

BANKING SUPERVISION
ANNUAL REPORT 2020



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, Bureau 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 a 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, prudent 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.

**BANKING SUPERVISION
ANNUAL REPORT 2020**

BANK OF BOTSWANA

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BANK OF BOTSWANA: BANKING SUPERVISION

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LIST OF ABBREVIATIONS

Absa	Absa Bank Botswana Limited
AML/CFT	Anti-money Laundering and Combating the Financing of Terrorism
ATM	Automated Teller Machine
BancABC	African Banking Corporation of Botswana Limited
Banking Act	Banking Act (Cap. 46:04)
Bank Gaborone	Bank Gaborone Limited
Bank SBI	Bank SBI Botswana Limited
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
BoI	Bank of India (Botswana) Limited
BPS	Botswana Police Service
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
CCO	Chief Credit Officer
CET1	Common Equity Tier 1
COVID-19	Corona Virus Disease 2019
DEs	Developed Economies
DTA	Deferred Tax Assets
EDMEs	Emerging Market and Developing Economies
EFT	Electronic Funds Transfer
ESAAMLG	East and Southern Africa Anti-money Laundering Group
FATF	Financial Action Task Force
FCB	First Capital Bank Limited
FIA	Financial Intelligence Agency
Fintech	Financial Technology
FNBB	First National Bank of Botswana Limited
GBP	British Pound (Sterling)

LIST OF ABBREVIATIONS (CONTINUED)

GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
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
MFED	Ministry of Finance and Economic Development
MFS	Mobile Financial Services
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
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
SARB	South African Reserve Bank
SMM	Standardised Measurement Method
Stanbic	Stanbic Bank Botswana Limited
Stanchart	Standard Chartered Bank Botswana Limited
Suptech	Supervisory Technology
TAM	Technical Assistance Mission
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 2020. 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 and Economic Development, 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.

It is common knowledge that the stability and soundness of the banking system is inextricably linked to the macroeconomic environment and performance of the real sector. The coronavirus disease (COVID-19) caused a major dislocation in economic activity in 2020, with devastating effects on the Botswana economy. This led to a sharp contraction in output and, consequently, weakening of fiscal and external buffers, which hitherto underpinned the resilience of the Botswana economy. Notwithstanding, the domestic banking sector remained resilient, buoyed by accommodative monetary conditions and other policy support measures. The vulnerabilities related to the potential for corporate insolvency, high levels of unemployment and a rise in non-performing loans (NPLs) were moderated by the pre-existing strong capital and liquidity buffers, as well as prudent management and moderate profitability of the domestic banking system.

Global gross domestic product (GDP) is estimated to have contracted by 3.5 percent in 2020, with the decrease in output widespread across all regions of the world, because of the negative effect of the COVID-19 pandemic, which constrained economic activity on an unprecedented scale. Uncertainty continues with respect to the magnitude and duration of the adverse impact of the COVID-19 pandemic on the global economy even as vaccination against the disease has started. In Botswana, real GDP contracted by 7.9 percent in 2020 compared with a growth of 3.7 percent in 2019. The contraction in output in 2020 was due to a decline in both mining and non-mining activities, largely indicating the adverse effect of containment measures against COVID-19 involving movement restrictions that resulted in significantly reduced economic activity.

The Bank received one application for a banking licence that was assessed and rejected on account of material deficiencies with respect to ownership and capital structure. Therefore, there was no new banking licence issued in 2020. Consequently, the number of licensed banks in Botswana remained at nine. However, Bank SBI Botswana Limited (Bank SBI) has decided to voluntarily surrender its banking licence and will cease to operate as a licensed bank in Botswana on June 30, 2021.

The banking sector grew relative to the overall size of the economy in 2020, with the ratio of banking assets to GDP increasing from 50 percent in 2019 to 56.8 percent in 2020, while access to banking services, indicated by the ratio of the number of depositors to the adult population, rising from 72 percent to 76.6 percent in the same period. Overall, financial sector development and depth increased between 2019 and 2020 mainly because of an increase in relevant

FOREWORD (CONTINUED)

financial soundness indicators, while nominal GDP contracted. The Bank continued to ensure that banking regulations, supervisory practices and related prudential and market conduct policies foster innovation, financial inclusion and, in general, financial sector development.

In order to maintain the potential for banks to continue lending to customers and to support economic activity in the COVID-19 environment, the Bank amended the Directive on International Convergence of Capital Measurement and Capital Standards for Botswana by reducing the minimum threshold of the prudential capital adequacy ratio from 15 percent to 12.5 percent and implementing measures to ensure an uninterrupted supply of bank liquidity. In addition, the Bank issued a Circular on Guidance on the Regulatory Treatment of International Financial Reporting Standard (IFRS) 9 Provisions in the context of the COVID-19 pandemic. The Bank endorsed an initiative by the banking industry to selectively modify loan-payment schedules, including a moratorium on loan servicing for a period of three to six months, to mitigate the adverse effects of the COVID-19 pandemic on borrowers. Furthermore, to support the initiative, the Bank suspended the need for banks to raise specific provisions against loans qualifying for the loan repayment moratorium.

Notwithstanding, commercial bank credit grew by 4.4 percent in 2020, slower than the 7.6 percent growth in 2019, even as deposits increased by 6.4 percent. The average cost of deposits fell slightly in line with the monetary policy easing in 2020, albeit not to the same magnitude on account of the structure of funding of banks, which is dominated by highly volatile, large-value deposits controlled by institutional investors. However, the cost-to-income ratio increased marginally compared with that of the prior year owing to, in the main, additional investment on infrastructure (physical and technology) to ensure safety of customers and sustenance of banking services in the COVID-19 environment. The overall effect of sluggish credit growth and the increase in the cost-to-income ratio was a decline in the banking sector profitability in 2020. Nevertheless, the asset quality of the banking sector, as measured by NPLs, improved, with the ratio of NPLs to gross loans and advances falling from 4.8 percent in 2019 to 4.3 percent in 2020. NPLs decreased mainly because of the ongoing efforts by banks to strengthen credit assessment criteria, focussing on creditworthiness and bankable projects. In addition, implementation of the circular to banks on guidance on the regulatory treatment of IFRS 9 provisions on account of the COVID-19 pandemic contributed to the reduction in NPLs during the loan-payment holiday, since banks were allowed to treat all loans placed on “repayment holiday” (selective moratorium on the agreed payment programme) as performing credits.

Banks were assessed to be fully compliant with the minimum statutory and prudential requirements, including high levels of solvency and liquidity. In addition, banks largely met the minimum prescribed disclosure standards as set out in Pillar 3 disclosure requirements of the Basel II Capital Adequacy Framework. In this 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.

FOREWORD (CONTINUED)

Consistent with established practice, statutory annual meetings for discussion of matters of mutual interest between the Bank and supervised institutions were held. 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, coordination and exchange of information among supervisory authorities for internationally active banking groups to facilitate effective group-wide consolidated supervision.

Generally, in 2020, banks were compliant with statutory and other prudential requirements; in 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. However, the continued listing of Botswana by the Financial Action Task Force (FATF) and the European Union among countries with strategic deficiencies in their anti-money laundering and the combatting of the financing of terrorism and proliferation (AML/CFT) architecture, and thus considered to be posing a risk to the global financial systems, is a source of concern and could pose a risk to financial stability. It is expected that the next update by the FATF and the International Co-operation Review Group will reflect the significant progress made by the country in the implementation of the agreed remedial action plan.

Against this background, I am pleased to report that, notwithstanding the devastating impact of COVID-19 on the Botswana economy, the banking system continued to be healthy, sound and stable, supported by prudent management of the licensed banks, all nine of which are majority-owned subsidiaries of reputable regional and internationally active banks. I would also like to thank the Board for continuing 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) is designated as the regulatory and supervisory agency for banks, bureaux de change and one deposit-taking microfinance institution. The number of licensed commercial and statutory banks remained at nine and three, respectively, in 2020. The number of bureaux de change decreased from 60 in 2019 to 58 in 2020.

Commercial and statutory banks employed a total of 5 142 people in 2020 compared with 5 172 in 2019. In response to the constantly changing preferences, customer needs and intensifying competition in the banking industry, banks continued to enhance products and service offerings to satisfy the demands of the economy and sustain viable, profitable operations. The onset of the COVID-19 pandemic in early 2020 provided an added impetus for digital transformation by banks, with most banks adopting digital platforms, internet-based products and mobile banking transactions in order to enhance efficiency, customer service and, more significantly, mitigate possible COVID-19 infections at banking halls. While there was continuation of a digitisation trend in the provision of banking services and approaches to financial inclusion, this was also in line with the government regulations requiring businesses to decongest business premises and thus help contain the spread of the disease.

Total assets for the banking industry increased by 4.6 percent from P98.7 billion in 2019 to P103.3 billion in 2020, while customer deposits grew by 6.4 percent from P75.7 billion to P80.5 billion, contributing 78 percent to total funding of banks. The increase in deposits supported growth in loans and advances, which expanded by 4.4 percent (a slower pace than the 7.6 percent in 2019) from P62.8 billion to P65.6 billion in the same period. The financial intermediation ratio declined from 82.9 percent in 2019 to 81.4 percent in 2020. Broadly, therefore, the provision of banking services, including lending, held up even in the COVID-19 environment. Nevertheless, core indicators of financial sector depth and development continue to demonstrate that the country's banking industry is small relative to gross domestic product (GDP). Therefore, there is significant scope for growth enabled by adoption of new technologies, growing demand for innovative products and market competitiveness, sound governance standards and institutional arrangements, and effective prudential policies and regulation.

The banking industry remained adequately capitalised and complied with minimum prudential standards for regulatory capital requirements. The aggregate unimpaired capital for the banking industry increased by 9.1 percent from P12.8 billion in 2019 to P14 billion in 2020. All banks reported capital adequacy and common equity Tier 1 capital ratios of more than the respective prudential minimum thresholds of 12.5 percent and 4.5 percent.

Past due loans (accounts in arrears) decreased by 0.9 percent between December 2019 and December 2020, while non-performing loans (NPLs) declined by 10.7 percent to P2.8 billion. The resultant ratio of NPLs to gross loans and advances was 4.3 percent in December 2020, compared with 4.8 percent in December 2019, indicating an improvement in the asset quality of the banking industry, albeit in the context of forbearance, loan restructuring and repayment

INTRODUCTION (CONTINUED)

moratoria associated with the COVID-19 challenges. As the rate of the decline in NPLs was more than that of specific provisions, the ratio of specific provisions to NPLs rose from 58.2 percent in 2019 to 60.7 percent in 2020. The banks' large exposures to unimpaired capital ratio decreased marginally from 150.5 percent to 149.7 percent in the same period and thus remained below the 800 percent prudential limit for banks in Botswana.

Generally, the composite credit risk for the banking industry was assessed to be high. The credit quality is expected to deteriorate in the short-to-medium term owing to the possible loss of employment and slowdown in economic activity, generally, resulting from the adverse impact (closures and partial operations) of the COVID-19 pandemic on businesses and households. This outlook for asset quality deterioration is expected to be moderated inasmuch as a large proportion of bank credit in Botswana is accounted for by retail and household credit, which, although mostly unsecured, is to a large number of relatively small uncorrelated borrowers employed mainly in the public sector. Furthermore, a significant amount of household and other retail loans is supported or protected by credit-life policies, mortgage payment protection insurance and lien over life insurance policies, which has effectively transferred some banking risks to the insurance industry.

The net after-tax profit of the banking industry declined by 17.5 percent from P1.8 billion in 2019 to P1.5 billion in 2020. The return on equity and return on average assets decreased from 16.2 percent and 1.9 percent in 2019 to 12.9 percent and 1.4 percent, respectively, in 2020. The level of banking profits has generally trended downwards in recent years on account of relatively low levels of interest rates and the resultant tight margins/spreads, increased competition for large-value, volatile deposits and the restrained growth in non-interest income, against a modest growth in the volume of business (customer base and loans).

The banking industry remained liquid as indicated by statutory liquid assets, which increased by 5.2 percent to P15.4 billion in 2020 from P14.7 billion in 2019. The liquid assets to total deposits ratio for banks declined slightly from 19.3 percent in 2019 to 19.1 percent in 2020 but remained above the required 10 percent prudential minimum. Notwithstanding, the banking sector continued to show high levels of funding and maturity mismatches. Banks continued to be funded by short-term, highly volatile deposits of large corporations and institutional investors, against a significant proportion of medium-to-long term loans (notably mortgages).

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

INTRODUCTION (CONTINUED)

In accordance with Section 24 of the Banking Act, the Bank carried a follow-up on-site prudential examination of three banks during 2020. In addition, the Bank conducted follow-up on-site examination of three banks on anti-money laundering and combating the financing of terrorism (AML/CFT). Overall, the results indicated that most supervisory concerns that were raised in the previous full-scope on-site examination for both prudential and AML/CFT had been addressed satisfactorily. There, however, were some areas relating to capital adequacy and governance oversight that required improvement. With respect to the follow-up on-site AML/CFT examination, three banks violated some sections of the Financial Intelligence Act, 2019 (Cap. 08:07) and, accordingly, the Bank imposed monetary fines.

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 circulating 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 amended various pieces of legislation in 2018, 2019 and 2020 and requested a re-rating from the ESAAMLG in April 2019 and December 2020. In 2020, the re-rating request was for three Financial Action Task Force (FATF) recommendations, namely, “6” (targeted financial sanctions related to terrorism and terrorist financing), “7” (targeted financial sanctions related to proliferation) and “10” (customer due diligence). Considering the progress made by Botswana in addressing the deficiencies that had been identified, the three recommendations were upgraded from partially compliant to largely compliant, implying that the remaining shortcomings were minor. The country is continuing efforts to achieve full compliance with respect to non-compliant and partially compliant FATF recommendations for it to be removed from the grey listed countries (technically referred to as high-risk third countries).

This Report is organised as follows: Chapter 1 outlines the structure of the financial sector, with particular emphasis on banks; Chapter 2 presents an assessment of the financial performance of the banking industry in 2020; Chapter 3 reports on licensing and consumer protection; Chapter 4 highlights the recent global standards and guidelines issued by the Basel Committee on Banking Supervision; and Chapter 5 summarises key issues arising from the on-site and off-site examinations. There is a number of appendices 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 used in the Report, and 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

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS

STRUCTURE OF THE FINANCIAL SECTOR

- 1.1 The Bank of Botswana (Bank) continued to regulate and supervise commercial banks, bureaux de change and a deposit-taking microfinance institution (Women's Finance House). As at December 31, 2020, the number of licensed commercial and statutory banks was nine and three, respectively. During the year under review, six applicants were issued a bureau de change licence and began operations, while eight licences were revoked, resulting in 58 bureaux de change compared with 60 in 2019. Ten bureaux de change requested and were granted temporary closure in response to the unprecedented decline in business activity resulting from the movement and travel restrictions designed to contain COVID-19 infections. As at the end of the year, two out of the ten bureaux de change that temporarily closed had resumed operations.

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 2018 to 2020. The restructuring and expansion of operations by banks resulted in the opening of six new branches. As a result, bank branches increased from 155 in 2019 to 161 in 2020. The number of ATMs increased from 542 to 564 during the year. Most of the new ATMs have enhanced functions, including the deposit-taking facility and card-less options for certain transactions, thus improving the convenience of access to transactional banking services. In addition, ATMs are increasingly used for cashing and re-depositing mobile money transfers/payments.
- 1.3 Regarding geographical distribution of the branch network, the South East District, which includes the capital city, Gaborone, led the concentration of branches at 66, followed by the Central District with 37, as at December 31, 2020. Four districts, Central (2), North East (1), North West (1) and Southern (1) had an increase in branch network, while the branch network for other districts was unchanged (Appendix 2).

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

Table 1.1: Branches and ATMs: 2018 – 2020

		Branches and Sub-branches			ATMs		
		2018	2019	2020	2018	2019	2020
Large Banks	Absa	34	35	35	113	113	114
	Stanchart	19	19	22	68	70	76
	FNBB	28	28	28	226	233	233
	Stanbic	16	17	18	53	56	70
	Sub-total	97	99	103	460	472	493
Small Banks	BancABC	9	13	13	15	14	14
	Baroda	3	4	4	6	6	7
	Bank Gaborone	12	13	14	16	16	17
	FCB	4	5	5	6	6	5
	Bol	1	-	-	-	-	-
	Bank SBI	1	1	1	-	-	-
Sub-total	30	36	37	43	42	43	
Total for Commercial Banks		127	135	140	503	514	540
Statutory Banks	BSB	5	6	7	8	14	14
	BBSL	10	10	10	12	14	14
	NDB	4	4	4	-	-	-
Total for Statutory Banks		19	20	21	20	28	28
Overall Total		146	155	161	523	542	564

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

- 1.4 Meanwhile, the number of point-of-sale (PoS) terminals increased from 16 725 in 2019 to 18 237 in 2020 and are owned by only four of the banks, FNBB, Absa, Stanbic and Bank Gaborone (Table 1.2).

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

Table 1.2: Point of Sale Terminals: 2018 – 2020

Banks	Point of sale		
	2018	2019	2020
Absa	4 666	5 004	4 927
FNBB	7 537	9 075	10 061
Stanbic	2 219	2 491	2 808
Bank Gaborone	0	155	441
Total	14 422	16 725	18 237

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

Access Indicators

- 1.5 Access to banking services, as measured by the ratio of number of depositors to adult¹ population, improved from 72 percent in 2019 to 76.6 percent in 2020. The number of depositors grew by 8.2 percent from 1.2 million in 2019 to 1.3 million in 2020, while the adult population increased by 2.3 percent from 1.6 million to 1.7 million.
- 1.6 The number of ATMs per 1 000 square kilometres and per 10 000 adults was one and three, in 2019, one and 3.4 (statistical average), respectively, in 2020, while there was one branch per 10 000 adults, and a statistical average of less than one branch per 1 000 square kilometres, indicative of the sparse population distribution in the country.

Banking Sector Employment Trends: 2019 – 2020

- 1.7 Employment levels in the banking sector for 2019 and 2020 are shown in Table 1.3. The number of persons directly employed in the banking sector decreased from 5 172 in 2019 to 5 142 in 2020. Increased automation and use of digital channels, along with staff resignations and retirements (not replaced), accounted for the reduced employment at those banks. While there was a decrease in staff complement for some banks, there was an increase with respect to three banks. Overall, the staff complement for small banks increased by 3.1 percent from 546 in 2019 to 563 in 2020; for large banks², the level of employment declined by 2.3 percent from 4 134 in 2019 to 4 042 in 2020. Expatriate representation as a share of total employees in the banking sector slightly decreased from 1.1 percent (59) in 2019 to 1.09 percent (56) in 2020.

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, 2020.

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

Table 1.3: Level of Employment by Domestic Banks: 2019 – 2020

		2019			2020		
		Citizens	Expatriates	Total	Citizens	Expatriates	Total
Large Banks	Absa	1 156	4	1 160	1 096	5	1 101
	Stanchart	641	10	651	622	10	632
	FNBB	1 396	4	1 400	1 370	5	1 375
	Stanbic	565	5	570	554	3	557
	Sub-total	3 758	23	3 781	3 642	23	3 665
Small Banks	BancABC	352	1	353	374	3	377
	Baroda	44	13	57	47	13	60
	Bank Gaborone	292	7	299	298	5	303
	FCB	169	8	177	182	6	188
	Bank SBI	10	3	13	9	3	12
	Sub-total	867	32	899	910	30	940
Total for Commercial Banks		4 625	55	4 680	4 552	53	4 605
Statutory Banks	BSB	165	-	165	212	-	212
	BBSL	215	4	219	207	3	210
	NDB	108	-	108	115	-	115
Total for Statutory Banks		488	4	492	534	3	537
Overall Total		5 113	59	5 172	5 086	56	5 142

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

New Banking Sector Products and Services

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

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

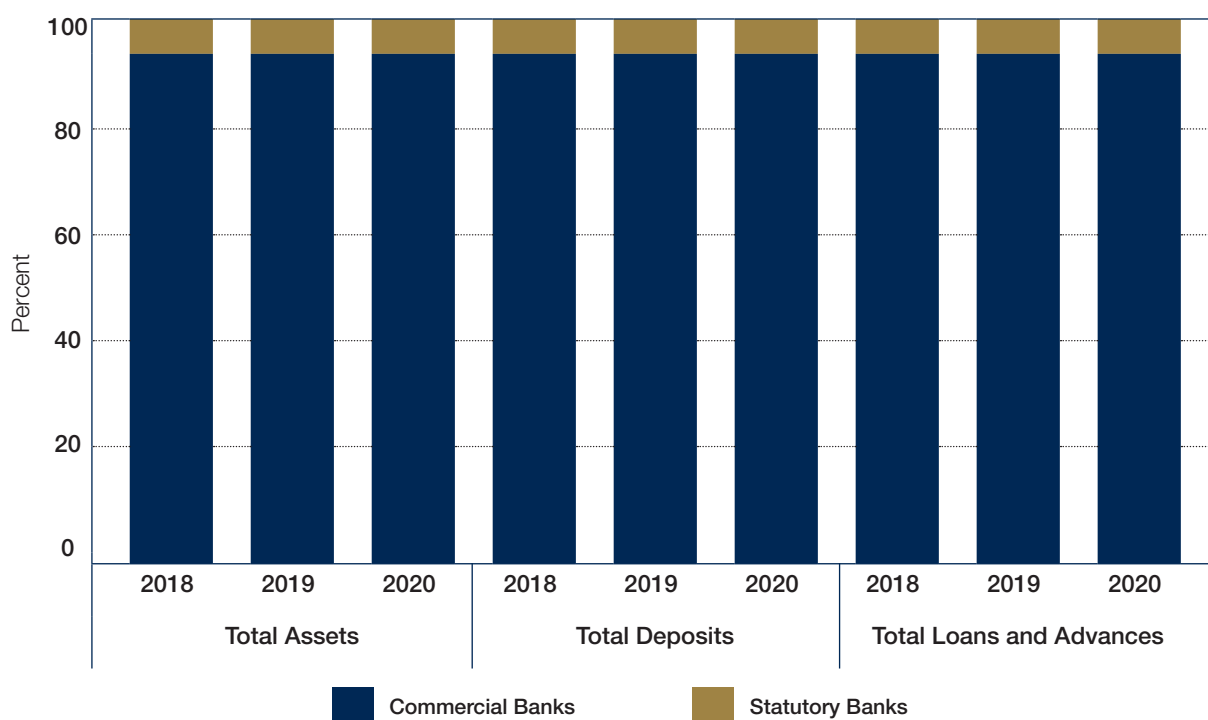
1.9 During the review period, banks introduced 24 new products and services covering a wide range of banking services, such as enhancement of transactional accounts and introduction of cross-border payment services. Most of these products and services target retail customers, with a view to retaining clients, broadening the customer base and expanding sources of income. Some banks have established collaborative arrangements with money-transfer service providers to facilitate provision of financial and payments services to the unbanked segment of the society and hence helping to broaden financial inclusion. In response to the COVID-19 pandemic, banks enhanced their digital offerings in an effort to attract and redirect customers away from over-the-counter to remote (internet and mobile) banking platforms and, consequently, reducing visits to branches, in line with the government regulations to decongest business premises in order to stem the tide of COVID-19.

BANKING SECTOR COMPETITION AND CONCENTRATION

Market Share

1.10 Commercial banks maintained a dominant share of total banking industry assets, total deposits, and total loans and advances compared to statutory banks (Chart 1.1). The market share of statutory banks decreased with respect to total assets and total deposits from 7.3 percent and 6.7 percent in 2019 to 6.3 percent and 6.5 percent in 2020, respectively. The share of total loans and advances grew from 7.5 percent to 8.2 percent in the period under review.

Chart 1.1: Market Share of Total Assets, Total Deposits and Total Loans and Advances* of the Banking Sector: 2018 – 2020 (Percent)



*Figures exclude one statutory bank.

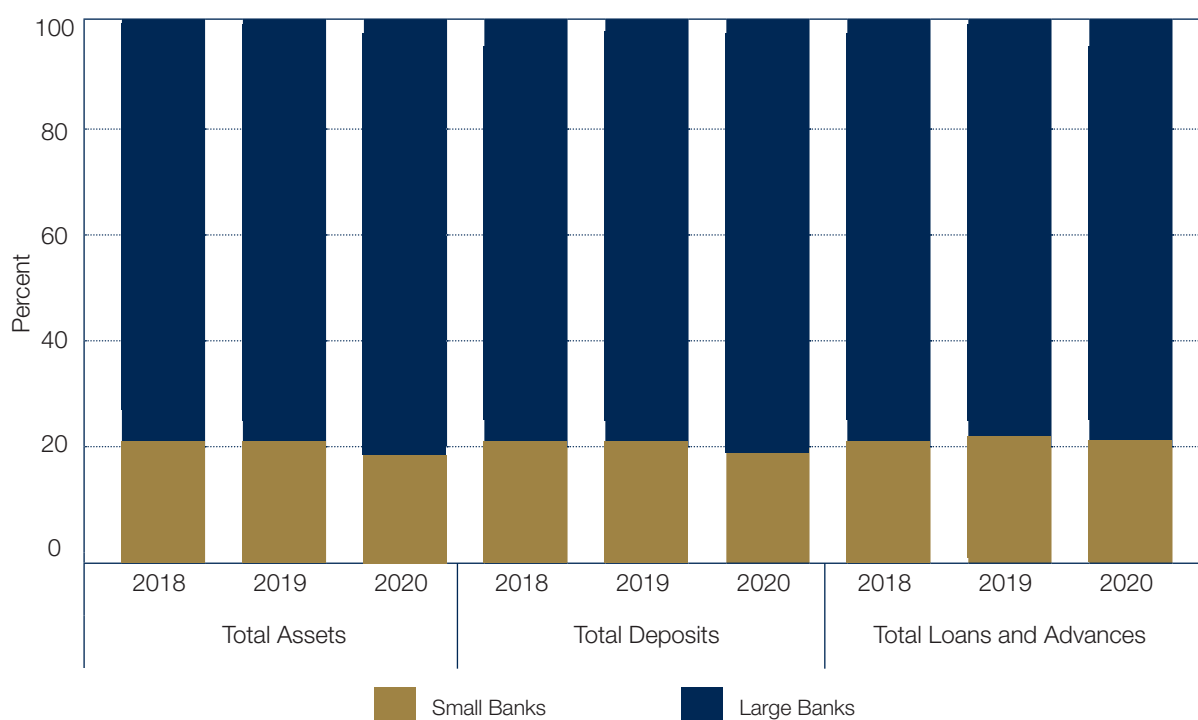
Source: Commercial and Statutory Banks (Statutory Returns submitted to the Bank).

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

1.11 The four large banks continued to dominate the banking sector and accounted, in aggregate, for 79.1 percent, 79.2 percent and 77.4 percent in total assets, total deposits and total loans and advances, respectively in 2020, compared with 78.7 percent, 78.6 percent and 76.7 percent of the same in 2019 (Chart 1.2).

Chart 1.2: Market Share of Total Assets, Total Deposits and Total Loans and Advances of Commercial Banks: 2018 – 2020* (Percent)



Source: Commercial Banks (Statutory Returns submitted to the Bank).
*2018 and 2019 figures revised.

Market Competition Indicators

The Herfindahl-Hirschman Index (HHI) of Competitiveness

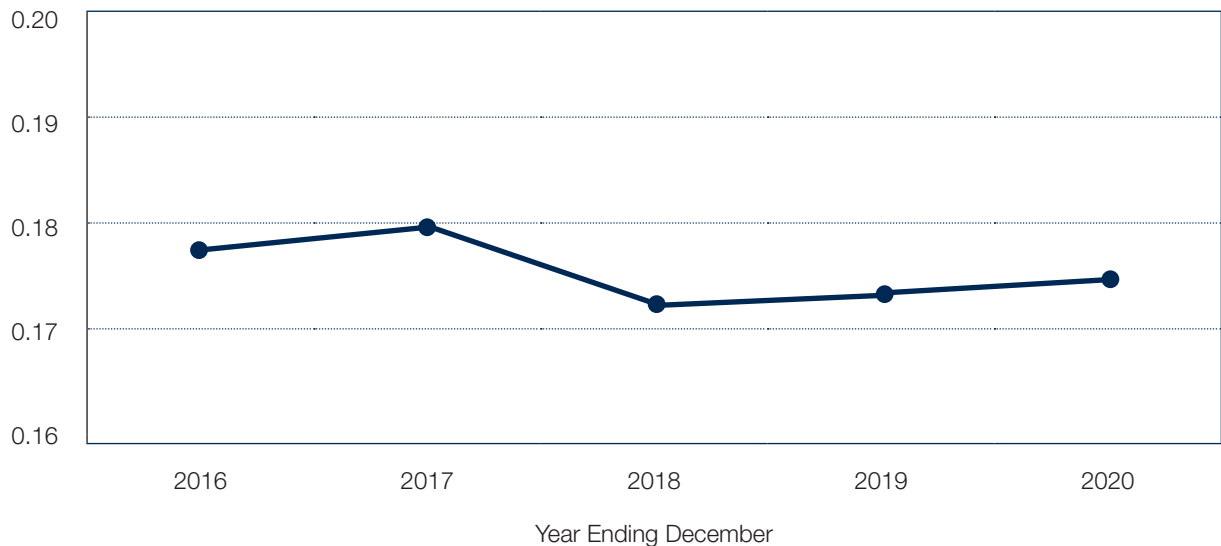
1.12 In addition to other measures, the Bank uses the Herfindahl-Hirschman Index³ (HHI), a widely applied measure of market concentration, to assess the degree of competition in the Botswana banking industry. The HHI marginally increased from 0.1756 in 2019 to 0.1770 in 2020 (Chart 1.3). The HHI remained lower than 0.1800, indicating continuance of a moderately concentrated market.

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 monopolist market, the HHI=1.

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

Chart 1.3: Herfindahl-Hirschman Index (HHI): 2016 – 2020

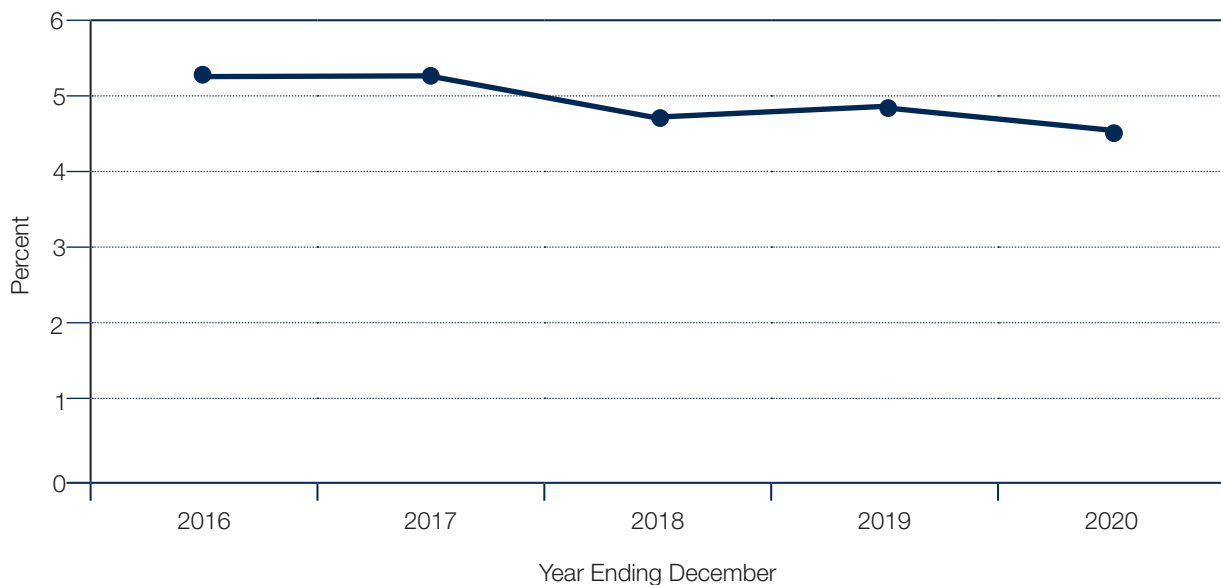


Source: Commercial Banks (Statutory Returns submitted to the Bank).

