Banking Supervision Annual Report 2004

Bank of Botswana

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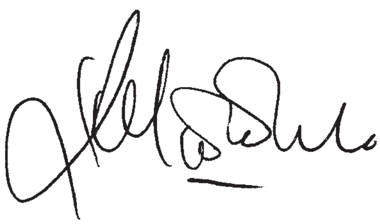
Foreword

This Report is based on the 2004 statutory report submitted to the Minister of Finance and Development Planning in accordance with the provisions of Section 28 of the Banking Act. The Report contains a snapshot of the banking industry's[1] structure and financial state, regulatory and supervisory developments and a chapter on developments in anti-money laundering and combating of the financing of terrorism. This relates to national and international initiatives aimed at preventing and suppressing money laundering and the financing of terrorism.

The industry contracted in the year under review as a result of the takeover of an investment bank by an existing commercial bank. This, however, did not detract the industry from introducing new products and posting strong financial performance results, albeit less impressive compared to the 2003 outcome, but consistent with broader economic conditions. The industry was financially sound, solvent, profitable, liquid and prudently managed throughout the year. The deterioration in the asset quality of some banks was the only blot on an otherwise good year for the banks, and appropriate steps have been taken to ensure that banks adequately provide for doubtful loans in order to safeguard sector stability.

On the regulatory and supervisory side, banks were generally compliant with applicable legislation and other supervisory guidelines. There remained, however, concerns over the quality of banking services, fraudulent automated teller machine transactions and perceived high bank charges. With regard to the activity of the non-banking institutions, a steady increase in activity was evident in the International Financial Services Centre (IFSC), Collective Investment Undertakings (CIUs), and bureaux de change components.

The last chapter of the Report is dedicated to a review of issues in money laundering and the financing of terrorism, and an assessment of progress made locally and abroad in dealing with them. The chapter highlights several major issues, among them the need to develop an appropriate and more comprehensive law on money laundering and the financing of terrorism, strengthen institutions driving the process aimed at curbing these practices and acquire requisite skills in support of those efforts.



Linah K. Mohohlo

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[1] Defined as banks licensed under the Banking Act (CAP 46:04)

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Structure of the Report

The purpose of the Report is to disseminate information to the public about the structure and conduct of banking supervision in Botswana. It is based on the 2004 statutory report submitted to the Minister of Finance and Development Planning on the Bank's supervisory activities.

Chapter 1 deals with an overview of the performance of the banking sector in 2004. Chapter 2 provides an update on major operational activities of supervised institutions and other developments during 2004. Chapter 3 reviews national and international developments in, and strategies for, combating money laundering and the financing of terrorism, the enabling statutory instruments available in Botswana, and the institutional set-up facilitating work in this area.

There are technical appendices relating to the framework for banking supervision as applied by the Bank, institutions licensed and supervised by the Bank, definitions of technical banking supervision terms, and tables and graphs on various statistical information on the banking industry.

Contents

Chapter 1

Industry Structure and Performance Highlights

1. Business Locations

The geographical representation of banks' branches, Automated Teller Machines (ATMs) and encashment points changed during 2004 as a result of relocations, closures, conversions and mergers in line with changing business needs requiring improvement in customer service and exploitation of new business opportunities. Consequently, the number of branches fell to sixty and encashment points to three, while the number of agencies remained unchanged compared to the 2003 situation (Table 1). The number of ATMs and mini-ATMs rose by 12 percent to 174. Nearly 90 percent of these were new installations of mini-ATMs by First National Bank of Botswana Limited (FNBB).

While it may have been justified for banks to re-configure their points of presence as described above, such changes have the potential to limit access to banking services by existing and prospective customers. However, the increase in ATMs and mini-ATMs may partially compensate for this potential loss of 'direct' access.

2. Operational Performance

The economic environment in which the banks had to operate in 2004 was characterised by, inter alia, a lower but broad based growth in economic activity, rapid increases in real private and government final consumption expenditure, a higher real rate of growth of fixed investment, stable interest rates, and supportive fiscal policy, all of which provided a conducive environment and lending opportunities. The increase in the advances/deposit ratios (which measure the effectiveness with which banks mobilise deposits/savings and on-lend) was consistent with prevailing economic conditions.

The performance of banks in 2004 continued to be good, with banks' balance sheets remaining strong, but weaker relative to their positions a year ago. Total banking assets grew at 10 percent (to reach P15.5 billion), compared to 17 percent for the previous year. Credit expanded at a rate of 13 percent to P8.9 billion, despite the fact that deposit liabilities, banks' primary funding source, grew by 9 percent (to P12.5 billion), which is less than half the growth rate recorded in 2003. These changes are shown in Chart 1 where net deposits (deposit liabilities minus loans and advances) at end 2004 fell to P3.6 billion from P3.8 billion at end 2003; rates of growth of both deposits and total assets were lower while growth of loans and advances was higher relative to 2003.

Table 1: Licensed Banks' Representation: 2003–2004

Bank	Branches and Sub-Branches		Agencies		Encashment Points		ATMs	
	2003	2004	2003	2004	2003	2004	2003	2004
Barclays	26	26	6	6	7	3	41	43
Stanchart	13	11	6	6	0	0	36	36
FNBB	13	12	0	0	0	0	69*	86**
Stanbic	9	8	0	0	0	0	9	9
Baroda	1	1	0	0	0	0	0	0
ABCB***	2	2	0	0	0	0	0	0
Investec****	1	0	0	0	0	0	0	0
Total	65	60	12	12	7	3	155	174

Notes:

* Comprises 39 ATMs and 30 mini-ATMs

** Comprises 43 ATMs and 43 mini-ATMs

*** ABCB stands for African Banking Corporation of Botswana Limited

**** Investec was taken over by Stanbic Bank Botswana Limited in April 2004

Chart 1: Net deposits and growth rates of deposits, total assets, and loans and advances

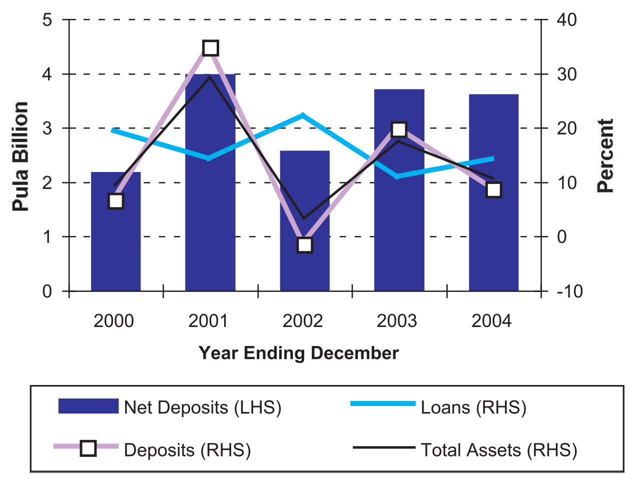
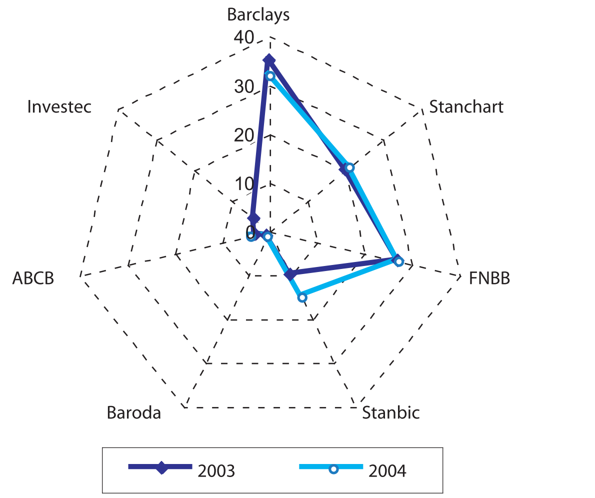


Chart 3: Banks' share in total loans and advances as at December



Most banks experienced increased lending growth rates, which resulted in a higher overall ratio of advances to deposits (Chart 2) and changes in lending proportions of individual banks to total lending (Chart 3). Chart 4 depicts the changing composition of banks' shares in total deposits.

Chart 4: Banks' share in total deposit liabilities as at December

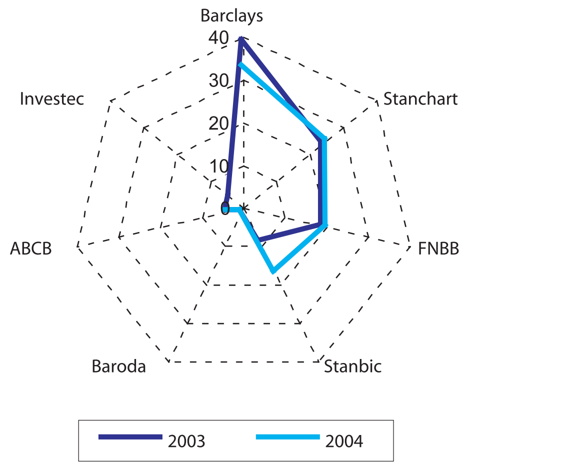
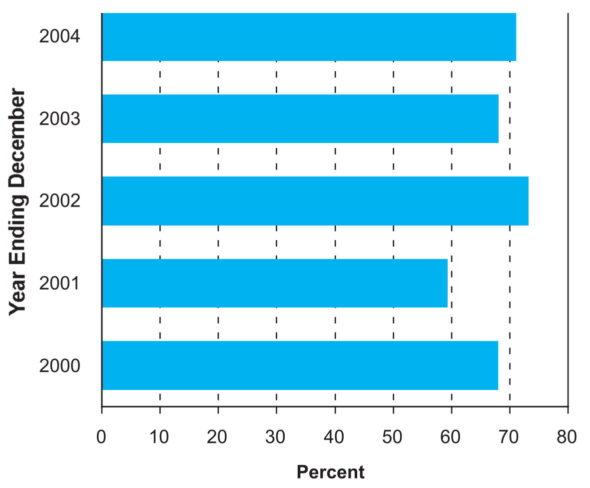


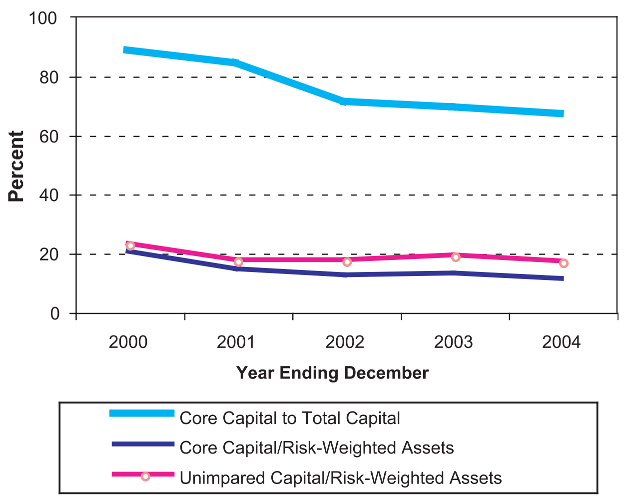
Chart 2: Advances to deposit ratio



3. Capital Adequacy (Solvency)

All banks met the minimum prudential capital requirement as set by the Bank. Chart 5 shows the ratio of core capital to total capital, core capital to risk-weighted assets and unimpaired capital to risk-weighted assets (capital adequacy ratio) for the banking industry.[2] The ratio of core capital to total capital for the industry was well above the 50 percent minimum

Chart 5: Capital ratios



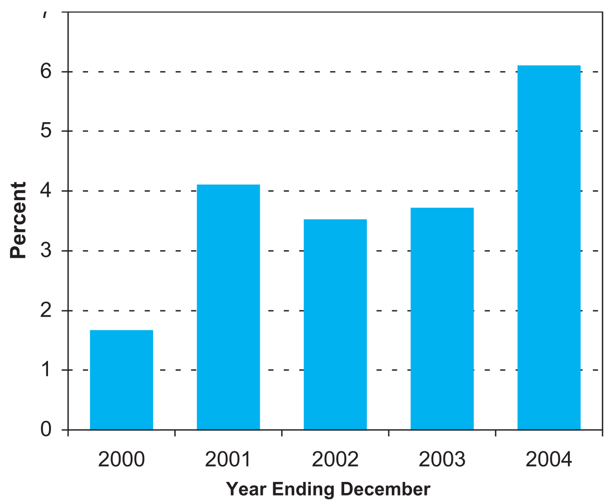
[2] See page 28 for the method of calculation of capital aggregates.

statutory requirement and, similarly, for individual banks, implying the existence of high quality capital. There has been a gradual decline in the ratio as banks consider it uneconomic and expensive to hold excessive levels of core capital. Accordingly, most banks have been resorting to paying frequent dividends and issuing supplementary capital over the years. The capital adequacy ratios for all banks were above the minimum statutory requirement of 8 percent and the 15 percent minimum level prescribed as a safe and prudent level for banks in Botswana.

4. Non-Performing Loans and Asset Concentrations

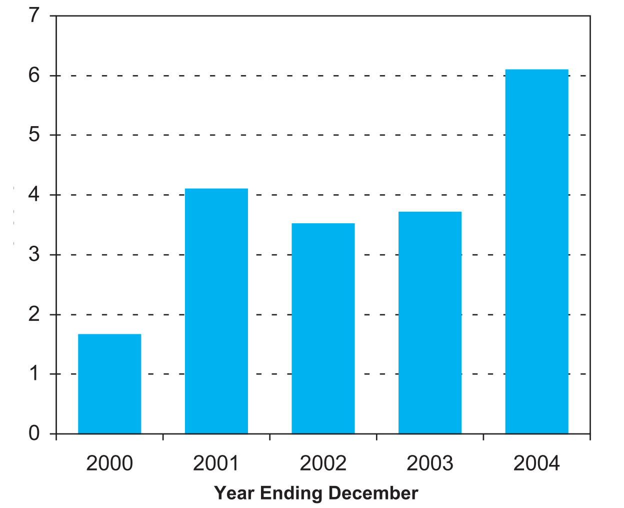
The level of non-performing loans in the banking sector remained high, mainly due to a slowdown in economic activity experienced during the second half of 2004 and failure by some banks to strictly adhere to their credit policies, resulting in increased levels of provisions for bad debts. As at December 2004, non-performing loans amounted to P407.5 million compared to P391.2 million in 2003. Non-performing loans as a proportion of total loans were 6.1 percent, compared to 3.7 percent in 2003 (Chart 6(a)). Similarly, the ratio of provisions for bad debts to total advances increased from 2.7 percent in 2003 to 3.3 percent in 2004 (Chart 6(b)).

CHART 6(A): PAST DUE ADVANCES/TOTAL ADVANCES



In general, banks avoided excessive asset concentrations and the industry as a whole kept large exposures (i.e., advances that are more than 10 percent of unimpaired capital) as a ratio of unimpaired capital, well below the stipulated maximum of 800 percent.

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



5. Profitability

Industry profitability, measured by pre-tax and after-tax income, increased to P720.7 million and P597.9 million, respectively, in 2004, representing increases of 14.8 percent and 10.1 percent, reversing the declining growth rate of profits since 2000 (Chart 7). Disaggregated data shows that all banks were profitable compared to 2003, but to differing degrees.

CHART 7: GROWTH RATES OF PROFIT/(LOSS) BEFORE AND AFTER TAX

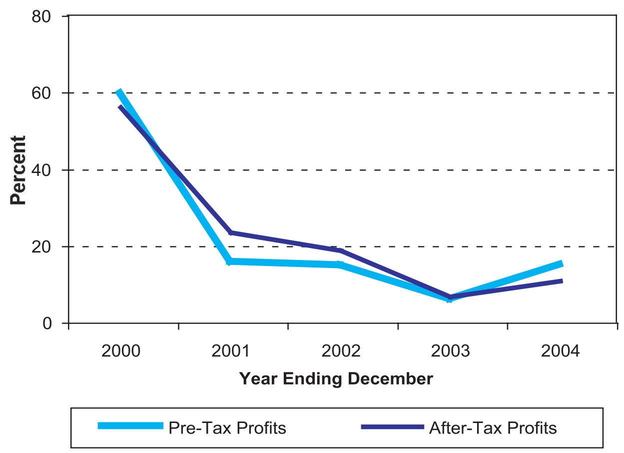


Table 2 presents a set of important earnings and profitability performance indicators. Interest income continued to be the major source of income for banks, accounting for 78 percent of total income (interest plus non-interest income), with the remaining 22 percent being attributable to non-interest income. The split between the two sources of income has been relatively stable over the past five years. For the majority of banks, non-interest income is derived from fees and commissions. Interest expenses accounted for 58 percent of total expenses, while operating expenses accounted for 42 percent. The increase in interest expense is directly related to the growing customer base.

Table 2 also shows the profitability of banks as measured by the Return on Average Total Assets (ROAA) and Return on Equity (ROE) ratios and net income after tax over two years. The ROAA measures how effectively the assets of a bank were utilised to generate income. The industry's ROAA was unchanged at approximately 4 percent from the previous year. Individual banks showed different levels of ROAA as shown on Chart 4.6 in Appendix 5.

