



## 4.0 FINANCIAL SYSTEM REGULATION AND SUPERVISION



4.0 FINANCIAL SYSTEM REGULATION AND SUPERVISION

4.1 BANKING SECTOR

Overview

The overall financial performance and condition of the banking sector during the year were satisfactory. Total assets increased by 29.1% to K13,779.3 billion. The banking sector remained adequately capitalised and all the banks, except one, met the minimum capital adequacy requirement of 10% for total regulatory capital. The asset quality of the sector was also satisfactory as reflected in the lower ratio of gross non-performing loans to total gross loans. Further, the sector's earnings performance was satisfactory as the profit before tax increased by K86.8 billion to K536.0 billion. Equally, the liquidity position was satisfactory.

Performance rating<sup>6</sup>

The performance of the banking sector was satisfactory during the reviewed year. Out of 13 operating commercial banks, 11, 10, 9 and 8 had satisfactory level of capital adequacy, asset quality, earnings and liquidity, respectively (see Table 25).

Table 25: Performance Rating<sup>7</sup> for Banks, 2005 - 2007

Performance	Capital Adequacy			Asset Quality			Earnings			Liquidity		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
Strong	13	3	0	6	0	0	8	1	0	1	0	0
Satisfactory	0	8	11	7	8	10	2	8	9	7	8	8
Fair Needs Improvement	0	2	1	0	5	2	2	4	2	5	3	3
Marginal	0	0	0	0	0	0	1	0	1	0	0	1
Unsatisfactory	0	0	1	0	0	1	0	0	1	0	2	1
Total	13	13	13	13	13	13	13	13	13	13	13	13

Source: Bank of Zambia

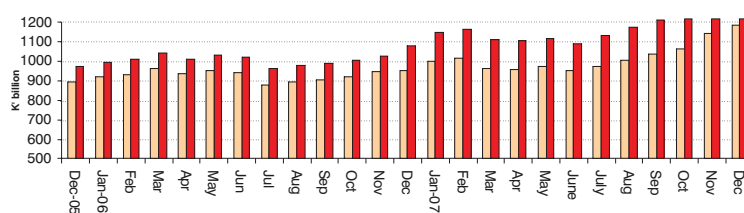
Capital and Liabilities

Capital Adequacy

The banking sector was adequately capitalised. The primary regulatory capital improved by 24.4% to close the year at K1,185.9 billion from K953.6 billion at end-December 2006. Total regulatory capital also increased by 28.2% to K1,385.3 billion from K1,080.2 billion. The increase in capital levels was mainly due to a rise in retained earnings, paid-up capital and subordinated debt. Retained earnings and paid-up capital went up by K178.3 billion (27.7%) and K47.1 billion (36.0%) to K822.6 billion and K178.1 billion from K644.2 billion and K131.0 billion, respectively. Subordinated debt increased by 48.3% to K149.7 billion from K100.9 billion at end of the preceding year (see Chart 16).

Chart 16: Capital Adequacy, Dec 2005 - Dec 2007

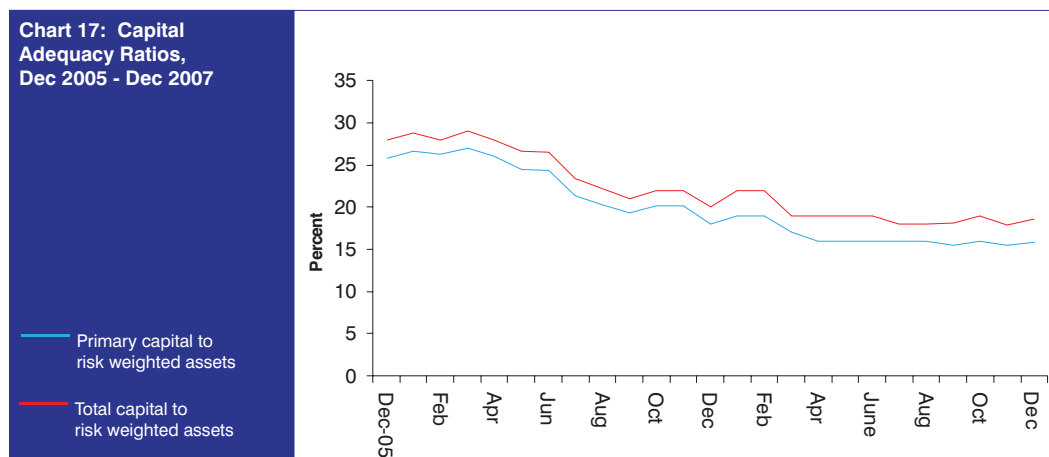
■ Primary Regulatory Capital  
■ Total Regulatory Capital



<sup>6</sup>The performance rating of banks is based on financial ratio analysis on the four key components of an institution's financial condition and performance as follows: Capital adequacy, Asset quality, Earnings performance and Liquidity. The rating scale ranges from 1 to 5, with a rating of 1; indicating the strongest financial condition and a rating of 5; the most critically deficient level of financial condition. The common rating nomenclature on a scale of 1 to 5 is: 1- Strong; 2-Satisfactory; 3 -Fair; 4 - Marginal and 5 - Unsatisfactory.

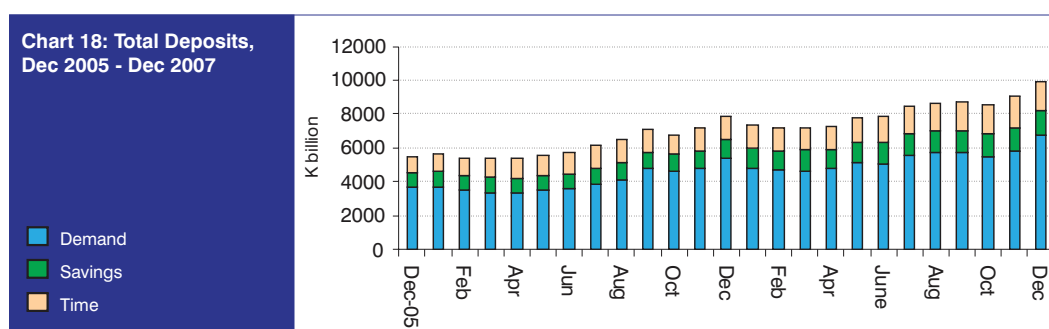
<sup>7</sup>**Strong**- Excellent performance and sound in every respect, no supervisory response required, **Satisfactory**- Above average performance and fundamentally sound with modest correctable weakness, **Fair**-Average performance with a combination of weaknesses if not redirected will become severe, **Marginal**-below average performance, immoderate weaknesses unless properly addressed could impair future viability of the bank. **Unsatisfactory**- Poor performance in most parameters, high risk of failure in the short term. The bank is under constant supervision and BOZ possession is most likely.

