Bank of Botswana

Banking Supervision Annual Report 2002

Mission Statement of the Banking Supervision Department

The primary responsibility of the Bank of Botswana, as the central bank, is to promote and maintain monetary stability, an efficient payments mechanism, and a sound and properly functioning domestic financial sector. Pursuant thereto, the Banking Supervision Department's mission is to promote and maintain a safe, stable, sound, efficient and competitive banking system.

In pursuit of its role, the Department is guided by the Banking Act, 1995 and other various Acts of Parliament governing the establishment and conduct of the financial institutions over which it has supervisory authority, which include commercial banks, investment banks, collective investment schemes, offshore financial services and bureaux de change.

The Department seeks to promote market integrity, fair-trading and encourage high standards of customer care through consultation and open communication with key players in the banking sector. Also, the Department is committed to uphold high standards of professionalism and practices consistent with international regulatory and accounting standards for effective banking supervision.

To realise its objectives the Department will continue to:

(a) set transparent criteria and guidelines for market entry. General surveillance will be maintained against unlicensed persons or illegal deposit taking activities to protect the integrity of the banking sector;

(b) receive and process applications for licences against the established criteria;

(c) establish and update on a regular basis, prudential policies and standards, to monitor solvency, liquidity, large exposures, insider loans, prudent provisioning, risk management strategies and related management structures for effective governance;

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

(e) ensure timely supervisory action for effective compliance with banking and other related laws governing the operations of financial institutions.

FOREWORD

This Annual Report provides information on banking supervision issues and the performance of the banking sector during 2002. In terms of Section 28 of the Banking Act, 1995, the Bank is required to produce by June 30, each year, a Report to the Minister of Finance and Development Planning, on the developments in the banking system. The Bank has consistently complied with this statutory requirement and this public document, the fourth of its kind, highlights key issues contained in the Report to the Minister for the year 2002.

Major Financial Sector Developments

Generally, the financial sector in Botswana continued to grow. The banking sector continued to be profitable, well capitalised, highly liquid and prudently managed, in spite of considerable costs incurred by banks in preparation for the implementation of Value Added Tax on July 1, 2002. Despite the good performance, however, there remained concerns about the cost and quality of banking services. The Bank of Botswana (the Bank) continues to engage in dialogue with banks on the matter and some positive response has been noted in this regard, with some banks having revised some charges downwards and in some instances, having frozen further increases. These developments should help dampen recent criticism that the banks overcharge while paying little attention to quality of service. Despite the numerous public complaints, it is worth noting that the contribution of the Banking Adjudicator, appointed by the banks in 2001 to mediate disputes between banks and their customers, is showing positive results. This is consistent with the Bank's view that bank charges and other matters of consumer interest can be better addressed outside the purview of supervisory responsibility. In the long term, the Bank hopes to see the establishment of an independent government agency that would, among others, support the creation of consumer councils for handling consumer-related banking matters.

Future Challenges

(a) The New Basel Capital Accord for Banks

The New Basel Capital Accord, expected to come into effect in 2006, is a critical issue to be addressed by bank supervisory authorities. The current Capital Accord, which first came into effect in 1988, has undergone a comprehensive review to reduce, inter alia, the gap between regulatory capital requirements and economic risks associated with banking activities to ensure that risk management tools are adequate for the underlying risks. The Bank is acutely aware of the importance of building the requisite skills in its banking supervisory cadres to ensure successful implementation of the New Accord. Accordingly, efforts will be made to sensitise and build technical capability of bank supervisors well ahead of the expected implementation year.

(b) Corporate Governance

Corporate Governance is of great concern to every banking supervisor because banks, as custodians of depositors' funds, should adhere to the highest standards of governance. Against the backdrop of the corporate governance scandals that befell several American companies and Japanese banks in 2002, the Bank consistently encourages banks to ensure that senior management and boards of directors of licensed banks are accountable, and that internal and external auditors disclose any impropriety they discover during the course of their duty, without fail. The Bank will continue to adhere to best international practice and standards when vetting senior management and members of boards of directors of banks.

(c) Consolidated Supervision

As the International Financial Services Centre grows, it is expected that more and more bank holding companies and Botswana licensed banks with subsidiaries will be engaged in a myriad of financial activities. This will require that the Bank is able to supervise these activities on a consolidated basis, and address supervisory challenges posed by conglomerates, such as multiple-leveraging of capital, regulatory bargaining and arbitrage, as well as to improve cross-border solvency assessments of the supervised entities.

In this regard, the Bank has consulted and is cooperating with other supervisory authorities when dealing with banking groups operating in multiple jurisdictions.

Linah K Mohohlo
GOVERNOR

STRUCTURE OF REPORT

The purpose of this annual report is to disseminate information on the banking supervision activities of the Bank of Botswana, and serves as a source of information to the public about the structure and conduct of banking supervision in Botswana.

Chapter 1 deals with an overview of the performance of the banking sector in 2002; chapter 2 gives an update on major operational activities and other developments in the banking system during 2002; chapter 3 is an update on regional and international developments, which directly and indirectly affect the approach to banking supervision both in Botswana and globally; and chapter 4 presents some of the emerging supervisory challenges for 2003 and beyond.

There are technical appendices pertaining to the framework for supervision as applied by the Bank of Botswana, institutions addressed in the report, definitions of technical banking supervision terms, and tables and graphs on various statistical information on the banking industry.

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APPENDICES/TABLES/CHARTS

CHAPTER 1

PERFORMANCE OF THE BANKING SECTOR AND TRENDS

The banking industry[1] continued to grow in terms of assets and allocation of credit to the economy. The industry was overall financially sound, solvent, profitable, highly liquid and prudently managed. Appendix 6 presents a number of charts of selected performance indicators. Notwithstanding the good financial performance, the cost and quality of delivery of services remained less than satisfactory from the consumers' perspective. However, through dialogue between the Bank and the banking industry, collectively and individually, efforts are underway to address the matter, as evidenced by reductions in charges by some banks and a freezing of further charges by others.

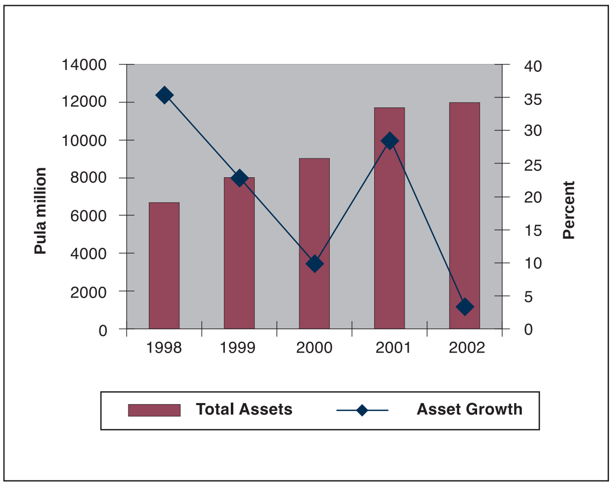
1. Balance Sheet Structure

(a) Composition of Assets

Total banking assets as at December 2002 amounted to P12 billion, up from P11.6 billion in 2001 (See Figure 1). This represents a growth of 3.5 percent compared to 29 percent growth registered during 2001. The high asset growth recorded during 2001 was attributable to a significant increase in deposit liabilities, due mainly to the funding of the Public Officers' Pension Fund. The situation has now normalised as this was a once-off occurrence. The 3.5 percent asset growth experienced in 2002 is the lowest in recent years.

Figure 1

AGGREGATE BALANCE SHEET



Figures 2 and 3 show that loans and advances constituted the highest proportion of total assets at 58 percent in 2002, compared to 48 percent reported in the prior year. There was a major shift in the composition of asset portfolio of the banking industry with "Balances Due from Other Banks" down from 26 percent in 2001 to 16 percent in 2002. Bank of Botswana Certificates (BoBCs) holdings were almost unchanged at 16 percent in 2002 compared to 17 percent in 2001.

[1] Banks and banking industry/banking sector refer to institutions licensed under the Banking Act, 1995. These include the commercial banks and investment banks.

Figure 2

COMPOSITION OF ASSETS - 2001

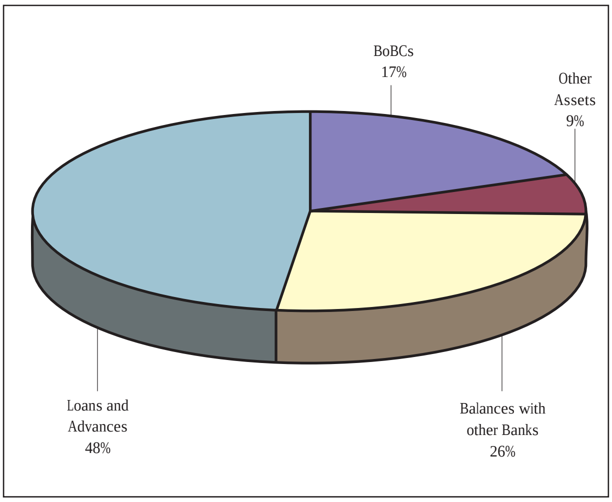
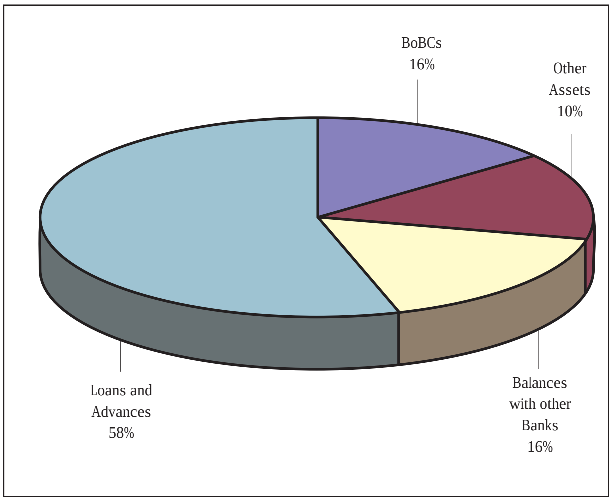


Figure 3

COMPOSITION OF ASSETS - 2002



(b) Composition of Advances

Total loans and advances increased from P5.8 billion in 2001 to P7 billion in 2002, a growth of 21 percent, compared to 12 percent in the preceding year. The acceleration in the growth rate in 2002 is a reversal of the downward trend in growth observed since 1998.

Figure 4 shows the growth in aggregate loans and advances over a five year period. As the graph shows, credit surged in 1998, registering a growth rate in excess of 50 percent. In response, monetary policy was tightened, leading to a progressive deceleration in credit growth until 2001. As shown in Figures 5 and 6, the major categories of advances in both years continued to be other instalment loans, overdrafts, mortgage and motor vehicle loans.

Figure 4

TOTAL LOANS AND ADVANCES

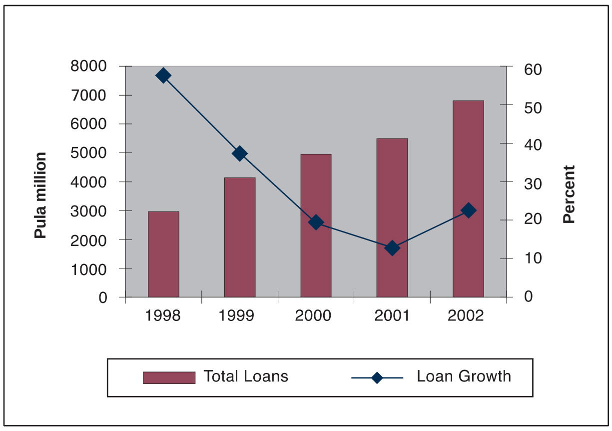


Figure 5

STRUCTURE OF ADVANCES - 2001

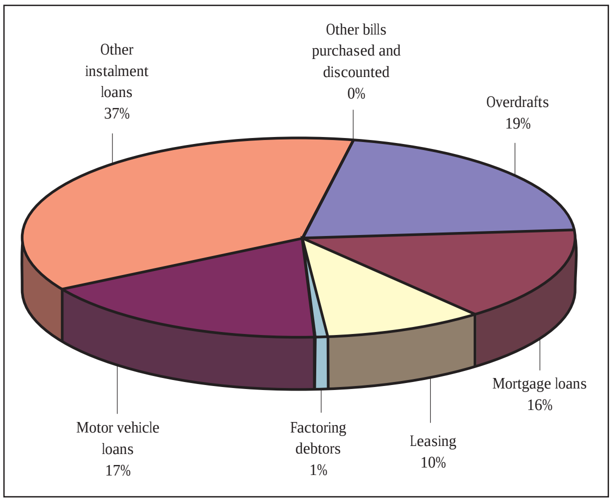
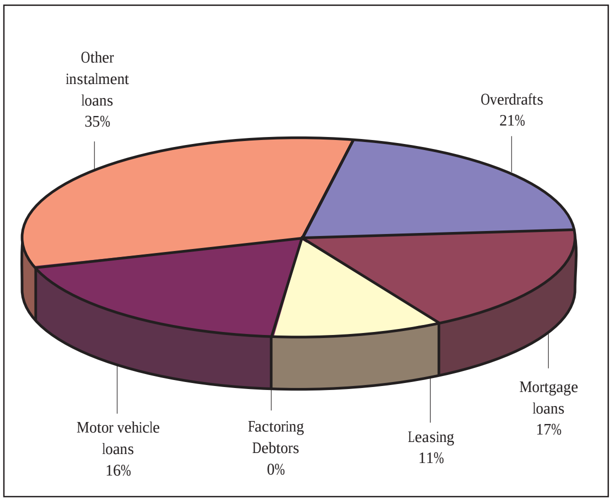


Figure 6

STRUCTURE OF ADVANCES - 2002



(c) Composition of Liabilities

The banking industry's liabilities are largely customer deposits, which posted a small decline to P9.6 billion in 2002 from P9.7 billion in 2001. Deposits decreased slightly as a proportion of the industry's overall liabilities, from 83 percent in 2001 to 80 percent in 2002, as shown in Figures 7 and 8. Owners' equity, which came second in terms of its contribution to total liabilities, increased slightly from 9 percent in 2001 to 10 percent in 2002.

Figure 7

COMPOSITION OF LIABILITIES - 2001

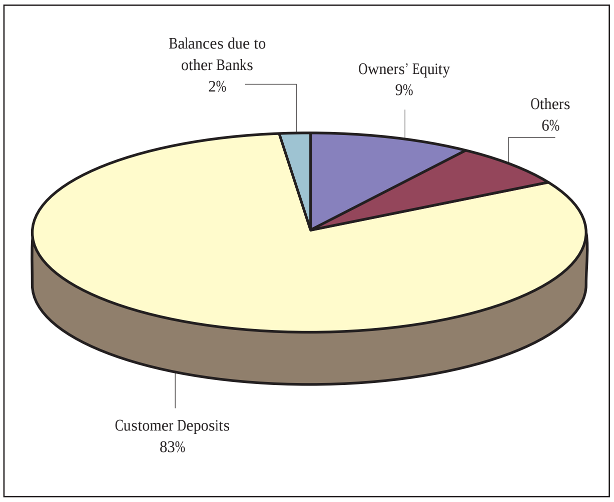
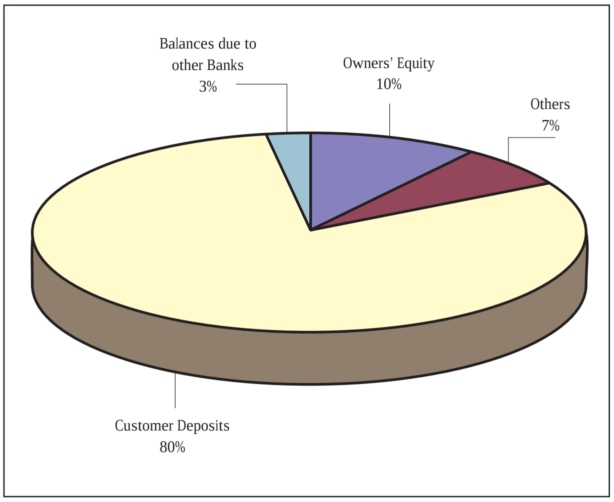


Figure 8

COMPOSITION OF LIABILITIES - 2002

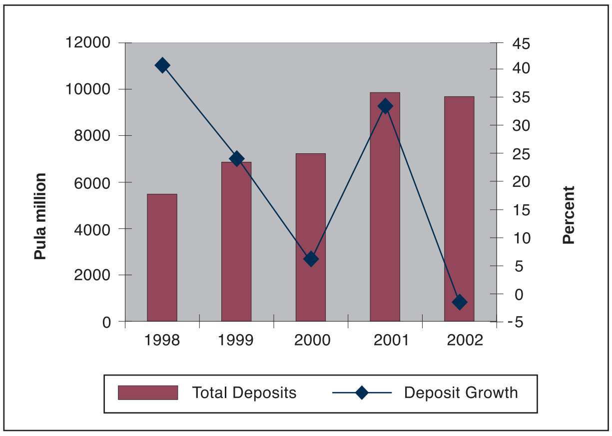


(d) Structure of Deposits

Figure 9 below illustrates the five-year trend in banking deposits while Figures 10 and 11 show the structure of deposits for 2001 and 2002, respectively. The banking industry experienced a decline in total deposits of 1 percent, from P9.7 billion in 2001 to P9.6 billion in 2002, following an increase of 33 percent between 2000 and 2001.

Figure 9

TOTAL DEPOSITS



Call deposits continued to account for the highest proportion (50 percent) of total deposits, followed by current and fixed deposits with 22 percent and 12 percent, respectively.

Figure 10

STRUCTURE OF DEPOSITS - 2001

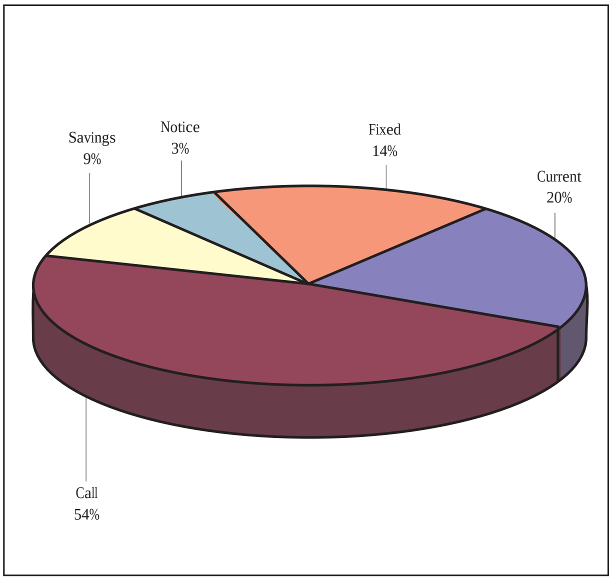
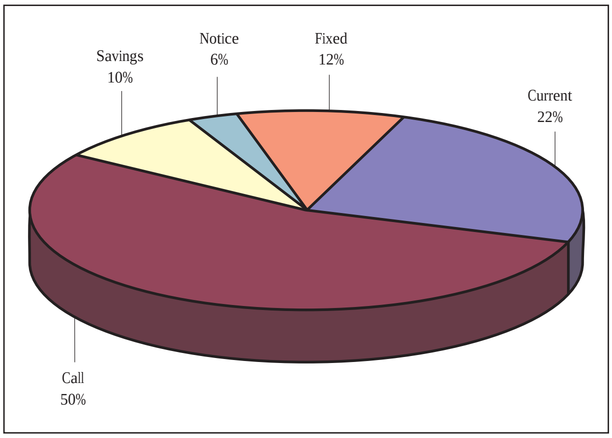


Figure 11

STUCTURE OF DEPOSITS - 2002



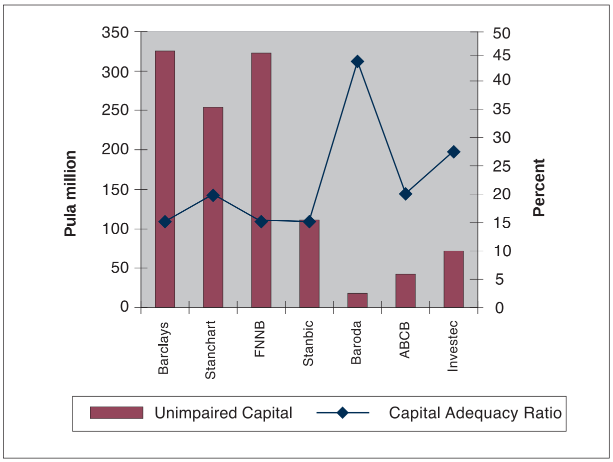
(e) Capital and Reserves

During the year under review, the banking industry was well capitalised with the capital adequacy ratio substantially in excess of the minimum statutory requirement of 8 percent and the 15 percent prescribed as the prudential minimum for banks in Botswana. The ratios ranged from 15.76 percent for Barclays to 43.83 percent recorded by Baroda. As stated in the previous year's report, the capital adequacy ratio of Baroda is abnormally high as the bank is still a relatively new entrant in the market. The ratio is expected to normalise once the bank accumulates a higher level of earning assets or increases its loan portfolio.

Figure 12 below shows the level of unimpaired capital funds and the capital adequacy ratios for banks during 2002.

Figure 12

CAPITAL ADEQUACY - 2002



Shareholders' funds increased by 15 percent, from P1 014.3 million in 2001 to P 1 167.9 million in 2002.

2. Levels, Trends and Sources of Profitability

(a) Profitability

The banking industry continued to be highly profitable during the year under review as shown by the increases in income before-tax recorded by all banks. Total gross income for the industry increased by 18 percent, from P1 688 million in 2001 to P1 997 million in 2002. Net income after-tax increased by 24 percent, increasing from P411.4 million in 2001 to P511.1 million in 2002. With the exception of one bank, which experienced a slight reduction in its after-tax profits, all banks recorded increases in their after-tax profits.

