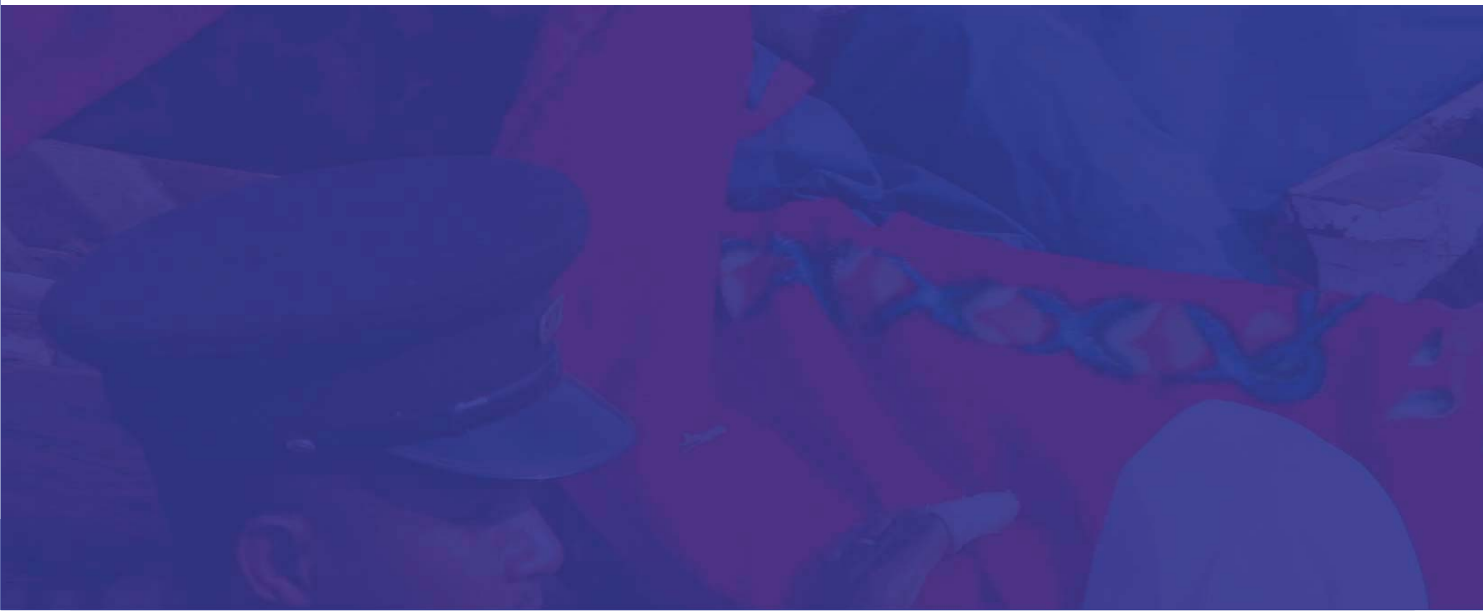




4.0 FINANCIAL SYSTEM REGULATION AND SUPERVISION



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 under review was satisfactory. As at 31 December, 2008, all banks met the minimum capital adequacy ratios of 5% and 10% for primary and total regulatory capital, respectively. However, one bank did not meet the minimum capital requirement of K12.0 billion. Asset quality was satisfactory, with the ratio of gross non-performing loans to total gross loans declining to 7.2% from 8.8% at end-December 2007. The earnings performance in 2008 was satisfactory, although a marginal increase in profit before tax of 1.6% was recorded. The liquidity position remained satisfactory despite the liquidity ratio declining to 43.0% from 46.0% in 2007.

Performance rating⁸

As at end-December, 2008, the overall performance ratings of the banking sector were satisfactory. Out of the 14 operating banks, 11 were rated satisfactory on capital adequacy and asset quality, while 9 and 5, were rated satisfactory for earnings performance and liquidity position, respectively (see Table 25).

Table 25: Performance Rating for Banks, 2006 - 2008

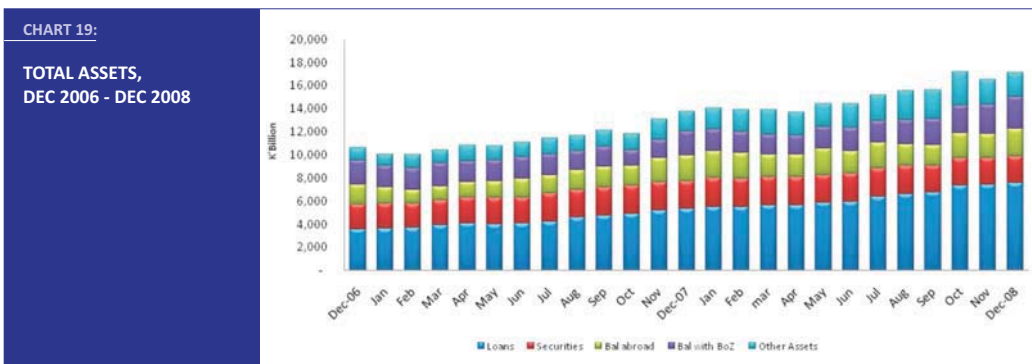
Performance	Capital Adequacy			Asset Quality			Earnings			Liquidity		
	2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008
Strong	3	0	0	0	0	0	1	0	0	0	0	0
Satisfactory	8	11	11	8	10	11	8	9	9	8	8	5
Fair Needs Improvement	2	1	1	5	2	1	4	2	2	3	3	7
Marginal	0	0	1	0	0	1	0	1	0	0	1	1
Unsatisfactory	0	1	1	0	1	1	0	1	3	2	1	1
Total	13	13	14	13	13	14	13	13	14	13	13	14

Source: Bank of Zambia

Balance Sheet Composition⁹

Asset Structure¹⁰

The banking sector's total assets increased by 24.4% to K17,146.6 billion in 2008 from K13,779.3 billion in 2007, largely on account of net loans and advances and balances with Bank of Zambia, which grew by 42.4% and 31.3%, respectively (see Chart 19).



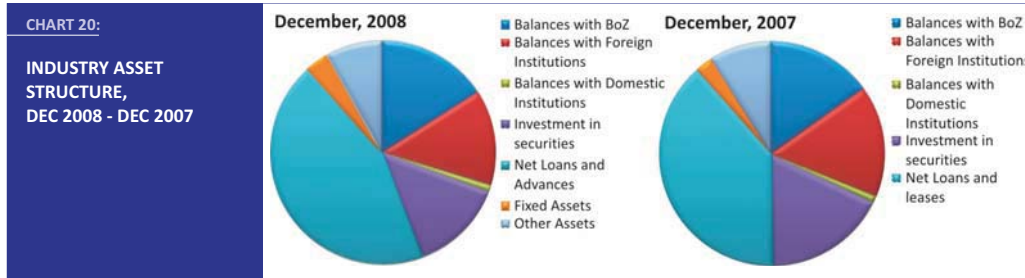
⁸The performance rating of banks is based on the financial ratio analysis on the four key components of a bank's financial condition and performance. These four key components for off-site analysis are Capital Adequacy, Asset quality, Earnings performance and Liquidity position (CAEL). There are five component and composite ratings as follows:-

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 near term. The bank is under constant supervision and BOZ possession is most likely.

