Banking Supervision Annual Report 2019

Bank of Botswana

MISSION STATEMENT

The principal objective of the Bank of Botswana (Bank) is to promote and maintain monetary stability, an efficient payments mechanism, liquidity, solvency and proper functioning of a soundly based monetary, credit and financial system in Botswana.

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

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

To achieve these goals, the Bank:

(a) sets transparent criteria, guidelines and other requirements for market entry as stipulated in the Licensing Policy;

(b) establishes and updates, on a regular basis, prudential policies and standards;

(c) monitors solvency, liquidity, large exposures, insider loans, provisioning and risk management strategies, as well as the adequacy of management and governance structures for the safe and sound operation of banks;

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

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

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

Banking Supervision Annual Report 2019

Bank of Botswana

CONTENTS

BANK OF BOTSWANA: BANKING SUPERVISION

CONTENTS

LIST OF ABBREVIATIONS

AML/CFT	Anti-money Laundering and Combating the Financing of Terrorism
ATM	Automated Teller Machine
BancABC	African Banking Corporation of Botswana Limited
Banking Act	Banking Act (Cap. 46:04)
Bank Gaborone	Bank Gaborone Limited
Bank SBI	Bank SBI Botswana Limited
Barclays	Barclays Bank of Botswana Limited
Baroda	Bank of Baroda (Botswana) Limited
BBSL	BBS Limited
BCBS	Basel Committee on Banking Supervision
BFM	Botswana Fund Motshelo
BIA	Basic Indicator Approach
BIS	Bank for International Settlements
BoBA	Bank of Botswana Act (Cap. 55:01)
BoBCs	Bank of Botswana Certificates
BoI	Bank of India (Botswana) Limited
BSB	Botswana Savings Bank
BSEL	Botswana Stock Exchange Limited
BURS	Botswana Unified Revenue Service
CAR	Capital Adequacy Ratio
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
CAMS	Credit Application Management System
CB	Central Bank
CET1	Common Equity Tier 1
DCN	Dynamic Cycle Network
DTA	Deferred Tax Assets
EFT	Electronic Funds Transfer
ESAAMLG	Eastern and Southern Africa Anti-money Laundering Group
FATF	Financial Action Task Force
FCB	First Capital Bank Limited
FIA	Financial Intelligence Agency
FNBB	First National Bank of Botswana Limited
GBP	Great Britain Pound
GDN	Global Dream Network
GDP	Gross Domestic Product

LIST OF ABBREVIATIONS

HHI	Herfindahl-Hirschman Index
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
IT	Information Technology
KBAL	Kingdom Bank Africa Limited
KYC	Know Your Customer
LAR	Liquid Asset Ratio
LHS	Left-hand Scale
MER	Mutual Evaluation Report
MFED	Ministry of Finance and Economic Development
ML/TF	Money Laundering and Terrorist Financing
NBFIRA	Non-bank Financial Institutions Regulatory Authority
NDB	National Development Bank
NIM	Net Interest Margin
NPF	National Petroleum Fund
NPLs	Non-performing Loans
NPS	National Payments System
OSS	Off-site Surveillance
RAS	Risk Assessment System
RBS	Risk-based Supervision
RHS	Right-hand Scale
ROAA	Return on Average Assets
ROE	Return on Equity
RWA	Risk-weighted Asset
TA	Technical Assistance
TSA	The Standardised Approach
SA	Standardised Approach
SMM	Standardised Measurement Method
Stanbic	Stanbic Bank Botswana Limited
Stanchart	Standard Chartered Bank Botswana Limited
USD	United States Dollar
VAT	Value Added Tax
ZAR	South African Rand

FOREWORD

This Annual Report presents information on banking regulation and supervision as well as the structure and performance of the banking sector in 2019.

Global economic growth slowed in 2019, reflecting weaker performance in all regions of the world. Economic activity was weighed down by negative sentiment engendered by the prolonged trade tension between China and the United States of America as well as uncertain prospects for Brexit, which adversely affected investment and trade. With respect to Botswana, real Gross Domestic Product (GDP) expanded by 3 percent in 2019, a slower pace of growth compared to the 4.5 percent in 2018. The deceleration in output growth in 2019 was due to a relatively weak performance of both the mining and non-mining sectors.

The Bank received one application for a banking licence that was subsequently withdrawn by the applicant before the application could be processed. Therefore, there was no new banking licence issued in 2019. Furthermore, following the decision by the Government of India to rationalise overseas operations of Indian banks, the entire shareholding of Bank of India (Botswana) Limited (BoI) was acquired by First Capital Bank Limited. Consequently, BoI surrendered its banking licence and exited the Botswana market. As a result, the number of licensed banks in Botswana decreased from ten to nine.

Relative to GDP, the banking sector size grew, as reflected in an increase in the ratio of banking assets to GDP, from 48 percent in 2018 to 50 percent in 2019; access to banking services, indicated by the ratio of the number of depositors to adult population, also increased from 70 percent to 72 percent in the same period. Overall estimates indicate that, in the recent period, financial sector development and depth have been sluggish and compare unfavourably with those for peer upper middle-income countries.

During the year, credit growth was 7.6 percent, virtually constant compared to 7.7 percent in 2018; deposits grew by 9.3 percent. The average cost of deposits ratio increased, albeit marginally. The cost-to-income ratio fell slightly to 58.3 percent compared to 60.7 percent in the previous year. The overall effect was an increase in the banking sector profitability in 2019. There was an improvement in the banking sector asset quality as measured by non-performing loans. In this regard, the ratio of non-performing loans to gross loans and advances decreased from 5.5 percent in 2018 to 4.8 percent in 2019.

Banks largely met the minimum prescribed disclosure standards as set out in Pillar 3 disclosure requirements of the Revised Directive on International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II Capital Directive). In this context, the Bank will continue to monitor developments and provide guidance, as necessary, to ensure improvement in the quality, consistency and comparability of financial and regulatory disclosure across banks.

Consistent with established practice, statutory annual meetings for discussion of issues of mutual interest between the Bank and supervised institutions were held. As in the previous year, the Bank participated in supervisory college meetings for global and regional banks with subsidiaries in Botswana. The meetings provide a regular forum for collaboration, coordination and exchange of information among supervisory authorities for internationally active banking groups for purposes of facilitating effectiveness of group-wide consolidated supervision.

Overall, in 2019, banks were compliant with statutory and other prudential requirements; in cases of non-compliance, appropriate supervisory actions, including remedial measures, were implemented in accordance with applicable laws and regulations. Overall, the banking system remained safe and sound, adequately capitalised and liquid, and profitable.

FOREWORD

It is worth noting that at the time of preparing this report, the global economy was subject to an unfolding crisis engendered by the outbreak of the coronavirus disease (COVID-19). Many countries, including Botswana, implemented containment measures of varying duration and degrees of intensity to mitigate the spread of the disease. These measures include extreme social distancing and restrictions of movement of people within and outside countries, resulting in disruption to supply chains and services, project implementation and production, thus negatively affecting economic activity. It is expected that the COVID-19-induced economic downturn will weaken the banking sector through an increase in non-performing loans (NPLs), resulting from the widespread loss of employment and curtailed business production and sales.

To avert a potential deeper and protracted economic dislocation due to constrained supply of credit resulting from the COVID-19 pandemic, the Bank decided to amend the Basel II Capital Directive by reducing the capital adequacy ratio for banks from 15 percent to 12.5 percent and implement measures to ensure an uninterrupted supply of bank liquidity.

Finally, I would like to thank the Board for continuing guidance on the various aspects of the operations of the Bank, including banking supervision.

Moses D Pelaelo
GOVERNOR

INTRODUCTION

In accordance with the provisions of the Banking Act (Cap. 46:04) (Banking Act), the Bank of Botswana Act (Cap. 55:01) and the Bank of Botswana (Bureaux de Change) Regulations, the Bank of Botswana (Bank) regulates and supervises banks, bureaux de change and one deposit-taking microfinance institution. The number of licensed commercial banks has decreased from ten to nine following the acquisition of the entire shareholding of Bank of India (Botswana) Limited by First Capital Bank Limited (FCB), while that of statutory banks remained at three in 2019. The number of bureaux de change was 60, a modest increase from 57 in 2018.

Commercial and statutory banks employed a total of 5 172 people in 2019 compared to 5 270 in 2018. As a response to ever-changing customer needs and the intensifying competition in the banking industry, banks continued to improve products and service offerings to meet the demands of the economy and sustain viable and profitable operations.

Total assets for the banking industry grew by 8 percent from P91.3 billion in 2018 to P98.7 billion in 2019; customer deposits increased by 9.3 percent from P69.3 billion in 2018 to P75.7 billion in 2019, contributing 77 percent to liabilities. The increase in deposits supported a 7.6 percent expansion in loans and advances from P58.3 billion to P62.8 billion in the same period, although slower than the growth of 7.7 percent in the previous year. As a result, the financial intermediation ratio declined from 84.2 percent in 2018 to 82.9 percent in 2019. Core indicators of financial sector depth and development continue to demonstrate that the country's banking industry is small relative to gross domestic product (GDP). There is, therefore, significant scope for growth enabled by adoption of new technologies, sound governance standards and institutional arrangements as well as facilitative and effective policies and regulation.

The banking industry remained adequately capitalised and complied with minimum prudential standards for regulatory capital requirements. The aggregate unimpaired capital for the banking industry increased by 6.4 percent from P12.1 billion in 2018 to P12.8 billion in 2019. All banks reported capital adequacy and common equity Tier 1 capital ratios in excess of the respective prudential minimum requirement of 15 percent and 4.5 percent.

Past due loans (accounts in arrears) decreased by 3.7 percent between December 2018 and December 2019; the amount of NPLs declined by 3.6 percent to P3.1 billion in the same period. The resultant ratio of NPLs to gross loans and advances was 4.8 percent in December 2019, a decrease from 5.5 percent in December 2018, indicating an improvement in the banking industry asset quality. The ratio of specific provisions to NPLs rose from 42.7 percent in 2018 to 58.2 percent in 2019, reflecting the effect of the International Financial Reporting Standard (IFRS) 9. The banks' large exposures to unimpaired capital ratio decreased from 209 percent to 150.5 percent in the same period and thus within the 800 percent prudential limit for banks in Botswana.

Generally, the composite credit risk for the banking industry was considered high. The credit quality is expected to deteriorate in the short-to-medium term as a result of the anticipated negative economic impact of COVID-19 on businesses and households, which is likely to lead to an increase in loan defaults or credit impairments. A large proportion of bank credit in Botswana is accounted for by the household credit, which, although mostly unsecured, is to a large number of relatively small uncorrelated borrowers employed, in the main, by the public sector.

The profitability of the banking industry improved in 2019 as aggregate after-tax profit increased by 5.1 percent from P1.7 billion in 2018 to P1.8 billion in 2019. The return on equity increased from 16.1 percent in 2018 to 16.2 percent in 2019, while the return on average assets was constant at 1.9 percent in the same period. Profitability ratios remained strong and in line with international norms for banks of comparable size.

INTRODUCTION (CONTINUED)

The banking industry remained liquid: statutory liquid assets increased by 11.1 percent to P14.7 billion in 2019 from P13.2 billion in 2018. As a result, the liquid assets to total deposits ratio (LAR) for banks rose from 19 percent in 2018 to 19.3 percent in 2019, above the 10 percent prudential minimum requirement. This notwithstanding, the banking sector continued to show high levels of funding and maturity mismatches. Banks continued to be funded by short-term, highly volatile deposits of large corporates, pension funds and institutional investors.

The regulatory and supervisory oversight by the Bank continued to focus on ensuring adherence to good governance standards and appropriate level of risk-taking by regulated institutions. The oversight framework encompasses on-site examination and off-site monitoring of banks using a risk-based supervision (RBS) approach and off-site surveillance (OSS) system. In addition to the prudential assessment, the Bank monitored the business conduct of banks to ensure that their customers were treated in a fair, professional and transparent manner.

In accordance with Section 24 of the Banking Act, the Bank carried out full-scope, limited-scope and follow-up on-site prudential and consumer-compliance examinations of five banks during 2019. In addition, the Bank conducted full-scope, limited-scope and follow-up on-site examinations of four banks on anti-money laundering and combating the financing of terrorism (AML/CFT). Overall, the results indicated sound governance, effective internal control environment and satisfactory market conduct. There were, however, some areas relating to consumer complaints management that required improvement; for example, there were instances where the annual percentage rate was not accurate and, in some cases, customers were charged for early loan settlement even after giving a 45-day notice.

Banks continued to comply with the minimum public disclosure and statutory requirements on bank charges by publishing monthly interest rates payable on deposits on their websites as well as in at least two newspapers widely circulated in Botswana. Large-value and longer-maturity deposits continued to earn commensurately higher deposit rates.

The Bank continued to guide banks on the requirements of the anti-money laundering and combating terrorist financing compliance regime to enhance effectiveness. Botswana made a high-level commitment to strengthen the effectiveness of its AML/CFT regime and address related strategic deficiencies. During 2019, three progress reports were submitted to the Financial Action Task Force (FATF) – International Cooperation Review Group Africa/Middle East Joint Group. FATF held a meeting in France in October 2019, following which a statement of progress made by Botswana was issued. It was noted that Botswana had adopted risk-based AML/CFT supervisory manuals for financial sector supervisors and implemented an electronic suspicious transactions reporting filing system among financial institutions and certain types of designated non-financial businesses and professions. The country is continuing efforts to ensure compliance with respect to non-compliant and partially compliant FATF recommendations in order to be removed from the grey listed countries.[1]

This report is organised as follows: Chapter 1 outlines the structure of the financial sector, with particular emphasis on banks; Chapter 2 presents an assessment of the financial performance of the banking industry in 2019; Chapter 3 reports on licensing and consumer protection issues; Chapter 4 highlights the recent global standards and guidelines issued by the Basel Committee on Banking Supervision; and Chapter 5 summarises key issues arising from the on-site and off-site examination processes. Appendices are provided at the end of the report.

[1] The European Union included Botswana on a list of high-risk countries using the 2018 FATF list of countries requiring close monitoring.

CHAPTER 1

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS

STRUCTURE OF THE FINANCIAL SECTOR

1.1 The Bank of Botswana (Bank) continued to regulate and supervise commercial banks, bureaux de change and a deposit-taking microfinance institution (Women's Finance House). As at December 31, 2019, the number of licensed commercial and statutory banks was nine and three, respectively. The number of licensed commercial banks decreased to nine in 2019 following the acquisition of Bank of India (Botswana) Limited (BoI) by First Capital Bank Limited (FCB). During 2019, six bureaux de change were licensed, while licences for three bureaux de change were revoked, resulting in an increase in the total number of licensed bureaux de change from 57 in 2018 to 60 in 2019.

Banking Sector Branch Network and Other Delivery Channels

1.2 Table 1.1 shows the number of bank branches and automated teller machines (ATMs) from 2017 to 2019. The restructuring of operations by banks resulted in the opening of ten new branches and closure of one. As a result, bank branches increased from 146 to 155 in 2019. The number of ATMs increased from 523 to 542 during the year. Most of the new ATMs have enhanced functions, including the deposit-taking capability, thus improving the convenience of access to transactional banking services.

1.3 With respect to the geographical distribution of the branch network, the South East District, which includes the capital city, Gaborone, led the concentration of branches at 65, followed by the Central District with 35, as at December 31, 2019. Nine districts, South East (2), Central (2), Chobe (1), Ghanzi (1), Kgalagadi (1), Kweneng (1), North West (1) and Southern (1) had an increase in branch network, while the branch network for other districts was unchanged (Appendix 2). 2018. Central district had an increase of 1 branch, while the branch network for the other districts was unchanged (Appendix 2).

Table 1.1: Bank Branches and Other Delivery Channels: 2017 – 2019

		Branches and Sub-branches			ATMs		
		2017	2018	2019	2017	2018	2019
Large Banks	Barclays*	34	34	35	113	113	113
	Stanchart	21	19	19	67	68	70
	FNBB*	27	28	28	206	226	233
	Stanbic*	16	16	17	34	53	56
	BancABC*	9	9	13	15	15	14
	Sub-Total	**107**	**106**	**112**	**435**	**475**	**486**
Small Banks	Baroda	3	3	4	6	6	6
	Bank Gaborone*	9	12	13	11	16	16
	FCB	4	4	5	6	6	6
	BoI	1	1	-	-	-	-
	Bank SBI	1	1	1	-	-	-
	Sub-Total	**18**	**21**	**23**	**23**	**28**	**28**
Total (Commercial Banks)		**125**	**127**	**135**	**458**	**503**	**514**
Statutory Banks	BSB*	5	5	6	3	8	14
	BBSL	9	10	10	12	12	14
	NDB	4	4	4	-	-	-
Total for Statutory Banks		**18**	**19**	**20**	**15**	**20**	**28**
Aggregate		**143**	**146**	**155**	**473**	**523**	**542**

*2018 figures were revised.

Source: Commercial and Statutory Banks (Statutory Returns submitted to the Bank).

Access Indicators

1.4 Access to banking services, as measured by the ratio of number of depositors to adult[2] population, increased from 70 percent in 2018 to 72 percent in 2019. The number of depositors grew by 5.3 percent from 1.11 million in 2018 to 1.17 million in 2019, while the adult population increased by 2.1 percent from 1.59 million to 1.63 million.

1.5 The number of ATMs per 1 000 square kilometres and per 10 000 adults was one and three, respectively, in 2019, the same as in 2018, while there was one branch per 10 000 adults, and a statistical average of less than one branch per 1 000 square kilometres, indicative of the sparse population distribution in the country.

[2] Adult refers to persons aged 15 and above. Projections for population were obtained from the Statistics Botswana Population Projections for Botswana 2011–2026 Report; medium scenario projections were used.

Banking Sector Employment Trends: 2018 and 2019

1.6 In the banking sector, employment levels for 2018 and 2019 are shown in Table 1.2. The number of people directly employed in the banking sector decreased from 5 270 in 2018 to 5 172 in 2019, representing a decline of 1.9 percent. The reduction in employment was distributed across five banks. Rationalisation of operations, including increased automation and use of digital channels, along with staff resignations and retirement, accounted for the reduced employment at the respective banks. While there was a decrease in staff complement for some banks, there was an increase with respect to seven banks. Overall, the staff complement for small banks increased by 9.2 percent from 500 in 2018 to 546 in 2019; for large banks,[3] the level of employment declined by 2.2 percent from 4 226 in 2018 to 4 134 in 2019. Expatriate representation was virtually unchanged, with a decrease of one from 60 to 59.

Table 1.2: Level of Employment by Domestic Banks: 2018 – 2019

		2018			2019		
		Citizens	Expatriates	Total	Citizens	Expatriates	Total
Large Banks	Barclays	1 152	4	**1 156**	1 156	4	**1 160**
	Stanchart	753	12	**765**	641	10	**651**
	FNBB	1 365	4	**1 369**	1 396	4	**1 400**
	Stanbic	589	3	**592**	565	5	**570**
	BancABC	342	2	**344**	352	1	**353**
	Sub-Total	4 201	25	4 226	4 110	24	4 134
Small Banks	Baroda	37	13	**50**	44	13	**57**
	Bank Gaborone	266	6	**272**	292	7	**299**
	FCB	145	7	**152**	169	8	**177**
	BoI	5	4	**9**			
	Bank SBI	14	3	**17**	10	3	**13**
	Sub-Total	467	33	500	515	31	546
Aggregate (Commercial Banks)		4 668	58	4 726	4 625	55	4 680
Statutory Banks	BSB	176	-	**176**	165	-	**165**
	BBSL	212	2	**214**	215	4	**219**
	NDB	154	-	**154**	108	-	**108**
Total for Statutory Banks		542	2	544	488	4	492
Grand Total		5 210	60	5 270	5 113	59	5 172

Source: Commercial and Statutory Banks (Statutory Returns submitted to the Bank).

[3] A large bank refers to a bank with total assets amounting to at least 10 percent of the aggregate banking sector total assets as at December 31, 2019.

New Banking Sector Products and Services

1.7 Disclosure of key information about a product is crucial to consumer awareness and protection as it enables customers to make informed decisions and choices from the range of products and services offered in the market. Banks continued to diversify, develop and improve their products and services to meet evolving customer needs and to accommodate and harness industry and technical innovation in areas of potential business growth.

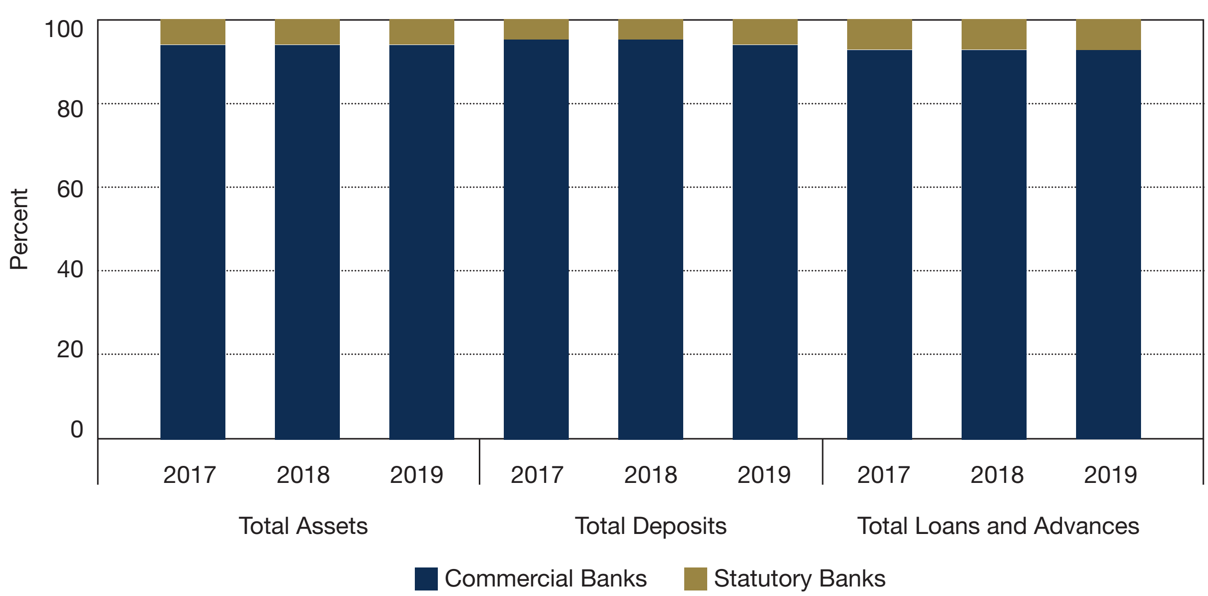
1.8 During the review period, banks introduced 17 new products and services covering a wide range of banking services, such as enhancement of transactional accounts and introduction of cross-border payment services. Most of these products and services target retail customers, with a view to retaining clients and broadening the customer base. Some banks have established collaborative arrangements with money-transfer service providers to facilitate provision of financial and payments services to the unbanked segment of society and therefore helping to broaden financial inclusion.

BANKING SECTOR COMPETITION AND CONCENTRATION

Market Share

1.9 Commercial banks maintained a dominant share of total banking industry assets, deposits, and loans and advances compared to statutory banks (Chart 1.1). The market share of statutory banks increased with respect to total assets and deposits to 7.3 percent and 6.7 percent in 2019 compared to 6.7 percent and 5.8 percent, respectively, in 2018. With regard to loans and advances, the statutory banks market share decreased to 7.5 percent from 7.7 percent in the same period.

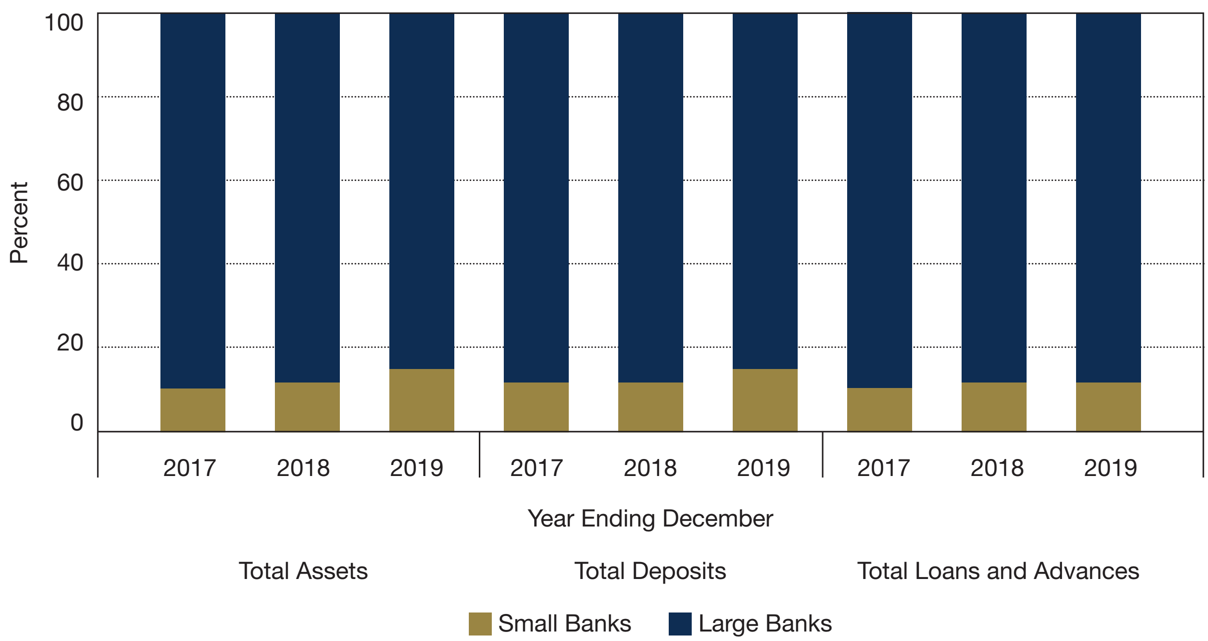
Chart 1.1: Banking Sector Market Share of Total Assets, Total Deposits and Total Loans and Advances*: 2017 – 2019 (Percent)



*Figures exclude one statutory bank.
Source: Commercial and Statutory Banks (Statutory Returns submitted to the Bank).

1.10 Five large banks continued to dominate the banking sector and accounted, in aggregate, for 84.7 percent, 85.3 percent and 87.5 percent of total assets, total deposits and total loans and advances, respectively, in 2019, which were lower than the respective proportions of 88.7 percent, 87.9 percent and 87.8 percent in 2018, reflecting some market gains by small banks.

Chart 1.2: Market Share of Total Assets, Total Deposits and Total Loans and Advances of Commercial Banks: 2017 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

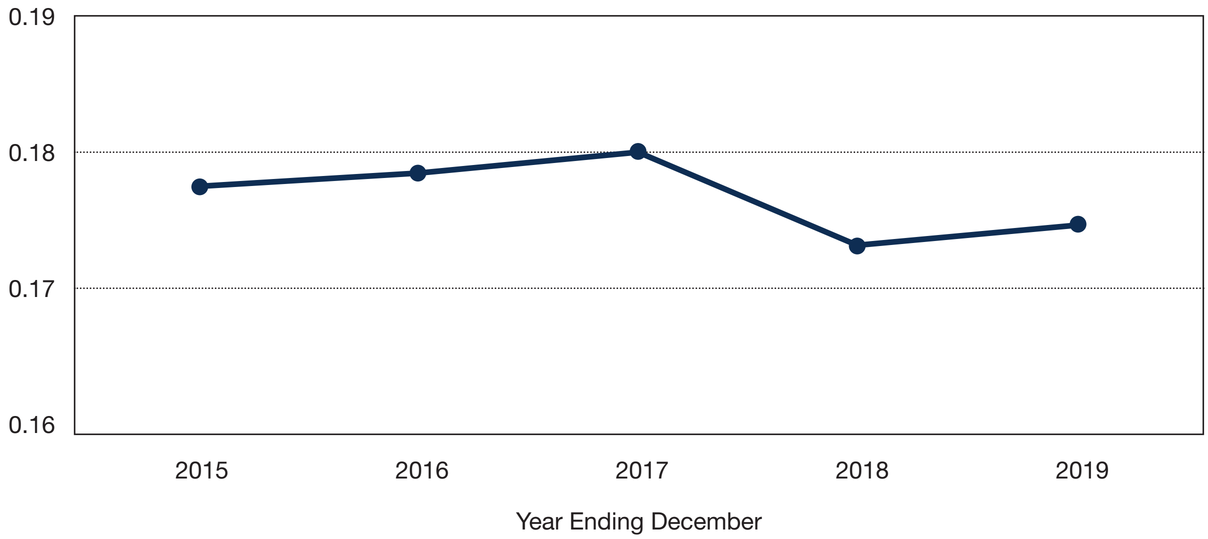
Market Competition Indicators

The Herfindahl-Hirschman Index (HHI) of Competitiveness

1.11 In addition to other measures, the Bank uses the Herfindahl-Hirschman Index[4] (HHI), a widely applied measure of market concentration, to assess the degree of competition in the Botswana banking industry. The HHI marginally increased from 0.1732 in 2018 to 0.1756 in 2019, indicating a modest loss in market competition (Chart 1.3). The measure, however, remains lower than 0.1800, indicative of the continuance of a moderately concentrated market.

[4] The HHI (calculated as the sum of squares of market shares of all banks) threshold indicators for the level of concentration in an industry are as follows: below 0.01, the market is highly competitive; values below 0.1 indicate an unconcentrated market; values between 0.1 and 0.18 indicate a moderately concentrated market; for a monopolist market, the HHI=1.

Chart 1.3: Herfindahl-Hirschman Index (HHI): 2015 – 2019

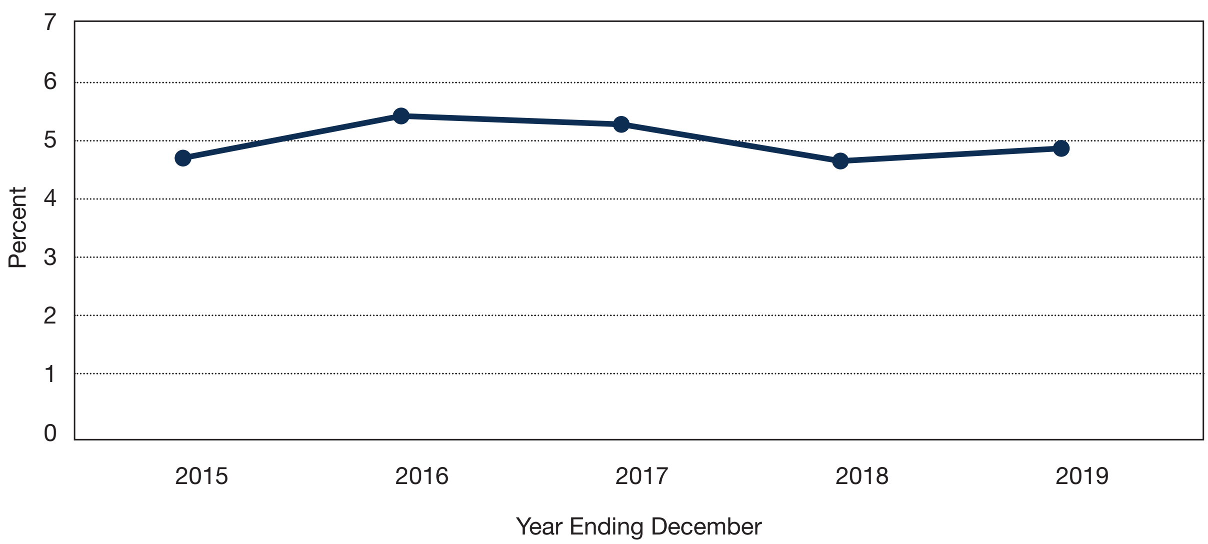


Source: Commercial Banks (Statutory Returns submitted to the Bank).