Table 1

EARNINGS AND PROFITABILITY OF BANKS

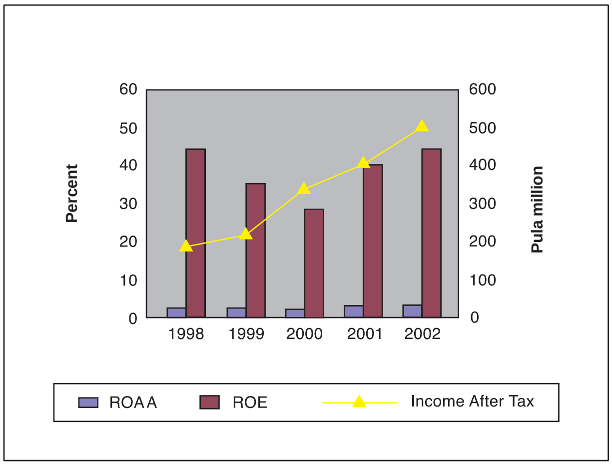
	Amount (P'000)		Growth %
	31-Dec-01	31-Dec-02	
Interest Income	1 320 220	1 544 842	17.0
Interest Expense	676 929	779 438	15.1
Net Interest Income	643 291	765 404	19.0
Non-Interest Income	367 513	452 158	23.0
Operating Expense	446 847	574 341	28.5
Profit Before Tax	519 997	594 745	14.4
Net Income After-tax	411 376	511 073	24.2
Performance Ratios	%	%	
Return on Average Assets	3.99	4.33	
Return on Equity	40.56	43.77	
Non Interest Expense/ATA*	4.33	4.86	
Return on Advances	17.25	17.48	
Non-Interest Income/ATA	3.56	3.83	
Interest Income/ Gross Income	78.23	77.36	
Net Interest Income/ATA	6.24	6.48	

*ATA- Average Total Assets

Figure 13 shows the profitability levels for the banking industry in terms of Return on Average Assets (ROAA), Return on Equity (ROE) and Net Income After-Tax. Appendix 6, Chart 7 and 8 show the trend in each bank's ROAA and ROE.

Figure 13

PROFITABILITY INDICATORS



(b) Expenses

Total expenses, consisting of interest and operating expense, increased by 20 percent from P1 123.8 million in 2001 to P1 353.8 million in 2002. Interest expense accounted for 58 percent of total expenses in 2002, a slight reduction from 60 percent in 2001. Operating expenses accounted for 42 percent of total expenses in 2002, up from 40 percent in 2001.

(c) Efficiency of Operations of Licensed Banks

Table 2 shows the various ratios used as proxy to measure operating efficiency of licensed banks. The banking industry's net spread (See definition in Appendix 4) declined from 9.42 percent in 2001 to 9.12 percent in 2002, while the net interest margin increased from 6.81 percent in 2001 to 7.03 percent in 2002. On the efficiency of staff, Net Income to Staff Expense ratio increased from 192 percent to 206 percent from 2001 to 2002, while net income per staff member improved from P170 030 in 2001 to P204 474 in 2002. Staff cost per employee increased from P70 800 in 2001 to P99 030 in 2002, indicating an upward pressure on salaries and employee benefits during the year. Further, Cost to Income ratio increased from 44 percent in 2001 to 47 percent in 2002, evidencing a moderate decline in the overall efficiency of banks.

Table 2

MEASURES OF EFFICIENCY

Performance Ratio	1998	1999	2000	2001	2002
Net Spread (%)	5.78	6.71	7.58	9.42	9.12
Net Interest Margin (%)	5.69	6.46	6.25	6.81	7.03
Other Operating Income/Average Total Assets (%)	2.79	2.64	3.24	3.56	3.83
Net Operating Margin (%)	8.71	9.39	7.08	9.97	5.29
Net Income Per Staff (P'000)	82.10	127.39	156.49	170.03	204.47
Net Income To Staff Expense (%)	156.51	178.43	198.59	192.37	194.75
Staff Cost Per Employee (P'000)	55.94	70.18	78.80	70.80	104.97
Asset Per Employee (P'000)	3 323.62	4 079.41	4 006.53	4 805.17	4 798.04
Cost/Income	41.43	44.43	41.73	44.21	47.16

(d) Market Share of Deposits and Advances

As shown in Figures 14 to 19, Barclays Bank of Botswana Limited continued to be the leading player in the market as the bank had the largest share of total banking assets, total advances and total deposits. Following closely were Standard Chartered Bank Botswana Limited and First National Bank of Botswana Limited. As in the previous year, Bank of Baroda was the smallest in terms of market share of assets and liabilities. This is due to the fact that the bank is a relatively new entrant in the market.

Figure 14

MARKET SHARE OF VALUE OF DEPOSIT LIABILITIES AS AT DEC 31, 2001

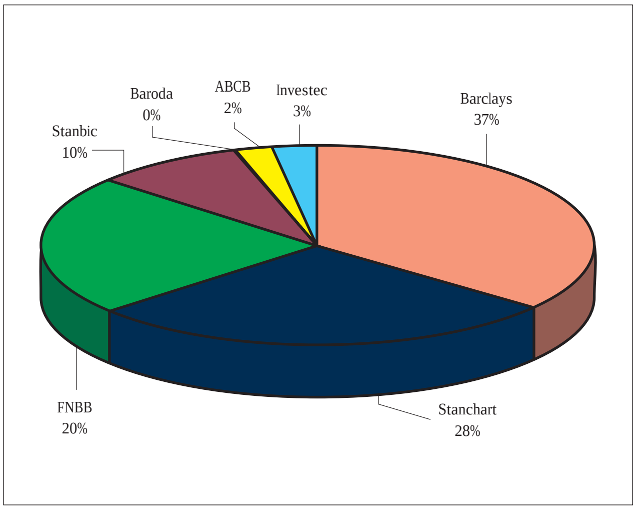


Figure 15

MARKET SHARE OF VALUE OF DEPOSIT LIABILITIES AS AT DEC 31, 2002

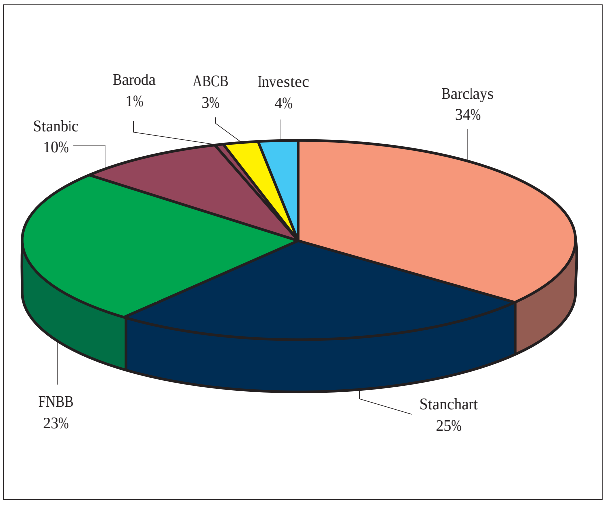


Figure 17

MARKET SHARE OF VALUE OF ADVANCES AS AT DEC 31, 2002

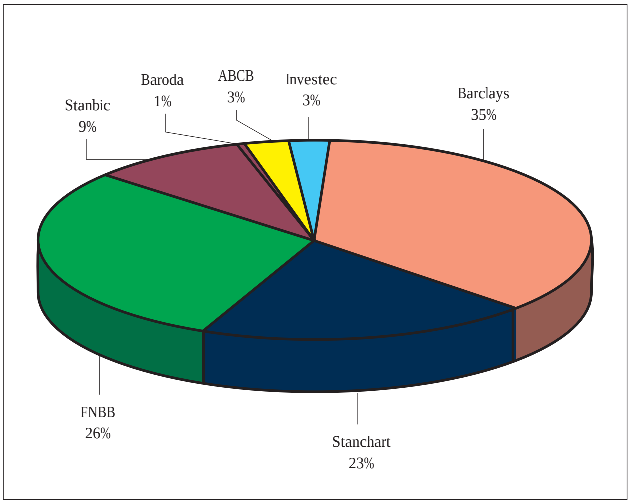


Figure 16

MARKET SHARE OF VALUE OF ADVANCES AS AT DEC 31, 2001

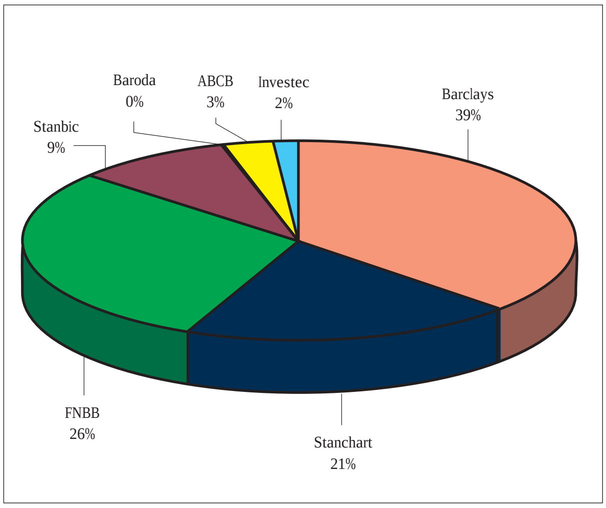


Figure 18

MARKET SHARE OF TOTAL BANKING ASSETS AS AT DEC 31, 2001

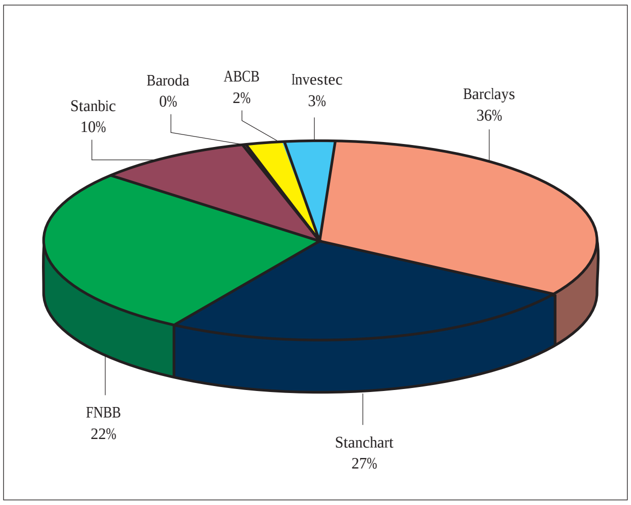


Figure 19

MARKET SHARE OF TOTAL BANKING ASSETS AS AT DEC 31, 2002

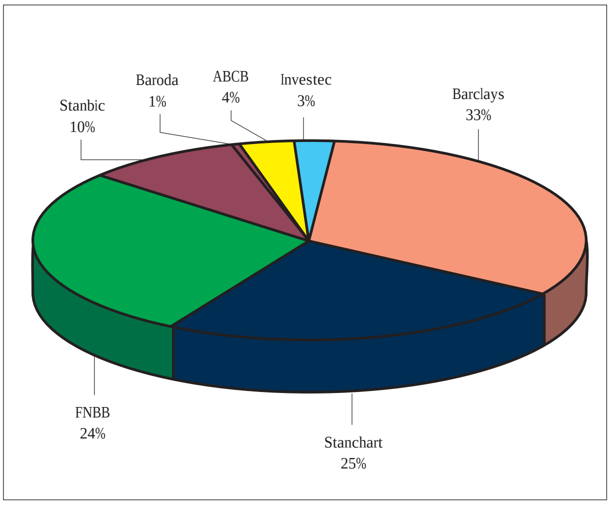
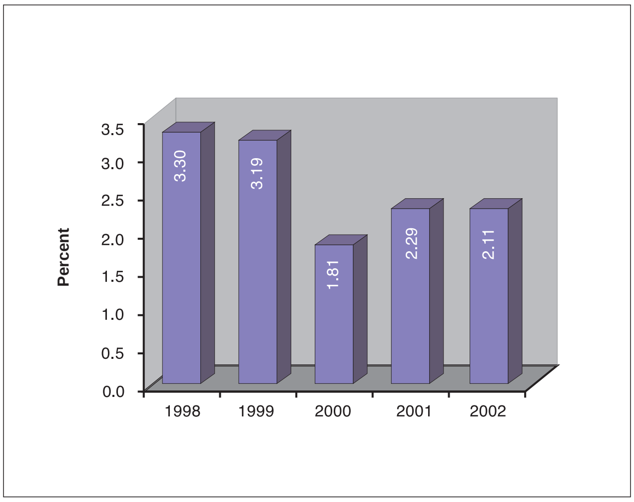


Figure 20

BAD DEBTS PROVISIONS TO ADVANCES



(e) Asset Quality

Assessment of asset quality is done by tracking the levels, trends and composition of accounts in arrears, the level of provisions and credit concentrations. A more comprehensive assessment of asset quality of banks is done during on-site examinations of banks.

(i) Provisions

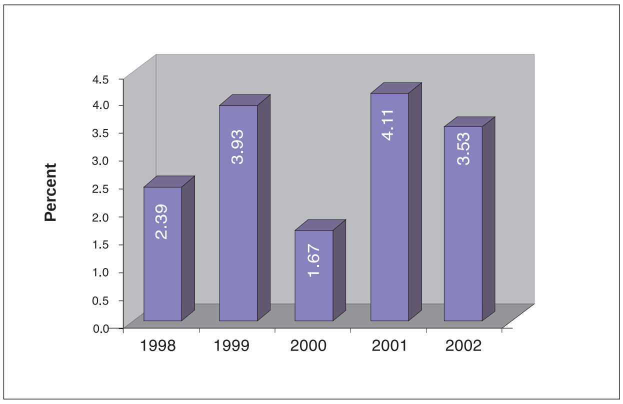
During the period under review, provisions for bad and doubtful debts increased from P128.3 million against advances of P5.8 billion in 2001 to P155.3 million held against advances of P7 billion in 2002. This represented an increase of 21 percent in provisions for bad and doubtful debts against a growth rate of the same magnitude (21 percent) in advances. Figure 20 shows the trend in the Bad Debt Provisions to Advances ratio. The ratio fell slightly from 2.29 percent to 2.11 percent from 2001 to 2002.

(ii) Past-Due Advances

Past-due advances refer to term loans that are 30 days or more in arrears. As shown in Figure 21, the Past-Due Advances to Total Advances ratio declined from 4.11 percent in 2001 to 3.53 percent in 2002. This improvement reflects the improved credit risk assessment and loan administration procedures that the banks have put in place in recent years.

Figure 21

PAST DUE ADVANCES TO TOTAL ADVANCES



(iii) Asset Concentrations (Large Exposures)

Over-dependence on a few large sources of funding by an institution is not prudent as this leads to concentration of risk. As at December 31, 2002, the total credit facilities (advances plus off-balance sheet items), which were 10 percent and above of the individual banks' unimpaired capital, amounted to P5.2 billion, representing a 26 percent reduction from the P7 billion recorded in December 31, 2001.

(f) Liquidity

Figures 22 and 23 show liquidity positions and financial intermediation, respectively, by the banks over the past five years. During 2002, all banks recorded healthy liquidity positions as all recorded Liquid Assets to Deposit ratios above the minimum statutory requirement of 10 percent. Notwithstanding the above, there has been a noticeable declining trend in the liquidity ratio since 1999. This could be due to the upward trend in deposits while BoBCs, which are a major component of liquid assets, either declined or remained constant. Further, there was an improvement in the Advances to Deposit ratio from 57.71 percent in 2001 to 71.40 percent in 2002. This is a positive development as it shows more efforts by the banking industry to perform their core business of financial intermediation.

Figure 22

LIQUID ASSETS TO TOTAL DEPOSITS

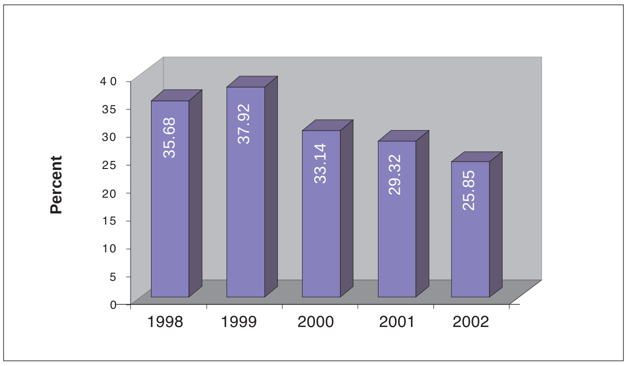
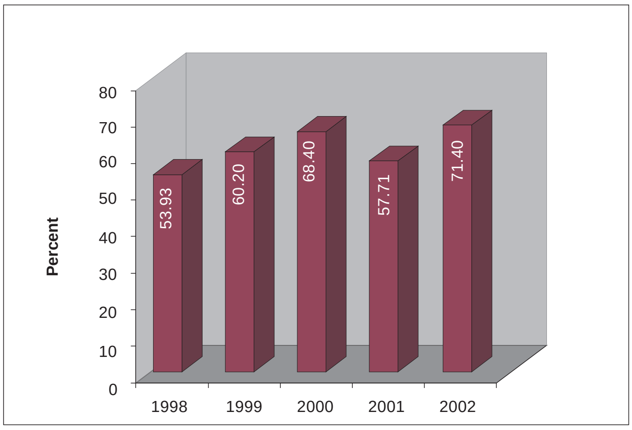


Figure 23

ADVANCES TO DEPOSITS RATIO



(g) Business Locations

There were changes in the geographical representation of banks during the year in terms of branch network, encashment points and Automated Teller Machines (ATMs). The number of ATMs increased from 115 in 2001 to 123 in 2002. It is worth noting that during the year Stanbic installed its first eight ATMs.

(h) Employment/Staffing

The total number of employees in the banking industry increased from 2 419 in 2001 to 2 500 in 2002, a growth of 3.35 percent, due to the significant increases in staff complements by Barclays and Stanbic of 78 and 30, respectively.

CHAPTER 2

MAIN OPERATIONAL ACTIVITIES AND DEVELOPMENTS DURING 2002

The following are some of the major developments in banking supervision activities during 2002.

(a) International Financial Services Centre (IFSC) Activities

As at December 31, 2002, the International Financial Services Centre Certification Committee had considered and approved 13 project proposals since commencement of the IFSC in 1999. In all cases, approval was granted on condition that the proposed projects were issued with either a banking licence or an exemption certificate by the Bank in accordance with the requirement of Section 137(4) of the Income Tax (Amendment) Act, 1999.

Out of the 13 project proposals approved by the IFSC Certification Committee, five applied for and had been issued with either a banking licence or an exemption certificate by the Bank. These are ABC Holdings Limited (ABCH), African Banking Corporation (International) Limited (ABCI), Seed Company International Limited, Kingdom Botswana (Pty) Limited and African Alliance International Limited. The remaining project proposals had not submitted applications to the Bank for licensing or exemption as at the end of the year.

In recognition of the need for an effective cross-border supervisory arrangement for the ABCH Group, which has operations in Zimbabwe, Zambia, Tanzania, Mozambique, Malawi and Botswana, the central banks in these countries signed a Memorandum of Understanding (MOU). Among others, the MOU established arrangements for the sharing of supervisory information among the respective supervisory authorities, for the conduct of on-site examinations and for continuing communication and cooperation to facilitate the performance of respective duties and responsibilities in respect of prudential supervision of ABCH, its subsidiaries and affiliated entities. The regulatory authorities agreed that the Reserve Bank of Zimbabwe will be the lead supervisor on a consolidated basis.

The Memorandum was executed in accordance with the spirit and principles embodied in the Basel Committee's Core Principles for Effective Supervision, and the associated Minimum Standards for Supervision of Cross-border Establishments.

(b) Collective Investment Undertakings (CIUs)

The Bank licensed African Alliance (Botswana) Management Company (Pty) Limited and African Alliance International Limited under Section 12 of the Collective Investment Undertakings Act, 1999 and Collective Investment Undertakings Regulations, 2001, to manage domestic investment funds and provide administration services for offshore funds, respectively. Stanbic Bank Botswana Limited was approved as a trustee for African Alliance Botswana Management Company (Pty) Limited funds. The Bank also approved the inward marketing of sub-funds of Hong Kong and Shangai Banking Corporation International Limited-Capital Secured Growth Fund (HSBC-CSGF) Plc, an umbrella fund licensed and regulated in Dublin, Ireland. The sub-funds are marketed through Capital Securities, a brokerage firm incorporated in Botswana.

(c) Licensing of New Banks

No new banks were licensed during the year. However, the Bank received a formal application from Kingdom Bank Africa Limited for a banking licence. (The application was still under consideration by the Bank when the Report went to press). Several enquires were also received from representatives of international banks as well as local and foreign individuals on the requirements for establishing a bank in Botswana, including the possibility of establishing Internet banks. As a result of some enquiries, the Bank is considering the review of existing legislative framework to reflect more recent changes in the technology of Botswana banking industry. The number of licensed and operating banks remained at seven as at December 31, 2002.

(d) Bureaux de Change Operations

As at December 31, 2002, the total number of operating bureaux de change was 25, with a total of 39 business locations (See Appendix 3). Five bureaux de change were licensed and commenced operations in Gaborone, Molepolole and Francistown during 2002. One bureau de change had its licence revoked because it had ceased operating.

Over the years, the volume of foreign exchange transacted through bureaux de change has increased significantly. In 2002, bureaux de change handled foreign exchange sales and purchases equivalent to P149.9 million and P115.2 million, respectively, compared to P104 million and P95 million, respectively in 2001. As depicted in Figure 24, quarterly figures for the year show that the bureaux continued to increase their volumes of foreign exchange trading.

