: Composition of Market Risk Regulatory Capital: December 31, 2017 (Percent)



FOREIGN EXCHANGE RISK EXPOSURE

2.24 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[8] for major, minor and overall currency exposures, respectively. This indicates that the banking sector had a relatively low net exposure to foreign exchange risk.

INTEREST RATE RISK EXPOSURE

2.25 The banking sector gap between rate sensitive assets and rate sensitive liabilities was positive in each time band, except for the 3-to-6 month band, which showed a negative gap of P85 million (Table 2.2). This negative gap indicated that a decline in interest rates would result in repricing of liabilities at a lower rate, consequently, increasing the sector's earnings. In contrast, on rate sensitive assets, a decline in interest rates would lower the banks' earnings, while an increase in interest rates would positively impact earnings and profitability and, by extension, economic capital.

[8] The 15 percent and 5 percent limits are for individual major (South African Rand (ZAR), United States Dollar (USD), Great Britain Pound (Pound), Euro) and minor currency exposures, respectively.

Table 2.2: Interest Rate Risk Exposure (P'million)

	Total Variable Rate Assets	Total Variable Rate Liabilities	Variable Gap
Up to 1 month	59 111	28 094	31 017
1 - 3 months	3 767	2 805	961
Over 3 - 6 months	205	291	(85)
Over 6 - 12 months	680	632	48
Over 12 months - 3 years	1 526	38	1 488
Over 3 - 5 years	1 158	348	810
Over 5 - 10 years	442	328	114
More than 10 years	429	0	429
Total	67 316	32 535	34 781

Note: Parenthesis denotes negative figure.

2.26 Overall, market risk in the banking sector was considered to be moderate and is expected to be stable in the foreseeable future.

OPERATIONAL RISK

REGULATORY CAPITAL REQUIREMENTS ON OPERATIONAL RISK

2.27 The risk-weighted assets for operational risk was P5.5 billion, constituting 9.9 percent of the total RWAs in December 2017. On the other hand, the total regulatory capital requirement for operational risk was P817 million in the same period. All banks calculated their operational-risk capital requirements using the basic indicator approach (BIA), with one bank conducting a trial run for the standardised approach (TSA) for operational risk.

OPERATIONAL RISK EXPOSURE

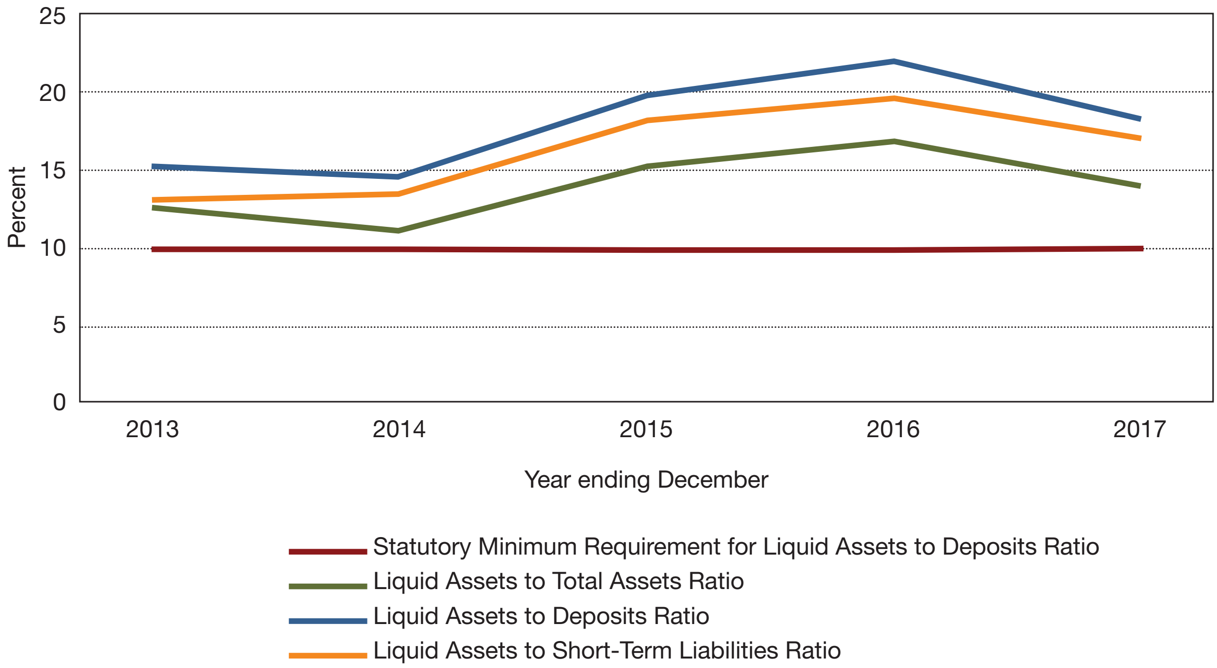
2.28 Information technology (IT) risk was identified as a high-risk component in external auditors' preliminary findings, mainly on account of the increasing trend of cyber-security risk. This was in recognition of the centrality of IT systems for conducting banking business and facilitating financial reporting thereof, while, at the same time, being complex and vulnerable. In addition, the other most common operational-risk factors among banks were management of suspense accounts and long-outstanding reconciling items, which carry an inherent risk of fraud. It was noted, however, that even though the suspense accounts increased banks' inherent operational risk, these had decreased compared to the prior year.

2.29 In the circumstances, the banking sector composite operational risk was considered to be moderate in the light of satisfactory risk-management measures in place to mitigate the risk. The risk is expected to remain stable in the foreseeable future.

LIQUIDITY AND FUNDING RISK

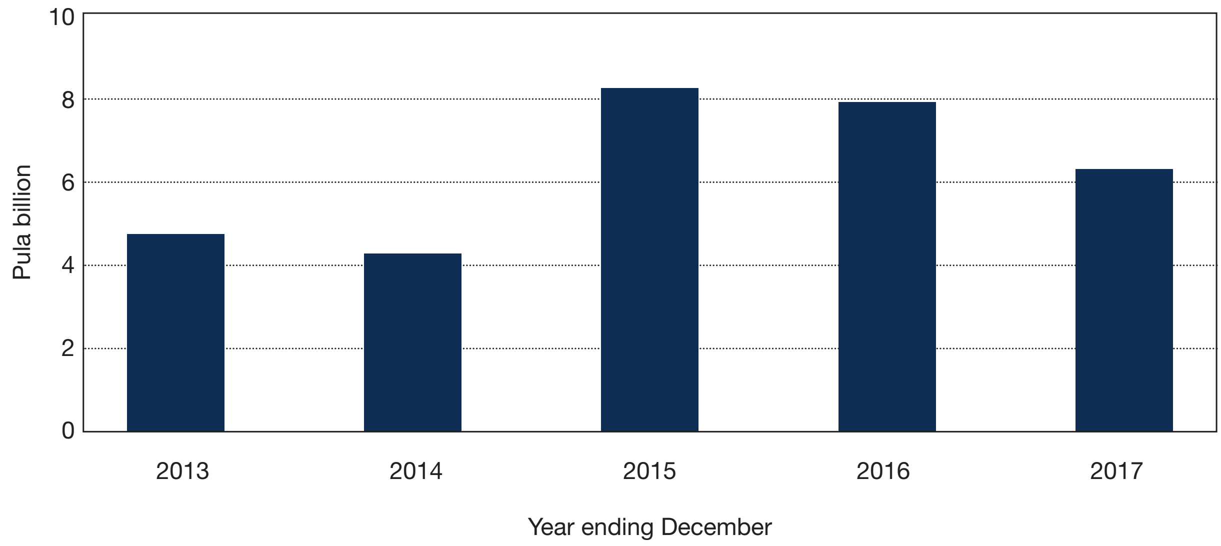
2.30 The banking sector's Liquid Assets to Total Deposit ratio (LAR) decreased from 21.6 percent in 2016 to 17.9 percent in 2017, but remained above the 10 percent minimum prudential requirement. Two banks reported the lowest liquidity ratios, one with a LAR of 12.2 percent and the other 12.5 percent. Other liquidity ratios for the banking sector decreased: Liquid Assets to Total Assets ratio and Liquid Assets to Short-Term Liabilities ratio fell to 13.6 percent and 16.6 percent, respectively. The decrease in these liquidity ratios resulted from a decline in statutory liquid assets by 15.5 percent to P11.4 billion in 2017 (December 2016: P13.5 billion) (Chart 2.12). The second largest contributor (after BoBCs) to liquid assets, cash and balances with the Bank of Botswana, decreased by 27.4 percent to P4.6 billion in 2017 (December 2016: P6.3 billion). Banks increased their nostro balances (which do not qualify as liquid assets) from P9 billion in 2016 to P11 billion in 2017. Taking into account vostro balances, the respective net nostro amounts were P6.8 billion and P8.8 billion in the same period. These amounts constituted 11.2 percent and 13.2 percent, of total banking assets, respectively.

Chart 2.12: Commercial Banks: Liquidity Ratios: 2013 - 2017



2.31 The Bank of Botswana Certificates (BoBCs) held by banks decreased significantly by 20.5 percent to P6.3 billion during 2017 (December 2016: P7.9 billion) (Chart 2.13). Overall, the banking sector inherent liquidity risk was considered to be moderate. The risk-management measures in place mitigated the risk; therefore, liquidity risk is expected to remain stable in the foreseeable future.

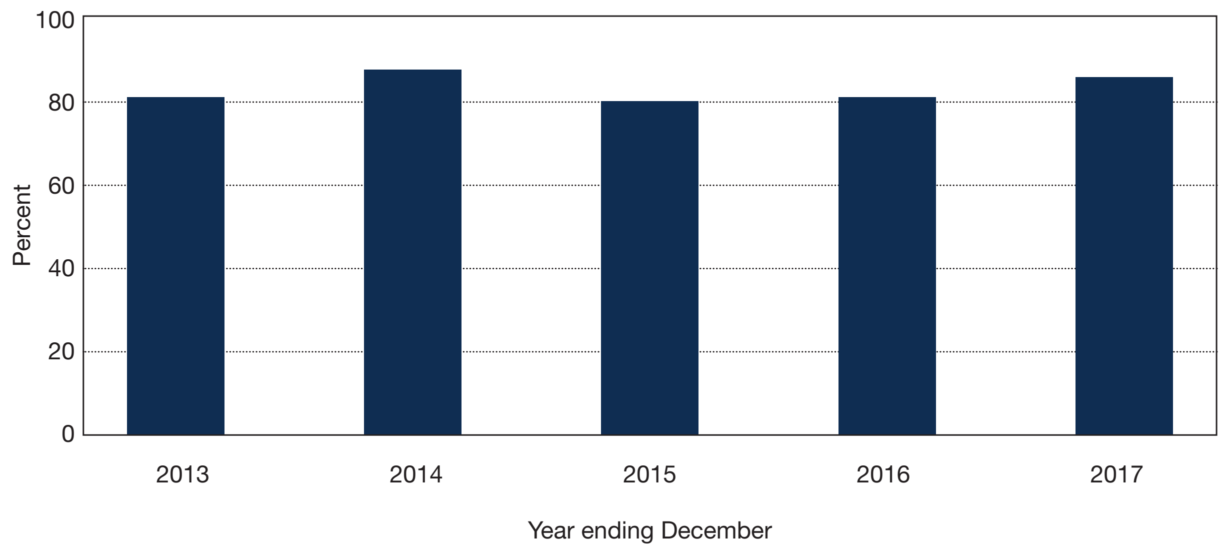
Chart 2.13: Commercial Banks: Market Value of Outstanding BoBCs Holdings



FINANCIAL INTERMEDIATION

2.32 The financial intermediation ratio (Loans and Advances to Deposits) increased from 82.2 percent in December 2016 to 85.2 percent in December 2017 (Chart 2.14), signifying dependence of banks on deposit liabilities for funding of loan growth.

Chart 2.14: Commercial Banks: Loans and Advances to Deposits Ratio (Financial Intermediation)

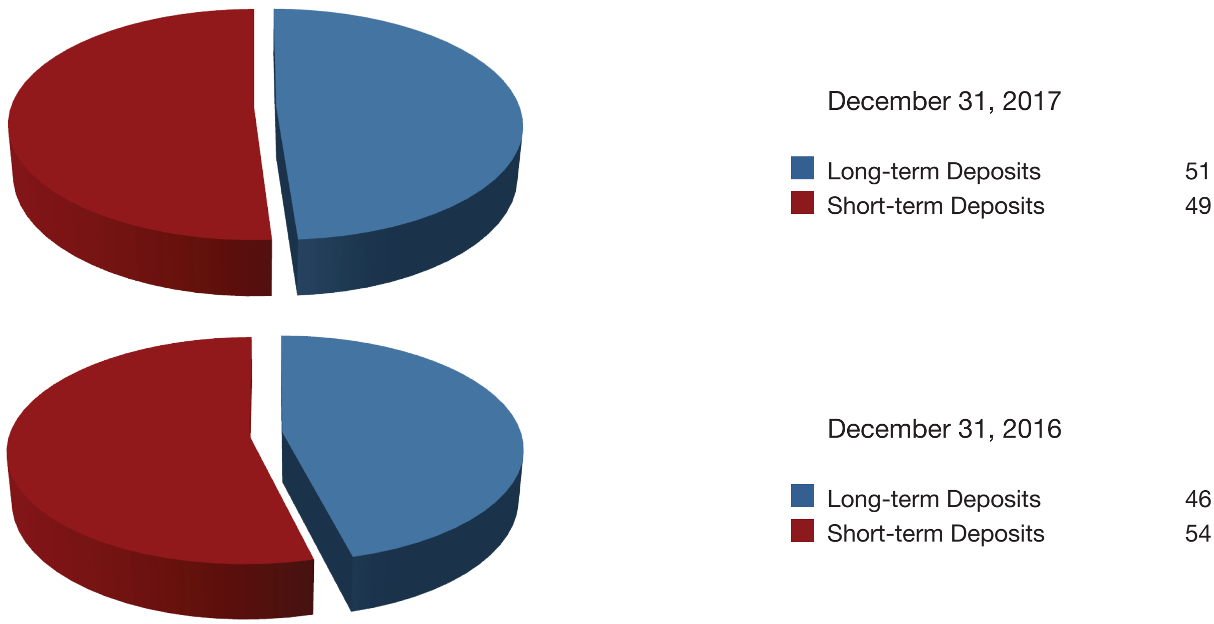


LIABILITIES AND FUNDING STRUCTURE

2.33 Customer deposits and shareholder funds remained the primary source of funding for asset growth. During 2017, customer deposits grew marginally (1.8 percent) to P63.6 billion, constituting the largest proportion of liabilities at 76.2 percent. The modest growth could partly be reflective of slower increase in personal incomes and rebalancing of portfolios by bank clients for diversification purposes and in search of investment opportunities in an environment of relatively low interest rates. Moreover, an increasing import trade relative to exports also contributes to external leakages. In contrast, shareholder funds declined from P9.7 billion in 2016 to P9.4 billion in 2017 (3.7 percent). Debt securities and other borrowing increased by 53.9 percent from P2.6 billion in 2016 to P4.1 billion in 2017 as banks utilised alternative sources of funding for asset growth.

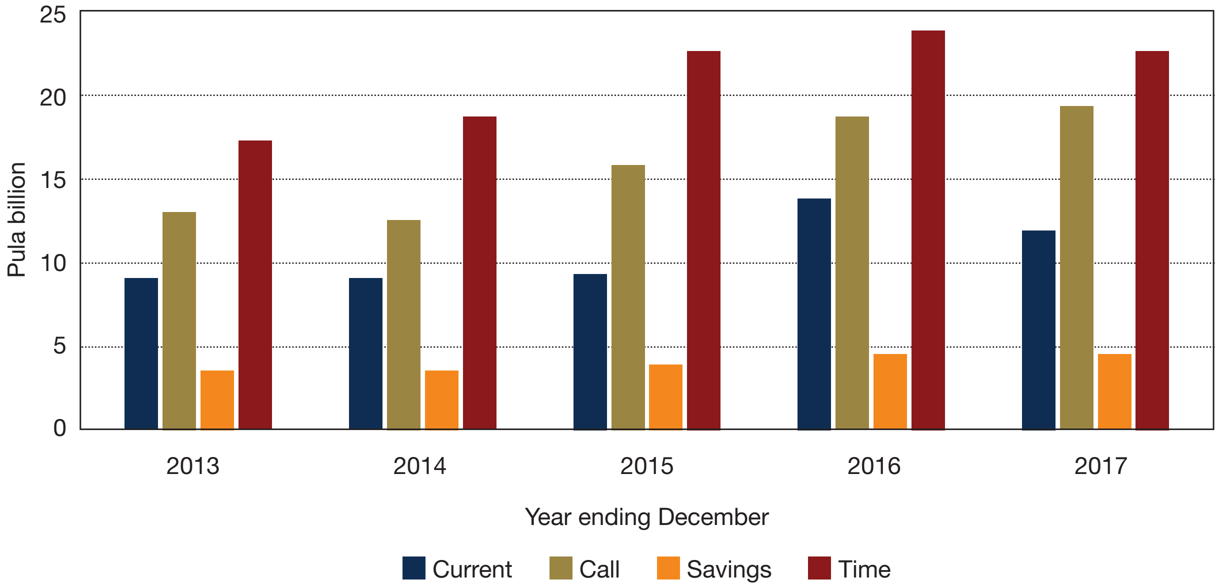
2.34 The relative share of deposits by maturity changed significantly between 2016 and 2017. The share of long-term deposits (time and savings) increased from 46 percent in 2016 to 51 percent in 2017, while that of short-term deposits (call and current) decreased from 54 percent to 49 percent (Chart 2.15). If this trend is sustained, it will reduce maturity mismatch risks, which has been a character of the Botswana system over the years.