⁹The composition of the balance sheet is analysed to determine the type and spread of bank's business activities, as well as to consider the impact of changes thereto on the risk profile of the banking sector. The composition of a bank's balance sheet is normally a result of asset-liability and risk management decision.

¹⁰The banking sector's assets comprise items that are a reflection of individual banks' balance sheets, although the structure of balance sheets may vary significantly depending on business orientation, market environment, customer mix, or economic environment.

The composition of the banking sector's assets remained fairly unchanged and continued to be dominated by net loans and advances, at 44.3% of total assets in 2008, from 38.7% in 2007. Other significant assets were balances with Bank of Zambia at 15.9%, balances with foreign institutions, 13.8% and investments in securities, 13.6% compared to 15.1%, 16.1% and 17.7% in 2007, respectively (see Chart 20).



Deposits and other Liabilities

In the year under review, total liabilities increased by 24.7% to K15,490.3 billion from K12,421.7 billion in 2007, largely on account of total deposits, which grew by 22.9% to K12,203.5 billion from K9,928.1 billion.

The composition of liabilities also remained fairly unchanged. Total liabilities accounted for 90.3% of total liabilities and shareholders funds compared to 90.1% in 2007, and total deposits continued to be the largest source of funding. As at end-December 2008, total deposits accounted for 78.8% and 71.2% of total liabilities and total assets compared to 79.9% and 72.0% in 2007, respectively. Further, demand deposits continued to be the largest component of total deposits, constituting 64.4% as at end-December, 2008 compared to 67.9% in 2007 (see Chart 21).



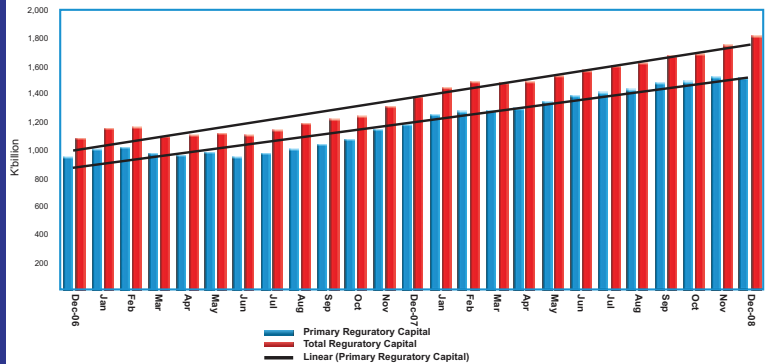
Capital Adequacy¹¹

In nominal terms, primary regulatory capital and total regulatory capital increased by 29.4% and 31.2% to K1,534.7 billion and K1,817.0 billion, respectively (see Chart 22). The increase in regulatory capital was on account of the rise in paid-up share capital, subordinated term debt and retained earnings by 64.3%, 58.8% and 17.1%, respectively.

¹¹Capital remains the most critical indicator of the relative strength of a bank. It provides a cushion against any losses that may be incurred by a bank. A bank's capital should be commensurate with the level of risk a bank takes to protect depositors as well as other providers of funds.

CHART 22:

CAPITAL ADEQUACY, DEC 2006 - DEC 2008



The overall banking sector's capital adequacy ratios closed the year at 15.7% and 18.6% for primary regulatory capital and total regulatory capital from 15.9% and 18.6% in 2007, respectively. Chart 23 depicts a decline in the capital adequacy ratios over the past three years. This was on account of the increase in the industry's total risk-weighted assets by 31.0% to K9,769.0 billion. The increase in total risk-weighted assets reflected a shift in the risk profile of the industry's total assets, from assets of lower-credit risk, largely Government securities, cash balances and balances with other banks, to assets of higher-credit risk, largely net loans and advances (see Chart 24).

CHART 23:

CAPITAL ADEQUACY RATIOS, DEC 2006 - DEC 2008

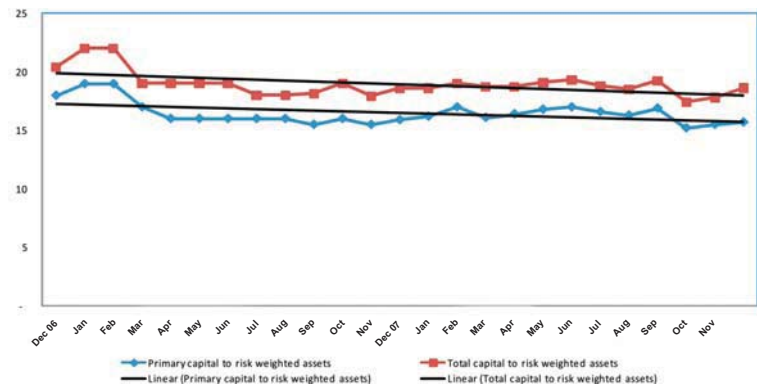
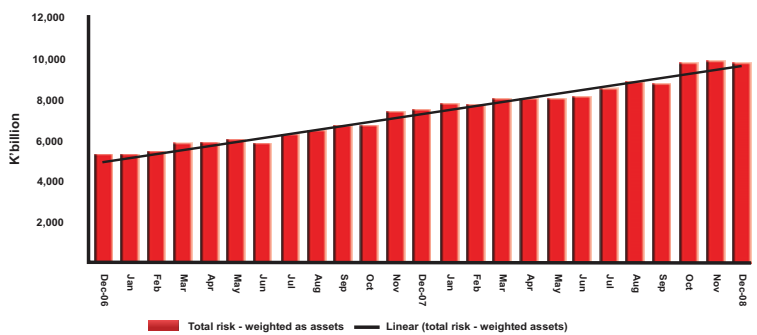


CHART 24:

TOTAL RISK-WEIGHTED ASSETS, DEC 2006 - DEC 2008



On a bank-by-bank basis, all banks in the sector, except for one, met the minimum capital requirement of K12.0 billion. However, all banks met the capital adequacy ratios of 5% and 10% for primary and total regulatory capital, respectively.

Asset Quality¹²

Sectoral Distribution of Loans and Advances

The asset quality of the banking sector in the year under review was satisfactory. During the year, gross loans and advances went up significantly by 41.9% to K8,085.7 billion from K5,700.1 billion in 2007. The rapid growth was notable largely in the following sectors; other sectors, individuals and households (or personal loans), 144.5%, the financial services sector, 163.7%, the real estate sector, 236.1% and the manufacturing sector, 45.0%.

The new Lafarge Cement Factory in Chilanga was one of the beneficiaries of increased lending to the manufacturing sector



NEW CEMENT FACTORY - CHILANGA

On a sector-by-sector basis, the 'other sectors, individuals and households (or personal loans)' accounted for the largest share of the banking industry's total loans and advances at 26.1% from 15.5% in 2007, displacing the agriculture, forestry, fishing and hunting sector, which was ranked first in 2007, at 18.4% and in 2008 accounted for 14.9%. Other significant sectors were the manufacturing sector at 10.9%, wholesale and retail trade sector, 9.8% and the financial services sector, 8.1% compared to 11.0%, 11.1% and 4.4% in 2007, respectively. The above sectors together accounted for 69.8% of the total industry's loans and advances, up from 60.4% in 2007.

