CHAPTER 6

FINANCE AND BANKING

INTRODUCTION

6.1 The financial system is one of the most important sectors in the economy as it facilitates the movement of scarce loanable funds from surplus to deficit economic units for use on consumption and investment. By facilitating lending and borrowing, the system provides an impetus to economic growth.

6.2 What happens, therefore, in the financial system has an impact on the productive capacity of the nation's economy. For example, in an economy which is operating below its productive potential, when credit becomes more costly and less available, aggregate demand for goods and services falls. As a result, the economy's growth is curtailed as firms cut back on production and inventories, thereby leading to reduced income and higher unemployment. In contrast, when credit becomes less costly, loanable funds become more readily available, aggregate demand increases, economic growth accelerates, and unemployment falls as more job opportunities become available. However, interest rates and credit are also important from a monetary policy perspective, as excessive credit growth can lead to inflationary pressures. In fact, this sector is an integral part of the entire economic system and as such cannot be viewed in isolation.

REVIEW OF FINANCIAL SECTOR PERFORMANCE DURING NDP 8

Evolution of the Financial Sector

6.3 The institutional structure and the type of financial services available in Botswana have been influenced by both historical factors and progressive global financial innovations over the years, assisted by, more recently, advances in information technology. The development of the financial sector until a few years prior to independence was slow. At the time, only two commercial banks operated with a total of four branches in the country.

6.4 The mineral-led development of the Botswana economy in the post-independence period resulted in the rapid growth of the financial sector. The establishment of Bank of Botswana in 1975, coupled with the introduction of the national currency, the Pula, in 1976, provided the major impetus to the general financial services sector development in Botswana. The Bank of Botswana supervises the banking sector, implements monetary policy and manages the exchange rate of the Pula and foreign exchange reserves.

6.5 There are five commercial banks; namely, Barclays Bank of Botswana, Standard Chartered Bank of Botswana Limited, Stanbic Bank (Botswana), the First National Bank of Botswana, and the Bank of Baroda. In addition to the commercial banks, the sector includes the Botswana Savings Bank (BSB), the Botswana Building Society (BBS), several microlenders and the insurance industry. The BSB (formerly the Post Office Savings Bank) services small savers and maintains a strong rural presence. Whereas the BBS provides financing for housing, the microlenders provide short-term loans to households and small enterprises. The insurance industry continues to show growth in the number of entities registered, as well as the assets being handled by those entities.

6.6 Although commercial and investment/merchant banks are covered by a single Act (Banking Act 1995), the remainder are established and supervised under different statutes. The commercial banks, Botswana Savings Bank and Collective Investment Undertaking (CIUs) are by law supervised by the Bank of Botswana, while the Ministry of Finance and Development Planning (MFDP) serves as the regulator of the National Development Bank (NDB), building societies, insurance companies and pension funds. The Stock Exchange Committee, under the overall supervisory oversight of MFDP, runs the Botswana Stock Exchange (BSE).

6.7 Besides commercial banks, the non-bank financial institutions (NBFIs), most of which were established during the 1970s (see Table 6.1), play an important role in providing funds for investment. These include two Government-owned financial institutions (Botswana Development Corporation and the National Development Bank), and the Government's direct lending facility, the Public Debt Service Fund (PDSF). The latter lent mainly to parastatals before such lending was virtually stopped in early 2002.

Table 6.1: Establishment of Botswana's Financial Institutions

Institution	Year started operations	Year of local incorporation
Central Bank		
Bank of Botswana	1975	1975
Commercial Banks		
Barclays Bank of Botswana Limited	1950	1975
Standard Chartered Bank Botswana Limited	1950	1975
First National Bank of Botswana Limited	1991	1991
Stanbic Bank Botswana Limited	1992	1992
Bank of Baroda (Botswana) Limited	2000	2000
Other Financial Institutions		
Botswana Savings Bank	1911	1963
National Development Bank	1964	1964
Botswana Building Society	1970	1977
Botswana Development Corporation	1970	1970
Tswelelo	1984	1984
ULC (Pty)Limited	1990	1990
Investec Bank (Botswana) Limited	2000	2000
Stock Exchange and Stock Broking Companies		
Stockbrokers Botswana	1989	1989
Botswana Stock Exchange	1994	1994
Investec Securities Botswana	1998	1997
Capital Securities	2000	1999
Life Insurance Companies		
Botswana Insurance Fund Management Limited	1970	1970
Botswana Life Insurance Limited	1994	1994
Regent Life Botswana Limited	1997	1997
Metropolitan Life of Botswana Limited	1996	1996

Source: Bank of Botswana Annual Report 1993 and respective institutions.

