BANK *OF* ZAMBIA

FINANCIAL SYSTEM SUPERVISION

2013 ANNUAL REPORT

Contents

Governor's Statement

The Zambian economy remained strong in 2013 despite a modest decline in real Gross Domestic Product (GDP) growth rate to 6.5% from 7.3% in 2012. The 6.5% growth in GDP was mainly driven by increased activity in transport and communications; construction; manufacturing; mining and trade. Based on the backdrop of strong economic performance, the overall financial performance and condition of the financial sector under the ambit of the Bank of Zambia (BoZ) continued to be satisfactory during 2013. As at 31 December 2013, the banking sector comprised 19 banks while the Non-Bank Financial Institutions (NBFIs) sector comprised 114 institutions.

The banking sector recorded improvements in the aggregate capital adequacy position, asset quality and liquidity position while the earnings performance remained satisfactory. In addition, the banking sector continued to expand both in terms of total assets and branch network. As at end-December 2013, the banking sector's total assets amounted to K41,953.0 million or 22.4% higher than K34,275.9 million recorded the previous year. Net loans and advances which accounted for the largest share of total assets, grew by 14.5% to K17,884.4 million, and was largely funded by deposits from customers which increased by 22.8% to K30,906.9 million.

Further the NBFIs sector's overall financial performance and condition was satisfactory in the year under review. The sector's regulatory capital, asset quality and profitability were all satisfactory. The aggregate assets of the sector increased by 34.8% to K3,941.5 million from K2,924.4 million as at end-December 2012. The increase in total assets was mainly noticeable in the gross loans which increased by 59.9% to K2,835.5 million as at end-December 2013 from K1,773.5 million as at end-December 2012.

In the year under review, the BoZ authorised the opening of an additional 31 branch and agency locations for banks in different parts of the country to bring the total to 345 as at end-December 2013 from 314 as at end-December 2012. In addition, 14 new NBFIs were licensed to bring the total to 114 and 21 new branch locations were authorised to bring the total to 307.

In addition, the BoZ continued to foster an environment that promotes the use of technology-based banking platforms and other branchless banking initiatives such as mobile banking and agency banking among others, in order to increase accessibility to financial services. In this regard, a number of financial service providers (FSPs) responded positively to these initiatives and implemented a number of products and services to improve on their range of products and services and also to expand their outreach. In view of the potential positive externalities associated with an inclusive financial system, financial inclusion remained a key policy priority for the BoZ during the review period. The BoZ will continue to implement appropriate regulatory measures in line with developments in the domestic and international financial landscape so as to enhance its supervisory capacity and strengthen the operations of the financial sector with the ultimate objective of financial system stability.

Michael Gondwe (Dr.)

GOVERNOR

The Directors' Review on the Financial Performance and Condition

The Financial System Supervision Report on the operations of banks and NBFIs is prepared in accordance with **Section 126 (1)** of the Banking and Financial Services Act (BFSA). The purpose of this report is to present an analysis of the performance and condition of banks and NBFIs under the mandate of the BoZ and an overview of the activities undertaken during the period 1 January 2013 to 31 December 2013.

In the year under review, the activities of the Bank Supervision Department (BSD) and the Non-Bank Financial Institutions Supervision Department (NBFISD) were directed towards fulfilling the BoZ's mandate to licence, regulate and supervise the activities of financial service providers so as to promote the safe, sound and efficient operations and development of the financial system.

With regard to the banking sector, the overall financial performance and condition was rated satisfactory on account of high capital adequacy and satisfactory asset quality, earnings performance and liquidity condition. Out of the 19 banks, 11 banks were rated satisfactory; seven were rated fair, while one bank was rated unsatisfactory.

The banking sector's aggregate primary and total regulatory capital increased by 50.4% and 50.5% to K5,656.9 million and K6,201.0 million respectively. Consequently, the capital adequacy ratios increased to 24.5% for the primary regulatory capital and 26.8% for the total regulatory capital from 19.4% and 21.3% as at end-December 2012, respectively. The increase in regulatory capital was mainly on account of new capital injections as well as retained earnings as banks prepared to meet the new minimum capital requirements. As at 31 December 2013, which was the deadline for meeting the new capital adequacy requirements, the majority of the banks in the sector met the new minimum capital requirements. Asset quality was satisfactory, as reflected by the quality of the loan book with the gross non-performing loans (NPLs) ratio improving to 7.0% as 31 December 2013 from 8.1% as at 31 December 2012. In addition, the NPL coverage ratio improved to 83.7% as at end-December 2013 from 73.5% the previous year. The sector's profitability as measured by the return on assets (RoA) and Return on Equity (RoE) remained satisfactory at 3.4% and 18.2% respectively. The sector's liquidity position was also satisfactory as reflected by the high liquidity ratios. The liquidity ratio stood at 49.3% as at end-December 2013, up from 44.4% as at end-December 2012 while the liquid assets ratio increased to 38.9% from 36.0% over the same period.

With regard to the NBFIs sector, the overall financial performance and condition was also satisfactory in the year under review. The sector's regulatory capital, asset quality and profitability were all satisfactory. The sector's aggregate regulatory capital increased by 3.9% to K1,011.1 million as at end-December 2013 from K973.3 million as at 31 December 2012. The increase in regulatory capital was largely due to retained earnings. However, the regulatory capital adequacy ratio declined to 22.6% as at end-December 2013 from 38.4% as at end-December 2012, mainly due to a proportionately higher increase in risk-weighted assets. Asset quality was satisfactory as reflected by the improvement in the gross NPLs ratio to 7.2% from 7.8% recorded at the previous year-end. Despite a reduction in the NPL coverage ratio to 83.6% from 91.7% as at end-December 2012, the ratio was still within the satisfactory range of 80-90%. The earnings performance of the NBFIs sector was satisfactory in the year under review despite the decline in the RoA and RoE ratios to 2.0% and 7.0% from 5.0% and 16.0%, respectively. The decline was mainly attributed to a decrease in net interest margin and deterioration in operational efficiency. Despite a reduction in the liquidity ratio to 37.0% as at end-December 2013 from 43.0% as at end-December 2012, the overall liquidity position of the sector was satisfactory.

In the year under review, both the BSD and NBFISD continued to execute their mandate of promoting a safe and sound financial system by conducting both off-site and on-site monitoring of the Financial Service Providers (FSPs) and taking appropriate supervisory action as necessary. Further, the BoZ continued to review regulatory policies and implemented new measures aimed at strengthening its oversight over institutions under its domain. One key development in the year was the commencement of the implementation of the Basel II capital adequacy framework for banks.

Notwithstanding the good performance of the financial sector recorded in 2013, the BoZ encountered a number of challenges. One such challenge related to the implementation of the Basel II capital adequacy framework which was hampered by insufficient data and inadequate Information, Communications & Technology (ICT) infrastructure in some banks.

Director – BSD **Director - NBFISD**

CHAPTER 1: ORGANIZATIONAL STRUCTURE OF THE FINANCIAL SYSTEM SUPERVISION

1.1 Introduction

The BoZ is mandated by Section 4(2)a of the Bank of Zambia Act of 1996 as amended to licence, supervise and regulate the activities of banks and NBFIs so as to promote the safe, sound and efficient operations and development of the financial system.

The Banking and Financial Services Act (BFSA) of 1994 as amended, supports the Bank of Zambia Act of 1996 as amended, by amplifying the legal and regulatory framework of licensing, supervising and regulating financial service providers (FSPs) in Zambia. The overriding objective of the BFSA is to create a comprehensive and robust regulatory and supervisory framework for conducting financial service business in Zambia. The BFSA outlines the licensing requirements of financial service providers; their organisation and administration; their operations; their financial accountability; their supervision and regulation; insolvency, dissolution and liquidation; appeals; and other miscellaneous matters.

1.2 Governance Structure

The Supervisory Policy Committee (SPC) and the Licensing Committee are responsible for providing oversight for the supervision of the FSPs.

1.2.1 Supervisory Policy Committee

The SPC, which is chaired by the Governor, is the policy-making organ of the BoZ in the execution of its financial stability mandate. The responsibility of the SPC is to review and sanction financial sector supervisory policy issues. The SPC is also responsible for the oversight of FSPs in liquidation.

1.2.2 Licensing Committee

The Licensing Committee is responsible for the evaluation of license applications for banks and non-bank financial institutions; reviewing and evaluation of applications relating to corporate restructuring, voluntary winding up and the sale of shares in FSPs.

1.3 Supervisory Structure

The BSD is responsible for the regulation and supervision of commercial banks while the NBFISD is responsible for the regulation and supervision of all non-bank Financial Service Providers specifically microfinance institutions, building societies, development finance institutions, savings and credit institutions, leasing finance institutions, bureaux de change and the credit reference bureau. The NBFISD also provides secretarial services to the Financial Sector Development Plan (FSDP). The BSD and the NBFISD are each organized into three (3) divisions, as follows (see also ***Appendix 1 and Appendix 1A***).

- **Inspections Division**, which is responsible for conducting on-site inspections of all supervised institutions;
- **Financial Analysis Division**, which is responsible for the monitoring of the performance of financial service providers through the evaluation of prudential returns; and

- **Regulatory Policy and Liquidation Division,** which is responsible for reviewing the adequacy of the regulatory framework under which financial service providers operate. The Division is also responsible for assessing licence applications and initiating the orderly exit of failed financial service providers from the financial sector.

1.4 Structure of the Financial System under Bank of Zambia

As at 31 December 2013, the banking sector comprised 19 banks while the non-bank sector comprised 114 institutions. During the year, 14 licences for NBFIs were granted, while seven were revoked. The licences issued comprised nine bureaux de change, three micro-finance and two financial businesses, while the revoked licences comprised three MFIs, three bureaux de change and one financial business **(**see ***Table 1.1*****).**

Table 1.1: Structure of the Financial System as at 31st December, 2013

Type of Institution	Number of Institutions		
	2011	2012	2013
COMMERCIAL BANKS	**19**	**19**	**19**
NON BANK FINANCIAL INSTITUTIONS			
Leasing Finance Institutions	9	8	7
Building Societies	3	4	4
Bureaux de Dhange	55	57	64
Savings and Credit Institutions	1	1	1
Microfinance Institutions	32	35	35
Development Finance Institutions	1	1	1
Financial Businesses	0	0	1
Credit Reference Bureau	1	1	1
Sub-Total	**102**	**107**	**114**
Grand Total	**121**	**126**	**133**

Source: Bank of Zambia

1.5 Compliance to Key International Regulatory Frameworks

The implementation of Basel II remains a strategic objective for the BoZ for the period 2012-2015. In the year 2013, the BoZ made remarkable headway in the phased implementation of the Basel II Framework. The progress was reflected in the finalisation of regulations for Pillar I, II and III. Further, submission of Basel II compliant returns commenced in the fourth quarter of 2013, on a parallel run basis.

The implementation is premised on the following methodologies:

- The Simplified Standardized Approach (SSA) for credit risk,
- The Standardized Approach (TSA) for market risk, and
- The Basic Indicator Approach (BIA) for operational risk.

1.6 Regional and International Co-operation Activities

During the year under review, the BoZ continued to play an active role in both international and regional supervisory initiatives on a number of supervisory issues as outlined below;

1.6.1 Anti-Money Laundering/Combating of Financing of Terrorism

The BoZ actively participated in matters relating to combating money laundering and the financing of terrorism. In this regard, the BoZ participated at the meetings of the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG). The BoZ also implemented measures to ensure that the country complied with the international standards in response to global developments.

1.6.2 Trade Agreements

Zambia is a signatory to multilateral, regional and bilateral trade agreements which include the World Trade Organisation (WTO), Common Market for Eastern and Southern Africa (COMESA), Southern African Development Community (SADC) and bilateral Economic Partnership Agreements (EPAs). The SADC and COMESA member states are currently engaged in negotiations in four priority areas, namely tourism, communication, transport and financial services. A working group on Trade in Services drawing membership from sector experts and regulators has been established and the BoZ is a member of the group, and contributed expertise in respect to the financial sector issues.

1.6.3 Foreign Account Tax Compliance Act (FATCA)

In 2010, the United States of America introduced the Foreign Account Tax Compliance Act (FATCA). The primary objective of FATCA is to prevent tax evasion by US taxpayers on transactions in foreign jurisdictions. Under the US tax law, US persons are required to report and pay taxes on income from all sources. FATCA requires foreign financial institutions investing in the U.S. market and any financial institutions which are part of a group which invests in the U.S. market to enter into an agreement with the US Internal Revenue Service to identify their US account holders and to disclose the account holders' names, their addresses, Tax Identification Numbers (TINs) and their account activity details. Given the extra-territorial application of the FATCA in sovereign states and its implication on financial institutions in Zambia, the BoZ wrote to the Ministry of Finance in October 2013 to consider entering into an intergovernmental agreement with the US Treasury to facilitate the implementation of the FATCA by financial institutions operating in Zambia. In the meantime, commercial banks were advised to start the necessary preparations for complying with the requirements under the FATCA, which takes effect on 1 July 2014.

1.6.4 Alliance for Financial Inclusion Activities

The BoZ is a member of the Alliance for Financial Inclusion (AFI) and is represented on the Financial Inclusion Data Working Group (FIDWG), Consumer Empowerment and Market Conduct Working Group (CEMC), Mobile Banking Working Group and the Africa Mobile Phone Initiative (AMPI). In the year under review, it participated in the various AFI activities aimed at developing international best practice in the area of financial inclusion.

1.7 Capacity Building and Skills Development

In 2013, the BoZ continued to expose staff to various training programmes in order to enhance the supervisory capacity of its staff and ensure the effective execution of its oversight mandate. Some of the programmes attended are listed in ***Table 1.2*** below.

Table 1.2: Training Activities and Meetings Attended by Staff

Course/Meeting	Venue and Date
1. Financial Stability Institute and Basel Committee on Banking Supervision eighth high level meeting for Africa.	Cape Town, South Africa, 23-25 January 2013
2. Corporate Governance Seminar.	Lusaka, Zambia, 13 February 2013
3. COMESA Business Council on Financial Sector Development.	Nairobi, Kenya, 19-20 February 2013
4. Basel III Monitoring Workshop.	Basel, Switzerland, 5-7 March 2013
5. Alliance for Financial Inclusion (FIDWG) Meeting.	Manila, Bangkok, 2-9 March 2013
6. FSI-SADC Seminar on the Basel Supervisory Review Process	Pretoria, South Africa, 2-4 July 2013
7. International Investment Forum	Livingstone, Zambia 18-22 August 2013
8. Macro Stress Testing and "Eight Meeting of the Financial System Development and Stability Sub Committee of the Common Market for Eastern and Southern Africa.	Nairobi, Kenya, 20-24 August 2013
9. Risk Based Supervision.	Kuala Lumpur, Malaysia, 8-11 October 2013
10. Crisis Preparedness in Interconnected Markets	Stockholm, Sweden, 30 September – 4 October 2013.
11. Credit Management and Appraisal	Lusaka, Zambia Institute of Bankers and Financial Services, 17-19 July 2013
12. Linkage of Pillar 2 of Basel II to Risk Based Supervision	Mauritius, IMF Africa Regional Technical Assistance South (AFRITAC), 13-15 August 2013
13. International Problem Bank School	Washington DC, The Office of the Controller of the Currency
14. Supervision of NBFIs	Lusaka, Zambia MEMFI, 8-12 April 2013

CHAPTER 2: THE BANKING SECTOR PERFORMANCE AND CONDITION

2.1 Introduction

The overall financial performance and condition of the banking sector for the year ended 31 December 2013 was rated satisfactory (see ***Table 2.1, 2.2 and 2.3***).

As at end-December 2013, the capital adequacy ratios increased to 24.5% for the primary regulatory capital (*minimum requirement: 5%*) and 26.8% for the total regulatory capital (*minimum requirement: 10%*) compared to 19.4% and 21.3% as at end-December 2012, respectively. The higher capital adequacy ratios in 2013 were on account of a significant increase in regulatory capital as a result of the new minimum primary capital requirements introduced by the BoZ in January 2012. The sector's regulatory capital increased both by way of retained earnings and fresh capital injections as banks continued to boost their capital positions ahead of the effective date of 2 January 2014.

In the year under review, the sector's profit before tax (PBT) of K1,292 million and profit after tax (PAT) of K871 million were higher by 8.5% and 24.5%, respectively when compared to K1,191 million and K700 million recorded in 2012, respectively. The improvement in profitability was largely attributed to a proportionately higher increase in net operating income compared to the increase in operating expenses.

The asset quality of the banking sector, as reflected by the quality of the loan book improved. The ratio of gross non-performing loans (NPLs) to total gross loans improved to 7.0% as at end-December 2013 from 8.1% as at end-December 2012, while the ratio of net non-performing loans (NNPL) to net loans also improved to 1.2% as at end-December 2013 from 2.3% as at end-December 2012.

During the period under review, the banking sector's liquidity position remained satisfactory. The liquidity ratio increased to 49.3% as at end-December 2013 from 44.4% as at end-December 2012. The increase in the ratio was on account of a proportionately higher increase in liquid assets of 31.5% compared to an increase in total deposits and other short term liabilities of 19.3%. Further, the liquid asset ratio increased to 38.9% from 36.0% over the same period.

Table 2.1: Composite Ratings of the Banking Sector Financial Performance and Condition

Rating	Number of Banks		% of Total Assets		% of Total Deposits	
	Dec-12	Dec-13	Dec-12	Dec-13	Dec-12	Dec-13
Satisfactory	10	11	85.3	86.0	84.3	85.7
Fair	9	7	14.7	13.2	15.7	13.5
Marginal	0	0	0.0	0.8	0.0	0.0
Unsatisfactory	0	1	0.0	0.0	0.9	0.8
Total	**19**	**19**	**100.0**	**100.0**	**100.0**	**100.0**

Table 2.2: Component Ratings of the Banking Sector Financial Performance and Condition

Rating[1]	Capital Adequacy		Asset Quality		Earnings		Liquidity	
	Dec-12	Dec-13	Dec-12	Dec-13	Dec-12	Dec-13	Dec-12	Dec-12
Satisfactory	18	18	13	12	12	10	10	9
Fair	1	0	5	4	0	2	6	8
Marginal	0	0	1	2	3	4	3	1
Unsatisfactory	0	1	0	1	4	3	0	1
Total	**19**	**19**	**19**	**19**	**19**	**19**	**19**	**19**

Table 2.3: Financial Performance Indicators of the Banking Sector

Indicator (%)	Dec-11	Dec-12	Dec-13
Primary capital adequacy ratio	16.8	19.4	24.5
Total regulatory capital adequacy ratio	19.2	21.3	26.8
Net non-performing loans to regulatory capital	10.2	8.7	3.5
Gross non-performing loans to total loans	10.4	8.1	7.0
Net non-performing loans to total loans	2.4	2.1	1.1
Net non-performing loans to net loans	2.6	2.3	1.2
Provisions to non-performing loans	76.7	73.5	83.2
Earning assets to total assets	81.8	77.7	82.1
Net operating income to total assets	10.9	11.2	10.5
Non-interest expense to total assets	7.4	7.3	6.9
Provision for loan losses to total assets	0.1	0.4	0.5
Net interest income to total assets	6.1	6.1	6.1
Return on assets	3.7	3.9	3.4
Return on equity	25.5	20.8	18.2
Efficiency ratio	68.1	65.5	66.0
Liquid assets to total assets	40.3	36.0	38.9
Liquid assets to deposits and short-term liabilities	48.6	44.4	49.3

1 In the Bank of Zambia Early Warning Rating System, the financial condition and performance of banks and NBFIs is assessed based on several ratios on four main components; which 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.

2.2 Structure of the Banking Sector

As at 31 December 2013, the banking sector comprised 19 commercial banks, and of these, 13 banks were subsidiaries of foreign banks[2], four banks were locally incorporated private banks[3] while two were partly owned by the Government of the Republic of Zambia. However, during the year 2013, six of the foreign owned banks applied to convert to locally owned banks in order to comply with the new minimum capital requirements by 31 December, 2013.

