Banking Supervision Annual Report 2007

Bank of Botswana

CONTENTS

List of Abbreviations

AACB	Association of African Central Banks
ABCI	African Banking Corporation International Limited
AMCP	African Monetary Cooperation Programme
AML	Anti-Money Laundering
ATA	Average Total Assets
ATM	Automated Teller Machine
BIS	Bank for International Settlements
BITF	Basel II Implementation Task Force
BCPs	Basel Core Principles
BoBCs	Bank of Botswana Certificates
BPOPF	Botswana Public Officers' Pension Fund
BSD	Banking Supervision Department
BVI	British Virgin Island
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CFT	Combating of the Financing of Terrorism
CIU	Collective Investment Undertaking
CP	Core Principle
DCEC	Directorate on Corruption and Economic Crime
DSA	Direct Sales Agent
EBG	Enterprise Banking Group
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FATF	Financial Action Task Force
FCA	Foreign Currency Account
FNBB	First National Bank of Botswana Limited
FSAP	Financial Sector Assessment Programme
FSIs	Financial Soundness Indicators
GDP	Gross Domestic Product
IAS	International Accounting Standards
IFSC	International Financial Services Centre
IMF	International Monetary Fund
IT	Information Technology

KBAL	Kingdom Bank Africa Limited
KFL	Kingdom Finance Limited
LHS	Left Hand Scale
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
MFIs	Micro Finance Institutions
NAV	Net Asset Value
NBO	Non-Banking Operations
NBFIRA	Non-Bank Financial Institutions Regulatory Authority
RHS	Right Hand Scale
ROAA	Return on Average Assets
ROE	Return on Equity
RTGS	Real-Time Gross Settlement
SADC	Southern African Development Community
SIMS	Stanbic Investment Management Services
SWIFT	Society for Worldwide International Financial Telecommunications
WFHB	Women's Finance House Botswana

Foreword

This *Report* is based on the 2007 Statutory Report submitted to the Minister of Finance and Development Planning (henceforth the 'Minister') in June 2008. It is intended to inform the public on the Bank's financial sector regulatory and supervisory activities in the year ended December 31, 2007. The *Report* covers an overview of the banking industry structure[1], the industry's operational and financial performance and other activities during 2007. It also highlights the activities of other financial institutions, such as Collective Investment Undertakings (CIUs), International Financial Services Centre (IFSC) entities and bureaux de change.

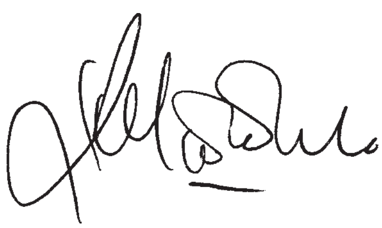
Generally, the financial sector performed very well during the year, aided by higher economic growth, which was shared across most sectors. With new entrants in the market, banks engaged in aggressive marketing strategies in order to retain or increase market share through branch and ATM network expansion, provision of more customer tailored products, increased use of technology in support of new products and improvements in service delivery.

The banks were adequately capitalised and highly liquid; maintained appropriate provisions for past due loans and held high quality assets in their books. Notwithstanding global financial disturbance occasioned by the sub-prime mortgage lending crisis that first originated in the United States in August 2007, and quickly spread to Europe and other major financial markets, Botswana banks continued to report high levels of profitability and growth in balance sheets.

However, while the rebounding of the economy and increased government spending provided greater impetus for financial sector expansion and increased opportunities for lending, there are major risks building in the system. First, the rapid growth of household lending, estimated to be in excess of the growth in real personal incomes, is worrisome. Second, the conventional practice of "impairment test" and provisioning based on the 'incurred model' of accounting tends to be backward looking. It lacks dynamism and it is unlikely to address the build-up of credit risk problems during periods of economic boom. Third, the recent deterioration of the global and domestic inflation outlook, driven primarily by escalating prices of crude oil and food, as well as upward domestic demand pressures, is likely to adversely impact on the bank borrowers' ability to repay loans. Equally significant is the increase in the number of banks and other credit institutions which is expected to put pressure on interest rate margins and, consequently, banks could face challenges going forward unless they improve productivity and efficiency of their operations.

The Bank continues to monitor these developments and respond, as deemed appropriate, to ensure that banks conduct their affairs in a safe and prudent manner.

Linah K. Mohohlo



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[1] Banks licensed under the Banking Act (CAP. 46:04)

Structure of the Report

Chapter 1 presents the structure of the banking industry, followed by a review of the statutory compliance and operational performance of the banking sector in Chapter 2. Other developments in the financial sector are highlighted in Chapter 3 while Chapter 4 summarises the overall state of supervised institutions.

The appendices list institutions licensed and supervised by the Bank, definitions of banking supervision technical terms, as well as tables and charts on various activities of the banking industry. Users are encouraged to pay particular attention to Appendix 2 which sets out the regulatory and supervisory framework for banks in Botswana.

Introduction

Performance of the Banking Sector

The performance of the banking industry was generally good in 2007 due to the higher economic growth which was shared across most sectors. Although they were in line with historical trends, some growth indicators were below the 2006 outturn. The exceptionally high rate of increase in bank deposits in 2006 was greatly influenced by the BoBC counterparty change in March 2006 which, *inter alia*, excluded bank customers and non-bank institutions from serving as primary dealers and investing directly in BoBCs.

The aggregate balance sheet[2] grew strongly at 22 percent which, while lower than the 64 percent increase in 2006, was above growth rates for the three years immediately preceding 2006; the growth of the industry balance sheet was funded by a healthy growth in deposit liabilities of 20 percent. Although significantly below the 79 percent rise in the previous year, the lower increase in bank deposits indicates a return to more normal growth rates following the dissipation of the impact of the change in the BoBC counterparty composition in March 2007. Given the growth in the funding base, bank credit increased by 25 percent, resulting in an improvement in the intermediation ratio from 45 percent in 2006 to 47 percent.

As in previous years, corporate deposits continued to be the major funding source for banks' operations; corporates were in a net depositor position in contrast to the retail sector which was a net borrower. The net borrower status of the retail sector was further entrenched as its share of total bank credit increased in 2007 largely due to a rapid increase in non-mortgage financing. The rate of growth of mortgage financing slowed down considerably compared to the previous year's increase.

The expected increase in corporate credit demand arising from projected higher levels of mining activity, improved implementation of large government projects and privatisation was, however, less than what was anticipated in the 2006 Report. In this respect, the 17 percent increase in credit to the business sector in 2007 was slower than the 21 percent rise in 2006. Notwithstanding the lower than expected profits for some banks, which were adversely affected by the collapse of Lobtrans at the end of 2007, collectively banks were more profitable in 2007 than in 2006. This outcome suggests strong income performance as these results were achieved despite the rising operating costs for some banks and a fall in lending interest rates following the reduction in the Bank Rate in June 2007, which reduced interest income from banks' investments in BoBCs.

The banking industry continued to be well capitalised and complied with minimum statutory requirements. An analysis of the composition of capital shows a movement towards a good balance between core and supplementary (Tier II) capital[3], reflecting increased activity by some banks in the secondary market aimed at raising Tier II capital in order to manage their asset/liability mismatches. As a result, Tier II grew by 54 percent in 2007 compared to a decline of 4 percent in 2006.

Banks continued to be prudently managed, financially sound and stable during 2007. Furthermore, they remained highly liquid and observed the regulatory limits for asset concentration. Although asset quality marginally deteriorated, there was adequate provisioning for non-performing loans.

Macroeconomic Environment

In 2007, real Gross Domestic Product (GDP) grew at 6.1 percent compared to the revised marginal growth of only 0.5 percent for 2006. Of particular relevance to the banking sector is the broad-based nature of the growth, which meant that potential credit demand arose in a wide cross-section of the economy. Similarly, demand for credit was supported by an increase in real domestic expenditure in contrast to a decline in 2006, driven mainly by a rebounding of both fixed investment and household consumption expenditure. Household lend-

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2 In comparing prior year figures with those contained in the previous versions of this Report, please note that there might be some differences as a result of banks restating some of their figures.

3 Refer to Appendix 4, Definition of Terms.

ing grew by 29.4 percent during 2007, compared to a growth rate of 16.7 percent recorded in 2006.

Monetary Conditions

As inflation continued to decline during the first half of the year, interest rates were reduced at mid-year on account of lower inflation expectations. The corresponding lowering of key lending rates by banks encouraged demand for credit which rose well above the 11–14 percent range desired by the Bank.

Despite the rapid increase in the banks' lending, the banking system continued to experience excess liquidity, which was absorbed by the Bank through the main instrument for open market operations, BoBCs.

Chapter 1

Industry Structure

1. Structure of the Financial Industry

Botswana's financial system comprises the Bank of Botswana (the country's central bank), commercial banks (7), investment/merchant bank (1), micro-finance institution (1), IFSC Companies (19) and bureaux de change (46). It also includes development finance institutions, insurance companies, asset management institutions, medical aid societies, stockbroking companies, a stock exchange, money transfer entities and money lenders.

The Bank of Botswana is responsible for supervision of banks and other deposit taking institutions. A number of entities which hitherto were either under the supervision of the Ministry of Finance and Development Planning (MFDP) or not supervised at all, fall under the newly established Non–Bank Financial Institutions Regulatory Authority (NBFIRA) (Box 1).

Box 1: Non-Bank Financial Institutions Regulatory Authority

The Non-Bank Financial Institutions Regulatory Authority Act was promulgated on January 23, 2007 with some sections of the Act becoming operational during 2007. In particular, the Board of Directors was established and commenced operations during 2007. The law brings a number of previously unregulated activities in the non-bank financial sector, including CIUs and those in the IFSC, under its umbrella.

The Act further provides for self-regulatory organisations, which may be declared as such by the Minister on the recommendation of the Regulatory Authority. Furthermore, the NBFIRA Act provides for the regulation of market conduct of non-bank financial institutions; this is expected to enhance the safety, soundness and stability of such institutions.

2. Banking Business Networks for Licensed Institutions[4]

All banks opened new outlets during the year except three which did not change their branch numbers from 2006. With new entrants in the market, banks engaged in aggressive marketing strategies, including establishment of their branch network in hitherto non-serviced rural areas, which was a welcome development. Thirteen (13) new branches (compared to none in 2006) were opened, bringing the total number of branches and sub-branches countrywide to 79. The total number of commercial bank agencies decreased from 11 to 8 due to closure of three agencies by one bank.

The number of Automated Teller Machines (ATMs) increased by 75 percent over 2006, with 167 new ATMs and mini-ATMs countrywide coming on stream (Table1). As a result, the total number of ATMs rose to

Table 1: Licensed Banks' Representation: 2006 – 2007

	Branches and Sub-Branches		Agencies		Encashment Points		ATMs	
Bank	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**
Barclays	30	38	5	2	1	1	45	87
Stanchart	11	11	6	6	0	0	36	34
FNBB	14	16	0	0	0	0	125**	177*
Stanbic	7	9	0	0	0	0	13	14
Baroda	1	2	0	0	0	0	0	0
ABCB	2	2	0	0	0	0	0	0
Bank Gaborone	1	1	0	0	0	0	3	77
Total	**66**	**79**	**11**	**8**	**1**	**1**	**222**	**389**

Notes: * Comprises 67 ATMs and 110 mini-ATMs ** Comprises 57 ATMs and 68 mini-ATMs

4 Refers to institutions licensed by Bank of Botswana

389 from 222 in the previous year. The expansion of both the branch and ATM infrastructure increased public access to banking services.

3. Employment

The banking industry's staff establishment rose by 8 percent to 3 013 compared to 4 percent in the prior year (Table 2). The increase excludes Direct Sales Agents (DSAs) who were heavily used by two banks, although they do not form part of the permanent banks' staff.

Table 2: Staffing Levels for Licensed Banks: 2006 – 2007

	2006			2007		
Bank	**Citizens**	**Expatriates**	**Total**	**Citizens**	**Expatriates**	**Total**
Barclays	957	8	965	854	19	873
Stanchart	572	12	584	654	9	663
FNBB	735	21	756	854	19	873
Stanbic	397	13	410	446	12	458
Baroda	13	6	19	18	7	25
ABCB	31	4	35	36	7	43
Bank Gaborone	28	4	32	73	5	78
Total	**2 733**	**68**	**2 801**	**2 935**	**78**	**3 013**

Chapter 2

Statutory Compliance and Operational Performance

1. On-site Examinations

The Bank carried out full scope on-site examinations of two banks in the second and third quarters of 2007, respectively. The examinations focused on the appraisal of assets; an assessment of banks' compliance with prudential and regulatory standards as per the provisions of the Banking Act; reviews of the adequacy of internal control systems and effectiveness of the banks' anti-money laundering measures.

The capital adequacy, asset quality, earnings, management and liquidity (CAMEL) components of one bank were all rated satisfactory, while the CAMEL components of the other bank were less than satisfactory. The bank has been requested to rectify the identified deficiencies, failing which appropriate supervisory action will be taken.

2. Consultative and Prudential Meetings with Banks and External Auditors

In accordance with Sections 22(8) and 22(9) of the Banking Act, the Bank held meetings with regulated financial institutions and their external auditors. The meetings covered the review of 2007 financial statements, strategic plans and risk management strategies for 2007, scope of statutory audits and other prudential matters. The supervised financial institutions and their external auditors used the opportunity to share with the Bank their views on recent economic developments, market perceptions and expectations based on their interactions with the business community.

Two Banking Committee meetings were held during the year and addressed, among others, the introduction of BoBC-linked products by commercial banks, where most banks reported that they had introduced these products to provide alternatives to customers who had previously invested in BoBCs prior to the changes in BoBC investment arrangements made in 2006; preparations for the implementation of Basel II and the performance of the national payment systems and the Real-Time Gross Settlement System (RTGS), both of which became operational on November 17, 2006. The meetings were also briefed on the Draft Financial Intelligence Bill, which was at an advanced stage of preparation.

The financial condition of the banking industry was generally satisfactory as assessed through regular bilateral and trilateral meetings and early warning off-site reports. Despite the deterioration in asset quality at some banks and impaired capital at one bank, in general, the industry performed well in 2007.

3. Corporate Governance Issues (Risk Management, Audit and Board)

Banks were generally prudently managed and had satisfactory risk management strategies which, for some, resulted in declining general provisions. Overall, audit reports also reflected no significant adverse findings with respect to management and board oversight, which are core corporate governance issues. Generally, the banks' senior management and Board members complied with the fit and proper requirements of the Bank and exercised effective judgement on corporate governance issues.

During the year, the Bank finalised two regulatory guidelines, one on the Appointment of Board and Senior Management Officials of Banks and the other on Transactions with Related Parties of a Bank; these will be adopted in 2008. The Bank also issued a draft guideline on Large Exposures to the market for comment. Banks will be consulted further during the course of 2008 on several additional guidelines still being processed. The guidelines are intended to guide the market on the interpretation and application of certain provisions of laws that govern the conduct of banks' business.