The capital adequacy ratios were satisfactory despite falling to 15.9% for primary regulatory capital and 18.6% for total regulatory capital at end-December 2007, from 18.0% and 20.4% at end-December 2006, respectively. The decline in the capital adequacy ratios was on account of an increase in total risk weighted assets by K2,169.6 billion (41.0%) to K7,454.9 billion (see Chart 17).



**Deposits and Other Liabilities**

Total liabilities increased by K2,775.9 billion (28.8%) to K12,421.7 billion from K9,645.9 billion at end-December 2006 and represented 90.1% of total liabilities and shareholders' funds compared to 90.4% in the preceding year. Deposits continued to be the largest source of funding and accounted for 72.0% of total liabilities and shareholders' funds compared to 73.9% in December 2006. Total deposits increased by K2,041.6 billion (25.9%) to K9,928.1 billion from K7,886.5 billion at end of preceding year. Demand deposits were the largest component of total deposits and constituted 67.9% of total deposits compared to 68.5% in December 2006 (see Chart 18).



**Asset Quality<sup>8</sup>**

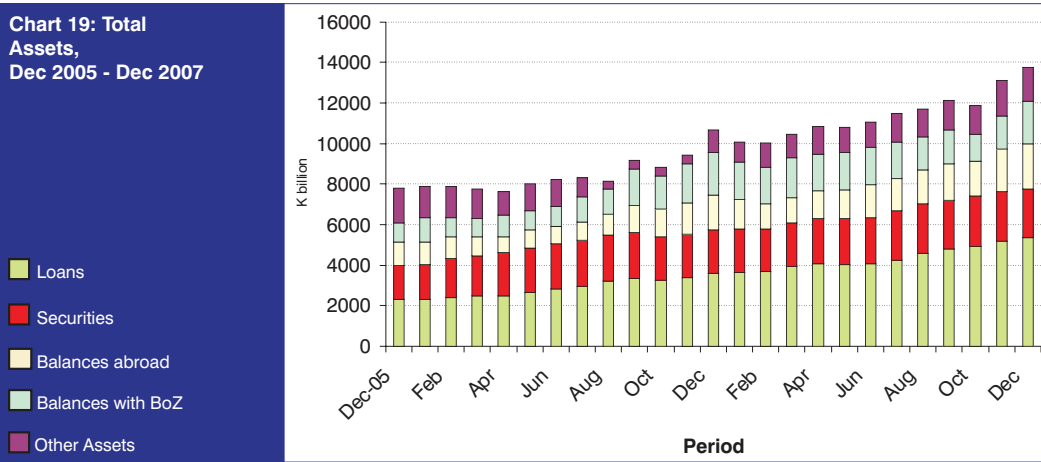
The asset quality of the banking sector in the year under review was satisfactory, as the level of gross non-performing loans (NPLs) to total gross loans and advances declined to 8.8% from 11.3% in the previous year. However, the nominal amount of NPLs increased by K61.0 billion (13.9 %) to K498.8 billion from K437.8 billion in December 2006.

In terms of asset structure, the banking sector continued to be dominated by net loans and leases at 38% of total assets from 34% in December 2006 while investments in securities were at 18% from 20% in December 2006. These were followed by balances with foreign institutions which remained at 16%, and balances with Bank of Zambia at 15%, down from 20% in December 2006 (see Charts 19 and 20).

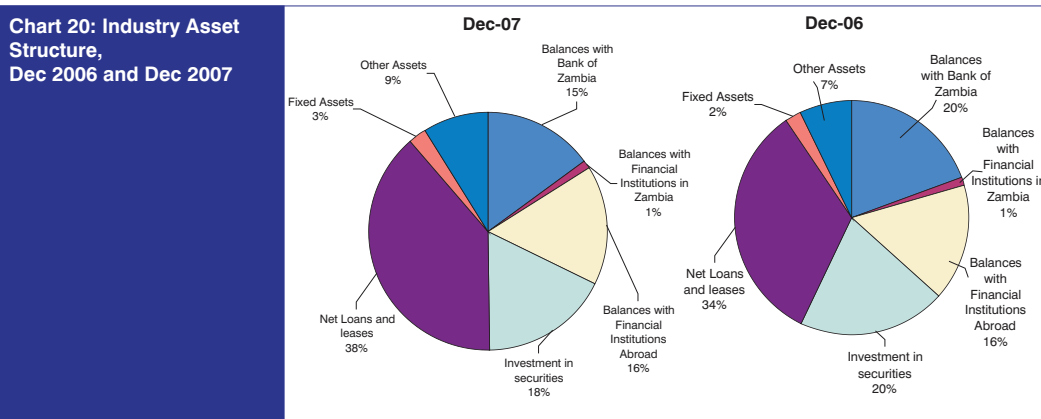
With net loans and advances increasing by K1,732.3 billion (48.1%), balances with foreign institutions by K498.4 billion (29.0%) and investments in securities by K284.6 billion (13.2%), the total assets of the banking sector grew by K3,104.1 billion (29.1%) to K13,779.3 billion from K10,675.2 billion in December 2006.

<sup>8</sup>The asset quality of the banking sector is assessed on the basis of capacity of assets to generate sufficient income to sustain operations and contribute positively to the capital formation through retained earnings.

