CENTRAL BANK OF LESOTHO
SUPERVISION DEPARTMENT
ANNUAL REPORT FOR 2003

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PART I

GOVERNOR'S REMARKS

A major goal we established in September 2001 has been to enhance delivery of financial services to all sectors of the economy, and to expand the public's understanding of the role of the Central Bank and the operations of the financial sector. I am particularly gratified by the valuable contributions of all the divisions towards "taking the Bank to the people". During the year under review all departments have taken part in disseminating information to the public on activities they are involved in.

Of significance to the Department of Supervision during the year, was the role played as a facilitator of discussions on important public policy issues such as establishment of the Development Fund and establishment of a Deposit Insurance Scheme. These workshops brought together academic researchers, members of the banking community and representatives of the private and public sectors to explore the desirability of the schemes. The department also organised workshops addressing Capital Markets Regulation and Supervision and the use of the ACCION Camel instrument in supervising Micro Finance Institutions (MFIs). Although these workshops were mainly aimed at equipping supervision staff with the necessary supervisory tools for the financial sector, we invited other organisations outside the Bank to attend. We did this in recognition of the important role played by the public and private sectors and to take into consideration the concerns of all the role players.

We have also participated in Government's efforts to look at strategies that can be employed towards poverty reduction, our contribution to the Poverty Reduction Strategy Paper has been on financial sector performance in Lesotho. The Bank staff at all levels provided considerable support to the efforts of promoting a better understanding of the Bank and its operations.

One of the main pre-occupation of the Bank is to improve financial intermediation, especially to the rural sector and small scale to medium enterprises. However progress has been constrained by structural deficiencies that continue to impede efficiency of the financial sector in extending credit to the poorer sectors of the economy.

In addressing these deficiencies, we have had to first take a hard look at institutional arrangements of the financial system. Substantial attention has been given to financial institutions that can be nurtured and transformed into banks that can provide credit and other financial services to the unbanked sectors of the economy. The Department of Supervision has been instrumental in preparing a report that has made recommendations on measures to be taken for the transformation of one multi-purpose cooperative society into a cooperative bank.

We continue to study the micro finance institutions to fully understand their operations for we believe that the micro finance sector could be the best vehicle through which to achieve our goal of taking financial services to the people. We have maintained relations with knowledgeable institutions, consultancy firms and donors that have offered various forms of assistance towards developing the sector. Finmark Trust have shared with us their findings on the study of the micro finance sector in Lesotho, GTZ have expressed interest in working with us in designing the appropriate regulatory framework, while Southern Africa Micro-Finance Capacity Building Facility (SAMCAF) have given our supervision staff an appreciation of using the ACCION Camel instrument to supervise the MIFs.

Fostering competition has been an on-going effort and 2003 saw an increasing interest from a number of different kinds of financial institutions to enter the market. Licence applications and enquiries have been processed, for different types of financial institutions like a merchant bank, a private bank, a post office bank and cooperative bank and many others. Furthermore, a foreign bank expressed interest in establishing a branch in Lesotho.

To lay out a framework for coping with these developments, we have prepared a paper for public debate, on the Legislative and Supervisory Framework for the Financial Sector in Lesotho. With specific reference to the insurance sector, we are reviewing the legal framework with the help of Financial Sector Reform and Strengthening Initiative (FIRST) Consultants.

Our efforts in improving the functioning of financial markets have included arranging funding for the High Court of Lesotho to host a workshop for legal practitioners to sensitise them on the workings of the Commercial Court and to develop expertise in handling legal cases arising from transactions of a commercial nature such as banking and finance. Further, the Bank has collaborated with the appropriate government ministries towards the establishment of a credit bureau. Commercial banks and other lending entities stand to benefit from the establishment of such a bureau.

These efforts and several other initiatives close the year 2003 with an ambitious agenda to carry us into 2004. Moving past policy formulation, 2004 will be the year of implementation. In implementing this agenda, we will be mindful of the fact that ours is a rapidly evolving sector that requires us to remain vigilant to the developments that take place.

With the commitment shown by the Bank staff in 2003, I am confident that great progress will be made in 2004.

PART II

2. OVERVIEW OF THE DEPARTMENT'S ACTIVITIES

Every year presents new challenges for the Department of Supervision and 2003 was no exception. We would like to believe that the department performed well in meeting those challenges, particularly in performing its core activities of licensing, monitoring compliance with statutory requirements and regulations, conducting on-site examination and performing off-site surveillance of institutions under the purview of the Central Bank of Lesotho.