4. Performance of Statutory Banks

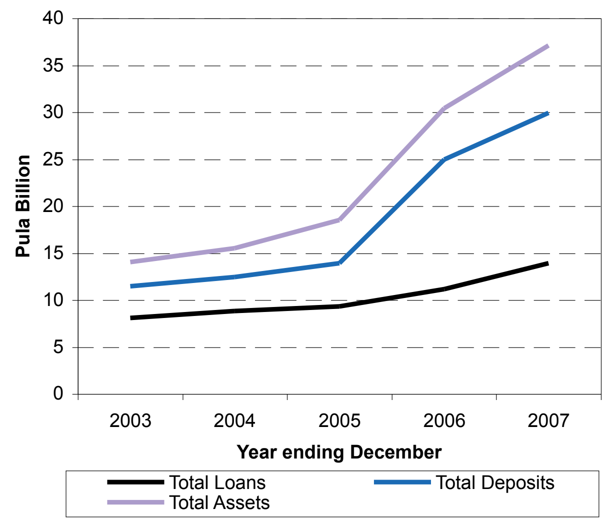
The combined assets of all statutory banks grew by 16 percent from P2.3 billion in 2006 to P2.7 billion in 2007, mainly due to a P216.3 million or 12 percent increase in loans and advances. Statutory banks were largely compliant with both the Bank's supervisory requirements and the provisions of their own statutes.

5. Balance Sheet Structure of the Banking Industry as at December 31, 2007[5]

Changes in the banking sector's balance sheet and income statement for 2007 should be viewed against the background of strong performance of the banking sector in 2006 due to the BoBC counterparty change in March of that year, the impact of which dissipated in April 2007. Notwithstanding this factor, overall balance sheet growth remained healthy, while the rate of growth in profitability was somewhat dampened by provisions for impairment losses due mainly to the Lobtrans fall-out.

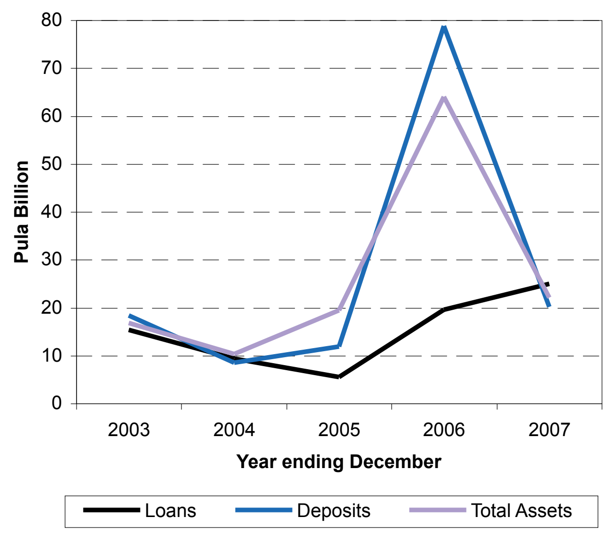
The value of the aggregate balance sheet of the banking sector rose by 22 percent in 2007 to P37.1 billion compared to P30.4 billion in 2006. On the asset side, the major contributing factors to the 2007 performance were loans and advances, as well as BoBCs which rose by 25 percent and 18 percent, respectively. On the liability side, total capital grew by 25 percent, an improvement on the 16 percent growth in 2006, while deposits rose by a satisfactory but significantly reduced rate of 20 percent compared to 79 percent in 2006. Charts 1 and 2 show five year trends in levels of deposits, total assets, total loans and associated growth rates.

Chart 1 : Levels of Deposits, Total Assets and Loans and Advances



When compared to 2006, the maturity structure of deposits shifted from long-term deposits (savings and time) into short-term deposits (call and current) in 2007 (Chart 3). The combined share of savings and time deposits dropped to 45 percent in 2007 from 51 percent in the previous year. The major change was in time deposits, the share of which was significantly reduced and approximated that of call deposits. Foreign currency deposits (the Pula equivalent of which is included in Chart 3 below) as a proportion of total deposits increased to 31 percent in 2007 from 22 percent in 2006. Charts 6.11 and 6.12 in Appendix 6 show the levels and trends of foreign currency accounts (FCAs) and the structure of FCAs of the banking sector.[6] The US dollar dominates the FCA deposit structure, with 88 percent of the FCA deposits being denominated in US dollars. About 41 percent of the FCA deposits are held in the form of fixed deposits, 29 percent in call accounts and 28 percent in notice deposits. The remaining small proportion is in current accounts.

Chart 2 : Growth Rates of Deposits, Total Assets and Loans and Advances



The banking industry's intermediation ratio (Advances to Deposits), which shows the extent to which deposit liabilities are used for lending purposes increased, albeit slightly, for the first time since 2003 to 47 percent in 2007 (Chart 4). This was due to faster growth of advances *vis-à-vis* deposits in most banks. Overall, advances rose by 25 percent in 2007, the highest growth rate in the five-year period since 2003. Conversely, aggregate deposits grew less rapidly in 2007 by 20 percent compared to 80 percent in 2006. However, the increase in deposits was well above the two-year growth trend prior to 2006.

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5 All figures exclude KBAL, an off-shore bank.

6 Source: Bank of Botswana 2007 Annual Report (Page S-52 to S-55).

CHART 3: STRUCTURE OF DEPOSITS

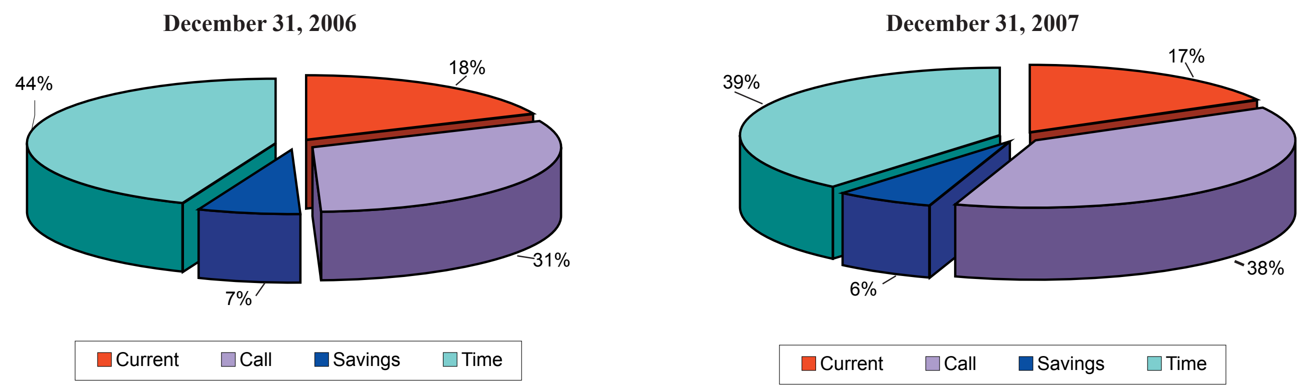


CHART 4: INDUSTRY ADVANCES TO DEPOSIT RATIO

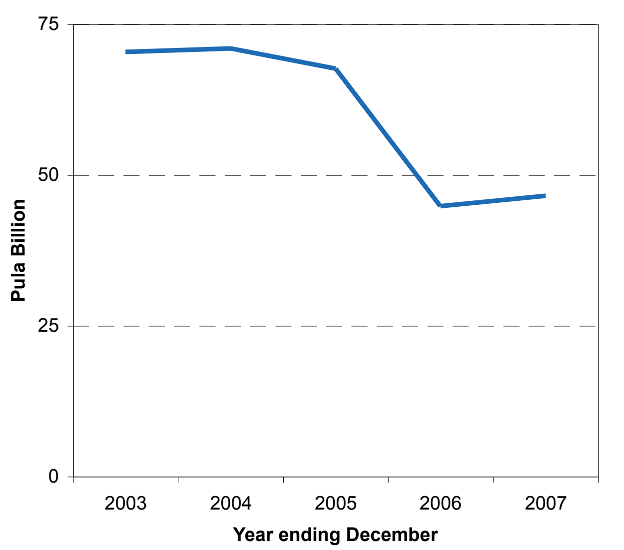
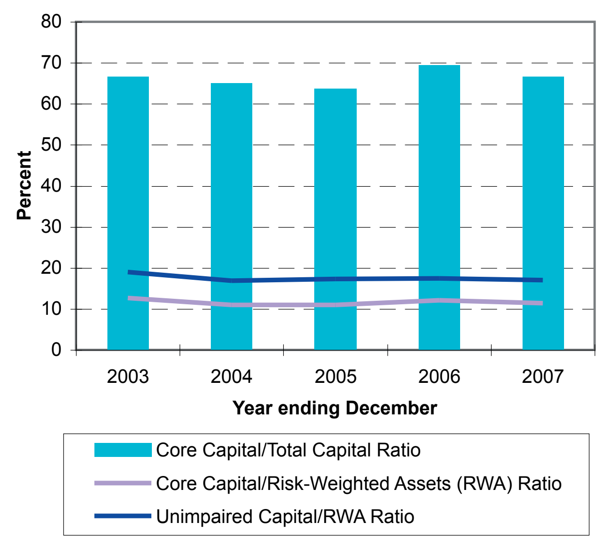


CHART 5: CAPITAL ADEQUACY RATIOS



6. CAPITAL ADEQUACY (SOLVENCY): LEVELS AND TRENDS

The international guidelines on capital adequacy measurement, issued by the Basel Committee on Banking Supervision, require banks to maintain capital ratios of not less than 8 percent. In Botswana, the prudential capital adequacy standard is 15 percent which has been in place since 1998. The adoption of the higher ratio takes into account market and operational risks which are not explicitly accounted for in the Basel Committee 1988 Capital Adequacy Measurement and Standards framework. At the industry level, the capital adequacy ratio in 2007 was above the 15 percent prudential minimum for banks operating in Botswana and little changed from that of the previous year (Chart 5).

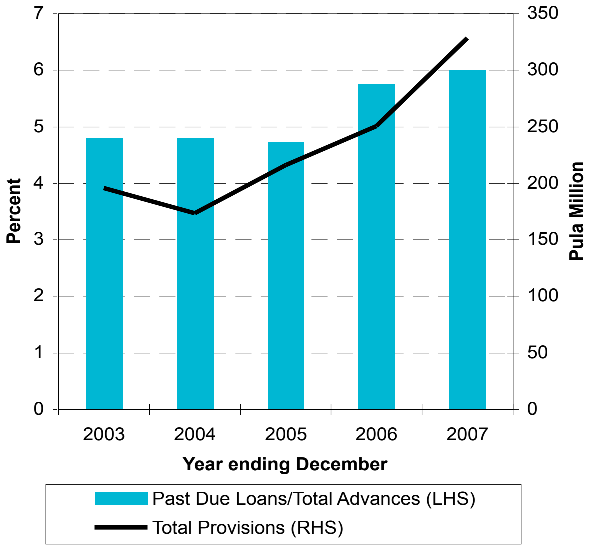
Appendix 5 (Table 5.5) shows the components of regulatory capital (capital structure) of the banking industry for the period 2006 – 2007. Total capital rose by 25 percent to P2.3 billion in the year to December 2007 due to a 36 percent increase in Tier II capital. As a result of a rapid increase in Tier II capital, core capital as a proportion of total capital declined to 67 percent in 2007 from 70 percent in 2006, but was still above the 50 percent statutory limit (Chart 5).

7. ASSET QUALITY: LEVELS AND TRENDS

As at December 31, 2007, the banking industry's total loan portfolio was P14 billion, up by 25 percent from 2006. However, the proportion of non-performing loans[7] (past due loans) to the industry's loan portfolio increased marginally to 6 percent in 2007 from 5.8 percent in 2006 (Chart 6). This trend is worrisome and requires close monitoring.

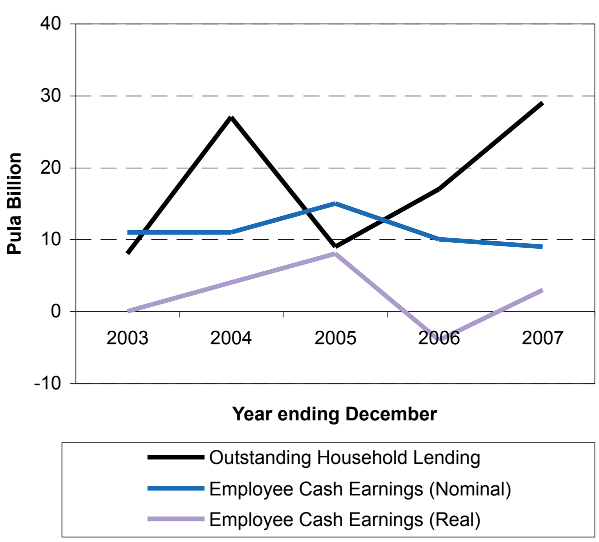
[7] Non-performing loans are term loans that are 30 days or more in arrears, including non-accrual loans.

Chart 6: Industry Past Due Loans/Total Advances and Total Provisions



The banking industry's loan portfolio continued to be largely retail. Loans to the household sector constituted 58 percent of the total loan portfolio in 2007, indicating further concentration compared to 2006 when the share was 55 percent. Over the past two years, the growth rate of outstanding household loans exceeded increases in household nominal and real incomes (Chart 7).[8] Thus, while banks continue to provide finance for investment by the private sector, a large proportion of the lending

Chart 7: Growth Rates of Household Loans and Household Nominal and Real Incomes[9]



is towards "consumption smoothing". This latter development is generating increased risk of default in the banking system particularly against the background of increasing interest rates as the Bank tightens monetary policy to fight upward inflationary pressures. Housing loans constituted 11 percent of total loans in 2007, which was lower than the 2006 share of 13 percent. One explanation for the lower share was a reduction in the growth of real estate loans at the largest banks.

As a general observation, Botswana banks were unaffected by the sub-prime mortgage lending crises, which started in the US during the second half of 2007 and quickly spread to Europe and other industrial economies. Most of the banking assets are "plain vanilla" loans and overdrafts and there are limited opportunities for trading "credit risk" in the Botswana market.

8. Portfolio Diversification

Sectoral portfolio diversification is a risk management strategy that spreads risks across sectors of the economy such that repayment or performance problems in one sector do not have a systemic effect on the banking industry. Chart 8 below shows a sectoral breakdown of the banking industry loan portfolio (i.e., excluding the household sector). Though credit to the transport, construction and manufacturing sectors grew significantly in 2007, their respective shares of the loan market declined. The chart also shows that in 2007, there was a shift in lending away from the transport, communication and storage, manufacturing, business services, construction and agricultural sectors in favour of real estate, trade, restaurants and bars, mining and quarrying, and community and personal services. As a proportion of total lending, loans to insurance, tourism and hotels, as well as electricity and water were unchanged from those of 2006. Loan exposures to the business community continued to be concentrated in the business services sector[10] in 2007 at 38 percent, compared to 41 percent in 2006.