**Chart 19: Total Assets, Dec 2005 - Dec 2007**



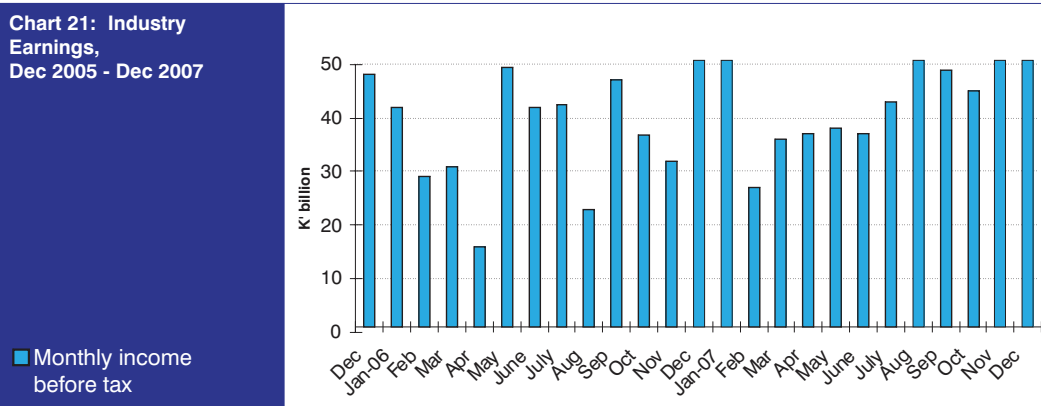
**Chart 20: Industry Asset Structure, Dec 2006 and Dec 2007**



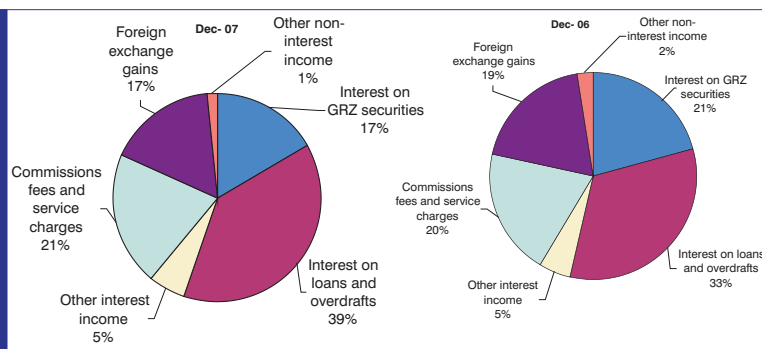
**Earnings Performance**

The banking sector's earnings performance in the year under review was satisfactory, with the profit before tax increasing by K86.8 billion (19.3%) to K536.0 billion from K449.2 billion in the previous year (see Charts 21 and 22).

**Chart 21: Industry Earnings, Dec 2005 - Dec 2007**



**Chart 22: Comparative Distribution of Income, Dec 2007 and Dec 2006**



The increase in earnings was largely on account of interest income, which went up by K270.2 billion (28.3%) to K1,224.0 billion from K953.8 billion for the previous year. The other contributing factors were an increase in non-interest income and the decline in loan-loss provisions. Total non-interest income increased by K84.4 billion (13.4%) to K714.6 billion from K630.2 billion in 2006, and was largely influenced by commissions, fees and service charges, which went up by K81.1 billion (27.0%) to K381.4 billion from K300.2 billion. Loan loss provisions decreased by K13.8 billion (7.9%) to K160.7 billion from K174.5 billion.

Financing of expansion projects increased the interest income of the financial sector in the year under review. One of the key projects in 2007 was the expansion of the Lafarge Cement plant in Chilanga



Lafarge Cement plant - Chilanga

On the other hand, total interest expenses grew by K73.9 billion (43.1%) to K245.3 billion from K175.4 billion in 2006 while total non-interest expenses went up by K207.6 billion (26.3%) to K996.5 billion from K788.9 billion. The increase in total non-interest expenses was largely attributed to salaries and employee benefits, which went up by K142.5 billion (35.5%) to K543.6 billion from K401.2 billion in 2006 (see Table 26).

**Table 26: Earnings Performance, 2005 - 2007 (K'-billion)**

Particulars	2005	2006	2007
Interest Income	842.7	953.8	1,224.0
Interest Expenses	134.3	171.4	245.3
<b>Net Interest Income</b>	<b>708.4</b>	<b>782.4</b>	<b>978.7</b>
Non-Interest Income	474.7	630.2	714.6
<b>Net Operating Income</b>	<b>1,183.1</b>	<b>1,412.6</b>	<b>1,693.3</b>
Non-Interest Expenses	694.9	788.9	996.8
<b>Gross Operating Profit</b>	<b>488.2</b>	<b>623.7</b>	<b>696.5</b>
Loan Loss Provisions	38.6	174.5	160.7
<b>Profit Before Taxation</b>	<b>449.6</b>	<b>449.2</b>	<b>535.8</b>
Taxation	89.5	141.6	148.2
<b>Net Profit</b>	<b>360.1</b>	<b>307.6</b>	<b>387.6</b>

Source: Bank of Zambia

Overall, the industry's average return on assets (ROA) and on equity (ROE) at 4.7% and 35.1%, respectively remained satisfactory. The ROA and ROE were 5.1% and 30.6% in 2006, respectively.

### Liquidity and Funds Management

The banking sector's liquidity position remained satisfactory, as reflected by the level of core deposits and the deposit concentration ratios. The core deposits to total deposits ratio remained stable and strong at 82.5% compared to 82.3% at end-December 2006. The deposit concentration ratio, as measured by the aggregate of each bank's twenty largest deposits, improved to 35.1% compared to 37.1% in December 2006. This was despite the decline in the liquidity and liquid to total asset ratios to 46.0% and 37.6% from 52.5% and 43.7% the previous year, respectively (see Table 27).

Table 27: Liquidity Indicators, Dec 2006 - Dec 2007

	2005	2006	2007											
	Dec	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Liquid assets/total assets ratio	41.0	43.7	40.8	37.9	38.3	37.8	38.4	38.5	36.4	35.0	35.0	33.5	36.0	37.6
Liquidity ratio <sup>9</sup>	51.0	52.5	49.1	46.1	46.8	46.2	46.4	47.2	44.0	42.2	42.6	40.8	44.1	46.0
Core deposits/ total deposits <sup>10</sup> ratio	83.0	82.3	80.7	81.2	81.7	80.9	80.9	80.4	81.1	81.1	80.5	80.0	79.7	82.5
Deposit Concentration <sup>11</sup> ratio	34.9	37.1	36.5	37.1	35.7	35.0	38.9	38.1	37.3	37.8	36.5	34.0	32.6	35.1

Source: Bank of Zambia

### Sensitivity Tests

#### Government Securities Trading Income Tests

With income from investments in Government securities decreasing by 4.9% to K301.3 billion from K316.8 billion in 2006, net profit before tax, which rose by 19.3% from the previous year, was less sensitive from this income item in 2007. Net profit before tax, on the other hand, was more influenced by interest income from loans and advances as well as the non-interest income from commissions, fees and service charges, which increased by 41.9% and 27.0%, respectively.