2.3 Banking Sector Balance Sheet Composition

2.3.1 Banking Sector Assets

In the year under review, the total assets of the banking sector increased by 22.4% to K41,953 million as at 31 December 2013 from to K34,276 million as at 31 December 2012. The increase in total assets was mainly on account of an increase in net loans and advances, investments in government securities, placements under the BoZ open market operations (OMO), and balances with financial institutions abroad which went up by K2,260 million (14.5%), K2,203 million (30.5%), K1,680 million (100.0%) and K1,170 million (33.7%), respectively. Overall, the banking sector's total assets continued to depict a positive growth trend over the past 3 years to 31 December 2013, and this growth was made possible largely by the sustained growth in total deposits (see ***Chart 2.1***).

As at end-December 2013, the banking sector's asset structure largely remained unchanged when compared to end-December 2012. The net loans and advances continued to account for the largest portion of the sector's total assets followed by investments in government securities. Net loans and advances which stood at K17,884 million accounted for 42.6% of total assets whilst investments in government securities stood at K9,427 million or 22.5% of total assets (December 2012: 45.6% and million (21.1%), respectively). The other significant assets as at end-December 2013 were balances with BoZ at K5,175 million or 12.3% and balances with financial institutions abroad at K4,647 million or 11.1% of total assets (December 2012: K4,241 million (12.4%) and K3,477 million (10.1%)), respectively.

2.3.2 Banking Sector Liabilities

In the year under review**,** the banking sector's total liabilities increased by 18.9% to K36,051 million as at end-December 2013 from K30,311 million recorded as at end-December 2012. The increase was mainly on account of a 22.8% rise in total deposits to K30,907 million (December 2012: K25,162 million). This increase was mainly driven by demand and time deposits, which increased by 18.6% and 32.9%, respectively. On the other hand, the sector's aggregate balances due to financial institutions abroad declined by 26.8% to close the year 2013 at K1,486 million from K2,030 million as at end-December 2012.

The banks continued to rely on customer deposits as the primary source of their funding and constituted 85.7% of the sector's total liabilities (December 2012: 83.0%). Of these, demand deposits accounted for the largest share of the banking sector's total deposits at K18,891 million or 61.1% (December 2012: K15,934 million or 63.3%). Time deposits followed at

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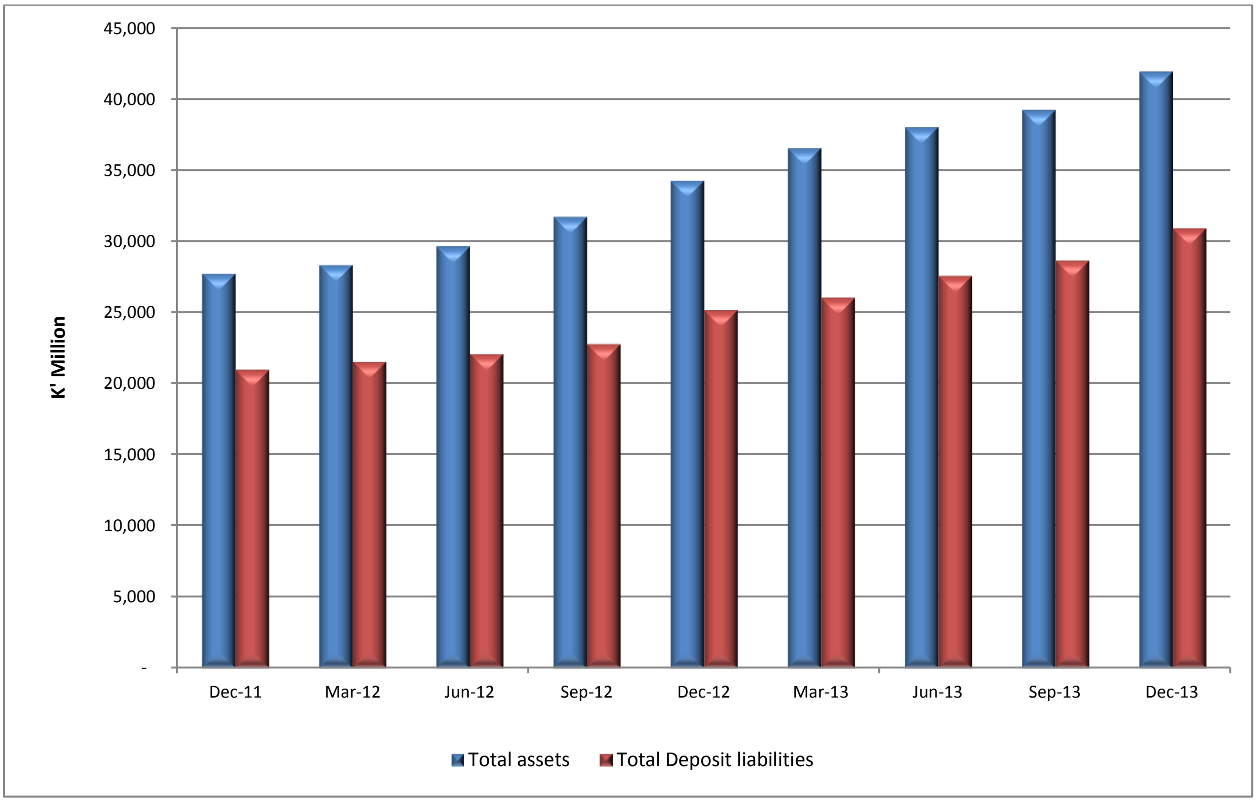
2 These are locally incorporated subsidiaries of foreign banks.

3 Banks incorporated locally which are neither subsidiaries of foreign banks nor partly owned by Government.

K7,718 million or 25.0% (December 2012: K5,806 million or 23.1%), and savings deposits at K4,298 million or 13.9% (December 2012: K3,422 million or 13.6%). The pre-dominance of demand deposits, which accounts for the largest share of the core deposits, was an indication of continued stability in the sector's deposit base.

Chart 2.1: Total Assets and Liabilities of the Banking Sector (2011-2013)



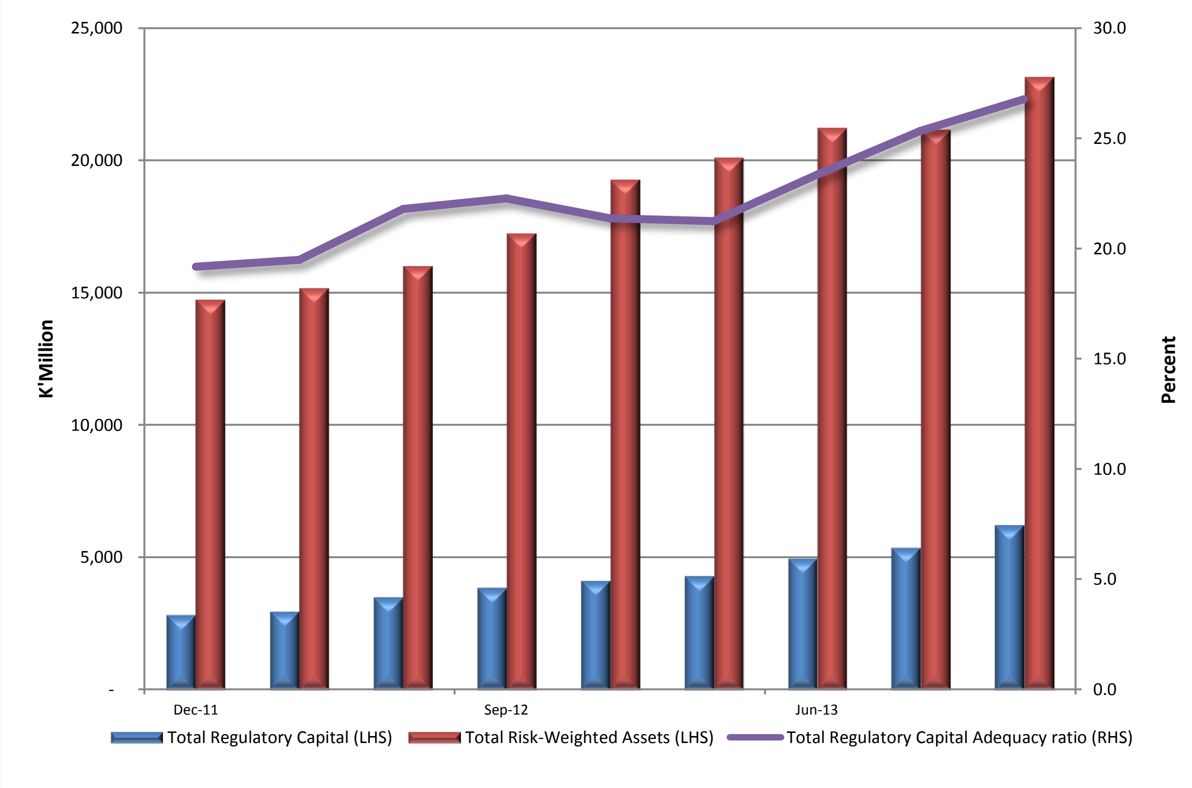
2.4 Capital Adequacy

As at end-December 2013, the aggregate capital adequacy position of the banking sector was rated satisfactory as indicated by the high capital adequacy ratios. The primary regulatory capital increased by 50.4% to K5,657 million (December 2012: K3,761 million) mainly on account of an increase in paid-up common shares and retained earnings. Paid-up common shares, which accounted for 63.6% of primary regulatory capital as at 31 December 2013, increased by 34.5% while retained earnings increased by 94.5% to K3,595 million and K1,144 million, respectively. The increase in regulatory primary capital was largely driven by the BoZ's new capital adequacy requirements which increased the minimum nominal primary capital from K12 million to K104 million and K520 million for locally owned and foreign owned banks respectively, of which 80% must be in the form of paid-up common shares.

Further, total regulatory capital increased by 50.5% to K6,201 million as at end-December 2013. This increase was also partly on account of an injection of subordinated term debt of K190 million in Tier 2 capital. On the other hand, the banking sector's total risk-weighted assets (RWA) increased by K3,751 million (19.4%) to K23,114 million (December 2012: K19,363 million), mainly on account of an increase in net loans and advances and off-balance sheet items.

As a result of a relatively higher increase of 50.4% and 50.5% in primary and total regulatory capital, respectively, compared to an increase in RWA of 19.4%, the banking sector's capital adequacy ratios increased to 24.5% and 26.8% as at end-December 2013 for the primary and total regulatory capital, respectively from 19.4% and 21.3%, respectively as at end-December 2012 (see ***Chart 2.2***). On a bank by bank basis, all banks except one, met the minimum capital requirements as at end-December 2013.

Chart 2.2: Regulatory Capital, RWA and Capital Adequacy Ratio (2011-2013)



The banking sector's resilience improved as implied by the ratio of net NPLs to total regulatory capital which decreased by 5.2 percentage points to 3.5% as at end-December 2013 from 8.7% as at end-December 2012. The reduction in the ratio was an indication of the sector's increased capacity to absorb unexpected loan losses.

In addition, the banking sector's risk profile improved as reflected by the drop of 3.1 percentage points in the RWA to total assets ratio to 55.1% as at end-December 2013 (December 2012: 58.2%). Further, the RWA to total assets ratio of 55.1% implied that banks continued to keep just slightly less than half (i.e. 44.9%) of their total assets in lower credit-risk assets *(*see ***Table 2.4****).*

Table 2.4: Asset Risk Profile

Asset Type and Risk-Weight Categories	2011	2012	2013
20 percent risk-weight (% of RWA)	**10.1**	**6.7**	**6.8**
Balances with banks	66.3	54.5	64.5
Investments in Government bonds	31.2	40.6	33.8
Inter-bank loans and advances	2.4	4.8	1.4
Assets in transit	0.1	0.1	0.2
Sub-total	*100.0*	*100.0*	*100*
50 percent risk-weight (% of RWA)	**5.5**	**6.1**	**7.8**
Loans and advances	97.1	99.5	97.9
Assets in transit	2.9	0.5	2.1
Sub-total	*100.0*	*100.0*	*100*
100 percent risk-weight (% of RWA)	**75.5**	**78.6**	**72.3**
Loans and advances	80.6	82.5	83.2
Inter-bank loans and advances	0.0	0.0	0.0
All other assets	19.5	21.4	16.8
Sub-total	*100.0*	*100.0*	*100*
Off-balance sheet items (% of RWA)	**8.8**	**8.3**	**13.1**
20 percent risk-weight	14.6	6.6	6.8
50 percent risk-weight	29.8	17.5	10.3
100 percent risk-weight	55.6	75.9	82.9
Sub-total	*100.0*	*100.0*	*100*
Total risk-weighted assets (RWA)	**100.0**	**100.0**	**100**
Total risk-weighted assets to total assets	**53.2**	**58.2**	**55.1**

2.5 Earnings Performance and Profitability

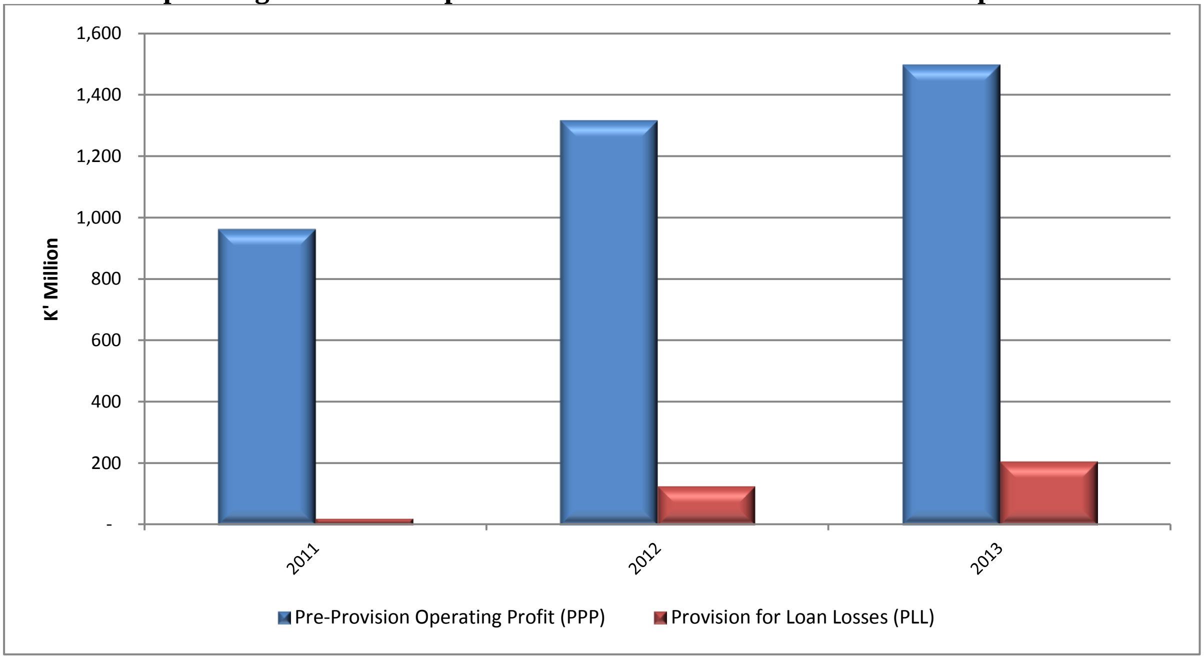
The earnings performance of the banking sector was rated satisfactory. When compared on a year by year basis, the sector posted a PBT of K1,292 million, which was 8.5% higher than the K1,191 million recorded in 2012, and a PAT of K872 million which was also 24.5% higher than the K700 million recorded in 2012. The increase in profitability in the year under review was mainly attributed to a higher increase in net operating income of K583 million compared to an increase in operating expenses of K482 million. The increase in net operating income was mainly on account of net interest income which increased by K439 million (20.8%) while non-interest income modestly increased by K144 million (8.4%). On the other hand, the increase in operating expenses was mainly on account of salaries and employee benefits which increased by K210 million (16.2%) while the provision for loan loss expenses also increased by K80 million (63.1%).

Despite the increase in the provision for loan losses, the loan loss-absorbing capacity of the banking sector as reflected by the pre-provision operating profit (PPP) (*i.e. gross profit before charging provision for loan losses*) also increased. At K1,498 million, the PPP was higher by K181 million (13.7%) compared to K1,317 million reported in the preceding year (see ***Table 2.5*** and ***Chart 2.3***).

Table 2.5: Summarized Income Statement

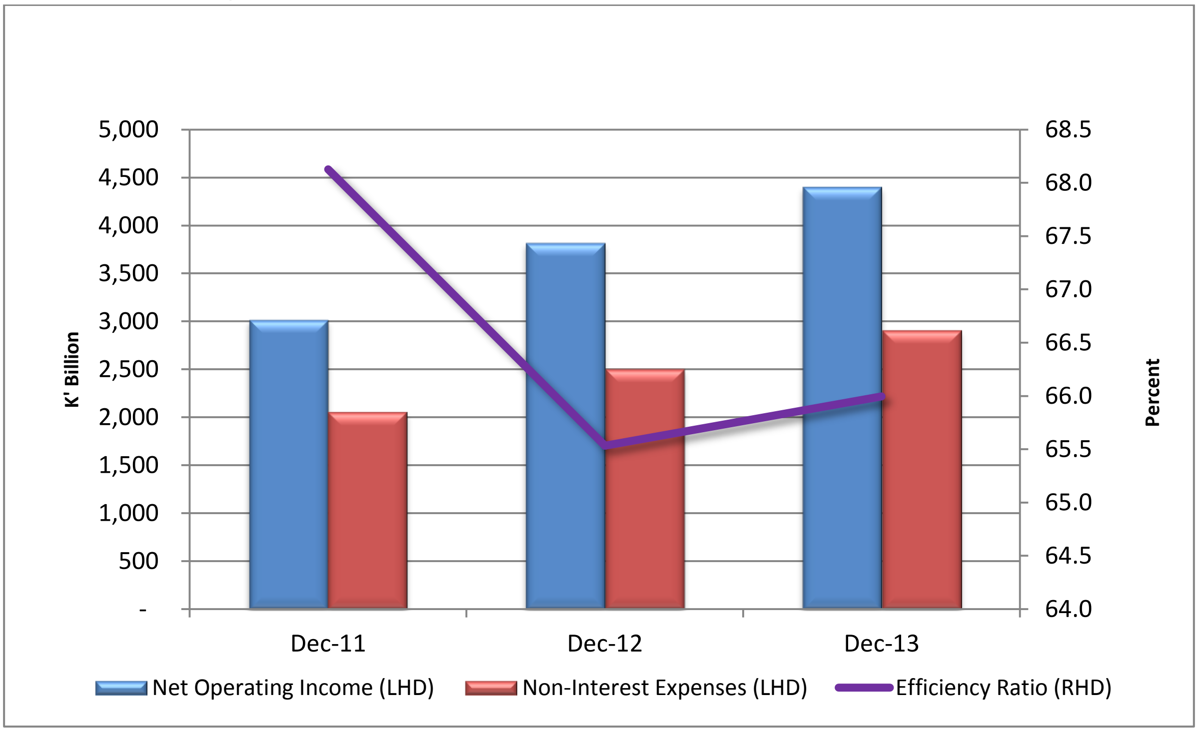
Particulars	**2011 K' million**	**2012 K' million**	**2013 K' million**
Interest Income	2,145	2,724	3,387
Interest Expenses	(450)	(619)	(845)
Net Interest Income	**1,694**	**2,104**	**2,543**
Non-Interest Income	1,327	1,718	1,862
Net Operating Income	**3,021**	**3,822**	**4,405**
Non-Interest Expenses	(2,058)	(2,505)	(2,907)
Pre-Provision Operating Profit (PPP)	**963**	**1,317**	**1,498**
Loan Loss Provisions	(21)	(126)	(206)
Profit Before Taxation	**942**	**1,191**	**1,292**
Taxation	(331)	(491)	(420)
Net Profit	**611**	**700**	**872**

Chart 2.3: Operating Profit before provisions and Provision for Loan Loss Expenses



The banking sector's operational efficiency deteriorated marginally to 66.0% in 2013 from 65.5% in 2012 (see ***Chart 2.3***) as a result of a proportionately lower increase in net operating income of 15.3% compared to the increase in non-interest expenses of 16.1%.