9. Asset Concentration Limits

Banks operating in Botswana are required to comply with the prescribed asset concentration limits with respect to unimpaired capital, i.e., exposures of more

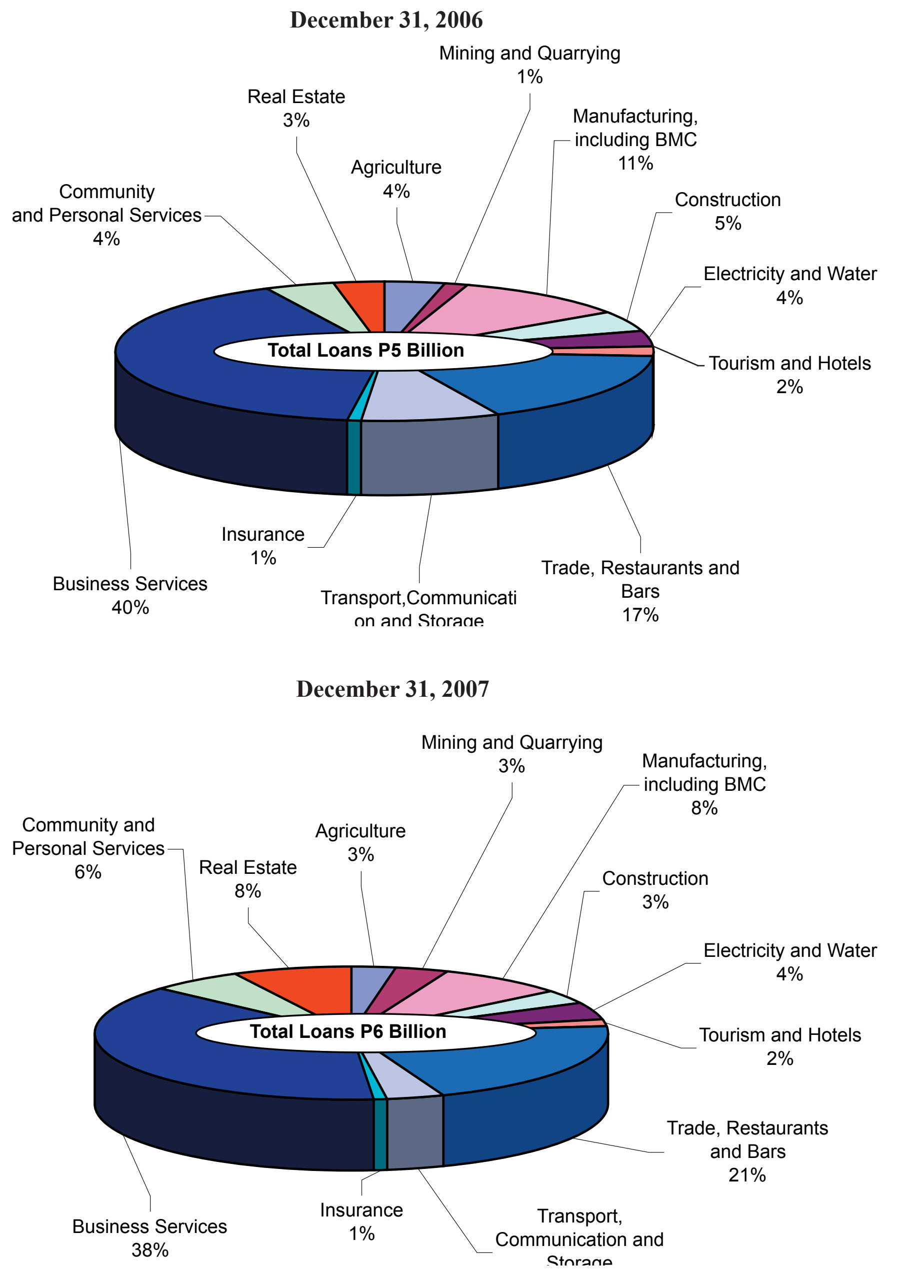
8 Source: Bank of Botswana 2007 Annual Report (Pages S-7 and S-26).

9 Household nominal and real incomes data are compiled as at end of March of each year.

10 Business services include legal, advisory, accounting, auditing, data processing, consulting, engineering, surveying, advertising, renting and leasing of machinery and equipment, services.

than 10 percent of unimpaired capital, when aggregated, should not exceed 800 percent of unimpaired capital. Industry large exposures declined by 2.4 percent in 2007 (8.8 percent growth in 2006) while the industry unimpaired capital rose by 26 percent. As a result, the industry large exposures to unimpaired capital ratio declined from 338 percent in 2006 to 261 percent in 2007, which was substantially below the 800 percent prudential maximum limit set by the Bank.

CHART 8: DISTRIBUTION OF BUSINESS SECTOR LOANS: 2006 – 2007[11]



10. LIQUIDITY AND HOLDINGS OF BANK OF BOTSWANA CERTIFICATES

A sound and well diversified funding base is a key aspect of banks' liquidity management as a bank with a large, stable and diverse deposit base is likely to have fewer liquidity problems than a bank lacking such a deposit base. Thus, diversification of funding sources enables a bank to avoid the vulnerabilities associated with the concentration of funding from a single source or single product range such as savings, call or time deposits.

Table 3 overleaf shows funding trends and the composition of funding sources of the domestic banking sector between 2003 and 2007. A major component of the funding base over the five-year period has been *customer deposits*. These deposits have accounted for around 80 percent of the total funding of banking operations. The second most important source of bank funds has been *other liabilities*[12] (in the three most recent years after having overtaken share capital in 2005). Funding from other banks ranks third, while *government* and *other borrowings* are relatively less significant funding sources.

Chart 9 overleaf shows that private sector enterprises were the largest source of funds followed by households and public sector enterprises.[13]

[11] Business sector loans exclude loans to the household sector, government, parastatals, non-resident businesses and non-resident individuals.

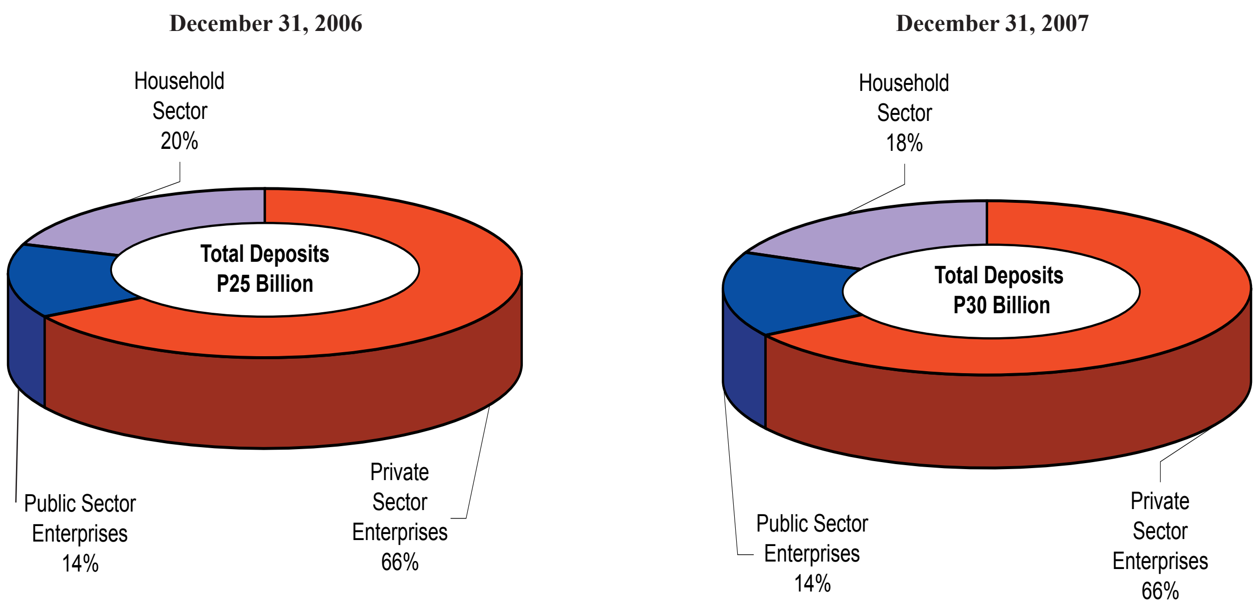
[12] Other liabilities include creditors, accruals, and deferred liabilities.

[13] Private sector enterprises consist of resident businesses and non-bank private financial institutions; household sector consists of residents and non-resident persons; and the Public Sector Enterprises comprise central government, local government, financial parastatals, non-bank financial parastatals and government majority owned businesses.

Table 3: Banking Industry Funding Trends (Pula Million)

Category	2003	2004	2005	2006	2007
Deposits	11 488	12 559	14 009	24 943	29 695
Growth Rate (%)	*18*	*9*	*12*	*78*	*19*
Share of Total Funding (%)	*82*	*81*	*76*	*82*	*80*
Other Liabilities	789	856	1 550	2 112	4 328
Growth Rate (%)	*3*	*9*	*81*	*36*	*105*
Share of Total Funding (%)	*6*	*6*	*8*	*7*	*12*
Share Capital	1 436	1 274	1 412	1 654	1 901
Growth Rate (%)	*18*	*(11)*	*11*	*17*	*15*
Share of Total Funding (%)	*10*	*8*	*8*	*5*	*5*
Owed to Government Institutions	109	104	105	50	100
Growth Rate (%)	*(4)*	*(5)*	*1*	*(52)*	*100*
Share of Total Funding (%)	*1*	*1*	*1*	*0*	*0*
Due to other Banks	254	410	1 467	1 654	1 030
Growth Rate (%)	*4*	*61*	*258*	*13*	*(38)*
Share of Total Funding (%)	*2*	*3*	*8*	*5*	*3*
Other Borrowings	0	317	0	0	86
Growth Rate (%)	*0*	*(100)*	*0*	*0*	*0*
Share of Total Funding (%)	*0*	*2*	*0*	*0*	*0*
Total Funding	**14 076**	**15 520**	**18 543**	**30 413**	**37 140**

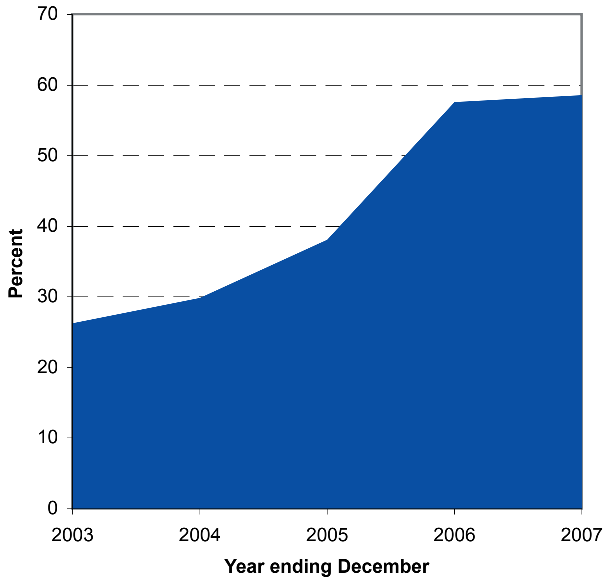
Chart 9: Sectoral Deposit Structure: 2006 – 2007



Note: Deposits of Private Sector Enterprises for 2006 consist of those from resident businesses (70 percent) and non-bank financial institutions (30 percent); and for 2007 consist of deposits from resident businesses (92 percent) and non-bank financial institutions (8 percent)

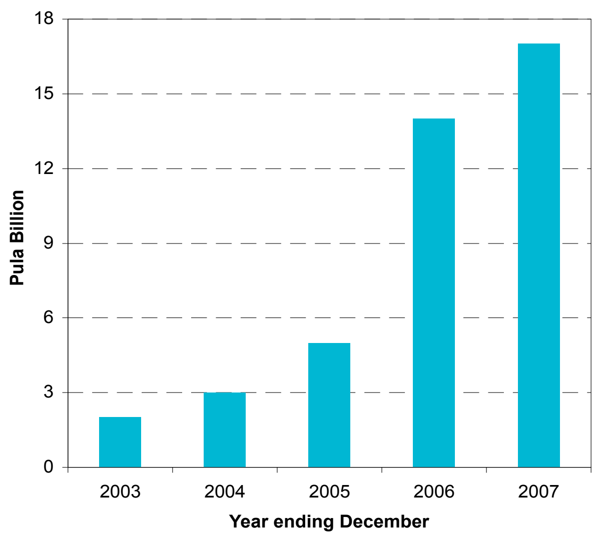
Although the funding base appears not to be well diversified, liquid assets increased to P17.5 billion from P14.3 billion in 2006, resulting in a Liquid Assets to Deposits ratio of 59 percent (more than five times the statutory ratio) during 2007, a slightly higher ratio than the 57 percent recorded in 2006 (Chart 10). The ratio suggests that the banking sector's ability to cover short-term obligations as they arise continued to be strong during 2007.

Chart 10: Industry Liquid Assets to Deposits Ratio



Growth of BoBCs held by banks was sharply lower (18 percent) in 2007 following the exceptional rise of 197 percent in 2006 attributed to the BoBC counterparty change, but still constituted a large proportion of the liquid assets. As at the end of 2007, the market value of BoBCs held by banks was P16.7 billion (Chart 11). Consistent with past trends, the four largest banks held the bulk (96 percent) of BoBCs.

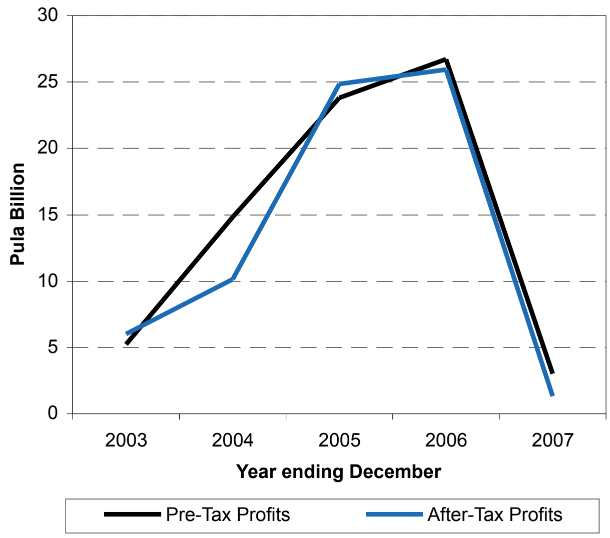
Chart 11: Outstanding Value of BoBCs



11. Profitability Levels and Trends

Though the banking sector continued to be profitable in 2007, the growth rate of profitability fell sharply compared to 2006 (Chart 12). Aggregate pre- and post-tax profits increased by 3 percent and 1 percent, respectively, in contrast to increases of 27 percent and 26 percent, respectively, in 2006. The slowdown in profit gains was explained by increases in operating expenses, high staff costs and impairment losses on financial assets, particularly with respect to exposure to Lobtrans. This development, in turn, adversely affected the Return on Average Assets (ROAA) (3 percent in 2007 compared to 4 percent in 2006).