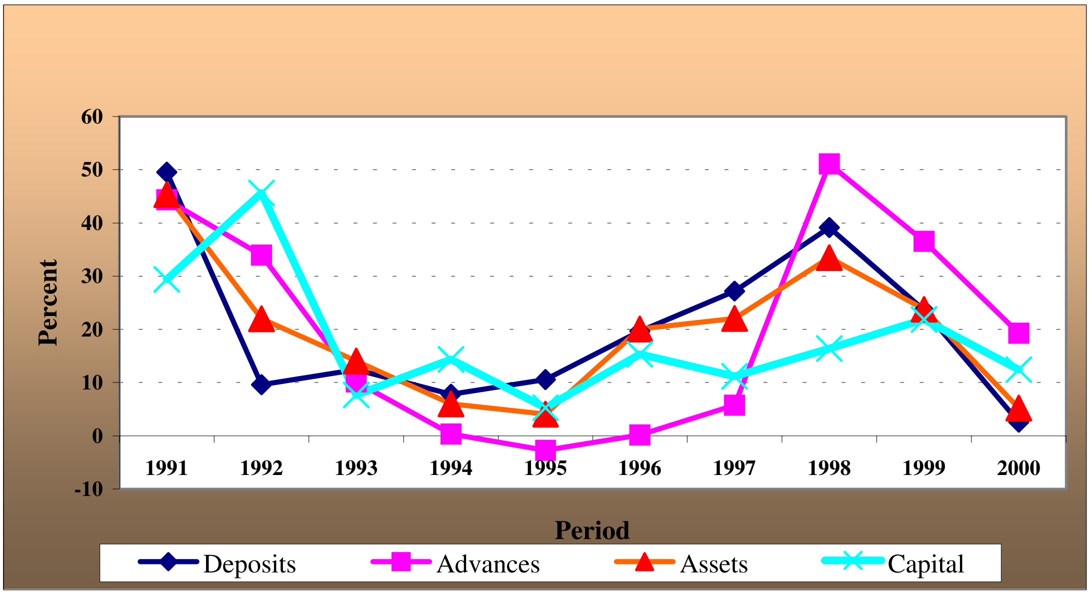
6.8 More recently, there has been considerable growth in micro-lending activities, with several firms engaged in making small loans from their own resources. Although the number of such loans is large, they account for a relatively small proportion of total credit.

FINANCIAL SECTOR DEVELOPMENT DURING NDP 8

Banking System

6.9 The activities of banks have expanded rapidly during the past decade. Chart 6.1 shows the growth rates for total banking assets, capital, deposits and advances. As shown in the chart, growth rates were low in the middle of the decade but rose through to 1998 before slowing down in 2000. A number of factors explain this trend. There was a substantial growth in credit from the late 1980s to the early 1990s, leading to concerns that the rate of expansion was unsustainable. By the mid-1990s, however, the rate of increase in credit was severely curtailed through interest rate increases, a slowdown in economic growth and a rise in arrears and bad debts.

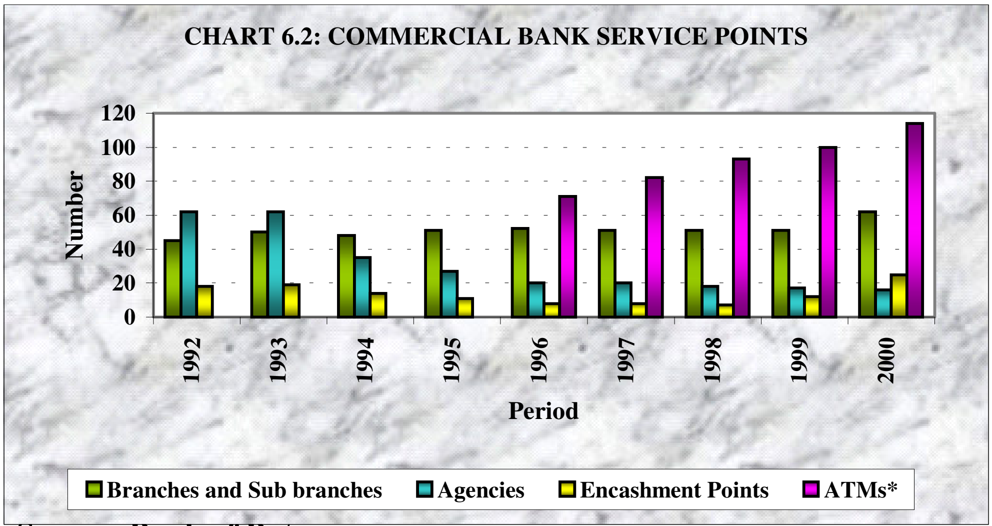
Chart 6.1: Growth Rates in Deposits, Advances, Total Banking Assets and Banking Capital



Source: Bank of Botswana

6.10 There has also been considerable expansion in the range of banking outlets during the 1990s. Chart 6.2 shows the composition of commercial bank business points (branches, agencies, encashment points and automatic teller machines (ATMs)) over the years. As at December 2000, the four commercial banks had between them, 59 branches and sub-branches, 17 agencies, 6 encashment points and 112 ATMs countrywide. The introduction of ATMs in the mid 1990s has had a major and beneficial impact on the provision of bank services, mainly by enabling an increase in the number of business points and an extension of their hours of availability. However, the number of agencies has declined either because of closure or upgrading to full branches. Banking services such as making deposits, cash withdrawals, checking account balances and others provided by encashment points and agencies, could be provided much more cheaply and efficiently by ATMs.

Chart 6.2 :Commercial Bank Service Points



Source: Bank of Botswana

- ***data on the number of ATMs is not available prior to 1996***

6.11 Of the 59 branches and sub-branches, 43 were in urban areas with the remainder in major villages and rural areas, indicating a concentration in urban areas. While this partly reflects the changing population distribution and increasing urbanisation[6], there are concerns that substantial segments of the population do not enjoy effective access to banking services. Providing such access in a cost-effective manner will be one of the main tasks facing the banks in the future.

6.12 Data on the number of accounts held at commercial banks indicates that there has been an improvement in the proportion of the population served by the banking system. In 1990, the banks held a total of 235,100 accounts, representing 320 accounts for every 1,000 adults in the country. By 2000, the number of accounts had nearly doubled to 400,475, representing 430 accounts for every 1,000 adults.

6 Preliminary results of the 2001 Population Census indicate that over half of the population resides in areas classified as urban, peri-urban or urban village.