The Bank has overall responsibility for the supervision of banks, insurance companies, money lenders and collective investment schemes. As a result of the growing interest shown by the public to enter the financial sector, pressure was mounted on the department to engage in a broad range of information gathering activities, as part of its licensing responsibilities. The highlights of these activities were two research papers, one, on how branches of foreign banks are regulated in other parts of the world and the other on determination of insurance threshold for burial societies. Over the course of the year the department remained vigilant to ensure that transformation in the financial services industry proceeds in an orderly fashion. Regulations on mergers and acquisitions were drafted, Ancillary Financial Service Providers Regulations were published and the review of legislation which falls within the jurisdiction of the Bank was initiated. It is expected that the eventual review of all the relevant legislations would greatly strengthen the regulatory framework of the financial system.

The routine examinations of banks were carried out as part of the 2003 plan, each bank was examined comprehensively. Arising from the severity of the previous examinations findings and market intelligence information, two targeted examinations were done on, one, the loan portfolio of one bank, and two, on the lending operations of one of the Government agencies. The weaknesses observed during the examinations have been adequately addressed.

The year 2003 heralded the Bank's concerted attention to the supervision of the insurance industry and hence enforcement of the Insurance Act not withstanding that this act has been in place since 1976. New ground was broken in the examination of all insurance companies.

A milestone achievement of these efforts has been the incorporation of a subsidiary company by an entity that had been registered as a foreign insurer in Lesotho and had been operating as such for many years.

The off-site monitoring continued satisfactorily in 2003 achieving the objectives of serving as an "early warning devise" to identify problems that may be faced by financial institutions and assessing the industry's patterns and trends. The observed trends that have remained unchanged through out the year have been the high credit and operational risks. Towards year end an implementation plan, to address these deficiencies, drawn on the basis of the International Monetary Fund's (IMF's) recommendations on Strengthning the Central Bank and the Financial System, was approved by Bank Management.

With the date of July 2004 set for deployment of the Bank Supervision Application (BSA) system in Lesotho, structures were put in place to start preparing for the system deployment. A Task Force comprising users of the system was established to identify the returns that will be used by the BSA, to go through the system's solution specifications and User Manuals and identify all areas that required custom BSA related processes. The commercial banks have also been sensitized to this project and their participation will be intensified in 2004.

Training of staff to keep pace with the growing complexity of financial institutions' operations has been an on-going activity of the Department. As is the usual practice of the Bank, Eastern and Southern African Supervision Group (ESAF) training opportunities have been used. Study tours and attachment programmes were undertaken particularly in countries where Deposit Insurance Schemes, Development Funds and Rural Banking are currently in operation.

In line with the Bank's special attention on the insurance industry a seminar was attended in Insurance Regulatory Accounts and Returns, a study tour was arranged with the Financial Services Board (FSB) of South Africa and one employee successfully completed a diploma in insurance.

PART III

SUPERVISION DEPARTMENT'S CORE ACTIVITIES

3.1 OFF-SITE SURVEILLANCE

3.1.1 Introduction

The Supervision Department draws its powers from the Financial Institutions Act of 1999 (FIA) to monitor the activities of the licensed institutions. The Department achieves this task through its Off-Site Surveillance Section. The main activities, which the section pursued during the reporting period were:

- Safeguarding the financial soundness of the financial system in Lesotho and;
- Ensuring compliance with the laws and regulations.

3.1.2 Objectives

The three major objectives of the Off-Site Surveillance section are to:

- Alert the On-Site Examination section of the emerging problems in the financial system.
- Monitor very closely those financial institutions already identified as having significant problems; and
- Advise management of the Central Bank on major policy decisions which it needs to undertake in order to level the playing field for all the stakeholders.

3.1.3 Off Site Returns

The FIA empowers the section to get returns on a regular basis from the licensed entities, which fall under its jurisdiction.