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



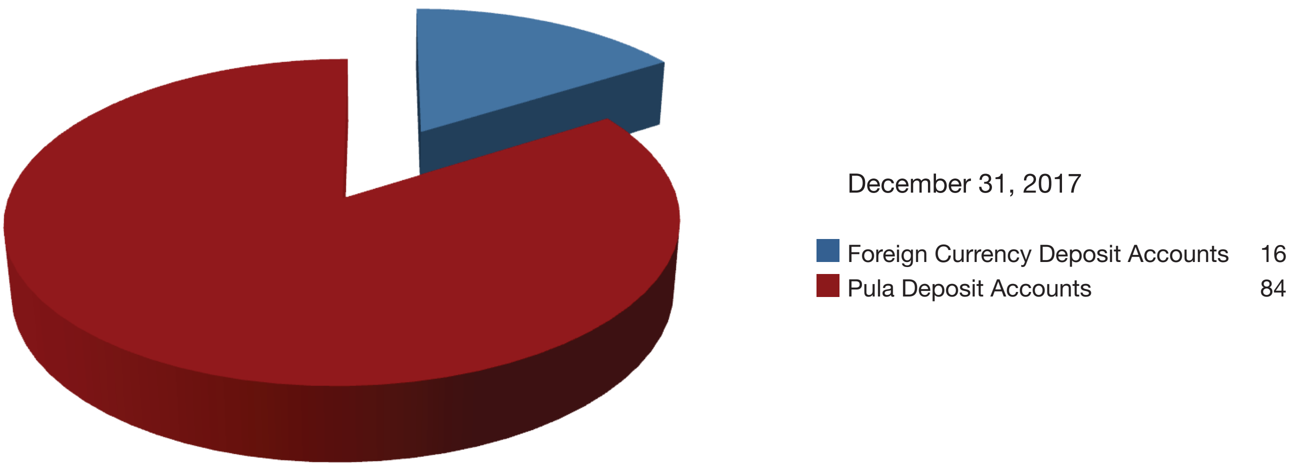
2.35 Chart 2.16 shows the value of Pula-denominated deposits by type, for the period 2013 to 2017. All deposit types, except savings, decreased during 2017. Call, current and time deposits decreased by 24.4 percent, 15.9 percent and 3.2 percent, respectively. As at December 31, 2017, time deposits (fixed and notice) amounted to P22.4 billion (December 2016: P23.2 billion), accounting for the largest proportion of total deposits at 35.3 percent. In contrast, savings deposits grew by 6.5 percent to P4.7 billion (December 2016: P4.4 billion), and constituted the smallest share of total deposits (7.4 percent).

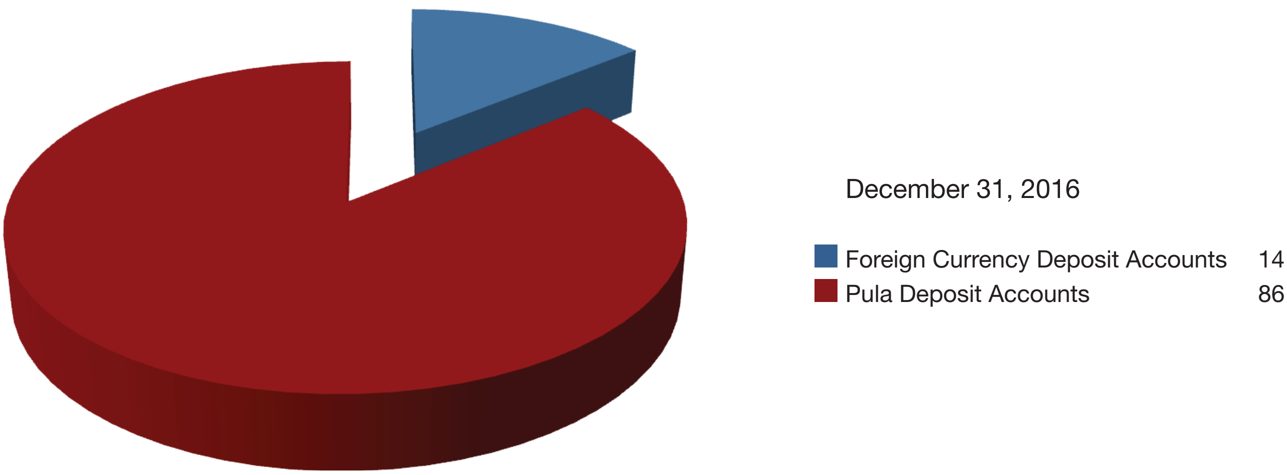
Chart 2.16: Commercial Banks: Share of Value of Pula Denominated Deposits by Type: 2013 - 2017



2.36 Foreign currency deposits grew by 17.3 percent to P10.3 billion as at December 31, 2017 (December 2016: P8.7 billion). The proportion of foreign currency deposits to total deposits increased from 14 percent in 2016 to 16 percent in 2017; thus a decrease in the proportion of Pula-denominated deposits from 86 percent to 84 percent in the same period (Chart 2.17). 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 and portfolio flows.

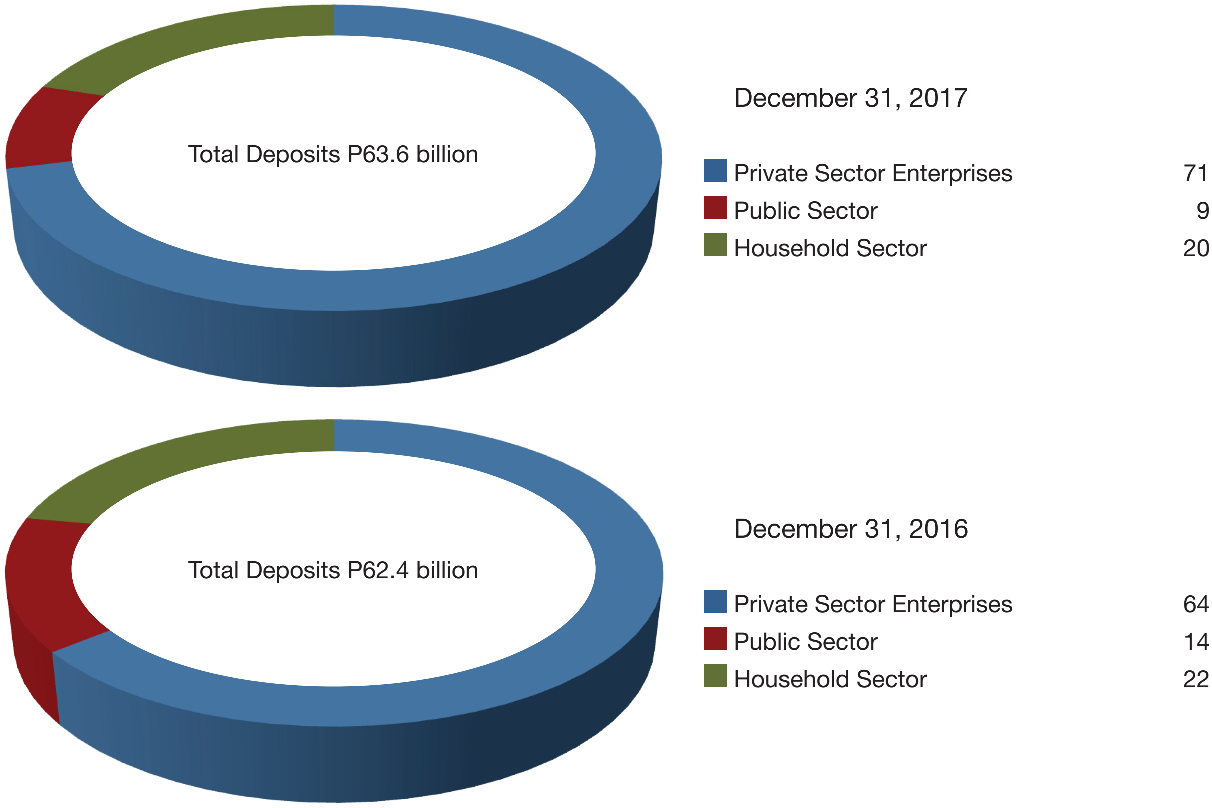
Chart 2.17: Commercial Banks: Share of Foreign Currency and Pula-Denominated Deposits to Total Deposits (Percent)





2.37 The sectoral distribution of total deposits remained highly concentrated in the private business sector, with a share of 71 percent in 2017 compared to 64 percent in 2016 (Chart 2.18). The share of deposits for the public sector (government and parastatals) decreased significantly from 14 percent in December 2016 to 9 percent in December 2017. Similarly, the household sector's share of total deposits declined from 22 percent in 2016 to 20 percent in 2017.

Chart 2.18: Commercial Banks: Sectoral Distribution of Deposits: 2016 - 2017 (Percent)



2.38 Other sources of funding (share capital, balances due to other banks, debt securities and other borrowing) comprised 11.2 percent, 5.1 percent and 4.9 percent of total funding, respectively, in 2017. Table 2.3 shows the sources of funding for the banking sector from 2013 to 2017.

Table 2.3: Main Sources of Funding (Pula million)

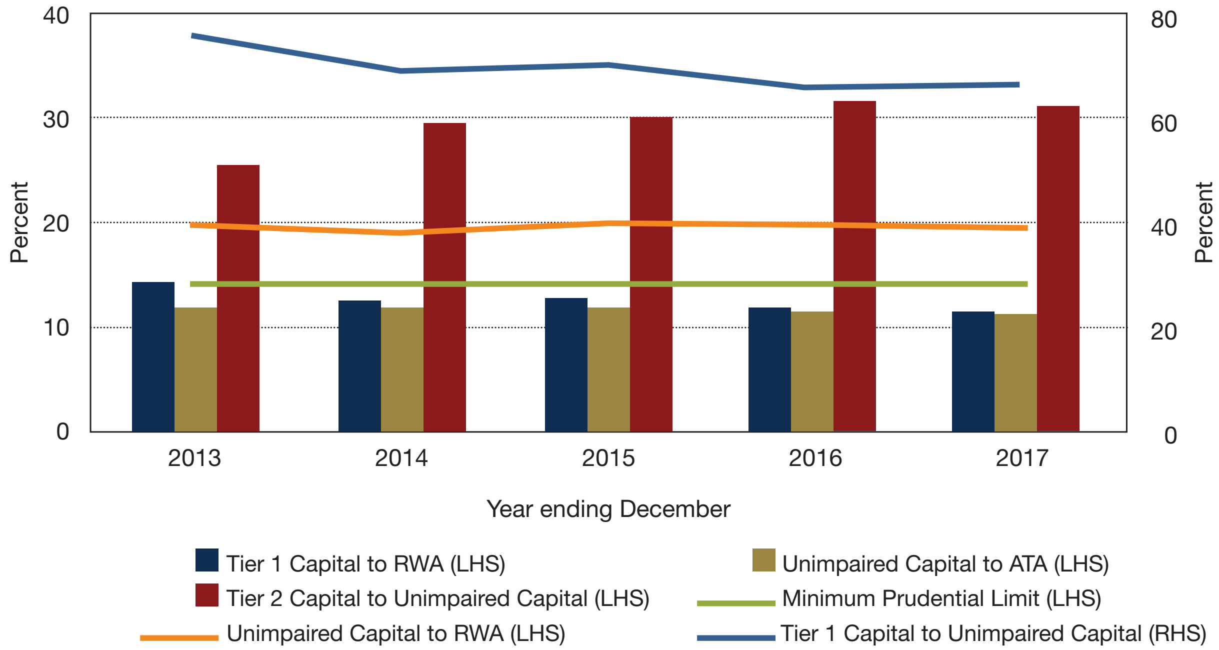
Category	2013	2014	2015	2016	2017
Deposits	48 589	51 492	59 940	62 438	63 581
Annual Growth Rate (Percent)	2.9	6.0	16.4	4.2	1.8
Share of Total Funding	81.0	75.7	78.2	77.4	76.2
Other Liabilities	1 207	3 109	1 999	1 828	2 196
Annual Growth Rate (Percent)	(58.9)	157.8	(35.5)	(9)	19.4
Share of Total Funding	2.0	4.6	2.6	2.3	2.6
Share Capital	6 479	7 724	8 195	9 748	9 383
Annual Growth Rate (Percent)	16.8	19.2	6.1	19	(3.7)
Share of Total Funding	10.8	11.4	10.7	12.1	11.2
Due to other Banks	1 394	3 581	3 308	3 984	4 250
Annual Growth Rate (Percent)	5.6	157.0	(7.6)	20.4	6.7
Share of Total Funding	2.3	5.3	4.3	4.9	5.1
Debt Securities and Other Borrowing	2 292	2 088	3 163	2 642	4 065
Annual Growth Rate (Percent)	143.5	(8.9)	51.5	(16.5)	53.9
Share of Total Funding	3.8	3.1	4.1	3.3	4.9
Total Funding	**59 962**	**67 994**	**76 605**	**80 640**	**83 475**

Note: Parentheses denotes negative figures.

CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

2.39 The banking sector remained adequately capitalised and complied with the regulatory capital requirements. All banks reported capital adequacy and common equity Tier 1 capital ratios in excess of the 15 percent and 4.5 percent prudential and statutory minimum requirements, respectively. The banks' total risk-weighted assets increased by 6 percent to P55.5 billion from P52.3 billion recorded in 2016. Consequently, the banks' capital adequacy ratio (CAR) declined marginally from 19.6 percent in December 2016 to 19.4 percent in December 2017. Chart 2.19 shows CARs over a five-year period (2013 - 2017).

Chart 2.19: Commercial Banks: Capital Ratios: 2013 - 2017



2.40 The banking industry's unimpaired capital increased by 5.2 percent to P10.8 billion from P10.2 billion in 2016. The increase was, however, slower than the 9.2 percent in 2016 due to the combined loss of P196 million incurred by three banks. All banks, with the exception of two had an increase in unimpaired capital. Retained earnings decreased by 8.4 percent from P6.4 billion in 2016 to P5.9 billion in 2017, negatively impacting the levels of capital. Only one bank injected additional capital, while four paid dividends.

2.41 Total qualifying Tier 1 capital, which accounted for 68.3 percent of total unimpaired capital, increased to P7.4 billion (December 2016: P6.9 billion). The main component, retained earnings, constituted 79.7 percent of Tier 1 capital. Furthermore, there was an increase in the ratio of Tier 1 Capital to Average Total Assets, at 9.4 percent (December 2016: 8.3 percent), signifying improvement in the quality of capital. The ratio of Tier 1 Capital to Risk-Weighted Assets was constant at 13.3 percent.

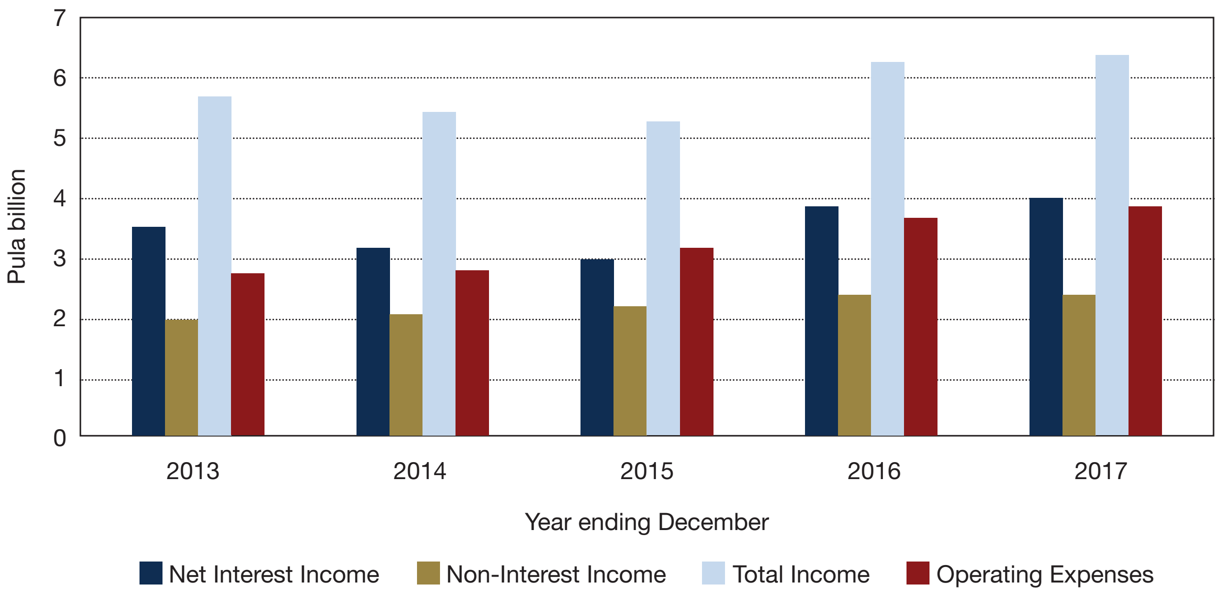
2.42 Total Tier 2 capital was P3.4 billion (December 2016: P3.3 billion), comprising mainly subordinated term debt (55.6 percent), unpublished current year's profits (32.9 percent) and general loan reserves (11.5 percent). The Tier 2 Capital to Unimpaired Capital ratio for 2017 was 31.7 percent, a slight decrease from 32.2 percent in December 2016. The non-qualifying Tier 2 capital decreased from P176 million in 2016 to P75 million in 2017, and accounted for 2.2 percent of Tier 2 capital. Only two banks had non-qualifying Tier 2 capital, which is expected to be phased out by 2020.

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

2.43 The total income for commercial banks (net interest and non-interest income), increased at a slower rate of 2.4 percent in 2017 compared to an increase of 18.2 percent in 2016, from P6.3 billion in 2016 to P6.5 billion in 2017. Growth for both net interest and non-interest income fell from 26.7 percent and 7.1 percent in 2016 to 3.6 percent and 0.5 percent, respectively, in 2017. In contrast, interest expense increased by 2.9 percent from P1.4 billion in 2016 to P1.5 billion in 2017 compared to a 31.9 percent decrease in the previous year. The ratio of Net Interest Income to Total Income increased from 60.8 percent in 2016 to 61.5 percent in 2017.

2.44 Operating expenses have been on a five-year upward trend for several reasons, including increasing staff costs and rental costs as banks expanded branch networks and relocated to modernised premises. As such, the Cost-to-Income ratio increased from 57 percent in 2016 to 59.9 percent in 2017, thus remaining within the 50 - 60 recommended range. The increase reflects faster growth in expenses than in income. Chart 2.20 shows trends and the composition of income and expenses for commercial banks for the period 2013 - 2017.