Non-Performing Loans

The industry's Non Performing Loans (NPLs) increased by 17% to K583.8 billion at end-December 2008 from K498.8 billion at end-December 2007. However, the ratio of gross NPLs to total gross loans, a key indicator of asset quality, improved to 7.2% from 8.8%, while that for net non-performing loans to total regulatory capital to 5.2% from 9.6%. Further, the allowance for loan losses to minimum regulatory requirement¹³ also improved to 104.6% from 98.4%, while the ratio for the allowance for loan losses to gross non-performing loans improved significantly to 83.8% from 73.2% (see Table 26).

Table 26: Key Asset Quality Ratios, Dec 2006 - Dec 2008

Key Ratios	2006	2007	2008
Non-performing loans to Total loans (%)	11.3	8.8	7.2
Net Non-performing loans to Total regulatory capital (%)	16.1	9.6	5.2
Allowance for loan losses to minimum regulatory requirement (%)	83.3	98.4	104.6

Source: Bank of Zambia

On a sector-by-sector basis, NPLs continued to be concentrated in the agriculture, forestry, fishing and hunting sector, but as a proportion of the industry's total NPLs, declined to 33.5% from 37.2% in 2007. This was followed by the wholesale and retail trade sector at 15.6%, manufacturing sector, 11.9%, and community, social and personal services sector, 10.7% compared with 14.6%, 11.4% and 6.5% in 2007, respectively. The above sectors together accounted for 71.7% of the industry's total NPLs (see Table 27).

¹²The asset quality refers to the amount of risk or "probable" loss in a bank's assets and the strength of management processes to control credit risk. The greatest concern is the loss associated with credit quality in the bank's loan portfolio. Credit risk is generally measured by the ratio of gross non-performing loans to total loans.

¹³The Statutory Instrument No. 142 (Classification and Provisioning of Loans, Regulations, 1996) [Regulation 18(1)] stipulates the minimum provisioning requirements of 20% for the Substandard loans category, 50% for the Doubtful loans category and 100% for the Loss category.

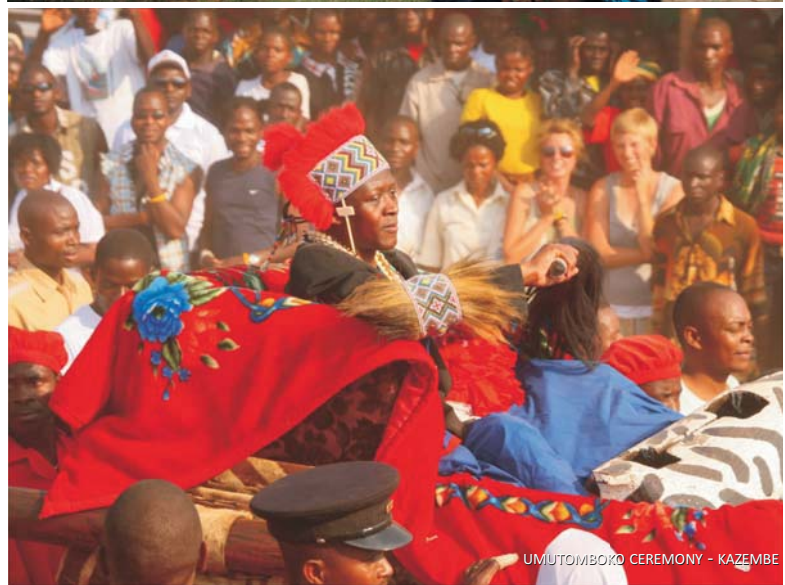
Table 27: Analysis of NPLs by Economic Sector, Dec 2006 - Dec 2008 (%)

Sector	2006	2007	2008
1. Agriculture, forestry, fishing and hunting	56	37	33
2. Mining and quarrying	2	5	3
3. Manufacturing	4	11	12
4. Electricity, gas, water and energy	0	0	2
5. Construction	1	6	7
6. Wholesale and retail trade	10	15	16
7. Restaurants and hotels	2	2	4
8. Transport, storage and communication	3	7	3
9. Financial services	0	0	1
10. Community, social and personal services	6	7	11
12. Real estate	0	1	1
11. Other sectors	15	9	7
Total	100	100	100

Tourism is one of the key contributors to the Zambia's economy. To boost the sector, the country has in the recent past engaged in the promotion of the Northern Circuit, tourism sites and activities in the Northern parts of Zambia like the Shiwang'andu Manor in Northern Province (top picture) and the annual Mutomoboko Ceremony of the Lunda people in Luapula Province (picture below)



SHIWANG'ANDU MANOR - NORTHERN PROVINCE



UMUTOMOBOKO CEREMONY - KAZEMBE

Table 28: Credit Risk Classification of Loans and Advances, Dec 2006 - Dec 2008

Loan Category	2006		2007		2008	
	K'bn	%	K'bn	%	K'bn	%
Pass	3,428.7	88.7	5,201.2	91.2	7,502.0	92.8
Substandard	99.1	2.6	109.5	1.9	99.9	1.2
Doubtful	84.9	2.2	80.0	1.4	75.8	0.9
Loss	253.9	6.5	309.4	5.5	408.0	5.0
Total Loans	3,866.6	100.0	5,700.1	100.0	8,085.7	100.0

Source: Bank of Zambia

Earnings Performance¹⁴

In the year under review, the sector's earnings performance was satisfactory. The sector's profit before tax increased by 1.6% to K544.3 billion from K536.0 billion the preceding year (see Table 29). While total net operating income increased by 26.5%, total non-interest expenses increased by 42.0%, contributing to the marginal increase in profitability (see Table 31). Further, the increase in provisions for loan losses by 13.4% negatively affected the profitability of the banking sector. Consequently, the industry's average return on assets and return on equity declined to 3.6% and 20.8% from 4.7% and 35.1%, respectively. However, the overall earnings performance remained satisfactory.

Table 29: Earnings Performance Indicators, 2006 - 2008

Key Ratios	2006	2007	2008
Return on Assets	5.1	4.7	3.6
Return on Equity	30.6	35.1	20.8
Net Interest Margin	11.8	11.5	10.4
Efficiency ¹⁵ Ratio	63.7	65.0	72.2

Source: Bank of Zambia

Table 30 below gives a summary of the banking industry's earnings performance over the last 3 years to 2008.