International Financial Service Centre (IFSC)

6.13 During NDP 8, a project to develop Botswana as an International Financial Services Centre was initiated. The first phase of the project was completed in 1999, with the enactment of legislation to provide the tax incentives, project approval process and regulatory structure necessary to create a world-class financial services centre.

6.14 Since the marketing phase, which commenced in 2000, a total of 13 projects have been approved, of which eight (8) have commenced operations. These projects have employment commitments of 150 people that are well on the way to being achieved. Furthermore, the marketing campaign has generated a further 50 contacts with major financial institutions which have expressed interest in having IFSC operations and these are being actively pursued.

6.15 The range of financial services includes banking, funds management and administration, captive insurance, corporate headquarters and treasury operations, and financial intermediaries. The approvals to date and the growing number of enquiries generated are broadly comparable to the levels achieved at a similar stage of development by other successful IFSC's.

Insurance and Pension Funds

6.16 The insurance sector plays an important role in the achievement and maintenance of economic stability in the country. As an instrument of risk management, insurance allows the release of funds for capital development and structured savings. Between 1997 and 2001, the assets of the insurance industry grew from P780 million to P2.9 billion. The industry grew from 4 insurers and a handful of intermediaries to 12 insurers, 18 insurance brokers and 75 corporate insurance agencies as at July 2002. Botswana's only captive insurer and specialist credit insurer were registered during NDP 8, as was the first local insurer to offer agricultural insurance cover. As a result of these developments, the insuring public in Botswana has access to a wider range of insurance products, at more competitive rates.

6.17 Furthermore, the development of Pension and Provident Funds continues. Since the enactment of the Pension and Provident Funds Act in 1987, 159 pension funds have been registered with total pension assets in excess of P5.7 billion. Of these, 17 have been established in the last 3 years. One of the major developments during this period was the introduction of a defined contribution pension scheme for public officers. The flow of contractual savings into these funds has been one of the most significant developments in the financial sector over the NDP 8 period.

6.18 However, up to now the bulk of pension fund assets have been invested offshore, mainly because of the need to diversify investment portfolios and a shortage of high-return low-risk domestic investment opportunities. In this regard, pension funds generally invest a relatively large proportion of their assets in long term government bonds, as these have the risk, return and maturity profiles that match their liabilities of funding future pensions. The lack of a Government bond market in Botswana is one of the factors that encourages investment offshore. It should also be noted that pension funds represent a large pool of long-term funds, and at the same time there is a perceived shortage of long-term finance for investment in Botswana. An issue that still faces the financial system is to develop in a way that facilitates the matching of these long-term funds to good long-term investment opportunities. In this regard, development of the stock market and the commercial bond market has the potential to play a very important role.

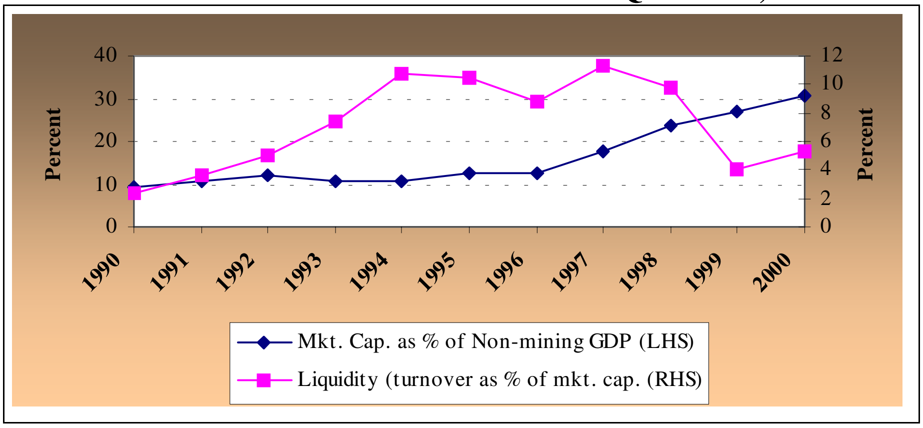
The Botswana Stock Exchange (BSE)

6.19 The Botswana Stock Exchange (BSE) has an important role to play in providing an alternative channel linking savers and investors. The instruments issued and traded on the BSE, corporate equities and bonds have characteristics that are distinctly different – in terms of risk, return, liquidity and maturity - to the loans and deposits offered by the banks. As such, the BSE extends a range of choices available to savers and borrowers, and hence has the potential to improve the efficiency of the financial sector by enabling a closer matching of the preferences of savers and investors.

6.20 The BSE has grown rapidly since its establishment in June 1989. Between 1989 and the end of 2002, the number of listed domestic companies rose from 5 to 18, the domestic companies index rose from 100 to 2,500.74, and market capitalisation rose from P120 million to P9,403.06 million. Six corporate papers were also issued. The amount of money raised through share and bond issues was, however, relatively small compared to the amounts raised directly as loans from financial intermediaries such as banks and (Non-Banking Financial Institutions) NBFIs.

6.21 While the BSE has grown rapidly in size, it has not been particularly liquid. Liquidity, measured by the Turnover Ratio (the total value of stocks traded during a year relative to average market capitalisation), has varied between two and eleven percent since 1990 (Chart 6.3). This is around the average for stock markets in Africa, but is low by the standards of more developed markets. The liquidity of the market depends on both transaction costs and investor willingness to trade securities frequently; these factors influence both the availability of shares and the attractiveness of investing in shares of listed companies vis-à-vis alternative investment opportunities. Most shares on the BSE are held either by controlling interests or by local institutional investors, which contributes to low liquidity. Controlling interests are unwilling to sell for obvious reasons, while institutional investors tend to buy and hold rather than have an active trading strategy because positions, once liquidated, can be difficult to re-establish. To this extent, low liquidity reflects a lack of alternative investment opportunities. Low liquidity retards the deepening of the stock market and reduces its contribution to economic growth; experience elsewhere suggests that stock market liquidity is positively and significantly correlated with capital accumulation, improvements in productivity and economic growth.