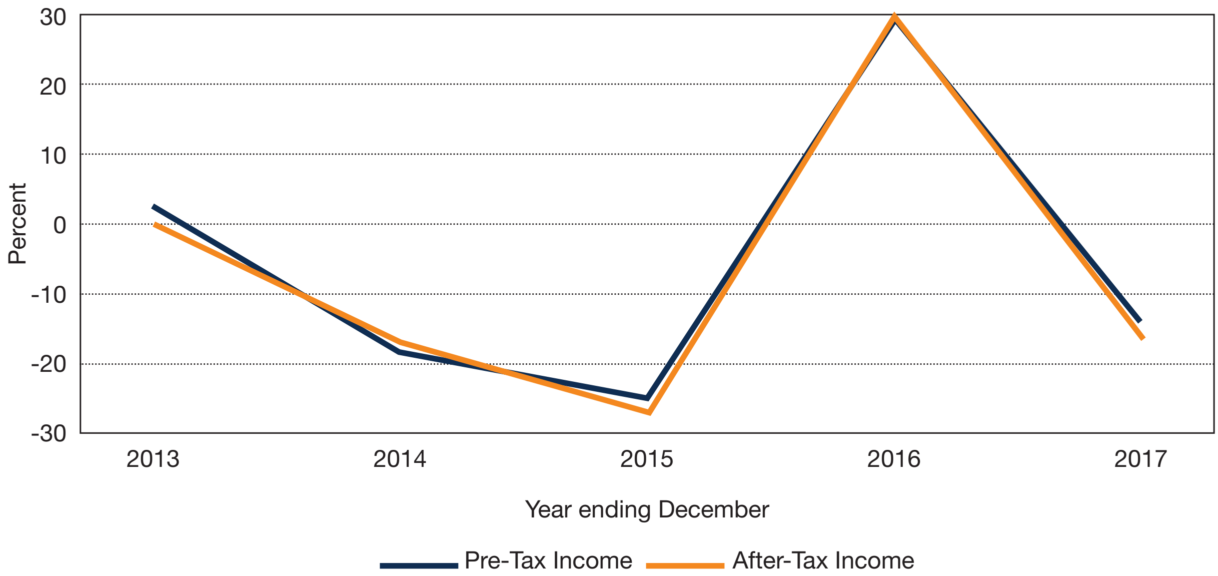
Chart 2.20: Commercial Banks: Composition of Income and Expenses: 2013 - 2017



LEVELS, SOURCES AND TRENDS OF PROFITABILITY

2.45 The banking sector profitability decreased during the year. The aggregate net profit after-tax declined by 16 percent, from P1.4 billion in 2016 to P1.2 billion in 2017. Although net profit after-tax fell in the aggregate, two large banks had higher net profit after-tax, which increased by approximately 24 percent each between 2016 and 2017. Nevertheless, losses incurred by three banks were a drag on the industry's profitability. Furthermore, such losses could erode the adequacy of capital as losses are deducted from the Tier 1 capital; as such, remedial measures may be necessary to restore previous capital adequacy levels. Chart 2.21 shows pre- and after-tax profit growth rates for commercial banks over a five-year period.

Chart 2.21: Commercial Banks: Growth Rates of Pre- and After-Tax Profits: 2013 - 2017

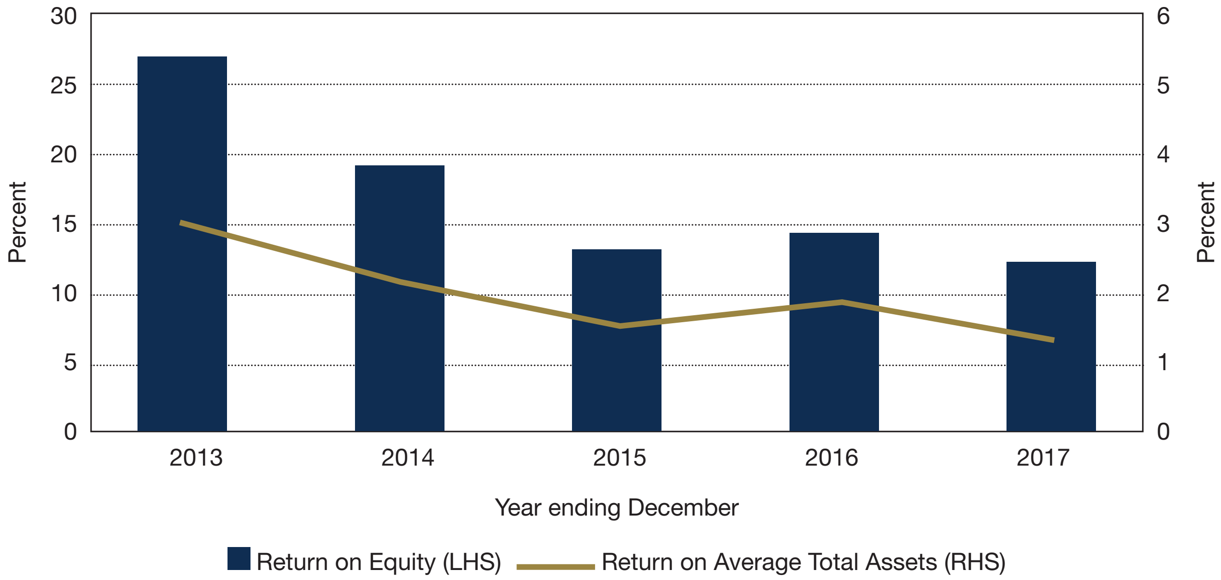


PROFITABILITY AND OPERATING EFFICIENCY INDICATORS

PROFITABILITY INDICATORS

2.46 Profitability of banks, as measured by return on equity (ROE) and return on average assets (ROAA) ratios (Chart 2.22), decreased, partly due to a 16 percent fall in aggregate net profit after-tax in 2017. The ROE and ROAA decreased from 14.4 percent and 1.8 percent in 2016 to 12.6 percent and 1.4 percent, respectively. These profitability ratios compare favourably with international norms for banks of comparable sizes, indicative of continuing strong earnings.

Chart 2.22: Commercial Banks: Profitability Indicators for Commercial Banks: 2013 - 2017



2.47 The Net Interest Income to Average Total Assets (ATA) ratio decreased from 4.9 percent in 2016 to 3 percent in 2017 (Table 2.4). The Non-Interest Income to Total Income ratio further declined to 38.5 percent (December 2016: 39.2 percent), signalling reduced reliance by banks on non-interest income to augment earnings. Table 2.4 provides data on key financial performance indicators for the banking sector for 2013 - 2017.

Table 2.4: Financial Performance Ratios (Percent)

Financial Performance Ratios	2013	2014	2015	2016	2017
Income on Investments and Securities to Total Income	11.3	4.5	4.3	3.0	3.8
Non-Interest Income to Total income	36.4	39.6	43.2	39.2	38.5
Net Interest Income to Total Income	63.6	60.4	56.8	60.8	61.5
Return on Equity	27.4	19.1	13.3	14.4	12.6
Return on Average Assets	3.0	2.3	1.5	1.8	1.4
Net Interest Income to Average Total Assets	6.0	5.1	4.2	4.9	3.0
Interest Income to Average Earnings Assets	11.8	8.8	7.9	7.4	8.7
Non-Interest Income to Average Total Assets	3.4	3.4	3.2	3.2	3.0
Interest Expense to Average Total Assets	2.7	2.6	2.9	1.8	1.8
Earnings Retention	69.9	70.1	37.6	80.0	67.7
Interest Income on Loans to Average Total Assets	7.7	6.9	6.3	6.0	5.9
Non-Interest Expense to Average Total Assets	4.6	4.3	4.5	4.6	4.7
Gross Interest Income to Average Total Assets	8.7	7.7	7.1	6.7	7.9

OPERATING EFFICIENCY INDICATORS

2.48 Table 2.5 shows trends in commercial banks' efficiency measures for the period 2013 - 2017. The Net Income to Employee ratio decreased to P255 800 in 2017 (2016: P310 500), and the Net Income to Employee Costs ratio also fell from 91.2 percent in 2016 to 68.3 percent in 2017 in the context of an increase in employee costs and a reduction in net profit.

2.49 The core earning capability of commercial banks improved in 2017 as indicated by the increase in the net spread from 4.8 percent in 2016 to 6.1 percent in 2017. On the other hand, the net interest margin and average cost of deposits ratios were constant at 5.4 percent and 1.7 percent, respectively.

Table 2.5: Commercial Banks: Other Efficiency Measures: 2013 - 2017

	2013	2014	2015	2016	2017
Percent					
Average Cost of Deposits	3.0	2.9	3.1	1.7	1.7
Return on Loans and Advances	12.4	10.4	9.7	9.5	9.2
Net Interest Margin	8.2	5.8	4.7	5.4	5.4
Net Spread	7.9	6.2	4.0	4.8	6.1
Cost to Income	48.6	51.2	60.6	57.0	59.9
Net Income to Employee Costs	142.2	107.9	80.7	91.2	68.3
P' 000					
Net Income per Employee	390.4	317.6	233.9	310.5	255.8
Staff Costs per Employee	274.5	294.4	289.9	340.5	374.6
Assets per Employee	13 190	14 610	16 460	17 793	18 060

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

2.50 The Bank's off-site surveillance (OSS)[9] system results and the annual risk-assessment review indicated that, during 2017, commercial banks' financial performance was sound and stable. The sector's strongest components were sensitivity to market risk and capital adequacy. On the other hand, asset quality, liquidity and earnings were rated adequate, with industry average scores of 2.03, 2.39 and 2.40, respectively.

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

2.51 The low rating for commercial bank earnings was attributed to losses made by three commercial banks. Consequently, the management[10] component was rated 2.49, which was the weakest ranking assigned to the CAMELS components. Table 2.6 shows the 2017 overall banking sector quarterly OSS results.

Table 2.6: Banking Sector OSS Results as at December 31, 2017

	Capital Adequacy	Asset Quality	Market Sensitivity	Earnings	Liquidity	Overall Score
Banking Sector Average	1.77	2.03	1.30	2.40	2.39	1.98

Definition of the Colour Codes:

	Rating	Strong		Adequate		Partially Adequate		Weak	
Camels	Category	Band 1		Band 2		Band 3		Band 4	
	Sub Category	B1-Upper	B1-Lower	B2-Upper	B2-Lower	B3-Upper	B3-Lower	B4-Upper	B4-Lower
	Score	1.0-1.49	1.5-1.99	2.0-2.49	2.50-2.99	3.0-3.49	3.5-3.99	4.0-4.25	4.26-4.50
Risk Assessment Summary	Risk Rating	Low		Medium		Medium High		High	

[10] Management is responsible for the activities and the condition of a 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.

STATUTORY BANKS[11]

STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

2.52 The balance sheets for the two statutory banks increased by 13 percent to P6.8 billion (December 2017) compared to P6 billion in December 2016. In terms of market share, the two banks continued to account for the smallest proportion of total assets, total loans and advances and deposits, within the banking industry.

LIQUID ASSETS AND LIQUIDITY RISK

2.53 The total liquid assets of the two statutory banks comprised cash and balances due from domestic banks only. The liquid assets increased by 60.8 percent to P1.6 billion in 2017 from P1 billion in 2016. The LAR increased significantly from 28.4 percent in 2016 to 39.5 percent in December 2017 and was above the statutory limit of 10 percent. Furthermore, the Liquid Assets to Total Assets and Liquid Assets to Advances ratios increased from 16.6 percent and 20.8 percent in December 2016 to 23.6 percent and 33.3 percent in December 2017, respectively.

LOANS AND ADVANCES, CREDIT RISK AND ASSET QUALITY

2.54 The statutory banks' loan book was largely unchanged at P4.8 billion between December 2016 and December 2017. On the other hand, NPLs increased by 53.9 percent to P331.3 million in December 2017 from P215.3 million in December 2016. Accordingly, the two statutory banks augmented the balance of specific provisions to P59.3 million (December 2016: P28 million). Consequently, the proportion of NPLs to Total Loans and Advances increased to 7 percent (December 2016: 5 percent). The ratio of Specific Provisions to NPLs was at 17.9 percent (December 2016: 13 percent). Although this coverage of NPLs was considered to be low, most of the loan book was secured lending.

COMPOSITION OF LIABILITIES AND FUNDING STRUCTURE OF STATUTORY BANKS

2.55 Growth in assets was largely financed by deposits, which grew by 15.7 percent to P4 billion (December 2016: P3.5 billion). The funding structure of statutory banks was such that deposits constituted 59.6 percent, equity 19.3 percent and borrowing 18.2 percent. The financial intermediation ratio remained significantly high at 118.5 percent in 2017, albeit falling from 136.6 percent in 2016. This indicated the use of equity and borrowing for funding by the two statutory banks in addition to deposit liabilities.

CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

2.56 Statutory banks held adequate capital, as at the end of December 31, 2017, to be able to withstand shocks. The banks complied with minimum regulatory capital adequacy requirements, with an aggregate average ratio of Common Equity Tier 1 Capital to Risk-Weighted Assets (CET1 capital ratio) and CAR of 41.2 percent and 43 percent, respectively. These ratios were above the prudential minimum requirements of 4.5 percent and 15 percent, respectively, for the CET1 capital ratio and CAR.

[11] The analysis excludes one statutory bank because it is still reporting under Basel I, while other banks are reporting under Basel II.

STATEMENT OF COMPREHENSIVE INCOME

2.57 The two statutory banks were profitable as at the year ended December 31, 2017. However, the aggregate income after-tax decreased by 43.5 percent to P36.9 million in December 2017 (December 2016: P65 million) due to a fall in total income as well as an increase of 35 percent in impairment charges.

2.58 As a result of the decline in income levels at the two statutory banks, efficiency and profitability ratios also declined, but remained positive. The ROAA and ROE ratios declined from 1.1 percent and 5 percent in 2016 to 0.6 percent and 2.8 percent in 2017, respectively. The return on advances ratio eased from 9.5 percent in 2016 to 8 percent in 2017, while the average cost of deposits ratio increased to 3.4 percent (December 2016: 1.9 percent). Table 2.7 shows key performance indicators for statutory banks during 2013 - 2017.

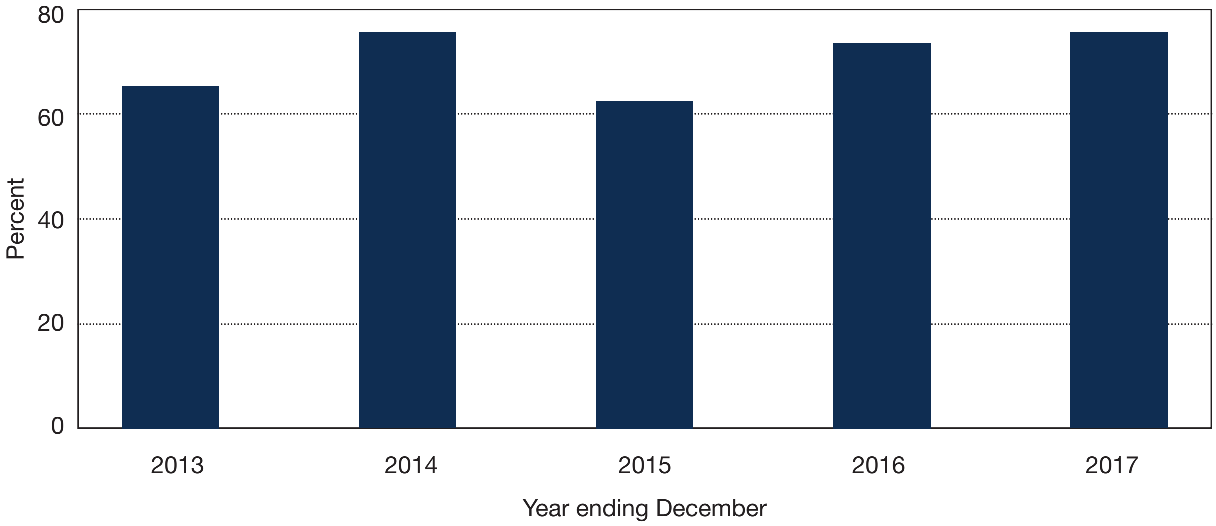
Table 2.7: Statutory Banks: Financial Performance Indicators: 2013 - 2017

Indicator	2013	2014	2015	2016	2017
P' million					
Net Income	68	60	96	65	37
Interest Income	352	370	475	482	265
Net Interest Income	192	197	242	251	234
Non-Interest Expense	151	174	189	214	197
Total Assets	4 333	4 834	6 031	5 982	6 777
Average Total Assets	4 114	4 584	5 432	6 006	6 379
Average Earning Assets	1 443	1 636	1 890	2 120	6 111
Unimpaired Capital	1 062	1 205	1 325	1 297	1 316
Risk-Weighted Assets	2 171	2 700	2 943	2 878	3 060
Percent					
Interest Income to ATA	8.6	8.1	8.7	8.0	4.1
Cost to Income	65.7	74.7	64.3	72.1	74.3
ROAA	1.7	1.3	1.8	1.1	0.6
ROE	2.8	3.6	7.6	5.0	2.8
Return on Advances	9.8	8.9	9.9	9.5	8.0
Average Cost of Deposits ratio	5.7	5.5	4.7	3.9	3.4

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

2.59 Chart 2.23 presents the trend of the Cost-to-Income ratio for statutory banks over the five-year period (2013 - 2017). The ratio increased modestly from 72.1 percent in 2016 to 74.3 percent in 2017, reflecting lower income for the two banks during the latter year.

Chart 2.23: Statutory Banks: Cost to Income Ratio: 2013 - 2017



OPERATIONAL RISK

REGULATORY CAPITAL REQUIREMENTS IN RESPECT OF OPERATIONAL RISK

2.60 The total risk-weighted assets for operational risk decreased from P434.9 million in 2016 to P277.1 million during 2017 and constituted 9.1 percent of the total risk-weighted assets of statutory banks. The operational risk-weighted assets decreased on account of the lower income in 2017. As a result, the total regulatory capital requirement for operational risk decreased from P64.9 million (December 31, 2016) to P41.4 million (December 31, 2017). The two statutory banks used the BIA operational-risk measurement technique to compute operational-risk capital requirements.

OVERVIEW OF PILLAR 3 DISCLOSURE REQUIREMENTS

2.61 Pillar 3 disclosure supports performance and assessment of the banking system as it allows market participants to monitor the financial health, risk profile and corporate governance practices of institutions in which they invest. The disclosure allows market participants to price banks' risks accurately and thereby playing a role in instilling market discipline and influencing appropriate response and behaviour of banks. Such disclosure and transparency also offer benefits of the reduced cost of capital.

2.62 Importantly, much as disclosure increases market confidence by reducing information asymmetry between banks and market participants, it should be appropriately managed; inappropriate disclosure can create uncertainty about the true health and/or value of a financial institution and thus undermine the soundness and stability of a bank. Inadequate and inconsistent public disclosure can also amplify uncertainty about the underlying value of assets and exposures of a bank during periods of stress, by making it difficult for market participants to differentiate between high-risk and low-risk institutions.

2.63 In the context of the foregoing, the Bank, despite having "technically" commenced Pillar 3 implementation on January 1, 2016, opted to delay public disclosure by banks, with a view to ensuring that banks appropriately concluded all necessary processes to allow for comprehensive disclosures across the banking industry in a manner anticipated by Pillar 3 Disclosure Requirements, as outlined in the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II), and the related Circular on Pillar 3 Disclosure Requirements for enhanced disclosures. Furthermore, the Bank wanted to be satisfied that banks had reached the same level of preparedness, including adequate capacity to efficiently and accurately disclose material risks to which they are exposed, as well as their financial situation and corporate governance practices, to ensure consistency in reporting across the banking sector.