Net Interest Margin

1.13 The net interest margin (NIM) for the banking industry decreased marginally from 4.9 percent in 2019 to 4.7 percent in 2020 (Chart 1.4), signalling enhanced competition and efficiency of the banking system in 2020. It is noted that, in addition to competitive forces, the NIM can be driven by operating costs, loan quality and the macroeconomic environment, including interest rates and demand (although aspects of these may be indirect facets of market competition).

Chart 1.4: Banking Sector Trend of Net Interest Margin (NIM): 2016 – 2020 (Percent)



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

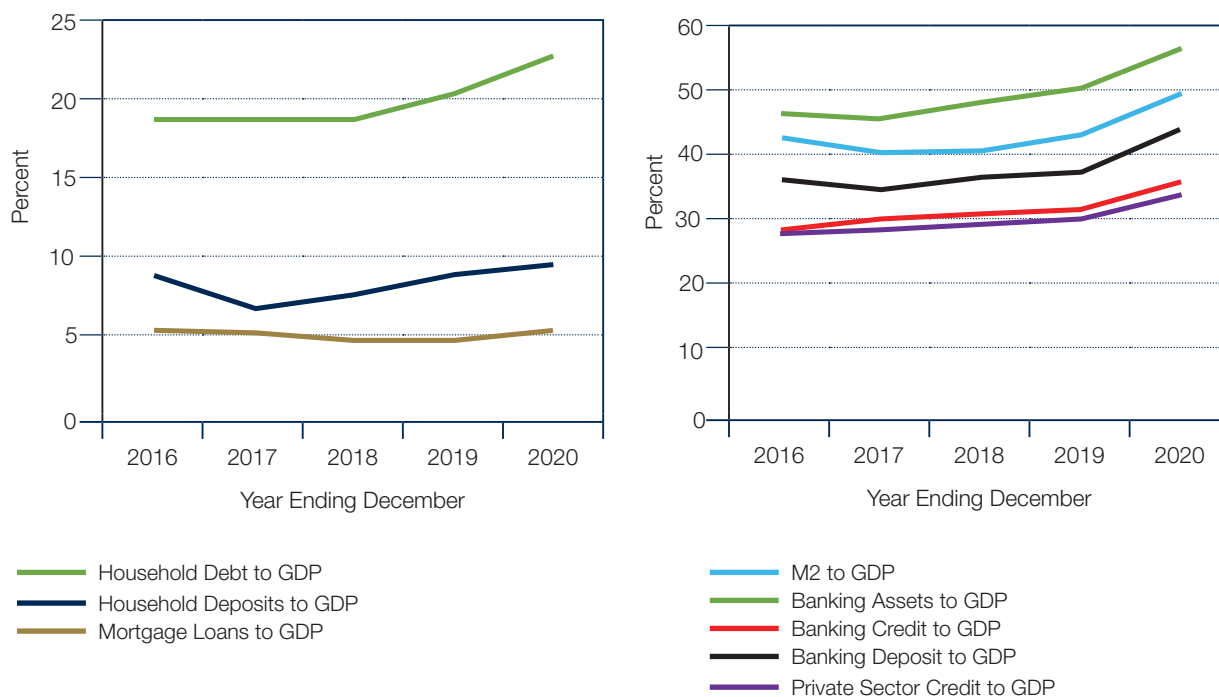
CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

BANKING SECTOR SIZE AND DEPTH

1.14 Financial deepening refers to the increased use, relative to overall GDP, of financial services, particularly broader choices with improved access by various societal (or income) groups, thus a greater and beneficial role of financial services in business activity, enhancement of welfare and living standards and overall economic performance. Chart 1.5 shows several ratios commonly used as measures of financial deepening and development. Overall, financial sector development and depth increased between 2019 and 2020. However, there is a potential for improvement through policy stimulus, structural transformation and strategic realignment by financial institutions to achieve sustainable and far-reaching financial sector support for economic activity.

Chart 1.5: Financial Sector Deepening Indicators: 2016 – 2020 (Percent)



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

1.15 Financial depth and development, as estimated by the ratio of private sector credit to GDP⁴, increased from 30 percent in 2019 to 34 percent in 2020. Similarly, private sector credit as a proportion of non-mining GDP rose from 35.3 percent in 2019 to 38.4 percent in 2020. In comparison with the global average ratio of private sector credit to GDP of 52.2 percent (as reported by the World Bank's 2019/2020 Global Financial Development Report), private sector credit in Botswana is relatively small, suggesting capacity for further credit expansion under stable conditions of the macroeconomy and prudent lending. The ratio, however, was higher than the average of 21.6 percent for sub-Saharan Africa.

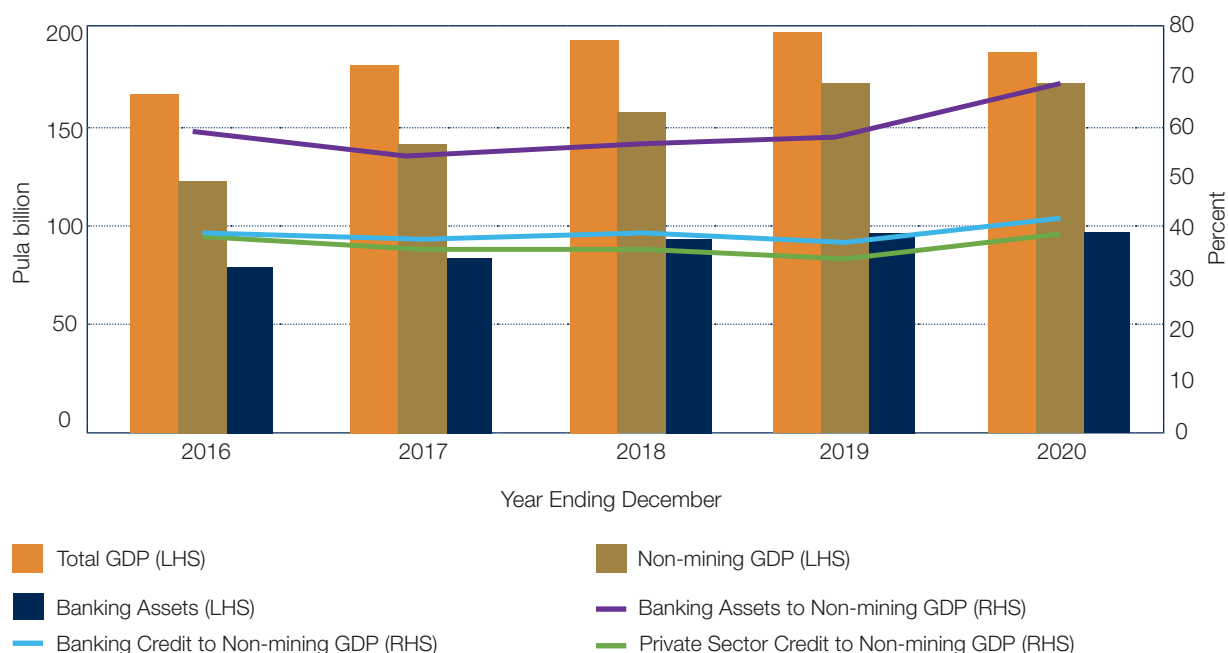
⁴ The private sector credit to GDP ratio, as defined by the World Bank, excludes credit issued to government, government agencies and public enterprises.

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

1.16 Banking credit as a share of total GDP grew from 31.8 percent in 2019 to 36.3 percent in 2020. Regarding the overall sectoral size, the ratio of banking assets to GDP increased from 50 percent in 2019 to 57.1 percent in 2020, while the relative size of banking assets to non-mining GDP increased from 59 percent in 2019 to 64.5 percent in 2020 (Chart 1.5). The increase in these indicators was largely a statistical outcome of the growth in banking credit (4.4 percent) and banking assets (4.6 percent) compared with a decline of 8.5 percent in nominal GDP, rather than real progress in financial development.

Chart 1.6: Financial Sector Size and Depth Indicators: 2016 – 2020



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

1.17 The M2⁵ to GDP ratio, which estimates the degree of monetisation of an economy, increased from 43 percent in 2019 to 49.6 percent in 2020, in the main, indicating the GDP contraction in the period. In normal circumstances, a high M2 to GDP ratio would suggest that a significant part of economic activity was supported by the financial resources mobilised by the banking sector.⁶

⁵ M2 (P89.8 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 4.5 percent compared with a decline of 8.5 percent in nominal GDP.

CHAPTER 1:

BOTSWANA'S FINANCIAL SYSTEM AND SELECTED INDICATORS (CONTINUED)

- 1.18 Total household debt as a proportion of total GDP increased to 23.7 percent in 2020 from 20.3 percent in 2019. The commercial bank mortgage lending to GDP ratio also increased moderately from 4.9 percent in 2019 to 5.6 percent in 2020. Likewise, including statutory banks, the broader ratio of mortgage lending to GDP increased from 7.1 percent in 2019 to 8 percent in 2020, indicating an important role of statutory banks in mortgage financing.⁷ The low level of mortgage lending remains a concern, especially for the banking sector dominated by unsecured household lending, and detracts from the potential welfare benefits of appropriately funded expansion of residential housing. The household deposits to GDP ratio⁸ increased to 9.4 percent in 2020 from 8.1 percent in 2019, largely reflecting the contraction in GDP.
- 1.19 The ratio of pension fund assets to GDP increased from 47.2 percent in 2019 to 58.2 percent in 2020, as pension fund assets grew by 12.9 percent to P105.2 billion. Meanwhile, as at December 31, 2020, the overall household savings, including pension funds, in the banking sector amounted to P122.2 billion compared with the household borrowing of P42.9 billion. Therefore, the household sector was a net saver⁹ in the economy.
- 1.20 The value of electronic funds-transfer transactions (EFTs) relative to economic activity increased slightly from 10.2 percent in 2019 to 12.6 percent in 2020, owing to a growth of 13.4 percent in EFTs.

7 Mortgages (for commercial and statutory banks) increased by 2.5 percent, while nominal GDP declined by 8.5 percent.

8 Household deposits grew by 9.5 percent compared with a decline of 8.5 percent in nominal GDP.

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: MOBILE FINANCIAL SERVICES AS A DRIVER FOR FINANCIAL INCLUSION

In recent years, mobile financial services (MFS) have been recognised as an innovative and effective means to achieve financial inclusion. Consumer preferences are leaning towards ease of use, speed, and faster connectivity, which has stimulated industry key players to provide innovative solutions based on mobile platforms, enabling better user experience, albeit reliant on resilient connectivity. The provision of MFS generally entails the use of a mobile device to access financial services platforms and execute financial transactions. These transactions include mobile payments (m-payments), money transfers through mobile devices between own and peer accounts, and mobile money domestic and international remittances.

MFS can be facilitated by interoperability between mobile network operators (MNOs) and banks' payments systems owing to established partnerships that are beneficial to both parties. Interoperability enables transfer of funds from a bank account to a mobile money account and vice versa; it also facilitates person-to-person cash remittance, as cash remitted through a mobile phone can be collected directly from a nearby agent or automated teller machine (ATM). MFS tend to be offered under well-established, risk-managed, regulated infrastructures and are therefore reliable and easily accessible.

Mobile Payments

Mobile payments involve the use of a mobile device to pay for goods or services, either remotely or at a point of sale. The mobile payments service is easy to use and can be used by anyone with access to a mobile-phone network. To make mobile payments, the prospective mobile-money user must register and open an account with a mobile-money service provider. Mobile-money subscribers are able to collect cash from authorised agents and ATMs as well as make cashless payments to selected merchants and other individuals through their mobile devices. Mobile money is a popular alternative to cash, bank cards and electronic funds transfers. Existing mobile-money facility platform providers in Botswana are Smega by Botswana Telecommunications Corporation Limited, Orange Money by Orange Botswana Limited, MyZaka Mascom Money by Mascom Wireless Proprietary Limited and Posomoney by Botswana Post.

The MNOs have partnered with banks and fintech companies to provide services that can be extended to the unbanked. The mobile-money service is convenient in areas where access to banks is not easy or is unavailable. Users are able to make payments for goods and services in shops or online, pay bills, pay merchants and buy mobile-phone airtime.

Mobile Banking

Mobile banking is a service provided through the collaboration of the banks and MNOs, enabling users to perform selected banking transactions. An active bank account is needed and a mobile phone equipped with features that allow banking transactions. Mobile banking also facilitates efficient service delivery, especially for people in areas where there is limited access or no access to banks and other banking facilities.

While most banks are making their online payment platforms compatible with mobile devices, mobile banking is more commonly associated with accessing accounts through a banking application and unstructured supplementary service data. Mobile banking, like online banking, which is also accessible on personal computers and laptops, in addition to mobile devices, provides convenience to customers who want to manage their finances from anywhere and at any time.

The adoption of mobile telephony for the provision of financial services has become instrumental in providing services to the unbanked and underbanked communities. According to the FinMark Trust's Making Access Possible Report, 2019, the total number of active mobile-money agents per 100 000 adult population in Botswana increased markedly from 76 to 130 between September 2018 and September 2019, while mobile-money accounts increased from 5 593 per 10 000 adult population in September 2018, to 9 150 per 10 000 adult population in September 2019. As at December 31, 2020, there were approximately 1.4 million mobile money accounts in Botswana. This increase highlights that indeed mobile money plays a key role in driving financial inclusion in Botswana.

	September 2018	September 2019
Mobile-money accounts per 10 000	5 593	9 150
Number of Mobile Money Agents per 100 000	76	130

Source: FinMark Trust, 2019.

In Botswana, oversight and regulatory frameworks of payments-related services have been developed in recognition and support of the evolving developments in MFS. In this regard, the Electronic Payment Services Regulations, 2019 (Regulations) is the main regulatory instrument for licensing of payments-service providers, including those providing MFS. The Regulations provide a regulatory framework for the provision and usage of electronic payment services, and promote an enabling environment for innovation in delivery of financial services, thereby creating an opportunity to serve the financial needs of Botswana's unbanked communities. In addition, the electronic payments-service providers of MFS are subject to oversight and anti-money laundering/counter financing of terrorism supervision by the Bank of Botswana to ensure compliance with the Financial Intelligence Act (Cap. 08:07) and Regulations, 2019, and the Financial Action Task Force requirements.

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CHAPTER 2

PERFORMANCE OF THE BANKING INDUSTRY

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COMMERCIAL BANKS

Statement of Financial Position: Balance Sheet

Assets

- 2.1 Total assets of the banking industry increased by 4.6 percent in 2020, a slower rate compared with the growth of 8 percent in 2019. The aggregate banking assets amounted to P103.3 billion as at December 31, 2020, compared with P98.7 billion in December 2019. Among the assets, gross loans and advances grew by 4.4 percent from P62.8 billion in 2019 to P65.6 billion in 2020, while investment and trading securities, with a lower value increased by 11.4 percent. Net loans and advances constituted the largest share of the banking sector assets at 61 percent, followed by placements with other banks and credit institutions (15 percent), investment and trading securities (15 percent), cash and balances with the central bank (6 percent) and other assets (3 percent).

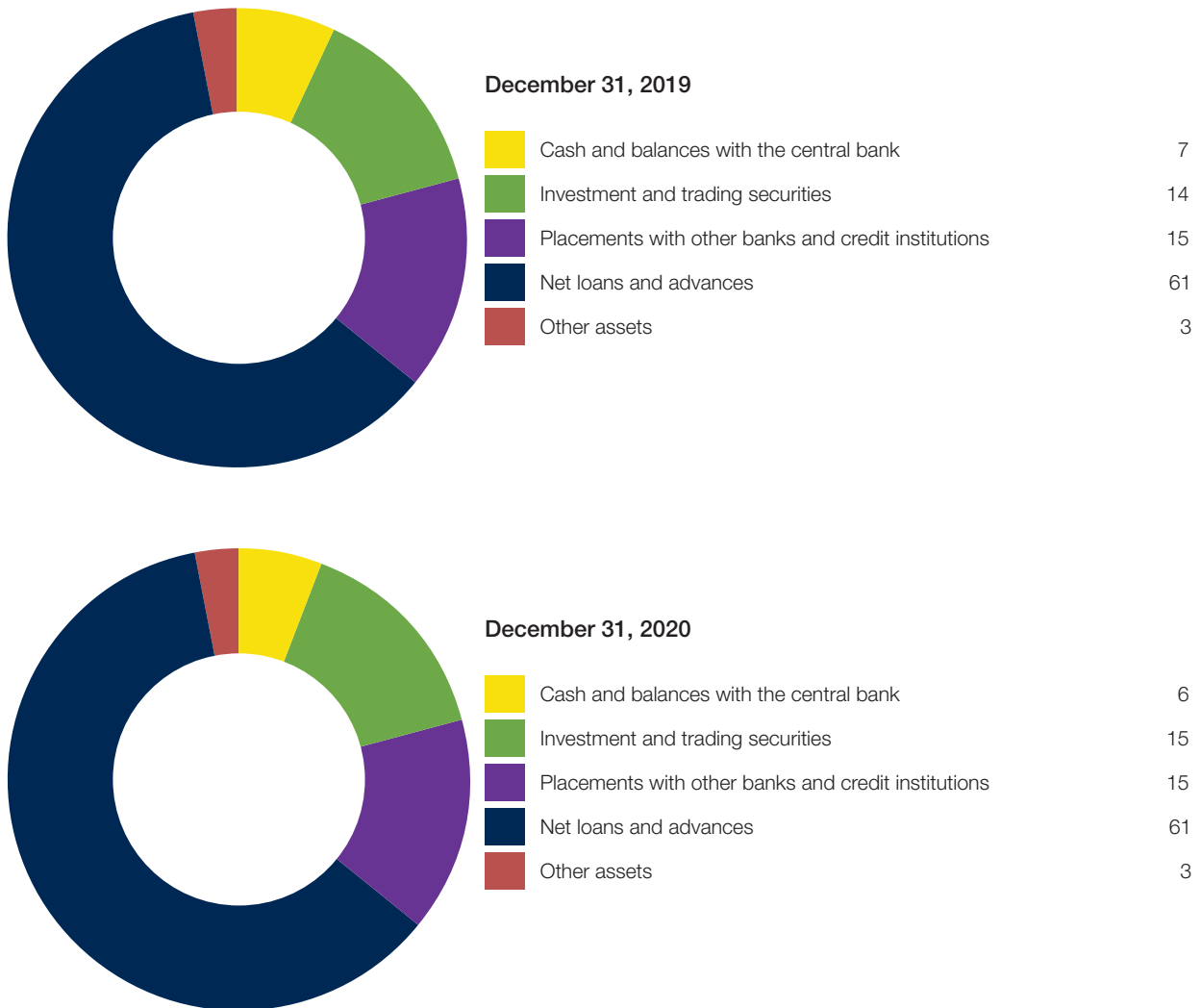
Liabilities

- 2.2 Total liabilities (excluding shareholder funds) of the banking sector grew by 4.8 percent from P87.8 billion in December 2019 to P92 billion in December 2020. Of the liabilities, customer deposits, which constituted 78 percent of the total, increased by 6.4 percent from P75.7 billion in 2019 to P80.5 billion in 2020. In addition, all the other liabilities increased, except balances due to other banks and credit institutions, which fell by 33.3 percent to P3 billion in 2020.
- 2.3 Charts 2.1 and 2.2 show the respective composition of assets and liabilities for 2019 and 2020. The proportions of both assets and liabilities remained largely unchanged, with small variations between the two periods.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.1: Commercial Banks: Composition of Assets: 2019 and 2020 (Percent)

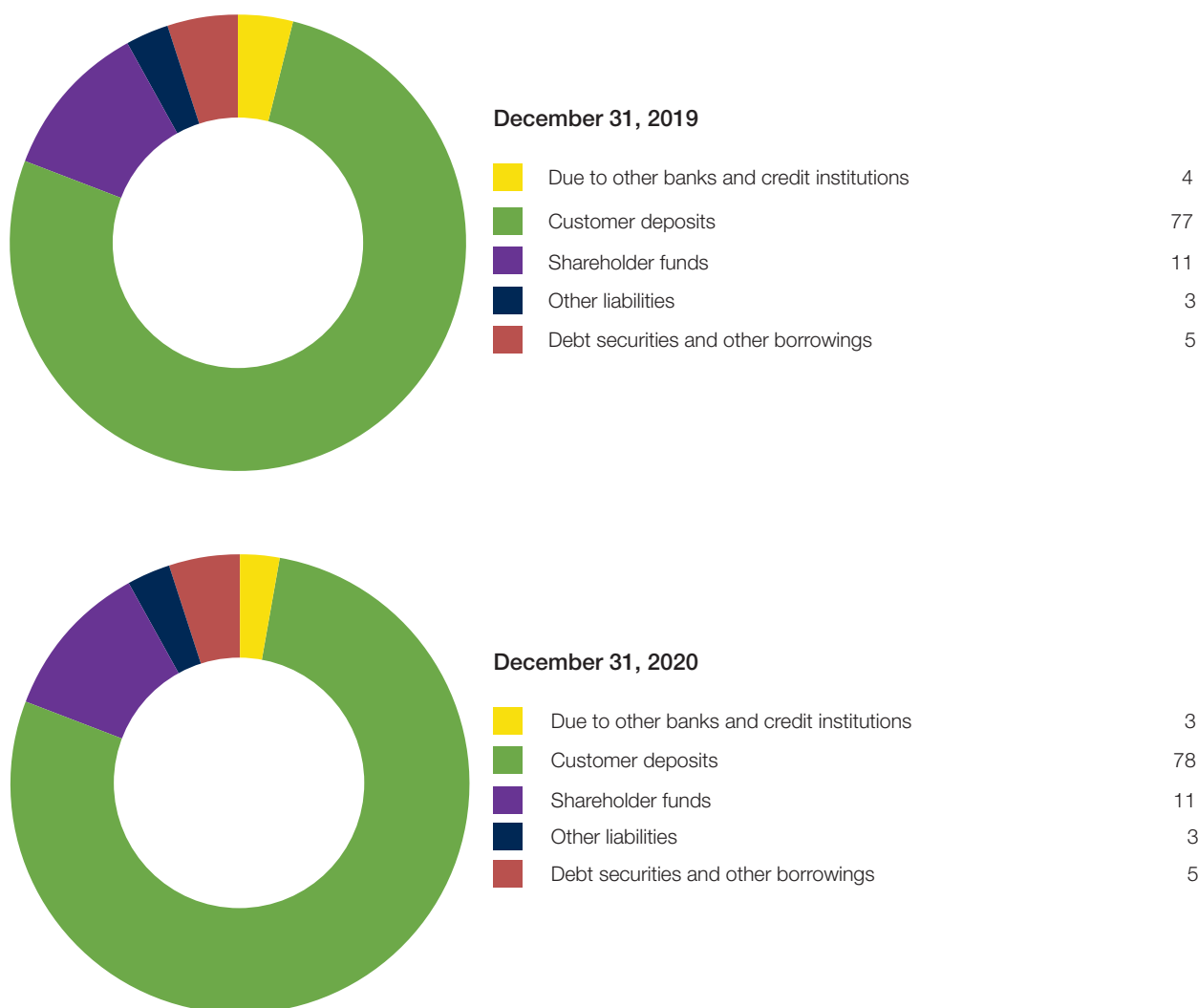


Source: Commercial Banks (Statutory Returns submitted to the Bank).

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.2: Commercial Banks: Composition of Liabilities: 2019 and 2020 (Percent)



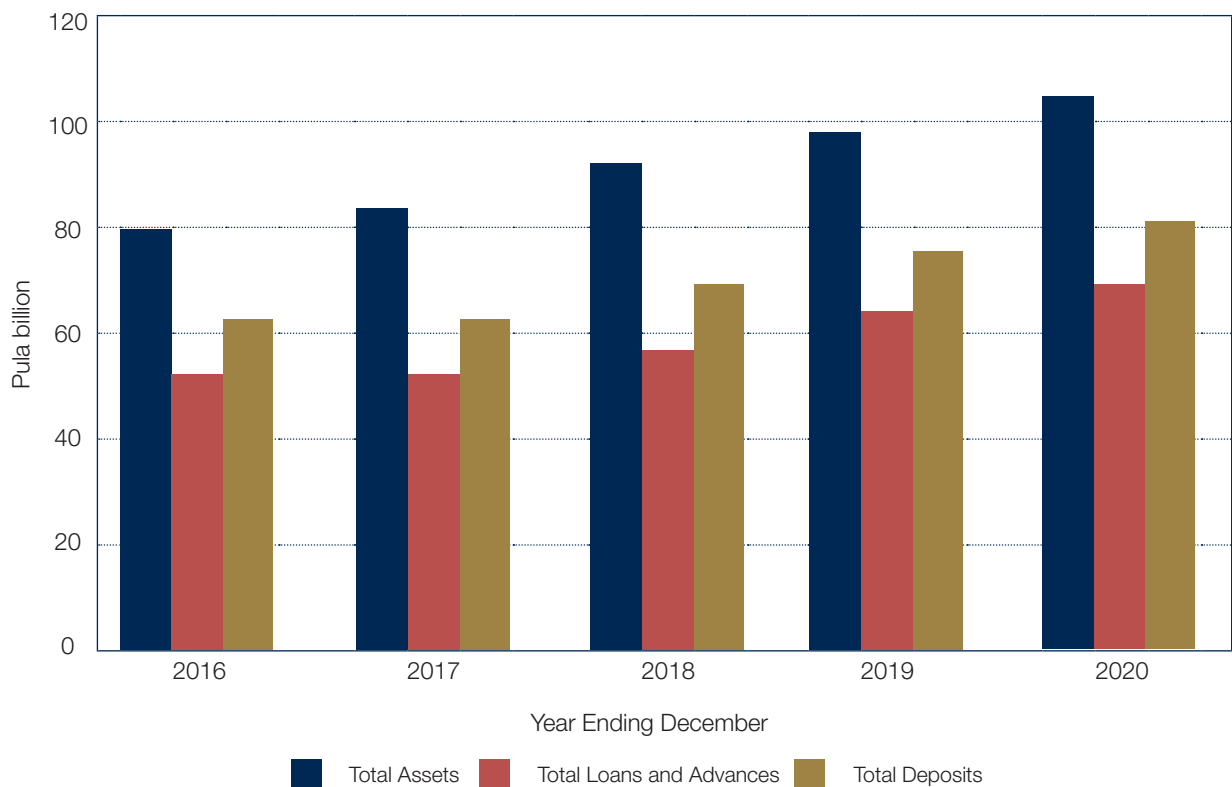
Source: Commercial Banks (Statutory Returns submitted to the Bank).

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

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 2016 – 2020. The growth rates fell for assets, deposits, and loans and advances in 2020 compared with those for 2019, indicating the negative impact of the COVID-19 pandemic on the banking sector business.

Chart 2.3: Commercial Banks: Total Assets, Total Deposits and Total Loans and Advances: 2016 – 2020 (P billion)

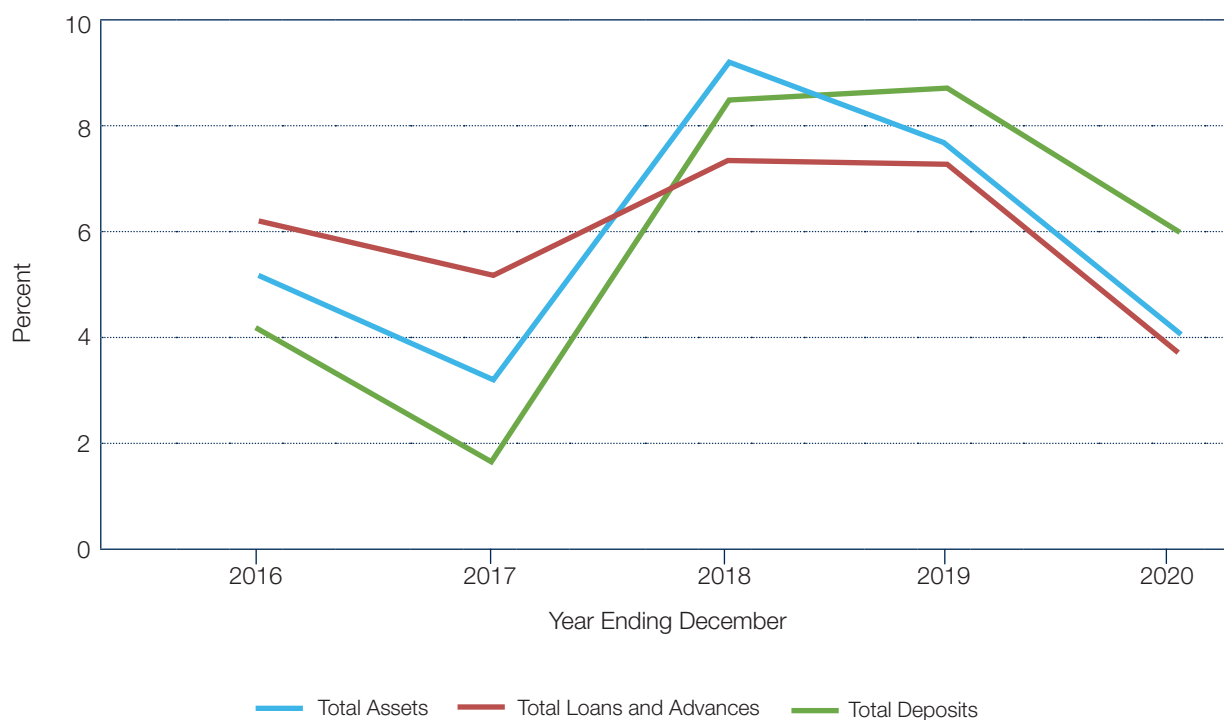


Source: Commercial Banks (Statutory Returns submitted to the Bank).