Chart 6.3: BSE CAPITALISATION AND LIQUIDITY, 1990-2000



Source: Bank of Botswana

6.22 Public offerings of shares and bonds have exposed the extent of the demand for savings instruments, as all share issues and most bond issues have been oversubscribed. Although shares are held directly by a relatively small group of savers, and the BSE is relatively illiquid, there is a reasonable degree of public confidence in the stock market.

6.23 The listing and information disclosure requirements of the BSE have helped bridge information gaps between the public/institutional investors on the one hand and listed companies on the other and, therefore, encouraged saving in the form of share ownership. Similarly, the favourable treatment of capital gains on disposal of shares of listed companies and the absence of double taxation of dividends have also encouraged share ownership.

6.24 There have been two other important Government schemes for the provision of finance to private sector enterprises. The first is the Financial Assistance Policy (FAP), established in 1982, which provided grants to approved, new or expanding enterprises. The second is the Small, Medium and Micro Enterprises (SMME) scheme, established in 1999, which provided subsidised loans to approved borrowers. Although FAP is considered to have been reasonably successful in promoting enterprise growth in its early years, especially in the manufacturing sector, by the late 1990s it had grown substantially (costing well over P100 million a year) and had become less cost-effective. Following its fourth evaluation, the FAP Scheme was wound up with effect from mid 2000. There have also been concerns about the effectiveness of the SMME loan scheme, given the rapid draw-down of its initial capital and substantial arrears. Both FAP and SMME have been replaced with a new agency, the Citizen Entrepreneurial Development Agency (CEDA), which provides subsidised loans to commercially viable enterprises, and is also intended to run a venture capital scheme. Unlike its predecessors, CEDA puts emphasis on training, monitoring and mentoring as a way of developing entrepreneurship among Batswana.

Collective Investment Undertakings

6.25 The Collective Investment Undertakings Act, 1996 was repealed and replaced by a more comprehensive and modern Collective Investment Undertakings Act, 1999. The main objective of the new Act was to ensure that it met international best practices standards pertaining to regulation and supervision of investment funds. The Act became effective in 2001 following approval, by the Minister of Finance and Development Planning, of the Collective Investment Undertakings Regulations. The Bank of Botswana has been designated as the Regulatory Authority for collective investment schemes.

6.26 As at March 31, 2001, two fund management companies, African Alliance Botswana Management Company (Pty) Limited and African Alliance International Limited, had been licensed under the Collective Investment Undertakings Act, 1999. The former manages Botswana domestic funds while the latter has been licensed to manage offshore funds under the Botswana International Financial Services Centre rules.

6.27 Collective investment schemes have many advantages to the country and the investing public. For example, in Botswana, where there is a serious dearth of investment instruments, collective investment schemes have added to the limited number of such instruments. In addition, like bank deposits, collective investment schemes mobilize savings. Unlike deposits, collective investment schemes have a longer investment horizon, and funds can be invested in longer-term projects. With regard to the investing public, they give smaller investors the opportunity to invest in a wider range of stocks by pooling their resources to achieve economies of scale and access investment expertise.

Exchange Controls

6.28 In accordance with the Government's stated objectives of progressive financial liberalization of the financial sector, Botswana abolished all remaining exchange controls on both current and capital account transactions, in 1999. With the increasing globalisation, greater openness and free mobility of capital are important ingredients for achieving higher levels of investment, technological progress, employment creation and economic growth. An exchange control free environment projects confidence and commitment to sound macroeconomic policy management and is expected to market Botswana as a viable and attractive financial services centre. The abolition of exchange controls created significant effects on the Botswana Stock Exchange as evidenced by a number of bond listings that attracted participation by both residents and non-residents.

6.29 In order to counter any adverse impact of the abolition of exchange controls on the banking sector, the Bank of Botswana enhanced prudential standards and guidelines for measuring, controlling and monitoring foreign currency exposure limits. Further, an effective anti-money laundering programme was established with a view to curbing any possible attempts to use the banking system for criminal activities, including money laundering.

Letlole National Savings Certificates

6.30 The need for financial sector deepening to create alternative saving and investment opportunities for small savers was recognised in both NDP 7 and NDP 8. In June 1999, Government established the Letlole National Savings Certificates (NSC) scheme, administered by the Bank of Botswana, to mobilise long-term savings by citizens. The rate of interest offered on NSCs is attractive and competitive relative to the rates offered by commercial banks. The absence of transaction fees on savings and redemptions provides an added advantage and an incentive to small savers. Over the two years of its existence, the scheme has attracted 2,871 investments, with gross savings in excess of P2.7 million and net savings (less redemptions) of just over P1.6 million.

6.31 The Bank of Botswana continues to market the savings certificates to increase market penetration and investment levels.