6. Operating Efficiency

Table 3 shows a five-year trend in operational and allocative efficiency ratios for the banking industry (see Appendix 3 for definitions of ratios). The net spread decreased from 7.4 percent in 2003 to 5.3 percent in 2004, while the net interest margin decreased from 6.7 percent to 6.3 percent over the same period**.** It is worth noting that two banks contributed significantly to the decline in both ratios as they operated below the margins, at almost zero or negative. This effectively means that both banks paid more interest on deposits than what they earned from loans and advances. Notwithstanding this, both banks were profitable as they generated income from sources such as Bank of Botswana Certificates (BoBCs) and other investments, as well as non-interest income. The industry's net income per employee increased from

Table 2: banking industry earnings and Profitability – 2004

	Amount (P million)		Growth (Percent)	
	31-Dec-03	31-Dec-04	2004	2003
Gross Interest Income	1 790.6	2 089.8	16.7	15.9
Interest Expense	914.9	982.2	7.4	17.4
Net Interest Income	875.7	937.4	7.1	14.4
Non-Interest Income	487.9	547.5	12.2	7.9
Operating Expense	661.2	713.6	7.9	15.2
Net Income Before Tax	627.6	720.7	14.8	5.5
Net Income After Tax	543.2	597.9	10.1	6.3
Performance Ratio	**(Percent)**	**(Percent)**		
Return on Average Total Assets	4.1	4.0		
Return on Equity	44.3	43.3		
Interest Income to Total Income	78.6	77.7		
Non-Interest Income to Total Income	21.4	22.3		
Interest Income to ATA	13.7	13.1		
Non-Interest Income to ATA*	3.7	3.7		
Interest Expense/ATA	7.0	6.7		
Non Interest Expense/ATA	5.1	4.8		
Net Interest Income/ATA	6.7	6.3		
Average Return on Advances	19.1	17.2		
Average Cost of Deposits	10.3	7.5		

ATA* refers to Average Total Assets

TABLE 3: BANKING INDUSTRY EFFICIENCY MEASURES

Performance Ratios (Percent)	2000	2001	2002	2003	2004
Net Spread	7.6	9.4	9.1	7.4	5.3
Net Interest Margin	6.3	6.8	7.0	6.7	6.3
Other Operating Income/Average Total Assets	3.2	3.6	3.9	3.7	3.7
Net Operating Margin	7.1	10.0	5.3	8.9	9.7
Net Income Per Employee (P'000)	156.9	170.0	204.4	214.7	235.0
Net Income To Employee Expense	198.6	192.4	194.8	181.1	190.8
Cost/Income	41.7	44.2	47.2	48.5	33.0
Staff Cost Per Employee (P'000)	78.8	70.8	105.0	118.6	123.2
Asset Per Employee (P'000)	4 006.5	4 805.1	4 798.0	5 564.6	6 102.1

P215 000 in 2003 to P235 000 in 2004 and assets per employee increased from P5 565 000 to P6 102 000. In general, the ratios indicated improved efficiency across banks.

7. LIQUIDITY

Banks in Botswana are highly liquid, a situation that leads to structural surpluses in the banking system. Accordingly, over the years, monetary policy has generally focused on absorbing the excess liquidity in the system through the use of BoBCs, which is a short-term monetary instrument issued by the Bank. The market share of BoBCs held by banks is shown in Chart 8. The banking liquidity situation in 2004 was not very different from the historical trend. In fact, the liquidity ratio (liquid assets as a proportion of deposits) increased from 26 percent in 2003 to 30 percent in 2004, and was three times the required ratio of 10 percent (Chart 9). This has generally engendered public confidence in the banking system to the extent that the high ratio implies ample leverage to cover short-term obligations of the banks. More importantly, the ratio also gives a pointer to the degree to which banks have potentially loanable funds. In this context, banks have sufficient funds that could be loaned to productive activities without compromising their ability to meet any unexpected withdrawals of depositors' funds. As seen in the foregoing, intermediation increased in 2004 relative to 2003.

CHART 8: BANKS' SHARES IN MARKET VALUE OF BoBCs

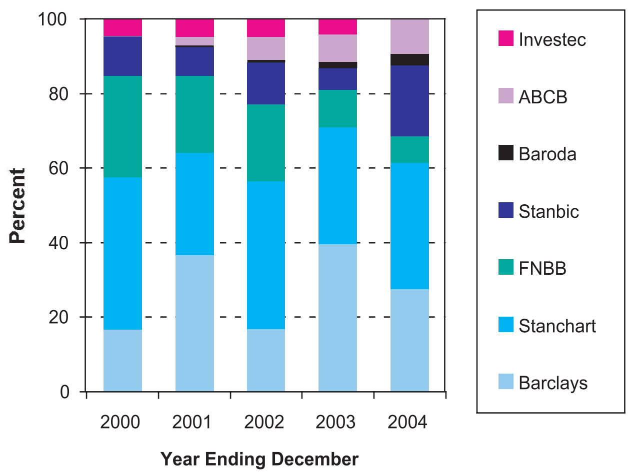
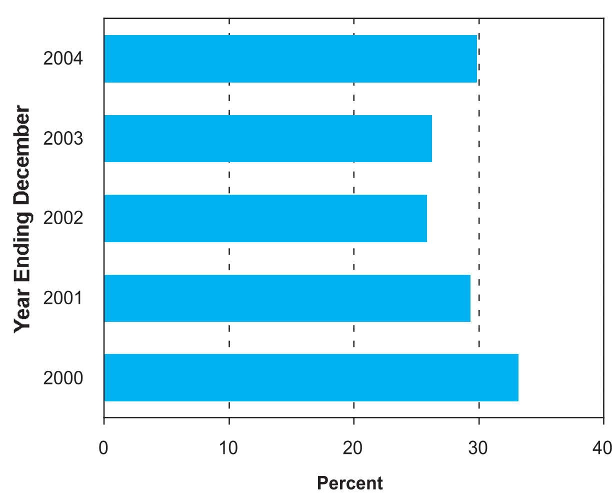


CHART 9: LIQUID ASSETS TO DEPOSITS RATIO



Chapter 2

Operational Activities and Developments in 2004

This chapter covers some of the major banking supervision-related activities undertaken during 2004.

1. On-site Examinations of Licensed Banks

The Bank conducted limited and full-scope on-site examinations of Standard Chartered Bank Botswana Limited (Stanchart) and Stanbic Bank Botswana Limited (Stanbic), respectively. The examination of Stanchart focused on the bank's information technology structure, particularly its impact on the quality of service. The examination revealed that the bank's IT environment was stable. Stanbic was found to be financially sound and well managed.

2. Consumer Compliance Examinations

In addition to the prudential examinations, on-site consumer protection examinations were conducted at two banks. These examinations focused on the implementation of the Policy on Disclosure of Bank Charges, administration of dormant accounts, electronic banking activities, anti-money laundering programmes and policies on, and procedures for, handling consumer complaints. The banks were generally found to be complying with the policies and procedures except that there were concerns about the poor quality of banking services and numerous complaints by bank customers about fraudulent ATM transactions at one of the banks. Furthermore, both banks were given guidance on how to improve their compliance with the Banking (Anti-Money Laundering) Regulations, 2003, particularly customer identification requirements.

3. International Financial Services Centre (IFSC)

Activity in the IFSC continued to expand during the year. Enterprise Banking Group (Pty) Limited, a Botswana incorporated holding company, was granted a banking licence to establish a bank holding company in accordance with the requirements of Section 138(4) of the Income Tax Act, (CAP 52:01). This brought to three the number of licensed offshore banks in Botswana as at year-end 2004. Ten projects were granted regulatory approval during the year, bringing the total number of companies granted regulatory approval since the inception of the IFSC in 1999 to 16. The services provided by the 10 companies fall into one or more of the following categories: Financial Services Management, Corporate Advisory Services, Risk and Treasury Services, Special Finance Solutions, Risk Management Insurances, Investment Funds Management and Offshore Banking.

4. Collective Investment Undertakings (CIUs)

The net asset value of CIUs[3] declined by 8 percent between 2003 and 2004 from P2.9 billion to P2.6 billion, as depicted in Chart 10, mainly attributable to the withdrawal of P0.8 billion from the funds by the Botswana Public Officers Pension Fund (BPOPF) during 2004.

Chart 10: Net Asset Value of CIUs

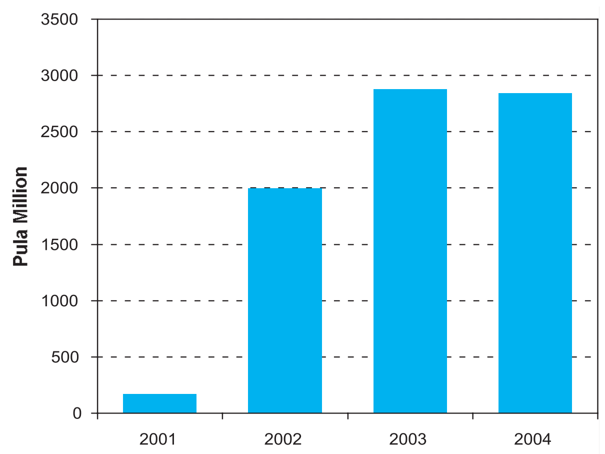
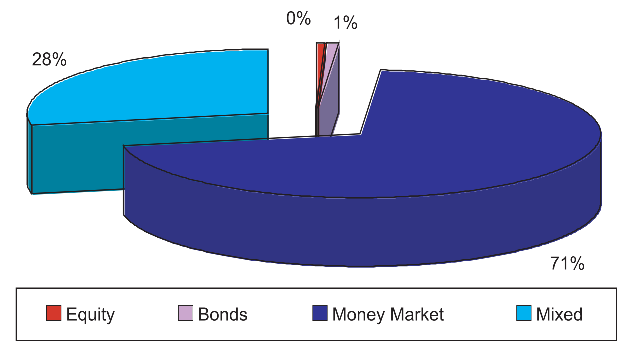


Chart 11 shows that, in 2004, 71 percent of the total net asset value of CIUs was invested in money market funds, followed by mixed security funds at 28 percent. Less than 1 percent each was invested in equities and bonds.

[3] Collective Investment Undertakings are investment vehicles through which investors are able to pool their funds so as to access investment opportunities that they would otherwise find difficult to invest in.

CHART 11: CIUS INVESTMENT BY ASSET CLASS



Stanbic Investment Management Services, a subsidiary of Stanbic Bank Botswana Limited, was licensed to manage a money market fund under the CIU Act and commenced operations in October 2004. This brought the total number of local CIUs licensed to operate in Botswana to two. A total of nine sub-funds of Hong Kong Shanghai Banking Corporation International-Capital Secured Growth Funds plc (HSBC-CSGF) were granted approval for marketing in Botswana during the year, bringing the number of sub-funds of HSBC-CSGF being marketed in the country to 26. As at December 31, 2004, there were seven Botswana investors (retail and corporate) and their investment amounted to P917.6 million.

5. STATUTORY BANKS (BOTSWANA BUILDING SOCIETY, BOTSWANA SAVINGS BANK AND NATIONAL DEVELOPMENT BANK)

During the year, all three statutory banks complied with the Bank's regulatory requirements. Analyses of the banks' returns indicated a steady increase in assets, from P1.3 billion in 2003 to P1.6 billion in 2004, representing an increase of 26 percent. The banks continued to be adequately capitalised, liquid and profitable.

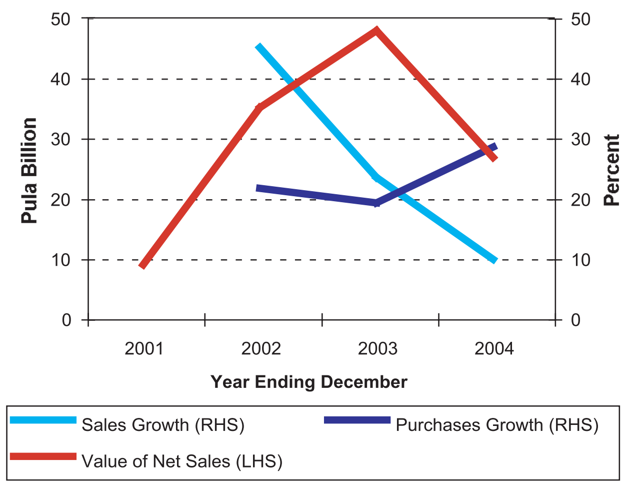
6. BUREAUX DE CHANGE AND MICRO-FINANCE INSTITUTIONS

(a) Bureaux de change

Effective September 2004, all bureaux operated under a new set of regulations, the Bank of Botswana (Bureaux de Change) Regulations, 2004. The new legislation on bureaux replaced the administrative "Terms and Conditions for Licensing and Operation of Bureaux de Change" previously used to regulate the bureaux. The changes introduced by the new regulations included, among others, increased licence and application processing fees, penalties for violations of the regulations, and a change of the financial year-end for all bureaux to March 31 annually. Thirty-four bureaux de change were operational on December 31, 2004, including four new bureaux licensed during the year. On-site inspections of some of the bureaux revealed a generally satisfactory operating environment. The bureaux are required to comply with the auditing requirement and also change their financial years to March 31 by March 2006.

The value of foreign exchange transacted through bureaux fell sharply in 2004, reversing the very rapid increase seen in previous years (Chart 12). This is reflected in the net sales (sales less purchases) trend, which reached a peak of P47 billion in 2003 but dropped to under P30 billion in 2004. Year-on-year growth of sales of foreign currency, while still relatively strong, fell to less than 10 percent in 2004, continuing the sharp fall in the growth rate seen in the previous year. The rate of growth of purchases of foreign currency rose from just under 20 percent in 2003 to nearly 30 percent in 2004, mainly due to an increase in the number of operating bureaux.

CHART 12: BUREAUX DE CHANGE FOREIGN EXCHANGE SALES AND PURCHASES



There have been changes in the composition of currencies underlying these transactions, with a shift away from the rand towards the US dollar, while transactions in the British pound and euro were largely unchanged (Charts 13 and 14).

CHART 13: BUREAUX DE CHANGE FOREIGN CURRENCY SALES

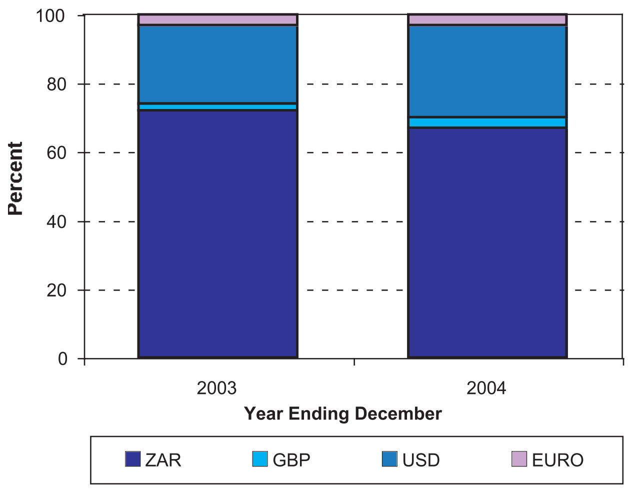
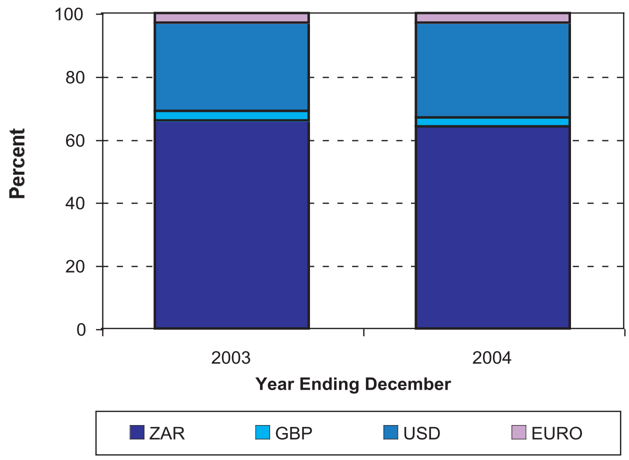


CHART 14: BUREAUX DE CHANGE FOREIGN CURRENCY PURCHASES



(b) Micro-finance establishments

Kuru Savings and Loans Scheme, one of the two micro-finance institutions that had been issued with an Exemption Certificate under Section 3 of the Banking Act, surrendered its licence because it was restructured and transformed from a savings and loan scheme into a training programme; the latter does not require an exemption certificate. Women's Finance House Botswana remained the only operating institution in this category.

The Bank continued to receive enquiries for setting up money lending business operations and clearance for use of prohibited words in accordance with Section 3 of the Banking Act. However, the frequency with which these enquiries were received lessened. The Bank has maintained interest in efforts by the Ministry of Trade and Industry to develop consumer protection (micro-lending) regulations that are expected to take effect during 2005.

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

The Bank continued to receive and process suspicious transactions reports from the banks. In that regard, the Bank liaised with the Directorate on Corruption and Economic Crime (DCEC) to ensure that timely and appropriate feedback was given to all reporting institutions. The Bank was represented at six meetings that were held by the National Task Force on Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT); issues discussed at the meetings covered, among others, the drafting of a national anti-money laundering strategy and a country report on AML/CFT issues. The Bank was also represented at a meeting hosted by the National Anti-Terrorism Committee, where Botswana's UN report on the ratification and implementation of UN Security Council Resolution 1373 (2001)[4] was discussed.

8. ABANDONED FUNDS

The Bank continued to receive and maintain records of abandoned funds[5] during 2004 in accordance with Section 39 of the Banking Act. Claims from owners/heirs of funds were received and duly processed throughout the year, resulting in reduced abandoned funds balances as shown in Table 4 below. Baroda has been in operation for less than 10 years and, accordingly, did not have abandoned funds, while Stanbic currently had no such funds.

Unclaimed abandoned funds amounting to P554 484 were transferred to the High Court's Guardian Fund. These were funds that had been held by the Bank for more than the statutory five years.

9. BANK CHARGES

The issue of perceived high bank charges by the public

[4] This resolution criminalise states from the wilful provision or collection, by any means, directly or indirectly, of funds by their nationals or in their territories with the intention that the funds should be used, or in the knowledge that they are to be used, in order to carry out terrorist acts.