Chart 12: Growth Rates of Profit Before and After-Tax



Tables 4 and 5 overleaf show additional key financial performance indicators on banks' earnings and profitability. As shown in the tables, the intermediation function continued to be the main source of income for banks. In 2007, interest income from loans and advances constituted 45 percent of gross income, followed by BoBCs at 35 percent. The slowdown in the rate of growth of interest expense (26 percent in 2007 compared to 93 percent the previous year), was again a normalisation from the extraordinary deposit growth in 2006. The high interest expense was largely due to interest paid on additional deposits after the March 2006 change in the BoBC primary counterparty arrangements. The largest component of banks' non-interest expense continued to be staff costs, as shown by the ratio of personnel expenses to non-interest income of 53 percent, which was higher than the 49 percent in 2006.

ROAA declined slightly to 3 percent from 4 percent in 2006, while the Return on Equity (ROE) remained unchanged (Table 5). The decline in the ROAA in 2007 is partly explained by lower growth rates in profitability

Table 4: Banking Industry Earnings and Profitability: 2006 – 2007

	Amount (P million)		Growth (Percent)
	Dec 2006	Dec 2007	2006 – 2007
Gross Interest Income	3 422.0	4 295.3	25.5
Interest Expense	2 105.6	2 660.2	26.3
Net Interest Income	1 316.4	1 635.1	24.2
Non-Interest Income	757.2	878.0	15.9
Operating Expense	852.9	1 142.9	34.0
Total Expense	2 958.5	3 791.3	28.2
Net Income Before-Tax	1 130.3	1 164.5	3.0
Net Income After-Tax	939.9	952.1	1.3

Table 5: Performance Ratios (Percent)

	Dec 2005	Dec 2006	Dec 2007
Return on Average Total Assets (ROAA)	4.4	3.8	2.8
Return on Equity (ROE)	52.9	56.8	57.1
Interest Income to Total Income	76.7	81.9	83.0
Non-Interest Income to Total Income	23.4	17.9	17.0
Interest Income to ATA	12.8	14.0	12.7
Non-Interest Income to ATA	3.9	3.1	2.6
Interest Expense/ATA	6.5	8.6	7.9
Interest Expense/Total Expense	58.1	71.2	69.9
Operating Expense/Total Expense	41.9	28.8	30.1
Non-Interest Expense/ATA	4.7	3.5	3.4
Average Return on Advances	16.9	17.8	17.5
Net Interest Income/ATA	6.4	5.4	4.8
Average Cost of Deposits	7.4	7.6	9.7

Note: ATA = Average Total Assets

for some banks arising from factors including higher provisions for loans to Lobtrans and an increase in operating expenses.

12. Operating Efficiency

Table 6 below shows a five-year trend of operational and allocative efficiency ratios for the banking industry. In general, there was a deterioration in the banks' operational efficiency as indicated by the industry's lower net spread[14] of 5 percent in 2007, down from 10 percent in 2006. This was as a result of the 81 percent growth in interest paid on deposits compared to 20 percent growth in interest on loans and advances which had the effect of narrowing the spread. Net interest margin[15] also decreased due to the high growth of the deposit interest expense coupled with the impact of the reduction in the prime lending rate following the Bank Rate cut in June 2007.

Net Income to Staff Expense ratio decreased from 255 percent in 2006 to 205 percent in 2007, indicating that the returns made by the banks continued to be shared with staff in the form of increased salaries and benefits, although to a lesser extent than in the previous year. Net income per staff member ratio declined from 336 percent to 316 percent in the same period, which im-

14 Refer to Appendix 4, Definition of Terms.

15 Refer to Appendix 4, Definition of Terms.

Table 6: Banking Industry Efficiency Measures

Performance Ratios (Percent)	2003	2004	2005	2006	2007
Net Spread	7.6	7.4	7.7	9.5	5.4
Net Interest Margin	6.7	7.6	6.4	5.4	4.8
Other Operating Income/ATA	3.7	3.8	4.0	3.1	2.6
Net Operating Margin	9.4	9.2	9.6	10.3	7.8
Net Income Per Employee (P'000)	214.7	235.0	278.2	335.6	316
Net Income To Employee Expense	181.1	190.8	219.1	254.8	205.1
Cost/Income	48.5	43.1	45.5	41.1	45.5
Staff Cost Per Employee (P'000)	118.6	123.2	127.0	131.7	154.0
Asset Per Employee (P'000)	5 564.7	6 102.1	6 911.1	10 858.1	12 326.4

Note: ATA = Average Total Assets

plies that net income generated by each staff member decreased. Furthermore, the Cost to Income ratio increased from 41 percent to 46 percent in 2007, boosted mainly by infrastructure developments at some banks. A cost to income ratio of 55 – 60 percent is considered highly competitive by international norms.

Chapter 3

Other Developments in the Financial System

1. Licensing of New Banks

During 2007, the Bank received and processed two banking licence applications for domestic investment and commercial banking licences. Both applications were unsuccessful due to failure to meet the Bank's licensing requirements, especially inadequacies relating to home country supervisory arrangements. The third applicant (Capital Bank) whose application was received and processed in 2006 was granted a banking licence in December 2007 and it is expected to commence business within 12 months of being issued with the licence.

In accordance with Section 11(2) of the Banking Act, Enterprise Banking Group (EBG), a bank holding company licensed in December 2004 to operate in the IFSC, surrendered its licence. The grounds for surrender of the licence were a change in the group's investment strategy. African Banking Corporation International (ABCI), an offshore bank licensed to operate in the IFSC also surrendered its licence during 2007.

In June 2007, the Minister announced a revision to the supervisory fees for licensed institutions as shown in Table 7 below.

2. Abandoned Funds

The level of abandoned funds as declared by commercial banks in accordance with Section 39 of the Banking Act continued to increase in 2007. About P0.7 million unclaimed funds, which had remained with the Bank for five years, were transferred to the Guardian's Fund in 2007, compared to P0.5 million in 2006. Claims paid out increased by 109 percent in 2007, possibly due to increased public awareness of the existence of these funds. Abandoned funds were advertised in the local newspapers and *Government Gazette* during the last quarter of 2007. Table 8 below gives a summary of abandoned funds received and processed in 2006 and 2007.

3. Bank Charges

Most commercial banks and statutory banks filed notification for the introduction of products and services, signalling increased product and price competition in the market. The Bank maintained its policy of signalling market restraint in increasing tariffs, with particular focus on encouraging the banking sector's support for the national policy objectives of enhancing savings and promoting financial deepening.

Table 7: Revised Statutory Fees (Pula)

Supervisory Fee	Previous Fee (P)	New Fee (P)
Application fee for a banking licence	3 000	15 000
Annual licence fee for banks	10 000	50 000
Application fee for a bureau de change licence	500	2 000
Annual licence fee for bureau de change	1 000	4 000
Application fee for IFSC non-banks	3 000	10 000

Table 8: Summary of Abandoned Funds Balances (Pula)

	2006	2007
Balance brought forward	4 268 952	4 075 841
Funds received	570 047	2 209 147
Claims paid out	(219 436)	(458 914)
Transfer to Guardian's Fund	(543 723)	(722 644)
Balance at year end	**5 103 430**	**5 103 430**

Table 9 below provides selected banking industry average charges applied during 2007. The charges have been classified into four broad categories of frequently applied charges, namely, behavioural deterrent, international trade, savings mobilisation and financial intermediation.

aimed at retaining clientele, enhancing customer service or attracting new credit-seeking customers. These initiatives included credit cards for high net worth customers, revolving credit lines, internet banking, and bancassurance business (which involves the provision of both banking and insurance products and services to bank customers through the same distribution channel). Statutory banks also diversified their products by introducing, among others, loans to cover school fees, purchases of residential property, motor vehicle loans, and unsecured personal loans.

Table 9: Banking Industry Average Charges – 2006 and 2007 (Pula)

Service Charges Category	2006	2007	Service Charges Category	2006	2007
Savings mobilisation			**Financial Intermediation**		
Maintenance fees on savings accounts	19.28	7.80	Vehicle/asset arrangement fees	425.00	353.00
Over-the-counter withdrawal fees	10.00	14.00	Other loan arrangement fees	480.00	558.00
Behavioural Deterrent Charges			**International Trade**		
ATM charges	2.05	1.64	Commission & purchase of foreign currency	14.95	14.50
Over-the-counter withdrawal	10.00	17.80	Inter-bank/Swift fees	260.00	266.00
Special clearance of cheques	89.00	85.00	Advisory fees on letters of credit	301.25	228.25
Bounced cheques	250.00	227.00	Travellers' cheques (TC) commission	300.00	2.1% of TC Value

Note: Charges are simple averages for all the banks carrying the specific charge.

As shown in Table 9 above, there was a general decline across the different categories of charges compared to 2006. However, financial intermediation charges were the highest in the industry, as in previous years. All the behavioural deterrent charges declined except the over-the-counter withdrawal fee, which increased by 78 percent. Some international trade fees also declined significantly. With regard to savings mobilisation charges, the savings account maintenance fee fell by 147 percent while the branch withdrawal fee increased by 40 percent. The low account maintenance fee is aimed at encouraging saving, while the higher withdrawal fee is intended to discourage savings withdrawals.

The general decline in banking industry average charges reflects some achievements made by the Bank in its dialogue with banks to offer affordable banking services through the exercise of moral suasion. The lower fees may also be indicative of heightened competition due to the entry of new banks into the market, which offer comparatively lower bank charges and certain banking services free of charge as a market penetration strategy.

4. New Banking Products and Systems

Most banks introduced customer-tailored products

5. Bureaux de Change Activities

A total of 46 bureaux de change were operational at the end of 2007 compared to 42 in 2006, following the licensing of eight new bureaux and voluntary closure of four during the year. Further expansion of the industry occurred due to the opening of three new branches by existing bureaux de change. Appendix 1 shows a list of bureaux de change operating in Botswana as at December 31, 2007.

The Bank examined five bureaux de change in 2007. While, in general, these bureaux de change complied with the Bank of Botswana (Bureaux de Change) Regulations 2004, a number of regulatory violations were noted, which included failure to maintain the statutory minimum balance of P5 000 in a deposit account; allowing daily cash transactions per customer in excess of P10 000; not recording all the details of customers in the receipt books; submitting inaccurate returns to the

Bank; and effecting changes to the directors, shareholders and principal officers without prior approval of the Bank. Appropriate supervisory action was taken in each case.

Chart 13 below shows the aggregate value and growth rates of bureaux de change foreign currency transactions over the five-year period from 2003 to 2007. The value of foreign exchange transactions rose further in 2007 partly due to the increase in the number of operators and the improved performance of individual bureaux de change. Sales rose by 50 percent while purchases increased by 30 percent. The growth rate of purchases of foreign currency slowed significantly in 2007 mainly due to a reduction in the purchases of the South African rand.

Charts 14 and 15 below show the market share (Pula equivalent) of foreign exchange sales and purchases by currency in 2006 and 2007. The South African rand and the United States dollar continued to dominate foreign currency transactions in the bureaux market. However, the share of the South African rand purchases and sales declined, which could be attributable to the continued effect of the depreciation of the Pula.

Chart 13: Bureaux de Change Sales and Purchases of Foreign Currency[16]

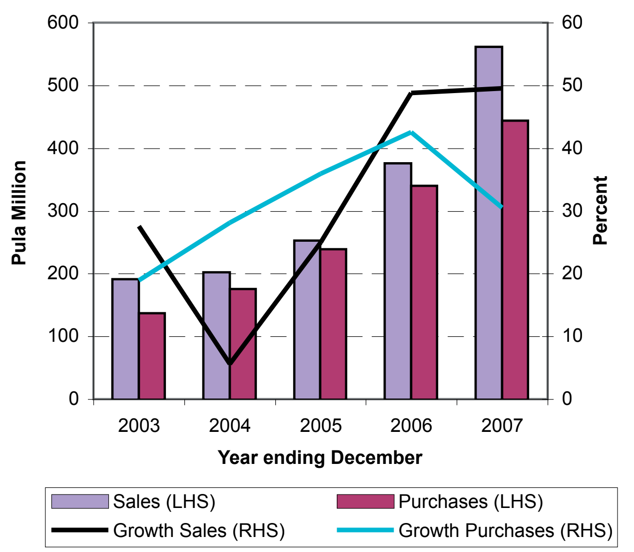


Chart 14: Bureaux de Change Sales of Foreign Currency: 2006 – 2007

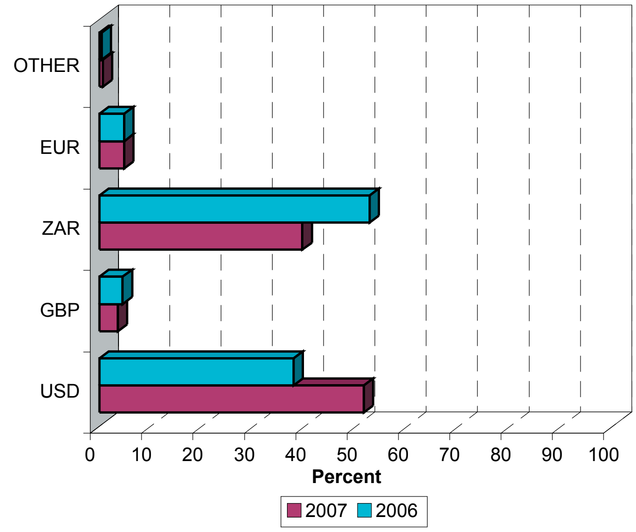
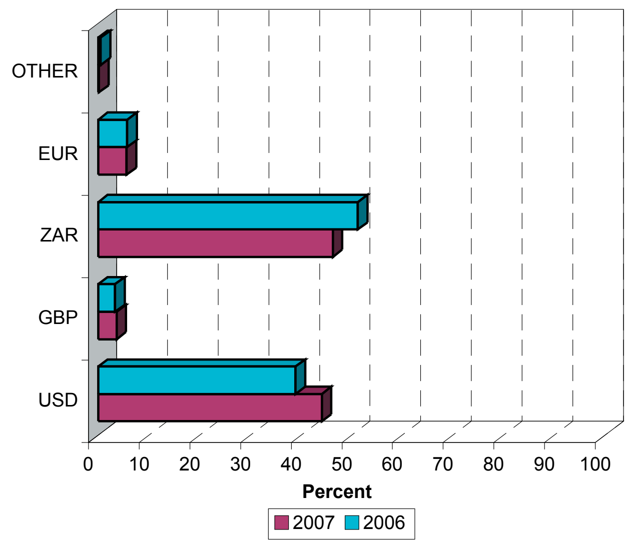


Chart 15: Bureaux de Change Purchases of Foreign Currency: 2006 – 2007



6. Money Lending Business

Enquiries for the establishment of money lending business fell by 29 percent to 44 percent in 2007, compared to 53 percent in 2006. With effect from April 2008, money lending businesses will fall under the supervisory purview of the new NBFIRA.