FINANCIAL SECTOR STRATEGY FOR NDP 9

6.32 The financial sector strategy outlined in this Chapter takes into account several key features of both national and international financial markets, in particular, financial sector efficiency, service quality and innovation, advances in technology, and the growing internationalisation of financial services. Each of these raises issues of public policy, especially in the area of the regulation and supervision of the financial sector, that require a commitment of resources on the part of government. The strategy takes account of potential developments during NDP 9 in money and capital markets, insurance and pensions, and focuses on principles, policies, procedures and practices that will be needed to guide those developments against the background of the need to maintain financial sector stability and growth. There are four distinct areas of financial sector development that will be the subject of attention during NDP 9: supervision and regulation; development of markets; consumer protection; and, the national payments system. Each of these is discussed in turn below. What follows immediately is a brief review of the role of the financial sector in economic development and the regulatory and supervisory arrangements currently in place in Botswana.

6.33 As mentioned earlier in paragraph 6.1, financial institutions and markets are a critical component of the economic system of a country. Their primary function is to intermediate between savers and borrowers. Banks also play a central role in the national payments system. In order for the financial sector to perform these functions efficiently and effectively, it should command public confidence. Public confidence and support is instilled by a proper authorisation of financial institutions that establish in those markets, and by their observance of certain prudential requirements stipulated by the supervisory and regulatory bodies. These requirements are aimed at maintaining stability, soundness and efficiency of the country’s financial system. Such a system is better able to promote savings and protect the interests of depositors while responding adequately to the expanding credit requirements of the economy.

Regulatory and Supervisory Developments during NDP 9

The Role of Supervision in the Development of Financial Markets

6.34 The objective of supervising and regulating the financial sector is first and foremost to limit systemic risk. This is the risk that the entire system will fail as a result of failure of one or more of its components. Supervision and regulation aim at ensuring that participants in the financial system have sufficient resources to meet their obligations which, in turn, reduces the chances of failure and engenders public confidence in the system. The second objective is to mitigate information asymmetries between service providers and users that make assessment of risks and returns on products and services difficult. Supervision and regulation provide, as well, an independent assurance about the soundness of firms by insisting on the safety of a financial institution's assets and prudent management, while encouraging appropriate disclosure of information on charges and products, which promotes competition in financial markets.

Pre-Conditions for Effective Financial Sector Supervision

6.35 The authorities responsible for supervising the financial system can do so efficiently and effectively under certain favourable conditions. These are:

i. sound and sustainable macroeconomic policies;
ii. a well-developed public infrastructure;
iii. effective market discipline;
iv. procedures for efficient resolution of problems in financial markets; and
v. mechanisms for providing an appropriate level of systemic protection.

6.36 A sound macroeconomic policy environment is distinguished by, inter alia, the pursuit of monetary, fiscal and exchange rate policies that support sustainable growth. The challenge for policy makers is to ensure that such policies also support the safety and soundness of the financial sector, given that financial sector stability and performance and economic growth are integrally linked. Therefore, surveillance of the impact of policy implementation on financial sector performance will need to be sustained during NDP 9 Plan period.

6.37 A well-developed public infrastructure embraces a sound legal basis (effective and well-functioning business laws, such as corporate, bankruptcy, contract, consumer protection and private property laws) for the financial sector; the existence of mechanisms for effective and speedy resolution of contractual disputes; well-defined and implemented accounting, disclosure and auditing standards; effective banking supervision; and a secure and efficient national payments, clearing and settlement system.

6.38 With respect to the efficient resolution of financial sector problems, a variety of problem resolution procedures should be available to supervisors in order to permit the adoption of remedial measures that are proportional to the problem being experienced. The existence of these procedures helps to instill public confidence in financial institutions and markets.

6.39 In terms of mechanisms for providing an appropriate level of systemic protection, institutional arrangements for handling problem financial institutions, including limited public safety nets, have to be in place.

6.40 It is important to recognise that licensing, regulation and supervision do not prevent failure of financial institutions. Indeed, banks can and have failed even in mature financial systems with the best of regulatory and supervisory frameworks. When a bank fails, a process needs to be in place either to restore the health of the institution or to manage it out of the system. Since Botswana cannot be immune to bank failures, an operating framework with clear objectives and explicit and transparent rules for managing weak institutions will be developed. Such arrangements will also help to manage the "expectation gap" – the expectation that licensing and supervision implicitly guarantee the full recovery of deposits in the event of a bank failure.

6.41 During NDP 9 period, consideration will be given to two critical institutional arrangements to support the financial system in the event of crisis; they are a national contingency plan for handling financial sector crises; and a funded and credible limited deposit protection scheme[7] targeting small savers. The design of the deposit protection scheme should neither increase moral hazard nor reduce market discipline. A law establishing the scheme will need to be enacted. As a complementary measure to the deposit insurance scheme, it will be important to endorse the principle that recourse to lender-of-last-resort arrangements would be considered only when the ailing bank is presumed solvent and be applied on a case-by-case basis.

6.42 Improvement of the public infrastructure is another critical area that will receive attention during the current Plan period. In order to deal with problem credits, banks require clear property rights, modern insolvency and company laws, and an efficient judicial system to adjudicate contractual disputes. While the judicial system in Botswana is, by and large, sound, concerns have been raised regarding delays in trying and settling cases. This can be a constraint when quick judgements are required in cases involving banking institutions. The usefulness of commercial courts in this context will be explored. Furthermore, efforts to modernise existing laws and address these concerns will be enhanced. Simultaneously, supervisory bodies will continue to monitor and enforce more

[7] Its objectives would be to protect depositors against loss of insured deposits in the event of a bank failure and, therefore, contribute to the stability of the financial system. By guaranteeing compensation of insured deposits, the deposit insurance scheme is expected to allay public concerns in the immediate aftermath of a bank failure and pre-empt a run on bank deposits, which could trigger a more general bank or financial crisis.

closely the requirements that borrowers and banks should adhere to sound accounting, auditing and disclosure standards that are consistent with best international practices.