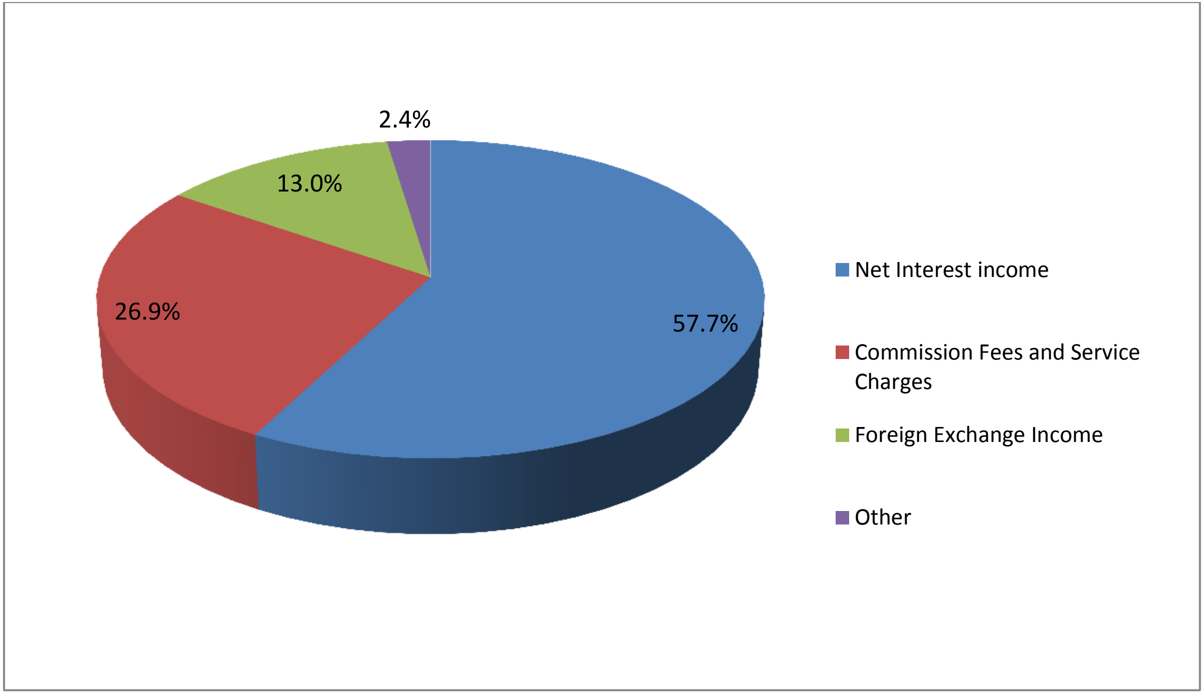
2.4: Net Operating Income, Non-interest Expenses and Efficiency Ratio (2011-2013)



Overall, the banking sector's profitability, as measured by the RoA dropped to 3.4% as at 31 December 2013 from 3.9% as at end-December 2012, while the RoE [4] decreased to 18.2% as at end-December 2013 from 20.8% as at end-December 2012. The decrease in RoA and RoE was largely on account of a proportionately higher increase in total assets and equity compared to an increase in profit before tax (PBT) and profit after tax (PAT), respectively.

The sector's principal source of income was net interest income which constituted 57.7% of the total net operating income (see ***Chart 2.5***).

Chart 2.5: Composition of Net Operating Income for the Banking Sector (2013)



4 **ROA** and **ROE** are computed based on the 12 month moving average.

2.6 Asset Quality

2.6.1 Level of Non-Performing Loans

Asset quality of the banking sector was satisfactory with the ratio of NPLs to total gross loans as at end-December 2013 declining to 7.0% from 8.1% as at end-December 2012.

Gross loans and advances increased by 14.2% to K18,980 million as at end-December 2013 from K16,616 million as at end-December 2012. On the other hand, gross NPLs decreased by 2.1% to K1,321 million as at end-December 2013 from K1,350 million as at end-December 2012. As a result of the increase in gross loans coupled with a reduction in gross NPLs, the gross NPL ratio registered a decrease of 1.1 percentage points to 7.0% as indicated earlier (see ***Table 2.6***). Further, the gross NPLs to total assets improved to 3.1% from 3.9% as at end-December 2012 while the net NPL ratio[5] improved to 1.2% as at end-December 2013 from 2.3% as at end-December 2012.

Table 2.6: Gross Loans and Non-Performing Loans

Item/year	**2011**	**2012**	**2013**
Gross loans (K' million)	**11,979**	**16,617**	**18,980**
NPLs (K' million)	**1,243**	**1,350**	**1,321**
Substandard	81	123	104
Doubtful	243	120	106
Loss	919	1,107	1,111
NPL ratio (%)	10.4	8.1	7.0

[5] Net NPL ratio is the ratio of non-performing loans that have not been provided for to net loans (loans net of Allowance for Loan Losses)

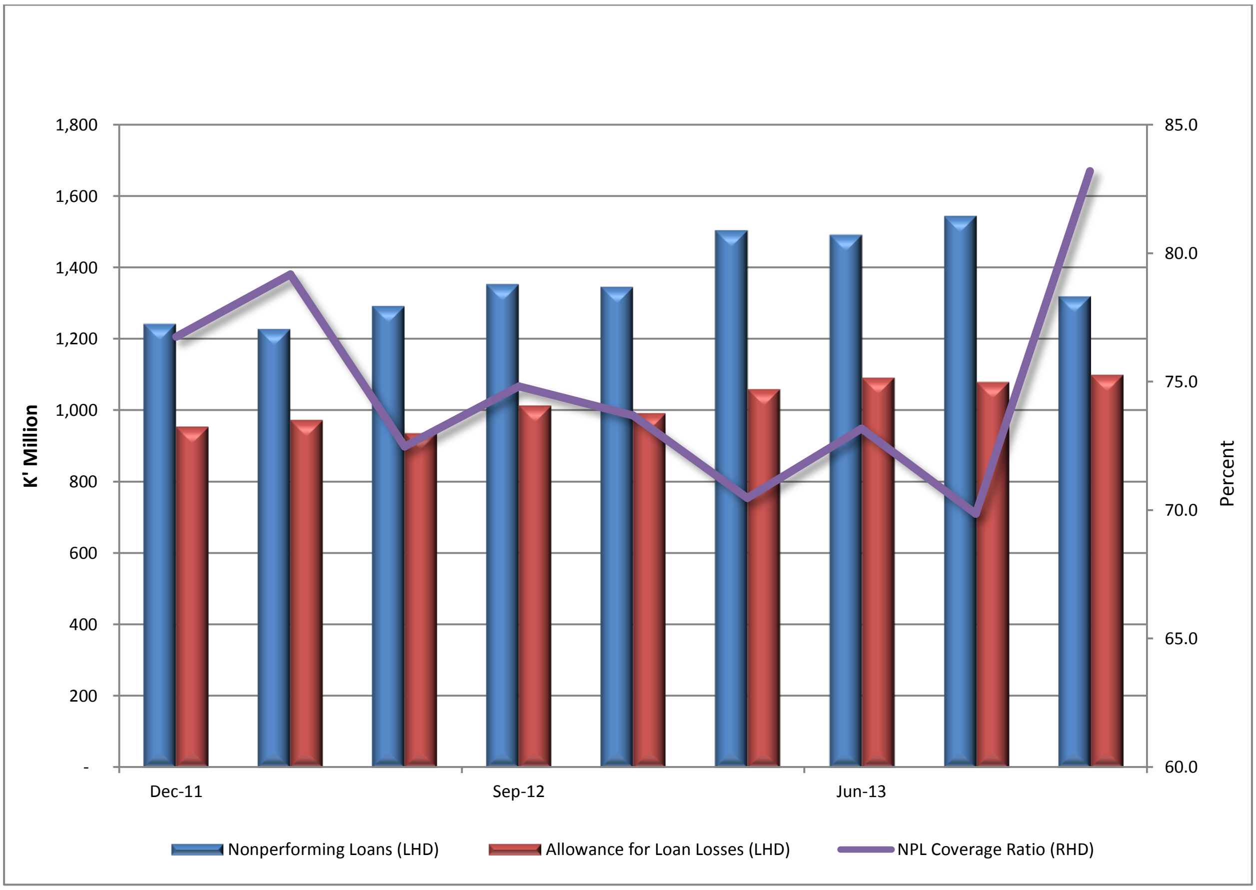
2.6.2 Loss-Absorbing Capacity

The banking sector continued to be resilient and its loss absorption capacity enhanced as the allowance for loan losses (ALL) increased by 10.7% to K1,099 million as at end-December 2013 from K992 million as at end-December 2012.

The decline in gross NPLs coupled with an increase in the ALL resulted in an increase in the NPL coverage ratio[6] by 9.7 percentage points to close the year 2013 at 83.2% from 73.5% recorded as at end-December 2012, indicating an improvement in the reserve for expected loan losses (see ***Chart 2.6***). Similarly, the minimum regulatory allowance for loan losses increased to 92.5%, from 83.3% over the same period.

Additionally, the ratio of net NPLs to total regulatory capital, a measure of the potential impact of NPL related losses on bank capital, significantly reduced to 3.5% as at end-December 2013 from 8.7% as at end-December 2012, implying that there was an improvement in the absorption capacity for unexpected loan losses in the banking sector.

Chart 2.6: Non-Performing Loans, Provisions and NPL Coverage Ratio (2011-2013)



6 **NPL Coverage ratio** is the proportion of the gross NPLs covered by the allowance for loan losses (ALL) [i.e., PLL/NPLs].

2.6.4 Sectoral Distribution of Loans

The banking sector's lending continued to be dominated by 'personal loans' which accounted for the largest share of the total loans and advances at 33.2% followed by the 'agriculture, forestry, fishing and hunting' sector at 20.2%. The 'manufacturing' sector was the third largest at 9.5% while the 'wholesale and retail trade' sector accounted for 9.1% of the industry's total credit (see ***Table 2.7***).

With regard to the distribution of NPLs by economic sector, personal loans contributed the largest share to the industry's total NPLs at 21.4% followed by the 'construction', 'agriculture, forestry, fishing and hunting', and 'wholesale & retail trade' sectors at 18.4%, 10.8% and 9.8% respectively (see ***Table 2.8***).

As regards the loss experience by economic sector, the 'construction' sector was the worst performing sector with the highest NPL ratio of 37.1%. Other sectors with significant NPLs included the 'restaurant and hotels' and the 'transport, storage and communications' sectors whose intra-sector NPL ratios were 33.7% and 13.9%, respectively. Nonetheless, the two sectors' contribution to the banking sector's total loans and advances were insignificant at 1.6% and 4.5%, respectively (see ***Table 2.9***).

Table 2.7: Banking Sector Sectoral Distribution of Loans (2011-2013)

Sector	2011	2012	2013
Agriculture, forestry, fishing and hunting	17.9	23.2	20.2
Mining and quarrying	4.3	5.8	6.6
Manufacturing	12.4	11.6	9.5
Electricity, gas, water and energy	1.7	2.1	1.7
Construction	4.4	3.8	3.5
Wholesale and retail trade	10.5	6.8	9.1
Restaurants and hotels	1.9	2.0	1.6
Transport, storage and communication	5.4	4.7	4.5
Financial services	5.2	1.9	2.1
Personal loans	29.0	34.4	33.2
Other sectors	7.3	3.7	8.0
Total	**100.0**	**100.0**	**100.0**

Source: Bank of Zambia

Table 2.8: Banking Sector Sectoral Distribution of NPLs (2011-2013)

Sector	2011	2012	2013
Agriculture, forestry, fishing and hunting	15.7	12.9	10.8
Mining and quarrying	6.8	5.9	5.3
Manufacturing	14.7	12.5	6.3
Electricity, gas, water and energy	0.2	0.2	0.3
Construction	15.8	18.5	18.4
Wholesale and retail trade	7.4	6.7	9.8
Restaurants and hotels	3.2	4.0	7.5
Transport, storage and communication	5.5	9.0	8.7
Financial services	1.2	1.9	1.2
Personal loans	15.0	14.8	21.4
Other sectors	14.5	13.6	10.3
Total	**100.0**	**100.0**	**100.0**

Source: Bank of Zambia

Table 2.9: Intra-sector NPL Ratio (2011-2013)

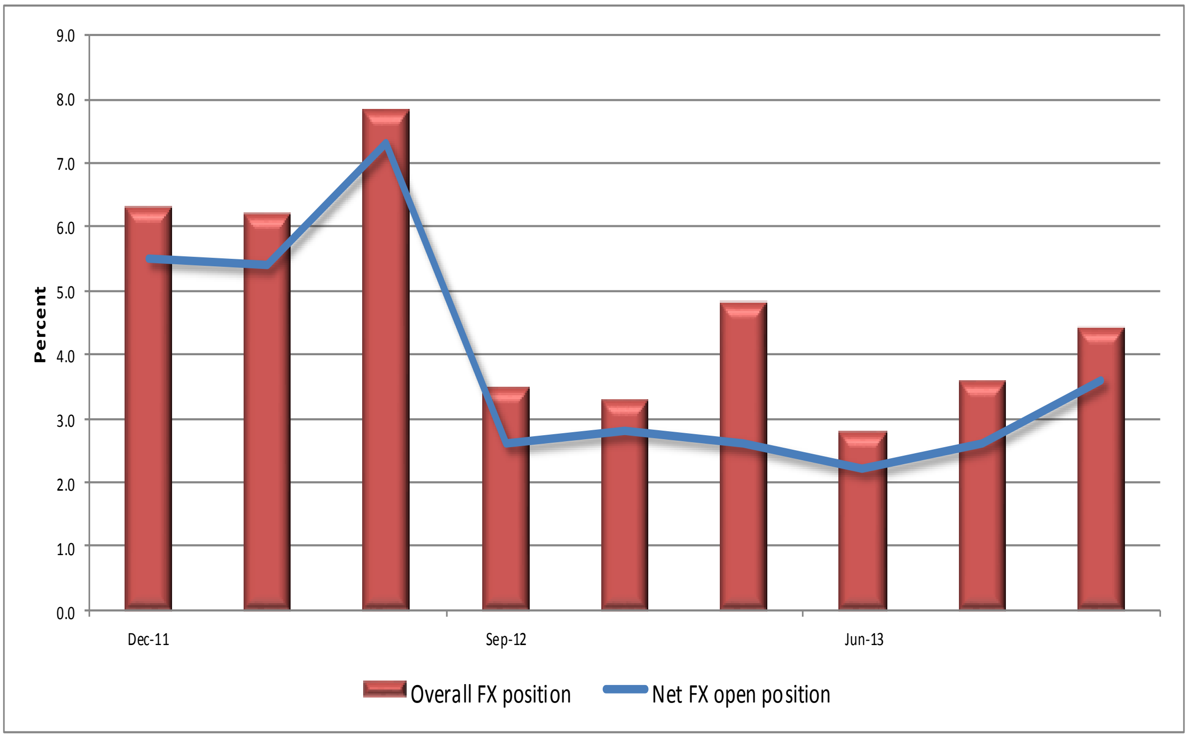
Sector	2011	2012	2013
Agriculture, forestry, fishing and hunting	9.1	4.6	3.8
Mining and quarrying	17.5	8.4	5.7
Manufacturing	12.1	9.0	4.8
Electricity, gas, water and energy	1.9	1.0	1.2
Construction	28.0	40.3	37.1
Wholesale and retail trade	7.3	8.2	7.7
Restaurants and hotels	19.4	16.9	33.7
Transport, storage and communication	10.5	16.1	13.9
Financial services	3.1	8.5	4.2
Personal loans	7.1	4.6	5.3

Source: Bank of Zambia

2.7 Sensitivity to Market Risk

The sector's exposure to movements in foreign exchange rates remained low in 2013. The net foreign exchange position to total regulatory capital marginally increased to 3.6% as at end-December 2013 from 2.8% as at end-December 2012, indicating a moderate increase in foreign exchange risk. In addition, the overall foreign currency exposure increased to 4.4% from 3.3% over the same period. Despite the increase, the overall exposure to regulatory capital ratio remained well below the regulatory limit of 15.0% (see ***Chart 2.7***).

Chart 2.7: Net Foreign Exchange Position and Overall Foreign Currency Exposure to Capital



2.8 Funding and Liquidity Risk

The banking sector's growth was mainly funded by customer deposits, of which demand deposits continued to dominate at 75.0% as at end-December 2013, dropping slightly from 76.9% recorded at end-December 2012. However, asset funding from borrowings continued to be insignificant and declined to 4.6% from 6.9% as at end-December 2012 (see ***Table 2.10 below***).

During the year under review, the banking sector continued to be characterized by high levels of liquidity as evidenced by an upward trend in both the liquidity ratio and the liquid assets ratio. The liquidity ratio remained high throughout the year and stood at 49.3% as at end-December 2013 from 44.4% as at end-December 2012. The increase was on account of a higher percentage increase in liquid assets which went up by 31.5% compared to a 19.3% increase in deposits and short-term liabilities. In addition, the proportion of liquid assets to total assets increased to 38.9% from 36.0% over the same period. The increase in liquid assets mainly emanated from banks' increased investment in Treasury bills and balances with foreign banks, which went up by 46.1% and 33.7% respectively. In addition, OMO deposits stood at K1,680 million as at end-December 2013 from a nil balance as at end-December 2012 (see ***Chart 2.8 below***). The total liquid assets continued to be dominated by Treasury bills and balances with financial institutions abroad at 41.4% and 28.6%, respectively as at end-December 2013 compared to 37.2% and 28.1%, respectively as at end-December 2012 (see ***Table 2.11 below***).

Further, there was a decrease of 4.6 percentage points in the loan-to-deposit ratio to close the year at 61.4% from 66.0% as at end-December 2012, an indication of the banking sector's capacity to fund loan growth from stable and relatively low cost deposit liabilities. The decrease in the ratio was on account of the proportionately higher growth in deposits compared to the growth in gross loans (see ***Chart 2.9 below***).