Net Interest Margin

1.12 The net interest margin (NIM) for the banking industry increased from 4.8 percent in 2018 to 4.9 percent in 2019 (Chart 1.4). A significant increase in the NIM would signal reduced competitiveness of the banking system. It is noted, however, that, in addition to competitive forces, the NIM can be driven by factors such as operating costs, loan quality and the macroeconomic environment, including interest rates and demand (although aspects of these may be indirect facets of market competition).

Chart 1.4: Banking Sector Trend of Net Interest Margin (NIM): 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

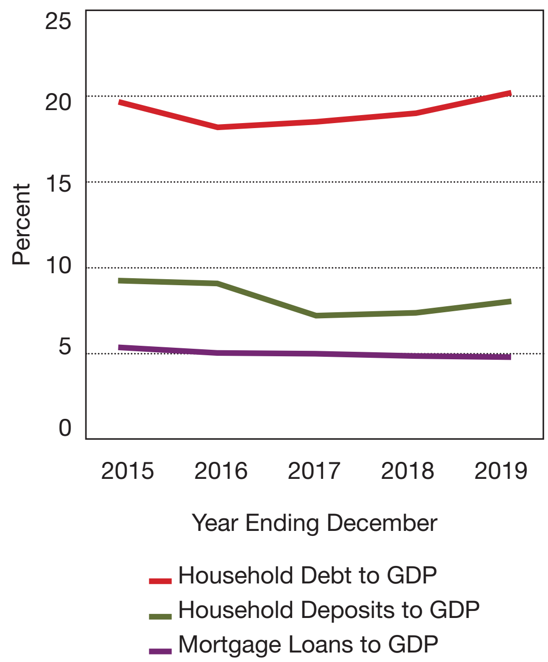
Operating Expenses to Total Assets Ratio

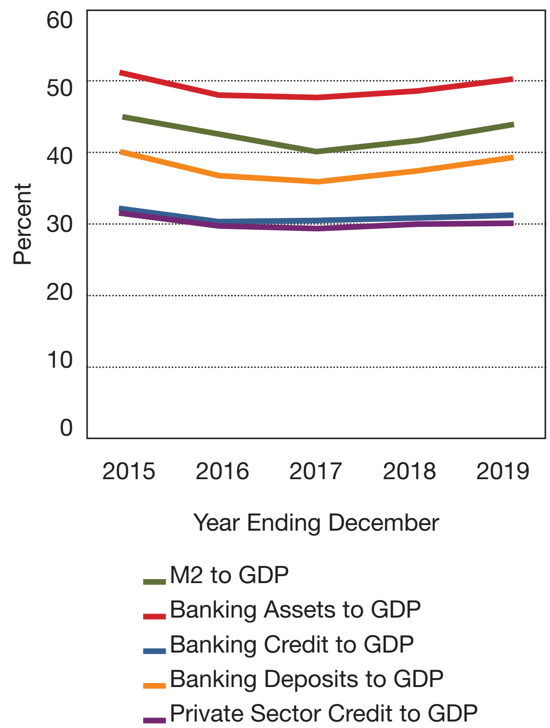
1.13 The ratio of operating expenses to total assets declined from 4.4 percent to 4.2 percent in the same period, implying some degree of efficiency improvement in generating banking assets.

BANKING SECTOR SIZE AND DEPTH

1.14 Financial deepening refers to the increased use, relative to overall economic activity, of financial services, particularly broader choices with improved access by various societal groups, thus a greater and beneficial role of financial services in business activity, enhanced welfare and living standards and overall economic performance. Chart 1.5 shows several ratios commonly used as measures of financial deepening and development. Overall, financial sector development and depth have been sluggish in the past five years, highlighting scope for improvement through policy stimulus, structural transformation and strategic realignment by financial institutions to achieve sustainable and impactful financial sector support for economic activity.

Chart 1.5: Financial Sector Deepening Indicators: 2015 – 2019 (Percent)



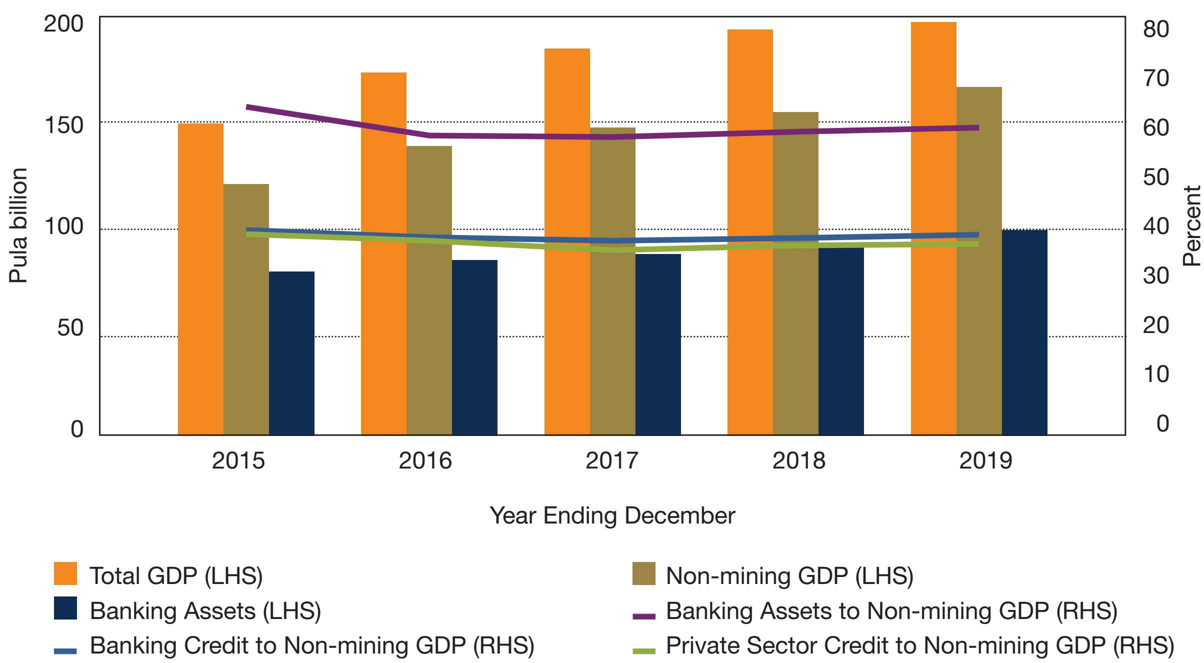


Source: Commercial Banks (Statutory Returns submitted to the Bank) and Statistics Botswana.

1.15 Financial depth and development, as estimated by the ratio of private sector credit to GDP,[5] increased marginally from 28.9 percent in 2018 to 30 percent in 2019. Similarly, private sector credit as a proportion of non-mining GDP rose from 34.6 percent in 2018 to 35.4 percent in 2019. When benchmarked against the global average ratio of private sector credit to GDP of 52.2 percent (as reported by the World Bank's 2019/2020 Global Financial Development Report), the Botswana banking system is relatively small, suggesting capacity for further growth in an environment of stable macroeconomic conditions and prudent credit expansion. The ratio was, however, higher than the sub-Saharan African average of 21.6 percent.

1.16 Banking credit as a share of GDP grew from 30.6 percent in 2018 to 31.8 percent in 2019 (Chart 1.5). The increase in the ratio was a result of a faster growth in banking credit (7.6 percent) compared to a 3.6 percent growth in nominal GDP. The proportion of banking assets in non-mining GDP increased from 57.5 percent in 2018 to 59 percent in 2019 (Chart 1.6). Regarding the overall size of the banking sector, the ratio of banking assets to GDP increased to 50 percent in 2019 from 48 percent in 2018 owing to a faster growth (8 percent) in banking assets than the 3.6 percent increase in nominal GDP (Chart 1.5).

Chart 1.6: Financial Sector Size and Depth Indicators: 2015 – 2019



Source: Commercial Banks (Statutory Returns submitted to the Bank) and Statistics Botswana.

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

1.17 The M2[6] to GDP ratio, which estimates the degree of monetisation of an economy, increased from 41.2 percent in 2018 to 43 percent in 2019, showing a marginal improvement. A high M2 to GDP ratio would suggest that a significant part of economic activity was supported by the financial resources mobilised by the banking sector.

1.18 Total household debt as a proportion of GDP increased from 18.4 percent in 2018 to 20.3 percent in 2019. Despite this increase, the commercial bank mortgage lending to GDP ratio decreased slightly from 5.1 percent to 4.9 percent in the same period. Similarly, including statutory banks, the broader ratio of mortgage lending to GDP declined marginally from 7.2 percent in 2018 to 7.1 percent in 2019. This relatively low level of mortgage lending and, in general, housing finance, is a cause for concern, especially in the context of the banking sector dominated by unsecured household lending. The ratio of household deposits to GDP[7] increased from 7.3 percent in 2018 to 8.1 percent in 2019, indicating enhanced mobilisation of household financial resources by banks.

1.19 The ratio of pension fund assets to GDP increased from 41.5 percent in 2018 to 47.2 percent in 2019, reflecting the growth of 17.9 percent in pension fund assets. Pension funds amounted to P93.1 billion in 2019. Meanwhile, as at December 31, 2019, household savings in the banking sector and pension funds amounted to P109.2 billion compared to the household borrowing of P40 billion.[8] Therefore, including pension funds, the household sector was a net saver in the economy.

1.20 The value of electronic funds transfer transactions (EFTs) relative to GDP rose from 8.6 percent in 2018 to 10.2 percent in 2019, mainly reflecting growth of 22.2 percent in EFTs.

[6] M2 comprises all liabilities of financial corporations included in a country's definition of broad money. In the case of Botswana, M2 (P84.8 billion) comprises currency outside depository corporations, transferable deposits (demand deposits) and other deposits included in broad money (time and fixed deposits).

[7] Household deposits grew by 16 percent compared to a 3.6 percent growth in nominal GDP.

[8] Data used was obtained from pension funds and commercial banks. Because of data limitations, the analysis does not include other financial institutions, such as micro-lenders and insurance companies.

BOX 1: EFFECT OF THE IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARD 16 ON BANKS

International Financial Reporting Standard (IFRS) 16 – Leases was issued in January 2016 and, in comparison to its predecessor, International Accounting Standard (IAS) 17, IFRS 16 makes significant changes to the way in which leasing transactions are reported in the financial statements of lessees.

A lease is a contract by which one party conveys, among others, land, property and services to another for a specified time, usually in return for a periodic payment. IFRS 16 defines a lease as a contract or part of a contract that conveys the right to use an asset for a period in exchange for payment. According to IFRS 16, for such a contract to exist, the user of the asset needs to have the right to obtain substantially all the economic benefits from the use of the asset and the right to direct use of the asset.

Banks enter into long-term operating leases to use the leased property for branches and call centres. Under IAS 17, operating lease assets were not recognised on a bank's balance sheet. Instead, a rental expense was recognised in the income statement. To recognise the rental expense in the income statement under IFRS 16, a discount factor is applied on the total rental amount for the lease period, spread between the lease period and allocated between depreciation and interest expense (on the lease liability). As a result, the operating income of banks is expected to remain generally unchanged (at the end of the lease period) following the adoption of IFRS 16 because a bank pays an amount equivalent to the rental expense that it would pay under IAS 17; the difference is that payments for interest expense under IFRS 16 are higher for the initial years of the lease period, and gradually decrease when the interest expense tapers off towards the end of the lease. However, the depreciation amount remains the same because it is calculated using the straight-line method.

Under IAS 17, banks did not report operating lease assets in their statements of financial position. Therefore, such assets received no risk-weighting for the purposes of capital calculations. In the context of IFRS 16, the right-of-use assets are expected to be recorded on the balance sheet and be classified as non-counterparty-related assets like a bank's own property, plant and equipment. For banks with material off-balance-sheet leases, the implementation of IFRS 16 is expected to increase risk-weighted assets and, as a result, the capital ratios used for calculating the regulatory capital will also rise; such assets are expected to be treated as tangible assets and to receive a risk weight of 100 percent, making it expensive and capital depletive for banks upon adoption of IFRS 16. The statement of financial position is also expected to increase as a result of the recognition of the lease liability and the right to use leased assets as own.

There is no significant change of lease accounting for lessors under IFRS 16. The lessor will continue to classify leases as either finance or operating leases. IFRS 16, however, introduces additional disclosure requirements for assets subject to operating leases and how the lessor manages risks relating to residual values.

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https://home.kpmg/ch/en/blogs/home/posts/2016/01/ifrs-16-leases-impact-on-financial-institutions.html

CHAPTER 2

PERFORMANCE OF THE BANKING INDUSTRY

CHAPTER **2**:
PERFORMANCE OF THE BANKING INDUSTRY

COMMERCIAL BANKS

Statement of Financial Position: Balance Sheet

Assets

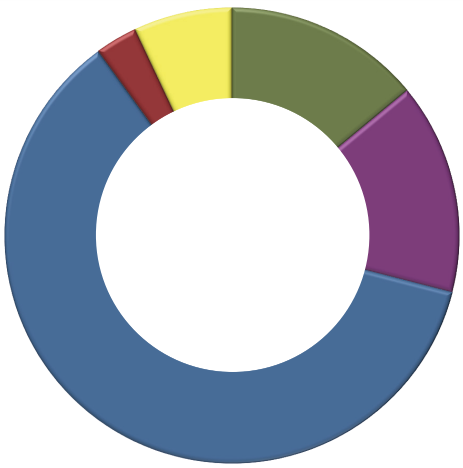
2.1 Total assets of the banking industry continued to grow, increasing by 8 percent in 2019, albeit at a slower rate compared to 9.4 percent in 2018. The banking assets amounted to P98.7 billion as at December 31, 2019, compared to P91.3 billion in December 2018. The growth in assets was mainly driven by gross loans and advances, which increased by 7.6 percent from P58.3 billion in 2018 to P62.8 billion in 2019. The increase of 17 percent in investment and trading securities also contributed to the expansion of banking assets in the review period. Net loans and advances remained the largest component of total assets of the banking sector at 61 percent, followed by placements with other banks and credit institutions (15 percent), investment and trading securities (14 percent), cash and balances with the central bank (7 percent) and other assets (3 percent).

Liabilities

2.2 Total liabilities (excluding shareholder funds) of the banking sector grew by 8.4 percent from P81 billion in December 2018 to P87.8 billion in December 2019. Of the total liabilities, customer deposits, which constituted 77 percent of the total, increased by 9.3 percent from P69.3 billion in 2018 to P75.7 billion in 2019. All components of total liabilities increased, except for balances due to other banks and credit institutions, which fell by 4.3 percent to P4.5 billion in 2019.

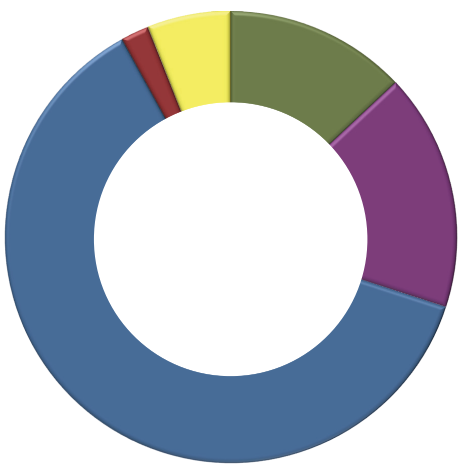
2.3 Charts 2.1 and 2.2 show the composition of assets and liabilities in 2018 and 2019, respectively. There was a slight change in the constituent asset shares, while those of liabilities remained largely unchanged.

Chart 2.1: Commercial Banks: Composition of Assets: 2018 and 2019 (Percent)



December 31, 2019

Cash and Balances with the Central Bank	7
Investment and Trading Securities	14
Placements with Other Banks and Credit Institutions	15
Net Loans and Advances	61
Other Assets	3

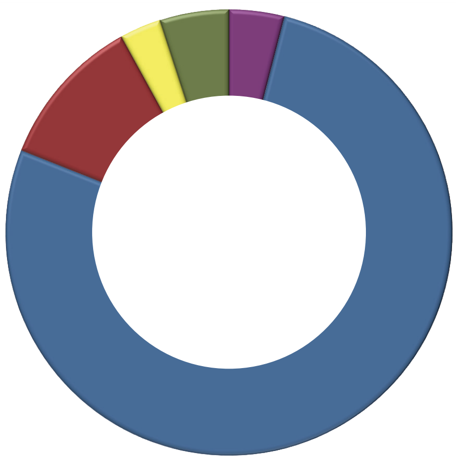


December 31, 2018

Cash and Balances with the Central Bank	6
Investment and Trading Securities	13
Placements with Other Banks and Credit Institutions	17
Net Loans and Advances	62
Other Assets	2

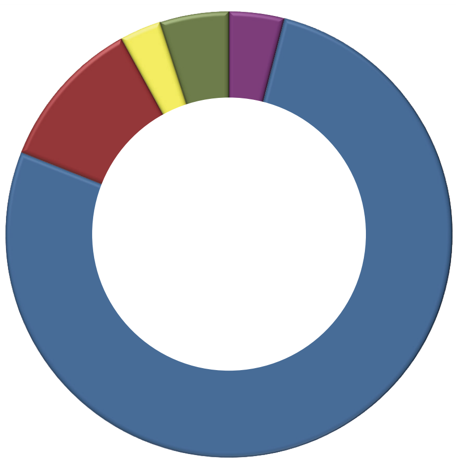
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Chart 2.2: Commercial Banks: Composition of Liabilities: 2018 and 2019 (Percent)



December 31, 2019

Due to Other Banks and Credit Institutions	4
Customer Deposits	77
Shareholder Funds	11
Other Liabilities	3
Debt Securities and Other Borrowing	5



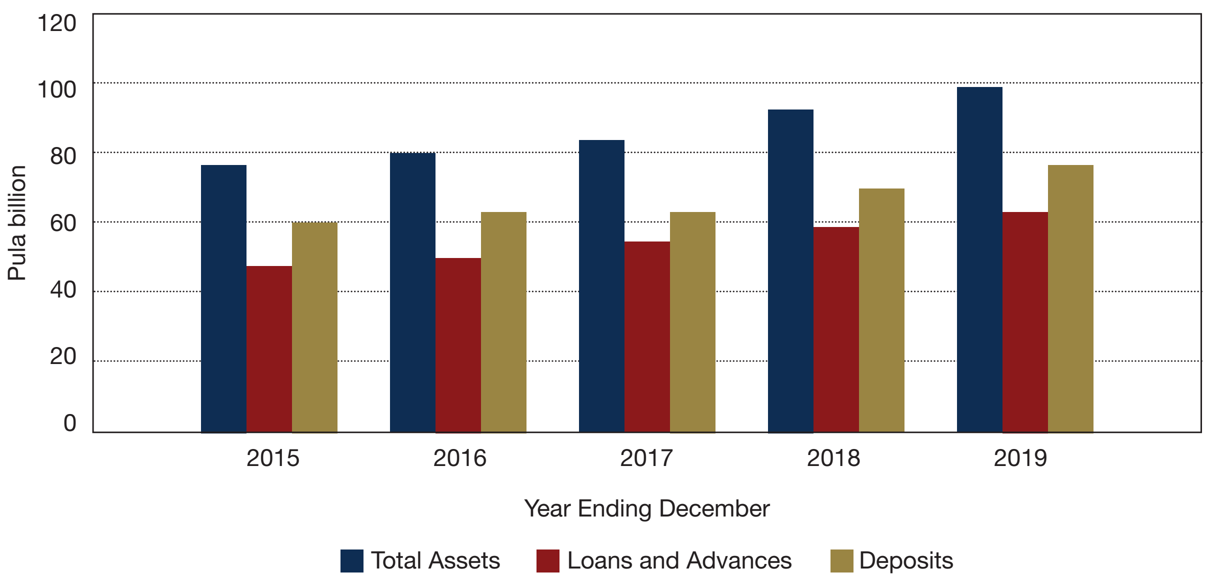
December 31, 2018

Due to Other Banks and Credit Institutions	5
Customer Deposits	76
Shareholder Funds	11
Other Liabilities	3
Debt Securities and Other Borrowing	5

Source: Commercial Banks (Statutory Returns submitted to the Bank).

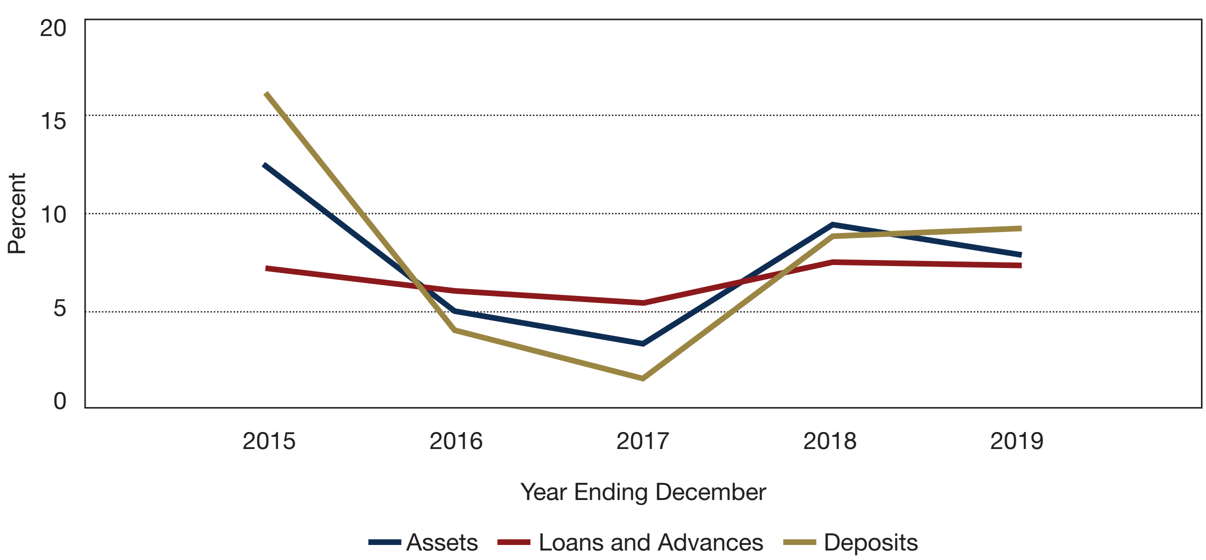
2.4 Chart 2.3 shows the level of assets, deposits and loans and advances, while Chart 2.4 presents growth rates of assets, deposits, and loans and advances for the period 2015 – 2019. There was a slight increase in the growth rates for loans and advances and deposits in 2019, compared to 2018, continuing the trend that began in 2017.

Chart 2.3: Commercial Banks: Total Assets, Total Deposits and Total Loans and Advances: 2015 – 2019 (Pula billion)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Chart 2.4: Commercial Banks: Annual Growth Rates of Total Assets, Total Deposits and Total Loans and Advances: 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Riskiness of On-balance-Sheet Assets

2.5 Table 2.1 compares the riskiness of on-balance-sheet assets of banks as at December 31, 2018, and December 31, 2019. Total assets held by banks with risk weights of 35 percent, 100 percent and 150 percent declined in 2019. On-balance-sheet assets risk-weighted at 75 percent had the largest share of 34.3 percent; that was a result of the migration of one bank's residential mortgages from the 35 percent risk weight to the 75 percent risk weight as the bank did not value the properties within the three-year period as required. This risk-weight substitution is consistent with the Revised Directive on International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II Capital Directive).

2.6 Overall, 26 percent of on-balance-sheet asset items were above the 75 percent risk-weight category in 2019 compared to 29.1 percent in 2018, indicating a modest decrease in the riskiness of bank assets.

Table 2.1: Riskiness of Banks' Portfolios of On-balance Sheet Assets in 2018 and 2019

Risk Weights (Percent)	On-balance-Sheet Assets (Pula million)	Shares of On-balance-sheet Asset Items in Total On-balance-sheet Assets (Percent)	On-balance-sheet Assets (Pula million)	Shares of On-balance-sheet Asset Items in Total On-balance-sheet Assets (Percent)
	December 2018*		December 2019	
0	16 950	18.5	19 945	19.9
20	10 615	11.6	12 418	12.4
35	8 280	9.0	5 373	5.4
50	1 791	2.0	2 007	2.0
75	27 195	29.7	34 318	34.3
100	25 110	27.4	24 985	25.0
150	1 506	1.6	941	0.9
250	52	0.1	65	0.1
Total	91 499	100.0	100 053	100.0

*2018 figures were revised.

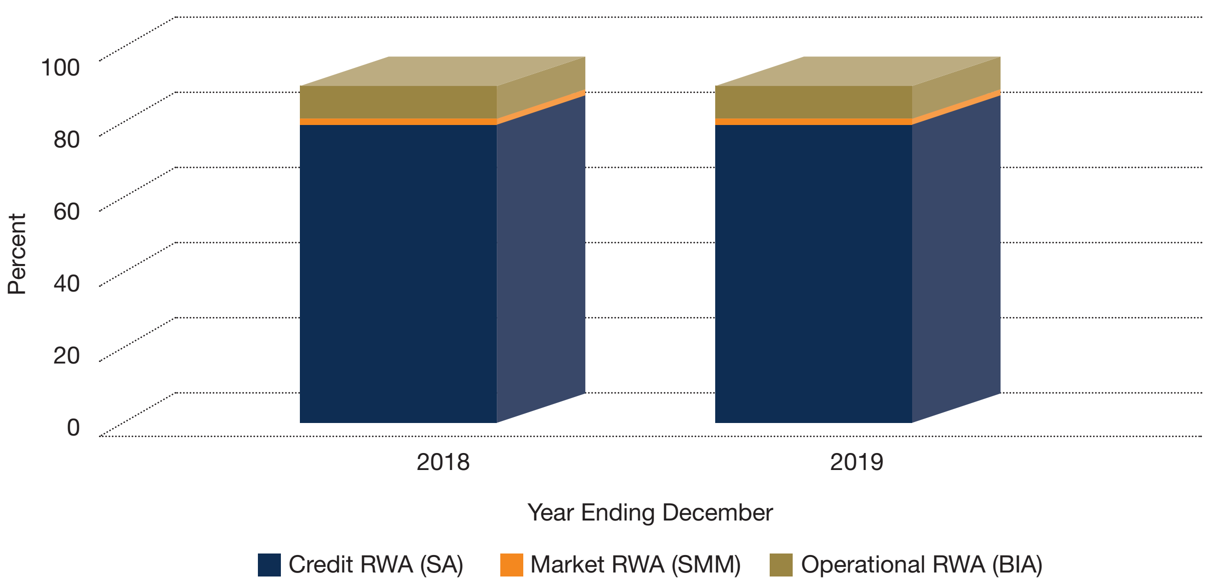
Source: Commercial Banks (Statutory Returns submitted to the Bank).

RISK ASSESSMENT

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

2.8 Chart 2.5 shows the aggregate risk-weighted assets (RWAs) of the banking sector in 2018 and 2019 as calculated under Pillar 1 of Basel II. Total RWAs increased by 6 percent from P62.5 billion in 2018 to P66.3 billion in 2019, mainly indicative of the growth in loans and advances. Proportions of RWAs were the same as in the previous year, with credit RWAs constituting the bulk of the banking sector's RWAs at 89 percent, followed by operational RWAs at 10 percent and market RWAs at one percent.

Chart 2.5: Composition of Risk-weighted Assets: 2018 and 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Credit Risk

Regulatory Capital Requirements on Credit Risk

2.9 Credit RWAs increased by 5.9 percent to P58.8 billion in December 2019 from P55.5 billion in December 2018, reflecting the growth in loans and advances.

Asset Quality: Levels and Trends

2.10 Gross loans and advances grew by 7.6 percent from P58.3 billion in 2018 to P62.8 billion in 2019. The increase in gross loans and advances occurred across all banks, except one bank.[9] The expansion in gross loans and advances of the banking industry is expected to continue, following the reduction of the Bank Rate in August 2019 by 25 basis points and by 50 basis points in April 2020. However, the anticipated slow economic activity in the short term owing to the COVID-19 pandemic may result in slower credit growth.

2.11 Total past due loans (loans with repayment arrears) decreased by 3.7 percent to P3.9 billion in 2019 from P4.02 billion in 2018, while NPLs (impaired loans) decreased from P3.2 billion to P3.1 billion in the same period.

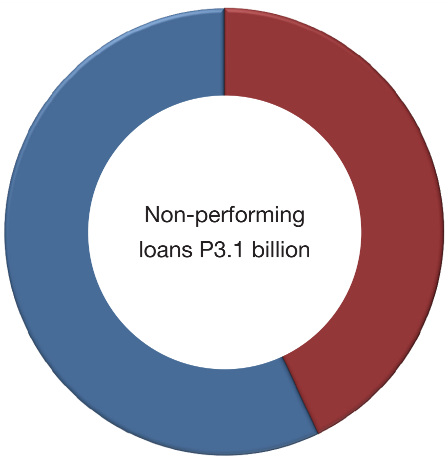
2.12 The proportion of NPLs to total loans and advances decreased from 5.5 percent in 2018 to 4.8 percent in 2019, indicating an improvement in asset quality in the banking sector. The ratio ranged between 0.5 percent and 6.5 percent for individual banks.

2.13 The banking industry gross loans and advances classified according to the Bank's supervisory loan classification method of pass, special mention, sub-standard, doubtful and loss loans, constituted 90.6 percent, 3.9 percent, 0.7 percent, 2.6 percent and 2.2 percent, respectively, of total loans and advances as at December 31, 2019.

2.14 As at December 31, 2019, private business and household (predominantly unsecured loans) sectors accounted for 57 percent and 42.7 percent of NPLs, respectively. Meanwhile, the public sector and financial institutions had negligible NPLs (0.1 percent and 0.2 percent, respectively). Chart 2.6 shows the sectoral distribution of NPLs between 2018 and 2019.

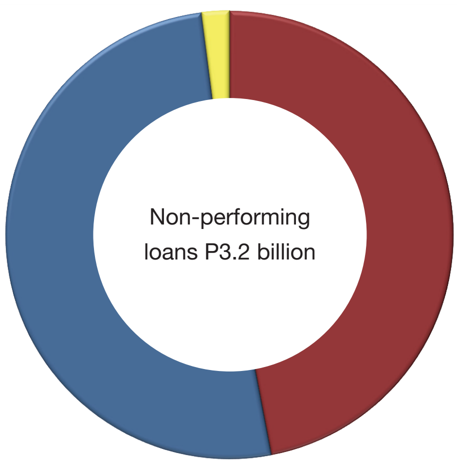
[9] The bank suspended lending as it was preparing for market exit.