#### Foreign Exchange Trading Income Tests

With regard to foreign exchange trading, income increased by 4.7% to K306.4 billion from K292.6 billion in 2006, while net profit before tax increased by 19.3%, implying that net profit before tax was less sensitive to this profit and loss item. This further implied that there was reduced dependence on foreign exchange trading as a source of income by the commercial banks in 2007 compared to 2006. The contributing factor to the decreased sensitivity was the increase in income from loans and advances as well as from commission, fees and service charges during the year, which had greater influence; thus making the net profit before tax more sensitive to changes in these income items.

### Market Share

#### Assets, Loans and Deposits

Subsidiaries of foreign banks<sup>12</sup> continued to dominate the banking sector in terms of assets, loans and deposits. As at end-December 2007, these banks held 63.8% of the sector's total assets, 65.2% of total loans and 60.2% of total deposits compared to 63.5%, 67.4% and 61.1% in 2006, respectively. On the other hand, banks partially owned by Government<sup>13</sup> accounted for 20.6% of total assets, 16.5% of total loans and 23.8% of total deposits compared to 21.7%, 16.0% and 24.5% in 2006, respectively. Local banks<sup>14</sup> accounted for 15.5% of total assets, 18.4% of total loans and 16.0% of total deposits compared to 14.8%, 16.6% and 14.4% in 2006, respectively (see Table 28).

<sup>9</sup>The liquidity ratio gives a rough indication of a bank's ability to meet its short-term payment obligations, with short-term liquid assets (with a maturity of not more than six months). However, the liquidity ratio assumes that no loan will repay in not less than six months.

<sup>10</sup>Core Deposits Savings plus Demand Deposits

<sup>11</sup>Deposit Concentration is the proportion of the 20 largest deposits to total deposits

<sup>12</sup>These are locally incorporated subsidiaries of foreign banks.

<sup>13</sup>These are banks that wholly or partially owned by the Government of Zambia (Two)

<sup>14</sup>Other banks incorporated locally which are not subsidiaries of foreign banks or government owned

In the year under review, a lot of asset financing was undertaken by firms in Zambia, especially the mining companies. Konkola Copper Mines (KCM) Limited imported a cooling unit that was part of the smelter upgrade at the Chingola plant



Table 28: Assets, Loans and Deposits by Type of Ownership (%), 2005 - 2007

	2005			2006			2007		
	Assets	Loans	Deposits	Assets	Loans	Deposits	Assets	Loans	Deposits
Subsidiaries of foreign banks	61.7	72.7	58.6	63.5	67.4	61.1	63.8	65.2	60.2
Banks with partial Government Ownership	25.6	15.1	29.3	21.7	16.0	24.5	20.6	16.5	23.8
Local banks	12.7	12.2	12.1	14.8	16.6	14.4	15.6	18.3	16.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Bank of Zambia

#### Profit before Taxation

The distribution of profit before tax indicated that subsidiaries of foreign banks accounted for 69.8% of the sector's total earnings in 2007 compared to 68.7% in 2006. Banks partially owned by government accounted for 8.0% compared to 11.2%, while local banks accounted for 22.2% compared to 20.1% (see Table 29).

Table 29: Earnings by Type of Ownership (%), 2005 - 2007

	2005	2006	2007
Subsidiaries of foreign banks	66.1	68.7	69.8
Government banks	17.3	11.2	8.0
Local banks	16.6	20.1	22.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Bank of Zambia

#### Regulation and Supervision

##### *Risk Based Supervision Approach*

During the year, the Bank of Zambia in its efforts to strengthen the supervisory capacity reviewed the Risk-Based Supervision (RBS) framework. This culminated in the Enhanced RBS framework. The enhanced RBS approach to supervision entails regular interaction with banks in order to understand and monitor their activities and risks and determine the adequacy of the banks' management systems to identify, measure, monitor and control their risk. The framework is a structured, forward-looking and continuous process designed to identify key risk factors to which individual banks and the entire banking sector are exposed. The framework focuses the level of supervisory attention on those areas or banks that pose the greatest risks to financial system stability.

The BoZ plans to roll-out the enhanced RBS framework in 2008. As part of the implementation plan of the enhanced Risk-Based Supervision framework, the Supervision Department shall issue Risk Management Guidelines to the supervised banks.

##### *Branch Network Expansions*

In 2007, five of the licensed banks opened a total of 23 new branches and 2 new agencies (see Table 30). This was an indication of a positive step towards financial inclusion, which is one of the critical objectives of the FSDP. Most of the branches opened were targeted at the rural and peri-urban population which has been identified as being financially excluded.

**Table 30: New Branches Opened in 2007**

Bank	Branches	Location
Barclays Bank (Z) Plc	18	Lusaka; Chelstone, Chilenje, Kabwata, Lusaka International Airport; Chingola; Kabwe; Kalomo; Kalulushi; Kapiri Mposhi; Lundazi; Mansa; Mongu; Monze; Mufulira; Mumbwa; Nakonde; Petauke; & Solwezi
Cavmont Capital Bank (Z) Limited	1	Solwezi
Finance Bank (Z) Limited	2	Lusaka; Mulungushi Conference Centre & University of Zambia.
Investrust Bank (Z) Limited	2	Chililabombwe & Mwami Border Post
Standard Chartered Bank Plc	1	Lusaka (Cross Roads Shopping Complex)
Zambia National Commercial Bank Limited	1	Senanga
<b>Total</b>	<b>25</b>	

Source: Bank of Zambia

**Capital Adequacy Review**

Effective 2 January 2007, the minimum capital requirement for banks was raised from K2 billion to K12 billion. The revision was necessitated by the dilution, in US Dollar terms, of the K2 billion, which had declined to approximately US \$460,000 as at end-December 2006 compared to US \$2.1 million when the minimum capital was last revised in 1995. The revision in the minimum capital for banks was announced by way of Government Gazette Notice No. 682 published on 29 December 2006. The Gazette Notice further advised that those banks whose primary paid up capital was below the prescribed minimum requirement of K12 billion had up to 30 June 2008 to comply with the revised minimum capital requirement. Twelve out of the registered thirteen banks met the revised minimum capital requirement as at 31 December 2007.