Table 2.10: Banking Sector Funding of Assets (percentage of total assets)

	Dec-2011	Dec-2012	Dec-2013
	%	%	%
Deposits	75.6	73.4	73.7
Borrowings	9.8	6.9	4.6
Capital	9.8	11.6	14.1

***Source*: Bank of Zambia**

Chart 2.8: Banking Sector Liquidity Condition

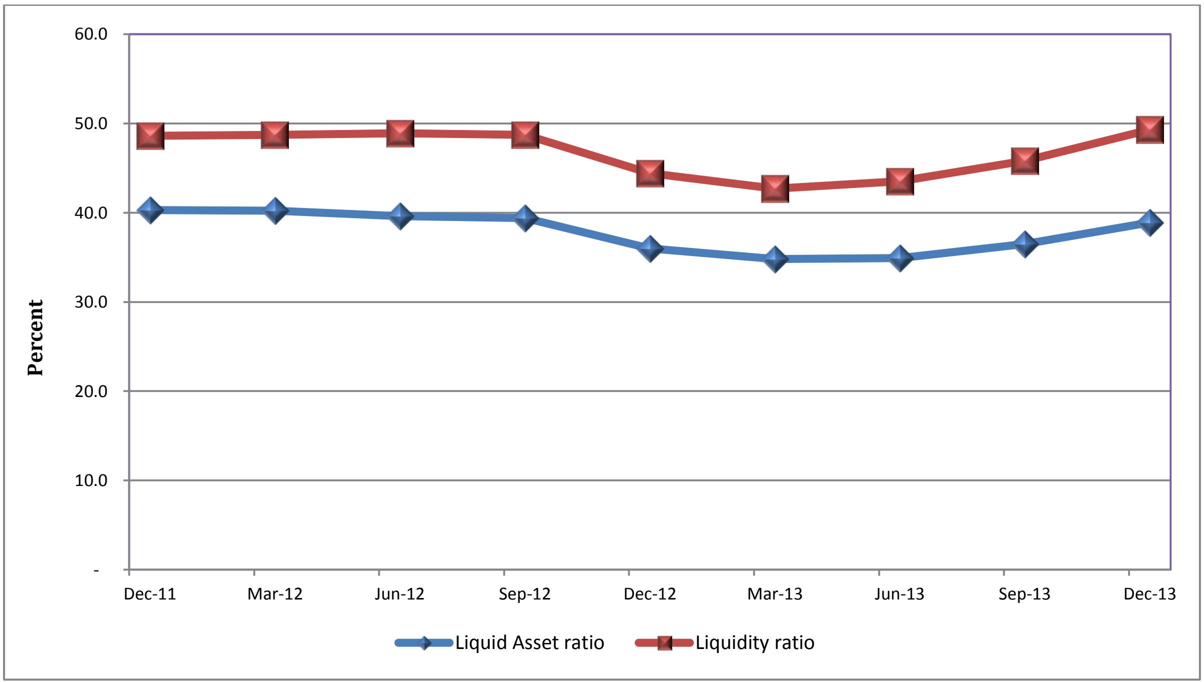


Chart 2.9: Deposits, Loans and Loan-to-Deposit Ratio

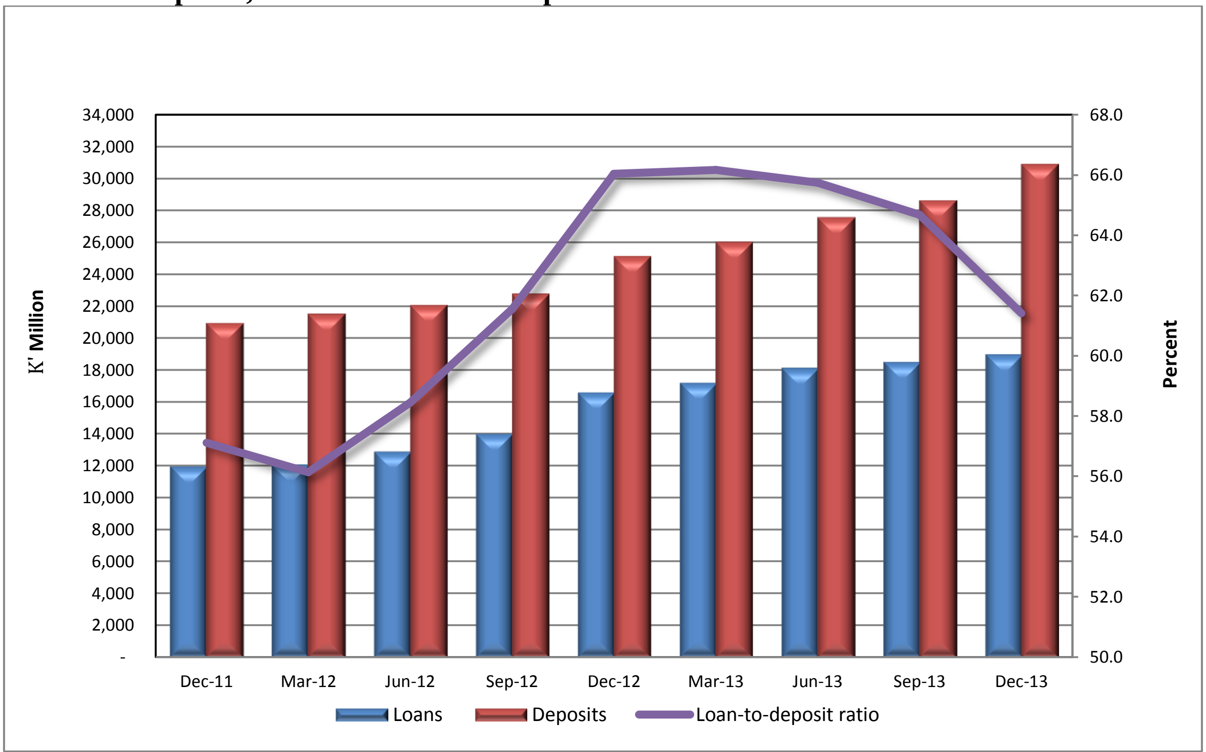


Table 2.11: Composition of Liquid Assets (K' million)

	Dec-2011	Dec-2012	Dec-2013
Cash and balances with domestic banks	2,014	3,974	2,846
Balances with foreign institutions	4,673	3,477	4,647
BOZ securities (OMO)	0	0	1,680
Treasury bills	4,331	4,603	6,724
Government bonds (6 months to maturity)	161	304	358
Total liquid assets	**11,179**	**12,357**	**16,255**

***Source*: Bank of Zambia**

2.9 Market Share

2.9.1 Market Share and Performance Indicators Bank by Bank

Based on the proportion of the total assets, total loans and total deposits, Zambia National Commercial Bank Plc (ZANACO), Stanbic Bank Zambia Limited, Standard Chartered Bank Plc, and Barclays Bank Plc continued to dominate the banking sector's market share. In terms of asset and deposit size, the four banks accounted for 58.0% and 60.3% of the sector's totals compared to 61.5% and 61.7%, respectively as at end-December 2012. The banks that accounted for the largest portion of the industry's total PBT in order of significance were Standard Chartered Bank Plc (28.3%), Zambia National Commercial Bank Plc (17.3%), Stanbic Bank Zambia Ltd (15.1%), Barclays Bank Plc (10.9%) and Citibank Zambia Ltd (9.5%) (see ***Table 2.12)*** below.

Table 2.12:Commercial Banks' Market Share and Performance Indicators as at 31 December 2013

Bank	Percentage of assets	Percentage of deposits	Percentage of loans	Profit before tax (K' m)	Return on Assets (%) (pre-tax)	Return on Equity (%)	Total Regulatory Capital Ratio
ZANACO	16.3	17.1	16.2	224	3.7	24.6	19.9
Stanbic	15.0	15.6	17.9	195	3.2	19.6	21.8
StanChart	13.4	13.8	15.4	366	6.7	35.6	22.1
Barclays	13.3	13.8	16.9	141	2.6	15.1	15.3
Bank of China	7.2	7.5	1.4	53	2.0	11.1	105.1
Finance Bank	5.6	6.3	5.0	108	5.0	28.9	25.2
Citibank	5.5	4.8	1.6	123	6.0	15.8	94.3
First National	5.0	4.6	6.6	(10)	(1.1)	14.9	39.0
Indo-Zambia	4.7	4.9	4.8	57	3.1	12.3	25.4
BancABC	3.3	1.5	4.3	57	5.5	28.4	56.8
Investrust	3.2	3.3	4.0	13	1.1	10.2	14.1
Ecobank	2.0	1.9	1.4	(7)	(1.6)	(7.0)	35.6
Cavmont	1.3	1.4	1.2	(27)	(4.5)	(33.8)	24.7
United Bank	1.0	0.5	0.3	(13)	(6.7)	(45.5)	56.8
First Alliance	0.9	0.7	1.1	24	5.5	11.4	42.5
Access Bank	0.9	1.0	0.5	(4)	(1.2)	(11.8)	14.7
Intermarket	0.7	0.8	0.8	10	3.1	37.8	(5.0)
First Capital	0.5	0.4	0.4	(9)	(5.9)	(24.4)	69.3
AB Bank	0.1	0.0	0.1	(10)	(22.2)	(57.5)	50.5
Total/Weighted average	**100.0**	**100.0**	**100.0**	**1,292**	**3.4**	**18.2**	**26.8**

Source: Bank of Zambia

2.9.2 Market share: Assets, Loans, Deposits and Profits by Ownership type

Foreign owned banks [7] (13) continued to dominate the banking sector's market share in terms of assets, loans and deposits. These were followed by banks partly owned by Government (2)[8] and then lastly locally incorporated private banks (4)[9]. Further, the distribution of PBT by type of ownership indicated that subsidiaries of foreign banks accounted for the largest share of the sector's total PBT, followed by banks partly owned by Government (see ***Table 2.13 below***).

Table 2.13: Distribution of the Banking Sector's Assets, Loans[10] and Deposits by Ownership Type

	2011				2012				2013			
	Assets	**Loans**	**Deposits**	**PBT**	**Assets**	**Loans**	**Deposits**	**PBT**	**Assets**	**Loans**	**Deposits**	**PBT**
	%	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Subsidiaries of foreign banks	69.0	67.7	68.5	67.4	66.7	65.4	65.8	64.1	67.9	67.6	66.2	71.3
Banks with Government stake	21.3	21.4	20.8	25.2	21.8	21.6	21.8	24.1	21.0	21.1	22.0	21.5
Local private banks	9.8	10.9	10.7	7.4	11.5	13.0	12.5	11.8	11.0	11.4	11.8	7.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank of Zambia

2.10 Delivery Channels: Bank Branches, Agencies and Automated Teller Machines

In the year under review, there was an increase in the banking sector's physical delivery channels (i.e., bank branches, agencies and automated teller machines (ATMs)). The number of branch and agency locations increased to 345 as at end-December 2013 from 314 as at end-December 2012; while the number of ATMs increased to 724 from 629 over the same period.

Three banks namely; Zambia National Commercial Bank Plc, Barclays Bank Zambia Plc. and Finance Bank Zambia Limited, accounted for the largest share of the banking sector branch network at 66, 54 and 53 as at end-December 2013 compared with 63, 54, and 51 as at end-December 2012 , respectively (see ***Table 2.14 below***). In terms of the geographical dispersion of the branch network, Lusaka Province had the highest number of branches at 130 branches as at end-December 2013 (December 2012: 123 branches), followed by the Copperbelt Province at 77 branches (December 2012: 67 branches) and the Southern Province at 41 branches (December 2012: 40 branches). The 3 provinces accounted for 71.9% of the total banking sector branch network (December 2012: 73.2%) (see ***Appendix 3***).

7 These are locally incorporated subsidiaries of foreign banks.

8 Banks which are partly owned by the Government of the Republic of Zambia.

9 Other banks incorporated locally which are neither subsidiaries of foreign banks nor partly owned by Government.

10 Net loans.

Table 2.14: Banking Sector Physical Delivery Channels (2011-2013)

Bank	No. of Branches 2011	No. of Branches 2012	No. of Branches 2013	No. of ATMs 2011	No. of ATMs 2012	No. of ATMs 2013
AB Bank Zambia	1	3	4	0	0	0
Access Bank Zambia	5	5	5	7	7	4
BancABC Zambia	6	11	15	0	0	15
Bank of China Zambia	2	2	2	0	0	0
Barclays Bank Zambia	54	54	54	150	150	148
Cavmont Bank	15	15	15	0	0	0
Citibank	2	2	2	0	0	0
Ecobank Zambia	4	5	8	0	16	32
Finance Bank	49	51	53	63	66	88
First Alliance Bank	4	4	4	0	0	0
First National Bank	6	9	12	22	43	61
Indo Zambia Bank	15	18	25	24	27	33
Intermarket Bank	4	7	7	5	6	8
International Commercial Bank Zambia	2	2	3	0	2	3
Investrust Bank	18	19	23	25	33	47
Stanbic Bank Zambia	18	19	22	61	63	66
Standard Chartered Bank	19	21	21	36	45	45
United Bank for Africa	3	4	4	0	4	4
ZNCB	59	63	66	144	167	170
Total	**286**	**314**	**345**	**537**	**629**	**724**

Source: Bank of Zambia

2.11 The Banking Sector Outlook

The overall financial performance and condition of the banking sector in 2014 is expected to remain satisfactory. Expectations are that the capital adequacy ratios will increase on account of retained earnings and fresh capital injections for the banks that are yet to meet the new minimum capital requirements. Asset quality and liquidity will remain satisfactory, while earnings performance is expected to remain strong and stable. The strong earnings performance is likely to be on account of the increased capital base on which banks will leverage on and increase their earning assets base in order to remain in line with their shareholders' expected rate of returns.

CHAPTER 3: THE NON-BANK FINANCIAL INSTITUTIONS SECTOR (NBFIs)

3.1 Overview of the Financial Performance and Condition of the NBFIs

The overall financial performance and condition of the NBFIs sector was satisfactory in the year under review. The sector's regulatory capital and asset quality were satisfactory while profitability was fair. In terms of the NBFI sub-sectors, leasing finance institutions, and development finance institutions reported satisfactory regulatory capital, asset quality, earnings performance and liquidity position. On the other hand, the building societies reported satisfactory regulatory capital, fair asset quality and liquidity while the earnings performance was marginal. The enterprise-lending microfinance institutions (MFIs) also reported satisfactory regulatory capital, fair asset quality and marginal earnings performance whereas the consumer-lending MFIs were adequately capitalised with satisfactory asset quality and earnings performance.

However, six institutions, accounting for 12.1% of the sector's total assets had regulatory capital deficiencies as at end-December 2013 and were under close monitoring by the BoZ.

Eight institutions accounted for 33.9% of the sector's total assets and were rated strong, while 32 which accounted for 46.0% were rated satisfactory. Further, 37 institutions and 21 institutions were rated fair and marginal, respectively. The remaining six which accounted for 12.1% were rated unsatisfactory on account of regulatory capital deficiency (see ***Table 3.1***).

Table 3.1: Performance and Financial Condition of the NBFIs Sector, 2011 - 2013

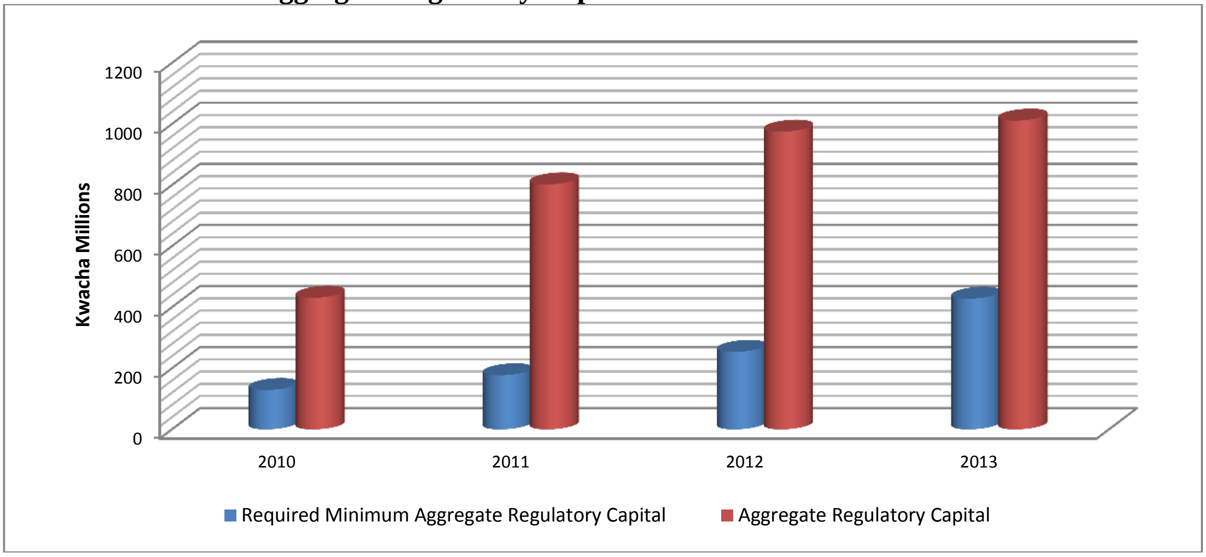
Performance Rating	Licence Type	Number of Institutions			% of Total Assets for 2013
		2011	2012	2013	
Strong	Deposit-taking	2	2	2	9.9%
	Non-Deposit-taking	7	7	6	24.0%
Satisfactory	Deposit-taking	3	3	3	15.5%
	Non-Deposit-taking	29	29	29	30.5%
Fair	Deposit-taking	6	6	5	1.4%
	Non-Deposit-taking	30	26	32	3.7%
Marginal	Deposit-taking	1	1	2	2.2%
	Non-Deposit-taking	5	6	19	0.6%
Unsatisfactory	Deposit-taking	1	1	5	0.6%
	Non-Deposit-taking	4	3	1	11.5%
Total		88	84	103[11]	100%

3.1.1 Capital Adequacy

The sector's capital adequacy was satisfactory. The total regulatory capital increased by 3.9% to K1,011.1 million as at end-December 2013 from K973.3 million as at 31 December 2012. The increase in the regulatory capital was largely due to a PAT of K35.4 million recorded during the year under review (see ***Chart 3.1***).
Despite the increase in the regulatory capital, the capital adequacy ratio declined to 22.6% as at end-December 2013 from 38.4% as at end-December 2012 on account of a proportionately higher increase in the RWA.

[11] The total number of licensed NBFIs was 114. Out of the 114, 3 MFIs, six bureaux de change, 1 building society and 1 financial business had not yet started operations as at the reporting date. The other institution is a credit reference bureau that is not required to submit prudential returns.

Chart 3.1: Trend in Aggregate Regulatory Capital of the Non-Bank Financial Institutions.



3.1.2 Asset Quality

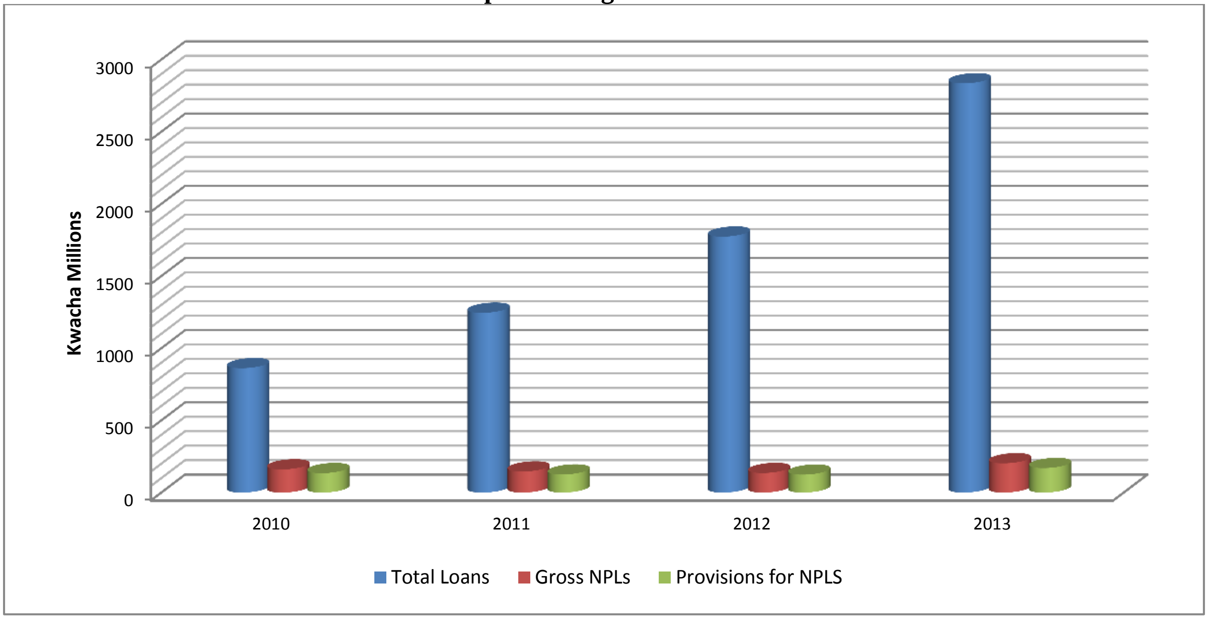
Asset quality was satisfactory at end-December 2013 as the NPLs ratio at 7.2% was below the maximum prudential limit of 10%. This was an improvement from 7.8% at previous year-end, largely on account of a proportionately higher increase in gross loans of 59.9% compared to the increase in gross NPLs of 33.2% (see ***Chart 3.2***).