Table 30: Earnings Performance, 2006 - 2008 (K'billion)

Item	2006	2007	2008
Interest Income	953.8	1,224.0	1,619.8
Interest Expenses	171.4	245.3	365.1
Net Interest Income	782.4	978.7	1,254.8
Non-Interest Income	630.2	714.6	887.8
Net Operating Income	1,412.6	1,693.3	2,142.5
Loan Loss Provisions	174.5	160.7	182.3
Gross Operating Profit	1,238.1	1,532.6	1,960.2
Non-Interest Expenses	788.9	996.8	1,416.0
Profit Before Taxation	449.2	535.8	544.2
Taxation	141.6	148.2	228.3
Net Profit	307.6	387.6	315.9

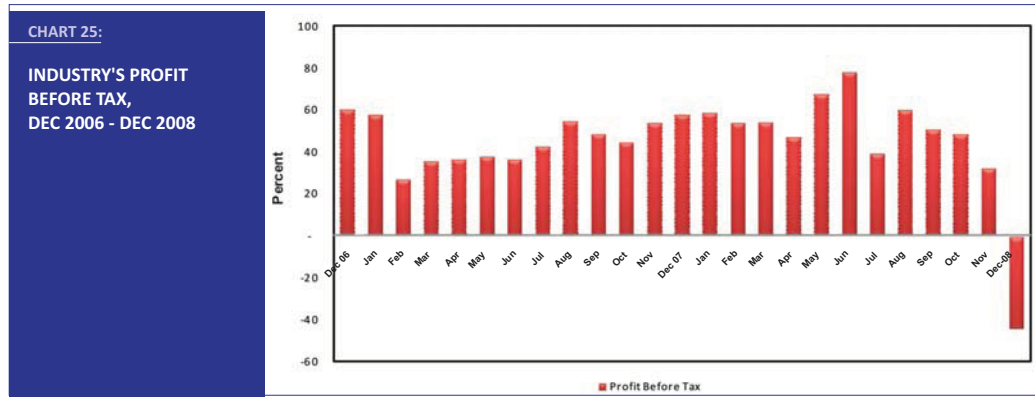
Source: Bank of Zambia

The principal sources of income for the sector, in order of significance, were interest from loans and advances and income from foreign exchange transactions at 39.7% and 17.0% of total income compared to 36.3% and 15.8% in 2007, respectively. Other sources were interest income from securities and income from commissions, fees and service charges at 12.9% and 17.2% compared to 14.6% and 19.7%, correspondingly (see Chart 25).

On the other hand, total non-interest expenses largely comprised salaries and employee benefits at 53.5% of the total compared to 54.5% in 2007. Other significant expenses were management fees at 7.1%, depreciation costs at 4.5% and occupancy at 4.3% relative to 5.1%, 4.7% and 4.2% in 2007, respectively.

¹⁴Earnings are an important source for capital formation. An evaluation of a bank's earnings performance involves an assessment of the quality of income and the long term sustainability of the activities that generate the income.

¹⁵The "overhead efficiency ratio" gives a measure of how effectively a bank is operating. An increase in the efficiency ratio means that the bank is losing a larger percentage of its income to overhead expenses. However, if it is getting lower, it is a good measure of improving profitability. The international benchmark for the efficiency ratio is normally 60%.



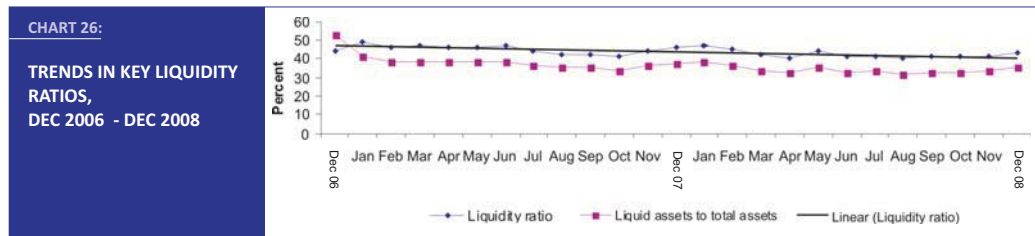
Liquidity and Funds Management

In the year under review, the industry's liquidity position remained satisfactory, although liquidity indicators pointed downwards. The liquidity ratio¹⁶ declined to 42.5% from 46.0% in 2007, and the ratio of liquid assets to total assets to 35.0% from 37.6% (see Table 31). In addition, the banking industry's core deposit ratio¹⁷ declined to 79.4% from 82.5% and the deposit concentration ratio¹⁸ to 39.8% from 35.1%. Further, the banking sector's liquidity position continued to show some signs of weakening over the past 3 years (see Chart 26).

Table 31: Liquidity Ratios Dec 2006 - Dec 2008

Key Ratios	2006	2007	2008
Liquid assets to total assets	43.7	37.6	35.0
Liquid assets to deposits & short-term liabilities (<i>Liquidity ratio</i>)	52.5	46.0	42.5
Core deposits/ total deposits ratio	82.3	82.5	79.4
Deposit concentration ratio	37.1	35.1	39.8

Source: Bank of Zambia



Sensitivity Tests

Government Securities Trading Income Tests

During the year, income from investments in Government securities for the banking industry increased by 13.9% to K322.4 billion from K283.2 billion in 2007, while overall net profit before tax increased by only 1.6%. The sensitivity test results for Government securities trading income shows that income flows from Government securities as a source of income had reduced influence on profit before tax than it had in 2007. The increase in profit was driven largely by interest income from loans and advances, which went up by 42.5%, implying that profit was more sensitive to changes in interest income from loans and advances than to changes in income flows from Government securities. Profit before tax, however, increased only marginally because of the significant increase of 42.1% in non-interest expenses.

Foreign Exchange Trading Income Tests

With regard to foreign exchange trading, income increased by 55.6% to K373.2 billion from K239.8 billion in 2007. The sensitivity test revealed that despite foreign exchange trading income increasing significantly in

¹⁶The liquidity ratio gives a rough indication of a bank's ability to meet its short-term payment obligations, with short-term liquid assets (with at least a maturity of six months). However, the liquidity ratio takes a more conservative approach by assuming that no loan proceeds are expected in the coming six months.

¹⁷The 'Core deposits' shows how much of the asset base is funded by core deposits (Demand plus Savings Deposits). A larger ratio is better and suggests less liquidity risk.

¹⁸The 'Deposit Concentration ratio' (an indication of funding risk) is measured by the aggregate of each bank's twenty largest deposits.

2008, profit was less sensitive to this profit and loss item. Industry income was more sensitive to interest income from loans and advances which, in nominal terms, increased by a greater proportion. However, the banking industry's overall profitability was held back by the large increase in non-interest expenses.

Market Share and Performance Indicators

Market Share and performance indicators by bank

The banking industry's market share, based on the proportion of assets, loans and deposits held of the industry's totals as at 31 December 2008, continued to be dominated by Barclays Bank, Zambia National Commercial Bank, Standard Chartered Bank, Stanbic Bank and Finance Bank. The five largest banks, in terms of asset size, were Barclays Bank, Zambia National Commercial Bank, Standard Chartered Bank, Stanbic Bank and Finance Bank, which together accounted for 76.4% of the industry's total assets compared to 73.4% in 2007. The five banks that accounted for the largest portion of the industry's total profit before tax, in order of significance, were Finance Bank, Citibank, Barclays Bank, Zambia National Commercial Bank and Standard Chartered Bank (see Table 32).