Figure 24

QUARTERLY SALES AND PURCHASES OF FOREX BY BUREAUX de CHANGE (2002)

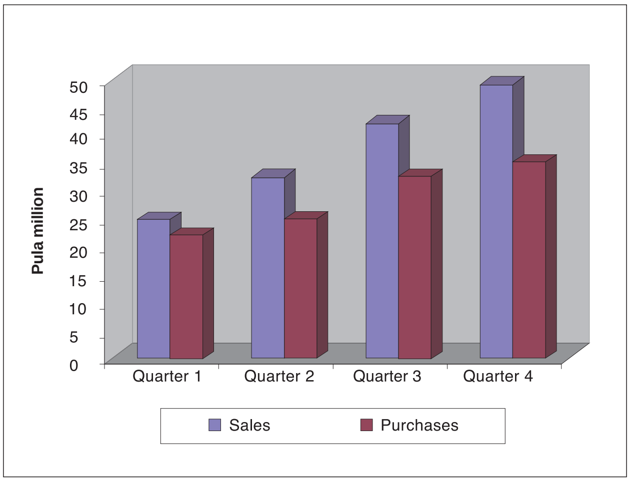
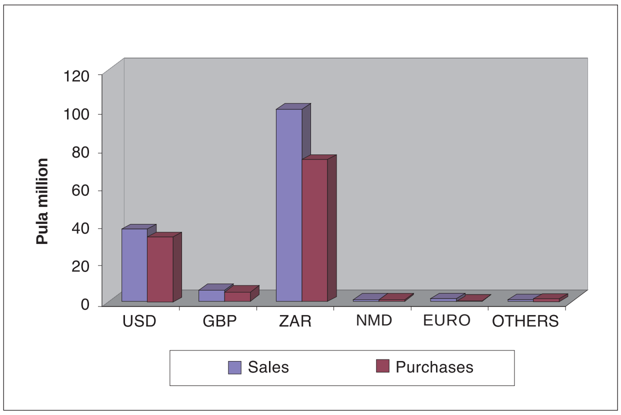


Figure 25 shows the foreign exchange currencies handled by bureaux de change in Botswana. During the year, bureaux de change dealt mostly in South African rand and United States dollars, which accounted for 70 percent and 27 percent, respectively, in terms of sales; and 65 percent and 31 percent, respectively, in terms of purchases. Other currencies which were traded included the British pound and the euro. Some bureaux, particularly those operating in the tourist areas of Kasane and Maun, traded in other currencies such as the Namibian dollar and Zambian kwacha on a small scale. There has been a significant decline in trade in the Zimbabwean dollar.

Figure 25

BUREAUX de CHANGE FOREX SALES AND PURCHASES BY CURRENCY (2002)



As in 2001, most of the bureaux de change were unable to produce audited accounts regularly, thus making it difficult to analyse the performance of the industry. The Bank will vigorously pursue the bureaux to submit the financial statements during 2003, and a provision has been made in the draft Bureaux de Change Regulations to include the imposition of a monetary fine for non-compliance.

(e) On-site Examination and Off-site Surveillance

The financial and other conditions of banks are assessed through regular bilateral meetings with the Bank, on-site examinations, risk profiling and early-warning management reports.

During 2002, the Bank conducted a limited scope on-site examination of First National Bank of Botswana Limited (FNBB), and a full scope on-site examination of African Banking Corporation of Botswana Limited (ABCB). These examinations were conducted in accordance with Section 24 of the Banking Act, 1995. The strategy and scope followed a risk-focused methodology. Overall the examinations found these banks to be in sound financial condition. However, there were some minor transgressions of the Banking Act, 1995 for which the Bank instituted the required supervisory action.

The Bank continued its off-site monitoring activities through the analysis of statutory returns and other financial reports. The analysis showed that all the banks' financial condition in terms of capital, liquidity, asset quality and profitability, satisfied regulatory requirements.

Regular supervisory and consultative meetings in the form of Banking Committee[2], bilateral and trilateral meetings were held with supervised financial institutions throughout the year. Bilateral meetings were also held with external auditors of individual financial institutions in accordance with Section 22(9) of the Banking Act, 1995. The discussions covered a wide range of supervisory topics; for example, audit programmes for banks, anti-money laundering, audit approach, as well as new developments on supervisory requirements and standards.

(f) Bank Charges

The perceived escalation of bank charges, which was in part precipitated by the introduction of the Value Added Tax (VAT) during 2002, remained a concern to the Bank. There was widespread public concern that the level of bank charges in the country was onerous relative to the quality of service. Consequently, the Bank discussed the matter with banks, the result of which has been a positive response by banks. While the search for a long-term solution continues, the Bank now requires banks to moderate tariff increases while abiding by the Policy on Disclosure of Bank Charges, which was implemented in February 2001.

The Disclosure Policy aims to achieve the following three objectives:

(i) transparency and simplicity of bank charges;

(ii) disclosure of full cost of credit, (effective annual interest rate); and

(iii) effective response to customers' complaints.

Its aim is to enable bank customers to compare charges and make informed decisions.

(g) Consumer Compliance Examinations

The Bank carried out two consumer compliance examinations in June and November, to determine the extent to which licensed institutions complied with the requirements of Section 40 of the Bank of Botswana Act, 1996, and Sections 39 and 44 of the Banking Act, 1995, respectively. The institutions examined were Stanbic Bank Botswana Limited (Stanbic), Barclays Bank of Botswana Limited (Barclays), Standard Chartered Bank Botswana Limited (Stanchart) and First National Bank of Botswana Limited (FNBB). The areas examined included administration of dormant accounts, anti-money laundering programmes, implementation of the Policy on Disclosure of Bank Charges and handling of customer complaints. Overall, all the banks were found to be complying with the law. However, the main concern with regard to some banks was delays in rectification of weaknesses highlighted in previous examination reports. Accordingly, the banks were instructed to attend to the weaknesses highlighted as a matter of urgency. Some other weaknesses noted were inconsistency in policy implementation across bank branches, and inadequate completion of disclosure forms for advances and overdrafts in one of the examined banks. The concerned banks were advised to enhance staff training on anti-money laundering, among others.

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2 Banking Committee is an industry-wide consultative forum on monetary, financial stability, industry welfare and other operations of banks. It is chaired by the Governor and meets twice a year.

(h) Capital Restructuring by Banks

During the year, Stanchart and Barclays applied for and were granted permission to raise Tier II capital through the issue of floating rate notes of up to P170 million and P150 million, respectively. Their respective initial issues were P75 million and P100 million. This development, together with the bond issue by Stanbic in 2001, suggest a major initiative by Botswana banks to restructure their capital bases for a more optimal use of capital funding of their activities.

(i) New Banking Products

A number of banks introduced new banking products during 2002. Stanchart introduced customer segmentation products, namely, Kgatelopele and Motswedi short-term loans. Stanbic introduced home loans and custody accounts. Investec introduced several retail treasury fixed deposit accounts.

CHAPTER 3

REGIONAL AND INTERNATIONAL SUPERVISORY COOPERATION

The Bank continued to participate in and follow regional and international banking supervisory activities in pursuit of the objective of strengthening supervisory standards and harmonising them with international best practice.

(a) East and Southern Africa Banking Supervisors Group (ESAF) Activities

The Bank was represented at the East and Southern Africa Banking Supervisors Group (ESAF) Annual General Meeting held in Cape Town, South Africa on September 17, 2002.

The major discussion at the meeting focused on ESAF becoming a sub-committee of the SADC Committee of Central Bank Governors (CCBG). A document entitled "Establishment of a sub-committee of central bank governors in SADC on banking supervision or to make ESAF an institution under CCBG" was circulated to member countries for their input. The draft document by CCBG requested ESAF's views, suggestions, recommendations and position on the possibilities of establishing a committee under CCBG to deal with banking supervision issues along the lines of existing specialist area sub-committees such as payment systems, human resources, information technology and balance of payments. The initiative was prompted by the realisation that some member countries were not giving adequate feedback to their Governors on the activities of ESAF. Members were of the view that ESAF should be allowed to continue in its present form. The matter is still under discussion.

During the year, ESAF was involved in the following projects;

(i) Micro finance Research Project

ESAF considers research an essential component of banking supervision and, in this regard has published a report on the ESAF website on a research project on micro finance. The purpose of the report was to develop best practice guidelines for a harmonised approach to micro finance in the region.

(ii) On-site Supervisory Model

ESAF is currently developing guidelines on best practice for on-site surveillance. The objective is to determine a minimum standard of on-site supervision.

(iii) Assessment on Implementation of Basel Core Principles for Effective Banking Supervision

Members continued to conduct self-assessment exercises in compliance with the Basel Committee Core Principles for Effective Banking Supervision.

(iv) Harmonisation of Licensing Standards

Another development was the preparation of a draft document on harmonising of licensing standards in the region. The project is still ongoing.

(b) Bank for International Settlements/ Basel Committee Activities

(i) International Conference of Banking Supervisors (ICBS)

The Bank was represented at the twelfth International Conference of Banking Supervision, held in Cape Town, South Africa, on September 17 - 18, 2002. The twin themes of the conference were the Review of the Basel Capital Accord (Basel II) and How to Create a Stable Financial Environment in Emerging Market Economies.

The deliberations on the Review of the Basel Capital Accord covered a number of issues relating to transition to Basel II for emerging market economies. Issues addressed on the second theme included dealing with weak banks, insolvency framework, micro finance, pre-conditions for supervisory authorities and corporate governance.

(ii) **Developments on the New Basel Capital Accord**

The New Basel Capital Accord is to be finalised during 2003 and implemented in 2006. During the three-year implementation period, banks and supervisors are expected to adapt and develop necessary systems and processes in conformity with the standards of the new Accord. The Basel Committee has issued several working papers for public discussion and has conducted quantitative impact studies to estimate the effect of its proposals on the level of capital that would be required of banks.

The banking industry worldwide has welcomed the longer period for consultations, following concerns that the proposals are complex and difficult to implement. On the other hand, regulators are concerned that the extended timetable may tempt some banks from making the necessary investments in time in preparation for the implementation of the new system. In the ESAF region, there is an argument that to accommodate all countries, with their differing levels of data collection capabilities, the design of the new Accord must:

- adopt a more differentiated risk weight framework; and
- ensure a level playing field not only between internationally active banks, but also for domestic banks.

CHAPTER 4

CHALLENGES FOR 2003 AND BEYOND

(a) New Basel Capital Accord

The Basel Committee on Banking Supervision will introduce a new capital adequacy framework for banks, known as the New Basel Capital Accord (Basel II), to replace the current Capital Accord, which first came into effect in 1988. Basel II, scheduled for implementation by the end of December 2006, sets the framework to align regulatory capital requirements more closely with underlying risks. The proposed capital framework for banks consists of three pillars, viz, minimum regulatory capital requirements (Pillar I), a supervisory review of an institution's capital adequacy and internal assessment process (Pillar II), and an effective use of market discipline (Pillar III). It will provide banks and supervisory agents with a number of options for determining capital requirements. The Bank recognises that the incentive-driven nature of the New Capital Accord will contribute towards enhancing financial stability as banking institutions will be encouraged to improve their internal risk assessment operations, systems and procedures as a means to reduce their capital charges under Pillar I of the Accord.

The 2000 Banking Supervision Annual Report provided detailed coverage of the structure of the new Accord. As the Bank prepares for its implementation, it has identified a number of challenges to be addressed:

(i) Selecting the Appropriate Method

Banks in Botswana are wholly foreign-owned and that implies that the Bank should maintain an open mind concerning the capital measurement framework to be adopted by banks in the country. In the final analysis, the choice of an appropriate framework will seek to achieve a balance between the capital measurement standards required by parent banks; discussions between the Bank and home supervisory agencies; and the Bank's own judgment on what is considered an optimal capital measurement framework for domestic banks.

(ii) Sensitisation Programme

The Bank has commenced arrangements for building internal capacity to enable it to coordinate consultations across the industry and direct discussions towards achieving a common understanding of the New Accord, as well as building industry consensus on implementation and regulatory considerations. Given the comprehensive nature of amendments to the 1988 Capital Accord, it will be necessary to thoroughly sensitise supervisors, financial institutions and other stakeholders ahead of its adoption and implementation. In addition to using its own resources, the Bank will draw on external resources to promote industry-wide awareness.

(iii) Capacity Building

The development of supervisory capacity to implement and monitor the compliance of banks under the New Capital Accord will be based on the assumption that all the risk measurement frameworks will be implemented in Botswana. Therefore, the initial capacity building strategy will aim to establish limited pools of expertise under each measurement framework.

(iv) Information Systems

A practical constraint which may affect the ability of banks to adopt advanced approaches to capital measurement is the fact that long-term historical data which is essential to the process of risk analysis across the banking industry is not readily available. To facilitate the credit-rating processes as envisioned in the New Capital Accord, considerable amounts of historical data will be required on the various types of risks to which the banks are exposed in order to compute reliable risk profiles.

(v) Legal and Regulatory Framework

The adequacy of existing legal and regulatory arrangements will be examined and the necessary reviews undertaken, with the objective of ensuring the existence of a sound legal and regulatory framework by the implementation date. The Bank will carefully examine the possible effects of lifting its current prudential capital adequacy ratio of 15 percent as it adopts Basel II, against the extent to which the current ratio may be serving as a proxy for operational risk. Due attention will be paid to the need to avoid a "one size fits all" approach which is discouraged under the New Accord.

(vi) Credit Risk Assessment Methodologies

The new Accord recommends two broad approaches to calculating minimum capital requirements, the Standardised and Internal Ratings Based Approaches. The proposed risk weighting methodologies under the Standardised Approach, which is the default minimum for compliance with the New Accord, places great emphasis on the utilisation of external rating agencies for credit scoring. The choice to adopt the Standardised Approach to measuring capital for Botswana banks may carry an implicit requirement for banks to obtain credit ratings for their exposures and the obvious risk of solicited ratings which the New Accord specifically wishes to discourage. The real challenge would be to manage the orderly emergence of rating agencies. The Internal Ratings Based Approach on the other hand poses its own set of problems. Although this method would accurately align the capital requirements of a bank with its intrinsic credit risk exposures, it relies on the banks' own internal risk assessment. This sophisticated method, therefore, would be a major challenge for supervisors given the fact that it will require extensive understanding of the method by supervisors.

(b) Consolidated Supervision

Through consolidated supervision of banks with international branches, supervisors are able to satisfy themselves about the efficient operation of all the branches of a banking group across jurisdictions, thus mitigating the risk of damaging loss of confidence if an associated enterprise in a different jurisdiction encounters financial difficulties. Consolidated supervision helps to protect the integrity and the confidence of markets in the supervised groups or entities. The main supervisory challenges deriving from the implementation of the New Accord for Botswana will be the need to harmonise capital measurement practices between host and home supervisors, whether primary or secondary.

Notwithstanding the specific challenges occasioned by the New Accord, the Bank will, in its role as a primary supervisor, maintain specific focus on the following key objectives:

(i) support the principle that no banking operation, wherever located, should escape supervision altogether;

(ii) prevent multiple-leveraging of capital; and

(iii) ensure that all the risks incurred by a banking group, no matter where they are booked, are evaluated and controlled on a global basis.

Since the Bank established the Banking Supervision Department in 1982, its supervisory and regulatory approaches have focused on banking related activities as those were, by far, the main business activities of banks. Of late, banks have been venturing into non-banking related business activities like insurance brokerage, asset management, microlending, etc; which will require consolidated supervision. Section 17(10)(b) of the Banking Act, 1995, guides the extent to which banks may engage in other undertakings.

In an effort to come up with a consolidated supervision framework, the Bank is facing several challenges including the following:

(i) some financial institutions are either inadequately regulated and supervised, or are not regulated at all;

(ii) the current thinking in the Bank is that a single regulatory structure may not be the most suitable arrangement for Botswana. Notwithstanding this, in the absence of a single supervisory authority, consolidated supervision would continue to be carried out in collaboration or cooperation with supervisors of other financial institutions such as building societies, insurance companies, asset management companies, pension and provident funds and stock and securities exchanges; and

(iii) the capacity and capability of supervisors to supervise groups would have to be enhanced, because unlike single institutions, groups are not easy to supervise due to their complex inter-relationships.

(c) Money Laundering and Combating of the Financing of Terrorism

Money laundering is an evolving phenomenon and has become a topical issue around the globe particularly after the events of September 11, 2001 in the United States. As such, anti-money laundering initiatives should equally evolve. During 2003 and beyond, the Bank and other stakeholders will have to focus on the following issues to ensure that the country meets international standards in Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) initiatives:

(i) issuing appropriate guidelines to financial institutions on money laundering as well as equipping banking supervisors with the necessary skills for the enforcement of compliance with the guidelines. Accordingly, the Bank submitted a Draft Directive on Anti-Money Laundering (AML) to the Attorney General's Chambers for legal drafting into AML regulations to be issued under the Banking Act, 1995. These regulations will be issued as an interim measure to ensure that banks, as the most vulnerable financial institutions, have appropriate guidance while consultations continue on developing more comprehensive regulations under the Proceeds of Serious Crimes Act, 1990. This approach will ensure that Botswana has a comprehensive and uniform set of regulations on AML measures for the whole economy;

(ii) cooperating fully in regional and international efforts to combat money laundering and the financing of terrorism. Botswana is also a member of a regional grouping called the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG), which was established to coordinate efforts in combating money laundering in the region. It is currently among the countries that have endorsed the 40 Guidelines on Anti-Money Laundering issued by the Financial Action Task Force (FATF);

(iii) building capacity in terms of human skills and general infrastructure of the Directorate of Criminal and Economic Crime (DCEC) to enable the institution to combat money laundering, the financing of terrorism and other financial crimes;

(iv) criminalising the financing of terrorism and enacting laws for the freezing of assets linked to terrorists and other criminals; and

(v) considering how best to prevent money laundering risks in the proposed privatisation programme.

The above challenges call for strategies to combat money laundering that are wide-ranging, involving governmental and private sector action in legal, regulatory, financial and law enforcement fields. As a first step, the revival of the National Task Force on Money Laundering will be given priority. The Task Force will be in a position to recommend legislative, regulatory or policy enhancements, which would then determine the agenda to be followed.

(d) Corporate Governance and Transparency

Corporate governance has been a topical issue globally in recent years. Corporate governance relates to the relationship between the shareholders, directors and management of a company, as defined by the corporate charter, bye laws, formal policies and domestic law. Banking supervisors hold the view that banking supervision cannot function effectively if sound corporate governance is not in place. Accordingly, banking supervisors have a strong interest in ensuring that there is effective corporate governance in financial institutions. This need is reinforced by the fact that banks are a critical component of the economy. They provide financing for commercial enterprises, basic financial services to a broad segment of the population and participate in the national payments system. Corporate Governance is a critical issue in financial institutions because of the high risk and the greater scope for fraud and related activities.Therefore, improving corporate governance for the banking sector is an important component of the national effort to achieve financial stability.

The Basel Committee on Banking Supervision, in its document "Enhancing Corporate Governance for Banking Organisations", cites corporate governance and transparency among the requirements of sound corporate governance practices. Guidance to banks on corporate governance is provided through Section 29(4) of the Banking Act, 1995, which states that;

> "No person shall become a director of a bank unless he is a fit and proper person in accordance with such criteria as may be determined by the Central Bank".

In an effort to promote good corporate governance, the Bank is drafting a policy on "Fit and Proper Test and Code of Good Conduct for Directors and Senior Management of Financial Institutions". The policy will set criteria for appointing persons to become directors of banks as required under Section 29(4) of the Banking Act 1995.

The proposed guidelines will, among others, address the following issues regarding directors and management:

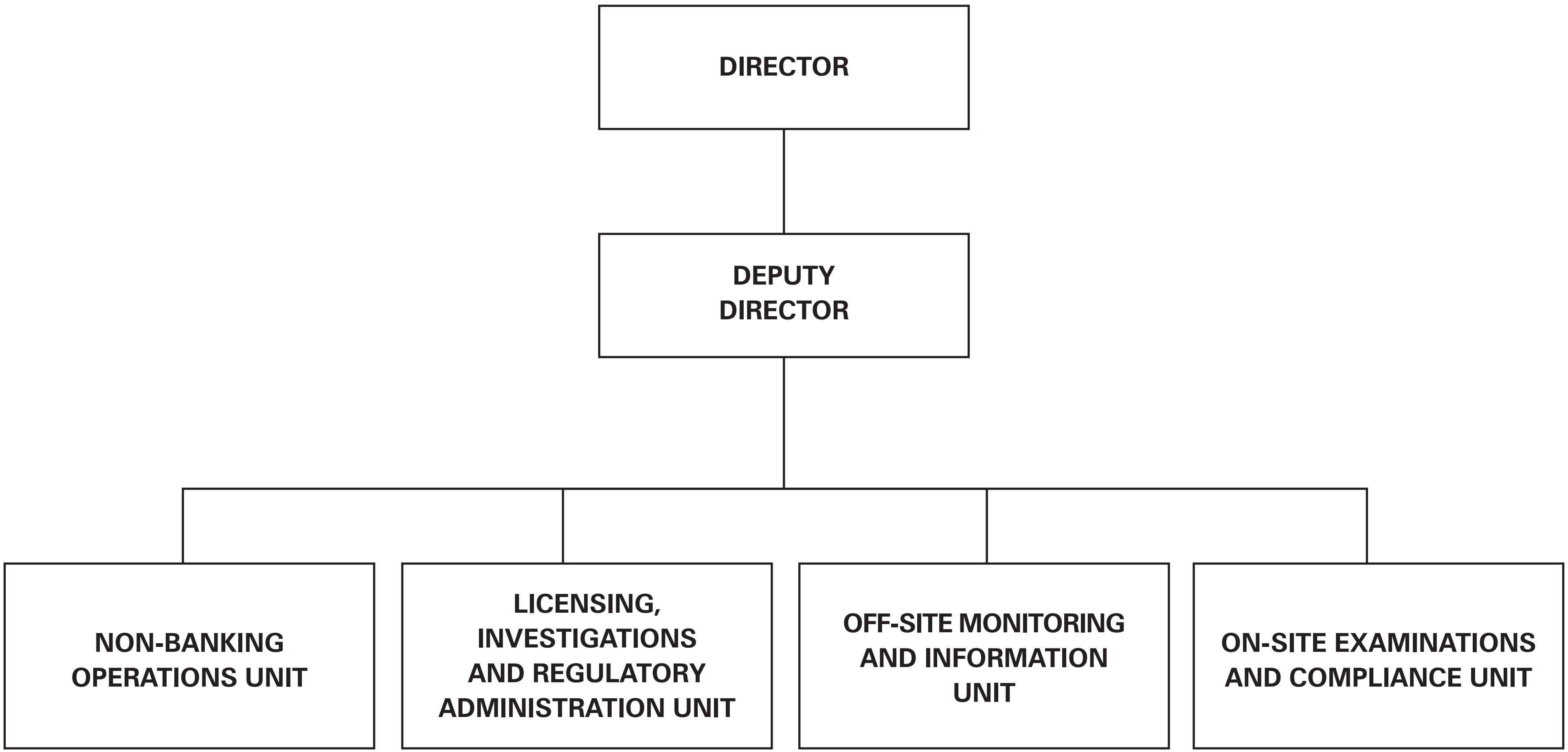
(i) misuse of position;
(ii) misuse of information;
(iii) conflict of interests;
(iv) confidentiality and transparency;
(v) separation of board and management functions;
(vi) dual directorship;
(vii) political interference;
(viii) banking knowledge; and
(ix) balance of skills.

