Banking Supervision Annual Report 2021

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 sound monetary, credit and financial system in Botswana.

In pursuit of a key aspect of this objective, the Bank established the Banking Supervision Department with a specific mandate and mission 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, 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 risk 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 enforcement of supervisory actions and compliance with the banking and other related laws governing the operations of banks in Botswana; and

(f) maintains general market surveillance, monitors and investigates unlicensed or illegal deposit-taking activities and practices to protect the public and integrity of the banking system.

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Bank of Botswana

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BANK OF BOTSWANA: BANKING SUPERVISION

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LIST OF ABBREVIATIONS

Absa	Absa Bank Botswana Limited
Access Bank	Access Bank Botswana Limited
AML/CFT/PF	Anti-Money Laundering and Combating the Financing of Terrorism and Proliferation Financing
ATM	Automated Teller Machine
Banking Act	Banking Act (Cap. 46:04)
Bank Gaborone	Bank Gaborone Limited
Bank SBI	Bank SBI Botswana Limited
Baroda	Bank of Baroda (Botswana) Limited
BBSL	BBS Limited
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
BIS	Bank for International Settlements
BoBA	Bank of Botswana Act (Cap. 55:01)
BoBCs	Bank of Botswana Certificates
BRC	Board Risk Committee
BSB	Botswana Savings Bank
BSEL	Botswana Stock Exchange Limited
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
CAR	Capital Adequacy Ratio
CB	Central Bank
CCBG	Committee of Central Bank Governors
CET1	Common Equity Tier 1
COVID-19	Coronavirus Disease 2019
CPMI	Committee on Payments and Market Infrastructures
DEs	Developed Economies
DTA	Deferred Tax Assets
EFT	Electronic Funds Transfer
ESAAMLG	East and Southern Africa Anti-Money Laundering Group
EU	European Union
FATF	Financial Action Task Force
FCB	First Capital Bank Limited
FIA	Financial Intelligence Agency
Fintech	Financial Technology
FMI	Financial Market Infrastructure
FNBB	First National Bank of Botswana Limited
FSB	Financial Stability Board
GBP	British Pound (Sterling)
GDP	Gross Domestic Product
G20	Group of 20 Countries
HHI	Herfindahl-Hirschman Index

LIST OF ABBREVIATIONS (CONTINUED)

ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
LAR	Liquid Asset Ratio
LC	Largely Compliant
LHS	Left-hand Scale
ML/TF	Money Laundering and Terrorist Financing
MNOs	Mobile Network Operators
NDB	National Development Bank
NIM	Net Interest Margin
NPLs	Non-performing Loans
OSS	Off-site Surveillance
PC	Partially Compliant
PoS	Point of Sale
PSPs	Payments Services Providers
RAS	Risk Assessment System
RBS	Risk-based Supervision
Regtech	Regulation Technology
RHS	Right-hand Scale
RoAA	Return on Average Assets
RoE	Return on Equity
RWA	Risk-weighted Asset(s)
SA	Standardised Approach
SADC	Southern African Development Community
SADC-RTGS	Southern African Development Community Real Time Gross Settlement
SARB	South African Reserve Bank
SMM	Standardised Measurement Method
Stanbic	Stanbic Bank Botswana Limited
Stanchart	Standard Chartered Bank Botswana Limited
Suptech	Supervisory Technology
TA	Technical Assistance
TCIB	Transactions Cleared on an Immediate Basis
TCRs	Technical Compliance Ratings
TSA	The Standardised Approach
USD	United States dollar
ZAR	South African rand

FOREWORD

This Annual Report presents information on the structure, performance and general state of the banking industry as well as banking regulation and supervision developments in Botswana during 2021. In accordance with Section 28 of the Banking Act (Cap. 46:04), the Bank of Botswana (Bank) is required to submit to the Minister of Finance, by June 30 each year, a report on the business affairs of all banks and of all persons or institutions whose affairs were examined by the Bank and all other pertinent matters, which the Bank dealt with during the year under review. The Bank has consistently complied with this statutory requirement.

The global economic performance strengthened in 2021, underpinned by improved demand and supply conditions resulting from the easing of the coronavirus disease (COVID-19) containment measures, supported by the roll-out of vaccines, and consequent opening of economies in many countries. Consequently, the global output growth was estimated at 6.1 percent in 2021 and projected to progressively slow down to 3.2 percent in 2022 and 2.9 percent in 2023, as pent-up demand tapers off, and fiscal and monetary policies are normalised across the world. Meanwhile, risks to the global inflation outlook are assessed to be skewed to the upside owing to the potential increase in international commodity prices, persistence of supply and logistical constraints due to lags in production, geo-political tensions and uncertain COVID-19 profile. Across the world, there is uncertainty about the withdrawal of the COVID-19-related regulatory and economic policy support, given the competing and interrelated considerations for financial and price stability, and for underpinning sustainable economic growth.

In Botswana, real gross domestic product (GDP) expanded by 11.4 percent in the 12 months to December 2021 compared with a contraction of 8.7 percent in the corresponding period in 2020. The increase in output mainly reflects base effects associated with the economic fallout from the COVID-19 pandemic containment measures in 2020. Projections by the Ministry of Finance indicate growth of 4.3 percent and 4.2 percent in real GDP for Botswana in 2022 and 2023, respectively. Nevertheless, it is projected that the economy will operate below full capacity in the short-to-medium term, thus not generate any demand-driven inflationary pressures.

There was no new banking licence issued in 2021. In contrast, Bank SBI Botswana Limited voluntarily surrendered its banking licence and ceased to operate as a bank in Botswana on June 30, 2021. Consequently, the number of licensed banks in Botswana was reduced from nine to eight in 2021.

Relative to GDP, the banking sector size (measured by total industry assets) declined in 2021, with the ratio of banking assets to GDP decreasing from 60.4 percent in 2020 to 55.6 percent in 2021. Access to banking services, indicated by the ratio of the number of depositors to the adult population, rose from 76.9 percent to 78.9 percent in the same period. Overall estimates indicate that the financial sector development and depth were sluggish between 2020 and 2021. The Bank continued to ensure that banking regulations, supervisory practices and related prudential and market conduct policies did not hinder innovation, financial inclusion and, generally, financial sector development.

Annual growth in bank credit was 5.1 percent in 2021 compared with 4.4 percent in 2020. On the other hand, customer deposits grew annually by 4.7 percent, while the average cost of deposits ratio was unchanged between 2020 and 2021, at 1.9 percent. The banking industry's cost-to-income ratio fell slightly to 60.3 percent from 61 percent in the previous year. The banking sector asset quality slightly improved as shown by the decrease in the ratio of non-performing loans to total loans and advances from 4.3 percent in 2020 to 4.2 percent in 2021.

All the commercial banks operating in Botswana were assessed to be fully compliant with the minimum statutory and prudential requirements and had high solvency and liquidity levels. In addition, banks largely met the minimum prescribed disclosure standards as set out in Pillar 3 disclosure requirements of the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana. In that regard, the Bank continues to monitor developments and provide guidance, as necessary, to ensure improvement in the quality, consistency and comparability of financial and regulatory disclosure across banks.

In conformity with established practice, statutory annual meetings were held to discuss matters of mutual interest between the Bank and supervised institutions. As in the previous year, the Bank participated in supervisory college meetings for internationally active banks with subsidiaries in Botswana. The meetings provide a regular forum for collaboration,

FOREWORD

coordination, and exchange of information among supervisory authorities for internationally active banking groups to facilitate effectiveness of group-wide consolidated supervision in line with core principle 13 of the Basel Core Principles for Effective Banking Supervision.

At its October 2021 plenary meeting, the Financial Action Task Force (FATF) determined that Botswana had strengthened its anti-money laundering and combating the financing of terrorism and proliferation regime and addressed related technical deficiencies. Consequently, FATF removed the country from the list of countries subject to FATF enhanced-monitoring regime. The European Union (EU) also removed Botswana from the EU blacklist of high-risk third countries on January 7, 2022. The removal from the grey list is expected to have a positive effect on the domestic financial system and, more broadly, on the economic development of the country. In addition, the removal of Botswana from the FATF greylist and EU blacklist, should help restore the reputation of Botswana as a transparent and credible investment destination as well as reduce the cost of correspondent banking relationship and access to global markets for Botswana-based economic agents. Thus, it is crucial that all stakeholders ensure continuing compliance to minimise the risk of adverse listing of the country.

In 2021, banks were generally compliant with statutory and prudential requirements; in a few cases of non-compliance, appropriate supervisory action, including remedial measures, was implemented in accordance with applicable laws and regulations. Overall, the banking system remained safe, sound, profitable, adequately capitalised and liquid.

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

Moses D Pelaelo
GOVERNOR

INTRODUCTION

In accordance with 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 decreased from nine to eight, following the exit of Bank SBI (Botswana) Limited from the market, while that of statutory banks remained at three. On the other hand, bureaux de change decreased from 58 in 2020 to 53 in 2021.

Employment by commercial and statutory banks decreased by 3.5 percent from 5 142 in 2020 to 4 963 in 2021. In response to technological advancement, customer needs, and increasing competition in the banking industry from non-bank institutions, banks have adapted to the new environment by digitising their work processes and developing innovative products to enhance product offering and operational efficiency to satisfy the demands of the economy and sustain profitable operations. Banks continue to streamline internal processes by adopting electronic processing to improve the convenience of access to transactional banking services, indicating that digitalisation of banking processes has become key to the provision of financial services and an enabler of financial inclusion.

Total assets for the banking industry increased by 5.2 percent from P103.3 billion in 2020 to P108.6 billion in 2021 mainly driven by the growth in loans and advances of 5.1 percent from P65.6 billion to P68.9 billion in the same period. Customer deposits grew by 4.8 percent from P80.5 billion in 2020 to P84.4 billion in 2021. Deposits remain a major source of funding for banks as they constituted 77.7 percent of the total liabilities as at the end of 2021. The average financial intermediation ratio for the banking industry increased marginally from 81.4 percent in December 2020 to 81.7 percent in 2021. The ratio shows that banks sustained their intermediation role and were able to retain and attract customers, despite the negative effect of the coronavirus disease (COVID-19) pandemic. That notwithstanding, the core indicators of financial sector depth and development continue to demonstrate that the banking sector is relatively small in relation to the gross domestic product (GDP). However, the digital transformation and product innovation on which banks have embarked, changes in consumer demands and improvement in financial infrastructure have the potential to contribute to the growth of the financial sector.

The banking industry was adequately capitalised and complied with minimum prudential standards for regulatory capital requirements. The aggregate unimpaired capital for the banking industry declined by 2.7 percent from P14 billion in 2020 to P13.6 billion in 2021. All banks reported capital adequacy and common equity Tier 1 capital ratios of more than the respective prudential minimum limits of 12.5 percent and 4.5 percent.

Total past due loans (loans with repayment arrears) decreased by 8.3 percent from P3.9 billion in 2020 to P3.6 billion in 2021. Despite the reduction in past due loans, non-performing loans (NPLs) increased by 3.5 percent from P2.8 billion to P2.9 billion, while the ratio of NPLs to total loans and advances decreased from 4.3 percent in 2020 to 4.2 percent in 2021. Specific provisions decreased by 3.4 percent from P1.71 billion in 2020 to P1.65 billion in 2021. The reduction in the level of provisions was due largely to recoveries and loan write-offs, which resulted in the removal of the associated amount from the reserves accounts. As a result, the specific provisions to NPLs ratio decreased from 60.7 percent in 2020 to 56.6 percent in 2021. The ratio of banks' large exposures to unimpaired capital increased from 149.7 percent in 2020 to 179.7 percent in 2021 but remained below the 800 percent prudential maximum limit for banks in Botswana.

The composite credit risk for the banking industry was assessed to be high; the inherent credit risk is likely to increase over the next 12 months because of the COVID-19-related shutdown of some businesses, which resulted in loss of employment. The increase in levies, taxes (value added tax) and the upward adjustment of Botswana Housing Corporation rentals, tariffs for water and electricity, fuel prices and public transport fares in an environment of restrained increase in real wages, are also likely to reduce ability to repay bank loans in accordance with agreed terms, hence an increase in credit risk. However, this outlook for an increase in credit risk due to asset-quality deterioration is expected to be moderated; that is because the loan book of the banking industry is diversified in that it consists of individual small amounts to numerous, uncorrelated retail borrowers in various sectors of the economy, notably public sector employees; moreover, most of the personal loans are scheme loans with an arrangement for instalment deduction at source. In addition, banks employ various credit risk mitigation instruments, for instance, mortgage payment protection insurance, credit life and lien over life insurance policies, which have resulted in the transfer of a significant portion of credit risk for sharing with the insurance sector.

INTRODUCTION (CONTINUED)

The banking industry net after-tax profit increased by 25 percent from P1.5 billion for the 12 months to December 2020 to P1.8 billion in the corresponding period in 2021. The banking industry's operational efficiency improved, as both aggregate return on equity and return on average assets increased from 12.9 percent and 1.4 percent to 16.9 percent and 1.7 percent, respectively, in the same period. Notwithstanding, the level of banking profits has trended downwards over the last three years, reflecting increased operating costs resulting from investment in technology to adapt to the technologically advanced operating environment, as well as subdued income on account of the low interest-rate environment.

The banking industry was liquid as indicated by the liquid assets to total deposits ratio (LAR) for banks, which was above the 10 percent minimum prudential requirement, at 16.6 percent, as at December 31, 2021, a decrease from 19.1 percent in 2020. Statutory liquid assets declined by 9.1 percent from P15.4 billion in 2020 to P14 billion in 2021. There was a notable improvement in the structure of the balance sheet of the banking sector, as long-term deposits constituted 52 percent, while short-term deposits accounted for 48 percent of total deposits. If this trend is sustained, the maturity mismatch risk, an enduring feature of the Botswana banking sector, will ease.

The Bank continued to conduct regulatory and supervisory oversight to ensure adherence to good governance standards, appropriate level of risk-taking and proper conduct of business by regulated institutions as a contribution to the safety and soundness of the financial sector. The oversight framework includes off-site monitoring and on-site examination of banks using a risk-based supervision approach and an off-site surveillance system. In addition to prudential supervision, the Bank monitored the business conduct of banks to ensure that their customers were treated in a fair, equitable and professional manner within a transparent resolution framework, and that banks comply with laws and regulations, including those relating to anti-money laundering and financing of terrorism (AML/CFT).

In accordance with Section 24 of the Banking Act, the Bank conducted prudential, consumer compliance and AML/CFT on-site examinations in 2021. Overall, the results indicated that most supervisory concerns that were raised in the previous on-site examinations had been addressed satisfactorily. There, however, were some areas of supervisory concern that needed remedial action and the concerned banks were directed to rectify those. Furthermore, with respect to the follow-up prudential on-site examination, one bank violated some sections of the Banking Act, and accordingly, the Bank imposed monetary fines on the bank. With regard to AML/CFT on-site examination, one bank was found to have weak AML/CFT risk management systems, while one bank violated the Financial Intelligence Act, 2019 (Cap. 08:07). The concerned banks were required to regularise the anomalies/deficiencies.

Banks complied with the minimum public disclosure and statutory requirements on bank charges by publishing monthly payable deposit rates on their websites as well as in at least two newspapers widely circulated in Botswana. In accordance with expectations, large-value and longer-maturity deposits earned commensurately higher interest rates.

The Bank continued to guide banks on the requirements of the AML/CFT compliance regime. Botswana has made a high-level commitment to strengthen the effectiveness of its AML/CFT regime and address related strategic deficiencies. To address technical deficiencies identified in the 2017 AML/CFT mutual evaluation conducted by the East and Southern Africa Anti-Money Laundering Group (ESAAMLG), the country continued to amend various pieces of legislation and requested a rerating from the ESAAMLG in 2020 and 2021. Following concerted efforts by all concerned parties, including the Bank, to strengthen the effectiveness of its AML/CFT regime, at its October 2021 plenary meeting, FATF made a determination that Botswana had strengthened its AML/CFT regime and also addressed related technical deficiencies. Consequently, FATF removed the country from the list of countries subject to FATF enhanced-monitoring regime. The European Union (EU) also removed Botswana from the EU blacklist of high-risk third countries on January 7, 2022. The country was encouraged to sustain its strong political commitment to AML/CFT and promote coordination and cooperation among all stakeholders. The removal from the grey list is expected to have a positive effect on the domestic financial system and, broadly, on the economic development of the country. In addition, the removal from the FATF greylist and EU blacklist is expected to help restore the reputation of Botswana as a transparent and credible investment haven, as well as reduce the cost of correspondent banking relationship and access to global markets.

INTRODUCTION (CONTINUED)

This report is organised into five chapters as follows: Chapter 1 outlines the structure of Botswana's financial system and selected indicators; Chapter 2 presents an assessment of the financial performance of the banking industry in 2021; Chapter 3 reports on licensing and consumer protection; Chapter 4 highlights other supervisory activities; and Chapter 5 summarises key issues arising from the on-site and off-site surveillance. There are technical appendices contained in the report pertaining to the framework for banking supervision in Botswana, organisation of the Banking Supervision Department, schedule of institutions regulated and supervised by the Bank, glossary of banking supervision terminology in the report, as well as tables and graphical representation of prudential and other statistical information on the banking industry at the end of the report.

CHAPTER 1

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS

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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, statutory banks, bureaux de change and one deposit-taking microfinance institution (Women's Finance House). As at December 31, 2021, the number of licensed commercial banks decreased from nine to eight, following the exit of Bank SBI (Botswana) Limited (Bank SBI) from the market, while that of statutory banks remained at three. During the year under review, two bureaux de change were licensed, while seven had their licences revoked; of the seven, six voluntarily closed business, while one failed to comply with the Bank of Botswana (Bureaux de Change) Regulations (Regulations). Therefore, the resultant number of operating bureaux de change decreased from 58 in December 2020 to 53 in December 2021. The Bank granted permission to eight bureaux de change that had requested permission to temporarily cease business operations citing adverse effects of the COVID-19 pandemic on their businesses.

Banking Sector Branch Network and Other Delivery Channels

1.2 Table 1.1 shows the number of bank branches and automated teller machines (ATMs) for the period 2019 to 2021. Banks continued to restructure their operations, resulting in the opening of four and closure of three branches. The net result was that the overall number of bank branches increased from 161 to 162 in 2021. The number of ATMs increased from 564 in 2020 to 583 in 2021. It has been observed that ATMs are increasingly being used for cashing and depositing funds for mobile-money transfers/payments.

1.3 The geographical distribution of the branch network indicates the continued lead of the South East District, which includes the capital city, Gaborone, in concentration of branches at 63, followed by the Central District with 37, as at December 31, 2021. Three districts, North West (2), Southern (1) and Kweneng (1) had an increase in branch network, while two districts, South East (2) and North East (1) had a decrease in the branch network. For the rest of other districts, the branch network was unchanged (Appendix 2).

Table 1.1: Branches and ATMs: 2019 – 2021

		Branches and Sub-branches			ATMs		
		2019	2020	2021	2019	2020	2021
Large Banks	Absa	35	35	36	113	114	114
	Stanchart	19	22	20	70	76	76
	FNBB	28	28	28	233	233	236
	Stanbic	17	18	18	56	70	80
	Sub-total	**99**	**103**	**102**	**472**	**493**	**506**
Small banks	Access Bank	13	13	13	14	14	19
	Baroda	4	4	4	6	7	7
	Bank Gaborone	13	14	14	16	17	21
	FCB	5	5	5	6	5	5
	Bank SBI	1	1	-	-	-	-
	Sub-total	**36**	**37**	**36**	**42**	**43**	**52**
Total for Commercial Banks		**135**	**140**	**138**	**514**	**536**	**558**
Statutory Banks	BSB	6	7	10	14	14	16
	BBSL	10	10	10	14	14	9
	NDB	4	4	4	-	-	-
Total for Statutory Banks		**20**	**21**	**24**	**28**	**28**	**25**
Overall total		**155**	**161**	**162**	**542**	**564**	**583**

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

1.4 Meanwhile, the number of point-of-sale (PoS) terminals increased from 18 237 in 2020 to 20 570 in 2021. The terminals are owned by four banks, namely, FNBB, Absa, Stanbic and Bank Gaborone (Table 1.2), more than half of which are for FNBB.

Table 1.2: Point-of-Sale Terminals: 2019 – 2021

Banks	Point of sale		
	2019	2020	2021
Absa	5 004	4 927	5 245
FNBB	9 075	10 061	10 949
Stanbic	2 491	2 808	3 571
Bank Gaborone	155	441	805
Total	**16 725**	**18 237**	**20 570**

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

Access Indicators

1.5 The ratio of number of the depositors to adult[1] population, which measures access to banking services improved from 76.9 percent in 2020 to 78.6 percent in 2021. There was an increase in the number of depositors by 4.4 percent from 1.28 million in 2020 to 1.33 million in 2021, while the adult population increased by 2.1 percent from 1.66 million to 1.69 million in the same period.

1.6 The number of ATMs per 1 000 square kilometres and per 10 000 adults was constant at one and 3.4 between 2020 and 2021, respectively. There was one branch per 10 000 adults and less than one branch per 1 000 square kilometres in 2021, indicative of the sparse population distribution in the country.

Banking Sector Employment Trends: 2020 – 2021

1.7 Table 1.3 compares employment levels in the banking sector between 2020 and 2021; the number of people employed in the banking sector declined by 179, from 5 142 in 2020 to 4 963 in 2021, reflecting a 3.5 percent decrease over the period. The fall in employment at banks was attributable to increased automation and use of digital channels, and rationalisation, along with staff resignations and retirements. While there was a decrease in staff complement for some banks, there was an increase with respect to five banks. Small banks increased personnel by 2.3 percent from 940 in 2020 to 962 in 2021, while the number of employees for large banks[2] declined by 6 percent from 3 665 in 2020 to 3 444 in 2021. Expatriate employees in the banking sector decreased from 56 in 2020 to 51 in 2021.

1 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.

2 A large bank refers to a bank with total assets amounting to at least 10 percent of the banking sector consolidated assets as at December 31, 2021.

Table 1.3: Level of Employment by Domestic Banks: 2020 – 2021

		2020			2021		
		Citizens	Expatriates	Total	Citizens	Expatriates	Total
Large Banks	Absa	1 096	5	1 101	1 045	4	1 049
	Stanchart	622	10	632	523	9	532
	FNBB	1 370	5	1 375	1 314	4	1 318
	Stanbic	554	3	557	543	2	545
	Sub-total	**3 642**	**23**	**3 665**	**3 425**	**19**	**3 444**
Small Banks	Access Bank	374	3	377	383	5	388
	Baroda	47	13	60	51	13	64
	Bank Gaborone	298	5	303	292	4	296
	FCB	182	6	188	208	6	214
	Bank SBI	9	3	12	-	-	-
	Sub-total	**910**	**30**	**940**	**934**	**28**	**962**
Total for Commercial Banks		**4 552**	**53**	**4 605**	**4 359**	**47**	**4 406**
Statutory Banks	BSB	212	-	212	221	-	221
	BBSL	207	3	210	205	4	209
	NDB	115	-	115	127	-	127
Total for Statutory Banks		**534**	**3**	**537**	**553**	**4**	**557**
Overall Total		**5 086**	**56**	**5 142**	**4 912**	**51**	**4 963**

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

New Banking Sector Products and Services

1.8 In order to enable customers to make informed decisions and choices from the range of products and services offered by the market and for consumer awareness and protection, it is crucial for banks to disclose key information about any product. Banks continued to develop, enhance and diversify products and services to meet evolving customer needs and to accommodate and harness financial technology in search of growth opportunities.

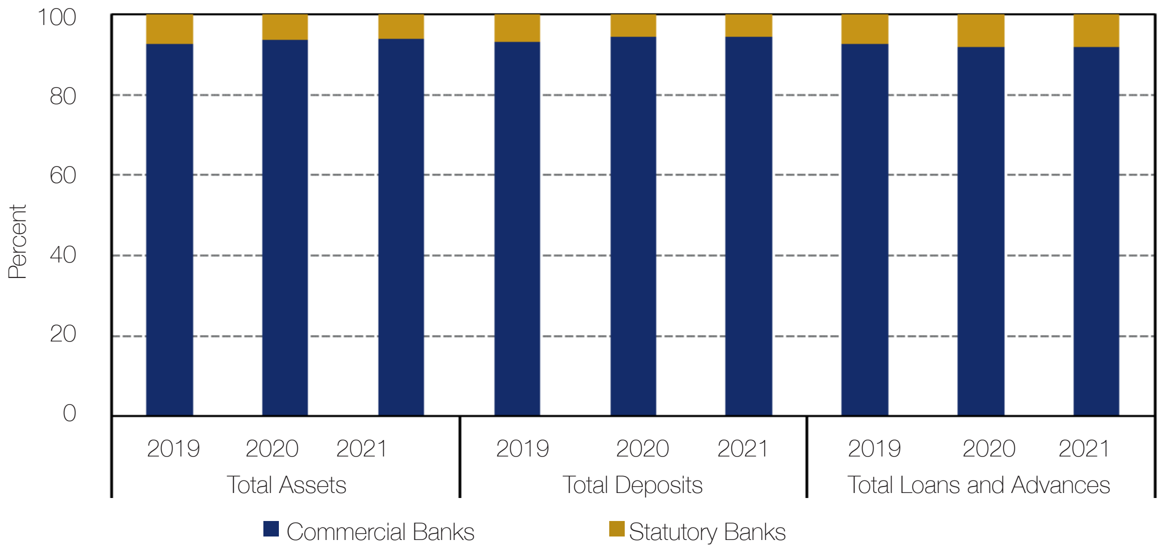
1.9 In 2021, the Bank approved 29 new products and services covering a wide range of banking services, including enhancement of existing products by adding digital features to reduce visits to bank branches. Most of these products and services target retail customers, with a view to retaining clients and attracting others to broaden the customer base.

BANKING SECTOR COMPETITION AND CONCENTRATION

Market Share

1.10 Commercial banks continued their dominance of the banking sector in 2021, with respect to assets, deposits, and loans and advances (Chart 1.1). By value of assets, loans and advances, the market share of statutory banks fell from 6.3 percent to 6.2 percent and from 8.2 percent to 8.1 percent, respectively, while deposits increased from 5.6 percent to 5.7 percent in the review period.

Chart 1.1: Market Share of Total Assets, Total Deposits, and Total Loans and Advances* of the Banking Sector: 2019 – 2021 (Percent)

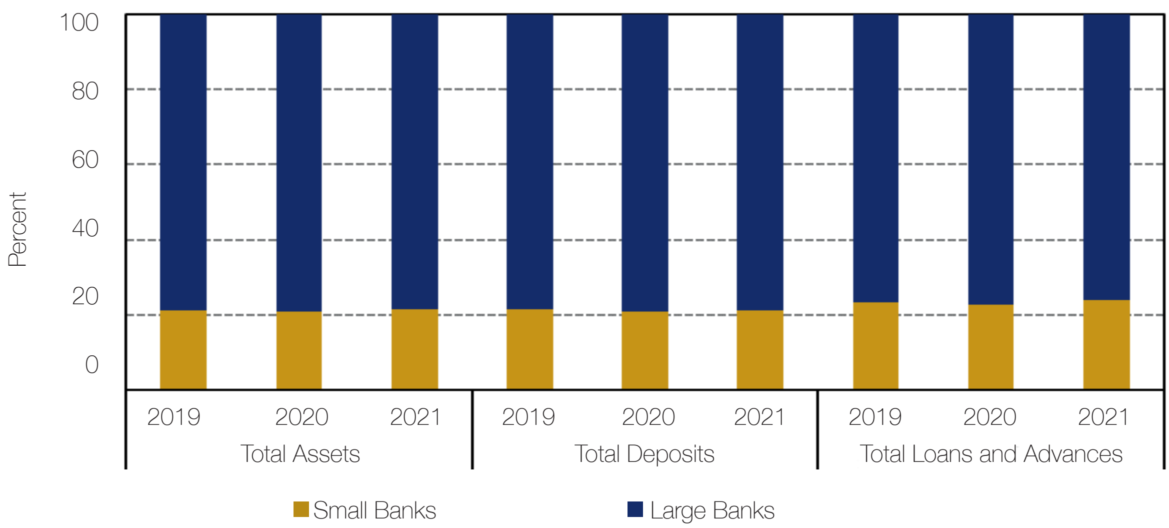


*Figures exclude one statutory bank.

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

1.11 The four large banks retained their dominant position in the banking sector and accounted, in aggregate, for 78.4 percent, 78.8 percent and 76 percent of total assets, total deposits, and total loans and advances, in 2021, compared with 79.1 percent, 79.2 percent and 77.4 percent, respectively, in the previous year (Chart 1.2).

Chart 1.2: Market Share of Total Assets, Total Deposits, and Total Loans and Advances of Commercial Banks: 2019 – 2021 (Percent)



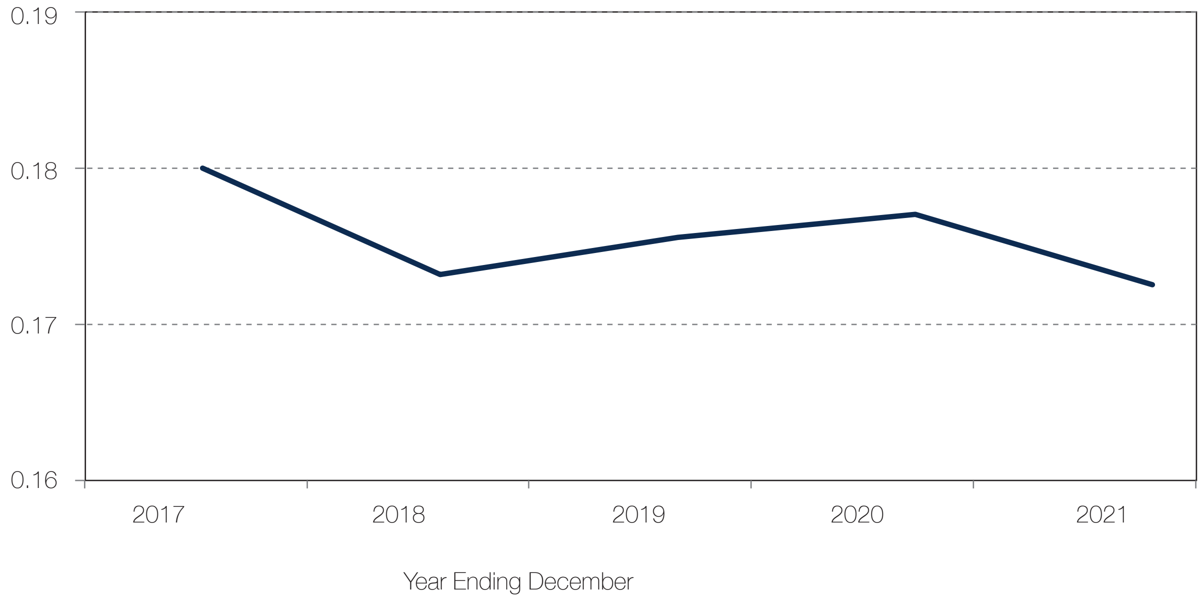
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Market Competition Indicators

The Herfindahl-Hirschman Index (HHI) of Competitiveness

1.12 In tandem with other measures, the Bank uses the Herfindahl-Hirschman Index[3] (HHI), a widely applied measure of market concentration, to assess the degree of competition in the Botswana banking industry. The HHI marginally decreased from 0.1770 in 2020 to 0.1725 in 2021 (Chart 1.3). The HHI remained lower than 0.1800, indicative of a moderately concentrated market and therefore moderate competition.