Table 32: Commercial Banks' Market Share and Performance Indicators, 2008

Bank	Percentage of assets	Percentage of loans	Percentage of deposits	Percentage of profit before tax	Return on Assets (%)	Return on Equity (%)
Barclays	24.8	36.6	18.5	15.7	2.2	14.1
ZNCB	16.4	12.1	18.9	12.5	3.1	28.3
Stanchart	14.3	13.5	16.6	9.7	2.4	13.7
Stanbic	11.8	13.5	13.3	7.1	1.9	14.3
Citibank	6.1	3.6	5.4	17.8	9.3	27.6
Indo Zambia	6.7	3.4	7.2	7.8	4.8	14.6
Finance Bank	9.1	8.6	10.0	20.3	7.8	43.5
Bank of China	3.0	0.2	3.1	3.2	4.1	29.5
First Alliance Bank	1.3	1.1	1.3	4.6	13.1	24.4
ABC	1.9	3.2	1.1	(0.8)	(1.8)	(12.3)
Investrust	2.7	3.5	2.8	3.5	4.4	34.8
Cavmont Capital	1.0	0.3	1.1	1.1	3.8	20.8
Intermarket	0.6	0.5	0.6	(1.1)	(14.4)	(79.5)
Access	0.3	0.0	0.3	(1.4)	(62.7)	(175.4)
Total/Weighted average	100.0	100.0	100.0	100.0	3.6	20.8

Source: Bank of Zambia

Market Share: assets, loans and deposits by ownership

Subsidiaries of foreign banks¹⁹ continued to dominate the banking industry in terms of assets, loans and deposits. As at end-December, 2008, they owned 63.8%, 65.2% and 60.2% of the banking industry's total assets, total loans and total deposits compared to 62.8%, 71.1% and 58.8 in 2007%, respectively. Government owned banks²⁰ on the other hand accounted for 20.6%, 16.5% and 23.8% of the industry's total assets, total loans and total deposits compared with 23.1%, 15.5% and 26.0%, in that order. Local banks²¹ accounted for 15.5%, 18.4% and 16.0% compared with 14.1%, 13.4% and 15.2%, correspondingly (see Table 33).

Table 33: Assets, Loans and Deposits by Type of Ownership, 2006 - 2008 (%)

	2006			2007			2008		
	Assets	Loans	Deposits	Assets	Loans	Deposits	Assets	Loans	Deposits
Subsidiaries of foreign banks	63.6	67.4	61.1	62.8	71.1	58.8	63.8	65.2	60.2
Banks with Government stake	21.7	16.0	24.5	23.1	15.5	26.0	20.6	16.5	23.8
Local banks	14.8	16.6	14.4	14.1	13.4	15.2	15.5	18.4	16.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank of Zambia

¹⁹These are locally incorporated subsidiaries of foreign banks (Eight)

²⁰Banks which are partly owned by the Government of the Republic of Zambia (Two).

²¹Other banks incorporated locally which are neither subsidiaries of foreign banks nor partly owned by Government (Four).

Market Share: profit before tax by ownership

During the year under review, the distribution of profit before tax by type of ownership indicated that subsidiaries of foreign banks accounted for 50.2% of the industry's total earnings, down from 69.8% in 2007. Local banks accounted for 29.6% compared to 22.3% while Government owned banks had 20.3%, up from 8.0% (see Table 34).

Table 34: Profit-before Tax by Type of Ownership (%)

	2006	2007	2008
	Profit before tax	Profit before tax	Profit before tax
Subsidiaries of foreign banks	68.7	69.8	50.2
Banks with Government stake	11.2	8.0	20.3
Local banks	20.2	22.3	29.6
Total	100.0	100.0	100.0

Source: Bank of Zambia

Regulation and Supervision**Licensing**

During the year under review, banking licences were issued to Access Bank Zambia Limited and First National Bank Zambia Limited. Access Bank Zambia Limited is a wholly owned subsidiary of Access Bank PLC of Nigeria. It commenced operations in August 2008. First National Bank Zambia Limited is a wholly owned subsidiary of FirstRand Bank Holdings Limited of South Africa. The bank is expected to commence operations in April 2009.

Financial Inclusiveness

In line with its strategic objective on financial inclusion, the Bank continued to evaluate and approve innovations by commercial banks aimed at deepening and broadening the financial system in Zambia. To this end, a number of initiatives were approved such as the In-Store banking services, Truck Banking Services, Mobile Banking Services and Internet Banking Services. The focus during the year under review was towards promoting non-traditional distribution channels as well as products and services. In addition to these initiatives, the Bank conducted a survey on Islamic Banking in Zambia which culminated into the first ever Islamic Finance Conference, which was held in Lusaka between 20 and 21 October 2008.

Risk Based Supervision Approach

During the year under review, the Bank of Zambia rolled out the Risk Based Supervision (RBS) framework following the formal approval of the RBS Policy in August 2008 and the subsequent issuance of the Risk Management Guidelines (RMG) in early October 2008. The RMG provides guidance to the banks and financial institutions in their design and implementation of risk management systems, and enables the Bank of Zambia to focus supervisory resources on ensuring that management of all banks and financial institutions are able to identify, measure, control and monitor the types and levels of all risks assumed. Overall, the Risk-based approach to supervision will enable the Bank of Zambia to focus and dedicate supervisory resources to identifying activities and practices of greater risk to the soundness of banks, and also to identifying higher-risk institutions.

Bank Branch Network and Agencies²²

During the year under review, the commercial banks' branch and agency network increased by 10.9% to 224 as at end-December 2008 from 202 in 2007 (see Table 35).

²²A bank agency falls under a branch and does not offer the full range of products and services which are provided at the branch. Further, depending on the bank, an agency may not open on all the working days of the week.

Table 35: Commercial Banks' Branch Network and Agencies, 2006 - 2008

Bank Name	2006	2007	2008
Access Bank Zambia Limited*	n/a	n/a	1
African Banking Corporation (Z) Ltd	2	2	2
Bank of China	1	1	1
Barclays Bank Zambia Plc	21	39	52
Cavmont Capital Bank Limited	11	12	12
Citibank Zambia Limited	2	2	2
Finance Bank Zambia Limited	40	42	44
First Alliance Bank (Z) Limited	3	3	3
Indo-Zambia Bank Limited	9	9	12
Intermarket Banking Corporation (Z) Ltd	3	3	3
Investrust Bank Plc	7	8	9
Stanbic Bank Zambia Limited	12	12	12
Standard Chartered Bank Zambia Plc	15	16	17
Zambia National Commercial Bank Plc	52	53	54
Total	178	202	224

Source: Bank of Zambia *Access Bank started operating in 2008. n/a = not applicable

4.2 NON-BANK FINANCIAL INSTITUTIONS SECTOR

Overview

In 2008, the overall financial performance and condition of the non-bank financial institutions sector was satisfactory. The leasing, bureaux de change and microfinance sub-sectors and the development finance institutions registered satisfactory performance while the building societies and the savings and credit institutions showed some improvements.

The structure of Non-Bank Financial Institutions (NBFIs) supervised by the Bank of Zambia as at 31 December 2008 is tabulated in Table 36 below.

Table 36: Structure of NBFIs under the Supervisory Ambit of the BoZ, Dec 2006 - Dec 2008

Type of Institution	Number of Institutions 2006	Number of Institutions 2007	Number of Institutions 2008
Leasing Companies	10	12	10
Building Societies	3	3	3
Bureaux de change	31	35	39
Savings and credit institutions	1	1	1
Microfinance institutions	4	8	21
Development finance institutions	1	1	1
Credit reference bureaux	1	1	1
Total	51	61	76

Source: Bank of Zambia

The number of NBFIs, increased to 76 as at end-December 2008 from 61 as at end-December 2007. This development was mainly due to an increase in the number of microfinance institutions (MFIs) to 21 from 8 during the same period following the Bank's directive for all MFIs to comply with the Banking and Financial Services (Microfinance) Regulations, by 1 February 2008.