2.64 The experience so far is that, of the disclosure policies submitted to the Bank, only a few met the minimum requirements; and those that did not were returned to the concerned banks to address the shortcomings before publishing on their respective websites. In the case of the few banks with approved disclosure policies, inconsistencies were noted in some of the disclosure reports that were submitted to the Bank for review; and irregular reporting was observed for some banks. A follow-up has since been made with these banks to normalise the situation. This is with the exception of one bank, which has started publishing its disclosures on a quarterly basis on its website. Therefore, to enhance the understanding of the Pillar 3 disclosure requirements by banks, the Bank conducted a training workshop for all banks and external auditors in July 2017.

NON-BANK FINANCIAL INSTITUTIONS

BUREAUX DE CHANGE ACTIVITIES

MARKET ENTRY AND EXIT

2.65 In 2017, the Bank licensed four bureaux de change and revoked one licence. Two bureaux de change voluntarily surrendered their licences, bringing the total number of operating bureaux de change to 61 as at December 31, 2017.

ON-SITE EXAMINATIONS OF BUREAUX DE CHANGE

2.66 The Bank conducted 16 on-site examinations to assess the compliance of bureaux de change with the regulations during 2017. The on-site examinations revealed that five bureaux de change complied with all the provisions of the regulations, while the rest violated various aspects of the provisions of the regulations. Nine bureaux de change were fined a total of P13 440 (VAT inclusive), for violating the regulations. One bureau de change was cautioned, while another had its licence suspended for three months. The suspension was lifted on September 15, 2017. Most recurring violations related to effecting change in the composition of shareholders or principal officers without the approval of the Bank and failure to take reasonable measures to obtain information about the true identity of a person on whose behalf a transaction is conducted (Table 2.8).

Table 2.8: 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
5(2)(b)	Change of premises without prior written approval by the Bank	1
5(2)(c)	Maintenance of minimum balance	3
5(2)(e)	Effecting change in the composition of shareholders or principal officers without prior written approval of the Bank	5
6(e)	Failure to notify the Bank of any changes in the bureau's operating hours	1
6(f)(i)	Failure to display operating hours of business	1
7(1)	Failure to pay annual licence fees	1
12(2)(a)	Failure to take reasonable measures to obtain information about the true identity of a person on whose behalf a transaction is conducted	5
12(2)(d)(vi)	Failure to continuously train employees on anti-money laundering measures	2
13(1)	Transactions, per person per day, of cash amount exceeding P10 000	1
13(3)	Failure to verify that the foreign currency emanates from an authorised bona fide and clearly identifiable source	1
15(1)(f)	Failure to maintain a register of daily summaries	2
18(5)	Failure to submit auditor's report	3
21(1)	Failure to display the original licence	1

OFF-SITE SURVEILLANCE OF BUREAUX DE CHANGE

2.67 Sales and purchases of foreign currency by bureaux de change maintained an upward trend as evidenced by the increase of 20.4 percent and 18.1 percent in 2017 compared to 14.9 percent and 16.7 percent, respectively, in the prior year. The USD and ZAR dominated the bureaux de change foreign exchange transactions during 2017.

Chart 2.24: Bureaux de Change: Shares of Sales and Purchases of Foreign Currency in 2017

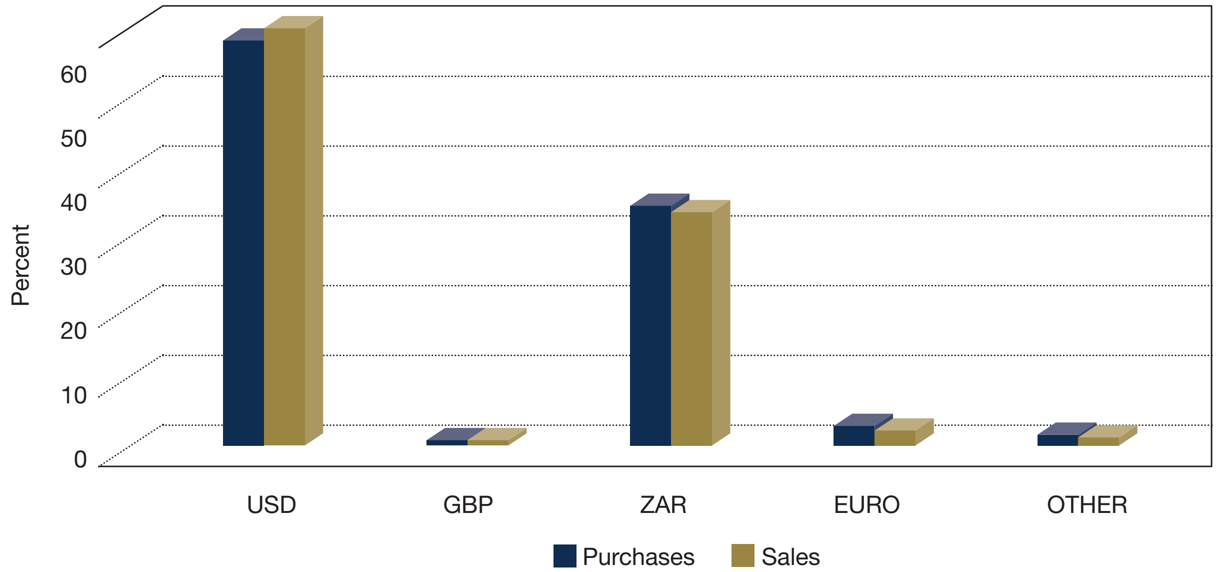


Chart 2.25: Bureaux de Change: Shares of Sales and Purchases of Foreign Currency in 2016

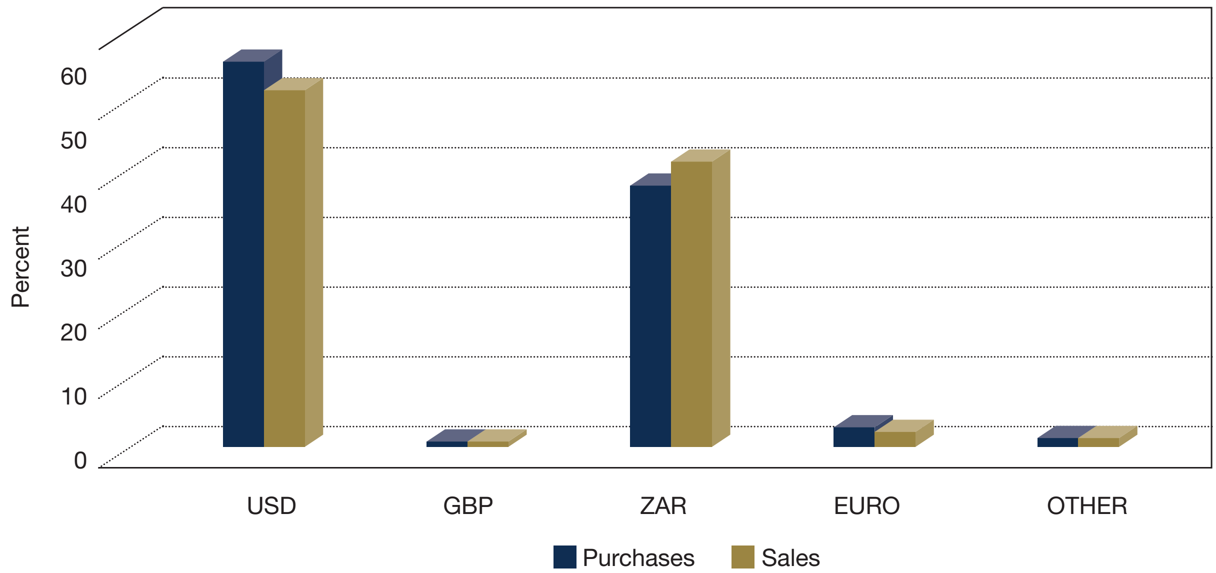
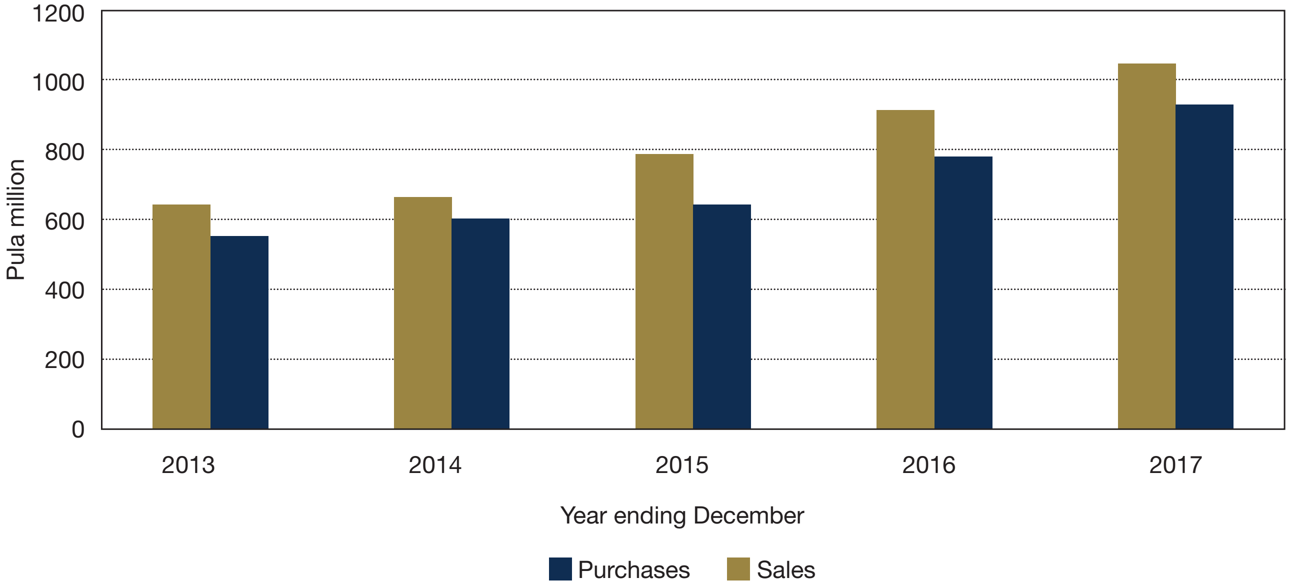


Chart 2.26: Bureaux de Change: Shares of Sales and Purchases of Foreign Currency: 2013 - 2017 (by Value)



CHAPTER 3

LICENSING AND CONSUMER PROTECTION ISSUES

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION ISSUES

MARKET ENTRY ENQUIRIES AND LICENSING OF NEW BANKS

3.1 During 2017, the Bank received nine enquiries for different types of licences. However, none of the enquiries led to a formal submission of an application.

ILLEGAL DEPOSIT TAKING

3.2 During 2017, the Bank investigated two suspected illegal deposit-taking activities, with one originating in Botswana and the other from South Africa. The schemes were Botswana Index Rating (Pty) Limited and Pipcoin Refiloe Letlhogonolo Nkele (Pipcoin).

3.3 Following an investigation of Botswana Index Rating (Pty) Limited (BIR), the Bank concluded that the company's activities constituted illegal deposit-taking. As such, the entity was found to be in violation of the provision of Section 3(1) of the Baking Act. The Bank, therefore, accordingly ordered BIR to "cease and desist" from all activities involving the acceptance of money from the public in accordance with Section 5(5) of the Act.

3.4 In relation to Pipcoin, the Bank consulted the South African Reserve Bank (SARB), which confirmed that the company had contravened the South African Banks Act 94 of 1990 by taking deposits illegally from members of the public. The SARB indicated that the matter had been referred to the National Prosecuting Authority of South Africa for appropriate action. This notwithstanding, the Bank also concluded that Pipcoin's activities constituted illegal deposit-taking and, therefore, contravened Section 3(1) of the Banking Act, which restricts transacting banking business and/or soliciting deposits of money to licensed banks.

3.5 The Bank issued a press release warning the public about illegal deposit-taking activities and advised them to desist from participating in such unlicensed schemes.

FINANCIAL INCLUSION INITIATIVES

3.6 In 2017, banks launched a number of financial inclusion-targeted products and increased value proposition for clients. These products included transactional accounts; housing loans which required no down payment; mobile banking services; remote account opening and increase in the number of ATMs with cash-deposit functionality. Other products introduced or extended in the year were the more secure Europay, Mastercard, Visa Chip and PIN technology, which helps to mitigate card fraud.

BOX 2: THE IMPORTANCE OF FINANCIAL INCLUSION

Financial inclusion, as defined by the Centre for Financial Inclusion, refers to “access to a full suite of financial services (including credit, savings, insurance and payments) provided with quality (convenient, affordable, suitable, provided with dignity and client protection) to everyone who can use financial services (excluded and underserved people, special attention to rural people with disabilities, women and other often excluded groups), with financial capability (clients are informed and able to make good money management decisions), through a diverse and competitive marketplace (a range of providers, robust financial infrastructure and clear regulatory framework).” In short, it is the access to and use of a broad range of financial services by individuals and firms. In this way, households and businesses, regardless of income level, are able to have access to and can effectively use appropriate financial services to meet their needs. Therefore, an indicator of financial inclusion measures the proportion of firms and individuals using financial products and services, both formal and informal.

Access to a bank account is a critical step towards broader financial inclusion, since it facilitates storage, saving and conduct of transactions (to send and receive payments). A research by the World Bank, conducted in 137 countries from 2005 to 2011, observed that lack of access to finance constitutes a major problem for households and acts as a barrier to the growth of small enterprises. The research concluded that financial inclusion empowers poor women-headed households and small enterprises by bringing them into the mainstream economy through financial access, thereby reducing extreme levels and incidence of poverty and the degree of inequality.

Financial inclusion is, therefore, important for economic development and poverty reduction. Considerable evidence indicates that the poor benefit significantly from basic payments, savings and insurance services, while for small firms, in particular, access to finance enhances opportunities for innovation, job creation and economic growth (World Bank, 2014). This means that greater access of firms and households to various financial services, including increasing access and usage of these services by women, leads to higher economic growth.

Financial inclusion plays a key role in enhancing the effectiveness of monetary policy. In particular, given that monetary policy is transmitted through the financial sector, it has a greater and wider effect when a larger part of the population and businesses use financial services and products. For example, given that market players collectively affect the rate of increase in prices and economic activity, a business or an individual is more proximately affected by a change in interest rates if it uses the financial system to save or borrow.

Access to formal financial services in Botswana is relatively high compared to other SADC countries. According to the 2014 Botswana Finscope Survey, more than 68 percent of the adult population is formally served and a further 8 percent uses informal services, while 24 percent is totally excluded. This is an improvement from the 2009 Botswana Finscope Survey, which showed that 59 percent of the adult population had access to banking and financial services, 33 percent were excluded, and 8 percent (unchanged) had access to informal services. Assessed by location, the 2014 survey shows that 87 percent of adults in urban areas enjoy access to finance compared to 71 percent in rural areas. The use of financial services is mostly concentrated in savings, remittances, insurance and credit. Financial inclusion is relatively low in sub-Saharan Africa, South Asia and Latin America and the Caribbean compared to the developed countries, in particular the Nordic countries (Table 1).

Table 1: Degree of Financial Inclusion as at 2015 (% of Population of 15 years+)

Region	Any Account	Financial Account	Mobile Account
OECD	**94.0**	**94.0**	**n.a**
Denmark	100.0	100.0	n.a
Finland	100.0	100.0	n.a
Norway	100.0	100.0	n.a
United States of America	93.6	93.6	n.a
Latin America & Caribbean	**51.4**	**51.1**	**1.7**
Chile	63.3	63.2	3.8
Mexico	39.1	38.7	3.4
South Asia	**46.4**	**45.5**	**2.6**
India	53.1	52.8	2.4
Bangladesh	31.0	29.1	2.7
Sub-Sahara Africa	**34.2**	**28.9**	**11.5**
Botswana	52.0	49.2	20.8
Kenya	74.7	55.2	58.4
Mauritius	82.2	82.2	0.9
Namibia	58.8	58.1	10.4
Rwanda	42.1	38.1	18.1
South Africa	70.3	68.8	14.4

Source: World Bank Little Data Book on Financial Inclusion: 2015

The main policy objective of the financial inclusion agenda in Botswana is to improve household welfare, increase economic efficiency and support sustainable economic growth.

Significantly, technological advances have engendered an increase in opportunities and scaling up of financial inclusion. Thus, modern communications infrastructure, particularly mobile money and efficient payment system, plays a crucial role in financial inclusion. For example, banks are increasingly taking advantage of opportunities provided by technological advancements to offer affordable online products and services such as deposit-taking machines, mobile money remittances and payments service, internet and web-based access and card-based payment services. In addition, the availability of user-friendly and cost-effective information and communication products and platforms play an important role in broadening safe and secure access to financial services.

The 2012 - 2016 Financial Sector Development Strategy outlines a number of initiatives such as enhancing commercial banks' contribution to improving access to finance, supervising large micro-lenders effectively, establishing a robust mobile banking system as well as an effective credit information system.

In addition, government has adopted "Making Access Possible" approaches to financial inclusion as announced in the 2015 Budget Speech. Making Access Possible (MAP) is a multi-country initiative to support financial inclusion using a process of evidence-based country diagnostic and stakeholder dialogue. Some of the MAP priorities are improving the payments ecosystem, both domestic and cross-border transactions; facilitating low cost; accessible savings products through the use of mobile savings accounts and less onerous know-your-customer requirements for savings accounts.

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POLICY ON COMMERCIAL BANK CHARGES AND SELECTED AVERAGE CHARGES

3.7 Banks continued to diversify products and services by introducing new products and enhancing existing products. The Bank assessed proposed fees for the products in order to ensure fair pricing and access to services. In instances where fees were considered very high, the concerned banks were instructed to revise such fees to a reasonable level.

3.8 Banks were largely compliant with the minimum public disclosure and statutory requirements on publishing interest rates payable on deposits on their websites, as well as in at least two newspapers widely circulating in Botswana (Table 3.1). Disclosure of key information about the products encourages responsible business conduct by banks, and also enables customers to make informed decisions when making choices of products and services offered in the market.

3.9 Table 3.2 shows commercial banks' average lending rates for various products for 2017. The differential between the lowest and highest interest rates charged was substantial in respect of some products. With regard to Table 3.1, large value and longer-maturity deposits attract higher deposit rates. As for lending (Table 3.2), loans to more creditworthy clients are charged lower lending rates. Furthermore, scheme loans also attract lower lending rates as they are deemed low-risk, given that repayment is deducted directly from the income source.