Chart 2.6: Sectoral Distribution of Non-performing Loans and Advances: 2018 and 2019 (Percent)



December 31, 2019

Household Sector	43
Private Businesses	57



December 31, 2018

Household Sector	47
Private Businesses	51
Public Sector Entities	2

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.15 As in the previous year, manufacturing and trade, restaurants and bars sub-sectors dominated the private business NPLs in 2019, contributing 27.1 percent and 23.7 percent of the private business NPLs, respectively. Table 2.2 shows sectoral distribution of private business NPLs, while Table 2.3 shows the levels of loans and advances, NPLs and specific provisions as well as the proportions of NPLs to gross loans and advances, and specific provisions to NPLs.

Table 2.2: Sectoral Distribution of Private Business Non-performing Loans and Advances: 2015 – 2019 (Percent)

Private Business Subsectors	2015	2016	2017	2018	2019
Agriculture, forestry and fishing	12.2	9.8	7.9	9.0	7.4
Mining and quarrying	3.6	0.1	0.0	2.5	2.5
Manufacturing	8.5	10.6	30.9	29.5	27.1
Construction	9.9	5.9	6.9	10.0	10.2
Commercial real estate	11.6	11.1	14.1	8.9	9.4
Electricity	1.2	0.0	1.4	0.7	0.5
Water	0.0	0.0	0.2	0.0	0.0
Telecommunications	0.0	0.4	0.0	0.0	0.0
Tourism and hotels	0.4	4.5	5.4	4.2	3.2
Transport	4.9	4.4	4.2	5.7	3.4
Trade, restaurants and bars	22.1	31.5	17.1	17.2	23.7
Business Services	6.7	14.7	10.3	10.3	9.5
Other community, social and personal services	18.9	7.0	1.4	2.0	3.1

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 2.3: Levels and Proportions of Loans and Advances, Non-performing Loans and Advances and Specific Provisions: 2015 – 2019

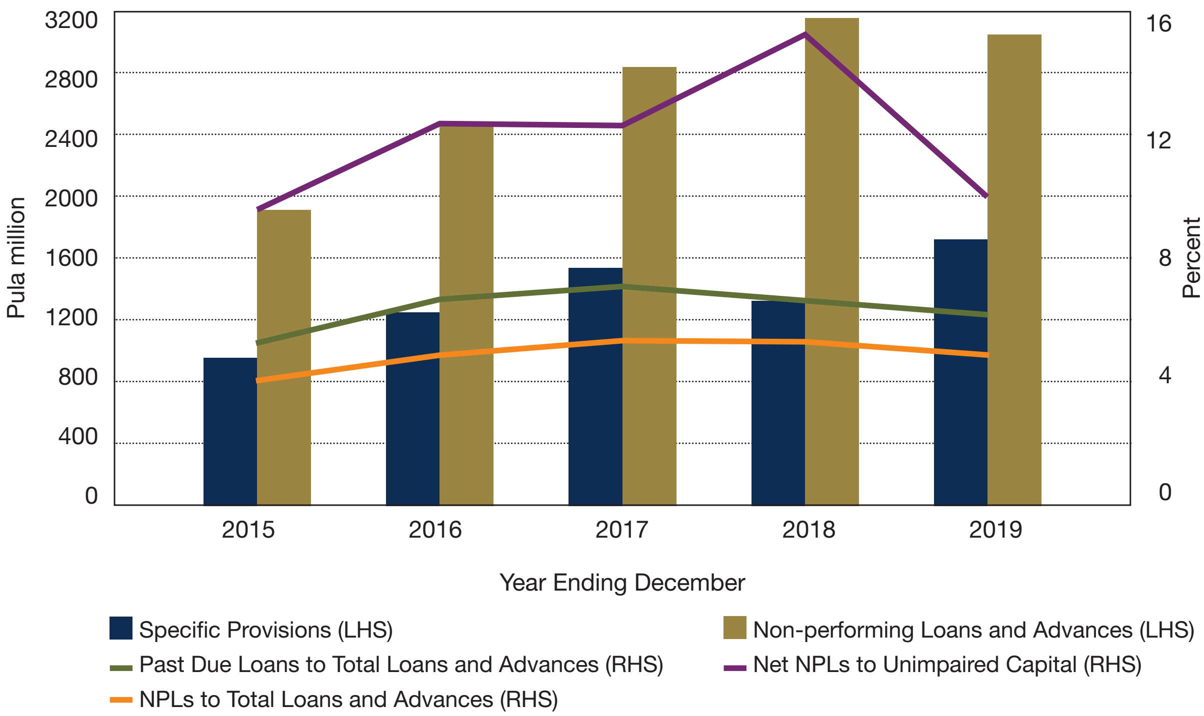
	2015	2016	2017	2018	2019
Pula million					
Loans and advances	48 310	51 325	54 181	58 332	62 770
Non-performing loans (NPLs)	1 894	2 516	2 859	3 166	3 051
Specific provisions	1 009	1 270	1 536	1 352	1 775
Percent					
NPLs to Loans and Advances	3.9	4.9	5.3	5.5	4.8
Specific Provisions to NPLs	53.3	50.5	53.7	42.7	58.2

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.16 Specific provisions rose from P1.4 billion in 2018 to P1.8 billion in 2019, representing growth of 31.3 percent. Consequently, the ratio of specific provisions to NPLs increased from 42.7 percent in 2018 to 58.2 percent in 2019. Net NPLs (net of specific provisions) to unimpaired capital ratio declined from 15 percent to 9.9 percent during the period, indicating a decreasing influence of NPLs on capital.

2.17 Chart 2.7 shows trends in the commercial bank asset-quality indicators for the period 2015 – 2019.

Chart 2.7: Commercial Banks: Asset Quality Indicators: 2015 – 2019

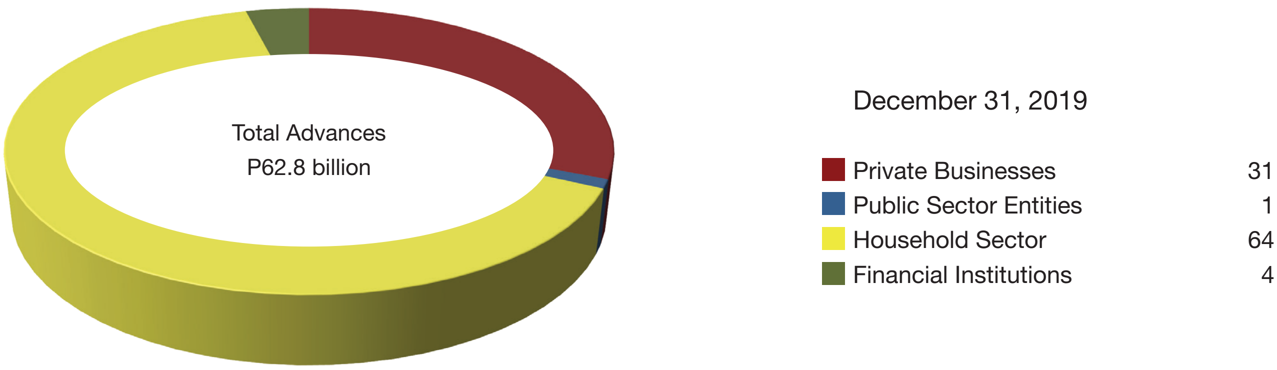


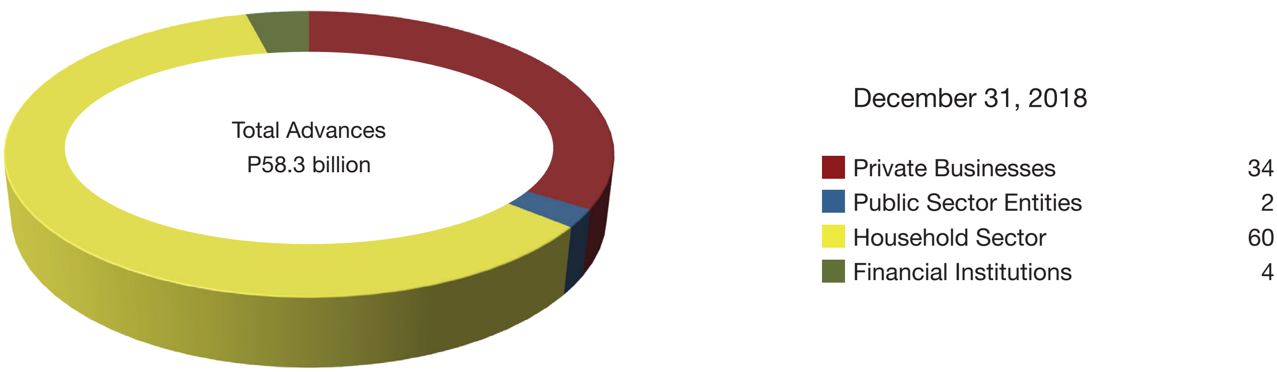
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Credit Concentration Risk and Sectoral Distribution of Commercial Bank Loans and Advances

2.18 Chart 2.8 compares the sectoral distribution of loans and advances between 2018 and 2019. Loans and advances to households grew by 13.8 percent to P40 billion in 2019 from P35.1 billion in 2018, thus accounting for 64 percent of total loans and advances. The share of public sector entities (parastatals) and private business loans in total loans and advances declined from 2 percent and 34 percent in 2018 to 1 percent and 31 percent, respectively, in 2019. The share of financial institutions in total loans and advances was unchanged at 4 percent between 2018 and 2019.

Chart 2.8: Sectoral Distribution of Loans and Advances: 2018 and 2019 (Percent)



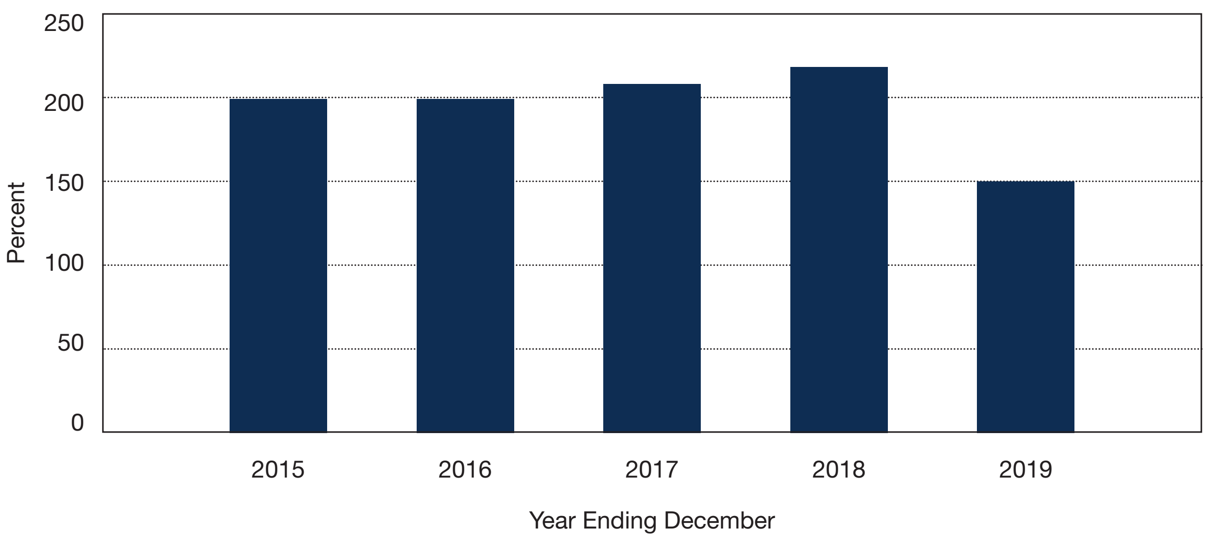


Source: Commercial Banks (Statutory Returns submitted to the Bank).

Large Exposures

2.19 Large exposures[10] for commercial banks decreased by 23.4 percent from P25.3 billion in 2018 to P19.3 billion in 2019, and unimpaired capital increased by 6.4 percent from P12.1 billion to P12.8 billion in the same period. Consequently, the ratio of large exposures to unimpaired capital decreased from 209 percent in 2018 to 150.5 percent in 2019, remaining below the 800 percent prudential limit for banks in Botswana (Chart 2.9). This ratio ranged from 44.2 percent to 425.7 percent for individual banks.

Chart 2.9: Commercial Banks: Large Exposures to Unimpaired Capital Ratio: 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

The Structure of Private Business Loans and Advances

2.20 Table 2.4 shows the distribution of private business loans and advances for the period 2015 to 2019. The market share of three subsectors, namely, agriculture, forestry and fishing; commercial real estate, and tourism and hotels increased during the review period. Despite the increase of their shares in credit, the output growth for the subsectors weakened, contributing to the slowdown in overall GDP expansion (Table 2.5).

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

Table 2.4: Sectoral Distribution of Private Business Loans: 2015 – 2019 (Percent)

Distribution of Private Business Loans	2015	2016	2017	2018	2019
Agriculture, forestry and fishing	7	8	7	6	8
Mining and quarrying	6	2	2	2	3
Manufacturing	17	22	19	18	10
Construction	6	6	6	6	6
Commercial real estate	25	25	21	20	23
Electricity	1	-	-	-	-
Telecommunications	1	1	1	1	1
Tourism and hotels	2	4	5	4	6
Transport	4	3	3	2	3
Trade, restaurants and bars	32	24	33	21	19
Business services	-	-	-	-	16
Other	-	6	4	20	4

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 2.5: Selected Sectoral Growth Rates and Shares in Non-mining Nominal GDP: 2015 – 2019 (Percent)

	2015	2016	2017	2018	2019
Agriculture, forestry and fishing					
Growth rate	5.6	8.7	2.5	5.9	0.4
Share in non-mining GDP	2.7	2.6	2.4	2.4	2.3
Commercial real estate					
Growth rate	12.2	10.8	9.6	9.4	6.4
Share in non-mining GDP	1.6	1.6	1.6	1.6	1.6
Manufacturing					
Growth rate	9.1	4.9	4.0	6.3	4.3
Share in non-mining GDP	7.0	6.5	6.2	6.2	6.1
Construction					
Growth rate	10.6	10.1	8.6	9.5	5.2
Share in non-mining GDP	8.0	7.8	7.8	7.9	7.9
Tourism and hotels					
Growth rate	11.3	12.6	9.5	9.6	6.4
Share in non-mining GDP	7.4	7.3	7.4	7.5	7.6
Non-mining nominal GDP					
Growth rate	5.9	13.0	8.8	7.7	5.2

Source: Commercial Banks (Statutory Returns submitted to the Bank) and Statistics Botswana.

Loans to Directors and Related Parties

2.21 The exposure to related parties[11] as a proportion of unimpaired capital increased from 0.9 percent in December 2018 to 4.7 percent in December 2019. At this level, insider loans are assessed to pose minimal credit risk to the banking industry.

[11] Related persons include all of the following: significant shareholder; member of a board of directors or audit committee; principal officer and senior management officials; guarantor of a trust; a person who maintains a trust on behalf of an institution or its affiliate; any person who is related to such significant shareholder, member of a board of directors or audit committee, principal officer or family member or business interest; subsidiary of a bank; company or undertaking in which at least a 5 percent interest is held by a bank; parent company of a bank; company that is under common control with a bank; and a company that holds at least a 5 percent interest of another company in which a bank holds at least a 5 percent interest.

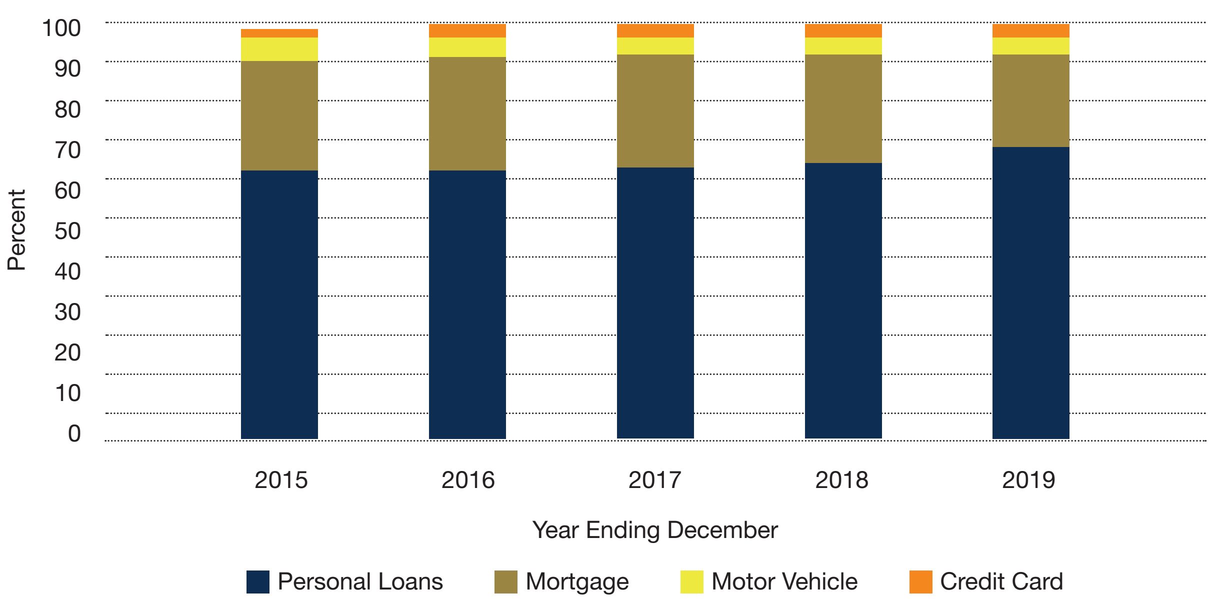
Foreign Currency-Denominated Loans and Liabilities

2.22 Foreign currency-denominated loans decreased by 14.2 percent to P3.9 billion in 2019 from P4.5 billion in 2018, while foreign currency-denominated deposits decreased by 4.3 percent from P11.6 billion to P11.1 billion in the same period. As a result, the ratio of loans denominated in foreign currency to foreign currency-denominated deposits declined from 38.9 percent to 34.9 percent in the same period. For banks that have foreign-currency products, the ratio ranged from 3.3 percent to 88.7 percent.

Composition of Household Loans and Advances

2.23 Credit to the household sector increased by 13.8 percent from P35.1 billion in 2018 to P40 billion in 2019. Categories of household credit, namely, personal loans (mostly unsecured), mortgage loans, motor vehicle loans and credit cards increased by 19.6 percent, 1.2 percent, 12.7 percent and 5.7 percent to P27.2 billion, P9.7 billion, P2 billion and P980 million, respectively. As shown in Chart 2.10, personal loans constituted the largest proportion of gross loans and advances to the household sector at 68 percent, higher than 65 percent in 2018; the share of mortgages declined to 24 percent from 27 percent in the same period.

Chart 2.10: The Distribution of Household Loans and Advances: 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.24 In general, the inherent credit risk for the banking sector was considered high. The risk management systems and controls of banks were satisfactory, but the residual risk remained high. The inherent credit risk is likely to increase over the next 12 months because of the potential shutdown of businesses and loss of employment resulting from the adverse economic impact of the COVID-19 pandemic. This outlook for credit-quality deterioration, however, will be moderated to the extent that the bulk of the banking credit comprises relatively small amounts to multiple uncorrelated retail borrowers in the various sectors of the economy, especially public sector employees.

Market Risk

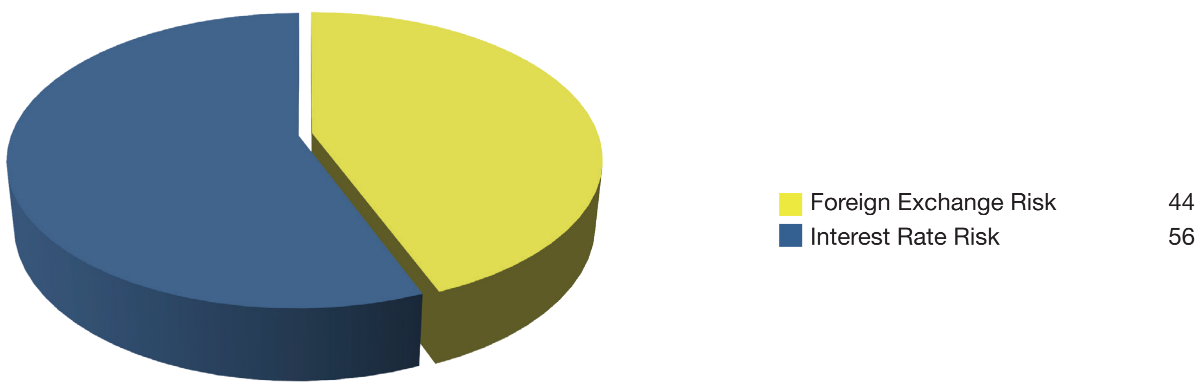
Regulatory Capital Requirements on Market Risk

2.25 Market RWAs amounted to P980 million (constituting 1 percent of total RWAs) in 2019, a marginal increase of 1.3 percent from P967 million in the prior year (Table 2.6). Within these exposures, the total regulatory capital requirement for the market risk increased from P144.3 million in 2018 to P146.3 million in 2019, with the interest-rate risk accounting for a greater amount of P82 million or 56.1 percent and foreign-currency exposure contributing P64.2 million or 43.9 percent (Chart 2.11).

Table 2.6: Regulatory Capital Requirements on Market Risk (Pula thousand)

	2018	2019
Interest rate risk	64 316	82 017
Foreign exchange risk	79 985	64 242
Total Pillar 1 market risk capital requirements	144 301	146 259
Market risk-weighted assets	966 817	979 936

Chart 2.11: Composition of Market Risk Regulatory Capital: December 31, 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

Foreign Currency (Exchange Rate) Risk

2.26 All banks complied with the Foreign Currency Exposure Directive No. BoBA 1/99 by maintaining the foreign-currency exposure to unimpaired capital ratios within the required 15 percent, 5 percent and 30 percent limits for major, minor and overall foreign-currency exposures, respectively. The ratio of overall foreign-currency exposure to total unimpaired capital for the banking sector decreased from 9.4 percent in 2018 to 4.5 percent in 2019.

Interest Rate Risk

2.27 For all the time bands, except for the 3-to-6-month category (which had a negative gap of P1.3 billion), the gap between interest rate-sensitive assets and interest rate-sensitive liabilities for the banking sector was positive, implying that a bank's profits would improve in response to an increase in interest rates. With a negative gap, a decline in interest rates would result in the repricing of liabilities (deposits) by banks at a low rate, thus raising earnings for the banking sector. An increase in interest rates, however, would result in repricing of liabilities at a higher rate. In contrast, for prime rate-sensitive advances and other assets, a decline in interest rates would lower the banks' earnings; an increase in interest rates would positively affect earnings and profitability and, by extension, economic capital.

Table 2.7: Interest Rate Risk Exposure: December 2019 (Pula million)

	Total Variable Rate Assets	Total Variable Rate liabilities	Variable Gap
Up to 1 month	63 261	36 379	26 882
1-3 months	3 044	1 040	2 004
Over 3-6 months	426	1 731	(1 305)
Over 6-12 months	6 149	2 893	3 256
Over 12 months-3 years	316	236	80
Over 3-5 years	1 234	482	751
Over 5-10 years	1 365	116	1 249
More than 10 years	623	0	623
Total	76 417	42 877	33 540

Note: Parentheses denote negative figures.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.28 Overall, market risk in the banking sector was considered low and the risk is expected to be stable in the next 12 months.

Operational Risk

Regulatory Capital Requirements for Operational Risk

2.29 Banking assets subject to operational risk increased from P6 billion in 2018 to P6.5 billion in 2019, while the regulatory capital charge for operational risk increased by 7.7 percent from P896 million to P965.2 million in the same period (Table 2.8). All banks calculated the respective operational-risk capital requirements using the BIA in 2019. One bank further reported operational-risk capital requirement under the standardised approach, which is a more risk-sensitive method of computing the capital requirements.

Table 2.8: Regulatory Capital Requirements for Operational Risk (Pula million)

	2018	2019
Operational risk capital charge: BIA	896	965
Operational risk-weighted assets	6 003	6 466

Operational Risk Exposure

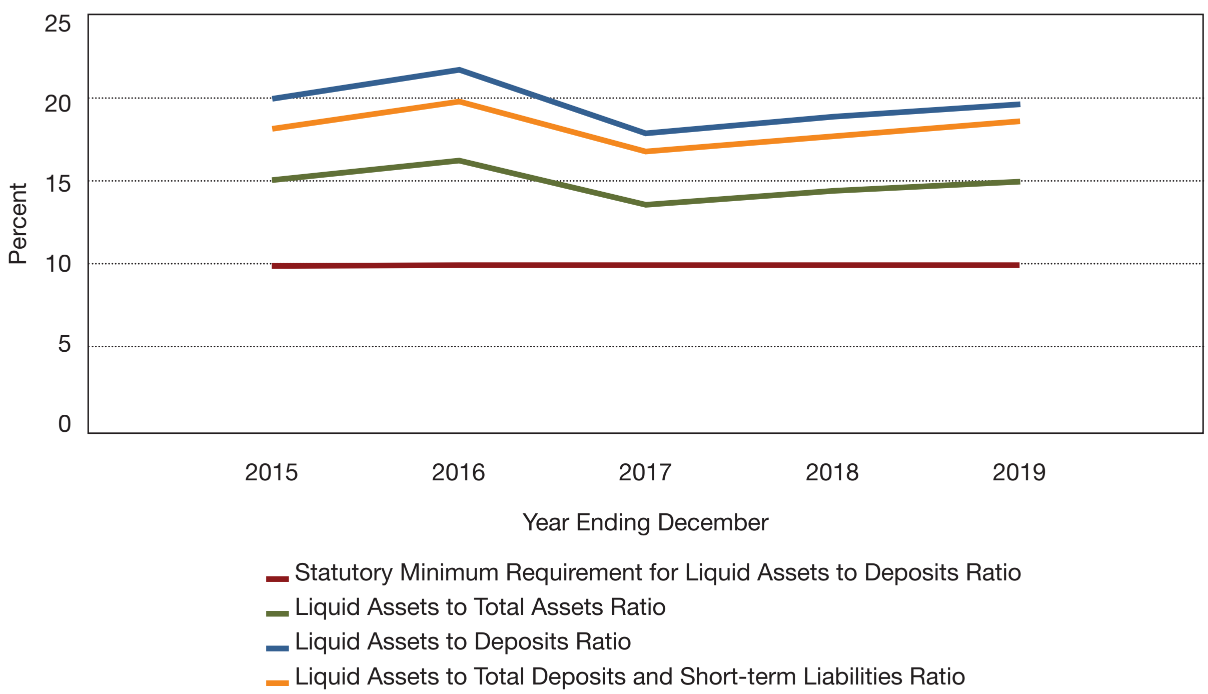
2.30 The most common operational risk management weaknesses among banks in 2019, to varying degrees, continued to be the lack of segregation of duties in some functions, lax credit-underwriting practices, lapses in internal controls and information-technology (IT) security, suspense account items that remained outstanding for prolonged periods, weak collateral management, given that some residential properties held as security were, contrary to the Basel II Capital Directive, not valued every three years. Furthermore, lack of documented procedures for processes, inadequate review of policies and procedure manuals, periodic breaches of internal limits and lack of integration of management information system into the core banking system contributed to an increase in the operational risk. The above deficiencies heightened operational risk.

2.31 Operational risk is expected to increase in the next 12 months in the context of the increasing digitalisation of operations by banks, which increases vulnerability to cyber-crime risks.

Liquidity and Funding Risk

2.32 Statutory liquid assets for the industry totalled P14.7 billion in 2019 compared to P13.2 billion in the previous year. Reflecting that increase, the liquid assets to deposits ratio rose slightly from 19 percent to 19.3 percent between 2018 and 2019 and was above the 10 percent prudential minimum. The ratio across banks ranged from 16.2 percent to 37.8 percent. The proportion of liquid assets to total assets also increased from 14.4 percent in 2018 to 14.8 percent in 2019 (Chart 2.12).

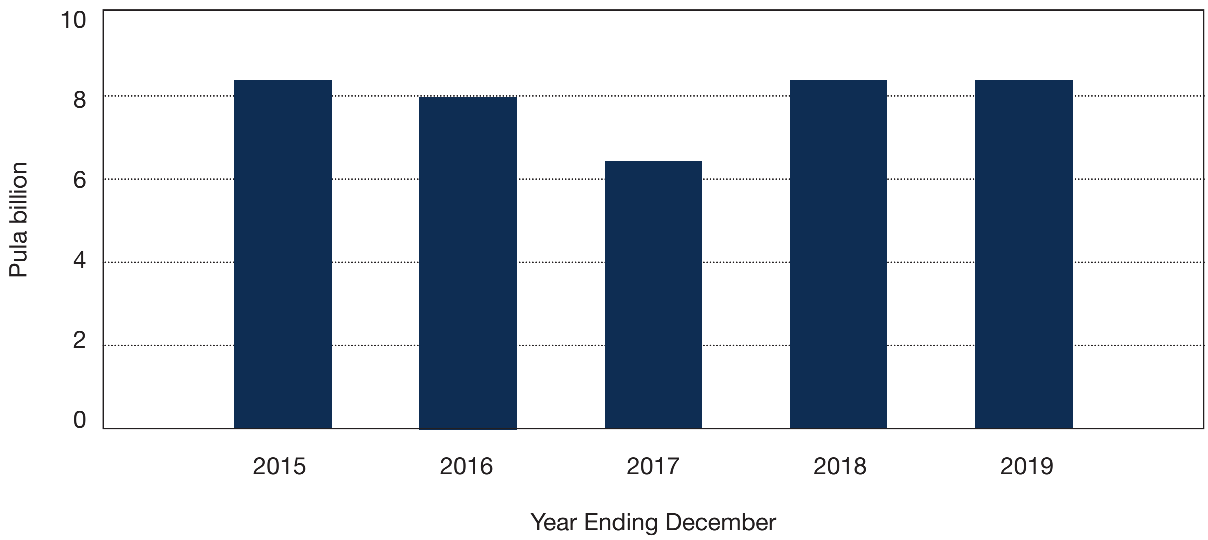
Chart 2.12: Commercial Banks: Liquidity Ratios: 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.33 Within the liquid assets, Bank of Botswana Certificates (BoBCs), representing 56.9 percent of the total, increased by 1.7 percent from P8.2 billion in 2018 to P8.3 billion in 2019 (Chart 2.13). Banks' nostro and vostro balances declined by 4.3 percent and 15.6 percent to P12.7 billion and P2.6 billion, respectively. As a proportion of total assets, nostro and vostro balances constituted 12.9 percent and 2.7 percent, respectively. The industry's resultant net nostro balances were P10.1 billion in 2019, a marginal decrease from P10.2 billion in 2018.

