

# **BANKING SUPERVISION**

# **ANNUAL REPORT 2008**

**BANK OF BOTSWANA**



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## LIST OF ABBREVIATIONS

AABMC	African Alliance Botswana Management Company
AAI	African Alliance International
AML	Anti-Money Laundering
ATM	Automated Teller Machine
BIS	Bank for International Settlements
BITF	Basel II Implementation Task Force
BCPs	Basel Core Principles
BoBCs	Bank of Botswana Certificates
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CFT	Combating of the Financing of Terrorism
CIUs	Collective Investment Undertakings
ESAAMLG	Eastern and Southern African Anti-Money Laundering Group
FATF	Financial Action Task Force
FCA	Foreign Currency Account
FIP	Finance and Investment Protocol
FSAP	Financial Sector Assessment Programme
FSIs	Financial Soundness Indicators
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
IFSC	International Financial Services Centre
IMF	International Monetary Fund
IT	Information Technology
MoU	Memorandum of Understanding
NBFIRA	Non-Bank Financial Institutions Regulatory Authority
PSMP	Payments System Modernisation Project
ROAA	Return on Average Assets
ROE	Return on Equity
SADC	Southern African Development Community
SIMS	Stanbic Investment Management Services
SMMEs	Small Medium and Micro Enterprises
SSBS	SADC Sub-Committee of Banking Supervisors
USD	United States Dollar
VAT	Value Added Tax
ZAR	The South African Rand



## FOREWORD

In accordance with Section 28 of the Banking Act (CAP. 46:04), Bank of Botswana (Bank) is required to submit to the Minister of Finance and Development Planning, annually by June 30, a *Report* on the business affairs of banking institutions in Botswana. The *Report* provides the basis on which this public version of the *Report* is prepared, the aim of which is to inform the public about the activities of the Bank in relation to its mandate of ensuring proper regulation and supervision of banks. The public version of the statutory report covers issues on the structure, operations and financial performance of the banking industry, as well as activities of Collective Investment Undertakings (CIUs), International Financial Services Centre (IFSC) entities and Bureaux de Change.

During 2008, Botswana's banking system remained resilient, even in the wake of the global financial crisis. Foundations of this resilience could be seen on both sides of the banks' balance sheet, as deposit liabilities continued to grow strongly, while asset growth also firmed up to exceed the 2007 performance. The favourable domestic macroeconomic climate, as characterised by strong growth in the non-mining sector, and a favourable investment climate for industry, served as major contributors to the positive banking sector balance sheet performance. Against this background, the banking sector recorded a healthy increase in profitability, thus sustaining the historically high levels of shareholder value.

Banking sector assets remained predominantly domestic, as did banking sector liabilities; only 27 percent of the latter was denominated in foreign currency. Off-balance sheet foreign currency holdings were minimal, thus reinforcing the strong domestic orientation of the banks' balance sheet. Not surprisingly, therefore, the Botswana banking sector remained relatively immune from the first-round effects of the global financial crisis. However, guarding against the inevitable second-round and additional effects of the resultant economic recession in many countries, particularly the impact of dampened commodity prices on the domestic mining sector and fiscal revenues, the banking sector's credit underwriting standards began to tighten and general credit quality outlook altered towards the end of 2008.

Asset quality developments maintained a healthy track record, as non-performing assets grew at a much slower pace than the growth of loan portfolios of most banks. This trend moderated some latent fears that the worrisome 2007 corporate liquidations (Lobtrans and African Express) could have been a signal for tighter credit quality conditions in subsequent years. The positive outcome also reaffirmed the results of active supervisory interventions during 2008, which indicated the prevalence of prudent asset underwriting and relatively robust risk management standards and practices in the banking system.

Both the quantum and quality of regulatory capital reflected a healthy banking system. Against the capital adequacy requirement of 15 percent, the banking system maintained its capital at a healthy 2 percent above the prudential norm. Despite some moderate adjustments to the banking system capital structure, as banks took on additional Tier II (supplementary) capital, core capital continued to command a dominant proportion of bank capital.

**Linah K. Mohohlo**



**GOVERNOR**



## STRUCTURE OF THE REPORT

The *Report* is structured as follows: an introductory section outlines the macroeconomic environment within which the financial sector operated. The first chapter presents the structure of the banking industry; it is 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 provide a list of 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

Despite the ongoing global financial crisis that has continued to undermine consumer and investor confidence worldwide and evoking fears of contaminating the quality of banking assets, the performance of the Botswana banking sector was generally satisfactory in 2008. The annual growth rate of credit to the corporate sector continued to increase amid higher lending rates and increased fuel prices that strained corporate budgets. There was a slight deceleration in the annual growth rate of household credit which maybe attributable to the decrease in the propensity to borrow by a number of people in formal employment. Notwithstanding, the proportion of household credit to total lending by banks at 55 percent or 12 percent of Gross Domestic Product (GDP) is worrisome and requires close monitoring.

The aggregate banking sector balance sheet maintained the same growth rate of 22 percent during 2008 as in the previous year, with both industry deposits and loans and advances growing faster than the year before. The banking industry total assets amounted to P45 billion in 2008 compared to P37 billion in 2007. Notwithstanding the poor output performance of the mining and quarrying sector in the wake of depressed commodity prices worldwide, the sector's contribution to corporate credit demand rose significantly in 2008. Meanwhile, the non-mining sector continued to dominate corporate credit lending. There were also improvements in the asset quality of banks relative to the previous year and banks continued to maintain adequate provisioning for non-performing loans.

The proportion of household deposits to total deposits improved slightly from 18 percent to 22 percent, while corporate deposits continued to provide the major funding source for banks' operations. Businesses continued to be net depositors while households were net borrowers. With the ongoing global financial crisis that has started to impact negatively on government fiscal balances<sup>1</sup>, banks could in future be faced with funding problems and increased credit risk as the crisis could possibly

spill over to other sectors of the economy. The banking industry continued to be profitable and well capitalised and complied with minimum capital requirements. All banks observed prudential guidelines and stayed within the 800 percent threshold ratio of aggregate large exposures to unimpaired capital. The banking industry continued to maintain a healthy liquidity position with liquidity ratios significantly in excess of the 10 percent minimum statutory requirement.

Overall, the banking sector remained resilient, sound and stable. This, however, does not mean that the economy is immune from the effects of the potentially prolonged global financial turmoil. As the regulator and, in cooperation with banks and other stakeholders, the Bank will continue to be vigilant and, where necessary, take appropriate measures to ensure that banks make adequate provisions for any possible stressful occurrence.

### MACROECONOMIC ENVIRONMENT

In spite of the decline in mining sector output (which contracted by 3.5 percent in 2008 compared to an increase of 4.7 percent in 2007), rising international crude oil prices and energy supply disruptions, the economy demonstrated resilience and recorded a positive growth rate during 2008. Real GDP registered a slower growth rate of 3.3 percent in 2008 compared to the revised growth rate of 5.3 percent in 2007. Despite the reduced growth rate of real GDP, the banking sector recorded an increase in demand for credit. Household lending grew by 22 percent in 2008, which was slower than the 30 percent recorded in 2007. Positive growth in domestic credit was recorded across all sectors of the economy and was mainly driven by the continued increase in real domestic expenditure.

### MONETARY CONDITIONS

Inflation maintained an upward trend for the most part of the year, declining only towards the end of the year. On account of high inflation rates, monetary policy tightened in mid-year and eased towards the end of the year in line with the improved inflation outlook. In December 2008, the Bank Rate was reduced (after two successive increases in May and June) from 15.5 per-

<sup>1</sup> Poor performance of the mineral sector, in particular the decline in diamond sales, accompanied by a sharp decline in commodity prices of other minerals like copper and nickel have adversely affected government revenues. Other sources of government revenue like taxes are also likely to be affected once the crisis spills over to other sectors of the economy.

cent to 15 percent, followed by a corresponding reduction in banks' lending interest rates.

Excess liquidity continued to be a factor in the banking system and the Bank used monetary operations by conducting BoBC auctions in mopping it up. Furthermore, a combination of the appreciation of the real effective exchange rate and tight monetary policy that prevailed during the year led to tight monetary conditions.

# CHAPTER 1: INDUSTRY STRUCTURE

## 1. STRUCTURE OF THE FINANCIAL INDUSTRY

Botswana's financial industry has structurally remained the same during 2008. Regulated entities falling under the mandate of the Bank included commercial banks (8),<sup>2</sup> an investment/merchant bank, International Financial Services Centre (IFSC) companies (22), bureaux de change (51), Collective Investment Undertakings (CIUs) (4), and a micro-finance institution. The Bank continued to provide agency role supervisory activities for development finance institutions (3). The regulatory framework for financial institutions that are not regulated and supervised by the Bank, firmed up as the newly established Non-Bank Financial Institutions Regulatory Authority (NBFIRA) began to consolidate its business operations and adopt an active supervisory profile. Institutions regulated by NBFIRA included insurance companies, asset management institutions, medical aid societies, stock broking companies, a stock exchange, money transfer institutions and money lenders.

## 2. BANKING BUSINESS NETWORKS FOR LICENSED INSTITUTIONS

Positive developments were evident in market outreach, as banks expanded their operations during 2008 to areas where they were previously unrepresented. The branch network of the banking industry expanded with the commencement of business by Capital Bank Limited (Capital Bank) and the opening of five branches by four of the existing banks (Table 1). This brought the total number of branches and sub-branches to 87. The licensing of Capital Bank raised the number of banks to 9 by year end. The establishment of 12 sales centres by Barclays Bank during 2008 offset the decline in the number of agencies from 8 in 2007 to 5 in 2008.

As banks reacted to market developments during the review period by closing services which were deemed unprofitable, the network of automated teller machines (ATMs) and mini-ATMs shrunk by 29, thus resulting in 360 operational terminals in 2008. This was due to the reduction in the number of mini-ATMs which, in turn, was partially offset by an increase in the number of newly installed ATMs. The latter are a more flexible and convenient facility compared to mini-ATMs.

**TABLE 1: LICENSED BANKS' REPRESENTATION: 2007–2008**

Bank	Branches and Sub-Branches		Agencies		Sales Centres		Encashment Points		ATMs	
	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
Barclays	40	40	2	2	0	12	1	0	87	100
Stanchart	11	13	6	3	0	0	0	0	34	42
FNBB	16	17	0	0	0	0	0	0	177*	164**
Stanbic	9	9	0	0	0	0	0	0	14	16
Baroda	2	2	0	0	0	0	0	0	0	0
ABCB	2	2	0	0	0	0	0	0	0	0
Bank Gaborone	1	2	0	0	0	0	0	0	77	38
Capital Kingdom	–	1	–	0	–	0	–	0	–	0
Kingdom	1	1	–	–	–	–	–	–	–	–
<b>Total</b>	<b>82</b>	<b>87</b>	<b>8</b>	<b>5</b>	<b>0</b>	<b>12</b>	<b>1</b>	<b>0</b>	<b>389</b>	<b>360</b>

Notes:

\* Comprises 67 ATMs and 110 mini-ATMs

\*\* Comprises 83 ATMs and 81 mini-ATMs

‘–’ Means not applicable

<sup>2</sup> Including an offshore bank. Data for the offshore bank is not included in the industry data analysed in the Report.

TABLE 2: STAFFING LEVELS FOR LICENSED BANKS: 2007–2008

Bank	2007			2008		
	Citizens	Expatriates	Total	Citizens	Expatriates	Total
Barclays	854	19	873	1 434	14	1 448
Stanchart	654	9	663	643	11	654
FNBB	854	19	873	948	16	964
Stanbic	446	12	458	456	15	471
Baroda	18	7	25	21	8	29
ABCB	36	7	43	63	6	69
Bank Gaborone	73	5	78	147	6	153
Capital	–	–	–	45	4	49
<b>Total</b>	<b>2 935</b>	<b>78</b>	<b>3 013</b>	<b>3 757</b>	<b>80</b>	<b>3 837</b>

### 3. EMPLOYMENT

A 27 percent growth in employment was recorded by the banking industry, and this resulted in a staff complement of 3 837, compared to 3 013 in 2007 (Table 2). This outcome is largely influenced by the 66 percent rise in the staff complement of Barclays Bank; all other banks posted marginal staff increases, with the exception of Standard Chartered Bank of Botswana Limited (Stanchart) which showed a small reduction. The official staffing statistics do not include Direct Sales Agents (DSAs), who are treated as temporary staff. If the DSAs were to be included, the total staff complement would be 4 197.

### 4. MARKET SHARE

Despite improvements in financial and operational aspects of statutory banks over the years, they remain fairly small as a group relative to the size of the bank-

ing industry when measured in terms of assets, deposits and advances. As Chart 1(a) shows, statutory banks accounted for less than 10 percent of industry assets, deposits and advances, except in 2007 when the proportion of advances was slightly above 10 percent.

Consistent with past trends, the enhancement of competition through the entry of more banks in the market has not as yet stimulated market correction and significantly influenced the share of business. Thus the four major banks continue to dominate the private banks market share of total assets, deposits and advances as in previous years (Chart 1 (b)).