[5] Customers' deposits/funds in a bank that have been left untouched and not reclaimed for ten years or more.

TABLE 4: SUMMARY OF ABANDONED FUNDS (PULA)

	Barclays	Stanchart	FNBB	Total
Balance brought forward	1 795 434	808 858	350 219	2 954 511
Funds received 2004	700 153	542 903	31 817	1 274 873
Claims paid out 2004	49 671	39 033	852	89 556
Payment to Guardian Fund	475 484	79 000	–	554 484
Balance at year-end 2004	1 970 432	1 233 729	381 184	3 585 345

continued to be a subject of major concern to the Bank during 2004. While most commercial banks submitted applications for an upward review of their bank charges in 2004, the Bank exercised caution and ensured that any increase was limited to what was justified by inflationary developments in 2003. Furthermore, banks were encouraged to streamline their charges in order to avoid perceived multiplicity of bank charges by the public. The banks were also advised to adopt pricing structures that were supportive of government policies on economic diversification.

10. EAST AND SOUTHERN AFRICAN BANKING SUPERVISORS GROUP (ESAF)

At a workshop held in Pretoria (South Africa) in November 2004, the Southern African Development Community (SADC) Committee of Central Bank Governors (CCBG) adopted a resolution to formally dissolve ESAF and convert it into a new CCBG sub-committee on banking supervision as per the decision of the 2003 ESAF annual general meeting. The Bank was represented at the inaugural meeting of the new sub-committee, called the SADC Sub-committee of Banking Supervisors (SSBS). A Steering Committee was elected, comprising Mauritius, Zambia, South Africa, Mozambique, Zimbabwe and chaired by Malawi.

11. BASEL COMMITTEE ON BANKING SUPERVISION ACTIVITIES

The new capital adequacy framework, commonly known as Basel II, was released in June 2004. The framework lays out principles for banks to assess the adequacy of their capital and for supervisory authorities to review such assessments with a view to ensuring more risk-sensitive capital requirements. The revised time frame for implementing Basel II for G10 member countries is the end of 2006 and 2007 for advanced approaches to risk management. It is, however, acknowledged that the adoption of Basel II may not be a first priority for many countries and, as such, the time schedules may extend beyond the Basel Committee's implementation dates. It has also been recognised that implementing Basel II is a country decision, but that there are benefits to its ultimate goal of strengthening financial systems. The Bank is in the process of establishing the regulatory implications of the Basel II capital adequacy framework for Botswana.

Chapter 3

Developments in Anti-Money Laundering Strategies

1. Introduction

Money laundering continues to pose a threat to the integrity of the global financial system. This chapter is an update on anti-money laundering measures covered in the 2001 Banking Supervision Annual Report. It reviews new developments in anti-money laundering and combating of the financing of terrorism (AML/CFT) and progress made by Botswana in this regard. The chapter discusses money laundering trends in Botswana and international developments on AML/CFT. It reviews AML/CFT strategies assessment programmes as conducted by Eastern and Southern African Anti-Money Laundering Group (ESAAMLG) and the IMF/World Bank, and comments on on-site AML examinations, with particular emphasis on risk-based examinations methodology. The chapter also highlights future AML/CFT strategic plans for Botswana, focusing on major planned activities.

Money laundering is a process by which ill-gotten money is used to finance personal or business investments and consumption, with the ultimate intention of making it appear that the money has a legitimate origin. After the September 11, 2001 attacks in the US, the international community expanded the definition of money laundering to include money and other property obtained through legal means and used to fund terrorist activities. Money laundering trends and techniques continue to evolve against the background of tremendous efforts by the international financial community to combat the scourge. As a result, the cost of compliance with Anti-Money Laundering (AML) laws, policies and procedures has also been rising as new and improved compliance systems were being introduced in the market.[6] Financial institutions are increasingly adopting risk-focused approaches in their AML compliance measures as a way of minimising compliance costs and enhancing AML risk identification and mitigation strategies. Jurisdictions that have not yet revised their AML laws, policies and procedures are increasingly at a disadvantage in that those that have modern AML requirements shun doing business with jurisdictions that appear to lag behind in implementing AML reforms.

2. Money Laundering Trends in Botswana

Money launderers and supporters of terrorism have demonstrated creativity in combining traditional money laundering techniques with more complex schemes designed to thwart the ability of authorities to prevent and detect money laundering and other financial crimes and to prosecute those committing the crimes.

In Botswana, the Directorate of Corruption and Economic Crime (DCEC) is mandated to receive, analyse and disseminate disclosures of information on suspected proceeds of crime in order to combat money laundering. The DCEC, in collaboration with the Bank of Botswana and the Ministry of Finance and Development Planning, acts as the domestic and international adviser on money laundering generally, and offers practical guidance and assistance to the financial sector on the subject of money laundering. The DCEC is, however, not a full-fledged financial intelligence unit (FIU)[7] and, as such, undertakes this responsibility as a secondary function. That notwithstanding, the DCEC reported that during 2003, six percent of the reports it received and investigated related to money laundering (DCEC Annual Report, 2003).

Botswana revived the National Task Force on Anti-Money Laundering in 2001 and finalised the terms of reference in 2003. The National Task Force coordinates, at a strategic level, all AML/CFT activities in the country and advises the Minister of Finance and Development Planning and other stakeholders on developments in this area. The Task Force also acts as a liaison point between Botswana and international bodies (such as ESAAMLG, International Monetary Fund (IMF), World Bank, Commonwealth Secretariat, Financial Action Task Force (FATF) and United Nations) that promote best standards on combating money laundering and the financing of terrorism.

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6 Global Anti-Money Laundering Survey, 2004 “How Banks are facing up to the challenge”, KPMG International

7 FIU is a body that receives, analyses and disseminates information on suspicious transactions. The DCEC is an investigation institution.

Statistics indicate that there was an increase in the number of money laundering predicate offences committed during 2003 (the latest year for which data are available) compared to the previous year. These included increases in fraud cases (commercial crime), robbery, drugs and related substances (Botswana Police Service Annual Report, 2003).

3. International Developments on AML/CFT

After the events of September 11, 2001, countries have been investing substantial amounts of resources in strengthening their financial systems against the adverse effects of money laundering and the financing of terrorism activities. Investment spending has been directed into, among others, human resource training and development, review of legislation to incorporate international best practice in the area of prevention and detection of money laundering and the financing of terrorism, and new technologies that monitor, recognise and report on any suspicious activities conducted through the formal financial system. The developing world is looking to the developed countries, IMF and World Bank to provide technical assistance in, among others, the drafting of appropriate AML/CFT legislations and developing AML/CFT risk-based assessment methodologies.

(a) Developments on the FATF 40+8

The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, aimed at combating money laundering and the financing of terrorism. The FATF developed the 40+8 recommendations and these are recognised internationally as best standards for combating money laundering and the financing of terrorism. The recommendations were released in 1990 and revised in 1996 and 2003.

Although Botswana is among the countries that are yet to adopt the latest 2003 40+8 FATF recommendations, the Banking Act (CAP 46:04) incorporated most of the 40 FATF recommendations relating to the 'Role of the Financial System in Combating Money Laundering', in particular, customer identification, record keeping and reporting of suspicious activities. In addition, the Banking Regulations, 2003 (Anti-Money Laundering) took account of 40+8 FATF recommendations. Furthermore, the Banking Act is being reviewed with a view to incorporating most of the best international standards in banking practices. Consideration will be given to incorporating most, if not all, of the 2003 revised 40+8 FATF recommendations in the Act currently under review.

The new mandate of FATF extends over the period September 2004 to December 2012. FATF's main tasks during this period will include revising standards for combating money laundering and the financing of terrorism, carrying out typologies and compliance work in order to ensure global action against money laundering and the financing of terrorism, developing closer cooperation with the IMF and World Bank, and enhancing FATF's relationships with FATF-style Regional Bodies (FSRBs). Since February 2004, FATF has worked closely with the IMF and World Bank and the FSRBs to develop a common methodology for assessing compliance with the 40+8 recommendations. Botswana looks forward to a mutual evaluation exercise, (see Section (b) below) under the common methodology.

Given the relative newness of the 8 special recommendations, the Bank is cognisant of the efforts being made by the FATF to continue to interpret and refine guidance on how best to implement these special recommendations. This also applies to the impending endorsement of the proposed FATF special recommendation 9, which deals with cash couriers.

Despite the absence of a specific legislation on combating the financing of terrorism in Botswana, acts of terrorism and the associated offences, such as, aiding and abetting, can be prosecuted under the Penal Code, the Arms and Ammunition Act and related legislations. Botswana is also considering developing legislation that could be used to freeze assets suspected to be linked to terrorists or other criminals and to bar access to the financial system or to stop payment to, or for the account of, any known or suspected terrorist organisations, entities or persons. It is hoped that these initiatives would help to ensure that Botswana fully implements the requirements of the United Nations Convention on the Suppression of the Financing of Terrorism that was signed in 2000 and UN Resolution 1373.

(b) Mutual evaluations

Mutual evaluations involve an on-site visit by a team of selected experts drawn from the legal, financial and law enforcement sectors for the purpose of conducting an in-depth assessment of AML/CFT systems, reporting on progress made by the evaluated member country towards developing an effective system for countering money laundering and highlighting areas where more effort is required. The goals of a mutual evaluation exercise are to increase knowledge among nations, to monitor progress towards implementing standards by individual countries and reviewing momentum for corrective actions. The spirit of the mutual evaluation process depends on moral and political commitment from countries.

Botswana has volunteered for a mutual evaluation by ESAAMLG, which is to be conducted in 2006. ESAAMLG should successfully perform the evaluations as it has already undertaken similar evaluations jointly with the FATF, IMF and World Bank. Within the region, ESAAMLG has conducted mutual evaluations in Swaziland, Lesotho, Namibia and Malawi. The Group participated in the mutual evaluation of South Africa, which was led by the FATF.

(c) The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)

ESAAMLG was established in 1999 to combat money laundering by encouraging member countries to implement the FATF forty recommendations. This Group, comprising fourteen East and Southern African countries, is the only FSRB in Africa. So far, ESAAMLG has been successful in a number of areas, including training of AML/CFT experts, conducting mutual evaluations, and hosting workshops and seminars.

Botswana continues to be a committed member of the Group and actively participates in most of the ESAAMLG training, meetings and workshops. In August 2004, Botswana's draft strategy on AML was presented at the ESAAMLG Task Force meeting of senior officials in Mauritius and the Minister of Finance and Development Planning attended the ESAALMG Council of Ministers meeting held subsequent to the meeting of the Task Force of Senior officials.

(d) The Role of the IMF/World Bank in AML/CFT issues

The recognition of risks posed by money laundering and the financing of terrorism to the reputation and integrity of financial systems has resulted in the establishment of a working relationship between government agencies and financial institutions to develop robust AML/CFT programmes and internal control systems. For this reason, the World Bank's Global Dialogue Series on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was instituted to enable member countries, the IMF and World Bank, FSRBs, regional development banks and other international organisations to discuss and exchange information on the challenges faced in the struggle against illicit money flows, share lessons from success stories and identify the type of assistance countries need in order to combat money laundering and the financing of terrorism. The IMF, through its International Monetary Financial Committee (IMFC), in conjunction with the World Bank agreed on their respective roles in combating money laundering and financial crimes for the protection of the international financial system.

The IMF and World Bank continue to provide broad-based Technical Assistance (TA) to countries to help develop and strengthen their AML/CFT infrastructures, with greater emphasis on regional projects, including capacity building for FSRBs. Local staff continue to work with regional and international organisations in the identification, coordination and delivery of technical assistance. Assistance is provided both through review and comments on draft legislation and through TA missions. Much of this type of assistance now covers AML/CFT issues.

There are TA programmes on AML/CFT that Botswana has taken advantage of to improve its AML/CFT systems. The country was among the first to undergo AML/CFT Detailed Assessment and Diagnostic Review under the auspices of the IMF and World Bank in 2002. The assessment focused on the review of legal, institutional and supervisory/regulatory aspects of Anti-Money Laundering and Combating the Financing of Terrorism pursuant to the draft AML/CFT methodology of June 2002. Some of the recommended action plans from the diagnostic review part of the technical assistance to Botswana were incorporated into the Banking (Anti-Money Laundering) Regulations, 2003. The remaining recommended action plans require legislative review, and consideration will be given to including them in the ongoing review of the Banking Act and other relevant laws.

4. AML/CFT STRATEGIC PLANS FOR BOTSWANA

Botswana has undertaken to continuously improve and maintain effective anti-money laundering laws, policies and institutions. The Government continues to encourage all stakeholders to work together to put in place appropriate counter measures in their areas of operation. The Ministry of Finance and Development Planning has the responsibility of integrating activities of the existing structures in the work of other arms of government. The Bank and other stakeholders will continue to make their contributions to the national strategy through their representation in the National Task Force.

(a) Major activities from the National Strategy on AML/CFT Measures

The National Task Force plans to enlist the service of other governments to assist with technical expertise and other resources necessary for the development of the requisite legislation and other AML/CFT infrastructure.

There is also a crucial need for educational campaigns to be carried out in Botswana to raise awareness among the public about the dangers of money laundering and the financing of terrorism. Currently, there is an ongoing public awareness campaign spearheaded by the DCEC to sensitise banks about money laundering. The objective is to extend this to the general public and to include issues of combating the financing of terrorism. The goal is to build relationships between different existing committees and form a consultative forum for various stakeholders including bankers, insurers and Botswana Confederation of Commerce, Industry and Manpower.

(b) Anti-money laundering examinations and the adoption of AML/CFT Risk-Based Examination Methodology

Supervisory authorities around the world are embracing a risk-focused approach to supervision of financial institutions. It has been noted that while a "core" AML examination of all banking institutions is required, risk-focused procedures would allow examiners to apply the appropriate level of scrutiny to higher risk business lines where necessary.

The Bank ensures that during every on-site examination of a financial institution, bank examiners review the institution's previous and current compliance with AML laws and programmes. Examiners are required to determine whether the institution has included AML procedures in all of its operational areas and has adequate internal control procedures to detect and report money laundering activities, as well as other potential financial crimes. As part of such examinations, bank examiners also consider fraud detection and prevention capabilities, and the bank's policies and procedures for cooperating with law enforcement agencies.

(c) Anti-money laundering laws in Botswana

Although Botswana has no homogeneous and comprehensive legislation, it relies on several pieces of legislation listed below to address money laundering and terrorism-related offences:

(i) The **Corruption and Economic Crime Act (CAP 08:05)** – this legislation provides for the establishment of a law enforcement agency whose mandate is to investigate and prosecute corruption and economic offences, including money laundering offences.

(ii) The **Banking Act (CAP 46:04)**, under which the Banking Regulations were promulgated, requires banks to notify the central Bank of any suspicious transactions, keep financial transaction records for at least five years and to conduct thorough due diligence on all their customers.

(iii) The **Proceeds of Serious Crime Act (CAP 08:03)** – it criminalises money laundering in accordance with the requirements of the 1988 Vienna Convention. The Act, as amended, applies to all activities intended to conceal or disguise the nature, source, location, disposition, movement, ownership, or any rights with respect to the money or property concerned. It also covers acts aimed at converting, transferring or removing the property concerned. The Act is applicable to the entire financial sector.

(iv) The **Banking (Anti-Money Laundering) Regulations, 2003** – they provide minimum guidelines on Know Your Customer (KYC) requirements, record keeping, recognition and reporting of suspicious transactions, cooperation with law enforcement agencies, awareness raising and staff training on anti-money laundering measures.

(v) The **Arms and Ammunitions Act (CAP 24:01)**, the **Penal Code (CAP 08:01)** and **the National Security Act (CAP 23:01)** address terrorism activities.

To address the problem of disjointed pieces of legislation and the absence of other relevant laws, the National Task Force on AML/CFT has proposed the following activities as part of the national strategy:

(i) Development of a comprehensive anti-money laundering legislation;

(ii) Development of anti–terrorism legislation by extracting relevant provisions from the penal code and other statutes;

(iii) Drafting legislation to criminalise the financing of terrorism; and

(iv) Development of the Assets Forfeiture (Civil Forfeiture) Act, which will build on the provisions of the Corruption and Economic Crime Act and the Proceeds of Serious Crime Act.

In addition, the absence of a dedicated financial intelligence unit (FIU) is well recognised, since its functions have been designated to the DCEC as a secondary responsibility. Botswana is critically examining the existing guidelines to develop a legislation that will establish the FIU as an independent, well-resourced institution that will coordinate matters relating to the receipt, analysis and disclosure of information on suspicious activities.

Consideration will also be given to the development of a database that will be used for analysing suspicious transactions and to give feedback to the banks on the number of disclosures, information on current techniques, methods and trends (anti-money laundering typologies) so that banks could develop better systems to deal with such activities. The Bank would also use the information from this database to respond to enquiries by international bodies, such as the IMF and World Bank, United Nations, Commonwealth Secretariat, FATF and ESAAMLG.

5. Conclusion

Botswana is committed to pursuing the fight against money laundering and the financing of terrorism. To that end, Botswana has undertaken to develop legislation to address AML/CFT issues. Because of capacity constraints, it is hoped that donor and other relevant organisations will continue to render various types of assistance towards the development of effective legislation and other AML/CFT infrastructure.

Appendices

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Appendices, Tables and Charts

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Appendix 1: Regulation and Supervision of Banks in Botswana: Framework for Supervision

1. Introduction

This Appendix outlines the basic elements of the framework, standards and processes for banking supervision in Botswana. The Bank of Botswana (the Bank) is committed to the development of a sound, stable and competitive banking system that 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).