Table 3.1: Commercial Banks: Deposit Rates for December 2017

Deposit Product	Deposit Rates (Annual Percent)	
	Lowest	Highest
Ordinary Savings	0.20	4.00
Call	0.03	2.96
91 days	1.50	3.75
6 months	1.50	4.50
12 months	1.60	4.50
24 months	2.00	5.00

Table 3.2: Commercial Banks: Lending Rates for December 2017

Lending Product	Lending Rates (Percent)	
	Lowest	Highest
Mortgage (property loans)	3.50	13.00
Overdraft (revolving credit lines)	1.50	38.50
Credit Card	17.70	36.00
Lease Loans	4.50	23.50
Personal Loans (excluding overdrafts, mortgage and credit cards)	3.50	38.50
Other Long-term Loans	3.50	47.50
Prime Lending Rate	6.50	6.50

3.10 Table 3.3 provides selected banking industry average charges applied during 2017. The structure is based on four broad categories of frequently applied charges, namely, access facilitation, investment/intermediation, trade facilitation, and payments and clearing charges. The selected banking industry average charges indicate that the cost of financial services has generally increased compared to 2016.

Table 3.3: Selected Commercial Banks Average Charges: 2016 - 2017 (Pula)

Service Charge Category (Pula)	2016	2017	Growth Rate (Percent)
Access Facilitation			
ATM Charges			
(i) Cash withdrawal (own bank)	2.09	2.62	25.31
(ii) Lost ATM card replacement	60.99	62.73	2.86
(iii) Point of Sale	0.75	0.76	1.06
Internet/Mobile Banking Charges			
(i) Monthly fees	174.27	206.92	18.74
(ii) Transfers (third party within Bank)	3.12	2.75	(11.90)
(iii) Utility bill payment	3.10	3.16	1.94
(iv) Payment to third party accounts	2.62	2.66	1.54
(v) Buy Pre-paid airtime	0.22	0.27	25.77
(vi) Cash Send/E-wallet/instant money	9.43	9.46	0.35
Investment/Intermediation			
(i) Personal loan - arrangement fee (Min)	391.20	405.01	3.53
(ii) Vehicle/Asset Finance - arrangement fee (Min)	633.82	668.25	5.43
(iii) Mortgage arrangement fee (Min)	608.80	630.57	3.58
Trade Facilitation			
(i) Purchase of foreign currency (Min)	21.86	22.21	1.61
(ii) International SWIFT transfer (Max)	344.36	319.09	(7.34)
(iii) Advising commission on Letters of Credit	216.84	221.16	1.99
(iv) Real Time Gross Settlement	192.12	202.88	5.60
(v) Transfer to accounts at foreign banks (Max)	321.95	342.35	6.33
Payment and Clearing Charges			
(i) Bank cheque (standard 100 pages)	59.39	56.28	(5.24)
(ii) Unpaid cheque due to lack of funds	197.80	200.73	1.48

Note: Parentheses denote negative figures.

CONSUMER COMPLAINTS MANAGEMENT

3.11 During 2017, the Bank received and processed 19 consumer complaints, 15 of which were successfully resolved, while investigation of four cases was in progress. The majority of complaints related to unauthorised ATM withdrawals, unsatisfactory service and unfair treatment of a customer.

Table 3.4: Commercial Banks' Consumer Complaints (2017)

Nature of Complaint Received	Total Number Received in 2017	Total Number Resolved	Total Outstanding as at December 31, 2017
Unauthorised transactions	6	5	1
Unfair dealings by the bank	5	5	-
Unsatisfactory service	4	3	1
Other	4	2	2
Total	19	15	4

ABANDONED FUNDS

3.12 In accordance with Section 39 of the Banking Act, the Bank continues to administer abandoned funds from commercial banks. Table 3.5 shows that the balance of abandoned funds was P10.6 million as at December 31, 2017 (December 2016: P6.9 million).

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

	2016	2017
	Pula	Pula
Balance Brought forward	5 515 681	6 918 216
Funds Received	2 321 882	7 059 644
Claims Paid Out	(372 291)	(2 913 227)
Transfer to Guardian's Funds	(547 055)	(445 962)
Balance at Year-end	6 918 217	10 618 671

Note: Parentheses denote negative figures.

CORPORATE GOVERNANCE

3.13 In line with the requirements of Section 29 of the Banking Act, relevant guidelines and international best practice, commercial banks appointed board members and senior management officials who were considered to be fit and proper for their respective roles. During 2017, the Bank received 13 applications for appointments to boards of banks and 38 to senior management positions, 45 (i.e., 12 board members and 33 senior management officials) of which were approved. Five applications for senior management appointment were returned due to inadequate information. Out of the total appointments, six Botswana citizens were appointed to boards and 20 to senior management positions. This represented a 13 percent increase in the number of citizen appointments reported in 2016.

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

3.14 Following the mutual evaluation of Botswana's compliance with the Financial Action Task Force (FATF) Recommendations on AML/CFT, by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), conducted on June 13 - 24, 2016, the findings of the Mutual Evaluation Report were discussed at the ESAAMLG meeting held in April 2017 in Arusha, Tanzania. The report was adopted by the ESAAMLG Council of Ministers through a round-robin process in May 2017.

3.15 The assessment was based on compliance with the FATF Recommendations (2012) and the Methodology (2013). The technical assessment rating showed that Botswana was non compliant (NC) with 23 recommendations, partially compliant with 14, largely compliant with two and compliant with none. One recommendation was determined not to be applicable. The ratings indicated that the country had major and moderate shortcomings. The level of effectiveness was also rated low in 9 out of 11 immediate outcomes (IO). Botswana was rated moderate only for IO 2 (international cooperation) and IO 6 (financial intelligence ML/TF risk).

BOX 3: A REVIEW OF BOTSWANA'S INITIATIVES TOWARDS FULL COMPLIANCE WITH THE FATF RECOMMENDATIONS ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT)

INTRODUCTION

The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 on the initiative of the then G7-member countries to combat money laundering. In Africa, there is a FATF-styled regional body: the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), of which Botswana is a member. The objectives of the FATF have evolved over time and now encompass the setting of standards (i.e., the FATF Recommendations) and promotion of effective implementation of legal, regulatory and operational measures for combating money laundering, terrorism financing and other related threats to the integrity of the international financial system. The FATF also works towards generating the necessary political will to bring about national legislative and regulatory reforms in these areas. It monitors progress in the implementation of the FATF Recommendations through peer reviews (i.e., mutual evaluations) of member countries. The mutual evaluation assessment tool is the FATF assessment methodology. The key outcome of these mutual evaluations is a detailed report, which provides an in-depth description and analysis of a country's system for preventing criminal abuse of the financial system, as well as focused recommendations to the country to further strengthen its AML/CFT systems. Together, the assessments of both technical compliance and effectiveness present an integrated analysis of the extent to which the country is compliant with the FATF standards and how successful it is in maintaining a strong AML/CFT system, as required by the FATF Recommendations.

These are recognised as the international standards for combating money laundering and the financing of terrorism and proliferation of weapons of mass destruction. These standards form the basis for a coordinated response to threats to the integrity of the financial system and help ensure a level playing field. First issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003 and most recently in 2012 to ensure that they remain up-to-date and relevant.

Each recommendation is rated based on the extent to which a country complies (or not) with the standard. There are four possible levels of compliance: compliant (C), largely compliant (LC), partially compliant (PC) and non-compliant (NC). In some cases, a recommendation may be rated as not applicable (N/A). These ratings are based only on the criteria specified in the technical compliance assessment methodology.

For each immediate outcome, there are four possible ratings for effectiveness based on the extent to which the core issues and characteristics are addressed: High level of effectiveness; substantial level of effectiveness; moderate level of effectiveness; and low level of effectiveness.

SUMMARY OF BOTSWANA'S TECHNICAL COMPLIANCE AND EFFECTIVENESS RATINGS - MUTUAL EVALUATION REPORT (MAY 2017)

The first AML/CFT assessment of Botswana was carried out by the World Bank in March 2007 and the report was adopted by the ESAAMLG Council of Ministers in August 2007. Out of the 40 FATF recommendations, Botswana was rated favourably on 14 recommendations and non-compliant (NC) on 23 recommendations, while three recommendations were rated not applicable (N/A). Botswana made progress after 2007 Mutual Evaluation by setting up the Financial Intelligence Agency (FIA), establishing the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), and enacting new and amending existing legislations, such as Proceeds and Instruments of Crime Act (2014), Counter-Terrorism Act (2014) and Anti-Human Trafficking Act (2014), among others. However, despite the progress made, the 2017 Mutual Evaluation Report revealed that there were several outstanding issues that relate to both technical compliance (that is, existence of the relevant legal and institutional framework of the country, and the powers and procedures of the competent authorities) and effectiveness assessment (i.e., the extent to which the legal and institutional framework is producing the expected results) under the new AML/CFT assessment methodology.

Botswana's second-round mutual evaluation on AML/CFT was carried out on June 13 - 24, 2016 by ESAAMLG. The Mutual Evaluation Report was released in May 2017. The ratings showed that out of the 40 recommendations, Botswana was non compliant (NC) with 23, partially compliant (PC) with 14, largely compliant (LC) with two and compliant (C) with none. One recommendation was rated not applicable (N/A). The ratings indicated that the country had major and moderate shortcomings. The level of effectiveness was also rated low in nine out of 11 immediate outcomes (IO). Botswana was rated moderate only for IO 2 (International Cooperation) and IO 6 (Financial Intelligence ML/TF risk). The ratings of compliance with the FATF Recommendations (technical compliance) and immediate outcomes (effectiveness compliance) are presented in Tables 1 and 2, respectively.

CONCLUSION AND RECOMMENDATIONS

Following the country's adverse ratings, significant work was carried out at a country level to ensure that a satisfactory level of compliance with the core FATF Recommendations, namely, recommendations on money laundering offence (3), terrorist financing offence (5), targeted financial sanctions related to terrorism and terrorist financing (6), customer due diligence (10), record keeping (11) and reporting of suspicious transactions (20), is attained by June 2018. This is done through the review of various pieces of legislation by the relevant stakeholders.

For its part, during 2017, the Bank intensified AML/CFT on-site examinations of banks operating in Botswana in order to improve the level of effectiveness. Furthermore, to harmonise Botswana's banking legislation with the FATF Recommendations, the reporting of suspicious transactions is handled by the FIA, and not the central bank. Consequently, a proposal was made to amend Section 21(4) of the Banking Act (CAP. 46:04) to facilitate the filing of suspicious transactions with FIA only. In addition, there was also a proposal to amend Section 21(5) to remove the provision that deals with the penalty imposed on a bank for its failure to report a suspicious transaction to the Bank of Botswana. Furthermore, Section 43 of the Banking Act was amended to empower FIA to request for information on a customer's bank account without requesting for permission from the concerned customer.

TABLE 1: COMPLIANCE WITH THE FATF RECOMMENDATIONS - TECHNICAL COMPLIANCE

Number	Old Number		2007	2017
(A) AML/CFT POLICIES AND COORDINATION				
1	N/A	Assessing risks and applying a risk-based approach*	N/A	NC
2	R.31	National cooperation and coordination	PC	PC
(B) MONEY LAUNDERING AND CONFISCATION				
3	R.1 & R.2	Money-laundering offence*	PC	PC
4	R.3	Confiscation and provisional measures*	PC	PC
(C) TERRORIST FINANCING AND FINANCING OF PROLIFERATION				
5	SRII	Terrorist-financing offence*	NC	NC
6	SRIII	Targeted financial sanctions related to terrorism and terrorist financing*	NC	NC
7	N/A	Targeted financial sanctions related to proliferation	N/A	NC
8	SRVIII	Non-profit organisations	NC	NC
(D) PREVENTIVE MEASURES				
9	R.4	Financial institution secrecy laws	C	NC
		Customer due diligence and record keeping		
10	R.5	Customer due diligence	NC	NC

11	R.10	Record keeping	LC	NC
		Additional measures for specific customers and activities		
12	R.6	Politically-exposed persons	NC	NC
13	R.7	Correspondent banking	NC	NC
14	SRVI	Money or value transfer services	NC	NC
15	R.8	New technologies	PC	NC
16	SRVII	Wire transfers	NC	NC
		Reliance, Controls and Financial Groups		
17	R.9	Reliance on third parties	PC	N/A
18	R.15 & R.22	Internal controls and foreign branches and subsidiaries	PC/N/A	PC
19	R.21	Higher-risk countries	NC	NC
		Reporting of suspicious transactions		
20	R.13 & SRIV	Reporting of suspicious transactions	NC	PC
21	R.14	Tipping-off and confidentiality	LC	NC
		Designated non-financial Businesses and Professions (DNFBPs)		
22	R.12	DNFBPs: Customer due diligence	NC	NC
23	R.16	DNFBPs: Other measures	NC	PC
(E) TRANSPARENCY AND BENEFICIAL OWNERSHIP OF LEGAL PERSONS AND ARRANGEMENTS				
24	R.33	Transparency and beneficial ownership of legal persons*	NC	NC
25	R.34	Transparency and beneficial ownership of legal arrangements*	NC	NC
(F) POWERS AND RESPONSIBILITIES OF COMPETENT AUTHORITIES AND OTHER INSTITUTIONAL MEASURES				
		Regulation and Supervision		
26	R.23	Regulation and supervision of financial institutions	NC	NC
27	R.29	Powers of supervisors	LC	LC
28	R.24	Regulation and supervision of DNFBPs	NC	NC
		Operational and Law Enforcement		
29	R.26	Financial intelligence units	NC	NC

30	R.27	Responsibilities of law enforcement and investigative authorities	PC	PC
31	R.28	Powers of law enforcement and investigative authorities	C	PC
32	SRIX	Cash couriers	NC	PC
		General Requirements		
33	R.32	Statistics	NC	NC
34	R.25	Guidance and feedback	NC	PC
		Sanctions		
35	R.17	Sanctions	NC	NC
(G) INTERNATIONAL COOPERATION				
36	R.35 & SRI	International instruments	PC/NC	PC
37	R.36 & SRV	Mutual legal assistance	LC /NC	LC
38	R.38	Mutual legal assistance - freezing and confiscation	LC	PC
39	R.39	Extradition	PC	PC
40	R.40	Other forms of international cooperation	PC	PC

The "old number" column refers to the corresponding 2003 FATF Recommendations.
* The 2007 assessment conducted by the World Bank/IMF

TABLE 2: THE 2017 EFFECTIVENESS ASSESSMENT FOR BOTSWANA

Immediate Outcome (IO)	Ratings
IO.1 : Risk, policy and coordination	Low
IO.2 : International cooperation	Moderate
IO.3 : Supervision	Low
IO.4 : Preventive measures	Low
IO.5 : Legal persons and arrangements	Low
IO.6 : Financial intelligence	Moderate
IO.7 : Money-laundering investigation and prosecution	Low
IO.8 : Confiscation	Low
IO.9 : Terrorist financing investigation and prosecution	Low
IO.10 : Terrorist financing preventive measures and financial sanctions	Low
IO.11 : PF financial sanctions	Low

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 (BIS)

4.1 The Basel Committee on Banking Supervision (BCBS) continued to issue and revise guidelines and standards that will materially impact on the regulation and supervision of banks and banking groups. The following guidelines/standards and reports were issued in 2017:

(i) The Net Stable Funding Ratio - February 2017;
(ii) Pillar 3 Disclosure Requirements - Consolidated and Enhanced Framework - March 2017;
(iii) Regulatory Treatment of Accounting Provisions - Interim Approach and Transitional Arrangements - March 2017;
(iv) Range of Practices in Implementing the Countercyclical Capital Buffer Policy - June 2017;
(v) The Liquidity Coverage Ratio Framework - June 2017;
(vi) Guidelines on Sound Management of Risks Related to Money Laundering and Financing of Terrorism - June 2017;
(vii) Guidelines on Identification and Management of Step-in Risk - October 2017;
(viii) Supervisory and Bank Stress Testing: Range of Practices - December 2017;
(ix) Basel III: Finalising Post-crisis Reforms - December 2017; and
(x) Guidelines on Prudential Treatment of Problem Assets - Definitions of Non-Performing Exposures and Forbearance - April 2017.

4.2 In addition, the BCBS issued, for consultation, the following Standards during 2017:

(i) Simplified Alternative to the Standardised Approach to Market Risk Capital Requirements;
(ii) Global Systemically Important Banks - Revised Assessment Framework;
(iii) The Regulatory Treatment of Sovereign Exposures;
(iv) Stress Testing Principles;
(v) Implications of Fintech Developments for Bank Supervisors;
(vi) Treatment of the Extraordinary Monetary Policy Operations in the Net Stable Funding Ratio; and
(vii) Progress Report on the Implementation of Principles for Effective Supervisory Colleges.

4.3 The Bank has implemented Pillar 3 disclosure requirements and selected enhancements, while intending to implement net stable funding ratio and liquidity coverage ratio frameworks in 2019. Meanwhile, the Bank has initiated the drafting of supervisory guidelines for bank stress testing and sound management of risk related to AML/CFT. The Bank has issued a Circular on Regulatory Treatment of Accounting Provisions - Interim Approach and Transitional Arrangements to the banking industry for comments and implementation upon finalisation. In addition, some aspects of the Guidelines on Prudential Treatment of Problem Assets - Definitions of Non-Performing Exposures and Forbearance has been incorporated into the risk management guidelines issued in May 2018.

PARTICIPATION IN INTERNATIONAL AND DOMESTIC REGULATORY AND SUPERVISORY FORA

SUPERVISORY COLLEGES

4.4 During 2017, the Bank attended supervisory college[12] meetings organised by the home supervisors of the parent banks of banking groups with subsidiaries in Botswana, namely, State Bank of India in Mumbai, India; two for Barclays Africa Group Limited in Pretoria, South Africa; African Banking Corporation Holdings Limited in Harare, Zimbabwe; FirstRand Group Limited in Pretoria, South Africa; and First Merchant Bank Group in Lilongwe, Malawi.

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

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

OTHER SUPERVISORY MATTERS

4.6 Consistent with the spirit and principles of best international practice on cooperation and collaboration with other regulatory authorities, an induction workshop and a meeting were held between the Bank and the Competition Authority during the year. Furthermore, the Bank held a meeting with the Financial Intelligence Agency (FIA) to discuss the memorandum of understanding (MoU), which was finalised and signed by both parties in 2017.

4.7 The Bank, through the Ministry of Finance and Economic Development, presented a bill on the enhancements/revisions to the relevant sections of the Banking Act relating to anti-money laundering, combating the financing of terrorism and proliferation of proceeds and instruments of crime to address the shortcomings that were identified by the country's AML/CFT Mutual Evaluation Report.

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

CROSS-BORDER SUPERVISION

4.9 Consistent with Core Principle 12 of the Basel Core Principles, the SARB conducted a supervisory visit to the Bank as the home supervisor of one commercial bank on November 29 - 30, 2017. The visit included a bilateral meeting with SARB officials to discuss the recent regulatory developments, highlights pertaining to the economic environment, an overview of the banking sector and an overall risk assessment of the bank and a prudential meeting involving senior management of that bank.