CHART 1 (A): BANKING INDUSTRY MARKET SHARE OF TOTAL ASSETS, TOTAL DEPOSITS AND TOTAL ADVANCES

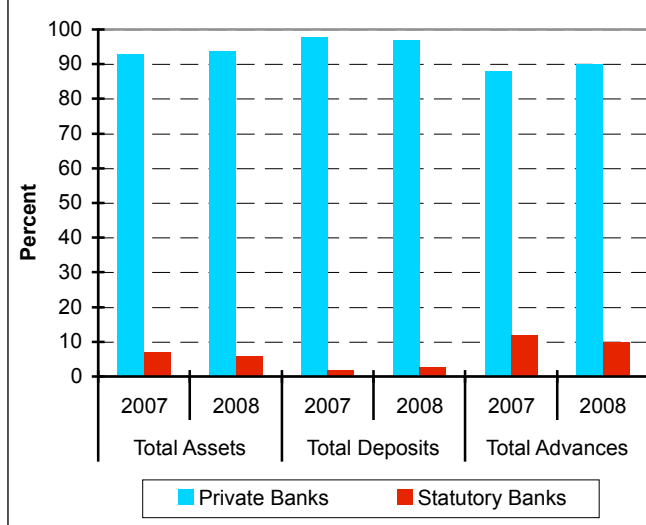
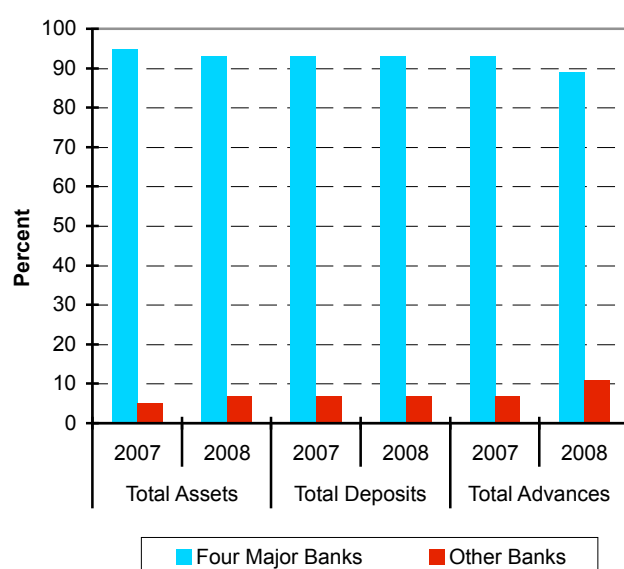


CHART 1 (B): PRIVATE BANKS MARKET SHARE OF TOTAL ASSETS, TOTAL DEPOSITS AND TOTAL ADVANCES



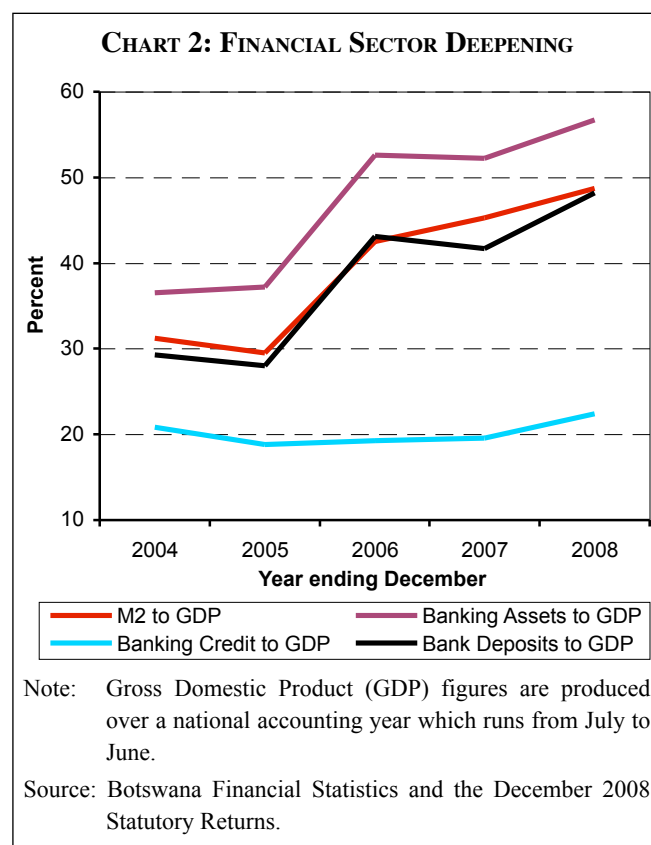
Note: The four major banks are Barclays, Stanchart, FNBB and Stanbic and other banks are Baroda, ABCB, Bank Gaborone and Capital.

## 5. FINANCIAL DEEPENING

Financial deepening has traditionally been measured by the ratios of money supply (M2)<sup>3</sup> to GDP and Cash<sup>4</sup> to M2. The M2/GDP ratio is a measure of the money supply relative to the size of the economy, with a higher ratio indicating greater financial sector depth. The lower the cash/M2 ratio, which is a measure of liquidity preference, the more the public is willing to hold onto money in the form of bank deposits, which itself reflects a level of confidence in the banking system. In an attempt to mitigate the shortcomings of these measures and broaden the understanding of the drivers of financial system development, newer indicators that measure access to, efficiency and stability of, the financial system have been added to the analytical toolbox.

The M2/GDP ratio increased from 31 percent to 49 percent between 2004 and 2008, while the cash/M2 ratio fell from 32 percent to 19 percent over the same period. Both measures suggest that there has been considerable financial deepening and the confidence in the financial system has been increasing. This is also reflected by the growth rate of household savings by 58 percent in 2008 compared to 11 percent in 2007. Similarly, banking assets, banking deposits, and banking credit to GDP ratios have all trended upward suggesting a developing financial system (Chart 2).

As previously observed, the Botswana banking sector has grown remarkably in size between 2004 and 2008 with the number of banks increasing from 7 to 9, bank branches increasing from 72 to 87 and bureaux de change increasing from 49 to 51, thereby broadening accessibility of financial services to most segments of society. As already indicated above, one exceptional characteristic of the banking sector's outreach during 2008 was the fact that banks established a presence in areas that they previously avoided. Further indications of financial deepening have also been evidenced by the expansion efforts of other financial entities, notable among which are the Botswana Savings Bank through its linkage with the Botswana Postal Services, and the mushrooming of micro-lending entities countrywide.



The ratio of Private Sector Credit (PSC) to GDP, which is commonly used as an indicator of banking sector development and a proxy for access to finance at a macro level, also increased from 7.9 percent in 2007 to 9.6 percent in 2008, thus signifying an improvement in financial sector development.

<sup>3</sup> M2 comprises all the liabilities of the financial corporations that are included in the country's definition of broad money. In the Botswana case, M2 comprises the following: currency outside depository corporations, transferable deposits (demand deposits) and other deposits included in broad money (time and fixed deposits).

<sup>4</sup> Cash = M1



## CHAPTER 2: STATUTORY COMPLIANCE AND OPERATIONAL PERFORMANCE OF THE BANKING SECTOR

### STATUTORY COMPLIANCE

#### 1. ON-SITE EXAMINATIONS

The Bank carried out limited scope on-site examinations of two banks. The examinations focused on asset quality and operational risk, particularly areas relating to board and senior management oversight, loan application procedures at branches, anti-money laundering and combating the financing of terrorism (AML/CFT) and information technology (IT) policies and procedures. The on-site examinations also covered the review of treasury operations at the branches of the concerned banks countrywide.

Examinations revealed that banks had adequate operational risk control measures in place while ensuring adherence to prudential regulatory requirements. Particular attention was paid to loan underwriting standards and broad asset quality management practices on an ongoing basis. While some observed asset quality management lapses fell within acceptable tolerance levels, one bank was encouraged to adopt more conservative provisioning policies to prevent the possible adverse impact of rapid asset deterioration on its profitability. Some compliance problems relating to AML/CFT were observed, notably the failure of the bank to file suspicious transactions reports with the Directorate on Corruption and Economic Crime (DCEC), a problem that was caused by the inadequate training of staff on AML/CFT issues.

#### 2. CONSULTATIVE AND PRUDENTIAL MEETINGS WITH BANKS AND EXTERNAL AUDITORS

The Bank held bilateral and trilateral meetings with supervised financial institutions and their respective external auditors in accordance with Sections 22(8) and 22(9) of the Banking Act during 2008. The focus of the meetings was to review the annual draft financial statements, strategic plans, risk management strategies and other prudential matters. These meetings facilitate broad-based exchange of ideas, among which are an appraisal of macroeconomic and business conditions as they unfold during any year. The Bank urged financial

institutions to be more prudent in diversifying the asset side of their respective balance sheets. Among others, banks were also requested to develop a domestic corporate base through actively supporting Small, Medium and Micro Enterprises (SMMEs), given that some of them could grow into big business entities.

The two Banking Committee meetings held during the year addressed, among others, progress made on implementation of the Payments System Modernisation Project and the revised International Convergence of Capital Measurement and Capital Standards (Basel II), as well as the planned introduction of a closed credit reference bureau for banks.

#### 3. CORPORATE GOVERNANCE ISSUES (RISK MANAGEMENT, AUDIT AND BOARD)

Recent developments in corporate governance have renewed attention to the important role of directors and senior management in shaping the governance climate of institutions, hence influencing future profitability and viability. Accordingly, the Bank has scaled up its off-site surveillance practices by conducting regular reviews of banks' management letters issued by external auditors, as well as internal audit reports. Through such reviews, timely identification of impending governance problems have taken place, with appropriate interventions being made. In general, however, the banks' senior management and boards exercised a reasonable degree of care, diligence and skill in the running of banks as reaffirmed by the satisfactory performance of banks during 2008, including exercising the desired level of responsiveness to regulatory interventions.

In a bid to ensure adherence to good corporate governance principles and robust risk management practices, the Bank, in consultation with market participants, issued regulatory guidelines on "*Transactions with Related Persons of a Bank*" and the "*Appointment of New Directors and Senior Management Officials of Banks*". Further guidelines on "*Large Exposures*" and "*Banks' Audit Committee, Annual Independent Audit, and Publication of Audited Financial Statements*" were

issued to the market for comment and will be finalised during 2009.

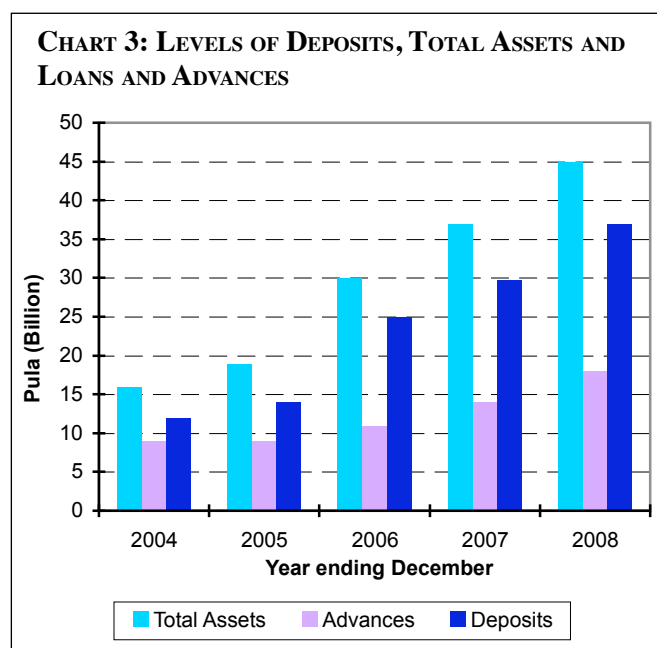
## OPERATIONAL PERFORMANCE

### 4. BALANCE SHEET STRUCTURE OF THE BANKING INDUSTRY AS AT DECEMBER 31, 2008

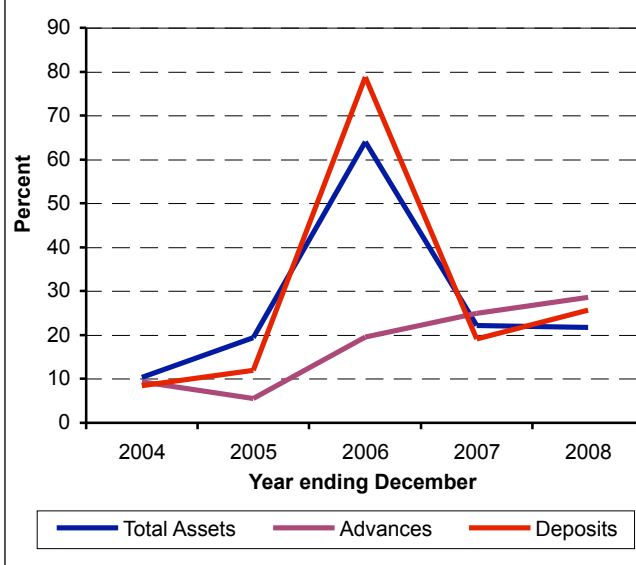
Underpinned by the strong macroeconomic fundamentals, growth in the banking industry balance sheet matched the 2007 rate of 22 percent to reach P45 billion at the end of 2008. The growth was broad-based as all income earning asset components registered positive growth and all but one bank contributed significantly to the strong balance sheet outcome. Among the asset components, total loans and other forms of credit, which constituted 39 percent of industry assets, experienced an increase in the growth rate from 22 percent to 29 percent. An increase of 26 percent in deposit liabilities helped fund the credit expansion (against 19 percent recorded in 2007). Smaller banks contributed substantially to the increase in the quantum of lending, albeit from a smaller base.

The level of aggregate deposits, assets and advances and respective annual growth rates are indicated in Charts 3 and 4 below.

The sharp rise in the value of deposits added to the banks' surplus funds given that, as a group, the banks continued to utilise less than half the deposit balances

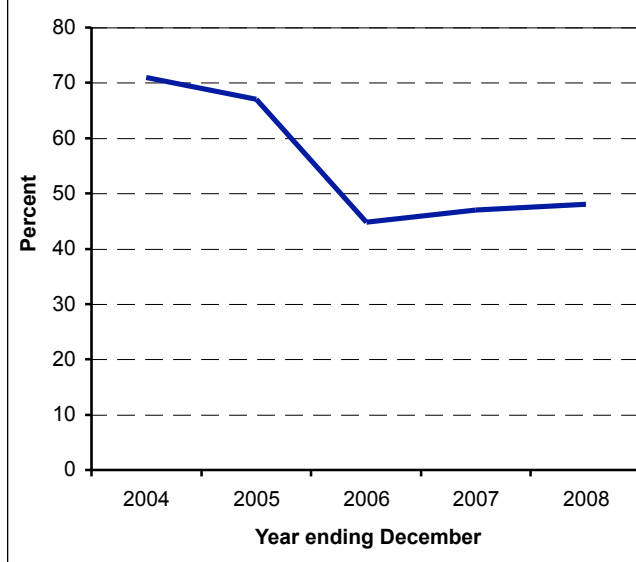


**CHART 4: GROWTH RATES OF DEPOSITS, TOTAL ASSETS AND LOANS AND ADVANCES**



for lending purposes. Consequently, the aggregate loan to deposit (intermediation) ratio increased slightly to 47 percent in 2008 from 46 percent in 2007 (Chart 5). There were variations, however, in the extent of intermediation among the banks: some of them intermediated far less than they did in the previous year, while three others improved their intermediation ratios, with one raising it to almost 80 percent.