The Creation of a Financial Services Authority (FSA)

6.43 As indicated earlier, the development of capital markets in Botswana has lagged behind that of money markets. This is an imbalance that may have constrained the development of the real economy. That there are gaps in the provision of long-term debt financing and risk capital, suggests that the further development of capital markets, with the associated infrastructure and improvement in the supervisory and regulatory framework, would be a positive development.

6.44 One of the major challenges in the promotion of the financial sector during NDP 9 will be to ensure balanced growth of the financial sector, through the development of capital markets. A major component of the promotional strategy will be the creation of a Financial Services Authority (FSA), to regulate and provide oversight of a range of non-bank financial institutions and systems not supervised by the central bank. The FSA will need to be operationally independent of but responsible to the Government. It is envisaged that the Government will retain the responsibility to set the policy parameters within which the FSA will function. It is further envisaged that the FSA will work through self-regulated organisations (SROs), which would have direct oversight of the activities of non-bank financial institutions.

6.45 The FSA will seek to attain the following objectives: to foster confidence in the financial system; ensure that the public fully understands the functioning of the capital markets in the financial system; improve financial intermediation; provide a certain degree of consumer protection through proper authorisation that ensures that honest, competent and financially sound firms engage in regulated activities; and guard against and control financial crime such as fraud, dishonesty, money laundering and market manipulation, e.g., insider trading.

Development of Financial Markets

6.46 Financial markets serve a diverse group of market participants with different risk/return expectations that are not necessarily constant over time. Therefore, the challenge for financial markets is to continually provide good quality services and products that are relevant to the changing needs of market participants. Financial markets in Botswana have been broadly successful at playing this role. However, notwithstanding this, gaps exist in certain areas while some aspects of the financial sector require strengthening.

Money Markets

6.47 ***Efficiency and quality of service:*** A long-standing concern has been the poor quality of some bank services. Despite improvements in recent years, the quality of bank services was rated only average in a recent survey[8]. In particular, concerns were raised regarding delays in the delivery of

[8] DCDM Botswana, 2001, *National Survey on the Quality of Banking Services in Botswana.*

services, inadequate disclosure of information on charges, and certain infrastructure problems. Despite these concerns, public confidence in the financial system was generally high as customers held banks in high regard. The challenge during NDP 9 would be to continue to adapt both the prudential regulations and anti-money laundering, consistent with prevailing best international practices, to ensure a stable banking system, market integrity and, more broadly, financial deepening and sustainable development of the economy.

6.48 Three issues emerge from this. First, delays in the delivery of services, especially in the context of the predominant use of traditional channels for delivering services, suggests that automation and more extensive use of electronic banking may be the way forward. Second, opaque charge or tariff structures impair informed decision-making and may hamper the mobility of customers across institutions and therefore reduce competition. Third, there is a risk that financial intermediation may be compromised if, in pricing their services, banks do not ensure that their services are affordable as that will militate against growing use of financial services. In light of these, during NDP 9, priority will be given to ensuring the continual improvement of the quality of bank services as it determines the banks' ability to attract and allocate savings efficiently which, in turn, affects investment levels and economic growth. That there continue to be delays in service delivery and those services are not consistently of a high standard may be indicative of weak competition in the financial sector. The expected issuance of Government and corporate debt may change this to some extent as some bank deposits will shift into these long-term debt instruments, pushing banks to pay more attention to efficiency and the quality of service.

6.49 ***Innovation:*** Banking facilities are currently highly concentrated in urban areas, despite rapid population growth in non-urban areas. Banks are faced with the challenge to make banking services widely available. This will mean making use of modern technology to bypass constraints imposed on them by the traditional banking model, which requires physical existence of branches. Efforts will also be made to integrate the sale of NSCs into the formal market by establishing arrangements for purchasing certificates through payroll deductions. A study on the feasibility of introducing custodial arrangements for NSCs will also be carried out. Use of technology could potentially reduce service and product costs and ensure affordability and greater use of bank facilities.

6.50 ***Supervision*****:** The switch in 2000 from the full scale, cumbersome and long-cycle on-site examinations[9] supervisory approach of the Bank of Botswana to a more efficient, effective and on-going risk-based[10] one, is

---

[9] The objectives of an examination are to establish the financial soundness and safety of bank operations and compliance with the provisions of the Banking Act, 1995, as well as with the banking regulations and policies.

[10] This is a supervisory and regulatory approach that provides for the identification and understanding of primary business risks faced by supervised financial institutions. It involves the reviewing and examining, both on and off-site on an on-going

expected to impact positively on the soundness of supervised banks during NDP 9. The implementation of the new Basel Committee on Banking Supervision Capital Accord in 2006 should further improve bank soundness. Moreover, a self-assessment by the Bank on compliance with the Core Principles for Effective Banking Supervision[11] revealed that local banking supervision arrangements conform to most of the requirements of the core principles, except in the area of market risk, adequacy of resources, freedom to offer attractive salaries and supervision of statutory financial institutions. Strategies to address the observed shortcomings will be explored during NDP 9.

6.51 ***Offshore banking*****:** With the establishment of companies under the International Financial Services Centre (IFSC), it has become necessary to review supervisory requirements in order to provide for the supervision of bank holding companies, as well as develop efficient and comprehensive offshore banking regulations. Ongoing reviews will continue into NDP 9 and will provide guidance for handling offshore banking activities.