Chart 2.13: Commercial Banks: Market Value of Outstanding BoBCs Holdings: 2015 – 2019 (Pula billion)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

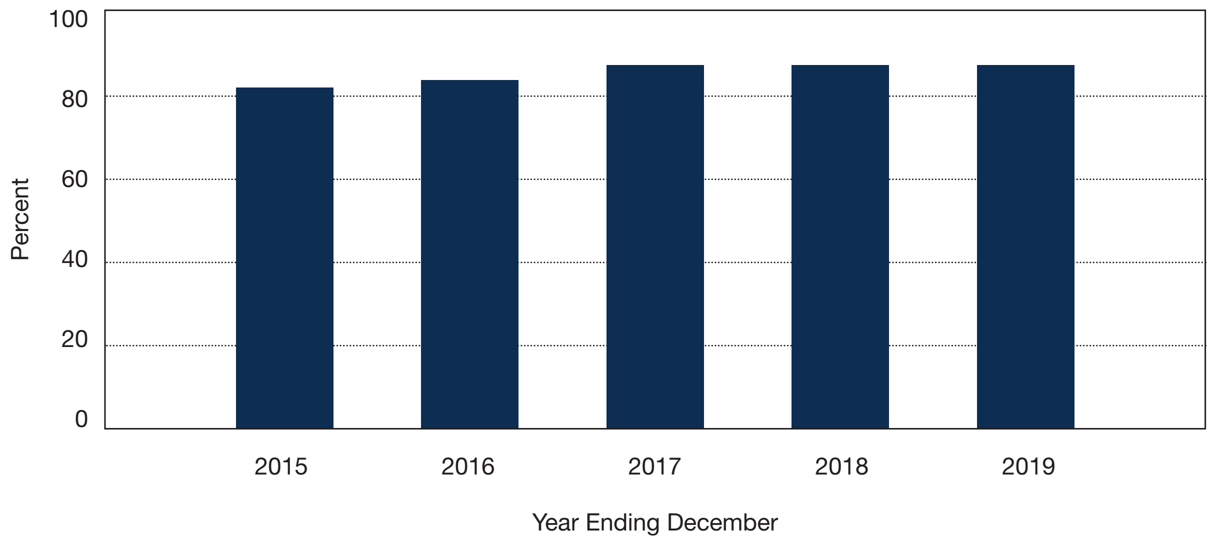
2.34 The banking sector's inherent liquidity risk was considered moderate, while the existing risk management measures were satisfactory. Therefore, the residual liquidity risk remained moderate, with an increasing trend owing to the intense competition for stable deposits by banks.

2.35 The Bank is undertaking a market scoping exercise on the requirements of Basel III liquidity standards with a view to implementing the standards at the appropriate time. The objective of these liquidity standards is to improve the short-term liquidity risk profile for banks and to foster long-term resilience of banks by providing additional incentives for them to fund their activities with more robust sources of funding on a continuing basis. The scoping exercise, in the main, involves stocktaking of the banking industry's high-quality liquid assets, which are a prerequisite for implementing the liquidity coverage ratio (LCR) aimed at ensuring that banks meet their liquidity needs for 30 calendar days in the event of a financial stress. The LCR is supplemented by the net stable funding ratio (NSFR), the main objective of which is to promote a sustainable maturity structure of assets and liabilities.

Financial Intermediation

2.36 The average financial intermediation ratio (loans and advances to deposits) for the banking industry fell from 84.2 percent in December 2018 to 82.9 percent in December 2019 (Chart 2.14). For individual institutions, the intermediation ratio ranged from 62.7 percent to 96.6 percent across the industry.

Chart 2.14: Commercial Banks: Loans and Advances to Deposits Ratio (Financial Intermediation): 2015 – 2019 (Percent)



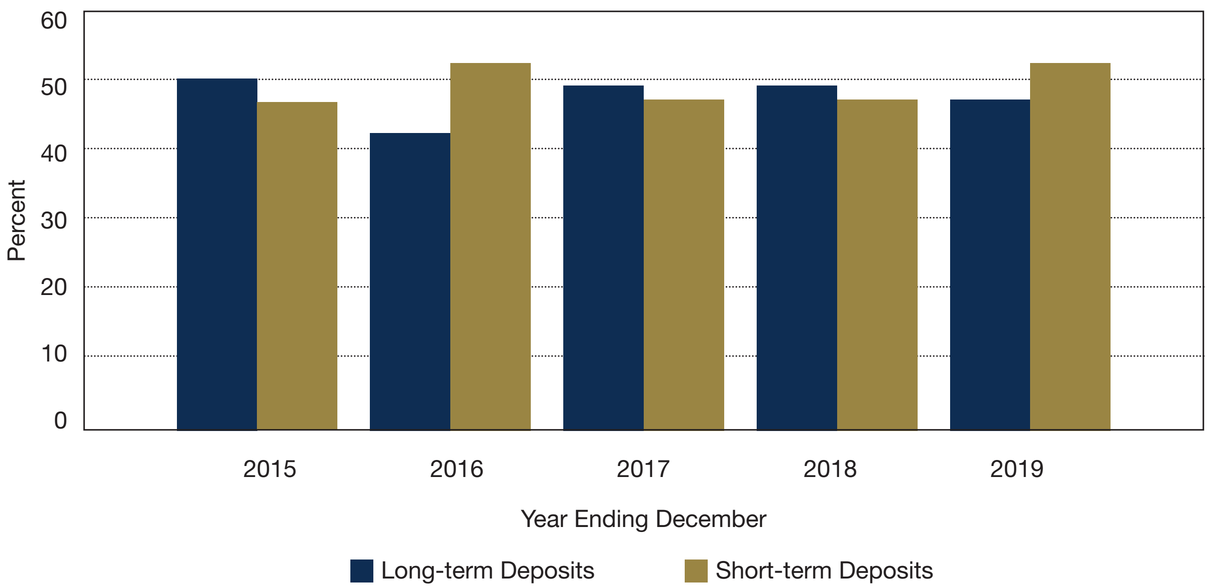
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Liabilities and Funding Structure

2.37 Funding sources for asset growth were customer deposits, share capital and balances due to other banks. Customer deposits, which are the main source of funding for the banking industry, grew by 9.3 percent from P69.3 billion in 2018 to P75.7 billion in 2019 and constituted 77 percent of liabilities. Share capital, accounting for 11.2 percent of liabilities, increased by 6.6 percent from P10.4 billion to P11.1 billion in the same period. Debt securities and other borrowings increased by 0.3 percent from P4.7 billion in 2018 to P4.8 billion in 2019. Meanwhile, balances due to other banks declined by 4.3 percent from P4.7 billion to P4.5 billion.

2.38 The relative shares of deposits by maturity changed between 2018 and 2019; long-term deposits (time and savings) contributed 47 percent in 2019 and short-term deposits (call and current) accounted for 53 percent (Chart 2.15). If this trend is sustained, the maturity mismatch risk, an enduring feature of the Botswana banking sector, will continue.

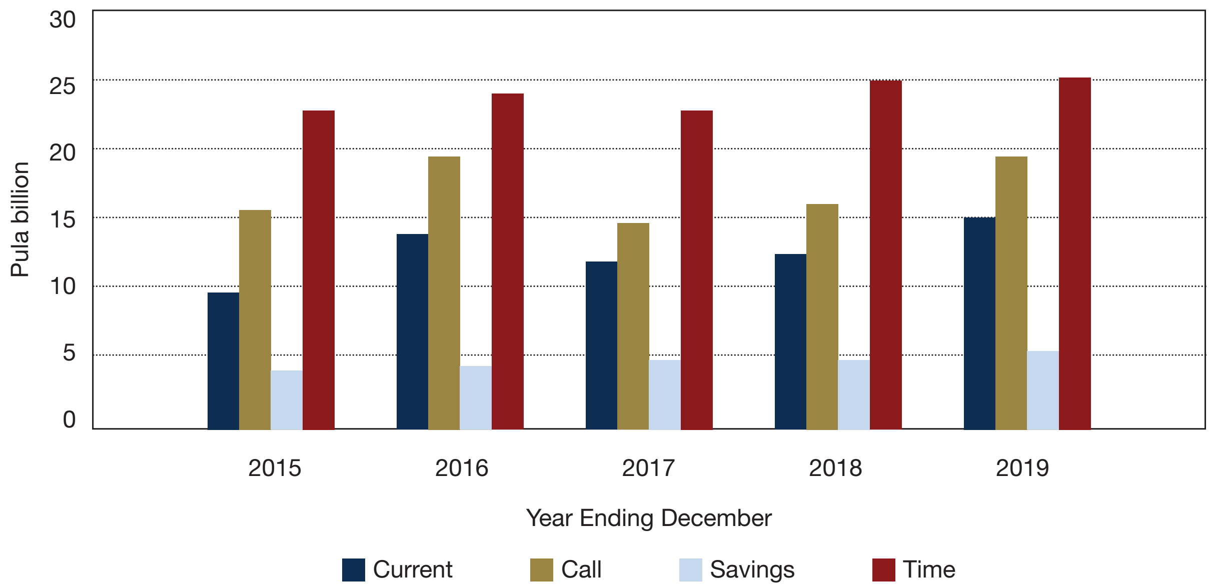
Chart 2.15: Commercial Banks: Deposits by Maturity: 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.39 Chart 2.16 shows the value of Pula-denominated deposits by type for 2015 to 2019. Call, savings, current, and time deposits grew by 20.9 percent, 9.7 percent, 22.6 percent and 2 percent, respectively, during the review period. At P25 billion, time deposits accounted for the largest proportion of total deposits (38.6 percent), followed by call deposits (29.8 percent), current deposits (23.4 percent) and savings deposits (8.1 percent).

Chart 2.16: Commercial Banks: Share of Pula-denominated Deposits by Type: 2015 – 2019 (Pula billion)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.40 Foreign currency-denominated deposits amounted to P11.1 billion in 2019, a decline from P11.6 billion in 2018. Foreign currency-denominated deposits accounted for 15 percent of total deposits in 2019, lower than the proportion of 17 percent in 2018. The level of Pula-denominated deposits as a share of total deposits was 85 percent in 2019, up from 83 percent in 2018 (Chart 2.17).

Chart 2.17: Commercial Banks: Share of Foreign Currency and Pula-denominated Deposits to Total Deposits: 2018 and 2019 (Percent)

December 31, 2019	
Foreign Currency Deposit Accounts	15
Pula Deposit Accounts	85

December 31, 2018	
Foreign Currency Deposit Accounts	17
Pula Deposit Accounts	83

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.41 The share of private-business deposits in total deposits decreased from 49 percent in 2018 to 45 percent in 2019, implying some degree of deposit-source diversification. The proportions of deposits for the public (government and parastatals) and household sectors in the total were 10 percent and 21 percent, respectively, in the same period. The shares of financial institutions and non-residents in total deposits were 23 percent and 1 percent, respectively.

Chart 2.18: Commercial Banks: Sectoral Distribution of Deposits: 2018 and 2019 (Percent)

December 31, 2019	
Private Businesses	45
Public Sector Entities	10
Household Sector	21
Financial Institutions	23
Non-residents	1

December 31, 2018	
Private Businesses	49
Public Sector Entities	9
Household Sector	20
Financial Institutions	21
Non-residents	1

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.42 Table 2.9 shows the sources of funding for the banking sector from 2015 to 2019.

Table 2.9: Main Sources of Funding: 2015 – 2019

Category	2015	2016	2017	2018	2019
Deposits (Pula million)	59 940	62 438	63 581	69 270	75 709
Annual Growth Rate (Percent)	16.4	4.2	1.8	8.9	9.3
Share of Total Funding	78.2	77.4	76.2	75.8	76.7
Other Liabilities (Pula million)	1 999	1 828	2 196	2 199	2 612
Annual Growth Rate (Percent)	(35.5)	(9)	19.4	1.4	18.8
Share of Total Funding	2.6	2.3	2.6	2.4	2.6
Share Capital (Pula million)	8 195	9 748	9 383	10 390	11 080
Annual Growth Rate (Percent)	6.1	19	(3.7)	10.7	6.6
Share of Total Funding	10.7	12.1	11.2	11.4	11.2
Due to other Banks (Pula million)	3 308	3 984	4 250	4 735	4 532
Annual Growth Rate (Percent)	(7.6)	20.4	6.7	11.4	(4.3)
Share of Total Funding	4.3	4.9	5.1	5.2	4.6
Debt Securities and Other Borrowing (Pula million)	3 163	2 642	4 065	4 747	4 761
Annual Growth Rate (Percent)	51.5	(16.5)	53.9	16.8	0.3
Share of Total Funding	4.1	3.3	4.9	5.2	4.8
Total Funding (Pula million)	**76 605**	**80 640**	**83 475**	**91 341**	**98 695**

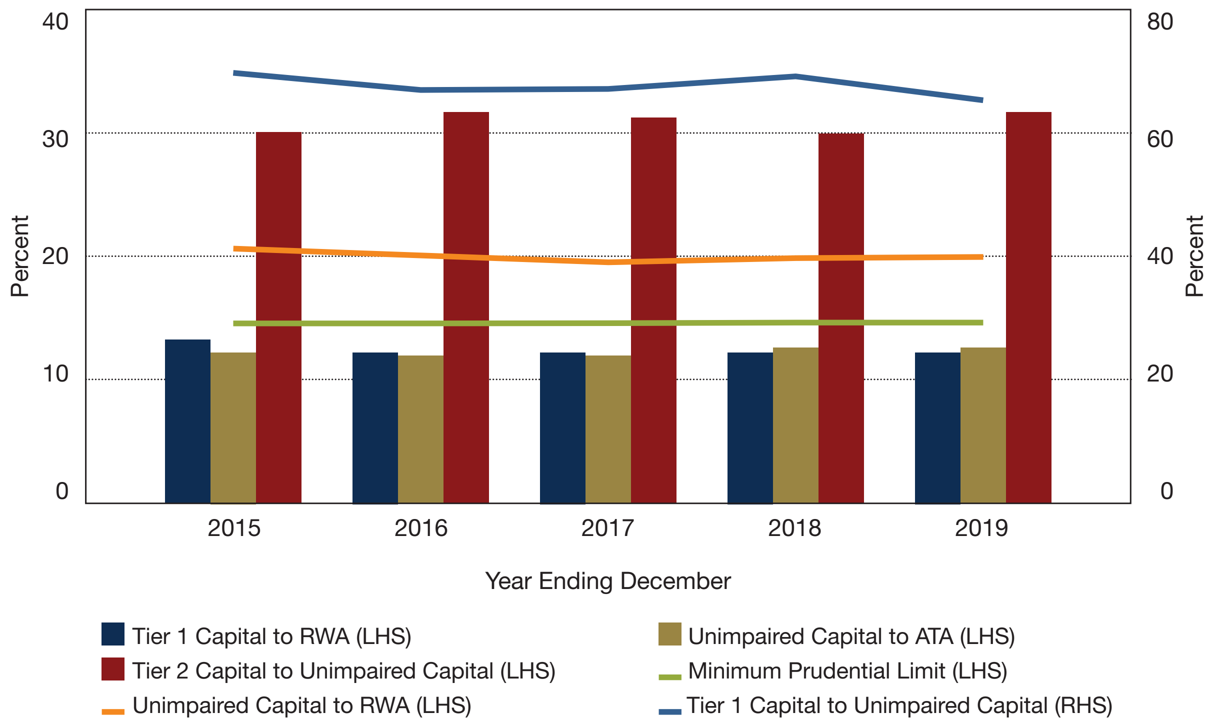
Note: Parentheses denote negative figures.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

CAPITAL ADEQUACY (SOLVENCY): LEVEL, QUALITY AND TREND

2.43 The banking sector remained adequately capitalised and complied with the minimum thresholds for regulatory capital adequacy measurement and capital standards. Banks reported capital adequacy and common equity Tier 1 capital ratios in excess of the 15 percent and 4.5 percent prudential and statutory minimums, respectively. Total RWAs for banks increased by 6 percent from P62.5 billion in 2018 to P66.3 billion in 2019. The capital adequacy ratio (CAR) for the banking industry increased marginally from 19.3 percent in 2018 to 19.4 percent in 2019. Chart 2.19 shows the CAR over a five-year period, 2015 – 2019.

Chart 2.19: Commercial Banks: Capital Ratios: 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.44 Unimpaired capital for the banking industry rose by 6.4 percent from P12.1 billion in 2018 to P12.8 billion in 2019. All banks, except one, reported an increase in unimpaired capital. Four banks injected additional capital, while three paid dividends.

2.45 The largest component (68.8 percent) of unimpaired capital, Tier 1 capital, increased by 4.8 percent from P8.4 billion in 2018 to P8.8 billion in 2019. Within Tier 1 capital, retained earnings contributed the greatest proportion of 76.5 percent following a 5.3 percent increase from P6.4 billion in 2018 to P6.8 billion in 2019. The ratio of unimpaired capital to average total assets fell from 13.8 percent to 13.5 percent in the same period, a marginal increase in the financial leverage of banks. The ratio of common equity Tier 1 capital to risk-weighted assets decreased slightly from 12.9 percent (2018) to 12.7 percent (2019), remaining above the 4.5 percent prudential minimum.

2.46 The banking industry Tier 2 capital amounted to P4 billion in 2019, higher than P3.6 billion in 2018, and comprised subordinated term debt (55.3 percent), unpublished current year profits (27.3 percent), general loan reserves (17.2 percent) and Tier 2 capital instruments subject to phase-out treatment (0.2 percent). The Tier 2 capital to unimpaired capital ratio increased to 31.2 percent (2019) from 30.2 percent (2018). The non-qualifying Tier 2 capital (to be phased out by 2020) decreased from P140 million in 2018 to P10 million. One bank had non-qualifying Tier 2 capital in 2019; all other banks had phased out the capital.

COMMERCIAL BANKS' STATEMENT OF COMPREHENSIVE INCOME AND EXPENSES

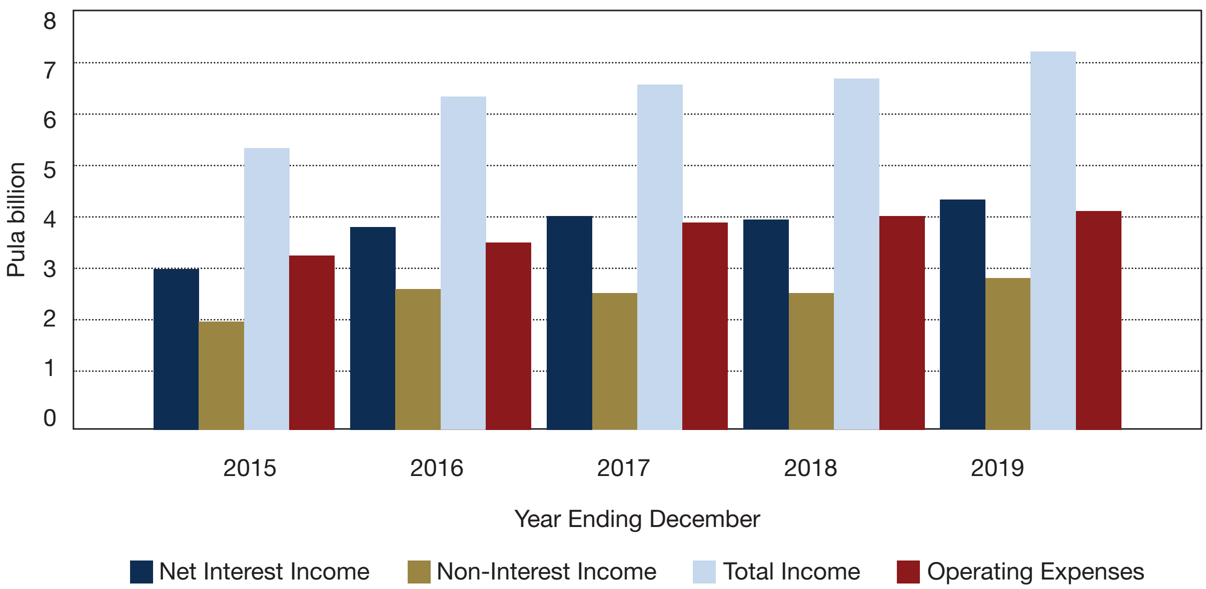
Income

2.47 Total income (net interest income and non-interest income) of commercial banks increased by 9.4 percent from P6.6 billion in 2018 to P7.2 billion in 2019 (Chart 2.20). Net interest income grew by 11.3 percent from P3.9 billion to P4.4 billion, while operating income (non-interest income) rose at a slower pace of 6.6 percent to P2.8 billion, from P2.7 billion in the same period. As a result, the proportion of non-interest income to total income decreased to 39.4 percent in 2019 from 40.4 percent in 2018; the respective ratios of net interest income to total income were 60.6 percent and 59.6 percent in the same period.

Expenses

2.48 On the cost side, operating expenses contributed 68.9 percent to total expenses incurred by commercial banks, with interest expense accounting for 31.1 percent. Operating expenses increased by 5.1 percent from P4 billion in 2018 to P4.2 billion in 2019 (Chart 2.20); staff cost was the major expense element, constituting 45.3 percent, followed by administration and other expenditures at 35.7 percent, other expenses (audit and consulting fees, and occupancy and depreciation) at 10.8 percent and legal and management fees at 6.7 percent.

Chart 2.20: Commercial Banks: Composition of Income and Expenses: 2015 – 2019 (Pula billion)

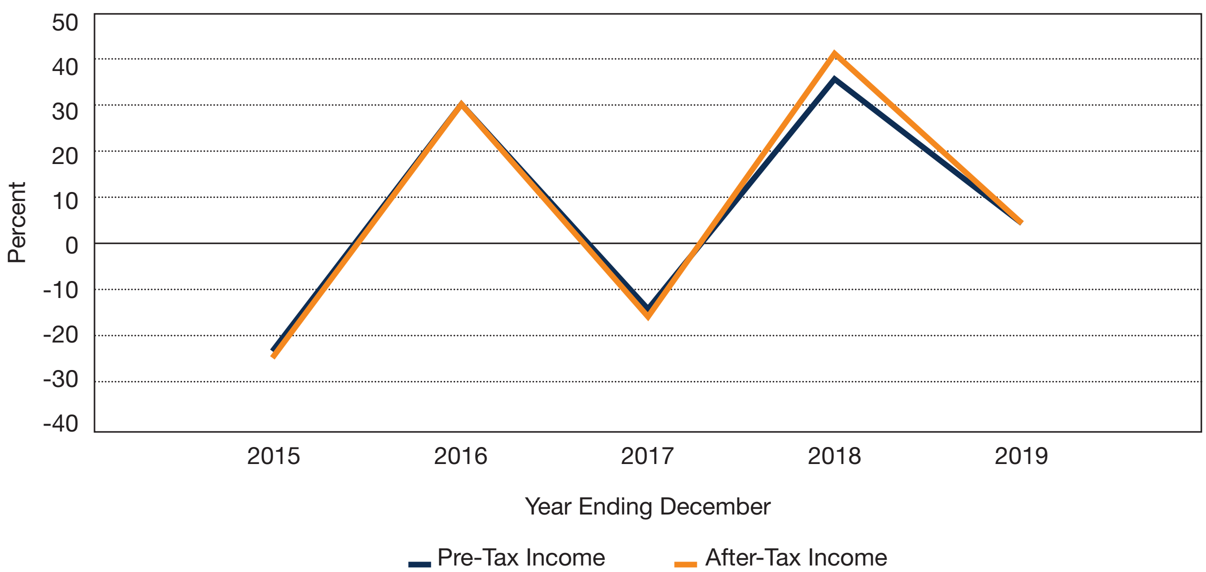


Source: Commercial Banks (Statutory Returns submitted to the Bank).

Profitability: Level, Source and Trend

2.49 The banking sector profitability improved in 2019, with net after-tax profits increasing by 5.1 percent from P1.7 billion in 2018 to P1.8 billion in 2019; all banks were profitable in 2019. The increase in profits was due to growth in both net interest and non-interest income by 11.3 percent and 6.6 percent, respectively. Chart 2.21 shows pre- and after-tax profit growth rates for commercial banks over a five-year period.

Chart 2.21: Commercial Banks: Growth Rates of Pre- and After-Tax Profit: 2015 – 2019 (Percent)



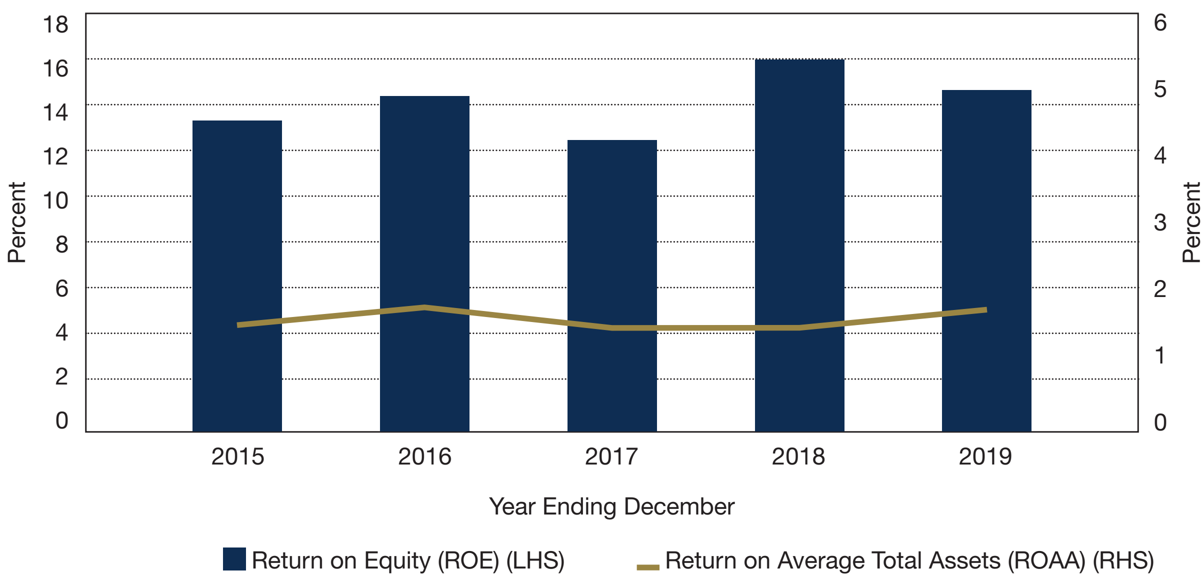
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Profitability and Operating Efficiency Indicators

Profitability Indicators

2.50 Aggregate return on equity (ROE) increased marginally from 16.1 percent in 2018 to 16.2 percent in 2019, while return on average assets (ROAA) remained unchanged at 1.9 percent in the same period (Chart 2.22). Across banks, ROE ranged between 3.1 percent and 23.4 percent in 2019. With respect to ROAA, the ratio ranged between 0.3 percent and 3 percent.

Chart 2.22: Commercial Banks: Profitability Indicators: 2015 – 2019 (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.51 Table 2.10 provides financial performance indicators for the banking sector for the five-year period, 2015 – 2019.

Table 2.10: Financial Performance Ratios: 2015 – 2019 (Percent)

Financial Performance Ratios	2015	2016	2017	2018	2019
Income on investments and securities to total income	4.3	3.0	3.8	3.8	4.4
Non-interest income to total income	43.2	39.2	38.5	40.4	39.4
Net interest income to total income	56.8	60.8	61.5	59.6	60.6
Return on equity	13.3	14.4	12.6	16.1	16.2
Return on average assets	1.5	1.8	1.4	1.9	1.9
Net interest income to average total assets	4.2	4.9	3.0	4.5	4.6
Interest income to average earning assets	7.9	7.4	8.7	8.0	7.0
Non-interest income to average total assets	3.2	3.2	3.0	3.0	3.0
Interest expense to average total assets	2.9	1.8	1.8	2.1	2.0
Earnings retention	37.6	80.0	67.7	73.9	69.5
Interest income on loans to average total assets	6.3	6.0	5.9	5.8	4.4
Non-interest expense to average total assets	4.5	4.6	4.7	4.6	4.4
Gross interest income to average total assets	7.1	6.7	7.9	7.5	6.6

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Operating Efficiency Indicators

2.52 Table 2.11 presents trends in efficiency measures for commercial banks for 2015 – 2019. The weighted industry average cost-to-income ratio declined from 60.7 percent in 2018 to 58.3 percent in 2019, indicating the general gain in operating efficiency of banks. Severally, however, some banks had high cost-to-income ratios, which ranged between 76.4 percent and 95 percent.

Table 2.11: Commercial Banks: Other Efficiency Measures: 2015 – 2019

	2015	2016	2017	2018	2019
Percent					
Average cost of deposits	3.1	1.7	1.7	1.8	2.1
Return on loans and advances	9.7	9.5	9.2	9.0	6.9
Net interest margin	4.7	5.4	5.4	4.8	4.9
Interest rate spread	4.0	4.8	6.1	5.2	3.7
Cost-to-income	60.6	57.0	59.9	60.7	58.3
Net income to employee costs	80.7	91.2	68.3	94.1	92.8
Pula thousand					
Net income per employee	233.9	310.5	255.8	354.7	376.4
Staff costs per employee	289.9	340.5	374.6	376.8	405.8
Assets per employee	16 460	17 793	18 060	19 327	21 085

Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.53 As indicated by the decrease in the interest-rate spread and return on loans and advances ratios, the core earning capability of commercial banks declined moderately (Table 2.11). The interest-rate spread fell from 5.2 percent in 2018 to 3.7 percent in 2019, while the return on loans and advances ratio declined from 9 percent to 6.9 percent, to some extent, reflecting the fall in the Bank Rate (a monetary policy signalling rate). The cost of deposits ratio increased from 1.8 percent in 2018 to 2.1 percent in 2019 against the background of increased competition for large-value and highly volatile deposits. Owing to the improved profit levels of banks, net income per employee increased from P354 700 to P376 400 in the same period, while the proportion of net income to employee costs eased from 94.1 percent in the previous year to 92.8 percent in 2019. Assets per employee increased from P19.3 million to P21.1 million in 2019 because of the balance sheet expansion and the decrease in the employment levels in the banking sector.

ASSESSMENT OF THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS: OFF-SITE SURVEILLANCE SYSTEM RESULTS

2.54 The Bank's off-site surveillance[12] (OSS) system results and the annual risk assessment review indicate that, during 2019, the financial performance of commercial banks was sound and stable. The strongest components were sensitivity to market risk, capital adequacy and asset quality. On the other hand, earnings and liquidity were rated adequate, with industry average scores of 2.64 and 2.32, respectively.

2.55 Table 2.12 shows the definition of colour codes, score ranges and risk rating for the OSS. A summary of OSS ratings for the nine banks included in the framework is provided in Table 2.13.

Table 2.12: Definition of Colour Codes, Score Ranges and Risk Rating

	Rating	Strong		Adequate		Partially Adequate		Weak	
CAMELS	Category	Band 1		Band 2		Band 3		Band 4	
	Sub Category	B1-Upper	B1-Lower	B2-Upper	B2-Lower	B3-Upper	B3-Lower	B4-Upper	B4-Lower
	Score	1.0	1.5	2	2.5	3	3.5	4	4.5
Risk Assessment Summary	Risk Rating	Low		Medium		Medium High		High	

Source: Bank of Botswana.

Table 2.13: OSS Results as at December 31, 2019

	Capital Adequacy	Asset Quality	Earnings	Liquidity	Market Sensitivity	Overall Score
Banking Sector Average	1.52	1.41	2.64	2.32	1.11	1.80

Source: Bank of Botswana.

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

STATUTORY BANKS[13]

STATEMENT OF FINANCIAL POSITION

Assets

2.56 Total assets for two statutory banks[14] increased by 18.8 percent from P6.5 billion in 2018 to P7.8 billion in 2019. The expansion in assets of the two statutory banks was mainly driven by an increase in placements with other banks and credit institutions, which grew by 74.3 percent from P1.4 billion in 2018 to P2.4 billion in 2019. Loans and advances issued to customers by the statutory banks amounted to P5.1 billion in 2019, out of which 76.2 percent was mortgage, compared to P4.9 billion in 2018. The market share of statutory banks with respect to total assets, deposits and loans and advances were 7.3 percent, 6.7 percent and 7.5 percent, respectively, in 2019.