2. Legal Framework

In general, it is considered that to be effective, a regulatory framework must have sufficient authority established by law, a high degree of independence or autonomy and adequate human and financial resources. In Botswana, the primary legislation covering the supervision and regulation of licensed financial institutions is the Banking Act (CAP 46:04). 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 are: explicit provisions for the licensing and authorisation processes that 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 the primary 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 that 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.

3. Authority for Licensing Banks

A central feature of banking supervision is establishing criteria for licensing of banks. Banking is a regulated industry because of the fact that banks take deposits from the public, have a key role to play in the country's payments system, and, related to both of these functions have a 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. This Section covers licensing of commercial banks, merchant/investment banks, credit institutions and discount houses.

4. Licensing Policy and Procedures for Establishing a Bank

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

For any institution to be licensed as a bank in Botswana, it must 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.

5. 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 is described briefly below.

(a) 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[1]. 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.

(b) Reserve requirements

In terms of Section 39(1) of the Bank of Botswana Act (CAP 55:01), 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 stipulates that every bank and credit institution must maintain in Botswana, on a daily basis, liquid assets as a percentage of its deposit liabilities equal to 10 percent and 3 percent, 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.

(c) Asset quality

(i) Asset concentrations (large exposures)

Section 17 of the Banking Act 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 to customers which, in aggregate, are in excess of 30 percent of a bank's unimpaired capital.

(ii) 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.

(iii) Provisions

Section 14 of the Banking Act deals with items, against

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

which provisions must be held, that is, reserves against potential losses, when determining a bank's capital adequacy. It establishes the legal framework for the Bank to assess adequacy of the provisions for non-performing assets.

(d) Main supervisory approaches

(i) On-site examinations

The Bank conducts routine on-site examinations pursuant to Section 24(1) of the Banking Act. The Bank of Botswana 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.

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 of Botswana also reviews management letters from external auditors to ensure that recommendations are implemented expeditiously and effectively.

(ii) 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. The Act also provides for discussions between the Bank, respective licensed financial institutions, and their external auditors as per Sections 22(8) and 22(9) of the Banking Act. 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.

(iii) Statutory meetings

Bilateral meetings

In accordance with Section 22(9) of the Banking Act, 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 institutions and serve to improve communication and information flow between the Bank and these institutions.

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 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.

6. Accounting, Auditing and Disclosure Standards

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

7. 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[2] 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 introduce international best practice into banking supervision.

The Bank annually conducts a detailed self-assessment for compliance with the Core Principles using the methodology adopted by 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.

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

BASEL COMMITTEE: CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

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

Appendix 2: Supervised Financial Institutions as at December 31, 2004

(a) Banks and other deposit-taking institutions

Institution	Postal Address	Business Locations*	External Auditors
COMMERCIAL BANKS			
Barclays Bank of Botswana Limited	P O Box 478, Gaborone	35	Pricewaterhouse Coopers
Standard Chartered Bank Botswana Limited	P O Box 496, Gaborone	17	KPMG
First National Bank of Botswana Limited	P O Box 1552, Gaborone	12	Deloitte & Touche
Stanbic Bank Botswana Limited	P/Bag 00168, Gaborone	8	KPMG and PricewaterhouseCoopers
Bank of Baroda (Botswana) Limited	P O Box 21559, Gaborone	1	Grant Thornton Acumen
MERCHANT BANKS			
African Banking Corporation of Botswana Limited	P/Bag 00303, Gaborone	2	KPMG
STATUTORY BANKS			
Botswana Savings Bank[3]	P O Box 1150, Gaborone	1	Pricewaterhouse Coopers
National Development Bank	P O Box 225, Gaborone	4	Deloitte & Touche
BUILDING SOCIETIES			
Botswana Building Society	P O Box 40029, Gaborone	9	Pricewaterhouse Coopers

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

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

(b) Bureaux de change

Name	Postal Address	Business Locations[4]
Universal Bureau de Change	P O Box 2444, Gaborone	2
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	2
Exim Bureau de Change	P O Box 1020, Gaborone	1
ASA Bureau de Change	P O Box 2, Lobatse	3
Prosper Bureau de Change	Private Bag BO7, Gaborone	3
Kwa Nokeng 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	1
Madikwe Bureau de Change	P O Box 402885, Gaborone	1
Aldaph Bureau de Change	P O Box 41436, Gaborone	2
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
SMI Bureau de Change	P O Box 201641, Gaborone	1
American Express Bureau de Change	P O Box 45140, Gaborone	1
Star Bureau de Change	P O Box 80491, Gaborone	1
Unity Bureau de Change	P O Box 1586, Francistown	1
Royalty Bureau de Change	P O Box 1398, Francistown	2
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Open Door Bureau de Change	P O Box 839, Maun	1
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
Blondie Bureau de Change	P O Box 21712, Gaborone	1
FX Africa Bureau de Change	P O Box 20537, Gaborone	1
Cape to Cairo Bureau de Change	P O Box 5, Kasane	1
Business Towers Bureau de Change	P O Box 40943, Gaborone	1
Nsundano Bureau de Change	P O Box 243, Kasane	1
Theo Bureau de Change	P O Box 20918, Maun	1
Sedibelo Bureau de Change	P O Box 2385, Mochudi	1

[4] Branches and Head Office

(C) COLLECTIVE INVESTMENT UNDERTAKINGS

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

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

Name	Postal Address
SeedCo. International Limited	P O Box 478143, Gaborone
ABC (International) Limited	Private Bag 00303, Gaborone
African Alliance International	P O Box 270, Gaborone
ABC Holdings Limited	Private Bag 00303, Gaborone
RPC Data International Limited	Private Bag BR 42, Gaborone
Kingdom Bank Africa Limited	P O Box 45078, Gaborone
Nugen (Pty) Limited	P O Box 408, Gaborone
Imara Holdings Limited	Private Bag 00186, Gaborone
Andisa Capital (Botswana) (Pty) Limited	Private Bag BR 351, Gaborone
Andisa Treasury Solutions (Botswana) (Pty) Limited	Private Bag BR 351, Gaborone
Andisa Corporate Advisors (Botswana) (Pty) Limited	Private Bag BR 351, Gaborone
Andisa Special Projects (Botswana) (Pty) Limited	Private Bag BR 351, Gaborone
AON Risk Management	P O Box 624, Gaborone
Wilderness Safaris Botswana (Pty) Limited	Private Bag 14, Maun
Cherubin Ventures (Pty) Limited	P O Box 1444, Gaborone
Enterprise Banking Group (Pty) Limited	Private Bag 351, Gaborone

(E) MICRO-FINANCE INSTITUTIONS

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

Appendix 3: Definition of Terms

1. Capital elements

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

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

(i) Ordinary shares (issued and paid-up)

(ii) Perpetual (non-redeemable) non-cumulative preferred shares

(iii) Disclosed prior years' reserves (audited)
- Share premium
- General reserves
- Accumulated retained earnings

(iv) Published current year's retained earnings

(v) Minority interests

less

(vi) Current year's unpublished losses

(vii) Goodwill and other intangible assets

(viii) Shareholders' equity funded through the capitalisation of unrealized gains arising from property revaluation

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

(i) Current year's unpublished profits

(ii) 50% of fixed asset revaluation reserves

(iii) Unencumbered general provisions not to exceed 1.25% of Risk Weighted Assets

(iv) Hybrid (debt/equity) capital instruments (eligible for inclusion)

iv) Subordinated term debt (eligible for inclusion)

(vi) Minority interests (in Tier 2 preference shares)

(vii) Shareholders' equity funded through the capitalisation of property revaluation reserves

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

(i) Investments in unconsolidated subsidiaries and associated companies

(ii) Connected lending of a capital nature, including unlawful lending to directors, owners or their indirect interests

(iii) Capitalised establishment costs/pre-incorporating expenses

(iv) Underwriting commission

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

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

2. RATIOS

(a) **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.

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

(c) **Dividend Payout:** 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 for 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.

(d) **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 weakened.

(e) **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 Basel 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 excludes, however, any elements that are likely to impair a bank's capital such as investment in unconsolidated subsidiaries and associated companies, and connected lending of a capital nature. The use of risk-weighted assets is 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.

(f) **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:

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

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

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

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

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

(i) **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:

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

(j) **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:

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

(k) **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.

$$\frac{\text{Net Income after Tax}}{\text{Total Expense}}$$

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

(m) **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.

3. 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 collateralised by BoBCs or any securities issued by the Government of Botswana	0
Foreign currency notes	20
Advances to Local Government Authorities	20
Cash items in the process (course) of collection	20
Assets secured by cash investments held at another domestic bank/local financial institution	20
Due from other banks – demand or maturity under 1 year	20
Loans and other advances secured by first class bank guarantees acceptable to the Bank of Botswana	20
Loans secured by recognised multilateral development financial institutions (e.g. IBRD ADB etc)	20
Claims to or credit facilities guaranteed by Statutory Corporations (Parastatals)	20
Claims to or credit facilities guaranteed by Debswana	20
Assets due from or guaranteed by other domestic public sector entities	50
Loans secured by owner occupied residential property	50
Loans secured by commercial and industrial property	100
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 Letters of Credit Bankers Acceptances)	100
Assets securitised with recourse	100
Transaction-related contingent items (performance bonds bid bonds etc.)	50
Formal commitments credit lines (original maturity over 1-year undrawn commitments) and underwriting and note-issuance facilities	50
Short-term self liquidating trade related (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

4. Other terms

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

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

(c) **Adverse Classifications:**

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

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

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

(d) **Core Capital**: an aggregate of share capital, share premium, general reserve and retained earnings, also called Tier 1 capital. It represents the most stable and permanent form of capital for supporting a bank's operations. (See Appendix 3 for computations).

(e) **Total Risk Weighted Assets:** An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk weighting are presented on page 31.

(f) **Unimpaired Capital:** Unimpaired in relation to the capital of a bank means the absence of any legal or technical covenant, term, restriction or encumbrance which would otherwise render such capital not to be freely available for distribution to depositors or other creditors in the event of the liquidation or dissolution of the bank, and the absence of any condition or arrangement which would, in the opinion of the Central Bank, diminish the value of the whole or any portion of the capital of the bank. An outline of capital elements used to compute unimpaired capital is presented on page 28.

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

Appendix 4: Data Tables

Table 5: aggregate balance sheet of licenced financial institutions in botswana (pula million)

Total Assets in Local Currency	2000	2001	2002	2003	2004
1. Cash and balances with the Central Bank	350.6	471.6	628.2	776.3	843.0
a. Currency	207.9	258.7	327.8	315.8	314.1
aa. Hard currency and gold bullion	36.6	38.0	33.7	32.5	35.1
ab. Local currency	171.3	220.7	294.1	284.2	279.0
b. Balances with the Central Bank	142.7	212.9	287.7	417.7	432.1
c. Other	0.0	0.0	17.4	248.5	254.6
2. Trading securities at market value (BoBCs)	1 299.9	2 015.0	1 946.9	2 517.7	3 046.3
3. Placements with other banks and credit institutions	1 533.7	2 997.2	1 959.7	2 004.5	1 957.3
4. Loans and advances to other customers (net of specific provisions)	4 964.4	5 608.6	6 862.9	7 609.2	8 680.7
5. Investment securities	151.0	78.4	82.9	532.6	385.6
6. Fixed assets net of depreciation	168.0	178.0	197.8	208.8	212.2
7. Other assets (net)	535.1	274.8	368.5	429.5	408.7
Total Assets	**9 002.7**	**11 623.6**	**12 046.9**	**14 078.6**	**15 533.8**
Liabilities in Local Currency					
1. Amounts owed to government institutions	121.9	0.1	0.1	0.1	0.1
a. Central Bank accounts	0.0	0.0	0.0	0.0	0.0
b. Direct Government credits (CB or MoF)	121 905.0	117.9	113.6	108.8	104.2
c. Other	0.0	0.0	0.0	0.0	0.0
2. Due to other banks and credit institutions	227.2	229.0	244.2	254.4	410.4
3. Securities sold under repurchase agreements	0.0	0.0	0.0	0.0	0.0
4. Due to other customers/depositors	7 257.8	9 718.4	9 701.3	11 488.4	12 568.7
5. Shareholders funds	829.8	1 014.3	1 219.7	1 436.4	1 233.8
6. Other liabilities	566.0	544.0	768.0	788.8	896.6
a. Taxes payable	79.3	116.7	126.4	61.7	102.9
b. Dividends payable	139.9	184.6	219.4	53.2	118.3
c. Accrued expenses	44.2	41.1	82.0	135.0	30.6
d. Other	302.6	201.6	340.3	540.7	648.4
7. Other borrowing incl. International lending agencies	0.0	0.0	48.5	0.0	0.0
Total Liabilities	**9 002.7**	**11 623.6**	**12 046.9**	**14 078.6**	**15 533.8**

Table 6: Aggregate income statement of licensed financial institutions in Botswana (Pula million)

	2000	2001	2002	2003	2004
1. Interest and similar income	1 101.7	1 320.2	1 544.8	1 790.7	1 903.6
2. Interest expense	565.2	676.9	779.4	914.9	970.8
3. Net interest income [1-2]	536.6	643.3	765.4	875.7	932.8
4. Other operating income	278.0	367.5	452.2	487.9	545.6
5. Gross operating income/(loss) [3+4]	814.6	1 010.8	1 217.6	1 363.6	1 478.4
6. Bad and Doubtful Debts Provisions	7.5	44.0	46.5	74.7	50.2
a) Specific loss provision expenses	20.0	43.9	61.9	88.9	94.0
b) General loss provision	1.5	7.3	8.3	8.9	– 22.6
c) Releases and Recoveries of bad debts previously written off	5.6	– 7.2	– 23.8	– 23.1	– 21.2
7. Operating income/(loss) net of specific loss provisions	807.1	966.8	1 171.1	1 288.9	1 428.2
8. Operating expenses	356.7	446.8	574.2	661.2	707.8
a) Salaries and employee benefits	177.1	213.0	262.4	300.0	313.1
b) Administrative expenses	21.3	16.6	22.2	0.0	97.4
c) Auditing and consulting expenses	1.4	3.4	6.9	0.4	25.5
d) Rents paid	0.0	6.6	9.3	22.2	32.9
e) Depreciation and amortization	25.9	30.7	30.0	38.5	38.4
f) Other	131.1	176.5	243.4	300.2	200.5
9. Other provisions and write-offs	0.0	0.0	0.0	0.0	0.0
a) Investments	0.0	0.0	0.0	0.0	0.0
b) Other balance sheet items	0.0	0.0	0.0	0.0	0.0
c) Off-balance sheet items	0.0	0.0	0.0	0.0	0.0
10. Net operating income/(loss) [7-8-9]	0.5	520.0	596.8	627.7	720.3
11 Extraordinary Gains/(Losses	0.7	0.0	– 2.0	– 0.4	– 2.1
a) Gains/Losses on revaluation of assets (Net)	0.0	0.0	– 2.0	0.0	0.0
b) Translation Gains/Losses (Net)	0.0	0.0	0.0	0.0	0.0
c) Other Gains/Losses	0.7	0.0	0.0	– 0.4	– 2.1
12. Net income/(loss) before tax [10+11]	451.1	520.0	594.9	627.3	718.2
13. Income tax	99.5	87.6	83.7	84.0	119.1
14. Net income/(loss) after tax [12-13]	351.6	432.4	511.2	543.3	599.2
15. Transfers from revaluation/to general provisions	– 0.5	– 0.9	– 0.8	0.0	– 0.3
16. Dividends declared (paid & proposed)	229.6	294.6	489.7	399.0	476.9
17. Retained earnings for the year [14-15-16]	122.6	138.8	22.3	144.3	122.5
18. Retained earnings at the beginning of the year	385.7	497.1	635.9	658.2	601.3
19. Retained earnings at the end of the year [17+18]	508.2	635.9	658.2	802.4	723.8