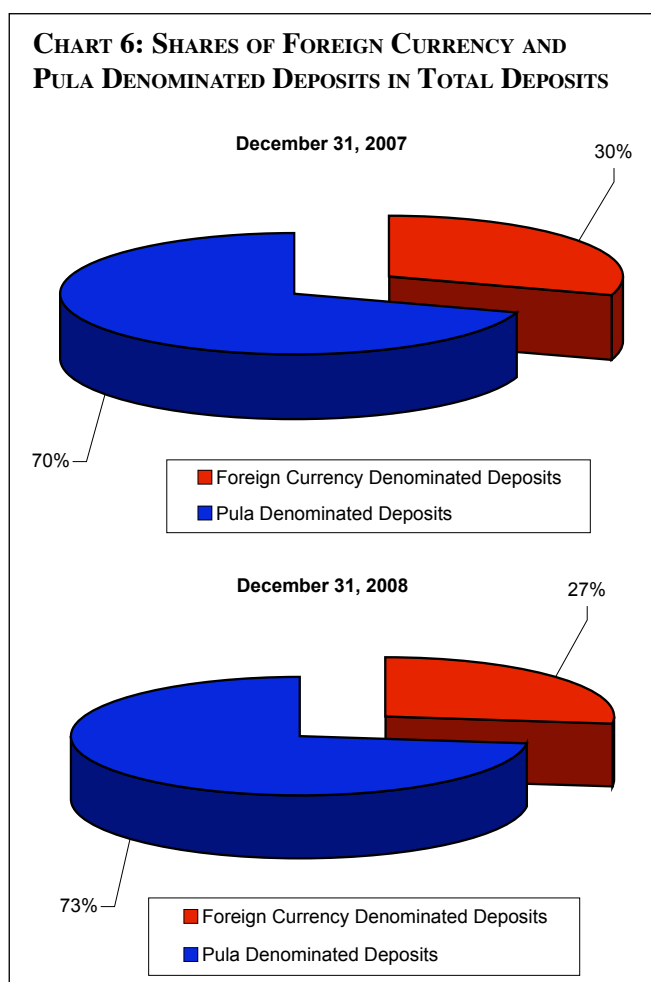
**CHART 5: INDUSTRY ADVANCES TO DEPOSIT RATIO (FINANCIAL INTERMEDIATION)**



Deposit liabilities constituted 83 percent of total liabilities in 2008 compared to 80 percent in 2007. Despite the growth in total capital of 35 percent during 2008, compared to 25 percent in 2007, capital constituted only 7 percent of the funding base for the banking industry.

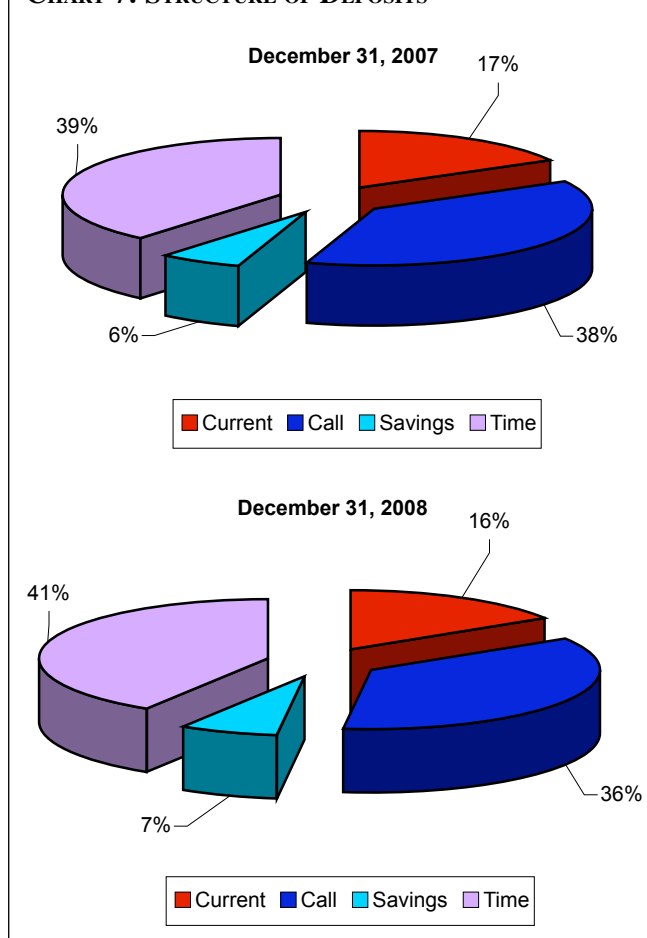
The value of outstanding BoBCs continued to exhibit an upward trend (Chart 14), albeit at a reduced growth rate of 4 percent in 2008. Consequently, the share of BoBCs in banking industry assets dropped from 40 percent in 2007 to 35 percent.

Out of the P37 billion worth of deposits, 73 percent were Pula denominated and 27 percent foreign currency denominated, thus indicating a slight shift away from foreign currency denominated deposits which, in 2007, accounted for 30 percent of total deposits (Chart 6). This was much more the result of a drastic reduction in the growth rate of Foreign Currency Deposit Accounts, from 91 percent in 2007 to 15 percent in 2008; the Pula denominated deposits rose by 26 percent in 2008 compared to 17 percent in 2007.



The deposit maturity structure indicates a predominance of short-term deposits. Considering shorter-dated deposits as a group, including *savings* accounts which in practice are operated as transactional accounts, the deposit portfolio remains predominantly short-term, with shorter-dated deposits accounting for 60 percent of total deposits.

**CHART 7: STRUCTURE OF DEPOSITS**

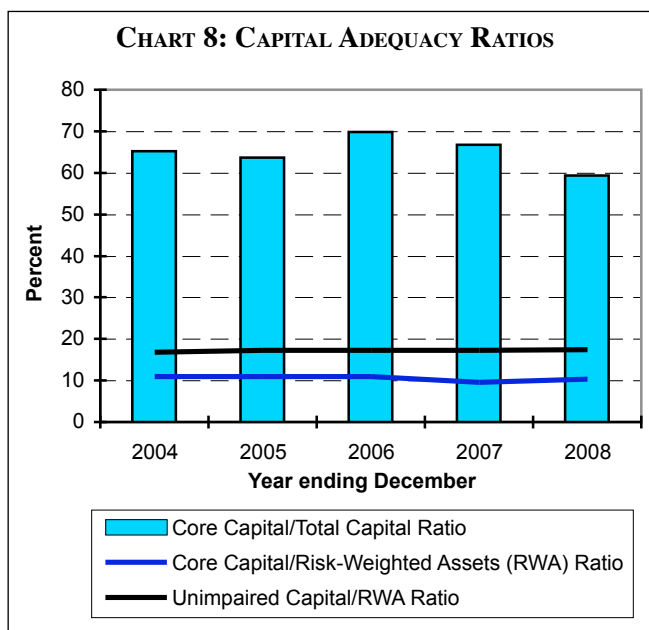


## 5. CAPITAL ADEQUACY (SOLVENCY): LEVELS, QUALITY AND TRENDS

The industry capital adequacy ratio (CAR), which is a measure of Unimpaired Capital to Risk-Weighted Assets, demonstrated the ability of regulated financial institutions to absorb shocks during difficult times, given that it exceeded both the statutory 8 percent floor and the prescribed prudential standard of 15 percent throughout the year. In the year to December 2008, the banking industry aggregate capital adequacy ratio was 17 percent (Chart 8). In addition to satisfying the 4 percent statutory minimum requirement, the quality of banks' capital, as measured by the Core Capital to Risk-Weighted Assets ratio remained strong, albeit slightly decreasing from 11 percent in 2007 to 10 percent in 2008.

The banks showed a growing tendency to utilise Tier II instruments (supplementary capital such as long term debt and bonds) as a funding option for balance sheet activity as shown by the continued decline in the structure and share of the industry's Core Capital to Total Capital over the three-year period, 2006–2008. Tier II

CHART 8: CAPITAL ADEQUACY RATIOS



capital grew rapidly by 65 percent in 2008 compared to an increase of 36 percent in 2007. Appendix 5 (Table 5.5) shows the capital structure of the banking industry for 2006–2008.

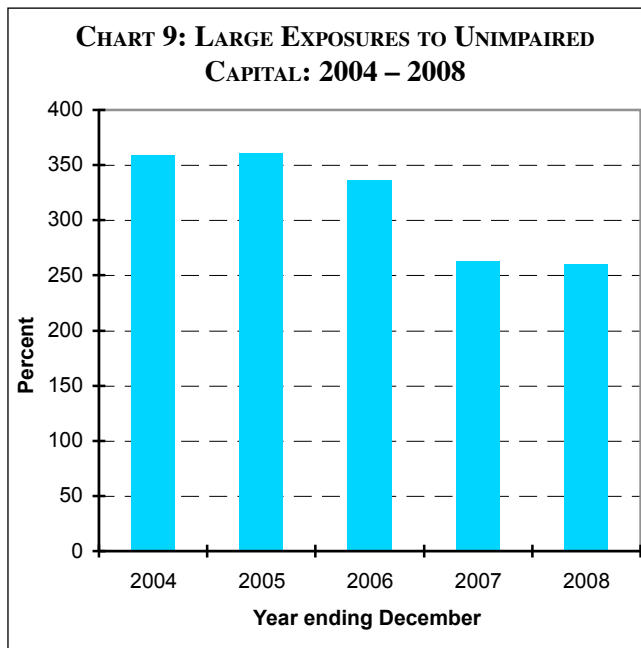
The likelihood of the banks carrying high concentration levels in Botswana is influenced by a combination of two factors, namely, a low density corporate sector and the high value nature of corporate transactions. Asset concentration has not been an issue of concern at the industry level as all banks have operated within the required regulatory asset concentration limits. The industry's ratio of Large Exposures to Unimpaired Capital (where large exposures are those that are more than 10 percent of unimpaired capital) remained below the 800 percent prudential threshold for banks in Botswana. The ratio declined slightly from 263 percent in 2007 to 260 percent in 2008 (Chart 9).

## 6. ASSET QUALITY: LEVELS AND TRENDS

Credit growth increased to 29 percent in 2008 compared to 22 percent in 2007, however, the growth rate of non-performing loans declined to 20 percent, in comparison to a growth of 30 percent in 2007. In absolute value terms, past due loans amounted to P1 billion in 2008, up from P834 million in 2007.

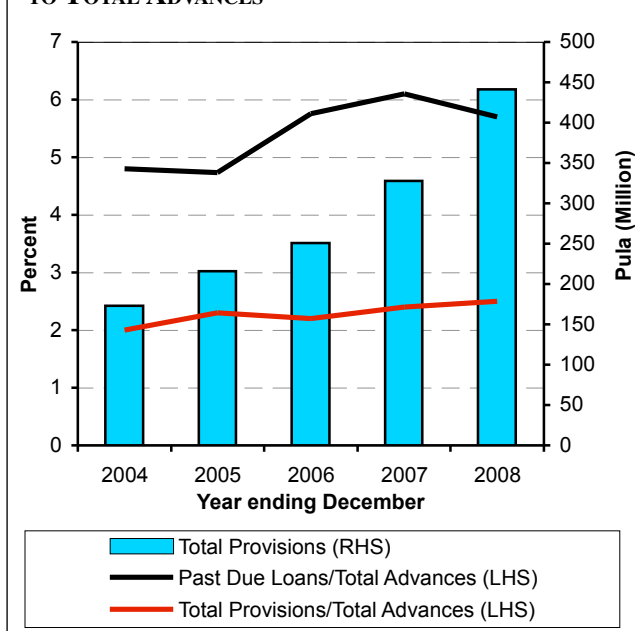
The marginal deterioration in asset quality observed at two banks did not affect the industry asset quality ratio for 2008, as reflected in the unchanged proportion of Past Due Loans to Total Advances of 6 percent (Chart 10). The adverse movement of the two banks' asset quality was deemed to be a transient challenge as the

CHART 9: LARGE EXPOSURES TO UNIMPAIRED CAPITAL: 2004 – 2008



historical series for the banks did not suggest the presence of major underlying asset quality problems. The banks raised adequate provisions for emerging non-performing loans, hence the aggregate value of provisions rose by 34 percent (against 31 percent in 2007).

CHART 10: INDUSTRY TOTAL PROVISIONS, PAST DUE LOANS TO TOTAL ADVANCES AND TOTAL PROVISIONS TO TOTAL ADVANCES

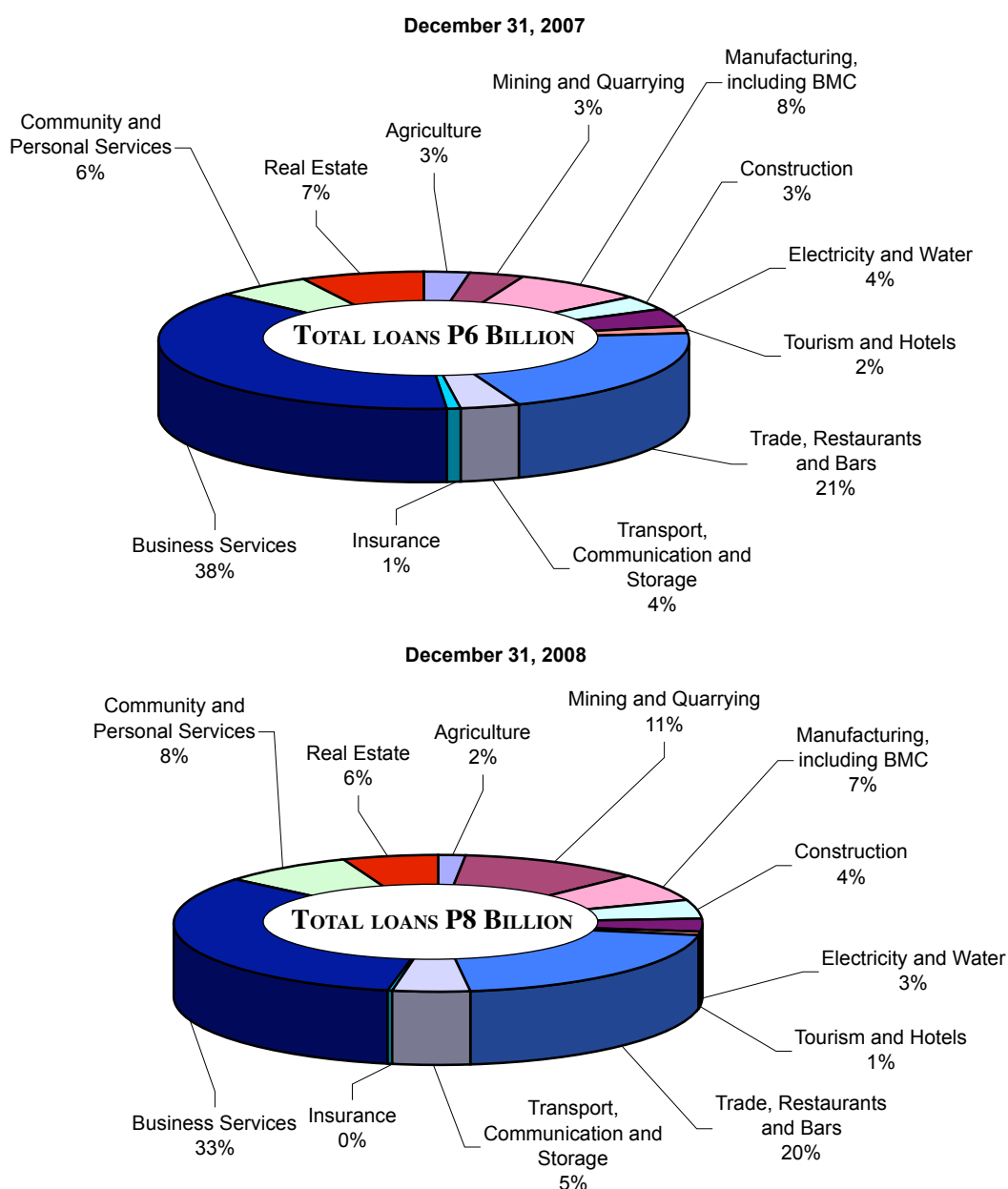


The proportion of total loans extended to the retail sector was 55 percent in 2008, a drop from 58 percent in 2007. Consequently, the share of business in total loans increased to 45 percent from 42 percent over the same period. The lower share of household loans to total loans is reflective of a significantly slower growth of credit to households of 21 percent in 2008 against 31 percent in 2007.