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.4: Commercial Banks: Annual Growth Rates of Total Assets, Total Deposits and Total Loans and Advances: 2016 – 2020 (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, 2019, and December 31, 2020. Assets held by banks with risk weights of 20 percent, 35 percent, 50 percent and 100 percent declined in 2020, while assets with risk weights of zero, 75 percent and 150 percent increased. On-balance-sheet assets risk weighted at 75 percent had the largest share of 35.6 percent, following the migration of one bank's residential mortgages from the 35 percent risk weight to the 75 percent risk-weight category. The adjustment was made because the bank did not value the properties within the three-year period, contrary to the requirement. This risk-weight substitution is consistent with the requirements of the Directive on the Revised International Convergence of Capital Measurement Standards for Botswana (Basel II Capital Directive).
- 2.6 Overall, 25.5 percent of on-balance-sheet asset items were above the 75 percent risk-weight category in 2020 compared with 26 percent in 2019, indicating a modest decrease in the riskiness of bank assets.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.1: Riskiness of Banks' Portfolios of On-balance Sheet Assets in 2019 and 2020

Risk Weights (Percent)	On-balance Sheet Assets (P' million)	December 2019		December 2020	
		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)	On-balance Sheet Assets (P'million)
0	19 945	19.9	20 942	20.1	
20	12 418	12.4	12 259	11.8	
35	5 373	5.4	5 340	5.1	
50	2 007	2.0	1 952	1.9	
75	34 318	34.3	37 073	35.6	
100	24 985	25.0	24 474	23.5	
150	941	0.9	1 977	1.9	
250	65	0.1	106	0.1	
1250	0	0	1.92	0.002	
Total	100 053	100.0	104 124	100.0	

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

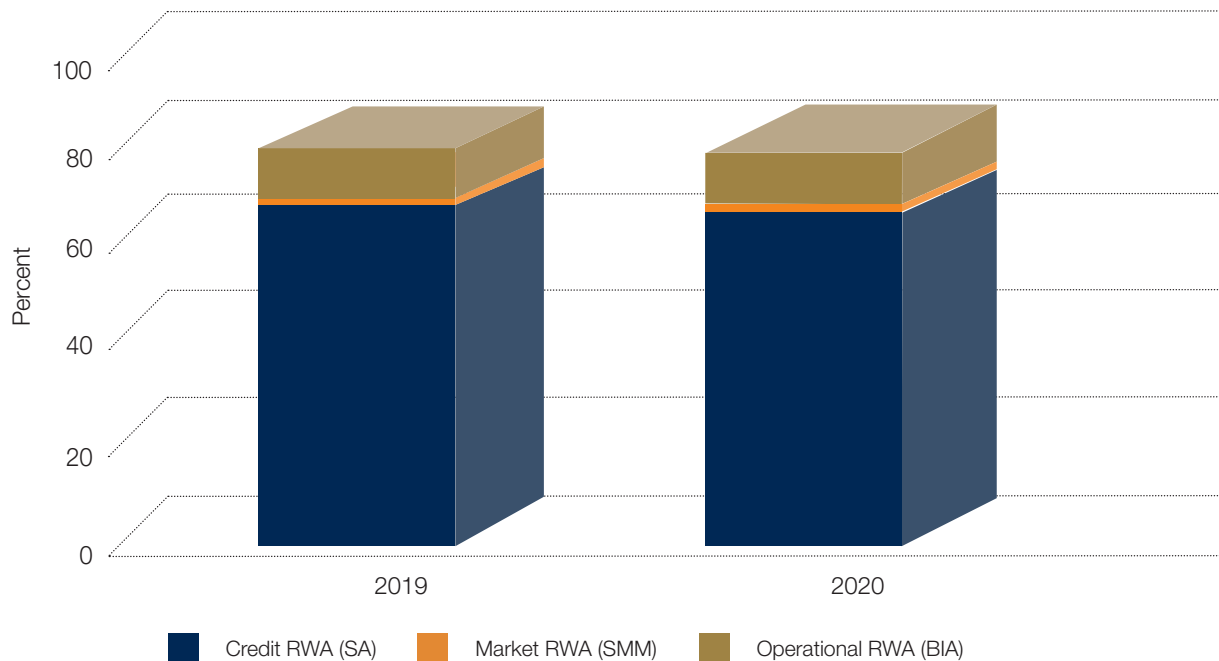
RISK ASSESSMENT

- 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.
- 2.8 Chart 2.5 shows the aggregate risk-weighted assets (RWAs) of the banking sector in 2019 and 2020, as calculated under Pillar 1 of Basel II Capital Directive. Total RWAs increased by 5.6 percent from P66.3 billion in 2019 to P69.9 billion in 2020, mainly indicative of the growth in loans and advances. Proportions of RWAs were largely the same as in the previous year, with credit RWAs constituting the bulk of the banking sector's RWAs at 88 percent, followed by operational RWAs at 10 percent and market RWAs at 2 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.5: Composition of Risk-Weighted Assets: 2019 and 2020 (Percent)



Credit Risk

Regulatory Capital Requirements on Credit Risk

- 2.9 Credit RWAs increased by 4.6 percent to P61.5 billion in December 2020 from P58.8 billion in December 2019, reflecting the growth in credit.

Asset Quality: Levels and Trends

- 2.10 Gross loans and advances grew by 4.4 percent from P62.8 billion in 2019 to P65.6 billion in 2020, albeit slower than the 7.6 percent growth in 2019. Growth in gross loans and advances occurred across all banks, except three banks in 2020. The slow growth in credit could reflect the reluctance of the banking industry to extend credit, the use of more stringent credit assessment criteria and a reduction in the borrowing capacity and appetite of prospective borrowers, given the impact of the COVID-19 pandemic and associated uncertain prospects for economic performance.

CHAPTER 2:

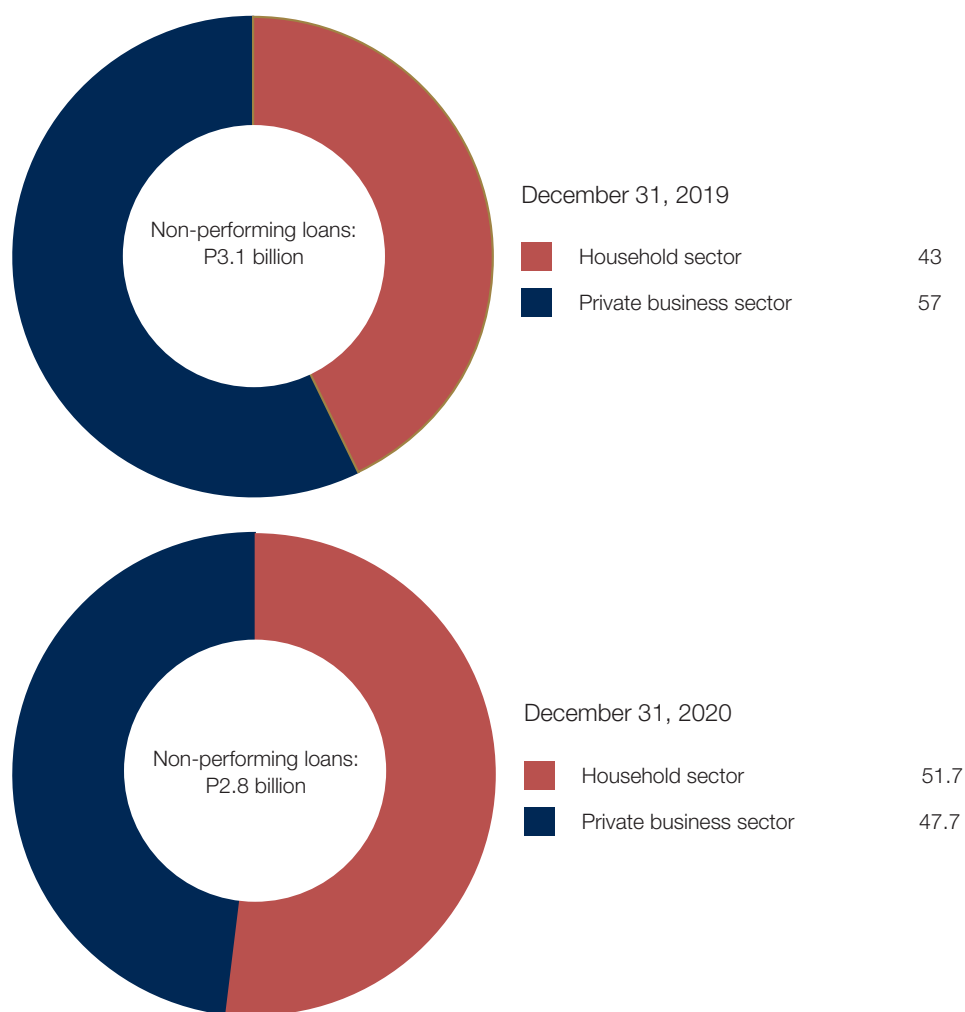
PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

- 2.11 Total past due loans (loans with repayment arrears) decreased by 0.9 percent to P3.87 billion in 2020 from P3.9 billion in 2019, while non-performing loans (NPLs) (impaired loans) decreased by 7.5 percent from P3.1 billion to P2.8 billion. NPLs decreased mainly as a result of ongoing efforts by banks to intensify credit assessment criteria and focus on creditworthy clients. In addition, it should be noted that the implementation of a circular to banks on guidance on the regulatory treatment of International Financial Reporting Standard (IFRS) 9 on account of COVID-19 may have contributed to a reduction in NPLs during the loan-payment holiday, given that banks were allowed to treat all loans granted the selective moratorium as performing and to suspend the raising of specific provisions for these loans during the period. The moratorium lasted for six months; some banks, however, continued to give their clients loan payment holiday beyond six months on a case-by-case basis.
- 2.12 There was therefore an improvement in the banking sector asset quality as indicated by the decrease in the ratio of NPLs to gross loans and advances from 4.8 percent in 2019 to 4.3 percent in 2020; for individual banks, the ratio ranged between 1.1 percent and 6.4 percent. Notwithstanding the decrease in NPLs, the Bank expects a deterioration in asset quality should the pandemic last for a much longer time. Furthermore, the withdrawal of the regulatory forbearance measures and the lifting of the state of public emergency are also likely to result in deterioration of asset quality and credit losses, given the expected loss of employment and the anticipated impairment provisions for the non-performing loan book that was not classified as such during the period of payment holiday or repayment moratorium.
- 2.13 The banking industry loans and advances classified as pass, special mention, sub-standard, doubtful and loss loans (see Appendix 5 for definitions) constituted 91.6 percent, 3.3 percent, 1.3 percent, 2.5 percent and 1.3 percent, respectively, of total loans and advances, as at December 31, 2020.
- 2.14 As at December 31, 2020, households (predominantly unsecured loans) and private businesses accounted for 51.7 percent and 47.7 percent of NPLs, respectively. Meanwhile, the public and financial institutions sub-sectors had negligible NPLs of zero and 0.5 percent, respectively. Chart 2.6 shows the sectoral distribution of NPLs between 2019 and 2020.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.6: Sectoral Distribution of Non-performing Loans and Advances: 2019 and 2020 (Percent)



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

2.15 Trade, restaurants and bars, business services, manufacturing, construction, and commercial real estate sub-sectors constituted 17.9 percent, 16 percent, 14.3 percent, 13.2 percent and 12.6 percent of the private business sector NPLs, respectively, in 2020. Table 2.2 shows sectoral distribution of private business NPLs, while Table 2.3 shows the levels of gross loans and advances, NPLs and specific provisions as well as the proportion of NPLs to gross loans and advances, and specific provisions to NPLs.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.2: Distribution of Private Business Sector Non-performing Loans and Advances: 2016 – 2020 (Percent)

Private Business Subsectors	2016	2017	2018	2019	2020
Agriculture, forestry and fishing	9.8	7.9	9.0	7.4	7.2
Mining and quarrying	0.1	0.0	2.5	2.5	5.6
Manufacturing	10.6	30.9	29.5	27.1	14.3
Construction	5.9	6.9	10.0	10.2	13.2
Commercial real estate	11.1	14.1	8.9	9.4	12.6
Electricity	0.0	1.4	0.7	0.5	0.8
Water	0.0	0.2	0.0	0.0	0.0
Telecommunications	0.4	0.0	0.0	0.0	0.1
Tourism and hotels	4.5	5.4	4.2	3.2	2.8
Transport	4.4	4.2	5.7	3.4	5.1
Trade, restaurants and bars	31.5	17.1	17.2	23.7	17.9
Business Services	14.7	10.3	10.3	9.5	16.0
Other community, social and personal services	7.0	1.4	2.0	3.1	4.3

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: 2016 – 2020

	2016	2017	2018	2019	2020
P thousand					
Gross loans and advances	51 325	54 181	58 332	62 770	65 554
Non-performing loans (NPLs)	2 516	2 859	3 166	3 051	2 824
Specific provisions	1 270	1 536	1 352	1 775	1 713
Percent					
NPLs to gross loans and advances	4.9	5.3	5.5	4.8	4.3
Specific provisions to NPLs	50.5	53.7	42.7	58.2	60.7

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

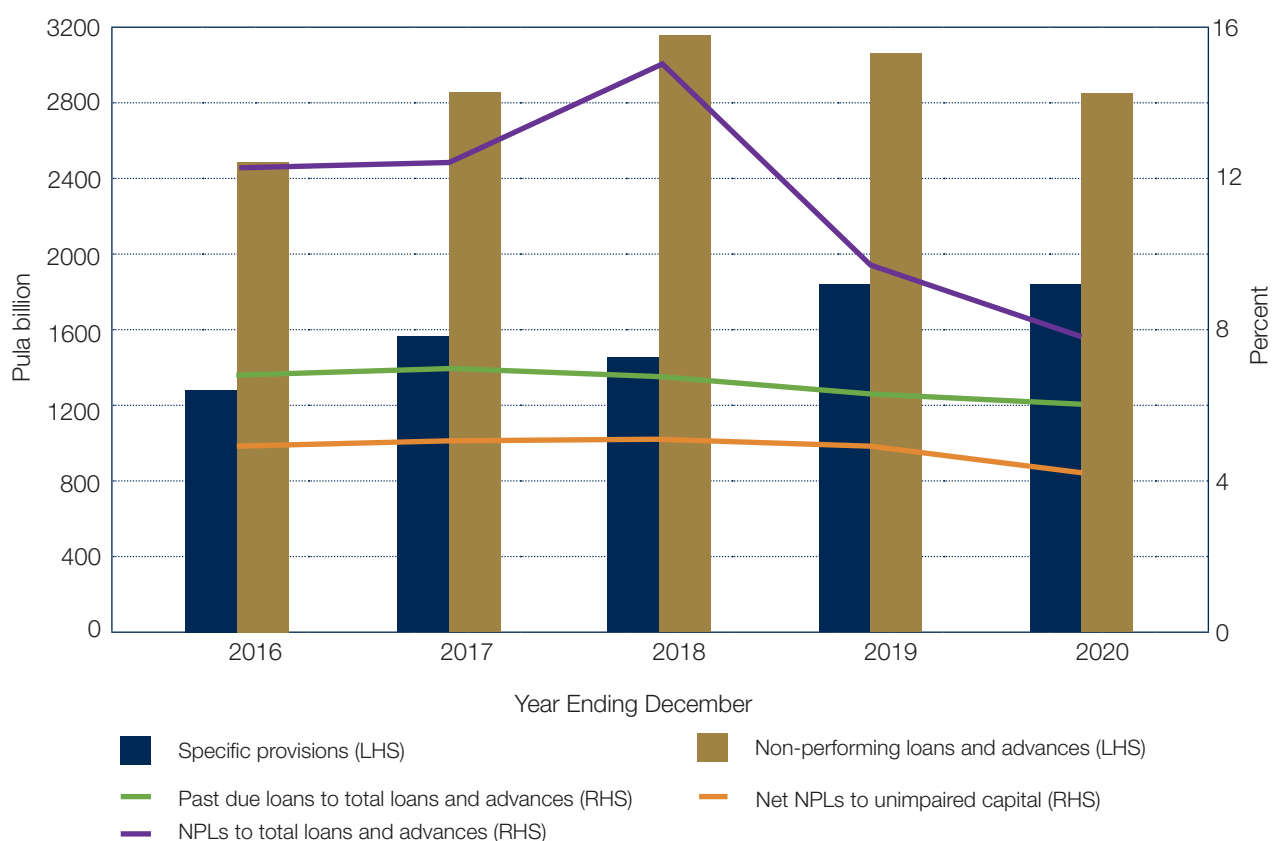
CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

2.16 Specific provisions for non-performing assets fell from P1.8 billion in 2019 to P1.7 billion in 2020, representing a decline of 3.5 percent. Consequently, the ratio of specific provisions to NPLs increased from 58.2 percent in 2019 to 60.7 percent in 2020, because the fall in NPLs (7.5 percent) was more than that in specific provisions (3.5 percent). Net NPLs (net of specific provisions) to unimpaired capital ratio declined from 9.9 percent to 7.9 percent during the period, indicating a decreasing effect of NPLs on capital.

2.17 Chart 2.7 shows trends in the commercial bank asset-quality indicators for the period 2016 – 2020.

Chart 2.7: Commercial Banks: Asset-Quality Indicators: 2016 – 2020 (P million)



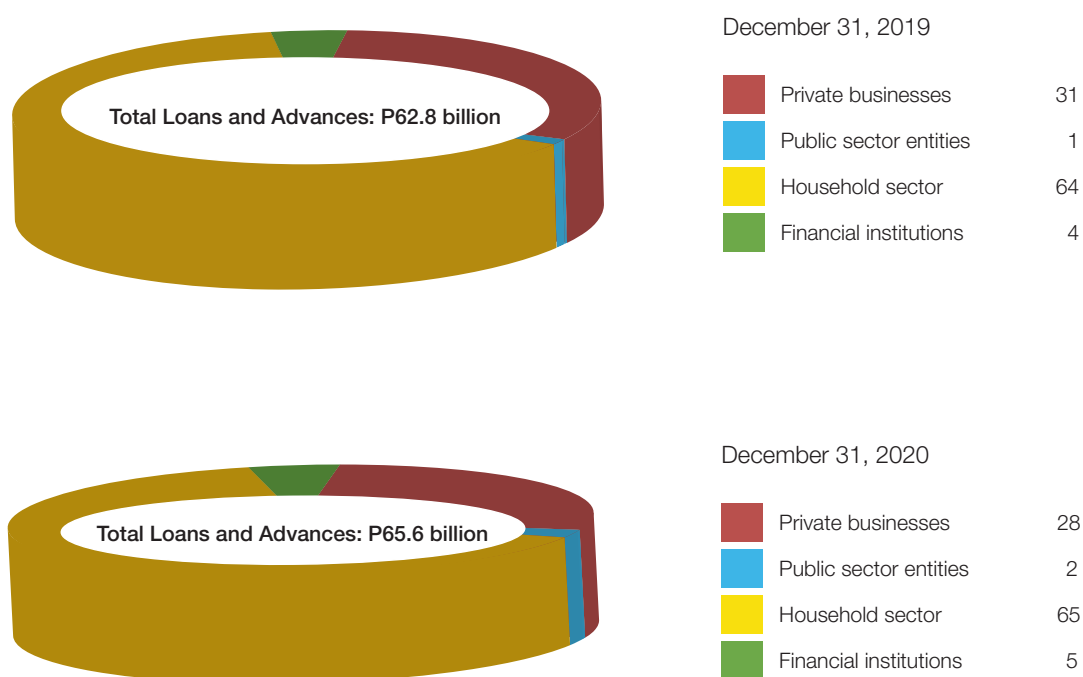
CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

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

2.18 Chart 2.8 compares the sectoral distribution of loans and advances between 2019 and 2020. Loans and advances to households grew by 7.3 percent to P42.9 billion in 2020 from P40 billion in 2019, thus accounting for 65 percent of gross loans and advances. The share of credit to public sector entities (parastatals) and financial institutions in gross loans and advances increased from one percent and 4 percent in 2019 to 2 percent and 5 percent in 2020, respectively, while that of private business decreased from 31 percent to 28 percent in the same period.

Chart 2.8: Sectoral Distribution of Loans and Advances: 2019 and 2020 (Percent)



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

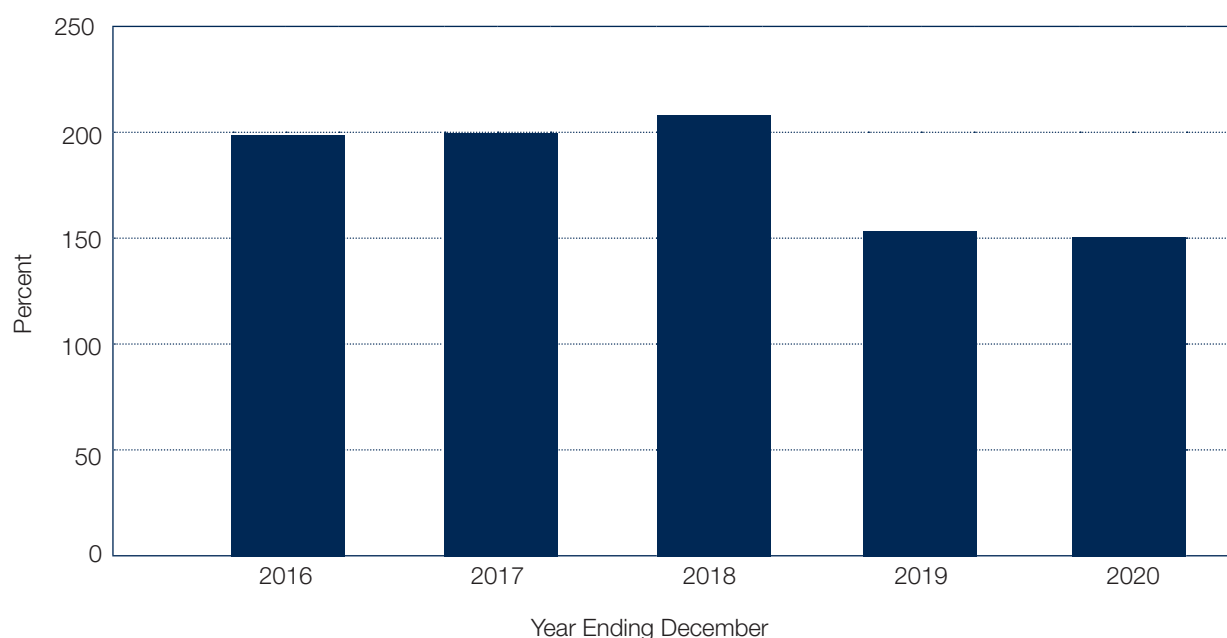
CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Large Exposures

2.19 Large exposures¹⁰ for commercial banks increased by 8.5 percent from P19.3 billion in 2019 to P21 billion in 2020, and unimpaired capital increased by 9.1 percent from P12.8 billion to P14 billion in the same period. Consequently, the ratio of banks' large exposures to unimpaired capital decreased marginally from 150.5 percent in 2019 to 149.7 percent in 2020, remaining below the 800 percent prudential limit for banks in Botswana (Chart 2.9). This ratio ranged from 32.6 percent to 517.2 percent.

Chart 2.9: Commercial Banks: Large Exposures to Unimpaired Capital Ratio: 2016 – 2020 (Percent)



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

The Structure of Private Business Loans and Advances

2.20 Table 2.4 shows the distribution of private business loans and advances for the period 2016 – 2020. The market share of two sub-sectors, namely, trade, restaurant and bars, and commercial real estate increased marginally during the review period. Despite the increase in its share of credit, the output growth for the commercial real estate sub-sector was negative, contributing to the fall in overall GDP (Table 2.5). The COVID-19 pandemic negatively affected the tourism and hotels, and construction sub-sectors, resulting in the respective contraction in output by 33.3 percent and 11 percent in 2020, from the growth of 4.6 percent and 3 percent in 2019.

¹⁰ 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.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.4: Sectoral Distribution of Private Business Loans: 2016 – 2020 (Percent)

Distribution of Private Business Loans	2016	2017	2018	2019	2020
Agriculture, forestry and fishing	8	7	6	8	7
Mining and quarrying	2	2	2	3	3
Manufacturing	22	19	18	10	9
Construction	6	6	6	6	5
Commercial real estate	25	21	20	23	24
Electricity	-	-	-	-	-
Telecommunications	1	1	1	1	1
Tourism and hotels	4	5	4	6	6
Transport	3	3	2	3	2
Trade, restaurants and bars	24	33	21	19	22
Business services	-	-	-	16	16
Other	6	4	20	4	5

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

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.5: Selected Sectoral Economic Growth Rates and Shares in Non-mining Real GDP 2016 – 2020 (Percent)

	2016	2017	2018	2019	2020
Agriculture, forestry and fishing					
Growth rate	0.6	1.9	2.6	(0.1)	2.3
Share in non-mining GDP	1.8	1.8	1.8	1.7	1.8
Commercial real estate					
Growth rate	7.5	6.2	6.6	6.6	(4.5)
Share in non-mining GDP	1.6	1.6	1.7	1.7	1.7
Manufacturing					
Growth rate	1.6	2.2	3.4	2.8	(8.7)
Share in non-mining GDP	6.8	6.7	6.6	6.6	6.4
Construction					
Growth rate	4.2	3.5	3.7	3.0	(11.0)
Share in non-mining GDP	8.5	8.4	8.4	8.3	7.9
Tourism and hotels					
Growth rate	5.2	5.6	7.2	4.6	(33.3)
Share in non-mining GDP	8.1	8.2	8.4	8.5	6.0
Non-mining Real GDP					
Growth rate	5.5	4.8	4.1	3.9	(5.9)

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

Loans to Directors and Related Parties

2.21 The exposure to related parties¹¹ as a proportion of unimpaired capital increased from 4.7 percent in December 2019 to 7.5 percent in December 2020. At this level, insider loans are assessed to pose minimal credit risk to the banking industry.

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

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Foreign Currency-Denominated Loans and Liabilities

2.22 Foreign currency-denominated loans decreased by 16.8 percent to P3.2 billion in 2020 from P3.9 billion in 2019, while foreign currency-denominated deposits increased by 23.1 percent from P11.1 billion to P13.7 billion in the same period. As a result, the ratio of loans denominated in foreign currency to foreign currency-denominated deposits declined from 34.9 percent to 23.6 percent in the same period. Foreign currency-denominated loans (from three banks) were mainly used to fund diamond sightholders and buying goods and services denominated in foreign currency. For banks that have foreign-currency products, the ratio ranged from 0.7 percent to 50.6 percent.

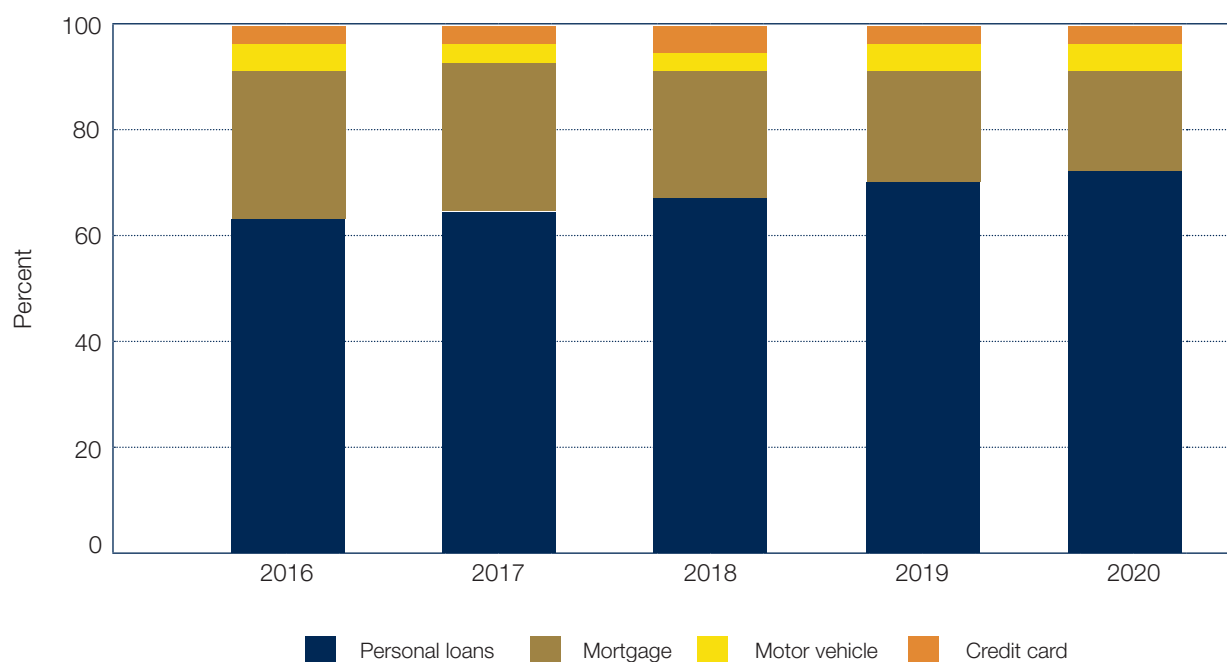
Composition of Household Loans and Advances

2.23 The increase of 7.3 percent in household sector loans in 2020 was slower than the 13.8 percent in the previous year. Personal (mostly unsecured lending), mortgage and motor vehicle loans increased by 9.6 percent, 4 percent and 2.8 percent to P29.8 billion, P10.1 billion and P2.1 billion, respectively, while credit cards declined by 27.7 percent to P709 million in the same period. The moderate growth rates of most components of household loans was as a result of the negative effect of the COVID-19 pandemic on the economy. The resultant shutdown of businesses and loss of employment reduced the borrowing capacity of retail customers. As shown in Chart 2.10, in 2020, personal loans constituted the largest proportion (70 percent) of loans and advances to the household sector, and was higher than 68 percent in 2019, while the share of mortgages was unchanged at 24 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.10: The Distribution of Household Loans and Advances: 2016 – 2020 (Percent)



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

2.24 The inherent credit risk is likely to increase over the next 12 months because of the shutdown and partial operation of businesses and loss of employment resulting from the economic fallout from the COVID-19 pandemic. However, this outlook for an increase in credit risk due to asset-quality deterioration is expected to be moderated, for the bulk of the banking credit comprises relatively small amounts to multiple uncorrelated retail borrowers in the various sectors of the economy, especially public sector employees. In addition, through a variety of credit-risk mitigation mechanisms, such as mortgage payment protection insurance, credit life and lien over life insurance policies, a significant portion of credit risk has been transferred to, and warehoused by, the insurance sector.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Market Risk

Regulatory Capital Requirements on Market Risk

2.25 Market RWAs amounted to P1.5 billion (constituting 2 percent of total RWAs) in 2020, representing an increase of 52.1 percent from P980 million in the previous year (Table 2.6). Within these exposures, the total regulatory capital requirement for market risk increased from P146.3 million in 2019 to P222.4 million in 2020, with interest-rate risk accounting for a greater amount of P167.4 million or 75 percent and foreign-exchange exposure contributing P55 million or 25 percent (Chart 2.11).

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

	2019	2020
Interest-rate risk	82 017	167 390
Foreign-exchange risk	64 242	55 038
Total Pillar 1 market-risk capital requirements	146 259	222 428
Market risk-weighted assets	979 936	1 490 270

Chart 2.11: Composition of Market Risk Regulatory Capital: December 31, 2020 (Percent)



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

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Foreign Currency (Exchange Rate) Risk

2.26 All banks complied with the Foreign Currency Exposure Directive No. BoBA 1/99 by maintaining the foreign exchange currency exposure to unimpaired capital ratios within the required 15 percent, 5 percent and 30 percent limits for major, minor and overall foreign-currency exposures, respectively. The ratio of overall foreign-currency exposure to total unimpaired capital for the banking sector decreased from 4.5 percent in 2019 to 3.3 percent in 2020.