Liabilities

2.57 Total liabilities (excluding shareholder funds) grew by 22.3 percent from P5.8 billion in 2018 to P7.1 billion in 2019, reflecting a significant increase in customer deposits. As shown in Table 2.14, the funding of assets for the two banks was mainly through deposits, which increased by 28.7 percent to P5.5 billion and constituted 70.3 percent of total liabilities. Other funding sources, which comprise debt securities and borrowings, and equity declined by 10.6 percent and 7.3 percent to P1.2 billion and P718 million, respectively, in 2019. These accounted for 15.2 percent and 9.2 percent of total liabilities, respectively.

Table 2.14: Main Sources of Funding for Statutory Banks: 2015 – 2019

Category	2015	2016	2017	2018	2019
Deposits (Pula million)	3 340	3 493	4 042	4 244	5 462
Growth rate (Percent)	53.3	4.6	15.7	5.0	28.7
Share of total funding	55.4	58.4	59.6	64.9	70.3
Other Liabilities (Pula million)	156	200	193	200	410
Growth rate (Percent)	15.0	27.8	(3.1)	3.4	104.9
Share of total funding	2.6	3.3	2.9	3.1	5.3
Share Capital (Pula million)	1 263	1 303	1 306	775	718
Growth rate (Percent)	(24.1)	3.2	0.3	(40.7)	(7.3)
Share of total funding	20.9	21.8	19.3	11.8	9.2
Debt Securities and Other Borrowings (Pula million)	1 271	987	1 235	1 325	1 185
Growth rate (Percent)	48.7	(22.3)	(50.6)	171.5	(10.6)
Share of total funding	21.1	16.5	7.2	20.2	15.2
Total Funding (Pula million)	6 031	5 982	6 777	6 544	7 774

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

[13] Banks established by specific statutes.

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

Liquidity Risk

2.58 The liquid assets of the two statutory banks, largely cash and balances due from domestic banks, increased from P1.5 billion in 2018 to P2.5 billion in 2019, a 65.4 percent growth. The liquid assets to deposits ratio increased from 36.1 percent to 46.4 percent in the same period and remained above the statutory limit of 10 percent. Furthermore, the liquid assets to total assets and liquid assets to gross loans and advances ratios increased from 23.4 percent and 31.4 percent in 2018 to 32.6 percent and 50.2 percent, respectively, in 2019, reflecting an improvement in liquidity for the statutory banks.

Credit Risk

Regulatory Capital Requirements for Credit Risk

2.59 In line with the increase in loans and advances, credit RWAs of the two statutory banks rose by 11.1 percent from P2.8 billion in 2018 to P3.1 billion in 2019. The credit risk-weighted assets constituted 91.8 percent of total risk-weighted assets as at December 31, 2019.

Loans and Advances, Credit Risk and Asset Quality

2.60 Credit growth for the two statutory banks accelerated to 3.3 percent in 2019 from 2.1 percent in 2018, resulting in a loan book of P5.1 billion in 2019 compared to P4.9 billion in 2018. The loan book comprised loans to the household sector and private businesses, which accounted for 93.7 percent and 6.3 percent of total loans and advances, respectively. NPLs increased by 9.3 percent from P412 million in 2018 to P450 million in 2019. Of the two sectors, households had the largest NPLs at 62.1 percent of total NPLs. The ratio of NPLs to total loans and advances for the banks increased from 8 percent in 2018 to 8.9 percent in 2019. Consistent with the increase in NPLs, the two banks raised specific provisions by 12.6 percent to P106.8 million in 2019 from P94.9 million in 2018, and the resultant ratio of specific provisions to NPLs slightly increased to 23.7 percent from 23 percent in 2018.

2.61 The inherent credit risk for the two statutory banks was considered high, while risk management systems and controls were assessed to be weak. As such, the residual credit risk remained high and is likely to increase over the next 12 months because of, first, adverse effects of COVID-19 on the ability of some borrowers to service their loans; second, expected economic contraction in 2020; third, inadequate risk management infrastructure (such as lack of comprehensive credit policy and integrated credit risk management systems) and, fourth, the intense competition from commercial banks.

Solvency (Capital Adequacy): Levels, Quality and Trends

2.62 During the period under review, unimpaired capital for the two statutory banks declined from P880 million in 2018 to P706 million in 2019, while RWAs increased by 10.2 percent to P3.4 billion from P3.1 billion in 2018. Consequently, the average CAR of the two banks was 20.7 percent, in 2019, which was above the 15 percent prudential minimum for banks in Botswana. Tier 1 capital to unimpaired capital ratio was 98.4 percent in 2019, indicative of high-quality capital levels of the statutory banks.

Statement of Comprehensive Income

2.63 The aggregate net profit of the two statutory banks fell from P0.2 million in 2018 to a loss of P34 million. The loss was driven by increased interest and non-interest expenses, which rose by 38.9 percent and 26.9 percent, respectively, as a result of a significant growth in deposits during the period.

2.64 As a result of the fall in the level of profits of the two banks, ROAA and ROE declined sharply from 0.003 percent and 0.023 percent in 2018 to -0.47 percent and -4.7 percent in 2019, respectively. In addition, the cost-to-income ratio increased from 85.5 percent in 2018 to 100 percent in 2019. Table 2.15 shows key performance indicators for statutory banks during 2015 to 2019.

Table 2.15: Statutory Banks: Financial Performance Indicators: 2015 – 2019

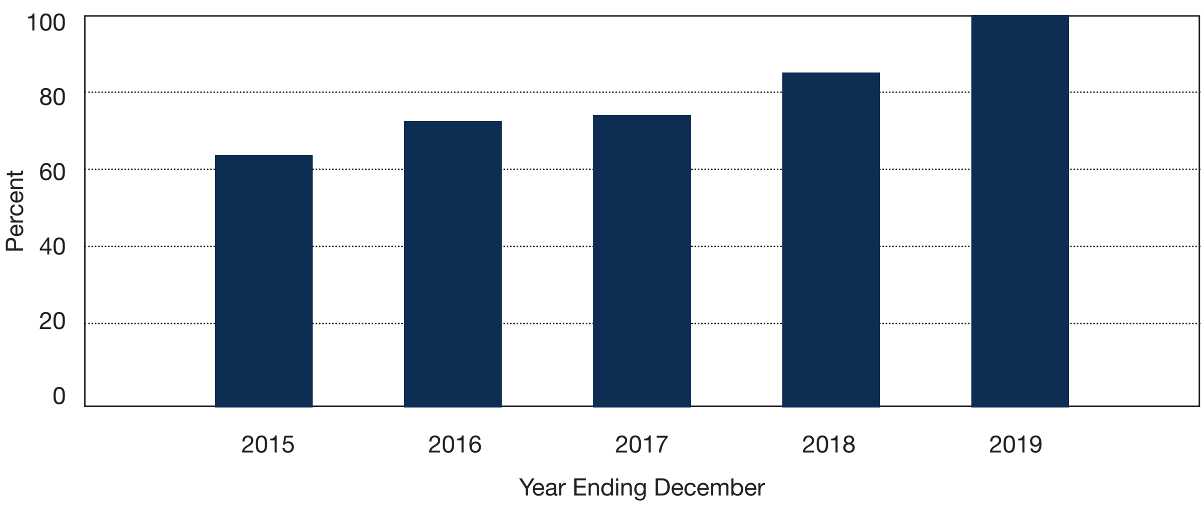
Indicator	2015	2016	2017	2018	2019
Pula million					
Net income	96	65	37	0.2	(34)
Interest income	475	482	265	441	535
Net interest income	242	251	234	213	218
Non-interest expense	189	214	197	212	269
Interest expense	233	231	198	228	316
Total assets	6 031	5 982	6 777	6 544	7 774
Average total assets	5 432	6 006	6 379	6 660	7 159
Average earning assets	1 890	2 120	6 111	6 307	6 716
Unimpaired capital	1 325	1 297	1 316	880	706
Risk-weighted assets	2 943	2 878	3 060	3 092	3 407
Percent					
Net income growth rate	60.3	(31.7)	(43.5)	(89.2)	(19 098)
Interest income to average total assets	8.7	8.0	4.1	3.7	7.5
Cost-to-income	64.3	72.1	74.3	85.5	100
Return on average assets	1.8	1.1	0.6	0.0	(0.5)
Return on equity	7.6	5.0	2.8	0.0	(4.7)
Return on advances	9.9	9.5	8.0	7.8	9.7
Average cost of deposits	4.7	3.9	3.4	3.8	4.5

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

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

2.65 Chart 2.23 presents the trend of the cost-to-income ratio for statutory banks over the five-year period, 2015 – 2019, which is incrementally upward.

Chart 2.23: Statutory Banks: Cost-to-Income Ratio: 2015 – 2019 (Percent)



Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

Operational Risk

Regulatory Capital Requirements in Respect of Operational Risk

2.66 RWAs for operational risk of the two statutory banks increased slightly from P279 million in 2018 to P280.6 million in 2019 and constituted 8.2 percent of total RWAs.

2.67 The inherent operational risk of the two statutory banks was considered high, while risk management systems and controls were assessed to be satisfactory. The residual operational risk remained high and is expected to increase over the next 12 months, given that one statutory bank is likely to continue having challenges in respect of its core-banking-system upgrade. Furthermore, working-capital challenges of one statutory bank are expected to continue in the near future, which will present difficulties for the bank in acquiring resources necessary to manage the operational risk.

OVERVIEW OF PILLAR 3 DISCLOSURE REQUIREMENTS

2.68 Pursuant to the implementation of the Basel II Capital Directive and Circular on Implementation of Pillar 3 Disclosure Requirements (Pillar 3 Circular), it is a requirement for banks in Botswana to publish key regulatory information, including financial position and performance, risk management systems, risk profile, corporate governance and internal controls on their websites and through published financial reports.

2.69 During 2019, most banks published information on the capital position, risk profile and risk management systems in accordance with the Pillar 3 Circular. Some banks, however, were in the process of addressing gaps in disclosure policies and thus could not meet the requirement. Overall, banks were compliant with the requirements of the Basel II Capital Directive and Pillar 3 Circular, with minor shortcomings noted at a few banks. The Bank continues to monitor the compliance of banks with the disclosure requirements to ensure improvement in the quality, consistency and comparability of disclosures across banks and compliance with all other regulatory requirements.

BOX 2: THE ROLE OF GREEN FINANCE AND RESPONSIBLE BANKING IN ADDRESSING THE EFFECTS OF CLIMATE CHANGE

Introduction

Climate change remains topical globally and is the subject of both policy review and business strategic decisions. Climate change refers to significant long-term variations in global or regional climate patterns, in particular with respect to temperature, precipitation, sea level, and wind patterns, largely attributable to the increase in atmospheric carbon dioxide associated with the use of fossil fuels (Bourma, 2001). The emission of greenhouse gases, including carbon dioxide, into the atmosphere over decades has caused health and ecological problems, making the planet less habitable.

Commercial banks, as financial institutions that play an important role in economic growth and development, can contribute towards channelling economic activity in the direction of responsible and sustainable ventures and pursuits. In this regard, green, or responsible, banking has become an area of growing interest in finance. Given Botswana's vulnerability to climate vagaries and likely development of binding guidelines and standards in this area, commercial banks in Botswana need to be able to respond and redirect their strategies to business relationships that help to decelerate or reverse climate change.

Responsible, or Green, Banking

Green, or responsible, banking is defined by the International Institute for Sustainable Development as the inclusion of environmental and social practices in core functional business and operations of commercial banks. The negative effects of climate change have compelled governments, international organisations and businesses to take measures that are aimed at reversing the damage caused by climate change, slowing the damage or both.

Responsible banking has two components:

- incorporation of environmental and social responsibility in operations of commercial banks through environmentally friendly initiatives (such as recycling programmes and improving energy efficiency) and socially responsible initiatives (for example, support for cultural events and sustainable human capital practices and policies); and
- integration of environmental and social considerations into product design, mission policy and business strategy. Ideally, commercial banks' target clients should include companies that support environmental or social projects.

Gravitation towards Responsible Banking

The crucial role commercial banks play in channelling funds from lenders to borrowers in support of economic activity, should be harnessed in promoting environmental sustainability. This is because banks can, through this intermediation function, influence their customers to engage in climate-friendly business activities. To this end, banks across the globe are making environmental and social aspects a priority in their business dealings.

A total of 130 banks have committed to adopting the United Nations Environment Programme Finance Initiative's principles for responsible banking, launched on September 22, 2019, in New York, United States of America. The banks have also given an undertaking to support the Paris Climate Agreement through financing socially and environmentally sustainable economic activities. For example, HSBC Holdings Plc, a British multinational investment bank and financial services holding company, has pledged USD100 billion for sustainable financing and investment by 2025.

Impact of Responsible Banking on Financial Performance

Some studies have suggested that there is a direct relationship between company environmental, social and corporate governance practices (ESG) and their financial performance. The October 2019 global progress report on sustainable banking by the International Finance Corporation evaluated performance of 656 companies and found that those with high ESG scores achieved higher profit margins than those with low scores.

Way Forward

It should be noted that some international financial institutions have recently embarked on adopting sustainable business practices in the financial industry. Commercial banks as well as central banks ought to take a cue from these institutions by integrating principles of responsible banking into their businesses. In Botswana, commercial banks need to familiarise themselves with global developments and thinking with respect to green banking and consider incorporating principles of responsible banking in their banking operations, processes, procedures and systems. This would require them to implement environmental, social and governance risk-management strategies and fund business activities with positive climate impact to fulfil the global responsibility for addressing the effects of climate change.

On the other hand, central banks are also increasingly playing a pivotal role in promoting responsible banking practices in the financial industry, as part of their efforts to advance the sustainability agenda in line with the United Nation's sustainable development goals. For example, the Network for Greening the Financial System, which consists of the world's leading central bankers and regulators support the transition to sustainable economic growth through encouraging environmental best practices in the financial sector. The Bank of Botswana, as a regulatory and supervisory authority, is keenly following these developments for guidance and adoption as necessary.

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NON-BANK FINANCIAL INSTITUTIONS

Bureaux de Change Activities

Market Entry and Exit

2.70 The Bank received 11 applications for a bureau de change licence during 2019, out of which one bureau de change was licensed, four were awaiting security-vetting results, while six were to invite the Bank for pre-operation inspection as part of the assessment process. Overall, the number of licences issued in 2019 was six, including five applications that were carried forward from 2018 and approved after satisfying security vetting and other supervisory requirements during the review period. The number of operating bureaux de change increased from 57 in 2018 to 60 in 2019.

On-site Examination of Bureaux de Change

2.71 The Bank conducted on-site examination of five bureaux de change to assess their compliance with the Bank of Botswana (Bureaux de Change Regulations) (regulations) and the Financial Intelligence Act, 2019.

2.72 A spot on-site examination was conducted at one bureau de change in response to its failure to submit statutory monthly returns. It was observed that the bureau de change had breached most provisions of the regulations and was, as a result, instructed to suspend operations for a period of six months effective November 18, 2019, within which it was to normalise the identified irregularities.

2.73 The Bank conducted AML/CFT on-site examination of five bureaux de change. The finding was that two bureaux de change were fully compliant with the AML/CFT requirements as their risk-mitigation measures were commensurate with the high risk of money laundering and terrorist financing (ML/TF) to which the bureaux de change are exposed. For the three bureaux de change, the ML/TF risk was high, while the risk-mitigation measures were weak. Consequently, the bureaux de change were fined and directed to have regularised all supervisory issues by April 30, 2020.

2.74 A snap on-site examination was carried out on one bureau de change, which had relocated without approval of the Bank and thus contravened regulation 5(2)(1) of the regulations. In addition, it was found that the bureau de change had violated some regulatory requirements. The bureau de change was fined for changing premises without informing the Bank and cautioned against any contravention of the provisions of the regulations.

Table 2.16: Common and Specific Violation of the Provisions of the Financial Intelligence Act, 2019 by Bureaux de Change

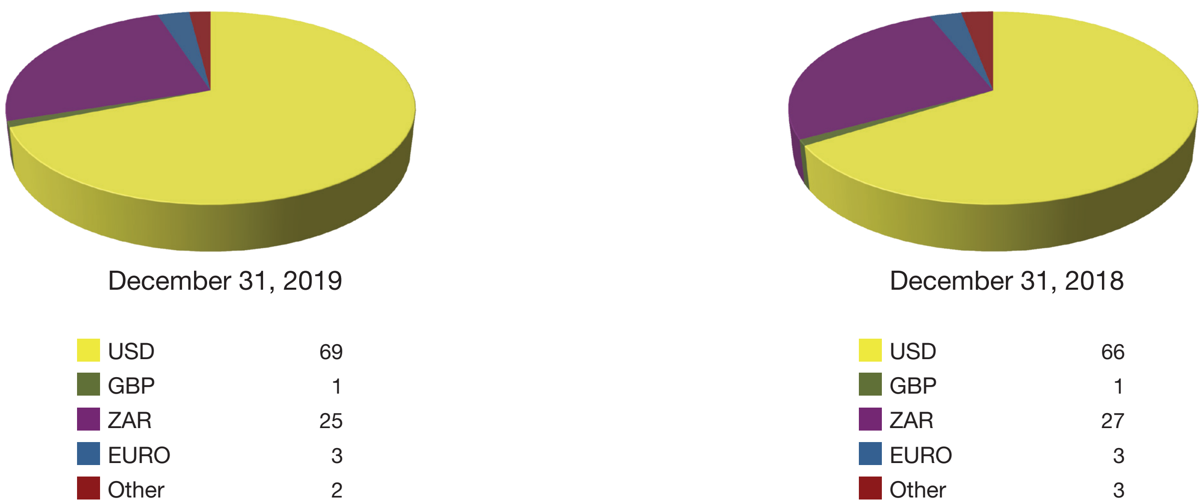
Provisions of the Regulations	Details of violations
Corporate governance	The bureaux de change AML/CFT policies were not approved by management and did not have AML/CFT compliance officers.
Customer identification programme	The bureaux de change did not conduct enhanced due diligence on high-risk customers. Two bureaux de change did not record customers' sources of funds. Two bureaux de change conducted large-cash transactions with businesses but did not verify some know-your-customer (KYC) information.
Screening of customers against sanctions list	Customers were not screened against sanctions list.
Customer risk assessment	Internal risk assessment did not include all risks that the bureaux de change was exposed to.
Monitoring and reporting of suspicious transactions	There was no formal process for monitoring customer transactions against their profiles. One bureau de change was not conversant with the preparation and submission of suspicious transaction reports. One bureau de change did not report suspicious transactions to the Financial Intelligence Agency (FIA) within five working days as required.
Cash transactions	The bureaux de change did not have measures in place to monitor cash transactions. The frequency and pattern of some cash transactions at two bureaux de change were suspicious, but these had not been detected, hence not reported.
Wire transfers	Wire transfers for one bureau de change were incorrectly completed. One bureau de change did not, contrary to requirement, submit forms A (transfer of funds outside the country) and S (receipt of funds from outside Botswana) to the Bank.
Statutory returns	Non-cash transactions were reported as cash transactions in one bureau de change's statutory returns.
Record keeping	One bureau de change staff could not retrieve transaction receipts, an indication that the bureau de change's record keeping was not satisfactory.
AML/CFT training programme	The bureaux de change did not have AML/CFT training programmes.

Source: Bank of Botswana.

Off-Site Surveillance of Bureaux de Change

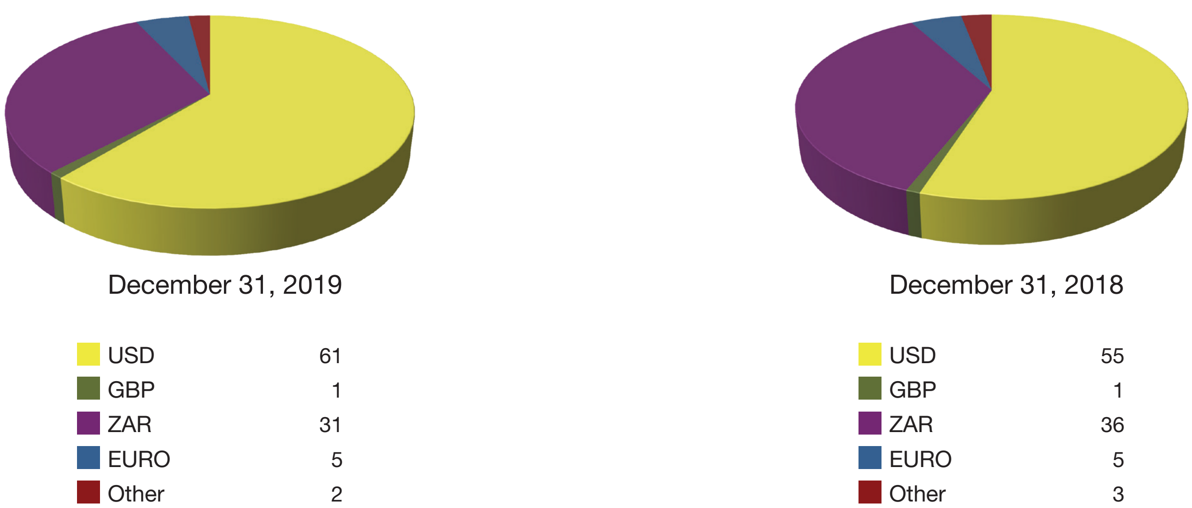
2.75 An off-site review of the statutory returns showed that bureaux de change continued to play an important role of facilitating foreign exchange in the economy. The value of sales of foreign currency by bureaux de change increased by 6 percent in 2019 compared to 11 percent increase reported in the previous year. On the other hand, the value of purchases increased by 12 percent in 2019 compared to a 10.3 percent decline in 2018. The United States dollar (USD) and South African rand (ZAR) dominated foreign-exchange transactions at bureaux de change during 2019.

Chart 2.24: Bureaux de Change: Sale Shares of Foreign Currency in 2018 and 2019 (Percent)



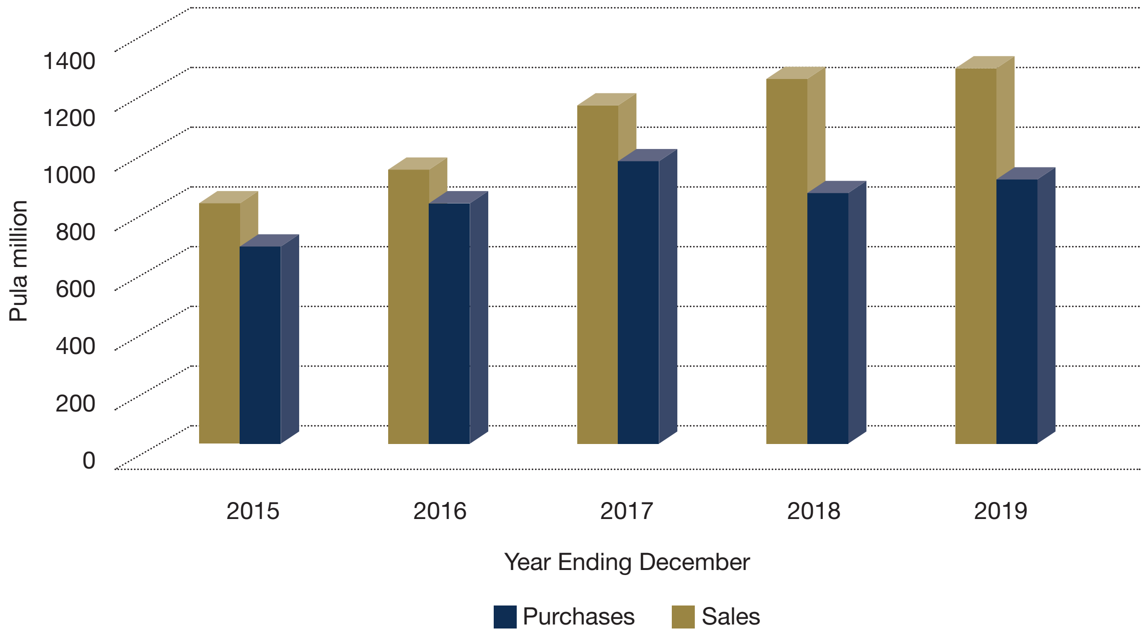
Source: Bureaux de Change (Statutory Returns submitted to the Bank).

Chart 2.25: Bureaux de Change: Purchase Shares of Foreign Currency in 2018 and 2019 (Percent)



Source: Bureaux de Change (Statutory Returns submitted to the Bank).

Chart 2.26: Bureaux de Change: Sale and Purchase Shares of Foreign Currency: 2015 – 2019 (Pula million)



Source: Bureaux de Change (Statutory Returns submitted to the Bank).

CHAPTER 3

LICENSING AND CONSUMER PROTECTION ISSUES

CHAPTER **3**:

LICENSING AND CONSUMER PROTECTION ISSUES

MARKET ENTRY ENQUIRIES AND LICENSING OF NEW BANKS

3.1 During the year, the Bank received seven enquiries for a banking-licence application, none of which materialised. The Bank also received an application for a banking licence which was subsequently withdrawn.

ILLEGAL DEPOSIT TAKING

3.2 The Bank investigated Global Dream Network (GDN), Dynamic Cycle Network (DCN), Botswana Fund Motshelo (BFM) and Nitty Publications Limited (Nitty Publications) on the suspicion that these entities were conducting illegal deposit-taking activities. GDN, DCN and Nitty Publications were based in Gaborone and conducted business through an internet link, while BFM was based in Francistown. Investigations indicated that the four entities had been conducting illegal deposit-taking activities.

3.3 Illegal deposit-taking activities are unlawful in Botswana; activities of these entities involved soliciting of money from the public without approval of the Bank, hence contravening Section 3(1) of the Banking Act. This section of the Banking Act restricts the transacting of banking business or advertising for or soliciting deposits of money to licensed banks. It is also a criminal offence, punishable by law, for any person to promote illegal banking activities in Botswana, as that constitutes unfair trading practice. Section 5(1) of the Banking Act empowers the Bank to investigate a person or entity suspected of conducting unlicensed banking business or illegal deposit-taking activities. If the investigations confirm a contravention, subject to other intervening measures, the activities are suspended forthwith.

3.4 Pursuant to Section 5(5) of the Banking Act, GDN, DCN, BFM and Nitty Publications were ordered to "cease and desist" from conducting the business of soliciting and accepting public deposits as well as peddling pyramid schemes.

3.5 In addition, the Bank issued a press release warning the public about illegal deposit-taking activities and advised them to desist from participating in such unlicensed schemes. The Bank continues to sensitise the public about pyramid schemes and their illegality.

COMMERCIAL BANK INTEREST RATES AND CHARGES

Interest Rates and Policy

3.6 The Bank Rate was reduced by 25 basis points to 4.75 percent on August 29, 2019, following which banks adjusted deposit and lending rates downwards. Given enhanced competition for deposits, however, some banks left interest rates unchanged on some deposit products, benefitting depositors while ensuring stable and reliable sources of funding for banks.

3.7 Table 3.1 shows an indicative range of deposit interest rates payable on the various deposit products offered by both commercial and statutory banks as at December 31, 2019. Banks continued to comply with the disclosure framework for deposit rates, which requires that the interest rate payable on the 91-day deposit, be at most 350 basis points below the prevailing Bank Rate, while longer-maturity rates are commensurately higher. The rates on the 91-day fixed deposits fell from 1.5 percent in 2018 to 1.25 percent in 2019. In addition, the threshold of P1 000 set by the Bank in the amendment of Directive REF: 01.09.2009 on Disclosure Framework for Deposit and Lending Interest Rates, for opening the 91-day fixed account was observed across the industry. Furthermore, banks continued to comply with the disclosure requirements of publishing the deposit interest rates offered in at least two newspapers widely circulating in Botswana.

3.8 Table 3.2 shows a range of lending rates offered by various banks as at December 31, 2019. The differential between the lowest and highest interest rates charged were noted with respect to some products, with unsecured loans attracting higher interest rates, while secured loans were charged lower interest rates.

Table 3.1: Commercial Banks: Deposit Rates for December 2019

Deposit Product	Deposit Rates (Annual Percent)	
	Lowest	Highest
Current account	0.00	2.97
Savings*	0.00	4.25
Call	0.00	2.47
91 days	1.25	2.75
6 months	1.25	3.75
12 months	1.25	4.25
24 months	1.70	4.75
Prime lending rate	6.25	
Bank Rate	4.75	

*Savings include both ordinary and special savings acocunts.

Source: Newspapers.

Table 3.2: Commercial Banks: Lending Rates for December 2019

Lending Product	Lending Rates (Percent)	
	Lowest	Highest
Mortgage (property loans)	3.25	12.50
Overdraft (revolving credit lines)	18.54	84.00*
Credit Card	4.75	23.50
Lease Loans	3.50	38.50
Personal Loans (excluding overdrafts, mortgage and credit cards)	3.50	38.50
Other Long-term Loans (including purchase order financing)	3.25	84.00**
Prime Lending Rate	6.50	6.50

*Interest rate charged to all customers irrespective of risk profile, by one commercial bank, for loan amounts below P10 000.

**A 7 percent interest rate per month charged to small and medium enterprises that do not bank with one commercial bank.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Commercial Bank Charges

3.9 Table 3.3 presents average charges for selected banking services in 2019. The structure is based on four broad categories of frequently applied charges, namely, access facilitation, investment/intermediation, trade facilitation, and payments and clearing charges. The data shows that the cost of financial services was generally higher in 2019 than in 2018.

Table 3.3: Selected Commercial Banks Average Charges: 2018 and 2019 (Pula)

Service Charge Category (Pula)		2018	2019	Growth Rate (Percent)
Access Facilitation				
(i)	Cash withdrawal (own bank)	2.90	2.99	3.17
(ii)	Lost ATM card replacement	66.08	59.10	(10.57)
(iii)	Point of sale	1.00	0.64	(35.39)
Internet Banking Charges				
(i)	Monthly fees	208.11	210.37	1.08
(ii)	Transfers (third party within bank)	2.38	2.38	0.00
Mobile Banking Charges				
(i)	Utility bill payments	3.00	3.00	0.00
(ii)	Payment to third-party accounts	2.98	2.98	0.00
(iii)	Buy pre-paid airtime	0.31	0.31	0.00
(vi)	Cash send/e-wallet/instant money	9.67	9.77	1.03
Investment/Intermediation				
(i)	Personal loan – arrangement fee (min.)	405.84	406.59	0.18
(ii)	Vehicle/asset finance – arrangement fee (min.)	671.85	675.87	0.60
(iii)	Mortgage – arrangement fee (min.)	698.49	701.10	0.37
Trade Facilitation				
(i)	Purchase of foreign currency (min.)	27.67	31.60	14.20
(ii)	International SWIFT transfer (max.)	343.98	360.38	4.77
(iii)	Advising commission on letters of credit	220.77	222.07	0.59
(iv)	Real Time Gross Settlement	218.21	190.86	(12.53)
(v)	Transfer to accounts at foreign banks (max.)	365.75	371.21	1.49
Payment and Clearing Charges				
(i)	Standard cheque book (20 – 50 pages)	35.74	45.00	25.93
(ii)	Unpaid cheque due to lack of funds	222.28	216.17	(2.75)

Note: Parentheses denote negative figures.

Source: Commercial Banks.