Chart 1.3: Herfindahl-Hirschman Index (HHI): 2017 – 2021



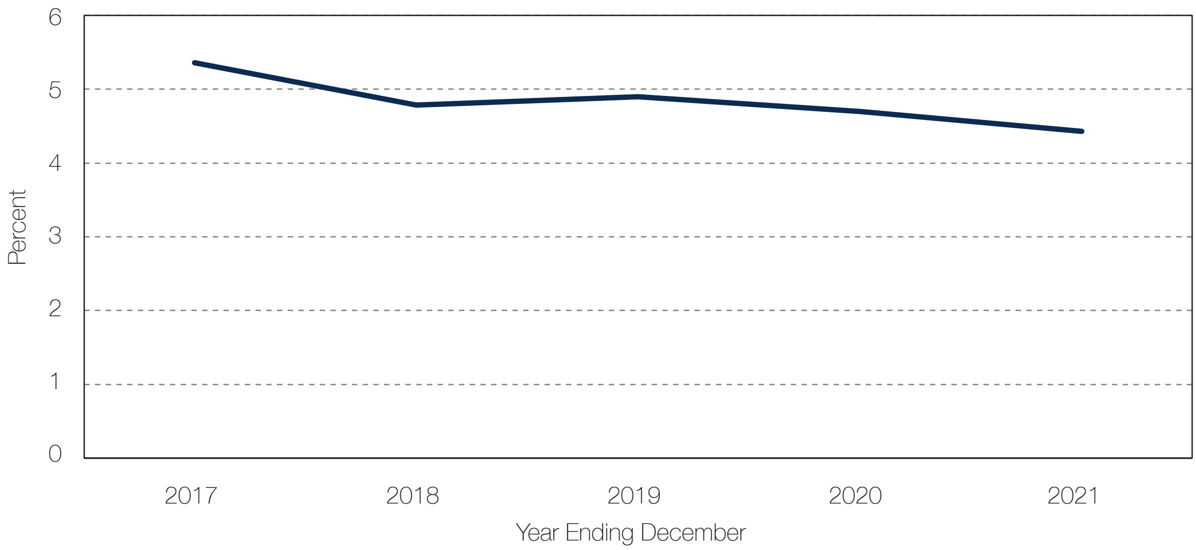
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Net Interest Margin

1.13 The industry net interest margin (NIM) eased moderately from 4.7 percent in 2020 to 4.4 percent in 2021 (Chart 1.4), indicating enhanced competition and efficiency of the banking system in 2021.

[3] 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 monopolistic market, the HHI=1.

Chart 1.4: Banking Sector Trend of Net Interest Margin: 2017 – 2021 (Percent)

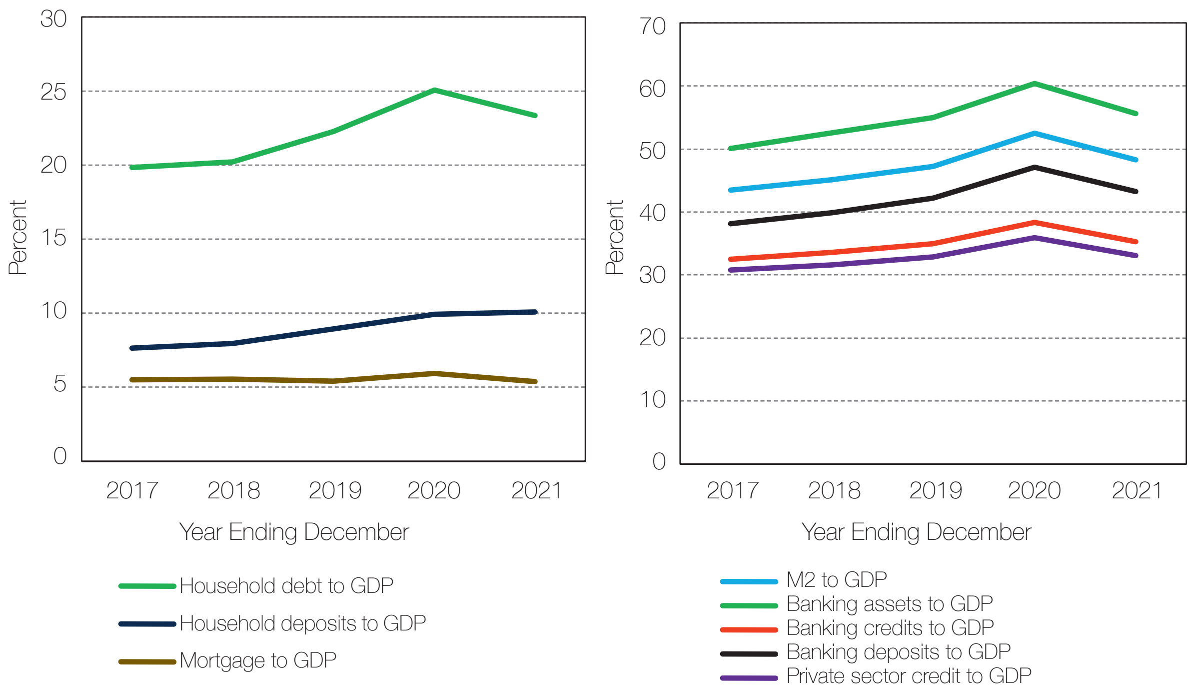


Source: Commercial Banks (Statutory Returns submitted to the Bank).

BANKING SECTOR SIZE AND DEPTH

1.14 Financial deepening refers to the increased use, relative to the overall nominal gross domestic product (GDP), of financial services, particularly broader choices with improved access by various societal (or income) groups. Financial deepening enhances the beneficial effect of financial services on business activity, welfare and living standards and the overall economic performance. Chart 1.5 shows several ratios commonly used as measures of financial deepening and development. Overall, financial sector development and depth were unchanged between 2020 and 2021. Thus, in that regard, there continues to be potential for supporting financial depth and development, through policy intervention, structural reforms and focussed strategic initiatives by financial institutions to broaden access to financial services and attain sustainable, transformational financial-sector support for economic activity.

Chart 1.5: Financial Sector Deepening Indicators: 2017 – 2021 (Percent)



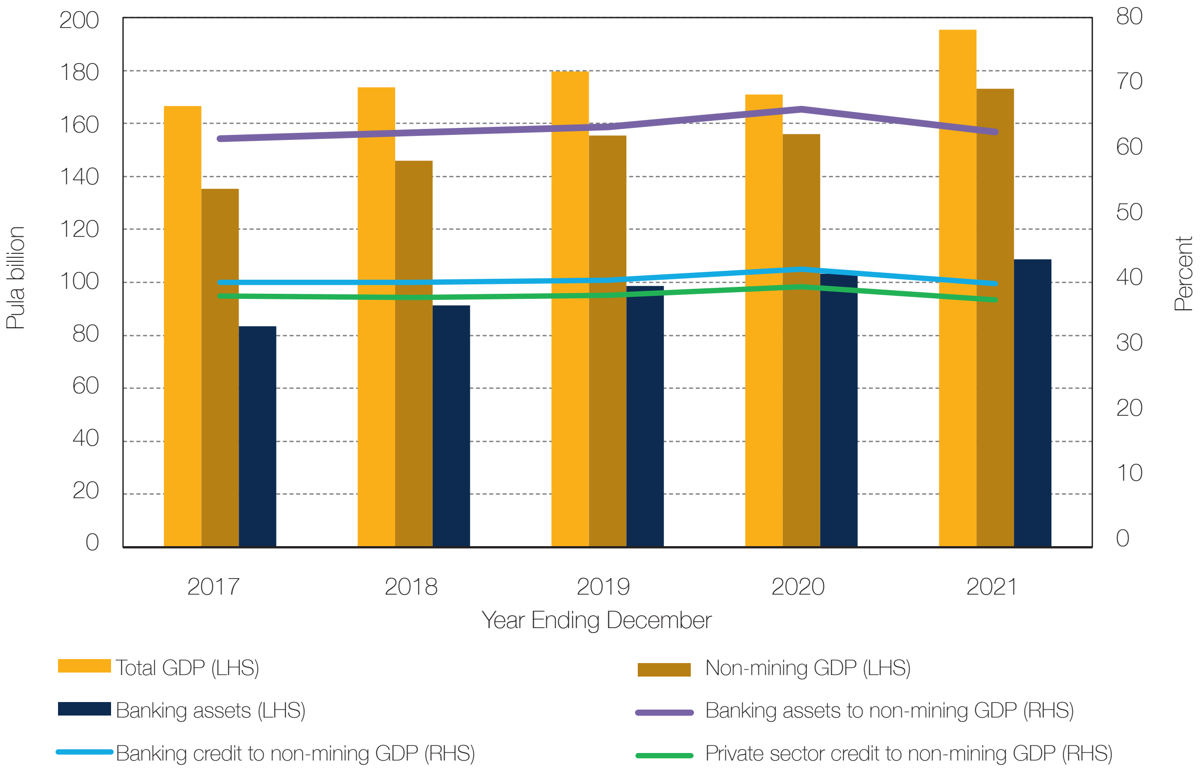
Source: Commercial Banks (Statutory Returns submitted to the Bank) and Statistics Botswana.

1.15 The ratio of private sector credit to nominal GDP[4] decreased from 35.9 percent in 2020 to 33.1 percent in 2021. Private sector credit as a proportion of non-mining nominal GDP declined marginally from 39.3 percent in 2020 to 37.4 percent in 2021. Compared with the global average ratio of private sector credit to nominal GDP of 52.2 percent (as reported by the World Bank's 2019/2020 Global Financial Development Report), private sector credit in Botswana is relatively small, suggesting capacity for increased role of private sector credit in supporting economic growth under conditions of a stable macroeconomy, prudent lending and sound risk management. The ratio, however, was higher than the average of 21.6 percent for sub-Saharan Africa.

1.16 The ratio of banking credit to nominal GDP decreased from 38.3 percent in 2020 to 35.3 percent in 2021. On the other hand, the overall sectoral size, banking assets as a share of nominal GDP, declined from 60.4 percent in 2020 to 55.6 percent in 2021, while the relative size of banking assets to non-mining nominal GDP decreased from 66.2 percent in 2020 to 62.7 percent in 2021 (Chart 1.5).

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

Chart 1.6: Financial Sector Size and Depth Indicators: 2017 – 2021



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

1.17 The M2[5] to nominal GDP ratio, which estimates the degree of monetisation of an economy, decreased from 52.5 percent in 2020 to 48.3 percent in 2021. In normal economic circumstances, a high M2 to nominal GDP ratio suggests that a significant part of economic activity is supported by the financial resources mobilised by the banking sector.[6]

1.18 Total household debt as a proportion of total nominal GDP slightly decreased from 25.1 percent in 2020 to 23.4 percent in 2021. The ratio of commercial bank mortgage to nominal GDP marginally decreased from 5.9 percent in 2020 to 5.4 percent in 2021. Similarly, including statutory banks, the ratio of mortgage loans to nominal GDP was 7.3 percent in 2021[7], an indication of meaningful contribution of statutory banks in mortgage financing. The low level of mortgage nevertheless remains a concern, notably for a banking sector dominated by unsecured household lending, as it constrains the extent to which an appropriately bank-financed growth in housing investment, including residential properties, can contribute to social welfare. The household deposits to nominal GDP ratio[8] increased to 10.1 percent in 2021 from 9.9 percent in 2020, largely reflecting enhanced mobilisation of household financial resources by banks.

[5] M2 (P94.3 billion) comprises all liabilities of financial corporations included in a country's definition of broad money. In the case of Botswana, M2 comprises currency outside depository corporations, transferable deposits (demand deposits) and other deposits included in broad money (time and fixed deposits).

[6] M2 increased by 5 percent compared with a 14.2 percent increase in nominal GDP.

[7] Mortgages (commercial and statutory banks) decreased by 0.8 percent, while nominal GDP increased by 14.2 percent.

[8] Household deposits grew by 11.6 percent compared with a 14.2 percent increase in nominal GDP.

1.19 The pension fund assets to nominal GDP ratio remained unchanged, at 61.5 percent, between 2020 and 2021. Meanwhile, as at the end of December 31, 2021, the overall household savings, including pension funds, in the banking sector amounted to P139.8 billion compared with the household borrowing of P45.6 billion. This development indicates the continued net-saver[9] position of the household sector in the economy.

1.20 The value of electronic funds-transfer transactions (EFTs) relative to economic activity decreased from 12.6 percent in 2020 to 11.9 percent in 2021 owing to a slower growth of 2.5 percent in the value of EFTs from P22.7 million to P23.3 million in the same period.

[9] 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: ENHANCING PAYMENTS INFRASTRUCTURES TO ENABLE CROSS-BORDER PAYMENTS

For many businesses, individuals and government agencies, making or receiving cross-border payments is a necessary activity. The increased international mobility of goods and services, capital, and people is contributing to the growing global importance of cross-border payments.

What are Cross-border Payments

Cross-border payments are financial transactions where the payer and the payee are based in different countries; they encompass both wholesale and retail payments, and remittances. Cross-border wholesale payments typically involve large-value transfers that are made between financial institutions for their own accounts or on behalf of their customers (including for the settlement of retail payments) through dedicated bilateral interbank arrangements or multilateral payment systems. Cross-border payments can be made through bank transfers, card payments and alternative payment methods, such as e-money wallets and mobile payments. Traditionally, cross-border payments flow via the correspondent banking network, which most front-end providers use to settle payments. Enhancing cross-border payments by making them faster, cheaper, more transparent, safer and inclusive would have widespread benefits for supporting economic growth and development, global trade and financial inclusion.

Challenges with Cross-border Payments

Traditionally, cross-border payments have been executed via correspondent banking arrangements, with the Society for Worldwide Interbank Financial Telecommunications (SWIFT) acting as the message carrier. Correspondent banking is an arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) from other countries and provides payment and other services to those respondent banks. Correspondent banking arrangements enable banks to access financial services in different jurisdictions and provide cross-border payment services to their customers, supporting, inter alia, international trade, financial inclusion and global economic activity. There are numerous friction points associated with correspondent banking. These include delay in transmission of transactions due to multilateral counterparties and limited infrastructures in some jurisdictions; cross-border operating differences (including foreign-exchange uncertainty and time differences) that could affect transaction costs; and conflicting regulatory frameworks across jurisdictions, with ambiguity around cyber and financial risk management frameworks.

Cross-border Payments Enabling Legislation

Underlying the global payments ecosystem are contracts, schemes, and legal and regulatory frameworks, which are relevant for processing, clearing and settlement of cross-border payments. Therefore, cross-border payments, which are processed by payments services providers (PSPs) and/or payment infrastructures, are subject to the legal and regulatory regimes of multiple jurisdictions. The intermediaries providing payment services for the payer and payee in a cross-border payment must meet the different legal and regulatory requirements of two or more jurisdictions in areas such as licensing and authorisation; prudential supervision; financial integrity (for example, anti-money laundering and combating the financing of terrorism and proliferation (AML/CFT)); cyber security and other operational risks; transparency (including traceability of transactions, and disclosure of costs and fees); consumer protection and safeguarding customer funds; foreign exchange regulations and data collection, protection and transfer. Regulation is therefore considered a key target area for achieving frictionless cross-border payments.

Global Efforts geared towards Cross-border Payments Enhancements

The Committee on Payment and Settlement Systems – World Bank's General Principles for International Remittance Services[10], published in 2007, provides guidance on improving the market for international remittance services. The principles are aimed at promoting a comprehensive approach, covering transparency and consumer protection, payment infrastructures, the legal and regulatory framework, market structure and competition, and governance and risk management. Roles for remittance service providers and public authorities for the implementation of the general principles are also provided.

Enhancing cross-border payments was set as a priority in 2020 by the Group of 20 (G20) countries. The effort included identifying the challenges associated with cross-border payments that arise from a series of frictions in existing processes and developing a set of building blocks to address them. The Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements (BIS) and the Financial Stability Board (FSB) identified high costs, low speed, limited access and limited transparency as the four challenges facing cross-border payments in the report titled Enhancing Cross-border Payments: Building Blocks of a Global Roadmap, July 2020.[11] To address these challenges, the G20 has endorsed the road map developed by the FSB in coordination with the CPMI and other relevant organisations to implement building blocks that enhance cross-border payments. Furthermore, FSB has developed targets to implement the cross-border payments road map, which consists of five focus areas and 19 building blocks as depicted in Figure 1.

Figure 1: Cross-border Road Map

Source: CPMI

10 https://www.bis.org/cpmi/publ/d76.pdf

11 https://www.bis.org/cpmi/publ/d193.pdf

The road map essentially provides for the required cooperation, collaboration and coordination by key stakeholders in the global payments ecosystem around issues that engender reduction or elimination of payments frictions in cross-border payments. To this end, global quantitative targets for addressing the challenges of cost, speed, transparency and access have been agreed upon as part of the preliminary work of the road map and will accordingly apply to both wholesale (interbank transactions) and retail payments (business to business, person to business, business to person, person to person and remittances). It is expected that the evolution of the road map (which should yield positive results by 2030) will stimulate development of existing and new payments infrastructures, platforms and instruments intended to provide the basis for achievement of key performance indicators. These platforms/instruments, some of which are currently used by payers and payees to initiate and receive cross-border payments, vary across payment service providers and use cases depending on the capabilities and needs of the respective end users. The following methods are mostly commonly used in cross-border transactions.

(a) Money transfer

Money transfer operators are widely used for remittances, especially when the receiver does not have a bank account. Agents located in different countries will receive and deliver the funds; settlement of net positions between agents is then managed by the money-transfer operator. Money-transfer operators are increasingly enabling the use of debit cards, credit transfers and mobile money by partnering with banks and mobile money operators. Money-transfer operators often have accounts with different banks that provide them access to settlement in different domestic payment systems.

(b) Bank transfers

Bank transfers are used by businesses to send payments to other businesses for the purchase of goods and services. Businesses receive cross-border payments from individuals through bank transfers. Businesses tend to use bank transfers to pay their staff salaries abroad as well as to receive and pay back funding by financial institutions or to pay taxes and tariffs to foreign authorities. Governments also use bank transfers to pay benefits and pensions to their nationals living abroad and make purchases from businesses abroad. Payments from governments to other governments or supranational organisations for international aid or contributions to common funding tend to take place through bank transfers.

(c) Card payments

Underlying schemes and processing platforms for card payments are relevant in several ways for cross-border retail payments. Debit, credit and prepaid cards can be used for in-person payments using a point-of-sale terminal or remote payments (for example, through the internet for e-commerce). Both methods of payment may involve a cross-border component. Interbank settlement of cross-border card transactions typically relies on traditional correspondent banking. Some remittance service providers offer the possibility to initiate or receive international remittances by means of card payment, either in person or remotely. Card networks have traditionally offered payments from persons to businesses or government agencies. More recently, some card networks have introduced products for person-to-person payments, including international remittances using their access to existing cardholders and network of issuing banks. In addition, card payment networks have offered cards for business-to-business payments, some of which include cross-border payments.

(d) **Mobile money**

Mobile telecommunication-technologies providers have become increasingly involved in retail payments through mobile payments. The Committee on Payment and Settlement Systems (2012) report[12] indicates that retail payments involve the use of mobile phones and other devices as service channels and access points and mobile communication networks as channels for sending and receiving payments and the provision of mobile money by mobile network operators (MNOs); mobile money facilitates cross-border retail payments and international remittances. To allow mobile payments generally for cross-border retail payments and specifically for international remittances, international MNOs leverage their mobile payment-service offering in different countries (acting as end-to-end PSPs); PSPs enter into agreements with multiple MNOs across jurisdictions and MNOs from different jurisdictions agree among themselves to exchange payments or partner with traditional or online mobile payments operators or global remittance hubs on one side of the cross-border retail payments corridor. The success of these cross-border arrangements may result from the widespread distribution of mobile phones and transaction accounts (including mobile money accounts) across jurisdictions. The number of such services for remittances may grow as existing links between MNOs are employed or new links established.

The initiatives to address cross-border payment services across regional blocs face similar challenges as those identified by FSB and BIS (CPMI) in their report. Thus, it is imperative that all stakeholders, including the regulators and system operators, collaborate to enhance cross-border payments by addressing these challenges.

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12 https://www.bis.org/cpmi/publ/d102.pdf

CHAPTER 2

PERFORMANCE OF THE BANKING INDUSTRY

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PERFORMANCE OF THE BANKING INDUSTRY

COMMERCIAL BANKS

Statement of Financial Position: Balance Sheet

Assets

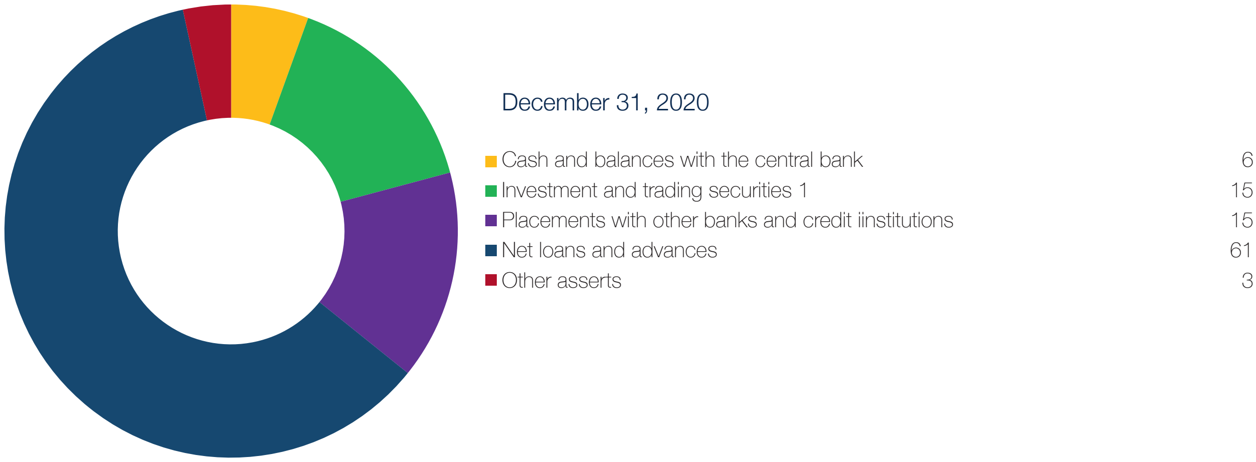
2.1 The banking industry total assets increased by 5.2 percent from P103.3 billion in 2020 to P108.6 billion in 2021. The growth in assets largely reflected an increase of 5.1 percent in gross loans and advances from P65.6 billion to P68.9 billion in the same period. Within the banking sector asset portfolio, net loans and advances constituted the largest share, at 61 percent, followed by placements with other banks and credit institutions (18 percent), investment and trading securities (13 percent), cash and balances with the central bank (5 percent) and other assets (3 percent).

Liabilities

2.2 For the sources of funding, total liabilities (excluding shareholder funds) of the banking sector grew by 6.4 percent from P92 billion in December 2020 to P97.8 billion in December 2021. Customer deposits, which constituted 77.7 percent of the total liabilities, increased by 4.7 percent from P80.5 billion in 2020 to P84.4 billion in 2021. While other liabilities increased, shareholder funds fell by 4.8 percent from P11.3 billion in 2020 to P10.8 billion in 2021. The decline in shareholder funds reflects a decrease of 2.4 percent in Tier 1 capital funds from P9.6 billion to P9.4 billion in the same period.

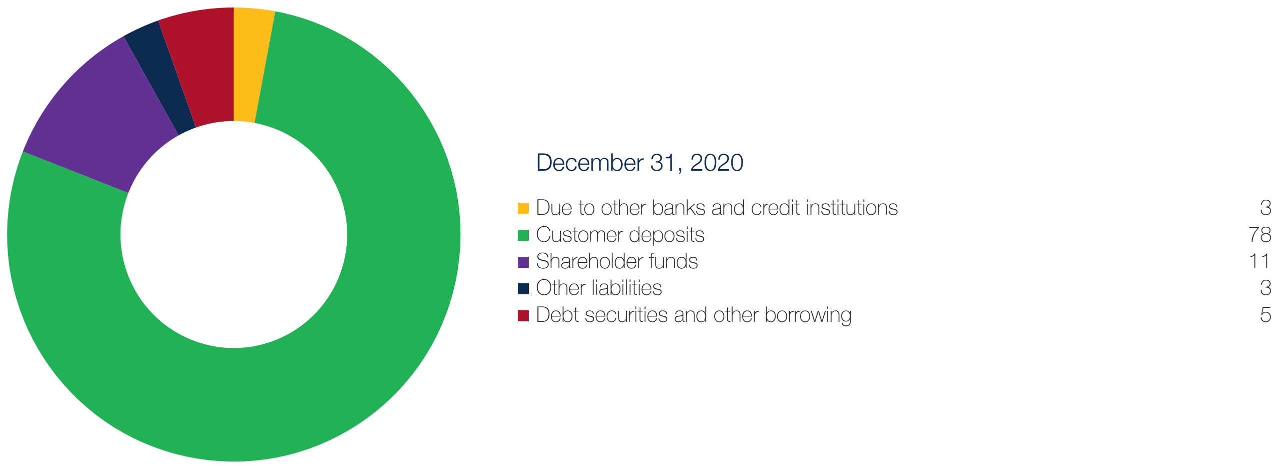
2.3 Charts 2.1 and 2.2 show the composition of assets and liabilities for 2020 and 2021. The proportions of constituents of both assets and liabilities remained largely unchanged, with small variations between the two periods.

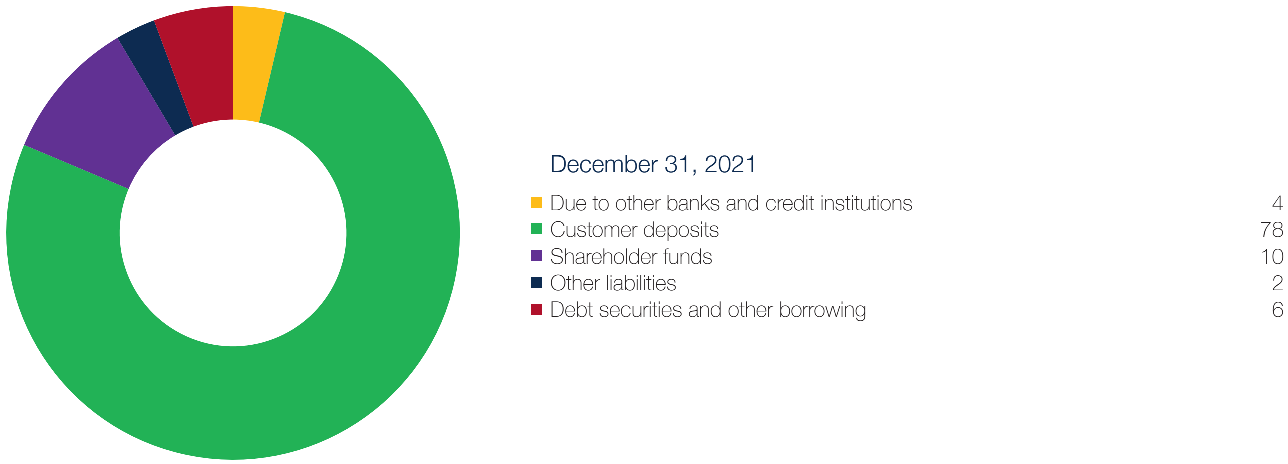
Chart 2.1: Commercial Banks: Composition of Assets: 2020 and 2021 (Percent)



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

Chart 2.2: Commercial Banks: Composition of Liabilities: 2020 and 2021 (Percent)

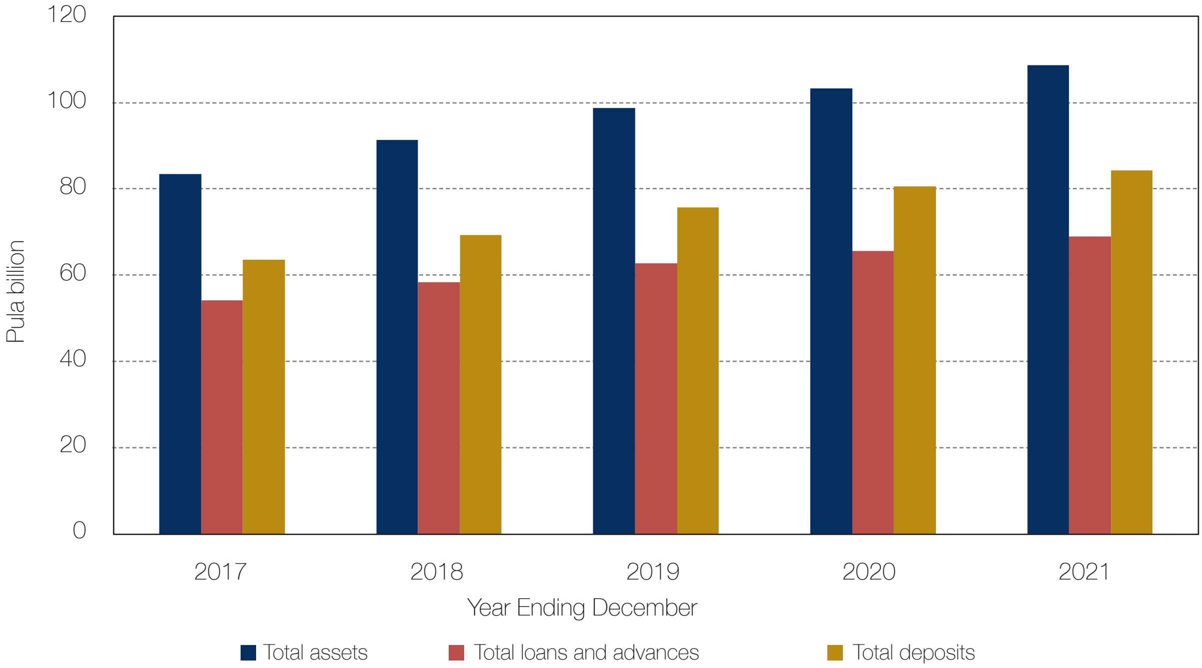




Source: Commercial Banks (Statutory Returns submitted to the Bank).

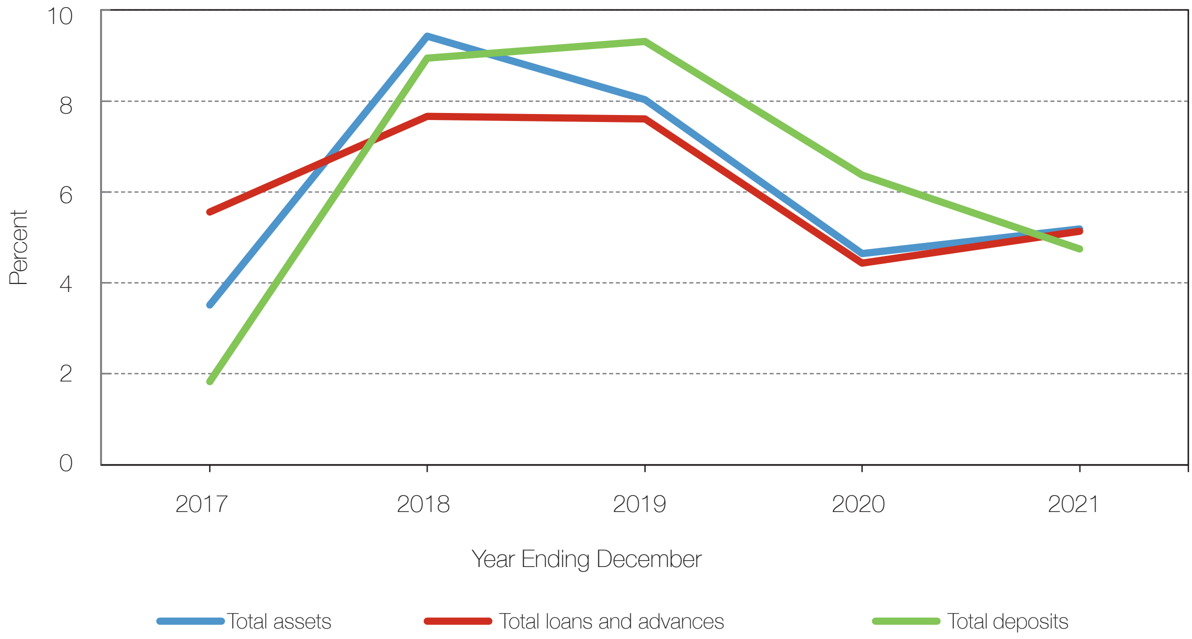
2.4 Chart 2.3 shows the level of assets, deposits, and loans and advances, while Chart 2.4 presents growth rates of assets, deposits, and loans and advances, for the period 2017 – 2021. The annual growth rates of total assets, and loans and advances increased in 2021, while that for deposits fell. The growth trend for deposits has been downwards since 2019, with the annual growth rate lower than that of loans and advances in 2021, suggesting an increase in the influence of other funding sources on lending by banks, such as debt instruments and borrowings from other financial institutions.

Chart 2.3: Commercial Banks: Total Assets, Total Deposits, and Total Loans and Advances: 2017 – 2021 (P 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: 2017 – 2021 (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, 2020, and December 31, 2021. The risk profile of assets held by banks with risk weights of zero and 1250 percent decreased, while assets of other risk weights grew. A significant portion (33. 8 percent) of assets were risk weighted at 75 percent in 2021, which is a decline from 35.6 percent in 2020.