Household borrowing may have been constrained by the increasing cost of credit due to the tight monetary policy stance during 2008, as well as possible deferral of borrowing decisions in the face of a higher cost of living. Considering future prospects of lending patterns, the concentration of credit in the household sector may be a cause for concern, especially if viewed in the context of the impact of the ongoing global financial crisis. With the weakening local labour market as companies right-size and/or reduce pay in response to changing macroeconomic conditions, the loan servicing capacity of households may be severely compromised and the risk of default heightened.

Asset diversification is critical to banking institutions as it helps spread risks across the various economic sectors, thus mitigating the probability of a default in one particular sector having a systemic effect on a banking institution or the banking sector as a whole. Loans to corporates were well distributed across economic sectors (Chart 11). Although the *business services sector*<sup>5</sup> was the single largest borrower, as this was the case in 2007, its share declined from 38 percent in 2007 to 33 percent in 2008. *Mining and quarrying* was the main beneficiary of the compositional changes, as its share rose from 3 percent in 2007 to 11 percent in 2008. The growing interest in mineral prospecting and explora-

**CHART 11: DISTRIBUTION OF BUSINESS SECTOR LOANS: 2007-2008**



<sup>5</sup> Business services include legal, advisory, accounting, auditing, data processing, consulting, engineering, surveying, advertising, renting and leasing of machinery and equipment and services.

**Box 1: ASSET QUALITY OF THE BANKING INDUSTRY**

The Botswana commercial banks' asset quality condition as measured by Past Due Loans to Total Advances, improved in 2008 and averaged 4.96 percent relative to 8.03 percent and 8.58 percent in 2006 and 2007, respectively. Yet another measure of asset quality, i.e., impairments to total advances, confirmed the banks' strong asset quality position falling from 2.54 percent in 2007 to 2.25 percent in 2008. This was mainly a result of the tightening of risk management practices at the banks following problems experienced with some large corporate bodies in 2007 such as Lobtrans (a haulage company) and against the backdrop of deteriorating economic conditions. While there are variations among the banks regarding exposures to any single obligor, the industry average shows a rather steady performance with a mean of 264.82 percent (2006), 218.25 percent (2007) and 252.37 percent (2008) in Total Concentration to Unimpaired Capital ratios.

The banking sector credit extension has historically been heavily biased towards the "Trade, Restaurants & Bars" and "Business Services" sectors in absolute value and percentage terms, a trend that continued into 2008 with the former occupying 20 percent while the latter comprised 33 percent of the business sector loans and advances' portfolio. This was nevertheless a decline from the 21 percent and 38 percent for the respective sectors in 2007. A combination of factors including the legislative changes in 2008 that affected the alcoholic beverage industry could possibly account for these results particularly the Trade, Restaurants and Bars sector. Evidently, credit extension to the Mining and Quarrying sector increased in 2008, comprising 11 percent of the business sector loan portfolio relative to 3 percent in 2007. This is attributable to advances extended for new mining operations. Prolonged global economic and financial crisis will likely negatively affect the asset quality condition of the Botswana banks which have thus far been spared its deleterious effects.

tion, which has led to new mining projects coming on stream, as well as the activity around the diamond hub, partially explain the growth in mining-related loans. The second largest borrower, *trade, restaurants and bars*, shed a fraction of its share in total loans despite significant growth in credit granted. As a proportion of total lending, borrowing by other sectors changed marginally compared to a year earlier.

## **7. LIQUIDITY AND HOLDINGS OF BANK OF BOTSWANA CERTIFICATES**

As part of liquidity risk management, the banks need to diversify their funding to avoid vulnerability associated with concentration of funding from a single source. In aggregate, there is a high concentration of funding sources for banks in Botswana. The bulk (83 percent) of the funding comes from deposit liabilities, followed by a distant six percent and five percent for 'other liabilities' and share capital, respectively (Table 3). Other funding sources account for two percent or less of total

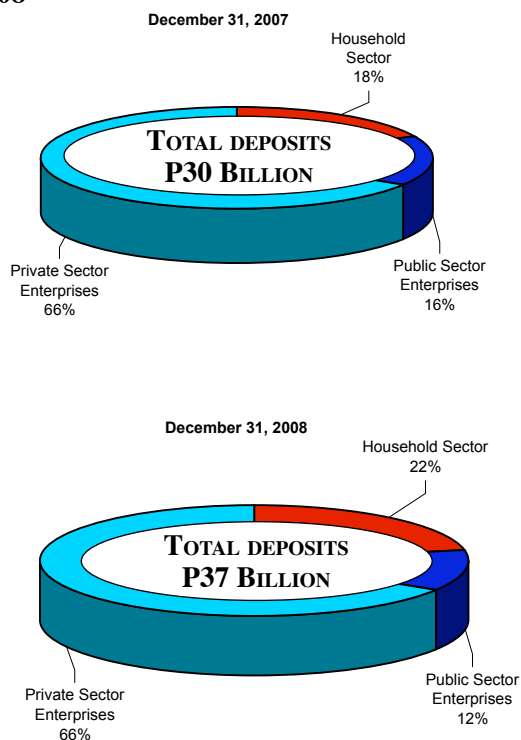
liabilities. However, within the category of deposit liabilities, there is a degree of diversification; 66 percent of the deposits originate from private sector enterprises, 22 percent from households and 12 percent from public sector enterprises (Chart 12). Although the balance between the three could be improved even at this level of diversification, the concentration risk has been mitigated to a certain extent. In particular and consistent with expectations, most of the funding is mobilised from the private sector, notably institutional investors such as pension funds.

As shown in Chart 13, the industry Liquid Assets to Total Deposits ratio fell from 59 percent in 2007 to 51 percent in 2008. This was largely due to a rapid increase in total deposits. The banking sector continued to experience a high level of liquidity, even as the global negative sentiment hit hard on confidence and economic fundamentals. With the liquidity ratio in excess of the required minimum of 10 percent, the banks continued to have sufficient funds to finance bankable projects and

TABLE 3: BANKING INDUSTRY FUNDING TRENDS (PULA MILLION)

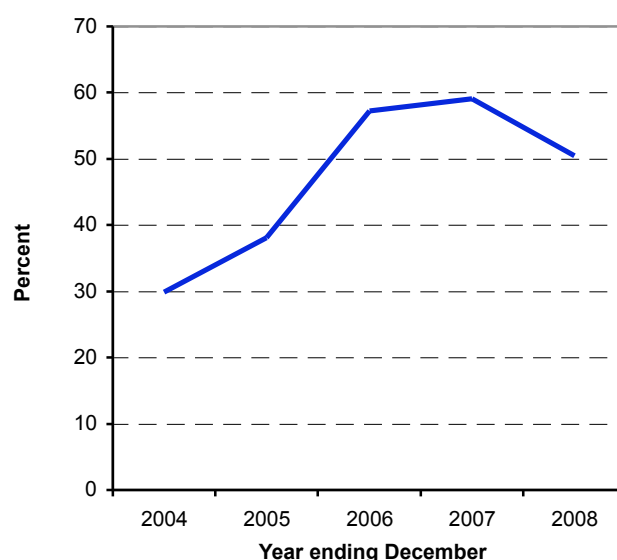
Category	2004	2005	2006	2007	2008
Deposits	12 559	14 009	24 943	29 695	37 329
Growth Rate (%)	9	12	78	19	26
Share of Total Funding (%)	81	76	82	80	83
Other Liabilities	856	1 550	2 112	2 882	2 879
Growth Rate (%)	9	81	36	36	(0.1)
Share of Total Funding (%)	6	8	7	8	6
Share Capital	1 274	1 412	1 654	1 883	2 420
Growth Rate (%)	(11)	11	17	14	27
Share of Total Funding (%)	8	8	5	5	5
Owed to Govt. Inst	104	105	50	100	0
Growth Rate (%)	(5)	1	(52)	100	(100)
Share of Total Funding (%)	1	1	0	0	0
Due to other Banks	410	1 467	1 654	1 224	1 058
Growth Rate (%)	61	258	13	(26)	3
Share of Total Funding (%)	3	8	5	3	2
Other Borrowings	317	0	0	1 544	1 565
Growth Rate (%)	(100)	0	0	100	1 720
Share of Total Funding (%)	2	0	0	4	4
<b>Total Funding</b>	<b>15 520</b>	<b>18 543</b>	<b>30 413</b>	<b>37 328</b>	<b>45 251</b>

CHART 12: SECTORAL DEPOSIT STRUCTURE: 2007–2008



Note: Deposits of Private Sector Enterprises for 2007 consist of those from resident businesses (92 percent) and non-bank financial institutions (8 percent); and for 2008 consist of deposits from resident businesses (91 percent) and non-bank financial institutions (9 percent).

CHART 13: INDUSTRY LIQUID ASSETS TO DEPOSITS RATIO

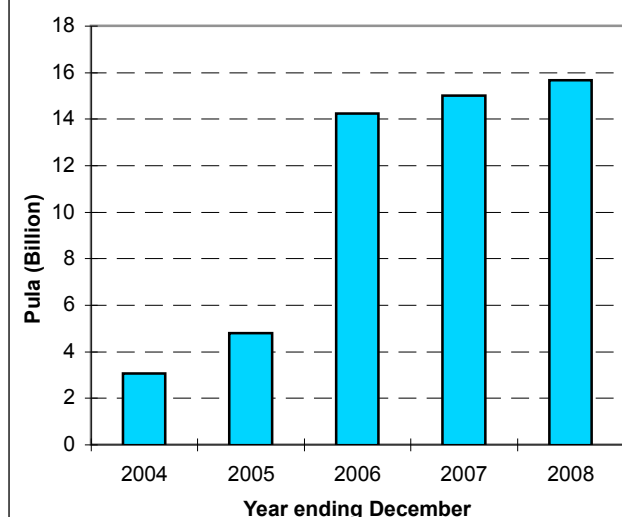


meet deposit withdrawals without forced liquidation of non-liquid assets.

Chart 14 traces changes in the outstanding market value of BoBCs held by commercial banks for the past five years, 2004–2008. BoBC holdings by banks increased substantially since 2006 when the BoBC counterparty policy changed. This trend continued to prevail in 2008,

as the level of banks' BoBC outstanding balances increased by 4 percent from P15 billion in 2007 to P15.6 billion in 2008.

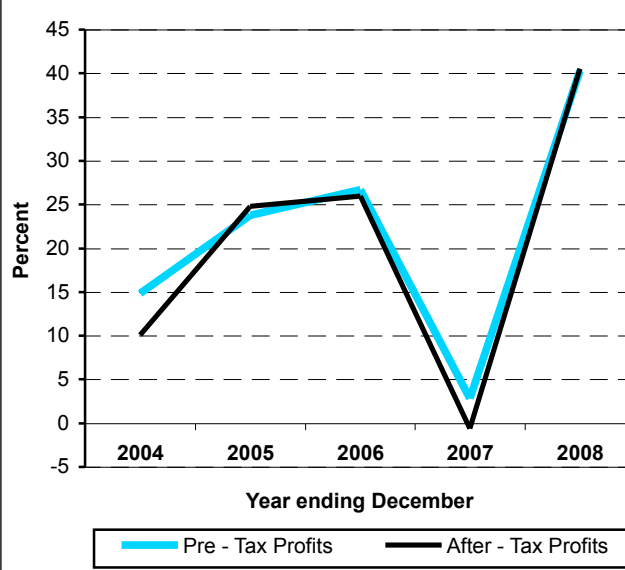
**CHART 14: OUTSTANDING MARKET VALUE OF BoBCs**



## 8. PROFITABILITY: LEVELS AND TRENDS

Banking industry profitability improved substantially in 2008, with net income before and after tax growing by 40 percent and 41 percent, respectively (Chart 15). This was a sharp reversal of the almost flat growth in 2007 and the highest growth rate since 2000 when an increase of 51 percent was recorded. The major contributors to the robust growth of industry profits were the major banks, although one small bank posted an exceptionally high increase which, in terms of scale of impact, would nonetheless have a relatively small impact. The drivers of profitability were both funded and non-funded income, as shown in Table 4.

**CHART 15: GROWTH RATES OF PROFIT BEFORE AND AFTER-TAX**



Among the major determinants of the good profitability results for the year under review were interest income from loans and advances which rose from P2.3 billion in 2007 to P3 billion in 2008 (constituting 48 percent of total income in 2008, up from 47 percent in 2007), and a 74 percent growth in non-interest income (largely fees and commissions and foreign exchange gains). The cost of deposits ratio dropped by 23 percent from 8 percent in 2007 to 6 percent in 2008. All the major banks posted a drop in this ratio, while the smaller banks experienced no change or recorded an increase in the ratio. While this would appear to be consistent with the competitive strategies of banks in either group, with the smaller ones paying more on deposits to attract business, the widening differential between the return on advances and cost of deposits remained a cause for concern.

**TABLE 4: BANKING INDUSTRY EARNINGS AND PROFITABILITY: 2007–2008**

	Amount (P million)		Growth (Percent)
	Dec 2007	Dec 2008	2007–2008
Gross Interest Income	4 295.3	5 154.0	20.0
Interest Expenses	2 660.2	2 953.8	11.0
Net Interest Income	1 635.1	2 200.3	34.6
Non-Interest Income	679.5	1 179.9	73.6
Operating Expenses	1 142.9	1 542.4	35.0
Total Expenses	3 803.1	4 496.2	18.2
Net Income Before-Tax	1 162.2	1 630.6	40.3
Net Income After-Tax	934.6	1 313.4	40.5

**TABLE 5: PERFORMANCE RATIOS (PERCENT)**

	Dec 2006	Dec 2007	Dec 2008
Return on Average Total Assets (ROAA)	3.8	2.8	3.2
Return on Equity (ROE)	56.8	56.6	58.8
Interest Income to Total Income	81.9	83.0	81.4
Non-Interest Income to Total Income	17.9	17.0	18.6
Interest Income to ATA	14.0	12.7	12.5
Non-Interest Income to ATA	3.1	2.0	2.9
Interest Expense/ATA	8.6	7.9	7.2
Interest Expense/Total Expenses	71.2	69.9	66.0
Operating Expense/Total Expenses	28.8	30.1	34.0
Non-Interest Expense/ATA	3.5	3.4	3.7
Average Return on Advances	17.8	19.1	19.5
Net Interest Income/ATA	5.4	4.8	5.3
Average Cost of Deposits	7.6	8.0	6.1

Note: ATA = Average Total Assets

Table 5 shows additional key financial performance indicators of the banking industry. Interest expenses continued to be the major cost component, although as a proportion of total expenses the ratio declined to 66 percent in 2008 from 70 percent in 2007. The largest component of the banks' non-interest expense was staff costs, which constituted 44 percent of total non-interest expense.