Despite an increase by 36.6% in the allowance for loan losses to K169.8 million from K124.3 million as at end-December 2012, the NPL coverage ratio marginally declined to 83.6% from 91.7% as at end-December 2012. The decline in the ratio was on account of a proportionately higher increase of 33.2% in gross NPLs compared to an increase of 26.8% in the allowance for loan losses. However, the coverage ratio was still within the satisfactory range of 80-90%.

Meanwhile, the total assets of the sector increased by 34.8% to K3,941.5 million from K2,924.4 million as at end-December 2012. The increase was mainly noticeable in the gross loans which went up by 59.9% to K2,835.5 million as at end-December 2013 from K1,773.5 million as at end-December 2012. Most NBFIs expanded their loan portfolios during the year under review in order to compensate for reduced interest margins following the introduction of interest rate caps at the beginning of 2013.

Net loans and advances amounted to K2,628.4 million and accounted for 66.8% of total assets compared to K1,707.4 million (58.4%) as at end-December 2012.

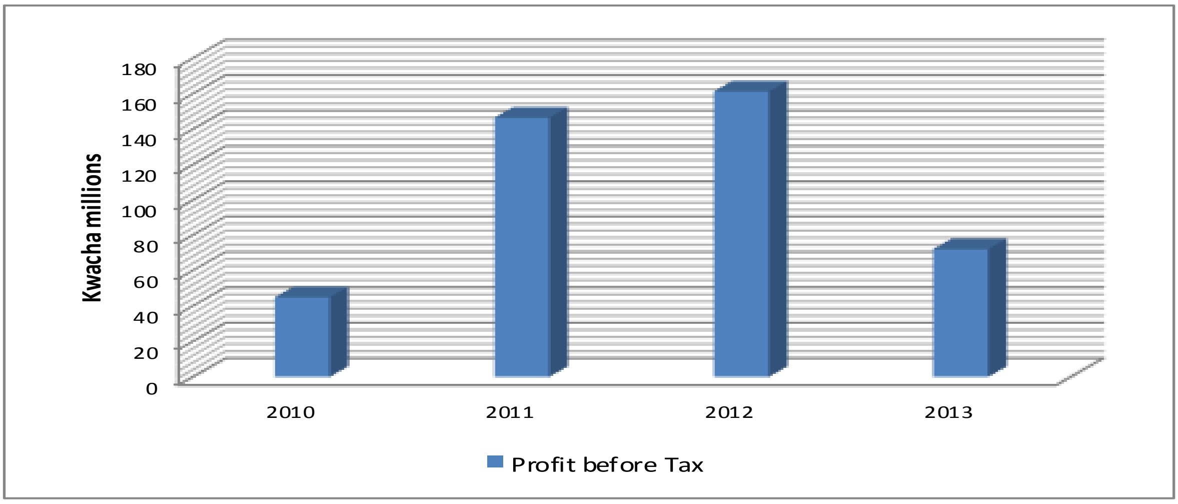
Chart 3.2: Trend in Total Loans and Non-performing Loans of the Non-Bank Financial Institutions.



3.1.3 Earnings

The earnings performance of the NBFI sector was fair in the year under review. The sector recorded a PBT of K72.1 million in 2013 which was lower by 52.8% compared to K152.9 million recorded in 2012 (See Chart 3.3). The decline was mainly attributed to a reduction in net interest margin[12] and deterioration in operational efficiency. The net interest margin declined to 73.0% from 81.0% in 2012 whereas the operational efficiency, as measured by the ratio of non-interest expenses to net interest income, deteriorated to 111% from 78% in the previous year. Consequently, the profitability ratios declined to 2.0% and 7.0% from 5.0% and 16.0% for the RoA and RoE, respectively.

Chart 3.3: Trend in Earnings of the Non-Bank Financial Institutions.



[12]The decline in the net interest margin was attributed to interest caps introduced during the year under review.

3.1.4 Liquidity

The NBFI sector's liquidity position was satisfactory as at end-December 2013. Despite a reduction in the ratio of liquid assets to total deposits and short-term liabilities to 37.0% as at end-December 2013 from 43.0% as at end-December 2012, the liquidity ratio was still above the prudential minimum limit of 15.0%.

3.1.5 Sensitivity to Market Risk

Sensitivity to market risk was rated fair. The sector's exposure to foreign exchange was high. However, the potential that the earnings performance or capital position could be adversely affected by adverse movements in foreign exchange and interest rates was moderate as the level of capital was adequate.

The foreign exchange exposure deteriorated to 68.9% of regulatory capital from 20.5% as at end-December 2012, on account of the increase in foreign currency subordinated debt attributed to the MFI sub-sector. However, 77.9% of the net exposure was attributed to shareholders' loans at one MFI which were being converted to kwacha denominated subordinated debt as a way of mitigating the excess foreign exchange exposure. With this measure, foreign exchange exposure was expected to fall within the prudential limit of 25.0% of regulatory capital.

Net interest income sensitivity analysis indicates a moderate potential that earnings performance or capital could be adversely affected by movement in interest rates. As at end-December 2013, the sector had a short term positive asset-liability gap of K766.9 million. Therefore, a 5% adverse movement in interest rate would result in a decrease in interest income of approximately K38.3 million which was less than 5.0% of regulatory capital.

3.2 Performance of the Leasing Sector

The overall financial performance and condition of the leasing finance sub-sector in 2013 was rated satisfactory. The sub-sector was adequately capitalised, had satisfactory asset quality and earnings performance while its liquidity management was fair.

Out of the seven leasing finance companies, one institution accounting for 1.0% of the sub-sector's total assets was rated unsatisfactory due to regulatory capital deficiency. In this regard, the BoZ put in place measures to compel shareholders of the institution to address the capital deficiency. Table 3.2 show the year-end composite and performance ratings for the leasing sub-sector.

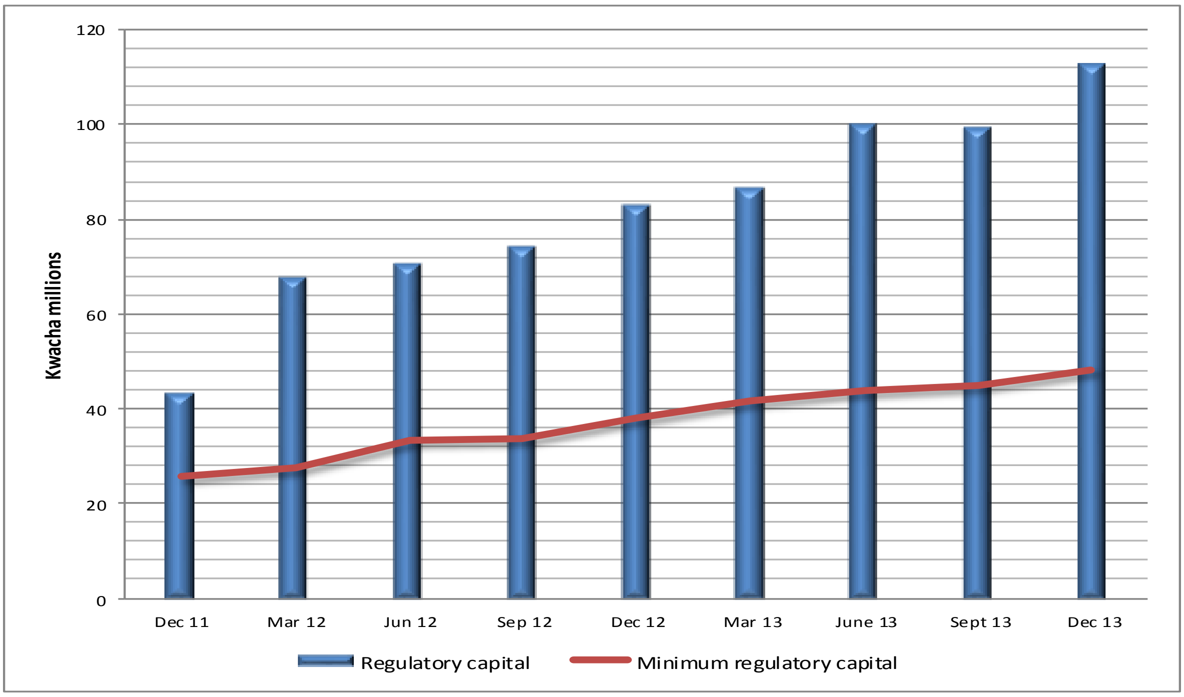
Table 3.2: Year-End Composite Rating for the Leasing Finance Subsector, 2011-2013

Performance Category	Composite Rating Scale	Number of Leasing companies			Proportion of Industry Assets (%)		
		2011	2012	2013	2011	2012	2013
Strong	1.0 - 1.5	1	1	2	0	39	63
Satisfactory	1.6 - 2.4	1	1	2	2	5	35
Fair	2.5 - 3.4	4	4	0	52	55	0
Marginal	3.5 - 4.4	1	0	1	0	0	1
Unsatisfactory	4.5 - 5.0	2	2	2	13	1	1
Total		**9**	**8**	**7**	**100**	**100**	**100**

3.2.1 Capital Adequacy

The capital adequacy was satisfactory. The regulatory capital increased by 35.9% to K112.7 million at end-December 2013 from K82.9 million at 31 December 2012 (see Chart 3.4), largely due to a PAT of K18.9 million recorded in 2013 coupled with direct equity injections of K11.3 million. The regulatory capital adequacy ratio, however, marginally declined to 23.4% at end-December 2013 from 24.0% as at end-December 2012. The decline was on account of a proportionately higher increase of 39.1% in RWA to K482.7 million at end-December 2013 from K347.1 million at end-December 2012, although it remained well above the minimum prudential limit of 10.0%.

Chart 3.4: Trend in Regulatory Capital of Leasing Subsector, December 2011 – Dec 2013

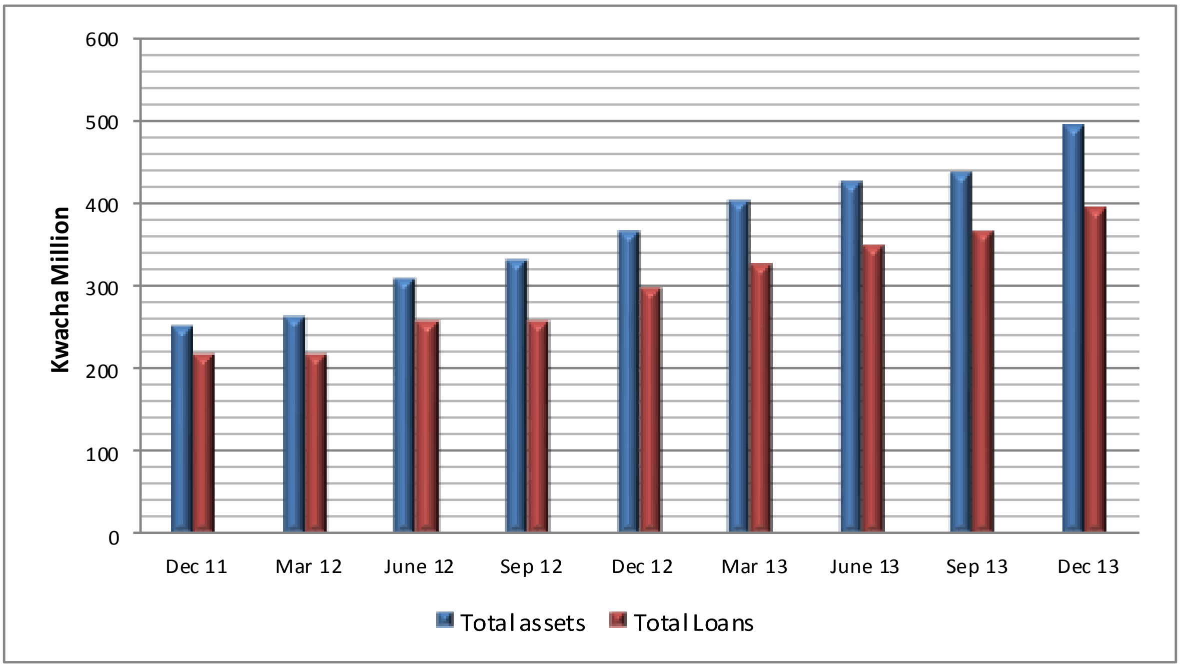


3.2.2 Asset Quality

At end-December 2013, the asset quality was satisfactory. Despite the increase in the gross NPLs ratio to 5.4% at end-December 2013 from 3.3% at end-December 2012 on account of an increase in gross NPLs to K21.2 million from K9.8 million, the ratio was still below the acceptable limit of 10.0%. On the other hand, the allowance for loan losses increased by 14.0% to K11.4 million from K10.0 million at end-December 2012. However, due to the proportionately higher increase in gross NPLs compared to the increase in the allowance for loan losses, the NPL coverage ratio decreased to 53.4% from 100.0% at end-December 2012.

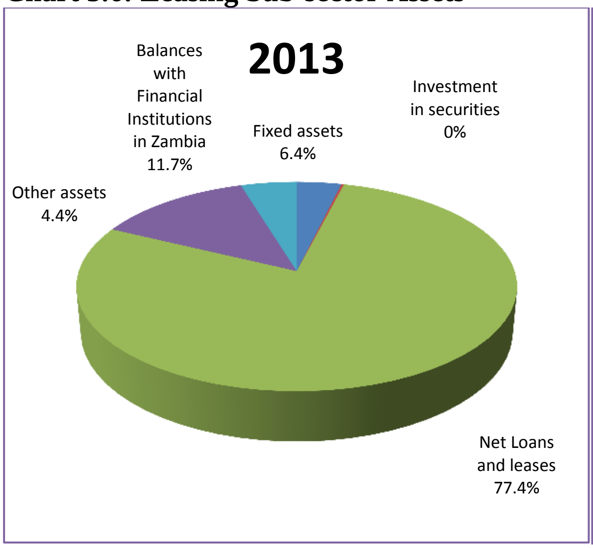
Meanwhile, total assets increased by 35.8% to K494.1 million from K363.8 million at end-December 2012. The increase was mainly noticeable in the gross loans which went up by 32.5% to K393.9 million from K297.3 million (see ***Chart 3.5***).

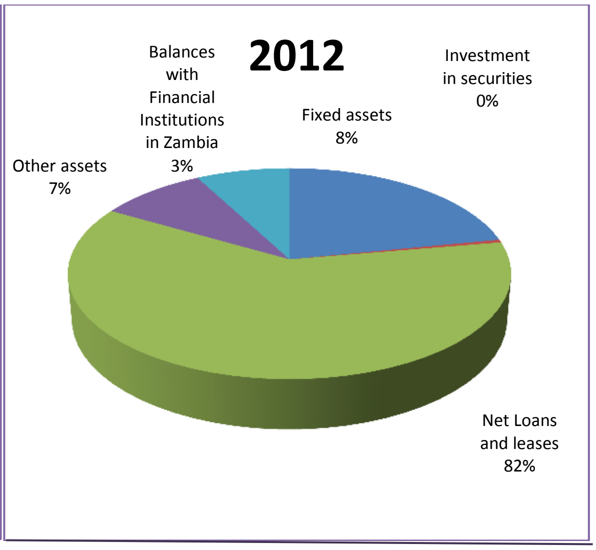
Chart 3.5: Leasing Subsector Total Assets, March 2011 – December 2013



Net loans and advances, which stood at K382.5 million constituted the largest proportion of total assets at 77.4% compared to K287.3 million 82% as at end-December 2012 (see ***Chart 3.6***).

Chart 3.6: Leasing Sub-sector Assets





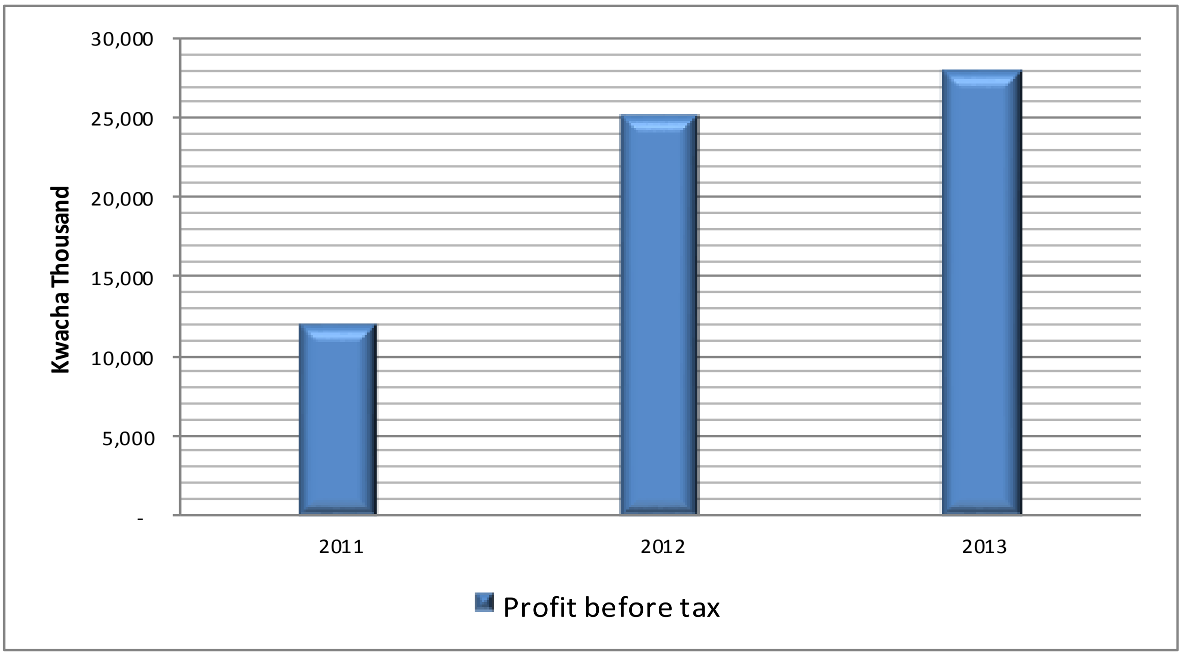
3.2.3 Earnings

The earnings performance was satisfactory in the year under review. The sector recorded an increase in the profit before tax of 7.7% to K27.9 million in 2013 from the profit before tax of K25.9 million recorded in 2012 (see Table 3.3 and Chart 3.7). The increase was mainly attributed to an increase in interest income of 40.6% to K78.8 million from K56.1 million in the previous year. However, profitability, as measured by the RoA ratio declined marginally to 6.0% compared to 7.0% in the previous year. The decline in the RoA ratio was due to the increase in total assets.