2.6 Overall, 26.9 percent of on-balance-sheet asset items were above the 75 percent risk-weight category in 2021, compared with 25.5 percent in 2020, indicating a marginal increase in the riskiness of bank assets. That notwithstanding, 57.9 percent of on-balance-sheet asset items were in the 75 percent and 100 percent risk-weight category, implying that most of the loan book of banks comprises risky assets.

Table 2.1: Riskiness of Banks' Portfolios of On-balance Sheet Assets in 2020 and 2021

Risk weights (Percent)	On-balance sheet assets (P million)	Shares of on-balance sheet asset items in total on-balance sheet assets (Percent)	On-balance sheet assets (P million)	Shares of on-balance sheet assets items in total on-balance sheet assets (Percent)
	December 2020		December 2021	
0	20 942	20.1	18 527	16.7
20	12 259	11.8	14 969	13.5
35	5 340	5.1	7 834	7.1
50	1 952	1.9	2 353	2.1
75	37 073	35.6	37 426	33.8
100	24 474	23.5	26 678	24.1
150	1 977	1.9	2 948	2.7
250	106	0.1	149	0.1
1250	1.92	0.002	0.004	0.000003
Total	**104 124**	100.0	**110 884**	100.0

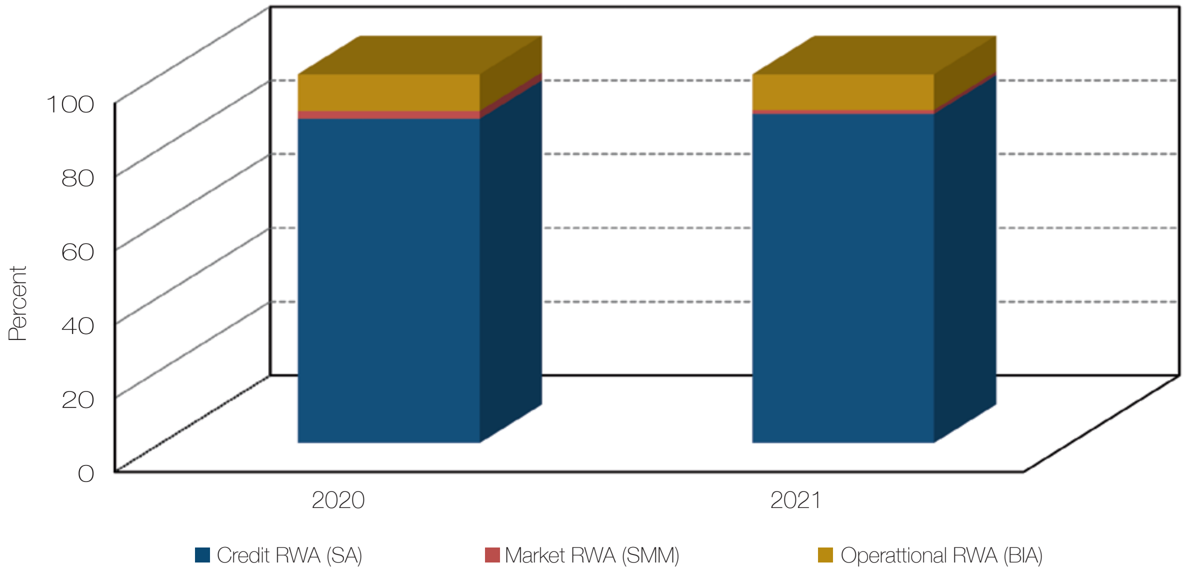
Source: Commercial Banks (Statutory Returns submitted to the Bank).

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. The definition of capital using advanced approaches has been deferred to a later stage.

2.8 Chart 2.5 illustrates the composition of risk-weighted assets (RWAs) of the banking sector in 2020 and 2021 as calculated under Pillar 1 of Basel II Capital Directive. Total RWAs increased by 7.2 percent from P69.9 billion in 2020 to P75 billion in 2021, mainly reflecting the growth in loans and advances. Proportions of RWAs were substantially constant between 2020 and 2021, 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: 2020 and 2021 (Percent)



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

Credit Risk

Regulatory Capital Requirements on Credit Risk

2.9 Credit RWAs increased by 9 percent from P61.5 billion in December 2020 to P67 billion in December 2021, a faster expansion in credit than the 4.6 percent growth in 2020.

Asset Quality: Levels and Trends

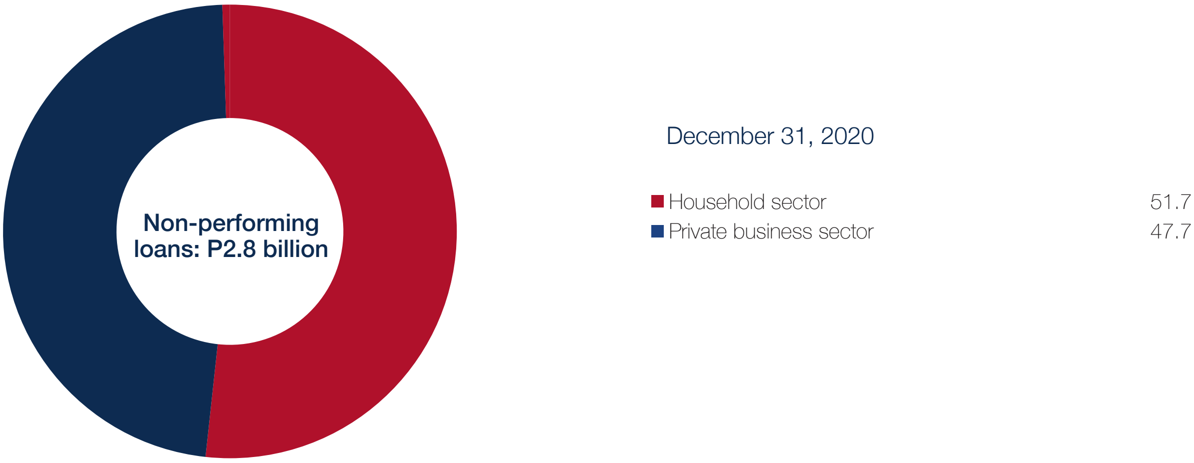
2.10 Gross loans and advances grew by 5.1 percent from P65.6 billion in 2020 to P68.9 billion in 2021, a higher growth rate than 4.4 percent in 2020. The growth in gross loans and advances was distributed across all banks, except for three banks in 2021. The growth in loans and advances during the challenging macroeconomic environment due to the COVID-19 pandemic indicates the willingness of banks to continue supporting economic activity while applying stringent underwriting standards to mitigate possible defaults or incidents of NPLs.

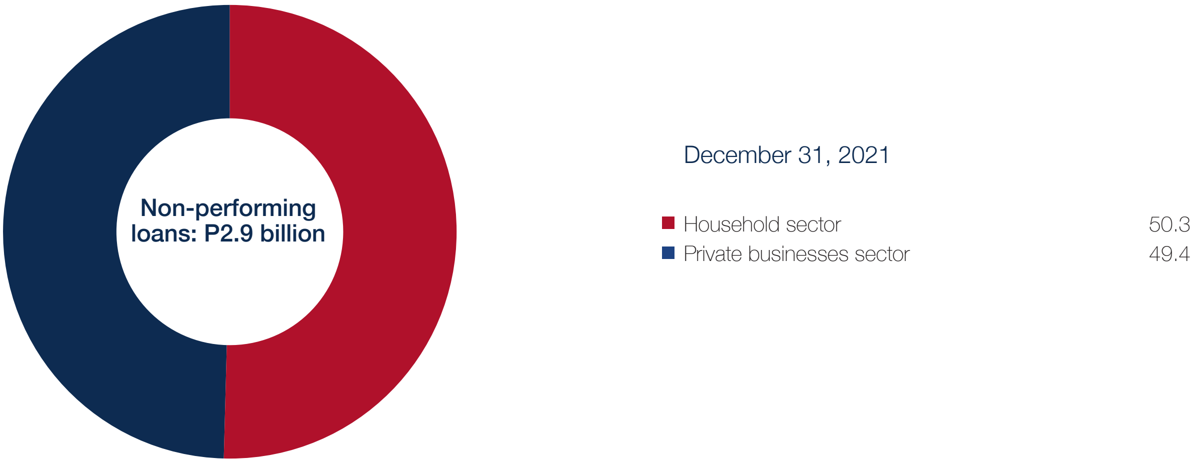
2.11 Total past due loans (loans with payment arrears) decreased by 8.3 percent from P3.9 billion in 2020 to P3.6 billion in 2021, while NPLs (impaired loans) increased by 3.5 percent from P2.8 billion to P2.9 billion in the same period. As a result, the ratio of NPLs to gross loans and advances for the entire industry marginally eased from 4.3 percent in 2020 to 4.2 percent in 2021; for individual banks, the ratio ranged between 0.7 percent and 6.2 percent.

2.12 The banking industry loans and advances classified as pass, special mention, substandard, doubtful and loss loans (see Appendix 5 for definitions) constituted 90.8 percent, 4.8 percent, 1.7 percent, 1.3 percent and 1.4 percent of total loans and advances, as at the end of December 31, 2021. The proportions of all the classification categories of loans and advances in 2021 were broadly consistent with those in 2020, indicating that the credit risk profile of the banking sector was largely unchanged.

2.13 Households (predominantly unsecured loans) and private businesses accounted for 50.3 percent and 49.4 percent of NPLs, respectively, in 2021. Meanwhile, the financial institutions (0.2 percent) and non-residents sub-sectors (0.1 percent) had negligible NPLs. Chart 2.6 compares the sectoral distribution of NPLs in 2020 and 2021.

Chart 2.6: Sectoral Distribution of Non-performing Loans and Advances: 2021 and 2021 (Percent)





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

2.14 In 2021, the business services sub-sector constituted 23.4 percent of private business sector NPLs, while trade, restaurants and bars; tourism and hotels; and commercial real estate constituted 14.4 percent, 12.4 percent and 12 percent of total NPLs, respectively. Table 2.2 shows the sectoral distribution of private business sector NPLs, while Table 2.3 shows the levels of loans and advances, NPLs and specific provisions as well as the proportion of NPLs to gross loans and advances, and specific provisions to NPLs.

Table 2.2: Distribution of Private Business Sector Non-performing Loans and Advances: 2017 – 2021 (Percent)

Private Business Subsectors	2017	2018	2019	2020	2021
Agriculture, forestry and fishing	7.9	9.0	7.4	7.2	7.4
Mining and quarrying	0.0	2.5	2.5	5.6	2.9
Manufacturing	30.9	29.5	27.1	14.3	9.6
Construction	6.9	10.0	10.2	13.2	7.9
Commercial real estate	14.1	8.9	9.4	12.6	12.0
Electricity	1.4	0.7	0.5	0.8	0.6
Water	0.2	0.0	0.0	0.0	0.0
Telecommunications	0.0	0.0	0.0	0.1	0.1
Tourism and hotels	5.4	4.2	3.2	2.8	12.4
Transport	4.2	5.7	3.4	5.1	4.3
Trade, restaurants and bars	17.1	17.2	23.7	17.9	14.4
Business services	10.3	10.3	9.5	16.0	23.4
Other community, social and personal services	1.4	2.0	3.1	4.3	4.8

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

Table 2.3: Levels and Proportions of Gross Loans and Advances, Non-performing Loans and Advances and Specific Provisions: 2017 – 2021

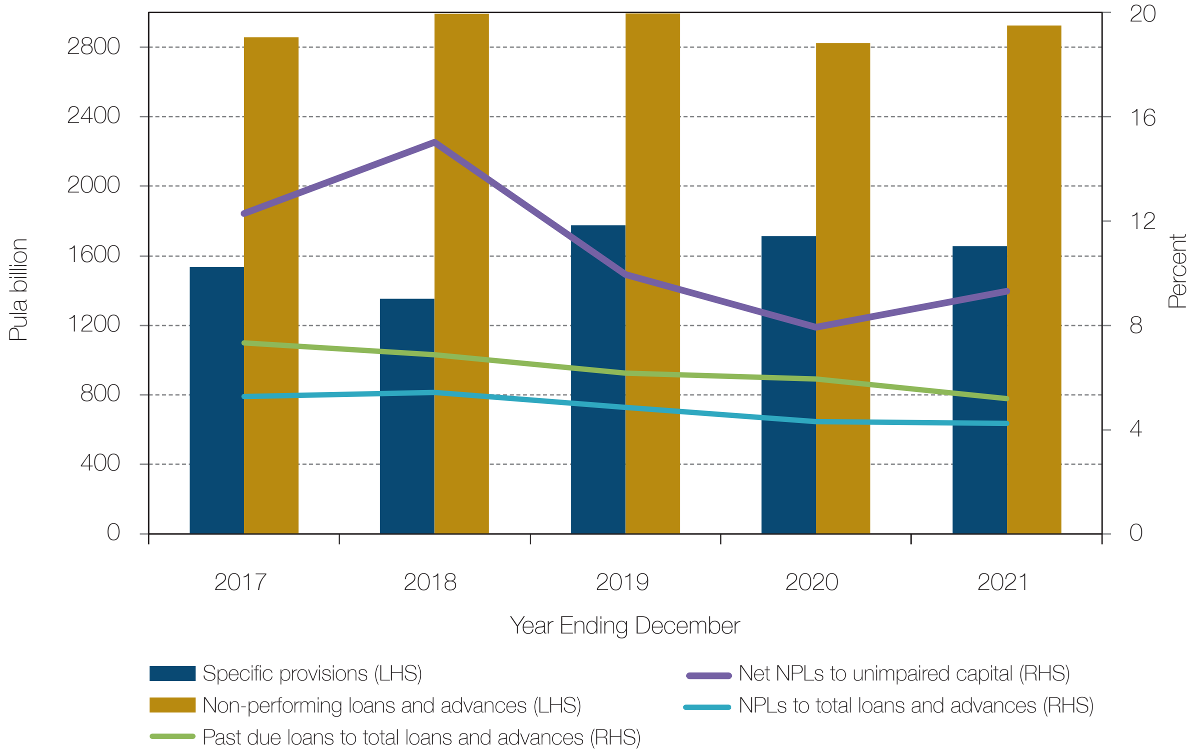
	2017	2018	2019	2020	2021
P million					
Gross loans and advances	54 181	58 332	62 770	65 554	68 920
Non-performing loans (NPLs)	2 859	3 166	3 051	2 824	2 922
Specific provisions	1 536	1 352	1 775	1 713	1 654
Percent					
NPLs to gross loans and advances	5.3	5.5	4.8	4.3	4.2
Specific provisions to NPLs	53.7	42.7	58.2	60.7	56.6

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

2.15 Specific provisions for the banking industry contracted by 3.4 percent from P1.71 billion in 2020 to P1.65 billion in 2021. Therefore, consistent with the decline in industry specific provisions, the ratio of specific provisions to NPLs fell from 60.7 percent in 2020 to 56.6 percent in 2021. Net NPLs (net of specific provisions) to unimpaired capital ratio increased from 7.9 percent to 9.3 percent during the period, indicative of a slight impairment in the loss-absorption capacity of banks. Nevertheless, at that level, the ratio is not of any supervisory concern, albeit remaining a key focus area for the Bank.

2.16 Chart 2.7 shows trends in the commercial bank asset-quality indicators for the period 2017 – 2021.

Chart 2.7: Commercial Banks: Asset Quality Indicators: 2017 – 2021

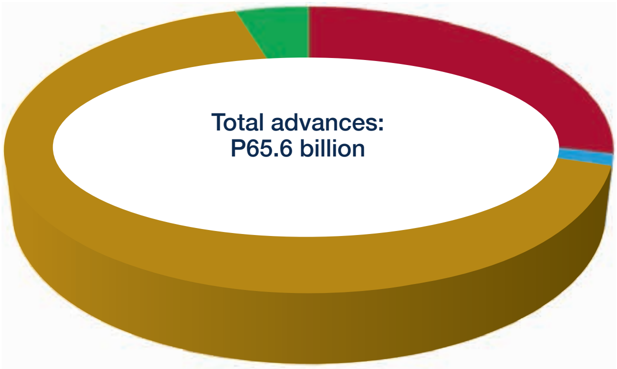


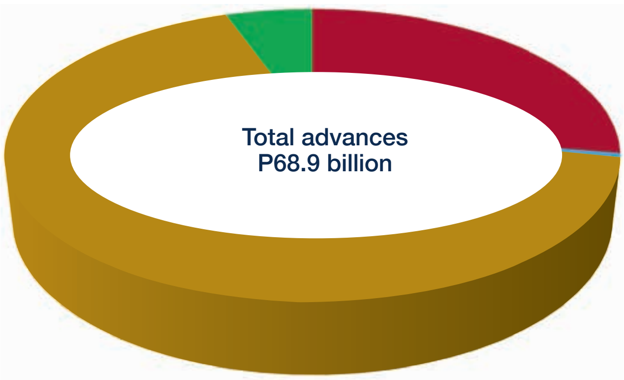
Source: Commercial Banks (Statutory Returns submitted to the Bank).

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

2.17 Loans and advances to households grew by 6.4 percent from P42.9 billion in 2020 to P45.6 billion in 2021 and accounted for 66 percent of gross loans and advances. The share of credit to public-sector entities (parastatals) in gross loans and advances decreased from 2 percent in 2020 to one percent in 2021, while the respective shares for private business and financial institutions remained at 28 percent and 5 percent in the same period. Chart 2.8 compares the sectoral distribution of loans and advances between 2020 and 2021.

Chart 2.8: Sectoral Distribution of Loans and Advances: 2020 and 2021 (Percent)





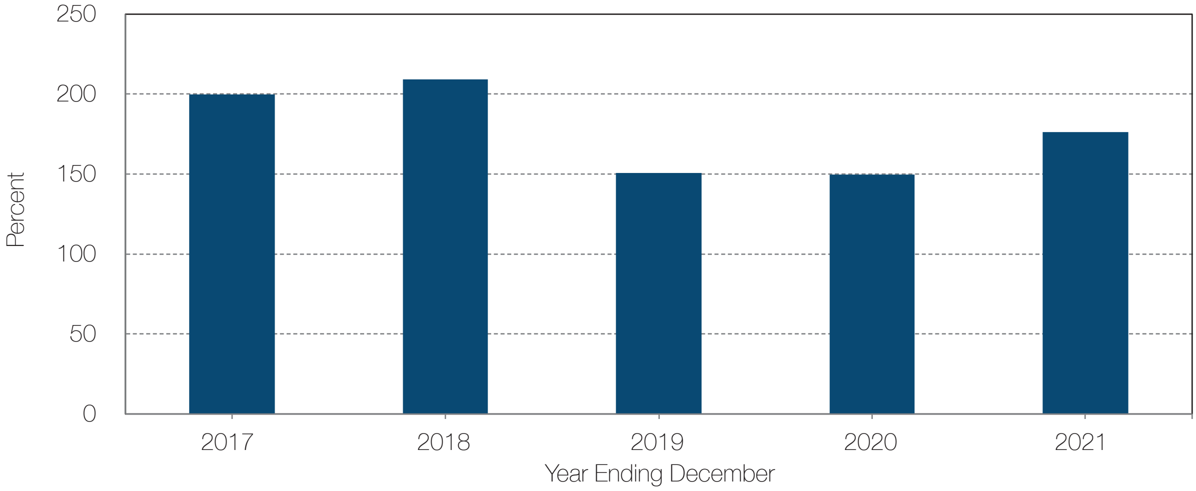
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Large Exposures

2.18 Commercial banks' large exposures[13] increased by 16.8 percent from P21 billion in 2020 to P24.5 billion in 2021, and unimpaired capital decreased by 2.7 percent from P14 billion to P13.6 billion in the same period. Consequently, the average ratio of large exposures to unimpaired capital increased from 149.7 percent in 2020 to 179.7 percent in 2021, remaining below the 800 percent prudential limit for banks in Botswana (Chart 2.9). Across banks, the ratio differed considerably, ranging from 23.9 percent to 692.6 percent.

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

Chart 2.9: Commercial Banks: Large Exposures to Unimpaired Capital Ratio: 2017 – 2021 (Percent)



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

The Structure of Private Business Loans and Advances

2.19 Table 2.4 shows the distribution of private business loans and advances for the period 2017 – 2021. The market share of commercial real estate and business services sub-sectors increased, while that of mining and quarrying, manufacturing, and trade, restaurants and bars sub-sectors decreased during the review period. Growth in economic activity for the commercial real estate and manufacturing sub-sectors was positive, which modestly increased their share in non-mining real GDP (Table 2.5). For the tourism and hotels, and agriculture, forestry and fishing sub-sectors, output growth was negative in both 2020 and 2021.

Table 2.4: Sectoral Distribution of Private Business Loans: 2017 – 2021 (Percent)

Private business sector loans	2017*	2018	2019	2020	2021
Agriculture, forestry and fishing	7	6	8	7	7
Mining and quarrying	2	2	3	3	2
Manufacturing	19	18	10	9	8
Construction	6	6	6	5	5
Commercial real estate	20	20	24	24	25
Electricity	-	-	-	-	-
Telecommunications	1	1	1	1	1
Tourism and hotels	5	4	6	6	6
Transport	3	2	3	2	2
Trade, restaurants and bars	33	21	19	22	21
Business services	-	-	16	16	19
Other	4	20	4	5	4

* Figures for 2017 revised.

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

Table 2.5: Selected Sectoral Growth Rates and Shares in Non-mining Real GDP 2017 – 2021 (Percent)

Private business sector output	2017	2018	2019	2020	2021
Agriculture, forestry and fishing					
Growth rate	(8.8)	8.1	2.4	(2.7)	(2.9)
Share in non-mining GDP	2.3	2.4	2.3	2.3	2.1
Commercial real estate					
Growth rate	5.0	5.4	5.5	(3.1)	7.9
Share in non-mining GDP	5.7	5.9	5.9	5.9	6.0
Manufacturing					
Growth rate	(2.2)	(1.2)	4.5	(14.9)	8.1
Share in non-mining GDP	8.0	7.7	7.6	6.7	6.8
Construction					
Growth rate	3.9	4.8	3.1	(11.4)	6.5
Share in non-mining GDP	12.7	12.9	12.7	11.6	11.6
Tourism and hotels					
Growth rate	3.9	3.4	3.0	(28.5)	(1.5)
Share in non-mining GDP	3.4	3.4	3.3	2.4	2.2
Non-mining Real GDP					
Growth rate	3.5	2.9	5.2	(3.5)	7.2

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

Loans to Directors and Related Parties

2.20 The exposure to related parties[14] was 5.2 percent of unimpaired capital for banks in 2021, a decrease from 7.5 percent in December 2020, indicating low indebtedness of related parties to the banking sector.

Foreign Currency Denominated Loans and Liabilities

2.21 Loans denominated in foreign currency decreased by 25.5 percent from P3.2 billion in 2020 to P2.4 billion in 2021, while deposits denominated in foreign currency increased by 14 percent from P13.7 billion to P15.6 billion in the same period. The ratio of loans denominated in foreign currency to foreign currency-denominated deposits declined from 23.6 percent to 15.4 percent in the same period. The ratio ranged from 0.2 percent to 45.3 percent. Loans denominated in foreign currency were mainly used to finance diamond sightholder businesses and imports of goods and services.

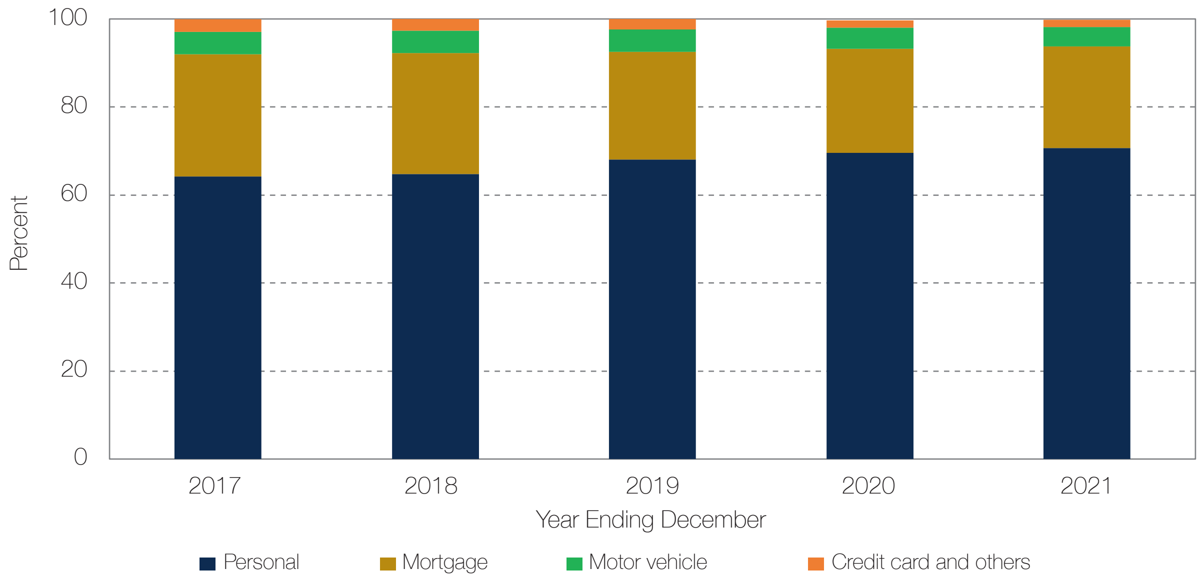
Composition of Household Loans and Advances

2.22 Household sector loans increased by 6.4 percent from P42.9 billion in 2020 to P45.6 billion in 2021. The loans comprised personal (71 percent), mortgage (23 percent), motor vehicle (4 percent), and credit card and other loans (2 percent) (Chart 2.10). Personal (mostly unsecured loans), mortgage and credit card loans increased by

[14] 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.

8.1 percent, 3.8 percent and 2.6 percent to P32.3 billion, P10.5 billion and P727 million, respectively, while motor-vehicle loans declined by 3 percent to P2 billion in the same period.

Chart 2.10: The Distribution of Household Loans and Advances: 2017 – 2021 (Percent)



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

2.23 The inherent credit risk for the banking industry was considered high, while the risk management systems of banks was satisfactory; hence, the residual risk remained high.

2.24 The composite credit risk for the banking industry was high; the inherent credit risk is likely to increase over the next 12 months because of the lingering effect of COVID-19-related shutdowns of some businesses, which resulted in loss of employment. The increase in levies, taxes (value added tax) and the upward adjustment of Botswana Housing Corporation rentals, tariffs for water and electricity, public transport fares and fuel prices in an environment of restrained increase in real wages are also likely to impair the ability to repay loans in accordance with agreed terms, hence lead to an increase in credit risk. The expected asset quality deterioration should be moderated, for a larger amount of the banking credit is a cumulative value of individual small loans to numerous, uncorrelated retail borrowers in various sectors of the economy, notably public sector employees. Moreover, banks have deployed a mix of credit risk mitigation instruments, in particular, mortgage payment protection insurance, credit life and lien over life-insurance policies, which have resulted in the transfer of a significant portion of credit risk to the insurance sector.

Market Risk

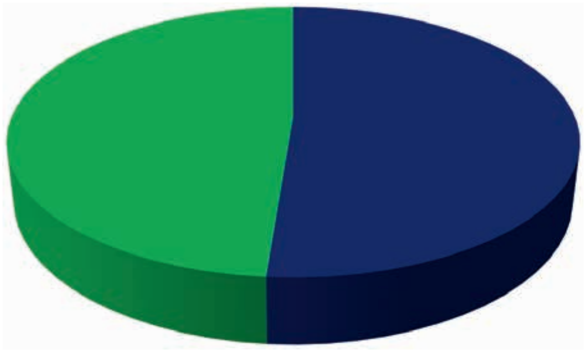
Regulatory Capital Requirements on Market Risk

2.25 Market RWAs fell by 53.2 percent from P1.5 billion in 2020 to P696.8 million (constituting one percent of total RWAs) in 2021 (Table 2.6). The total regulatory capital requirement for market risk decreased from P222.4 million in 2020 to P116.1 million in 2021, with interest-rate risk accounting for P59.5 million or 51 percent and foreign exchange exposure contributing P56.6 million or 49 percent (Chart 2.11). The fall in market RWAs was attributable to the reduction by two banks and clearance by one bank of bonds and subordinated debt instruments, subsequently lowering the interest-rate RWAs for the industry.

Table 2.6: Regulatory Capital Requirements on Market Risk (P million)

	2020	2021
Interest rate risk	167	59
Foreign exchange risk	55	57
Total Pillar 1 market risk capital requirements	222	116
Market risk-weighted assets	1 490	697

Chart 2.11: Composition of Market Risk Regulatory Capital: December 31, 2021 (Percent)



Interest rate risk	49
Foreign exchange risk	51

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

Foreign Currency 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 overall foreign currency exposure to total unimpaired capital ratio for the banking sector decreased from 3.3 percent in 2020 to 0.1 percent in 2021. On the other hand, at P16.8 billion, the banking industry nostro balances (due from foreign banks) constituted 15.5 percent of total banking assets. In contrast, the vostro balances (due to foreign banks) amounted to P2.1 billion or 1.9 percent of the consolidated banking liabilities.

Interest Rate Risk

2.27 For all the maturities, except for the 1–3 months, which had a negative gap of P385 million (Table 2.7), the gap between interest rate-sensitive assets and interest rate-sensitive liabilities for the banking sector was positive, implying that a bank would gain profitability in response to a rise in interest rates. With a negative gap, a decrease in interest rates would result in repricing of liabilities (deposits) by banks at a low rate, thus increasing earnings for the banking sector, while an increase in interest rates would result in repricing of liabilities at a higher rate, with an opposite effect on earnings. Conversely, for interest rate-sensitive advances and other assets, a fall in interest rates would lower the banks' earnings, whereas an increase in interest rates would raise earnings and, indirectly, economic capital.

Table 2.7: Interest Rate Risk Exposure: December 2021 (P million)

Maturity	Total variable rate assets	Total variable rate liabilities	Variable gap
Up to 1 month	58 075	28 787	29 288
1–3 months	1 802	2 187	(385)
Over 3–6 months	1 669	1 351	318
Over 6–12 months	7 250	2 966	4 283
Over 12 months–3 years	656	370	286
Over 3–5 years	940	380	560
Over 5–10 years	565	293	272
More than 10 years	683	0	683
Total	**71 639**	**36 334**	**35 305**

Note: Parentheses denote negative figures.

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

2.28 Overall, the 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 Operational RWAs grew from P7 billion in 2020 to P7.3 billion in 2021, while the regulatory capital charge for operational risk increased by 4.7 percent from P1 billion to P1.1 billion in the same period (Table 2.8). In 2021, all banks calculated the operational risk capital requirements using BIA in 2021. Over and above using BIA, one bank computed operational risk capital requirement under the standardised approach for operational risk, which is a more risk-sensitive method of determining capital requirements.

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

	2020	2021
Operational risk capital charge: BIA	1 039	1 087
Operational risk-weighted assets	6 959	7 286

Operational Risk Exposure

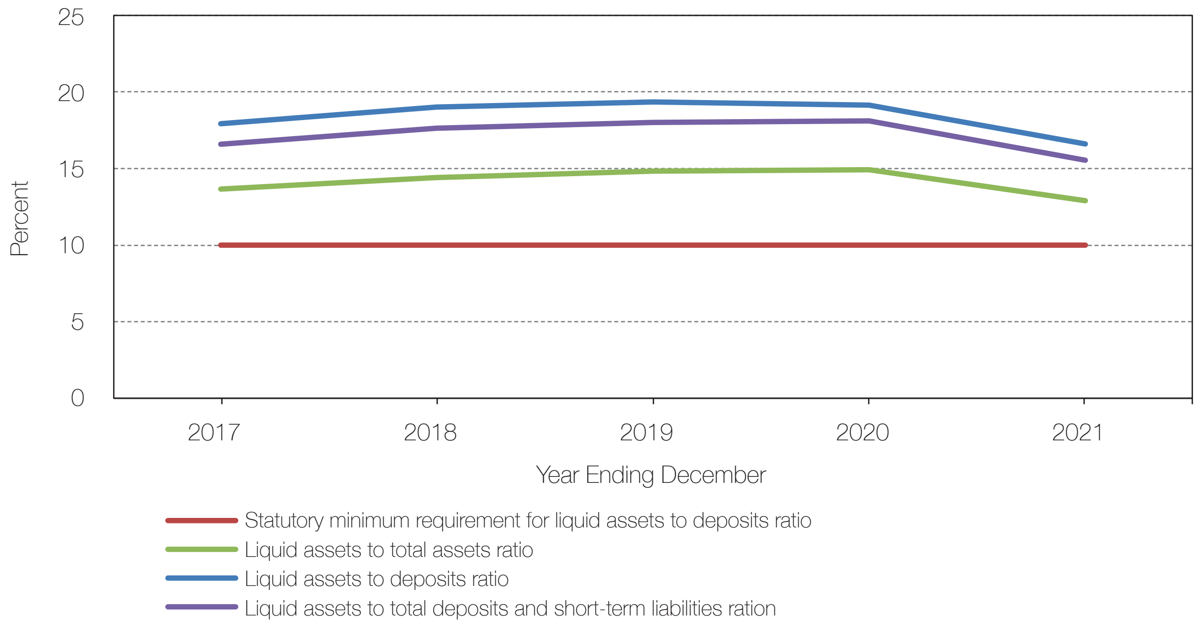
2.30 A review of internal controls of banks revealed that operational risk management deficiencies in 2021, for some banks, included lack of adequate separation of duties in some functions, compromised quality of underwriting practices and invalid insurance policies, inadequate review of policies and procedure manuals, and under-resourcing of some functions.