Appendix 5: Charts of Key Prudential Indicators

Chart 15: Total Capital

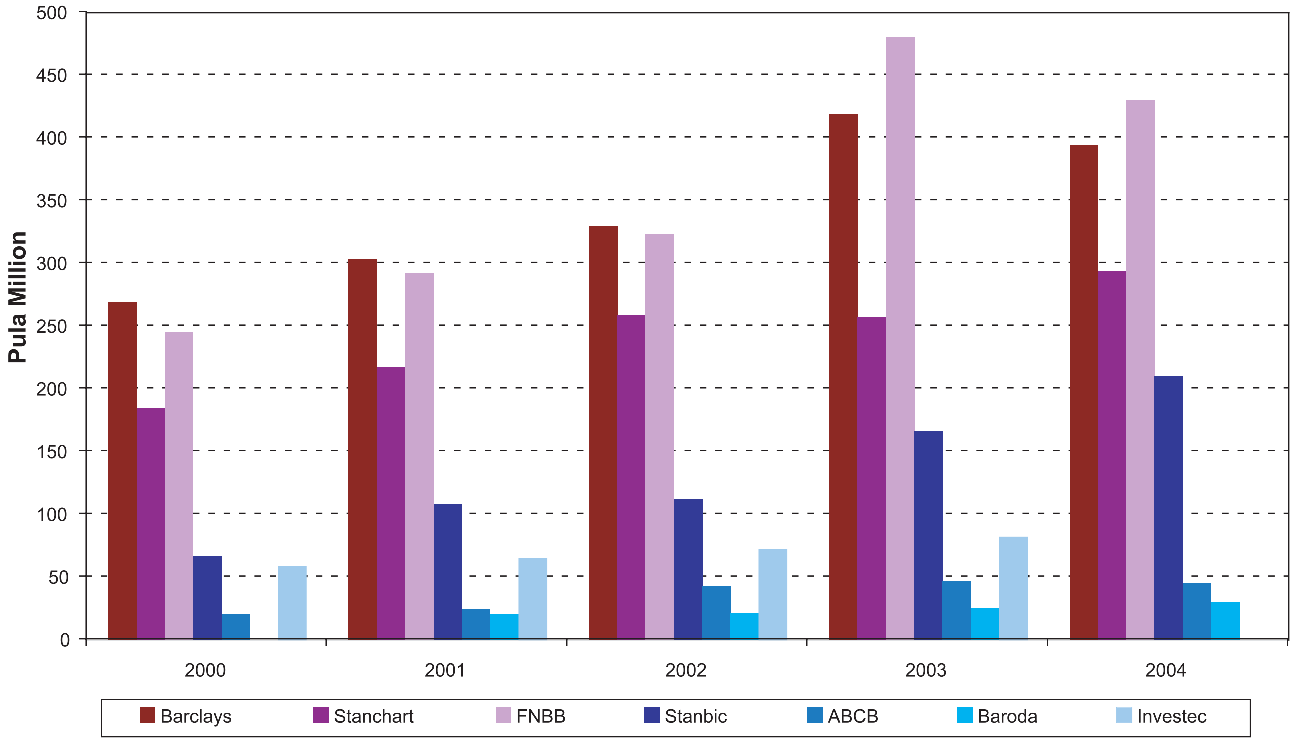


Chart 16: Unimpaired Capital

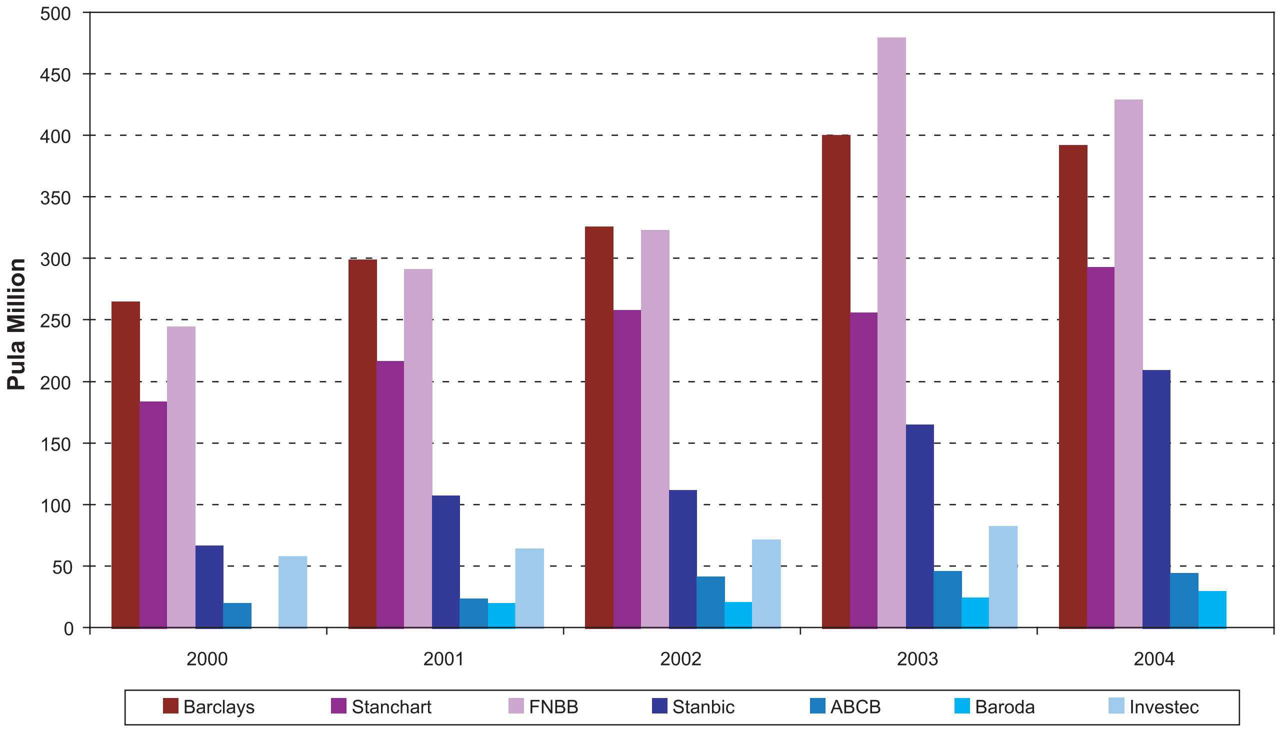


CHART 17: CORE CAPITAL TO TOTAL CAPITAL

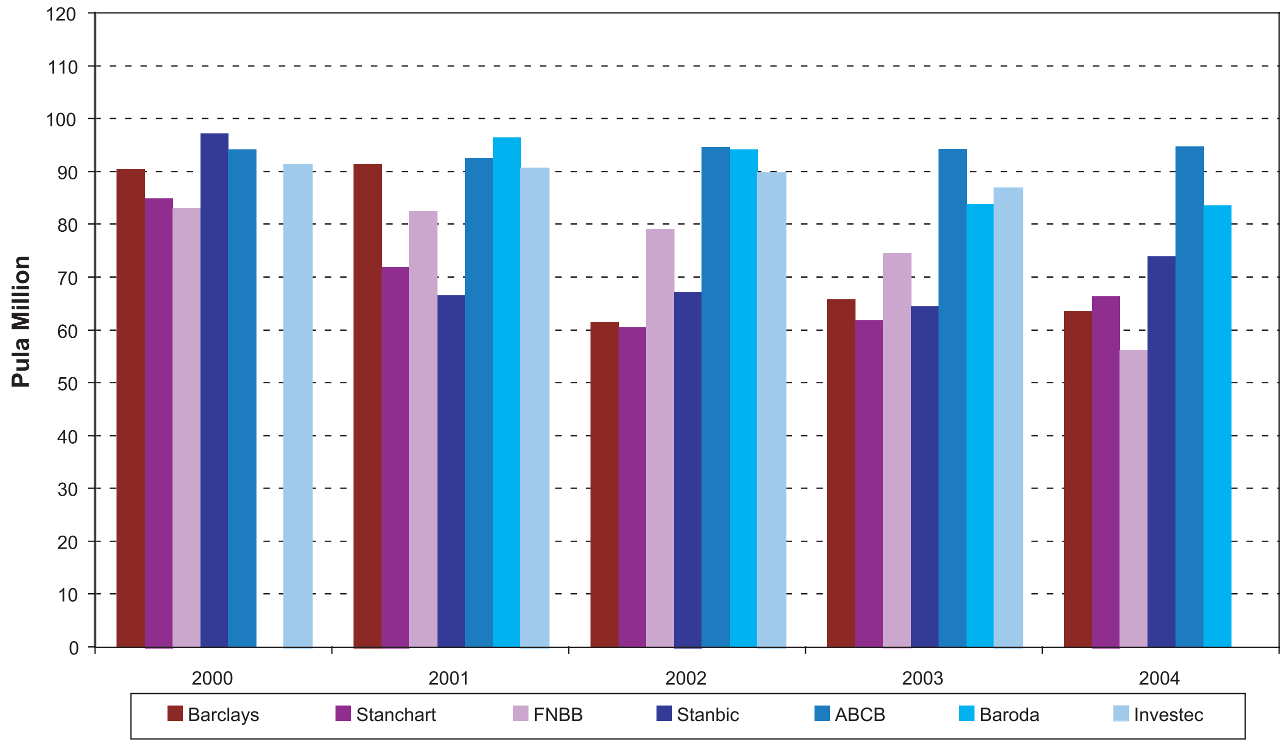


CHART 18: CORE CAPITAL TO RISK WEIGHTED ASSETS

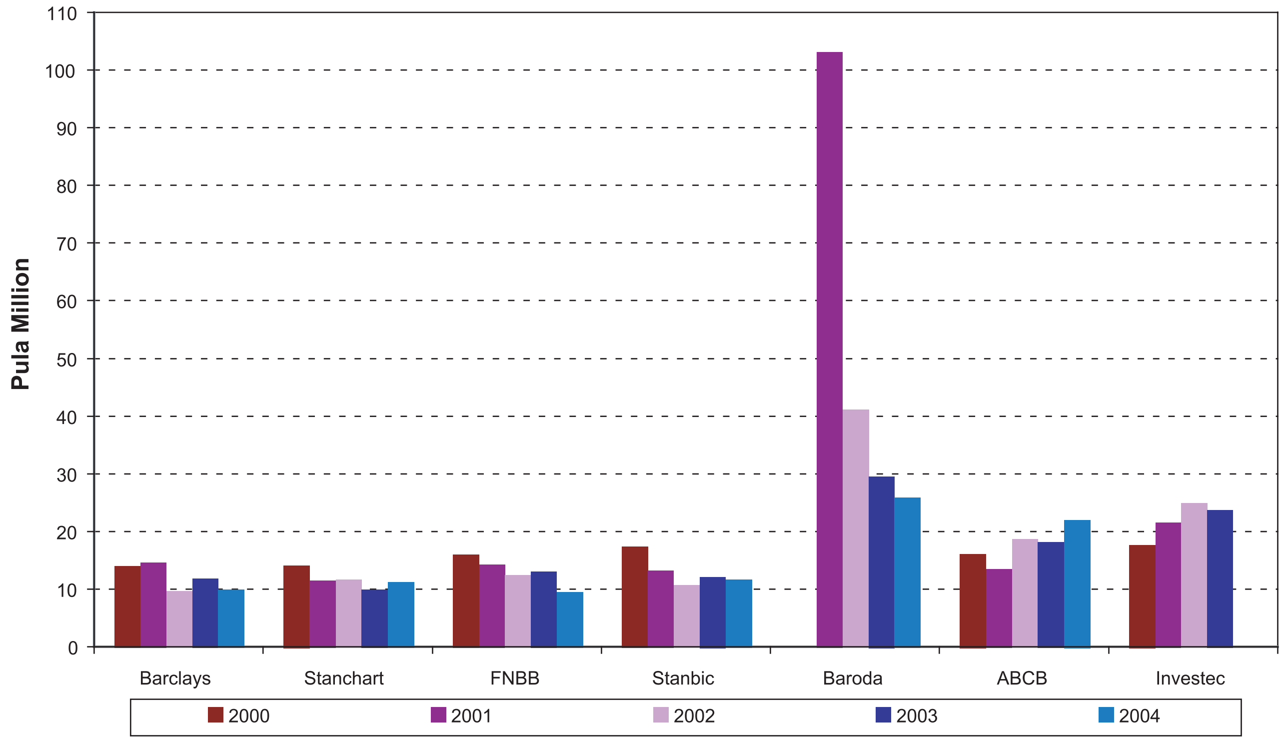


Chart 19: Unimpaired Capital to Risk Weighted Assets (Capital Adequacy Ratio)