**Status of Commercial Banks in Liquidation**

The Bank continued to oversee the liquidation processes of ten banks, namely, African Commercial Bank (In Liquidation), Credit Africa Bank (In Liquidation), Commerce Bank (In Liquidation), First Merchant Bank (In Liquidation), Export Import Bank (In Liquidation) Manifold Investment Bank (In Liquidation), Meridien Biao Bank (In Liquidation), Prudence Bank (In Liquidation), Union Bank Zambia Limited (In Liquidation) and United Bank of Zambia (In Liquidation).

During the year, the Bank reviewed the process of winding up African Commercial Bank (In Liquidation), Credit Africa Bank (In Liquidation), First Merchant Bank (In Liquidation), Export and Import Bank (In Liquidation), Manifold Investment Bank (In Liquidation), and Prudence Bank (In Liquidation). This was on account of the liquidation processes of these banks having reached an advanced stage while minimal realisations were attained.

*Meridien Biao Bank Zambia Limited (In Liquidation)*

The Bank disposed of most of the major assets of Meridien Biao Bank Zambia Limited (In Liquidation) as well as settled in full its obligations to depositors. The remaining assets once realised would be applied towards the bank's obligations to the central bank. The Bank has advertised for a tender to audit Meridien Biao Bank Zambia Limited (In Liquidation) to facilitate the termination of the liquidation process.

*United Bank of Zambia Limited (In Liquidation)*

The Bank placed United Bank of Zambia under compulsory liquidation on 24 May 2006. Following this, the Bank undertook the legal and administrative process to facilitate the declaration of a dividend to depositors.

*Commerce Bank (In Liquidation)*

Two major issues remain outstanding namely Kabwe Tannery Limited and the audit of United Machining Works Limited (In Receivership). Upon the conclusion of these issues, the Bank shall commence the winding up of Commerce Bank (In Liquidation).

*Union Bank Zambia Limited (In Liquidation)*

The bank is in the process of declaring the payment of its sixth dividend of up to K100 million per depositor.

## 4.2 NON-BANK FINANCIAL INSTITUTIONS SECTOR

### Overview

In 2007, the overall financial performance and condition<sup>15</sup> of the non-bank financial sector were satisfactory. The leasing, bureaux de change and micro-finance sub-sectors and the Development Bank of Zambia registered satisfactory performance while that of building societies continued to improve.

As at 31 December 2007, the structure of the non-bank financial sector under the supervisory authority of the Bank of Zambia comprised twelve leasing companies, three building societies, thirty six bureaux de change, one savings and credit bank, one development finance institution, eight microfinance institutions and one credit reference bureau.

### Regulation and Supervision

During the year, ten operating licences for non-bank financial institutions (NBFIs) were granted while two bureaux de change voluntarily surrendered their licences (see Table 31). This brought the total number of NBFIs to 62 as at 31 December 2007 from 54 in 2006.

Table 31: Licences Issued and Revoked in 2007

Sub-Sector	Institution Licensed	Date Licensed	Institution Closed	Date Closed
A. Leasing Companies	1. Executive Financial Services Limited	14 May 2007		
	2. Mercantile Leasing Limited	28 February 2007		
B. Micro-Finance Institutions	1. Letshego Financial Services Limited	24 September 2007		
	2. Royal Microfinance of Zambia Limited	11 April 2007		
C. Bureaux de Change	1. Saints Bureau de Change	11 May 2007	1. Seven Hills Bureau de Change	23 April 2007
	2. Struts Bureau de Change	28 February 2007	2. Southend Bureau De Change	17 February 2007
	3. Zamwiche Bureau de Change	28 February 2007		
	4. Goldfield Bureau de Change	22 August 2007		
	5. Northmead Bureau de Change	9 July 2007		
	6. A and I Bureau de Change	13 September 2007		

Source: Bank of Zambia

### Performance of the Non-Bank Financial Sector

The overall financial performance and condition of the NBFIs was satisfactory. On average, the leasing, micro finance institutions (MFIs) and bureaux de change sub-sectors reported adequate regulatory capital. However, two leasing companies and one building society had regulatory capital deficiencies. In this regard, measures were taken by shareholders to recapitalise the three institutions.

### Leasing Sub-Sector

During the year, the overall performance of the leasing sub-sector was satisfactory. Overall, the leasing sub-sector maintained adequate capital and reserves relative to their risk profiles. Out of the ten (10) leasing companies in operation as at 31 December 2007, eight (8) met the prescribed minimum capital adequacy ratio of 10 percent, while two had regulatory capital deficiencies and as a result remedial measures were recommended for each institution (see Tables 32a and 32b).

<sup>15</sup>The financial condition and performance of the NBFIs was evaluated on the basis of their performance in the parameters of Capital Adequacy, Asset Quality, Earnings Performance and Liquidity (CAEL). The composite rating averages the effects of the individual ratings in each of the above parameters. A five-tier rating system was utilised as follows :

Strong (rating 1) : Excellent performance in all components  
 Satisfactory (rating 2) : Satisfactory performance and meets minimum statutory requirements  
 Fair (rating 3) : Average performance and meets minimum statutory requirements  
 Marginal (rating 4) : Below average performance in some of the components  
 Unsatisfactory (rating 5) : Poor performance in most components and violates minimum statutory requirements

Table 32a: Year-End Composite Rating for the Leasing Sub-Sector, 2005 - 2007

Performance Category	Composite Rating Scale	Number of Leasing companies			Proportion of Industry Assets (%)		
		2005	2006	2007	2005	2006	2007
Current Condition	1.0-2.0	4	3	4	96	48.5	51.1
Satisfactory							
Possible Emerging Problem	2.1-2.5	2	3	1	1	47.6	1.7
Watch	2.6-3.5	1	1	2	2	1.1	8.7
Problem	3.6 or greater	1	1	3	1	2.8	38.5
<b>Total</b>		<b>8</b>	<b>8</b>	<b>10</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Bank of Zambia