Return on Average Total Assets (ROAA) was 3.2 percent in 2008 compared to 2.8 percent in 2007. This is largely due to the 41 percent increase in Net Income After-Tax, compared to a 22 percent increase in Average Total Assets.

The Return on Equity (ROE) ratio increased slightly to 59 percent, due to an increase in the ratio of some large

banks. Most other banks recorded ROE that was less than that of the previous year.

## 9. OPERATING EFFICIENCY

Table 6 shows the banking industry's efficiency measures for the past five years. Net Spread widened in 2008 to 11 percent from 9 percent in 2007, owing to a slower growth of 11 percent in interest expense on deposits in 2008. Accordingly, Net Operating Margin widened from 11 percent in 2007 to 13 percent in 2008, thus reflecting the reduced cost on the banking system of intermediating between the providers and users of funds. Similarly, the banking industry's Cost to Income ratio decreased from 49 in 2007 to 46 in 2008.

The banks improved their performance on other opera-

**TABLE 6: BANKING INDUSTRY EFFICIENCY MEASURES**

Performance Ratios (Percent)	2004	2005	2006	2007	2008
Net Spread	7.4	7.7	9.5	8.8	10.8
Net Interest Margin	7.6	6.4	5.4	4.8	5.3
Other Operating Income/ATA	3.8	4.0	3.1	2.0	2.9
Net Operating Margin	9.2	9.6	10.3	11.0	13.4
Net Income Per Employee (P'000)	235.0	278.2	335.6	310.2	342.3
Net Income To Employee Costs	190.8	219.1	254.8	205.1	195.1
Cost/Income	43.1	45.5	41.1	49.4	45.6
Staff Cost Per Employee (P'000)	123.2	127.0	131.7	154.0	175.5
Asset Per Employee (P'000)	6 102.1	6 911.1	10 858.1	12 388.9	11 793.2

Note: ATA = Average Total Assets

tional areas in addition to their primary banking business operations. Operating indicators such as Net Income per Employee and Net Income to Employee Expenses improved. However, the Assets per Employee ratio fell from P12.4 billion in 2007 to P11.8 billion in 2008, and disrupted the upward trend that had been evident in earlier years. Generally, the banking sector's overall operational efficiency improved in 2008.

## **10. PERFORMANCE OF STATUTORY BANKS**

Total assets of statutory banks stood at P3.1 billion as at December 2008, up from P2.7 billion as at December 2007, thus representing a growth of 14 percent (16 percent in 2007). The growth is attributable to a 23 percent increase in loans and advances. Statutory banks continued to be generally compliant with the Bank's supervisory requirements and their own statutes.

## CHAPTER 3: OTHER DEVELOPMENTS IN THE FINANCIAL SYSTEM

### 1. LICENSING OF NEW BANKS

During 2008, the Bank received a number of enquiries concerning the requirements for setting up different types of banking businesses in Botswana, from which three banking licence applications were received. Of the three banking licence applications received, two were for commercial banking businesses and one was for an offshore investment/merchant banking business. By the end of 2008, the applications were at different stages of processing, with one of the commercial bank applications having been rejected.

### 2. ABANDONED FUNDS

As required under Section 39 of the Banking Act, the banks continued to submit reports on abandoned funds records, and surrendered a total of P1.6 million for the year. Accordingly, the abandoned funds were advertised in the local newspapers and the Government Gazette during 2008. Claims made during the year were significantly lower (P65 383) than those made in 2007. The

funds that had remained unclaimed in the Bank for five years and had been transferred to the Guardian's Fund increased slightly to about P0.8 million from P0.7 million in 2007. The balance of abandoned funds was P5.9 million as at December 2008, a slight increase from P5.1 million recorded in 2007. Total funds received and claims processed during the year are as shown in Table 7 below.

### 3. BANK CHARGES

Some banks revised banking tariffs on account of, among others, inflation and high/rising operating costs. Notwithstanding this, the Bank continued to impress upon the banks the need to uphold the national policy objectives of enhancing savings and promoting financial deepening, by making the cost of basic banking services affordable to customers.

Table 8 below provides selected banking industry average charges applied during 2008. The structure is based on four broad categories of frequently applied charges,

**TABLE 7: SUMMARY OF ABANDONED FUNDS (PULA)**

	2007	2008
Balances brought forward	4 075 841	5 103 430
Funds received	2 209 147	1 584 794
Claims paid out	(458 914)	(65 383)
Transfer to Guardian Fund	(722 644)	(776 270)
Balances at year end	5 103 430	5 846 571

**TABLE 8: BANKING INDUSTRY AVERAGE CHARGES – 2007 AND 2008 (PULA)**

Service Charges Category	2007*	2008	Service Charges Category	2007	2008
<b>Savings Mobilisation</b>			<b>Financial Intermediation</b>		
Maintenance Fees on Savings Accounts	20.30	15.42	Vehicle/Asset Arrangement Fees	472.50	514.17
Over-the-Counter Withdrawal	40.95	50.81	Personal Loan Arrangement Fees	480.83	427.88
<b>Behavioural Deterrent</b>			<b>International Trade</b>		
ATM Charges	1.64	1.77	Commission & purchase of foreign currency	59.75	55.29
Over-the-Counter Withdrawal	40.95	50.81	Interbank SWIFT	205.17	257.40
Bounced Cheques	231.83	230.14	Advisory fees on Letters of Credit	196.24	199.57
			Travellers' cheques (TC) commission	2.1% of TC value	2.2% of TC value

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

\*The 2007 figures have been revised.

namely, behavioural deterrent (behaviour influencing charges), international trade, savings mobilisation and financial intermediation. Bank charges, in particular the behavioural deterrent and international trade charges, increased over the two-year period.

#### 4. NEW BANKING PRODUCTS AND SYSTEMS

A number of new products were introduced by banks as part of improving service delivery, promoting savings, retaining clientele, enhancing customer service or attracting new credit-seeking customers. The products included credit cards for private clients, bancassurance, internet banking, special savings accounts, international trade account and financing products for integrated crop farming.

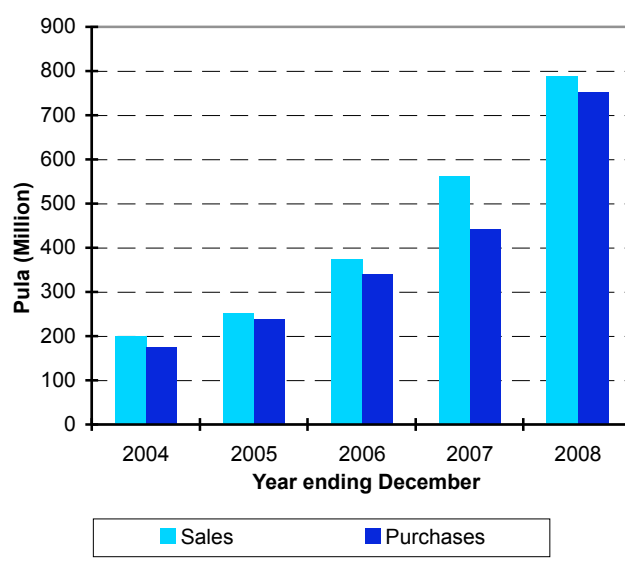
#### 5. BUREAUX DE CHANGE ACTIVITIES

Total assets of bureaux de change amounted to P22.9 million in 2008, up from P22.6 million in 2007 (one percent increase). Most of the bureaux de change had the bulk of their assets in the form of current assets, mainly cash and accounts receivable. The bureaux de change covered in 2008 were profitable, with income after tax of P7.2 million compared to P3.9 million in 2007 (85 percent increase). The main source of income was foreign exchange dealings, which is the core business of the bureaux.

The Bank carried out on-site examinations of eight bureaux de change during 2008, which revealed satisfactory operating performance by the respective bureaux. It was found that the majority of the bureaux de change had contravened Sections 13(1) and 18(5) of the Bank of Botswana (Bureaux de Change) Regulations of 2004, as they transacted business involving amounts in excess of the statutory cash limit of P10 000, and failed to submit audited financial statements to the Bank, respectively. All the concerned entities were given supervisory warnings, except one on which a monetary fine was imposed.

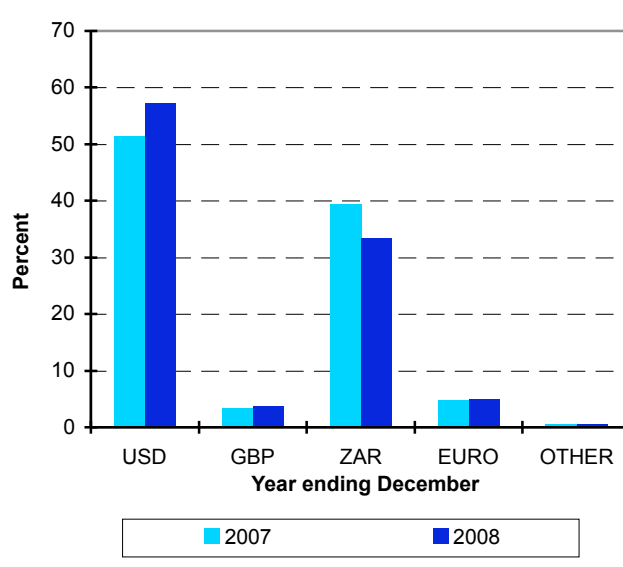
Chart 16 below shows the value of aggregate transactions of bureaux de change over a five-year period. The value of foreign exchange transactions increased by 54 percent in 2008, compared with 40 percent in 2007, as a result of an increase in the number of operators to 51 and the opening of new branches (6) by existing operators.

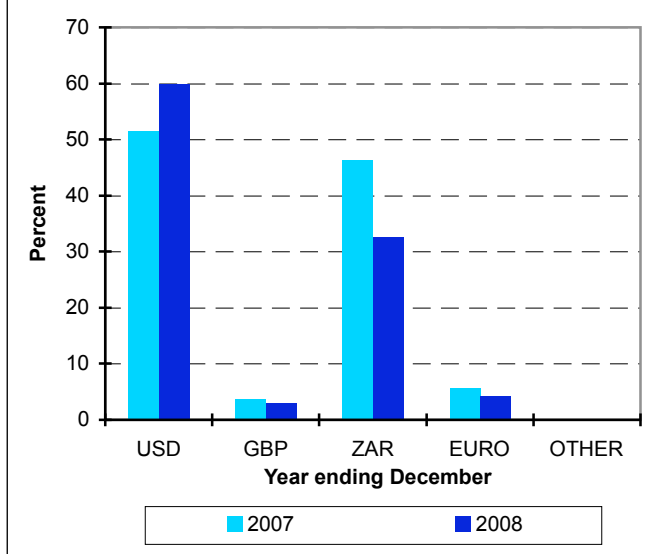
**CHART 16: AGGREGATE BUREAUX DE CHANGE SALES AND PURCHASES OF FOREIGN CURRENCY**



Charts 17 and 18 below show the share of currencies in foreign exchange sales and purchases by bureaux de change in 2007 and 2008. The United States Dollar (USD) and the South African Rand (ZAR) were by far the most used currencies in foreign exchange transactions. Enquiries revealed that the high demand for USD was attributable to the increased demand for grey market vehicles from abroad, and by Zimbabwean visitors to purchase essential goods in Botswana.

**CHART 17: BUREAUX DE CHANGE SALES OF FOREIGN CURRENCY**



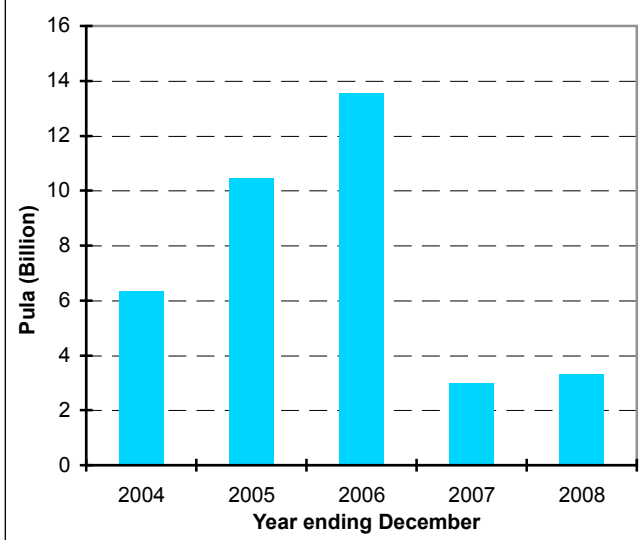
**CHART 18: BUREAU DE CHANGE PURCHASES OF FOREIGN CURRENCY**

## 6. COLLECTIVE INVESTMENT UNDERTAKINGS (CIUs)

Investec Fund Managers Botswana (Pty) Limited (IFMB) was licensed during the year under the Collective Investment Undertakings Act (CAP. 56:09) (CIU Act), and this brought the number of locally licensed management companies to four. IFMB has one fund under

adequacy requirements throughout the period.

International fund management companies granted approval to market their funds in Botswana increased from four in 2007 to five in 2008, while the total number of foreign licensed funds being marketed in Botswana by these companies rose to 21 (Table 10).

**CHART 19: NET ASSET VALUE MOVEMENTS BETWEEN 2004 AND 2008****TABLE 9: MANAGEMENT COMPANIES AND FUNDS LICENSED IN BOTSWANA**

Management Company	Funds Managed	Licensing Date
African Alliance Botswana Management Company (Pty) Limited	Botswana Global Allocation Fund	March 22, 2002
	Botswana Global Income Fund	March 22, 2002
	Botswana Value Fund	March 22, 2002
	Botswana Liquidity 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	Stanbic Money Market Fund	May 27, 2004
	Stanbic Managed Prudential Fund	October 5, 2005
	Stanbic Equity Fund	November 13, 2007
Investec Fund Managers Botswana (Pty) Limited	Investec Botswana Managed Fund	December 16, 2008

its management, and this increased the number of domestically licensed funds from 13 in 2007 to 14 in 2008 (Table 9).