Capital Markets

6.52 ***Role of capital markets***: It was noted earlier in this chapter that despite clear evidence of diversification of the financial sector institutional structure, the role of capital markets in savings mobilisation and allocation remains limited. Therefore, the challenge is to develop capital markets that are deep and liquid in order to provide a wider range of financial instruments for savers and different types of financing for borrowers. The planned bond issue programme by the Government in 2002, and the privatisation of certain state-owned enterprises, should increase the supply of instruments available to investors. As well, the recent decision to fund the civil service pension fund should stimulate demand for these instruments, thereby broadening financial markets. Furthermore, government bond issues will establish a benchmark rate for domestic long-dated instruments and facilitate the development of a yield curve for other participants in the domestic capital market.

6.53 ***Long-term funding*****:** The recent interest shown by banks in raising long-term funding from the market through the securitisation of assets, bond issues and subordinated debt instruments, should be encouraged in support of capital market development.

International Financial Services Centre (IFSC)

6.54 The future development of the IFSC will require the vigorous implementation of the marketing programme in the key markets already identified. The immediate objectives will be the attraction of other known international financial institutions in the banking, funds management and administration, insurance and corporate treasury sectors.

---

basis, of an institution's management systems in order to identify, measure, monitor and control risks. This compares with the previous 1½-2 year-cycle of full scope on-site examination.

11 Internationally accepted principles developed by the Basel Committee on Banking Supervision to which the Bank of Botswana subscribes.

6.55 There is a requirement to strengthen the institutional framework for developing the IFSC by placing it under an appropriate agency of Government. While the current arrangement has worked well up to now, the scale and scope of the administrative and operational activities have now grown to the stage where a new administrative structure is necessary. An important factor to be taken into account is the need for the IFSC agency to have a measure of independence in the performance of its functions.

6.56 The continued cooperation and support of other relevant ministries and parastatals will be vitally important to the success of the project, particularly in areas such as telecommunications, and issuance of work and residence permits. Financial institutions, accountancy and law firms will also play a key role in the future development of the IFSC.

Insurance and Pension Funds

6.57 As was mentioned earlier, the insurance industry recorded significant growth during NDP 8 by, among other things, extending its offerings to include agriculture insurance products. The success of the National Master Plan for Arable Agriculture and Diary Development (NAMPAADD) will be further enhanced by encouraging partnerships between members of the farming community and providers of agriculture insurance.

6.58 The Insurance Industry Regulations were amended during NDP 8 to bring about improvements in the regulation and monitoring of the insurance industry. These amendments were effected to invoke greater compliance of the industry with international standards, geared at increasing levels of competence of the industry and the confidence of the insuring public. Further amendments will be effected during NDP 9 to the Insurance Industry Act. A primary aspect of the legislation is the protection of the insuring public. In this regard, the restriction on placement of insurance cover outside Botswana will remain in place. This is an important feature of policyholder protection, since our Regulatory Authority has no jurisdiction to influence the settlement of insurance claims outside Botswana.

6.59 To facilitate the process of increasing levels of professional standing of insurance intermediaries in Botswana, renewals of licences will be approved based on higher levels of professional qualifications. The process was started during NDP 8 by requiring the principal officers of corporate insurance agents to be qualified to a minimum standard of the certificate of proficiency. This drive will continue into NDP 9, with principal officers of corporate insurance agents being required to possess at least the intermediate qualifications. As was the case during NDP 8, facilitation of the process will continue by granting subventions to the Botswana Accountancy College to assist in offering the necessary training.

6.60 Full computerisation of the insurance regulatory unit in the Ministry of Finance and Development Planning during NDP 9, will go a long way in assuring investors and the insuring public of the stability and proper functioning of the industry. Insurance returns will be filed electronically and members of the industry, the insuring public and other stakeholders will be able to access information, and register queries and complaints on line. In addition, it will be easier to track agents and monitor their activities. These activities will augur well for the credibility of the industry.

6.61 Insurance services provided under the International Financial Services Centre will begin during NDP 9, starting with captive insurance services. This will eventually be extended to include all classes of insurance, but it is expected that the main focus will be on captives and reinsurance service. The provision of life insurance products will also be pursued under the auspices of the Centre.

6.62 The pensions industry is recognized as an important economy driver. As such the integrity of the industry is paramount in order to safeguard the future livelihood of pension funds and pensioners and promote public confidence. This will be achieved during NDP 9 period through increased policing of the industry in general and of pension schemes registered under the Pension and Provident Funds Act 1987. It will also include a review of the standard practices adopted within the industry, disclosure requirements, accountability and self regulation. Consideration will also be given to introduction of legislation for the regulation and supervision of pension fund asset managers who hitherto have not been regulated under the Pension and Provident Fund or any other Act.

6.63 The growth in the pension industry has led to an increase in the number of scheme members making pension contributions. This has brought about a rapid increase in the contractual savings held by households when compared to the deposits made by them in the banking system. This trend is expected to become stronger still further following the introduction of the Botswana Public Officers Pension Fund.

6.64 Further growth in the number of pension funds and their assets is expected during NDP 9. In particular, those assets held by the Public Officers Pension Fund, which is still in its infancy, are expected to increase greatly during the next couple of years. As their assets grow, so too will the need for the funds to diversify their investment portfolios. The long term nature of pension fund liabilities will require that a large proportion of their assets be held in long term assets such as government bonds. The development of such a market for these assets during the period of NDP 9 will help to provide a link between these sources of long term savings and the needs of long term borrowers.

Towards a Strategy for Developing Capital Markets

6.65 Capital markets are part of the financial sector that deal with the provision of long-term finance. Capital markets have two components - the securities component, providing funding through instruments such as shares and bonds, and the non-securities component involving mostly term loans and mortgages. How best to promote capital markets is a question that will be addressed during the course of NDP 9.