2.31 The banking sector composite operational risk remained high because the instituted risk management measures were considered to be unsatisfactory. For the ensuing 12 months, operational risk is expected to trend upwards, mainly influenced by expanding digitalisation of operations by banks, which increased susceptibility to cyber-crime risks. The identified lapses in internal controls at some banks is likely to exacerbate operational risks.

Liquidity and Funding Risk

2.32 The banking industry statutory liquid assets contracted by 9.1 percent from P15.4 billion in 2020 to P14 billion in 2021, while the liquid assets to deposit ratio (LAR) decreased from 19.1 percent in 2020 to 16.6 percent in 2021 but remained above the 10 percent prudential minimum. The ratio varied across banks, with a range of 14 percent to 21.3 percent.

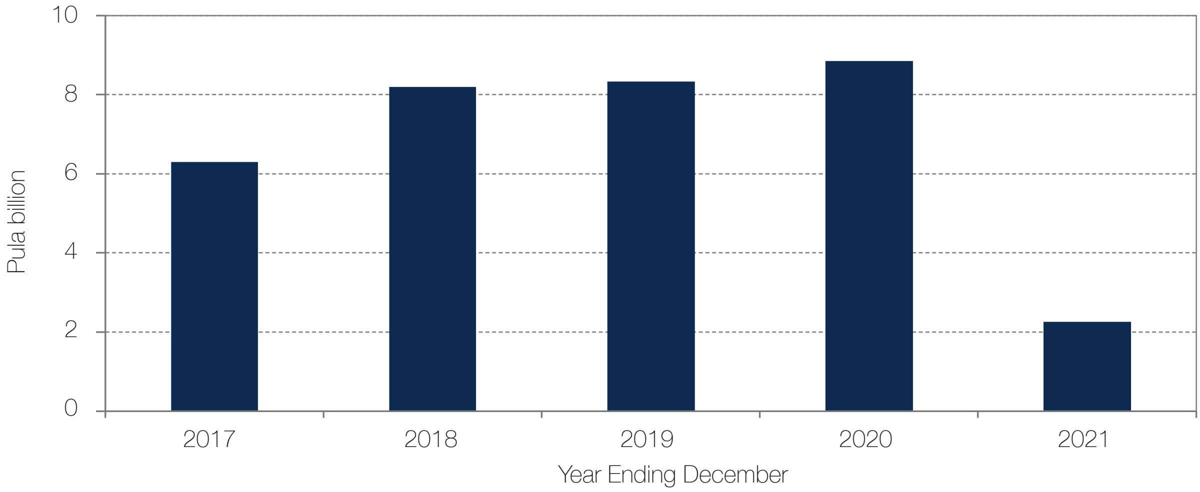
Chart 2.12: Commercial Banks: Liquidity Ratios: 2017 – 2021 (Percent)



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

2.33 The banking industry significantly reduced holdings of the Bank of Botswana Certificates (BoBCs) by 74.4 percent from P8.8 billion in 2020 to P2.3 billion in December 2021 (Chart 2.13). All banks reduced BoBC holdings, and one bank held no BoBCs. The decline in BoBC holdings by banks is attributable to portfolio recomposition by banks through which the higher yield investments in instruments such as treasury bills, government bonds and investment with local asset managers were substituted for BoBCs.

Chart 2.13: Commercial Banks: Market Value of Outstanding BoBCs Holdings: 2017 – 2021 (P billion)



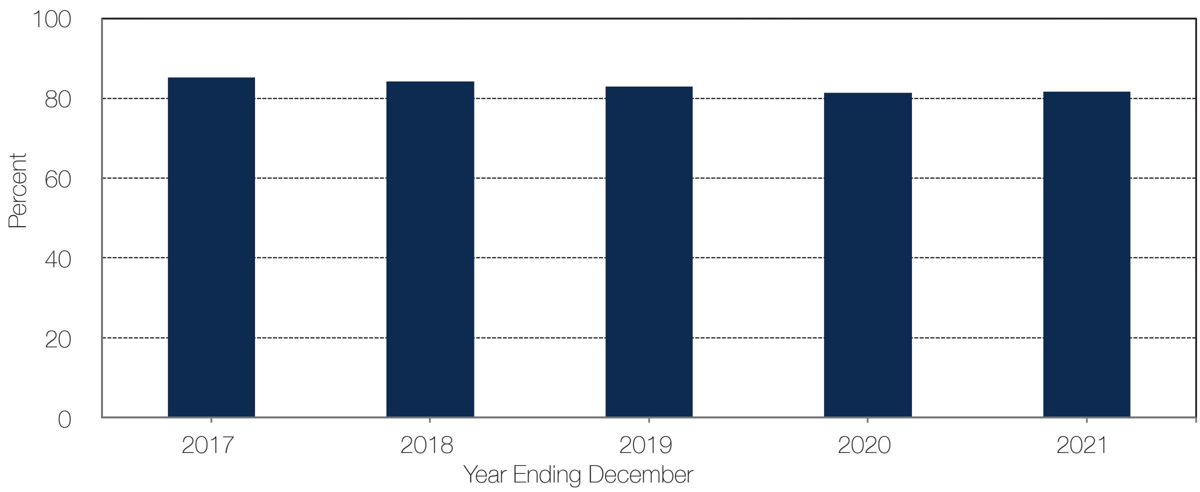
Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.34 The banking sector's inherent liquidity risk was considered moderate, and the associated risk management initiatives considered adequate; thus, the residual liquidity risk continued to be moderate, with an upward trajectory due to the competition for volatile deposits by banks.

Financial Intermediation

2.35 The banking industry average financial intermediation ratio (loans and advances to deposits) increased slightly from 81.4 percent in December 2020 to 81.7 percent in 2021 (Chart 2.14). The intermediation ratio for banks ranged from 62.9 percent to 103.2 percent.

Chart 2.14: Commercial Banks: Loans and Advances to Deposits Ratio (Financial Intermediation): 2017 – 2021 (Percent)



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

Liabilities and Funding Structure

2.36 Asset growth was funded by customer deposits, share capital, debt securities and other borrowings, and balances due to other banks. Customer deposits remained the main source of funding for the banking industry and grew by 4.7 percent compared with 6.4 percent in 2020. Customer deposits increased from P80.5 billion in 2020 to P84.4 billion in 2021 and constituted 77.7 percent of liabilities. Share capital, accounting for 10 percent of liabilities, decreased by 4.8 percent from P11.3 billion to P10.8 billion in the same period. Debt securities and other borrowings increased by 10.2 percent from P5.6 billion in 2020 to P6.2 billion in 2021. Balances due to other banks also increased by 32.3 percent from P3 billion to P4 billion in the same period.

2.37 Table 2.9 presents the sources of funding for the banking sector from 2017 to 2021.

Table 2.9: Main Sources of Funding: 2017 – 2021 (Pula million)

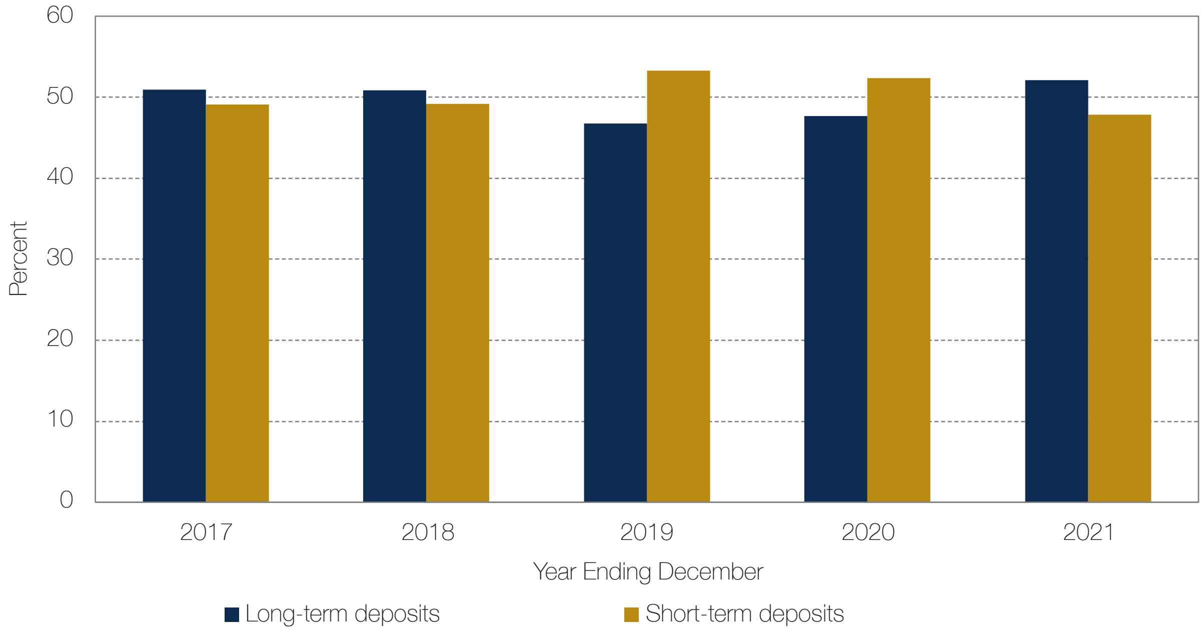
Source of funding	2017	2018	2019	2020	2021
Deposits (P million)	63 581	69 270	75 709	80 540	84 364
Annual growth rate (percent)	1.8	8.9	9.3	6.4	4.7
Share of total funding (percent)	76.2	75.8	76.7	78.0	77.7
Share capital (P million)	9 383	10 390	11 080	11 299	10 756
Annual growth rate (percent)	(3.7)	10.7	6.6	3.6	(4.8)
Share of total funding (percent)	11.2	11.4	11.2	11.0	9.9
Debt securities and other borrowings (P million)	4 065	4 747	4 761	5 594	6 162
Annual growth rate (percent)	53.9	16.8	0.3	17.5	10.2
Share of total funding (percent)	4.9	5.2	4.9	5.4	5.7
Due to other banks (P million)	4 250	4 735	4 532	3 022	3 999
Annual growth rate (percent)	6.7	11.4	(4.3)	(33.3)	32.3
Share of total funding (percent)	5.1	5.2	4.6	2.9	3.7
Other liabilities (P million)	2 196	2 199	2 612	2 804	3 310
Annual growth rate (percent)	19.4	1.4	18.8	(0.2)	20
Share of total funding (percent)	2.6	2.4	2.6	2.7	3
Total Funding (P million)	**83 475**	**91 341**	**98 695**	**103 260**	**108 591**

Note: Parentheses denote negative figures.

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

2.38 The relative shares of deposits indicated partial maturity substitution between 2020 and 2021; that is, while long-term deposits (time and savings) contributed 48 percent and short-term deposits (call and current) 52 percent in 2020, the respective shares were 52 percent and 48 percent in 2021 (Chart 2.15). The development shows persistence of maturity mismatches for the banking sector in Botswana.

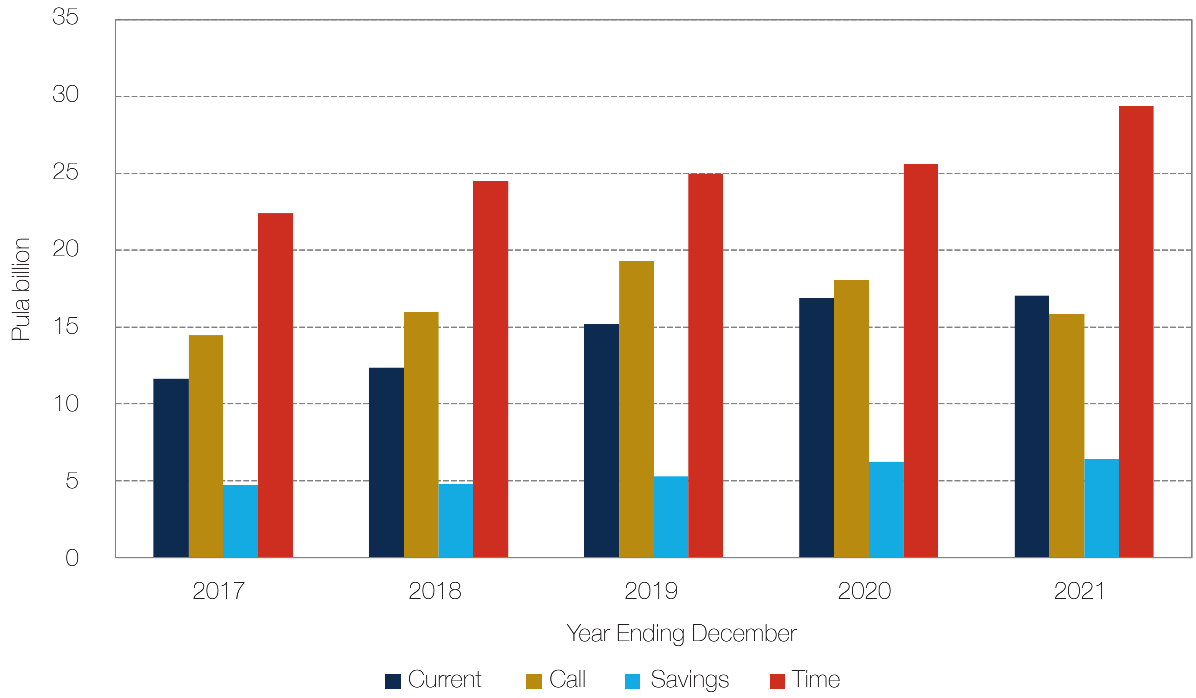
Chart 2.15: Commercial Banks: Deposits Type by Maturity: 2017 – 2021 (Percent)



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

2.39 Time, savings and current deposits grew by 14.7 percent, 3.2 percent and 0.7 percent, respectively, while call deposits declined by 12.1 percent in 2021. Time deposits amounted to P29.4 billion, the largest proportion of total deposits (42.7 percent), followed by current deposits (24.8 percent), call deposits (23.1 percent) and savings deposits (9.4 percent). Chart 2.16 shows the value of Pula-denominated deposits by type for 2017 to 2021.

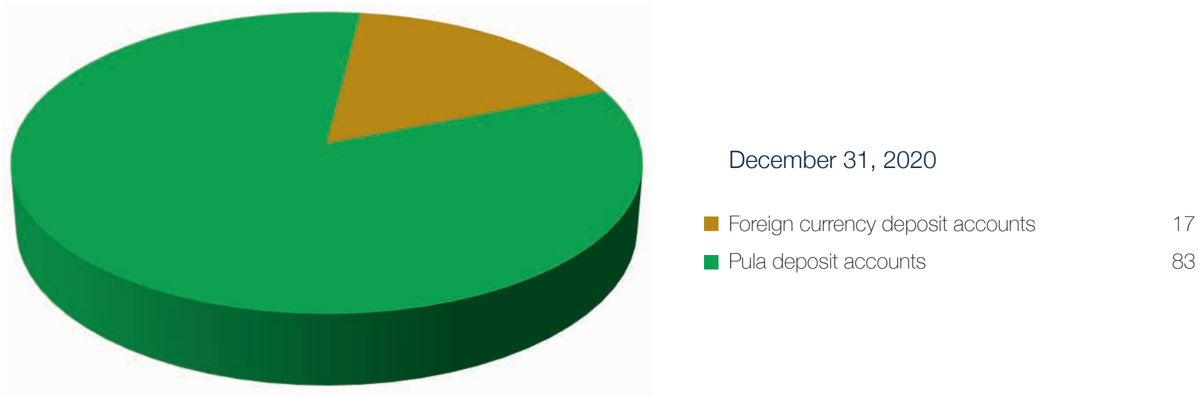
Chart 2.16: Commercial Banks: Share of Pula-denominated Deposits by Type: 2017 – 2021 (Pula billion)

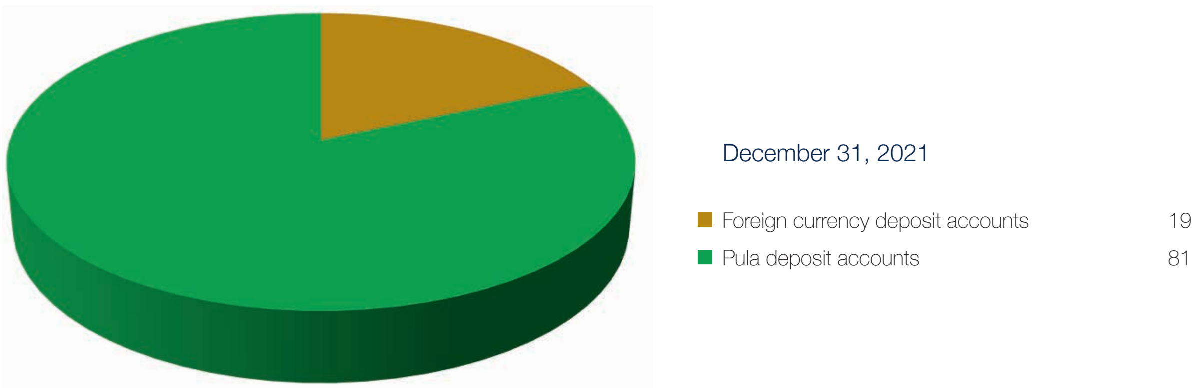


Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.40 Deposits denominated in foreign currency rose by 14 percent from P13.7 billion in 2020 to P15.6 billion in 2021, thus increasing the share of those deposits in total deposits from 17 percent in 2020 to 19 percent in 2021. That change resulted in a slight decrease of the proportion of Pula-denominated deposits in total deposits from 83 percent in 2020 to 81 percent in 2021 (Chart 2.17).

Chart 2.17: Commercial Banks: Share of Foreign Currency and Pula-denominated Deposits to Total Deposits: 2020 and 2021 (Percent)

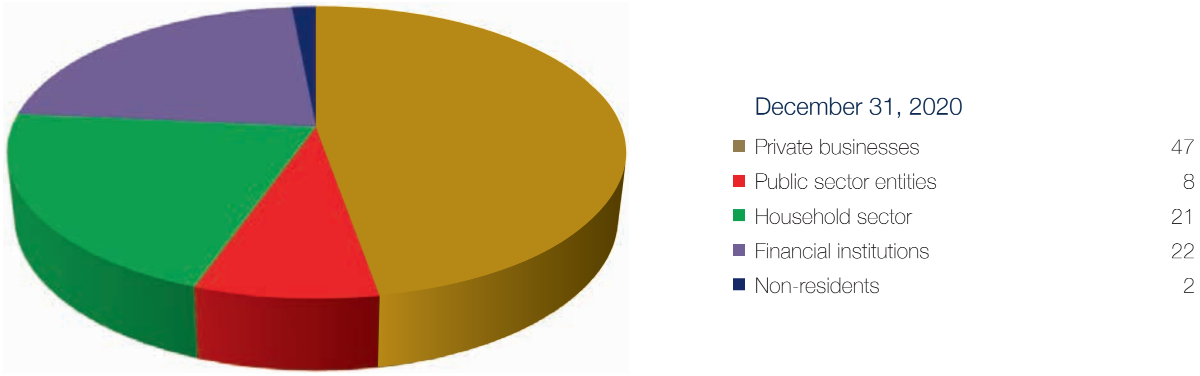


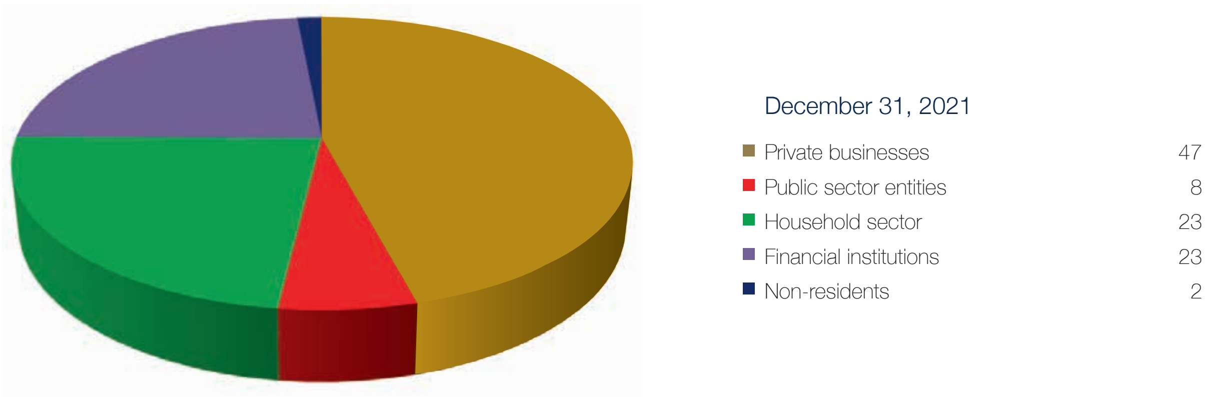


Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.41 The share of private business and public (government and parastatals) deposits in total deposits marginally decreased from 47 percent and 8 percent in 2020 to 46 percent and 6 percent, respectively, in 2021. On the other hand, the share of deposits of financial institutions and the household sector in total deposits increased from 22 percent and 21 percent to 23 percent each. The share of non-resident deposits was constant at 2 percent between the two periods.

Chart 2.18: Commercial Banks: Sectoral Distribution of Deposits: 2020 and 2021 (Percent)





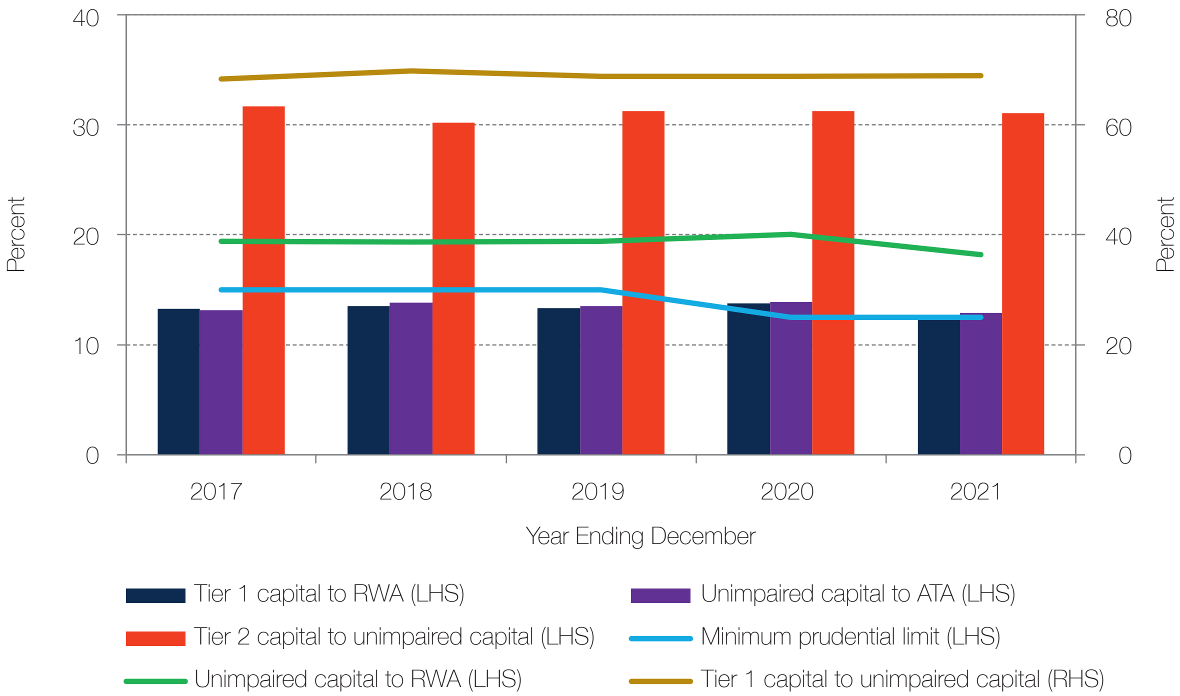
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Capital adequacy (solvency): level, quality and trend

2.42 The banking sector remained adequately capitalised and complied with the regulatory capital adequacy thresholds. Banks reported capital adequacy and common equity Tier 1 capital ratios higher than the prudential minimum of 12.5 percent and 4.5 percent, respectively. Total RWAs for banks increased by 7.4 percent from P69.9 billion in 2020 to P75 billion in 2021. The banking industry capital adequacy ratio (CAR) fell from 20 percent in 2020 to 18.2 percent in 2021. Chart 2.19 shows CAR over a five-year period (2017 – 2021).

2.43 Unimpaired capital for the banking industry declined by 2.7 percent from P14 billion in 2020 to P13.6 billion in 2021. All banks, except two, reported an increase in unimpaired capital.

Chart 2.19: Commercial Banks: Capital Ratios: 2017 – 2021



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

2.44 Tier 1 capital constituted the largest share of unimpaired capital, at 69 percent, confirming that the banking industry had a strong high-quality capital base. Tier 1 capital decreased by 2.4 percent from P9.6 billion in 2020 to P9.4 billion in 2021. Within Tier 1 capital, retained earnings contributed 79.4 percent, though they decreased by 2 percent from P7.6 billion in 2020 to P7.5 billion in 2021. As a proportion of average total assets, unimpaired capital decreased from 13.9 percent to 12.9 percent in the same period, reflecting an increase in the financial leverage of banks. The ratio of common equity Tier 1 capital to risk-weighted assets decreased from 13.8 percent in 2020 to 12.5 percent in 2021 but remained above the 4.5 percent prudential minimum (Chart 2.19).

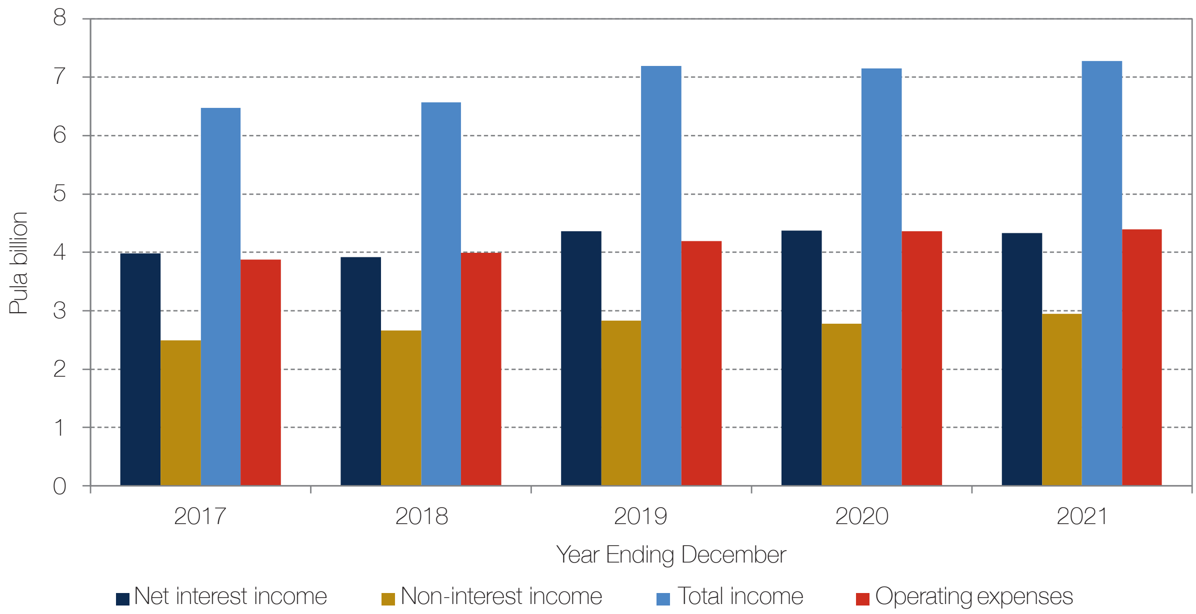
2.45 The banking industry Tier 2 capital amounted to P4.2 billion in 2021, slightly lower than P4.4 billion in 2020, and comprised subordinated term debt (54.9 percent), unpublished current year profits (25.7 percent) and general loan reserves (19.4 percent). The ratio of Tier 2 capital to unimpaired capital marginally decreased to 31 percent in 2021 from 31.2 percent in 2020. The expected deterioration in the asset quality of the banking sector poses a downside risk to capital of banks in the next 12 months.

Statement of comprehensive income and expenses

Income

2.46 Commercial banks' total income (net interest and non-interest income) increased by 1.7 percent from P7.1 billion in the year to December 31, 2020, to P7.3 billion in the corresponding period in 2021 (Chart 2.20). The increase in total income was due to a 6.2 percent growth in non-interest income from P2.8 billion to P2.9 billion. Consequently, non-interest income as a proportion of total income rose from 38.8 percent to 40.5 percent in the same period. The source of non-interest income was mainly growth in fees and commissions, which gained from the increased transactional volumes driven by the use of digital platforms. Fee and commission income in the 12 months to December 2020 was P1.8 billion or 66 percent of total non-interest income, and it was P2 billion or 70 percent of total non-interest income in the corresponding period in 2021. Net interest income declined marginally by 1.1 percent from P4.4 billion in 2020 to P4.3 billion in 2021 owing to the low interest-rate environment. Consequently, the ratio of net interest income to total income declined from 61.2 percent in the 12 months ending December 2020 to 59.5 percent in the similar period of 2021.

Chart 2.20: Commercial Banks: Composition of Income and Expenses: 2017 – 2021 (P billion)



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

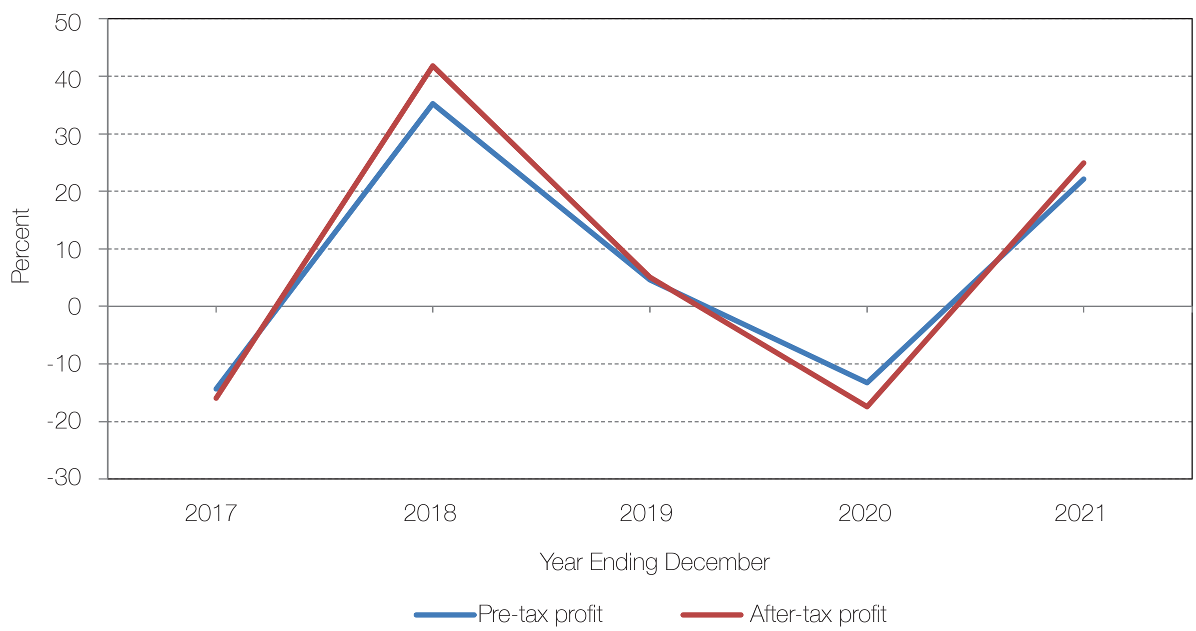
Expenses

2.47 Operating expenses constituted 70 percent of commercial banks' total expenses, while the share of interest expenses was 30 percent. Operating expenses grew marginally by 0.6 percent from P4.36 billion in the 12 months to December 2020 to P4.39 billion in the corresponding period in 2021 (Chart 2.20). The largest operating expense item was staff costs, at 46.1 percent, followed by administration and other expenditures, at 36.9 percent, other expenses (audit and consulting fees, and occupancy and depreciation), at 9.8 percent, and legal and management fees, at 7.2 percent.