The management companies met the minimum capital

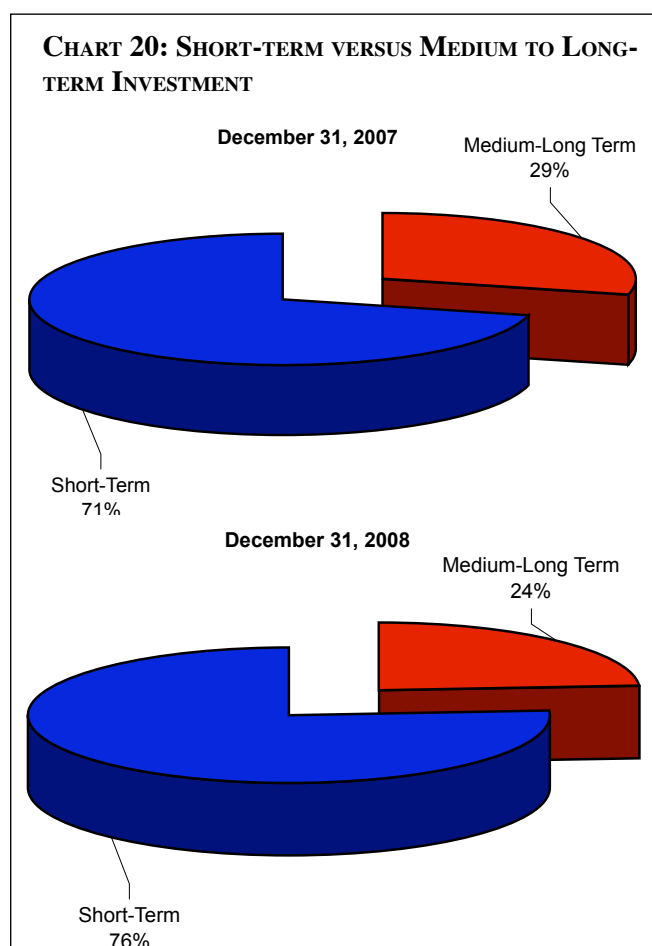
Chart 19 above illustrates the trend in net asset values (NAV) of locally licensed funds managed by the three management companies<sup>6</sup> (Stanbic Investment Management Services (Pty) Ltd (SIMS), African

<sup>6</sup> Excludes Investec Fund Managers Botswana which had not become operational as it was licensed only in December 2008.

**TABLE 10: EXTERNALLY LICENSED FUNDS BEING MARKETED IN BOTSWANA**

Management Company	Funds Managed
Orbis Investment Management Limited (Bermuda)	Orbis Global Equity Fund Orbis Africa Equity Fund Orbis Japan Equity (USD) Fund Orbis Optimal (EUR) Fund Orbis Optimal (USD) Fund Orbis Leveraged (EUR) Fund Orbis Optimal (Yen) Fund Orbis Asia ex-Japan Equity Fund Orbis Leveraged (USD) Fund
Allan Gray Unit Trust Management Limited (RSA)	Allan Gray Stable Fund Allan Gray Equity Fund Allan Gray Balanced Fund Allan Gray Bond Fund Allan Gray Optimal Fund Allan Gray Money Market Fund Allan Gray Global Fund of Funds Allan Gray Global Feeder Fund
Standard Chartered Bank London plc	Standard Chartered USD Liquidity Fund <sup>1</sup>
Imara Asset Management Limited (BVI)	Imara African Opportunities Fund Imara Global Managed Fund
Ashburton Replica Portfolio Limited	Ashburton Sub Funds

1 Inward marketing of this Fund ceased in 2008 due to poor response by Botswana Investors.



Alliance Botswana Management Company (Pty) Ltd (AABMC) and African Alliance International (Pty) Ltd (AAI). The NAV increased moderately by 9 percent, from P2.98 billion in 2007 to P3.23 billion in 2008, mainly due to the introduction of the Stanbic Equity Fund which started trading in 2008.

The investment horizon of Botswana investors has tended to be short-term. Over 70 percent of total investments were held in short-term placements (Chart 20). The increase in the share of short-term investments in total investments may have been precipitated by the global economic downturn, hence a move by some investors to safer short-term investments, which is the reason the unit trust value in 2008 was not adversely affected by the economic downturn.

## 7. INTERNATIONAL FINANCIAL SERVICES CENTRE (IFSC)

In 2008, five non-bank International Financial Services Centre (IFSC) entities were issued with Exemption Certificates in accordance with the requirements of Section 45 of the Bank of Botswana Act (CAP. 55:01) and Section 138(4) of the Income Tax Act (CAP.

52:01). The entities were Windward Capital (Pty) Ltd, Leisure Investments (Pty) Ltd, Findev (Pty) Limited, Genesis Financial Services (Pty) Ltd and Runway Asset Management Holdings Limited. As a result, the total number of approved IFSC entities increased from 19 in 2007 to 22 in 2008. Out of this number, 10 companies are fully operational.

The Bank also revised and introduced supervisory fees for non-bank IFSC companies, which were effected in January 1, 2008. An annual licence fee of P25 000 (VAT exclusive) was introduced while the application fee was increased from P3 000 to P10 000 (VAT exclusive).

The on-site examination of the only micro-finance entity in Botswana, Women's Finance House Botswana, was conducted during 2008 and no issues of supervisory concern were identified.

## **8. ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT) ISSUES**

The Bank participated in putting together the Draft Financial Intelligence Bill of 2008, which was gazetted in November 2008. The objective of the Financial Intelligence Bill is to establish the Financial Intelligence Agency, which shall be responsible for requesting, receiving, analysing and disseminating financial information to an investigatory authority, supervisory authority or such comparable bodies outside Botswana on matters relating to or incidental to financial transactions.

The Financial Intelligence Bill also provides for the establishment of a National Coordinating Committee on Financial Intelligence. This Committee will be responsible for, among others, evaluation of the effectiveness of policies and measures designed to combat financial crime. The enactment of the Financial Intelligence Act will go a long way in ensuring that Botswana complies with most of the 40+9 Financial Action Task Force (FATF) recommendations on combating money laundering and the financing of terrorism.

The Bank conducted AML/CFT on-site examinations as part of full-scope bank examinations undertaken during the year. Overall findings were that banks filed suspicious transactions reports with the Directorate on Corruption and Economic Crime and that they were making significant improvements in their AML/CFT systems.

## **9. BASEL II IMPLEMENTATION TASK FORCE**

The Bank, in consultation with the industry, has made a commitment to implement Basel II in Botswana. The Basel II Implementation Task Force (BITF), comprising representatives of all banks, continued to guide the strategic implementation of Basel II in Botswana.

The BITF held two meetings during 2008. Among the issues discussed at the meetings were the Basel II implementation plan for Botswana and the establishment of Basel II implementation sub-committees. The key deliverables that will ensure a successful realisation of the implementation plan include developing a suite of national discretions, establishing sub-committees of the BITF and developing new "Capital Adequacy Guidelines".

Even as the Bank proceeds with preparations for implementation of Basel II, it has maintained a close watch on the impact of the ongoing financial crisis on the architecture of the global financial system. In particular, the Bank is carefully monitoring current thinking at the Basel Committee and its proposals for the refinement of the Basel II Accord to build in flexibility and resilience to future shocks emanating from financial innovation and more sophisticated financial instruments. The Bank will ensure that the proposed enhancements to the minimum regulatory capital, risk management and the supervisory review processes, as well as disclosure requirements, are properly refined and domesticated for incorporation into the revised capital adequacy measurement and standards for the Botswana banking industry.



## CHAPTER 4: CONCLUSION

The unfavourable external developments (global financial crisis and soaring fuel and food prices) high domestic inflation and tight monetary conditions appear to have had no significant adverse impact on the performance of the banking sector during 2008. The rate of growth of banking assets was maintained at the high levels of 2007, supported by a rapid increase in loan assets. The bulk of the lending (55 percent) was to the household sector. The funding (deposit) base expanded at a rate faster than that of 2007. Customer deposits continued to be the major source of funding as they accounted for 83 percent of total funding of banking operations in 2008. Corporates were, as in the past years, the major contributors on a net basis to the deposit base. As a result of the growing loan portfolio, the level of intermediation increased slightly from 46 percent in 2007 to 47 percent in 2008.

All banks were profitable, liquid, adequately capitalised and satisfied all the minimum prudential requirements.

The quality of assets, which was a concern during 2007, improved as shown by the decline in the ratio of past due loans to total loans and maintenance of adequate specific provisions for non-performing loans.

Access to banking and other financial services improved as well, as shown by the expansion of bank branches and the ATM network. There was also growth in the number of CIUs, IFSC companies and Bureaux de change and an increase in the services provided by these entities.

Going forward, the effects of the global financial crisis, which started to filter through to the domestic real economy towards the end of 2008, will likely affect bank performance in 2009 and beyond, through possible corporate failures and household defaults that are linked to the troubled diamond sector. Both the banking sector and the regulatory authorities continue to monitor the situation closely and stand ready to intervene as necessary.

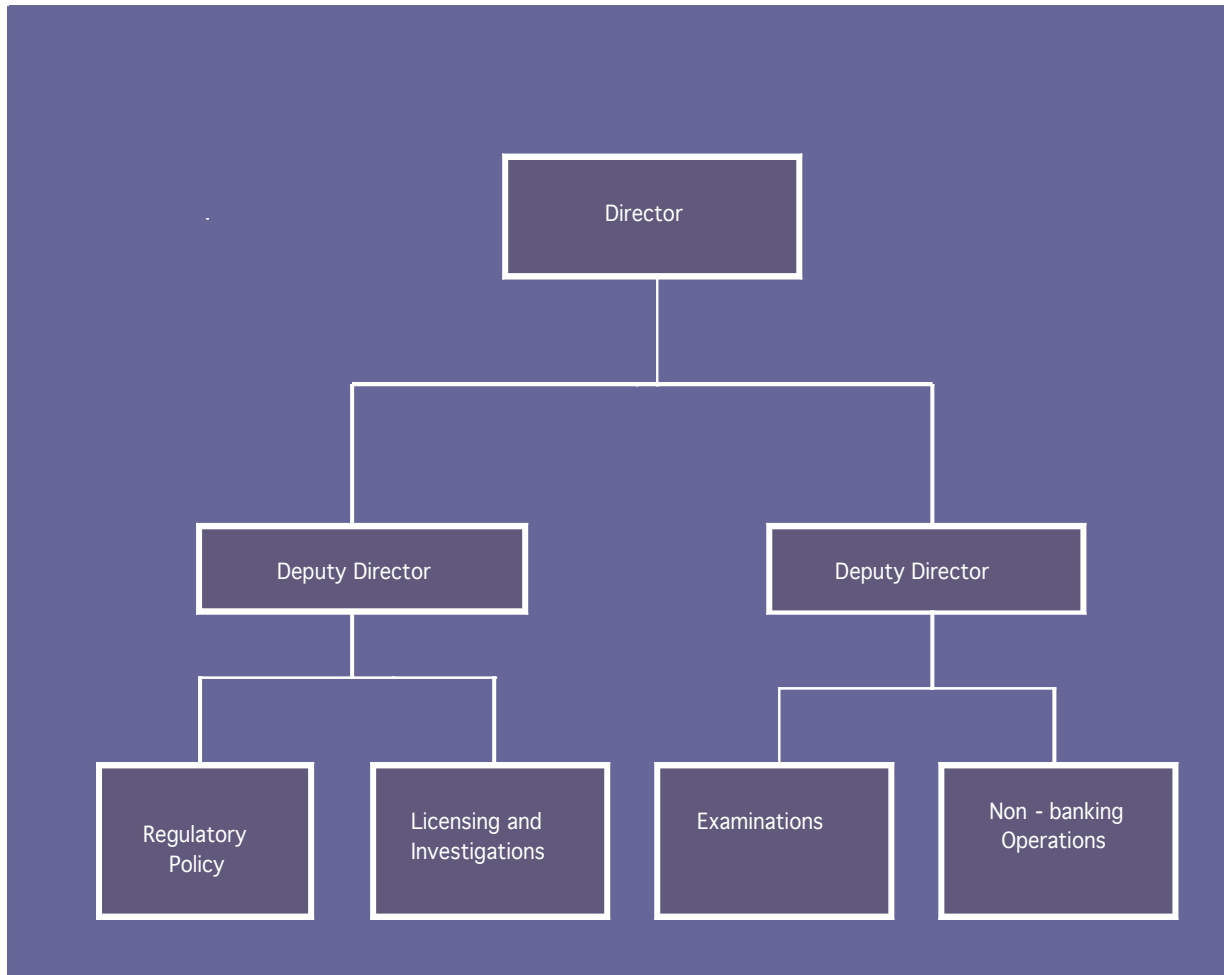


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## APPENDIX 1: BANKING SUPERVISION DEPARTMENT ORGANISATIONAL CHART





## APPENDIX 2: APPROACHES TO REGULATION AND SUPERVISION OF BANKS IN BOTSWANA

### 1. 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 on page 32).

### 2. LEGAL FRAMEWORK

In general, it is considered that to be effective, a regulatory framework must have sufficient authority established by law, a high degree of independence or 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 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 own-

ers 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.

### 3. 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.

### 4. LICENSING POLICY AND PROCEDURES FOR ESTABLISHING A BANK

The licensing requirements and procedures for establishing a bank in Botswana are set out in Sections 6(1) and 8 of the Banking Act, and detailed in Banking 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, cur-

rently 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.

## 5. 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 is 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. Liquid Assets 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 entity 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, determines 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 and 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 deter-

mine 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.

## 6. Accounting, Auditing and Disclosure Standards

Section 22 of the Banking Act requires banks to annually appoint independent external auditors acceptable to the Bank. Statutory audits are conducted annually, usually at financial year-end, 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.

## 7. 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<sup>7</sup> 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 2 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.

<sup>7</sup> G10 comprises 11 countries: United States, Japan, Germany, Canada, Britain, France, Italy, Netherlands, Belgium, Sweden and Switzerland.

**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 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 off 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 cooperation 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, 2008

### (A) BANKS AND OTHER DEPOSIT-TAKING INSTITUTIONS

Institution	Postal Address	Business Locations	External Auditors
<b>Commercial Banks</b>			
Barclays Bank of Botswana Limited	P O Box 478, Gaborone	52*	PricewaterhouseCoopers
Standard Chartered Bank Botswana Limited	P O Box 496, Gaborone	16	KPMG
First National Bank of Botswana Limited	P O Box 1552, Gaborone	17	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	Private Bag 00325, Gaborone	2	PricewaterhouseCoopers
Capital Bank Limited	P O Box 5548, Gaborone	1	KPMG
<b>Merchant Banks</b>			
African Banking Corporation of Botswana Limited	P/Bag 00303, Gaborone	2	PricewaterhouseCoopers
<b>Statutory Banks</b>			
Botswana Savings Bank	P O Box 1150, Gaborone	2	PricewaterhouseCoopers
National Development Bank	P O Box 225, Gaborone	4	KPMG
<b>Building Society</b>			
Botswana Building Society	P O Box 40029, Gaborone	9	KPMG

\* Includes branches, sub-branches, agencies and sales centres.