Regulation and Supervision

During the year, 18 operating licences for NBFIs were granted. Out of this number, 13 were for MFIs whilst five²³ were for bureaux de change (see Table 37).

As at end-December 2008, two leasing companies, Access Leasing Limited and Access Financial Services Limited, which were under the statutory management of the Bank since 13 January 2003, had been placed under compulsory liquidation.²⁴

²³One bureau de change was restructured and in the process changed its name from Ourrosogui Bureau de Change to Dondou Bureau de Change.

²⁴The compulsory liquidation was effected on 27th November 2008.

Table 37: Licences Issued in 2008

Sub-Sector	Institution Licensed	Date Licensed
A. Micro Finance Institutions	1. Capital Solutions Limited	20 March 2008
	2. Mtawila Financial Services Ltd	31 March 2008
	3. Unity Finance Limited	2 April 2008
	4. FINCA Zambia Limited	8 April 2008
	5. Bomach Finance Limited	16 May 2008
	6. Meanwood Finance Corporation	6 August 2008
	7. CETZAM Financial Services Ltd	18 August 2008
	8. Yakabutala Musa Limited	18 August 2008
	9. Microbankers Trust	18 August 2008
	10. Pulse Financial Services Limited	18 August 2008
	11. Pelton Finance Limited	19 October 2008
	12. Genesis Finance Limited	3 December 2008
	13. Microcredit Foundation Limited	3 December 2008
B. Bureaux de Change	1. Challenge Bureau de Change Limited	11 January 2008
	2. Roseco Bureau de Change Limited	20 February 2008
	3. Swift Bureau de Change Limited	31 March 2008
	4. Dondou Bureau de Change Limited	7 April 2008
	5. Walk Tall Bureau de Change Limited	16 May 2008

Source: Bank of Zambia

Seven bureau de change branch applications were approved in 2008 while seven NBFIs branches were opened (see Tables 38 and 39).

Table 38: Approved Bureau de Change Branch Applications

No.	Name of Institution	No. of Branches	Date Approved
1	Bullion Bureau de Change- Lusaka, Chipata and Ndola branches	3	24 July 2008
2	Struts Bureau de Change Ltd- Westgate Mall Branch, Lusaka	1	8 September 2008
3	CFB Bureau de Change- Lusaka and Solwezi Branches	2	5 November 2008
4	FX Africa Zambia Bureau de Change- Chipata Branch	1	8 December 2008
	Total	7	

Source: Bank of Zambia

Table 39: New NBFIs Branches Opened in 2008

No.	Name of Institution	No. of Branches	Date Opened
1	Unity Finance Limited	2	2 April 2008
2	CETZAM Financial Services Zambia Limited- Livingstone, Kabwe and Ndola Branches	3	18 August 2008
3	National Savings and Credit Bank- Lukulu Branch	1	17 October 2008
4	Blue Financial Services Zambia Limited- Mongu Branch	1	25 November 2008
	Total	7	

Source: Bank of Zambia

Performance of the Non-Bank Financial Sector

During 2008, the overall financial performance and condition of the NBFIs was satisfactory²⁵ as was the case in 2007. Forty NBFIs, five of which were deposit taking, accounting for 51% of total sector assets were rated satisfactory while nine NBFIs accounting for 15% of total sector assets were rated fair. In addition, five NBFIs,

²⁵ 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

four of which were deposit-taking, accounting for 33% of total sector assets, were rated unsatisfactory and measures to address the capital deficiencies of the five NBFIs were instituted.

Leasing

During the year, the overall performance of the leasing sub-sector was satisfactory (see Tables 40a and 40b). The leasing sub-sector maintained adequate capital and reserves relative to their risk profiles. Out of the 10 leasing companies in operation as at 31 December 2008, eight met the prescribed minimum capital adequacy ratio of 10%, while two had regulatory capital deficiencies and as a result remedial measures were instituted for each institution.

Table 40a: Year-End Composite Rating for the Leasing Sub-Sector, 2006-2008

Performance Category	Composite Rating Scale	Number of Leasing companies			Proportion of Industry Assets (%)		
		2006	2007	2008	2006	2007	2008
Current Condition Satisfactory	1.0-2.0	3	4	4	48.5	51.1	49.8
Possible Emerging Problem	2.1-2.5	3	1	1	47.6	1.7	6.6
Watch	2.6-3.5	1	2	3	1.1	8.7	7.9
Problem	3.6 or greater	1	3	2	2.8	38.5	35.7
Total		8	10	10	100	100	100

Source: Bank of Zambia

Table 40b: Year-End Performance Rating for the Leasing Sub-Sector, 2006-2008

Performance Category	Capital Adequacy No. of Leasing companies			Asset Quality No. of Leasing companies			Earnings No. of Leasing companies			Liquidity No. of Leasing companies		
	2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008
Strong	4	2	4	1	1	0	1	1	1	1	3	3
Satisfactory	2	3	1	4	3	5	2	1	1	0	1	2
Fair Needs Improvement	1	2	2	2	2	2	4	4	1	3	1	1
Marginal	0	1	1	0	1	2	0	0	3	2	1	1
Unsatisfactory	1	2	2	1	3	1	1	4	4	2	4	3
Total	8	10	10	8	10	10	8	10	10	8	10	10

Source: Bank of Zambia

Capital Adequacy

As at 31 December 2008, the sub-sector's regulatory capital decreased to K36,110 million from K42,829 million in 2007. Nevertheless, this was above the minimum regulatory capital of K25,000 million (see Chart 27). The decrease was mainly as a result of the sub-sector's after tax loss of K2,964 million recorded during the year coupled with lease and other loss adjustments of K31,790 million, which were largely attributed to one leasing company. The sub-sector's after tax loss and adjustments to regulatory capital outweighed additional capital injected by four existing leasing companies amounting to K28,066 million.

CHART 27:

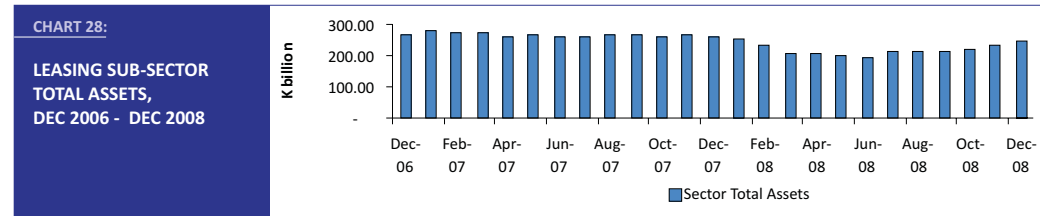
LEASING SUB-SECTOR
REGULATORY CAPITAL,
DEC 2006 - DEC 2008



Asset Quality

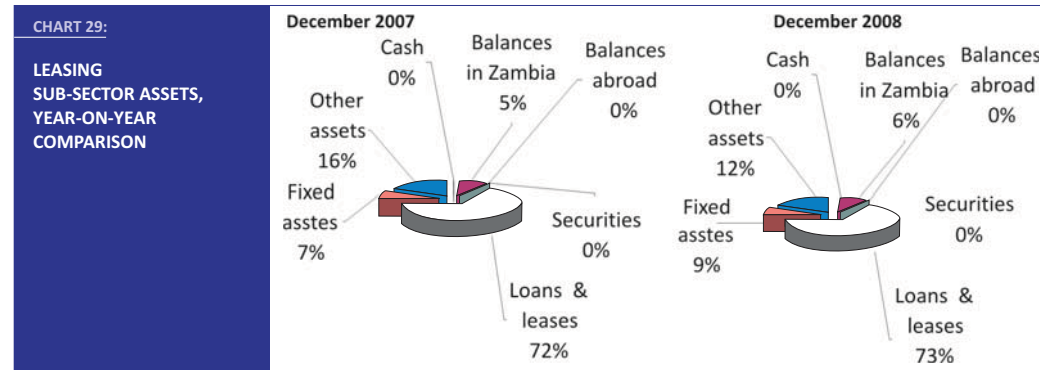
As at 31 December 2008, the total assets of the leasing sub-sector declined by 5% to K250,715 million from K263,882 million the previous year (see Chart 28). This was largely attributed to the reduction in the sub-