Table 3.3: Earnings Performance, 2011 – 2013 (K'000)

	2011	2012	2013
Interest income	57,838	56,082	78,827
Interest expenses	14,854	14,105	23,950
Net interest income	42,984	41,977	53,820
Provisions/(Provisions reversals)	3,165	8,291	5,683
Net interest income after provisions	39,819	33,686	49,194
Non-interest income	9,479	20,951	16,811
Total net income	49,298	54,637	66,004
Non-interest expenses	37,300	29,523	38,037
Profit before tax	**11,998**	**25,112**	**27,968**
Tax	2,460	8,980	9,068
Profit after tax	**9,538**	**16,132**	**18,900**

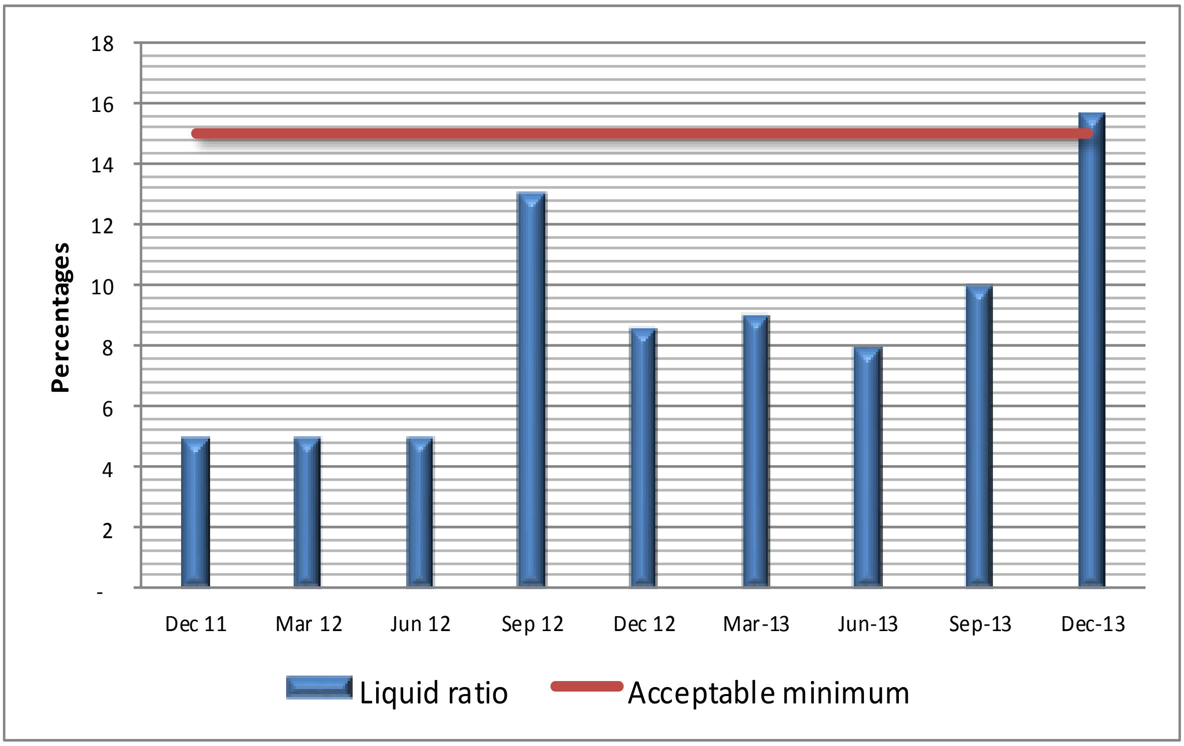
Chart 3.7: Leasing Subsector Profit before Tax, 2011 – 2013



3.2.4 Liquidity

The liquidity position was rated marginal. The overall liquidity position as measured by the ratio of liquid assets to total deposits and short-term liability improved to 15.4% at end-2013 from 8.6% at end-2012 (see ***Chart 3.8***) and was above the minimum prudential threshold of 15.0%.

Chart 3.8: Leasing Sub-sector Liquidity Trend 2011-2013



3.2.5 Foreign Exchange Exposure

The foreign exchange exposure was rated unsatisfactory. At end-December 2013, the sub-sector's overall foreign exchange exposure increased to 58.8% of regulatory capital from 41.0% of regulatory capital at end-December 2012 and therefore was above the maximum statutory limit of 25.0%. The high foreign exchange exposure position was largely attributed to two institutions and the BoZ directed them to unwind the foreign exchange exposure in order to comply with the regulations.

3.3 Performance of the Building Societies Sector

The overall financial performance and condition of the building societies was fair (see Table 3.4). The sub-sector was adequately capitalised relative to its risk profile. Asset quality and earnings performance were rated fair unsatisfactory, respectively.

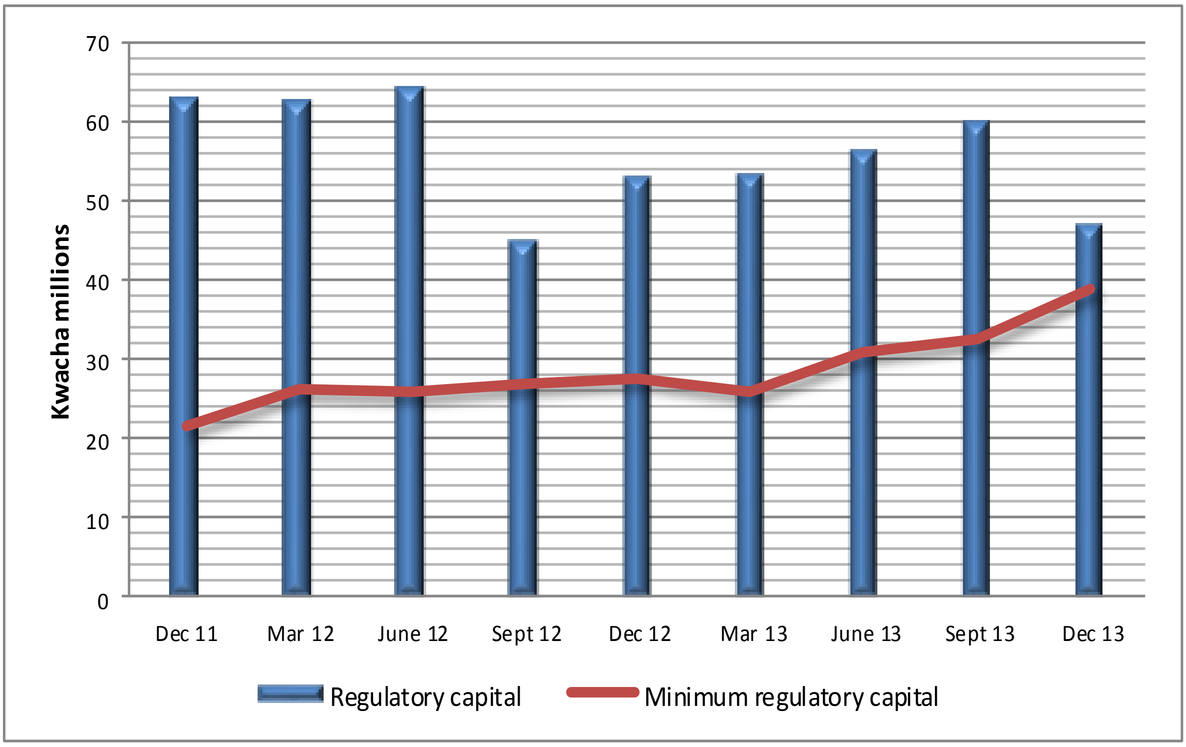
Table 3.4: Year-End Composite Rating for the Building Society Sub-sector, 2011-2013

Performance Category	Composite Rating Scale	Number of Building Societies			Proportion of Industry Assets (%)		
		2011	2012	2013	2011	2012	2013
Strong	1.0 - 1.5	0	0	0	0	0	0
Satisfactory	1.6 - 2.4	1	1	1	72	68	71
Fair	2.5 - 3.4	1	1	1	20	17	29
Marginal	3.5 - 4.4	1	0	1	8	0	0
Unsatisfactory	4.5 - 5.0	0	1	0	0	15	0
Total		3	3	3	100	100	100

3.3.1 Capital Adequacy

Capital adequacy was satisfactory. However the total regulatory capital declined by 11.6% to K46.7 million at end-December 2013 from K52.8 million at end-December 2012, mainly due to a loss after-tax of K15.7 million. Consequently, the regulatory capital adequacy ratio declined to 12.0% from 19.1% as at end-December 2012 although it remained above the minimum required ratio of 10.0% (see ***Chart 3.9***).

Chart 3.9: Building Societies Subsector Regulatory Capital Trend, 2011-2013



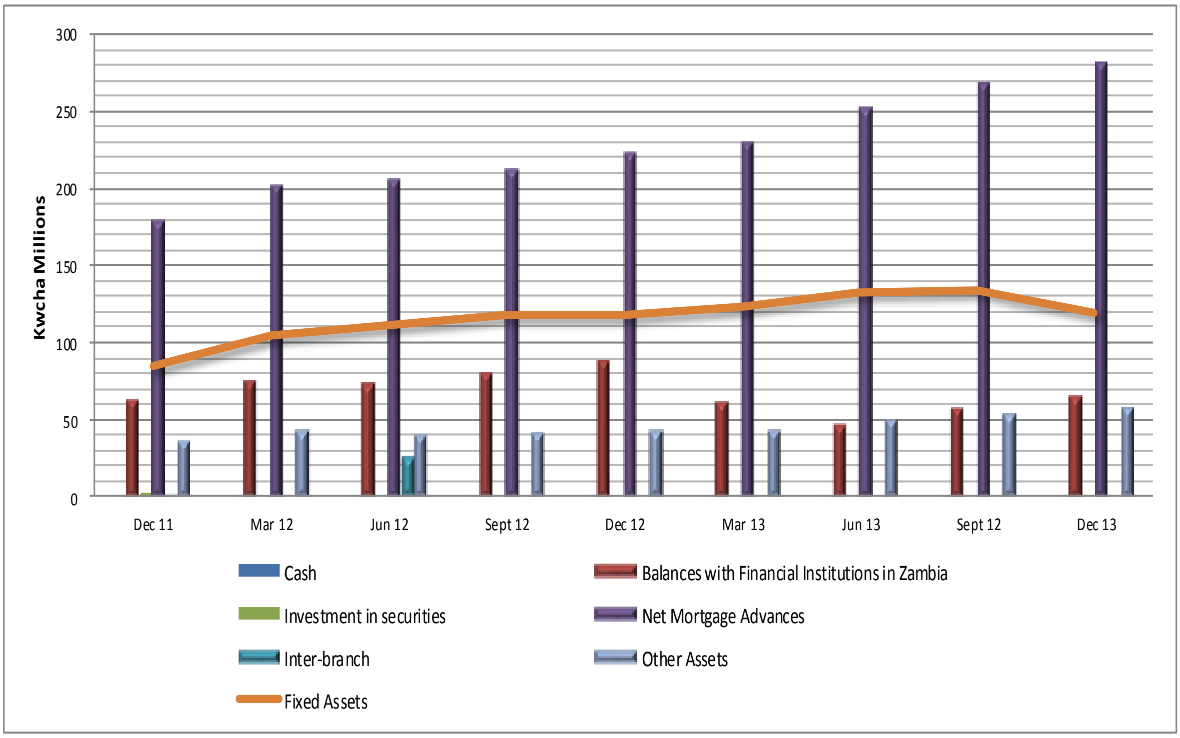
3.3.2 Asset Quality

At end-December 2013, the asset quality was rated marginal as the ratio of NPLs to gross loans was above the maximum prudential limit of 10.0%. The ratio of NPLs to gross loans decreased to 10.4% from 13.2% at end-December 2012. The decrease was largely due to an increase in mortgages and loans.

The NPL coverage ratio also declined to 66.9% from 71.9% at end-December 2012. This was on account of the decline in allowance for loan losses to K20.9 million at end-December 2013 from K23.3 million at the end of the previous year.

With regard to aggregate assets, the sub-sector recorded an increase by 10.7% to K521.3 million from K470.8 million at end-December 2012. The increase was mainly observed in the gross mortgages and loans which rose by 21.7% to K298.7 million at end-December 2013 from K245.5 million at end-December 2012.

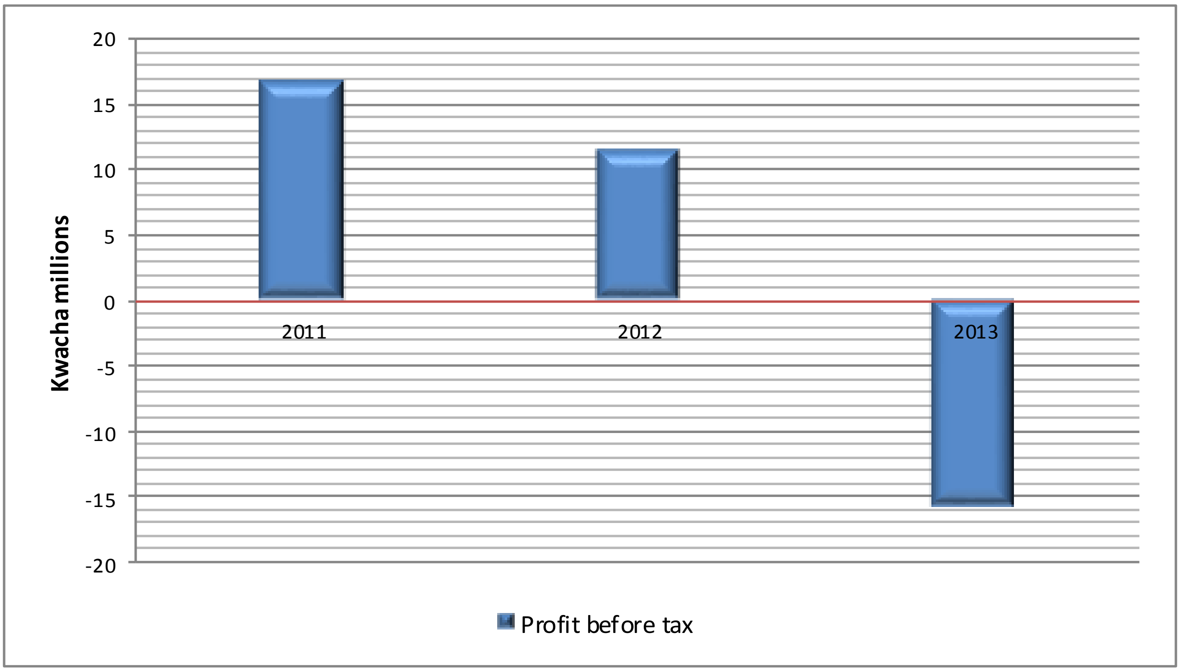
Chart 3.10: Building Society Asset Composition 2011-2013



3.3.3 Earnings Performance

The earnings performance was rated unsatisfactory in the year under review. The sector recorded a loss before tax of K15.7 million compared to a PBT of K11.7 million in 2012 (see Chart 3.11). The loss was largely attributed to deterioration in operational efficiency which worsened to 219.8% from 154.1% the previous year.

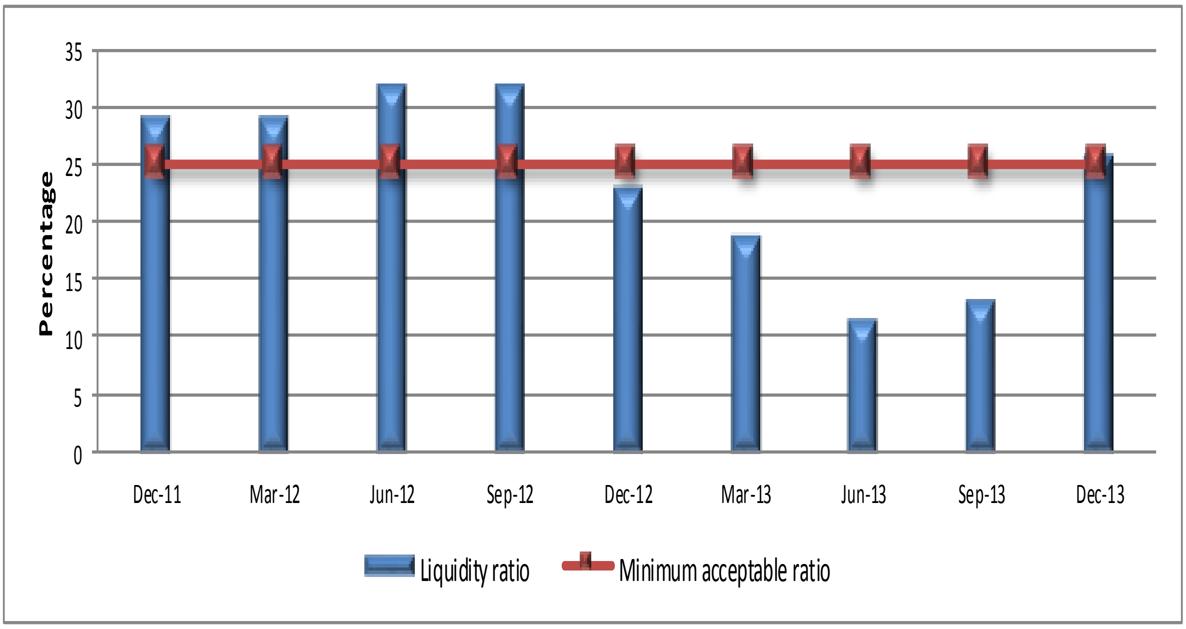
Chart 3.11: Trend in the Earnings Performance of the Building Society Subsector, 2011 – 2013



3.3.4. Liquidity

The sub-sector's liquidity position was satisfactory despite a decline in the liquidity ratio to 25.7% from 34.5% in 2012. The liquidity ratio was above the prudential minimum ratio of 25.0% for building societies (see ***Chart 3.12***).

Chart 3.12: Trend in Liquidity Positions of the Building Society Subsector, 2011 – 2013



3.4 Performance of the Microfinance Sub-sector

During the year under review, the BoZ re-categorised the MFI sub-sector into the enterprise-lending and consumer-lending MFIs in order to foster appropriate policy interventions in the sub-sector. Accordingly, MFIs whose exposure to micro-enterprises constituted 80% or more of total loans were categorised as enterprise-lending MFIs while the rest were categorised as consumer-lending MFIs.

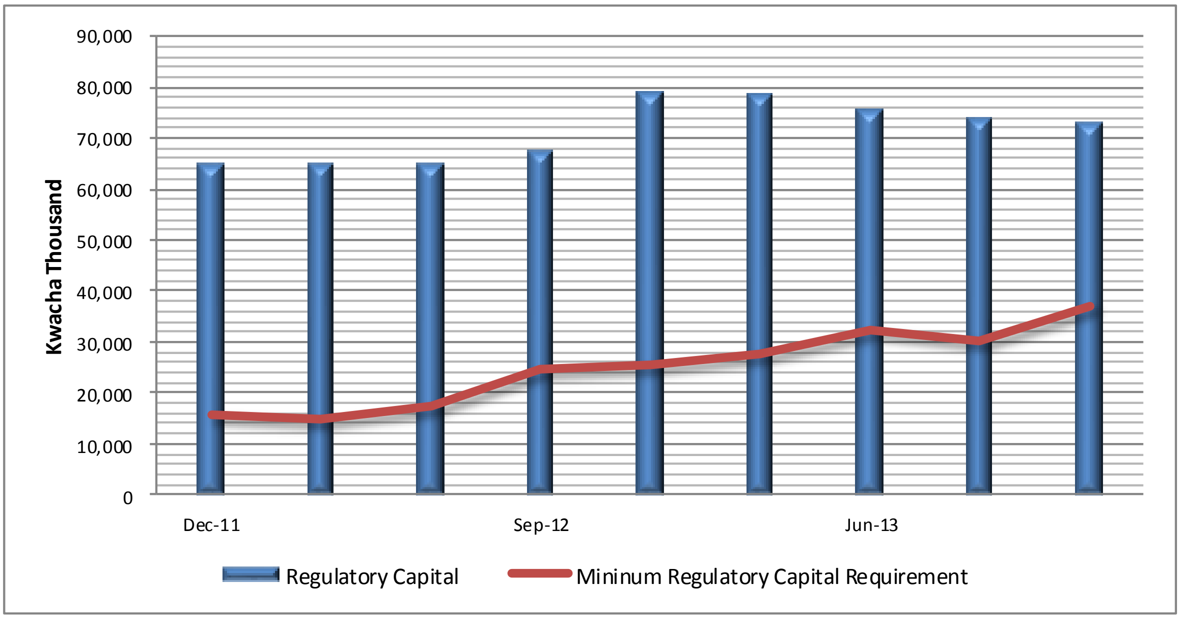
3.4.1 Enterprise-Lending Microfinance Institutions

The overall financial performance and condition of the enterprise-lending MFIs was rated marginal. Their aggregate regulatory capital was satisfactory while asset quality was fair. However, earnings performance was unsatisfactory.

3.4.1.1 Capital Adequacy

The aggregate capital declined by 7.5% to K72.8 million at end-December 2013 from K78.7 million at end-December 2012, mainly due to a loss after tax of K7.2 million. Consequently, the capital ratio fell to 19.6% from 31.1% at end-December 2012. However, this ratio was satisfactory, as it was above the minimum regulatory requirement of 15.0% (see ***Chart 3.13***).