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

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

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

BOX 4: INTERNATIONAL FINANCIAL REPORTING STANDARD 9 - IMPACT ON PROVISIONING

INTRODUCTION

The International Financial Reporting Standard (IFRS) 9, which replaces IAS 39 on financial instruments, recognition and measurements, became effective for annual periods beginning on/or after January 1, 2018. IAS 39 was widely criticised for provisions of credit losses that were regarded as “too little, too late” in the wake of the global financial crisis that began in 2007 (Financial Stability Institute, 2015). The new standard encompasses a comprehensive range of accounting requirements for financial assets and liabilities, including new credit loss recognition requirement.

IFRS 9 seeks to eliminate the threshold (within IAS 39) that required a credit event to have occurred before credit losses were recognised and implements a methodology that measures expected credit losses[13] (ECLs) and changes in ECLs. That is, the impairment requirements of IFRS 9 are forward-looking as the standard requires financial institutions to recognise ECLs at all times, not only when evidence of a loss is apparent. In addition to past events and current conditions, reasonable and justifiable forecasts affecting collectability are also taken into account when determining the amount of impairment in accordance with IFRS 9.

In contrast, IAS 39 only recognised credit losses[14] when and if there was tangible evidence of impairment. Furthermore, only past events and current conditions were considered of relevance when determining the amount of impairments (i.e., the effects of future credit loss events could not be considered, even when there was expert judgement regarding such expected losses).

THE IFRS 9 IMPAIRMENT APPROACH

There are two parts to the measurement approach of IFRS 9, which addresses the stages of impairment: 12 months of ECLs that result from default events possible within the next 12 months (stage 1) - this is applicable for loans with no significant increase in credit risk since purchase or origination of loans; and lifetime of ECLs[15] (stages 2 and 3 - for loans with significantly increased credit risk since original recognition of the loan (stage 2) and loans that are considered credit-impaired (stage 3) (Deloitte, 2015).

[13] Expected credit loss (ECL) is the weighted average of credit losses, with the respective risks of a default occurring used as weights.

[14] Credit losses are defined as the difference between all the contractual cash flows that are due to an entity and the cash flows that it actually receives (cash shortfalls).

[15] Lifetime expected credit losses are the expected shortfalls in contractual cash flows, taking into account the potential for default at any point during the life of the financial instrument.

IMPACT ON PROVISIONING

IFRS 9 will align measurement of financial assets with a bank's business model, contractual cash flow of instruments and future economic scenarios. In addition, the IFRS 9 provision framework requires banks to evaluate how economic and credit changes will alter their business models, portfolios, capital and the provision levels under various scenarios. Deloitte's Fifth Global IFRS Banking Survey: Finding Your Way, showed that 85 percent of banks anticipated that their expected credit loss provisions would exceed those calculated under Basel rules, mostly driven by requirements to provide for lifetime expected losses under "stage II" (Deloitte, 2015). The preliminary impact assessment on capital for banks in Botswana has yielded similar results. The impact assessments of three domestic banks revealed that the implementation of IFRS 9 raised provisions by an average of P100.3 million (40.2 percent). Consequently, this reduced the banks' Tier 1 Capital to Risk-Weighted Assets (RWA) and Capital Adequacy ratios by an average of 1.7 percentage points and 1.4 percentage points, respectively. Although there was a decrease in banks' capital, all banks, except one, complied with the prudential requirements of the Bank after IFRS 9-related adjustments.

CONCLUSION

The introduction of IFRS 9 financial instruments will bring a significant change to financial reporting of banks. It is expected that IFRS 9 will align supervisory and accounting requirements as banks will recognise credit losses in a more timely manner. The Bank is in the process of assessing the quantitative impact of ECL on the banking industry, and issued a circular on IFRS 9 to the industry for comments.

REFERENCES

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[Accessed 17 February 2018]

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 two banks in 2017. The scope of the examinations comprised a review of capital adequacy; asset quality; management and effectiveness of board oversight; earnings and profitability; liquidity; and sensitivity to market risk (CAMELS); and an assessment of risk areas under the risk-based supervision (RBS) approach: strategic/governance risk, credit risk, liquidity risk, market risk, operational risk and money laundering and terrorism financing risk.

5.2 The examination of the two commercial banks indicated that the financial condition and performance for one bank were satisfactory, while they were weaker for the other. Some supervisory concerns were noted and brought to the attention of the respective boards of the banks. These related to governance and strategic deficiencies; failure to adhere to internal policies and procedures; information inaccuracies; potential cyber-security risk; and violation of the requirement of Section 17 of the Act and Section 9 of the Banking Regulations.

5.3 Assessment of one of the two bank's liquidity risk indicated some deficiencies, including concentration of deposits as the bank relied on high-cost volatile wholesale deposits to fund its lending activities. Furthermore, the bank's ML/TF risk was considered to be significant as it had not conducted risk assessment in respect of all its clients, geographical areas, products and services, transactions and/or delivery channels. As a result, the bank was unable to characterise its inherent ML/TF risk levels.

5.4 As for the other bank, supervisory concern related to uncompetitive product pricing and significant credit concentration on corporate investment banking (CIB) loan book. This negatively affected its asset quality and, consequently, profitability. As a result, the bank's financial condition deteriorated and it could not augment capital through retained earnings.

5.5 In addition, limited-scope on-site examinations focusing on AML/CFT issues were conducted on three commercial banks. For two banks, ML/TF risk was rated high owing to high-risk products and services they offer, while the risk level for one bank was rated moderate. All three banks had limited KYC documentation, which compromises investigation of suspicious and unusual transactions performed by the AML officers.

5.6 The five banks examined were ordered to implement corrective actions to remedy identified areas of weakness.

STATUTORY BANKS' EXAMINATIONS

5.7 A full scope on-site examination was carried out at one statutory bank in 2017. The examination revealed that the bank had governance and strategic deficiencies that needed to be addressed, including inability to return the bank to profitability; inherently risky model of funding start-ups and agricultural businesses; high levels of NPLs; high staff turnover at the senior management level with no substantive replacements; deficient liquidity; and poor capital planning. The bank needed immediate liquidity and capital injection, as well as a viable turnaround strategy, to be able to continue as a going concern.

CONSUMER COMPLIANCE ON-SITE EXAMINATIONS

5.8 The Bank conducted full-scope consumer compliance on-site examination of three banks during 2017. The examination revealed that the three banks had documented comprehensive policies and procedures. Furthermore, the banks complied satisfactorily with most consumer issues, except for the violations shown in Table 5.1.

Table 5.1: Violation of Consumer Compliance Standards

Violation	Description
The Disclosure of Bank Charges Government Notice No. 41 of 2001, Section 5(b)	In all banks, some charges were not distinctly identified as some narrations in the bank statements did not conform to those in the approved tariff guide; thus making it difficult for customers to understand and reconcile transactions.
Disclosure of Bank Charges Notice (Government Notice No. 41 of 2001)	Two banks did not accurately compute and levy some charges as approved by the Bank.
Section 39(1) of the Banking Act (CAP. 46.04)	One bank had an inadequate policy on abandoned funds: no provision for the transfer of abandoned funds to the central bank.
Disclosure Framework for Deposit and Lending Interest Rates, Regulatory Guideline No. RG 01/09/2009	One bank charged customers penalty for breaking term deposit in less than a month, which is not in line with the approved penalty of "interest rate due less 1 percent for breaking the term after one month." Moreover, the penalty was not disclosed to the customers.

CONSULTATIVE AND PRUDENTIAL MEETINGS

5.9 Prudential bilateral and statutory trilateral meetings were held in 2017, during which banks outlined their business strategies for the previous year and the period ahead, as well as presented their financial year-end results. Furthermore, statutory bilateral meetings were held with external auditors to discuss audit strategies for the respective banks.

SUPERVISORY DEVELOPMENTS

5.10 Apart from the discussion of financial performance at the prudential meetings, there were three topical issues discussed:

IMPLEMENTATION OF IFRS

5.11 There were discussions with banks in which they shared with the Bank their approaches to implementation of IFRS 9 in 2018. All commercial banks indicated that they were following a group-wide methodology and at a data collection stage, while statutory banks indicated that they had engaged consultants for technical advice.

CYBER CRIME

5.12 Cyber-crime risk was one of the key areas of supervisory developments during 2017. It was noted that the intensity of data in the operations of the banking sector and the high reliance on the internet and other technologies had increased the risk of banks becoming targets of cyber attacks. Banks were requested to implement robust cyber-crime control measures.

ML/FT RISK ASSESSMENTS

5.13 Regarding the need for increased regulatory requirements with respect to ML/TF risk, the Bank directed each bank to conduct an ML/TF risk assessment for its customers, geographic areas, products and delivery channels. All banks provided their risk assessments and this enhanced the ML/TF risk profiling of the respective banks.

VIOLATIONS OF THE BANKING ACT

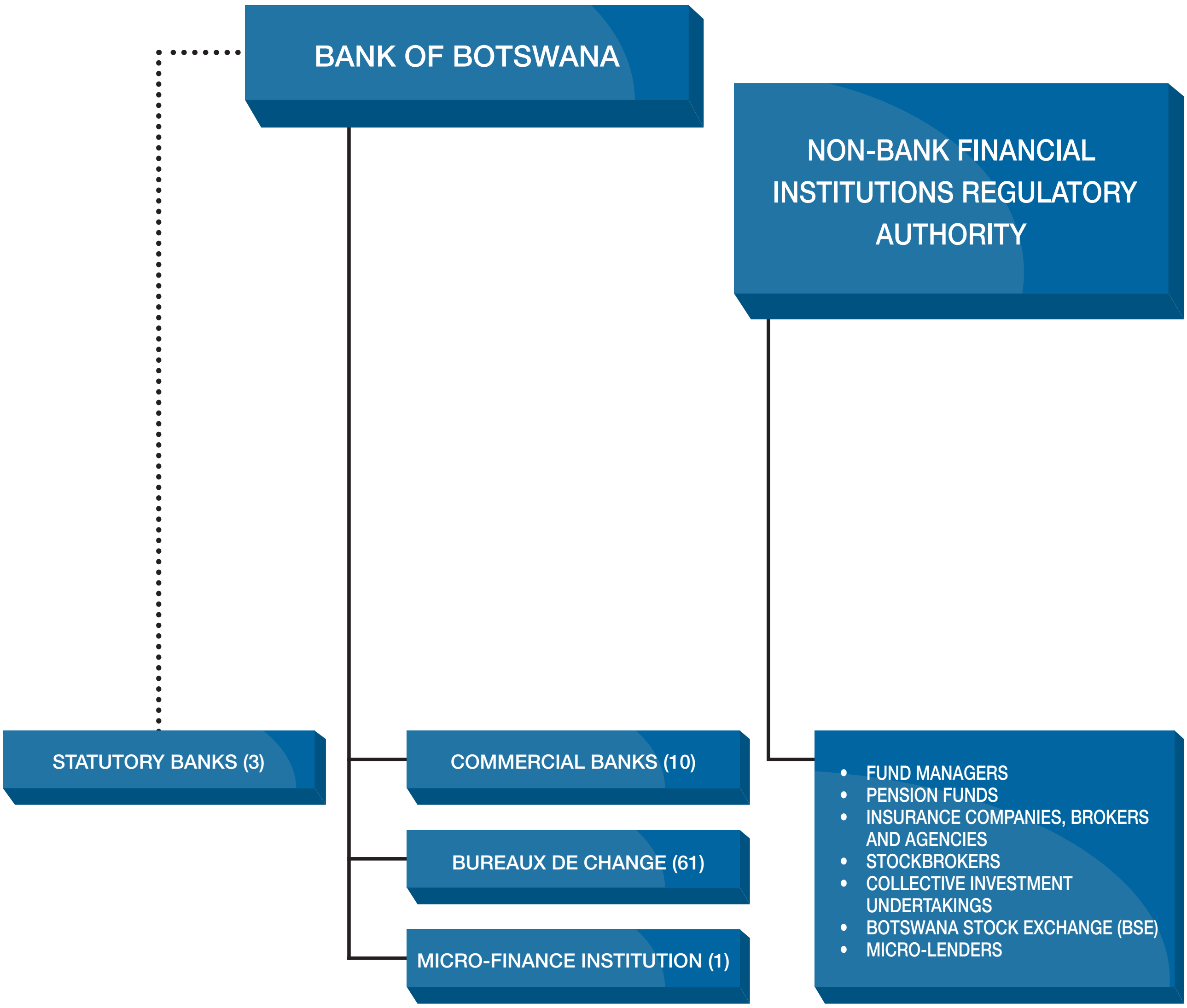
5.14 Two banks violated several sections of the Banking Act during 2017, that is, the submission of incorrect and misleading data, and advancing staff unsecured loans in excess of the recipients' annual salaries. Consequently, a monetary penalty was levied on the banks.

APPENDICES

APPENDICES

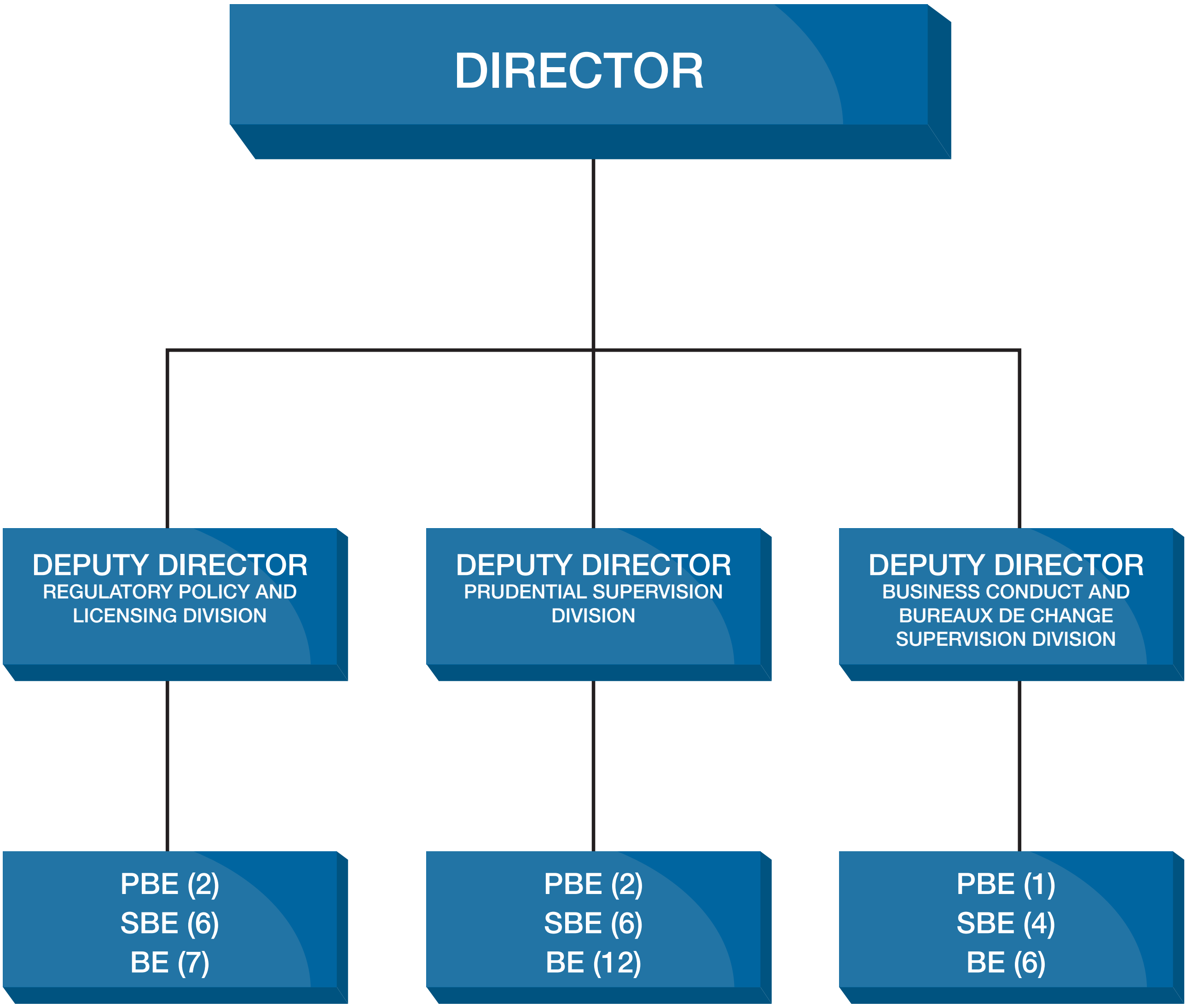
APPENDIX 1

DIAGRAM 1.1: THE REGULATORY ARCHITECTURE OF THE DOMESTIC FINANCIAL SYSTEM



APPENDIX **1**

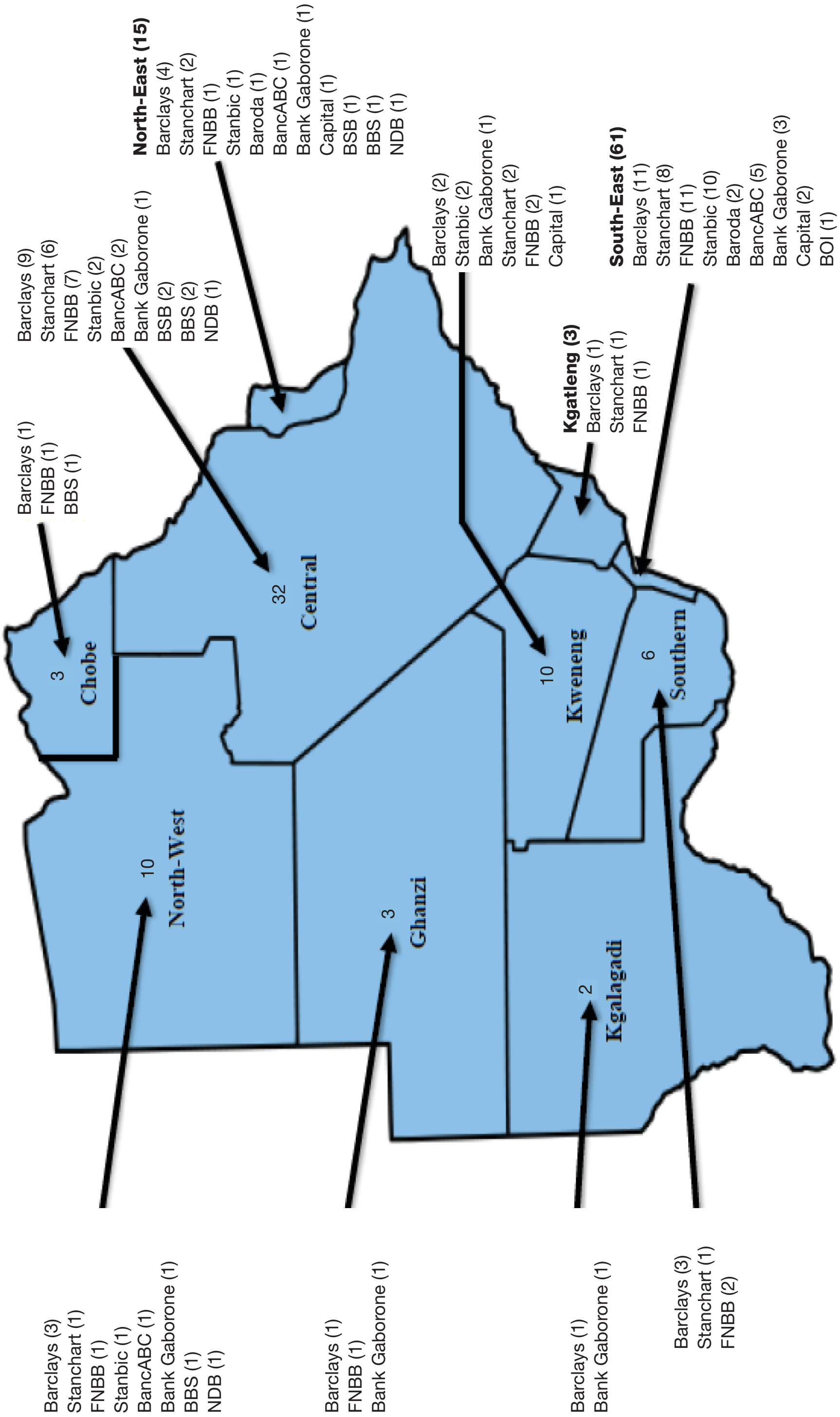
DIAGRAM 1.2: BANKING SUPERVISION DEPARTMENT ORGANISATIONAL STRUCTURE



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

APPENDIX **2**

BANK BRANCH DISTRIBUTION NETWORK BY DISTRICT AS AT DECEMBER 31, 2017



APPENDIX **3**

APPROACHES TO REGULATION AND SUPERVISION OF BANKS IN BOTSWANA

1. INTRODUCTION

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

2. LEGAL FRAMEWORK

2.1 In general, it is considered that, to be effective, a regulatory framework must have sufficient authority established by law, a high degree of independence or operational autonomy and adequate human and financial resources. In Botswana, the primary legislation covering the supervision and regulation of licensed banking institutions is the Banking Act. Important elements of the Banking Act are explicit provisions for licensing and authorisation processes, which give the Bank powers to regulate market entry to the banking sector; 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 of banks; rules governing accounting, auditing and disclosure of bank information; and guidelines for the management and/or restructuring of banks in distress.