Until the guidelines are finalised and implemented, the Bank will continue to be guided by the provisions of the Banking Act 1995, and other sources like the Organisation for Economic Cooperation and Development (OECD), Core Principles for Effective Banking Supervision, King Report of South Africa, and the Cadbury Report of United Kingdom.

APPENDICES

BANKING SUPERVISION DEPARTMENT

Organisation Chart



REGULATION AND SUPERVISION OF BANKS IN BOTSWANA

FRAMEWORK FOR SUPERVISION

Introduction

This Appendix outlines the basic elements of the framework, standards and processes for banking supervision in Botswana. The Bank is committed to the development of a sound, stable and competitive banking system which promotes savings mobilisation while responding, in a prudent and sustainable manner, to the credit requirements of the economy. The Bank also seeks to adhere to best international practice as enshrined in the Basel Committee's 25 Core Principles for Effective Banking Supervision (see Box 1).

Legal Framework

In general, it is considered that to be effective, a regulatory framework must have sufficient authority established by law, a high degree of independence or autonomy and adequate human and financial resources. In Botswana, the primary legislation covering the supervision and regulation of licensed financial institutions is the Banking Act, 1995. This legislation has been through various phases of development since it was first promulgated as the Financial Institutions Act, in 1975. Important elements of the Banking Act, 1995 are: explicit provisions for the licensing and authorisation processes, which give the Bank powers to regulate market entry; guidelines for the management and/or restructuring of banks in distress; the power to establish prudential supervisory standards and policies with respect to capital adequacy, liquidity, restrictions on large exposures, loans to insiders and quality of management; and rules governing accounting, auditing and disclosure of information.

The banking law also extensively covers matters of governance, market discipline within the banking system, and official supervision of the banking system. It is recognised that, primarily, the responsibility for bank soundness lies with owners and managers who have an incentive to operate banks prudently.

Market discipline provides further pressure and incentives for good internal governance and imposes sanctions for failures, particularly for institutions listed on the stock exchange. Official supervision is essential to provide external incentives for management and owners of banks to rectify inadequacies in governance and impose control where market behaviour could lead to imprudent conduct, which could have adverse systemic repercussions. These three aspects are subsumed within the legislation and prudential requirements. Thus, the continuing stability and soundness of the banking system and the extent to which it is effective in facilitating intermediation between savers and borrowers as well as operating the payments system, is a reflection of efficiency in all these three areas.

Authority for Licensing Banks

A central feature of banking supervision is establishing criteria for licensing of banks. Banking is a heavily regulated industry because of the fact that banks take deposits from the public, the key role of banks in the country's payments system, and, related to both of these functions, the potential for systemic risk in the event of banking problems. There are, as a result, regulatory barriers to entry that importantly influence the structure of the banking industry, in terms of the number, size and ownership of banks in the country. These market entry requirements must be carefully balanced with the public policy objective of a competitive and efficient banking system.

The responsibility for licensing banks is exclusively conferred on the Bank by Section 3 of the Banking Act, 1995. This section covers licensing of commercial banks, merchant/investment banks, credit institutions and discount houses.

Licensing Policy and Procedures for Establishing a Bank

The licensing requirements and procedures for establishing a bank in Botswana are set out in Sections 6 (1) and 8 of the Banking Act, 1995, and detailed in Banking Regulations 3, 4 and 5.

For any institution to be licensed as a bank in Botswana, it should satisfy the following requirements:

(a) be locally incorporated in Botswana;

(b) have the prescribed initial minimum capital, currently P5 million, and its owners must demonstrate willingness and ability to provide additional financial support as and when required;

(c) have adequate managerial capacity, which includes the appointment of "fit and proper" persons;

(d) in the case of foreign banks, the parent bank must be subject to adequate home supervision, and a consent of 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 allows effective consolidated supervision; and

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

Core Prudential Standards

Among the most significant prudential regulations on bank management are capital adequacy requirements, statutory and liquid asset requirements, legal lending or exposure limits, and asset quality requirements. Each of these are described briefly below.

1. Capital Adequacy Requirements

A bank must maintain a minimum capital adequacy (solvency) ratio of at least 8 percent, calculated as Unimpaired Capital divided by Total Risk Weighted Assets[3] See Appendix 4 for definition of technical terms. However, this is regarded as the statutory floor. Banks in Botswana are required to maintain their capital adequacy ratios at or above 15 percent which, in the current macroeconomic environment, is regarded as a safe and prudent level. The key issue is that a bank must maintain sufficient capital and other financial resources to match the nature and scale of its operations and the risks associated with them.

2. Reserve Requirements

In terms of Section 39 (1) of the Bank of Botswana Act, 1996, banks are required to maintain primary reserves against deposits and other similar liabilities as specified by the Bank. Currently, banks in Botswana are required to maintain primary reserves equivalent to 3.25 percent of their deposit liabilities.

Section 16(2) of the Banking Act, 1995, stipulates that every bank must maintain in Botswana, on a daily basis, liquid assets as a percentage of its deposit liabilities equal to 10 percent and 3 percent for commercial banks and credit institutions, respectively.

In general, a licensed financial institution should establish appropriate and prudent policies for the management of its liquidity. 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.

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[3] See Appendix 4 for definition of technical terms.

3. Asset Quality

(a) Asset Concentrations (Large Exposures)

Section 17 of the Banking Act, 1995, restricts a bank from granting facilities that are in excess of 10 percent of a bank’s unimpaired capital to a single or group of related customers without the specific approval of a bank’s entire board of directors. Furthermore, a bank is required to seek prior approval of the Bank before granting loans and other credit facilities which, in aggregate, are in excess of 30 percent of a bank's unimpaired capital.

(b) Insider Lending

Section 17 also restricts banks from granting 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 a bank’s entire board of directors. In addition, no bank may grant facilities, direct or indirect, to a member of its board of directors in excess of 25 percent of its unimpaired capital.

(c) Provisions

Section 14 of the Banking Act, 1995, deals with certain items, which should be provided for; that is, reserves to be made to take into account potential losses when determining a bank's capital adequacy. It establishes the legal framework for the Bank of Botswana to assess adequacy of the provisions for non-performing assets.

4. Main Supervisory Approaches

(a) On-site Examinations

The Bank conducts routine on-site examinations pursuant to Section 24 (1) of the Banking Act, 1995. The Bank may also conduct an examination of a bank if so petitioned by one fifth of depositors as provided for under Section 24 (3) of the Banking Act, 1995.

Effective 2000, the Bank adopted a risk-based approach to supervision. This approach entails identification and understanding of the primary business risks of an individual financial institution, and then focusing examination work on these risk areas. The objectives of on-site examinations are to assess and evaluate the overall condition and financial soundness of the institution, its compliance with applicable laws and regulations, and to check the accuracy of statutory reports submitted to the Bank.

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

The evaluation of the financial soundness of the institution is achieved by assessing Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Market Risk Sensitivity components (referred to as CAMELS), and adherence to statutory prudential limits in each of these areas.

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

The internal control systems are also assessed to determine their effectiveness and the role of the internal audit function. Effective running of operations depends on the adequacy of records maintained, the adoption and implementation of appropriate systems and controls for its functioning and efficiency in preventing fraud and defalcations.

Adequacy of supervision of management and effective participation in policy formulation and leadership by a bank's board of directors are important. The Bank also reviews management letters from external auditors to ensure that recommendations are implemented expeditiously and effectively.

(b) Off- site Monitoring

Licensed financial institutions are required to submit statutory returns in a prescribed format to the Bank as per Section 20 (1) of the Banking Act, 1995. The Act also provides for discussions among the Bank, respective licensed financial institutions and their external auditors as per Sections 22 (8) and 22 (9) of the Banking Act, 1995. Banks also submit audited annual financial statements in a format and disclosure standard prescribed by the Bank in line with International Accounting Standard 30.

Off-site monitoring is used to collect and analyse information, on a regular basis, to determine financial performance of a bank. It is also used for early detection of signs of problems so that corrective measures could be taken in a timely manner. Individual institutions are compared with peers and historical trends are monitored. In case of signs of negative developments, the matter is brought to the attention of the management of the institution concerned.

As part of the Bank's early warning surveillance, the monthly and quarterly returns submitted to the Bank by licensed financial institutions are analysed in order to record changes in the CAMELS components. Any significant negative change in any of these components is investigated and the financial institution concerned is monitored in the affected area until there is an improvement. This would normally include a special meeting to discuss the particular performance area, or the issue could be raised at any of the regular scheduled meetings.

In addition to monitoring absolute changes in the balance sheet items, common sizing the balance sheet is used in order to identify proportions of risk areas and any change in the structure of the banks' balance sheets. For example, a significant change in "balances due from foreign banks" is monitored in order to ensure that the counterparty banks are of acceptable credit rating to minimise risks to the domestic banking industry. As part of its early warning surveillance, the Bank assesses non-adherence to sound banking principles, material changes in accounting policies, deterioration of a bank's asset quality, weakening of liquidity position, declining capital position, and any other circumstances of a bank which could ultimately endanger the safety of depositors' funds.

(c) Statutory Meetings

(i) Bilateral Meetings

In accordance with Section 22 (9) of the Banking Act, 1995, the Bank holds bilateral meetings annually with the external auditors of the financial institutions it supervises. The meetings are part of the Bank's strategy to enhance complimentarity of its role as a supervisor and that of statutory auditors. At such meetings, bank auditors are expected to disclose to the Bank any material issues that may adversely affect the performance of a bank. It is also at such meetings that the Bank takes the opportunity to discuss with auditors, its expectations regarding the scope of statutory audits and other general issues of a prudential nature.

Bilateral meetings are held once a year with all supervised financial institutions. These meetings provide a forum for exchange of views on matters affecting the supervised institution and serve to improve communication and information flow between the Bank and the supervised financial institutions.

(ii) Trilateral Meetings

In addition to the separate bilateral meetings with both external auditors and the respective licensed financial institutions, the Bank, pursuant to Section 22(8) of the Banking Act, 1995, holds tripartite meetings with each financial institution and its external auditors. These 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 balance sheet and profit and loss account. The forum is also used to share information on the critical risk areas and/or any new developments in accounting and regulatory standards.

Accounting, Auditing and Disclosure Standards

Section 22 of the Banking Act, 1995, requires banks to annually appoint independent external auditors, acceptable to the Bank. Statutory audits are conducted annually, usually at financial year-end, except that when a bank intends to capitalise half-year interim profits, it must call for an audit of the accounts. The Bank expects at least one monthly statutory return each year to be audited. A change of external auditors or financial year-end requires prior approval of the Bank.

Core Principles For Effective Banking Supervision

The Bank, like other supervisory authorities, is guided in its supervisory approach by the Basel Committee's Core Principles for Effective Banking Supervision. The Core Principles were released by the Basel Committee on Banking Supervision in 1997 for use in both G-10[4] G10 comprises 11 countries: the United States of America, Japan, Germany, Canada, Britain, France, Italy, The Netherlands, Belgium, Sweden and Switzerland. and non-G10 countries. They comprise 25 Core Principles that need to be in place for a supervisory system to be effective and are used as a benchmark in the development of a country's supervision strategies. The main objective of the Core Principles is to harmonise international supervisory standards. In Botswana, they are also used to reinforce international best practice in banking supervision.

The Bank annually conducts a detailed self-assessment for compliance with the Core Principles using the methodology adopted by the international banking supervisors and recommended by the International Monetary Fund, and submits the report to the East and Southern Africa Banking Supervisors Group (ESAF). Box 1 below presents the 25 Core Principles for Effective Banking Supervision.

[4] G10 comprises 11 countries: the United States of America, Japan, Germany, Canada, Britain, France, Italy, The Netherlands, Belgium, Sweden and Switzerland.

BOX 1: LIST OF CORE PRINCIPLES FOR EFFECTIVE BANKING

Pre-conditions for Effective Banking Supervision

1. *An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking organisations and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.*

Licensing and Structure

2. *The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.*

3. *The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or partner is a foreign bank, the prior consent of its home country supervisor should be obtained.*

4. *Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.*

5. *Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose a bank to undue risks or hinder effective supervision.*

Prudential Regulations and Requirements

6. *Banking supervisors must set minimum capital adequacy requirements for all banks. Such requirements should reflect the risk that the banks undertake, and must define the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the Basel Capital Accord and its amendments.*

7. *An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.*

8. *Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.*

9. *Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.*

10. *In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.*

11. *Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate reserves against such risks.*

12. *Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.*

13. *Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.*

14. *Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.*

15. *Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.*

Methods of Ongoing Banking Supervision

16. *An effective banking supervisory system should consist of some form of both on-site and off-site supervision.*

17. *Banking supervisors must have regular contact with bank management and thorough understanding of the institution's operations.*

18. *Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a solo and consolidated basis.*

19. *Banking supervisors must have a means of independent validation of supervisory information either through on-site examination or use of external auditors.*

20. *An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.*

Information Requirements

21. *Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.*

Formal Powers of Supervisors

22. *Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking licence or recommend its revocation.*

Cross-Border Banking

23. *Banking supervisors must practise global consolidated supervision over their internationally active banking organisations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these organisations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.*

24. *A key component of consolidated supervision is establishing contact and information exchange with various other supervisors involved, primarily host country authorities.*

25. *Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.*

Source: Basel Committee on Banking Supervision

FINANCIAL INSTITUTIONS IN BOTSWANA

(a) SUPERVISED FINANCIAL INSTITUTIONS AS AT DECEMBER 31, 2002

Institution	Postal Address	Business Locations*	External Auditors
COMMERCIAL BANKS			
Barclays Bank of Botswana Limited	P O Box 478 Gaborone	39	PricewaterhouseCoopers
Standard Chartered Bank Botswana Limited	P O Box 496 Gaborone	20	KPMG
First National Bank of Botswana Limited	P O Box 1552 Gaborone	13	Deloitte & Touche
Stanbic Bank Botswana Limited	P/Bag 00168 Gaborone	8	KPMG and PricewaterhouseCoopers
Bank of Baroda (Botswana) Limited	P O Box 21559 Gaborone	1	Grant Thornton Acumen
INVESTMENT BANKS			
Investec Bank (Botswana) Limited	P O Box 49 Gaborone	1	Ernst & Young
African Banking Corporation of Botswana (Pty) Ltd	P/Bag 00303 Gaborone	2	KPMG
STATUTORY BANKS			
Botswana Savings Bank[5]	P O Box 1150 Gaborone	1	PricewaterhouseCoopers
National Development Bank	P O Box 225 Gaborone	4	Deloitte & Touche
BUILDING SOCIETIES			
Botswana Building Society	P O Box 40029 Gaborone	9	Deloitte & Touche

* Branches, sub-branches, agencies and encashment points.

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

(b) BUREAUX DE CHANGE AS AT DECEMBER 31, 2002

Name	Postal Address	Business Location[6]
Universal Bureau de Change	P O Box 2444 Gaborone	1
Garona Bureau de Change	P O Box 408 Gaborone	5
Kasane Bureau de Change	P O Box 55 Kasane	1
Sunny Bureau de Change	P O Box 370 Maun	1
Exim Bureau de Change	P O Box 1020 Gaborone	1
ASA Bureau de Change	P O Box 2 Lobatse	4
Prosper Bureau de Change	Private Bag BO7 Gaborone	4
Kwanokeng Bureau de Change	P O Box 10 Sherwood	1
Proxy Bureau de Change	P O Box 404108 Gaborone	2
Edcom Bureau de Change	P O Box 502429 Gaborone	2
Thari Bureau de Change	P O Box 40074 Gaborone	1
La-Civette Tshipalore Bureau de Change	Private Bag 326 Maun	1
Sherwood Ranch Bureau de Change	P O Box 1 Sherwood	2
Madikwe Bureau de Change	P O Box 402885 Gaborone	1
Aldaph Bureau de Change	P O Box 41436 Gaborone	1

Cont/

[6] Branches and Head Office

Cont/

Name	Postal Address	Business Location[6]
Counter Bureau de Change	Private Bag F388 Francistown	1
Kalahari Bureau de Change	P O Box 1116 Gaborone	1
Maeto Bureau de Change	P O Box 22 Mahalapye	1
Bellagio Bureau de Change	Private Bag BR 321 Gaborone	2
Ngina Bureau de Change	P O Box 39 Francistown	1
SMI Bureau de Change	P O Box 201641 Francistown	1
American Express Bureau de Change	P O Box 45140 Francistown	1
Star Bureau de Change	P O Box 80491 Francistown	1
Motswedi Bureau de Change	P O Box BR 291 Francistown	1
Unity Bureau de Change	P O Box 1586 Francistown	1

DEFINITION OF TERMS

(a) CAPITAL ELEMENTS

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

1. **Tier 1 [Core Capital = Sum of 1(a) to (e) less (f) to (h)]**

   (a) Ordinary Shares (issued and paid-up)
   (b) Perpetual (non-redeemable) Non-cumulative Preferred Shares
   (c) Disclosed prior years' reserves (audited)
       (i) Share Premium
       (ii) General Reserves
       (iii) Accumulated retained earnings
   (d) Published current year's retained earnings
   (e) Minority Interests

less

   (f) Current year's unpublished losses
   (g) Goodwill and other intangible assets
   (h) Shareholders' equity funded through the capitalisation of unrealized gains arising from property revaluation

2. **Tier 2 Capital [Supplementary Capital = Sum of 2(a) to 2(g)]**

   (a) Current year's unpublished profits
   (b) 50% of fixed asset revaluation reserves
   (c) Unencumbered general provisions not to exceed 1.25% of risk weighted assets
   (d) Hybrid (debt/equity) capital instruments (eligible for inclusion)
   (e) Subordinated term debt (eligible for inclusion)
   (f) Minority interests (in Tier 2 preference shares)
   (g) Shareholders' equity funded through the capitalisation of property revaluation reserves

3. **Impairments of Capital = Sum of 3(a) to 3(d)**

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

4. **Total Capital Funds = Sum of 1 and 2**

5. **Total Unimpaired Capital : 4 - 3**

(b) RISK WEIGHTS

TYPE	RISK FACTOR(%)
On-Balance Sheet Items	
Cash (Pula notes)	0
Balances of Accounts held at Bank of Botswana	0
Loans, advances and other credit facilities to the Government of Botswana or fully and unconditionally guaranteed by the Government of Botswana	0
Assets secured by a lien or pledge over fixed/notice or savings deposits (cash) held by the (same) bank	0
Central Bank Securities (BoBCs)	0
Advances collateralized by BoBCs or any securities issued by the Government of Botswana	0
Foreign currency notes	20
Advances to Local Government Authorities	20
Cash items in the process (course) of collection	20
Assets secured by cash investments held at another domestic bank/local financial institution	20
Due from other banks - demand or maturity under 1 year	20
Loans and other advances secured by first class bank guarantees acceptable to the Bank of Botswana	20
Loans secured by recognised multilateral development financial institutions (e.g. IBRD, ADB, etc)	20
Claims to or credit facilities guaranteed by Statutory Corporations (Parastatals)	20
Claims to or credit facilities guaranteed by Debswana	20
Assets due from or guaranteed by other domestic public sector entities	50
Loans secured by owner occupied residential property	50
Loans secured by commercial and industrial property	100
Financial leases, factoring agreements and hire purchase contracts	100
Due from other banks maturing over 1 year	100
Credit facilities to subsidiaries of parastatals (claims on commercial companies owned by public sector entities (e.g. BDC subsidiaries)	100
Eligible equity investments	100
All other private sector advances	100
All other assets	100

Off-Balance Sheet Items	
Direct credit substitutes (guarantees, Standby L/Cs, Bankers Acceptances)	100
Assets securitised with recourse	100
Transaction related contingent items (performance bonds, bid bonds, etc.)	50
Formal commitments, credit lines (original maturity over 1 year-undrawn commitments) and underwriting and note-issuance facilities	50
Short-term self-liquidating, trade related (documentary credits secured by shipment)	20
Forward foreign exchange contracts (over 1 year)	5
Forward foreign exchange contracts (under 1 year)	1
Undrawn commitments, original maturity under 1 year or less or can be cancelled	0
Currency swaps	0
BoBCs held on behalf of customers	0

(c) OTHER TERMS

(i) **Asset Concentration:** Measures aggregate exposure to one borrower, an affiliated group of borrowers, or borrowers with a common controlling interest, common management, cross-guarantees or financial interdependency which cannot be substituted in the short term. This exposure is usually expressed as a percentage of a bank's unimpaired capital and its various thresholds are subjected to prudential regulatory requirements. In terms of the Banking Act, 1995, 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 a lending financial institution. Exposure in excess of 30 percent of a bank's unimpaired capital requires prior Bank of Botswana approval.