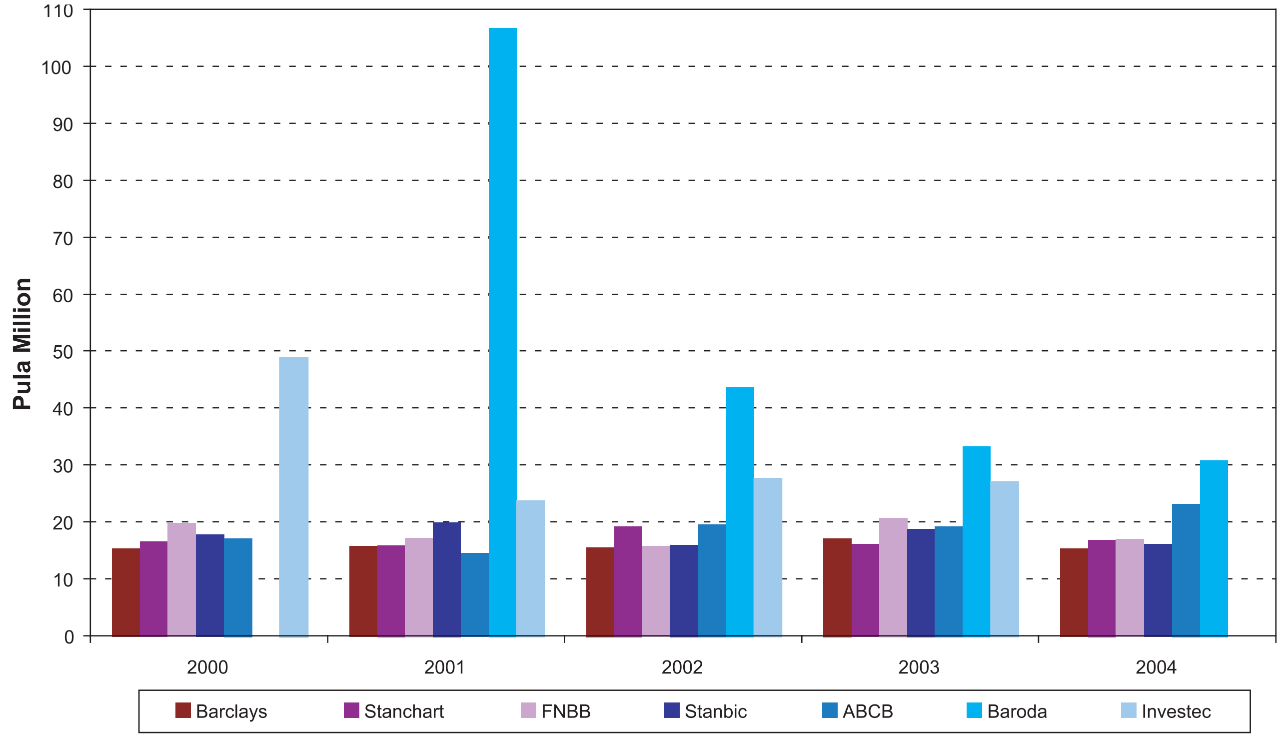


Chart 20: Net Income After-Tax and Growth

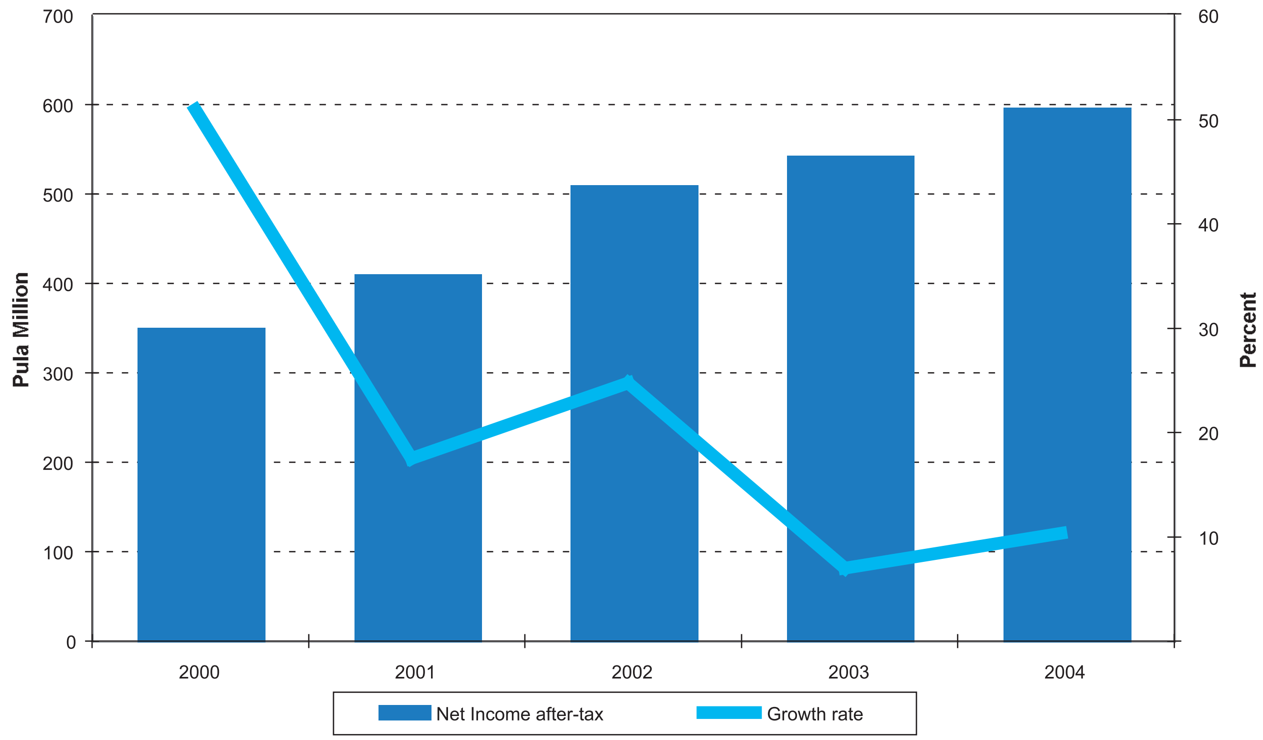


CHART 21: RETURN ON AVERAGE TOTAL ASSETS

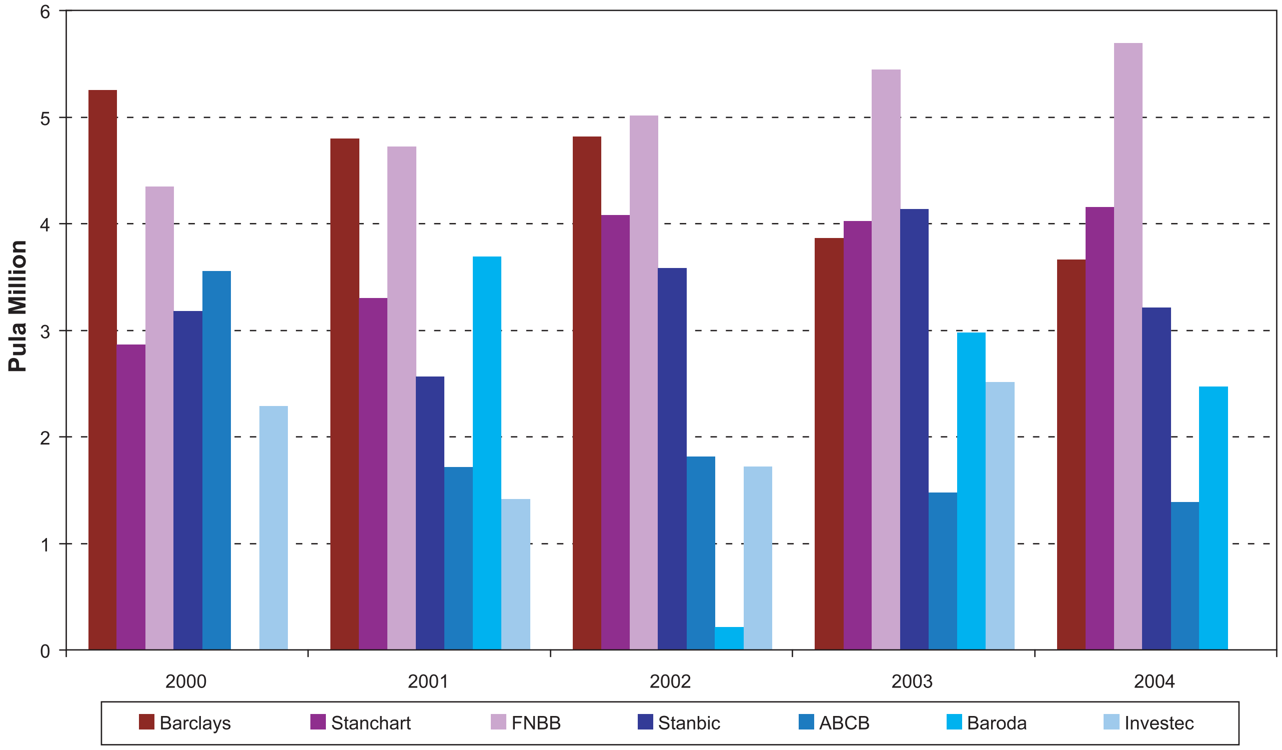


CHART 22: RETURN ON EQUITY

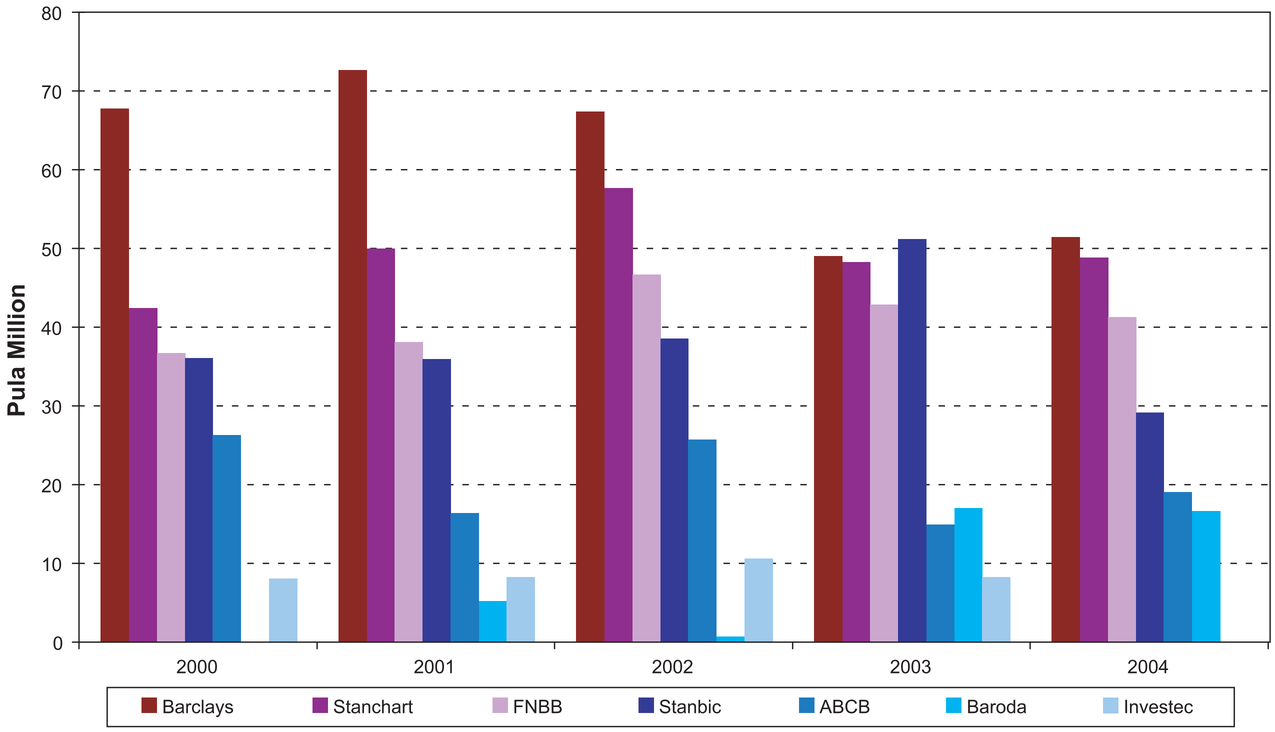


Chart 23: non-interest income to total income

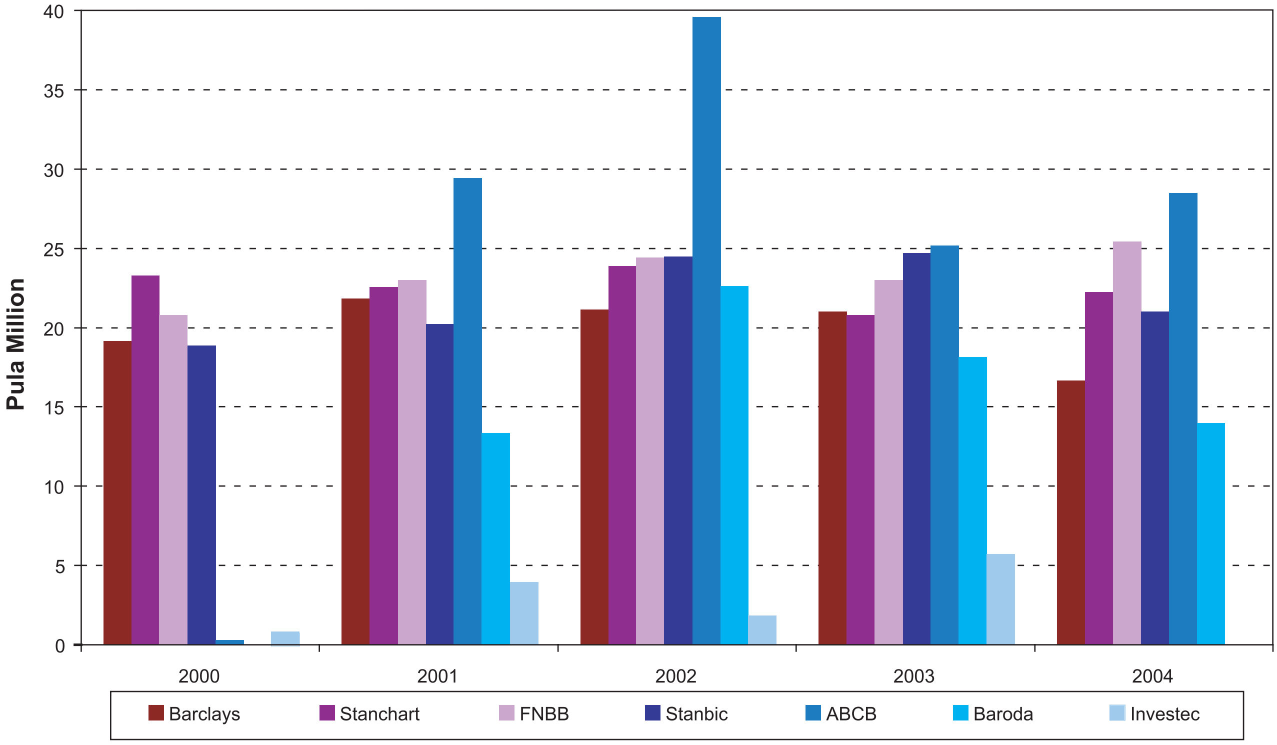


Chart 24: interest income to average total assets

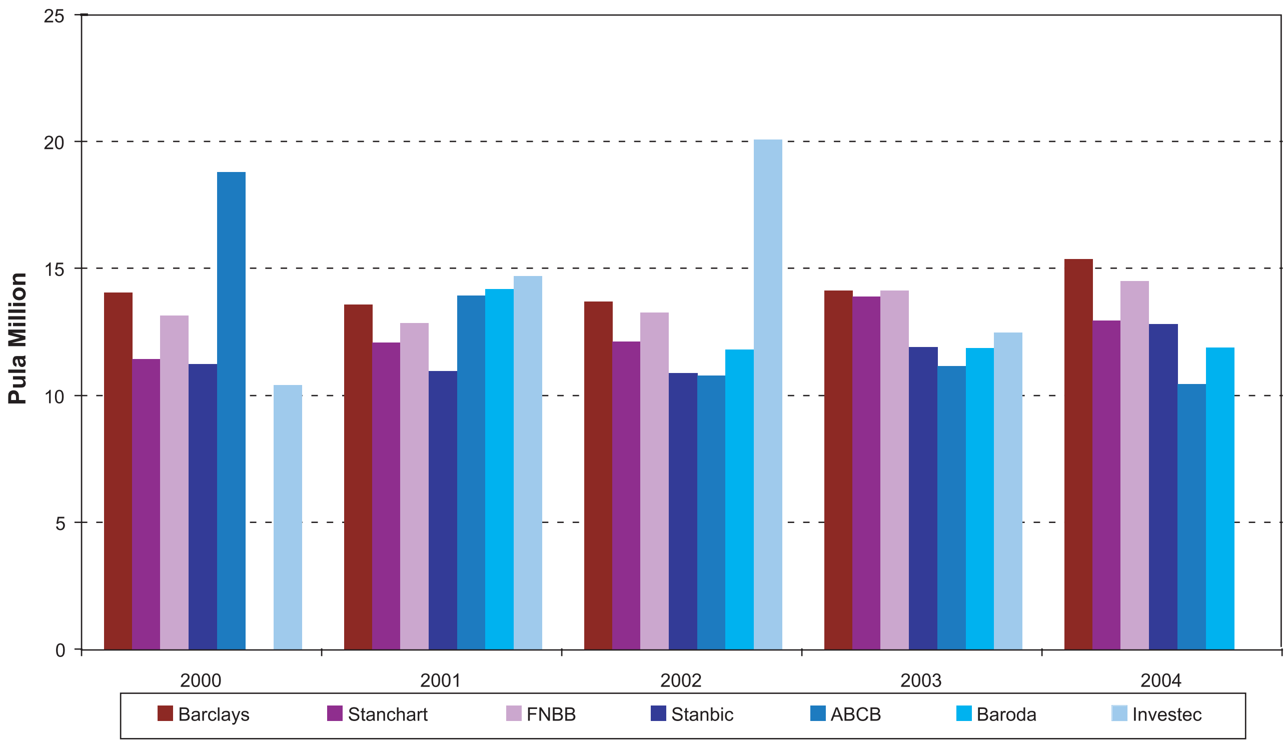


CHART 25: NON-INTEREST INCOME TO AVERAGE TOTAL ASSETS

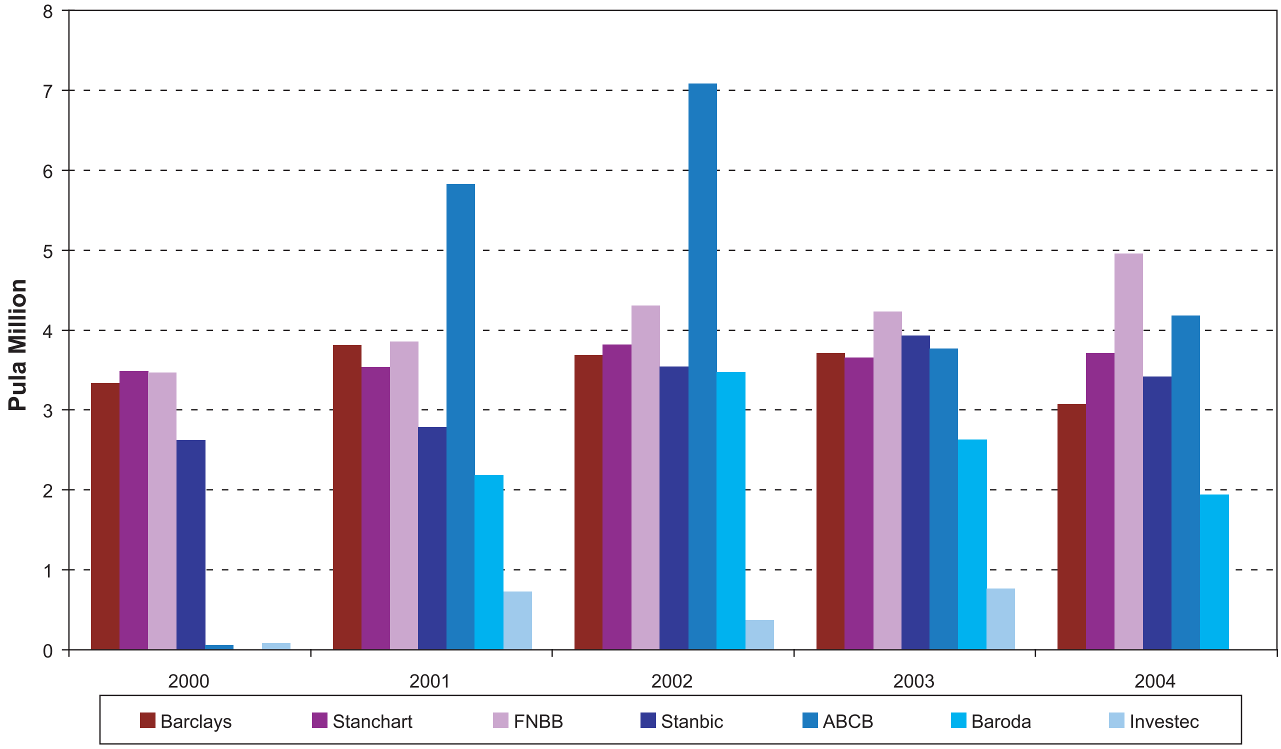


CHART 26: NON-INTEREST EXPENSE TO AVERAGE TOTAL ASSETS