CONSUMER COMPLAINTS MANAGEMENT

3.10 The Bank received and processed 22 new complaints involving nine banks during the review period, while two complaints were brought forward from the previous year. Thirteen complaints were resolved, while eleven were undergoing the resolution process, including on-site inspections. There were various complaints as illustrated in Table 3.4.

Table 3.4: Commercial Banks' Consumer Complaints in 2019

Nature of Complaint Received	Total Number Received	Total Number Resolved	Total Outstanding as at December 31, 2019
Unsatisfactory service	10	4	6
Unfair handling of loans	8	5	3
Fraudulent transactions	5	4	1
Other	1	0	1
Total	24	13	11

Source: Bank of Botswana.

ABANDONED FUNDS

3.11 In accordance with Section 39 of the Banking Act, the Bank continued to administer abandoned funds from commercial banks. As indicated in Table 3.5, the balance of abandoned funds increased by 12.2 percent from P15 077 033 in 2018 to P16 917 687 in 2019.

Table 3.5: Total Abandoned Funds from Commercial Banks in 2019 (Pula)

	2018	2019
	Pula	Pula
Balance brought forward	10 618 671	15 077 033
Funds received	6 184 744	2 966 201
Claims paid out	(423 292)	(201 122)
Transfer to Guardian's Fund	(1 303 090)	(924 425)
Balance at year-end	15 077 033	16 917 687

Note: Parentheses denote negative figures.

Source: Commercial Banks.

CORPORATE GOVERNANCE

3.12 During 2019, the Bank received and processed 39 applications for the appointment of new directors and senior management officials of banks in line with the 2008 Guidelines on the Appointment of New Directors and Senior Management Officials of Banks and Section 29 of the Banking Act. Of the 39 applications, 37 were approved, while two, one each for senior management and board, were rejected. The application for senior management was rejected because the applicant was resident outside Botswana, while the proposed director was serving in a similar capacity in two financial institutions. Most of the approved appointments were of Botswana nationals, who accounted for 79.4 percent of applicants compared to 67.9 percent of the 42 approved in 2018.

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

3.13 In October 2018, Botswana made a high-level commitment to strengthen the effectiveness of its AML/CFT regime and addressed related technical compliance deficiencies. During 2019, three progress reports were submitted to FATF – International Cooperation Review Group Africa/Middle East Group. In addition, three face-to-face meetings were held. Moreover, the Bank has established a Unit, within the Banking Supervision Department, that focusses on AML/CFT issues in the banking sector.

3.14 Following the third FATF meeting held in France in October 2019 to discuss progress made by Botswana in addressing the AML/CFT deficiencies, a statement on Botswana's AML/CFT position was issued. In the statement, FATF noted that Botswana had adopted risk-based AML/CFT supervisory manuals for financial sector supervisors and implemented an electronic suspicious transactions-reporting filing system among financial institutions and certain types of designated non-financial businesses and professions.

3.15 In addition, to address the technical compliance deficiencies identified in the 2017 mutual evaluation conducted by the East and Southern Africa Anti-money Laundering Group (ESAAMLG), the country amended various pieces of legislation in 2018 and requested a re-rating from the ESAAMLG in April 2019. Table 3.6 shows the comparative 2017 mutual evaluation report rating and the 2019 re-rating.

Table 3.6: Mutual Evaluation Ratings for Botswana (2017 and 2019)

	2017 MER	2019 Re-rating
Compliant	0	6
Largely Compliant	2	13
Partially Compliant	14	16
Non-Compliant	23	4
Non-applicable	1	1

3.16 The country is continuing the effort to ensure compliance with non-compliant and partially compliant recommendations. To this end, the Financial Intelligence Act and Regulations (Cap. 08:07) was repealed and re-enacted as the Financial Intelligence Act, 2019. The amendment enhanced the law to ensure that Botswana complies with the international AML/CFT requirements. The act came into effect on September 4, 2019.

BOX 3: NATIONAL PAYMENTS SYSTEM VISION AND STRATEGY 2020 - 2024 FOR BOTSWANA

A national payments system (NPS) is a set of arrangements and infrastructures that enable consumers, businesses and other entities to transfer funds to one another using accounts they have at financial institutions and at payments-service providers. The National Payments System Vision and Strategy 2020 – 2024 outlines the essential characteristics of Botswana's future NPS and identifies key strategic actions in the development of the country's payments system. It encompasses goals and strategies aimed at building a world-class, efficient, safe, innovative, inclusive NPS. The five-year strategy reflects collective views of the NPS stakeholders in Botswana and was issued in recognition of the importance of a strategic approach to the development of the NPS.

The strategy guides the NPS modernisation projects, resource mobilisation, infrastructure development, linkages and role descriptions required to achieve the vision of a safe, efficient, innovative, inclusive NPS in the next five years. The overarching vision for the industry is anchored in ten pillars.

Pillar 1: The Payment and Securities Settlement Infrastructures

The strategic objective is to enhance the safety and efficiency of payment and securities settlement infrastructures in Botswana, such as the Botswana Interbank Settlement System (BISS) and Botswana Automated Clearing House (BACH); participation by statutory banks and other non-bank institutions will be given due consideration.

Pillar 2: Sound Legal Framework

An all-encompassing national payments law is critical for the management of risk and effective supervision of the NPS. The current legal framework will therefore need to be reviewed to more effectively support the evolving national payments system.

Pillar 3: Government Payments

Government payments and receipts are a key component of the NPS. In recognising the importance of NPS both for its payment role and the advancement of the financial inclusion agenda, the government of Botswana is committed to modernising its own payments activity.

Pillar 4: Retail Payments

The strategic objective is to build a retail payments system that offers customers the widest possible choice of payment channels and instruments for conducting day-to-day payments across the country.

Pillar 5: Oversight of the NPS

Oversight is a central bank function that aims at ensuring a safe, secure, efficient operation of payments and settlement systems. Therefore, the strategy endeavours to establish frameworks that provide for flexibility in overseeing the diverse components of the NPS.

Pillar 6: Cooperation

Modernising the NPS and securing its effective operation requires cooperation among stakeholders at various levels. This necessitates a multiple-level cooperation between the Bank and other regulators and supervisors, between the Bank and NPS stakeholders and among stakeholders themselves.

Pillar 7: Access Criteria and Participation

Promoting wider access to payment services is a fundamental requirement for meeting the public policy objectives of financial inclusion and inclusive growth. The strategy aims at achieving broader access by consumers through innovative payment services, such as mobile payments.

Pillar 8: Risk Management

The safety of payments system is central to facilitating financial transactions and supporting economic growth. The advance in technology presents an opportunity for payments-system providers to develop innovative products and services. These technological advances, however, change the risk landscape, particularly by increasing exposure to cyber and money-laundering, and terrorism-financing risks.

Pillar 9: Public Education and Outreach Programmes

The objective of the public education programme is to sensitise the public to the safe use, benefits and risks associated with the NPS.

Pillar 10: Financial Technologies Developments

The NPS will leverage financial technology (fintech) to improve access to financial services and facilitate broader digital transformation. Fintech companies will be embraced to foster development of innovative payment services to meet the changing customer preferences and expectations.

The strategy and vision form part of the work of the National Payments Task Force, which, among others, manages the NPS modernisation programme in Botswana and facilitates collaboration and cooperation among various stakeholders in the financial sector and the entire economy.

CHAPTER 4

OTHER SUPERVISORY ACTIVITIES

CHAPTER 4:
OTHER SUPERVISORY ACTIVITIES

RECENT GLOBAL STANDARDS AND GUIDELINES ISSUED BY THE BASEL COMMITTEE ON BANKING SUPERVISION AT THE BANK FOR INTERNATIONAL SETTLEMENTS

4.1 The Basel Committee on Banking Supervision (BCBS) issued new and revised guidelines and standards that materially affect the regulation and supervision of banks and banking groups. The following reports, guidelines and standards were issued in 2019:

(a) Minimum Capital Requirements for Market Risk, January 2019;
(b) Basel III Monitoring Report, March 2019;
(c) Standardised Approach – Implementing the Mapping Process, April 2019;
(d) Revisions to Leverage Ratio Disclosure Requirements, June 2019;
(e) Overview of Pillar 2 Supervisory Review Practices and Approaches, June 2019; and
(f) Margin Requirements for Non-centrally Cleared Derivatives, July 2019.

4.2 In addition, the BCBS circulated, for consultation, the following standards during 2019:

(a) Consolidated Basel Framework;
(b) Introduction of Guidelines on Interaction and Cooperation Between Prudential and AML/CFT Supervision;
(c) Revisions to Market Risk Disclosure Requirements;
(d) Voluntary Disclosure of Sovereign Exposures; and
(e) Basel Committee consults on Pillar 3 Disclosure Templates related to Banks Market Risk and Sovereign Exposures.

PARTICIPATION IN INTERNATIONAL AND DOMESTIC REGULATORY AND SUPERVISORY FORUMS

4.3 During 2019, the Bank attended supervisory college[15] meetings organised by home supervisors of parent banks of banking groups with subsidiaries in Botswana. The meetings for Absa Group Limited (formerly Barclays) and First Rand Limited were held in South Africa; for Standard Chartered PLC Group in England; and for First Merchant Bank Group in Malawi.

4.4 The supervisory college meetings were held in compliance with principle 13 of the Basel Core Principles for Effective Banking Supervision (Core Principles). The principle requires home supervisors to establish bank-specific supervisory college meetings for banking groups and host supervisors to be included in the colleges. The objective of the supervisory college meetings is to discuss key supervisory issues and engage with senior management officials of banks with a view to enhancing supervision of the internationally active banking groups. Issues discussed include group financial performance, growth strategies, risk management strategies, business conduct and oversight by boards of directors of these banks.

[15] Supervisory colleges are working groups of supervisors formed under the aegis of the BCBS to enhance the consolidated supervision of internationally active banking groups.

OTHER SUPERVISORY MATTERS

4.5 Consistent with the spirit and principles of best international practice on cooperation and collaboration with other regulatory authorities, the Bank and the Competition and Consumer Authority Joint Working Committee held two meetings during the year.

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

4.7 On February 4-8, 2019, the Bank hosted a joint Technical Assistance (TA) scoping mission from the IMF, the Office of Technical Assistance of the US Department of the Treasury and the United Kingdom's Her Majesty's Treasury. The focus of the mission was to review the country's main weaknesses in the AML/CFT regime and provide guidance on the way forward. The mission met all the country's key AML/CFT stakeholders: FIA, the Bank and the Non-Bank Financial Institutions Regulatory Authority (NBFIRA).

4.8 Subsequent to the scoping mission, a programme of TA mission visits was instituted to cover a period of two years, while a capacity development work programme was prepared and disseminated to stakeholders.[16] The IMF will help the Bank strengthen the AML/CFT regime by developing capacity to regulate and supervise financial institutions, focussing first on banks, then proceeding to bureaux de change, money-and-value transfer services, and micro-finance institutions, using a risk-based approach. Two IMF follow-up TA missions were conducted on May 27-29 and August 13-21, 2019.

4.9 The Bank's Law Review Committee conducted a review of the draft Banking Act between March 2019 and July 2019. Moreover, the Bank hosted the IMF TA mission on October 2-11, 2019, for further review of the draft Banking Act and for the TA mission to provide a high-level perspective on the draft Banking Act. The internal review of the draft was planned for completion in the first half of 2020 before submission to the Ministry of Finance and Economic Development in the second half of the year for further processing and legal drafting.

4.10 On September 16-19, 2019, the Bank hosted a Basel III liquidity standards implementation TA mission facilitated by IMF Regional Technical Assistance Center for Southern Africa. The objective of the TA mission was to develop requisite skills for the assessment of compliance of banks with requirements of the Basel III liquidity standards and to provide guidance to bank examiners who are developing guidelines and policies for the new liquidity standards.

4.11 As part of the implementation of Pillar 2, banks submitted their internal capital adequacy assessment process (ICAAP) reports. The Bank reviewed the initial ICAAP reports for three banks; subsequently, meetings were held with the respective banks for presentation of the ICAAP reports and feedback on the assessment was provided to the banks. Six banks submitted ICAAP reports for 2018 for review.

[16] Complementary technical assistance is also being provided to the Non-Bank Financial Institutions Regulatory Authority.

CROSS-BORDER SUPERVISION

4.12 Consistent with principle 12 of the Core Principles for Effective Banking Supervision, the Bank held two teleconference supervisory meetings with the South African Reserve Bank on the separation process of ABSA bank from Barclays PLC. The purpose of the meetings was to discuss the banking group's separation process and the resultant impact on the Botswana subsidiary and operational issues of supervisory concern. During these meetings, the bank was urged to enhance its AML/CFT risk management processes.

4.13 The meetings discussed measures to ensure that the separation process of the banking group did not negatively affect the operations of the subsidiaries. It was concluded that the banking group would be supervised on a consolidated basis and adequately monitored, with prudential standards applied to all aspects of the business conducted by the banking group across countries.

KINGDOM BANK AFRICA LIMITED IN LIQUIDATION

4.14 The winding-up of the operations of Kingdom Bank Africa Limited (KBAL) is in progress, with the liquidator continuing efforts to collect funds from debtors. The liquidator has indicated that an interim dividend of about P500 000 had been paid, pro rata, to the creditors. Furthermore, the liquidator is expected to conclude the KBAL liquidation process following an out-of-court settlement of the matter between the liquidator and KPMG.

FIRST CAPITAL BANK LIMITED ACQUISITION OF BANK OF INDIA (BOTSWANA) LIMITED

4.15 BoI announced its intention to exit the Botswana market on May 6, 2018, and entered into a sale-of-shares agreement with FCB on December 31, 2018. Thereafter, BoI obtained regulatory approvals from the Competition and Consumer Authority, the Bank and Botswana Unified Revenue Services and surrendered its banking licence on December 5, 2019. Following these regulatory approvals, the acquisition of BoI by FCB was consummated on March 9, 2020. Therefore, the number of licensed banks in Botswana reduced from ten to nine.

CHAPTER 5

SUMMARY OF KEY ISSUES ARISING FROM ON-SITE EXAMINATIONS AND PRUDENTIAL MEETINGS

CHAPTER **5**:

SUMMARY OF KEY ISSUES ARISING FROM ON-SITE EXAMINATIONS AND PRUDENTIAL MEETINGS

EXAMINATION OF COMMERCIAL BANKS

5.1 The Bank conducted full-scope on-site examination of two banks. The focus of the full-scope examination of the two banks was to assess the inherent risks across the banks' operations and effectiveness of their risk management frameworks.

5.2 For the first bank, the full-scope on-site examination indicated that the bank generally complied with statutory and prudential requirements. There, however, were governance and strategic deficiencies that needed to be rectified, such as lack of training of board members. Weaknesses in the bank's credit management system were noted; these included failure to periodically review some credit facilities, non-segregation of duties in the loan collections unit and weak credit-underwriting practices. Lapses were also identified in internal controls and information technology security, among others, failure to report renegotiated loans in the statutory return, lack of audit of virtual information-technology systems and delayed communication between the ATM system and core-banking system. Furthermore, the bank had violated its credit risk policy.

5.3 With respect to the second bank, the board of directors comprised seven members, a size considered to be adequate for effective oversight of the bank. However, no executive directors were board members, contrary to international best practice. In addition, not only did the bank not conduct training for board members to equip them with the relevant skills necessary for effective execution of their roles but also did not perform board performance evaluation. The bank's budgeting tool was not reliable, as it could not accurately estimate capital requirements. The bank did not regularly conduct stress tests to assess the resilience of capital to shocks.

5.4 Moreover, the bank had instances of non-compliance with internal policy requirements; for example, at the examination time, loans and advances that had been non-performing for more than the period specified in the bank's credit policy had not been written off. The bank's credit evaluation was compromised by lack of comprehensive credit-underwriting procedures. As an indication of the generally weak governance, the bank did not monitor third-party service providers, exposing it to a high operational risk. In addition, records management was deemed unsatisfactory as facility letters and security documents were not filed properly.

5.5 At another bank, a limited-scope on-site examination was carried out focussing on liquidity and operational risks of the bank, effectiveness of risk management systems and assessment of supervisory concerns arising from the 2016 full-scope on-site examination. The examination established that the bank had a liquidity risk management framework and liquidity contingency funding plan, both of which were assessed to be adequate and comprehensive. It was also evident that the bank's assets were funded mainly by customer deposits, which comprised wholesale deposits (89 percent) and retail deposits (11 percent), indicating the bank's reliance on volatile, relatively expensive wholesale funds.

5.6 The treasury function of the bank did not provide sufficient oversight, as internal audit had been conducted last in 2016. Consequently, weaknesses were observed in the treasury wherein the liquidity risk control environment was judged to be partially effective as the risk-identification process did not consider the liquidity risk inherent in new products; in addition, policies and procedure manuals were not adequately reviewed.

5.7 Furthermore, there was no integration between the bank's management information systems and the core-banking system, a weakness continuing from 2016. The bank did not adequately conduct disaster recovery tests.

5.8 For two other banks, a follow-up examination was conducted to evaluate progress on the resolution of concerns raised in the 2017 full-scope on-site examination of the banks. At one of the banks, the review focussed on governance structure, quality of capital management, adequacy of management systems for credit risk, liquidity and operational risks, and the bank's strategy for management of operating costs, particularly those attributable to group recharges.

5.9 The remedial actions on governance, in particular, board oversight matters, strategic planning, governance structure and talent management of one bank were considered satisfactory. The bank had completed the board performance review for 2018, while the 2019 board review was ongoing; board committees were adequately resourced. Furthermore, the bank's response to emerging opportunities in the local environment was considered adequate as the concerned bank had improved product offerings. The Bank, however, was concerned about that bank's high staff-attrition rate at the senior-management level and non-compliance with Guidelines on Transactions with Related Parties.

5.10 Supervisory concerns relating to the bank's capital adequacy had been satisfactorily addressed; the bank had good-quality capital and had developed a comprehensive capital management plan. Apart from NPLs that had been in the books of the bank for eight years, it had adequately remedied all supervisory concerns on credit risk.

5.11 To address concerns about high group recharges, the bank had implemented a plan to manage costs associated with the recharges.

5.12 As regards the other bank, the examination entailed assessing the adequacy of its risk management frameworks with respect to strategic, credit and liquidity risks, as well as risk to capital. The follow-up examination indicated that the bank had localised the credit evaluation process for real estate loans as advised. However, the underwriting of loan applications from financial institutions and review of interbank limits were conducted at the group level, thus inhibiting capacity building and knowledge transfer to local staff.

5.13 Furthermore, the credit-application management system for the bank was not configured to automatically flag unsecured exposures that exceed a staff member's annual emoluments, which may result in infringement of Section 17(8) of the Banking Act.

AML/CFT ON-SITE EXAMINATION

5.14 In 2019, the Bank conducted a full-scope on-site examination of two banks, a targeted on-site examination of one bank and a follow-up on-site examination of one bank. The objective of the full-scope AML/CFT on-site examination of the two banks was to assess the adequacy and effectiveness of the banks' AML/CFT policies and procedures and determine whether they were commensurate with the risk profile of the banks concerning money laundering and terrorist financing. The examination also assessed compliance of the banks with the Financial Intelligence Act (Cap. 08:07) and Regulations.

5.15 The full-scope on-site examination conducted at the two banks noted that the banks had implemented internal programmes and procedures for AML/CFT, including introducing customer acceptance policy; appointing money laundering reporting officers; maintaining records, monitoring and reporting suspicious transactions; screening customers against sanction lists; maintaining ongoing AML/CFT employee training; and providing for the reviewing of AML/CFT policies, procedures and controls of the banks by internal audit.

5.16 That notwithstanding, the examination identified some deficiencies in AML/CFT risk management, including invalid KYC documents, discrepancy in KYC information in systems at the two banks and provision of generic AML/CFT training programmes instead of tailoring them to employee with specific responsibilities. Consequently, the banks were directed to address the observed supervisory concerns within 12 months and to submit quarterly progress reports to the Bank.

5.17 The targeted on-site examination of one bank was conducted in collaboration with the Financial Intelligence Agency and focussed on assessing the effectiveness of the bank's AML/CFT policies, procedures and processes for monitoring, analysing and reporting suspicious transactions.

5.18 With respect to the targeted examination of that one bank, in general, the system used for suspicious transaction monitoring was satisfactory and the set of parameters configured in the system were considered adequate. Of concern, however, was the protracted period the bank was taking to investigate and analyse triggered events.

5.19 In relation to the follow-up examination conducted at one bank, the Bank assessed the adequacy of progress made by the bank in addressing the deficiencies identified during the 2017 on-site examination. The findings indicated some remedial progress concerning deficiencies, unresolved matters observed during the 2017 on-site examination, particularly the lack of identification of ultimate beneficial ownership on legal persons and prominent influential persons, and non-submission of large-cash transaction reports to the Financial Intelligence Agency through the go-AML reporting portal. Consequently, the bank was directed to regularise the supervisory concerns raised in the report within 12 months and submit quarterly progress reports to the Bank.

CONSUMER COMPLIANCE ON-SITE EXAMINATIONS

5.20 During 2019, a consumer-compliance on-site examination was conducted at two banks, wherein it was noted that both banks had comprehensive policies and procedures and complied with most consumer-compliance standards except the violations shown in Table 5.1.

Table 5.1: Violation of Consumer Compliance Standards (2019)

Violated	Description
Disclosure of Bank charges Notice GN. No. 41 of 2001	One bank: • had discontinued sending monthly bank statements by post; • did not adhere to approved bank charges and charged VAT twice; • did not adhere to agreed loan instalments; and • had debited customer accounts for failed transactions at ATMs and points of sale. Another bank: • did not accurately compute and disclose the annual percentage rate for all facilities; and • occasionally deviated from some charges in the approved tariff guide.
Section 39(1) of the Banking Act (Cap 46:04)	Customers of one bank were not informed about the dormancy status of their accounts. The dormant account policy of one bank did not provide the timeframe for suspension of interest and accrual of charges.
Prescription of Notice Period and Early Settlement Penalties for Term Loans and Similar Credit Facilities: Government Notice No. 111 of 2011	Contrary to the prescription that banks should not impose a penalty where a customer has given a 45-day notice, one bank was charging customers a two-month compounded interest penalty.

Source: Bank of Botswana.

CONSULTATIVE AND PRUDENTIAL MEETINGS

5.21 Prudential bilateral and statutory trilateral meetings were held in 2019, during which banks presented a review of their business strategies for the previous year(s) and those for the period ahead as well as their financial year-end results. Furthermore, bilateral meetings were held with external auditors to discuss audit strategies for the respective banks.

VIOLATIONS OF THE AML-CFT REQUIREMENTS

5.22 One bank violated various sections of the Financial Intelligence Act during 2019. Consequently, a total monetary penalty charge of P30 000 was levied on the bank.

Table 5.2: Penalties Levied on Banks for Various Violations of the Financial Intelligence Act (2019)

Name of Bank	Violation	Banking Act & Financial Intelligence Act Sections	Amount (Pula)
One bank	Lapses in internal controls regarding account-opening procedures for one account and non-compliance with customer identification and verification requirements.	Violation of sections 10 (1) (b) and 10 (2) of the Financial Intelligence Act.	30 000
Total			30 000

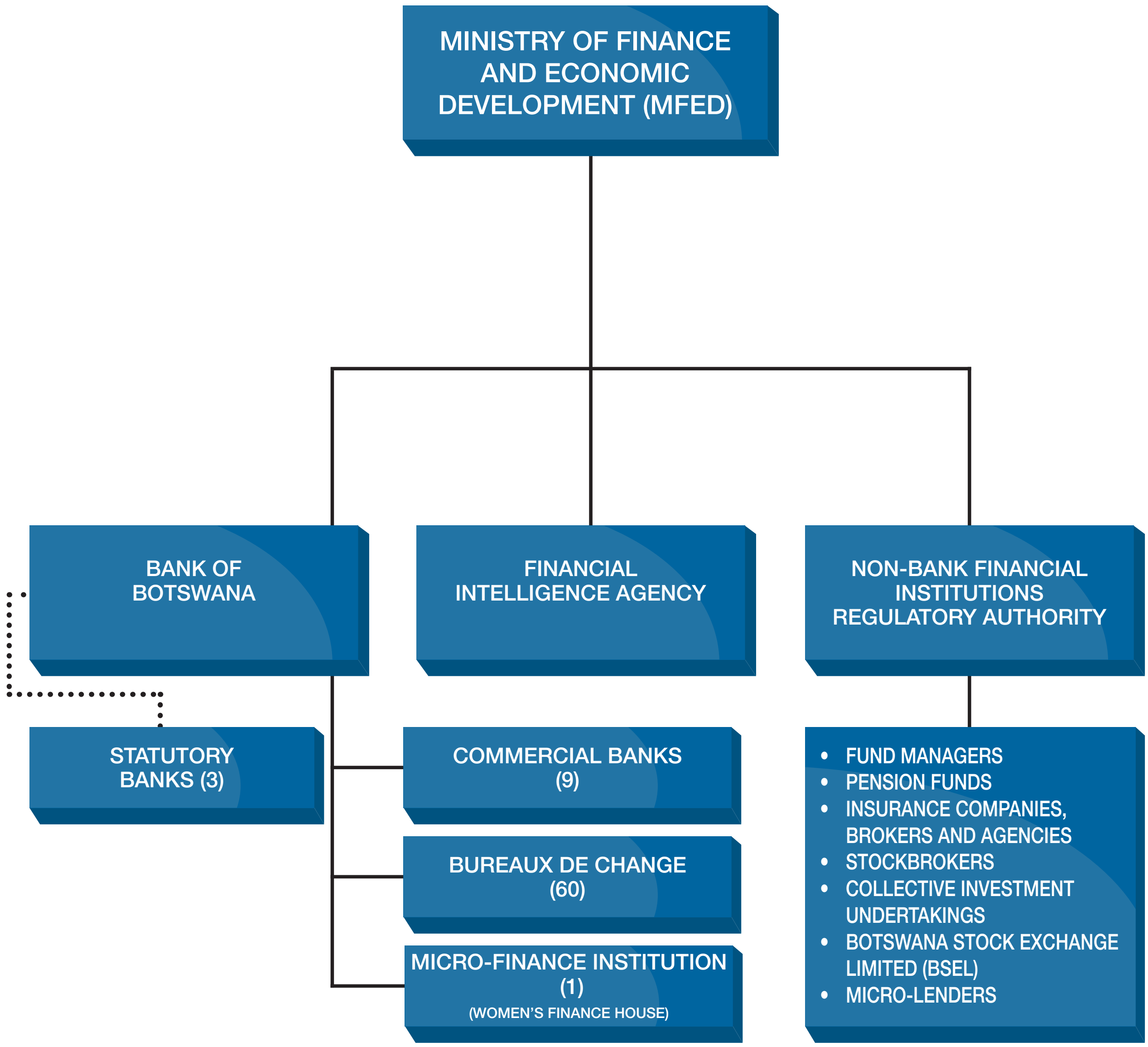
Source: Bank of Botswana.

APPENDICES

APPENDICES

APPENDIX 1

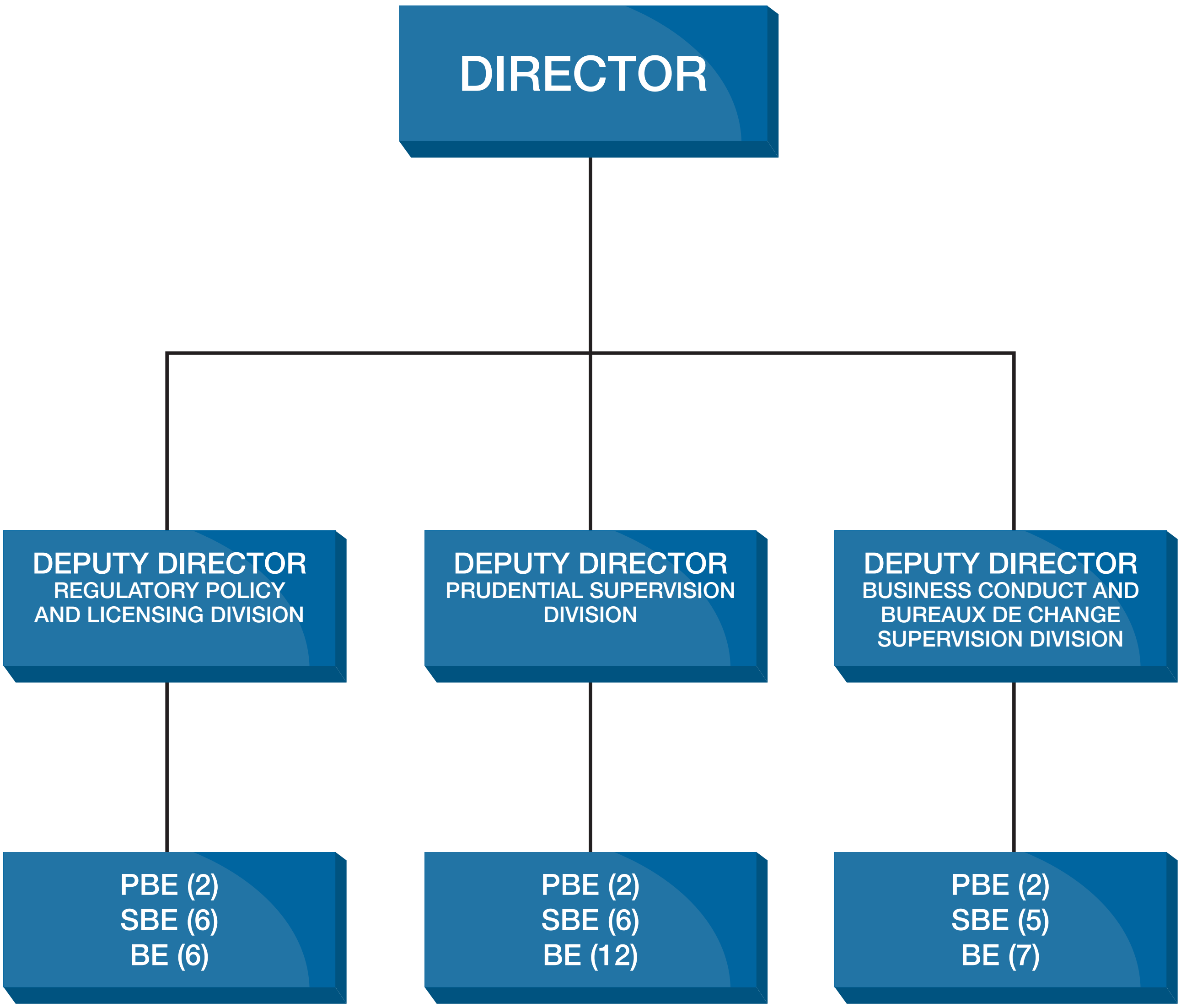
DIAGRAM 1.1: THE REGULATORY ARCHITECTURE OF THE DOMESTIC FINANCIAL SYSTEM



Source: Bank of Botswana.