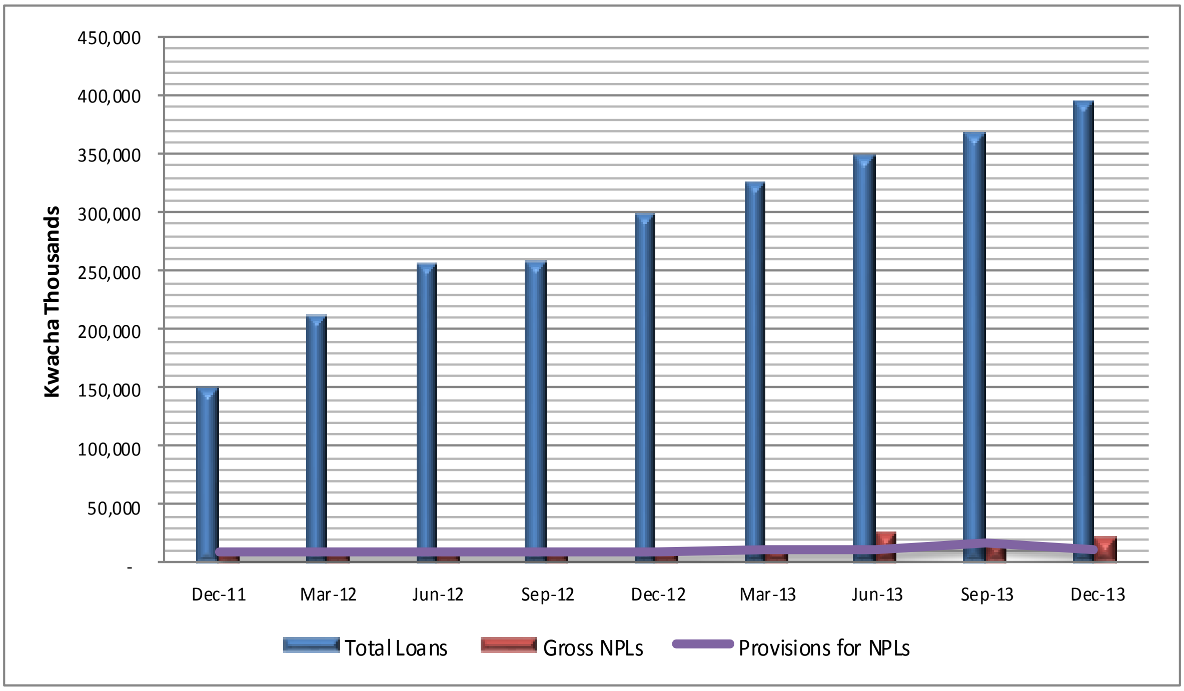
Chart 3.13: Trend in the Regulatory Capital Positions, 2011 – 2013



3.4.1.2 Asset Quality

At end-December 2013, the asset quality was satisfactory. Despite the increase in the ratio of NPLs to gross loans to 7.4% from 5.9% at end-December 2012, the ratio was below the acceptable limit of 10.0%. Aggregate assets increased by 51.3% to K367.2 million at end-December 2013 from K242.7 million at end-December 2012. This was mainly on account of a 70.1% increase in the gross loans to K284.3 million from K167.1 million in the previous year (see ***Chart 3.14***).

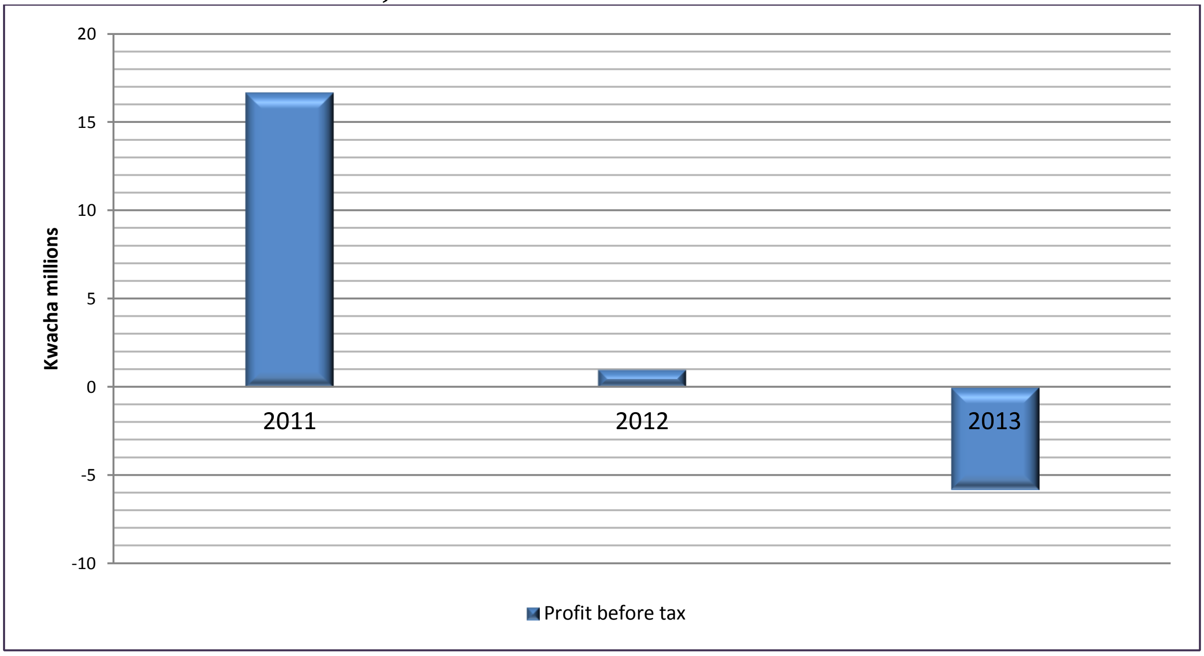
Chart 3.14: Aggregate Total Loan, Gross Non-Performing Loans and Provision for Non-Performing Loans, 2011-2013



3.4.1.3 Earnings Performance

Earnings performance was unsatisfactory during the year under review as the enterprise-lending MFIs recorded a loss before tax of K5.8 million in 2013 compared to profit before tax of K0.96 million in 2012 (see ***Chart 3.15***). The loss was largely attributed to deterioration in operational efficiency which worsened to 172.0% from 132.0% the previous year.

Chart 3.15: Profits before Tax, 2011-2013



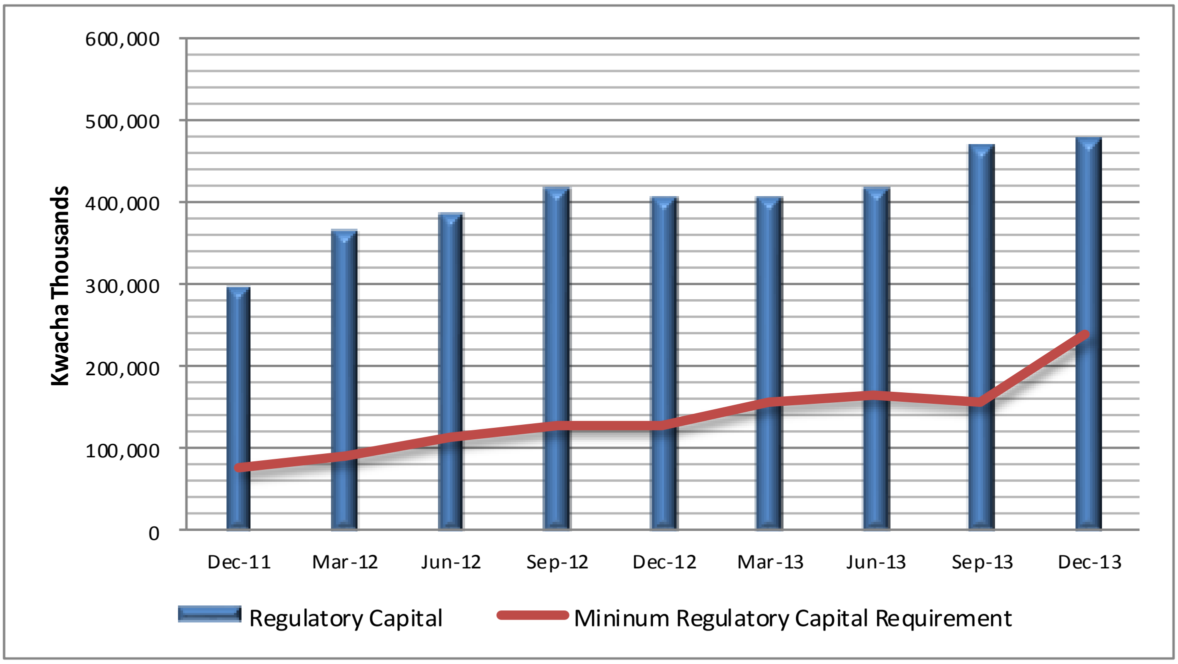
3.4.2 Consumer-Lending Microfinance Institutions

The overall financial performance and condition was satisfactory. This category of MFIs had strong regulatory capital, satisfactory asset quality and earnings performance during the year under review.

3.4.2.1 Capital Adequacy

Capital adequacy was rated strong at end-December 2013. The regulatory capital increased by 8.1% to K477.0 million from K419.0 million (see Chart 3.16). However, due to a higher increase in the RWA by 98.2% to K1,599.1 million from K806.9 million at end-December 2012 relative to an increase in regulatory capital, the capital adequacy ratios declined to 29.9% from 51.9% at end-December 2012 but was still above the minimum ratio of 10.0%.

Chart 3.16: Regulatory Capital; 2011-2013

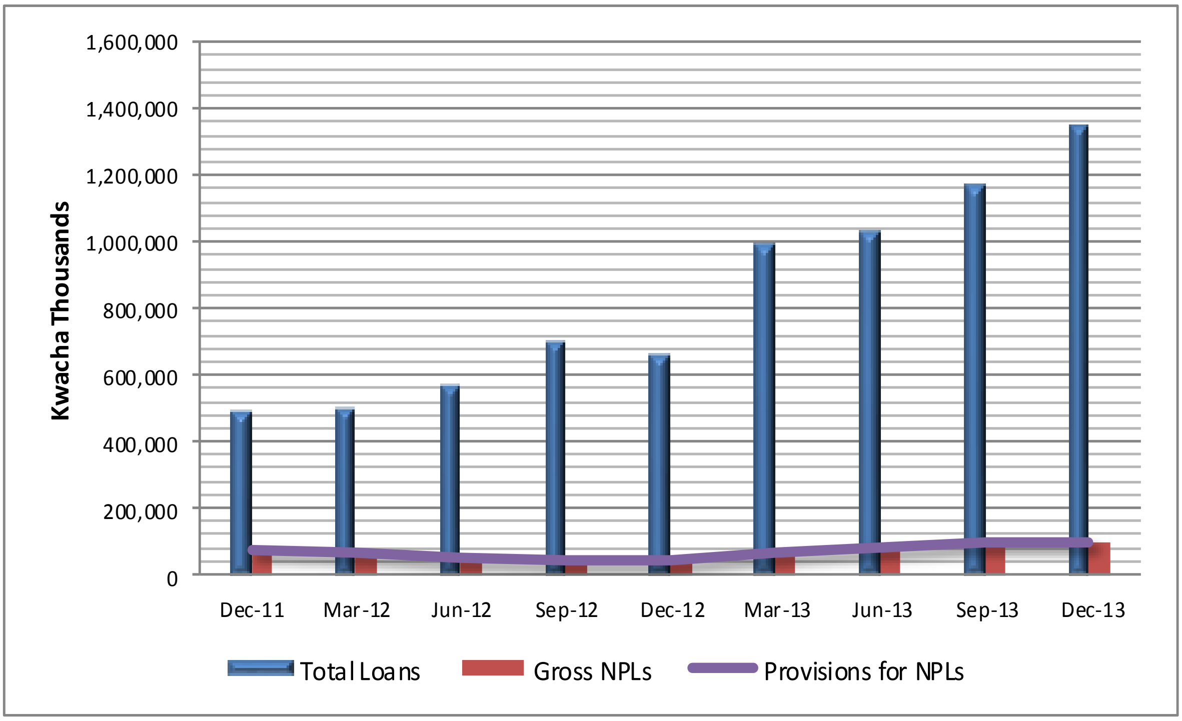


3.4.2.2 Asset Quality

At end-December 2013, the asset quality of the consumer lending MFIs was satisfactory. Although the ratio of gross NPLs to gross loans marginally increased to 6.9% at end-December 2013 from 6.6% at end-December 2012, the ratio was below the maximum acceptable limit of 10.0%. The increase in the ratio was on account of a rise in NPLs to K94.0 million from K56.4 million the previous year (see ***Chart 3.17***).

Aggregate assets increased by 39.0% to K1,570.8 million from K1,129.8 million at end-December 2012. The rise was mainly due to the growth in gross loans by 57.8% to K1,345.1 million from K852.6 million at end-December 2012.

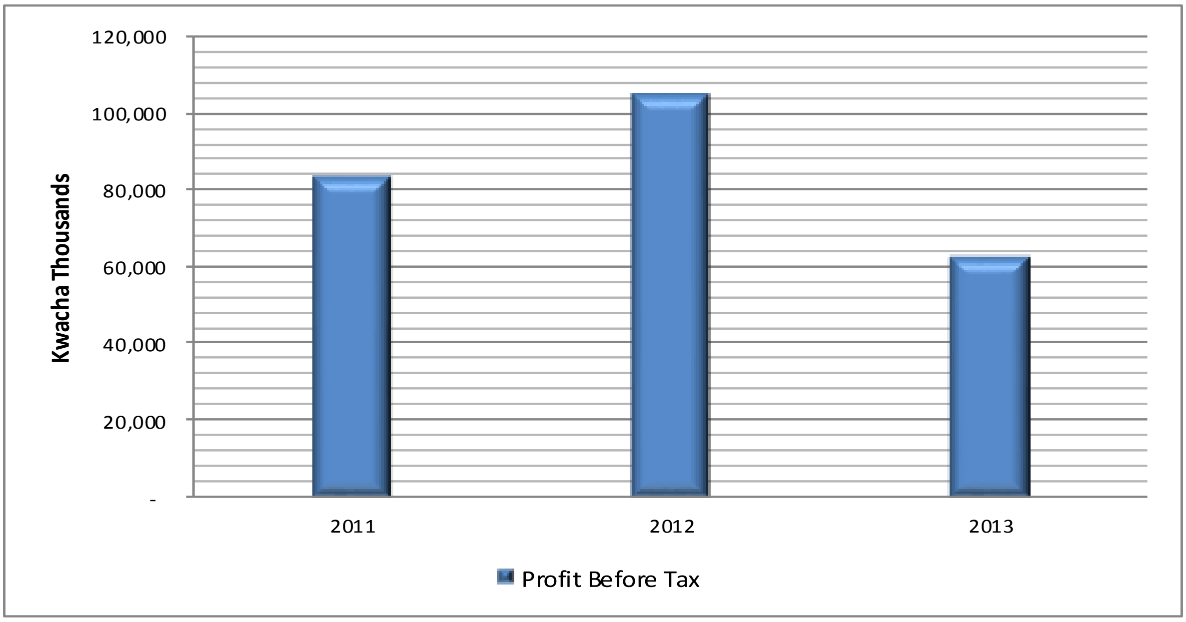
Chart 3.17: Total Loans, Gross Non-Performing Loans and Provision for Non-Performing Loans, 2011-2013



3.4.2.3 Earnings Performance

The earnings performance of the consumer-lending MFIs was satisfactory. The sector recorded a PBT of K62.5 million in 2013 which however, was lower than the K104.7 million in 2012. The lower profit was largely due to a reduction in the interest margin to 70.5% from 88.1% the previous year (see Chart 3.18). As a result of the decrease in PBT, profitability as measured by the RoA declined to 4.0% from 9.0% in the previous year.

Chart 3.18: Profit before Tax of the Consumer-Lending Microfinance, 2011-2013

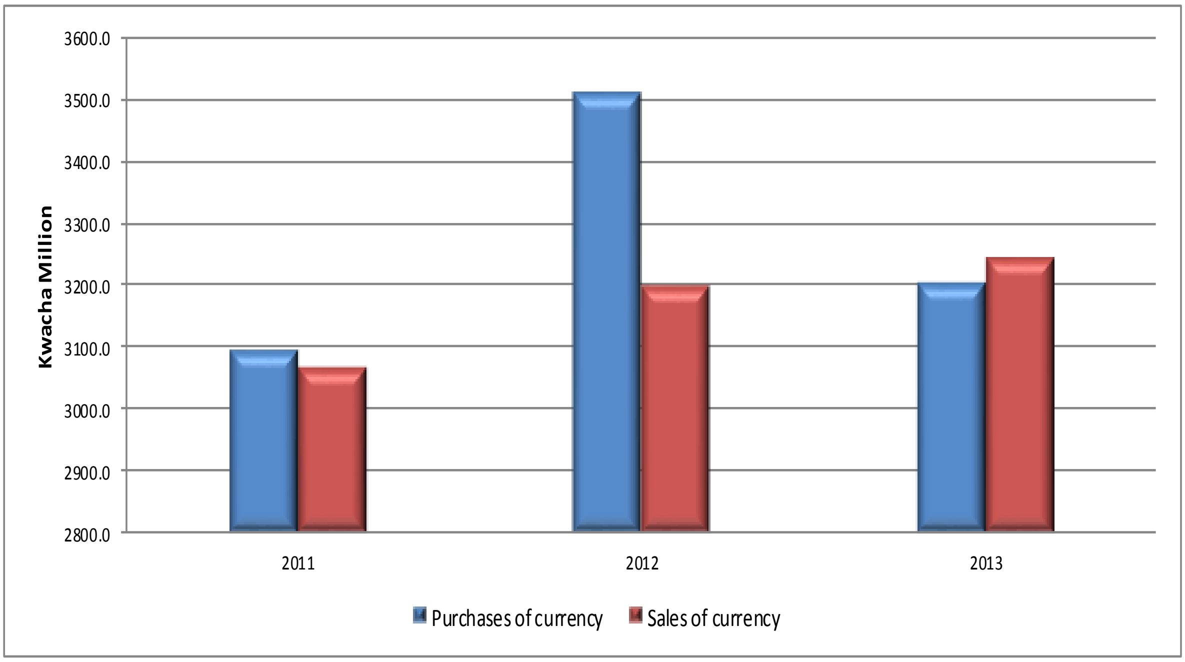


3.5 Bureaux de Change

The sub-sector was adequately capitalised at end-December 2013. All the bureaux de change, met the minimum capital requirement of K0.40 million. Their aggregate capital and reserves increased by 16.7% to K39.1 million from K33.5 million at end-2012, largely on account of equity capital from newly licenced bureaux de change.

In terms of profitability, the sub-sector recorded a PBT of K2.4 million, which was however, lower by 77.1% when compared with the PBT of K10 5 million recorded in the previous year. The decline was mainly on account of the reduction in the volume of purchases and sales of foreign currency. The volumes of purchases and sales of foreign currency declined by 8.7% and 7.1% to K3,204.9 million and K3,242.2 million from K3,508.9 million and K3,491.2 million in 2012, respectively (see ***Chart 3.19***).