7. Collective Investment Undertakings (CIUs)

The number of management companies licensed in Botswana remained unchanged at three in 2007. These are African Alliance Botswana Management Company (Pty) Limited (AABMC), African Alliance International Limited (AAI) and Stanbic Investment Management Services (Pty) Ltd (SIMS). Table 10 below gives details of 13 funds under their management, up from 12 funds in existence in 2006.

[16] The 2003 sales and 2006 sales and purchases figures have been revised after receipt of additional information from bureaux de change.

Table 11 below shows that externally licensed funds marketed in Botswana increased from nine in 2006 to twenty in 2007. The newly licensed funds comprise 8 managed by Allan Gray, 2 by Orbis and 1 by Imara.

Table 10: Management Companies and Their Funds

Management Company	Funds Managed	Licensing Date
African Alliance Botswana Management Company (Pty) Limited	Botswana Global Income Fund	March 22, 2002
	Botswana Value Fund	March 22, 2002
	Botswana Liquidity Fund	March 22, 2002
	Botswana Global Allocation Fund	March 22, 2002
	Lobaka Equity Fund (formerly African Alliance Private Equity Fund)	June 17, 2004
African Alliance International (Pty) Limited	Global Managed Fund	March 22, 2002
	African Alliance Euro Fund	March 22, 2002
	African Alliance Dollar Fund	March 22, 2002
	Global Fixed Income Fund	March 22, 2002
	Global Equity Fund	March 22, 2002
Stanbic Investment Management Services (Pty) Limited	Stanbic Money Market Fund	May 27, 2004
	Stanbic Equity Fund	October 5, 2005
	Stanbic Managed Prudential Fund	November 13, 2007

Table 11: Externally Licensed Funds Marketed in Botswana

Management Company	Funds Managed	Licensing Date
Orbis Investment Management Limited (Bermuda)	Orbis Global Equity Fund	June 9, 2005
	Orbis Africa Equity Fund	June 9, 2005
	Orbis Japan Equity (USD) Fund	June 9, 2005
	Orbis Optimal (EUR) Fund	June 9, 2005
	Orbis Optimal (USD) Fund	June 9, 2005
	Orbis Leveraged (EUR) Fund	June 9, 2005
	Orbis Leveraged (USD) Fund	June 9, 2005
	Orbis Optimal (Yen) Fund	June 12, 2007
	Orbis Asia ex-Japan Equity Fund	June 12, 2007
Allan Gray Unit Trust Management Limited (RSA)	Allan Gray Stable Fund	June 12, 2007
	Allan Gray Equity Fund	June 12, 2007
	Allan Gray Balanced Fund	June 12, 2007
	Allan Gray Bond Fund	June 12, 2007
	Allan Gray Optimal Fund	June 12, 2007
	Allan Gray Money Market Fund	June 12, 2007
	Allan Gray Global Fund of Funds	June 12, 2007
	Allan Gray Feeder Fund	June 12, 2007
Standard Chartered Bank London PLC	Standard Chartered USD Liquidity Fund	August 17, 2005
Imara Asset Management Limited (BVI)	Imara African Opportunities Fund	June 21, 2006
	Imara African Managed Fund	January 23, 2007

The total Net Asset Value (NAV) of the domestic funds, which comprise those managed by SIMS and AABMC, was P2.3 billion as at December 31, 2007, a 60 percent decrease from the P5.6 billion as at December 31, 2006. The decline in NAV was attributable to the loss of the mandate by AABMC to manage the Botswana Public Officers' Pension Fund (BPOPF). The changes in NAVs of funds licensed in Botswana between 2003 and 2007 are shown in Chart 16 below.

Chart 16: Net Asset Value of Locally Licensed Funds

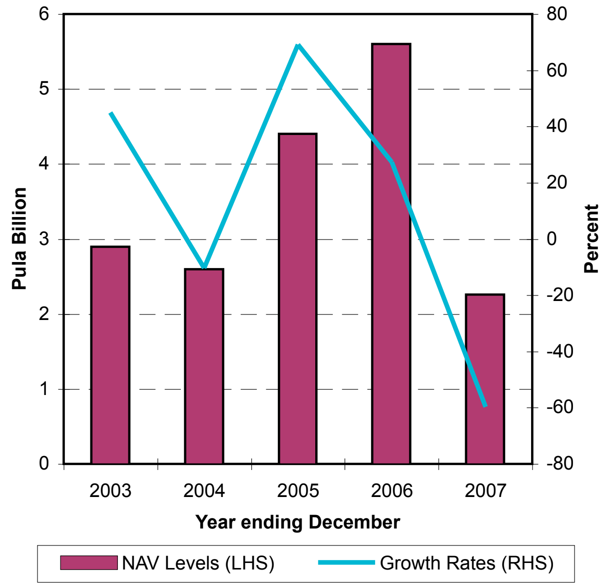


Chart 17 below shows that, of the P2.3 billion funds invested as at December 31, 2007, only 6 percent was invested outside the country while 94 percent was invested in the domestic market, compared to 69 percent and 31 percent, respectively, in the previous year. The large shift in the investment split was mainly due to the effect of the loss of BPOPF assets, which constituted the bulk of the domestic portfolio in the previous year.

8. International Financial Services Centre (IFSC) Activities

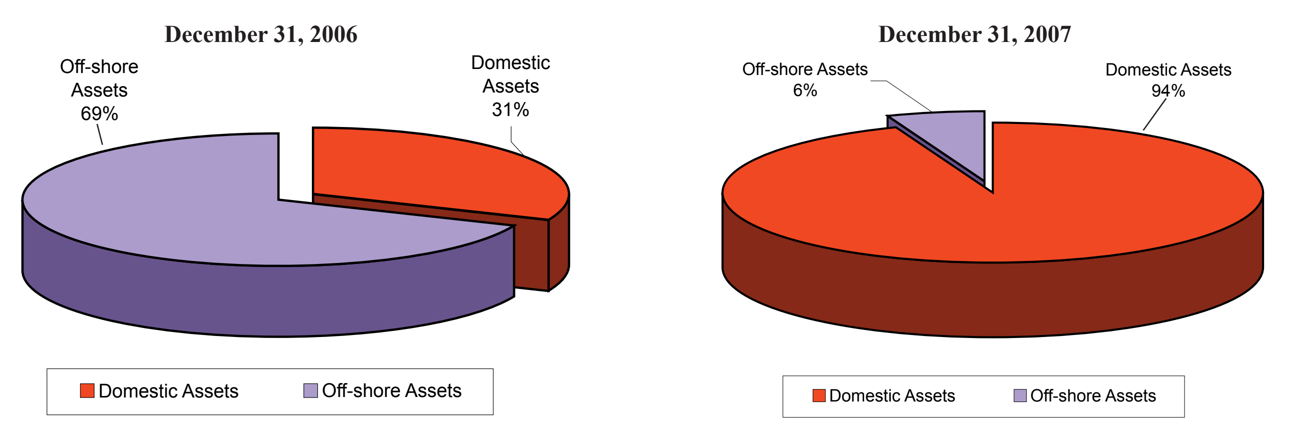
Micro Provident Botswana Limited, a financial services company, and Pangaea Development Holdings Limited, a company engaged in real estate development, were issued with Exemption Certificates to operate in the IFSC in accordance with the requirements of Section 45 of the Bank of Botswana Act (CAP. 55:01), read with Section 138(4) of the Income Tax Act (CAP. 52:01). As a result, the total number of IFSC licensed institutions increased from 17 in 2006 to 19 in 2007, of which 10 were operational during the review period.

9. Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Issues

During 2007, the Bank participated in the meetings of the National Anti-Money Laundering and the Counter Terrorism Committees. The Bank was also represented at the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) meeting for senior officials held in Gaborone in August 2007, during which Botswana's Financial Sector Assessment Programme (FSAP) report on AML/CFT was discussed and adopted.

About 400 reports of suspicious financial activities were submitted to the Directorate of Corruption and Economic Crime (DCEC) by the banks during 2007 for further analysis and possible investigation. Most of these reports were investigated and the funds were found to originate from legitimate sources. This suggests that banks need to strengthen their know-your-customer

Chart 17: Off-shore and Domestic Investments of Funds Licensed in Botswana



(KYC) framework and profiling of their customers to minimise the incidences of false reporting.

10. Regional International Supervisory Seminars and Workshops

The Bank participated at several regional seminars and workshops during 2007, many of which addressed Basel II implementation and related issues. In particular, the Bank facilitated a retreat in Gaborone for regional Heads of Banking Supervision to discuss compliance with the Basel Core Principles for Effective Banking Supervision (BCPs) as a prelude to Basel II implementation. The retreat was jointly organised by the Financial Stability Institute (FSI) and the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI). The retreat provided participants with a comprehensive overview of the revised BCPs and their linkage to effective implementation of Basel II. It also created awareness among participants on the need to develop comprehensive prudential regulatory frameworks that could reduce the scope for cross country contagion, regulatory arbitrage and regulatory gaps within the region. Similarly, the Bank was represented at a workshop in Namibia on Basel II during the year. The Workshop's objective was to provide participants with a comprehensive overview of the three pillars of Basel II and BCPs.

The Bank also benefited from a symposium organised by the Association of African Central Banks (AACB) which was held in Libya on 'Microfinance, Savings and Credit Unions in Poverty Alleviation'. Drawing on experiences from several African countries, the symposium concluded that microfinance institutions (MFIs) do not pose systemic risk to the financial system, but as a whole should be subjected to non-prudential regulation, including registration, publication of audited annual accounts, and greater transparency of the effective interest rate charged. It was also concluded that MFIs that were systemically important should be subjected to normal prudential regulation. The interest in microfinance from a regulator's perspective arises from the fact that MFIs increasingly transform themselves into "banking" institutions given the significance of their lending activities.

An AACB seminar was held in Namibia during 2007 at which sub-regional participants shared experiences on banking supervision practices in Africa with a view to finding ways and means of strengthening such practices in line with the requirements of the African Monetary Co-operation Programme (AMCP).

11. Compliance with the Basel Core Principles for Effective Supervision (BCPs)

The Basel Core Principles for Effective Banking Supervision (BCPs), introduced in 1997 by the Basel Committee of Banking Supervision, are one of the most important supervisory standards largely due to the dominant position banks have in a financial sector, as well as the potentially serious macroeconomic consequences of banking instability. The main objective of the BCPs is to harmonise international supervisory standards and can also be used to reinforce international best practices in banking supervision across regulatory jurisdictions.

BCPs form the foundation upon which Basel II was founded. Pillar I of Basel II builds on the provisions of BCP 6 on capital adequacy; Pillar II is based on BCP 1 dealing with enforcement authority and independence; and Pillar III, which seeks to promote effective risk management and the use of market disclosures for purposes of enhancing corporate governance, is founded on BCPs 7, 21 and 22. The principles of Pillar III are closely related to the requirements of the IFRS 7. Given the close linkage between BCPs and Basel II, it is important for the Bank to continually assess its compliance with the BCPs.

The Bank annually conducts a detailed self-assessment for compliance with the BCPs using the methodology adopted by the Bank for International Settlements (BIS) and recommended by the International Monetary Fund (IMF). Many countries have found that conducting the self-assessments brings important benefits, which improve domestic banking supervision.

The Bank was, for the first time, subjected to the Financial Sector Assessment Programme (FSAP) during 2007. The FSAP is a joint effort between the IMF and the World Bank which was introduced in 1999 with the aim of increasing the effectiveness of efforts to promote the soundness of financial systems in member countries. The programme seeks to identify the strengths and vulnerabilities of a country's financial system; determine how key sources of risk are being managed; ascertain the sector's developmental and technical assistance needs; and help prioritise policy responses. Many other countries have been subject to the FSAP exercise.

The determination of the degree of compliance with each principle is based on a four-grade scale; *compliant; largely compliant; materially non-compliant and non-compliant.* A 'not applicable' grading can be used under special circumstances. The main findings of the assessment and recommended actions are briefly summarised in Table 12 overleaf.

12. Basel II Implementation Task Force

The Bank is committed to implementing Basel II in Botswana, in consultation with the industry. The Basel II Implementation Task Force (BITF), comprising representatives of all banks, has been established. The role of the BITF includes evaluation of the suitability of implementing Basel II in Botswana; developing a national strategy for implementation; assessing the ability and readiness of the banking sector to implement Basel II; recommending a target date for implementation; and reaching consensus on regulatory and other market issues relating to Basel II implementation.

The BITF held two meetings during 2007 the purpose of which were mainly to foster consultation among all stakeholders on Basel II issues. As part of the rudimentary work of the BITF, the Bank conducted a survey of the banks' readiness to implement Basel II. The purpose of the survey was to gather baseline information on banks' organisational structures, reporting ability, data availability and compliance with Basel II requirements, capital allocation, Basel II action plan and technological readiness.

The results of the survey showed that, overall, banks were at different levels of readiness to implement Basel II. The four largest banks were at an advanced level in terms of implementation readiness, while the smaller banks would benefit from the work of the BITF. The survey also showed that the main challenges facing banks in Basel II implementation included database design, collection and compilation of Basel II compliant data, systems integration capability and budgetary constraints.