Interest Rate Risk

2.27 For all the maturities, except for the 3 – 6 months and over 12 months – 3 years, which had a negative gap of P1.1 million and P141 000, respectively (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's profits would improve in response to an increase in interest rates. With a negative gap, a decline in interest rates would result in repricing of liabilities (deposits) by banks at a low rate, thus raising 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. In contrast, for interest rate-sensitive advances and other assets, a decline in interest rates would lower the banks' earnings; an increase in interest rates would positively affect earnings and profitability and, by extension, economic capital.

Table 2.7: Interest Rate Risk Exposure: December 2020 (P million)

Maturity	2019	2020	Variable Gap
	Total Variable Rate Assets	Total Variable Rate liabilities	
Up to 1 month	62 574	29 119	33 455
1 – 3 months	2 214	1 645	569
Over 3 – 6 months	335	1 453	(1 118)
Over 6 – 12 months	5 443	2 537	2 907
Over 12 months – 3 years	184	325	(141)
Over 3 – 5 years	623	-	623
Over 5 – 10 years	709	-	709
More than 10 years	634	-	634
Total	72 718	35 079	37 639

Note: Parentheses denote negative figures.

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

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

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

Operational Risk

Regulatory Capital Requirements for Operational Risk

2.29 Banking assets subject to operational risk increased from P6.5 billion in 2019 to P7 billion in 2020, while the regulatory capital charge for operational risk increased by 7.6 percent from P965.2 million to P1 billion in the same period (Table 2.8). All banks calculated the respective operational-risk capital requirements using BIA in 2020. One bank further reported operational-risk capital requirement under the standardised approach, which is a more risk-sensitive method of computing the capital requirements.

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

	2019	2020
Operational-risk capital charge: BIA	965	1 039
Operational risk-weighted assets	6 466	6 959

Operational Risk Exposure

2.30 The most common weaknesses in operational risk management among banks, in 2020, continued to be the lack of segregation of duties in some functions, instances of lax credit underwriting practices and weak collateral management, given that some residential properties held as security were, contrary to the requirement of the Basel II Capital Directive, not valued every three years. Furthermore, lack of documented procedures for work processes, inadequate review of policies and procedure manuals, and high employee turnover also contributed to high operational risk.

2.31 The composite operational risk of the banking sector remained high because the risk management measures in place were considered to be unsatisfactory. Operational risk is expected to increase in the next 12 months on account of the increasing digitalisation of operations by banks, which increases vulnerability to cyber-crime risks. Significant internal control lapses identified at some banks also contribute to assessed greater operational risks.

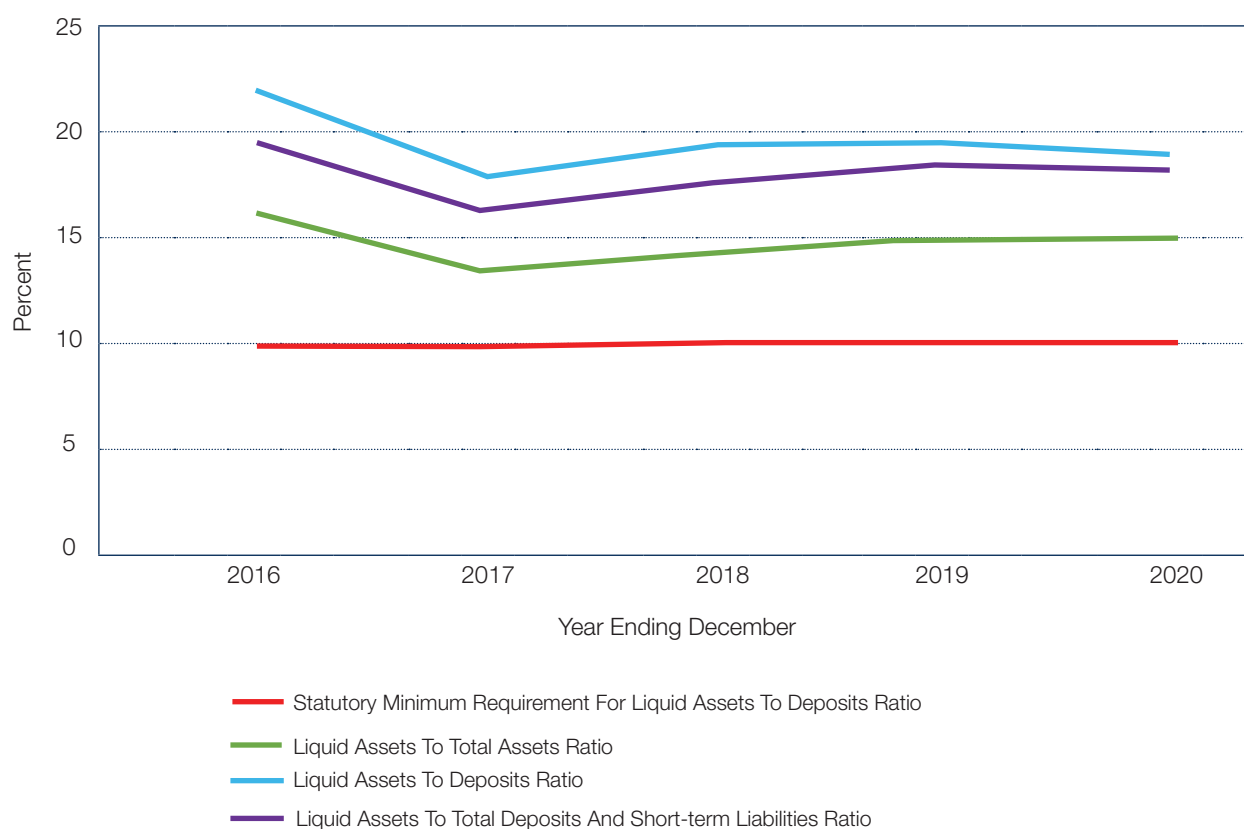
CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Liquidity and Funding Risk

2.32 Statutory liquid assets for the banking industry amounted to P15.4 billion in 2020 compared with P14.7 billion in 2019. The banking sector's liquid assets to deposit ratio (LAR) decreased marginally from 19.3 percent in 2019 to 19.1 percent in 2020, but remained above the 10 percent prudential minimum. The ratio across banks ranged from 13.8 percent to 51.7 percent. The proportion of liquid assets to total assets increased slightly from 14.8 percent in 2019 to 14.9 percent in 2020 (Chart 2.12).

Chart 2.12: Commercial Banks: Liquidity Ratios: 2016 – 2020 (Percent)

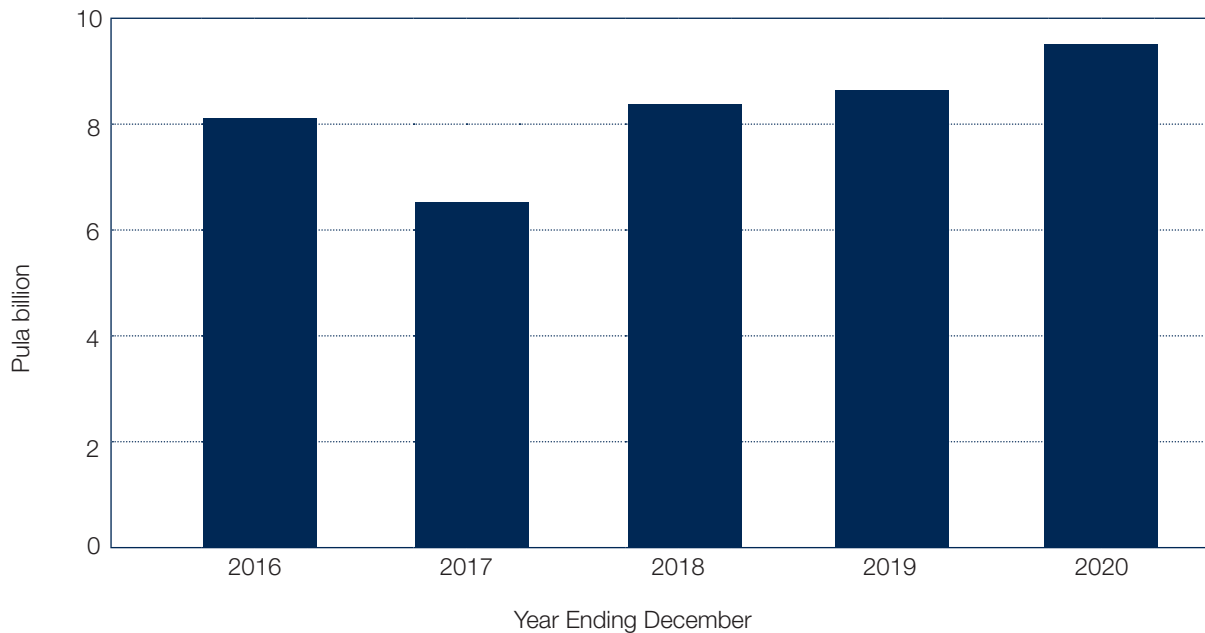


2.33 Within the liquid assets, the Bank of Botswana Certificates (BoBCs) increased by 6.2 percent from P8.3 billion in 2019 to P8.8 billion in 2020 (Chart 2.13).

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.13: Commercial Banks: Market Value of Outstanding BoBCs Holdings: 2016 – 2020 (P billion)



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

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

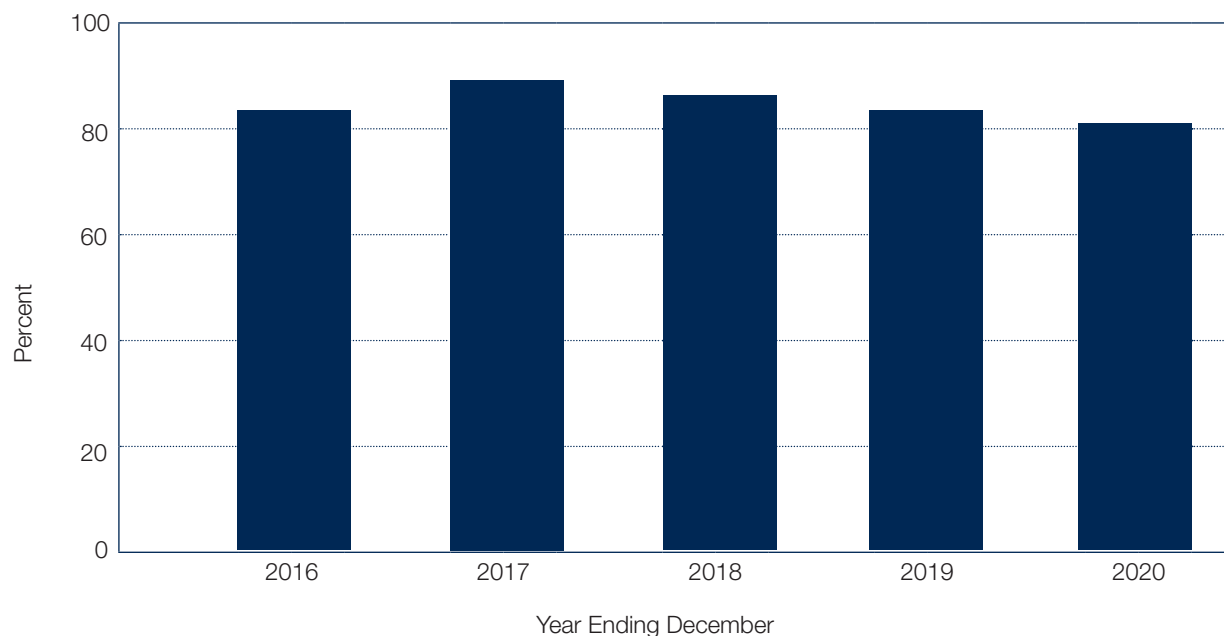
Financial Intermediation

2.35 The average financial intermediation ratio (loans and advances to deposits) for the banking industry fell from 82.9 percent in December 2019 to 81.4 percent in December 2020 (Chart 2.14). Across banks, the intermediation ratio ranged from 70.2 percent to 110.6 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.14: Commercial Banks: Loans and Advances to Deposits Ratio (Financial Intermediation): 2016 – 2020 (Percent)



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

Liabilities and Funding Structure

2.36 Funding sources for asset growth were customer deposits, share capital, debt securities and other borrowings and balances due to other banks. Customer deposits, which are the main source of funding for the banking industry, grew by 6.4 percent from P75.7 billion in 2019 to P80.5 billion in 2020 and constituted 78 percent of liabilities. Share capital, accounting for 11 percent of liabilities, increased by 3.6 percent from P10.9 billion to P11.3 billion in the same period. Debt securities and other borrowings increased by 17.5 percent from P4.8 billion in 2019 to P5.6 billion in 2020. Meanwhile, balances due to other banks declined by 33.3 percent from P4.5 billion to P3 billion in the same period.

2.37 Table 2.9 shows the sources of funding for the banking sector from 2016 to 2020.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.9: Main Sources of Funding: 2016 – 2020 (Pula million)

Category	2016	2017	2018	2019	2020
Deposits	62 438	63 581	69 270	75 709	80 540
Annual growth rate (percent)	4.2	1.8	8.9	9.3	6.4
Share of total funding	77.4	76.2	75.8	76.7	78.0
Share capital	9 748	9 383	10 390	11 080	11 299
Annual growth rate (percent)	19	(3.7)	10.7	6.6	3.6
Share of total funding	12.1	11.2	11.4	11.2	11.0
Debt Securities and Other Borrowings	2 642	4 065	4 747	4 761	5 594
Annual growth rate (percent)	(16.5)	53.9	16.8	0.3	17.5
Share of total funding	3.3	4.9	5.2	4.9	5.4
Due to other Banks	3 984	4 250	4 735	4 532	3 022
Annual growth rate (percent)	20.4	6.7	11.4	(4.3)	(33.3)
Share of total funding	4.9	5.1	5.2	4.6	2.9
Other liabilities	1 828	2 196	2 199	2 612	2 804
Annual growth rate (percent)	(9)	19.4	1.4	18.8	(0.2)
Share of total funding	2.3	2.6	2.4	2.6	2.7
Total Funding	80 640	83 475	91 341	98 695	103 260

Note: Parentheses denote negative figures.

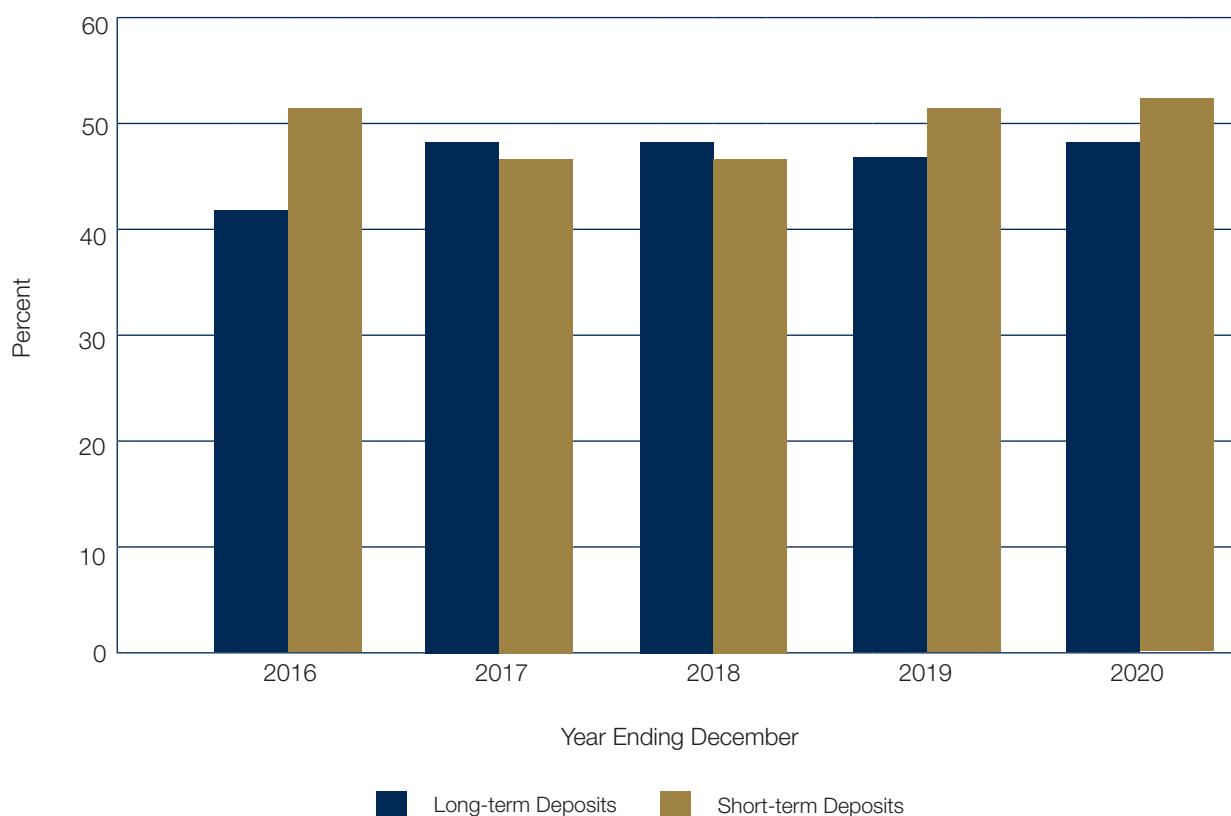
Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.38 The relative shares of deposits by maturity changed marginally between 2019 and 2020; long-term deposits (time and savings) contributed 48 percent in 2020 and short-term deposits (call and current) accounted for 52 percent (Chart 2.15). If this trend is sustained, the maturity mismatch risk, a persistent characteristic of the Botswana banking sector, will continue.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.15: Commercial Banks: Deposits Type by Maturity: 2016 – 2020 (Percent)



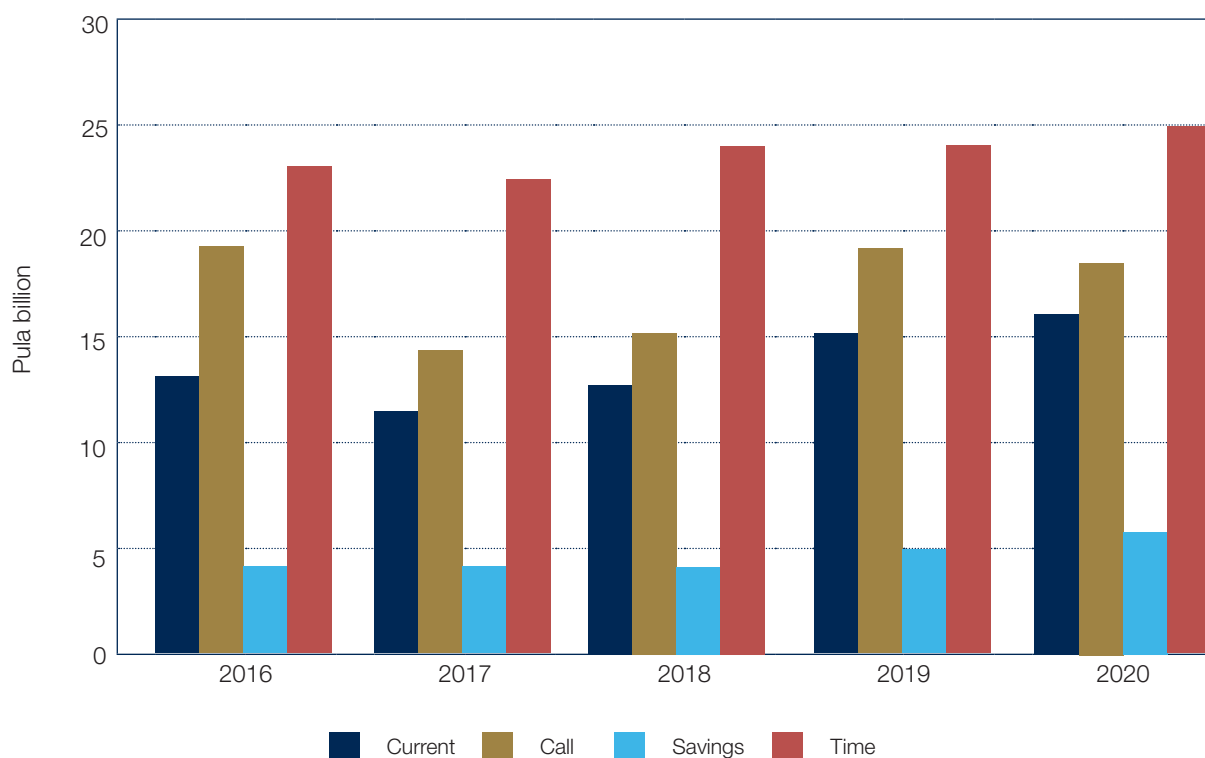
Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.39 Chart 2.16 shows the value of Pula-denominated deposits by type for 2016 to 2020. Savings, current, and time deposits grew by 18.6 percent, 11.5 percent and 2.5 percent, respectively, in 2020, while call deposits declined by 6.5 percent. At P25.6 billion, time deposits accounted for the largest proportion of total deposits (38.3 percent), followed by call deposits (27 percent), current deposits (25.3 percent) and savings deposits (9.3 percent).

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.16: Commercial Banks: Share of Pula-Denominated Deposits by Type: 2016 – 2020 (Pula billion)



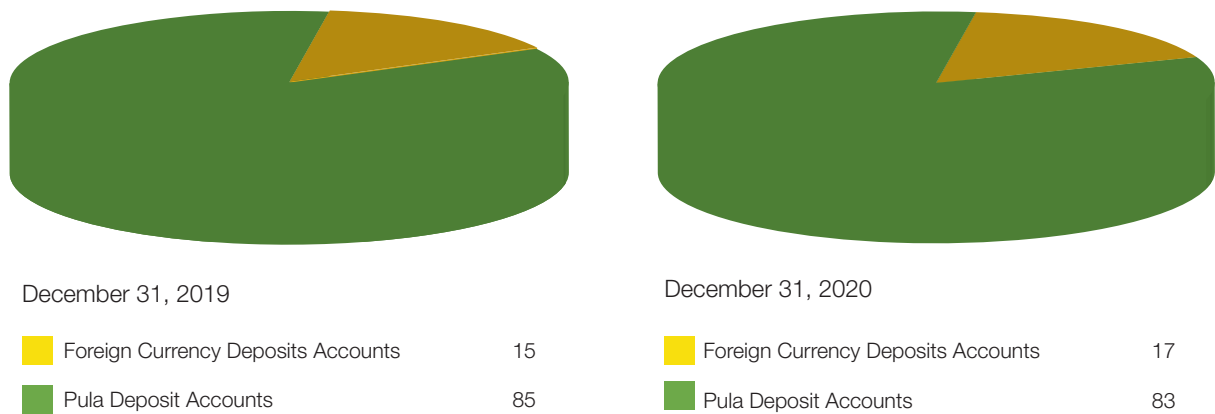
Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.40 Foreign currency-denominated deposits increased by 23.1 percent from P11.1 billion in 2019 to P13.7 billion in 2020. Foreign currency-denominated deposits accounted for 17 percent of total deposits in 2020, an increase from 15 percent in 2019. Conversely, the share of Pula-denominated deposits in total deposits declined from 85 percent in 2019 to 83 percent in 2020 (Chart 2.17).

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.17: Commercial Banks: Share of Foreign Currency and Pula-Denominated Deposits to Total Deposits: 2019 and 2020 (Percent)



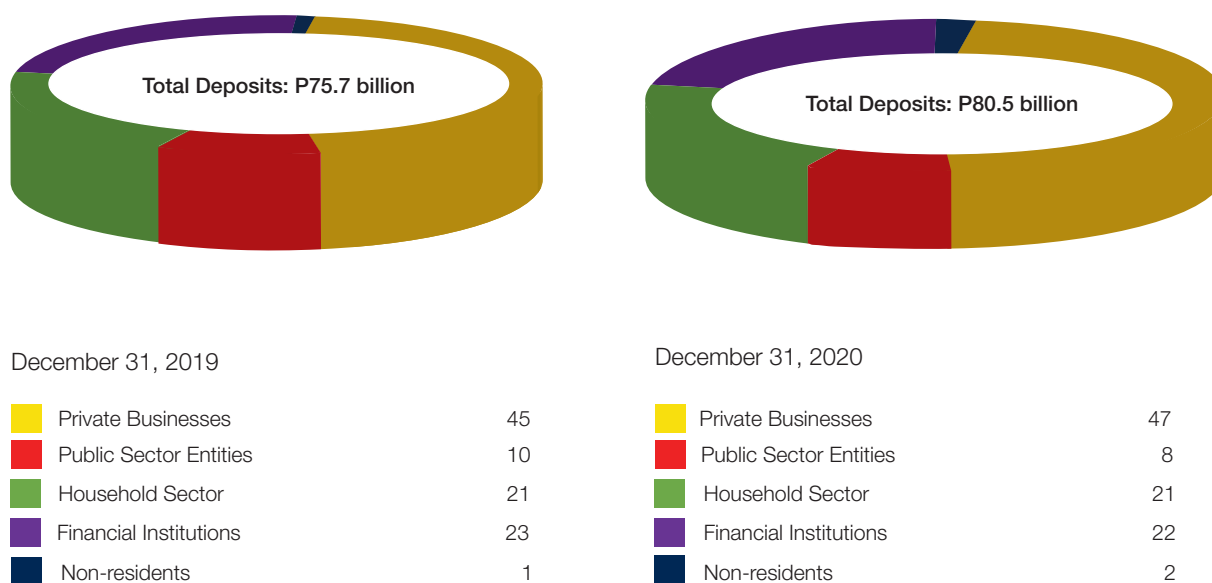
Source: Commercial Banks (Statutory Returns submitted to the Bank).

2.41 The share of private business deposits in total deposits increased from 45 percent in 2019 to 47 percent in 2020, while the share of non-residents deposits to total deposits increased from one percent to 2 percent. Meanwhile, the shares of deposits for financial institutions and the public (government and parastatals) sectors decreased from 23 percent and 10 percent to 22 percent and 8 percent, respectively, in the same period. The share of household sector deposits in total deposits was unchanged at 21 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.18: Commercial Banks: Sectoral Distribution of Deposits: 2019 and 2020 (Percent)



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

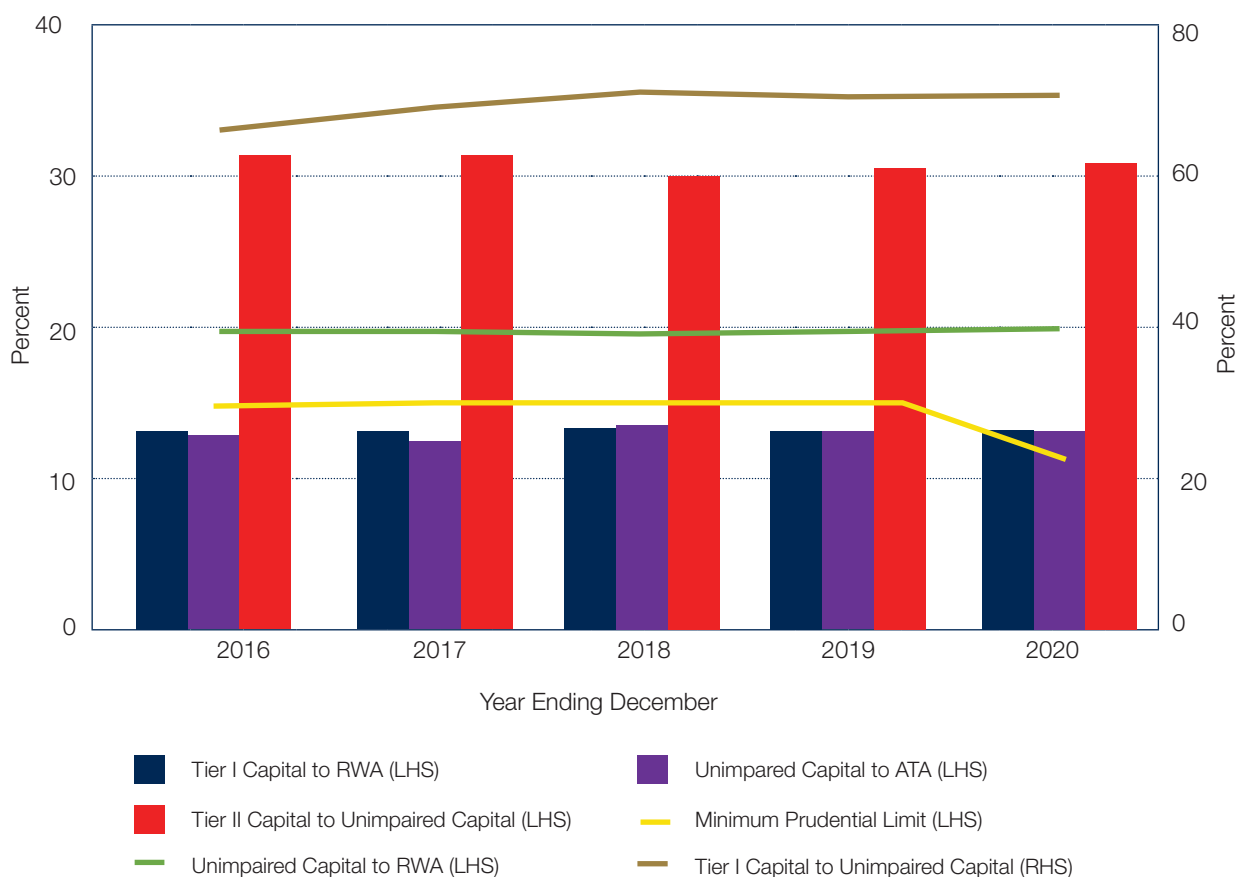
Capital Adequacy (Solvency): Level, Quality And Trend

2.42 The banking sector remained adequately capitalised and complied with the minimum thresholds for regulatory capital adequacy measurement and capital standards. Banks reported capital adequacy and common equity Tier 1 capital ratios of more than the respective prudential minimum of 12.5 percent and 4.5 percent. Total RWAs for banks increased by 5.6 percent from P66.3 billion in 2019 to P69.9 billion in 2020. The capital adequacy ratio (CAR) for the banking industry increased from 19.4 percent in 2019 to 20 percent in 2020. Chart 2.19 shows the CAR over a five-year period, 2016 – 2020.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.19: Commercial Banks: Capital Ratios: 2016 – 2020



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

- 2.43 Unimpaired capital for the banking industry rose by 9.1 percent from P12.8 billion in 2019 to P14 billion in 2020. All banks, except one, reported an increase in unimpaired capital, while five banks paid dividends in 2020.
- 2.44 The largest component (68.8 percent) of unimpaired capital, Tier 1 capital, increased by 9.1 percent from P8.8 billion in 2019 to P9.6 billion in 2020. Within Tier 1 capital, retained earnings contributed the greatest proportion of 79.1 percent, following an increase of 12.8 percent from P6.8 billion in 2019 to P7.6 billion in 2020. The ratio of unimpaired capital to average total assets increased from 13.5 percent to 13.9 percent in the same period, signifying a marginal decrease in the financial leverage of banks. The ratio of common equity Tier 1 capital to risk-weighted assets increased slightly from 12.7 percent in 2019 to 13.2 percent in 2020, and remained above the 4.5 percent prudential minimum (Chart 2.19).