Table 32b: Year-End Performance Rating for the Leasing Sub-Sector, 2005-2007

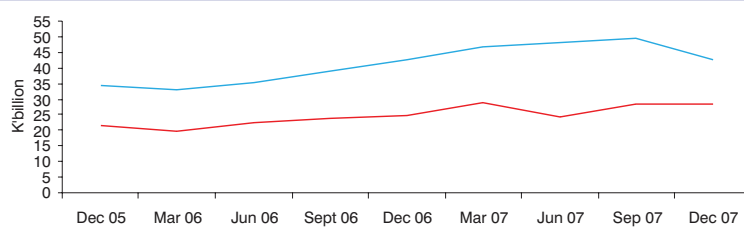
Performance Category	Capital Adequacy No. of Leasing companies			Asset Quality No. of Leasing companies			Earnings No. of Leasing companies			Liquidity No. of Leasing companies		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
Strong	4	4	2	2	1	1	1	1	1	2	1	3
Satisfactory	3	2	3	3	4	3	3	2	1	2	0	1
Fair Needs Improvement	0	1	2	2	2	2	1	4	4	1	3	1
Marginal	0	0	1	0	0	1	2	0	0	2	2	1
Unsatisfactory	1	1	2	1	1	3	1	1	4	1	2	4
<b>Total</b>	<b>8</b>	<b>8</b>	<b>10</b>	<b>8</b>	<b>8</b>	<b>10</b>	<b>8</b>	<b>8</b>	<b>10</b>	<b>8</b>	<b>8</b>	<b>10</b>

Source: Bank of Zambia

### Capital Adequacy

As at 31 December 2007, the sector's regulatory capital marginally increased to K42,829 million from K42,637 million in 2006 and was above the minimum regulatory capital of K26,834 million (10% of risk-weighted assets) by K16,168 million (see Chart 23). The increase in capital resources was mainly as a result of additional capital introduced by two new entrants amounting to K5,517 million coupled with additional capital injected by three existing leasing companies amounting to K1,037 million. However, the impact of the capital injections made during the year under review were negated by the after tax loss of K4,973 million recorded during the year. This was compounded by the loan loss provisions of K1,581 million largely attributed to one leasing company.

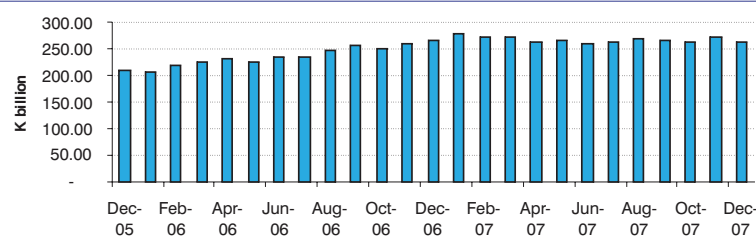
Chart 23: Leasing Sub-sector Regulatory Capital, Dec 2005 Dec 2007



### Asset Quality

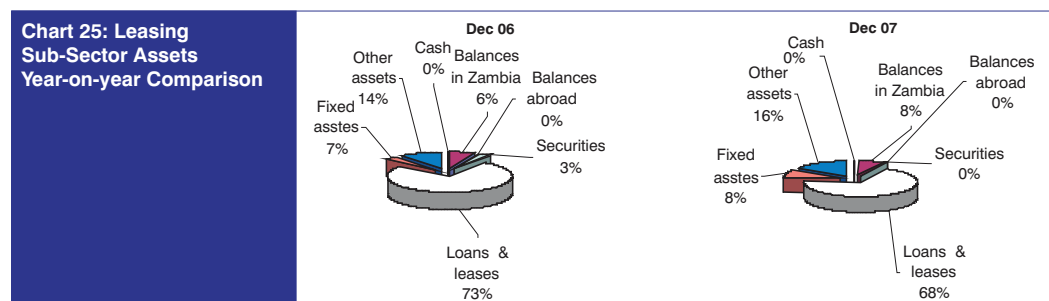
As at 31 December 2007, the total assets of the leasing sub-sector declined by K3,718 million (1%) to K263,882 million from K267,600 million the previous year (see Chart 24). The decrease was largely attributed to the reduction in the sub-sector's loan portfolio which reduced by K17,084 million (9%) to K178,445 million at 31 December 2007 from K195,529 million in 2006.

Chart 24: Leasing Sub-sector Total Assets, Dec 2005 Dec 2007



Net loans and advances constituted the largest proportion of total assets at 68% (K178,445 million) (see Chart 25). Non-performing loans amounted to K43,012 million out of the sub-sector's total gross loan portfolio of K196,025 million and represented 22% of total loans which was above the prudential level of 10%. On the basis of the ratio of non-performing loans and advances to gross loan portfolio, the leasing sub-sector's asset quality was rated marginal. However, one leasing company accounted for K32,843 million (76%) of the sub-sector's total non-performing loans.

As at 31 December 2007, net loans and advances at K178,445 million or 68%, constituted the largest proportion of total loans compared to 73% in 2006. Other assets represented 16% of total assets whilst balances in Zambia were 8% of total loans in 2007 compared to 14% and 6% respectively in 2006 (see Chart 25).



Non-performing loans amounted to K43,012 million out of the sub-sector's total gross loan portfolio of K196,025 million and represented 22% of total loans which was above the prudential level of 10%. On the basis of the ratio of non-performing loans and advances to gross loan portfolio, the leasing sub-sector's asset quality was rated marginal. However, one leasing company accounted for 74% or K32,843 million of the sub-sector's total non-performing loans.

As at 31 December 2007, total earning assets amounted to K174,162 million and accounted for 66% of total assets. Balances with financial institutions in Zambia accounted for 12% of total earning assets while loans and leases accounted for 88%.

**Earnings**

The earnings performance of the leasing sub-sector was designated unsatisfactory because of a loss before tax of K4,358 million recorded in the period under review (see Table 33 and Chart 26). The loss reflected a decrease of K16,648 million (135%) from a profit of K12,290 million recorded in 2006, largely due to statutory provisioning requirements for lease loan losses amounting to K11,795 million made during the year under review. This was attributed to one leasing company.