Profitability: Level, Source and Trend

2.48 The overall net after-tax profit of banks increased by 25 percent from P1.5 billion in the 12 months to December 2020 to P1.8 billion in the corresponding period in 2021. The growth in profits also reflected the base effects of the fall in profits in 2020. In the review period, net after-tax profit increased for all banks, except for two banks. 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: 2017 – 2021 (Percent)



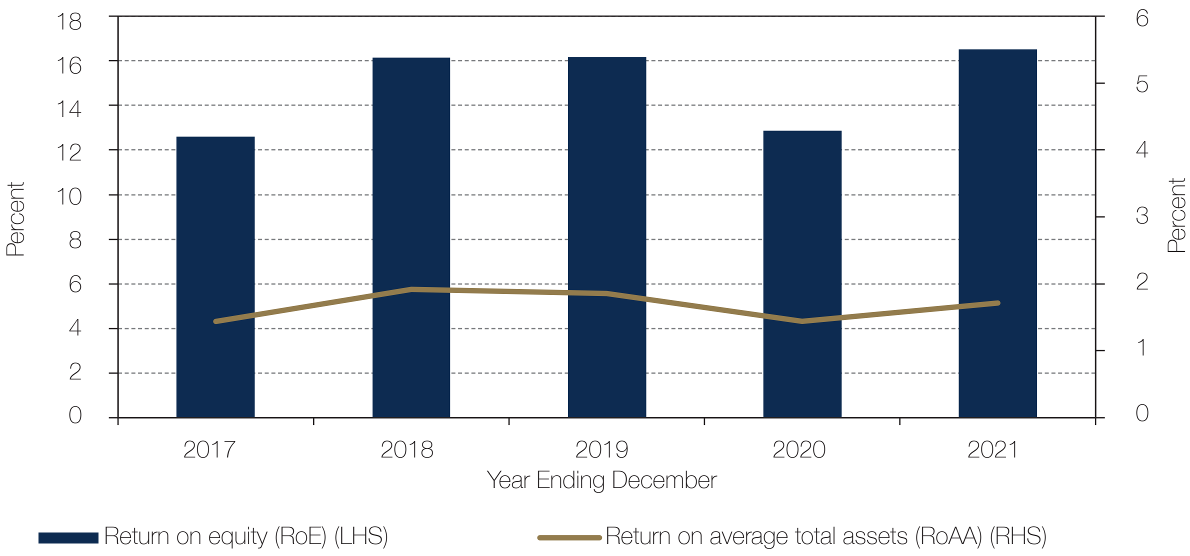
Source: Commercial Banks (Statutory Returns submitted to the Bank).

Profitability and Operating Efficiency Indicators

Profitability Indicators

2.49 Consistent with improved financial performance in the banking industry, aggregate return on equity (RoE) and return on average assets (RoAA) increased from 12.9 percent and 1.4 percent in the year to December 2020 to 16.9 percent and 1.7 percent in the corresponding period in 2021, respectively (Chart 2.22). Across banks, RoE ranged from 3 percent to 28.1 percent in the review period, while RoAA ranged between 0.4 percent and 3 percent.

Chart 2.22: Commercial Banks: Profitability Indicators: 2017 – 2021 (Percent)



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

2.50 Table 2.10 provides financial performance indicators for the banking sector for the five-year period, 2017 – 2021.

Table 2.10: Financial Performance Ratios: 2017 – 2021 (Percent)

Financial Performance Ratios	2017	2018	2019	2020	2021
Income on investments and securities to total income	3.8	3.8	4.4	5.3	6.5
Non-interest income to total income	38.5	40.4	39.4	38.8	40.5
Net interest income to total income	61.5	59.6	60.6	61.2	59.5
Return on equity	12.6	16.1	16.2	12.9	16.9
Return on average assets	1.4	1.9	1.9	1.4	1.7
Net interest income to average total assets	3.0	4.5	4.6	2.7	4.1
Interest income to average earning assets	8.7	8.0	7.0	6.6	6.4
Non-interest income to average total assets	3.0	3.0	3.0	2.7	2.8
Interest expense to average total assets	1.8	2.1	2.0	1.8	1.8
Earnings retention	67.7	73.9	69.5	85.9	17.3*
Interest income on loans to average total assets	5.9	5.8	4.4	5.7	5.2
Non-interest expense to average total assets	4.7	4.6	4.4	4.3	4.1
Gross interest income to average total assets	7.9	7.5	6.6	6.1	5.9

* Earnings retention was the lowest in five years because dividends declared and paid in 2021 increased.

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

Operating Efficiency Indicators

2.51 Trends in efficiency measures for commercial banks for 2017 – 2021 are shown in Table 2.11. Reflecting enhanced operating efficiency of banks, the industry average cost-to-income ratio decreased from 61 percent in the 12 months to December 2020 to 60.3 percent in the year to December 2021. Severally, however, some banks had high cost-to-income ratios, which ranged between 70.2 percent and 90.7 percent and were above the recommended range of 50–60 percent.

Table 2.11: Commercial Banks: Other Efficiency Measures: 2017 – 2021

	2017	2018	2019	2020	2021
Percent					
Average cost of deposits	1.7	1.8	2.1	1.9	1.9
Return on loans and advances	9.2	9.0	6.9	9.0	8.2
Net interest margin	5.4	4.8	4.9	4.7	4.4
Interest rate spread	6.1	5.2	3.7	4.0	3.8
Cost-to-income	59.9	60.7	58.3	61.0	60.3
Net income to employee costs	68.3	94.1	92.8	74.4	89.8
P'000					
Net income per employee	255.8	354.7	376.4	315.8	412.5
Staff costs per employee	374.6	376.8	405.8	424.6	459.5
Assets per employee	18 060	19 327	21 085	22 423	24 646

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

2.52 For the year ending in December 2021, the return on loans and advances ratio decreased from 9 percent to 8.2 percent and interest rate spread fell from 4 percent to 3.8 percent, reflecting the low interest-rate environment within which the banking sector operated. The cost-of-deposits ratio was unchanged, at 1.8 percent, between December 2020 and December 2021. The net income-to-employee cost ratio increased from 74.4 percent in the 12 months to December 31, 2020, to 89.9 percent in the similar period in 2021, owing to a faster increase in net income than employee-related expenditure. As a result of the increased profit levels and a reduction in the number of employees of banks, net income per employee increased from P315 800 to P412 900 in the same period. Assets per employee increased from P22.4 million to P24.7 million, reflecting the effect of 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

2.53 The Bank's off-site surveillance[15] (OSS) system results and the annual risk assessment review indicate that, during 2021, the financial performance of commercial banks was sound. The strongest components were sensitivity to market risk (1.28), asset quality (1.53) and capital adequacy (1.74). Liquidity and earnings were rated adequate, with an industry average score of 2.71 and 2.81, respectively.

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

15 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).

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, 2021

	Capital adequacy	Asset quality	Earnings	Liquidity	Market sensitivity	Overall score
Banking Sector Average	1.74	1.53	2.81	2.71	1.28	2.05

Source: Bank of Botswana.

STATUTORY BANKS [16]

Statement of Financial Position

Assets

2.55 Total assets for two statutory banks[17] grew by 2.8 percent from P7 billion in 2020 to P7.2 billion in 2021. The growth in total assets of the two statutory banks reflects a 16.4 percent increase in loans and advances of one statutory bank from P2.8 billion in 2020 to P3.3 billion in 2021. Conversely, assets for one statutory bank decreased by 6.6 percent from P4.1 billion in 2020 to P3.8 billion in 2021. The market share of the two statutory banks was 6.2 percent for assets, 5.7 percent for deposits and 8.1 percent for loans and advances in the review period.

Liabilities

2.56 The two statutory banks' liabilities (excluding shareholder funds) rose by 3 percent from P6.2 billion in 2020 to P6.4 billion in 2021, reflecting an increase in deposits. The main source of funds for the two banks was deposits, which constituted 70.8 percent of liabilities (Table 2.14). The deposits increased by 6.3 percent from P4.8 billion in 2020 to P5.1 billion in 2021. The second largest funding source, debt securities and borrowings, declined by 14.6 percent and accounted for 13.1 percent of total liabilities, while equity increased by 1.6 percent and contributed 10.1 percent to liabilities.

Table 2.14: Main Sources of Funding for Statutory Banks: 2017 – 2021 (P million)

Funding category	2017	2018	2019	2020	2021
Deposits (P million)	**4 042**	**4 244**	**5 462**	**4 762**	**5 062**
Growth rate (percent)	15.7	5.0	28.7	(12.8)	6.3
Share of total funding (percent)	59.6	64.9	70.3	68.5	70.8
Debt Securities and Other Borrowings (P million)	**1 235**	**1 325**	**1 185**	**1 100**	**940**
Growth rate (percent)	(50.6)	171.5	(10.6)	(7.1)	(14.6)
Share of total funding (percent)	7.2	20.2	15.2	15.8	13.1
Share Capital (P million)	**1 306**	**775**	**718**	**709**	**720**
Growth rate (percent)	0.3	(40.7)	(7.3)	(1.2)	1.6
Share of total funding (percent)	19.3	11.8	9.2	10.2	10.1
Other Liabilities (P million)	**193**	**200**	**410**	**384**	**430**
Growth rate (percent)	(3.1)	3.4	104.9	(6.4)	12.1
Share of total funding (percent)	2.9	3.1	5.3	5.5	6.0
Total Funding (P million)	**6 777**	**6 544**	**7 774**	**6 955**	**7 153**

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

16 Banks established by specific statutes.

17 The analysis excludes one statutory bank because it reports under Basel I, while other banks are reporting under the Basel II framework.

Liquidity Risk

2.57 Liquid assets of the two statutory banks decreased by 13.1 percent from P897 million in 2020 to P779.8 million in 2021. The decrease reflected the fall of 34.9 percent in balances due from domestic banks, for one bank. The ratio of liquid assets to total deposits decreased from 18.8 percent to 15.4 percent in the same period but remained above the statutory minimum of 10 percent.

Credit Risk

Regulatory Capital Requirements in Respect of Credit Risk

2.58 Consistent with the growth in loans and advances, credit RWAs of the two statutory banks rose by 3.3 percent from P3.5 billion in 2020 to P3.6 billion in 2021. The credit RWAs constituted 93.4 percent of RWAs as at December 31, 2021.

Loans and Advances, Credit Risk and Asset Quality

2.59 The loan book of the two statutory banks grew by 4.1 percent from P5.9 billion in 2020 to P6.1 billion in 2021. The loan book comprised loans to the household sector and private businesses, which accounted for 95.6 percent and 4.4 percent of gross loans and advances, respectively. Mortgages constituted the largest proportion of total loans, at 57.2 percent, while personal loans accounted for 37.3 percent, commercial real estate for 4.4 percent, motor vehicle for 0.2 percent and other loans for 0.9 percent of total loans and advances. Aggregate NPLs for the two banks decreased by 28.2 percent from P429 million in 2020 to P308 million in 2021. One statutory bank wrote off non-recoverable loans amounting to P24 million. In addition, the bank adjusted its system to correctly reflect performing loans that it had previously reported as non-performing, hence the decline in NPLs. The ratio of NPLs to gross loans and advances for the banks decreased from 7.3 percent in 2020 to 5 percent in 2021.

2.60 The two banks raised specific provisions amounting to P130 million in 2021 from P115.3 million in 2020, a 12.8 percent increase. The resultant ratio of specific provisions to NPLs increased from 26.9 percent to 42.2 percent in the same period.

2.61 The inherent credit risk for the two statutory banks was considered high, while risk management systems and internal controls were weak. Thus, the residual credit risk remained high and is expected to rise over the subsequent 12 months because of the continued negative effect of the COVID-19 pandemic on the ability of some borrowers to service their loans.

Capital Adequacy (Solvency): Levels, Quality and Trends

2.62 Unimpaired capital of the two statutory banks increased by 11.4 percent from P732 million in 2020 to P815.8 million in 2021, while RWAs rose by 3 percent from P3.7 billion in 2020 to P3.9 billion in 2021. As a result, the average CAR of the two banks was 21.1 percent in 2021, above the 12.5 percent minimum prudential requirement for banks in Botswana. The levels of CAR for the two banks were 29.2 percent and 14.7 percent, respectively. The ratio of Tier 1 capital to unimpaired capital was 88.3 percent in 2021, lower than the 98.6 percent in 2020; the ratio indicates high-quality capital levels for the statutory banks.

Statement of Comprehensive Income

2.63 The two statutory banks reported an aggregate loss of P11 million in the 12 months to December 2021, a reduction from that of P29 million in the prior year. RoAA and RoE for the two banks improved from -0.4 percent and -4.1 percent in the 12 months ending in December 2020 to -0.2 percent and -1.5 percent in the 12 months of the previous year, respectively. The average cost-to-income ratio for the two banks increased from 94 percent in the 12 months to December 2020 to 104 percent in the similar period in 2021. Table 2.15 shows key performance indicators for the statutory banks during 2017 to 2021.

Table 2.15: Statutory Banks: Financial Performance Indicators: 2017 – 2021

Indicator	2017	2018	2019	2020	2021
P' million					
Net income	37	0.2	(34)	(28.7)	(11)
Interest income	265	441	535	517	545
Interest expense	198	228	316	278	291
Net interest income	234	213	218	239	254
Non-interest expense	197	212	269	268	313
Total assets	6 777	6 544	7 774	6 955	7 153
Average total assets	6 379	6 660	7 159	7 365	7 054
Average earning assets	6 111	6 307	6 716	6 939	6 653
Unimpaired capital	1 316	880	706	732	816
Risk-weighted assets	3 060	3 092	3 407	3 749	3 862
Percent					
Net income growth rate	(43.5)	(89.2)	(19 098)	(15.5)	(61.6)
Interest income to average total assets	4.1	3.7	7.5	7.0	7.7
Cost-to-income	74.3	85.5	100	94	104
Return on average assets	0.6	0.0	(0.5)	(0.4)	(0.2)
Return on equity	2.8	0.0	(4.7)	(4.1)	(1.5)
Return on advances	8.0	7.8	9.7	8.4	8.5
Average cost of deposits	3.4	3.8	4.5	3.8	4.3

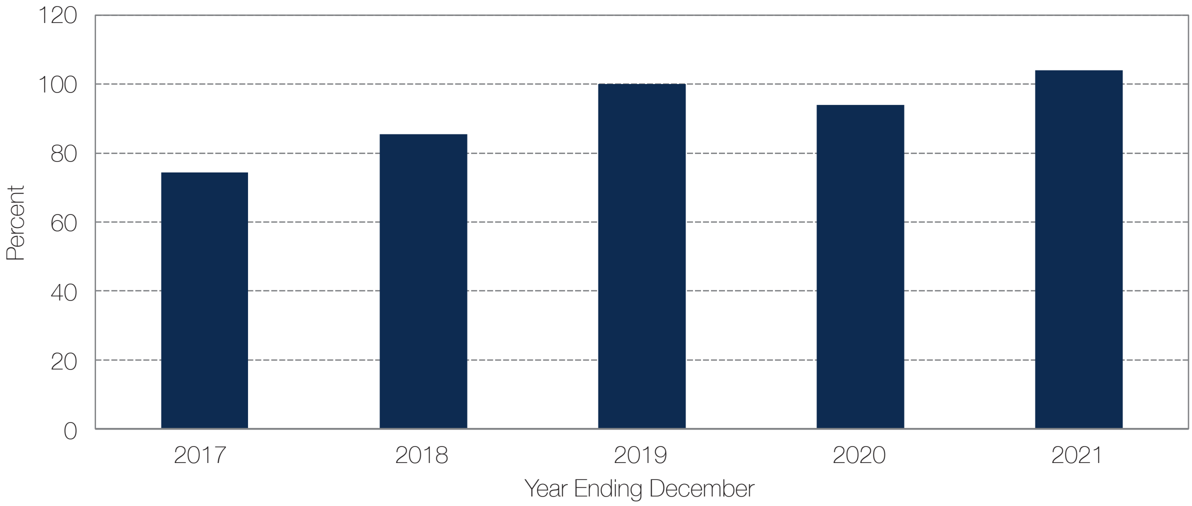
Notes: 1. Parentheses denote negative figures.

2. All figures in the table exclude one statutory bank.

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

2.64 Chart 2.23 presents the trend of the cost-to-income ratio for statutory banks over the five-year period, 2017 – 2021.

Chart 2.23: Statutory Banks: Cost to Income Ratio: 2017 – 2021 (Percent)



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

Operational Risk

Regulatory Capital Requirements in Respect of Operational Risk

2.65 Operational risk RWAs of the two statutory banks slightly declined from P257.7 million in 2020 to P256.8 million in 2021 and contributed 6.6 percent to total RWAs.

2.66 The inherent operational risk for one statutory bank was considered high, while risk management systems and controls were satisfactory. The residual operational risk remained high and is likely to increase over the next 12 months owing to AML/CFT deficiencies, such as an inadequate AML/CFT policy, lack of a mechanism for allocating a risk score to customers, a system to identify and screen all company directors, senior management and ultimate beneficial owners for companies against the sanctions list, and an information management system for monitoring suspicious transactions.

OVERVIEW OF PILLAR 3 DISCLOSURE REQUIREMENTS

2.67 Pursuant to the implementation of the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (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, capital structure, risk management systems, risk profile, corporate governance and internal controls on their websites and through published financial reports.

2.68 During 2021, all banks published information on the capital position, risk profile and risk management systems in accordance with the Pillar 3 circular. Overall, banks were found to be compliant with the requirements of the Capital Directive and Pillar 3 circular, with minor shortcomings noted at a few banks. The Bank continues to guide banks to fully comply with the disclosure and all other regulatory requirements.

BOX 2: ADAPTING BANKING REGULATION AND SUPERVISION FOR CLIMATE CHANGE-RELATED FINANCIAL RISKS

Introduction

There is an increasing recognition that climate change, as a negative externality resulting from the production and consumption of carbon-intensive goods, could be a source of financial instability. Increasingly, the financial system faces challenges arising from the adverse impact of climate change, which increases the risk profile of financial institutions. Physical and transition risks resulting from climate change threatens the safety, efficiency, and soundness of financial institutions. In response, banks are gradually fine-tuning their lending activities to reflect the effects of climate change on their lending activities, all in an effort to reallocate resources from carbon-intensive sectors to economic activities with a low carbon footprint. Most important, they seek to move in tandem with the climate action agenda to limit global warming to 1.5 degrees celsius above pre-industrial levels. For instance, Standard Chartered Bank Group has announced interim targets to cut financed emissions from thermal coal mining, oil, and gas by 2030. Against this backdrop, it has become imperative for banking regulation and supervision to adapt and be more responsive to the emerging climate-related financial risks.

Climate-related financial risks manifest themselves through micro and macro-economic transmission channels. There are two main types of climate-related risk drivers that could adversely impact the banking system–physical risk and transition risks. Physical risks derive from specific adverse weather events and long-term shifts in climate. Adverse weather events include heatwaves, storms, wildfires, and floods. All these can have negative effects on the creditworthiness of borrowers, collateral held by banks against loans and advances, especially physical property, and the value of the banking industry assets. Transition risks relate to the process of adjusting towards a low-carbon economy. Ajustment in carbon taxes and subsidies, policy and regulation, disruptive technology, and changes in consumer preferences could affect the value of the banking industry's balance sheets, as banks strive to align their asset and liability management policies to transtion risks occassioned by policy changes resulting from climate change.

Challenges of Integrating Climate-related Financial Risks into the Prudential Framework

Inevitably, estimating climate-related financial risks is one of the greatest challenges currently facing banking supervisors owing to the long-term nature and extreme uncertainty associated with the evolution of climate change. Notwithstanding this, most supervisory authorities are working on fine-tuning and adapting regulatory and supervisory policies to this constantly changing phenomenon. For instance, in the United Kingdom, banks are required to have comprehensive plans to manage the climate-related financial risks; the requirement includes developing capabilities and tools to measure and manage climate-related financial risks, conducting short and long-term scenario analysis and having clear lines of responsibility for the management of such risks, including at board level. Furthermore, in Lebanon, reserve requirement ratios are based on the amount of loans and advances to sectors that rely on renewable energy and low carbon footprint; Brazil requires commercial banks to integrate environment-related risk factors into their traditional risk management frameworks and conduct stress tests on environmental phenomena, whereas China has adopted the green credit guidelines that encourage banks to adapt their lending activities to low carbon emitting industries.

In other developments, in 2015, the Financial Stability Board set up a task force on climate-related financial disclosures, which aimed to promote climate-related financial disclosures. In 2017, another platform referred to as the Network of Central Banks and Supervisors for Greening the Financial System, was launched to develop bespoke environment and climate-risk management oversight processes for the financial sector and raise funds to support the green economy. Given the foregoing, it is apparent that efforts are underway to incorporate climate-related financial risks into the macro-prudential risk management framework. However, these efforts are largely uncoordinated.

In 2021, the Basel Committee on Banking Supervision (BCBS) issued a consultative paper reviewing some aspects of the Basel capital framework and proposing 18 principles to improve climate-related financial risk management by both banks and supervisors. The proposed BCBS principles cover corporate governance, internal control frameworks, capital and liquidity requirements, risk management processes, risk monitoring and reporting, and scenario analysis. The consultative paper highlighted that the existing Basel Core Principles for Effective Banking Supervision and the supervisory review process were flexible enough to incorporate climate-related risks and further proposed that banks should incorporate climate risk in their internal capital and liquidity assessments.

While the BCBS principles are more focussed on assessing materiality of climate-related financial risks, there has not been any adaptation of the Basel capital requirements to embed climate-related risks into the calculation of risk-weighted assets. Arguments in relation to the omission of climate-related financial risks into the computation of risk-weighted assets have been varied. Higher capital requirements can be deployed to demotivate banks from lending to brown sectors[18],whereas lower capital requirements can be used to incentivise banks' lending to green sectors. There are fears, however, that reducing capital requirements on banks that lend to low-carbon sectors could risk prudential policy objectives of ensuring financial stability. In addition, in a situation where climate-aligned prudential policies have not been enacted and harmonised across all jurisdictions, there is a risk that industries that use carbon-intensive inputs in their production processes could circumvent climate risk-mitigating prudential practices in one market by raising capital in non-compliant markets, which do not recognise the adverse impact of climate-related financial risks. Furthermore, there is a challenge that, if implemented, climate change-aligned prudential policies may fail to distinguish entities with a low-carbon footprint from carbon-intensive firms.

Recommendations for Adapting Banking Regulation and Supervision to Climate-related Financial Risks

Evidence suggests that the transition towards a low-carbon economy, through embedding climate-related financial risks in the existing macro-prudential framework, will not be without challenges. Because of the extreme and radical nature of climate change, conventional after-the-fact risk assessments and current models cannot accurately forecast the future trajectory of climate-related financial risks. As a result, there is need for the development of forward-looking models to capture the impact of climate-related shocks on the macro-prudential variables. As a starting point, supervisors can incorporate climate-related financial risks into the existing risk-based supervision framework, rather than specifying regulatory requirements for climate-related risks as a standalone risk category. In the interim, climate change-related financial risks should be estimated under operational risk. Integrating climate-related financial risks into the existing risk-based supervision framework will require financial institutions to make disclosures to investors and depositors concerning their governance, strategy, and risk management initiatives. The disclosures will foster symmetric information flow, which is a cardinal tenet of a well-functioning financial system. Disclosures also promote consumer choice and preference. Some jurisdictions are considering introducing a Pigouvian[19] carbon tax that would efficiently reallocate capital from carbon-intensive to low carbon emitting sectors.

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18 Pollution producing industries, such as various energy, petroleum, and other extractive industries, chemical industries, and the automotive industry.

19 A tax imposed on a market transaction that creates a negative externality.

Botswana's Policy and the Banking Industry's Response to Climate-related Risks

Although Botswana's carbon emissions footprint is insignificant, the country is a signatory to the Paris Agreement. Some international banking groups with operations in Botswana have announced that, in the future, they expect all their clients involved in mining and metals, and oil and gas production to have a strategy that aligns their operations with the guidelines of the Paris Agreement. Botswana's economy significantly relies on mining and the country's power generation is dependent on coal, which is a source of carbon dioxide, a greenhouse gas. The exposure of the domestic banking sector to the sectors that produce the greenhouse gas as a by-product is significant. Botswana recognises that climate change is a combination of social, economic, and other environmental factors. As a result, the government is developing a comprehensive climate change response policy, which covers the impact of climate change on Botswana's financial services sector.

Conclusion

Banks are pivotal to the speedy transition of the real economy to meet the requirements of initiatives, such as the United Nations Sustainable Development Goals and the 2015 Paris Agreement through the provision of the required capital and services. Therefore, it is also in the interest of banks to move quickly to develop climate-related risk management frameworks, given the scale of the opportunities and the risks that are already present in the financial system. An orderly transition to a net-zero carbon economy, which can be attained with the aid of effective banking regulation, will not only minimise the risks emanating from climate change, but also financial risks faced by firms and the financial system in the future. For its part, Botswana is developing a comprehensive policy response to climate change, which is expected to provide guidance to economic participants on managing climate-generated risks.

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NON-BANK FINANCIAL INSTITUTIONS

Bureaux de Change Activities

Market Entry and Exit

2.69 In 2021, six applications for a bureau de change licence were received by the Bank. Two bureaux de change were licensed and began operating, while seven bureaux de change licences were revoked. As a result, the number of bureaux de change decreased from 58 in 2020 to 53 in 2021. Eight bureaux de change requested and were granted temporary closure in response to the unprecedented decline in business due to the adverse effects of the COVID-19 pandemic.

On-site Examination of Bureaux de Change

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

2.71 The Bank conducted an on-site examination for compliance with anti-money laundering and combating the financing of terrorism (AML/CFT) of two bureaux de change. The on-site examination revealed that each bureau de change complied with most of the provisions of the Regulations and FI Act. There were, however, instances of violations across the two entities, which included inadequate AML/CFT policies and absence of a compliance officer. The exposure to the risk of money laundering and terrorist financing (ML/TF) of the two bureaux de change was high. The level of effectiveness of the risk management process was weak for one bureau de change and adequate for the other. Consequently, the bureau de change which had weak risk management process was fined for violating the FI Act and directed to rectify all compliance deficiencies. Table 2.16 shows a summary of the violations by the two bureaux de change.

Table 2.16: Common and Specific Violation of the Provisions of the FI Act by Bureaux de Change

Provisions of the Regulations	Details of violations
Corporate governance	One bureau de change's AML/CFT policy was inadequate and not approved by the management. Both bureaux de change did not have an AML/CFT compliance officer.
Customer identification programme	One bureau de change did not have documented customer due-diligence and enhanced due-diligence (EDD) procedures. As a result, there was no EDD and monitoring conducted on customers.
Screening of customers against sanctions list	One bureau de change did not screen customers against the sanctions list.
Customer risk assessment	There was no framework for conducting the overall ML/TF risk assessment on key operational areas at one bureau de change. There was absence of a risk-rating process/model to determine the appropriate riskiness of each customer at on-boarding stage at the bureau de change. As a result, customers were not profiled and risk-rated.
Monitoring and reporting of suspicious transactions	One bureau de change did not monitor customer transactions against their profiles.
AML/CFT training programme	One bureau de change did not have an AML/CFT training policy.

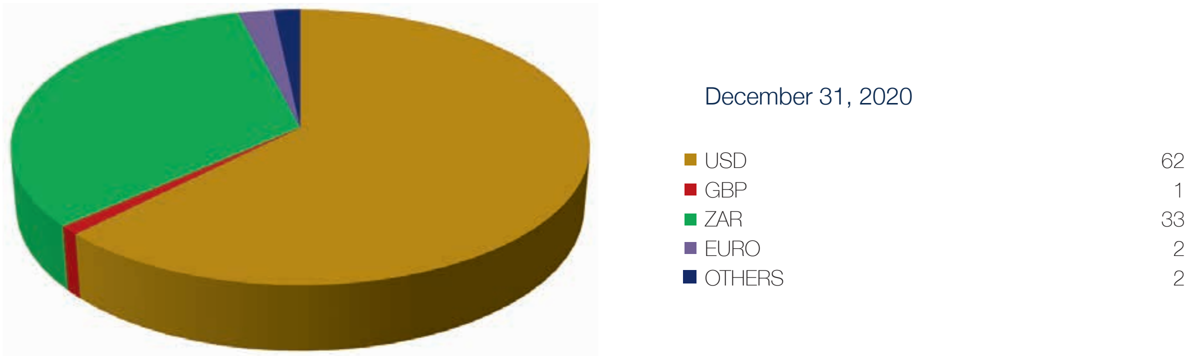
Source: Bank of Botswana.

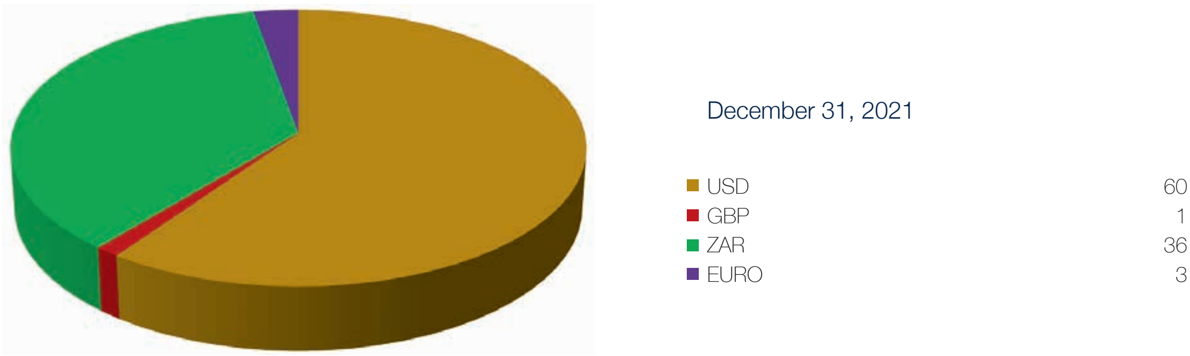
Off-site Surveillance of Bureaux de Change

2.72 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, even though the value of sales of foreign currency at bureaux de change decreased in the review period. The fall in the value of sales was attributed to onerous requirements, including costly COVID-19 tests, for cross-border travel, even with the relaxation of travel restrictions. In contrast, the increase of 6.6 percent in value of purchases reflected the modest recovery in the tourism and hospitality industry as foreign tourists visited, following the easing of travel restrictions. The United States dollar (USD) and South African rand (ZAR) dominated the bureaux de change foreign exchange transactions during 2021.

2.73 Charts 2.24 and 2.25 compare the shares of sales and purchases of various currencies by bureaux de change in 2020 and 2021, while Chart 2.26 shows bureaux de change sale and purchase shares of foreign currency in 2017 to 2021.