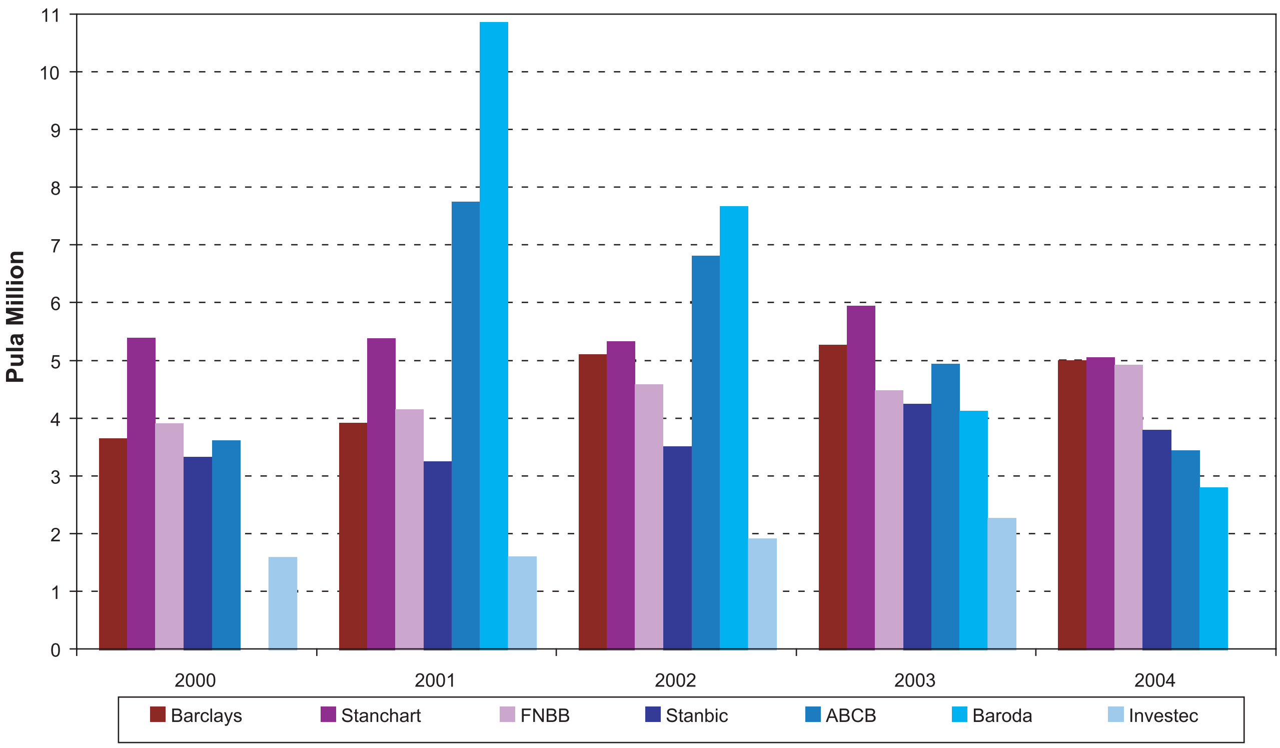


CHART 27: COST TO INCOME RATIO

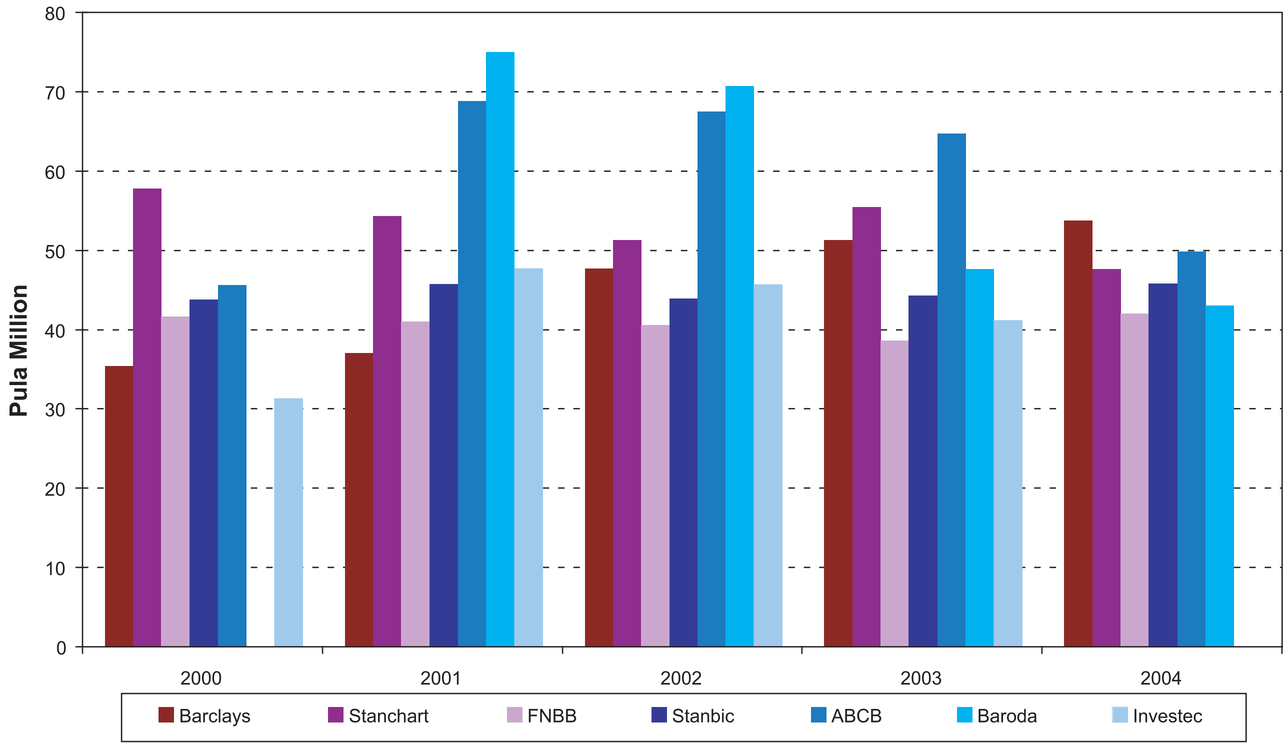


CHART 28: AVERAGE COST OF DEPOSIT

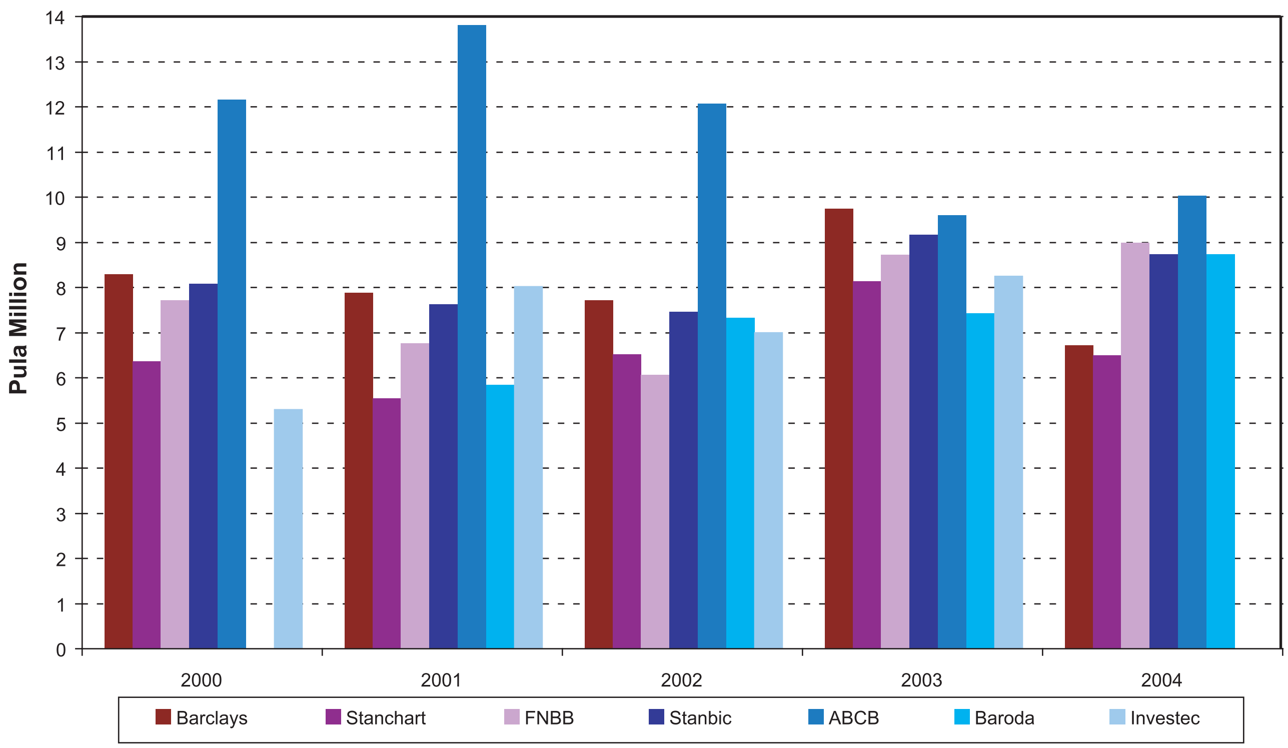


CHART 29: TOTAL PROVISIONS FOR BAD DEBTS

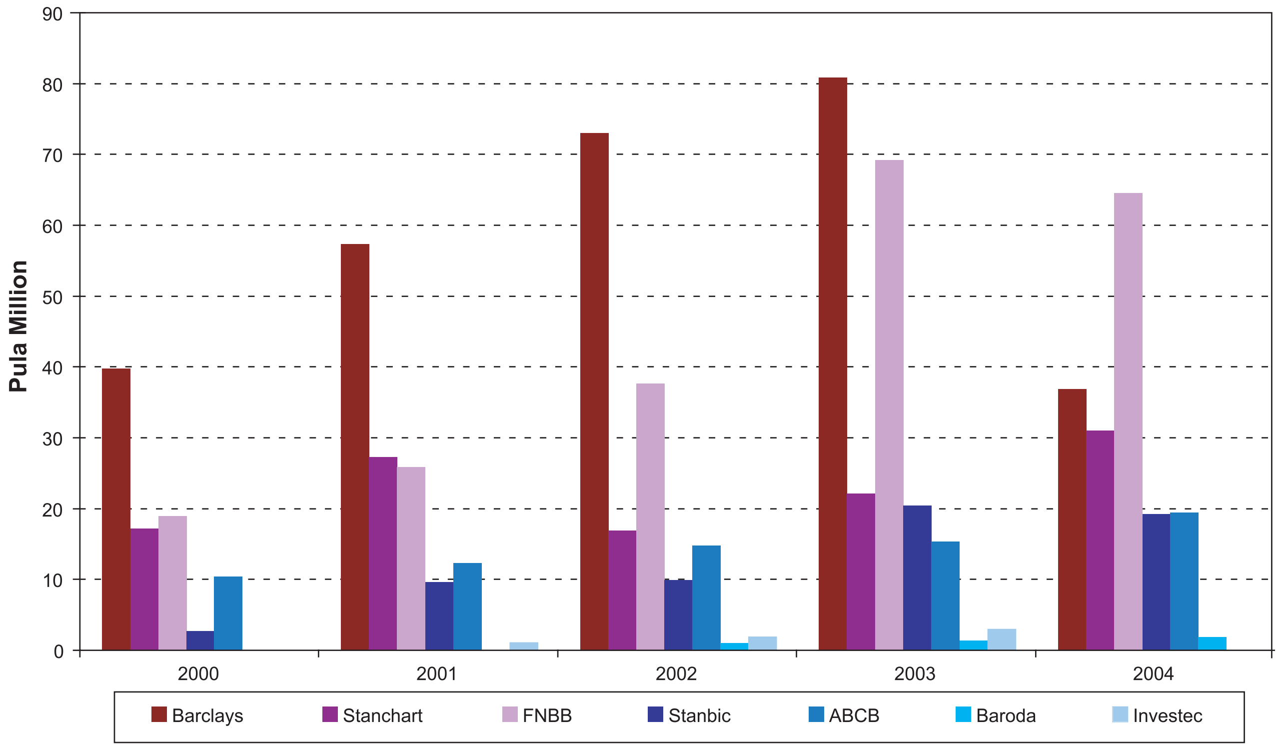


CHART 30: ADVANCES TO DEPOSIT RATIO

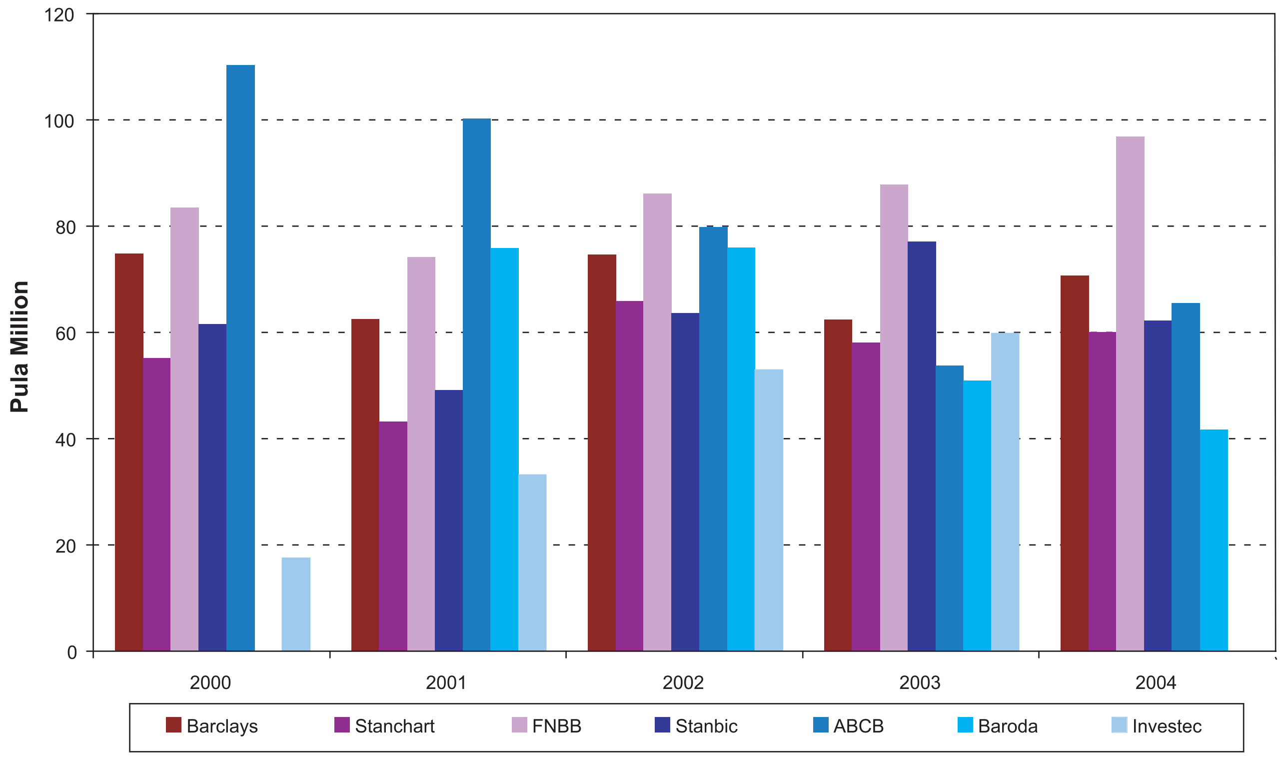


CHART 31: VALUE OF CURRENT ACCOUNTS

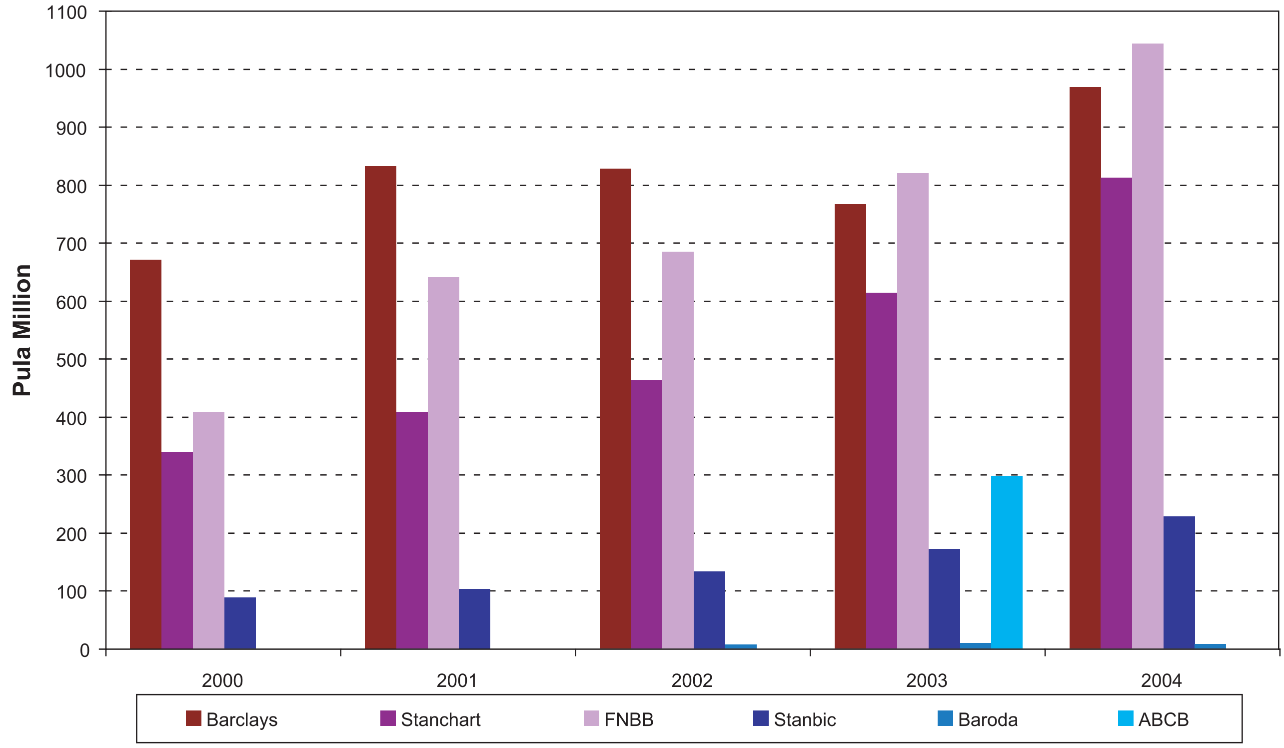


CHART 32: MARKET SHARE OF VALUE OF CURRENT ACCOUNTS

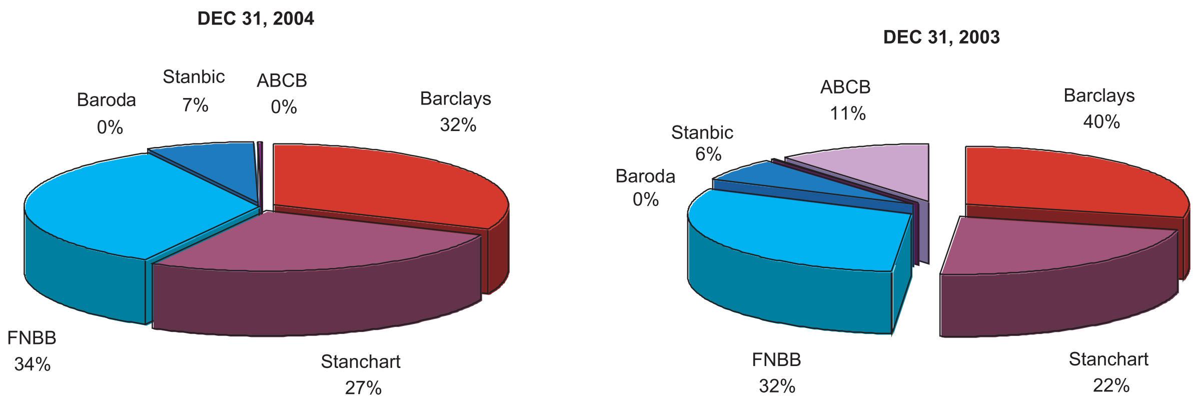


CHART 33: VALUE OF CALL ACCOUNTS

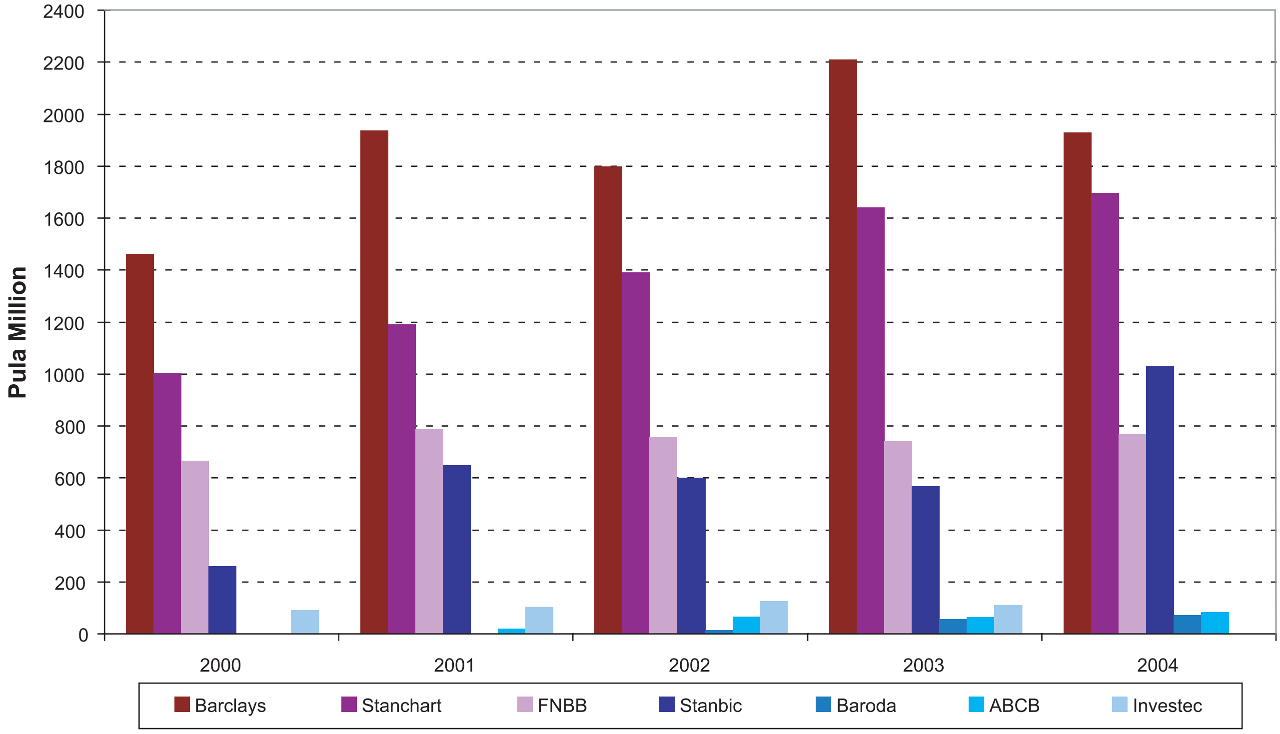