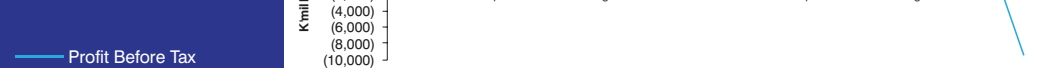
**Table 33: Earnings Performance, 2005 - 2007 (K' million)**

	2005	2006	2007
Interest income	39,756	38,897	41,437
Interest expenses	13,572	13,807	17,533
<b>Net interest income</b>	<b>26,184</b>	<b>25,090</b>	<b>23,904</b>
Provisions/(Provisions reversals)	589	(729)	11,795
Net interest income after provisions	25,594	25,819	11,957
Non-interest income	3,262	4,726	6,080
Total net income	28,857	30,545	18,037
Non-interest expenses	16,292	18,255	22,395
<b>Profit before tax</b>	<b>12,565</b>	<b>12,290</b>	<b>(4,358)</b>
Tax	1,443	319	615
<b>Profit after tax</b>	<b>11,122</b>	<b>11,971</b>	<b>(4,973)</b>

Source: Bank of Zambia

The principal source of income for the leasing sub-sector continued to be interest from loans and leases at 87% of total income. Interest income increased by 6.5% to K41,437 million in 2007 from K38,897 million in 2006. This was largely due to an increase in income from loans and advances to K18,785 million from K13,252 million over the period under review. Interest expenses increased by 27% to K17,533 million in 2007 from K13,807 million in 2006, driven by the 7% increase in deposits. Non-interest expenses also increased by 23% to K22,395 million from K18,255 million during the same period largely on account of a 26% increase in salary and employee related benefits.

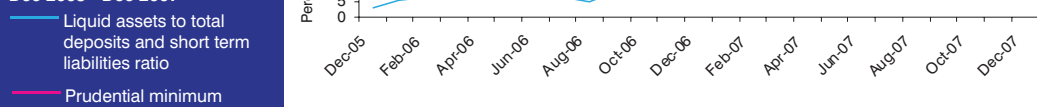
**Chart 26: Leasing Sub-sector Profit Before Tax, Dec 2005 - Dec 2007**



**Liquidity**

The general level of liquidity in the leasing sub-sector as measured by the ratio of liquid assets to total deposits and short-term liabilities averaged 10% which was below the prudential ratio of 15%. However a number of leasing companies had standby lines of credit with banks which provided them with liquidity as and when needed. Therefore, the liquidity of the sub-sector was designated fair as at 31 December 2007. Four out of the ten leasing companies in operation failed to meet the minimum prudential liquidity ratio of 15% for NBFIs (see Chart 27).

**Chart 27: Leasing Sub-Sector Liquidity Trend, Dec 2005 - Dec 2007**



**Building Societies Sub-Sector**

During the year, the overall performance of the building society sub-sector continued to improve as a result of capital injections and retained earnings. (See Tables 34a and 34b)

**Capital Adequacy**

As at 31 December 2007 the building society sub-sector's aggregate regulatory capital improved by 18% to negative K32,281 million from negative K39,351 million in 2006. The improvement in the capital position was largely due to the profit after tax recorded in the year amounting to K8,685 million. Out of the three building societies in operation, one did not meet the minimum risk-weighted regulatory capital of K10,823 million. In this regard, appropriate remedial measures were put in place by shareholders to recapitalise the financially distressed institution.

**Table 34a: Year-End Composite Rating for the Building Society Sub-Sector, 2005 - 2007**

Performance Category	Composite Rating Scale	Number of Building Societies			Proportion of Industry Assets (%)		
		2005	2006	2007	2005	2006	2007
Current Condition Satisfactory	1.0-2.0	0	0	2	0	0	37.4
Possible Emerging Problem	2.1-2.5	0	1	0	0	29.1	0
Watch	2.6-3.5	1	0	0	31.0	0	0
Problem	3.6 or greater	2	2	1	69.0	70.9	62.6
<b>Total</b>		<b>3</b>	<b>3</b>	<b>3</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Bank of Zambia

**Table 34b: Year-End Performance Rating for the Building Society Sub-Sector, 2005 - 2007**

Performance Category	Capital Adequacy No. of Building Societies			Asset Quality No. of Building Societies			Earnings No. of Building Societies			Liquidity No. of Building Societies		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
Strong	0	1	1	1	1	1	0	0	0	0	0	1
Satisfactory	0	0	1	0	0	0	1	1	3	0	1	2
Fair Needs Improvement	0	0	0	0	0	2	1	1	0	1	1	0
Marginal	1	0	0	1	1	0	0	1	0	0	0	0
Unsatisfactory	2	2	1	1	1	0	1	0	0	2	1	0
<b>Total</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>

Source: Bank of Zambia

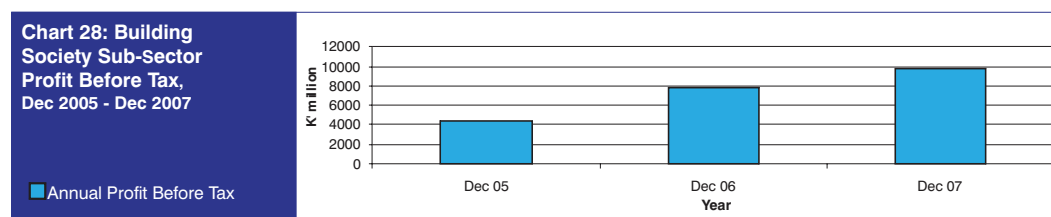
**Asset Quality**

The asset quality of the building society sub-sector was designated fair during the year. The proportion of non-performing assets to total assets was 0.11% in 2007, representing an increase of 0.06 percentage

points from the previous year. Total assets of the sector increased by 58% to K222,839 million as at 31 December 2007 from K140,757 million as at 31 December 2006. The increase in total assets was largely accounted for by increases in net mortgage advances of K62,404 million and balances with financial institutions of K29,864 million.