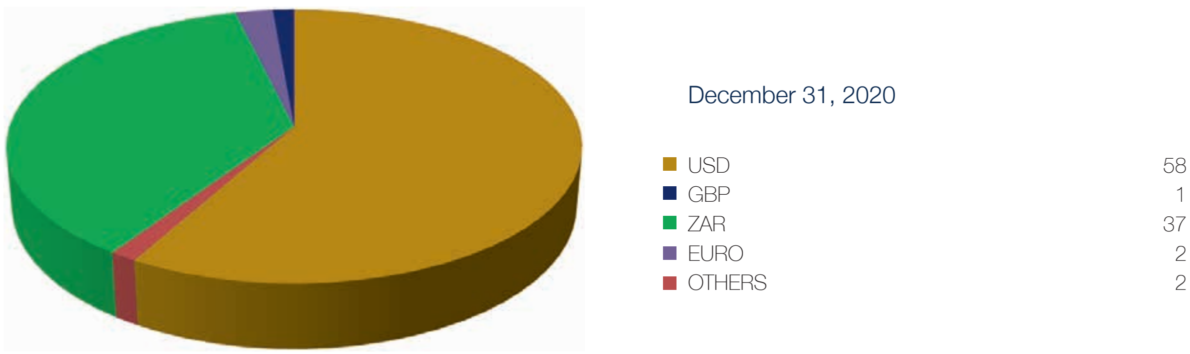
Chart 2.24: Bureaux de Change: Shares of Foreign Currency Sales in 2020 and 2021 (Percent)

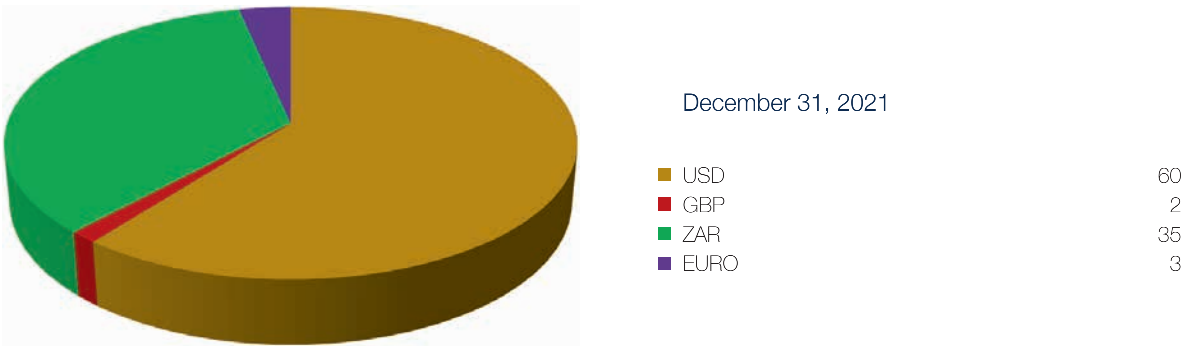




Source: Bureaux de Change (Statutory Returns submitted to the Bank).

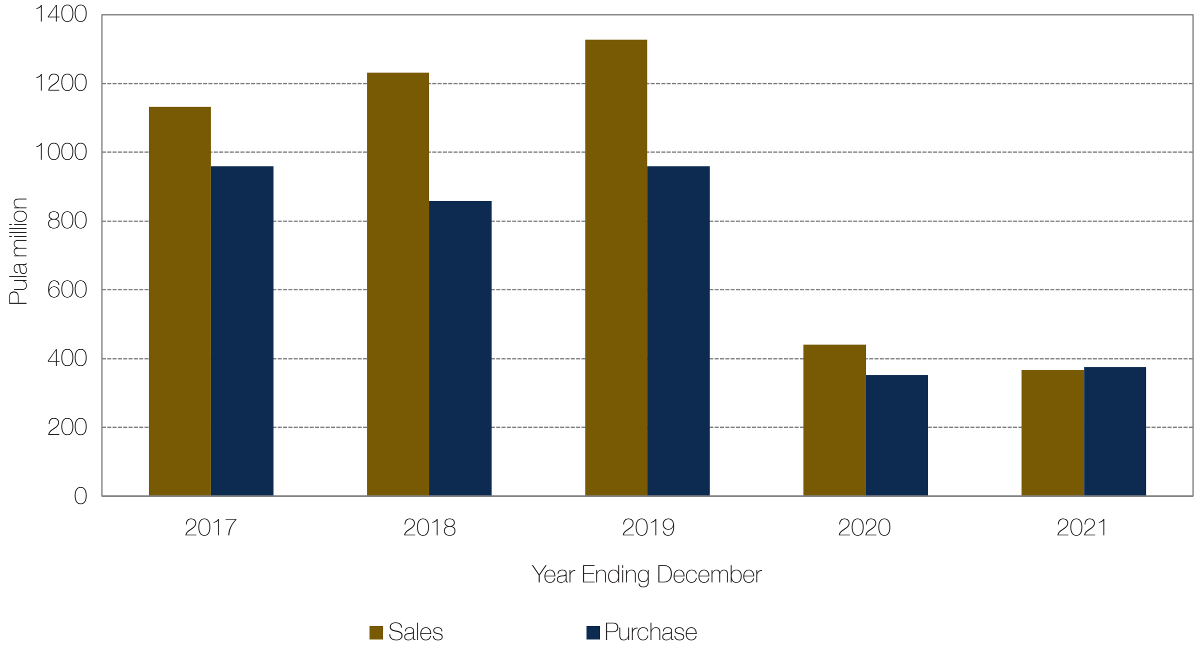
Chart 2.25: Bureaux de Change: Shares of Foreign Currency Purchases in 2020 and 2021 (Percent)





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

Chart 2.26: Bureaux de Change: Sale and Purchase of Foreign Currency: 2017 – 2021 (Value)



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

BOX 3: DEVELOPMENTS IN THE REGIONAL PAYMENT SYSTEM

Introduction

Integration of payment infrastructures is aimed at enabling cross-border payments between countries within the same region. The goal of such an arrangement is to foster increased intra-regional trade, investment and regional economic development, among others. The initiatives for integration of payment infrastructures are in effect enabling the integration of different national payments systems under a set of defined rules and business practices to facilitate a safe, fast, cost-effective and more efficient cross-border payments environment.

The mandate to integrate Southern African Development Community (SADC) payments systems is drawn from Article 3(b) of Annexure 6 of the SADC Protocol on Finance and Investment. The article advocates for cooperation and coordination between central banks and the private sector to define and implement a cross-border payment strategy for the SADC region. The initiative is led by the SADC Committee of Central Bank Governors (CCBG) and executed by the SADC Payment System Subcommittee comprising payments country leaders from SADC central banks. The implementation of both the SADC wholesale and retail payment systems is a significant step towards the realisation of the SADC vision for an African integrated payments system that facilitates closer economic integration and advances the region's aspirations in fulfilling the continental free trade agenda as advocated for by the African Continental Free Trade Agreement (AfCFTA) and to some extent Vision 2063. The regional payments systems therefore continue to evolve and develop in pursuit of economic growth and betterment of livelihoods achieved through some aspects of free and increased intra-regional trade, investment and tourism.

(a) SADC Real Time Gross Settlement System

The SADC Real Time Gross Settlement (RTGS) system is a regional cross-border settlement system, which became operational in July 2013. It is an automated interbank settlement system that settles obligations between participating banks within the SADC region on a gross basis and in real time. The SADC-RTGS system has been designated as a financial market infrastructure (FMI) consistent with the principles for financial market infrastructures (PFMIs) and therefore its objective has always been to achieve safe and secure cross-border payments offered within a well-managed risk environment that contributes to financial stability, while enhancing trade and investment in the SADC region. In addition, the SADC-RTGS system provides a reliable large-value payment service to support the integration of SADC financial services. As a designated FMI, the SADC-RTGS system is vital for the smooth flow of funds within the regional economies and is therefore a cornerstone of deeper financial integration of other continental regional blocs.

The SADC-RTGS system, operated by the South African Reserve Bank (SARB) as appointed and mandated by CCBG, settles transactions in the South African rand (ZAR). The system is considered as an alternative platform to correspondent banking arrangements that have subjected many banks in the region to de-risking by correspondent banks, following anti-money laundering and combating the financing of terrorism and proliferation (AML/CFT) regulatory requirements. In this regard, the SADC Payments System Subcommittee has, since the beginning of operations of the SADC-RTGS system undertaken to adopt improvements of the SADC-RTGS system that would ensure that the system could respond to changing consumer demands, while ensuring high levels of resilience and financial integrity. Some of the ongoing developments include plans to adopt other regional currencies and the United States dollar in the settlement basket. The system is also being reconfigured to align to ISO 20022 Society for Worldwide Interbank Financial Telecommunications (SWIFT) rich-data messaging standards. A payments system management body has been set as an additional structure to facilitate promotion of the SADC-RTGS system and speedy resolution of queries by participating institutions. Furthermore, the rules book is being reviewed to accommodate qualifying non-bank institutions to participate in the settlement system.

Fifteen of the sixteen SADC countries have participants in the SADC-RTGS system. As at end of December 2021, there were eighty-four regional banks participating in the SADC-RTGS system, comprising eight central banks and seventy-six commercial banks. In Botswana, two commercial banks are participants and have had considerable transactions settled in the SADC-RTGS system, accounting for approximately 10 percent in volume and 2 percent in value of the total SADC-RTGS system transactions. The system has registered cumulative 366 719 transactions valued at ZAR1 320 billion.

Specific benefits from use of the SADC-RTGS system, which Botswana businesses can realise include the following:

(i) wider reach of payment services across the SADC region;
(ii) enhanced pricing transparency;
(iii) uniform ways of making payments and payment instruments; and ability to compare services, leading to the use of efficient and cost-effective payment platforms;
(iv) increased cash flow for businesses because of more efficient and speedy payment and settlement; and
(v) further automation of payments, that is, business-to-business trade.

Benefits also extend to member states by reducing risk, as settlement happens in central bank money. There is also increased transparency for regulators, particularly from the point of view of balance of payments statistics and AML/CFT; faster payment and settlement; common standards, processes and formats (payments are made the same way across the region, predictable timeframes in which to make and receive payments); development of new value-added services and innovative products such as e-reconciliation and e-invoicing; and increased choice for service providers.

(b) Transactions Cleared on an Immediate Basis

As part of the broader SADC-payments integration road map and, in response to fintech innovations in the payment ecosystem (mainly because of customer demand for instant payments), the SADC Banking Association, in collaboration with BankservAfrica (Pty) Limited[20] (BankservAfrica), developed a low-value cross-border payment solution for the SADC region, referred to as Transactions Cleared on an Immediate Basis (TCIB). TCIB went live on July 30, 2021, as BankservAfrica successfully processed the first real-time cross-border transaction between a bank in Zimbabwe and non-bank in Namibia and has since then been open for business.

The TCIB payment scheme caters for transfers normally associated with the remittance market but can also be used for any form of low-value credit-push transfers. TCIB is open to all banks and authorised non-banks across the SADC region, undertaking cross-border payment transactions, with integration points into other African regions, including the East African Community and the Common Market for Eastern and Southern Africa and East African Community blocs. TCIB is able to provide cross-border interbank clearing and integration into SADC-RTGS system, fulfilling the need for efficient processing of high-volume day-to-day, low-value payments across the region.

Banks and non-banks are allowed to participate in the TCIB payment scheme, provided that they meet the set TCIB access criteria as defined by BankservAfrica. Transfers take place from bank-to-bank, bank-to-

[20] BankservAfrica is a licensed regional clearing and settlement operator.

non-bank, non-bank to bank, and non-bank to non-bank. The TCIB scheme seeks to enable a payments ecosystem across the SADC region, build a payments platform that connects low-value payments providers, and a payment mechanism that allows for immediate transfer of low-value transactions across countries in the region. TCIB is based on the ISO 20022 messaging standard to enable regulatory reporting requirements and other relevant payment information. The TCIB scheme is designed to be available on a 24/7/365 basis. In the scheme, transactions may be initiated via multiple channels, such as mobile phone, or through an agent used for cash-in and cash-out services. Obligations arising from the TCIB scheme are settled daily through the SADC-RTGS system or via correspondent banking arrangements where the settlement currency is not yet on-boarded on SADC-RTGS system.

The Bank encourages all local banks and non-banking financial institutions to participate in these regional cross-border payment schemes to broaden provision of services and facilitate safe, fast and efficient cross-border services. Prospective participants have to seek the Bank's approval to participate in these cross-border payment schemes.

Conclusion

The successful implementation of SADC-RTGS system and TCIB by SADC-CCBG is a demonstration that achieving regional cross-border payments system integration requires a multi-country agreement about operational standards and cooperation. The benefit of cross-border payments is greater regional competitiveness and the faster and easier regional transactions. For businesses operating in multiple SADC countries, banks making payments across borders, or consumers sending money across the region, payments platforms such as SADC-RTGS system and TCIB, will help to facilitate faster, more transparent and affordable cross-border payments.

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CHAPTER 3
LICENSING AND CONSUMER PROTECTION

CHAPTER 3:
LICENSING AND CONSUMER PROTECTION

MARKET ENTRY ENQUIRIES AND LICENSING OF NEW BANKS

3.1 The Bank received an application for a banking licence by BBSL on August 24, 2021. The application was assessed in accordance with Section 6 of the Banking Act as well as the criteria set out in the Banking Regulations (1995), the Bank's Licensing Policy and Principle 5 of the Basel Core Principles for Effective Banking Supervision (Core Principles). Assessing the application encompassed evaluating the following aspects: ownership structure and governance, proposed bank's board members and senior management (competence, and fit and proper criteria), financial strength of the proposed bank and ability to provide additional capital if required, strategic and operating plans for the proposed bank, risk management and internal controls, and projected financial condition of the resultant bank. Following assessment, the application was granted a conditional approval on November 1, 2021.

3.2 On January 20, 2021, the Bank received and assessed an application for a purchase and acquisition transaction involving sale of the entire ordinary shares held by African Banking Corporation Holdings Limited (ABCH) in the Botswana subsidiary, African Banking Corporation of Botswana Limited (BancABC), to Access Bank PLC, a pan-African bank originating and headquartered in Nigeria. The application was also assessed in accordance with the requirements of the Banking Act, Licensing Policy and the Core Principles.

3.3 Following the board approval and subsequent consummation of the sale agreement between ABCH and Access Bank PLC, the purchase and acquisition transaction resulted in effective transfer of the strategic ownership and control of BancABC to Access Bank PLC, with a singular majority shareholding of 78.15 percent. The remaining shares of 21.85 percent are listed and traded on the Botswana Stock Exchange Limited, thus held by the public. Following the satisfaction of all conditions set by the Bank for the transaction, by ABCH and Access Bank PLC, the Bank issued Access Bank Botswana Limited with a banking licence on November 9, 2021.

3.4 In addition, four banking licence enquiries were received during the year, none of which resulted in an application for a banking licence.

ILLEGAL DEPOSIT TAKING

3.5 The Bank investigated Crowd1, EnergyGlass Africa (Pty) Ltd (Energy Glass) and Dafritech (Pty) Ltd (Dafritech) on suspicion that the entities were conducting illegal deposit-taking activities. With respect to Crowd1, the Bank received an enquiry from an individual regarding failure by Crowd1 to pay him the return promised by the promoters on the investment. An investigation of the business activities of Crowd1 revealed that the activities resembled those of a pyramid scheme as defined under Section 9(2)(a) of the Consumer Protection Act 2018 (Cap. 42:07). Consequently, a letter was written to the complainant informing him that the operations of Crowd1 did not fall within the supervisory purview of the Bank and was advised to contact the Competition and Consumer Authority for further guidance.

3.6 EnergyGlass and Dafritech were investigated following a report by the Consumer Watchdog. The Bank conducted investigations of the operations of the two entities and concluded that Energy Glass and Dafritech were conducting illegal deposit-taking activities, contravening Section 3(1) of the Banking Act. In accordance with Section 5(5) of the Banking Act, the Bank issued a cease-and-desist order to both entities. Energy Glass was ordered to reimburse deposits to the rightful owners or beneficiaries. Meanwhile, Dafritech was ordered to cease soliciting funds from the public with immediate effect and to stop operating as an agent of Dafribank Digital Limited without the authority from the Bank.

COMMERCIAL BANK INTEREST RATES AND CHARGES

Interest Rates and Policy

3.7 In 2021, the Bank Rate was maintained at 3.75 percent. Owing to the increased competition for deposits, however, some banks increased deposit rates on some deposit products, to both reward depositors and ensure a stable supply of funds.

3.8 All banks complied with the disclosure framework for deposit rates, which requires that the interest rate payable on the 91-day deposit should at a minimum be 350 basis points below the prevailing Bank Rate, while longer-dated deposit rates are proportionately higher. The interest rate on the 91-day fixed deposit fell by 50 basis points from 0.75 percent in 2020 to 0.25 percent in 2021. Commercial and statutory banks continued to publish indicative ranges of deposit rates payable on various products they offer as shown, for instance, in Table 3.1 as at December 31, 2021; the publications are in compliance with the disclosure requirements that banks publish the deposit interest rates they offer in at least two newspapers widely circulating in Botswana.

3.9 Table 3.2 indicates a range of lending rates offered by banks as of December 31, 2021. The differential between the lowest and highest interest rates charged are generally significantly high, with unsecured loans tending to be costlier than secured loans, which attract lower interest rates.

Table 3.1: Commercial Banks: Deposit Rates as at December 31, 2021

Deposit Product	Deposit Rates (Annual Percent)	
	Lowest	Highest
Current account	0.00	2.48
Savings*	0.00	4.80
Call	0.00	3.00
91 days	0.25	1.50
6 months	0.73	2.50
12 months	0.50	3.00
24 months	0.56	4.65
Prime lending rate	5.25	

*Savings include both ordinary and special savings accounts.

Source: Various Newspapers.

Table 3.2: Commercial Banks: Lending Rates as at December 31, 2021

Lending Product	Lending Rates (annual percent)	
	Lowest	Highest
Mortgage Rate	2.25	11.25
Overdraft Rate (revolving credit lines)	2.50	84*
Credit Card Rate	16.59	36
Lease loans	5.25	22.50
Personal loans (excluding overdrafts, mortgage, and credit cards)	0.00	24.25
Other long-term loan rates	2.50	84**
Prime Rate	5.25	

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

** Interest rate 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

3.10 Table 3.3 presents average charges for selected banking services in 2021. The structure is based on four broad categories of frequently applied charges, namely, access facilitation, investment/intermediation, trade facilitation, and payment and clearing charges. The data shows that the cost of financial services was generally higher in 2021 than in 2020.

Table 3.3: Selected Commercial Banks Average Charges: 2020 and 2021 (Pula)

Category of Charged Services (Pula)	2020	2021	Growth Rate (Percent)
Access Facilitation			
(i) Cash withdrawal (own bank)	3.07	3.16	2.99
(ii) Lost ATM card replacement	70.67	70.63	(0.05)
(iii) Point of sale	0.79	0.97	22.84
Internet banking			
(i) Monthly fees	120.24	128.80	7.11
(ii) Transfers (third party within a bank)	4.13	3.47	(16.04)
Mobile banking			
(i) Utility bill payments	2.70	2.80	4.04
(ii) Payment to third-party accounts	2.81	2.95	4.96
(iii) Buy pre-paid airtime	0.33	0.25	(22.95)
(vi) Cash send/e-wallet/instant money	8.59	7.52	(12.37)
Investment/Intermediation			
(i) Personal loan arrangement fee (minimum)	476.38	487.45	2.32
(ii) Vehicle/asset finance arrangement fee (minimum)	701.06	719.80	2.67
(iii) Mortgage arrangement fee (minimum)	735.52	698.06	(5.09)
Trade Facilitation			
(i) Purchase of foreign notes (minimum)	28.49	30.27	6.25
(ii) International SWIFT transfer (maximum)	340.23	381.59	12.16
(iii) Advising commission on letters of credit (minimum)	238.24	244.33	2.56
(iv) Real time gross settlement (maximum)	181.72	206.34	13.54
(v) Transfer to accounts at foreign banks (maximum)	308.02	313.76	1.86
Payment and Clearing			
(i) Standard cheque book (20 – 50 pages)	51.30	59.81	16.58
(ii) Unpaid cheque due to lack of funds	243.25	271.93	11.93

Note: 1. Parentheses denote negative figures.

Source: Commercial Banks.

CONSUMER COMPLAINTS MANAGEMENT

3.11 In 2021, the Bank received and processed 14 new complaints involving six banks, while six complaints were brought forward from the previous year. Sixteen complaints were resolved, while four were under consideration. As shown in Table 3.4, the complaints mainly related to unfair handling of loans and unauthorised transactions.

Table 3.4: Commercial Banks' Consumer Complaints in 2021

Type of complaint	Received	Resolved	Total outstanding as at December 31, 2021
Unsatisfactory service	4	4	0
Unfair handling of loans	9	9	0
Unauthorised transactions	5	3	2
Disputed mortgage/credit card insurance covers	2	0	2
Total	**20**	**16**	**4**

Source: Bank of Botswana.

ABANDONED FUNDS

3.12 In accordance with Section 39 of the Banking Act, the Bank administered abandoned funds received from commercial banks. Table 3.5 shows that the balance of abandoned funds slightly increased by 0.1 percent from P17 674 953 in 2020 to P17 689 359 in 2021.

Table 3.5: Total Abandoned Funds from Commercial Banks in 2020 and 2021

	2020 Pula	2021 Pula
Balance brought forward	16 917 687	17 674 952
Funds received	3 033 188	2 197 779
Claims paid	(258 154)	(189 890)
Refund to banks	-	(1 518)
Transfer to Guardian Fund	(2 017 768)	(1 991 964)
Balance at year-end	**17 674 953**	**17 689 359**

Note: Parentheses denote Pula amount paid out.

Source: Commercial Banks.

CORPORATE GOVERNANCE

3.13 Consistent with the requirements of Section 29 of the Banking Act, the 2008 Guidelines on the Appointment of New Directors and Senior Management Officials of Banks, banks continued to appoint board and senior management officials who satisfied the fitness and propriety criteria for eligibility to be appointed to senior management roles in licensed banks. The Bank received 12 applications for appointment to boards of banks and 17 notifications of senior management appointments. For the 24 proposed appointments, the Bank had no objections, as the candidates satisfied the minimum requirements stipulated in the guidelines, while there was objection with respect to five candidates. Of the five candidates whose appointments were objected to, four of them were branch managers whom a bank was proposing to designate as senior management officials; branch managers did not qualify for designation as senior management officials according to Clause 2.9 of the Guidelines on Appointment of New Directors and Senior Management Officials of Banks. The fifth candidate did not qualify to be appointed as an executive director of the bank proposing the appointment, as he was not an employee of the bank proposing to appoint him. The majority of appointments for which there was no objection were Botswana nationals who accounted for 66.7 percent of the board and senior management officials compared with 46.2 percent in 2020.

Table 3.6: Number of Board and Senior Management Approvals in 2020 and 2021

	2020	2021
Number of Board approvals	**14**	**11**
Foreigners	5	4
Locals	9	7
Number of senior management approvals	**12**	**13**
Foreigners	9	4
Locals	3	9
Objections	**0**	**5**
Total number of approvals	**26**	**29**

Source: Bank of Botswana

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

Action to address the Financial Action Task Force action plan

3.14 In October 2018, Botswana was placed under increased monitoring (commonly referred to as the grey list) by the Financial Action Task Force (FATF) on account of what was deemed to be deficiencies in complying with AML/CFT requirements. Following concerted efforts by all concerned parties in the country, including the Bank, to strengthen the effectiveness of its AML/CFT regime, at its October 2021 plenary meeting, FATF determined that Botswana had strengthened its AML/CFT regime and also addressed related technical deficiencies. Consequently, FATF removed the country from the list of countries subject to FATF's enhanced-monitoring regime. The European Union (EU) also removed Botswana from the EU blacklist of high-risk third countries on January 7, 2022. The country was encouraged to sustain its strong political commitment to AML/CFT and promote coordination and cooperation among all stakeholders. The removal from the grey list is expected to have a positive effect on the domestic financial system and, broadly, on the economic development of the country. In addition, the removal from the FATF greylist and EU blacklist should contribute to restoration of the reputation of Botswana as a transparent and credible investment haven as well as reduce the cost of correspondent banking relationship and improve access to global markets by economic agents based in Botswana.

Action to address technical compliance deficiencies and re-rating

3.15 To address the technical compliance deficiencies identified in the 2017 AML/CFT mutual evaluation conducted by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), the country amended various pieces of legislation in 2020 and requested a rerating from the ESAAMLG in 2020 and 2021. Table 3.7 below compares the 2017 mutual evaluation report (MER) ratings with the 2019, 2020 and 2021 rerating outcomes.

Table 3.7: Technical Compliance Ratings for Botswana (2017, 2019, 2020 and 2021)

	2017 MER	2019 MER Rerating	2020 MER Rerating	2021 MER Rerating
Compliant	0	6	6	7
Largely compliant	2	13	16	22
Partially compliant	14	16	13	8
Non-compliant	23	4	4	2
Non-applicable	1	1	1	1

Source: Eastern and Southern Africa Anti-Money Laundering Group: 5th Enhanced Follow-up Report and Technical Compliance Rerating

BOX 4: GOVERNANCE, REGULATION AND SUPERVISION OF CREDIT REFERENCE BUREAUS

Introduction

The accessibility of finance by firms and entrepreneurs is often constrained by the unavailability of information on their creditworthiness. Credit bureaus, both public and private, exist to improve the availability of information to lending firms (and individuals) to use in assessing applications for financing. Information provided by credit bureaus about borrowers' state of financial affairs can allow lenders to supply credit at suitable interest rates.

Botswana has three operating credit bureaus, namely, TransUnion Botswana, Credit Reference Bureau and Experian Botswana, all of which are subsidiaries of South African-based credit bureau entities. The three operate in accordance with the requirements of the Companies Act (Cap. 42:01) and Regulations, with their activities in Botswana neither regulated nor supervised. On August 31, 2021, a Credit Information Act (CIA) was passed providing for the regulation of the credit reporting system, licensing and supervision of credit bureaus by the Bank of Botswana (Bank). The CIA seeks to provide a legal framework within which both positive and negative financial information of borrowers will be made available to improve access to credit by borrowers.

This article highlights the available legal frameworks for credit information sharing, the advantages of credit information sharing, the type(s) of information shared, data protection, consumer complaints management and conclusion.

Legal and Regulatory Framework for Credit Bureaus

Different countries have adopted varying legal and regulatory frameworks overseeing credit information-sharing institutions. In Botswana, credit bureaus have been operating without any legal and regulatory framework. However, following the enactment of the credit information legislation, the Bank was designated the regulatory and supervisory authority for credit bureaus, which includes ensuring protection of consumer information from loss, misuse and unathorised access. For purposes of smooth supervision of credit bureaus, the CIA empowers the Bank to ensure compliance with the laws and regulations governing credit bureaus, take supervisory actions against violations by the credit bureaus, including revocation of a licence. Furthermore, the CIA empowers the Bank to investigate a complaint on its own initiative or on receipt of one.

There are two regulatory approaches: a hands-off or hands-on approach. With the hands-on approach, the regulator is more involved through establishing laws or regulations; in the hands-off approach there are laws and regulations, but the regulator is less involved in the operations of credit bureaux. Many countries adopt a hands-off approach while others choose to be more hands-on and establish laws and/or regulations governing credit-information sharing. In the case of Botswana, a hands-on approach will be adopted as envisaged by the CIA.

Advantages of Credit Information Sharing

Availability of good quality and standardised credit information enables credit service providers to make informed decisions when evaluating credit applications. Accessing good-quality data is crucial for credit and risk assessments as well as for implementation of policies that support responsible consumer lending and services, which is key to supporting economic growth.

Sharing information about borrowers' characteristics and their indebtedness can have important effects on credit markets activity. The benefits of credit-information sharing to lenders, borrowers and the economy at large include the following:

(a) increases lenders' knowledge of the applicants' characteristics, hence allowing a more accurate prediction of borrowers' repayment probabilities;

(b) mitigates adverse selection and thus increase the financial institutions' ability to screen borrowers, which could result in those institutions offering larger loans at lower interest rates to borrowers with low credit risk.

(c) eliminates borrowers' incentive to become over indebted by taking credit simultaneously from many lending institutions. Information sharing between lenders reveals borrowers' debt exposure to all participating lenders, eventually reducing aggregate indebtedness as highly indebted individuals would receive less credit to reduce the default rate;

(d) acts as a borrower discipline device; borrowers may improve their payment performance knowing that information on their payment profiles is available to other financial service providers. Consequently, this could reduce delinquent payment on loans. It can also increase borrowers' chances of obtaining credit in the future and negotiating more favourable loan terms; and

(e) reduces the information asymmetry between lenders and borrowers; lenders with long-standing relationships with their borrowers know the credit history of those borrowers, while other lending institutions do not have access to this information. This can present an opportunity for such lenders to charge exorbitant interest rates and extract other payments (for example, deferred interest charges on promotional financing offers) from those high-quality borrowers.

From a supervisory perspective, the regulation of credit bureaus in Botswana will help with crucial historical data that could help supervisors with monitoring and preventing systemic risk. Data collected by credit bureaus will be a reliable aid to the performance of the following risk-monitoring functions:
(a) assessment of risk concentration;
(b) evaluation of the level of customer indebtedness as a key indicator of the risk of consumer credit crisis;
(c) assessment of the evolution of credit risk at specific sector/industry/geographical level; and
(d) assessment of credit risk by carrying out comparisons between performing and non-performing loans status reported about borrowers who are served by multiple banks.

Type of Information Shared

In addition to personal identity information of the data subject, credit bureaus store and share both positive (that is, outstanding loan amounts and a pattern of on-time payments) and adverse information (that is, late payments and the amount in default) relating to a data subject such as

(a) credit history: this includes the applications for credit and agreements that a data subject has been party to in terms of which credit is extended, patterns of payments, incidents of enforcement actions and the circumstances of termination of such agreement;

(b) financial history: it includes the data subject's past and current income, assets, debts and other matters within the scope of the borrower's financial means, prospects and obligations; and

(c) court judgement related to the data subject's debts.

Data Protection

Data protection and the right to privacy are fundamental to the establishment of a credit bureau. In an unregulated environment, borrowers would be reluctant to allow lending institutions to access their credit information and lending institutions would also be reluctant to share their information for fear of unknown retaliation from an uncertain legal environment. Existence of statutorily regulated credit bureau enables guaranteed protection of privacy in that there is a rule-based management of third-party information exchange between financiers. In Botswana, the CIA provides for the responsibilities and obligations that data providers, users and credit bureaus have as well as the rights of the data subjects.

The CIA lists the obligations of data providers or those who submit customer information to a credit bureau. These obligations include

(a) providing both positive and adverse information to credit bureaus in respect of a data subject;
(b) providing written notice to a customer prior to giving adverse customer information to other stakeholders;
(c) ensuring the integrity of information by preventing unauthorised destruction and/or unauthorised access to customer information; and
(d) ensuring information is accurate, complete, relevant, current and not misleading.

Data providers may be banks, non-bank financial institutions, or any person whose business is providing finance for the acquisition of goods and services.

In addition, the CIA lists the responsibilities of data users who access the information of credit bureaus, which include the following:

(a) notifying a consumer if a negative action has been taken on the basis of a credit report (for example, a loan has been denied because of a poor credit report);
(b) notifying the consumer of the source of the report (that is, the credit bureau from which it originated) to allow the consumer to verify its content;
(c) ensuring that consumer information is used for purposes that do not contravene the act; and
(d) ensuring protection of the confidentiality of the information.

While consumer information can be accessed from the credit bureau by any data user, the data subjects or consumers equally have rights to protect them against the unfair use of their credit information. The rights of the data subject include the right to access a free copy of their credit report. The information should include the list of users that have accessed the data subject's information in the previous six months.

Consumer Complaints Management

Where a consumer has a complaint about the information on a credit report that was issued by a credit bureau, the consumer is entitled to lodge a complaint with the concerned credit bureau. Credit bureaus will be expected to establish and make available in writing, a consumer complaint management procedure for dealing with complaints made by data subjects, including designating a person responsible for implementing and administering the procedure. A credit bureau shall periodically submit a register of complaints to the Bank and indicate how they were dealt with.

Conclusion

The regulation of a credit reporting system will significantly contribute to improving access to credit, especially to the small and medium-sized enterprises because availability of credit information to lending institutions may lead to increased credit issuance at favourable interest rates. From a supervisory perspective, an exchange of credit data would be used both to strengthen bank supervision and to improve the quality of credit analysis by financial institutions. Overall, credit-information sharing should bolster the stability and soundness of the financial system, it promotes transparency and less information asymmetry amongst creditors in as far as it relates to creditworthiness of borrowers.