**(B) BUREAUX DE CHANGE AS AT DECEMBER 31, 2008**

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
Sunny Bureau de Change	P O Box 370, Maun	3
Exim Bureau de Change	P O Box 1020, Gaborone	1
Prosper Bureau de Change	P/Bag BO 7, 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
American Express Bureau de Change	P O Box 45140, Gaborone	1
Star Bureau de Change	P O Box 80491, Gaborone	1
Unity Bureau de Change	P O Box 1586, Francistown	1
Open Door Bureau de Change	P O Box 839, Maun	2
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Royalty Bureau de change	P/Bag BO 259, Gaborone	1
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
FX Africa Bureau de Change	P O Box 20537, Gaborone	2
Cape to Cairo Bureau de Change	P O Box 5, Kasane	1
Business Towers Bureau de Change	P O Box 40943, Gaborone	1
Nsundano Bureau de Change	P O Box 243, Kasane	1
Limpopo Bureau de Change	P O Box 8, Sherwood	1
Palapye Bureau de Change	P O Box 10408, Palapye	2
Rennies Bureau de Change	P O Box 2482, Gaborone	2
Investors View Bureau de Change	P O Box 2381, Francistown	1
Crystal Diamond Bureau de Change	P O Box 20554, Gaborone	1
River Ride Bureau de Change	P O Box 301106, Francistown	5
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
Ozair Bureau de Change	P/Bag 149, Gaborone	1
Servewell Bureau de Change	P/Bag B02, Gaborone	1
Tsogo Bureau de Change	P O Box 502095, Gaborone	1
Mabote Bureau de Change	P O Box 120, Jwaneng	1
Fundex Bureau de Change	P O Box 401547, Gaborone	1
Boitekanelo Bureau de Change	P O Box 486, Gaborone	1
West Bureau de Change	P O Box 779, Gaborone	1
Money Quest Bureau de Change	P O Box 2748, Gaborone	1
Amah Bureau de Change	P O Box 11829, Francistown	1
Rose of Sharon Bureau de Change	P O Box 404338, Gaborone	1
Ten-Tab Bureau de Change	P O Box 301576, Francistown	2
CSS Bureau de Change	P O Box 45168, Riverwalk, Gaborone	2
Dollar Wave Bureau de Change	P/Bag 0024, Bobonong	1
Vintage Bureau de Change	P O Box 4594, Gaborone	1
Sango Bureau de Change	P O Box 1873, Francistown	1

**(C) COLLECTIVE INVESTMENT UNDERTAKINGS AS AT DECEMBER 31, 2008**

<b>Name</b>	<b>Postal Address</b>
African Alliance Botswana Management Company (Pty) Limited	P O Box 2770, Gaborone
African Alliance International Limited*	P O Box 2770, Gaborone
Stanbic Investment Management Services (Pty) Limited	Private Bag 00168, Gaborone
Investec Fund Managers Botswana (Pty) Limited	P O Box 49, Gaborone

\* An International Financial Services Centre company.

**(D) COMPANIES ISSUED WITH EITHER A BANKING LICENCE OR EXEMPTION  
CERTIFICATE UNDER THE INTERNATIONAL FINANCIAL SERVICES CENTRE AS AT  
DECEMBER 31, 2008**

<b>Name</b>	<b>Postal Address</b>
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) Limited	P O Box 408, Gaborone
Imara Holdings Limited	P/Bag 00186, Gaborone
Cherubin Ventures (Pty) Limited	P O Box 1444, Gaborone
AON Risk Management (Pty) Limited	P O Box 624, Gaborone
Island View (Pty) Limited	P O Box 41029, Gaborone
Wilderness Holdings (Pty) Limited	P/Bag 14, Maun
C B Richard Ellis (Pty) Limited	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) Limited	P O Box 495, Gaborone
Micro Provident Botswana Limited	P O Box 381, Gaborone
Pangaea Development Holdings Limited	P O Box 46699, Gaborone
Windward Capital (Pty) Limited	P/Bag 149, Gaborone
Leisure Investment Holdings (Pty) Limited	P O Box 41475, Gaborone
Findev (Pty) Limited	P O Box 26612, Gaborone
Genesis Global Finance (Pty) Limited	P O Box CY 1064, Harare, Zimbabwe
Runway Asset Management Holdings Limited	P O Box 786955, Johannesburg, South Africa

**(E) MICRO-FINANCE INSTITUTIONS AS AT DECEMBER 31, 2008**

<b>Name</b>	<b>Postal Address</b>
Women's Finance House Botswana	Private Bag 124, Gaborone



## APPENDIX 4: 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 characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status can be determined.
- (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 42.

- (g) **Weighted Classifications:** Represents an aggregate of 20 percent, 50 percent and 100 percent of the value of accounts classified “Sub-standard”, “Doubtful” and “Loss”, respectively.

## 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 at-

tached 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 ex-

penses 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

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

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**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)
<b>On-Balance Sheet Items</b>	
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
<b>Off-Balance Sheet Items</b>	
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: 2004–2008

**TABLE 5.1: AGGREGATE BALANCE SHEET OF LICENSED COMMERCIAL BANKS\*: 2004–2008 (PULA MILLION)**

<b>Total Assets in Local Currency</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007**</b>	<b>2008</b>
1. Cash and balances with the Central Bank	821	722	1 109	1 851	2 125
a. Currency	314	375	388	496	593
aa. Hard currency and gold bullion	35	81	80	123	137
ab. Local currency	279	294	308	373	456
b. Balances with Central Bank	432	347	722	1 339	1 399
c. Other	232	51	0	16	133
2. Trading securities at market value (BoBCs)	3 048	4 785	14 218	15 013	15 654
3. Placements with other banks and credit institutions	1 943	3 003	3 067	3 814	5 894
4. Loans and advances to other customers (net of specific provisions)	8 685	9 130	10 916	13 587	17 497
5. Investment securities	386	280	226	1 609	2 406
6. Fixed assets net of depreciation	212	200	213	295	364
7. Other assets (net)	430	423	663	1 159	1 311
<b>Total Assets</b>	<b>15 524</b>	<b>18 543</b>	<b>30 413</b>	<b>37 328</b>	<b>45 251</b>
<b>Liabilities in Local Currency</b>					
1. Amounts owed to government institutions	104	105	50	100	0
a. Central Bank accounts	0	105	50	100	0
b. Direct Government credits (CB or MoF)	104	0	0	0	0
c. Other	0	0	0	0	0
2. Due to other banks and credit institutions	410	1 467	1 654	1 224	1 058
3. Securities sold under repurchase agreements	0	0	0	0	0
4. Due to other customers/depositors	12 559	14 009	24 943	29 695	37 329
5. Shareholders funds	1 274	1 412	1 655	1 883	2 420
6. Other liabilities	856	1 550	2 112	2 882	2 879
a. Taxes payable	104	115	90	89	95
b. Dividends payable	118	33	81	0	115
c. Accrued expenses	86	167	83	2	27
d. Other	552	1 235	1 858	2 746	2 642
7. Other borrowing incl. international lending agencies	317	0	0	1 544	1 565
<b>Total Liabilities</b>	<b>15 524</b>	<b>18 543</b>	<b>30 413</b>	<b>37 328</b>	<b>45 251</b>

\* Including ABCB

\*\* 2007 figures restated

TABLE 5.2: AGGREGATE INCOME STATEMENT OF LICENSED COMMERCIAL BANKS\*: 2004–2008 (PULA MILLION)

	2004	2005	2006	2007**	2008
1. Interest and similar income	1 920	2 171	3 422	4 295	5 154
2. Interest expense	982	1 094	2 106	2 660	2 954
3. Net interest income [1–2]	937	1 077	1 316	1 635	2 200
4. Other operating income	547	655	752	868	1 179
<b>5. Gross operating income/(loss) [3+4]</b>	<b>1 485</b>	<b>1 732</b>	<b>2 068</b>	<b>2 503</b>	<b>3 379</b>
6. Bad and Doubtful Debts Provisions	51	53	90	218	193
(a) Specific loss provision expenses	92	66	105	236	202
(b) General loss provision	–23	6	0	11	23
(c) Releases and Recoveries of bad debts previously written off	–9	–8	–3	–29	–32
<b>7. Operating income/(loss) net of specific loss provisions</b>	<b>1 434</b>	<b>1 679</b>	<b>1 978</b>	<b>2 285</b>	<b>3 186</b>
8. Operating expenses	714	786	848	1 124	1 553
(a) Salaries and employee benefits	314	341	369	464	673
(b) Administrative expenses	78	22	29	0	260
(c) Auditing and consulting expenses	17	3	2	3	9
(d) Rental/lease expenses	38	17	18	43	58
(e) Depreciation and amortisation	42	10	12	43	76
(f) Other	225	394	418	570	476
9. Other provisions and write-offs	0	1	0	0	0
(a) Investments	0	1	0	0	0
(b) Other balance sheet items	0	0	0	0	0
(c) Off-balance sheet items	0	0	0	0	0
<b>10. Net operating income/(loss) [7–8–9]</b>	<b>721</b>	<b>892</b>	<b>1 130</b>	<b>1 161</b>	<b>1 633</b>
11. Extraordinary Gains/(Losses)	–2	0	0	1	–2
(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	–2	0	0	1	–2
<b>12. Net income/(loss) before tax [10+11]</b>	<b>719</b>	<b>892</b>	<b>1 130</b>	<b>1 162</b>	<b>1 631</b>
13. Income tax	121	146	190	228	317
14. Net income/(loss) after tax [12–13]	598	746	940	935	1 313
15. Transfers from revaluation/to general provisions	0	0	0	0	0
16. Dividends declared (paid & proposed)	477	643	716	555	762
17. Retained earnings for the year [14–15–16]	121	104	224	387	551
18. Retained earnings at the beginning of the year	774	896	999	1388	1 380
<b>19. Retained earnings at the end of the year [17+18]</b>	<b>896</b>	<b>999</b>	<b>1 223</b>	<b>1775</b>	<b>1 932</b>

\* Including ABCB

\*\* 2007 figures restated

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

Total Assets in Local Currency	2005	2006	2007	2008
1. Cash and balances with the Central Bank	12	2	2	3
a. Currency	7	0	2	3
aa. Hard currency and gold bullion	0	0	0	0
ab. Local currency	7	0	2	3
b. Balances with Central Bank	5	2	0	0
c. Other	0	0	0	0
2. Trading securities at market value (BoBCs)	183	0	0	0
3. Placements with other banks and credit institutions	265	493	650	482
4. Loans and advances to other customers (net of specific provisions)	1 361	1 693	1 917	2 479
5. Investment securities	2	0	0	0
6. Fixed assets net of depreciation	103	113	109	153
7. Other assets (net)	27	28	28	26
<b>Total Assets</b>	<b>1 953</b>	<b>2 328</b>	<b>2 706</b>	<b>3 143</b>
<b>Liabilities in Local Currency</b>				
1. Amounts owed to government institutions	0	0	0	3
a. Central Bank accounts	0	0	0	3
b. Direct Government credits (CB or MoF)	0	0	0	0
c. Other	0	0	0	0
2. Due to other banks and credit institutions	0	0	0	0
3. Securities sold under repurchase agreements	0	0	0	0
4. Due to other customers/depositors	367	407	517	618
5. Shareholders funds	1 110	1 380	1 513	1 674
6. Other liabilities	40	65	63	27
a. Taxes payable	0	0	0	0
b. Dividends payable	9	13	6	0
c. Accrued expenses	0	0	0	0
d. Other	30	52	58	27
7. Other borrowing incl. international lending agencies	436	475	613	821
<b>Total Liabilities</b>	<b>1 953</b>	<b>2 328</b>	<b>2 706</b>	<b>3 143</b>

TABLE 5.4: AGGREGATE INCOME STATEMENT OF STATUTORY BANKS IN BOTSWANA (PULA MILLION)

Statutory Banks	2006	2007	2008
1. Interest and similar income	259	293	392
2. Interest expense	83	95	126
3. Net interest income [1–2]	176	198	266
4. Other operating income	30	31	32
<b>5. Gross operating income/(loss) [3+4]</b>	<b>206</b>	<b>229</b>	<b>298</b>
6. Bad and Doubtful Debts Provisions	27	74	37
(a) Specific loss provision expenses	29	17	33
(b) General loss provision	– 1	57	4
(c) Releases and Recoveries of bad debts previously written off	0	0	0
<b>7. Operating income/(loss) net of specific loss provisions</b>	<b>179</b>	<b>155</b>	<b>261</b>
8. Operating expenses	104	110	140
(a) Salaries and employee benefits	50	52	73
(b) Administrative expenses	0	0	0
(c) Auditing and consulting expenses	0	0	0
(d) Rental/lease expenses	0	0	0
(e) Depreciation and amortisation	7	6	6
(f) Other	46	52	60
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
<b>10. Net operating income/(loss) [7–8–9]</b>	<b>75</b>	<b>45</b>	<b>122</b>
11. Extraordinary Gains/(Losses)	0	5	– 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	– 5
<b>12. Net income/(loss) before tax [10+11]</b>	<b>75</b>	<b>50</b>	<b>117</b>
13. Income tax	0	0	0
<b>14. Net income/(loss) after tax [12–13]</b>	<b>75</b>	<b>50</b>	<b>117</b>
15. Transfers from revaluation/to general provisions	0	0	0
16. Dividends declared (paid & proposed)	27	33	27
17. Retained earnings for the year [14–15–16]	48	17	90
18. Retained earnings at the beginning of the year	0	0	0
<b>19. Retained earnings at the end of the year [17+18]</b>	<b>48</b>	<b>17</b>	<b>90</b>

**TABLE 5.5: LICENSED BANKS\* CAPITAL STRUCTURE (TIER 1 CAPITAL, TIER 2 CAPITAL AND TOTAL CAPITAL) 2006–2008 (PULA THOUSAND)**