APPENDIX 1 (CONTINUED)

DIAGRAM 1.2: BANKING SUPERVISION DEPARTMENT ORGANISATIONAL STRUCTURE AS AT DECEMBER 31, 2019



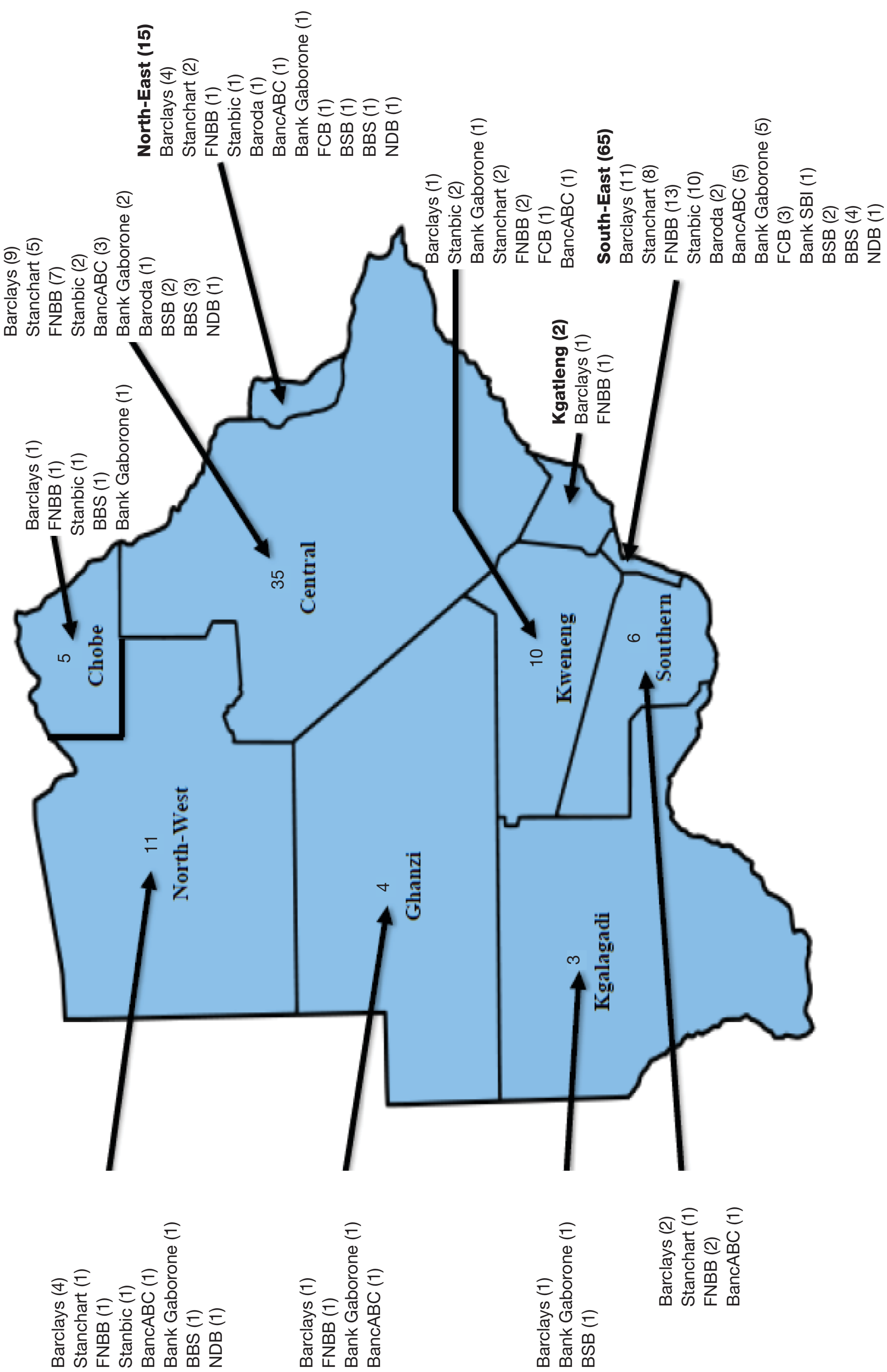
Key:

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

Source: Bank of Botswana.

APPENDIX **2**

BANK BRANCH DISTRIBUTION NETWORK BY DISTRICT AS AT DECEMBER 31, 2019



APPENDIX **3**

APPROACHES TO REGULATION AND SUPERVISION OF BANKS IN BOTSWANA

1. INTRODUCTION

1.1 This appendix outlines the basic elements of the framework, standards and processes for banking supervision in Botswana. The Bank is committed to the development of a sound, stable and competitive banking system, which promotes savings mobilisation while responding, in a prudent and sustainable manner, to the credit requirements of the economy. The Bank also seeks to adhere to the best international practice enshrined in the Basel Committee's 29 Core Principles and the 40 + 9 FATF Recommendations. FATF is an independent inter-governmental body that develops and promotes policies aimed at protecting the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction.

2. LEGAL FRAMEWORK

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

2.2 The banking law also covers issues of governance, market discipline within the banking system, and prudential supervision of the banking system. It is recognised that, primarily, the responsibility for banking soundness lies with owners (shareholders) and managers of banks, who have a commercial incentive to operate banks prudently. Market discipline, which is underpinned by minimum disclosure requirements, provides an incentive for good internal governance and imposes sanctions for failures, particularly for institutions listed on the BSEL. Prudential supervision is essential to provide external incentives for management and owners of banks to rectify inadequacies in governance and impose the appropriate level of control where market behaviour could lead to imprudent conduct, which could have adverse systemic repercussions. Thus, the continuing safety, soundness and stability of the banking system and the extent to which it is effective in facilitating financial intermediation between savers and borrowers, as well as operating the payment system, is a reflection of efficiency in all these three areas.

3. AUTHORITY FOR LICENSING BANKS

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

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

4. LICENSING POLICY AND PROCEDURES FOR ESTABLISHING A BANK

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

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

(a) The company must be locally incorporated in Botswana (branch banking is not permitted);
(b) The proposed banking establishment must have the prescribed initial minimum capital (currently P5 million) and the owners must demonstrate willingness and ability to provide additional financial support as and when required. In case of applicants that are majority owned by holding companies or a part of a financial conglomerate, the parent entity should demonstrate capacity to be a source of financial strength to the applicant;
(c) The applicant must have adequate managerial capacity, which includes the appointment of "fit and proper" persons, as well as sound risk-management and governance structures;
(d) In the case of foreign banks, the parent bank must be subject to adequate home supervision, and documentary evidence of consent by the parent supervisor to operate in Botswana must be provided;
(e) The proposed ownership and organisational structure must be acceptable to the Bank, and the structure must be such that it does not deter effective supervision, or, where necessary and appropriate, consolidated supervision; and
(f) The promoter must submit a business plan and five-year financial projections showing the establishment of a branch network, products to be provided, and demonstrate the ability to enhance effective competition, and effectively provide products and services to meet legitimate financial needs of the public in a prudent and safe manner.

5. CORE PRUDENTIAL REQUIREMENTS

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

Capital Adequacy Requirements

5.2 A bank must maintain a minimum capital adequacy (solvency) ratio of at least 8 percent, a statutory floor, calculated as the ratio of unimpaired capital to total risk-weighted assets. Banks in Botswana are required to maintain a capital adequacy ratio at or above 15 percent, which, in the context of the structure of the economy, prevailing 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 at a level that is commensurate with the nature and scale of its operations and the risks associated with them. The availability and adequacy of high-quality capital determines the degree of resilience of a bank to shocks to its financial position.

Liquid Assets Requirements

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

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

Asset Quality

Asset Concentrations (Large Exposures)

5.5 Section 17 of the Banking Act, read with Banking Regulation 9, restricts a bank from granting facilities that are in excess of 10 percent of a bank's unimpaired capital to a single customer or group of related customers without the specific approval of a bank's entire board of directors. Furthermore, a bank is required to seek approval of the Bank before granting loans and other credit facilities to a single entity or group of related companies which, in aggregate, are in excess of 30 percent of a bank's unimpaired capital. This is an asset-quality ratio intended to avoid vulnerabilities arising from excessive concentration of credit risk, or, put more positively, to encourage diversification of the loans and advances portfolio of a bank.

Insider Lending

5.6 Section 17 of the Banking Act, read with Banking Regulation 9, restricts banks from granting credit facilities to directors and their related interests in excess of the higher of P50 000 or 1 percent of a bank's core capital without the approval of the bank's entire board of directors. In addition, no bank may grant facilities, direct or indirect, to a member of its board of directors in excess of 25 percent of its unimpaired capital. This provision aims to avoid possibilities of insider abuse, self-dealing or over-reliance on related-party business. Any lending in violation of this requirement is deemed to be a withdrawal of capital and, therefore, deducted from the unimpaired capital in computing the capital adequacy ratio of a bank.

Non-performing Loans and Provisions

5.7 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 to assess the adequacy of provisions for non-performing assets. Accordingly, the Bank has statutory powers to assess, in consultation with the bank's independent statutory auditors, the level of impairments in a bank's loans and advances portfolio and the amount of charges to the bank's profit and loss as an expense for non-performing assets.

6. MAIN SUPERVISORY APPROACHES

On-site Examination

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

6.2 A full-scope prudential on-site examination is one that is sufficient in scope to assess an institution's capital adequacy (C), asset quality (A), management and effectiveness of board oversight (M), earnings and profitability (E), liquidity (L) and sensitivity to market risk (S) components (referred to as CAMELS) and the risk-management systems and make a conclusion about the institution's safety and soundness. A full-scope on-site examination should be conducted at least every 18 months. A limited-scope examination is an on-site examination that does not cover all components of the CAMELS, but rather focuses on a specific product, area, or risk, for example, consumer loans, treasury or operational risk. An ad hoc on-site examination is usually a limited-scope examination designed to test a specific area of supervisory concern, for instance, compliance with laws and regulations, liquidity, capital adequacy, among others. A full-scope business-conduct supervision examination focuses on the entire business conduct of an institution and how it relates to customers (consumer protection).

6.3 The objective of an on-site examination is to assess and evaluate the overall condition and financial soundness of a bank, compliance with applicable laws and regulations, the quality and effectiveness of governance structures, including the internal control environment, as well as to check the accuracy of statutory reports submitted to the Bank.

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

6.5 The evaluation of the financial soundness of the institution is achieved by assessing CAMELS, and the risk-assessment systems (RAS) rating. CAMELS and RAS ratings are awarded on a scale of 1 to 5. A rating of 1 indicates strong performance and strong risk-management practices, while a rating of 5 represents weak performance and inadequate risk-management practices. Consistent with the RBS method applied by the Bank, CAMELS ratings are used as a guide to determine, inter alia, the frequency of the on-site examination and intensity of supervisory programmes for each bank. A CAMELS rating of 1 (sound/strong bank) requires a bank to be examined within 24 months; a CAMELS rating of 2 within 18 months; a CAMELS rating of 3 within 12 months; and CAMELS ratings of 4 and 5 represent poor risk management and/or unsound banking operation, thus requiring a bank to be examined within six (6) months.

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

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

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

Bilateral and Trilateral Meetings

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

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

Off-site Monitoring and Surveillance

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

6.12 The Banking Supervision Department analyses financial data from banks continually to determine their financial condition, soundness and viability. Specific objectives of the analysis are to determine the levels, trends and sources of banks' profits; compare each bank's performance for the period with that of prior periods, and against that of other banks; note changes in the banks' capital accounts and the causes thereof (monthly, quarterly and annual performance review); and determine whether the banks have complied with the Banking Act, Banking Regulations, directives, circulars and guidelines pertaining to prudential requirements.

6.13 The outcome of the off-site analysis is used for preparing early warning reports, which also serve as an input to the on-site examination work, including planning, scope of on-site examination work and resourcing of the on-site examination teams. Furthermore, this regular off-site monitoring, surveillance and analysis serves an important function of risk profiling of banks, continuous engagement with bank management and, as may be necessary, any targeted supervisory interventions.

6.14 To enhance the off-site monitoring process, in 2015, the Bank adopted the use of an OSS quarterly monitoring tool. The OSS is a hybrid of the off-site rating system and the Financial Ratio and Peer Group Analysis monitoring tools that are used by regulators worldwide. The OSS rates and ranks banks based on an assessment of 32 financial soundness indicators or ratios. It is the adaptation of the traditional CAMELS ratings system that weighs the components relative to their current industry importance to financial soundness. The OSS scoring places banks within four broad categories of strong, adequate, partially adequate and weak, with a rating scale of 1 to 4.5, where 1 is strong and 4.5 is weak. This rating method was developed based on the Botswana banking sector data and, therefore, factored in the country-and-sector-specific variables affecting local banking business. It is expected that this system will bring some benefits in terms of tracking financial soundness and, accordingly, trigger appropriate supervisory reactions to systemic and idiosyncratic conditions that may warrant intervention.

7. ACCOUNTING, AUDITING AND DISCLOSURE STANDARDS

7.1 Section 22 of the Banking Act requires banks to annually appoint independent external auditors acceptable to the Bank. Statutory audits are conducted annually, usually at financial year-end, except when a bank intends to capitalise half-year interim profits, in which case it must call for an audit of the accounts. Change of external auditors or the financial year-end requires prior approval of the Bank.

APPENDIX **4**

SUPERVISED FINANCIAL INSTITUTIONS AS AT DECEMBER 31, 2019

A. COMMERCIAL AND STATUTORY BANKS

Institution	Total Assets (Pula million)	Postal Address	Business Locations	Auditors
Commercial Banks				
African Banking Corporation of Botswana Limited	9 090	Private Bag 00303 Gaborone	13	KPMG
Bank of Baroda (Botswana) Limited	2 131	P O Box 216 ADD Gaborone	4	Grant Thornton
Bank Gaborone Limited	5 882	Private Bag 00325 Gaborone	13	PricewaterhouseCoopers
Barclays Bank of Botswana Limited	19 005	P O Box 478 Gaborone	35	KPMG
First Capital Bank Limited	3 489	P O Box 5548 Gaborone	5	KPMG
Bank SBI Botswana Limited	412	P O Box 505243 Gaborone	1	Grant Thornton
First National Bank of Botswana Limited	26 623	P O Box 1552 Gaborone	28	Deloitte
Stanbic Bank Botswana Limited	16 409	Private Bag 00168 Gaborone	17	KPMG
Standard Chartered Bank Botswana Limited	15 635	P O Box 496 Gaborone	19	KPMG
Statutory Banks				
Botswana Savings Bank	3 133	P O Box 1150 Gaborone	6	PricewaterhouseCoopers
National Development Bank	1 051	P O Box 225 Gaborone	4	PricewaterhouseCoopers
Building Society				
BBS Limited	4 641	P O Box 40029 Gaborone	10	KPMG

Source: Commercial and Statutory Banks Returns submitted to the Bank.

B. BUREAUX DE CHANGE AS AT DECEMBER 31, 2019

Name	Postal Address	Business Location
4Corners Bureau de Change	P O Box 848, Ghanzi	1
Active Trade Bureau de Change	P O Box 11815, Francistown	1
Aldaph Bureau de Change	P O Box 404845, Gaborone	1
American Express Bureau de Change	P O Box 45140, Gaborone	1
Andy and Esi Bureau de Change	P O Box 504125, Gaborone	2
Apijoe Bureau de Change	P O Box 458, Mogoditshane	2
Arpanet Bureau de Change	P O Box 2241 ABG, Gaborone	2
Ban Mo Bureau de Change	P O Box 99, Sherwood	1
Bellagio Bureau de Change	Private Bag BR 321, Gaborone	1
Beni Fame Bureau de Change	P O Box 2143 AAD, Gaborone	5
Bosha Bureau de Change	P O Box 301529, Francistown	1
Chelyn Bureau de Change	P O Box AD505 ADD, Gaborone	1
City Exchange Bureau de Change	P O Box 50282, Gaborone	1
CSS Bureau de Change	P O Box 45168, Gaborone	3
Exim Bureau de Change	P O Box 1020, Gaborone	1
Fanz Bureau de Change	P O Box 617, Lobatse	1
Fundex Bureau de Change	P O Box 401547, Gaborone	3
Galaxy Bureau de Change	P O Box 501055, Gaborone	1
Garona Bureau de Change	P O Box 408, Gaborone	4
Genesis Bureau de Change	Private Bag BR 225, Gaborone	1
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Hi-Rated Bureau de Change	P O Box 3299, Gaborone	1
Kabona Bureau de Change	P O Box 455 ADD, Tlokweng	1
Kaycy Bureau de Change	P O Box 1693, Lobatse	2
Kwanokeng Bureau de Change	P O Box 10, Sherwood	2
Limpopo Bureau de Change	P O Box 8, Sherwood	2
Live Connection Bureau de Change	P O Box 52, Ramatlabama	1
Macheng Bureau de Change	P O Box 60474, Gaborone	1
Madikwe Bureau de Change	P O Box 268, Sikwane	1
Master Bureau de Change	Private Bag F199, Francistown	1
Mochudi Bureau de Change	P O Box 202147, Gaborone	2
Monty Cristo Bureau de Change	Private Bag 00254, Gaborone	1
Mukuru Bureau de Change	P O Box AD 148 ADD, Gaborone	4
Murhivudzo Bureau de Change	P O Box 799, Orapa	1

APPENDIX 4 (CONTINUED)

BUREAUX DE CHANGE AS AT DECEMBER 31, 2018

Name	Postal Address	Business Location
Ngami Bureau de Change	P O Box 44, Maun	1
Okavari Bureau de Change	P O Box 278, Charleshill	1
Open Door Bureau de Change	P O Box 839, Maun	8
Ozair Bureau de Change	P O Box 4862, Gaborone	2
Palm Bureau de Change	P O Box 502359, Gaborone	1
Prime Ex Bureau de Change	P O Box 686, Moshupa	1
Proxy Bureau de Change	P O Box 404108, Gaborone	2
Regash Bureau de Change	P O Box 45144, Gaborone	1
Rain Bureau de Change	P O Box 1751, Gaborone	1
River Ride Bureau de Change	P O Box 301106, Francistown	1
Royalty Bureau de Change	Private Bag BO 259, Gaborone	2
Sherwood Ranch Bureau de Change	P O Box 1, Sherwood	1
Sunny Bureau de Change	P O Box 370, Maun	2
Thari Bureau de Change	P O Box 40074, Gaborone	2
The Silver Bureau de Change	P O Box 1894, Ramotswa	1
Titanium Treasury Bureau de Change	P O Box 1890 ABG, Gaborone	1
Toluca Bureau de Change	P O Box 402026, Gaborone	1
Trans Fronter Bureau de Change	P O Box 183, Pitsane	2
Travelex Bureau de Change	P O Box 80981, Gaborone	1
Travellers' Choice Bureau de Change	P O Box 26725, Gaborone	1
TRL Money Link Bureau de Change	Private Bag F333, Francistown	2
Tshilong Bureau de Change	P O Box 40418, Gaborone	2
Unimoni Exchange Bureau de Change	P O Box AD 749 ADD, Gaborone	9
Unity Bureau de Change	P O Box 1586, Francistown	1
West Bureau de Change	P O Box 40854, Gaborone	1
WP Bureau de Change	P O Box 77, Ramatlabama	1
Total	60	103

Source: Bureaux de Change (Statutory Returns submitted to the Bank).

C. MICROFINANCE INSTITUTION

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

Source: Women's Finance House.

APPENDIX **5**

DEFINITION OF BANKING SUPERVISION TERMS

Asset Concentration

Measures aggregate exposure to one borrower, an affiliated group of borrowers, or borrowers with a common controlling interest, common management, cross-guarantees or financial interdependency that cannot be substituted in the short term. This exposure is usually expressed as a percentage of the bank's unimpaired capital and its various thresholds are subjected to prudential regulatory requirements. According to Section 17 of the Banking Act, an exposure in excess of 10 percent of a bank's unimpaired capital is deemed an asset concentration requiring prior approval of the board of directors of the lending financial institution. Exposures in excess of 30 percent of the bank's unimpaired capital require the Bank's approval.

Asset Quality

A relative measure of the performance of a bank's loan portfolio based on the appraisal of the asset using the degree of risk and the likelihood of recovery, adherence to the terms of contracts and orderly liquidation of the account. A good-quality asset means the loan, advance or investment is producing cash flows as was expected and/or agreed upon. A non-performing asset or loan is a loan where payment of interest and principal is past due by 90 days or more.

Loan Classifications

(i) "Pass" Assets

A credit is in the "pass/standard category if there are no material or significant performance problems (the credit is current and the borrower is complying, and is expected to continue to comply with all terms of the contract); or there are no technical and/or legal documentation deficiencies.

(ii) "Special Mention" Assets

A credit should be in the "special mention" or watch category if it is currently protected, but potentially weak. That is, assets with potential weaknesses that may, if not checked or corrected, weaken the asset as a whole or potentially jeopardise a borrower's repayment capacity in the future. This would, for example, include credit given through inadequate loan agreement or covenants, a lack of control over collateral, or incomplete or inadequate documentation, as well as adverse trends which are not yet serious enough for a classification of substandard.

(iii) "Sub-standard" Assets

A credit should be classified as "substandard" if it has one or more well-defined weaknesses that make the full collection of principal and interest questionable. This would include, for example,

(i) deterioration of the borrower's financial condition, including net worth and/or repayment capacity;
(ii) the pledged collateral (if any) is undocumented, insufficient, or deteriorating;
(iii) the borrower's financial information is absent or unsatisfactory;
(iv) other adverse factors exist, which cause concern regarding the ability of the borrower to repay the credit in accordance with the existing repayment terms, such as delinquency of 90 days, significant deviation from original source of repayment or carryover debt; and/or
(v) an actual breach of the contract has occurred.

(iv) "Doubtful" Assets

A credit shall be classified as "doubtful" when weaknesses exist that make collection or repayment in full, highly questionable and improbable based upon current circumstances, conditions and the estimated recoverable amount of the pledged collateral (if any). Such credits generally display high levels of delinquency and the possibility of loss is very high. However, because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the credit, classification of the credit as "loss" is deferred until its more exact status is determined. Pending factors may include a merger/acquisition and capital injection.

(v) "Loss" Assets

At the time of classification, the credit is deemed uncollectable and of such little value that it should not continue to be included in the accounts and financial statements of the bank. The classification of credit as loss does not mean that the credit has no recovery or salvage value, but that the bank should not defer writing it off even though at least part of the value could be recovered in the future. Such classification does not cancel the borrower's obligation to repay, nor does it mean that the bank should not continue to exercise its full legal right to collection or payment. Loans classified as loss may have severe delinquency, unsecured and/or not well secured and not in the process of collection. Overdrafts considered loss may be hardcore, stagnant for a long period of time and unsecured or not well secured.

Core Capital

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

Total Risk-weighted Assets

An aggregate of the total value of assets after adjusting for the risk inherent in each asset for both on-balance sheet and off-balance sheet items. A list of assets and the corresponding risk conversion factors used in risk-weighting is presented at Appendix 6 attached. The amount of the risk-weighted assets for both operational risk and market risk shall be determined by multiplying the respective capital requirements by 6.7, the result of which is added to the risk-weighted assets for credit risk to come up with the total risk-weighted assets for a bank.

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 and/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 at Appendix 5 capital elements.

PRUDENTIAL RATIOS

Return On Equity (ROE)

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

Return On Average Total Assets (ROAA)

The ratio measures after-tax profits as a percentage of average total assets. This ratio is widely used by both banking supervisors and market analysts, since banking assets are the base from which earnings are primarily derived. The ratio measures the earnings capacity of the assets of a financial institution. It measures profit earned 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.

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 prudential supervision. Emphasis is on the adequacy of capital with reference to the quality of capital funds in relation to the statement of financial position risk profile, for example, the core and unimpaired capital to risk-weighted assets ratio. The rationale is that owners of banks must have sufficient own funds in a bank, though it is recognised that unnecessarily high capital levels could result in economic inefficiencies, if not employed productively. However, for commercial and other strategic reasons, 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.

Risk-based Capital

On January 1, 2016, the Bank implemented the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II). This new framework augments the risk sensitivity of the Basel Committee Capital Accord (Basel I). In terms of the Basel II framework, in addition to credit risk, a separate and explicit computation of the regulatory capital for market risk and operational risk is introduced. Therefore, the minimum amount of regulatory capital (the ratio of unimpaired capital to risk-weighted assets) is derived from the summation of capital charges for credit risk, operational risk and market risk. The move to this method of capital adequacy measurement has alerted banks to the types of assets they hold and the associated risk profiles. The intention is to strengthen the resilience of banks. In the process, some existing capital instruments held by banks and fixed revaluation reserves were disqualified from being part of

APPENDIX 5 (CONTINUED)

Tier II capital. Also excluded are any elements that are likely to impair a bank's capital, such as investment in unconsolidated subsidiaries and associated companies, and connected lending of a capital nature. The use of risk-weighted assets is intended to take into account the risk inherent in the different types of assets. If two banks with the same size of assets and capital base are to be compared, their unadjusted capital ratio will be the same. However, if the inherent risk of the statement of financial position is taken into consideration, the bank with less risky assets will enjoy a higher capital adequacy ratio and is better able, therefore, to expand its business by lending to more borrowers, if opportunities arise. A good capital base implies that adequate funds are available to absorb risks inherent in the types of assets held by a bank, its foreign exchange dealing operations and all other risks associated with the business.

Interest Rate Spread

This covers only those assets and liabilities that have an interest rate attached to them. Thus, it excludes the effect of non-interest-bearing demand deposits, capital and non-remunerated reserve requirements on net interest earned and thus on bank profits. This is helpful in that it isolates the effect of interest rates on bank profits and thereby enables a better understanding of the sources of bank profitability and, consequently, of the vulnerability of bank earnings.

Net Interest Margin

This is net interest income as a percentage of average total earning assets. The ratio identifies the core earnings capability of a bank.

Other Operating Income to Total Assets

The ratio shows the dependence on "non-traditional" income such as foreign exchange fees and commissions. Growth in this ratio can indicate diversification into fee-based financial services or a reaching for speculative profits to make up for deficiencies in the bank's core interest differential income.

Net Operating (or Intermediation) Margin

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 incurred by the banking system for intermediating between the providers and the users of funds.

Net Income per Staff Member

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

APPENDIX 5 (CONTINUED)

Net Income to Staff Expense

Measures the return on investment in staffing costs. This ratio is probably a better measure than net income per staff member since it enables institutions of a different type to be compared to some degree. It considers the effect of staffing decisions, regardless of whether these are low cost, low expertise clerical staff, or high cost, high qualified professionals.

Cost-to-Income

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

Average Cost of Deposits

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

APPENDIX 5 (CONTINUED)

CAPITAL ELEMENTS

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

Source: Bank of Botswana.

APPENDIX 5 (CONTINUED)

Table 1: Regulatory Adjustments Applied In the Calculation of Capital

A.	REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF CET1 CAPITAL	
AA.	Full deductions	
	Line	Item
	1	Goodwill and other intangible assets
	2	Advances of a capital nature granted to connected persons
	3	DTA that rely on future profitability to be realised
	4	Investments in own shares, whether directly or indirectly
	5	Unrealised revaluation losses on investments in securities
	6	Defined benefit pension fund assets
	7	Reciprocal holdings in the capital of banking, financial and insurance entities
	8	Cash flow hedge reserve
	9	Gain on sale related to securitisation transactions
	10	Regulatory adjustments applied to CET1 capital due to insufficient additional Tier 1 and Tier 2 capital
	11	Full deductions applied to the calculation of CET1 capital line (1+2+3+4+5+6+7+8+9+10)
AB.	Threshold deductions	*(Recognition capped at 10 percent of the bank's common equity (after the application of all regulatory adjustments set out under paragraph 4.6 of the Basel II Directive)*
	Line	Item
	12	Significant investments in the common shares of unconsolidated financial institutions, where a bank or its subsidiary owns more than 10 percent common shares of the issuing entity (banks, insurance and other financial entities) - instead of full deduction, only deduct the excess above the 10 percent threshold, the remaining balance below thresholds shall be treated as other assets (paragraph 3.16 – 3.18 Basel II Guidelines)
	13	Deferred tax assets that arise from temporary differences
	14	Mortgage servicing rights
	15	Aggregate non-significant investments by the bank or its subsidiary in the equity of other banks and financial institutions, where the aggregate investment is equal to or greater than 10 percent of the capital of the institution in which the investment is made - instead of full deduction, only deduct the excess over the 10 percent threshold, the remaining amount below the 10 percent threshold shall be treated as other assets
	16	Threshold deductions applied to the calculation of CET1 capital line (12+13+14+15)
	17	Total regulatory adjustments applied to the calculation of CET1 capital lines (11+16)
B.	REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF ADDITIONAL TIER 1 CAPITAL	
BA.	Full Deductions	
	18	Direct investments in own additional Tier 1 capital, net of any short positions, if the short positions involve no counterparty risk
	19	Indirect investments in own additional Tier 1 capital (e.g., through holdings of index securities in which the bank itself is a constituent), net of any short positions
	20	Any own additional Tier 1 capital which the bank could be contractually obliged to purchase
	21	Reciprocal cross holdings and the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation
	22	Significant investments in the common shares of unconsolidated financial institutions, where a bank or its subsidiary owns more than 10 percent common shares of the issuing entity (banks, insurance and other financial entities)
	23	Full deductions applied to the calculation of additional Tier 1 capital line (18+19+20+21+22)

APPENDIX 5 (CONTINUED)

	Line	Item
BB.	Threshold deductions	*Recognition capped at 10 percent of the bank's common equity (after the application of all regulatory adjustments set out under paragraph 4.10 of the Basel II Directive)*
	24	Aggregate non-significant investments by the bank or its subsidiary in the equity of other banks and financial institutions, where the aggregate investment is equal to or greater than 10 percent of the capital of the institution in which the investment is made - instead of full deduction, only deduct the excess over the 10 percent threshold, the remaining amount below the 10 percent threshold shall be treated as other assets
	25	Total regulatory adjustments applied to the calculation of additional Tier1 capital line (23+24)
C.	REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF TIER 2 CAPITAL	
CA.	Full deductions	
	26	Direct investments in own Tier 2 capital, net of any short positions, if the short positions involve no counterparty risk
	27	Indirect investments in own Tier 2 capital (e.g., through holdings of index securities in which the bank itself is a constituent), net of any short positions
	28	Any own Tier 2 capital which the group could be contractually obliged to purchase
	29	Reciprocal cross holdings and the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation
	30	Significant investments in the common shares of unconsolidated financial institutions, where a bank or its subsidiary owns more than 10 percent common shares of the issuing entity (banks, insurance and other financial entities)
	31	Full deductions applied to the calculation of Tier 2 capital line (26+27+28+29+30)
CB.	Threshold deductions	*Recognition capped at 10 percent of the bank's common equity (after the application of all regulatory adjustments set out under paragraph 4.15 of the Basel II Directive)*
	32	Aggregate non-significant investments by the bank or its subsidiary in the equity of other banks and financial institutions, where the aggregate investment is equal to or greater than 10 percent of the capital of the institution in which the investment is made - instead of full deduction, only deduct the excess over the 10 percent threshold, the remaining amount below the 10 percent threshold shall be treated as other assets
	33	Total regulatory adjustments applied to the calculation of Tier 2 capital line (31+32)

Note: 1. The amount of the three items (12, 13, 14) not deducted (threshold amounts) in the calculation of CET1 is treated as other assets and risk-weighted at 250 percent.

2. Line 15: The amount above the 10 percent threshold shall be deducted from CET1, and the amount at or below threshold shall be risk-weighted as appropriate as per the Monthly Schedule M- SRWA 12a (CRM.1): Credit Risk Mitigation (Simple Approach) or Monthly Schedule M- SRWA 12b (CRM.2): Credit Risk Mitigation (Comprehensive Approach).