sector's other assets which reduced by 31% to K29,544 million at 31 December 2008 from K42,916 million in 2007, as total loans and advances remained relatively unchanged.



Net loans and advances constituted the largest proportion of total assets at 73% compared to 72% in 2007 (see Chart 29). Non-performing loans amounted to K38,891 million out of the sub-sector's total gross loan portfolio of K212,886 million and represented 18% of total loans which was above the prudential level of 10%. One leasing company accounted for K27,315 million or 70% of the sub-sector's total non-performing loans. On the basis of the ratio of net non-performing loans and advances to gross loan portfolio, the leasing sub-sector's asset quality was rated fair.

As at 31 December 2008, total earning assets amounted to K190,543 million and accounted for 76% of total assets.



Earnings

The earnings performance of the leasing sub-sector was designated unsatisfactory because of a loss before tax of K3,214 million recorded in the period under review. However, the loss declined by 26% from a loss of K4,358 million recorded in 2007 largely due to a decline in provisions for loan and lease losses of K7,624 million (see Table 41 and Chart 30).

Table 41: Earnings Performance, 2006 - 2008 (K'million)

Particulars	2006	2007	2008
Interest income	38,897	41,437	39,048
Interest expenses	13,807	17,533	15,545
Net interest income	25,090	23,904	23,412
Provisions/(Provisions reversals)	(729)	11,795	4,171
Net interest income after provisions	25,819	11,957	19,854
Non-interest income	4,726	6,080	5,770
Total net income	30,545	18,037	24,981
Non-interest expenses	18,255	22,395	28,118
Profit before tax	12,290	(4,358)	(3,214)
Tax	319	615	41
Profit after tax	11,971	(4,973)	(3,255)

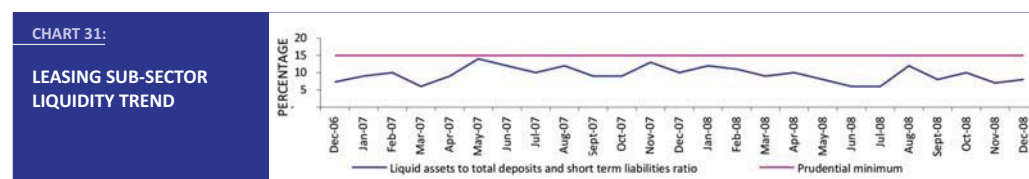
Source: Bank of Zambia

The principal source of income for the leasing sub-sector continued to be interest from loans and leases, and was 87% of total income in 2008. Interest income decreased by 6% to K39,048 million in 2008 from K41,437 million in 2007. This was largely due to the decrease in income from leases to K17,178 million from K21,096 million over the period under review. Interest expenses decreased by 11% to K15,545 million in 2008 from K17,533 million in 2007, driven by the 54% drop in borrowings from financial institutions in Zambia and abroad. Non-interest expenses increased by 26% to K28,118 million from K22,395 million during the same period largely on account of a 56% rise in other expenses.



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 9% which was below the acceptable ratio of 15% (see Chart 31). Despite the sector liquidity ratio being below the acceptable ratio, the liquidity was designated marginal, rather than unsatisfactory, because a number of leasing companies had lines of credit with commercial banks, which they could call on as and when necessary.



Building Societies Sub-Sector

During the year, the overall performance of the building society sub-sector showed some improvements largely on account of improvement in capital adequacy. Out of the 3 building societies, only one was rated unsatisfactory on account of capital deficiency and marginal liquidity (see Tables 42a and 42b).

Capital Adequacy

As at 31 December 2008 the building society sub-sector's aggregate regulatory capital, although below requirement, improved by 66% to negative K10,971 million from negative K32,281 million in 2007. This was largely due to the profit after tax recorded in the year amounting to K10,384 million, coupled with capital injections of K25,188 million. Out of the three building societies in operation, one did not meet the minimum risk-weighted regulatory capital of K9,767 million, signaling the need to prompt remedial measures by shareholders aimed at recapitalising the institution.

Table 42a: Year-End Composite Rating for the Building Society Sub-Sector, 2006-2008

Performance Category	Composite Rating Scale	Number of Building Societies			Proportion of Industry Assets (%)		
		2006	2007	2008	2006	2007	2008
Current Condition Satisfactory	1.0-2.0	0	2	1	0	37.4	31.8
Possible Emerging Problem	2.1-2.5	1	0	1	29.1	0	5.2
Watch	2.6-3.5	0	0	0	0	0	0
Problem	3.6 or greater	2	1	1	70.9	62.6	63.0
Total		3	3	3	100	100	100

Source: Bank of Zambia

Table 42b: Year-End Performance Rating for the Building Society Sub-Sector, 2006-2008

Performance Category	Capital Adequacy No. of Building Societies			Asset Quality No. of Building Societies			Earnings No. of Building Societies			Liquidity No. of Building Societies		
	2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008
Strong	1	1	1	1	1	0	0	0	0	0	1	0
Satisfactory	0	1	0	0	0	2	1	3	1	1	2	0
Fair Needs Improvement	0	0	1	0	2	1	1	0	2	1	0	1
Marginal	0	0	0	1	0	0	1	0	0	0	0	2
Unsatisfactory	2	1	1	1	0	0	0	0	0	1	0	0
Total	3	3	3	3	3	3	3	3	3	3	3	3

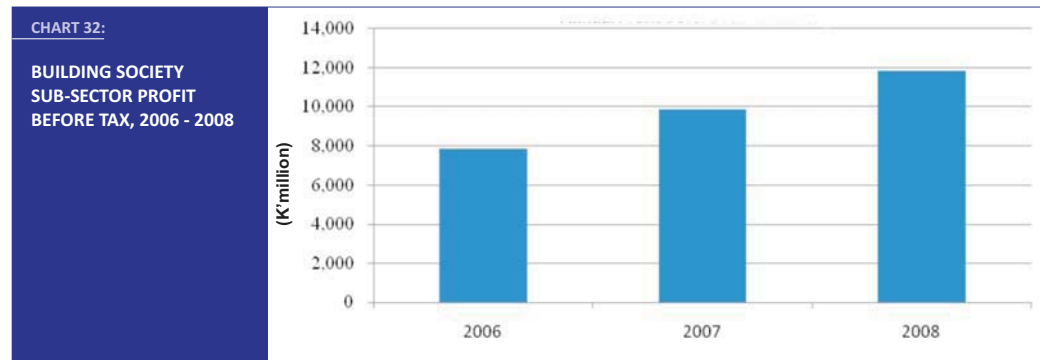
Source: Bank of Zambia

Asset Quality

The asset quality of the building society sub-sector was designated fair during the year. The proportion of net non-performing assets to total assets was 2.7% in 2008 representing an increase of 2.6 percentage points from the previous year. Total assets of the sector increased by 22% to K271,765 million as at 31 December 2008 from K222,839 million as at 31 December 2007. The increase in total assets was largely accounted for by increases in net mortgage advances of K38,589 million.