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CHAPTER 4

OTHER SUPERVISORY ACTIVITIES

CHAPTER 4:
OTHER SUPERVISORY ACTIVITIES

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

4.1 The Basel Committee on Banking Supervision (BCBS) issued new and revised guidelines and standards for the regulation and supervision of banks and banking groups. The following reports, guidelines and standards were issued in 2021:

(a) Principles for Operational Resilience on March 31, 2021. The principles aim to strengthen the ability of banks to withstand operational risk-related events that could cause significant operational failures or wide-scale disruptions in financial markets, such as pandemics, cyber incidents, technology failures or natural disasters.

(b) Climate-related Risk Drivers and their Transmission Channels on April 14, 2021. The report explores how climate-related risk drivers, including physical risks and transition risks, can arise and affect both banks and the banking system through micro- and macro-economic transmission channels.

(c) Climate-related Financial Risks–Measurement Methodology on April 14, 2021. The report provides an overview of conceptual issues related to climate-related financial risk measurement and methodologies, as well as practical implementation by banks and banking supervisors.

(d) Technical Amendments - Minimum Haircuts Floors for Securities Financing Transaction on July 1, 2021. The report sets out two technical amendments to the standard on minimum haircut floors for securities financing transactions (SFTs). The technical amendments address an interpretative issue relating to collateral upgrade transactions and correct for a misstatement of the formula used to calculate haircut floors for netting sets of STFs.

(e) Early Lessons from the COVID-19 Pandemic on the Basel Reforms on July 6, 2021. The report provides a preliminary assessment of whether the Basel reforms, which were developed in response to the global financial crisis of 2007 - 09 and implemented have thus far achieved the purpose in the light of the COVID-19 pandemic, which has resulted in a pronounced global economic shock, albeit one significantly different in nature from the financial crisis that motivated the reforms.

(f) Revisions to Market Risk Disclosure Requirements on November 11, 2021. The market risk disclosure requirements include several adjustments to reflect the revised market-risk framework introduced in minimum capital requirements for market risk in January 2019.

(g) Voluntary Disclosure of Sovereign Exposures on November 11, 2021. The voluntary disclosure standards for sovereign exposures comprise three templates for banks to use when disclosing their sovereign exposures and risk-weighted assets by jurisdictional breakdown, currency breakdown, and according to the accounting classification of the exposures.

PARTICIPATION IN INTERNATIONAL AND DOMESTIC REGULATORY AND SUPERVISORY FORUMS

Supervisory Colleges

4.2 During 2021, the Bank participated in supervisory college[21] virtual meetings for three commercial banks; the meetings were organised by home supervisors of the parent banks of banking groups with subsidiaries in Botswana.

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

4.3 The supervisory college meetings were held in compliance with core principle 13 of the Basel Core Principles for Effective Banking Supervision. The principle requires home supervisors to establish bank-specific supervisory college meetings for banking groups and host supervisors. The objective of the supervisory college meetings was 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 as well as the implications of the unwinding of the COVID-19 policy response measures on the group's performance growth strategies in the light of the COVID-19 pandemic, risk management strategies, business conduct, oversight by boards of directors of these banks, increased credit risk due to high non-performing loans and the negative impact of COVID-19, and increased operational risk resulting from the use of digital banking platforms by customers.

Other Supervisory Matters

4.4 The Bank continued compiling financial soundness indicators for disseminating to different stakeholders through posting on the Bank's and International Monetary Fund's websites as well as the African Development Bank's Open Data Platform website.

4.5 On August 9–20, 2021, the Bank hosted a Basel III liquidity standards implementation follow-up technical assistance (TA) mission facilitated by the International Monetary Fund Africa Regional Technical Assistance Center, South. The purpose of the TA mission was to assist with the implementation of the new liquidity standards, namely, liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) and to address skills deficiency. The TA mission has assisted the bank in assessing the readiness of the banking industry to adopt the new liquidity standards and in preparing for another LCR and NSFR survey round that was conducted in December 2021, aimed at strengthening the impact assessment process. The Bank is analysing the data collected through the LCR and NSFR survey.

4.6 As part of the implementation of Pillar 2, the Bank continued to receive internal capital adequacy assessment process (ICAAP) reports for banks. During the year the Bank received the 2020 ICAAP reports for six banks. The Bank reviewed the 2019 ICAAP report for one bank and subsequently held a virtual meeting with the bank for presentation of the ICAAP report for which assessment feedback was later provided.

Bank of Baroda (Botswana) Limited's Take-over of Loans and Advances, and Deposits of Bank SBI Botswana Limited

4.7 At a meeting held on March 25, 2021, the Bank's Board approved an application by Baroda to take over deposits and performing loans and advances of Bank SBI as well as Bank SBI's request to surrender its banking licence and cease to operate as a bank in Botswana. Accordingly, the public was notified to, thereafter, not to transact banking business with any person purporting to represent and/or trade in the name of Bank SBI; the bank surrendered its banking licence and ceased operating on June 30, 2021.

BOX 5: IMPLICATIONS OF THE USE OF REGULATORY AND SUPERVISORY TECHNOLOGY BY SUPERVISORY AUTHORITIES AND REGULATED INSTITUTIONS

Introduction

Following the 2007/8 Global Financial Crisis, the emergence of financial technology (fintech) is rapidly changing the landscape of the entire financial system and how it functions. Of late, the coronavirus disease (COVID-19) has also accelerated trends in digital adoption. Changes such as increased modes of digital payments have made it more essential to have resilient and accessible central bank-operated payment infrastructures that are able to withstand a wide range of shocks, including pandemics and cyber-attacks, as well as accumulation of customer data to perform enhanced credit analytics.

The popularity of fintech stems from the fact that it has a competitive advantage over traditional methods of providing financial services, as it offers efficient, accessible and convenient service provision. According to the Financial Stability Board, fintech refers to technologically enabled innovation in financial services that results in new business models, applications, processes or products with a material effect on financial markets. The implementation of fintech has covered areas such as payments, personal finance, lending, investment and banking. Although the use of fintech in Botswana is still at inchoate stages, a notable development in the local financial market is the collaboration of some commercial banks with mobile telecommunications-service providers for the provision of electronic money services in a bid to serve the underserved and unbanked population.

Beyond the use of fintech in financial services offering, the continually evolving financial regulatory landscape has given rise to the greater use of technology aimed at improving regulatory reporting and compliance (regulatory technology (regtech)) and overall supervision of financial institutions (supervisory technology (suptech)).

Implications of Adoption of Financial Technology for Regulatory and Supervisory Processes

Regtech and suptech solutions are subsets of fintech that automate regulatory and supervisory activities, respectively. Regtech focusses on technologies that facilitate the delivery of regulatory requirements more efficiently and effectively while suptech uses innovative technology to support supervision of financial institutions.

(a) Application of Regtech

Regulatory requirements placed on financial institutions have significantly increased in the last decade. These were mainly driven by market failures during the Global Financial Crisis as well as the increased complexity of financial services. In response, a number of supervised entities seek to leverage digital technology to assist with regulatory compliance. The use of regtech offers the following solutions for financial institutions:

(i) Compliance: a solution through which regulatory requirements are embedded into information technology (IT) protocols of a financial institution to ensure continuous compliance. This approach allows for changes in regulations to be readily identified and incorporated into the IT systems to assist institutions to stay up to date with regulatory requirements, identify potential financial crimes and maintain effective financial-risk monitoring and reporting systems.

(ii) Identity management and control: this offers tools that are particularly relevant to AML/CFT through conducting sufficient due-diligence processes, fraud detection, and know-your-customer procedures. For instance, it includes the digitalisation of partner on-boarding processes, submission of customer information and the identification and reporting of suspicious transactions.

(iii) Risk management: this involves automatically identifying and monitoring risks according to internal and regulatory thresholds. The solution involves creating automatic trigger alerts when predetermined risk levels are reached.

(b) Application of Suptech

The changes brought by technology-driven innovation in financial services provision have made it essential for regulators to shift away from resource-intensive current practices such as lengthy on-site inspections and manual submission and processing of data to a more pro-active and forward-looking approach to supervision. Several financial authorities are exploring opportunities to automate the supervisory process. Suptech offers the following solutions:

(i) data input efficiencies using tools that create a standard format for the automatic collection of data from supervised entities;

(ii) data-extraction using automatic processes controlled by the supervisor to collect and standardise raw business data directly from the institutions' operational systems;

(iii) dynamic predictive supervision that allows supervisors to view operational data at will by directly accessing the institutions' operational systems, which could assist in monitoring some business processes on a real-time basis; and

(iv) regulatory submissions and data-quality management through automatic procedures created to manage submissions from reporting institutions and ensure the quality of the reported data.

Benefits of the Adoption of Regtech and Suptech

The successful implementation of regtech could result in automated and improved processes for fraud detection, regulatory reporting, data collection and risk management, which would reduce operating costs and regulatory compliance risk and improve operational efficiency. Furthermore, the use of suptech reduces manual intervention, thus resulting in enhanced effectiveness, reduced costs and improved capabilities. Suptech reduces the operational risk arising from collecting data through reports submitted in documentary form. In addition, digitised validation, storage and analysis of data assists in assessing the implementation of recommended supervisory action plan aimed at improving business conditions and the health of financial institutions. Supervisors would also be able to enforce pre-emptive and early-supervisory actions to avert materialisation of potential problems.

Challenges of Adoption of Regtech and Suptech

Despite the benefits of regtech and suptech, these technologies also introduce inevitable risks to the financial system. It is imperative to understand the risks associated with the use of these financial technologies to be better able to establish mitigating factors.

At the centre of fintech, and by extension, regtech and suptech, is the use of large amounts of digital data (big data) made possible by the development of advanced data analytics and processing capacity. The downside, however, is that the use of big data raises concern over data protection and privacy, bank secrecy, cyber security, and data management risks of fraud and unfair and discriminatory uses of data. There are challenges inhibiting the seamless adoption of regtech and suptech, as most entities are not readily positioned to automate processes because of limited expertise and high implementation costs.

Other challenges preventing the faster adoption of these technologies are that potential users of these technologies do not fully understand concepts such as artificial intelligence and machine learning that are synonymous with the use of financial technologies. Furthermore, the number of experts such as engineers and model designers in the regtech and suptech realm is limited, making the adoption of technology a risky and costly move. For suptech, there may be need for establishing separate regulatory structures to adopt the new technologies parallel to the existing structures to facilitate a move-over and that may prove difficult to accommodate. Authorities are still looking to establish ways to manage all fintech risks while harnessing the benefits to ensure a stable, safer and resilient financial system.

Conclusion

The vast benefits of adoption of financial technology to help improve regulatory processes are widely documented. Supervisors and financial institutions have to date, however, not been able to adopt the new generation of technology more readily, owing to various challenges. Coordinated efforts are required for both supervisors and financial institutions to better embrace the technologically driven future path of financial-services provision. The new trends present an opportunity for regulatory authorities and financial institutions to prepare and shift towards becoming the institutions and supervisors of the future.

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CHAPTER 5

SUMMARY OF HIGHLIGHTS OF THE ON-SITE EXAMINATION OF BANKS AND PRUDENTIAL MEETINGS

CHAPTER 5:

SUMMARY OF HIGHLIGHTS OF THE ON-SITE EXAMINATION OF BANKS AND PRUDENTIAL MEETINGS

EXAMINATION OF COMMERCIAL BANKS

Prudential Supervision On-site Examination

5.1 The Bank conducted limited-scope on-site examination of one commercial bank in 2021 to assess the bank's asset quality and validate progress made by the bank in addressing the shortcomings that were raised during the 2018 limited-scope on-site examination. The Bank also carried out a follow-up on-site examination of two commercial banks to assess the adequacy of remedial actions from the 2019 full-scope on-site examination of the two banks. The follow-up on-site examination of the first bank focussed on the review of the bank's strategic, credit and operational risks, capital management and sensitivity to market risk. For the second bank, the objective of the follow-up on-site examination was to assess the board and senior management oversight and governance risk, and management of credit, liquidity and operational risks.

5.2 The limited-scope on-site examination of one commercial bank revealed that some NPLs of more than 180 days, which were not secured had not been written off, although the banks's loan write-off policy requires that all unsecured NPLs of more than 180 days be written off as non-bankable assets.

5.3 With respect to progress validation, the bank had addressed most shortcomings that were raised in the 2018 on-site examination. In addition, the bank had comprehensive credit-risk governance structures responsible for approving, monitoring and overseeing the credit-risk management and exposures of the bank and has a Board Credit Risk Committee, which was considered independent and made decisions within its delegated mandate. The unresolved issues comprised inadequate board training, governance policies that were not reviewed on time, loan security documents that were not in the bank's possession and invalid insurance policies relating to customer credit facilities. The bank was directed to rectify all the supervisory concerns and submit quarterly progress updates to the Bank.

5.4 The follow-up on-site examination of the first bank established that the bank had adequately addressed most supervisory concerns on governance risk. The bank, however, did not set a tenure for board members, thus the bank's board chairperson had exceeded a tenure of nine years, which has the potential to compromise his independence in decision making. In addition, the bank did not have a board succession plan. Furthermore, the bank did not conduct a comprehensive risk assessment of renegotiated and restructured loans to determine the customer's creditworthiness, which could result in inadequate risk identification and measurement of credit risk from those loans. There was no assessment of loan applications by the credit function for loans that were initiated by the sales staff, an arrangement that could compromise the quality of credit underwriting.

5.5 Furthermore, the bank's credit function was inadequately staffed, with five vacant positions. Moreover, there was no segregation of duties between the International Financial Reporting Standard (IFRS) 9 Committee and the Legal and Collections Unit (LCU), as some staff of LCU were members of the Committee. Meanwhile, the internal audit function remained inadequately staffed; despite the recommendation from the 2019 on-site examination for an increase in the staff complement, the bank maintained two staff members. Consequently, the bank was charged and directed to rectify all irregularities and submit quarterly progress updates to the Bank.

5.6 The follow-up on-site examination of the second bank revealed that the bank had addressed all strategic risk supervisory concerns raised during the 2019 full-scope on-site examination. The bank's Board Audit Committee nonetheless had two members instead of the three prescribed by Section 23(1) of the Banking Act. In addition, the bank's related party composition was 37.5 percent, thus breaching the 33.3 percent limit permitted at Clause 3.5 of the 2008 Guidelines on the Appointment of New Directors and Senior Management Officials of Banks.

5.7 Although the bank maintained CAR above the minimum statutory and prudential requirements, the bank's capital mix was not considered prudent because Tier 1 capital was lower than Tier 2 capital.

5.8 The examination, however, indicated improvement in credit-risk management processes, as the bank had a Credit Risk Management Committee that provides oversight of credit risk. Furthermore, the Credit Department within the bank was adequately staffed and applied stringent credit evaluation and monitoring processes.

5.9 The bank's Board Risk Committee provided adequate oversight of liquidity and funding risk. Meanwhile, the level of inherent operational risk was considered high owing to potential lapses in internal controls as a result of measures implemented to minimise the spread of COVID-19, such as working from home and digitalisation of some processes. In addition, the manual updating of the retail loans processed by the bank in the core banking system also contributed to the high inherent operational risk.

5.10 The bank's operational risk management strategies were considered satisfactory, following the separation of the risk and compliance functions to ensure segregation of duties, appointment of a country risk manager and adoption of a new product approval policy. The bank was directed to rectify all the irregularities.

Consumer Compliance On-site Examination

5.11 In 2021, a consumer-compliance on-site examination was conducted at one commercial bank. It was noted that the bank had comprehensive policies and procedures and complied with most consumer-compliance standards except the violations shown in Table 5.1. The bank was directed to ensure compliance with consumer-compliance standards with immediate effect.

Table 5.1: Violation of Consumer Compliance Standards in 2021

Violations	Description
Disclosure of Bank charges Notice GN. No. 41 of 2001	The bank did not accurately compute the annual percentage rate (APR) for one facility. The APR disclosed to customers was higher than what the bank prescribed.
Prescription of Notice Period and Early Settlement Penalties for Term Loans and Similar Credit Facilities: Government Notice No. 111 of 2011	In the tariff guide, the bank stated that there was no penalty for customers who settled personal loans early. Contrary to that notice, the bank imposed a penalty fee for customers who settled the facility before maturity.
Disclosure Framework for Deposit and Lending Interest Rates, Regulatory Guideline No. RG 01/09/2009	The bank did not accurately adjust interest amount on mortgage statements for customers. In addition, the bank did not adjust monthly instalments for customers on prime-linked motor-vehicle loans when the Bank Rate was reduced. The bank was directed to ensure compliance with consumer-compliance standards.

Source: Bank of Botswana

AML/CFT/PF On-site Examination

5.12 During 2021 the Bank conducted a full-scope AML/CFT on-site examination of one statutory bank, and a targeted on-site examination of one commercial bank. The objective of the examination for both banks was to assess whether the AML/CFT/PF measures adopted were commensurate with each institution's level of identified risks of money laundering and terrorist financing (ML/TF/PF). The examination also assessed the level of compliance of the institutions with the Financial Intelligence Act, 2019 (Cap. 08:07) (FI Act).

5.13 Overall, the statutory bank's adequacy and effectiveness of risk management practices and controls were weak on account of the following: the AML/CFT policy was found to be deficient; the bank did not report all large-cash transactions to the Financial Intelligence Agency, as some were rejected by the system and never resubmitted; the bank did not have a mechanism for allocating a risk score to customers, taking into account the level of ML/TF/PF financing risk posed by a customer; the bank did not identify and screen all company directors, senior management and ultimate beneficial owners for companies against sanction lists; and did not have an information-management system for monitoring suspicious transactions. The bank was directed to rectify the supervisory concerns raised in the examination report and the bank's effort to address these will be confirmed through quarterly updates.

5.14 The targeted on-site examination of one commercial bank revealed that the bank's inherent vulnerability to ML/TF/PF was high owing to significant transactions that were conducted through online platforms, a large clientele base and the bank's customers involved in high-risk industries. The adequacy and effectiveness of risk management practices were satisfactory. The following deficiencies, however, were noted for the bank: some products and services were offered without ML/TF risk assessment; some large-cash transactions were rejected by the system because of the inadequacy of customer due-diligence information required by the system; the bank had not resolved some deficiencies raised by internal auditors during the 2018 and 2020 audit; the bank had not identified ultimate beneficiaries where the beneficiary of an account was a company; the bank maintained business relationships with trust entities that had not registered with the Master of High Court; the bank violated Section 34(2) of the FI Act by not reporting all large-cash transactions to FIA; and the bank did not identify all prominent influential persons. It was also observed that the bank's system for monitoring suspicious transactions did not trigger alerts for all transactions that fell outside the bank's expected thresholds.

5.15 The bank was directed to rectify all supervisory concerns raised in the report of examination within 12 months and provide quarterly updates from June 30, 2022. In addition, the bank was requested to show cause why a charge in accordance with Section 34(2) of the FI Act could not be levied against the bank for failing to report all large-cash transactions to FIA.

CONSULTATIVE AND PRUDENTIAL MEETINGS

5.16 Prudential bilateral and statutory trilateral meetings were held in 2021, during which banks presented a review of their business strategies for the previous year(s) and those for the ensuing period, together with their financial year-end results. The Bank also held AML/CFT/PF bilateral meetings with banks in 2021, the purpose of which was to provide banks with a platform to discuss their risks of money laundering and terrorist financing and proliferation (ML/TF/PF) and policies and procedures for mitigating identified risks, with a focus on ML/TF/PF risk assessment. Furthermore, the meeting discussed the compliance function of banks, suspicious transactions monitoring and reporting, processes for sanction screening, customer-identification programme, identification of ultimate beneficial ownership and prominent influential persons, cross-border wire transfers, record-keeping arrangements and counter proliferation financing.

5.17 It was noted at the meetings that most banks were not able to identify all prominent influential persons in accordance with the FI Act; banks indicated that they could not identify all prominent persons because of the broadness of the definition. Furthermore, the Bank noted that there was inconsistency across the banking industry regarding the identification of ultimate beneficial owners. Banks adopted different shareholding thresholds, ranging from 5 percent to 25 percent. To address the deficiency, the Bank issued the Guidelines on Identification of Beneficial Ownership of Legal Entities and Legal Arrangements. Overall, however, the adequacy and level of effectiveness of AML/CFT/PF management systems and controls for banks were deemed satisfactory.

VIOLATIONS OF THE BANKING ACT AND FI ACT

5.18 Four banks contravened various sections of the Banking Act and of the FI Act during 2021. Consequently, a monetary penalty amounting to P85 973.90 was imposed on three banks as detailed in Table 5.2.

Table 5.2: Penalties Charged on Banks for Contravention of Various Sections of the Banking Act and FI Act

Banks	Contraventions	Banking Act and FI Act	Amount of Penalty
Bank 1	The bank did not submit audited financial statements for financial years ended March 31, 2020, and 2021. The bank's financial statements were not submitted to the Bank because the bank had terminated its contract with its auditors and no appointment of auditors was made. The reason for termination of the contract was high audit fees. The bank has since appointed a new external auditor for three years effective from March 31, 2021.	Section 19(2) of the Banking Act	No charge was levied against the bank. The bank was cautioned, and the importance of ongoing compliance emphasised.
Bank 2	The CAR for the bank was below the 12.5 percent minimum, at 11.7 percent, 11.5 percent and 11.8 percent in May, June and July 2021, respectively.	Section 13(1) of the Banking Act.	P14 573.90
	The bank maintained daily liquid asset ratio of 9.7 percent on both December 17 and 21, 2021, thus below the 10 percent statutory limit.	Section 16(1) of the Banking Act and the Directive on Managing Liquidity Risk.	No charge was levied against the bank. The bank has been written caution letters and has since normalised the situation.
Bank 3	The bank did not address the 2019 supervisory concern relating to a board member whose tenure had exceeded the set nine-year tenure limit and retirement age.	Section 52 of the Banking Act.	P3 000.00
	Provision of misleading information is in contravention of Section 25 of the Banking Act. Therefore, the bank is liable to a penalty of P10 000 in accordance with Section 25(3) of the Banking Act, for providing misleading information.	Section 25(3) of the Banking Act.	P68 400 (VAT inclusive), paid at the rate of P11 400 per month for the six months from January 2021 to June 2021
Bank 4	Failure to report cash transactions above the prescribed limit.	Section 34(2) of FI Act.	The bank was requested to show cause why a charge of P100 000 in accordance with Section 34(2) of the FI Act could not be levied against the bank for failing to report all large-cash transactions to FIA.
Total			**P85 973.90**

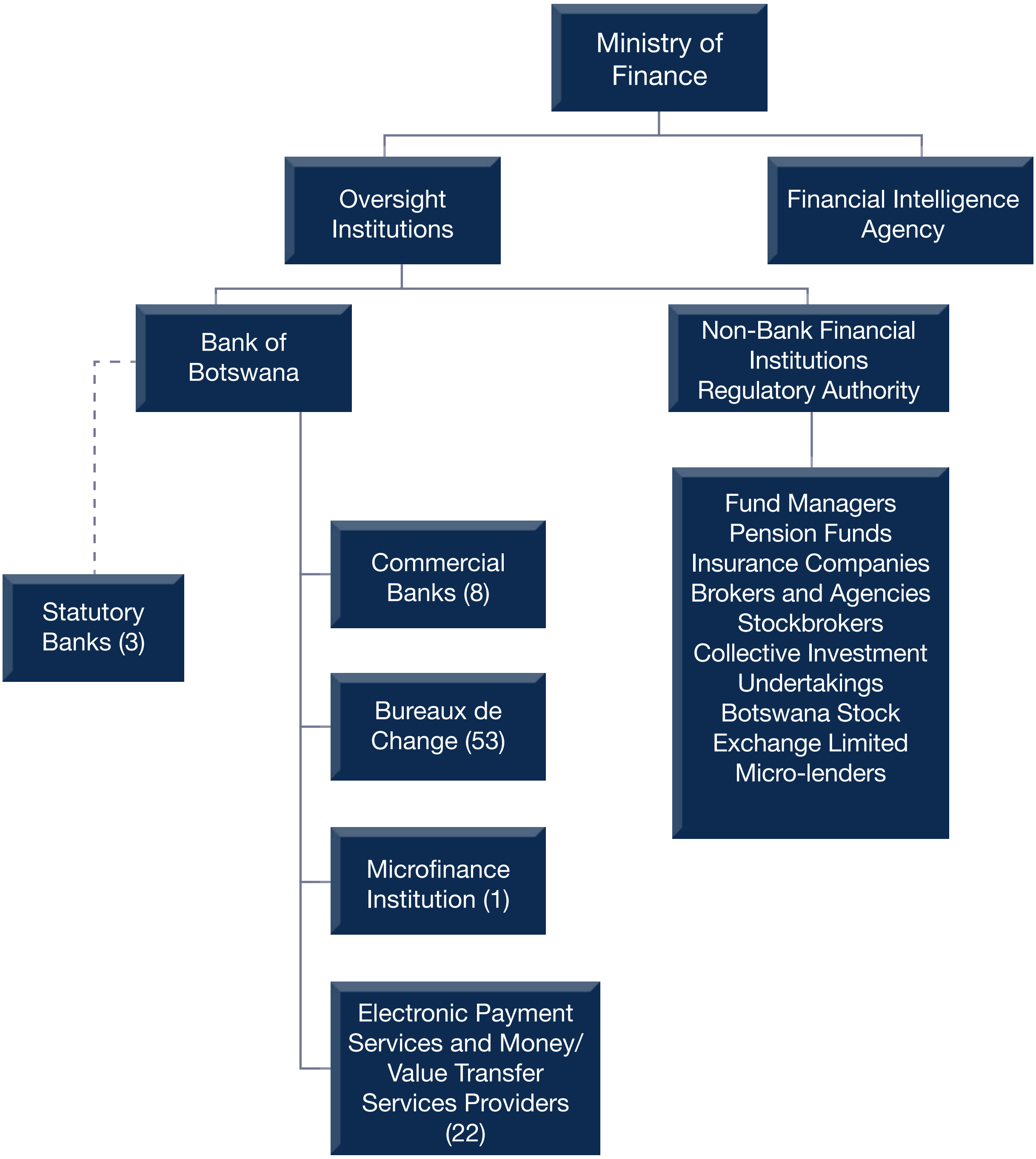
Source: Bank of Botswana.

APPENDICES

APPENDICES

APPENDIX 1

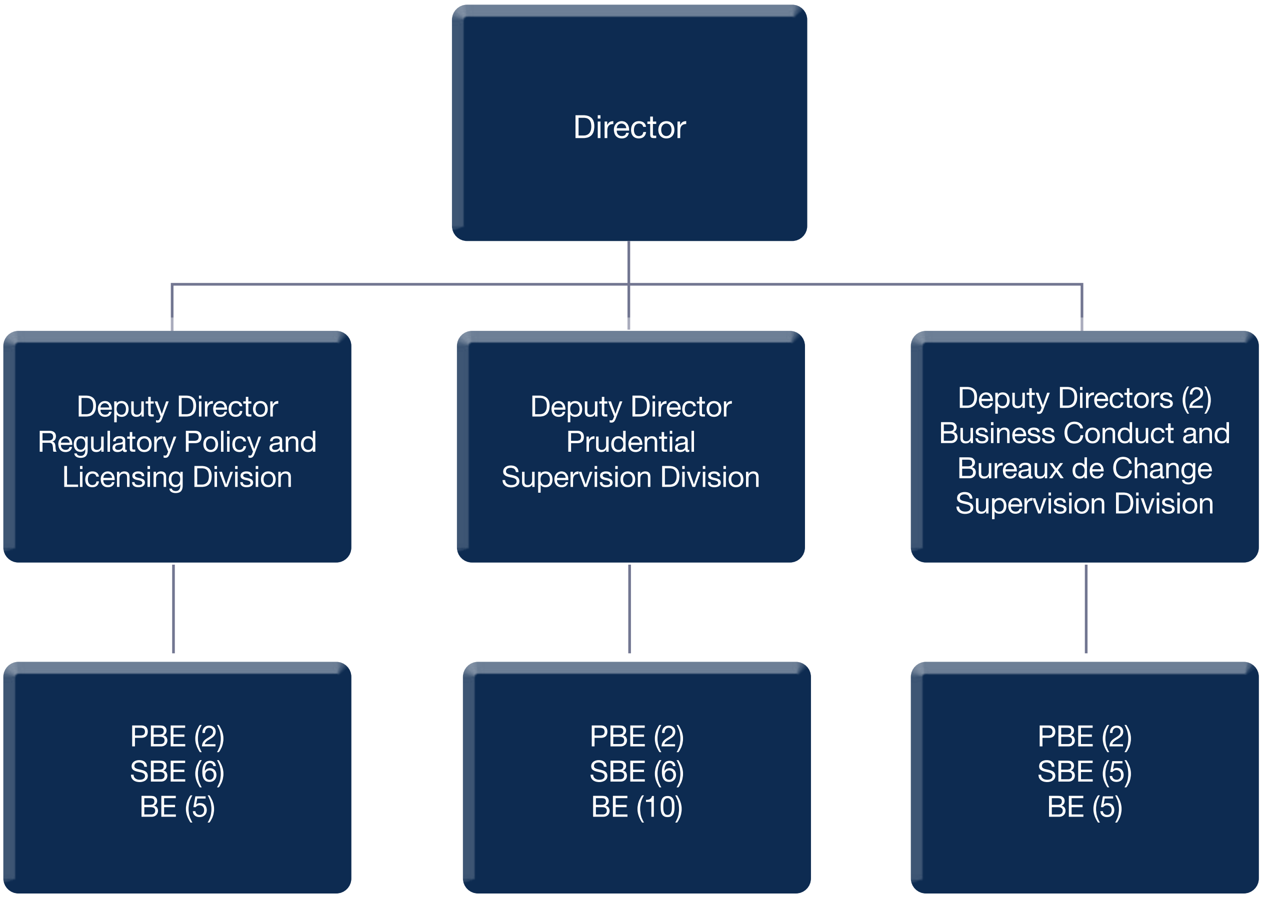
DIAGRAM 1.1: REGULATORY ARCHITECTURE OF THE FINANCIAL SYSTEM



Source: Bank of Botswana.

APPENDIX 1 (CONTINUED)

DIAGRAM 1.2: BANKING SUPERVISION DEPARTMENT ORGANISATIONAL STRUCTURE AS AT DECEMBER 31, 2021

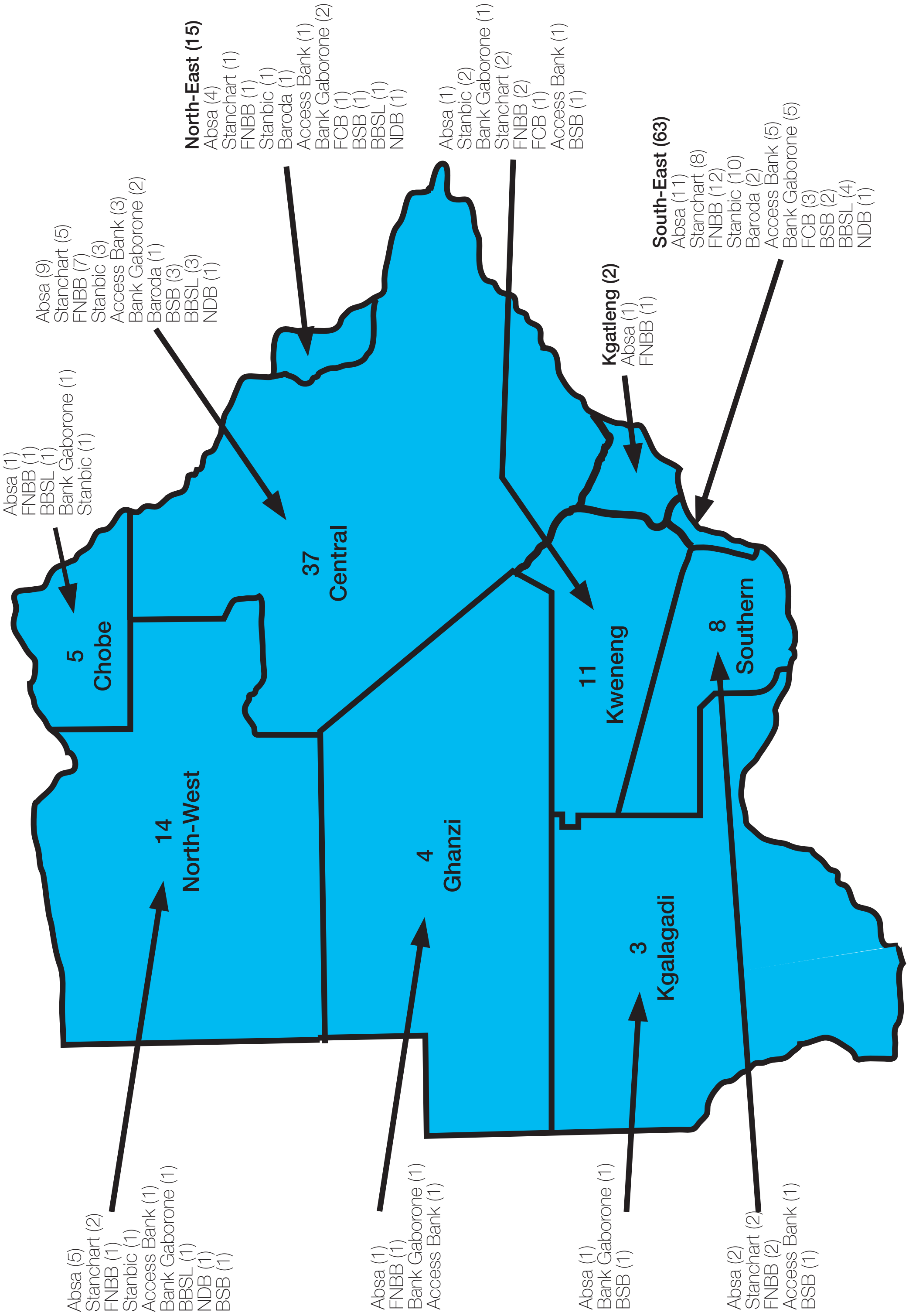


Key: PBE: Principal Bank Examiner
SBE: Senior Bank Examiner
BE: Bank Examiner

Source: Bank of Botswana.