Table 12: Summary of the Findings and Recommendations of the FSAP Mission

Core Principle (CP)	Findings	Recommended Action
CP 1: Objectives, powers, independence, transparency, and cooperation	The Bank's objectives were found to be clear, and the Bank was found to be operating as an independent, transparent entity. However, the Bank was found to be materially non-compliant with regard to information sharing with non-central bank supervisory authorities.	Revise the Banking Act (BA) to enable Bank of Botswana to exchange supervisory information with non-central bank supervisory institutions.
CP 2 – 5: Licensing and structure	The Bank operates as the sole licensing authority for commercial banks but there are dual powers between the Bank and the Ministry of Finance and Developing Planning (MFDP) in respect of supervision of statutory banks. MFDP also serves as an appeal forum for certain situations such as the rejection of licence applications or other licence conditions. It was also found that there was no definition in the Banking Act of the following; deposit, business of deposit taking and significant ownership.	Amend the statute to include definition of 'deposit' and 'business of deposit-taking'. Give over to the Bank full supervisory authority of statutory banks as a prelude to their privatisation and license these institutions. Review the Banking Act to enable appeals to be made to the courts and not MFDP. Make provisions for the definition of 'significant' and 'controlling' shareholders in the Banking Act and strengthen vetting powers for the Bank. This includes the powers to freeze voting rights and to reverse any share transfer that has taken place without approval.
CP 6 – 18: Prudential regulation and requirements	The Bank was found to be compliant with almost all the principles relating to prudential regulation requirements, but it was found lacking on requirements in respect of country and sovereign risk.	Set requirements for country and sovereign risk and require reporting of this exposure. Issue guidelines and step–up supervision of net funding requirements.
CP 19 – 21: Methods of ongoing banking supervision	The Bank has recently gone through a restructuring exercise, which has resulted in the creation of a new unit specifically targeted to do regulatory policy development and publication. The off-site and on-site supervision has been integrated, which has helped introduce a more risk-based approach to supervision, which will benefit further development.	Document supervisory approach, including explanations and instructions to encourage transparency and bridge information gaps amongst stakeholders. Further develop relationships with bank boards and audit committees. The Bank was also advised to revise the statutory returns to include reports on Islamic Banking and geographic concentration of assets.
CP 22: Accounting and Disclosure	Accounting practices as spearheaded by the major audit firms are to some degree consistent with International Financial Reporting Standards (IFRS). A new financial reporting law has been drafted which will require the full application of IFRS.	The Banking Act, all statutory returns, directives and guidelines are to be updated and made consistent with financial reporting standards where appropriate.
CP 23: Corrective and remedial powers of supervisors	The Bank has a good range of remedial powers, which it has so far had to use extensively.	Establish powers to sanction shareholders.
CP 24 – 25: Consolidated and cross-border banking supervision	Several small banking groups have emerged with a presence in several countries in the region. It may be challenging to supervise the groups effectively. Regional cooperation between supervisory authorities may be helpful.	Establish powers to supervise banking groups. Develop relationships with home supervisors to banks. Develop with other supervisors contingency planning for banking groups.

Chapter 4
Conclusion

Overall, the banking industry posted strong results in 2007, due to heightened competition that elicited innovative approaches to service delivery and product development. With new entrants in the market, the competitive environment changed and key players engaged in aggressive marketing strategies in order to retain or increase market share through branch and ATM network expansion, more customer tailored products, and greater use of technology in support of new products and service delivery. As a result, total banking assets grew rapidly by over 20 percent, funded by a similar growth in deposit liabilities, as well as an increase in equity partly due to growing involvement of banks in raising supplementary capital in capital markets. As net depositors within the banking system, corporates continued to be the main source of funding for banks' operations. In contrast, the retail sector was a net borrower and accounted for just under 60 percent of the banks' total loan portfolio. The analysis indicates that overall credit to the retail sector grew faster than in the previous year, but with mortgage lending contributing much less to that growth as its own growth decelerated considerably.

Banks generally complied with supervisory and regulatory requirements in 2007. They continued to be adequately capitalised and liquid, observed concentration limits, maintained appropriate provisions for past due loans, and held high quality assets in their books. In addition, the banks were generally more profitable than in the previous year.

Despite the overall good performance in 2007, the challenge remains to improve the intermediation ratio without driving credit growth beyond sustainable levels. Further challenges are diversification of funding sources, raising the level of retail savings, and affordable and easier access to banking services. Although bank charges generally declined in 2007, the cost of banking services was still relatively high by international standards.

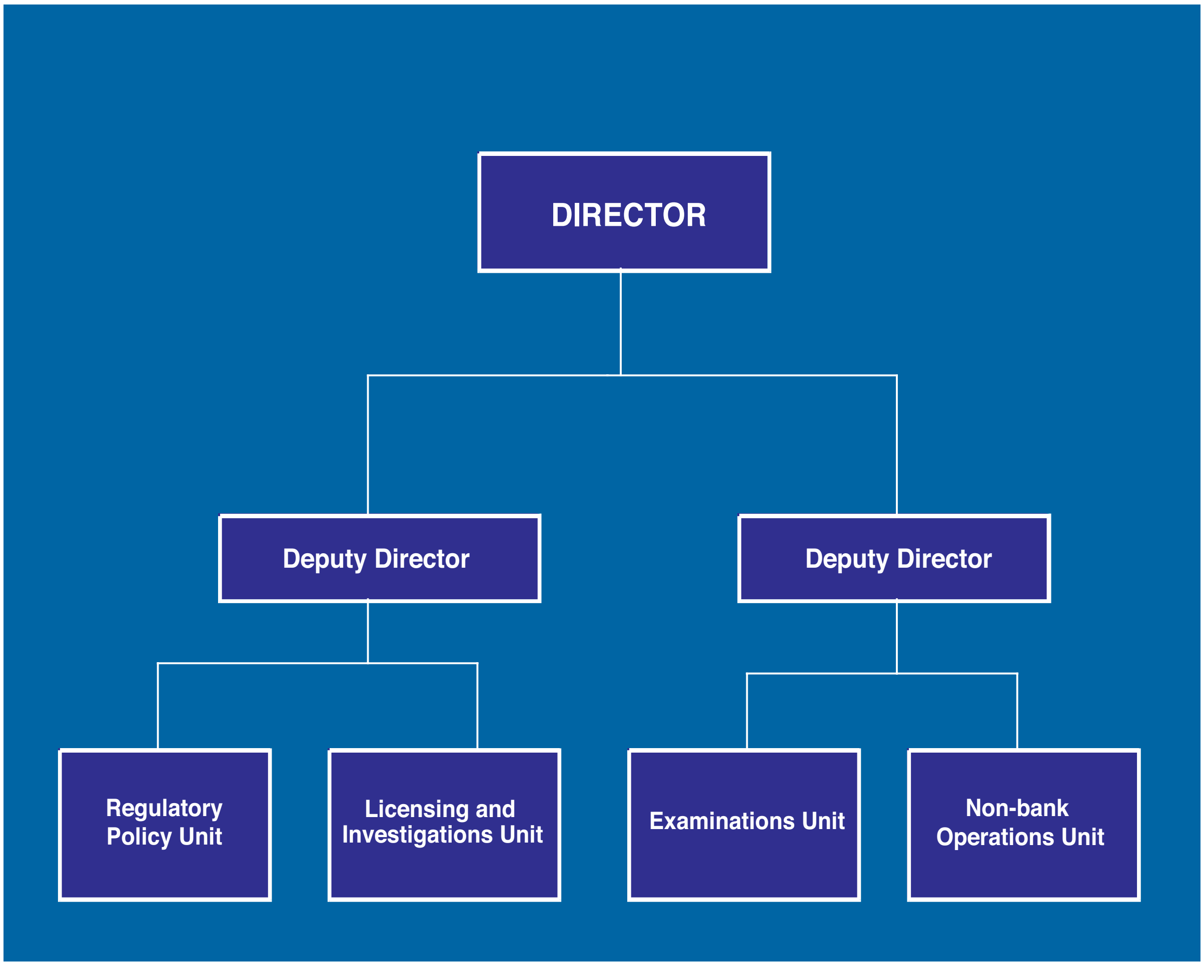
The short term outlook for the industry is, however, positive given that major economic projects, such as Morupule power plant expansion, diamond cutting and beneficiation related activities, mineral exploration, and privatisation initiatives, are expected to generate opportunities for growth of bank lending and improvement in the intermediation ratio.

With regard to other developments in the financial sector, bureaux de change performed well during the year: their number increased, assets expanded and profitability increased, while the US dollar and rand continued to be the preferred currencies in which foreign exchange transactions were conducted. Nonetheless, most bureaux were small in terms of asset size, but two bureaux dominated the business both in terms of asset size and profitability. The number of market players in the collective investment undertakings (CIUs) business was unchanged from that of the previous year, while the number of domestic funds and those licensed offshore but marketed in Botswana increased. The IFSC was less active during the year, with only two companies certificated during the year, taking the total number of operational entities to 19.

The Bank participated in a number of international fora addressing diverse subjects including Basel II implementation, AML/CFT, microfinance and banking supervisory practices in Africa. The FSAP concluded that the banking system was robust and resilient. However, a number of areas were identified that will need to be addressed as part of the broader strategy for financial sector deepening and, in general, strengthening the financial sector. The Bank, in consultation with the newly established NBFIRA and MFDP, will initiate work on a financial sector development strategy.

APPENDICES

Appendix 1: Banking Supervision Department Organisational Chart



Appendix 2: Approaches to Regulation and Supervision of Banks in Botswana

Introduction

This Appendix outlines the basic elements of the framework, standards and processes for banking supervision in Botswana. The Bank is committed to the development of a sound, stable and competitive banking system which promotes savings mobilisation while responding, in a prudent and sustainable manner, to the credit requirements of the economy. The Bank also seeks to adhere to best international practices as enshrined in the Basel Committee's 25 Core Principles for Effective Banking Supervision (see Box 2).

Legal Framework

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

The banking law also extensively covers matters of governance, market discipline within the banking system, and official supervision of the banking system. It is recognised that, primarily, the responsibility for banking soundness lies with owners and managers who have a commercial incentive to operate banks prudently. Market discipline provides further pressure and incentives for good internal governance and imposes sanctions for failures, particularly for institutions listed on the stock exchange. Official supervision is essential to provide external incentives for management and owners of banks to rectify inadequacies in governance and impose control where market behaviour could lead to imprudent conduct, which could have adverse systemic repercussions. These three aspects are subsumed within the legislation and prudential requirements. Thus, the continuing stability and soundness of the banking system and the extent to which it is effective in facilitating financial intermediation between savers and borrowers as well as operating the payment system, is a reflection of efficiency in all these three areas.

Authority for Licensing Banks

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

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

Licensing Policy and Procedures for Establishing a Bank

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

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

(a) be locally incorporated in Botswana. Branch banking is not permitted;

(b) have the prescribed initial minimum capital, currently P5 million, and the owners must demonstrate willingness and ability to provide additional financial support as and when required. In case of applicants that are majority owned by holding companies or a part of a financial conglomerate, the parent entity should demonstrate capacity to be a source of financial strength;

(c) have adequate managerial capacity, which includes the appointment of "fit and proper" persons as well as sound risk management and other governance structures;

(d) in the case of foreign banks, the parent bank must be subject to adequate home supervision, and a documentary evidence of consent by the parent supervisor to operate in Botswana must be provided;

(e) the proposed ownership and organisational structure must be acceptable to the Bank, and the structure must be such that it allows effective consolidated supervision; and

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

Core Prudential Standards

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

1. Capital Adequacy Requirements

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

2. Reserve Requirements

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

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

3. Asset Quality

(a) 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. Further, a bank is required to seek prior approval from the Bank of Botswana before granting loans and other credit facilities to a single entity or group of related companies which, in aggregate, are in excess of 30 percent of a bank's unimpaired capital.

(b) Insider Lending

Section 17 also restricts banks from granting facilities to directors and their related interests in excess of the higher of P50 000 or 1 percent of a bank's core capital without the approval of a bank's entire board of directors. In addition, no bank may grant facilities, direct or indirect, to a member of its board of directors in excess of 25 percent of its unimpaired capital. This provision seeks to avoid possibilities of insider abuse, self-dealing or over reliance on related party business.

(c) Provisions

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

4. Main Supervisory Approaches

(a) On-site Examinations

The Bank of Botswana conducts routine on-site examinations pursuant to Section 24(1) of the Banking Act. The Bank may also conduct an examination of a bank if so petitioned by one fifth of 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 on the basis thereof, determine the priorities and resources for on-site examination work. 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 (C), Asset Quality (A), Management (M), Earnings (E), Liquidity (L) and Market Risk Sensitivity (S) components (referred to as CAMELS), and adherence to statutory prudential limits in each of these areas.

In order to ascertain the soundness and prudence of the bank's practices and procedures, an assessment is made of its risk management policies and systems. 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 issues that may adversely affect the performance of a bank for which they are responsible.

(b) Bilateral and Trilateral Meetings

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

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, arranges 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. Trilateral meetings have an added advantage of fostering effective collaboration and communication between the Bank (regulatory authority) and external auditors of banks in the application of accounting standards and ensuring effective disclosure in financial statements and related reports of material risks in a bank's balance sheet.

It is also at such meetings that Bank of Botswana takes the opportunity to discuss with auditors, its expectations regarding the scope of statutory audits and other general issues of a prudential nature.

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, except that when a bank intends to capitalise half-year interim profits, it must call for an audit of the accounts. Change of external auditors or financial year-end requires prior approval of the Bank.

Core Principles for Effective Banking Supervision

Bank of Botswana, 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 issued by the Basel Committee on Banking Supervision in 1997 (revised in October 2006) for use in both G-10[17] and non-G10 countries. They comprise 25 "Core Principles" that need to be in place for a supervisory system to be effective and are used as a benchmark in the development of a country's supervision strategies.

The main objective of the Core Principles is to harmonise international supervisory standards. In Botswana, they are also used to reinforce international best practices in banking supervision.

Bank of Botswana annually conducts a detailed self-assessment for compliance with the Core Principles using the methodology adopted by the international banking supervisors and recommended by the International Monetary Fund. Box 1 below presents the 25 Core Principles for Effective Banking Supervision.

Box 2: The 25 Core Principles for Effective Banking Supervision

Principle 1: Objectives, independence, powers, transparency and cooperation: An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments 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.

Principle 2: Permissible activities: 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.

Principle 3: Licensing criteria: The licensing authority must have the power 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 ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.

Principle 4: Transfer of significant ownership: The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.

Principle 5: Major acquisitions: The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

Principle 6: Capital adequacy: Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define

[17] G10 comprises 11 countries: United States, Japan, Germany, Canada, Britain, France, Italy, Netherlands, Belgium, Sweden and Switzerland.

the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.

Principle 7: Risk management process: Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.

Principle 8: Credit risk: Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.

Principle 9: Problem assets, provisions and reserves: Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.

Principle 10: Large exposure limits: Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.

Principle 11: Exposures to related parties: In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.

Principle 12: Country and transfer risks: Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.

Principle 13: Market risks: Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.

Principle 14: Liquidity risk: Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.

Principle 15: Operational risk: Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.

Principle 16: Interest rate risk in the banking book: Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.

Principle 17: Internal control and audit: Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity 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 the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

Principle 18: Abuse of financial services: Supervisors must be satisfied that banks have adequate policies and processes in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.

Principle 19: Supervisory approach: An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.

Principle 20: Supervisory techniques: An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.

Principle 21: Supervisory reporting: Supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.

Principle 22: Accounting and disclosure: Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.

Principle 23: Corrective and remedial powers of supervisors: Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking licence or to recommend its revocation.

Principle 24: Consolidated supervision: An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.

Principle 25: Home-host relationships: Cross-border consolidated supervision requires co-operation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.