Source: Bank of Botswana.

APPENDIX **6**

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

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

	Credit Rate						
Claims on Exposure	AAA to AA-	A+ to A-	BBB+ to BBB-	BBB+ to B-	Below B-/BB	Unrated	Risk-weight/ Credit Conversion Factor Percentage
Government of Botswana and Bank of Botswana							0
Cash							0
Cash items in the process of collection							20
Sovereigns and central banks	0	20	50	100	150	100	
BIS, IMF							0
Domestic public sector entities							20
Public sector entities	20	50	100	100	150	100	
Domestic banks							20
Foreign banks	20	50	100	100	150	100	
Security firms	20	50	100	100	150	100	
Eligible retail							75
Other retail							100
Mortgages[1]							35
Corporates/insurance companies	20	50	100	100	150	100	100
Multilateral development banks	20	50	50	100	150	50	0/100
Commercial real estate	100	100	100	100	100	100	100
Other assets[2]							100
Past due items **							100(20); 100(20-50); 150(20)
Other non-qualifying residential property							75
Significant investments in equity and regulatory capital instruments issued by unconsolidated financial institutions							250
Mortgage servicing rights							250
Deferred tax assets (DTA)							250
Investments in commercial entities							1 250
Non-payment/delivery on non-delivery-versus-payment and non-payment-versus-payment transactions							1 250
Venture capital and private equity investment							150

Notes: **Treatment of past due loans (non-performing loans net of specific provisions)

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

2 Excludes cash items in the process of collection.

Source: Bank of Botswana.

APPENDIX 6 (CONTINUED)

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

APPENDIX 6 (CONTINUED)

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

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

Source: Bank of Botswana.

APPENDIX **7**

AGGREGATE FINANCIAL STATEMENTS OF LICENSED BANKS: 2015 – 2019

Table 1: Aggregate Statement of Financial Position of Licensed Commercial Banks: 2015 – 2019 (Pula million) as at 31st December

	TOTAL ASSETS IN LOCAL CURRENCY	2015	2016	2017	2018	2019
1.	Cash and balances with the central bank	4 584	6 333	4 597	5 364	6 501
	1.1. Currency	1 544	1 433	1 608	1 901	1 850
	a. Foreign currency	532	363	382	607	173
	b. Local currency	1 013	1 070	1 226	1 294	1 677
	1.2. Balances with central bank	2 982	4 900	2 989	3 462	4 651
	1.3. Other	58	-	-	-	-
2.	Investment and trading securities	12 537	11 425	10 811	12 142	14 203
3.	Placements with other banks and credit institutions	10 539	10 951	13 590	15 467	14 855
4.	Gross loans and advances to other customers	48 307	51 325	54 181	58 332	62 770
	4.1. Impairments-specific	1 007	1 270	1 536	1 352	1 775
	4.2. Interest in suspense	340	184	259	492	558
	4.3. Impairments portfolio	132	182	239	303	237
5.	Loans and advances to other customers (net of specific provisions)	46 875	49 690	52 147	56 185	60 200
6.	Fixed assets net of depreciation	968	908	926	956	1 348
7.	Other assets (net)	1 106	1 333	1 402	1 227	1 588
	Total Assets	76 605	80 640	83 475	91 341	98 695
	TOTAL LIABILITIES IN LOCAL CURRENCY					
1.	Amounts owed to government institutions	2	12	27	-	-
	a. Central bank accounts	2	12	27	-	-
	b. Direct government credits (CB or MFED)	-	-	-	-	-
2.	Due to other banks and credit institutions	3 308	3 984	4 250	4 735	4 532
3.	Debt securities and other borrowing	3 163	2 642	4 065	4 747	4 761
4.	Due to other customers/depositors	59 940	62 438	63 581	69 270	75 709
5.	Shareholder funds	8 204	9 748	9 383	10 390	11 081
6.	Other liabilities	1 997	1 817	2 169	2 199	2 612
	a. Taxes payable	252	195	246	185	201
	b. Dividends payable	7	-	-	-	-
	c. Accrued expenses	-	7	551	-	292
	d. Other	1 715	1 615	1 372	2 013	2 120
	Total Liabilities	76 605	80 640	83 475	91 341	98 695

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 2: Aggregate Statement of Comprehensive Income of Licensed Commercial Banks: 2015 – 2019 (Pula million) for the period ended 31st December

		2015	2016	2017	2018	2019
1.	Total interest and fee income from loans and advances	5 129	5 271	5 449	5 728	6 251
2.	Interest expense	2 093	1 425	1 466	1 811	1 894
3.	Net interest income [1-2]	3 036	3 847	3 983	3 916	4 357
4.	Total non-interest income	2 312	2 477	2 490	2 657	2 835
5.	**Gross operating income/(loss) [3+4]**	**5 348**	**6 323**	**6 473**	**6 573**	**7 192**
6.	Total Impairments	668	855	1 003	429	743
	a. Impairment of loans and advances – specific	587	685	994	344	700
	b. Impairment of loans and advances – portfolio	83	172	9	85	42
	c. Impairment on other financial assets	(2)	(2)	-	-	1
7.	**Operating income/(loss) net of bad and doubtful debts**	**4 680**	**5 469**	**5 470**	**6 144**	**6 449**
8.	Total non-interest expense	3 242	3 607	3 876	3 988	4 193
	a. Salaries and employee benefits	1 335	1 543	1 731	1 781	1 899
	b. Auditing and consulting expenses	49	173	299	15	47
	c. Rents paid	195	198	207	227	169
	d. Depreciation and amortisation	148	159	158	174	231
	e. Other	1 565	1 533	1 481	1 791	1 847
9.	Other provisions and write-offs	-	-	-	-	-
	a. Investments	-	-	-	-	-
	b. Other balance sheet items	-	-	-	-	-
	c. Off-balance sheet items	-	-	-	-	-
10.	**Net operating income/(loss) [7-8-9]**	**1 438**	**1 862**	**1 595**	**2 156**	**2 256**
11.	Extraordinary gains/(losses)	-	-	-	-	-
	a. Gains/losses on revaluation of assets (net)	-	-	-	-	-
	b. Translation gains/losses (net)	-	-	-	-	-
	c. Other gains/losses	-	-	-	-	-
12.	**Net income/(loss) before tax [10+11]**	**1 438**	**1 862**	**1 595**	**2 156**	**2 256**
13.	Income tax	349	455	412	480	494
14.	**Net income/(loss) after-tax [12-13]**	**1 088**	**1 407**	**1 182**	**1 676**	**1 762**

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 3: Aggregate Statement of Financial Position for Statutory Banks in Botswana: 2015 – 2019 (Pula million) as at 31st December

	TOTAL ASSETS IN LOCAL CURRENCY	2015	2016	2017	2018	2019
1.	Cash and balances with the central bank	9	23	70	177	234
	a. Currency	8	21	18	171	222
	aa. Foreign currency	-	-	-	-	-
	ab. Local currency	8	21	18	171	222
	b. Balances with central bank	1	2	52	6	12
	c. Other	-	-	-	-	-
2.	Investment and trading securities	-	-	-	-	-
3.	Placements with other banks and credit institutions	1 580	1 025	1 777	1 391	2 424
4.	Gross loans and advances to customers	4 278	4 769	4 792	4 891	5 054
5.	Impairments	37	47	93	143	185
6.	Net loans and advances to customers	4 240	4 722	4 699	4 745	4 869
7.	Fixed assets net of depreciation	131	151	152	146	141
8.	Other assets (net)	71	62	79	82	106
	Total Assets	6 031	5 983	6 777	6 544	7 774
	LIABILITIES IN LOCAL CURRENCY					
1.	Amounts owed to government institutions	-	-	-	-	-
	a. Central bank accounts	-	-	-	-	-
	b. Direct government credits (CB** or MFED)	-	-	-	-	-
	c. Other	-	-	-	-	-
2.	Debt securities and other borrowing	1 271	987	1 235	1 325	1 185
3.	Due to customers/depositors	3 340	3 493	4 042	4 244	5 462
4.	Shareholder funds	1 263	1 303	1 306	775	718
5.	Other liabilities	157	200	193	200	409
	a. Taxes payable	1	1	1	2	1
	b. Dividends payable	-	4	-	-	-
	c. Accrued expenses	-	-	-	-	-
	d. Other	156	195	192	198	408
	Total Liabilities	6 031	5 983	6 777	6 544	7 774

*2015 figures revised to exclude one statutory bank.

**CB denotes central bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

Table 4: Aggregate Statement of Comprehensive Income of Statutory Banks: 2015 – 2019
(Pula million) for the period ended 31st December

		2015	2016	2017	2018	2019
1.	Total interest and fee income from loans and advances	475	482	433	441	535
2.	Interest expense	233	231	198	228	317
3.	Net interest income [1-2]	242	251	234	213	218
4.	Total non-interest income	51	46	30	35	51
5.	**Gross operating income/(loss) [3+4]**	**294**	**297**	**265**	**248**	**269**
6.	6. Total Impairments	9	18	24	32	34
	a. Impairment of loans and advances – specific	-	-	-	18	23
	b. Impairment of loans and advances – portfolio	-	-	-	6	1
	c. Releases and recoveries of bad debts previously written off	-	-	-	2	-
	d. Share of associate company profits	-	-	-	-	2
	e. IFRS adjustments	-	-	-	-	4
	f. Reversal of interest in suspense	-	-	-	-	4
7.	**Operating income/(loss) net of specific loss provisions**	**284**	**279**	**241**	**216**	**235**
8.	Total non-interest expense	189	214	197	212	269
	a. Salaries and employee benefits	94	106	91	97	130
	b. Administrative expenses	-	-	-	-	-
	c. Auditing and consulting expenses	-	-	-	1	1
	d. Rents paid	-	-	-	2	13
	e. Depreciation and amortisation	13	10	16	19	23
	f. Other	81	98	88	93	102
9.	Other provisions and write-offs	-	-	-	-	-
	a. Investments	-	-	-	-	-
	b. Other balance sheet items	-	-	-	-	-
	c. Off-balance sheet items	-	-	-	-	-
10.	**Net operating income/(loss) [7-8-9]**	**96**	**65**	**44**	**4**	**(34)**
11.	Extraordinary gains/(losses)	-	-	-	-	-
	a. Gains/losses on revaluation of assets (net)	-	-	-	-	-
	b. Translation gains/losses (net)	-	-	-	-	-
	c. Other gains/losses	-	-	-	-	-
12.	**Net income/(loss) [10+11]**	**96**	**65**	**44**	**0.18**	**(34)**

*2015 figures revised to exclude one statutory bank figures.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

APPENDIX 7 (CONTINUED)

Table 5 (a): Aggregate Capital Structure of Commercial Banks in Botswana (under Basel I): 2015 (Pula million) as at 31st December

	TIER 1	2015
1.	Stated capital	1 381
2.	Preference (non-redeemable) non-cumulative shares	-
3.	General reserves	148
4.	Retained earnings	5 116
5.	Minority interests	-
6.	Less	(86)
	a. Goodwill and other intangible assets	(82)
	b. Shareholder equity funded through the capitalisation of unrealised gains arising from property revaluation	-
	c. Current year's unpublished losses	(4)
7.	**Total Tier 1 Capital (Sum of lines 1 - 5 less lines 6(a) - (c)**	**6 559**
	TIER 2	
8.	Current year's unpublished profits	780
9.	Fifty percent of fixed asset revaluation reserves	34
10.	Unrealised gains on available for sale revaluations	9
11.	Unencumbered general provisions not to exceed 1.25 percent of risk-weighted assets	332
12.	Hybrid (debt/equity) capital instruments eligible for inclusion	8
13.	Subordinated term debt eligible for inclusion	1 551
14.	Minority interest in Tier 2 preference shares	100
15.	Shareholders equity funded through the capitalisation of property revaluation reserves	-
16.	**Total Tier 2 Capital (sum of lines 8 - 15)**	**2 814**
17.	**Total Capital (sum of lines 7 and 16)**	**9 373**
	Impairments	**-**
18.	Investments in unconsolidated subsidiaries and associated companies	-
19.	Total Impairments of capital	-
20.	**Total Unimpaired Capital**	**9 373**

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 5 (b): The Revised Aggregate Capital Structure of Commercial Banks in Botswana (Basel II): 2016 – 2019 (Pula million) as at 31st December

	COMMON EQUITY TIER 1 (CET1) CAPITAL	2016	2017	2018	2019
1.	Common shares	1 165	1 265	1 265	1 265
2.	Share premium resulting from the issue of common shares	271	271	271	271
3.	Retained Earnings:	5 479	5 867	6 422	6 762
	Retained earnings brought forward from the previous financial year	5 325	6 404	6 700	7 041
	Add: interim profits (audited by external auditor)	506	(196)	63	(13)
	Less: IFRS 16 take on impact	-	-	-	190
	Less: dividend declared	-	6	160	75
	Less: dividend paid in the current financial year	352	335	180	-
4.	Accumulated other Comprehensive income and other disclosed reserves	156	207	289	304
	a. Statutory credit risk reserve	25	79	137	146
	b. Capital buffer	-	-	-	-
	c. Statutory reserves	2	2	2	2
	d. Other (specify)	129	126	150	156
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)	-	-	-	-
6.	Regulatory adjustments applied in the calculation of CET1 Capital[1]	123	249	275	-
	a. IFRS 9 provisions transitional adjustments	-	-	-	21
	b. Transitional adjustment amount added back to CET1	-	-	390	233
7.	CET1 Capital (Lines (1+2+3+4+5-6))	6 948	7 361	8 029	8 435
	ADDITIONAL TIER 1 CAPITAL				
8.	Instruments issued by the bank that meet the criteria for inclusion in additional Tier 1 capital as per paragraph 4.9 of the Basel II Directive	-	-	400	400
9.	Stock surplus (share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-	-	-	-
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in additional Tier 1 capital and are not included in CET 1 subject to terms and conditions in paragraph 3.5 of the Basel II Guidelines	-	-	-	-
11.	Regulatory adjustments applied in the calculation of additional Tier 1 capital	-	-	-	-
12.	Additional Tier 1 Capital (Lines (8+9+10-11))	-	-	400	400
13.	Total Tier 1 Capital (Lines (7+12))	6 948	7 361	8 429	8 835

	TIER 2 CAPITAL				
14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital);	1 641	1 683	1 853	2 218
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;	-	-	-	-
16.	Unpublished current year's profits	1 041	1 124	987	1 094
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	176	214	140	10
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)	-	-	-	-
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	432	391	678	691
20.	Regulatory adjustments applied in the calculation of Tier 2 capital	-	-	(11)	-
21.	**Total Tier 2 Capital (Lines (14+15+16+17+18+19-20))**	**3 293**	**3 412**	**3 648**	**4 013**
22.	**Total Unimpaired Capital (Lines (13+21))**	**10 241**	**10 774**	**12 077**	**12 848**

Note: Comprises goodwill and other intangible assets.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 5 (c): Listing of the Key Components of the Capital Structure of Commercial Banks in Botswana (Summary): 2015 – 2019 (Pula million) as at 31st December

		2015	2016	2017	2018	2019
1	Stated capital*	1 381	1 165	1 265	1 265	1 265
2	Share premium	-	271	271	271	271
3	Retained earnings	5 116	5 479	5 867	6 422	6 762
4	Total Tier 1 Capital	6 560	6 948	7 361	8 429	8 835
5	Subordinated term debt	1 551	1 817	1 897	1 993	2 228
6	Current year's unpublished profits	780	1 041	1 124	987	1 094
7	Total Tier 2 Capital	2 814	3 293	3 412	3 648	4 013
8	Total Unimpaired Capital (sum of Line 4 and 7)	9 374	10 241	10 774	12 077	12 848

*Stated capital for 2015 included share premium.

Source: Commercial Banks (Statutory Returns submitted to the Bank).

Table 6 (a): Aggregate Capital Structure of Statutory Banks in Botswana (Basel I): 2015 (Pula million) as at 31st December

	TIER 1	2015
1.	Stated capital	878
2.	Preference (non-redeemable) non-cumulative shares	-
3.	General reserves	228
4.	Retained earnings	130
5.	Minority interests	-
6.	Less	7
	a. Goodwill and other intangible assets	7
	b. Shareholders equity funded through the capitalisation of unrealised gains arising from property revaluation	-
	c. Current year's unpublished losses	-
7.	**Total Tier 1 Capital (Sum of lines 1 - 5 less lines 6(a) and 6(b)**	**1 229**
	TIER 2	
8.	Current year's unpublished profits	90
9.	50 percent of fixed asset revaluation reserves	-
10.	Unrealised gains on available for sale revaluations	-
	a. Unencumbered general provisions not to exceed 1.25 percent of risk-weighted assets	5
	b. Statutory credit risk reserve	-
11.	Subordinated term debt eligible for inclusion	-
12.	Minority interest in Tier 2 preference shares	-
13.	Shareholders equity funded through the capitalisation of property revaluation reserves	-
14.	**Total Tier 2 Capital (sum of lines 8 - 13)**	**95**
15.	**Total Capital (sum of lines 7 and 14)**	**1 324**
	Impairments	
16.	Investments in unconsolidated subsidiaries and associated companies	-
17.	Connected lending of a capital nature	-
18.	Total impairments of capital	-
19.	**Total Unimpaired Capital**	**1 324**

*2014 – 2015 figures revised to exclude one statutory bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

APPENDIX 7 (CONTINUED)

Table 6 (b): The Revised Aggregate Capital Structure of Statutory Banks in Botswana (Basel II): 2016 – 2019 (Pula million) as at 31st December

	COMMON EQUITY TIER 1 CAPITAL	2016	2017	2018	2019
1.	Common shares	922	952	507	507
2.	Share premium resulting from the issue of common shares	-	-	-	-
3.	Retained Earnings:	97	85	119	70
	Retained earnings brought forward from the previous financial year	157	132	119	143
	Add: interim profits (audited by external auditor)	-	-	-	-
	Less: unpublished current year's losses	-	-	-	(73)
	Less: dividend declared	-	-	-	-
	Less: transfer during the year	-	3	-	-
	Less: dividend paid in the current financial year	60	44	-	-
4.	Accumulated other comprehensive income and other disclosed reserves	64	230	145	137
	a. Statutory credit risk reserve	-	-	(14)	(22)
	b. Capital buffer	-	-	-	-
	c. Statutory reserves	-	166	159	159
	d. Other (specify)	64	64	-	-
5.	Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)	-	-	-	-
6.	Regulatory adjustments applied in the calculation of CET1 capital	-	-	17	19
7.	CET1 Capital (Lines (1+2+3+4+5-6))	1 083	1 259	754	695
	ADDITIONAL TIER 1 CAPITAL				
8.	Instruments issued by the bank that meet the criteria for inclusion in additional Tier 1 capital as per paragraph 4.9 of the Basel II Directive	-	-	-	-
9.	Stock surplus (share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-	-	-	-
10.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in additional Tier 1 capital and are not included in CET 1 capital subject to terms and conditions in paragraph 3.5 of Basel II Guidelines	-	-	-	-
11.	Regulatory adjustments applied in the calculation of additional Tier 1 capital	-	-	-	-
12.	Additional Tier 1 Capital (Lines (8+9+10-11))	-	-	-	-
13.	Total Tier 1 Capital (Lines (7+12))	1 083	1 259	754	695

	TIER 2 CAPITAL				
14.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)	-	-	102	-
15.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	-	-	-	-
16.	Unpublished current year's profits	67	40	4	3
17.	Tier 2 capital instruments (subject to gradual phase-out treatment)	-	-	-	-
18.	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (minority interests)	-	-	-	-
19.	General provisions/general loan-loss reserves eligible for inclusion in Tier 2 capital, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	-	17	19	8
20.	Regulatory adjustments applied in the calculation of Tier 2 capital	-	-	-	-
21.	**Total Tier 2 Capital (Lines (14+15+16+17+18+19-20))**	**67**	**57**	**126**	**11**
22.	**Total Unimpaired Capital (Lines (13+21))**	**1 150**	**1 316**	**880**	**706**

*Figures excludes one statutory bank.

Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

Table 6 (c): Listing of the Key Components of the Capital Structure of Statutory Banks in Botswana (Summary): 2015 – 2019 (Pula million) as at 31st December

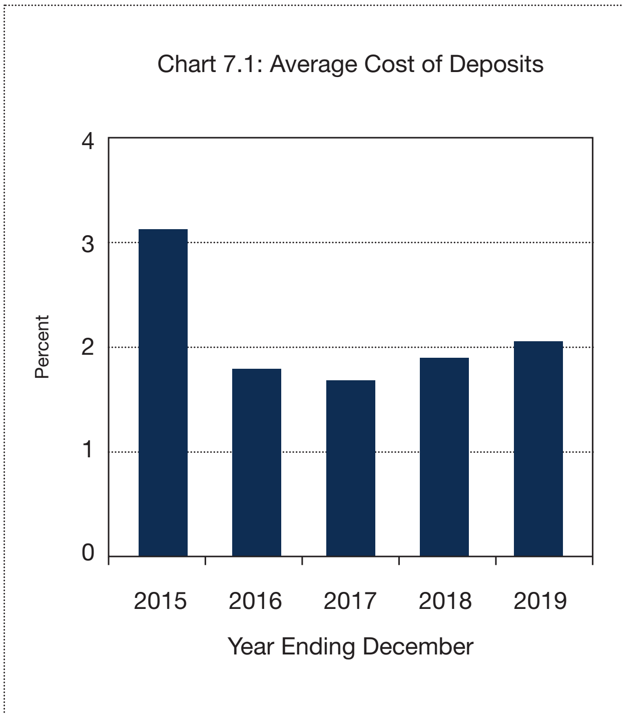
		2015	2016	2017	2018	2019
1.	Stated capital	878	922	952	507	507
2.	Retained earnings	228	97	85	119	70
3.	**Total Tier 1 Capital**	**1 229**	**1 083**	**1 259**	**754**	**695**
4.	Current year's unpublished profits	90	67	40	4	3
5.	**Total Tier 2 Capital**	**95**	**67**	**57**	**126**	**11**
6.	**Total Unimpaired Capital (sum of line 3 and 5 less impairments)**	**1 325**	**1 150**	**1 316**	**880**	**706**

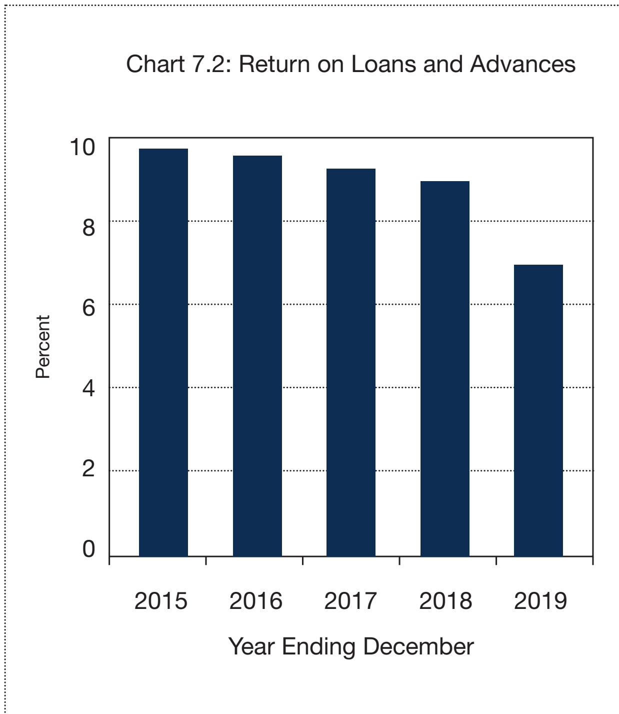
*Figures excludes one statutory bank.

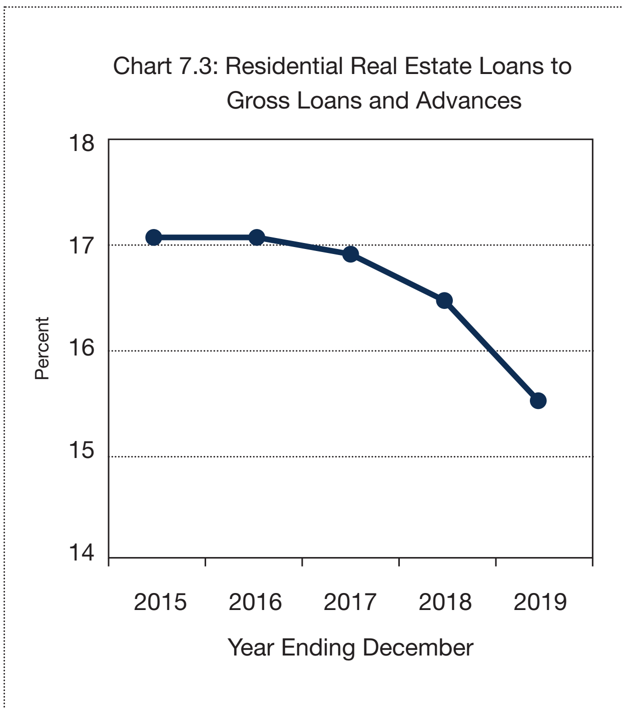
Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

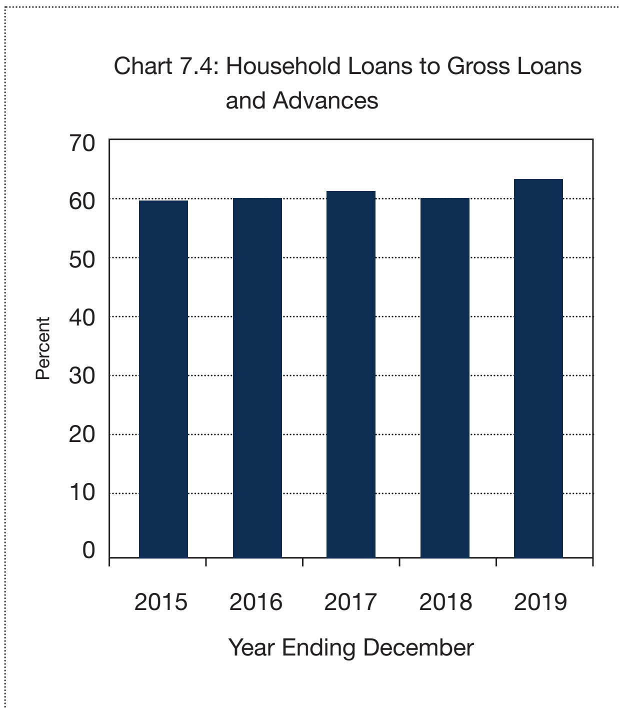
APPENDIX **8**

CHARTS AND TABLES OF KEY PRUDENTIAL AND OTHER FINANCIAL SOUNDNESS INDICATORS









Source: Commercial Banks (Statutory Returns submitted to the Bank).

CHARTS AND TABLES OF KEY PRUDENTIAL AND OTHER FINANCIAL SOUNDNESS INDICATORS

Chart 7.5: Non-performing Loans Growth Rate

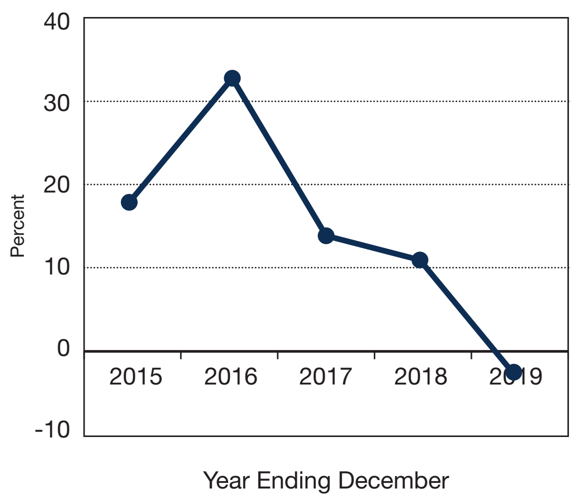


Chart 7.6: Share of Value of Total Deposits by Type (including FCAs)

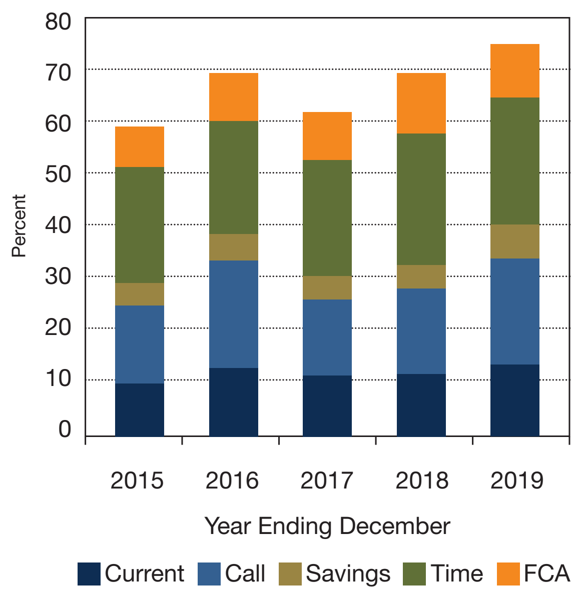


Chart 7.7: Growth Rate of Foreign Currency Accounts

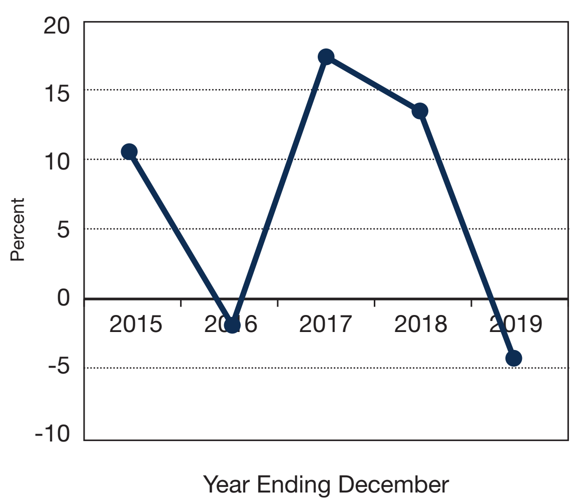
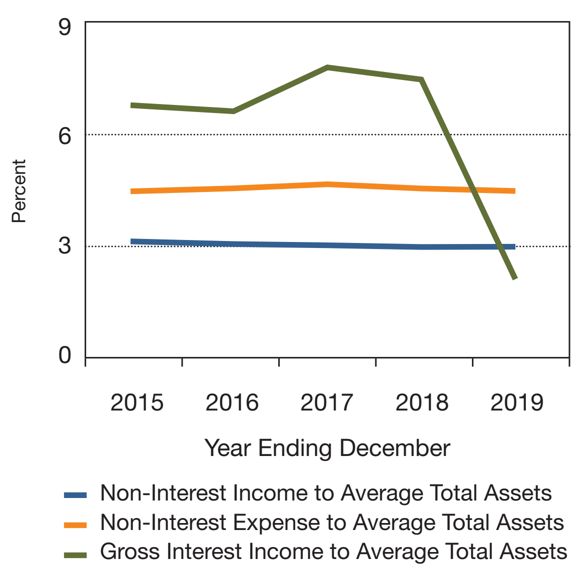


Chart 7.8: Efficiency Ratios



Source: Commercial Banks (Statutory Returns submitted to the Bank).

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