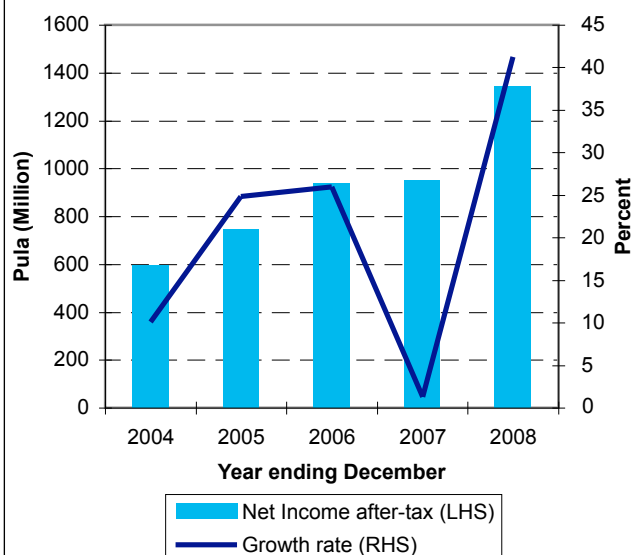
<b>Tier 1</b>	<b>Capital Elements</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
1	Ordinary Shares – Issued and paid up	131 349	147 106	187 106
2	Preference (non-redeemable) non-cumulative shares	–	–	–
3	Surplus – Share Premium	99 449	88 714	127 157
4	General Reserves	57 552	57 536	3 342
5	Undivided Profits (audited current year retained earnings/loss)	1 043 534	1 291 732	1 559 369
6	Minority Interests	–	–	–
7	<b>Less</b>			
	(a) Goodwill and other intangible assets	43 431	40 843	40 843
	(b) Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation	12 933	12 933	–
8	<b>Total Tier 1 Capital (Sum of lines 1–6 less lines 7 (a) and (b))</b>	<b>1 275 610</b>	<b>1 531 015</b>	<b>1 836 131</b>
<b>Tier 2</b>				
9	Current year's unpublished profits	70 934	171 731	478 967
10	Fifty percent of fixed asset revaluation reserves	12 305	16 717	18 217
11	Unencumbered general provisions not to exceed 1.25 percent of risk weighted assets	75 546	95 521	114 319
12	Hybrid (debt/equity) capital instruments eligible for inclusion	–	–	507
13	Subordinated term debt eligible for inclusion	401 801	480 072	6 444 585
14	Minority interest in Tier 2 preference shares	–	–	–
15	Shareholders equity funded through the capitalisation of property revaluation reserves	–	–	–
16	<b>Total Tier 2 Capital (sum of lines 9 to 15)</b>	<b>560 586</b>	<b>764 041</b>	<b>1 256 595</b>
17	<b>Total Capital (sum of lines 8 and 16)</b>	<b>1 836 196</b>	<b>2 295 056</b>	<b>3 092 726</b>
<b>Impairments</b>				
18	Investments in unconsolidated subsidiaries and associated companies	–	701	701
19	<b>Total Impairments of Capital</b>	<b>–</b>	<b>701</b>	<b>701</b>
20	<b>Total Unimpaired Capital (line 17 – line 19)</b>	<b>1 836 196</b>	<b>2 294 335</b>	<b>3 092 025</b>

\*Excluding statutory banks

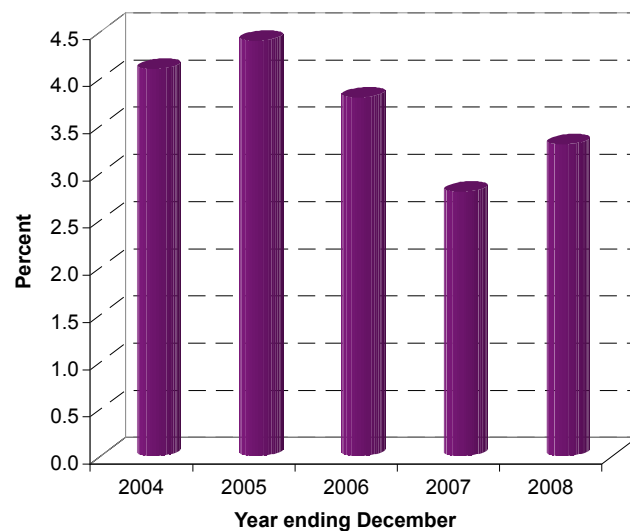


## APPENDIX 6: CHARTS OF KEY PRUDENTIAL AND OTHER FINANCIAL SOUNDNESS INDICATORS

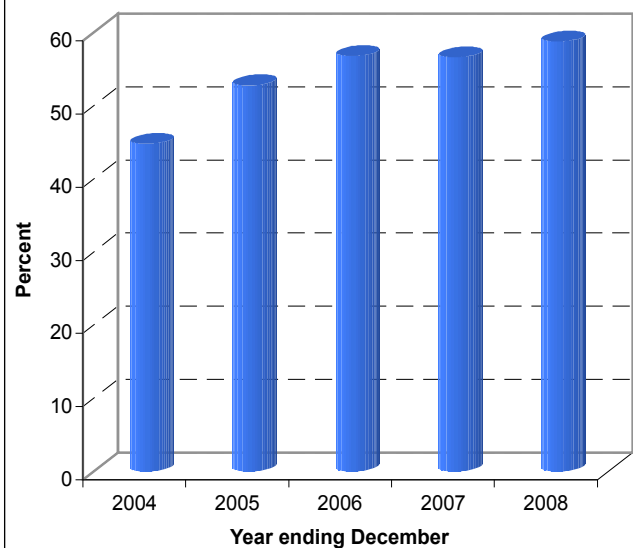
**CHART 6.1: AGGREGATE NET INCOME AFTER-TAX AND GROWTH**



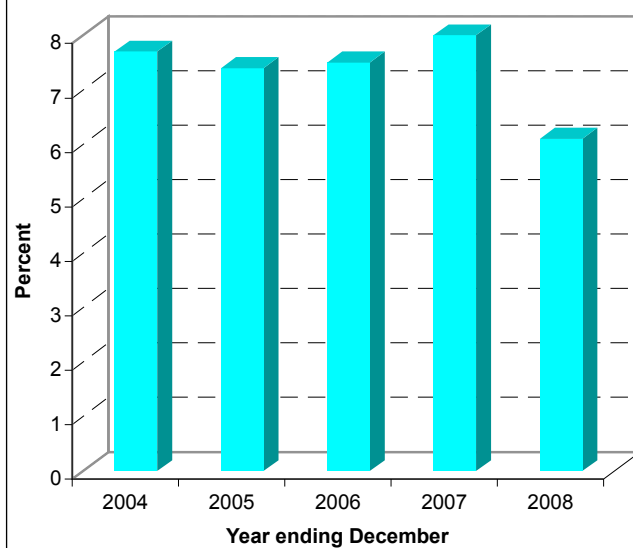
**CHART 6.2: AGGREGATE RETURN ON AVERAGE TOTAL ASSETS**



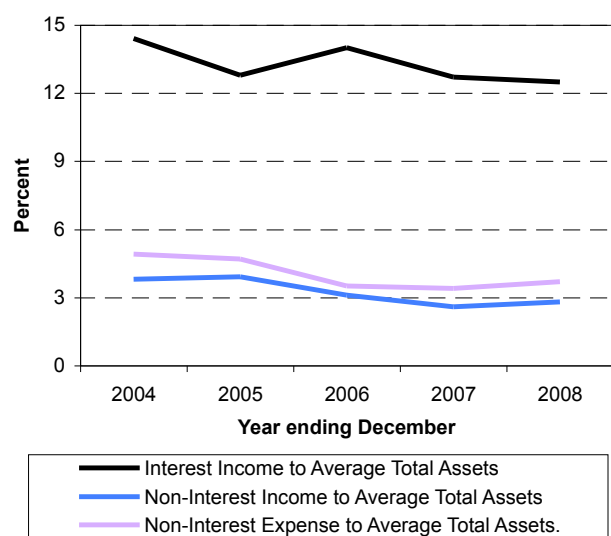
**CHART 6.3: AGGREGATE RETURN ON EQUITY**



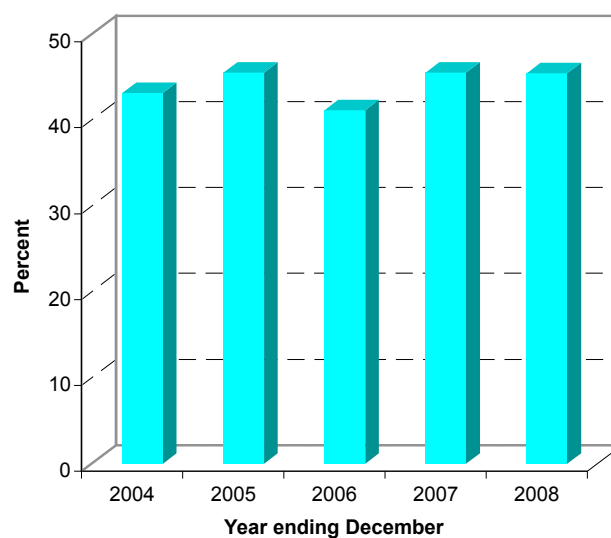
**CHART 6.4: AGGREGATE AVERAGE COST OF DEPOSITS**



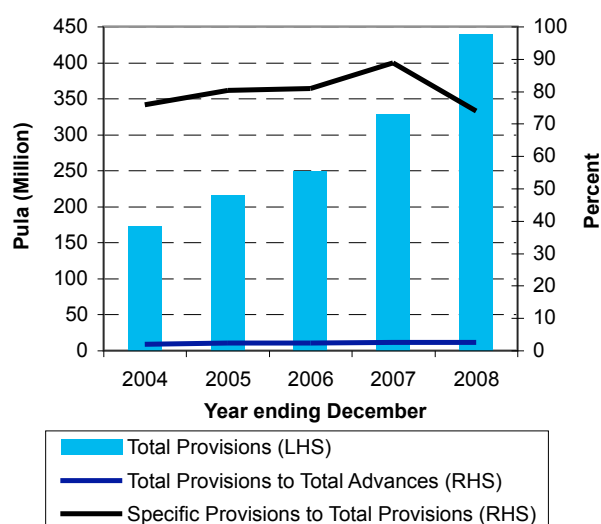
**CHART 6.5: AGGREGATE GROSS INTEREST INCOME, NON-INTEREST INCOME AND NON-INTEREST EXPENSE TO AVERAGE TOTAL ASSETS**



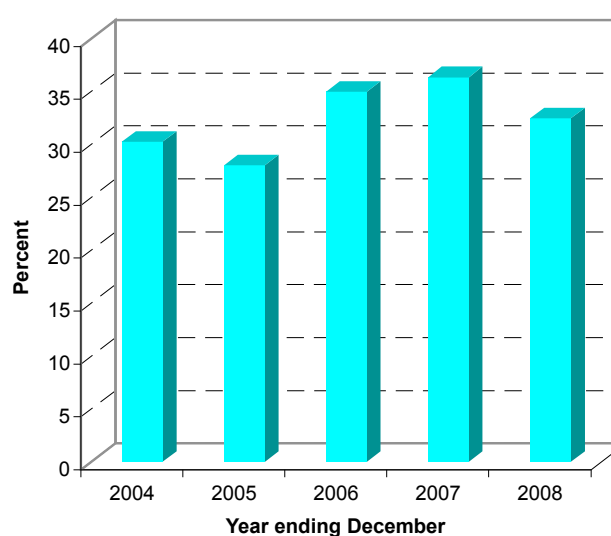
**CHART 6.6: AGGREGATE COST TO INCOME RATIO**



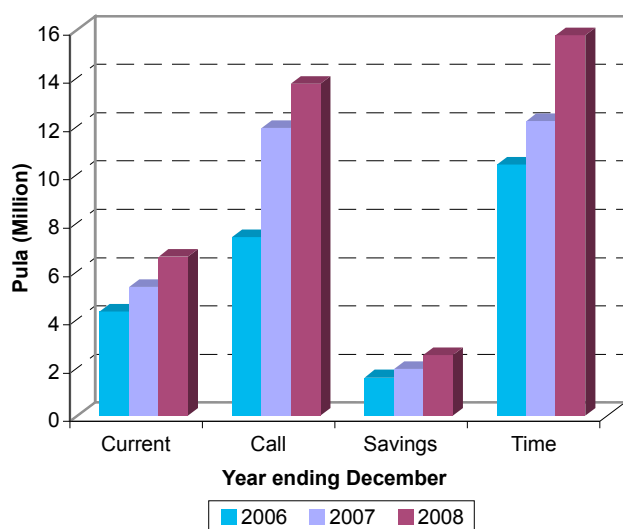
**CHART 6.7: TOTAL PROVISIONS, TOTAL PROVISIONS TO TOTAL ADVANCES AND SPECIFIC PROVISIONS TO TOTAL PROVISIONS**



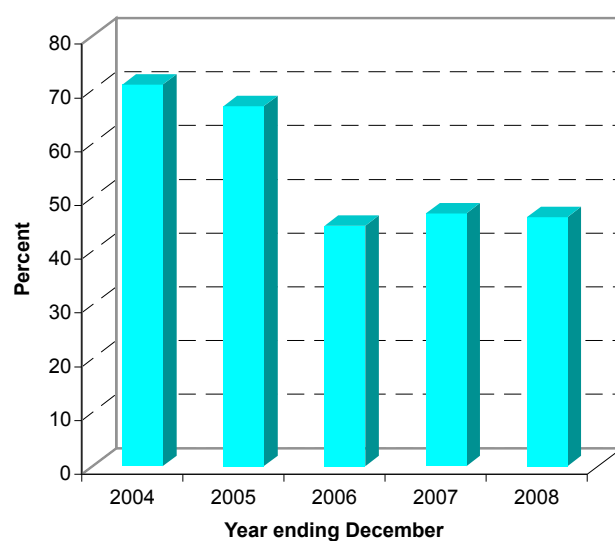
**CHART 6.8: PAST DUE LOANS TO TOTAL CAPITAL**



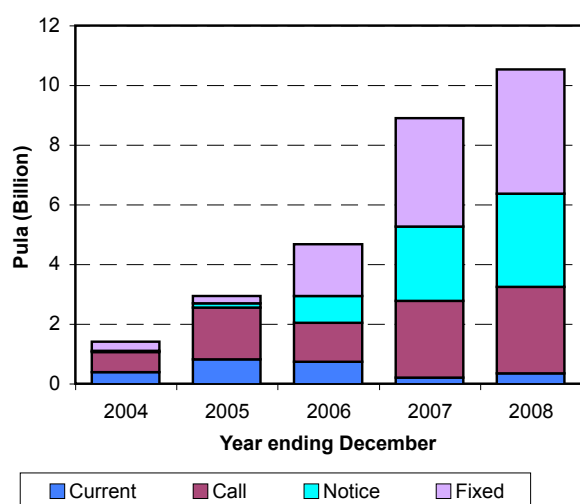
**CHART 6.9: AGGREGATE DEPOSIT BY TYPE**



**CHART 6.10: AGGREGATE ADVANCES TO DEPOSITS RATIO**



**CHART 6.11: FOREIGN CURRENCY ACCOUNTS BY TYPE**



**CHART 6.12: FOREIGN CURRENCY ACCOUNTS BY CURRENCY**