(ii) **Asset Quality:** A relative measure of the performance of a bank's loan portfolio based on the appraisal of the asset, concerning the degree of risk and the likelihood of recovery, adherence to the terms of contracts and orderly liquidation of the account. Good quality asset means the loan, advance, or investment is producing cashflow as was expected and/or terms agreed upon.

(iii) **Adverse Classifications:**

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

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

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

(iv) **Core Capital:** An aggregate of share capital, share premium, general reserve and retained earnings, also called Tier 1 capital. It represents the most stable and permanent form of capital for supporting a bank's operations. (See Appendix 4 for computations)

(v) **Total Risk Weighted Assets:** An aggregate of total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk weighting are presented on page 38.

(vi) **Unimpaired Capital:** Unimpaired in relation to the capital of a bank means the absence of any legal or technical covenant, term, restriction or encumbrance which would otherwise render such capital not to be freely available for distribution to depositors or other creditors in the event of liquidation or dissolution of the bank, and the absence of any condition or arrangement which would, in the opinion of the Central Bank, diminish the value of the whole or any portion of the capital of the bank. An outline of capital elements used to compute unimpaired capital is presented on page 37.

(vii) **Weighted Classifications:** represents an aggregate of 20 percent of the value of accounts classified “Substandard”, 50 percent of the value of accounts classified “Doubtful” and a total of the value of accounts classified "Loss".

(d) RATIOS

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

(ii) **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 assets are the base from which earnings are primarily derived. The ratio measures the earnings capacity of the assets of the financial institution. It measures profit earned against the amount invested in assets and is the key to profitability measurement as it shows how efficiently a financial institution's assets are employed. It is also used to measure the effectiveness of management's decisions with respect to resource utilisation. The higher the ratio, the more efficient the management is in its asset allocation decisions.

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

(iv) **Capital Growth:** The ratio measures the impact of retained income and other capitalised funds on the capital base of a bank. Ideally, the bank's rate of income retention must keep pace with its asset growth, or risk exposure. Where there is a disparity in growth, especially with acceleration of the latter, the bank's solvency will be gradually weakened.

(v) **Risk Based Capital:** In November 1995, the Bank adopted the internationally recommended framework on capital adequacy standards and measurement for banks, commonly known as the Basle Committee framework. In terms of this framework, capital adequacy is measured by the ratio of Unimpaired Capital to Risk Weighted Assets. The move to this method of capital adequacy measurement has sensitised banks to the type of assets they hold and balance sheet risk profiles. It has also broadened and standardised the acceptable supplementary capital items such as unencumbered general provisions, fixed assets revaluation reserves (adjusted by a 50 percent factor) and interim profits (provided an audit had been carried out). It, however, excludes 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 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 balance sheet is taken into consideration, the bank with less risky assets will enjoy a higher lending capital ratio and can, therefore, expand its business by lending to large borrowers, if opportunities arise. A good capital base ensures that adequate funds are freely available on a permanent basis to absorb risks inherent in the types of assets held by a bank, its off-balance sheet transactions, its foreign exchange dealing operations and all other risks associated with its business.

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

$$\frac{\text{Interest Earned}}{\text{Loans}} \times 100 - \frac{\text{Interest Paid}}{\text{Interest Earning Deposits}} \times 100$$

(vii) **Net Interest Margin (Percent):** This ratio identifies the core earnings capability of the bank - its interest differential income as a percentage of average total assets. It is calculated as follows:

$$\frac{\text{Interest Income} - \text{Interest Expense}}{\text{Average Total Earning Assets}} \times 100$$

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

$$\frac{\text{Other Operating Income}}{\text{Average Total Assets}} \times 100$$

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

$$\frac{\{\text{Yield on Earning Assets} + \text{Related Fees} \times 100\}}{\{\text{All Financial Assets}\}} - \frac{\{\text{Interest Expense} \times 100\}}{\{\text{All Funding Liabilities}\}}$$

(x) **Net Income Per Staff:** The ratio measures the average income generated by each staff member. Note that this ratio will be significantly different for a wholesale (investment) bank with relatively few but high paid staff compared to a retail bank with a large branch network and many low paid clerical staff. It is calculated as follows:

$$\frac{\text{Net Income After-Tax}}{\text{Total Number of Staff}}$$

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

$$\frac{\text{Net Income After-Tax}}{\text{Total Expense}}$$

(xii) **Cost to Income:** The ratio measure 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 in question relative to the level of total operating income.

(xiii) **Average Cost of Deposits:** The ratio measures interest paid on deposits as a percentage of total average deposits. It shows the average cost of deposits.

SUPPORTING DATA TABLES

TABLE 1: AGGREGATE BALANCE SHEET OF LICENSED FINANCIAL INSTITUTIONS IN BOTSWANA (PULA '000)

Total Assets in Local Currency	**1998**	**1999**	**2000**	**2001**	**2002**
1. Cash and balances with the Central Bank	369 506	328 426	350 580	471 622	610 776
a. Currency	160 149	229 067	207 875	258 741	323 079
aa.Hard currency and gold bullion	15 127	25 911	36 576	38 021	33 698
ab. Local currency	145 022	203 156	171 299	220 720	289 381
b. Balances with Central Bank	209 357	99 359	142 705	212 881	287 697
c. Other			-	-	-
2. Trading securities at market value (BoBCs)	1 325 148	1 719 382	1 299 930	2 015 023	1 946 893
3. Placements with other banks and credit institutions	1 445 377	1 434 157	1 533 686	2 997 249	1 959 700
4. Loans and advances to other customers (net of specific provisions)	2 971 969	4 123 905	4 964 375	5 608 577	6 862 939
5. Investment securities	174 470	192 531	150 992	78 378	87 155
6. Fixed assets net of depreciation	130 660	160 136	167 999	178 031	197 788
7. Other assets (net)	184 705	198 314	535 102	274 769	329 854
Total Assets	**6 601 835**	**8 156 851**	**9 002 664**	**11 623 649**	**11 995 105**
Liabilities in Local Currency					
1. Amounts owed to government institutions	129 041	125 614	121 905	117 882	113 567
a. Central Bank accounts	-	-	-	-	-
b. Direct Government credits (CB or MoF)	129 041	125 614	121 905	117 882	113 567
c. Other -	-	-	-		-
2. Due to other banks and credit institutions	126 676	159 378	227 217	229 047	334 012
3. Securities sold under repurchase agreements	-	-	-	-	-
4. Due to other customers/depositors	5 511 201	6 850 794	7 257 799	9 718 403	9 611 536
5. Shareholders funds	550 800	658 015	829 762	1 014 334	1 167 949
6. Other liabilities	-	363 050	565 981	543 983	768 041
a. Taxes payable	49 077	61 818	79 319	116 680	126 427
b. Dividends payable	48 762	65 297	139 864	184 590	219 356
c. Accrued expenses	17 491	32 000	44 152	41 145	49 321
d. Other	168 787	203 935	302 646	201 568	327 937
7. Other borrowing incl. International lending agencies	-	-	-	-	-
Total Liabilities	**6 601 835**	**8 156 851**	**9 002 664**	**11 623 649**	**11 995 105**

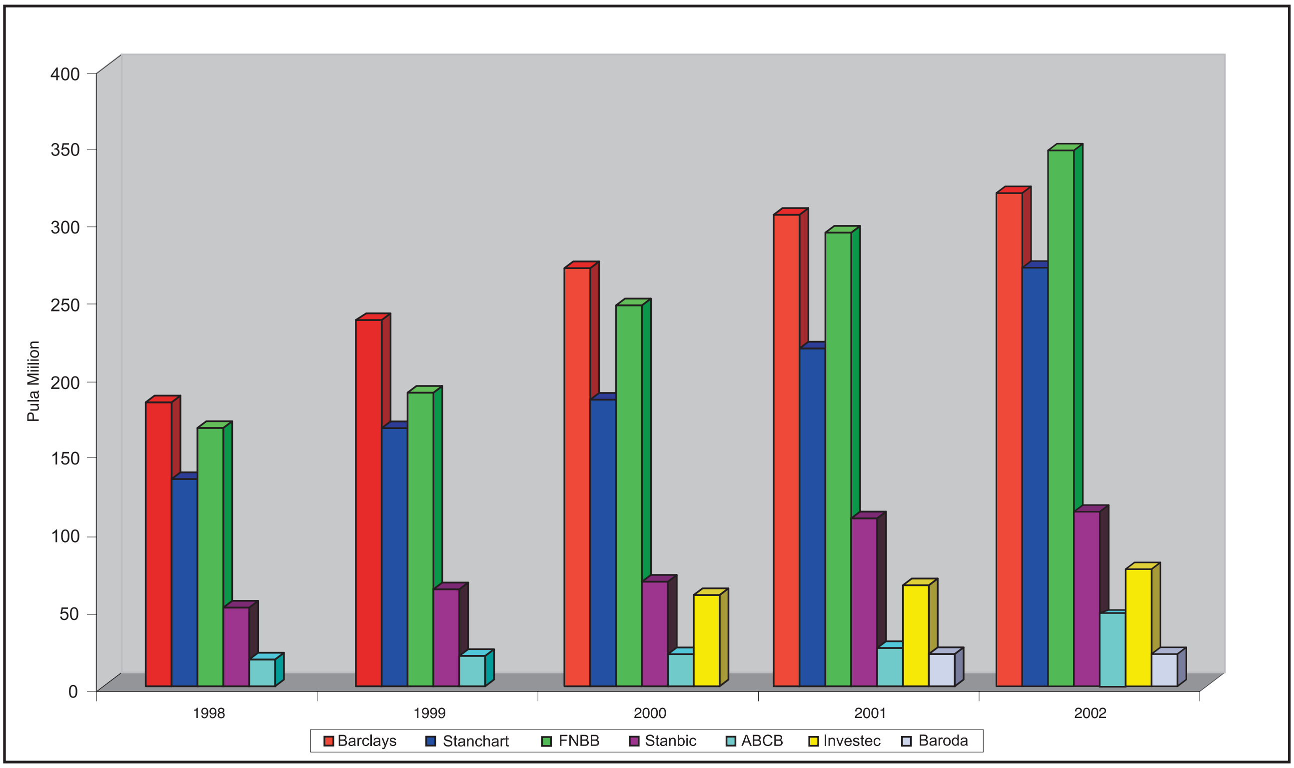
TABLE 2: AGGREGATE INCOME STATEMENT OF LICENSED FINANCIAL INSTITUTIONS IN BOTSWANA (PULA '000)

	1998	1999	2000	2001	2002
1. Interest and similar income	664 308	886 158	1 101 719	1 320 220	1 544 842
2. Interest expense	342 711	450 796	565 166	676 929	779 438
3. Net interest income [1-2]	321 597	435 362	536 553	643 291	765 404
					-
4. Other operating income	189 730	224 256	278 027	367 513	452 158
					-
5. Gross operating income/(loss) [3+4]	511 327	659 618	814 580	1 010 804	1 217 562
					-
6. Bad and Doubtful Debts Provisions	N/A	N/A	7 527	43 960	46 502
a) Specific loss provision expenses	N/A	N/A	19 966	43 871	61 295
b) General loss provision	N/A	N/A	1 537	7 304	8 344
c) Releases and Recoveries of bad debts previously written off	29 109	77 508	5 577	7 215	23 137
		-	-		-
7. Operating income/(loss) net of specific loss provisions	482 218	582 110	807 053	966 844	1 171 060
					-
8. Operating expenses	234 420	290 745	356 681	446 847	574 341
a) Salaries and employee benefits	114 007	140 132	177 070	213 006	262 422
b) Administrative expenses	8176	18 231	21 257	16 604	22 168
c) Auditing and consulting expenses	2 642	2 787	1 354	3 398	6 913
d) Rents paid	6 545	7 442	-	6 649	9 255
e) Depreciation and amortization	11 007	20 061	25 916	30 686	30 029
f) Other	92 043	102 092	131 084	176 504	243 554
					-
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]	247 798	291 365	450 372	519 997	596 719
					-
11.Extraordinary Gains/(Losses)	-	-	728	-	1 974
a) Gains/Losses on revaluation of assets (NET)	-	-	-	-	1 974
b) Translation Gains/Losses (NET)	-	-	-	-	-
c) Other Gains/Losses	-	-	728	-	-
					-
12. Net income/(loss) before tax [10+11]	247 798	291 365	451 100	519 997	594 745
13. Income tax	58 294	57 715	99 460	108 621	83 672
14. Net income/(loss) aftertax [12-13]	189 504	233 650	351640	411 376	511 073
15. Transfers from revaluation/to general provisions	-	-	-		833
16. Dividends declared (Paid & Proposed)	83 861	92 371	167 728	269 649	509 774
17. Retained earnings for the year [14-15-16]	105 643	141 279	183 912	141 727	2 132
18. Retained earnings at the beginning of the year	159 859	159 860	159 861	269 649	390 090
19. Retained earnings at the end of the year [17+18]	265 502	301 139	343 773	141 727	392 222

CHARTS OF KEY PRUDENTIAL INDICATORS

CHART 1

TOTAL CAPITAL



Note: ulc converted into a merchant bank in 2001 and changed its name to ABCB

CHART 2

UNIMPAIRED CAPITAL

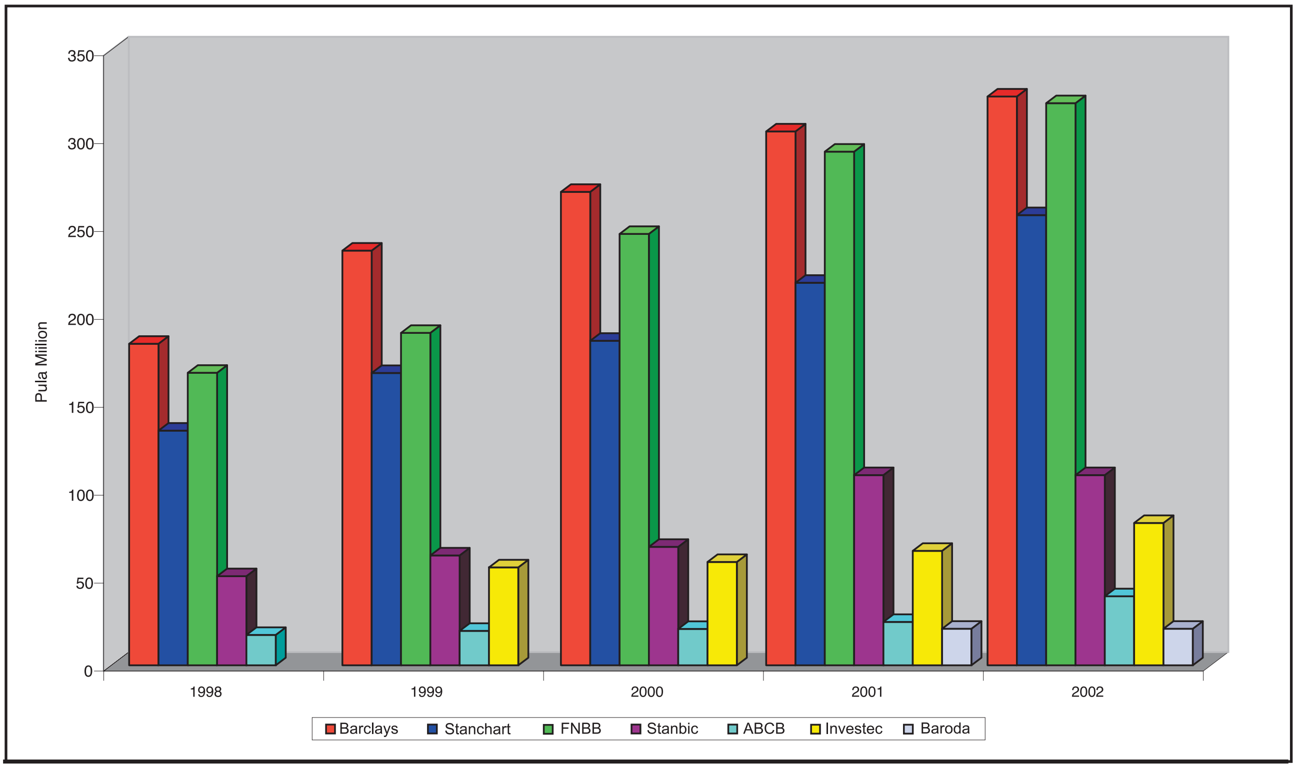


CHART 3

UNIMPAIRED CAPITAL TO RISK WEIGHTED ASSETS (CAPITAL ADEQUACY RATIO)