2.2 The banking law also covers issues of governance, market discipline within the banking system, and prudential supervision of the banking system. It is recognised that, primarily, the responsibility for banking soundness lies with owners (shareholders) and managers of banks, who have a commercial incentive to operate banks prudently. Market discipline, which is underpinned by minimum disclosure requirements, provides an incentive for good internal governance and imposes sanctions for failures, particularly for institutions listed on the Botswana Stock Exchange. 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 that could have significant 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, are a reflection of efficiency in all these three areas.

3. AUTHORITY FOR LICENSING BANKS

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

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

APPENDIX **3**

4. LICENSING POLICY AND PROCEDURES FOR ESTABLISHING A BANK

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

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

(a) The company must be locally incorporated in Botswana (branch banking is not permitted);
(b) The proposed banking establishment must have the prescribed initial minimum capital (currently P5 million) and the owners must demonstrate willingness and ability to provide additional financial support as and when required. In case of applicants that are majority owned by holding companies or a part of a financial conglomerate, the parent entity should demonstrate capacity to be a source of financial strength to the applicant;
(c) The applicant must have adequate managerial capacity, which includes the appointment of fit and proper persons, as well as sound risk management and 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 financial needs of the public in a prudent and safe manner.

5. CORE PRUDENTIAL REQUIREMENTS

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

CAPITAL ADEQUACY REQUIREMENTS

5.2 A bank must maintain a minimum capital adequacy (solvency) ratio of at least 8 percent, calculated as the ratio of the bank's 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. Fundamentally, 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 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, this requirement is equal to 10 percent and three percent of deposit liabilities 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; and that the level, trend and quality of bank funding sources, including cash flow from earning assets, are supportive of the bank's growth strategy.

ASSET QUALITY

ASSET CONCENTRATIONS (LARGE EXPOSURES)

5.6 Section 17 of the Banking Act, read together with Banking Regulation 9, restricts a bank from granting facilities that are in excess of 10 percent of a bank's unimpaired capital to a single customer or group of related customers without the specific approval of a bank's entire board of directors. 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, directly or indirectly, to a member of its board of directors in excess of 25 percent of its unimpaired capital. This provision seeks to avoid the possibility 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 is, 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 created to take into account potential losses when determining a bank's capital adequacy. It establishes the legal framework for the Bank to assess the adequacy of provisions for non-performing assets. Accordingly, the Bank has statutory powers to assess, in consultation with the bank's independent statutory auditors, the level of impairments in a bank's loans and advances portfolio and the amount of charges to the bank's profit and loss as an expense for non-performing assets.

APPENDIX **3**

6. MAIN SUPERVISORY APPROACHES

ON-SITE 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 the institution's 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, for instance, consumer loans, treasury or operational risk. An ad hoc on-site examination is usually a limited-scope examination designed to test a specific area of supervisory concern, for example, compliance with laws and regulations, liquidity and capital adequacy. 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 weakness in these areas. 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 six months.

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

APPENDIX **3**

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

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

BILATERAL AND TRILATERAL MEETINGS

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

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

APPENDIX **3**

OFF-SITE MONITORING AND SURVEILLANCE

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

6.12 The Banking Supervision Department continuously analyses financial data from banks to determine their financial condition, soundness and viability. The specific objectives of the analysis are to determine the levels, trends and sources of bank 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 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, the regular off-site monitoring, surveillance and analysis serve 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 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 one to 4.5, where one 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 significant benefits in tracking financial soundness and, accordingly, trigger appropriate supervisory reactions to systemic and idiosyncratic conditions that may warrant intervention.

7. ACCOUNTING, AUDITING AND DISCLOSURE STANDARDS

7.1 Section 22 of the Banking Act requires banks to annually appoint independent external auditors acceptable to the Bank. Statutory audits are conducted annually, usually at financial year-end, except when a bank intends to capitalise half-year interim profits, in which case it has to 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, 2017

Institution	Total Assets (P' million)	Postal Address	Business Locations	Auditors
Commercial Banks				
African Banking Corporation of Botswana Limited	8 109	Private Bag 00303 Gaborone	9	KPMG
Bank of Baroda (Botswana) Limited	1 588	P O Box 216 ADD Gaborone	3	Grant Thornton
Bank of India (Botswana) Limited	165	Private Bag 00111 Gaborone	1	Grant Thornton
Bank Gaborone Limited	4 679	Private Bag 00325 Gaborone	9	PricewaterhouseCoopers
Barclays Bank of Botswana Limited	15 247	P O Box 478 Gaborone	36	KPMG
Capital Bank Limited	1 939	P O Box 5548 Gaborone	4	KPMG
Bank SBI Botswana Limited	385	P O Box 505243 Gaborone	1	Grant Thornton
First National Bank of Botswana Limited	23 884	P O Box 1552 Gaborone	27	Deloitte
Stanbic Bank Botswana Limited	12 340	Private Bag 00168 Gaborone	16	KPMG
Standard Chartered Bank Botswana Limited	15 140	P O Box 496 Gaborone	21	KPMG
Statutory Banks				
Botswana Savings Bank	2 515	P O Box 1150 Gaborone	5	PricewaterhouseCoopers
National Development Bank	1 145	P O Box 225 Gaborone	4	PricewaterhouseCoopers
Building Society				
Botswana Building Society	4 261	P O Box 40029 Gaborone	9	KPMG

APPENDIX 4

BUREAUX DE CHANGE AS AT DECEMBER 31, 2017

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
Arpanet Bureau de Change	P O Box 2241 ABG, Gaborone	1
Ban Mo Bureau de Change	P O Box 99, Sherwood	1
Bellagio Bureau de Change	Private Bag BR 321, Gaborone	1
Beni Fame Bureau de Change	P O Box 2143 AAD, Gaborone	5
Berry-Pee Bureau de Change	P O Box 20051, Gaborone	1
Boitekanelo Bureau de Change	P O Box 2768, Gaborone	1
BT Bureau de Change	P O Box 601369, Gaborone	2
City Exchange Bureau de Change	P O Box 50282, Gaborone	2
CSS Bureau de Change	P O Box 45168, Gaborone	3
Dollar Wave Bureau de Change	P O Box 10784, Palapye	1
Dubs Bureau de change	P O Box 233, Lobatse	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	2
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
Kabona Bureau de Change	P O Box 455 ADD, Tlokweng	1
Kaycy Bureau de Change	P O Box 1693, Lobatse	2
Kwanokeng Bureau de Change	P O Box 10, Sherwood	2
Limpopo Bureau de Change	P O Box 8, Sherwood	2
Macheng Bureau de Change	P O Box 60474, Gaborone	1
Madikwe Bureau de Change	P O Box 268, Sikwane	1
Maeto Bureau de Change	P O Box 22, Mahalapye	1
Master Bureau de Change	Private Bag F199, Francistown	1
Mochudi Bureau de Change	P O Box 202147, Gaborone	2

APPENDIX **4**

BUREAUX DE CHANGE AS AT DECEMBER 31, 2017

Name	Postal Address	Business Location
Monty Cristo Bureau de Change	Private Bag 00254, Gaborone	1
Okavari Bureau de Change	P O Box 44, Karakubis	1
Open Door Bureau de Change	P O Box 839, Maun	8
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	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	4
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 Fronter Bureau de Change	P O Box 183, Pitsane	2
Travelex Bureau de Change	P O Box 80981, Gaborone	1
Travellers Bureau de Change	P O Box 20909, Maun	2
Travellers' Choice Bureau de Change	P O Box 26725, Gaborone	1
TRL Money Link Bureau de Change	Private Bag F333, Francistown	1
Tshilong Bureau de Change	P O Box 40418, Gaborone	1
Toluca Bureau de Change	P O Box 402026, Gaborone	1
UAE Exchange Bureau de Change	P O Box AD 749 ADD, Gaborone	7
Unity Bureau de Change	P O Box 1586, Francistown	1
West Bureau de Change	P O Box 40854, Gaborone	1
Total	61	107

MICROFINANCE INSTITUTION

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

APPENDIX **5**

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 that cannot be substituted in the short term. This exposure is usually expressed as a percentage of the bank's unimpaired capital and its various thresholds are subjected to prudential regulatory requirements. 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 as 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.

APPENDIX **5**

(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.

CORE CAPITAL

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

TOTAL RISK-WEIGHTED ASSETS

An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk-conversion factors used in risk-weighting is presented at Appendix 5 Table 1 (a) and (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 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 that would, in the opinion of the central bank, diminish the value of the whole or any portion of the capital of the bank. An outline of capital elements used to compute unimpaired capital is presented at Appendix 5 Capital Elements.

PRUDENTIAL RATIOS

RETURN ON EQUITY (ROE)

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

RETURN ON AVERAGE TOTAL ASSETS (ROAA)

The ratio measures after-tax profits as a percentage of average total assets. This ratio is widely used by both banking supervisors and market analysts since banking assets are the base from which earnings are primarily derived. The ratio measures the earnings capacity of the assets of a financial institution. It measures profit earned relative to the amount invested in assets and is 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 decisions with respect to resource utilisation. The higher the ratio, the more efficient the management is in its asset allocation decisions.

APPENDIX **5**

DIVIDEND PAY-OUT

The ratio measures the proportion of the after-tax income that is paid out to shareholders. This ratio is of the greatest 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, banks will from time to time retain some or a portion of their income to augment capital in order to take advantage of lending and/or investment opportunities in large projects, or to support organic growth of the bank.

RISK-BASED CAPITAL

On January 1, 2016, the Bank implemented the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II). This new framework augments the risk sensitivity of the Basel Committee Capital Accord (Basel I). In terms of the Basel II framework, in addition to credit risk, a separate and explicit computation of the regulatory capital for market risk and operational risk is introduced. Therefore, the minimum amount of regulatory capital (the ratio of Unimpaired Capital to Risk-Weighted Assets) is derived from the summation of capital charges for credit risk, operational risk and market risk. The move to this method of capital adequacy measurement has alerted banks to the 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 from being part of Tier 2 capital. Also excluded are any elements that are likely to impair a bank's capital, such as investment in unconsolidated subsidiaries and associated companies, and connected lending of a capital nature. 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 covers only those assets and liabilities that have a link to interest rate. 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 is net interest income as a percentage of average total earning assets. The ratio identifies the core earnings capability of a bank.

APPENDIX 5

OTHER OPERATING INCOME TO TOTAL ASSETS (PERCENT)

The ratio shows the dependence on non-traditional income such as foreign exchange fees and commission. 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 is defined as the differential between the cost of funds and the yield on earning assets plus related fee income. The differential quantifies the cost incurred by the banking system for intermediating between the providers and users of funds.

NET INCOME PER STAFF MEMBER

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

NET INCOME TO STAFF EXPENSE

This measures the return on investment on staff. This ratio is arguably a better measure than net income per staff member since it enables institutions of a different type to be compared to some degree. It considers the effect of staffing decisions, regardless of whether these are low cost, low expertise clerical staff, or high-cost, highly 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 (INTEREST PAID ON DEPOSITS TO TOTAL AVERAGE DEPOSITS)

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

APPENDIX **5**

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

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

	Credit Rate						
Claims on Exposure	AAA to AA-	A+ to A-	BBB+ to BBB-	BBB+ to B-	Below B-/BB	Unrated	Risk-Weight/ Credit Conversion Factor Percentage
Government of Botswana and Bank of Botswana							0
Cash							0
Cash items in the process of collection							20
Sovereigns and central banks	0	20	50	100	150	100	
BIS, IMF							0
Domestic Public Sector Entities							20
Public Sector Entities	20	50	100	100	150	100	
Domestic Banks							20
Foreign Banks	20	50	100	100	150	100	
Security Firms	20	50	100	100	150	100	
Eligible Retail							75
Other Retail							100
Mortgages[16]							35
Corporates/Insurance Companies	20	50	100	100	150	100	100
Multilateral Development Banks	20	50	50	100	150	50	0/100
Commercial Real Estate	100	100	100	100	100	100	100
Other Assets[17]							100
Past Due Items **							100(20); 100(20-50); 150(20)
Other Non-Qualifying Residential Property							75
Significant investments in equity and regulatory capital instruments issued by unconsolidated financial institutions							250
Mortgage Servicing Rights							250
Deferred Tax Assets							250
Investments in commercial entities							1 250
Non-payment/delivery on non-delivery-versus-payment and non-payment-versus-payment transactions							1 250
Venture capital and private equity investment							150

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

[17] Excludes cash items in the process of collection.

APPENDIX **5**

** Treatment of Past Due loans (more than 90 days, net of specific provisions)

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

APPENDIX **5**

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

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

APPENDIX **5**

CAPITAL ELEMENTS

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

APPENDIX **5**

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

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

APPENDIX **5**

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

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 6

AGGREGATE FINANCIAL STATEMENTS OF LICENSED BANKS: 2013 - 2017

Table 1: Aggregate Statement of Financial Position of Licensed Commercial Banks: 2013 - 2017 (P' million) as at December 31st

	TOTAL ASSETS IN LOCAL CURRENCY	2013	2014	2015	2016	2017
1.	Cash and balances with the Central Bank	5 268	5 838	4 584	6 333	4 597
	1.1. Currency	976	1 374	1 544	1 433	1 608
	a. Foreign Currency	159	463	532	363	382
	b. Local Currency	816	911	1 013	1 070	1 226
	1.2. Balances with Central Bank	4 292	4 419	2 982	4 900	2 989
	1.3. Other	-	45	58	-	-
2.	Investment and Trading Securities	8 059	6 482	12 537	11 425	10 811
3.	Placements with Other Banks and Credit Institutions	6 410	9 636	10 539	10 951	13 590
4.	Gross Loans and Advances to Other Customers	39 499	45 117	48 307	51 325	54 181
	4.1. Impairments-Specific	718	771	1 007	1 270	1 536
	4.2. Interest in Suspense	339	218	340	184	259
	4.3. Impairments Portfolio	-	-	132	182	239
5.	Loans and Advances to Other Customers (Net of Specific Provisions)	38 442	44 075	46 875	49 690	52 147
6.	Fixed Assets Net of Depreciation	872	910	968	908	926
7.	Other Assets (net)	911	1 054	1 106	1 333	1 402
	Total Assets	59 962	67 994	76 605	80 640	83 475
	TOTAL LIABILITIES IN LOCAL CURRENCY					
1.	Amounts Owed to Government Institutions	6	12	2	12	27
	a. Central Bank Accounts	6	12	2	12	27
	b. Direct Government Credits (CB or MFED)	-	-	-	-	-
2.	Due to Other Banks and Credit Institutions	1 394	3 581	3 308	3 984	4 250
3.	Debt Securities and Other Borrowing	2 292	2 088	3 163	2 642	4 065
4.	Due to Other Customers/Depositors	48 589	51 491	59 940	62 438	63 581
5.	Shareholder Funds	6 479	7 724	8 204	9 748	9 383
6.	Other Liabilities	1 202	3 097	1 997	1 817	2 169
	a. Taxes Payable	177	133	252	195	246
	b. Dividends Payable	-	4	7	-	-
	c. Accrued Expenses	-	1 167	-	7	551
	d. Other	1 025	1 794	1 715	1 615	1 372
	Total Liabilities	59 962	67 994	76 605	80 640	83 475

APPENDIX 6

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

		2013	2014	2015	2016	2017
1.	Interest and similar income	5 146	4 953	5 129	5 271	5 449
2.	Interest expense	1 600	1 670	2 093	1 425	1 466
3.	Net interest income [1-2]	3 546	3 284	3 036	3 847	3 983
4.	Other operating income	2 028	2 150	2 312	2 477	2 490
5.	**Gross operating income/(loss) [3+4]**	**5 575**	**5 434**	**5 348**	**6 323**	**6 473**
6.	Total Impairments	579	760	668	855	1 003
	a. Impairment of loans and advances - Specific	588	545	587	685	994
	b. Impairment of loans and advances - Portfolio	45	216	83	172	9
	c. Impairment on other financial assets	(53)	(1)	(2)	(2)	-
7.	**Operating income/(loss) net of bad and doubtful debts**	**4 995**	**4 674**	**4 680**	**5 469**	**5 470**
8.	Operating expenses	2 709	2 782	3 242	3 607	3 876
	a. Salaries and employee benefits	1 248	1 370	1 335	1 543	1 731
	b. Auditing and consulting expenses	17	49	49	173	299
	c. Rents paid	105	187	195	198	207
	d. Depreciation and amortisation	152	135	148	159	158
	e. Other	1 186	1 089	1 565	1 533	1 481
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]**	**2 287**	**1 893**	**1 438**	**1 862**	**1 595**
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]**	**2 305**	**1 893**	**1 438**	**1 862**	**1 595**
13.	Income tax	530	415	349	455	412
14.	**Net income/(loss) after tax [12-13]**	**1 775**	**1 478**	**1 088**	**1 407**	**1 182**

APPENDIX **6**

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

	TOTAL ASSETS IN LOCAL CURRENCY	2013	2014	2015	2016	2017
1.	Cash and balances with the Central Bank	19	8	9	23	70
	a. Currency	15	6	8	21	18
	aa. Foreign currency	-	-	-	-	-
	ab. Local currency	15	6	8	21	18
	b. Balances with Central Bank	3	2	1	2	52
	c. Other	-	-	-	-	-
2.	Investment and Trading securities	-	-	-	-	-
3.	Placements with other banks and credit institutions	856	854	1 580	1 025	1 777
4.	Gross Loans and Advances to Customers	3 316	3 823	4 278	4 769	4 792
5.	Specific Provisions	25	20	22	28	93
6.	Net Loans and Advances to Customers	3 273	3 781	4 240	4 722	4 699
7.	Fixed assets net of depreciation	129	121	131	151	152
8.	Other assets (net)	57	70	71	62	79
	Total Assets	4 333	4 834	6 031	5 983	6 777
	LIABILITIES IN LOCAL CURRENCY					
1.	Amounts owed to government institutions	-	-	-	-	-
	a. Central Bank accounts	-	-	-	-	-
	b. Direct Government credits (CB** or MFED)	-	-	-	-	-
	c. Other	-	-	-	-	-
2.	Borrowing from Other Banks, Credit Institutions and International Lending Agencies	918	855	1 271	987	1 235
3.	Due to customers/depositors	1 740	2 180	3 340	3 493	4 042
4.	Shareholder Funds	1 564	1 664	1 263	1 303	1 306
5.	Other liabilities	111	136	157	200	193
	a. Taxes payable	1	1	1	1	1
	b. Dividends payable	-	-	-	4	-
	c. Accrued expenses	-	-	-	-	-
	d. Other	110	135	156	195	192
	Total Liabilities	4 333	4 834	6 031	5 983	6 777

* 2013 - 2015 figures revised to exclude one statutory bank.