APPENDIX 2

DIAGRAM 1: BANK-BRANCH DISTRIBUTION NETWORK BY DISTRICT AS AT DECEMBER 31, 2021



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 a clear and transparent 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 12.5 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 one 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 Examinations

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 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 Risk Based Supervision (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 the Bank's Off-site Surveillance System (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, 2021

a) COMMERCIAL AND STATUTORY BANKS

Institution	Total Assets (P million)	Postal Address	Business Locations	Auditors
Commercial Banks				
Absa Bank Botswana Limited	21 544	P O Box 478, Gaborone	36	Ernst & Young
Access Bank Botswana Limited	9 101	Private Bag 00303, Gaborone	13	Pricewaterhouse Coopers
Bank Gaborone Limited	6 901	Private Bag 00325, Gaborone	14	Pricewaterhouse Coopers
Bank of Baroda (Botswana) Limited	2 378	P O Box 216 ADD, Gaborone	4	Grant Thornton
First Capital Bank Limited	5 078	P O Box 5548, Gaborone	5	Deloitte
First National Bank of Botswana Limited	26 423	P O Box 1552, Gaborone	28	Deloitte
Stanbic Bank Botswana Limited	21 495	Private Bag 00168, Gaborone	18	KPMG
Standard Chartered Bank Botswana Limited	15 670	P O Box 496, Gaborone	20	Ernst & Young
Statutory Banks				
Botswana Savings Bank	3 314	P O Box 1150, Gaborone	10	Deloitte
National Development Bank	1 221	P O Box 225, Gaborone	4	Ernst & Young
Building Society				
BBS Limited	3 839	P O Box 40029, Gaborone	10	Ernst & Young

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

APPENDIX 4 (CONTINUED)

(b) BUREAUX DE CHANGE AS AT DECEMBER 31, 2021

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
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
Beni Fame Bureau de Change	P O Box 2143 AAD, Gaborone	5
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
Felda's Bureau de Change	P O Box 10939 , Palapye	1
Fundex Bureau de Change	P O Box 401547, Gaborone	3
Galaxy Bureau de Change	P O Box 501055, Gaborone	4
Garona Bureau de Change	P O Box 408, Gaborone	5
Genesis Bureau de Change	Private Bag BR 225, Gaborone	1
Gorogang Bureau de Change	P O Box 46785, Gaborone	1
Kabona Bureau de Change	P O Box 465 ADD , Tlokweng	1
Kaycy Bureau de Change	P O Box 1693, Lobatse	2
KNO Forex Bureau de Change	P O Box 1750 ABG, Sebele Mall	1
Kuvuki Bureau de Change	P O Box 1108, Mogoditshane	1
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
Mochudi Bureau de Change	P O Box 202147, Gaborone	2
Monyglob Bureau de Change	P O Box AD 749, Gaborone	7
Moola Bureau de Change	P O Box 1304, Poso House	1
Moonlight Bureau de Change	P O Box 2080, Maun	1
Mukuru Bureau de Change	P O Box AD 148 ADD, Gaborone	4
Ngami Bureau de Change	P O Box 44 HAK, Maun	1
Open Door Bureau de Change	P O Box 839, Maun	8
Ozair Bureau de Change	P O Box 4862, Gaborone	2
Ozi Bureau de Change	P O Box 21260, Boseja, Maun	1
Prime Ex Bureau de Change	P O Box 686, Moshupa	1
Proxy Bureau de Change	P O Box 404108, Gaborone	2

Name	Postal Address	Business Location
Rain Bureau de Change	P O Box 1751, Gaborone	1
River Ride Bureau de Change	P O Box 301106, Francistown	1
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
Today's Best Bureau de Change	P O Box 20625, Maun	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
Tshilong Bureau de Change	P O Box 40418, Gaborone	3
Unity Bureau de Change	P O Box 1586, Francistown	1
Warriors Destiny Bureau de Change	P O Box 11247, Tatitown, Francistown	1
WP Bureau de Change	P O Box 77, Ramatlabama	1
Total	53	98

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 AS USED IN THE REPORT

DEFINITIONS 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 6 (d) for computations).

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 (c) 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 6.7 is an inverse of 15 percent minimum capital adequacy ratio), 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 6 (d) attached.

PRUDENTIAL RATIOS

Return on Equity

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

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 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 (Percent)

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 (Percent)

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 (Percent)

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 (Percent)

The intermediation margin can be defined as the differential between the cost of funds and the yield on earning assets plus related fee income. The differential quantifies the cost 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.

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	**CET1 Capital Lines (1+2+3+4+5-6)**
ADDITIONAL TIER 1 CAPITAL	
Line	Item
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 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)
13	**Total Tier 1 Capital Lines (7+12)**
TIER 2 CAPITAL	
Line	Item
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 risk 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)

Regulatory Adjustments Applied In the Calculation of Capital

A. Regulatory adjustments applied in the calculation of CET 1 Capital	
AA. Full deductions	
Line	**Item**
23	Goodwill and other intangible assets
24	Advances of a capital nature granted to connected persons
25	DTA that rely on future profitability to be realised
26	Investments in own shares, whether directly or indirectly
27	Unrealised revaluation losses on investments in securities
28	Defined benefit pension fund assets
29	Reciprocal holdings in the capital of banking, financial and insurance entities
30	Cash flow hedge reserve
31	Gain on sale related to securitisation transactions
32	Regulatory adjustments applied to CET1 capital due to insufficient additional Tier 1 and Tier 2 capital
33	**Full Deductions applied to the calculation of CET1 Capital Lines (23+24+25+26+27+28+29+30+31+32)**
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**
34	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 over the 10 percent threshold, the remaining balance below the threshold shall be treated as other assets (para 3.16 - 3.18 Basel II Guidelines)
35	DTAs that arise from temporary differences
36	Mortgage servicing rights
37	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.
38	**Threshold deductions applied to the calculation of CET 1 Capital Lines (34+35+36+37)**
39	**Total regulatory adjustments applied to the calculation of CET 1 Capital Lines (33+38)**
B. REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF ADDITIONAL TIER 1 CAPITAL	
BA. Full deductions	
40	Direct investments in own additional Tier 1 capital, net of any short positions, if the short positions involve no counterparty risk
41	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
42	Any own additional Tier 1 capital which the bank could be contractually obliged to purchase
43	Reciprocal cross holdings and the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation
44	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)
45	**Full deductions applied to the calculation of Additional Tier 1 Capital Lines (40+41+42+43+44)**

APPENDIX 5 (CONTINUED)

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)*
46	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.
47	**Total regulatory adjustments applied to the calculation of additional Tier 1 capital lines (45+46).**
C. REGULATORY ADJUSTMENTS APPLIED IN THE CALCULATION OF TIER 2 CAPITAL	
CA. Full deductions	
48	Direct investments in own Tier 2 capital, net of any short positions, if the short positions involve no counterparty risk
49	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
50	Any own Tier 2 capital which the group could be contractually obliged to purchase
51	Reciprocal cross holdings and the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation
52	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).
53	**Full deductions applied to the calculation of Tier 2 Capital Lines (48+49+50+51+52)**
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)**
54	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 above the 10 percent threshold, the remaining amount below the 10 percent threshold shall be treated as other assets.
55	**Total regulatory adjustments applied to the calculation of Tier 2 Capital Lines (53+54)**

Note (1): The amount of the three items (33, 34, 35) not deducted (threshold amounts) in the calculation of CET1 is treated as other assets and risk-weighted at 250 percent.

(2) Line 36: 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 Rating						
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 • Original maturity over 1 year • Unconditionally cancellable commitments without notice	20 50 0
Direct credit substitutes:	
• Acceptances and endorsements • Guarantees on behalf of customers • Letters of credit issued by the bank with no title to underlying shipment • 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 • Bid or tender bonds • Advance payment guarantees • Customs and excise bonds • 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 letters of credit/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 STATEMENT OF LICENSED BANKS: 2017 – 2021

Table 1: Aggregate Statement of Financial Position of Licensed Commercial Banks: 2017 – 2021 as at 31st December (P million)

Total Assets in Local Currency	2017	2018	2019	2020	2021
1. Cash and balances with the central bank	4 597	5 364	6 501	5 699	5 336
1.1. Currency	1 608	1 901	1 850	2 193	1 932
a) Foreign currency	382	607	173	173	197
b) Local currency	1 226	1 294	1 677	2 020	1 735
1.2. Balances with central bank	2 989	3 462	4 651	3 506	3 404
1.3. Other	-	-	-	-	-
2. Investment and trading securities	10 811	12 142	14 203	15 820	13 653
3. Placements with other banks and credit institutions	13 590	15 467	14 855	15 426	19 337
4. Gross loans and advances to other customers	54 181	58 332	62 770	65 554	68 920
4.1 Impairments – specific	1 536	1 352	1 775	1 713	1 654
4.2 Interest in suspense	259	492	558	318	216
4.3 Impairments portfolio	239	303	237	739	943
5. Loans and advances to other customers (net of specific provisions)	52 147	56 185	60 200	62 785	66 107
6. Fixed assets net of depreciation	926	956	1 348	1 449	1 323
7. Other assets (net)	1 402	1 227	1 588	2 081	2 835
Total Assets	**83 475**	**91 341**	**98 695**	**103 260**	**108 591**
Total Liabilities in Local Currency					
1. Amounts owed to government institutions	27	-	-	45	-
a) Central bank accounts	27	-	-	45	-
b) Direct government credits (CB or Ministry of Finance)	-	-	-	-	-
2. Due to other banks and credit institutions	4 250	4 735	4 532	3 022	3 999
3. Debt securities and other borrowing	4 065	4 747	4 761	5 594	6 162
4. Due to other customers/depositors	63 581	69 270	75 709	80 540	84 364
5. Shareholder funds	9 383	10 390	11 081	11 299	10 756
6. Other liabilities	2 169	2 199	2 612	2 759	3 310
a) Taxes payable	246	185	201	212	35
b) Dividends payable	-	-	-	-	254
c) Accrued expenses	551	-	292	907	1 008
d) Other	1 372	2 013	2 120	1 640	2 013
Total Liabilities	**83 475**	**91 341**	**98 695**	**103 260**	**108 591**

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

APPENDIX 7 (CONTINUED)

Table 2: Aggregate Statement of Comprehensive Income of Licensed Commercial Banksfor the period ended 31st December (P million)

	2017	2018	2019	2020	2021
1. Total interest income from loans and advances	5 449	5 728	6 251	6 149	6 207
2. Interest expense	1 466	1 811	1 894	1 774	1 880
3. Net interest income [1 – 2]	3 983	3 916	4 357	4 375	4 327
4. Total non-interest income	2 490	2 657	2 835	2 773	2 946
5. Gross operating income/(loss) [3+4]	6 473	6 573	7 192	7 148	7 273
6. Total impairments	1 003	429	743	830	495
a) Impairment of loans and advances – specific	994	344	700	611	632
b) Impairment of loans and advances – portfolio	9	85	42	224	(142)
c) Impairment on other financial assets	-	-	1	(4)	5
7. 7. Operating income/(loss) net of bad and doubtful debts	5 470	6 144	6 449	6 318	6 778
8.Total non-interest expense	3 876	3 988	4 193	4 361	4 388
a) Salaries and employee benefits	1 731	1 781	1 899	1 955	2 025
b) Auditing and consulting expenses	299	15	47	19	20
c) Rents paid	207	227	169	133	110
d) Depreciation and amortisation	158	174	231	281	299
e) Other	1 481	1 791	1 847	1 973	1 935
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]	1 595	2 156	2 256	1 957	2 390
11. Extraordinary gains/(losses)	-	-	-	-	-
a) Gains/losses on revaluation of assets (net)	-	-	-	-	-
b) Translation gains/losses (net)	-	-	-	-	-
c) Other gains/losses	-	-	-	-	-
12. Net before-tax income/(loss) [10+11]	1 595	2 156	2 256	1 957	2 390
13. Income tax	412	480	494	503	573
14. Net after-tax income/(loss) [12-13]	1 182	1 676	1 762	1 454	1 817

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

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

Total Assets in Local Currency	2017	2018	2019	2020	2021
1. Cash and balances with the central bank	70	177	234	38	56
a) Currency	18	171	222	29	45
aa) Foreign currency	-	-	-	-	-
ab) Local currency	18	171	222	29	45
b) Balances with central bank	52	6	12	9	12
c) Other	-	-	-	-	-
2. Investment and trading securities	-	-	-	-	-
3. Placements with other banks and credit institutions	1 777	1 391	2 424	935	771
4. Gross loans and advances to customers	4 792	4 891	5 054	5 866	6 104
5. Impairments	93	143	185	215	153
6. Net loans and advances to customers	4 699	4 745	4 869	5 650	5 951
8. Fixed assets net of depreciation	152	146	141	196	256
9. Other assets (net)	79	82	106	136	119
Total Assets	**6 777**	**6 544**	**7 774**	**6 955**	**7 153**
Liabilities in Local Currency					
1. Amounts owed to government institutions	-	-	-	-	-
a) Central bank accounts	-	-	-	-	-
b) Direct government credits (CB** or Ministry of Finance)	-	-	-	-	-
c) Other	-	-	-	-	-
2. Debt securities and other borrowing	1 235	1 325	1 185	1 100	940
3. Due to customers/depositors	4 042	4 244	5 462	4 762	5 062
4. Shareholders funds	1 306	775	718	709	720
5. Other liabilities	193	200	409	384	430
a) Taxes payable	1	2	1	1	1
b) Dividends payable	-	-	-	-	-
c) Accrued expenses	-	-	-	-	-
d) Other	192	198	408	383	429
Total Liabilities	**6 777**	**6 544**	**7 774**	**6 955**	**7 153**

** CB denotes central bank.

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

APPENDIX 7 (CONTINUED)

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

	2017	2018	2019	2020	2021
1. Total interest income from loans and advances	433	441	535	517	545
2. Interest expense	198	228	317	278	291
3. Net interest income [1-2]	234	213	218	239	254
4. Total non-interest income	30	35	51	46	48
5. Gross operating income/(loss) [3+4]	**265**	**248**	**269**	**285**	**301**
6. Total Impairments	24	32	34	46	(6)
a) Impairment of loans and advances – specific	-	18	23	85	(6)
b) Impairment of loans and advances – portfolio	-	6	1	2	-
c) Releases and recoveries of bad debts previously written off	-	2	-	2	-
d) Share of associate company profits	-	-	2	-	-
e) IFRS adjustments	-	-	4	(33)	-
f) Reversal of interest in suspense	-	-	4	(10)	-
7. Operating income/(loss) net of specific loss provisions	**241**	**216**	**235**	**239**	**307**
8.Total non-interest expense	197	212	269	268	313
a) Salaries and employee benefits	91	97	130	127	145
b) Administrative expenses	-	-	-	-	-
c) Auditing and consulting expenses	-	1	1	-	-
d) Rents paid	-	2	13	4	3
e) Depreciation and amortisation	16	19	23	27	32
f) Other	88	93	102	110	134
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]	**44**	**4**	**(34)**	**(29)**	**(6)**
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]	**44**	**0.18**	**(34)**	**(29)**	**(11)**

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

APPENDIX 7 (CONTINUED)

Table 5 (a): Aggregate Capital Structure of Commercial Banks in Botswana (Basel II) as at 31st December (P million)

		2017	2018	2019	2020	2021
COMMON EQUITY TIER 1 (CET1) CAPITAL						
1	**Common shares**	**1 265**	**1 265**	**1 265**	**1 265**	**1 140**
2	**Share premium resulting from the issue of common shares**	**271**	**271**	**271**	**275**	**275**
3	**Retained earnings:**	**5 867**	**6 422**	**6 762**	**7 629**	**7 473**
	Retained earnings brought forward from the previous financial year	6 404	6 700	7 041	7 831	7 887
	Add: Interim profits (audited by external auditor)	(196)	63	(13)	(9)	-
	Less: IFRS 16 take on impact	-	-	190	-	160
	Less: Dividend declared	6	160	75	-	254
	Less: Dividend paid in the current financial year	335	180	-	-	-
4	**Accumulated other comprehensive income and other disclosed reserves**	**207**	**289**	**304**	**319**	**335**
	a) Statutory credit risk reserve	79	137	146	163	174
	b) Capital buffer	-	-	-	-	-
	c) Statutory reserves	2	2	2	2	8
	d Other (specify)	126	150	156	154	153
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]	**249**	**275**	**-**	**324**	**141**
	a. IFRS 9 provisions transitional adjustments	**-**	**-**	**21**	**52**	**20**
	b. Transitional adjustment amount added back to CET1	**-**	**390**	**233**	**126**	**-**
7	**CET1 Capital** (Lines (1+2+3+4+5-6))	**7 361**	**8 029**	**8 435**	**9 238**	**9 008**
ADDITIONAL TIER 1 CAPITAL						
9	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	400	400
10	Stock surplus (share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-	-	-	-	-
11	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	-	-	-	-	-
12	Regulatory adjustments applied in the calculation of Additional Tier 1 capital	-	-	-	-	-
13	**Additional Tier 1 Capital** (Lines (9+10+11-12))	**-**	**400**	**400**	**400**	**400**
14	**Total Tier 1 Capital** (Lines (7+13))	**7 361**	**8 429**	**8 835**	**9 638**	**9 408**

TIER 2 CAPITAL						
15	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)	1 683	1 853	2 218	2 460	2 324
16	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	-	-	-	-	-
17	Unpublished current year profits	1 124	987	1 094	1 178	1 086
18	Tier 2 capital instruments (subject to gradual phase-out treatment)	214	140	10	-	-
19	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)	-	-	-	-	-
20	General provisions/general loan-loss reserves eligible for inclusion as Tier 2 capital, limited to a maximum of 1.25 percentage points of credit risk-weighted assets calculated under the standardised approach	391	678	691	741	825
21	Regulatory adjustments applied in the calculation of Tier 2 capital	-	(11)	-	-	-
22	**Total Tier 2 Capital** (Lines (15+16+17+18+19+20-21))	**3 412**	**3 648**	**4 013**	**4 378**	**4 235**
23	**Total Unimpaired Capital** (Lines (14+22))	**10 774**	**12 077**	**12 848**	**14 016**	**13 643**

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

Table 5 (b): Summary list of the Key Components of the Capital Structure of Commercial Banks in Botswana as at 31st December (P million)

		2017	2018	2019	2020	2021
1	Stated capital	1 265	1 265	1 265	1 265	1 140
2	Share premium	271	271	271	275	275
3	Retained earnings	5 867	6 422	6 762	7 629	7 473
4	Total Tier 1 capital	7 361	8 429	8 835	9 638	9 408
5	Subordinated term debt	1 897	1 993	2 228	2 460	2 324
6	Current year's unpublished profits	1 124	987	1 094	1 178	1 086
7	Total Tier 2 capital	3 412	3 648	4 013	4 378	4 235
8	Total unimpaired capital (sum of Lines 4 and 7)	10 774	12 077	12 848	14 016	13 643

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

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

		2017	2018	2019	2020	2021
COMMON EQUITY TIER 1 CAPITAL						
1	Common shares	952	507	507	507	507
2	Share premium resulting from the issue of common shares	-	-	-	-	-
3	**Retained earnings:**	**85**	**119**	**70**	**45**	**45**
	Retained earnings brought forward from the previous financial year	132	119	143	45	45
	Add: Interim profits (audited by external auditor)	-	-	-	-	-
	Less: Unpublished current year's losses	-	-	(73)	-	-
	Less: dividend declared	-	-	-	-	-
	Less: transfers during the year	3	-	-	-	-
	Less: dividend paid in the current financial year	44	-	-	-	-
4	**Accumulated other comprehensive income and other disclosed reserves**	**230**	**145**	**137**	**172**	**173**
	a) Statutory credit risk reserve	-	(14)	(22)	-	-
	b) Capital buffer	-	-	-	-	-
	c) Statutory reserves	166	159	159	172	173
	d) Other (specify)	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**	**14**	**17**
7	**CET1 Capital** (Lines (1+2+3+4+5-6))	**1 259**	**754**	**695**	**722**	**721**
ADDITIONAL TIER 1 CAPITAL						
9	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	-	-	-	-	-
10	Stock surplus (share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion	-	-	-	-	-
11	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	-	-	-	-	-
12	Regulatory adjustments applied in the calculation of additional Tier 1 capital	-	-	-	-	-
13	**Additional Tier 1 Capital** (Lines (9+10+11-12))	**-**	**-**	**-**		**-**
14	**Total Tier 1 Capital** (Lines (7+13))	**1 259**	**754**	**695**	**722**	**721**

APPENDIX 7 (CONTINUED)

TIER 2 CAPITAL						
15	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)	-	102	-	-	77
16	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	-	-	-	-	-
17	Unpublished current year's profits	40	4	3	(15)	(5)
18	Tier 2 capital instruments (subject to gradual phase-out treatment)	-	-	-	-	-
19	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)	-	-	-	-	-
20	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	25	23
21	Regulatory adjustments applied in the calculation of Tier 2 capital	-	-	-	-	-
22	**Total Tier 2 Capital** (Lines (15+16+17+18+19+20-21))	**57**	**126**	**11**	**10**	**95**
23	**Total Unimpaired Capital** (Lines (14+22))	**1 316**	**880**	**706**	**732**	**816**

*Figures excludes one statutory bank.

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

Table 6 (b): Summary list of the Key Components of the Capital Structure of Statutory Banks in Botswana (Summary) as at 31st December (P million)

		2017	2018	2019	2020	2021
1	Stated capital	952	507	507	507	507
2	Retained earnings	85	119	70	45	45
3	Total Tier 1 capital	1 259	754	695	722	721
4	Current year's unpublished profits	40	4	3	(15)	(5)
5	Total Tier 2 capital	57	126	11	10	95
6	Total unimpaired capital (sum of lines 3 and 5 less impairments)	1 316	880	706	732	816

*Figures exclude one statutory bank.

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

APPENDIX 8

CHARTS OF PRUDENTIAL AND FINANCIAL SOUNDNESS INDICATORS

Chart 8.1: Average Cost of Deposits

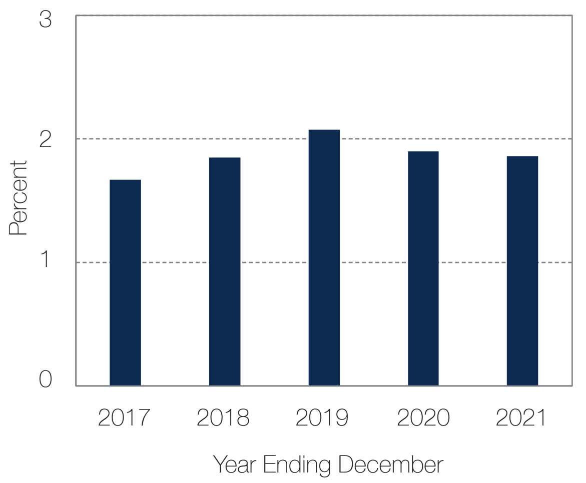


Chart..8.2: Return on Loans and Advances

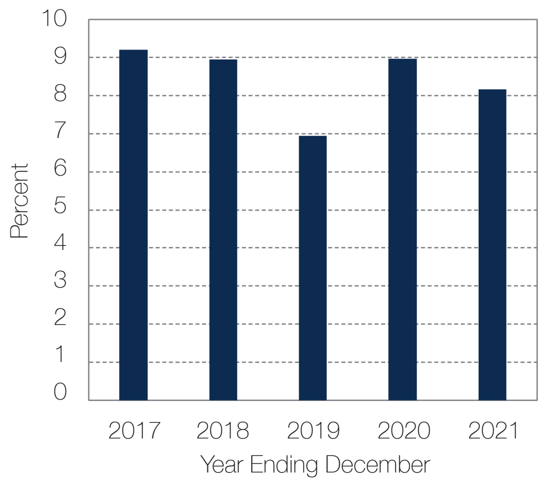


Chart 8.3: Residential Real Estate Loans to Gross Loans and Advances

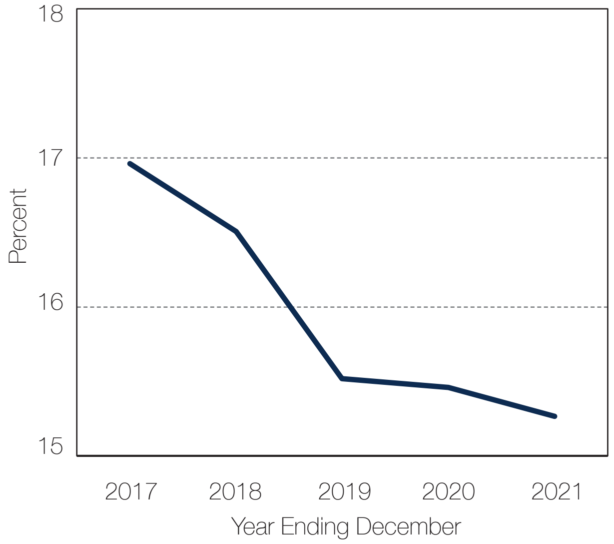
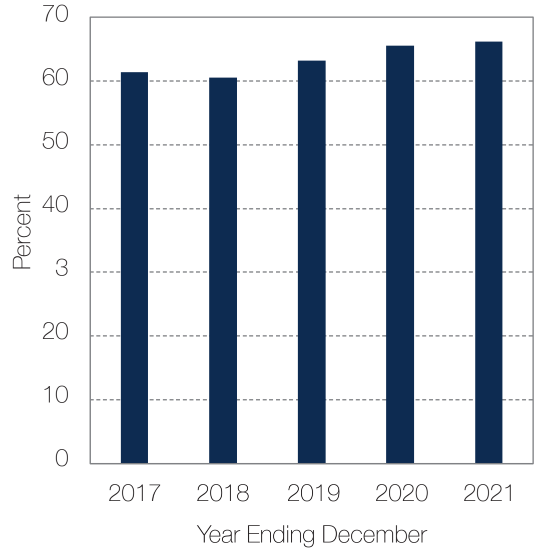


Chart 8.4: Household Loans to Gross Loans



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

CHARTS OF PRUDENTIAL AND FINANCIAL SOUNDNESS INDICATORS

Chart 8.5: Non-performing Loans Growth Rate

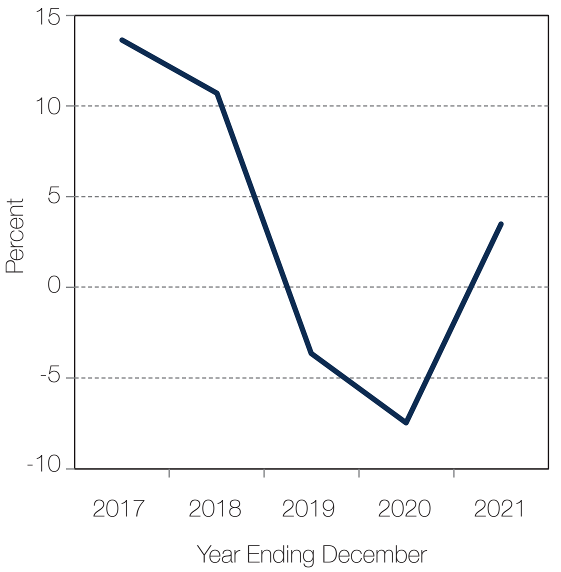


Chart 8.6: Share of Value of Total Deposits by Type (including FCAs)

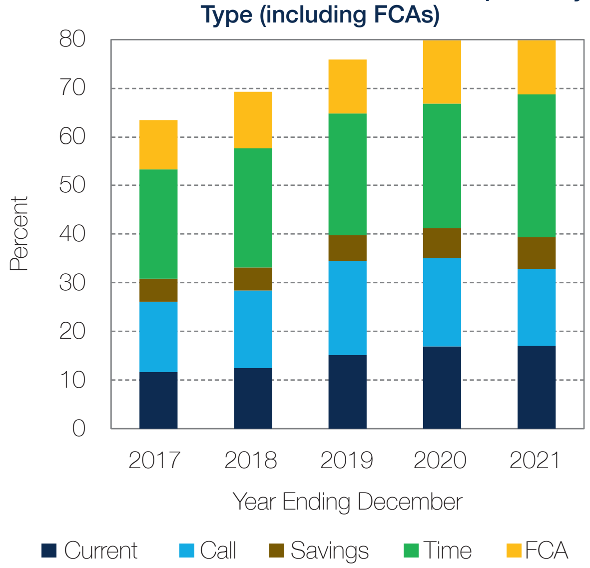


Chart 8.7: Foreign Currency Accounts

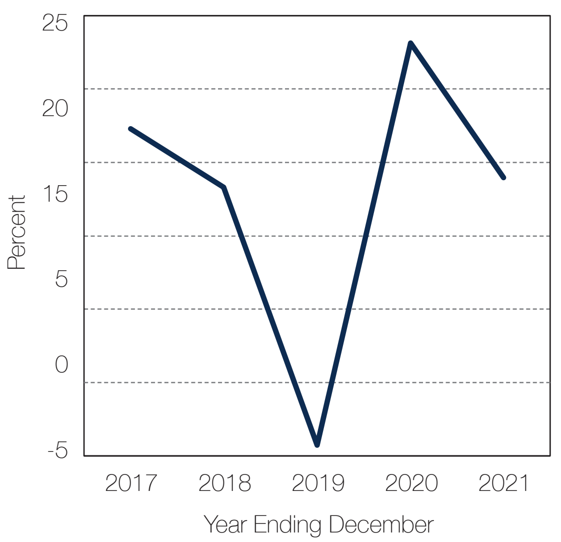
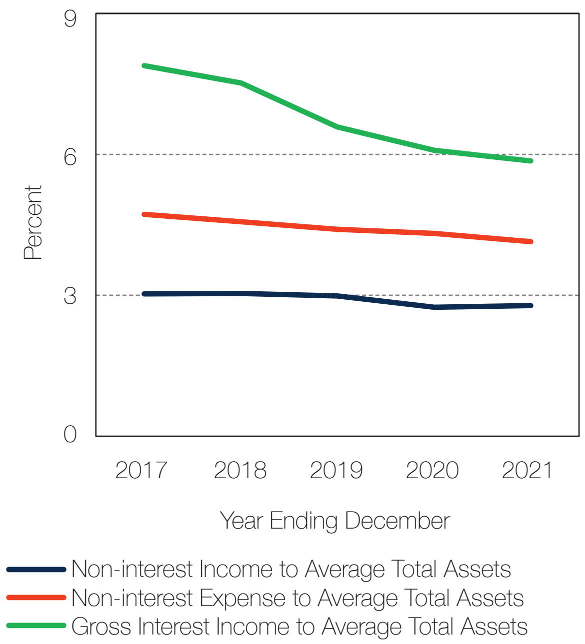


Chart 8.8: Efficiency Ratios



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

NOTES