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

2.45 The banking industry Tier 2 capital amounted to P4.4 billion in 2020, moderately higher than P4 billion in 2019, and comprised subordinated term debt (56.2 percent), unpublished current year profits (26.9 percent) and general loan reserves (16.9 percent). The Tier 2 capital to unimpaired capital ratio was constant at 31.2 percent between 2019 and 2020. The lower earnings of the banking sector and expected deterioration in asset quality pose a downside risk to the capital of banks in the next 12 months.

Commercial Banks' Statement Of Comprehensive Income And Expenses

Income

2.46 Total income (net interest income and non-interest income) of commercial banks decreased by 0.6 percent from P7.2 billion in 2019 to P7.1 billion in 2020 (Chart 2.20). The decline in total income was attributable to a decrease of 2.1 percent in non-interest income from P2.8 billion in 2019 to P2.7 billion in 2020. Net interest income grew slightly by 0.4 percent from P4.36 billion to P4.38 billion. As a result, the proportion of non-interest income in total income decreased to 38.8 percent in 2020 from 39.4 percent in 2019. Accordingly, the ratio of net interest income to total income increased from 60.6 percent in 2019 to 61.2 percent in 2020.

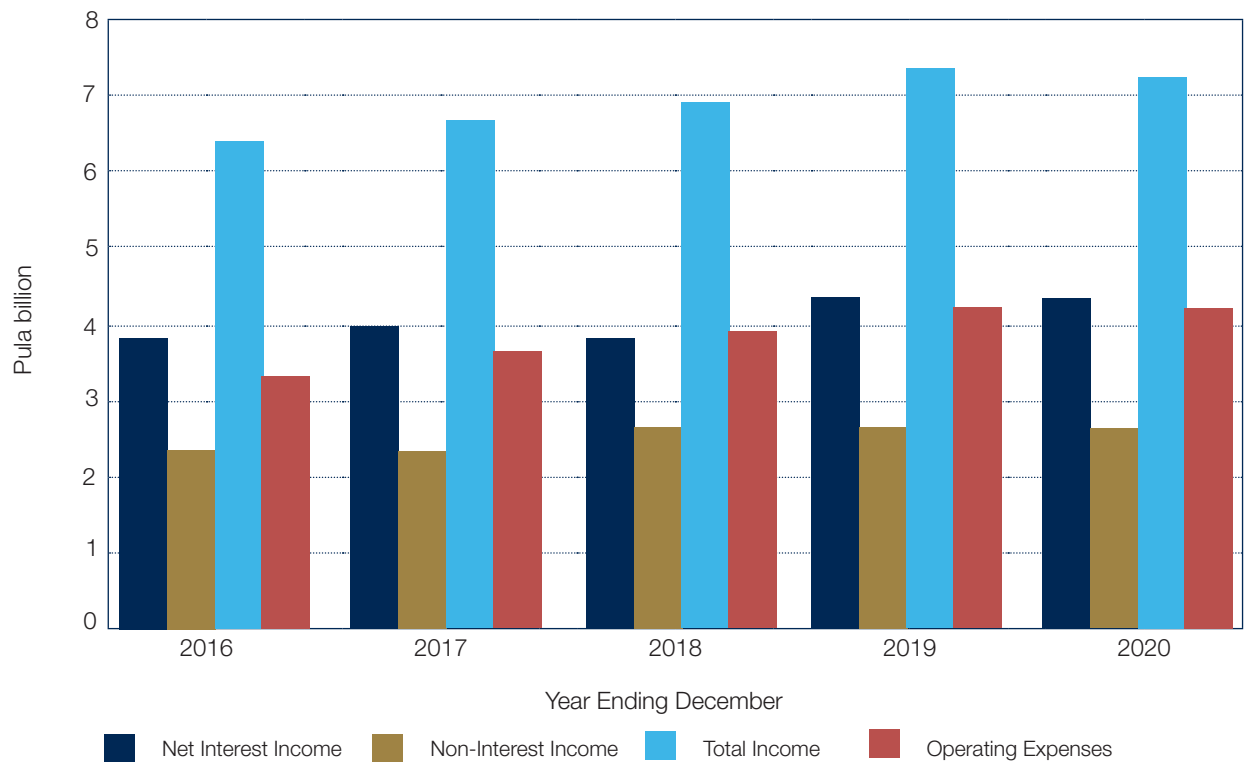
Expenses

2.47 Regarding expenditure, operating expenses constituted 71.1 percent of commercial banks' total expenses, while interest expenses contributed 28.9 percent. Operating expenses grew by 4.1 percent from P4.2 billion in 2019 to P4.4 billion in 2020 (Chart 2.20), the bulk of which was staff costs at 44.8 percent, followed by administration and other expenditures at 38.2 percent, other expenses (audit and consulting fees, and occupancy and depreciation) at 9.9 percent, and legal and management fees at 7.1 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.20: Commercial Banks: Composition of Income and Expenses: 2016 – 2020 (P billion)



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

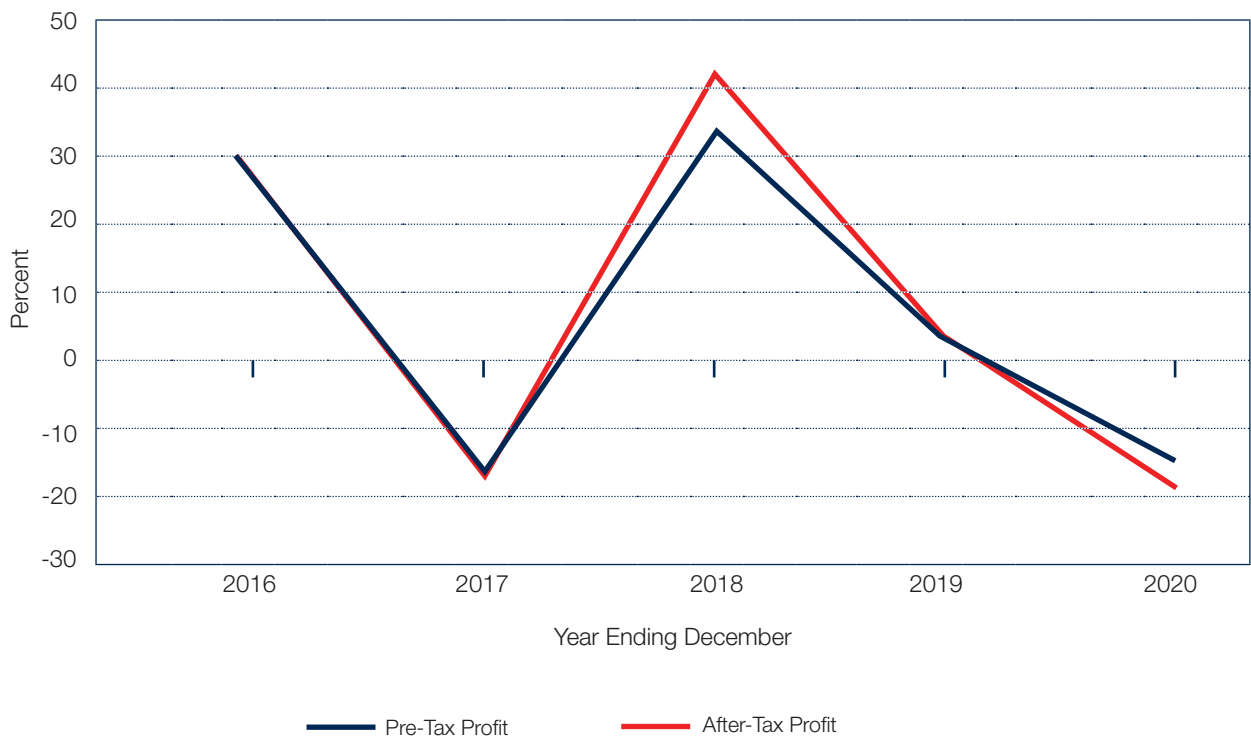
Profitability: Level, Source and Trend

2.48 The consolidated after-tax profit of the banking industry declined by 17.5 percent from P1.8 billion in December 2019 to P1.5 billion in December 2020. Although net after-tax profit fell, overall, it increased for three banks. Chart 2.21 shows pre- and after-tax profit growth rates for commercial banks over a five-year period, 2016 – 2020.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.21: Commercial Banks: Growth Rates of Pre- and After-Tax Profit: 2016 – 2020 (Percent)



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

Profitability and Operating Efficiency Indicators

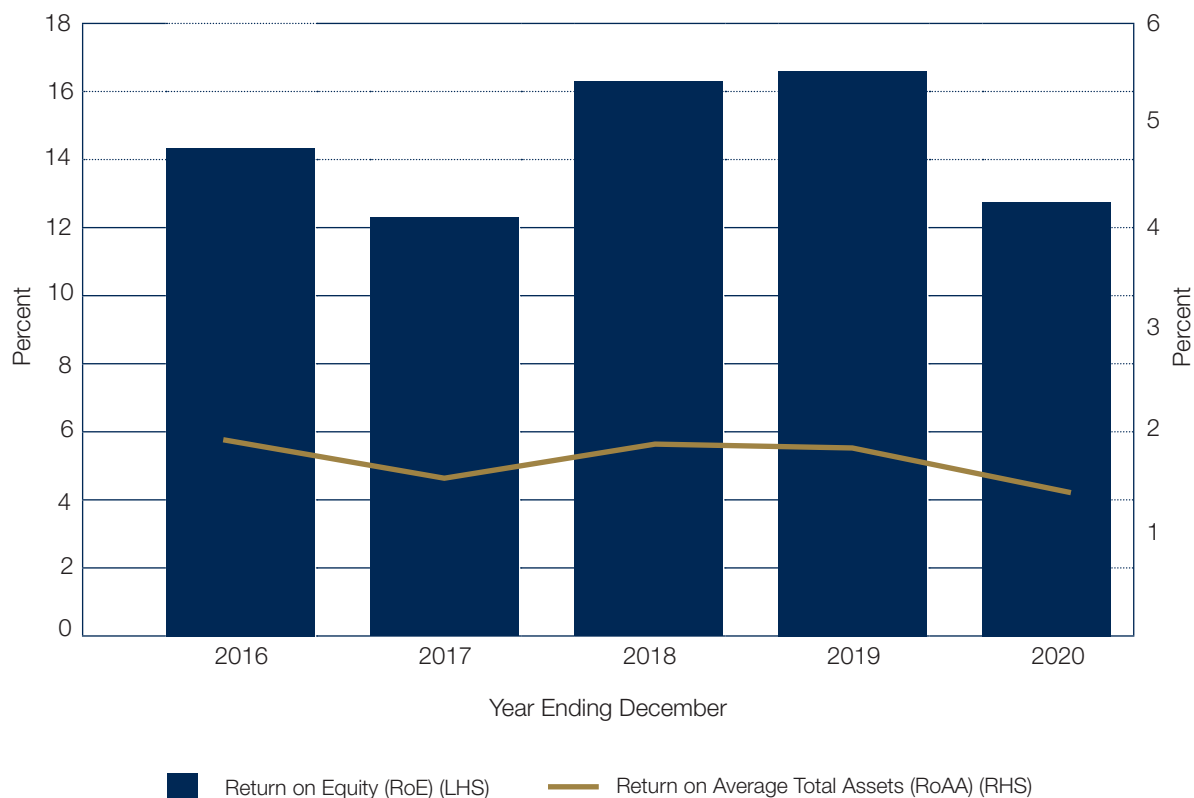
Profitability Indicators

2.49 As a result of weaker financial performance in the banking industry, both aggregate return on equity (RoE) and return on average assets (RoAA) declined, from 16.2 percent and 1.9 percent in 2019 to 12.9 percent and 1.4 percent in 2020, respectively (Chart 2.22). For individual banks, RoE ranged between -1.8 percent and 23.2 percent in 2020. With respect to RoAA, the ratio ranged between 0.02 percent and 2.3 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.22: Commercial Banks: Profitability Indicators: 2016 – 2020 (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, 2016 – 2020.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.10: Financial Performance Ratios: 2016 – 2020 (Percent)

Financial Performance Ratios	2016	2017	2018	2019	2020
Income on investments and securities to total income	3.0	3.8	3.8	4.4	5.3
Non-interest income to total income	39.2	38.5	40.4	39.4	38.8
Net interest income to total income	60.8	61.5	59.6	60.6	61.2
Return on equity	14.4	12.6	16.1	16.2	12.9
Return on average assets	1.8	1.4	1.9	1.9	1.4
Net interest income to average total assets	4.9	3.0	4.5	4.6	2.7
Interest income to average earning assets	7.4	8.7	8.0	7.0	6.6
Non-interest income to average total assets	3.2	3.0	3.0	3.0	2.7
Interest expense to average total assets	1.8	1.8	2.1	2.0	1.8
Earnings retention	80.0	67.7	73.9	69.5	85.9
Interest income on loans to average total assets	6.0	5.9	5.8	4.4	5.7
Non-interest expense to average total assets	4.6	4.7	4.6	4.4	4.3
Gross interest income to average total assets	6.7	7.9	7.5	6.6	6.1

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

Operating Efficiency Indicators

2.51 Table 2.11 presents trends in efficiency measures for commercial banks for 2016 – 2020. The weighted industry average cost-to-income ratio increased from 58.3 percent in 2019 to 61 percent in 2020, indicating a reduction in operating efficiency of banks. Severally, however, some banks had high cost-to-income ratios, which ranged between 71 percent and 93.9 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.11: Commercial Banks: Other Efficiency Measures: 2016 – 2020

	2016	2017	2018	2019	2020
Percent					
Average cost of deposits	1.7	1.7	1.8	2.1	1.9
Return on loans and advances	9.5	9.2	9.0	6.9	9.0
Net interest margin	5.4	5.4	4.8	4.9	4.7
Interest rate spread	4.8	6.1	5.2	3.7	4.0
Cost-to-income	57.0	59.9	60.7	58.3	61.0
Net income to employee costs	91.2	68.3	94.1	92.8	74.4
P'000					
Net income per employee	310.5	255.8	354.7	376.4	315.8
Staff costs per employee	340.5	374.6	376.8	405.8	424.6
Assets per employee	17 793	18 060	19 327	21 085	22 423

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

2.52 The core earning capability of commercial banks improved in 2020 as shown by an increase in the interest rate spread and return on loans and advances ratios (Table 2.11). The interest rate spread increased from 3.7 percent in 2019 to 4 percent in 2020, while the return on loans and advances ratio increased from 6.9 percent to 9 percent in the same period. The cost of deposits ratio decreased from 2.1 percent in 2019 to 1.9 percent in 2020. The net income to employee cost ratio declined from 92.8 percent in 2019 to 74.4 percent in 2020. Owing to the weakened profit levels of banks, net income per employee decreased from P376 400 to P315 800 in the same period. Assets per employee increased from P21.1 million in 2019 to P22.4 million because of the balance-sheet expansion and the decrease in the employment levels in the banking sector.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

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

- 2.53 The Bank's off-site surveillance¹² (OSS) system results and the annual risk assessment review indicate that, during 2020, the financial performance of commercial banks was sound. The strongest components were sensitivity to market risk (1.32), asset quality (1.50) and capital adequacy (1.69). Liquidity was rated adequate with an industry average score of 2.32, while earnings was rated partially adequate at 3.
- 2.54 Table 2.12 shows the definition of colour codes, score ranges and risk rating for the OSS. A summary of OSS ratings for the nine banks included in the framework is provided in Table 2.13.

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

	Rating	Strong		Adequate		Partially adequate		Weak	
CAMELS	Category	Band 1		Band 2		Band 3		Band 4	
	Sub-category	B1-upper	B1-lower	B2-upper	B2-lower	B3-upper	B3-lower	B4-upper	B4-lower
	Score	1.0	1.5	2	2.5	3	3.5	4	4.5
Risk Assessment Summary	Risk rating	Low		Medium		Medium high		High	

Source: Bank of Botswana

Table 2.13: OSS Results as at December 31, 2020

	Capital adequacy	Asset quality	Earnings	Liquidity	Market Sensitivity	Overall score
Banking Sector Average	1.69	1.50	3.00	2.32	1.33	1.97

Source: Bank of Botswana

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

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

STATUTORY BANKS¹³

Statement of Financial Position

Assets

2.55 Total assets for two statutory banks¹⁴ declined by 10.5 percent from P7.8 billion in 2019 to P7 billion in 2020. The fall in assets of the two statutory banks was mainly driven by a decrease in placements with other banks and credit institutions, which declined by 61.4 percent from P2.4 billion in 2019 to P935 million in 2020. The decline was attributable to the withdrawal of the Botswana Public Officers Pension Fund (BPOPF) deposits which were placed with the banks. Loans and advances granted to customers by the statutory banks amounted to P5.9 billion in 2020 compared with P5.1 billion in 2019. Mortgage loans constituted the largest proportion of total loans at 65 percent, while personal loans accounted for 29 percent, commercial real estate for 5 percent and motor vehicle and others for one percent. The market shares of the two statutory banks' assets, deposits, and loans and advances were 6.3 percent, 6.5 percent and 8.2 percent, respectively.

Liabilities

2.56 Total liabilities (excluding shareholder funds) of the two statutory banks declined by 11.5 percent from P7.1 billion in 2019 to P6.2 billion in 2020, reflecting a sharp decrease in customer deposits. As shown in Table 2.14, funding of assets for the two statutory banks was mainly through deposits, which constituted 68.5 percent of total liabilities. Deposits decreased by 12.8 percent from P5.5 billion in 2019 to P4.8 billion in 2020. Other funding sources, which comprise debt securities and borrowings, and equity declined by 7.1 percent and 1.2 percent to P1.1 billion and P709 million, respectively, in 2020. These accounted for 15.8 percent and 10.2 percent of total liabilities, respectively.

13 Banks established by specific statutes.

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

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.14: Main Sources of Funding for Statutory Banks: 2016 – 2020

Category	2016	2017	2018	2019	2020
Deposits (Pula million)	3 493	4 042	4 244	5 462	4 762
Growth rate (Percent)	4.6	15.7	5.0	28.7	(12.8)
Share of total funding	58.4	59.6	64.9	70.3	68.5
Debt Securities and Other Borrowings (Pula million)	987	1 235	1 325	1 185	1 100
Growth rate (Percent)	(22.3)	(50.6)	171.5	(10.6)	(7.1)
Share of total funding	16.5	7.2	20.2	15.2	15.8
Share Capital (Pula million)	1 303	1 306	775	718	709
Growth rate (Percent)	3.2	0.3	(40.7)	(7.3)	(1.2)
Share of total funding	21.8	19.3	11.8	9.2	10.2
Other Liabilities (Pula million)	200	193	200	410	384
Growth rate (Percent)	27.8	(3.1)	3.4	104.9	(6.4)
Share of total funding	3.3	2.9	3.1	5.3	5.5
Total Funding (Pula million)	5 982	6 777	6 544	7 774	6 955

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

Liquidity Risk

- 2.57 The liquid assets of the two statutory banks, largely cash and balances due from domestic banks, decreased by 64.6 percent from P2.5 billion in 2019 to P897 million in 2020. The decline in liquid assets was mainly attributable to a withdrawal of P450 million from one statutory bank by BPOPF and closure of the BPOPF account at the other statutory bank. The liquid assets to total deposits ratio decreased significantly from 46.4 percent to 18.8 percent in the same period but remained above the statutory minimum of 10 percent.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Credit Risk

Regulatory Capital Requirements in Respect of Credit Risk

- 2.58 In line with the increase in loans and advances, credit RWAs of the two statutory banks rose by 11.7 percent from P3.1 billion in 2019 to P3.5 billion in 2020. The credit RWAs constituted 93.1 percent of RWAs as at December 31, 2020.

Loans and Advances, Credit Risk and Asset Quality

- 2.59 The loan book of the two statutory banks grew by 16 percent in 2020 from P5.1 billion in 2019 to P5.9 billion in 2020. The loan book comprised loans to the household sector and private businesses, which accounted for 94.9 percent and 5.1 percent of gross loans and advances, respectively. NPLs decreased by 4.7 percent from P450.1 million in 2019 to P429 million in 2020. Of the two sectors, households had the larger NPLs at 94.6 percent of total NPLs, consistent with the greater proportion of loans, overall. The combined ratio of NPLs to gross loans and advances for the banks decreased from 8.9 percent in 2019 to 7.3 percent in 2020. The two banks raised specific provisions amounting to P115.3 million in 2020 compared with P106.8 million in 2019, and the resultant ratio of specific provisions to NPLs increased to 26.9 percent from 23.7 percent in the same period.
- 2.60 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 likely to increase over the next 12 months because of the continued negative effects of the COVID-19 pandemic on the ability of some borrowers to service their loans. Furthermore, inadequate risk management infrastructure (such as lack of integrated credit risk management systems) and the intense competition from commercial banks will likely contribute to the increasing credit risk.

Solvency (Capital Adequacy): Levels, Quality and Trends

- 2.61 During the review period, unimpaired capital for the two statutory banks increased by 3.6 percent from P706 million in 2019 to P732 million in 2020, while RWAs increased by 10 percent from P3.4 billion in 2019 to P3.7 billion in 2020. Consequently, average CAR of the two banks was 19.5 percent in 2020, which was above the 12.5 percent minimum prudential requirement for banks in Botswana. Tier 1 capital to unimpaired capital ratio was 98.6 percent in 2020, indicating high-quality capital levels of the statutory banks.

Statement of Comprehensive Income

- 2.62 On aggregate, the two statutory banks reported a loss of P28.7 million in 2020, an improvement from a loss of P34 million in 2019. As a result, RoAA and RoE improved from -0.5 percent and -4.7 percent in 2019 to -0.4 percent and -4.1 percent in 2020, respectively. Similarly, the cost-to-income ratio decreased from 100 percent in 2019 to 94 percent in 2020. Table 2.15 shows key performance indicators for statutory banks during 2016 to 2020.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Table 2.15: Statutory Banks: Financial Performance Indicators: 2016 – 2020

Indicator	2016	2017	2018	2019	2020
P' million					
Net income	65	37	0.2	(34)	(29)
Interest income	482	265	441	535	517
Interest expense	231	198	228	316	278
Net interest income	251	234	213	218	239
Non-interest expense	214	197	212	269	268
Total assets	5 982	6 777	6544	7 774	6 955
Average total assets	6 006	6 379	6 660	7 159	7 365
Average earning assets	2 120	6 111	6 307	6 716	6 939
Unimpaired capital	1 297	1 316	880	706	732
Risk-weighted assets	2 878	3 060	3 092	3 407	3 749
Percent					
Net income growth rate	(31.7)	(43.5)	(89.2)	(19 098)	(15.5)
Interest income to average total assets	8.0	4.1	3.7	7.5	7.0
Cost-to-income	72.1	74.3	85.5	100	94
Return on average assets	1.1	0.6	0.0	(0.5)	(0.4)
Return on equity	5.0	2.8	0.0	(4.7)	(4.1)
Return on advances	9.5	8.0	7.8	9.7	8.4
Average cost of deposits	3.9	3.4	3.8	4.5	3.8

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

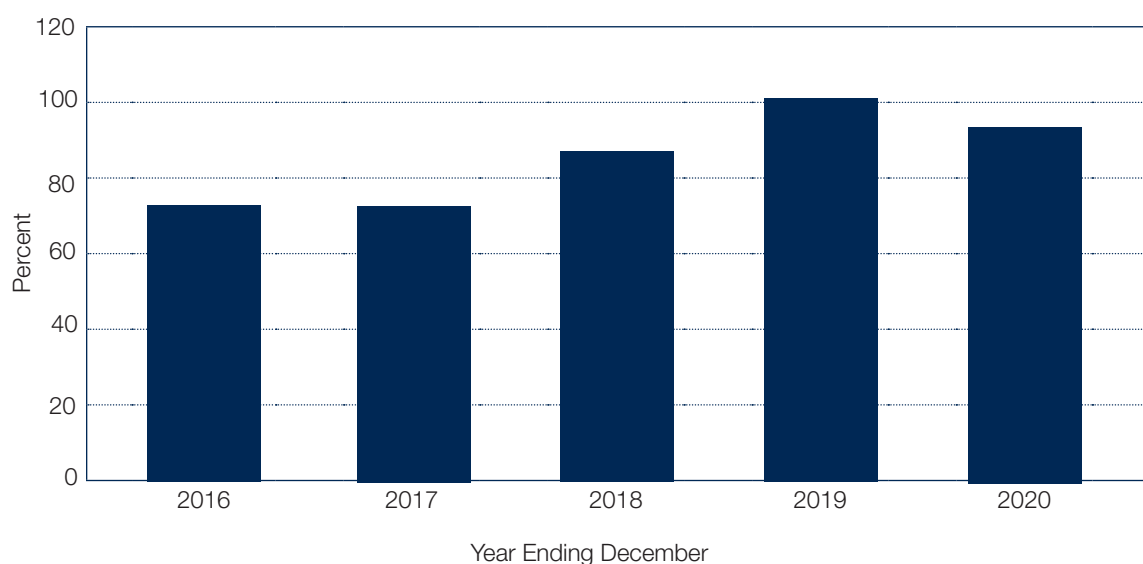
Source: Two Statutory Banks (Statutory Returns submitted to the Bank).

2.63 Chart 2.23 presents the trend of the cost-to-income ratio for statutory banks over the five-year period, 2016 – 2020.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.23: Statutory Banks: Cost-to-Income Ratio: 2016 – 2020 (Percent)



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

Operational Risk

Regulatory Capital Requirements in Respect of Operational Risk

- 2.64 RWAs for operational risk of the two statutory banks decreased from P280.6 million in 2019 to P257.7 million in 2020 and constituted 6.9 percent of total RWAs.
- 2.65 The inherent operational risk of the two statutory banks was considered high, while risk management systems and controls were assessed to be satisfactory. The residual operational risk remained high and is expected to increase over the next 12 months on account of lack of segregation of duties, the inability of the core banking system to support the banks' operations, failure to conduct continual customer due diligence, establish and verify the identity of beneficial owner companies and identify prominent influential persons.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

OVERVIEW OF PILLAR 3 DISCLOSURE REQUIREMENTS

- 2.66 Pursuant to the implementation of the Basel II Capital Directive and Circular on Implementation of Pillar 3 Disclosure Requirements (Pillar 3 circular), it is a requirement for banks in Botswana to publish key regulatory information, including financial position and performance, capital structure, risk management systems, risk profile, corporate governance and internal controls on their websites and through published financial reports.
- 2.67 During 2020, almost all the banks published information on the capital position, risk profile and risk management systems in accordance with the Pillar 3 circular. One statutory bank had published quarterly reports up to June 2019. The statutory bank was warned against failure to publish the Pillar 3 disclosure at the frequency set out in Clause 12.10 of the Capital Directive and against any continued contravention.
- 2.68 Overall, banks were compliant with the requirements of the Basel II Capital Directive and Pillar 3 circular, with minor shortcomings noted at a few banks. The Bank continues to guide banks to fully comply with the disclosure requirements and all other regulatory requirements.

BOX 2: IMPACT ASSESSMENT OF COVID-19 RELIEF MEASURES

Introduction

In response to the expected negative impact of the COVID-19 pandemic on economic activity, regulators and policymakers worldwide implemented policy measures intended to maintain financial stability and reduce the risks of systemic failure in banking systems.

The pandemic and consequent containment measures have negatively affected economic activity and thus prompting policy support from the regulators and policymakers worldwide to mitigate the effects of the COVID-19 pandemic on economies and the financial system. These policy response measures were expected to limit the amplification of the shock and buoy market confidence.

COVID-19-Related Policy Relief Measures

Botswana, like other developing economies, implemented targeted fiscal, financial and liquidity support measures to support affected sectors of the economy, including households. The financial support by government entailed wage subsidies and loan guarantees to eligible small and medium enterprises.

Policy response measures specific to Bank of Botswana (Bank) included reduction of the capital adequacy ratio (CAR) from 15 percent to 12.5 percent and the primary reserve requirement from 5 percent to 2.5 percent. The Bank also reduced the Bank Rate by a cumulative 100 basis points to 3.75 percent in 2020 to support economic activity. In addition, the Bank removed the penalty for borrowing by commercial banks from the credit facility and extended the collateral pool to include corporate bonds listed and traded on the Botswana Stock Exchange Limited.

Furthermore, the Bank endorsed the initiative of the banking industry to reschedule the service of loans (including selective moratoria on qualifying performing loans), which was aimed at mitigating the adverse effects of the COVID-19 pandemic on borrowers. To support that initiative, the Bank suspended the raising of specific provisions by banks against loans qualifying for the payment moratorium, thus reducing the credit risk arising from the negative effects of the COVID-19 pandemic on banks' customers. Consistent with the International Financial Reporting Standard 9, a higher credit risk would potentially increase the expected credit-loss charge.

Uptake of the COVID-19 Pandemic Relief Measures by the Banking Industry

The banking sector entered the crisis adequately capitalised and liquid. The sector was able to continue to support economic activity without using of the relief measures. As at December 31, 2020, banks had not used the released capital buffers and the liquidity support. The average CAR and liquid asset ratio (LAR) were above the hitherto prevailing 15 percent prudential minimum and the statutory minimum of 10 percent, respectively. However, continuance of the pandemic could undermine the resilience of banks and deplete available buffers.

Loans granted payment moratorium amounted to P4.3 billion, P7.3 billion, P6 billion and P5.6 billion in April, June, September and December 2020, respectively, representing shares of 8 percent, 11.4 percent, 9.5 percent and 8.5 percent in gross loans and advances. As at December 31, 2020, a total of 7 850 loan accounts in the banking industry had been given a payment holiday. Private sector enterprises loans accounted for 78.5 percent of loans granted payment holiday in December 2020. At 30.4 percent, commercial real estate loans were the largest share of the loans granted payment moratorium. Household loans accounted for 12 percent of loans granted payment moratorium. Although the tourism and hotels was reported to be the most negatively affected by the COVID-19 pandemic worldwide and locally, because of the shutdown of businesses and lockdowns, it was not the biggest beneficiary of the loan payment moratorium in Botswana. The sector accounts for only 1.8 percent of the banking industry loans and advances; the proportion of the exposure of tourism and hotels to the industry consolidated loans and advances for individual banks ranged from 0.2 percent to 5.4 percent.

Table 1: Consolidated Banking Industry Number and Value of Loans Granted Repayment Holiday April – December 2020

Consolidated Figures	April	June	September	December
Number of accounts given a loan repayment holiday	4 522	6 000	7 120	7 850
Value of loans given a repayment holiday (P million)	4 347	7 287	6 084	5 561
Share of loans given a repayment holiday in total loans and advances (percent)	6.8	11.4	9.5	8.5
Private sector enterprises loans given a repayment holiday to loans granted repayment holiday (percent)	86.1	73.7	78.7	78.5
Commercial real estate loans given a repayment holiday to total loans granted repayment moratorium (percent)	31.1	24.2	33	30.4
Tourism and hotels loans given a repayment holiday to total loans granted repayment moratorium (percent)	13.2	9.1	9	10
Household loans given a repayment holiday to total loans granted repayment moratorium (percent)	12.3	15.4	14.6	14.8

Source: Commercial Banks (COVID-19 Returns Submitted to the Bank).