** CB denotes Central Bank.

APPENDIX **6**

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

		2013	2014	2015	2016	2017
1.	Interest and similar income	352	370	475	482	433
2.	Interest expense	160	173	233	231	198
3.	Net interest income [1-2]	192	197	242	251	234
4.	Other operating income	38	35	51	46	30
5.	**Gross operating income/(loss) [3+4]**	**230**	**232**	**294**	**297**	**265**
6.	Bad and Doubtful Debts Provisions	11	(1)	9	18	24
	a. Specific loss provision expenses	-	-	-	-	-
	b. General loss provision	-	-	-	-	-
	c. Releases and Recoveries of bad debts previously written off	-	-	-	-	-
7.	**Operating income/(loss) net of specific loss provisions**	**220**	**233**	**284**	**279**	**241**
8.	Operating expenses	151	174	189	214	197
	a. Salaries and employee benefits	76	74	94	106	91
	b. Administrative expenses	-	-	-	-	-
	c. Auditing and consulting expenses	-	-	-	-	-
	d. Rents paid	-	-	-	-	-
	e. Depreciation and amortisation	9	9	13	10	16
	f. Other	66	90	81	98	88
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]**	**68**	**60**	**96**	**65**	**44**
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]**	**68**	**60**	**96**	**65**	**44**

*2013 - 2015 figures revised to exclude one statutory bank.

APPENDIX **6**

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

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

APPENDIX 6

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

	COMMON EQUITY TIER 1 (CET1) CAPITAL	2016	2017
1.	Common shares	1 165	1 265
2.	Share premium resulting from the issue of common shares	271	271
3.	Retained Earnings:	5 479	5 867
	Retained Earnings brought forward from the previous financial year	5 325	6 404
	Add: Interim profits (audited by external auditor)	506	(196)
	Less: Dividend declared	-	6
	Less: Dividend paid in the current financial year	352	335
4.	Accumulated other Comprehensive income and other disclosed reserves	156	207
	a. Statutory Credit Risk Reserve	25	79
	b. Capital Buffer	-	-
	c. Statutory Reserves	2	2
	d. Other (specify)	129	126
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[18]	123	249
7.	CET1 Capital (Lines (1+2+3+4+5-6))	6 948	7 361
	ADDITIONAL TIER 1 CAPITAL		
8.	Instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital as per paragraph 4.9 of the Capital Directive	-	-
9.	Stock surplus (Share premium) resulting from the issue of Additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-	-
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Additional Tier 1 capital and are not included in CET1 subject to terms and conditions in paragraph 3.5 of the Basel II Guidelines	-	-
11.	Regulatory adjustments applied in the calculation of Additional Tier 1 Capital	-	-
12.	Additional Tier 1 Capital (Lines (8+9+10-11))	-	-
13.	Total Tier 1 Capital (Lines (7+12))	6 948	7 361
	TIER 2 CAPITAL		
14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital);	1 641	1 683
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;	-	-
16.	Unpublished Current Year's Profits	1 041	1 124
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	176	214
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	391
20.	Regulatory adjustments applied in the calculation of Tier 2 Capital	-	-
21.	Total Tier 2 Capital (Lines (14+15+16+17+18+19-20))	3 293	3 412
22.	Total Unimpaired Capital (Lines (13+21))	10 241	10 774

[18] Comprised of goodwill and other intangible assets.

APPENDIX **6**

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

		2013	2014	2015	2016	2017
1	Stated Capital*	977	1 097	1 381	1 165	1 265
2	Share Premium	-	-	-	271	271
3	Retained Earnings	4 112	4 589	5 116	5 479	5 867
4	Total Tier 1 Capital	5 603	5 891	6 560	6 948	7 361
5	Subordinated Term Debt	1 088	1 036	1 551	1 817	1 897
6	Current year's unpublished profits	634	971	780	1 041	1 124
7	Total Tier 2 Capital	1 896	2 472	2 814	3 293	3 412
8	Total Unimpaired Capital (sum of Line 4 and 7)	7 499	8 363	9 374	10 241	10 774

* Stated capital for period 2013 - 2015 included share premium.

APPENDIX 6

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

	TIER 1	2013	2014	2015
1.	Stated Capital	712	809	878
2.	Preference (non-redeemable) non cumulative shares	-	-	-
3.	General Reserves	214	224	228
4.	Retained Earnings	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)**	**1 023**	**1 153**	**1 229**
	TIER 2			
8.	Current year's unpublished profits	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	4	5
	b. Statutory Credit Risk Reserve	-	-	-
11.	Subordinated term debt eligible for inclusion	-	-	-
12.	Minority interest in Tier 2 preference shares	-	-	-
13.	Shareholders equity funded through the capitalisation of property revaluation reserves	-	-	-
14.	**Total Tier 2 Capital (sum of lines 8 - 13)**	**39**	**55**	**95**
15.	**Total Capital (sum of lines 7 and 14)**	**1 062**	**1 208**	**1 324**
	Impairments			
16.	Investments in unconsolidated subsidiaries and associated companies	-	-	-
17.	Connected Lending of a Capital Nature	-	4	-
18.	Total Impairments of Capital	-	4	-
19.	**Total Unimpaired Capital**	**1 062**	**1 208**	**1 324**

*2013 - 2015 figures revised to exclude one statutory bank.

APPENDIX 6

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

	COMMON EQUITY TIER 1 (CET1) CAPITAL	2016	2017
1.	Common shares	922	952
2.	Share premium resulting from the issue of common shares	-	-
3.	Retained Earnings:	97	85
	Retained Earnings brought forward from the previous financial year	157	132
	Add: Interim profits (audited by external auditor)	-	-
	Less: Dividend declared	-	-
	Less: Transfer during the year	-	3
	Less: Dividend paid in the current financial year	60	44
4.	Accumulated other Comprehensive income and other disclosed reserves	64	230
	a. Statutory Credit Risk Reserve	-	-
	b. Capital Buffer	-	-
	c. Statutory Reserves	-	166
	d. Other (specify)	64	64
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (Minority Interest)	-	-
6.	Regulatory adjustments applied in the calculation of CET1 Capital	-	-
7.	CET1 Capital (Lines (1+2+3+4+5-6))	1 083	1 259
	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 CET1 capital subject to terms and conditions in paragraph 3.5 of Basel II Guidelines	-	-
11.	Regulatory adjustments applied in the calculation of Additional Tier 1 Capital	-	-
12.	Additional Tier 1 Capital (Lines (8+9+10-11))	-	-
13.	Total Tier 1 Capital (Lines (7+12))	1 083	1 259
	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	40
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	-	-
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)	-	-
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2 capital, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	-	17
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	57
22.	Total Unimpaired Capital (Lines (13+21))	1 150	1 316

*Figures excludes one statutory bank.

APPENDIX **6**

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

		2013	2014	2015	2016	2017
1.	Stated Capital	712	809	878	922	952
2.	Retained Earnings	97	224	228	97	85
3.	Total Tier 1 Capital	1 023	1 153	1 229	1 083	1 259
4.	Current year's unpublished profits	36	51	90	67	40
5.	Total Tier 2 Capital	39	55	95	67	57
6.	Total Unimpaired Capital (sum of line 3 and 5 less impairments)	1 062	1 205	1 325	1 150	1 316

*Figures excludes one statutory bank.

APPENDIX 7

CHARTS AND TABLES OF KEY PRUDENTIAL AND OTHER FINANCIAL SOUNDNESS INDICATORS

Chart 7.1: Average Cost of Deposits

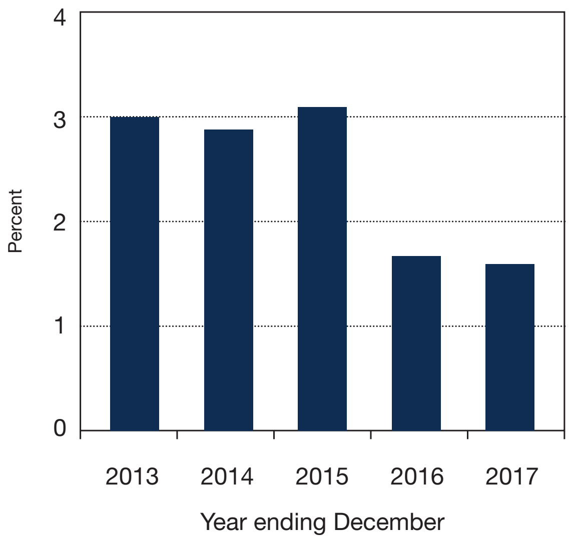


Chart 7.2: Return on Loans and Advances

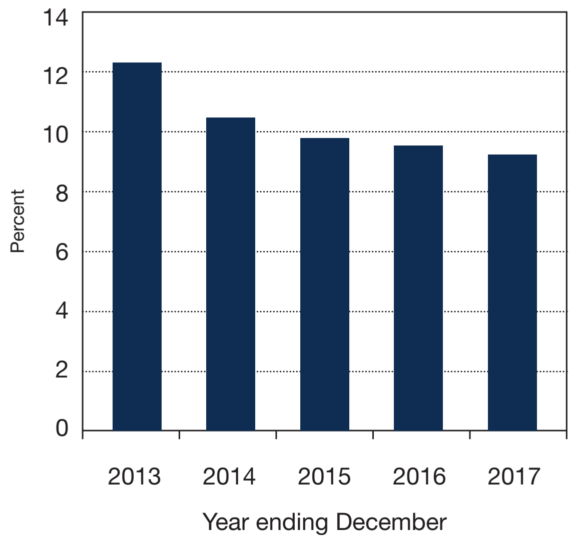


Chart 7.3: Residential Real Estate Loans to Gross loans

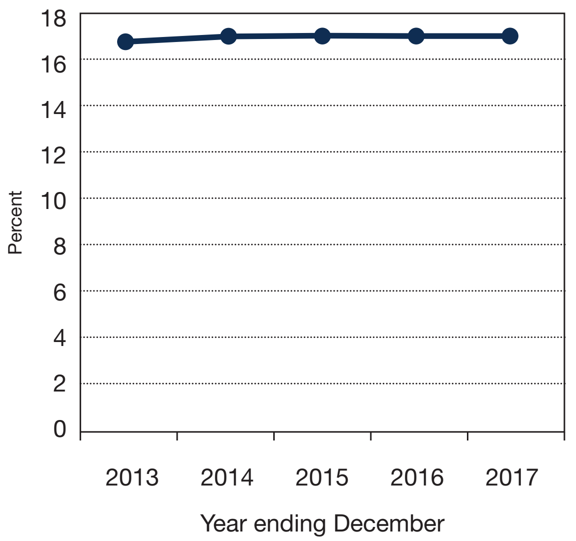
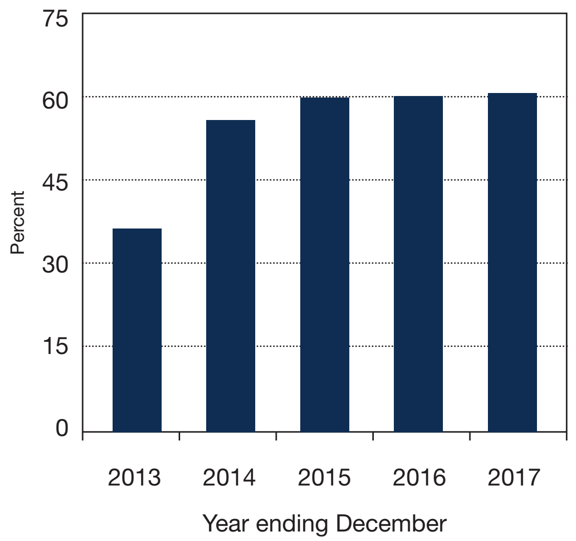


Chart 7.4: Household Loans to Gross Loans



APPENDIX 7

CHARTS OF KEY PRUDENTIAL AND OTHER FINANCIAL INDICATORS

Chart 7.5: Non-Performing Loans Growth Rate

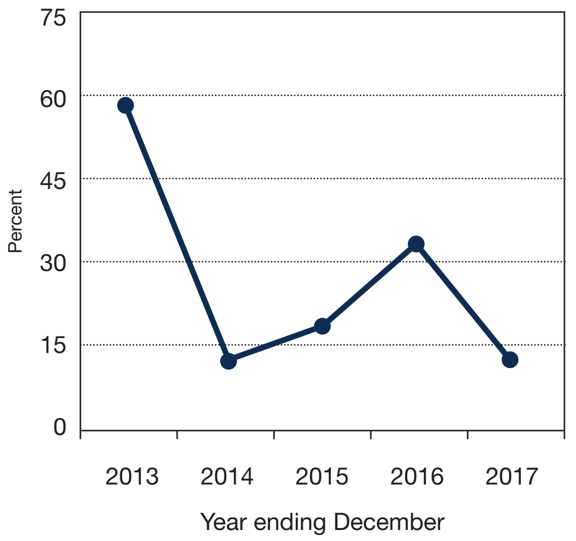


Chart 7.6: Share of Value of Total Deposits by Type (including FCAs)

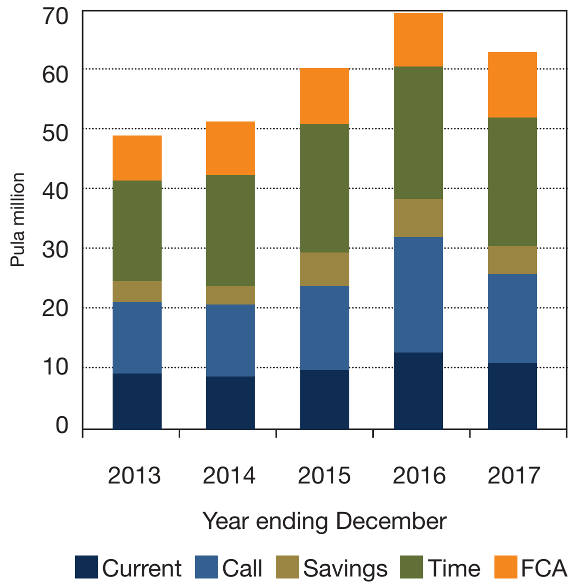


Chart 7.7: Growth Rate of Foreign Currency Accounts

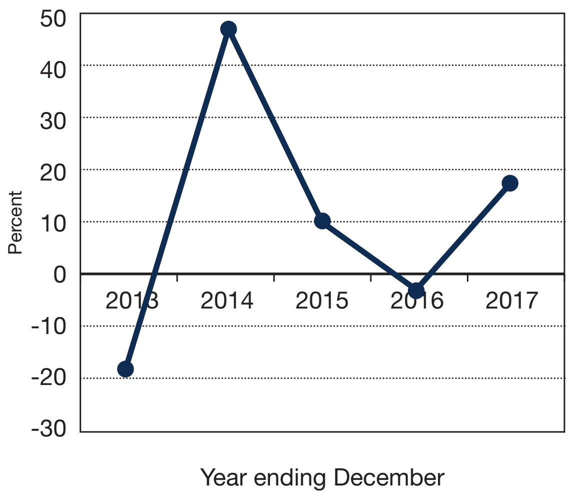
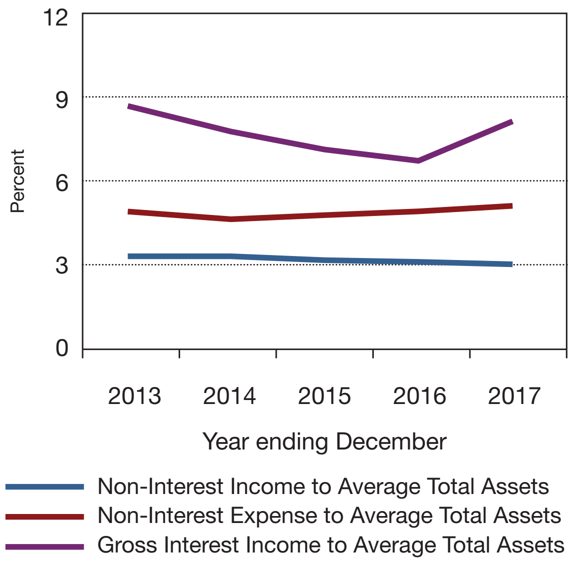


Chart 7.8: Efficiency Ratios



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