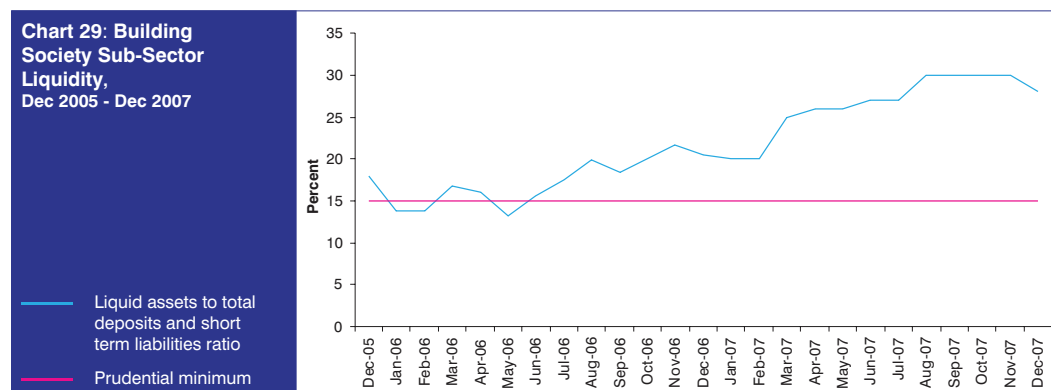
**Earnings Performance**

During 2007, the earnings performance of the building society sub-sector was satisfactory, with profit before tax rising by 25% to K9,857 million compared to a profit of K7,869 million for 2006 (see Chart 28). The improvement in earnings performance was largely due to the increase in interest income by 35% to K24,819 million from K18,368 million in 2006, mainly on account of the growth in the mortgage portfolio.



**Liquidity**

The average liquidity of the building society sub-sector, as measured by the ratio of liquid assets to total deposits and short-term liabilities was 26.6% in 2007. This was above the prudential minimum ratio of 25 percent for building societies and was therefore designated satisfactory (see Chart 29).



**Micro Finance Institutions**

The financial condition and performance of the micro finance institutions (MFIs) was designated satisfactory. All the eight MFIs licensed and supervised by the Bank of Zambia were adequately capitalised as at 31 December 2007. The aggregate capital of the MFIs increased by 73% to K79,263 million as at 31 December 2007 from K45,701 million as at 31 December 2006. The increase was largely due to the after tax profit recorded in the year amounting to K43,664 million.

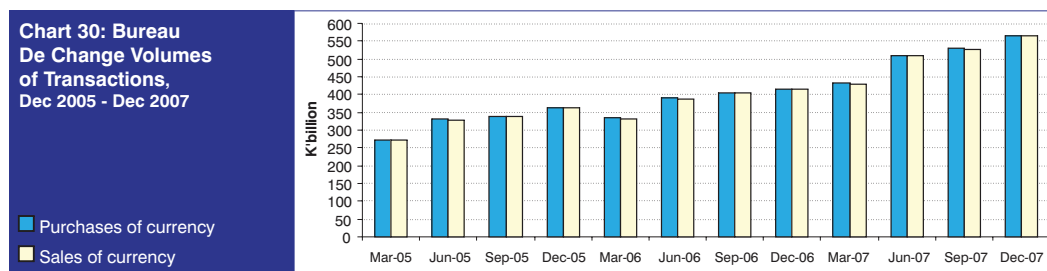
Total assets amounted to K254,687 million representing an increase of 78% from the position of K143,422 million as at 31 December 2006. Loans and advances constituted the largest component of total assets at 90% compared to 86% the previous year. The growth in assets was largely due to retained earnings and injections of capital into the sub-sector by new entrants.

**Bureaux de Change**

As at 31 December 2007, the bureau de change sub-sector was adequately capitalised. Out of the 36 bureaux de change, 35 met their minimum regulatory capital requirement of K40 million. The aggregate capital and reserves increased by 19% to K17,976 million in 2007 from K15,089 million in 2006, largely due to profits after tax of K4,274 million.

Total assets at K24,176 million represented an increase of 30% from K18,622 million in 2006. The increase in total assets was largely financed by retained earnings in 2007.

The volume of purchases and sales of foreign currency by bureaux de change amounted to K1,964,423 million (US\$510 million) and K1,988,425 million (US \$516 million), respectively. This, compared to K1,536,766 million (US\$348 million) and K1,558,079 million (US \$353 million) respectively in the previous year, represented an increase of 28% in the volume of transactions (see Chart 30).



### 4.3 FINANCIAL SECTOR DEVELOPMENT PLAN<sup>16</sup>

#### Overview

During 2007, the implementation of the Financial Sector Development Plan (FSDP) gathered pace and a number of achievements were recorded. These included Cabinet approval of obtaining a sovereign credit rating for Zambia, enactment of the National Payments Systems Act 2007 and issuance of the Pensions and Insurance Levy Regulation 2007, introduction of bonds with tenors of 7, 10 and 15 years and the launch of the first credit reference bureau.

#### *Sovereign Credit Rating*

In 2007, Government approved sovereign credit rating for Zambia. In this regard, terms of reference for a financial advisor were developed. In addition, a mechanism for monitoring the implementation was developed. Sovereign credit rating is aimed at complementing other Government initiatives to promote access to international financial markets.

#### *Measuring Financial Access in Zambia*

In 2007 FinMark Trust undertook the supply side study on the inclusiveness of Zambia's financial system. This was aimed at complementing the study on the demand for financial services in Zambia whose results were released in 2006.

#### *Pensions and Insurance Regulations*

Regulations relating to the Pensions and Insurance Levy, 2007, came into effect on 14 December 2007. The regulations will enable Pensions and Insurance Authority (PIA) to raise funds for enhancing its operations.

#### *Credit Reference Bureau*

The first credit reference bureau, Credit Reference Bureau Africa Limited (CRBAL), which was licensed by Bank of Zambia on 5 June 2006 was formally launched on 11 January, 2007. To facilitate the operations of the bureau, all commercial banks signed the Service Level Agreement with CRBAL in 2007 and the bureau subsequently commenced data mining from commercial banks.

<sup>16</sup>The vision of the FSDP is to create a stable, sound and market-based financial system that will support the efficient mobilisation and allocation of financial resources necessary to achieve economic diversification, sustainable growth and poverty reduction.