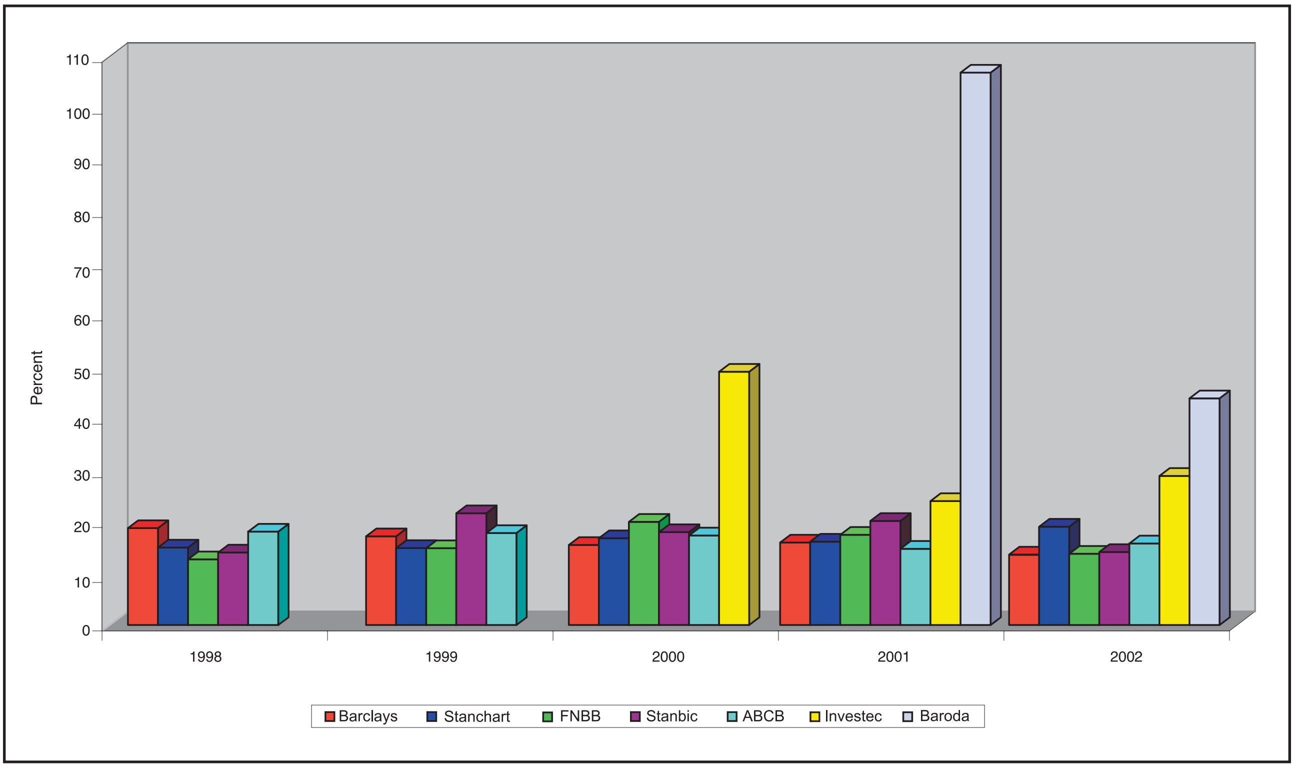


CHART 4

CORE CAPITAL TO TOTAL CAPITAL

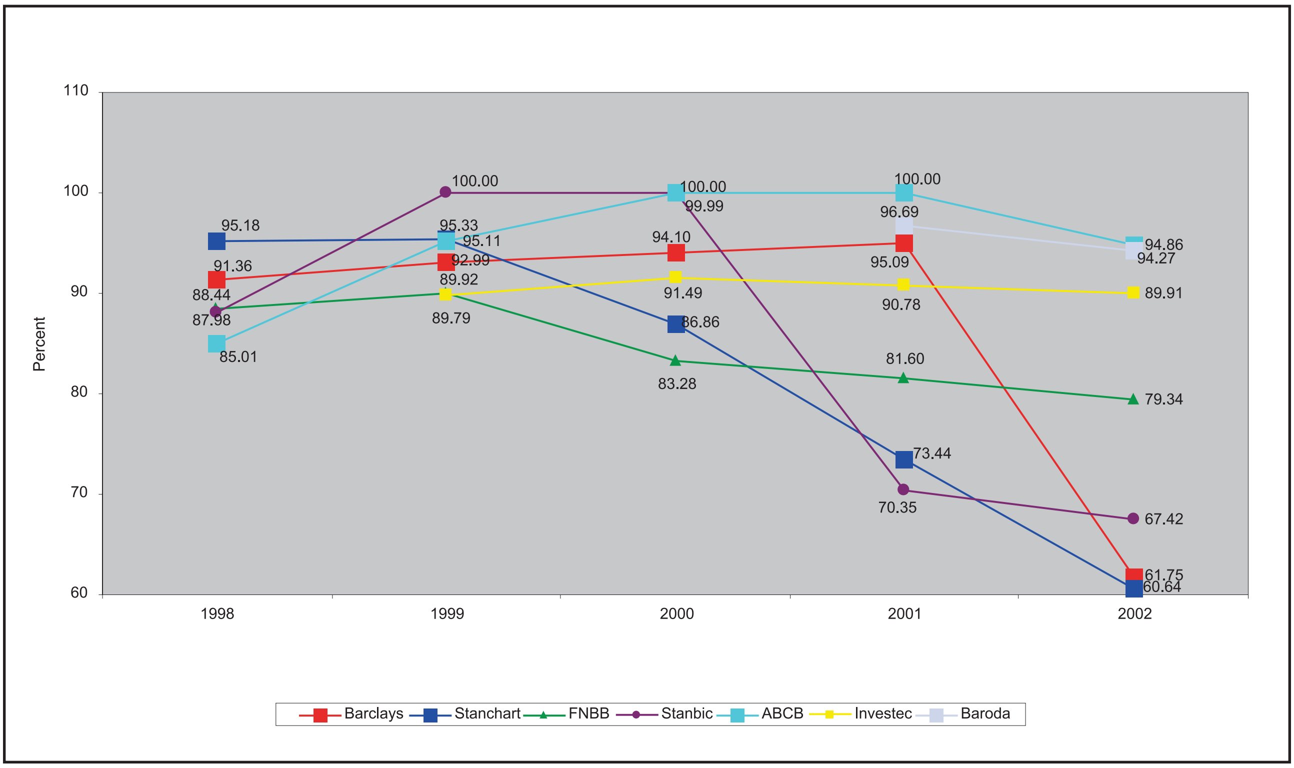


CHART 5

CORE CAPITAL TO RISK WEIGHTED ASSETS

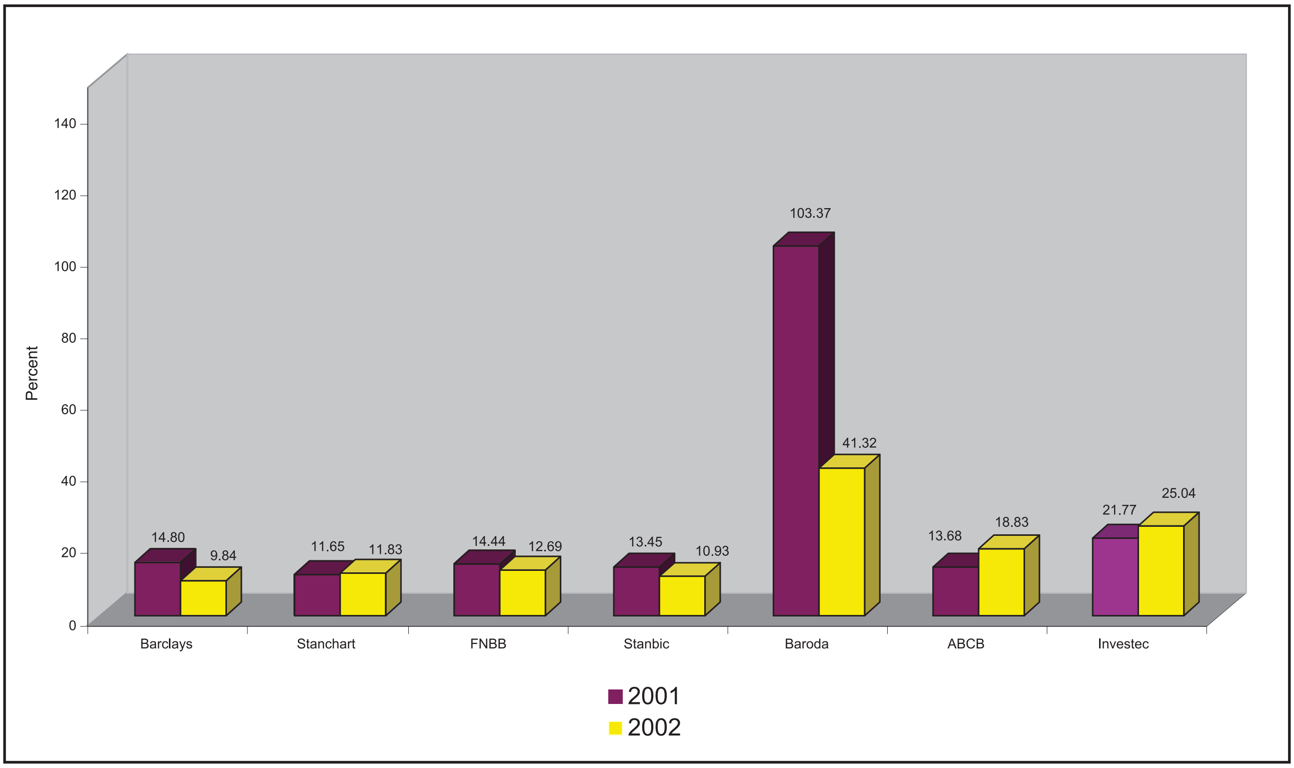


CHART 6

NET INCOME-AFTER TAX AND GROWTH

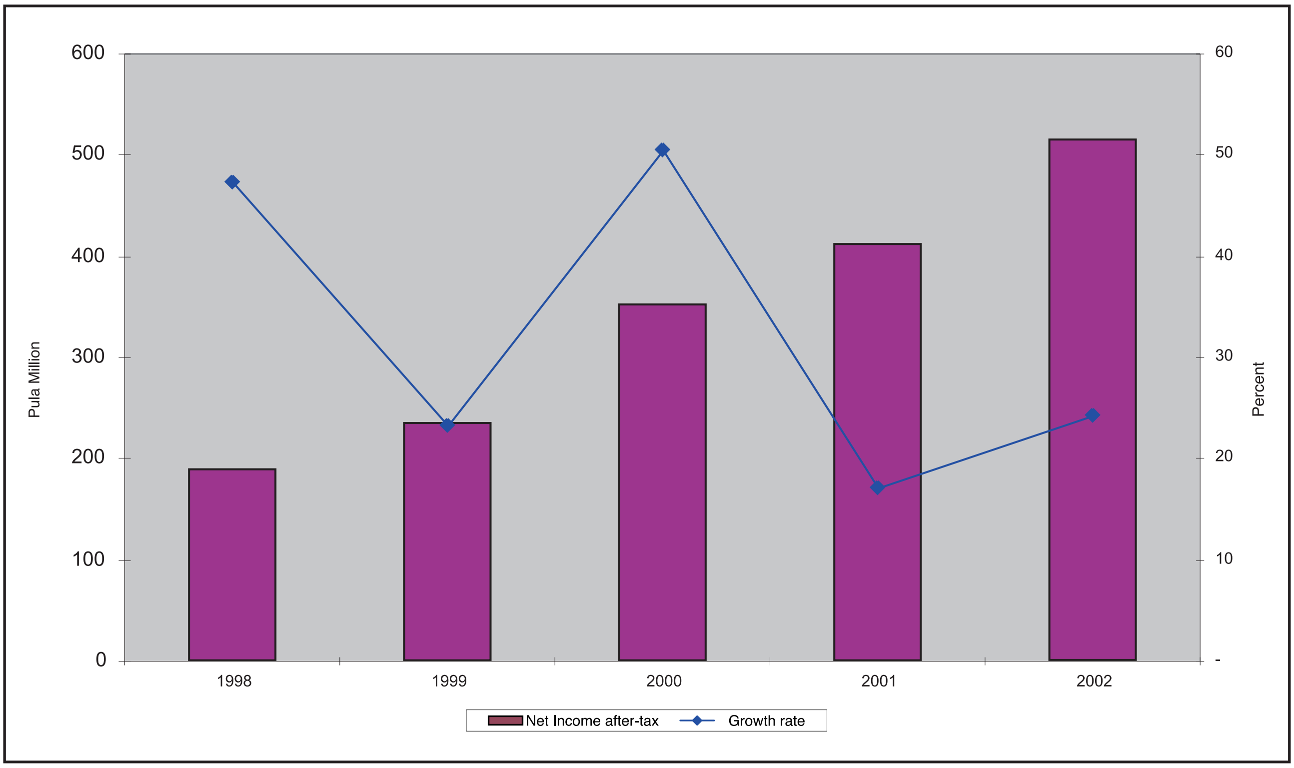
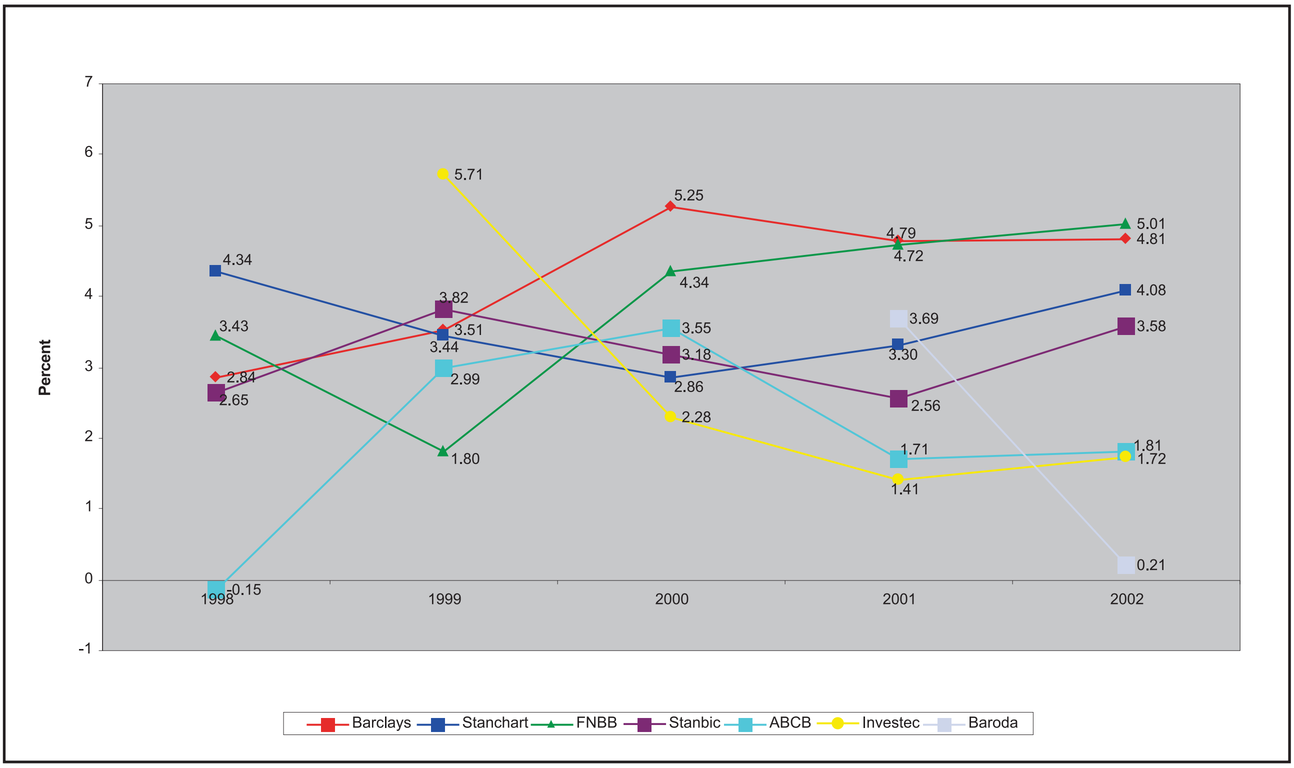


CHART 7

RETURN ON AVERAGE TOTAL ASSETS



Note: For the first time, we have standardised the reporting periods, hence some of the bank's figures are unaudited results submitted to the bank through statutory returns.