Concerning the loan guarantee scheme, as at December 31, 2020, there were 33 applications under the scheme from seven banks that had been submitted, processed and approved by the Export Credit Insurance and Guarantee Company Botswana (BECI), and the utilisation of the scheme fund was at 4.6 percent of the P1 billion offered for the scheme. At that usage level, the uptake of the loan guarantee scheme remains low.

Impact of the COVID-19 Pandemic on Banks and the Effectiveness of the Relief Measures

Total assets of the banking industry increased by 4.6 percent to P103.3 billion in December 2020, compared with P98.7 billion in December 2019. Loans and advances grew by 4.4 percent, slower than the 7.6 percent growth in 2019, while the banking industry non-performing loans (NPLs) decreased from P3.1 billion in 2019 to P2.8 billion in 2020. The ratio of NPLs to gross loans and advances also decreased from 4.8 percent to 4.3 percent in the same period. Customer deposits increased by 6.4 percent from P75.7 billion in 2019 to P80.5 billion in 2020. The banking industry was profitable. However, the banking sector aggregate after-tax profit declined by 17.5 percent from P1.8 billion in 2019 to P1.5 billion in 2020. The CAR for a majority of banks remained virtually unchanged during 2020. The industry average for CAR and LAR was 20 percent and 19.1 percent in 2020, respectively.

Notwithstanding the soundness and resilience of the banking sector, the Bank expects that continuance of the pandemic would adversely affect the banking sector, most notably through the deterioration in asset quality and profitability. In particular, the Bank expects increased operational risk, a rise in NPLs and credit loss, liquidity challenges and erosion of capital, as well as non-viability of some businesses and the consequent job losses in the short term. With regard to credit risk, however, credit loss is expected to be mitigated by some credit risk mitigation techniques, such as mortgage payment protection insurance, credit life and lien over life insurance policies. Through this risk mitigation measures, a significant amount of credit risks has been transferred to, and warehoused by, the insurance sector.

Table 2: Financial Soundness Indicators for Commercial Banks During the Implementation of COVID-19 Pandemic Relief Measures

Financial Soundness Indicators	December 2019	April 2020	June 2020	September 2020	December 2020
Gross loans and advances (P million)	62 770	64 378	63 962	63 774	65 554
Total NPLs (P million)	3 051	3 101	2 907	2 725	2 823
Total liquid assets (P million)	14 651	16 157	17 572	17 223	15 409
After-tax profit (P million)	1 762	2 066	1 394	1 466	1 454
NPLs to total loans and advances (percent)	4.8	4.8	4.5	4.7	4.3
Capital adequacy ratio (percent)	19.4	19.8	20.3	19.8	20
Liquid assets ratio (percent)	19.3	20.3	22.4	21.6	19.1

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

Conclusion

Overall, banks have not yet tapped into the capital release through a 2.5 percentage points reduction in the minimum prudential capital adequacy ratio; all banks were operating significantly above the 12.5 percent. On aggregate, as at December 31, 2020, the banking industry held a 7.5 percent capital buffer. Furthermore, there has been no explicit recourse to the Bank's liquidity support measures, while utilisation of the government loan guarantee scheme has remained low.

Despite the challenges posed by the COVID-19 pandemic, the banking industry remained sound with profitable, adequately capitalised and liquid banks. Moreover, no bank violated either prudential or statutory limits. The support measures, although less utilised, together with the transformation initiatives, continue to positively influence market confidence, prospects for stability and recovery and therefore economic and business decisions.

On the downside, there is likely to be a deterioration in the credit quality for most banks upon withdrawal of regulatory forbearance measures and if the lifting of the state of emergency results in unwinding of businesses currently operating at the margins. Even then, banks will be given sufficient notice when the Bank begins unwinding of forbearance measures. With the uncertainty surrounding the duration of the pandemic and the conclusion of the roll-out of the COVID-19 vaccines and the extent of the impact of associated risks, the Bank will continue to closely monitor the situation.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

NON-BANK FINANCIAL INSTITUTIONS

Bureaux de Change Activities

Market Entry and Exit

2.69 The Bank received six applications for a bureaux de change licence during 2020, out of which one bureau de change was licensed, two were awaiting security vetting results, while three were to invite the Bank for pre-operation inspection as part of the assessment process. Overall, the number of licences issued in 2020 was six, including five applications that were carried forward from 2019, while eight licences for bureau de change were revoked during the review period. Consequently, the number of operating bureaux de change declined from 60 in 2019 to 58 in 2020, out of which ten were temporarily closed because of low business following cross-border movement restrictions in response to COVID-19.

On-site Examination of Bureaux de Change

2.70 The Bank conducted on-site examination of three bureaux de change to assess their compliance with the Bank of Botswana (Bureaux de Change Regulations) (regulations) and the Financial Intelligence Act, 2019 (Cap. 08:07) (FI Act).

2.71 AML/CFT on-site examination was conducted at three bureaux de change. The observation was that all the three bureaux de change were not fully compliant with the AML/CFT requirements; their risk mitigation measures were not commensurate with the high risk of money laundering and terrorist financing (ML/TF) to which the bureaux de change were exposed. For all the three bureaux de change, the ML/TF risk was high, while the risk mitigation measures were weak. Consequently, the bureaux de change were fined and directed to regularise all compliance deficiencies.

CHAPTER 2:

PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

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	The bureaux de change AML/CFT policies were not approved by management and did not have AML/CFT compliance officers.
Customer identification programme	The bureaux de change did not conduct enhanced due diligence on high-risk customers. Three bureaux de change did not record the source of funds for customers. Three bureaux de change conducted large-cash transactions with businesses but did not verify some know-your-customer information.
Screening of customers against sanctions list	Customers for the three bureaux de change were not screened against sanctions list.
Customer risk assessment	Internal risk assessment did not include all risks that the bureaux de change were exposed to.
Monitoring and reporting of suspicious transactions	There was no formal process for monitoring customer transactions against their profiles. Three bureaux de change were not conversant with the preparation and submission of suspicious transaction reports. Three bureaux de change did not, contrary to requirement, report suspicious transactions to the Financial Intelligence Agency (FIA) within five working days.
Cash transactions	The three bureaux de change did not have measures in place to monitor cash transactions. The frequency and pattern of some cash transactions at three bureaux de change were suspicious, but these had not been detected, hence not reported to FIA.
Record keeping	Three bureaux de change did not have documented procedures and processes to adequately address the preparation and filing of large cash transactions.
AML/CFT training programme	The bureaux de change did not have an AML/CFT training programme.

Source: Bank of Botswana

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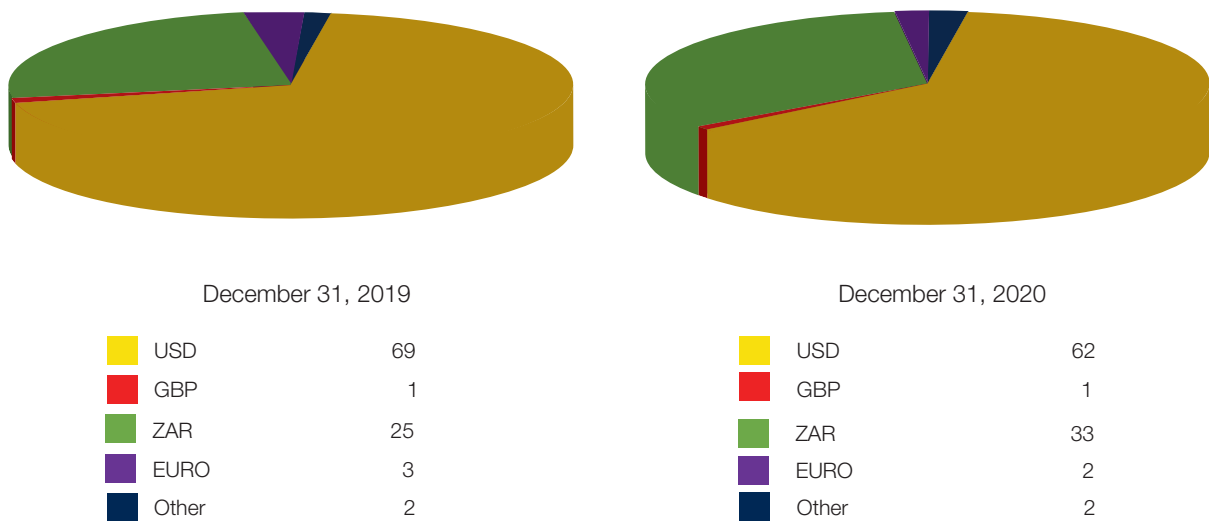
PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

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. However, the value of sales and purchases of foreign currency at bureaux de change declined by 66.8 percent and 63.3 percent in 2020 compared with an increase of 5.8 percent and 11.5 percent, respectively, in 2019. The significant decline in sales and purchases resulted from the unprecedented decrease in business activity following restrictions in cross-border movements in response to the COVID-19 pandemic. As in the past, the United States dollar (USD) and South African rand (ZAR) dominated the bureaux de change foreign-exchange transactions during 2020.

2.73 Charts 2.24 and 2.25 show the respective shares of sales and purchases of various currencies by bureaux de change in 2019 and 2020, while chart 2.26 shows bureaux de change sales and purchases shares of foreign currency in 2016 to 2020.

Chart 2.24: Bureaux de Change: Shares of Foreign Currency Sales in 2019 and 2020 (Percent)

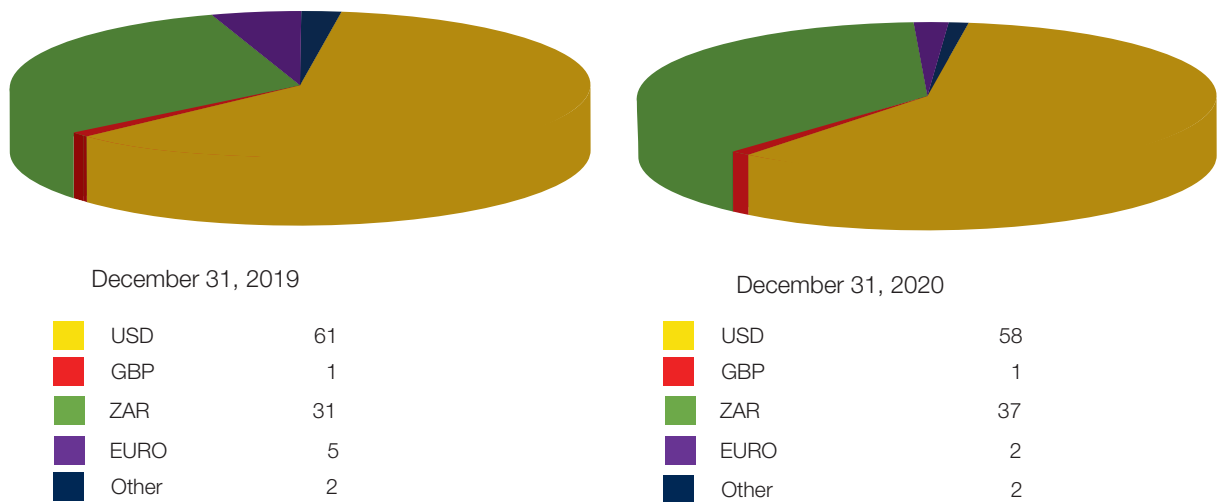


Source: Bureaux de Change (Statutory Returns submitted to the Bank).

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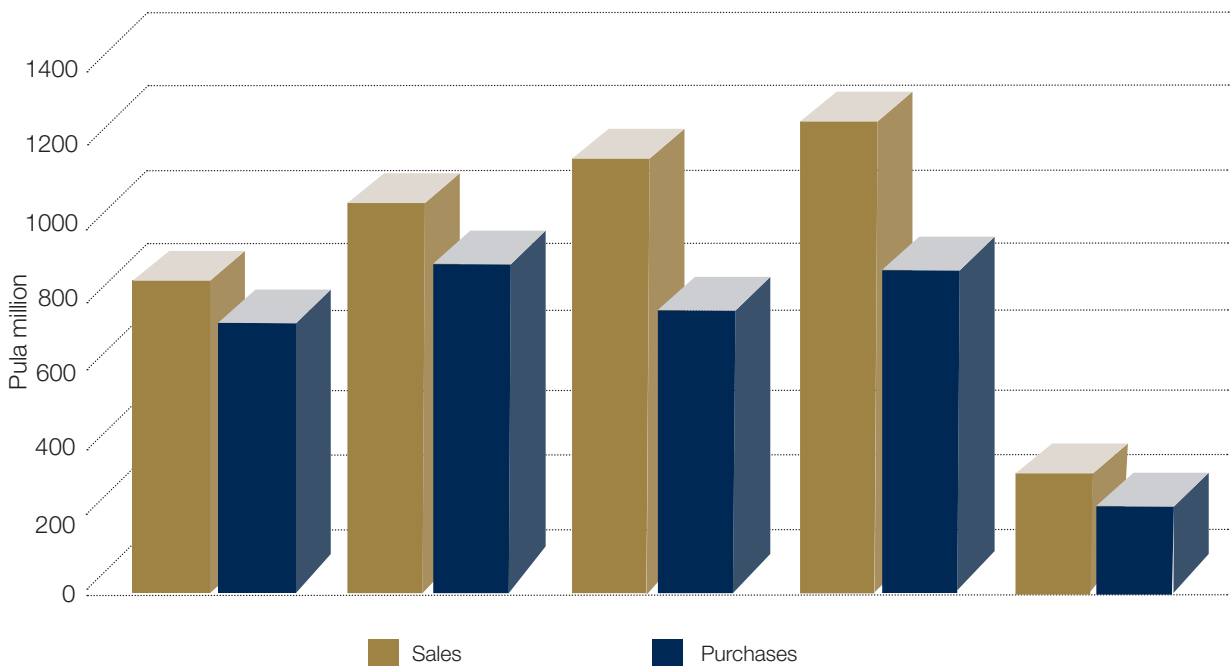
PERFORMANCE OF THE BANKING INDUSTRY (CONTINUED)

Chart 2.25: Bureaux de Change: Shares of Foreign Currency Purchases in 2019 and 2020 (Percent)



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

Chart 2.26: Bureaux de Change: Sale and Purchase of Foreign Currency: 2016 – 2020 (Value)



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

BOX 3: BANKING SUPERVISION BEYOND THE CORONAVIRUS DISEASE: LEVERAGING FINANCIAL TECHNOLOGY

Introduction

The outbreak of the coronavirus disease (COVID-19) and the resultant containment measures have negatively affected the conventional ways in which financial services are provided and the functioning of the financial system. Notable is the acceleration of transition from traditional banking practices to increased use of digital banking platforms to maintain as well as enhance provision of banking services. Furthermore, the containment measures lessened face-to-face engagement between banks and supervisory authorities, affecting the on-site surveillance process. As a result, regulators have tended to incorporate technology in their supervisory approaches and to enhance the off-site monitoring of supervised entities to address the challenge. The use of technology and automation of financial services delivery, which could result in new business models, applications, and products, is referred to as financial technology (fintech).

Immediate Responses to the COVID-19 Pandemic

Banks worldwide have come up with measures to cushion themselves against the challenges imposed by COVID-19. In Botswana, commercial banks invoked business continuity and liquidity contingency plans as part of measures to ensure operational resilience amid COVID-19. Furthermore, to cushion the adverse effects of COVID-19 on customers, some commercial banks granted moratoria on loans with a good payment history and offered to restructure some loans.

Across several jurisdictions, the immediate response by regulators to the COVID-19 outbreak was a relaxation of capital adequacy requirements and a reduction of policy rates. This was similarly the case in Botswana (Box 2).

COVID-19 containment measures, such as movement restrictions, physical distancing, and lockdowns, have meant that banks could not continue relying on traditional banking practices, such as over-the-counter cash withdrawals and deposits, to serve customers. To ensure that access to financial services was not curtailed, banks accelerated the adoption of digital banking solutions that enable remote access and conduct of banking transactions, including money transfers and service requests. The use of technology nevertheless heightens cyber and operational risks, which have prompted central banks to enhance the related regulatory reporting requirements in order to actively and effectively monitor this operational risk, among others. Related thereto, banks have accelerated the leveraging of technology to drive risk management and regulatory compliance. Similarly, to ensure effective supervision and regulation in a digital era, central banks continue to incorporate technology in their supervisory approaches to accommodate the recent developments and innovations in the financial sector.

Therefore, fintech continues to influence the development of new approaches to banking supervision, while it also improves compliance by supervised entities with increasing regulatory reporting requirements. The use of fintech by supervisors to enhance supervisory and regulatory oversight is referred to as supervisory technology (suptech), whereas the application of fintech by banks for regulatory compliance is termed regulation technology (regtech).

Implications of Fintech for Banking and Regulation

Overall, fintech has enabled banks and regulators, including central banks, to effectively carry out financial intermediation and supervisory oversight, respectively, amid COVID-19. Suptech is applied in data collection and big-data analytics, whereas regtech is applied in four main areas: regulatory compliance, financial crime surveillance, risk management, and identity management. Table 1 summarises the advantages and disadvantages of regtech and suptech.

Table 1: Advantages and Disadvantages of Regtech and Suptech

Advantages	
Regtech	Suptech
enables banks to better comply with regulatory reporting requirements and cope with the increased frequency of reporting and volume of granular data	helps supervisory authorities streamline reporting and regulatory processes
reduces compliance costs on account of the automation of key functions and the use of cloud storage	results in efficient and active monitoring of risk and compliance at banks in a cost-effective manner
	enhances supervisory capability of regulators by enabling the monitoring of risks in real time
Disadvantages	
Regtech	Suptech
banks still need to develop skills of employees on the use of regtech	raises concerns about data and job security
obtaining expertise in this area is costly	requires capacity building and management support and buy-in from supervised entities
increases the need for data localisation and standardisation	
reduces the need for human intervention, leading to job losses ¹⁵ , since it uses artificial intelligence	

¹⁵ The job security and loss concerns are short term and for incumbents, while in the long term there is potential for job opportunities in the related technology development and support services.

To fully benefit from supotech and regtech, regulators need to appropriately adapt the existing risk-based supervision methodology, while banks should refine the internal process of risk identification and management, to accommodate the recent technological advances in banking. The effective adoption of fintech can be achieved by developing well-defined strategies on the use of technology by supervised entities and a comprehensive legal framework to govern and guide the use of technology in key processes to ensure data accuracy and completeness. Nevertheless, given that the adoption of supotech and regtech is still at a nascent stage in advanced countries, the uptake of these technologies in developing countries is likely to be slow since they generally benchmark against advanced countries.

Conclusion

The COVID-19 pandemic has awakened banks to the need for, and adaptability to, increased use of technology and innovation. To unleash the full benefits of regtech and supotech, there is a need to undertake capacity building around regulatory and supervisory technologies for effective adoption and application. In addition, regulators need to leverage cross-border cooperation with other regulators to ensure they keep abreast of developments in fintech. The increased reliance on technology by supervised entities requires that regulators broaden the scope of supervisory processes to include monitoring of operational resilience and business continuity in the relevant areas to augment the focus on financial soundness.

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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 During the year, the Bank received an application for a banking licence on June 29, 2020, which was subsequently rejected on account of materially deficient ownership and capital structure. The Bank also received seven banking licence enquiries during the year, none of which resulted in an application for a banking licence.

ILLEGAL DEPOSIT TAKING

- 3.2 During 2020, the Bank investigated Elamant (Pty) Ltd on suspicion that it may be conducting illegal deposit-taking activity, following an anonymous report by a whistleblower. Upon engagement with the Botswana Police Service (BPS), the Bank noted that the BPS and the Consumer and Competition Authority (Authority) were also investigating the scheme, as the scheme was in contravention of Section 9 of the Consumer Protection Act, 2018, which prohibits persons from engaging directly or indirectly in pyramid schemes. The Bank received the outcome of the investigation by the BPS concluding that there was insufficient evidence to prosecute Elamant (Pty) Ltd.
- 3.3 The Consumer Protection Act, 2018 (Cap. 42:07) prohibits pyramid schemes and any person who participates or peddles such a scheme commits a criminal offence punishable by law. The Act provides that any person who directly or indirectly promotes, or knowingly joins, enters or participates, or causes any other person to promote, join, enter or participate in a pyramid scheme commits a criminal offence. Section 9 (2)(a) of the Consumer Protection Act, 2018 (Cap. 42:07) defines a pyramid scheme as an arrangement, agreement, practice or scheme where participants in the scheme receive compensation derived primarily from their respective recruitment of other persons as participants, rather than from the sale of any goods or services. A person who participates in an arrangement, agreement, practice or scheme under Section 9 (2) of the Consumer Protection Act, 2018 (Cap. 42:07) commits an offence and shall be liable, upon conviction, to a fine not exceeding P100 000 or to imprisonment for a term not exceeding five years, or to both.

COMMERCIAL BANK INTEREST RATES AND CHARGES

Interest Rates and Policy

- 3.4 The Bank Rate was reduced by 100 basis points to 3.75 percent in 2020, following which banks adjusted lending rates downwards. However, given increased competition for deposits, some banks left interest rates unchanged on some deposit products, benefitting depositors while ensuring stable and reliable sources of funding for banks.
- 3.5 Table 3.1 shows indicative ranges of deposit interest rates payable on the various deposit products offered by both commercial and statutory banks as at December 31, 2020. Banks continued to comply with the disclosure framework for deposit rates, which requires that the interest rate payable on the 91-day deposit be at a minimum 350 basis points below the prevailing Bank Rate, while longer-dated instruments (maturity) rates are commensurately higher. In addition, the threshold of P1 000 set by the Bank in the amendment of Directive REF: 01.09.2009 on Disclosure Framework for Deposit and Lending Interest Rates for opening the 91-day fixed account was observed across the industry. Furthermore, banks continued to comply with the disclosure requirements of publishing the deposit interest rates offered in at least two newspapers widely circulating in Botswana. Meanwhile, the rates on the 91-day fixed deposits fell from 1.25 percent in 2019 to 0.75 percent in 2020.

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION (CONTINUED)

3.6 Table 3.2 shows a range of lending rates offered by various banks as at December 31, 2020. The differential between the lowest and highest interest rates charged were noted with respect to some products, with unsecured loans being costly, while secured loans were charged lower interest rates.

Table 3.1: Commercial Banks: Deposit Rates as at December 31, 2020

Deposit Product	Deposit Rates (Annual Percent)	
	Lowest	Highest
Current account	0.00	2.48
Savings*	0.00	3.40
Call	0.00	2.30
91 days	0.75	1.50
6 months	1.25	2.25
12 months	1.30	3.35
24 months	1.75	3.75
Prime lending rate	5.25	

*Savings include both ordinary and special savings accounts.

Source: Newspapers.

Table 3.2: Commercial Banks: Lending Rates as at December 31, 2020

Lending Product	Lending Rates (Annual Percent)	
	Lowest	Highest
Mortgage (property loans)	2.25	11.25
Overdraft (revolving credit lines)	2.5	84*
Credit card	16.83	36
Lease loans	0.75	22.5
Personal loans (excluding overdrafts, mortgage and credit cards)	0	22.5
Other long-term loans	2.5	83**
Prime lending 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 that does not exceed 7 percent per month, charged on small and medium enterprises that do not bank with one commercial bank.

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

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION (CONTINUED)

Commercial Bank Charges

3.7 Table 3.3 presents average charges for selected banking services in 2020. 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 2020 than in 2019.

Table 3.3: Selected Commercial Banks Average Charges: 2019 and 2020 (Pula)

Service Charge Category (Pula)	2019*	2020	Growth Rate (Percent)
Access Facilitation			
(i) Cash withdrawal (own bank)	2.99	3.07	2.68
(ii) Lost ATM card replacement	59.10	70.67	19.58
(iii) Point of sale	0.64	0.84	31.25
Internet Banking Charges			
(i) Monthly fees	89.13	89.13	0.00
(ii) Transfers (third party within a bank)	4.07	4.07	0.00
Mobile Banking Charges			
(i) Utility bill payments	3.00	2.70	(10.00)
(ii) Payment to third-party accounts	2.98	2.60	(12.75)
(iii) Buy pre-paid airtime	0.31	0.33	6.45
(vi) Cash send/e-wallet/instant money	9.77	8.59	12.08
Investment/Intermediation			
(i) Personal loan arrangement fee (minimum)	406.59	476.38	17.16
(ii) Vehicle/asset finance arrangement fee (minimum)	675.87	701.06	3.73
(iii) Mortgage arrangement fee (minimum)	701.10	735.52	4.91
Trade Facilitation			
(i) Purchase of foreign notes (minimum)	28.09	28.49	1.42
(ii) International SWIFT transfer (maximum)	352.69	340.23	(3.53)
(iii) Advising commission on letters of credit (minimum)	237.67	253.14	6.51
(iv) Real time gross settlement (maximum)	187.43	181.72	(3.05)
(v) Transfer to accounts at foreign banks (maximum)	391.95	407.92	4.07
Payment and Clearing Charges			
(i) Standard cheque book (20 – 50 pages)	45.00	51.30	14.00
(ii) Unpaid cheque due to lack of funds	216.17	243.25	12.53

Note: Parentheses denote negative figures.

* 2019 figures revised.

Source: Commercial Banks.

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION (CONTINUED)

CONSUMER COMPLAINTS MANAGEMENT

3.8 The Bank received and processed 15 new complaints involving seven banks in 2020, while five complaints were brought forward from the previous year. Fourteen complaints were resolved, while six were undergoing the resolution process, including on-site inspections. There were various complaints as illustrated in Table 3.4.

Table 3.4: Commercial Banks' Consumer Complaints in 2020

Type of Complaint	Received	Resolved	Outstanding as at December 31, 2020
Unsatisfactory service	8	7	1
Unfair handling of loans	10	6	4
Fraudulent transactions	2	1	1
Total	20	14	6

Source: Bank of Botswana.

ABANDONED FUNDS

3.9 In accordance with Section 39 of the Banking Act, the Bank continued to administer abandoned funds received from commercial banks. As indicated in Table 3.5, the balance of abandoned funds increased by 4.5 percent from P16 917 687 in 2019 to P17 674 953 in 2020.

Table 3.5: Total Abandoned Funds from Commercial Banks in 2019 and 2020

	2019 Pula	2020 Pula
Balance brought forward	15 077 033	16 917 687
Funds received	2 966 201	3 033 188
Claims paid	(201 122)	(258 154)
Transfer to Guardian Fund	(924 425)	(2 017 768)
Balance at year-end	16 917 687	17 674 953

Note: Parentheses denote negative figures.

Source: Commercial Banks.

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION (CONTINUED)

CORPORATE GOVERNANCE

- 3.10 During 2020, 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 requisite fitness and propriety criteria for eligibility to be appointed to a senior management role in a licensed bank. The Bank received 14 applications for appointment to boards of banks and 12 notifications of senior management appointments. All 26 proposed appointments were approved as the candidates met the minimum requirements stipulated in the guidelines. The majority of approved appointments in 2020 were foreigners, who accounted for 53.8 percent of the board and senior management officials, compared with 2019 where a majority of approved appointments were Botswana nationals (81.8 percent).

Table 3.6: Number of Board and Senior Management Approvals in 2019 and 2020

	2019	2020
Number of Board approvals	16	14
Foreigners	3	5
Locals	13	9
Number of senior management approvals	21	12
Foreigners	4	9
Locals	17	3
Total number of approvals	37	26

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

Action to address technical compliance deficiencies, and re-rating

- 3.11 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 continued to amend various pieces of legislation during 2018, 2019 and 2020 to achieve full technical and effective compliance with the Financial Action Task Force (FATF) Recommendations. The country requested a re-rating from the ESAAMLG in April 2019 and December 2020.

CHAPTER 3:

LICENSING AND CONSUMER PROTECTION (CONTINUED)

- 3.12 In 2020, the re-rating request was with respect to three (FATF) recommendations, being “6” (targeted financial sanctions related to terrorism and terrorist financing), “7” (targeted financial sanctions related to proliferation) and “10” (customer due diligence). On the basis of the progress made by Botswana in addressing the deficiencies that were identified, the three recommendations were upgraded from partially compliant (PC) to largely compliant (LC) rating, indicating that the remaining shortcomings were minor. Table 3.7 compares the 2017 technical compliance ratings (TCRs) with the 2019 and 2020 re-rating outcomes.

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

	2017 TCRs	2019 Re-rating	2020 Re-rating
Compliant	0	6	6
Largely compliant	2	13	16
Partially compliant	14	16	13
Non-compliant	23	4	4
Not-applicable	1	1	1

- 3.13 The country continues to make progress on the remedial action programme towards full compliance with the remaining non-compliant and partially compliant FATF recommendations.

Financial Action Task Force – International Co-operation Review Group Africa/Middle East Joint Group Meetings

- 3.14 The sixth meeting with the Financial Action Task Force – International Co-operation Review Group (FATF – ICRG) Africa/Middle East Joint Group (Joint Group) was held virtually on January 20, 2021. The Joint Group noted progress made by the country in addressing its AML/CFT strategic deficiencies. In particular, it was noted that the country had made progress in relation to immediate outcome 3 (IO3), which deals with supervision and monitoring of financial institutions and designated non-financial business and professions for compliance with AML/CFT requirements. In that regard, the Joint Group has assessed all action items under IO3 to be largely compliant. The Joint Group has requested the country to continue providing progress updates in relation to IOs 6 (analysis and dissemination of financial intelligence), 9 (terrorist financing investigations), 10 and 11 (Implementation of effective targeted financial sanctions regime).

BOX 4: BIG TECHNOLOGY FIRMS AND THEIR ROLE IN THE FINANCIAL SYSTEM – EFFECT ON FINANCIAL STABILITY AND CONSUMER PROTECTION

Introduction

Big technology firms (Bigtechs) refers to large-scale technology firms whose business operations range from traditional telecommunication and social media services to online financial activities. The Bigtechs label is based on the balance-sheet size of these entities and the wide scope of operations leveraging technology. In pursuit of unlocking additional value from their existing telecommunication infrastructure, these firms have spread their business activities to include banking, insurance, wealth management and online shopping. At a global level, the commonest Bigtechs are Ant Group (Alibaba), Amazon, Apple, Google, Yahoo and Samsung. Econet, Orange and Vodafone, which are primarily telecommunication firms, have also assumed Bigtech status in sub-Saharan Africa. The common characteristic of Bigtechs is that their operations transcend several countries and their digital infrastructures enable them broader outreach than conventional service providers, which, in turn, lowers the unit cost of operations as the served population increases. This article highlights the emergence of Bigtechs in the financial sector, some of the common demand and supply factors that motivate these firms to set up operations in the financial sector, the regulatory and supervisory challenges, and policy imperatives.