Appropriate strategies will be adopted to stimulate capital markets development during NDP 9.

6.66 Capital markets provide a platform for firms and governments to raise capital and investors to acquire securities as a form of investment. However, the ability of firms to raise finance from the primary securities market depends importantly on the liquidity of the secondary securities market. Therefore, both aspects of the capital market have to be developed. At present, the key issue in secondary market development in Botswana is that of illiquidity – as participants in the limited primary market tend to buy and hold securities due to the limited supply of long-term instruments. Therefore, bond trading is limited. Furthermore, stocks and bonds issued to date have been oversubscribed, pointing to imbalances between demand and supply, raising the spectre of upward pressure on stock prices. In order to deal with the imbalances, the supervisory and regulatory environment must find ways to ensure an increase in the supply of stocks (and securities in general) while stimulating new demand for securities.

Botswana Stock Exchange

6.67 The Botswana Stock Exchange will be organised on a formal basis in accordance with best practices prevailing elsewhere. This will be done through broadening the Board of Directors of the Exchange to include representatives of government, institutional and public investors, stockbrokers, lawyers and accountants. During NDP 9 plan period, the Stock Exchange will move from the current call-over trading system to a continuous auction electronic trading system.

National Payments and Settlement Systems

6.68 The payments system is one of the key components of the financial system. A payments system is the set of arrangements (institutions and processes) that facilitate the flow of funds between accounts at different financial institutions. It also facilitates the transmission of monetary policy signals and enables the Central Bank to make accurate and timely assessments of market responses. Effectively, it underlies the operations of the entire financial system. An inefficient payments system that undermines users' confidence in it, could undermine confidence in the financial system more generally and possibly trigger a collapse of the system.

6.69 In Botswana, the payments system is being reformed, alongside those of other SADC countries, with a view to establishing a modern legal, regulatory and institutional framework as well as developing and introducing the physical infrastructure for a payments system that ensures finality of payments in real time at an optimum cost and minimum risk exposure for both individual payments and the financial system as a whole. These changes are expected to increase both the speed and safety of the system, while minimising costs. Besides the specific legislation governing the system, it will require amending a variety of other laws relevant to the payments system, such as the Bills of Exchange Act, the Criminal Procedures and Evidence Act, the Companies Act and the Insolvency Act.

These changes will be investigated during NDP 9.

6.70 A National Payments System Framework and Strategy Document completed during 2001 will guide the development of the payments system through to 2005, with the aim of being compliant with internationally accepted standards. Furthermore, the National Clearing and Settlement Systems (NCSS) Act was enacted in 2002. The new law addresses a number of key deficiencies in the Botswana payments system. It will close the legal vacuum that exists with respect to the operation and regulation of payments system activity; clarify roles of payments system participants; provide procedures for dealing with failure to settle by any participant; and address long clearing periods, which partly reflect the largely paper-driven and manual nature of the current payments system.

6.71 Efforts to improve the system during NDP 9 will build on on-going work, such as the automation of the clearing and settlement systems and a movement towards the adoption of Real Time Gross Settlement system (allowing settlement on a same-day basis).

Central Securities Depository

6.72 An important element of any developed financial market is a Central Securities Depository (CSD). This is where a register of ownership of authenticated securities, such as shares and bonds, which may be in physical or dematerialised form, is kept[12]. It may also clear and settle securities transactions. Several benefits flow from lodging securities with a CSD. These include controlling the number of counterfeit securities; minimisation of credit, market and systemic risks; reduced clearance and settlement costs; and the provision of safe custody of securities. A CSD therefore contributes to increasing transparency and investor confidence in the securities market.

6.73 It is Government's intention to create a CSD in Botswana. This has been necessitated by the desire to improve efficiency and depth in the financial system including an efficient clearing and settlement system for bonds and equities. An Act of Parliament will be required to establish the CSD. Options regarding the nature, ownership, operation, funding and coverage will be explored during NDP 9. This will require a broad cost-benefit analysis of the options and a clear definition of the objectives to be achieved.

6.74 In the interim, transactions involving Government and Bank of Botswana securities will be cleared and settled through a book entry system owned and operated by the Bank. At some point, consideration will be given to merging the system with a private sector based CSD.

12 A CSD is a facility or an institution for holding securities, which enables securities transactions to be processed by book entry. Physical securities may be immobilised and/or dematerialised by the depository (immobilisation involves the placement of certificated securities and financial instruments in a CSD to facilitate book-entry transfers; while dematerialisation means the elimination of physical certificates or documents of title conferring ownership of securities on beneficiaries so that securities exist only as accounting records).

Consumer Protection

6.75 Consumers in the market, in particular financial markets, are not always in possession of the information needed to make decisions on what to buy or the price to pay. The presence of information asymmetries can be exacerbated by market concentration. As financial markets develop, it is important to ensure that there is adequate competition to guard against the possibility of consumer exploitation. As in many other countries, the banking system in Botswana is characterised by the presence of a few large banks. This heightens the risk of practices that are not always in the best interests of consumers. In the absence of appropriate legislation, consumers may be disadvantaged and yet have no effective recourse to better service or product providers. This could adversely affect consumer confidence in the financial system. Although it is important to have laws that protect consumers of financial services, no law currently provides for this. Therefore, institutional arrangements and a legal basis for such consumer protection will be explored during NDP 9. While, such arrangements would be appropriately located in the Ministry of Trade and Industry, regulation and supervision of banks would remain with the Bank of Botswana. The separation of functions avoids the potential conflict of interest that arises when the two functions are discharged by one entity.