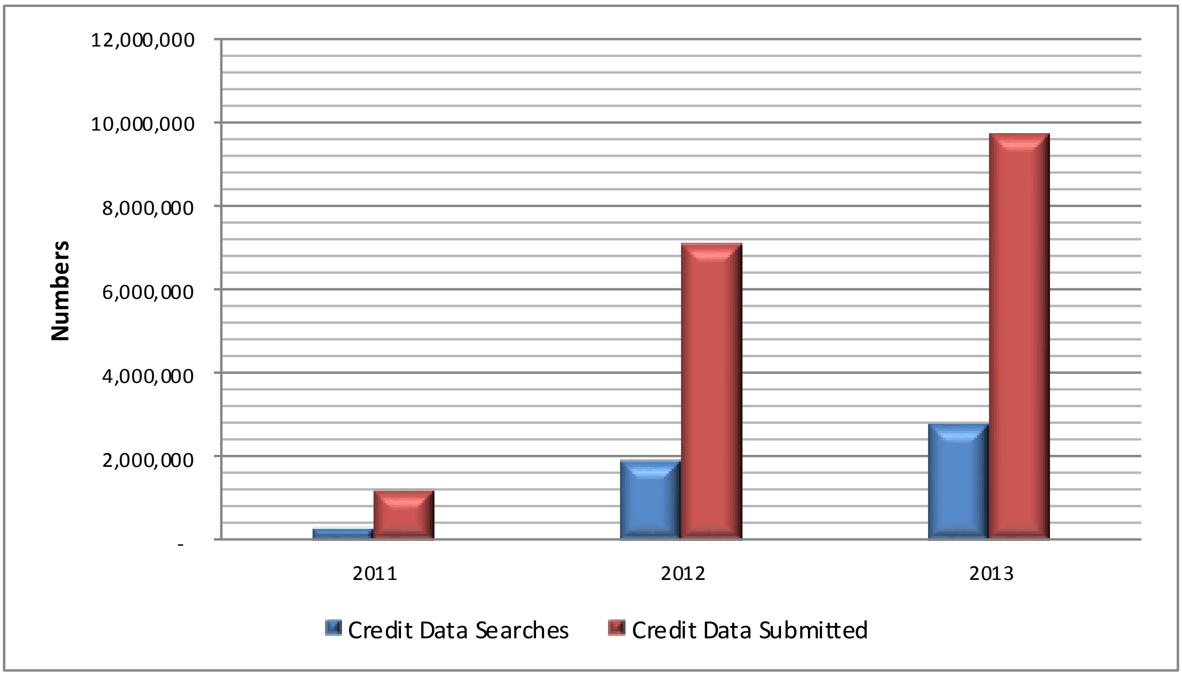
Chart 3.19: Bureau De Change Volumes of Transactions, 2011 –2013



3.6 Operations of Credit Reference Bureau Africa Limited

In the year under review, the submission of, and searches for, credit data by financial service providers increased mainly due to the continued sensitisation. The total number of credit files submitted increased by 37% to 9,709,557 from 7,084,175 in the previous year. Similarly, the total number of credit reports searched increased by 44% to 2,731,981 in 2013 from 1,898,124 during 2012 (see ***Chart 3.20***).

Chart 3.20: Trend of use of Credit reference System by Financial Service Providers in 2013



3.7 The NBFIs Sector Outlook

It is expected that in the first quarter of 2014 and beyond, the profitability of the NBFIs sector will continue to increase as NBFIs continue to expand their volume of credit and implement efficient operational measures, consistent with the trends observed in 2013. The volume in credit, especially for the leasing companies is likely to come from SME borrowers.

The BoZ will continue to closely monitor this expansion to ensure that it is supported by improvements in credit appraisal and administration so that any increase in NPLs is not disproportionate to the increase in the loan portfolio and that the NBFIs operate within the requirements of the BFSA.

CHAPTER 4: PRUDENTIAL SUPERVISION

4.1 On-Site Inspections of Banks

4.1.1 Full Scope Inspections

In 2013, the BoZ conducted scheduled inspections of five commercial banks. The objectives of the inspections included the determination and validation of the financial condition, risk profile, and the quality of management systems of the banks. In addition, the inspections made assessments of the banks' level of compliance with laws and regulations. Areas of concentration under risk management were credit, operational and liquidity risks. The inspections conducted revealed weaknesses in credit underwriting and credit administration processes. In view of the new capital adequacy requirements, the inspections helped establish the correct capital levels of banks and where applicable, banks were directed to inject the appropriate levels of capital to meet the capital requirements in line with the agreed recapitalization plans. Another area of concern was operational risk mainly arising from the information technology based products. Following these inspections, appropriate supervisory actions were recommended to the Board and management of the affected banks.

4.1.2 Compliance Examinations in Banks

In addition to the scheduled full scope inspections, BoZ conducted compliance checks at nine banks' branches. The main objectives of the compliance examinations were to assess the banks' adherence to money laundering preventative requirements, assessing the banks' compliance with CB Circular No. 03/2012 on Enhanced Security Measures at Business Premises and Section 48 of the Banking and Financial Services Act (BFSA) on Customer Complaints. In addition, the inspections sought to verify whether commercial banks were adhering to the regulations with respect to the requirement to display in a conspicuous place, in every branch, a copy of the latest annual statement as stipulated in Section 61 (4) (b) of the BFSA. Furthermore, the compliance inspections covered the assessment of the banks' compliance with Statutory Instrument No. 183 on Disclosure of Deposit Charges and Interest.

Overall, the inspections established that all commercial banks' branches covered under this exercise did not fully comply with the stated regulations and directives. In this regard, the BoZ issued directives to the affected banks to address the deficiencies noted.

4.1.3 Inspections of New Bank Branches

The BoZ conducted inspections of all the 31 new branches opened during the year prior to official opening in order to ensure that minimum required standards were adhered to. These standards included workplace health and safety standards, adequate security arrangements for both employees and bank customers, display of vital information in a conspicuous manner, and business continuity management best practices. By and large, the banks met these minimum requirements.

4.2 Inspections of NBFIs

The BoZ continued to employ on-site inspections as a means of verifying prudential information submitted by NBFIs, evaluating their financial condition and performance, and assessing the risk management and corporate governance practices in these institutions. The BoZ focused on the inspection of those institutions posing the greatest risk to the stability of the financial sector in line with the risk based supervision approach. In 2013, the BoZ conducted 4 on-site inspections of NBFIs and investigated 14 customer complaints. Salient findings from the inspections included the following:

i. Undercapitalisation of 3 institutions;
ii. Poor Board and Management oversight as evidenced by the lack of operational and procedures manuals in at least one institution;
iii. Unsatisfactory credit management practices;
iv. Non adherence to internal policies; and
v. Non-compliance with a number of statutory provisions in the Banking and Financial Services Act.

Customer complaints against NBFIs emanated from five major issues including credit reference bureau delinquency reports, high interest rates, unfair collection methods, wrong deductions and non-compliance with regulations. The BoZ instituted appropriate supervisory directives and recommendations in order to ensure that the concerned financial service provider address these issues.

CHAPTER 5: THE REGULATORY DEVELOPMENTS

In the period under review, the BoZ continued to review the regulatory policies underpinning the regulation and supervision of the financial sector in Zambia and to implement new measures aimed at strengthening the BoZ's oversight over the institutions under its supervisory ambit. Some of the initiatives undertaken included the measures outlined below.

5.1 Recapitalization of Commercial Banks

The BoZ revised the minimum capital requirements for commercial banks in 2012. In 2013, the central bank continued to work with individual banks to consolidate the recapitalization in order to make their balance sheets more adaptive and resilient to both internal and external shocks in the economy. Following the revision of the minimum capital adequacy requirements, 14 out of 19 banks met the minimum primary capital requirements as at 31 December 2013. The remaining five banks were granted special approval for recapitalisation plans that extended beyond the 31 December 2013 deadline. The BoZ entered into formal agreements with these banks to meet the minimum capital requirement.

5.2 New Capital Adequacy Framework for NBFIs

The BoZ through NBFI Circular 01/2014 reviewed the capital adequacy framework for the NBFIs. Table 5.1 shows the revised minimum capital for different sub-sectors of NBFIs.

Table 5.1: Revised Minimum Paid-Up Capital Requirements for NBFIs

Category	Previous (K)	Revised (K)
Financial Institutions		
Housing Finance Institutions	2,000,000	**50,000,000**
Savings and Credit Institutions	2,000,000	**50,000,000**
Leasing Companies	1,500,000	**50,000,000**
Micro Finance Institutions	250,000	**2,500,000**
Other Financial Institutions	-	**50,000,000**
Financial Businesses		
Development Finance Institutions	7,500,000	**750,000,000**
Leasing Companies	500,000	**5,000,000**
Microfinance Institutions	25,000	**100,000**
Bureaux de Change	40,000	**250,000**
Credit Reference Bureaux	1,000,000	**1,500,000**
Other Financial Businesses	-	**500,000**

Out of the 114 operational NBFIs as at end-December 2013, 30 did not meet the revised minimum paid-up capital requirements and therefore were required to progressively inject fresh capital to meet the minimum capital requirement by the deadline of 31 December 2016.

5.3 Interest Rate Caps on NBFIs

On 3 January 2013, the BoZ issued CB Circular 8/2012 which capped effective annual interest rates for NBFIs. The impact of this policy measure was assessed with respect to volume of loans and profitability. All the NBFIs subsectors continued to expand their loan portfolios in the period under review. The total volume of loans for the NBFI sector increased by 13.5% compared to an increase of 12.2% in the preceding six months. The acceleration in the growth of the volume of loans was an indication that NBFIs had not yet fully compensated for the shrinkage in interest margins as a result of the interest rate caps.

With regard to profitability, all the subsectors continued to be profitable in the period under review with the exception of the enterprise-lending MFIs which recorded losses. It is note-worth that even before the introduction of the interest rate caps, the profitability of enterprise-lending MFIs was characteristically low as these institutions largely pursued social objectives of delivering credit to a large number of micro-enterprises in rural and peri-urban areas which inevitably entailed high operating costs with consequent thin profit margins.

5.4 Development of Outsourcing Guidelines

During the year 2013, the BoZ initiated a process of drafting outsourcing guidelines to guide financial institutions on various aspects of outsourcing. The purpose of the guidelines is to provide direction and guidance to regulated entities to adopt sound and responsive risk management practices for effective oversight and management of risks arising from outsourcing. The guidelines are expected to be issued in 2014. While the reasons for outsourcing may be valid, it is generally agreed that outsourcing can significantly alter the risk profile of commercial banks; hence banks need to have clear criteria for assessing, identifying and measuring these risks.

5.5 Financial Inclusion Initiatives

The Bank continued to work with various stakeholders to ensure the creation and fostering of an environment that facilitates the development of such new initiatives aimed at expanding access to financial services. A number of commercial banks continued to respond positively to these initiatives and implemented a number of products and services to improve on their range of products and services and also to expand their outreach. In view of the potential positive externalities associated with an inclusive financial system, financial inclusion remained a key policy priority for BoZ during the review period.

5.6 Developments Related to Financial Sector Legislation

5.6.1 Credit Reporting Bill

In the year under review, the BoZ submitted the Credit Reporting Bill to the Ministry of Finance to facilitate enactment into law. The Bill seeks to contribute to the enhancement of efficiency, stability and safety of personal credit data by establishing a sound legal basis for credit reporting services in Zambia. The Bill recognizes the complexity and dynamism of credit reporting services and accordingly provides international best practice provisions.

5.6.2 Personal Property Security Interest Bill

The BoZ drafted a Personal Property Security Interest Bill which seeks to promote access to finance through expanding the scope of assets acceptable to financial service providers as collateral.

5.7 Licensed Institutions

During the year, 14 licences for NBFIs were granted, while seven were revoked. The licences issued comprised 10 bureaux de change, 3 micro-finance and 1 financial business, while the revoked licences comprised three MFIs, three bureaux de change and 1 financial business (see ***Tables 5.2, 5.3 and 5.4***).

Table 5.2: Bureau de Change Licences issued in 2013

No	Name of Bureau de Change	Date Licensed
1	NTC Bureau de Change Limited	29/05/2013
2	Khobili Bureau de Change Limited	24/05/2013
3	Southern Comfort Bureau de Change Limited	30/12/2013
4	Mutumbi Bureau de Change Limited	30/12/2013
5	Munikam Bureau de Change	30/12/2013
6	Top Rate Bureau de Change	10/10/2013
7	Metalco Bureau de Change	16/01/2013
8	Megabyte Bureau de Change	18/07/2013
9	Prestige Bureau de Change	18/04/2013

Table 5.3: Microfinance Institutions Licences Issued in 2013

No.	Name of Microfinance Institution	Date Licensed
1	Zambia Works Financial Services Limited	30/12/2013
2	Robert & Slyls Microcredit Limited	30/12/2013
3	Betternow Finance Company Limited	24/05/2013

Table 5.4: Financial Business' Licences Issued in 2013

No	Name of Building Society	Date Licensed
1	Zambia Home Loans Limited	29/05/2013

Five bureaux de change, 10 microfinance institutions, 4 savings and credit institutions and two building societies branch applications were approved in the year 2013 (see ***Table 5.5*** and ***Table 5.6***). Therefore, the branch network of sector increased to 307 in 2013 from 288 in 2012.

Table 5.5: Approved Bureau de Change Branches

No.	Name of Institution	No. of Branches	Date Approved
1	Runneymede Bureau de change Limited, Kitwe	1	21/02/2013
2	Superstar Bureau de Change Limited- Nakonde	1	02/08/2013
3	Dondou Bureau de Change – Kasumbalesa	1	08/07/2013
4	Mill Bureau de Change Limited, Provident House, Lusaka	1	12/09/2013
5.	UAE Exchange Zambia Bureau de Change Limited – Manda Hill, Lusaka	1	26/12/2013
	Total	**6**	

Table 5.6: NBFIs Branches Approved in 2013

No.	Name of Institution	No. of Branches	Date Opened
1	Agora Microfinance Zambia Limited, Chibombo	1	05/12/2013
2	National Savings and Credit Bank • Chavuma • Kalabo • Lufwanyama • Mpongwe	4	 18/03/2013 02/04/2013 22/07/2013 22/07/2013
3	Izwe Loans-Mongu	1	06/05/2013
4	Zampost Microfinance Limited • Ndola • Kitwe	2	 09/04/2013 30/05/2013
5	Zambia National Building Society • Soweto, Lusaka • Kapiri Mposhi	2	 25/03/2013 16/09/2013
6	Gray Pages • Luanshya • Mutanda	3	 29/04/2013

	• Solwezi		
7	FINCA, Kafue	1	09/09/2013
	Total	**14**	

In the year under review, the BoZ revoked the seven licences (see ***Tables 5.7, 5.8 and 5.9***).

Table 5.7: Bureau de Change Licences revoked in 2013

No	Name of Bureau de Change	Date Licensed
1	Binary Bureau de Change Limited	18/02/2013
2	Sterling Bureau de Change Limited	18/03/2013
3	Swift Bureau de Change Limited	28/03/2013

Table 5.8: Microfinance Institutions Licences Revoked in 2013

No.	Name of Microfinance Institution	Date Licensed
1	IMS Financial Services Limited	26/01/2013
2	Royal Microfinance Limited	13/03/2013
3	Wide and Deep Financial Services Limited	08/04/2013

Table 5.9: Financial Business' Licences Revoked in 2013

No	Name of Building Society	Date Licensed
1	Achievers Financial Services Limited	30/08/2013

5.8 Financial Sector Development Plan

In 2013, implementation of reforms in the financial sector continued through activities under the Financial Sector Development Plan (FSDP). Some of the activities implemented included the implementation of the National Strategy on Financial Education, hosting Small and Medium Enterprises Local Content and Business linkages Forum and review and modernisation of the financial principal sector laws.

5.8.1 Implementation of the National Strategy on Financial Education

The BoZ conducted various financial education awareness activities which included the commemoration of the first ever Financial Literacy Week in March 2013. This was part of the annual Child and Youth Finance International (CYFI) Global Money Week observed in over 80 countries globally.

In recognition of the positive efforts in promoting financial education for the young, Zambia received a runner's up Global Money Week award at the Global CYFI Summit. Arising from this recognition, Zambia hosted the second annual CYFI regional meeting for Africa which was held in Livingstone in September 2013 under the theme "reshaping the future of finance".

5.8.2 Small and Medium Enterprises Local Content and Business linkages Forum

In an effort to facilitate access to finance and use of locally-manufactured inputs, the BoZ hosted a forum on SMEs in Lusaka in November, 2013. This was under the theme "Encouraging local content and business linkages: Role of the financial sector".

5.8.3 Law Review

In 2013, the law review exercise continued with focus placed on updating the second batch of financial sector laws. In this regard, draft bills were submitted to Government for further consideration in May 2013.

CHAPTER 6: INSTITUTIONS IN LIQUIDATION

6.1 Banks in Liquidation

In the year under review, the BoZ continued to oversee and manage the liquidation processes of the seven banks in liquidation (see ***Table 6.1*** below).

Table 6.1: Banks in Liquidation as at 31 December 2013

Name of Bank in Liquidation	Receivership Date	Liquidation Date
African Commercial Bank Zambia Limited	13 November 1995	21 February 1996
Commerce Bank Zambia Limited	30 March 2000	14 December 2000
Credit Africa Bank Zambia Limited	28 November 1997	6 March 1998
First Merchant Bank Zambia Limited	2 February 1998	16 March 1999
Meridien Biao Bank Zambia Limited	15 February 1995	16 August 1995
Union Bank Zambia Limited	13 February 2001	29 March 2001
United Bank of Zambia Limited	9 July 2002	24 May 2006

The banks in liquidation made significant strides in terms of debt recoveries which consequently facilitated the payment of dividends to the depositors.

By close of the year, five out of the seven banks in liquidation declared dividends as follows;

- Meridien Biao Bank Zambia Limited (In Liquidation) made the final payment of uncollected dividends, from 1 March 2013 to 31 August 2013. The uncollected dividends thereafter shall be surrendered to BoZ in accordance with the BFSA and there shall be no further claims by depositors;
- Union Bank Zambia Limited (In Liquidation) paid its 8th interim dividend of up K400,000.00 per account from 20 May 2013 to 23 August 2013;
- African Commercial Bank Zambia Limited (In Liquidation) paid its 5th dividend of the full outstanding balance per account, from 15 July 2013 to 18 October 2013;
- Commerce Bank Zambia Limited (In Liquidation) paid its 3rd interim dividend of up to K200,000.00 per account, from 4 November 2013 to 3rd January 2014; and
- The United Bank of Zambia Limited (In Liquidation) paid its 3rd interim dividend of up to K150,000.00 per account for the period 11November 2013 to 14 February 2014.

6.2 NBFIs in Liquidation

At the end of December 2013, the number of NBFIs under liquidation remained at 3 as in the previous year. These were Commercial Capital Corporation Limited (CCCL), Access Financial Services Limited (AFSL) and Access Leasing Limited (ALL).

6.2.1 Commercial Capital Corporation Limited

The disposal process of MEL (trading as Cash4Africa) a wholly owned subsidiary of CCCL (In Liquidation) was completed on 31 December 2013 following the transfer of 2,500,000 shares with par value of K0.10 to Roraima Data Services in exchange for a cash consideration of K0.4 million and assumption of debts amounting to K1.8 million.

6.2.2 Access Financial Services Limited and Access Leasing Limited

As at 31 December 2013, the consolidated net-worth of AFSL and ALL stood at negative K6.28 million. The negative net-worth has largely resulted from the net effect of interest income, running costs, legal costs and additional provisions for bad and doubtful debts. However, the negative net-worth is expected to be reduced significantly when some fixed assets and investments are disposed of.

APPENDICES

Appendix 1 Departmental Organizational Chart - BSD

Appendix 1A Departmental Organizational Chart - NBFISD

Appendix 2 List of Commercial Banks

Appendix 3 Commercial Banks' Branch Network (Map)

Appendix 3A Non-bank Financial Institutions Network (Map)

Appendix 4 Banking Sector Consolidated Balance Sheet

Appendix 5 Banking Sector Consolidated Income Statement

Appendix 6 Banking Sector Consolidated Capital Position

Appendix 7 Banking Sector Key Performance Indicators

Appendix 8 Non-bank Financial Institutions Balance Sheet

Appendix 9 Non-bank Financial Institutions Income Statement

Appendix 10 Non-bank Financial Institutions Capital Position

Appendix 11 Non-bank Financial Institutions Profitability Indicators

Appendix 12 Non-bank Financial Institutions Key Performance Indicators

Appendix 13 Bureau de Change Income Statement