Appendix 3: Supervised Financial Institutions as at December 31, 2007

(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	42	PricewaterhouseCoopers
Standard Chartered Bank Botswana Limited	P O Box 496, Gaborone	11	KPMG
First National Bank of Botswana Limited	P O Box 1552, Gaborone	16	Deloitte & Touche
Stanbic Bank Botswana Limited	P/Bag 00168, Gaborone	9	KPMG
Bank of Baroda (Botswana) Limited	P O Box 21559, Gaborone	2	PricewaterhouseCoopers
Bank Gaborone Limited	P/Bag 00325, Gaborone	1	PricewaterhouseCoopers
MERCHANT BANKS			
African Banking Corporation of Botswana Limited	P/Bag 00303, Gaborone	2	PricewaterhouseCoopers
STATUTORY BANKS			
Botswana Savings Bank	P O Box 1150, Gaborone	1	PricewaterhouseCoopers
National Development Bank	P O Box 225, Gaborone	3	KPMG
BUILDING SOCIETY			
Botswana Building Society	P O Box 40029, Gaborone	9	KPMG

(B) Bureaux de Change as at December 31, 2007

Name	Postal Address	Business Locations
Universal Bureau de Change	P O Box 2444, Gaborone	2
Garona Bureau de Change	P O Box 408, Gaborone	5
Ozair Bureau de Change	P/Bag 149, Gaborone	1
Sunny Bureau de Change	P O Box 370, Maun	3
Exim Bureau de Change	P O Box 1020, Gaborone	1
ASA Bureau de Change	P O Box 2, Lobatse	4
Prosper Bureau de Change	P/Bag BO7, Gaborone	3
Kwa Nokeng Bureau de Change	P O Box 10, Sherwood	2
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	2
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	P/Bag F388, Francistown	1
Kalahari Bureau de Change	P O Box 1116, Gaborone	1
Maeto Bureau de Change	P O Box 22, Mahalapye	1
Bellagio Bureau de Change	P/Bag BR 321, Gaborone	3
Open Door Bureau de Change	P O Box 839, Maun	2
Servewell Bureau de Change	P/Bag B02, Gaborone	1
American Express Bureau de Change	P O Box 45140, Gaborone	1
Star Bureau de Change	P O Box 80491, Gaborone	1
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
Tsogo 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	4
Nsundano Bureau de Change	P O Box 243, Kasane	1
Mabote Bureau de Change	P O Box 120, Jwaneng	1
Unity Bureau de Change	P O Box 1586, Francistown	1
Royalty Bureau de Change	P/Bag BO 259 Gaborone	1
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Limpopo Bureau de Change	P O Box 8, Martins Drift	1
Palapye Bureau de Change	P O Box 10408, Palapye	2
Rennies Bureau de Change	P O Box 2482, Gaborone	1
Investors View Bureau de Change	P O Box 266, Nata	1
Crystal Diamond Bureau de Change	P O Box 20554, Gaborone	1
Buttercup Bureau de Change	P O Box 402084, Gaborone	1
River Ride Bureau de Change	P O Box 301106, Francistown	1
Goodrate Bureau de Change	P O Box 923, Ghanzi	1
Genesis Bureau de Change	P/Bag BR 225, Gaborone	1
Apijoe Bureau de Change	P O Box 458, Mogoditshane	1
Dlamini Bureau de Change	P O Box 210, Jwaneng	1
Fundex Bureau de Change	P O Box 401547, Gaborone	1
Boitekelo Bureau de Change	P O Box 486, Gaborone	1
West Bureau de Change	P O Box 779, Gaborone	1

(C) Collective Investment Undertakings as at December 31, 2007

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

(D) Operational Organisations Issued with Either a Banking Licence or Exemption Certificate under the International Financial Services Centre as at December 31, 2007

Name	Postal Address
Seedco. International Limited	P O Box 478143, Gaborone
ABC Holdings Limited	P/Bag 00303, Gaborone
RPC Data International Limited	P/Bag BR 42, Gaborone
Kingdom Bank Africa Limited	P O Box 45078, Gaborone
Nugen (Pty) Ltd	P O Box 408, Gaborone
Imara Holdings Ltd	P/Bag 00186, Gaborone
Cherubin Ventures (Pty) Ltd	P O Box 1444, Gaborone
AON Risk Management (Pty) Ltd	P O Box 624, Gaborone
Island View (Pty) Ltd	P O Box 41029, Gaborone
Wilderness Holding (Pty) Ltd	P/Bag 14, Maun
C B Richard Ellis (Pty) Ltd	P O Box 1136, Gaborone
Global Credit Ratings	P O Box 41015, Gaborone
Bergstan Investments	P/Bag 00234, Gaborone
Property and Asset Management International (Pty) Ltd	P O Box 495, Gaborone
Micro Provident Botswana Ltd	P O Box 381, Gaborone

(E) Micro-Finance Institutions as at December 31, 2007

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

Appendix 4: Definition of Terms

Definition of Banking Supervision Terminology as Used in This Report

(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 (Cap 46:04), 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 cashflow 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 page 42 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 43.

(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 43.

(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".

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 Pay-Out:** The ratio measures the proportion of the after-tax income that is paid out to shareholders. This ratio is of greater interest to investors than for banking supervision. It is the inverse of this ratio, profit retention ratio that is of greater interest 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, or to support organic growth of the bank.

(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 measurement and standards 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 capital adequacy 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.

(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.

(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.

(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.

(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 highly paid staff compared to a retail bank with a large branch network and many lowly paid clerical 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 qualified professionals.

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

Capital Elements

Core Capital + Supplementary Capital Less Impairments of Capital = Unimpaired Capital

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

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

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

(c) Disclosed prior years' reserves (audited)

(i) Share premium

(ii) General reserves

(iii) Accumulated retained earnings

(d) Published current year's retained earnings

(e) Minority interests

less

(f) Current year's unpublished losses

(g) Goodwill and other intangible assets

(h) Shareholders' equity funded through the capitalisation of unrealised gains arising from fixed property revaluation

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

(a) Current year's unpublished profits

(b) 50% of fixed asset revaluation reserves

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

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

(e) Subordinated term debt (eligible for inclusion)

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

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

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

(a) Investments in unconsolidated subsidiaries and associated companies

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

(c) Capitalised establishment costs/pre-incorporating expenses

(d) Underwriting commission

4. Total Capital Funds = Sum of 1 and 2

5. Total Unimpaired Capital: 4 – 3

Risk Weights Applied on Various Assets for Purposes of Capital Adequacy Measurement

Type	Risk Factor (Percent)
On-Balance Sheet Items	
Cash (Pula notes)	0
Balances of accounts held at Bank of Botswana	0
Loans, advances and other credit facilities to the Government of Botswana or fully and unconditionally guaranteed by the Government of Botswana	0
Assets secured by a lien or pledge over fixed/notice or savings deposits (cash) held by the (same) bank (cash collateralised loans)	0
Central Bank Securities (BoBCs)	0
Advances collateralised by BoBCs or any securities issued by the Government of Botswana	0
Foreign currency notes (dealing currencies)	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 (R/E)	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
Asset securitisation with recourse	100
Transaction-related contingent items (performance bonds, bid bonds, etc.)	50
Formal commitments, credit lines (original maturity over 1 year-undrawn commitments) and underwriting and note-issuance facilities	50
Short-term self liquidating, trade related (documentary credits secured by shipment)	20
Forward foreign exchange contracts (over 1 year)	5
Forward foreign exchange contracts (under 1 year)	1
Undrawn commitments, original maturity under 1 year or less or can be cancelled	0
Currency Swaps	0

Appendix 5: Aggregate Financial Statements of Licensed Banks: 2003 – 2007

Table 5.1: Aggregate Balance Sheet of Licensed Commercial Banks: 2003 – 2007 (Pula Million)

Total Assets in Local Currency	**2003**	**2004**	**2005**	**2006**	**2007**
1. Cash and balances with the Central Bank	776	821	722	1 109	1 851
(a) Currency	316	314	375	388	494
aa. Hard currency and gold bullion	32	35	81	80	93
ab. Local currency	284	279	294	308	401
(b) Balances with Central Bank	418	432	347	722	1 341
(c) Other	249	232	51	0	16
2. Trading securities at market value (BoBCs)	2 462	3 048	4 785	14 218	16 701
3. Placements with other banks and credit institutions	2 004	1 943	3 003	3 067	3 754
4. Loans and advances to other customers (net of specific provisions)	7 609	8 685	9 130	10 916	13 595
5. Investment securities	588	386	280	226	185
6. Fixed assets net of depreciation	209	212	200	213	296
7. Other assets (net)	430	430	423	663	758
Total Assets	**14 079**	**15 524**	**18 543**	**30 413**	**37 140**
Liabilities in Local Currency					
1. Amounts owed to government institutions	109	104	105	50	100
(a) Central Bank accounts	0	0	105	50	100
(b) Direct Government credits	109	104	0	0	0
(c) Other	0	0	0	0	0
2. Due to other banks and credit institutions	254	410	1 467	1 654	1 030
3. Securities sold under repurchase agreements	0	0	0	0	0
4. Due to other customers/depositors	11 488	12 559	14 009	24 943	29 695
5. Shareholders funds	1 436	1 274	1 412	1 655	1 901
6. Other liabilities	789	856	1 550	2 112	4 328
(a) Taxes payable	62	104	115	90	98
(b) Dividends payable	53	118	33	81	0
(c) Accrued expenses	135	86	167	83	2
(d) Other	541	552	1 235	1 858	4 228
7. Other borrowing incl. international lending agencies		317			86
Total Liabilities	**14 079**	**15 524**	**18 543**	**30 413**	**37 140**

Table 5.2: Aggregate Income Statement of Licensed Commercial Banks: 2003 – 2007 (Pula Million)

	2003	2004	2005	2006	2007
1. Interest and similar income	1 791	1 920	2 171	3 422	4 295
2. Interest expense	915	982	1 094	2 106	2 660
3. Net interest income [1 – 2]	876	937	1 077	1 316	1 635
4. Other operating income	488	547	655	752	868
5. Gross operating income/(loss) [3 + 4]	**1 364**	**1 485**	**1 732**	**2 068**	**2 503**
6. Bad and Doubtful Debts Provisions	75	51	53	90	211
(a) Specific loss provision expenses	89	92	66	105	228
(b) General loss provision	9	–23	6	0	11
(c) Releases and Recoveries of bad debts previously written off	–23	–9	–8	–3	–28
7. Operating income/(loss) net of specific loss provisions	**1 289**	**1 434**	**1 679**	**1 978**	**2 292**
8. Operating expenses	661	714	786	848	1 126
(a) Salaries and employee benefits	300	314	341	369	464
(b) Administrative expenses	0	78	22	29	0
(c) Auditing and consulting expenses	0	17	3	2	5
(d) Rental/lease expenses	22	38	17	18	36
(e) Depreciation and amortisation	38	42	10	12	44
(f) Other	300	225	394	418	577
9. Other provisions and write-offs	0	0	1	0	0
(a) Investments	0	0	1	0	0
(b) Other balance sheet items	0	0	0	0	0
(c) Off-balance sheet items	0	0	0	0	0
10. Net operating income/(loss) [7 – 8 – 9]	**628**	**721**	**892**	**1 130**	**1 166**
11. Extraordinary Gains/(Losses)	0	–2	0	0	4
(a) Gains/Losses on revaluation of assets (net)	0	0	0	0	0
(b) Translation Gains/Losses (net)	0	0	0	0	0
(c) Other Gains/Losses	0	–2	0	0	0
12. Net income/(loss) before tax [10 + 11]	**627**	**719**	**892**	**1 130**	**1 170**
13. Income tax	84	121	146	190	218
14. Net income/(loss) after tax [12 – 13]	**543**	**598**	**746**	**940**	**952**
15. Transfers from revaluation/to general provisions	0	0	0	0	0
16. Dividends declared (paid & proposed)	399	477	643	716	795
17. Retained earnings for the year [14 – 15 – 16]	144	121	104	224	157
18. Retained earnings at the beginning of the year	658	774	896	999	1 223
19. Retained earnings at the end of the year [17 + 18]	**802**	**896**	**999**	**1 223**	**1 380**

TABLE 5.3: AGGREGATE BALANCE SHEET OF STATUTORY BANKS IN BOTSWANA (PULA MILLION)

Total Assets in Local Currency	**2005**	**2006**	**2007**
1. Cash and balances with the Central Bank	12	2	2
(a) Currency	7	0	2
aa. Hard currency and gold bullion	0	0	0
ab. Local currency	7	0	2
(b) Balances with Central Bank	5	2	0
(c) Other	0	0	0
2. Trading securities at market value (BoBCs)	183	0	0
3. Placements with other banks and credit institutions	265	493	650
4. Loans and advances to other customers (net of specific provisions)	1 361	1 693	1 917
5. Investment securities	2	0	0
6. Fixed assets net of depreciation	103	113	109
7. Other assets (net)	27	28	28
Total Assets	**1 953**	**2 328**	**2 706**
Liabilities in Local Currency			
1. Amounts owed to government institutions	0	0	0
(a) Central Bank accounts	0	0	0
(b) Direct Government credits (CB or MoF)	0	0	0
(c) Other	0	0	0
2. Due to other banks and credit institutions	0	0	0
3. Securities sold under repurchase agreements	0	0	0
4. Due to other customers/depositors	367	407	517
5. Shareholders funds	1 110	1 380	1 513
6. Other liabilities	40	65	63
(a) Taxes payable	0	0	0
(b) Dividends payable	9	13	6
(c) Accrued expenses	0	0	0
(d) Other	30	52	58
7. Other borrowing including international lending agencies	436	475	613
Total Liabilities	**1 953**	**2 328**	**2 706**

Table 5.4: Aggregate Income Statement of Statutory Banks in Botswana (Pula Million)

Statutory Banks	2005	2006	2007
1. Interest and similar income	219	259	293
2. Interest expense	65	83	95
3. Net interest income [1 – 2]	153	176	198
4. Other operating income	22	30	31
5. Gross operating income/(loss) [3+4]	**176**	**206**	**229**
6. Bad and doubtful debts provisions	44	27	74
(a) Specific loss provision expenses	19	29	17
(b) General loss provision	12	–1	57
(c) Releases and recoveries of bad debts previously written off	12	0	0
7. Operating income/(loss) net of specific loss provisions	**132**	**179**	**155**
8. Operating expenses	104	104	110
(a) Salaries and employee benefits	55	50	52
(b) Administrative expenses	0	0	0
(c) Auditing and consulting expenses	0	0	0
(d) Rental/lease expenses	1	0	0
(e) Depreciation and amortisation	8	7	6
(f) Other	40	46	52
9. Other provisions and write-offs	0	0	0
(a) Investments	0	0	0
(b) Other balance sheet items	0	0	0
(c) Off-balance sheet items	0	0	0
10. Net operating income/(loss) [7 – 8 – 9]	**27**	**75**	**45**
11. Extraordinary Gains/(Losses)	0	0	5
(a) Gains/Losses on revaluation of assets (net)	0	0	0
(b) Translation Gains/Losses (net)	0	0	0
(c) Other Gains/Losses	0	0	0
12. Net income/(loss) before tax [10 + 11]	**27**	**75**	**50**
13. Income tax	0	0	0
14. Net income/(loss) after tax [12 – 13]	**27**	**75**	**50**
15. Transfers from revaluation/to general provisions	0	0	0
16. Dividends declared (paid & proposed)	0	27	33
17. Retained earnings for the year [14 – 15 – 16]	27	48	17
18. Retained earnings at the beginning of the year	0	0	0
19. Retained earnings at the end of the year [17 + 18]	**27**	**48**	**17**