CHART 8

RETURN ON EQUITY

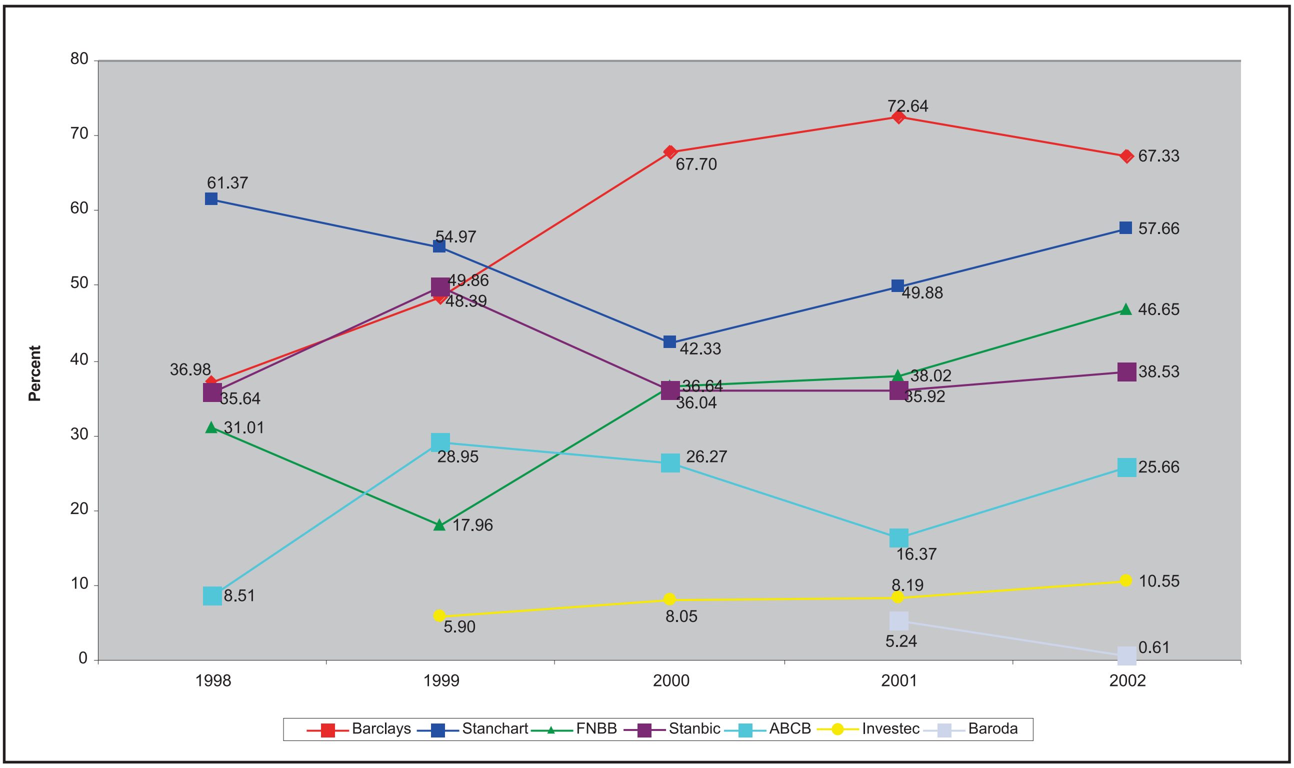


CHART 9

NON-INTEREST INCOME TO TOTAL INCOME

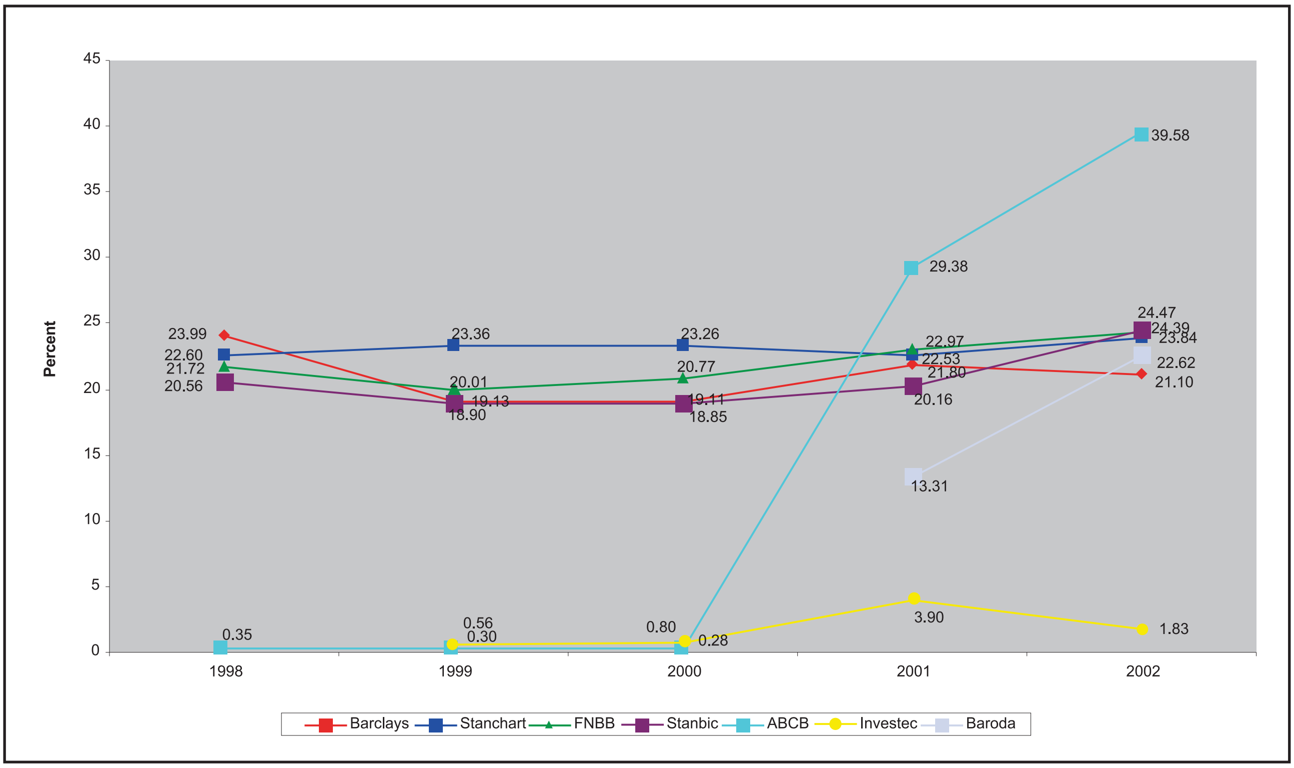


CHART 10

INTEREST INCOME TO AVERAGE TOTAL ASSETS

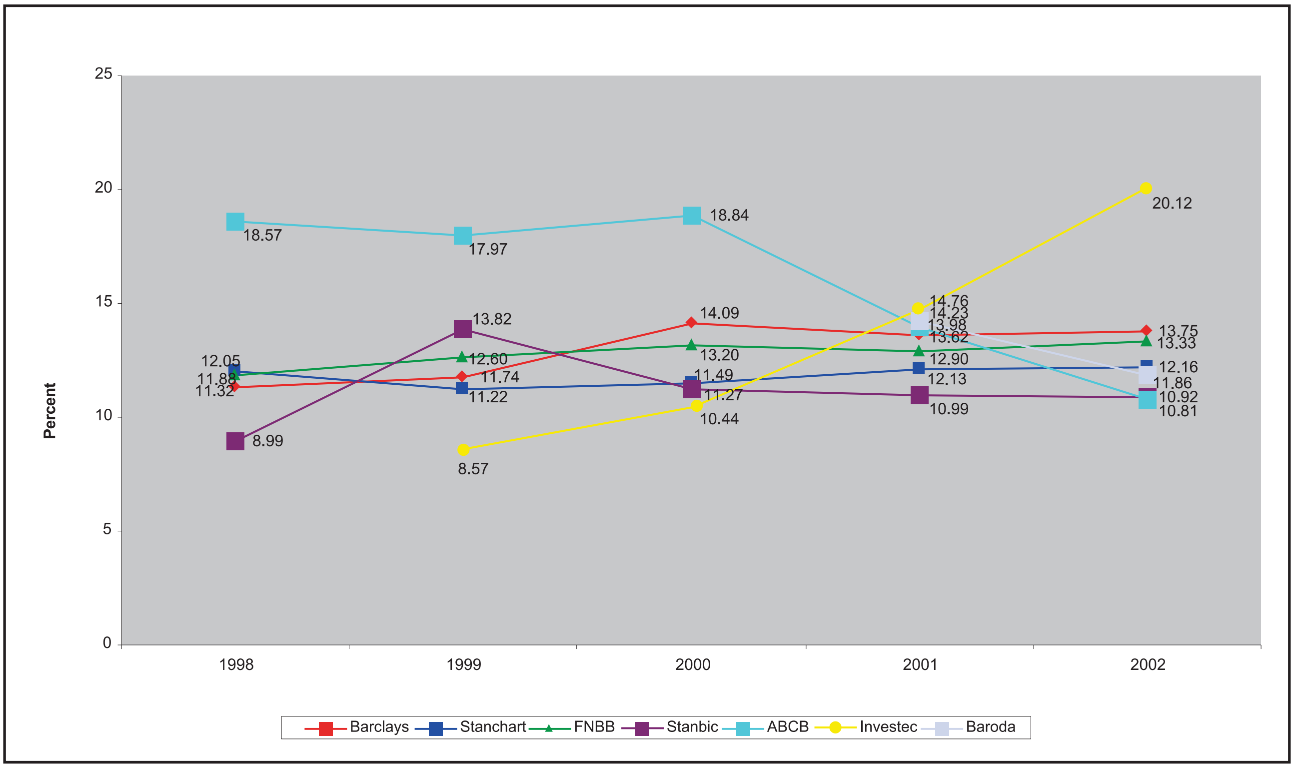


CHART 11

NON-INTEREST INCOME TO AVERAGE TOTAL ASSETS

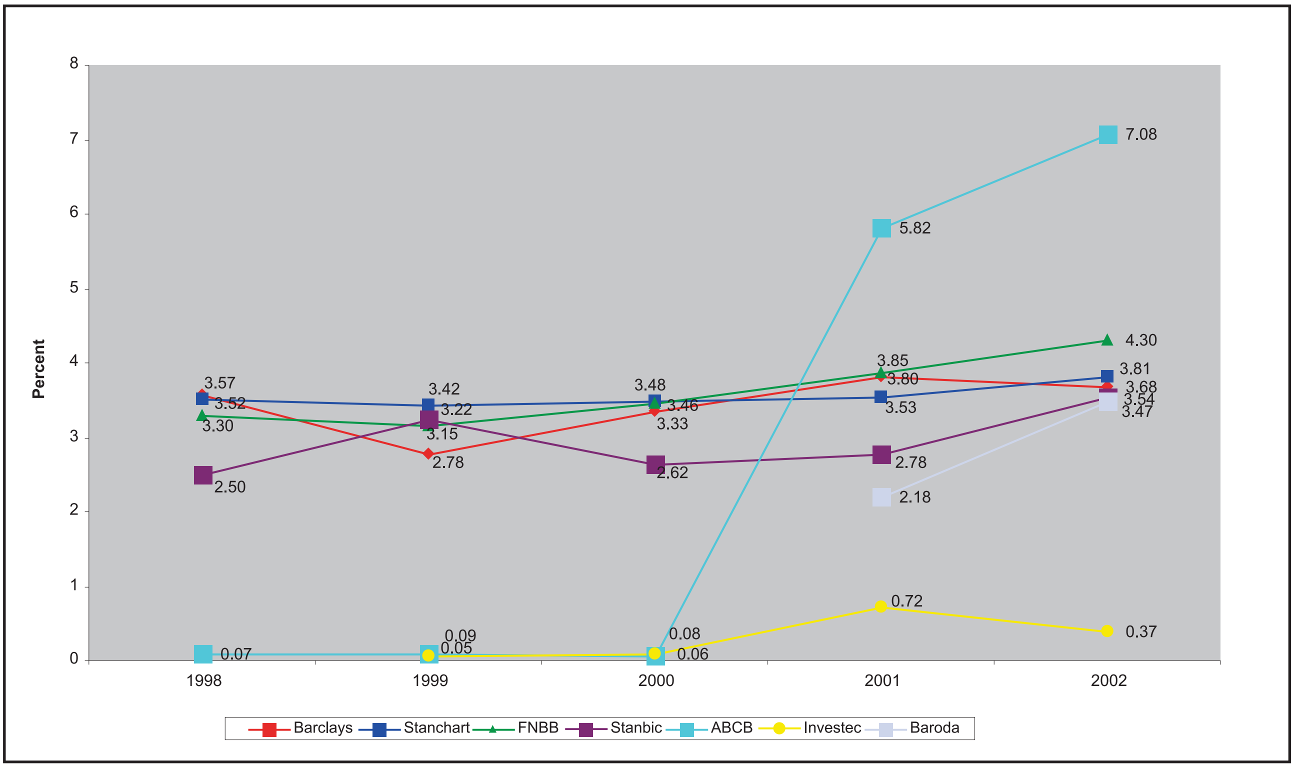


CHART 12

NON-INTEREST EXPENSE TO AVERAGE TOTAL ASSETS

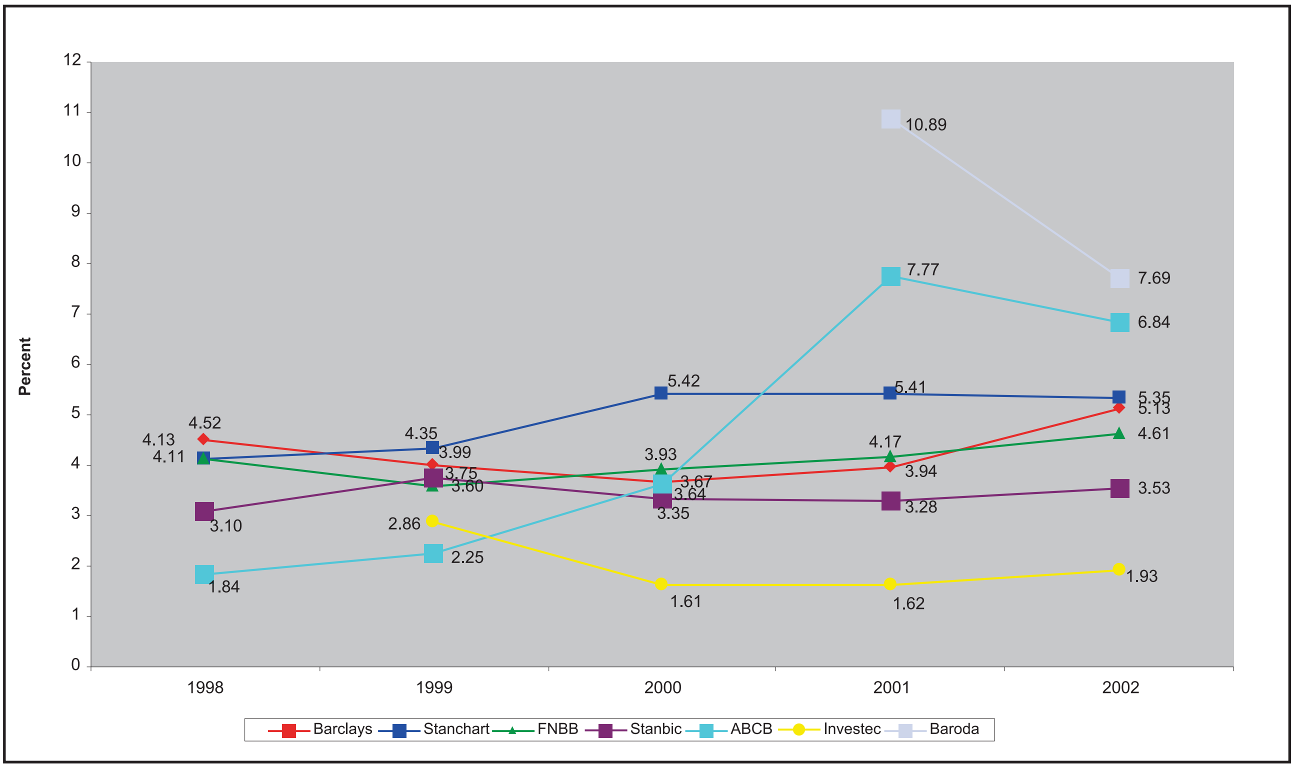


CHART 13

COST TO INCOME RATIO

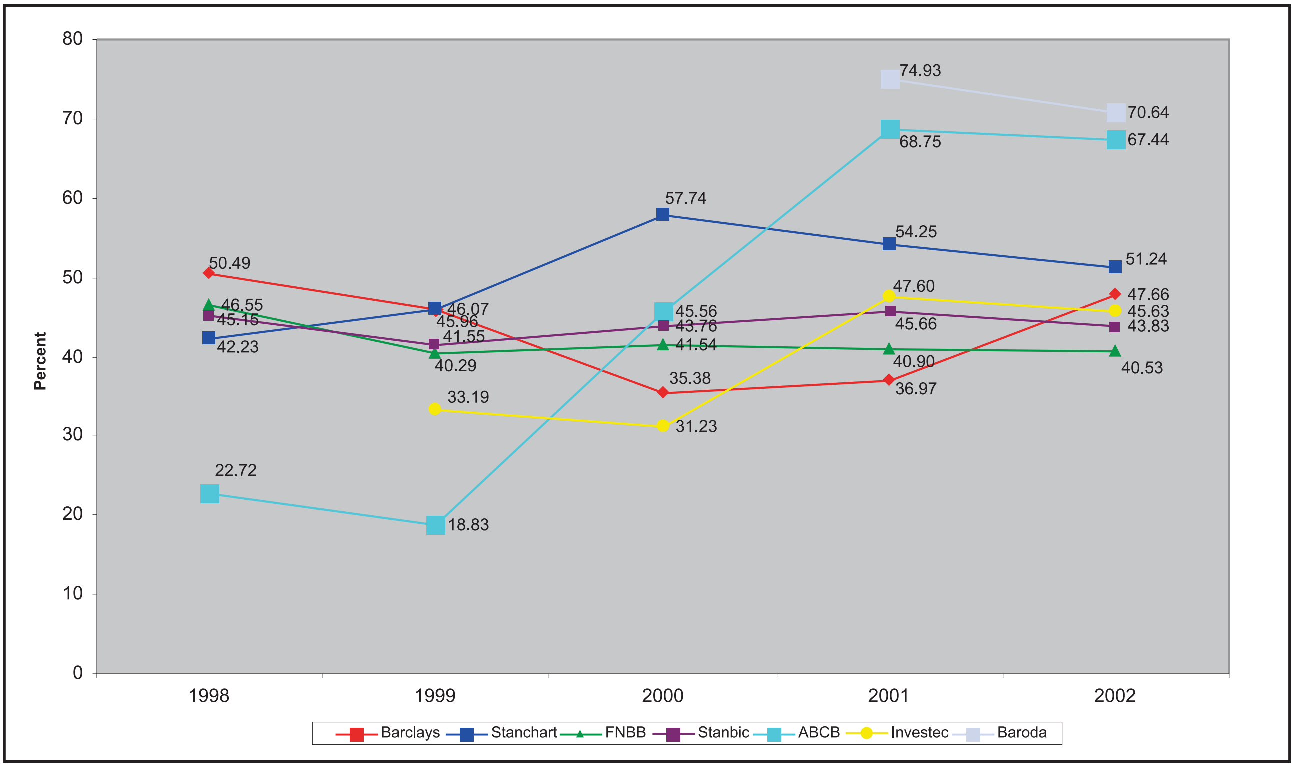


CHART 14

AVERAGE COST OF DEPOSIT

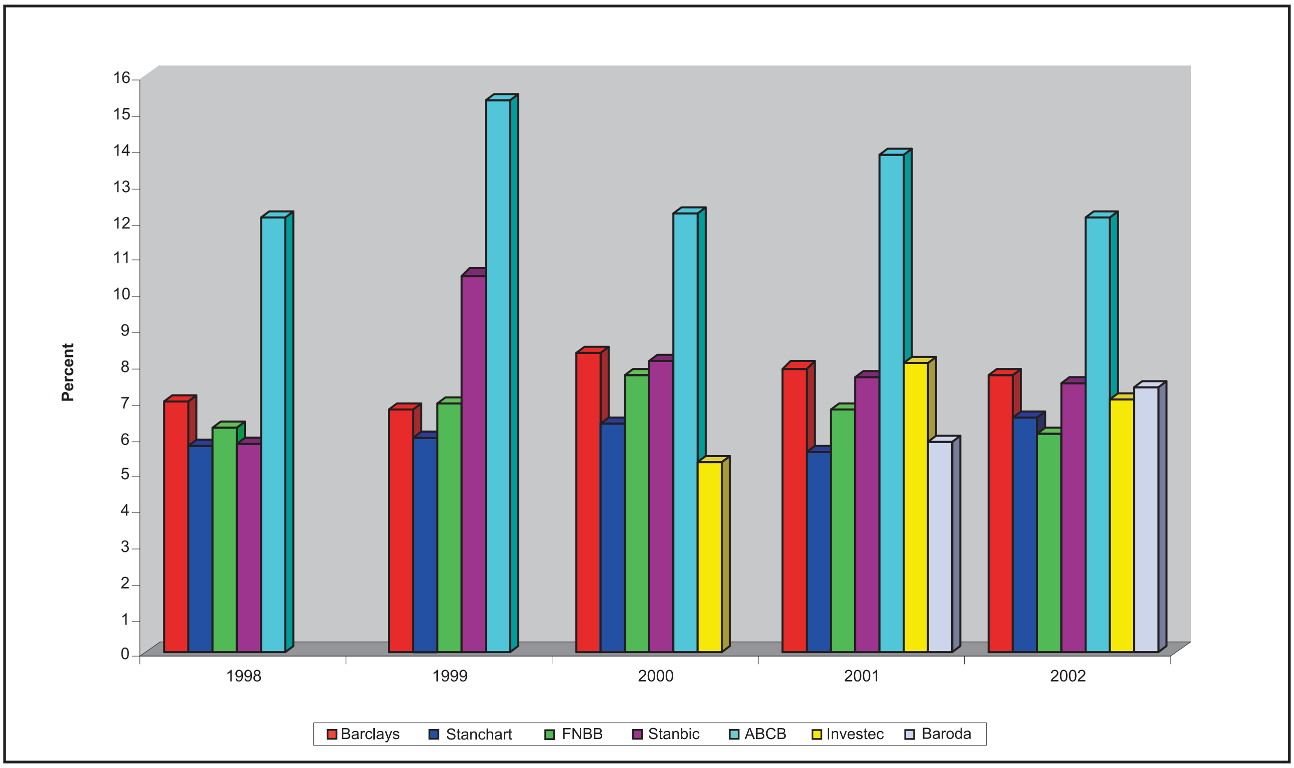


CHART 15

TOTAL PROVISIONS FOR BAD DEBT

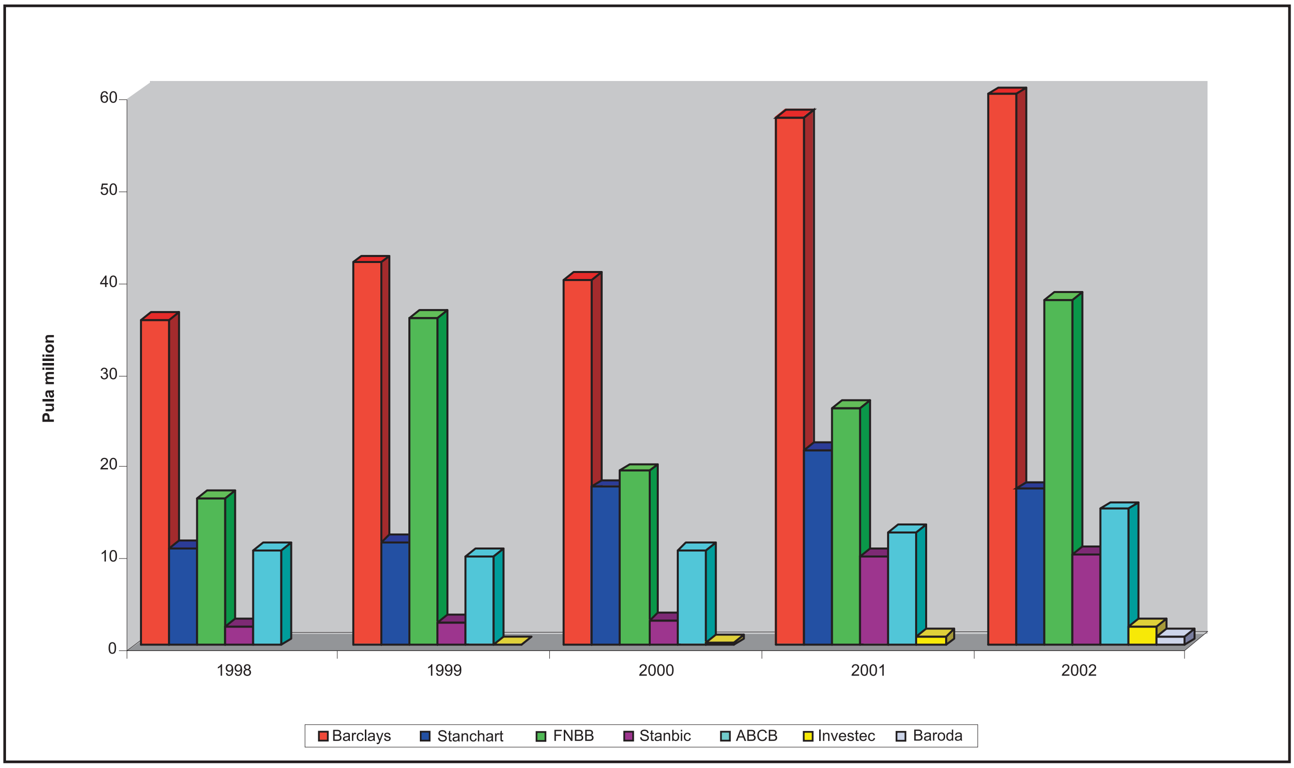


CHART 16

ADVANCES TO DEPOSITS RATIO

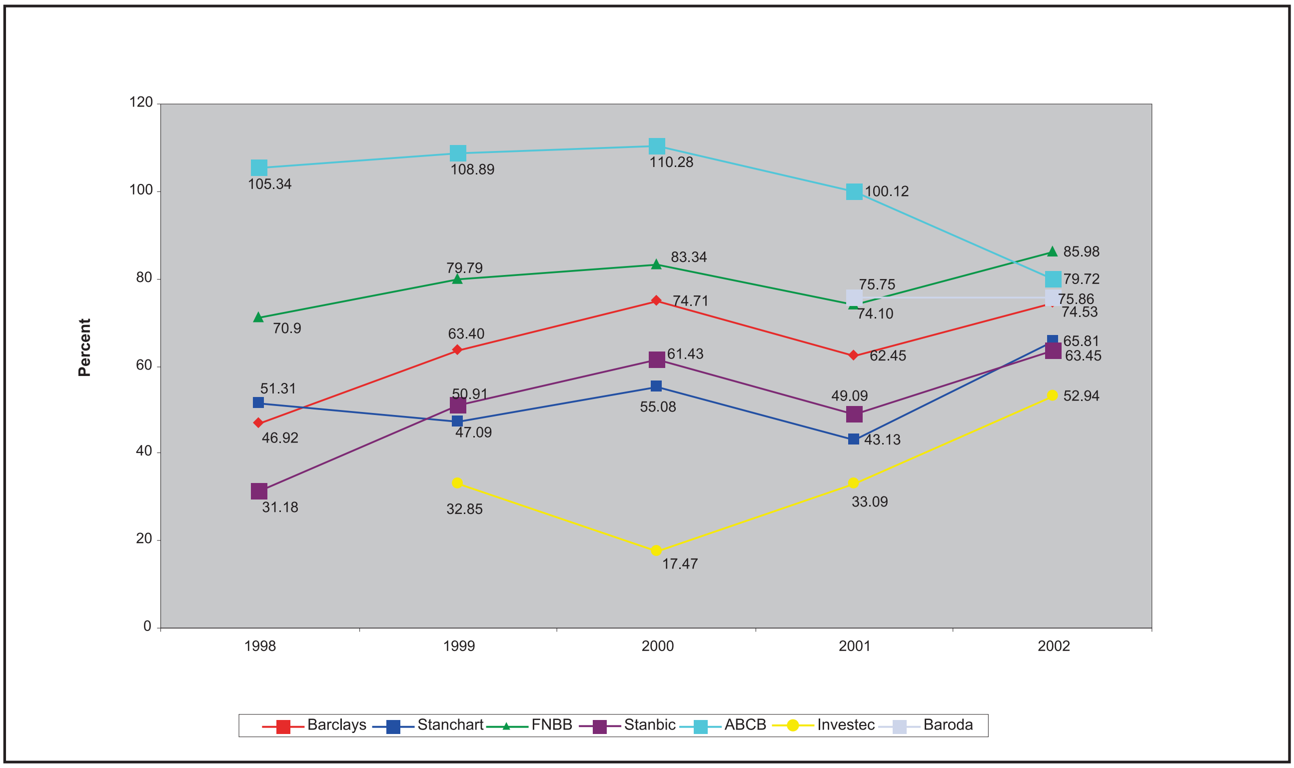


CHART 17

VALUE OF CURRENT ACCOUNTS IN BANKS

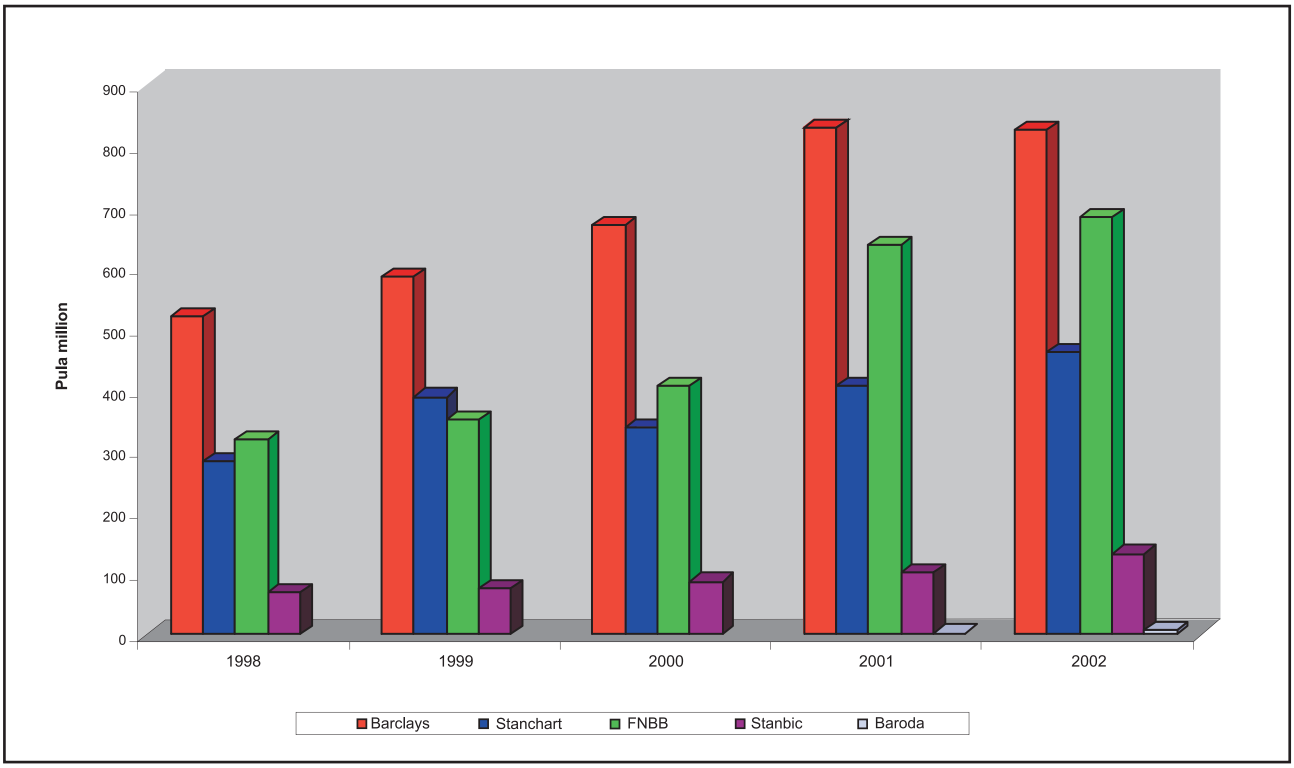


CHART 18

MARKET SHARE OF VALUE OF CURRENT ACCOUNTS
(Percent)