Emergence of Bigtechs in the Financial Sector

The spread of Bigtechs in the financial sector has been far more rapid and wider in emerging market and developing economies (EMDEs) than in advanced economies (AEs). The difference in the growth patterns is mainly due to the fact that there are more opportunities to be exploited in EMDEs than in AEs where banks and other conventional financial-services providers are well established and have a wider geographic presence. On the other hand, EMDEs have relatively low levels of financial development, which, along with limited financial inclusion, make alternative financial services attractive. It has been observed that people in rural areas of EMDEs are often underserved by conventional financial-services providers, forcing them to turn to Bigtech-leveraged financial services. Consequently, Bigtechs have tended to significantly contribute to both financial development and inclusion in EMDEs.

The influence of Bigtechs has been more pronounced in the payments system, where these firms have increased availability of money-value-transfer services (that is, money remittance) in EMDEs in general and in areas which have limited access to brick-and-mortar financial-services providers owing to poor road infrastructure, and lack of electricity and telecommunication services necessary for the provision of services. The potential significance of Bigtechs in the financial system has been demonstrated in China where payments transacted through these firms accounted for 38 percent of gross domestic product in 2018. It is also estimated that Bigtechs in China had extended credit in excess of US\$500 billion by 2019 to millions of borrowers. The influence of Bigtechs in the payments system in sub-Saharan Africa has been significant in East Africa through the M-Pesa mobile-phone-based money transfer-service platform that originates in Kenya. In contrast to the situation in China and East Africa, Bigtechs account

for a lower proportion of payments in AEs. This is partly attributed to the early availability of other payment alternatives, such as credit and debit cards in the AEs well before the advent of e-commerce. However, the shift towards open banking in Europe and the issuance of Payment Services Directive by the European Union in 2015 has enabled access by Bigtechs licensed to provide financial-services payment to the data previously available to banks only.

Bigtechs have transformed the financial system not only because of the magnitude of the financial services they offer but also because of the reliance of traditional financial-services providers, such as banks and insurance companies, on the technology platforms designed by those firms. The ongoing digital transformation in all spheres of business makes Bigtechs third-party partners to traditional financial-services providers that depend on the former to introduce digital products and services. For instance, Alibaba, Amazon, Microsoft and Google provide cloud data-storage services to traditional financial providers. Similarly, in sub-Saharan Africa, telecommunication operators, such as Orange, Econet, MTN, Vodafone and Safaricom, offer banking-related services, on one hand, and provide digital platforms to banks on the other.

Common Demand and Supply Factors that motivate Bigtechs to operate in the Financial Sector

Demand-side Factors

Bigtechs provide benefits, which are driven by either demand- or supply-side factors. Demand-side factors are influenced by consumers' preferences and unmet customer demand resulting from low levels of financial inclusion. As stated above, poor road infrastructure, shortage and unreliable supply of electricity and telecommunication services hinder consumer access to traditional brick-and-mortar-based providers of financial services.

The inadequate infrastructure and supply of electricity and telecommunication services provide Bigtechs with an opportunity to reach out to the underbanked or unbanked through the alternatives offered by mobile or digital banking. In some EMDEs, the lack of both requisite customer due diligence documentation for account opening and credit history impedes the opening of accounts at banks and other traditional financial-services providers by remote-area dwellers. On the other hand, the less onerous registration requirement for a mobile-money service has motivated telecommunication Bigtechs to reach out to sections of the society marginalised from mainstream financial services. This relationship established between Bigtechs and customers as the latter search for services that cannot be accessed from the mainstream financial-services providers is demand driven. One of the commonest factors is demand for credit by entities that are excluded through rating of creditworthiness by banks. Bigtechs tap into these excluded and underserved individuals and small businesses by providing lending through peer-to-peer platforms. These firms also make use of their technological infrastructure to provide financial services without face-to-face engagement with customers, which reduces operating costs as there are no branch networks. Through enabling peer-to-peer lending and increased access through technology, Bigtechs play a positive role in financial inclusion.

The demand for money-value-transfer services has been a key factor for establishing financial operations by Bigtechs in some countries. The demand for money-remittance services has been high in countries that have experienced high levels of emigration. To support their relatives back home, migrants usually transfer money to their home countries through platforms provided by Bigtechs. The preference for Bigtechs is mainly attributable to the fact that these firms often offer payment services at lower costs than banks because of their relatively low unit cost of transaction. Given that Bigtechs primarily drive technological innovation, these companies tend to appeal more to people who would have already been using the entities for nonfinancial services they offer. A study conducted in 2017 by Bain & Company and Research Now revealed that 91 percent, 86 percent and 60 percent of respondents from India, China and the United States of America, respectively, would prefer financial products from firms they already had a relationship with.

Supply-side Factors

Bigtechs may enter the financial sector in response to an opportunity created by the wide range of customer information or data they hold. The relationship established on this basis is characterised as supply-side driven. Another factor that drives the supply-side relationship is the existing technological knowhow in Bigtechs, which enables them to use artificial intelligence and machine learning technology to analyse client behavioural and consumption patterns. These technological advantages enable the firms to better determine customer demands and introduce products mix that are more acceptable to clients.

An additional supply-side factor that drives Bigtechs into the financial sector is regulatory weakness in their primary sector. Banks and other financial-services providers have been operating in a highly regulated and supervised environment for many years. Entities such as banks and insurance companies are subjected to regulatory frameworks that are costly and restrictive and involving prudential capital requirements. In contrast, Bigtechs have until recently been operating under minimal compliance requirements. Even then, most of the requirements relate to market conduct rather than the more costly prudential thresholds on primary reserves, capital adequacy and liquid assets statutorily prescribed for banks. In addition, the level of competition in the financial sector acts as a key supply-side factor in influencing entry by Bigtechs. A low level of competition in the financial sector would typically result in high profit margins, which could, in turn, motivate Bigtechs to venture into financial services. Access to funding might act as a barrier to entry in a financial sector already comprising a few large banks. In such cases, Bigtechs would usually partner with an existing bank or just establish own bank. According to the Institute of International Finance, in these partnerships, Bigtechs provide the core systems, interface and data storage through cloud computing technology, whereas banks manage the balance sheet.

Regulatory and Supervisory Challenges and Policy Imperatives

Bigtechs present challenges for regulators for a number of reasons. The status of competitor and third-party relationships established between technology companies and traditional financial-services providers creates a potential for conflict of interest. This potential is more pertinent in markets where

Bigtechs are increasingly gaining dominance in financial activities in a country where they also have access to the data of customers of financial institutions through the database custodial services they offer to the financial-services providers that they compete with and through access to information they are privy to through their other business operations. Bigtechs also have infrastructures that enable them to operate across jurisdictions and that could result in regulatory arbitrage if these firms were to take advantage of weaker regulatory environment in any of the countries where they have a presence. In addition, Bigtechs present oversight challenges as their cross-border operations could make it difficult for regulators to determine if there is unauthorised use of customer database.

Furthermore, joint-venture arrangements between Bigtechs and banks present regulatory challenges, given that a Bigtech in partnership with a bank might also provide a similar financial service through some technology affiliates in its digital ecosystem. Therefore, joint-venture arrangements may create problems for regulators when they determine the capital adequacy of the partnering bank, given the type of business.

The entry of Bigtechs in the financial sector poses financial stability risks since these firms increase competition that could erode profitability of mainstream financial-services providers, such as banks and insurance institutions to a level where they might not build up sufficient capital to adequately absorb shocks whenever there are adverse developments in the market. Further, the increase in participation of Bigtechs in conventional banking services such as deposit-taking could significantly divert deposits from the banking system to wallets owned by technology firms and adversely affect funding and stability of the financial system.

Conclusion

Bigtechs have established themselves as key players in the promotion, broadening of access and extension of financial services to benefit financial inclusion, ease of transacting and economic activity broadly. The technological capacity and sheer size of Bigtechs enable enhanced coverage of financial services in EMDEs that traditionally were not readily accessible through conventional financial-services providers, where their sheer size enables them to invest in innovation and promptly design products that are more suited to customer needs. Therefore, Bigtechs are viewed as playing a positive role in financial inclusion. On the other hand, the size and scope of financial activities offered by Bigtechs could raise consumer protection and financial stability concerns through unauthorised access to customers' proprietary data and inadequately regulated deposit-taking, respectively, while there could be propagation of cyber-security risks.

These challenges present supervisory concerns, and it is important that regulators prepare for the inevitable entrenchment and growth of financial activities offered by Bigtechs. In this regard, the Bank of Botswana will, similarly, closely monitor entry of Bigtechs into the financial sector and growth patterns of transactions leveraged through these firms and, where necessary, initiate engagement with the Botswana Communications Regulatory Authority and the Competition and Consumer Authority regarding the protection of bank customer information and safeguarding the integrity and stability of the financial system.

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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 2020:
- (a) Sound Management of Risks Relating to Money Laundering and Financing of Terrorism on July 2, 2020.
 - (b) Eighteenth Progress Report on the Adoption of the Basel Regulatory Framework on July 6, 2020.
 - (c) Capital Treatment of Securitisation of Non-Performing Loans on November 26, 2020.
 - (d) Supplemental Note to External Audits of Banks – Audit of Expected Credit Loss on December 7, 2020.
- 4.2 In addition, the BCBS circulated, for consultation and comments, the Revisions to the Principles for the Sound Management of Operational Risk.

PARTICIPATION IN INTERNATIONAL AND DOMESTIC REGULATORY AND SUPERVISORY FORUMS

Supervisory Colleges

- 4.3 During 2020, the Bank attended an annual global supervisory college¹⁶ meeting organised by a home supervisor of the parent bank of a banking group with a subsidiary in Botswana.
- 4.4 The supervisory college meeting was held in compliance with principle 13 of the Basel Core Principles for Effective Banking Supervision (core principles). The core principle requires home supervisors to establish bank-specific supervisory college meetings for banking groups and host supervisors to be included in the colleges. The objective of the supervisory college meeting was to review material prudential or business concerns in relation to one commercial bank, especially during the COVID-19 pandemic. The group chief executive officer of the commercial bank highlighted that the bank had continued its resilience in the COVID-19 environment and retained its 4-year strategy, which entailed regaining financial strength, improving earnings, enhancing existing networks and focussing on value-chain propositions, mainly through optimisation of customer relationships and digitalisation.

¹⁶ Supervisory colleges are working groups of supervisors formed under the aegis of the BCBS to enhance the consolidated supervision of internationally active banking groups.

CHAPTER 4:

OTHER SUPERVISORY ACTIVITIES (CONTINUED)

Cross-Border Supervision

- 4.5 Consistent with core principle 12, the Bank held two virtual supervisory meetings during the year. The Bank held a meeting with the South African Reserve Bank (SARB) in respect of the consolidated supervision of the Absa Banking Group. The objective of the meeting was to provide a progress update on the separation process between Barclays PLC and Barclays Africa Group Limited (BAGL) as well as highlight any supervisory issues of supervisory concern. The Bank also held a supervisory meeting with officials of the Prudential Authority of the SARB concerning one commercial bank. The meeting was a follow-up to the supervisory college meeting held by the regulators of the commercial bank in 2019, in which a recommendation was made to establish regular communication to enhance transparency and cooperation, as well as share information between supervisors of the bank's parent bank and its subsidiaries.

Other Supervisory Matters

- 4.6 Pursuant to sections 38 and 39 of the Bank of Botswana Act (Cap.55:01) and sections 13 and 14 of the Banking Act, the Bank issued a circular to banks (circular) amending the Revised Directive on Capital Measurement and Capital Standards for Botswana (Basel II). The amendment was intended to provide capital relief for the banking industry and support economic activity during the COVID-19 pandemic through a reduction of the minimum regulatory capital adequacy ratio from 15 percent to 12.5 percent effective on April 1, 2020. In addition, the Bank issued to all banks a Circular on Guidance on the Regulatory Treatment of IFRS 9 Provisions on account of the COVID-19 pandemic. In the circular, the Bank endorsed the initiative of the banking industry, in particular, the offering of a selective three-month payment moratorium on qualifying performing loans, to help mitigate the adverse effects of the COVID-19 pandemic on borrowers. To support the initiative, the Bank suspended the raising of specific provisions against loans qualifying for the loan restructuring and payment moratorium under this temporary arrangement.
- 4.7 The Bank continued compiling financial soundness indicators for disseminating to stakeholders through posting on the Bank's and International Monetary Fund websites as well as the African Development Bank's Open Data Platform website.
- 4.8 The Bank hosted an IMF technical assistance mission (TAM), the third follow-up visit, on February 3 – 7, 2020. The purpose of the TAM was to assist the Bank strengthen its AML/CFT regime by developing capacity to regulate and supervise financial institutions using a risk-based approach. The TAM reviewed the draft risk-based model that would be used to identify, measure and monitor ML/TF risks for banks.
- 4.9 As part of Pillar 2 implementation, the Bank continued to receive internal capital adequacy assessment process (ICAAP) reports for banks. During the year, the Bank received 2019 ICAAP reports for seven banks.
- 4.10 Following the divestiture of Barclays PLC from BAGL, Barclays Bank of Botswana Limited rebranded its branches and ATMs and officially changed the name to Absa Bank Botswana Limited on February 10, 2020. BAGL holds a 68 percent stake in Absa, while local institutions own 23 percent and 9 percent is held by the general public, listed on the Botswana Stock Exchange.

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 follow-up on-site examinations of two commercial banks and a statutory bank in 2020, the purpose of which was to assess and validate progress made by the banks in addressing the shortcomings that were raised in the 2018 full-scope on-site examinations. The follow-up on-site examination of the first bank focussed on assessment of board and senior management oversight and governance risk, credit risk management and operational risk. The follow-up on-site examination of the second bank concentrated on the review of the bank's strategic, credit and operational risk, while the follow-up on-site examination of the third bank sought to evaluate board and senior management oversight and governance risk, capital management, credit risk management and operational risk.
- 5.2 For the first bank, the follow-up on-site examination established that the remedial measures on governance, in particular, board oversight matters, governance structure and talent management were inadequate. The bank did not have a matrix to determine its risk appetite by setting key risk indicators that would act as early warning signs for the bank. The bank did not assess its key risk areas needed to develop effective risk management strategies to deal with the risks.
- 5.3 Furthermore, supervisory concerns relating to credit risk had not been satisfactorily addressed. There were no minutes of the credit committee proceedings, thus making it difficult for examiners to assess the performance and effectiveness of the credit committee. The IFRS 9 methodology adopted by the bank was not comprehensive, for it did not consider the macroeconomic environment. In addition, the bank did not value property held as collateral every three years in accordance with the loan policy, and there were instances where insurance policy cover for property held as collateral had expired. Moreover, the bank's write-off policy did not specify the period within which NPLs should be written off, thus resulting in the overstating of the value of assets by the bank.
- 5.4 With respect to the second bank, the three outstanding issues relating to the segregation of loan origination and assessment for business loans of up to P3.5 million, recruitment of a chief credit officer (CCO) and incorporation of an operational risk module to the bank's online talent learning system had been partially addressed. Meanwhile, the supervisory concerns relating to establishing a board credit committee, scaling up the involvement of in-country staff in the credit evaluation and approval process for loans to specialised sectors had been adequately addressed.
- 5.5 Regarding corporate governance, the bank's board had seven members, resulting in inadequately resourced board committees. The foregoing partly arose from board attrition rate, which was considered high as indicated by two and three resignations of board members in 2019 and 2020, respectively.

CHAPTER 5:

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

- 5.6 For the third bank, the follow-up on-site examination revealed that the following board oversight deficiencies had been resolved: expired terms of appointment for the majority of board members and the board secretary, for some board members lack of relevant banking experience; inadequate training of board members; lack of proper documentation of board minutes and resolutions, and absence of documented board-approved key policies.
- 5.7 The bank had satisfactorily resolved supervisory concerns raised in 2018 relating to credit risk management. In that regard, the bank was no longer involved in the credit administration of the Government Employees Motor Vehicle and Residential Property Advance Scheme, credit underwriting standards had been improved and resources in the credit department augmented. Furthermore, concerns which were raised relating to the bank's inability to identify, assess, monitor and manage operational risk had been resolved. In addition, the bank had filled all the vacancies in key managerial positions.
- 5.8 Overall, the examination indicated that the bank did not have a comprehensive capital management plan necessary to address capital needs under stressed conditions.

AML/CFT On-site Examinations

- 5.9 During 2020, the Bank conducted three follow-up on-site examinations of three banks and one targeted on-site examination of one bank. The objective of the follow-up on-site examination of the first bank was to assess the adequacy and effectiveness of AML/CFT policies and procedures of the bank and determine whether they were commensurate with the ML/TF risk profile of the bank. With respect to the second bank, the follow-up AML/CFT on-site examination was to establish whether the AML/CFT deficiencies raised during the full-scope on-site examination in 2018 had been rectified and to assess whether the AML/CFT measures adopted by the bank were commensurate with the bank's level of identified ML/TF risks. The examination also evaluated the bank's level of compliance with the FI Act. As for the third bank, the follow-up AML/CFT on-site examination was aimed at assessing progress made by the bank in addressing the AML/CFT weaknesses identified during the 2018 examination and the bank's compliance with the FI Act.
- 5.10 The 2020 examination found that the first bank had largely addressed the deficiencies that were identified during the 2017 full scope on-site examination. The bank, however, had failed to avail the results of ML/TF risk assessment with business lines, senior management and board of directors to enable them to have a comprehensive understanding of the level of the bank's exposure to the ML/TF risk. Moreover, the bank had delayed investigating financial transactions alerts triggered by the system, used by the bank for monitoring suspicious transactions.
- 5.11 The second bank's inherent vulnerability to ML/TF risk was rated low. The adequacy of the risk management practices and controls, however, was rated weak. The bank had violated the FI Act by failing to risk-rate senior executives of private entities as prominent influential persons; identify money laundering and terrorist financing risks relating to development of products, practices and delivery channels; appoint a money laundering reporting officer at the management level; and report all large transactions to FIA. The bank was directed to rectify the supervisory concerns raised.

CHAPTER 5:

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

- 5.12 The follow-up on-site examination of the third bank noted that the bank had not made significant progress in addressing deficiencies raised in the 2018 on-site examination. The bank had also violated certain provisions of the FI Act by failing to conduct ML/TF risk assessment and ongoing customer due diligence, establish and verify the identity of beneficial owners of companies, and identify prominent influential persons.
- 5.13 A targeted AML/CFT on-site examination of one bank was conducted because a concern had been raised by FIA on the bank's failure to report a suspicious transaction. The objective of the investigation was to determine whether the bank had complied with laid-down procedures when opening and operating the particular account. The examination also assessed whether the bank's know-your-customer processes complied with the FI Act. The investigation revealed that the transactions that went through the account had given rise to suspicion and hence the bank should have filed a suspicious transaction report to FIA for investigation.

CONSULTATIVE AND PRUDENTIAL MEETINGS

- 5.14 Prudential bilateral and statutory trilateral meetings were held in 2020, 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. Furthermore, statutory bilateral meetings were held with external auditors to discuss audit strategies for banks. The Bank also held AML/CFT bilateral meetings with all banks. The purpose of the bilateral meetings was to discuss banks' ML/TF risks and AML/CFT risk management policies, procedures and practices the banks had adopted to mitigate the identified inherent risks.

VIOLATIONS OF THE BANK OF BOTSWANA ACT AND THE FI ACT

- 5.15 Five banks violated various sections of the Bank of Botswana Act (Cap.55.01) (BoBA) and the FI Act during 2020. Consequently, monetary penalties were imposed on the defaulting banks which, in aggregate, amounted to P225 650, as detailed in Table 5.2

CHAPTER 5:

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

Table 5.1: Penalties Charged on Banks for Various Violations of the Bank of Botswana Act (Cap.55.01) and Financial Intelligence Act

Name of Bank	Violation	Bank of Botswana Act and FI Act	Amount (P)
First bank	Failure to maintain the minimum average holding of primary reserve requirements for the period between January 8, 2020, and February 11, 2020.	Violation of Section 40 of BoBA and operational guidelines for the primary reserve requirement averaging.	P1 650
Second bank	Failure to maintain the minimum average holding of primary reserve requirements for the period between August 12, 2020, and September 8, 2020.	Violation of Section 40 of BoBA and operational guidelines for the primary reserve requirement averaging.	P24 000
Third bank	Failure to file a suspicious transaction report with the Financial Intelligence Agency.	Violation of Section 25(1)(a) of the FI Act, 2009 (Cap. 08:07)	P100 000
Fourth bank	Inconsistency of information in the system and the customer documentary files.	Violation of Section 11(3A) of the FI Act, 2009, as read with the FI (Amendment) Act, 2018.	P50 000
Fifth bank	Failure to conduct risk assessment and ongoing customer due diligence, establish and verify the identity of beneficial owners of companies, and identify prominent influential persons	Violation of Section 11, 15(1), 16(1) and 18 of the FI Act, 2019.	P50 000
Total			P225 650

Source: Bank of Botswana Compilation.

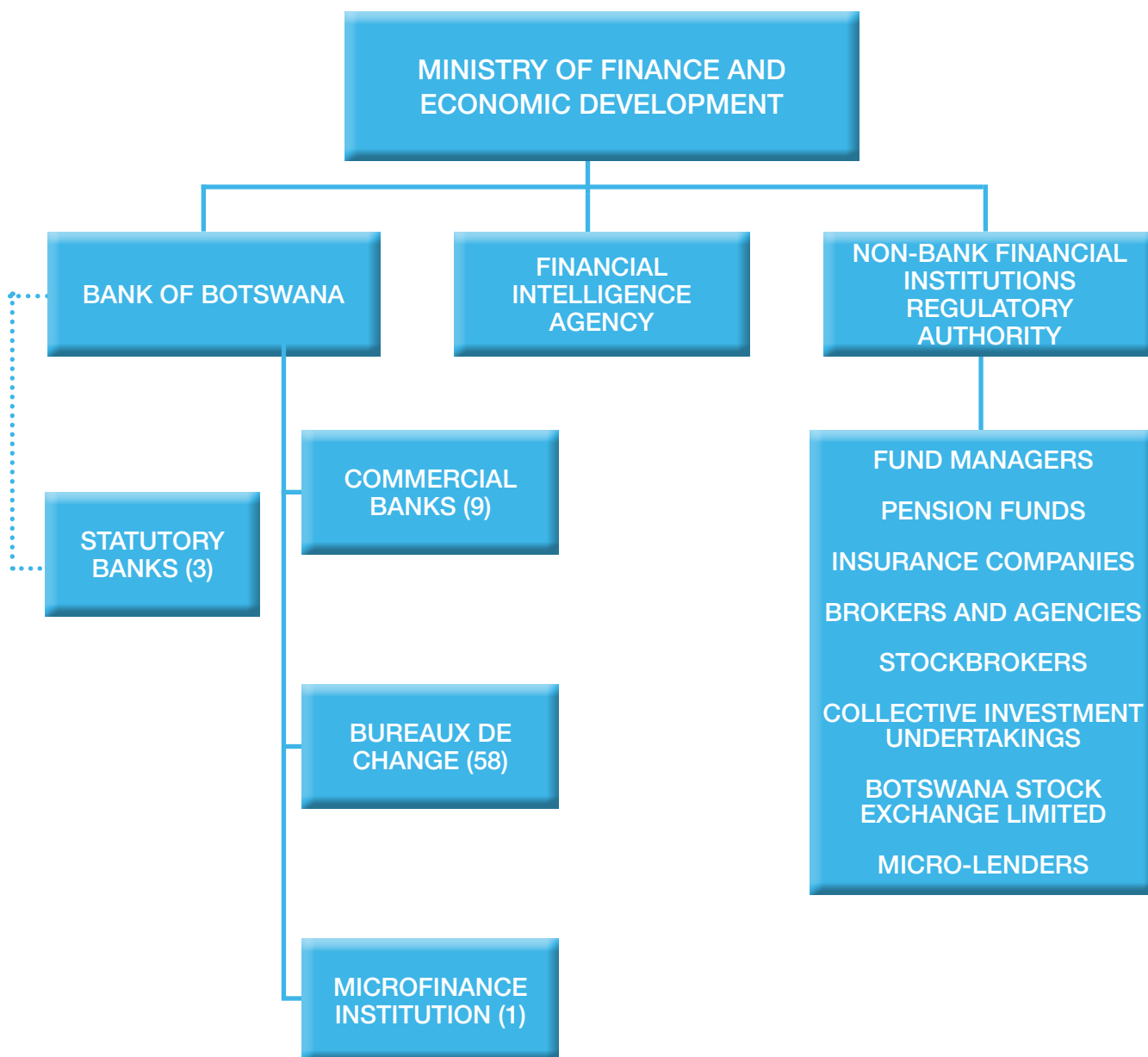
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APPENDIX 1

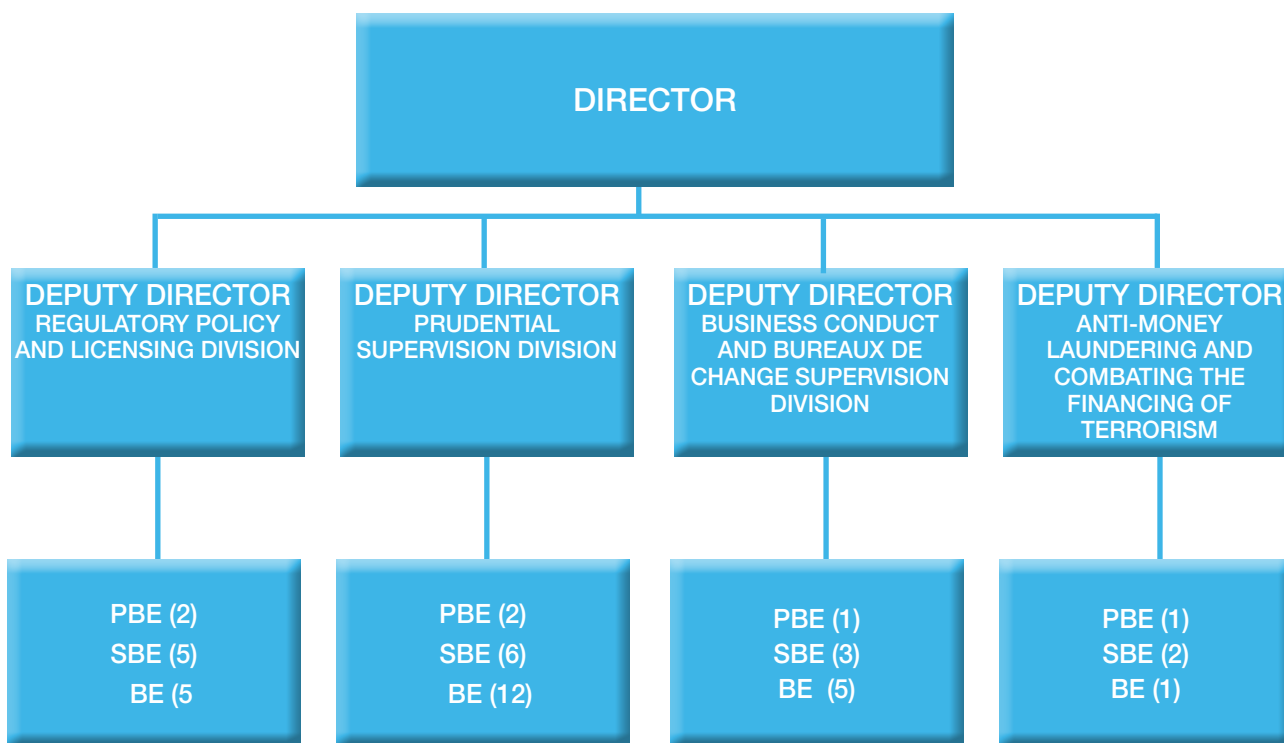
DIAGRAM 1.1: THE REGULATORY ARCHITECTURE OF THE DOMESTIC FINANCIAL SYSTEM



Source: Bank of Botswana.

APPENDIX 1 (CONTINUED)

DIAGRAM 1.2: BANKING SUPERVISION DEPARTMENT ORGANISATIONAL STRUCTURE AS AT DECEMBER 31, 2020

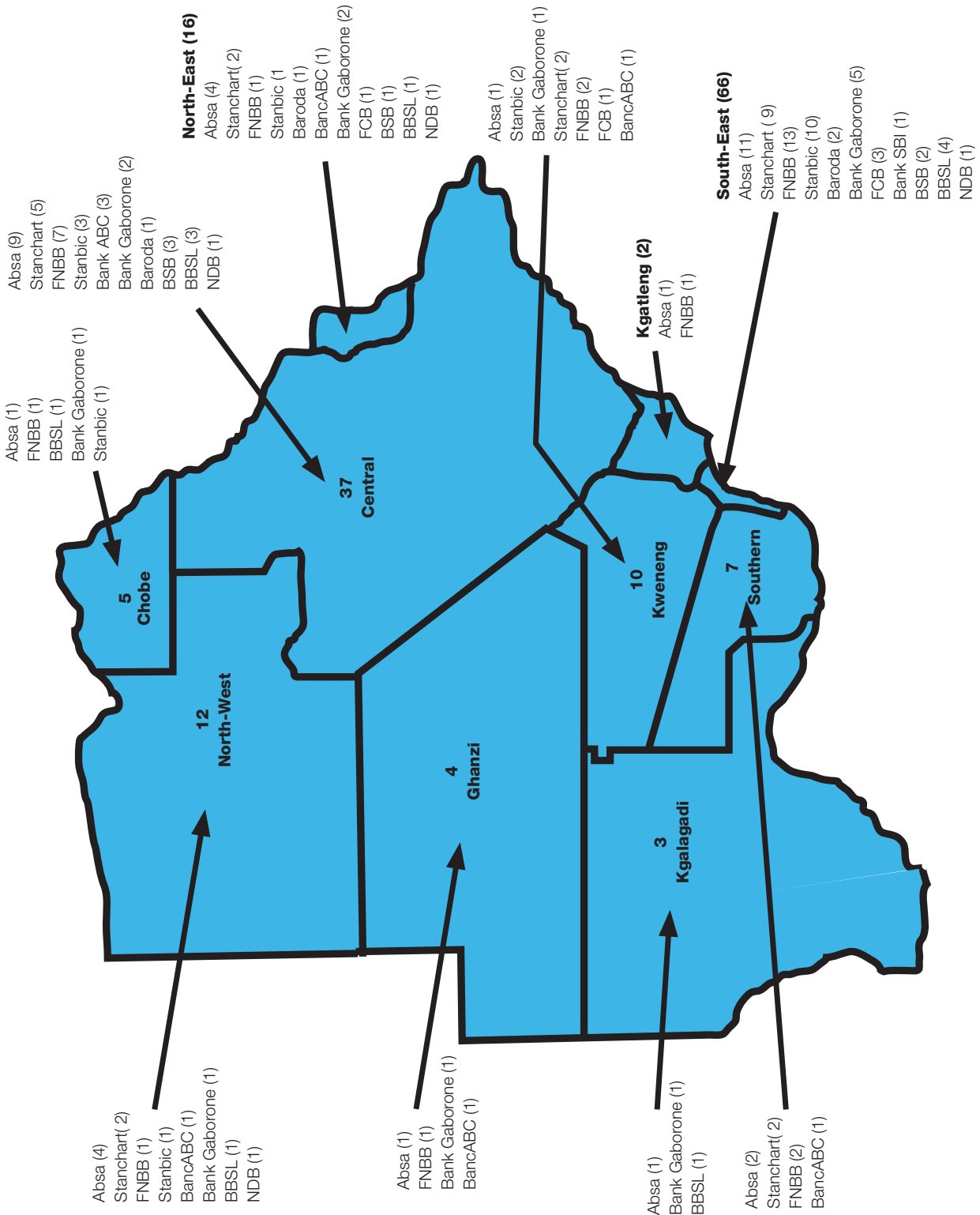


Key: PBE: Principal Bank Examiner
 SBE: Senior Bank Examiner
 BE: Bank Examiner

Source: Bank of Botswana.