TABLE 5.5: AGGREGATE CAPITAL STRUCTURE (PULA MILLION)

TIER 1	Capital elements	2006	2007
1	Ordinary Shares – Issued and paid up	131 349	147 106
2	Preference (non-redeemable) non cumulative shares	–	–
3	Surplus – Share Premium	99 449	88 417
4	General Reserves	280 765	300 117
5	Undivided Profits (audited current year retained earnings/loss)	820 321	1 049 151
6	Minority Interests	–	–
7	**Less:**	**–**	**–**
	(a) Goodwill and other intangible assets	43 341	40 843
	(b) Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation	12 933	12 933
8	**Total Tier 1 Capital (Sum of lines 1 to 6 less lines 7(a) and (b))**	**1 275 610**	**1 531 015**
TIER 2			
9	Current year's unpublished profits	70 934	171 731
10	Fifty percent of fixed asset revaluation reserves	12 305	16 717
11	Unencumbered general provisions not to exceed 1.25 percent of risk weighted assets	75 546	95 521
12	Hybrid (debt/equity) capital eligible for inclusion	–	–
13	Subordinated term debt eligible for inclusion	401 801	480 072
14	Minority interest in Tier 2 preference shares	–	–
15	Shareholders equity funded through the capitalisation of property revaluation reserves	–	–
16	**Total Tier 2 Capital (sum of lines 9 to 15)**	**560 586**	**764 041**
17	**Total Capital (sum of lines 8 and 16)**	**1 836 196**	**2 295 056**
IMPAIRMENTS			
18	Investments in unconsolidated subsidiaries and associated companies	–	701
	Total Impairments of Capital	**–**	**701**
	Total Unimpaired Capital	**1 836 196**	**2 294 355**

Appendix 6: Charts of Key Prudential and Other Financial Indicators

Chart 6.1: Aggregate Net Income After-Tax and Growth

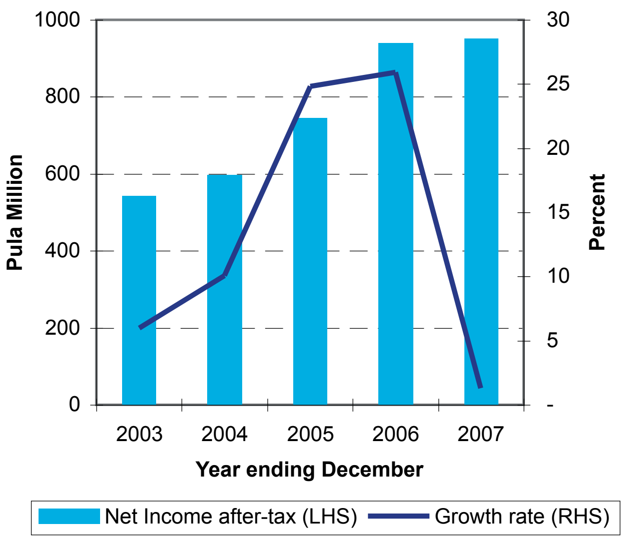


Chart 6.3: Aggregate Return on Equity

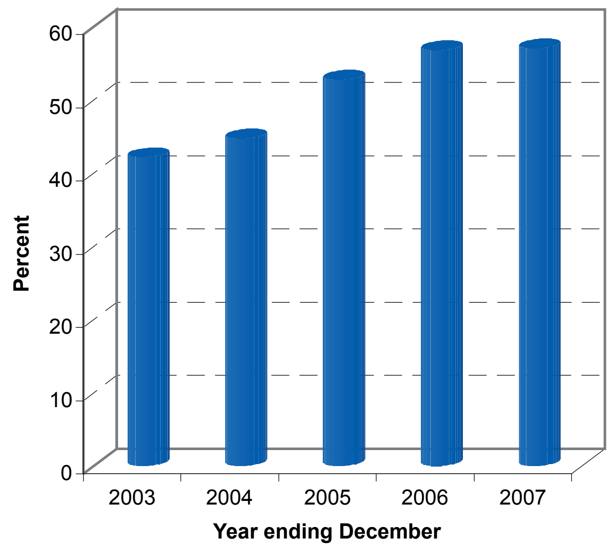


Chart 6.2: Aggregate Return on Average Total Assets

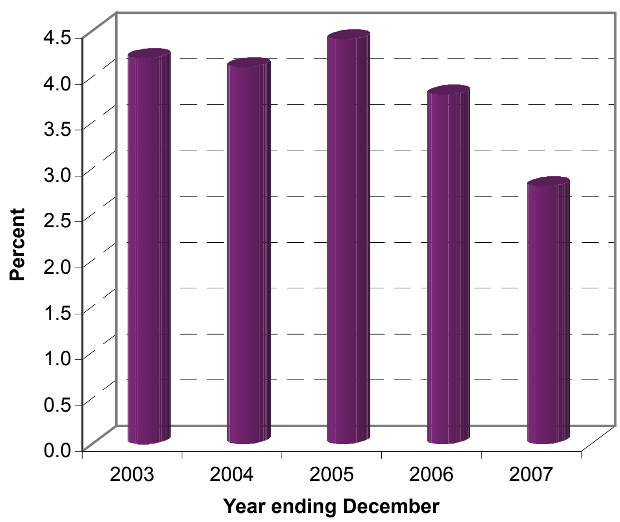


Chart 6.4: Aggregate Average Cost of Deposits

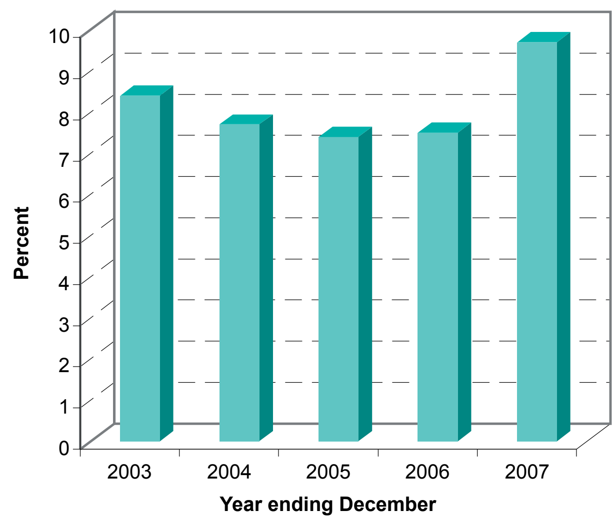


Chart 6.5: Aggregate Gross Interest Income, Non-Interest Income and Non-Interest Expense to Average Total Assets

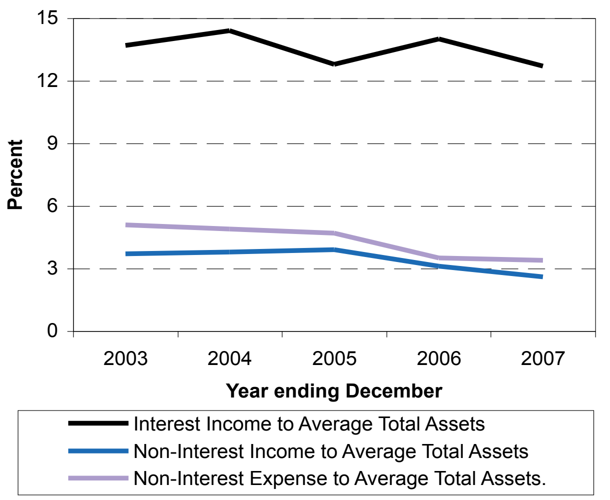


Chart 6.7: Total Provisions, Total Provisions to Total Advances and Specific Provisions to Total Provisions

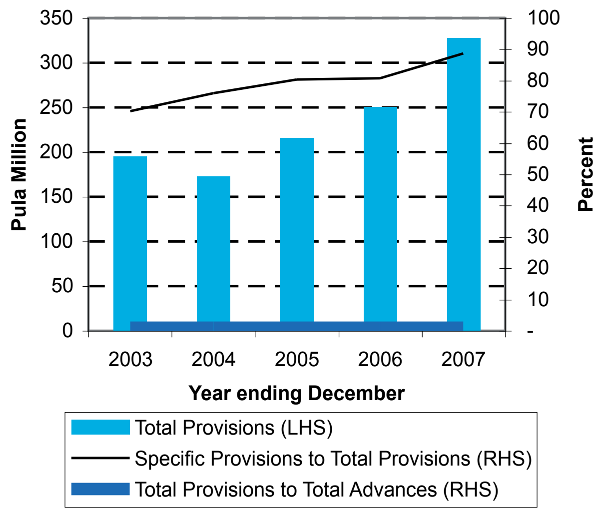


Chart 6.6: Aggregate Cost to Income Ratio

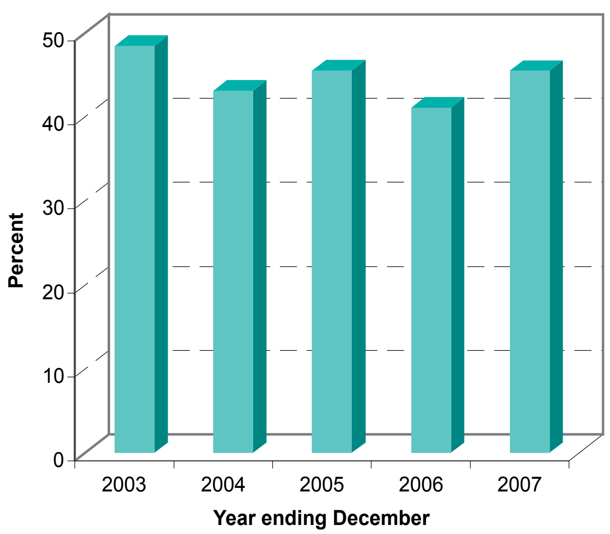


Chart 6.8: Past Due Loans to Total Capital

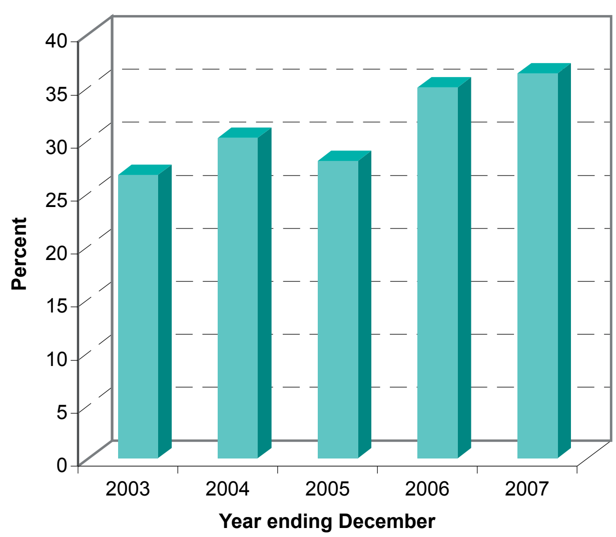


CHART 6.9: AGGREGATE DEPOSITS BY TYPE

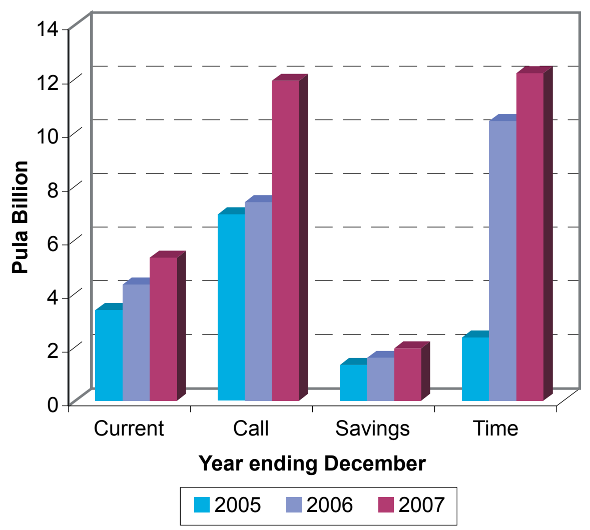


CHART 6.11: FOREIGN CURRENCY ACCOUNTS BY TYPE

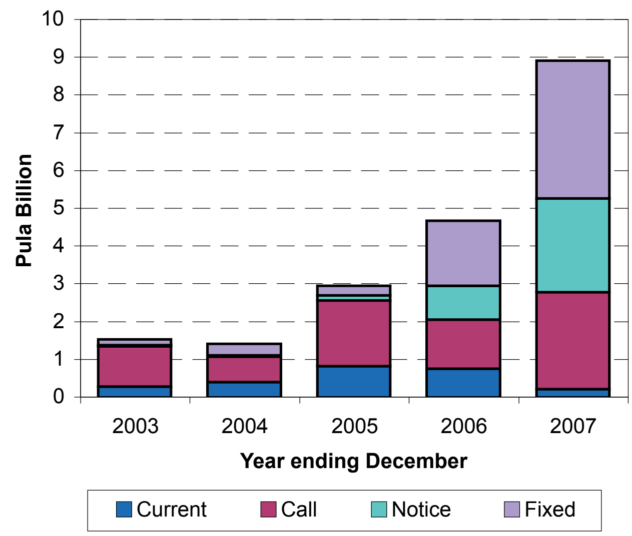


CHART 6.10: AGGREGATE ADVANCES TO DEPOSITS RATIO

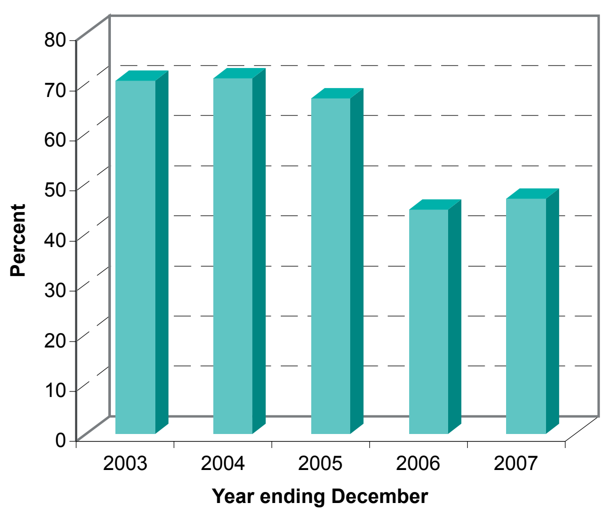


CHART 6.12: FOREIGN CURRENCY ACCOUNTS BY CURRENCY