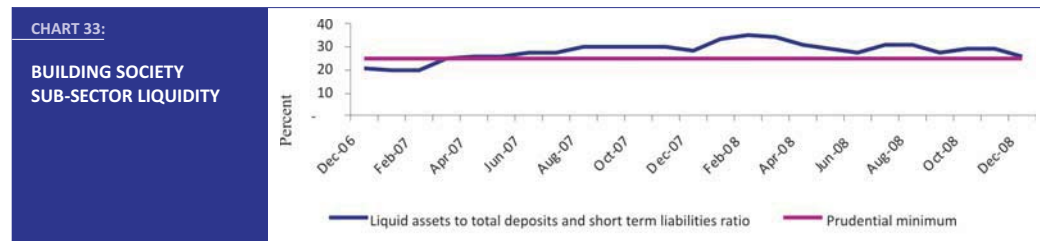
Earnings Performance

During 2008, the earnings performance of the building society sub-sector was satisfactory, with profit before tax rising by 20% to K11,820 million from a profit of K9,857 million for 2007 (see Chart 32). The improvement in earnings performance was largely due to the increase in interest income by 69% to K42,040 million from K24,819 million in 2007, which in turn was 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 30% in 2008. This was above the prudential minimum ratio of 25% for building societies and was therefore, designated satisfactory (see Chart 33).



Micro Finance Institutions

The financial condition and performance of the micro finance institutions (MFIs) was designated satisfactory.

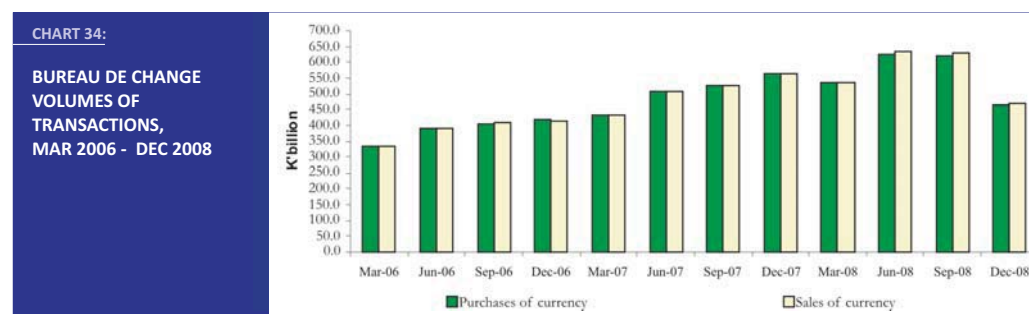
All the MFIs licensed and supervised by the Bank of Zambia were adequately capitalised as at 31 December 2008. The aggregate capital of the MFIs increased by 84% to K145,921 million as at 31 December 2008 from K79,263 million as at 31 December 2007. The increase was largely due to retained profits recorded in the year, amounting to K49,178 million, coupled with capital injections of K13,204 million introduced by newly licensed institutions. Total assets amounted to K467,777 million, representing an increase of 84% from the position of K254,687 million as at 31 December 2007. Loans and advances constituted the largest component of total assets at 82% compared to 90% 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 2008, the bureau de change sub-sector was adequately capitalised. All the 37 bureaux de change, which were in operation met their minimum regulatory capital requirement of K40 million. Aggregate capital and reserves increased by 58% to K28,314 million in 2008 from K17,976 million in 2007, largely due to retained profits of K4,210 million, coupled with capital injections of K6,762 million from newly licensed bureaux de change.

Total assets, at K39,301 million, represented an increase of 63% from K24,176 million in 2007. The increase in total assets was largely financed by capital injections of K6,762 million, profits after tax of K4,210 million and borrowings amounting to K4,786 million.

During 2008, bureaux de change purchased a total of K2,249,351 million (US \$462 million) compared with K1,964,423 million (US \$510 million) in 2007. Further, the volumes of sales were K2,280,066 million (US \$468 million) compared with K1,988,425 million (US \$516 million), (see Chart 34). This represented an increase of 15% in the volume of transactions.



4.3 FINANCIAL SECTOR DEVELOPMENT PLAN²⁶

Overview

During the year under review, progress continued to be made in the implementation of the Financial Sector Development Plan (FSDP). Notable milestones during the year included the following:

Sovereign Credit Rating for Zambia

The Government approved the proposal to conduct a sovereign credit rating for Zambia and subsequently selected a financial advisor to assist the country prepare for the rating. The rating exercise is expected to commence in 2009 and is part of Government's initiatives to promote investment in Zambia and stimulate the development of domestic capital markets.

Supply Side Study

During the year, the FSDP Steering Committee approved the results of the FinScope Supply Side Survey and subsequently disseminated the findings to banks and NBFIs. Major findings of the Survey included, among others:

- Commercial banks only reached about one million people;
- Spreads between deposits and lending rates were too high;
- Financial institutions needed to improve management of their cost structures in order to increase outreach;
- Formal banking sector, commercial micro-lenders, insurance companies and pension funds all serviced the top 20%, mostly the salaried adult population, while the outreach of social microfinance institutions was extremely limited.

²⁶The 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.

Credit Reference Services

Since the licensing of the first credit reference bureau by the Bank, Credit Reference Bureau Africa Limited (CRBAL), in June 2006, provision of data and usage of the Credit Reference Bureau (CRB) by financial institutions was still low. To enhance the usage of the CRB, the Bank directed all credit providers in December 2008 to provide credit data to the CRB and not to grant new loans without reference to the CRB.

Law Review

As part of the on-going law review exercise, the following guidelines, regulations and various legislations were considered.

The legal review of financial sector legislation aimed at modernising and harmonising laws, which include the Bank of Zambia Act, Securities Act, Pensions and Insurance Act, and Building Societies Act, among others, continued in 2008. The Accountants Amendment Bill was enacted on 24 September 2008 as part of the process to harmonize various financial sector and business laws and regulations.

- **Deposit Protection Scheme and Risk Management Guidelines**

The concept paper and the draft deposit insurance bill were developed while as an initiative aimed at enhancing financial stability, the Risk Management Guidelines were approved by the Bank and subsequently issued to all banks and NBFIs under the supervisory ambit of the Bank on 20 October 2008.

- **Disclosure and Publication of NBFIs Financial Charges**

The Bank issued a circular requiring financial institutions and financial businesses to submit information to the Bank on all financial charges or levies with regard to their services and transactions. This followed complaints from the public and more specifically financial sector customers on the high financial charges, fees and commissions for accounts and other general services and transactions being levied by NBFIs.