CHART 34: MARKET SHARE OF VALUE OF CALL ACCOUNTS

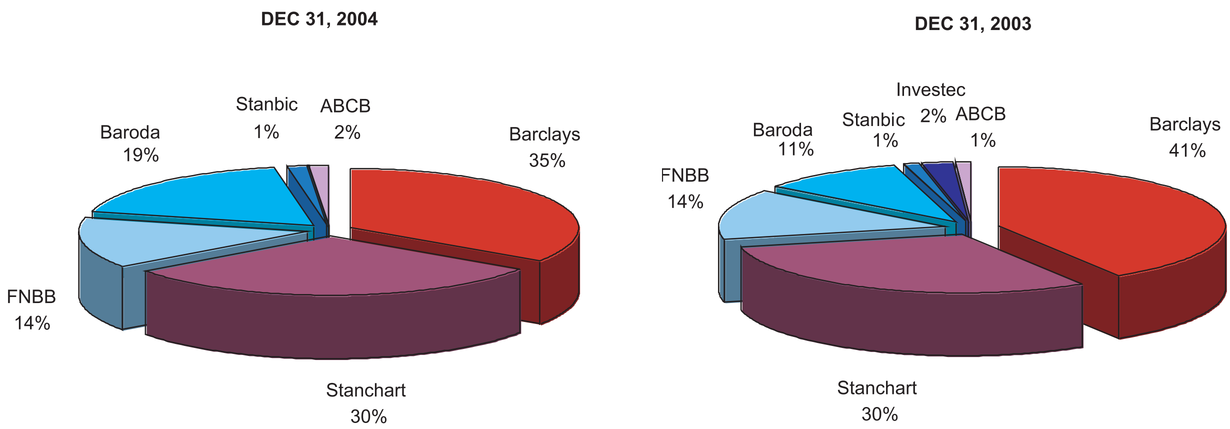


CHART 35: VA LUE OF SAVINGS ACCOUNTS

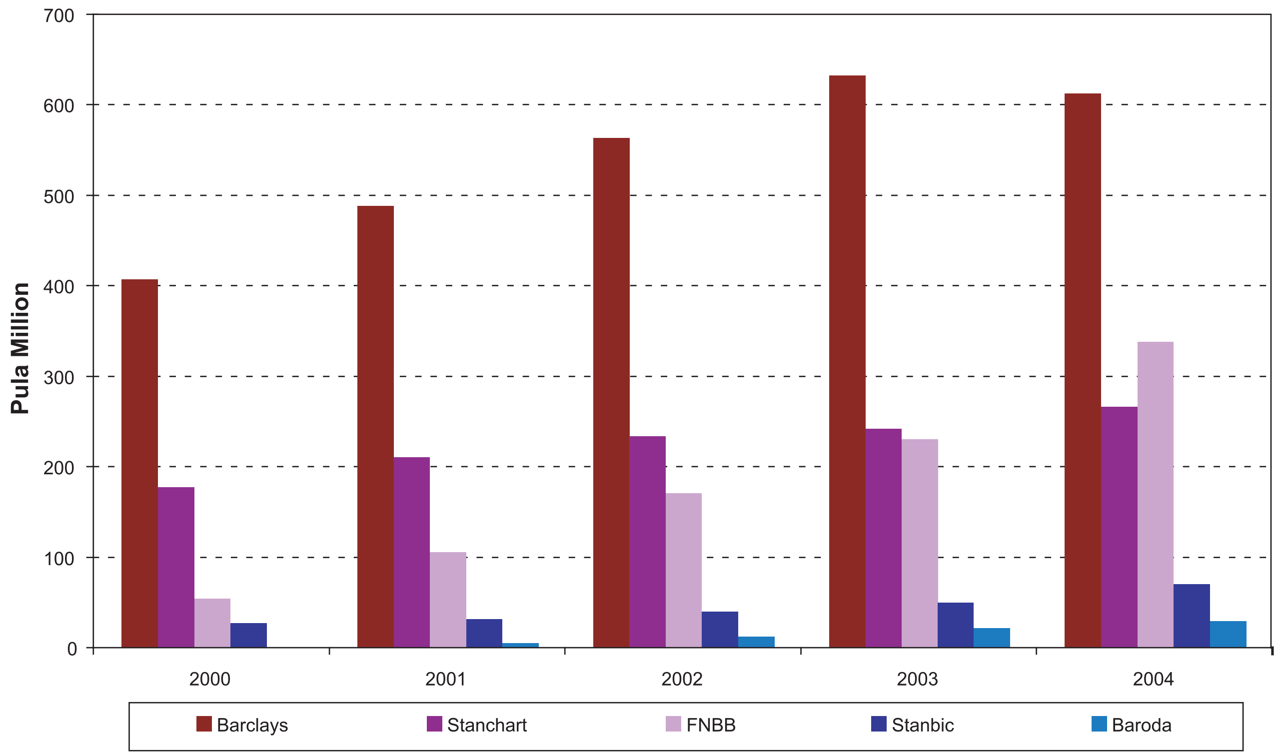


CHART 36: MARKET SHARE OF VALUE OF SAVINGS ACCOUNTS

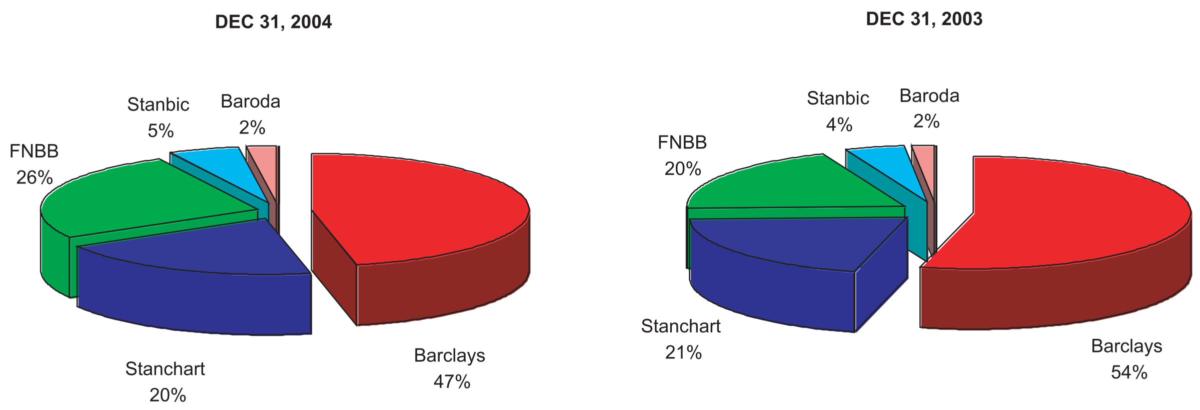


CHART 37: VALUE OF TIME DEPOSIT ACCOUNTS

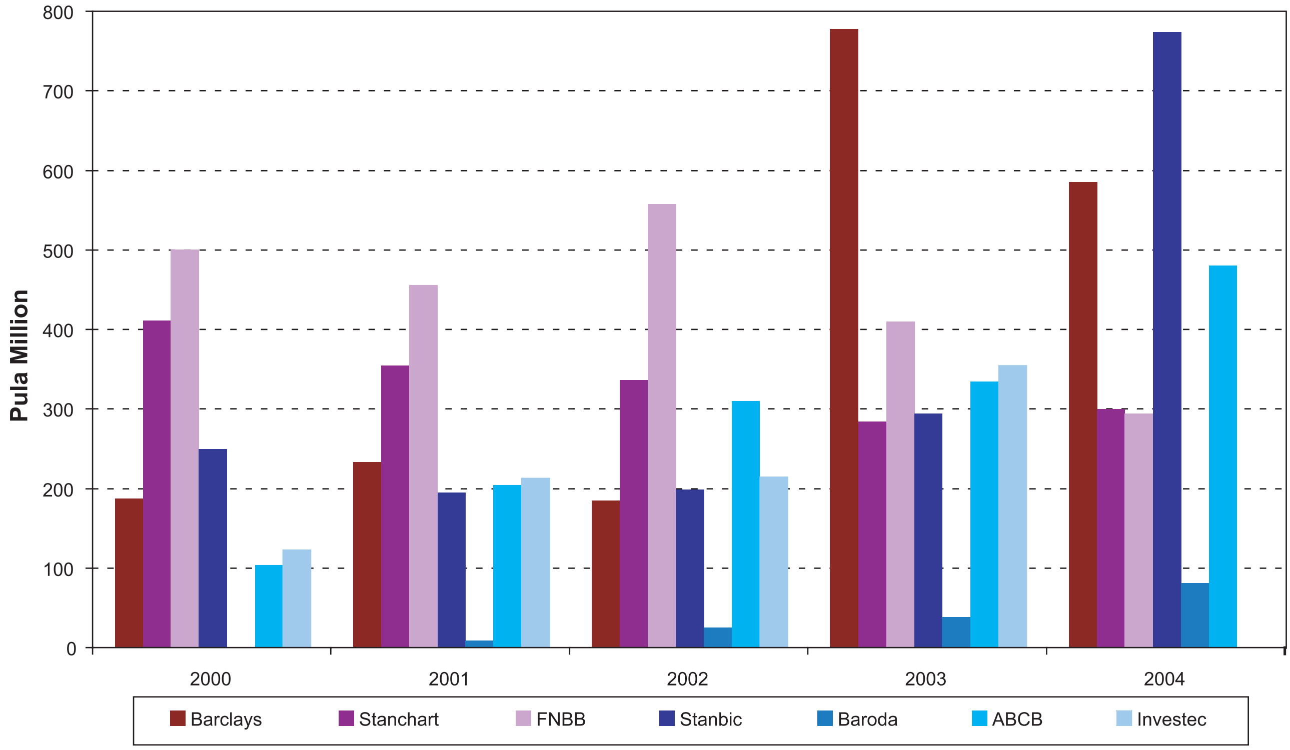


CHART 38: MARKET SHARE OF VALUE OF TIME DEPOSITS

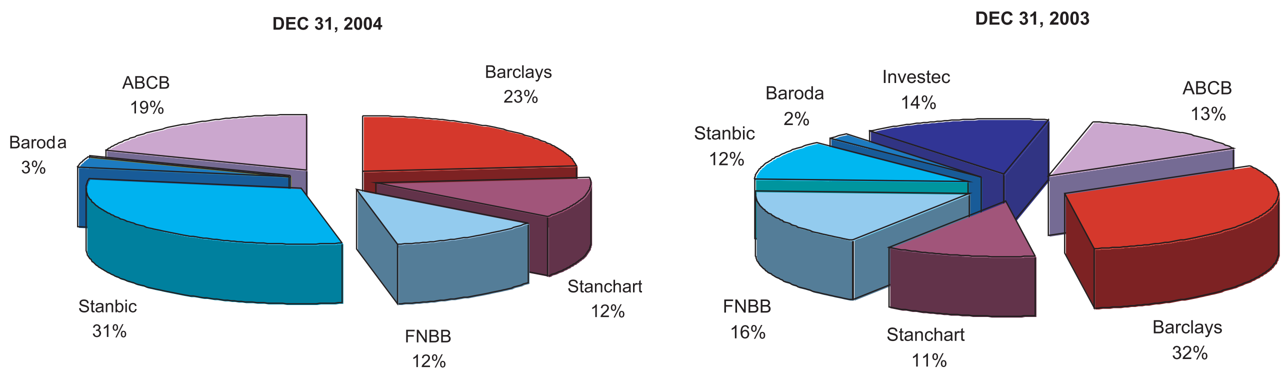
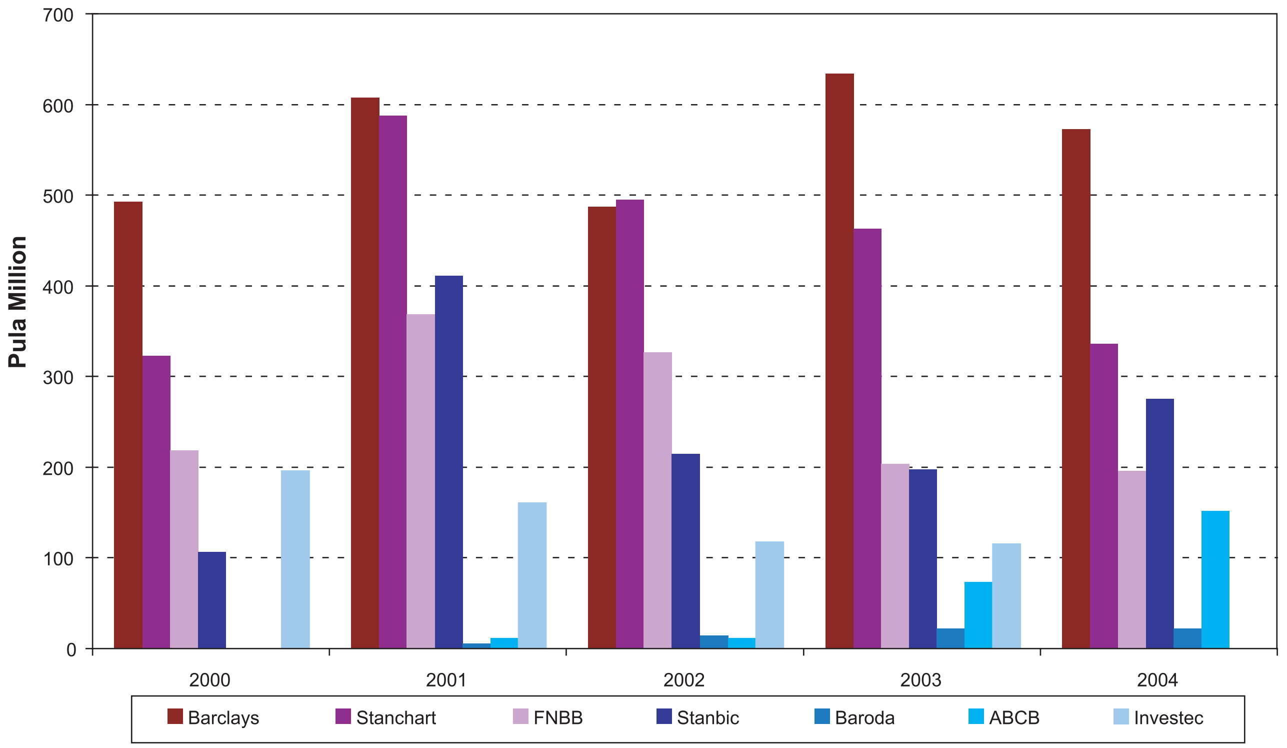


CHART 39: VALUE OF FOREIGN CURRENCY ACCOUNTS



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