APPENDIX 2

DIAGRAM 1: BANK-BRANCH DISTRIBUTION NETWORK BY DISTRICT AS AT DECEMBER 31, 2020



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

APPENDIX 3 (CONTINUED)

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.

APPENDIX 3 (CONTINUED)

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.

APPENDIX 3 (CONTINUED)

Insider Lending

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

Non-performing Loans and Provisions

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

6. MAIN SUPERVISORY APPROACHES

On-site 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 full-scope on-site examination should be conducted at least every 18 months. A limited-scope examination is an on-site examination that does not cover all components of the CAMELS, but rather focuses on a specific product, area, or risk, for example, consumer loans, treasury or operational risk. An ad hoc on-site examination is usually a limited-scope examination designed to test a specific area of supervisory concern, for instance, compliance with laws and regulations, liquidity, capital adequacy, among others. A full-scope business-conduct supervision examination focuses on the entire business conduct of an institution and how it relates to customers (consumer protection).
- 6.3 The objective of an on-site examination is to assess and evaluate the overall condition and financial soundness of a bank, compliance with applicable laws and regulations, the quality and effectiveness of governance structures, including the internal control environment, as well as to check the accuracy of statutory reports submitted to the Bank.

APPENDIX 3 (CONTINUED)

- 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.

APPENDIX 3 (CONTINUED)

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.

APPENDIX 3 (CONTINUED)

- 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, 2020

(a) COMMERCIAL AND STATUTORY BANKS

Institution	Total Assets (P' million)	Postal Address	Business Locations	Auditors
Commercial Banks				
Absa Bank Botswana Limited	20 798	P O Box 478, Gaborone	35	KPMG
African Banking Corporation of Botswana Limited	8 832	Private Bag 00303, Gaborone	13	KPMG
Bank Gaborone Limited	6 503	Private Bag 00325, Gaborone	14	Pricewaterhouse Coopers
Bank of Baroda (Botswana) Limited	2 106	P O Box 216 ADD, Gaborone	4	Grant Thornton
Bank SBI Botswana Limited	221	P O Box 505243, Gaborone	1	Grant Thornton
First Capital Bank Limited	3 941	P O Box 5548, Gaborone	5	KPMG
First National Bank of Botswana Limited	27 862	P O Box 1552, Gaborone	28	Deloitte
Stanbic Bank Botswana Limited	18 943	Private Bag 00168, Gaborone	18	KPMG
Standard Chartered Bank Botswana Limited	14 054	P O Box 496, Gaborone	22	KPMG
Statutory Banks				
Botswana Savings Bank	2 846	P O Box 1150, Gaborone	7	Pricewaterhouse Coopers
National Development Bank	1 232	P O Box 225, Gaborone	4	Pricewaterhouse Coopers
Building Society				
BBS Limited	4 109	P O Box 40029, Gaborone	10	KPMG

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

APPENDIX 4 (CONTINUED)

(b) BUREAUX DE CHANGE AS AT DECEMBER 31, 2020

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
Bosha Bureau de Change	P O Box 301529 Francistown	1
Chelyn Bureau de Change	P O Box 300158 Maun	1
City Exchange Bureau de Change	P O Box 50282 Gaborone	1
CSS Bureau de Change	P O Box 45168 Gaborone	3
Exim Bureau de Change	P O Box 1020 Gaborone	1
Fanz Bureau de Change	P O Box 617 Lobatse	1
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	2
Garona Bureau de Change	P O Box 408 Gaborone	4
Genesis Bureau de Change	Private Bag BR 225 Gaborone	1
Gorogang Bureau de Change	P O Box 46785 Gaborone	1
Kabona Bureau de Change	P O Box 465 ADD Tlokweng	1
Kaycy Bureau de Change	P O Box 1693 Lobatse	2
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
Monty Cristo Bureau de Change	Private Bag 00254 Gaborone	1

APPENDIX 4 (CONTINUED)

(b) BUREAUX DE CHANGE AS AT DECEMBER 31, 2020

Name	Postal Address	Business Location
Monyglob Exchange Bureau de Change	P O Box AD 749 Gaborone	7
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
Palm Bureau de Change	P O Box 502359 Gaborone	1
Prime Ex Bureau de Change	P O Box 686 Moshupa	1
Proxy Bureau de Change	P O Box 404108 Gaborone	2
Rain Bureau de Change	P O Box 1751 Gaborone	1
Regash Bureau de Change	P O Box 45144 Gaborone	1
River Ride Bureau de Change	P O Box 301106 Francistown	1
Royalty Bureau de Change	Private Bag BO 259 Gaborone	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 Frontier Bureau de Change	P O Box 183 Pitsane	2
Travelex Bureau de Change	P O Box 80981 Gaborone	1
Travellers' Choice Bureau de Change	P O Box 26725 Gaborone	1
TRL Money Link Bureau de Change	Private Bag F333 Francistown	2
Tshilong Bureau de Change	P O Box 40418 Gaborone	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		58
		101

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

APPENDIX 4 (CONTINUED)

(c) MICROFINANCE INSTITUTION

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

Source: Women's Finance House.

APPENDIX 5

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.

APPENDIX 5 (CONTINUED)

(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 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.

APPENDIX 5 (CONTINUED)

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

APPENDIX 5 (CONTINUED)

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.

APPENDIX 5 (CONTINUED)

Net Income to Staff Expense

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

Cost-to-Income

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

Average Cost of Deposits

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

APPENDIX 5 (CONTINUED)

CAPITAL ELEMENTS

COMMON EQUITY TIER 1 (CET1) CAPITAL	
Line	Item
1	Common shares
2	Share premium resulting from the issue of common shares
3	Retained earnings Retained earnings brought forward from the previous financial year Add: Interim profits (audited by external auditor) Less: dividend declared Less: dividend paid in the current financial year
4	Accumulated other comprehensive income and other disclosed reserves a. Statutory credit risk reserve b. Capital buffer c. Statutory reserves d. Other (specify)
5	Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)
6	Regulatory adjustments applied in the calculation of CET1 capital
7	CET1 Capital Lines (1+2+3+4+5-6)
ADDITIONAL TIER 1 CAPITAL	
8	Instruments issued by the bank that meet the criteria for inclusion in additional Tier 1 capital as per paragraph 4.9 of the Capital Directive
9	Stock surplus (Share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria for inclusion
10	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in additional Tier 1 capital and are not included in 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	
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)

Table 1: 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	<i>(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)</i>
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)

APPENDIX 5 (CONTINUED)

45	Full deductions applied to the calculation of Additional Tier 1 Capital Lines (40+41+42+43+44)
BB. Threshold deductions:	<i>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)</i>
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 Tier1 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	<i>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)</i>
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 (34, 35, 36) not deducted (threshold amounts) in the calculation of CET1 is treated as other assets and risk-weighted at 250 percent.

(2) Line 37: 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

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

Notes:

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

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

2 Excludes cash items in the process of collection.

Source: Bank of Botswana.

APPENDIX 6 (CONTINUED)

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

APPENDIX 6 (CONTINUED)

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

Maturity/Commitment	Credit Conversion Factor Percentage
Commitments:	
• Original maturity up to 1 year	20
• Original maturity over 1 year	50
• Unconditionally cancellable commitments without notice	0
Direct credit substitutes:	
• Acceptances and endorsements	100
• Guarantees on behalf of customers	100
• Letters of credit issued by the bank with no title to underlying shipment	100
• Letters of credit confirmed by the bank and standby letters of credit serving as financial guarantee	100
Repo style transactions:	
• Sales and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank	100
Lending of banks' securities or posting of securities as collateral:	
• Repurchase/reverse repurchase agreements and securities/borrowing transactions	100
Forward asset purchases:	
• Commitment to purchase at a specified future date on prearranged terms, a loan, security or other asset from another party, including written put options on specified assets with the character of a credit enhancement	100
Placements of forward deposits:	
• An agreement between a bank and another party where the bank will place a deposit at an agreed rate of interest at a predetermined future date	100
Partly paid shares and securities:	
• Amounts owing on the uncalled portion of partly paid shares and securities held by a bank representing commitments with certain draw down conditions by the issuer at a future date	100
Certain transaction-related contingent items:	
• Performance bonds, warranties and indemnities	50
• Bid or tender bonds	50
• Advance payment guarantees	50
• Customs and excise bonds	50
• Standby letters of credit related to particular contracts and non-financial transactions	50
Note issuance facilities and revolving underwriting securities:	
• An arrangement whereby a borrower may draw down funds up to a prescribed limit over a predetermined period by making repeated note issues to the market. If the issue is unable to be placed in the market, the unplaced amount is to be taken up or funds made available by a bank being committed as an underwriter of the facility	50
Short-term self-liquidating trade 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 STATEMENTS OF LICENSED BANKS: 2016 – 2020

Table 1: Aggregate Statement of Financial Position of Licensed Commercial Banks:
2016 – 2020 (P million) as at 31st December

Total Assets in Local Currency		2016	2017	2018	2019	2020
1.	Cash and balances with the central bank	6 333	4 597	5 364	6 501	5 699
	1.1. Currency	1 433	1 608	1 901	1 850	2 193
	a) Foreign currency	363	382	607	173	173
	b) Local currency	1 070	1 226	1 294	1 677	2 020
	1.2. Balances with central bank	4 900	2 989	3 462	4 651	3 506
	1.3. Other	-	-	-	-	-
2.	Investment and trading securities	11 425	10 811	12 142	14 203	15 820
3.	Placements with other banks and credit institutions	10 951	13 590	15 467	14 855	15 426
4.	Gross loans and advances to other customers	51 325	54 181	58 332	62 770	65 554
	4.1 Impairments – specific	1 270	1 536	1 352	1 775	1 713
	4.2 Interest in suspense	184	259	492	558	318
	4.3 Impairments portfolio	182	239	303	237	739
5.	Loans and advances to other customers (net of specific provisions)	49 690	52 147	56 185	60 200	62 785
6.	Fixed assets net of depreciation	908	926	956	1 348	1 449
7.	Other assets (net)	1 333	1 402	1 227	1 588	2 081
	Total Assets	80 640	83 475	91 341	98 695	103 260
Total Liabilities in Local Currency						
1.	Amounts owed to government institutions	12	27	-	-	45
	a) Central bank accounts	12	27	-	-	45
	b) Direct government credits (CB or MFED)	-	-	-	-	-
2.	Due to other banks and credit institutions	3 984	4 250	4 735	4 532	3 022
3.	Debt securities and other borrowing	2 642	4 065	4 747	4 761	5 594
4.	Due to other customers/depositors	62 438	63 581	69 270	75 709	80 540
5.	Shareholder funds	9 748	9 383	10 390	11 081	11 299
6.	Other liabilities	1 817	2 169	2 199	2 612	2 759
	a) Taxes payable	195	246	185	201	212
	b) Dividends payable	-	-	-	-	-
	c) Accrued expenses	7	551	-	292	907
	d) Other	1 615	1 372	2 013	2 120	1 640
	Total Liabilities	80 640	83 475	91 341	98 695	103 260

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

APPENDIX 7 (CONTINUED)

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

	2016	2017	2018	2019	2020
1. Total interest and fee income from loans and advances	5 271	5 449	5 728	6 251	6 149
2. Interest expense	1 425	1 466	1 811	1 894	1 774
3. Net interest income [1 – 2]	3 847	3 983	3 916	4 357	4 375
4. Total non-interest income	2 477	2 490	2 657	2 835	2 773
5. Gross operating income/(loss) [3+4]	6 323	6 473	6 573	7 192	7 148
6. Total impairments	855	1 003	429	743	830
a) Impairment of loans and advances – specific	685	994	344	700	611
b) Impairment of loans and advances – portfolio	172	9	85	42	224
c) Impairment on other financial assets	(2)	-	-	1	(4)
7. Operating income/(loss) net of bad and doubtful debts	5 469	5 470	6 144	6 449	6 318
8. Total non-interest expense	3 607	3 876	3 988	4 193	4 361
a) Salaries and employee benefits	1 543	1 731	1 781	1 899	1 955
b) Auditing and consulting expenses	173	299	15	47	19
c) Rents paid	198	207	227	169	133
d) Depreciation and amortisation	159	158	174	231	281
e) Other	1 533	1 481	1 791	1 847	1 621
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]	1 862	1 595	2 156	2 256	1 957
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]	1 862	1 595	2 156	2 256	1 957
13. Income tax	455	412	480	494	503
14. Net after-tax income/(loss) [12-13]	1 407	1 182	1 676	1 762	1 454

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

APPENDIX 7 (CONTINUED)

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

Total Assets in Local Currency		2016	2017	2018	2019	2020
1.	Cash and balances with the central bank	23	70	177	234	38
	a) Currency	21	18	171	222	29
	aa) Foreign currency	-	-	-	-	-
	ab) Local currency	21	18	171	222	29
	b) Balances with central bank	2	52	6	12	9
	c) Other	-	-	-	-	-
2.	Investment and trading securities	-	-	-	-	-
3.	Placements with other banks and credit institutions	1 025	1 777	1 391	2 424	935
4.	Gross loans and advances to customers	4 769	4 792	4 891	5 054	5 866
5.	Impairments	47	93	143	185	215
6.	Net loans and advances to customers	4 722	4 699	4 745	4 869	5 650
8.	Fixed assets net of depreciation	151	152	146	141	196
9.	Other assets (net)	62	79	82	106	136
	Total Assets	5 983	6 777	6 544	7 774	6 955
Liabilities in Local Currency						
1.	Amounts owed to government institutions	-	-	-	-	-
	a) Central bank accounts	-	-	-	-	-
	b) Direct government credits (CB** or MFED)	-	-	-	-	-
	c) Other	-	-	-	-	-
2.	Debt securities and other borrowing	987	1 235	1 325	1 185	1 100
3.	Due to customers/depositors	3 493	4 042	4 244	5 462	4 762
4.	Shareholders funds	1 303	1 306	775	718	709
5.	Other liabilities	200	193	200	409	384
	a) Taxes payable	1	1	2	1	1
	b) Dividends payable	4	-	-	-	-
	c) Accrued expenses	-	-	-	-	-
	d) Other	195	192	198	408	383
	Total Liabilities	5 983	6 777	6 544	7 774	6 955

** 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 (P million) for the period ended 31st December

	2016	2017	2018	2019	2020
1. Total interest and fee income from loans and advances	482	433	441	535	517
2. Interest expense	231	198	228	317	278
3. Net interest income [1-2]	251	234	213	218	239
4. Total non-interest income	46	30	35	51	46
5. Gross operating income/(loss) [3+4]	297	265	248	269	285
6. Total Impairments	18	24	32	34	46
a) Impairment of loans and advances – specific	-	-	18	23	85
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	279	241	216	235	239
8. Total non-interest expense	214	197	212	269	268
a) Salaries and employee benefits	106	91	97	130	127
b) Administrative expenses	-	-	-	-	-
c) Auditing and consulting expenses	-	-	1	1	-
d) Rents paid	-	-	2	13	4
e) Depreciation and amortisation	10	16	19	23	27
f) Other	98	88	93	102	110
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]	65	44	4	(34)	(29)
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]	65	44	0.18	(34)	(29)

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

APPENDIX 7 (CONTINUED)

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

	2016	2017	2018	2019	2020
COMMON EQUITY TIER1 (CET1) CAPITAL					
1. Common shares	1 165	1 265	1 265	1 265	1 265
2. Share premium resulting from the issue of common shares	271	271	271	271	271
3. Retained earnings	5 479	5 867	6 422	6 762	7 629
Retained earnings brought forward from the previous financial year	5 325	6 404	6 700	7 041	7 831
Add: Interim profits (audited by external auditors)	506	(196)	63	(13)	(9)
Less: IFRS 16 take on impact	-	-	-	190	-
Less: Dividend declared	-	6	160	75	-
Less: Dividend paid in the current financial year	352	335	180	-	-
4. Accumulated other comprehensive income and other disclosed reeves	156	207	289	304	321
a) Statutory credit risk reserve	25	79	137	146	163
b) Capital buffer	-	-	-	-	-
c) Statutory reserves	2	2	2	2	2
d) Other (specify)	129	126	150	156	156
5. Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)	-	-	-	-	-
6. Regulatory adjustment applied in the calculation of CET1 Capital ¹	123	249	275	-	324
a. IFRS 9 provisions transitional adjustments	-	-	-	21	52
b. Transitional adjustment amount added back to CET1	-	-	390	233	126
7. CET1 Capital (Line (1+2+3+4+5-6))	6 948	7 361	8 029	8 435	9 240
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
10. Stock surplus (share premium) resulting from the issue of additional Tier 1 capital instruments meeting all relevant criteria fro inclusion	-	-	-	-	-
11. Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in additional Tier1 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
14. Total Tier 1 Capital (Lines (7+13))	6 948	7 361	8 429	8 835	9 640

APPENDIX 7 (CONTINUED)

TIER 2 CAPITAL						
16.	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)	1 641	1 683	1 853	2 218	2 460
17.	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	-	-	-	-	-
18.	Unpublished current year profits	1 041	1 124	987	1 094	1 178
19.	Tier 2 capital instruments (subject to gradual phase-out treatment)	176	214	140	10	-
20.	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 and are not included in Tier 1 capital (minority interests)	-	-	-	-	-
21.	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	432	391	678	691	741
22.	Regulatory adjustments applied in the calculation of Tier 2 capital	-	-	(11)	-	-
23.	Total Tier 2 Capital (Lines (16+17+18+19+20+21-22))	3 293	3 412	3 648	4 013	4 378
24.	Total Unimpaired Capital (Lines (14+23))	10 241	10 774	12 077	12 848	14 018

Note: Comprises goodwill and other intangible assets.

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)

	2016	2017	2018	2019	2020
1. Stated capital	1 165	1 265	1 265	1 265	1 265
2. Shared premium	271	271	271	271	276
3. Retained earnings	5 479	5 867	6 422	6 762	7 629
4. Total Tier 1 Capital	6 948	7 361	8 429	8 835	9 640
5. Subordinated term debt	1 817	1 817	1 993	2 228	2 460
6. Current year's unpublished profits	1 041	1 124	987	1 094	1 178
7. Total Tier 2 capital	3 293	3 412	3 648	4 013	4 378
8. Total unimpaired capital (sum of lines 4 and 7)	10 241	10 774	12 077	12 848	14 018

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

APPENDIX 7 (CONTINUED)

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

COMMON EQUITY TIER 1 CAPITAL		2016	2017	2018	2019	2020
1	Common shares	922	952	507	507	507
2	Share premium resulting from the issue of common shares	-	-	-	-	-
3	Retained earnings:	97	85	119	70	45
	Retained earnings brought forward from the previous financial year	157	132	119	143	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	60	44	-	-	-
4	Accumulated other comprehensive income and other disclosed reserves	64	230	145	137	172
	a) Statutory credit risk reserve	-	-	(14)	(22)	-
	b) Capital buffer	-	-	-	-	-
	c) Statutory reserves	-	166	159	159	172
	d) Other (specify)	64	64	-	-	-
5	Common shares issued by consolidated subsidiaries of the bank and held by third parties (minority interest)	-	-	-	-	-
6	Regulatory adjustments applied in the calculation of CET1 capital	-	-	17	19	14
7	CET1 Capital (Lines (1+2+3+4+5-6))	1 083	1 259	754	695	722
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))	1 083	1 259	754	695	722

APPENDIX 7 (CONTINUED)

TIER 2 CAPITAL						
16	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital)	-	-	102	-	-
17	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	-	-	-	-	-
18	Unpublished current year's profits	67	40	4	3	(15)
19	Tier 2 capital instruments (subject to gradual phase-out treatment)	-	-	-	-	-
20	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)	-	-	-	-	-
21	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
22	Regulatory adjustments applied in the calculation of Tier 2 capital	-	-	-	-	-
23	Total Tier 2 Capital (Lines (16+17+18+19+20+21-22))	67	57	126	11	10
24	Total Unimpaired Capital (Lines (14+23))	1 150	1 316	880	706	732

*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 as at 31st December (P million)

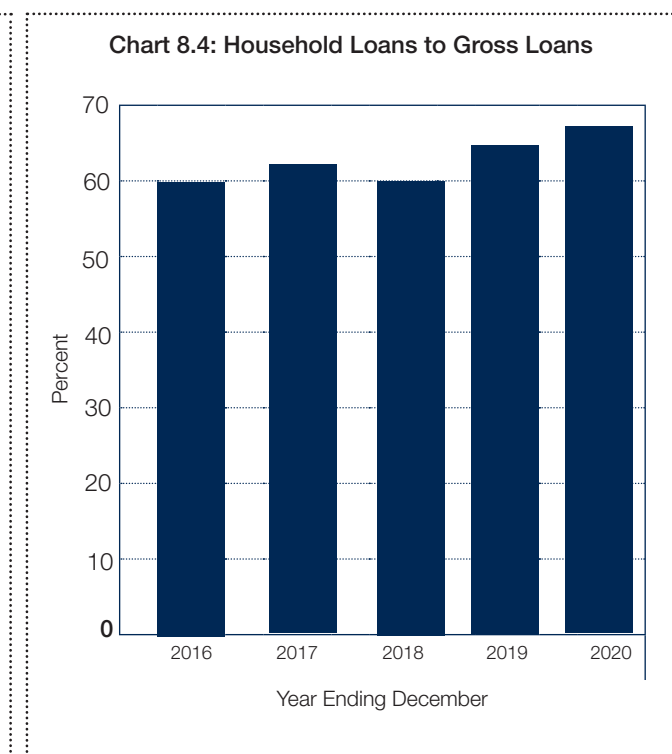
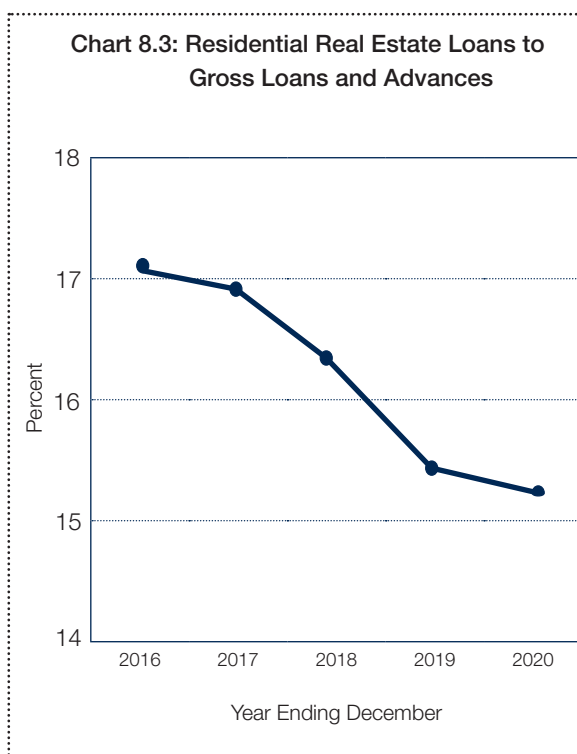
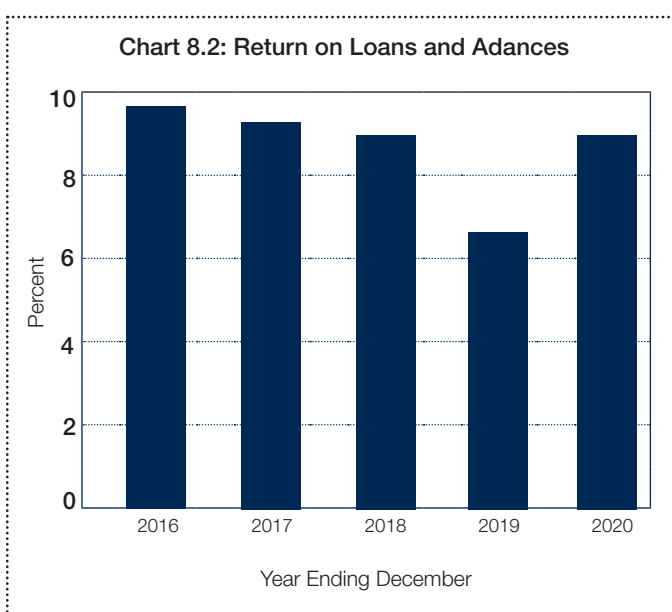
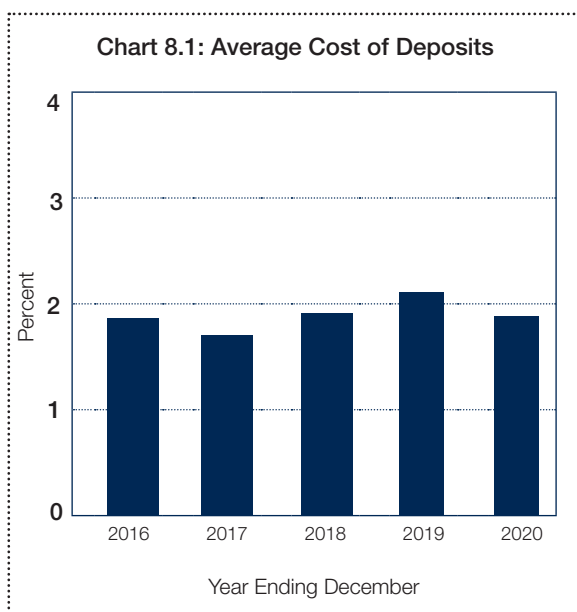
		2016	2017	2018	2019	2020
1.	Stated capital	922	952	507	507	507
2.	Retained earnings	97	85	119	70	45
3.	Total Tier 1 capital	1 083	1 259	754	695	722
4.	Current year's unpublished profits	67	40	4	3	(15)
5.	Total Tier 2 capital	67	57	126	11	10
6.	Total unimpaired capital (sum of lines 3 and 5 less impairments)	1 150	1 316	880	706	732

*Figures exclude one statutory bank.

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

APPENDIX 8

CHARTS OF PRUDENTIAL AND FINANCIAL SOUNDNESS INDICATORS



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

APPENDIX 8 (CONTINUED)

CHARTS OF PRUDENTIAL AND FINANCIAL SOUNDNESS INDICATORS

Chart 8.5: Non-performing Loans Growth Rate

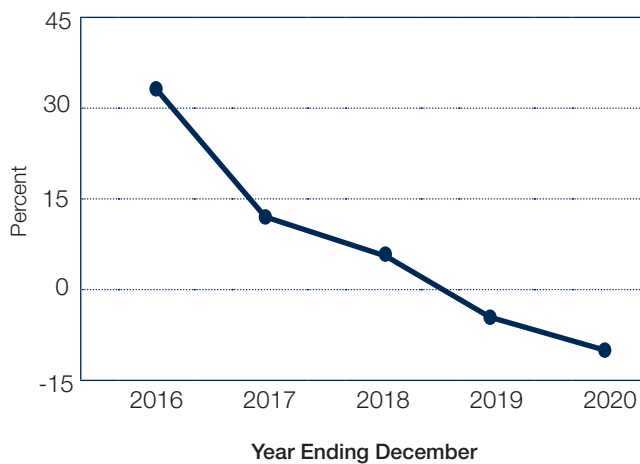


Chart 8.6: Share of Value of Total Deposits by Type (including FCAs)

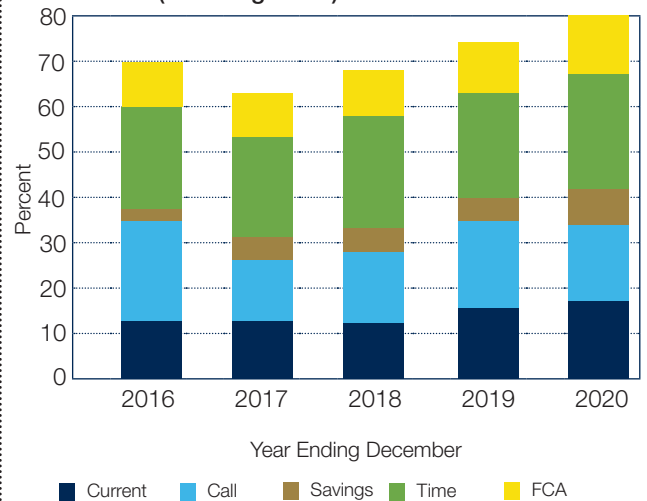


Chart 8.7: Growth Rate of Foreign Currency Accounts

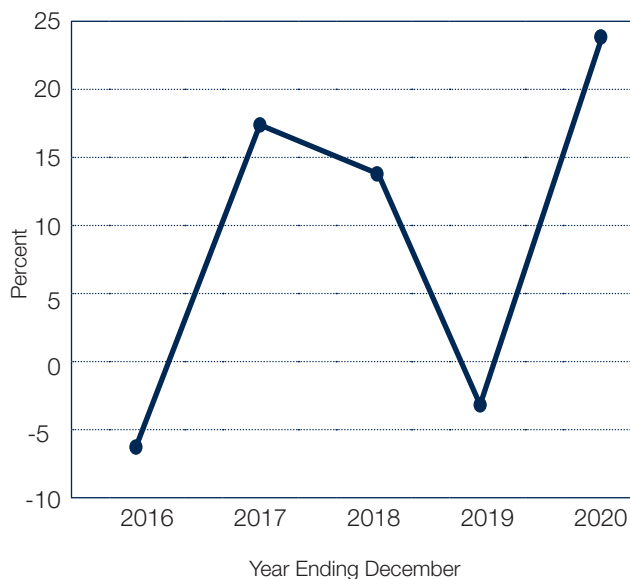
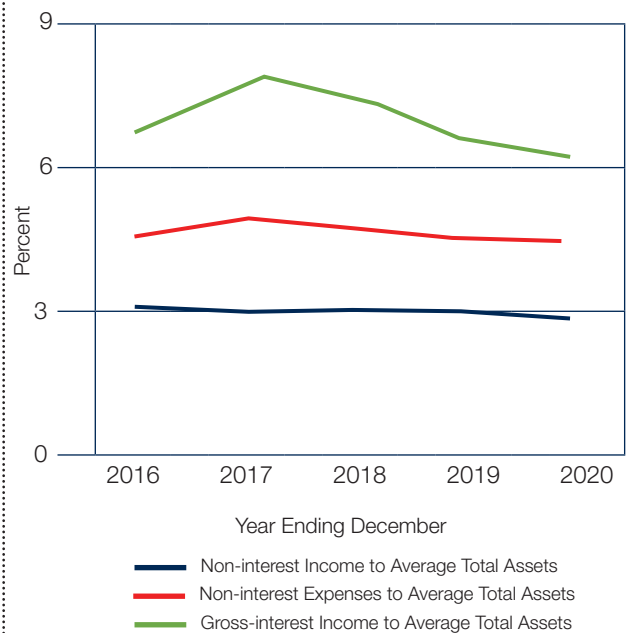


Chart 8.8: Efficiency Ratios



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