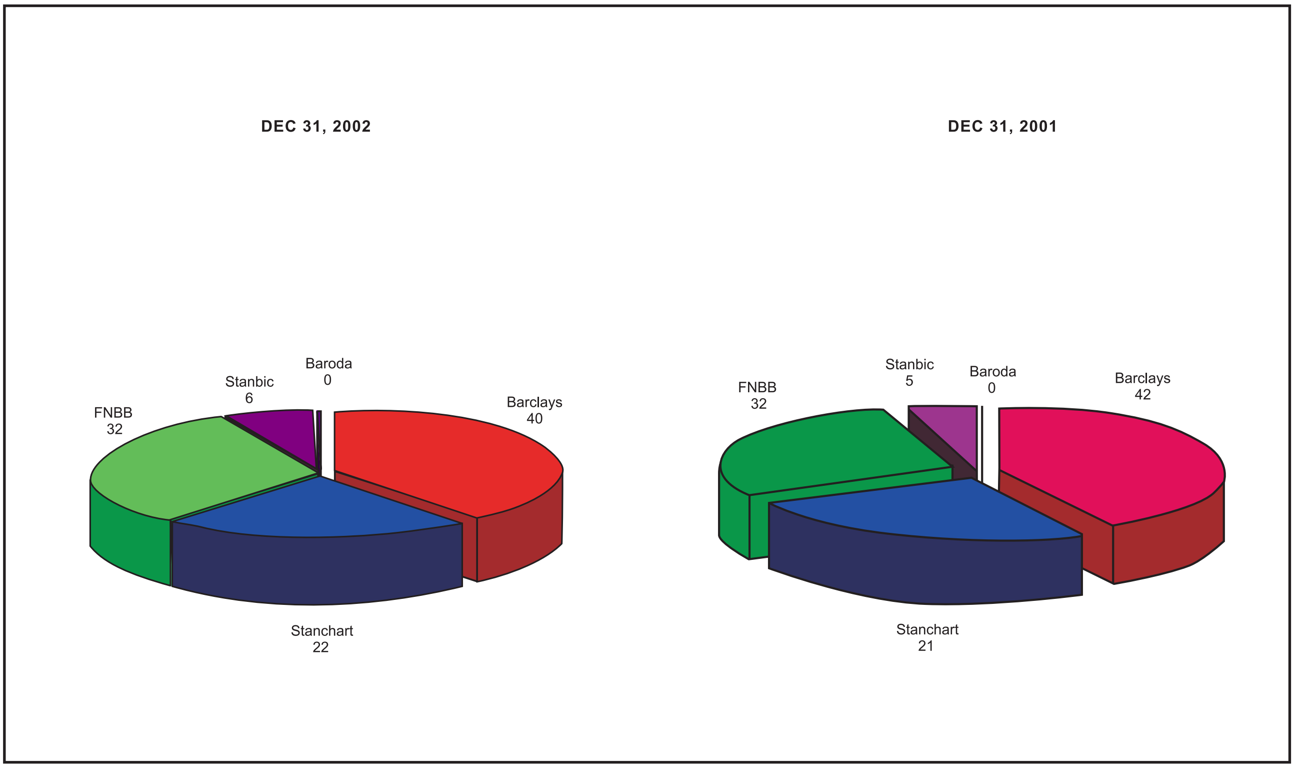


CHART 19

VALUE OF CALL ACCOUNTS

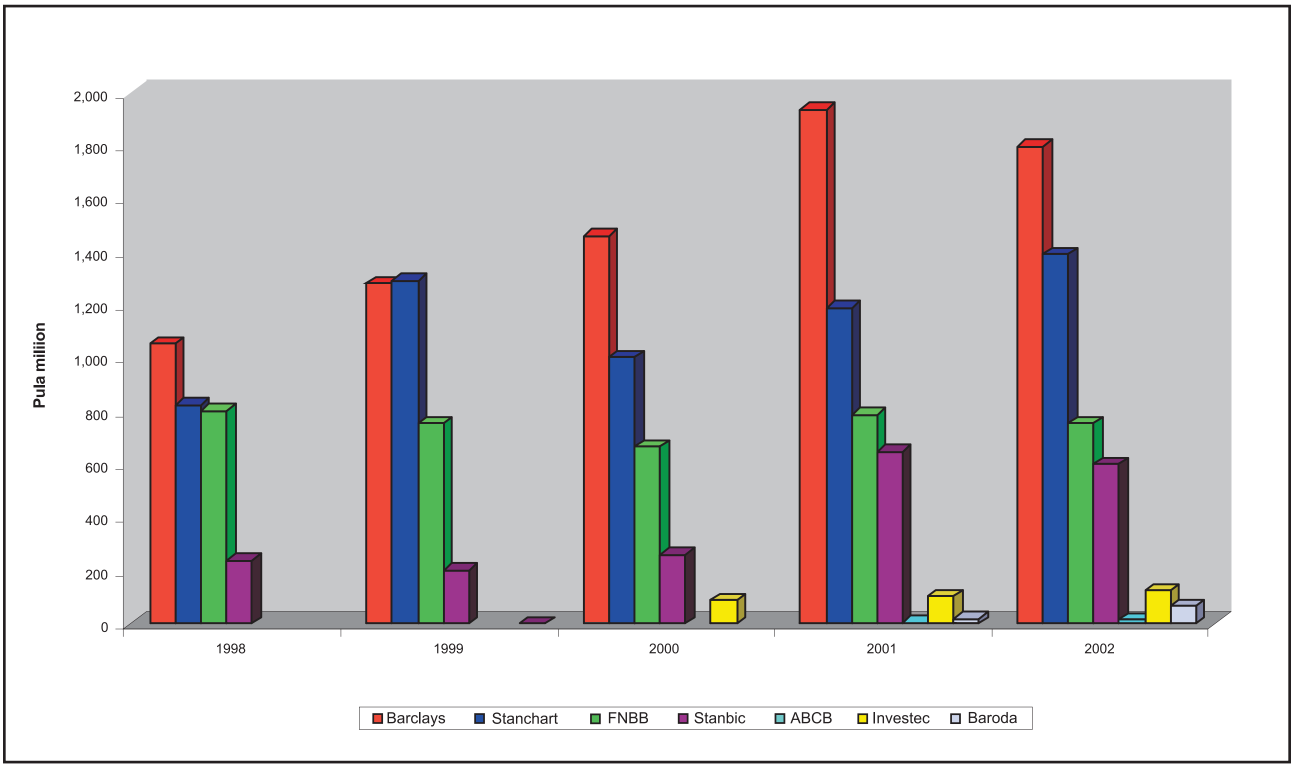


CHART 20

MARKET SHARE OF VALUE OF CALL ACCOUNTS

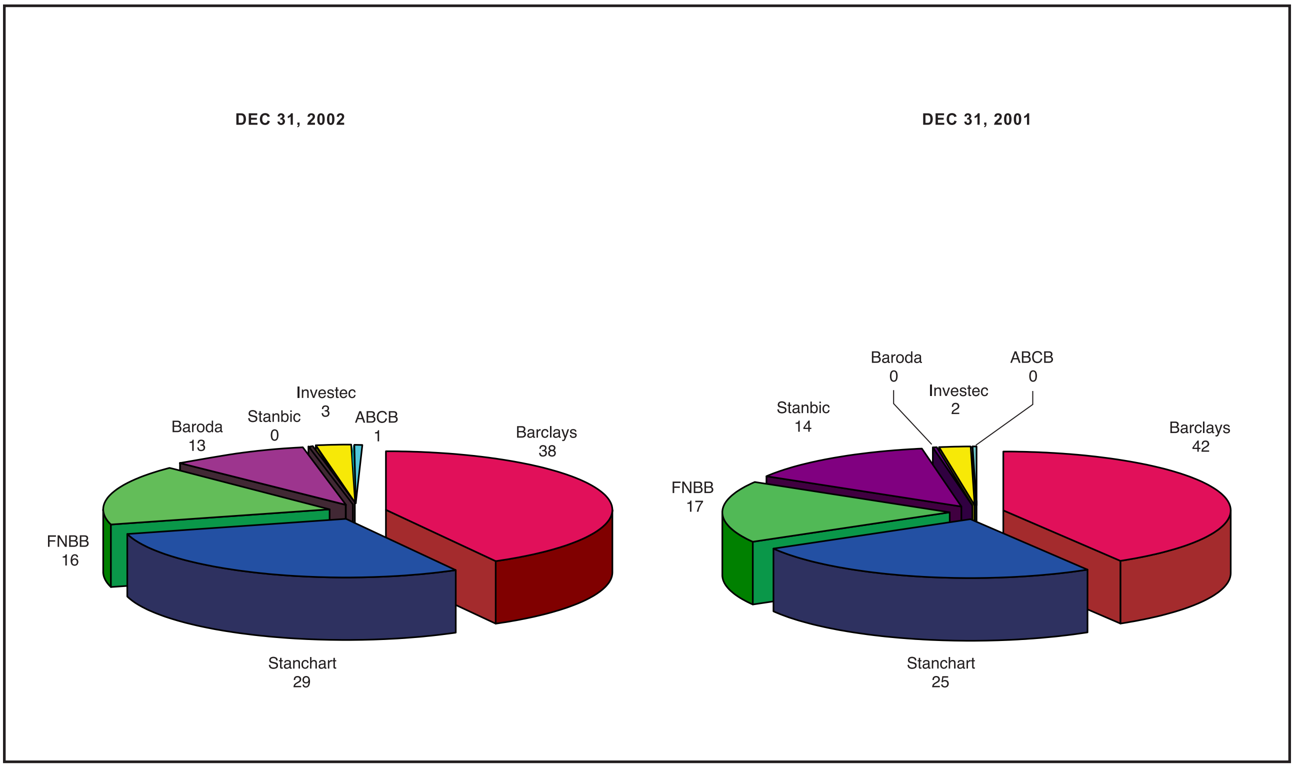


CHART 21

VALUE OF SAVINGS ACCOUNTS IN BANKS

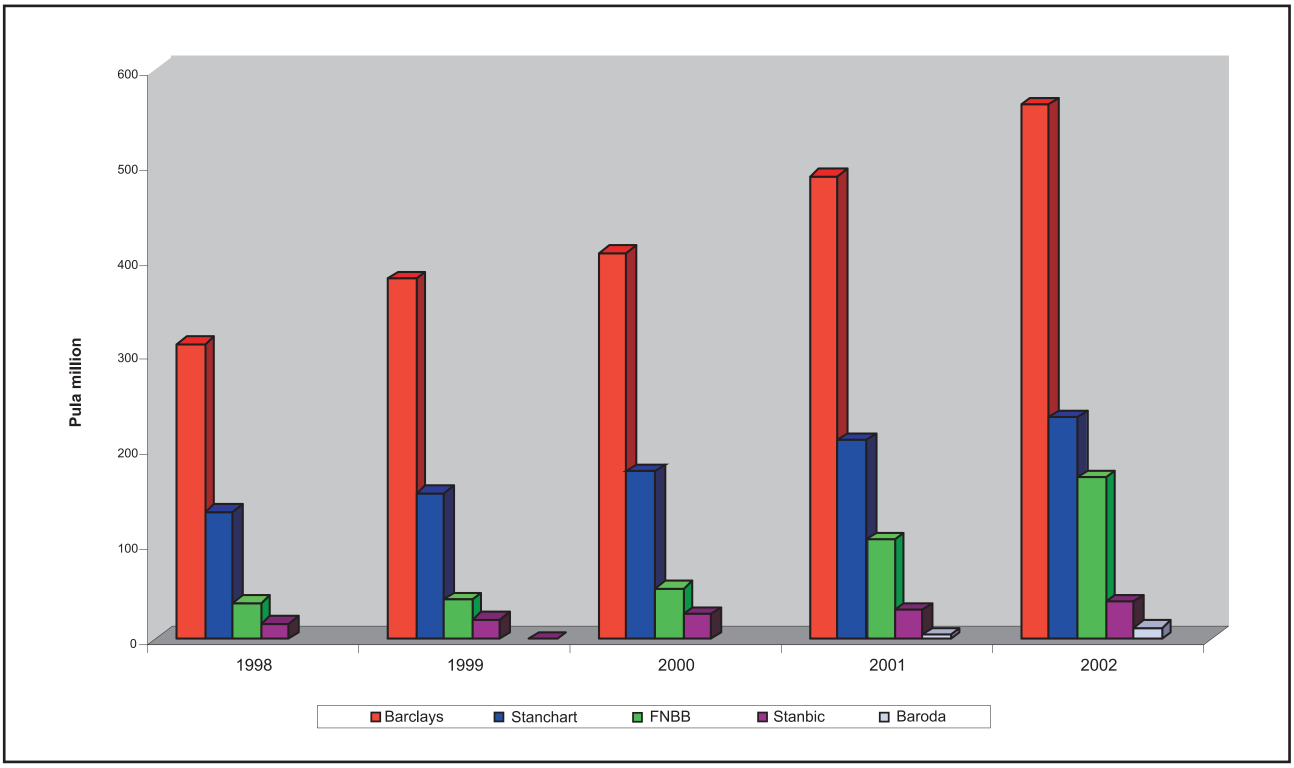


CHART 22

MARKET SHARE OF VALUE OF SAVINGS ACCOUNTS
(Percent)

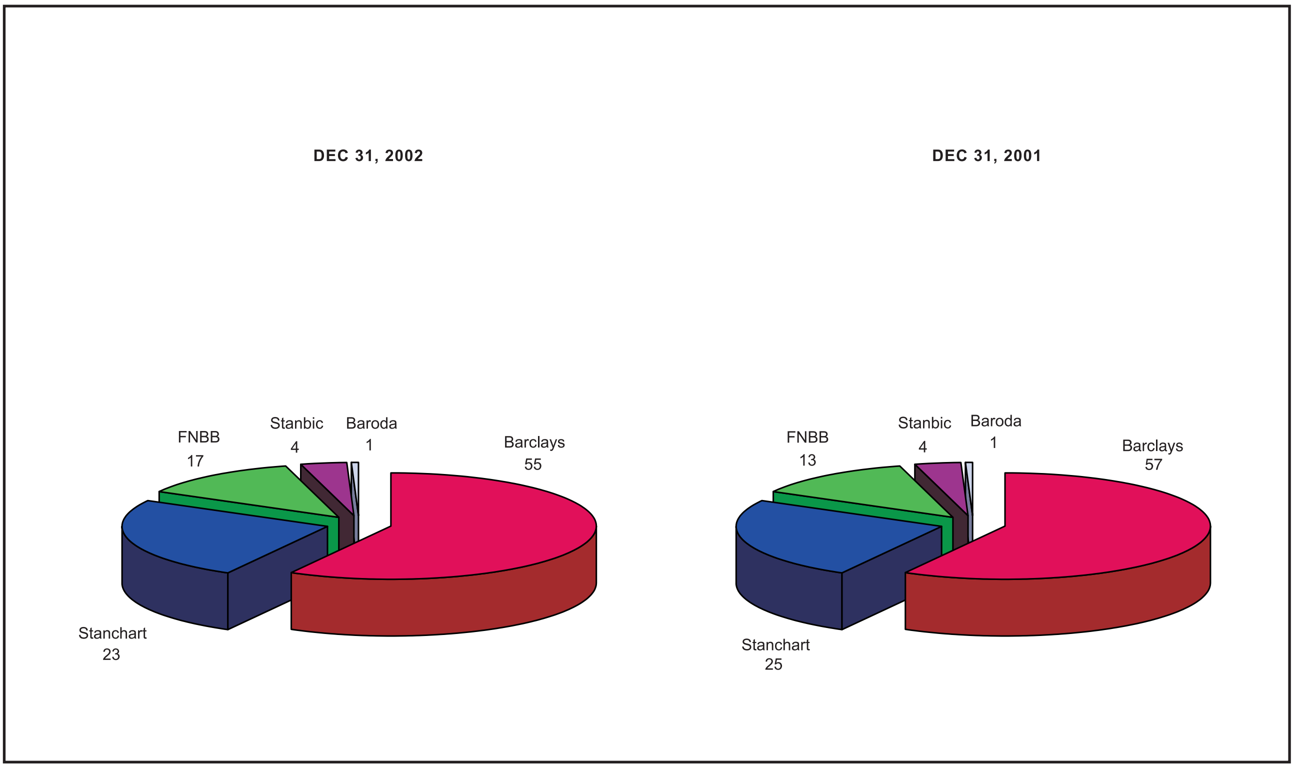


CHART 23

VALUE OF TIME DEPOSIT ACCOUNTS IN BANKS

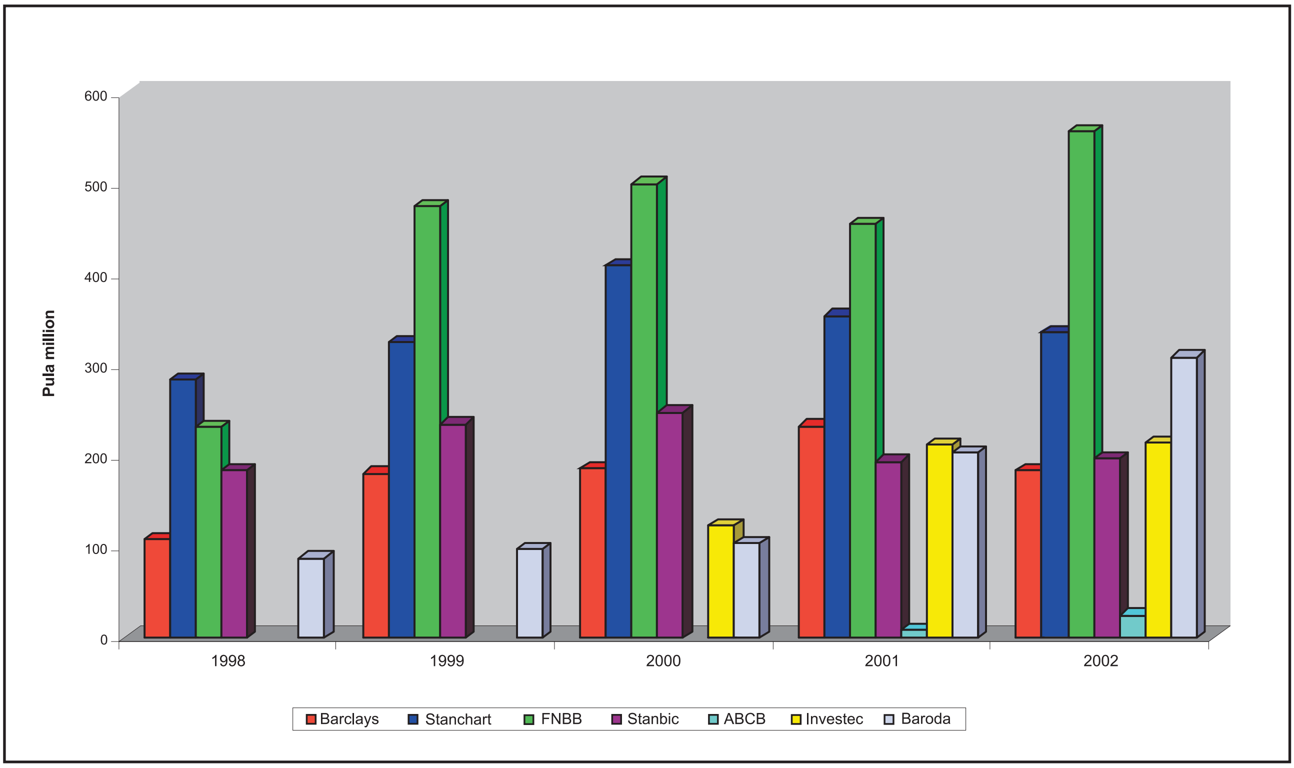


CHART 24

MARKET SHARE OF VALUE OF TIME DEPOSITS
(Percent)