The section reports to the Financial Institutions Supervision Technical Committee (FISTC) weekly. During the period ending December 2003 the following reports were tabled before the FISTC for discussion:

Name of the Report	**Reporting Frequency**
(a) Liquidity Requirements	Weekly
(b) Foreign Currency Exposure	Monthly
(c) Loans to Directors, Officers Shareholders and Other Related Persons	Quarterly
(d) Exposure to top 20 borrowers	Quarterly
(e) Capital Adequacy Report	Quarterly
(f) Minimum Local Assets Requirements	Quarterly
(g) Loan Portfolio Summary	Biannually
(h) Abandoned Funds and Properties	Yearly

The Minimum Local Assets Requirement is a monthly report emanating from the old FIA but is being phased out, the FISTC has made a ruling that minimum local assets be tabled quarterly. Foreign currency exposure is a weekly report, which the FISTC has requested that it be tabled monthly.

a) Liquidity Requirement

The Liquidity Requirements Regulations of 2000, require banks to keep cash reserves and liquid assets based on the deposit liabilities of the previous week. During the period ending December 2003 banks remained liquid.

b) Foreign Currency Exposure

The main objective of this report is to ensure that the banks are not overly exposed on their foreign exchange activities. A very high exposure on foreign exchange dealings could cause a bank to sustain heavy losses which may lead to a bank failure.The Foreign Currency Exposure Regulations of 1999 were amended in 2002. Originally the banks were required not to have an exposure exceeding 10 per cent of capital and reserves on a single currency and 20 per cent of capital and reserves on the overall exposure. The limits were revised to 15 per cent on a single currency and 25 per cent on the overall exposure in 2002. This status remained the same in 2003.

c) Loans to Directors, Officers, Shareholders and Related Parties

This report helps the Regulator to control insider lending within the banks.
The submitted reports revealed that the banks complied with the statutory requirements in relation to Directors and Officers. With regard to the related parties the banking industry was highly exposed, especially to the parent companies. To regularize the situation the banks have submitted the compliance plans to the regulator and their plans have been approved.

d) Exposure to Top Twenty Borrowers

The exposure to top twenty borrowers report enables the Central Bank of Lesotho to determine the extent of exposure by the banking industry in relation to the amount of loans granted to the business community. During the reporting period the banking sector remained highly exposed to the corporate sector just like in the previous year.

e) Capital Adequacy Report

The capital adequacy ratio per the Capital Adequacy Regulations of 1999 is 8 per cent of risk-weighted assets. During the year ending December 31, 2003 banks continued to keep ratios which were way above the required 8 per cent. Even though banks seem to be adequately capitalized there is a need for banks to inject more capital because of the single borrower limit, which is imposed by section 25 of the FIA. This restriction renders it impossible when banks want to make loans to large corporate clients because they easily exceed the 25 per cent of capital as prescribed under section 25 of the Act.

f) Minimum Local Assets

The Minimum Local Assets Requirements (MLAR) ratio is being phased out gradually by CBL. In 2002 the MLAR was moved down to 10 percent of the base amount. The ratio remained at 10 percent during 2003. Even after the revision was made, the banks continued to keep high ratios which are way above the set limit. The MLAR return is submitted monthly by commercial banks and analysed for consideration by the FISTC on a quarterly basis.

g) Loan Portfolio Review Summary

The report is bi-annual and submitted to the Central Bank of Lesotho by all the licensed banks operating in Lesotho. It contains an evaluation of loans and advances, which have been classified by the banks using an objective classification criteria as defined in the loan portfolio summary review regulations.

h) Abandoned Funds and Properties

The Abandoned Funds and Properties Regulations of 1999 require banks to submit a report once a year to the Accountant General. A copy of the same report is given to the Commissioner of Financial institutions. In this report, banks disclose dormant accounts which are fifteen years and over. During the review period the banks reported an amount of M69,421-00 as abandoned funds. This amount mostly consisted of savings accounts and current accounts.

3.2 BANK SUPERVISION APPLICATION (BSA)

3.2.1 Introduction

In preparation for the deployment of the BSA in Lesotho in July 2004, the Financial Institutions Supervision Technical Committee (FISTC) accepted a proposal to establish – The Bank Supervision Application Implementation Project Task Team to carry out the following tasks:'

- To specify the returns, their formats and the reporting time-frames;
- To establish and document the CBL specific parameters to be used in the Bank Supervision Application;
- To identify and document the CBL specific processes and workflows to be used in the Bank Supervision Application;
- To specify the reports to be provided by the Bank Supervision Application.

In initiating these tasks, it is anticipated that the time to be taken during implementation at the Central Bank of Lesotho (CBL) will be greatly reduced.

3.2.2 Project Participation

The following role players were involved in the project as a whole

a) Project Owner:

The project owner was the Director of Supervision

b) Project Stakeholders:

The stakeholders were made up of the following people: Head Financial Institutions Supervision Division (FISD), Head Policies and Exchange Control Division (PECD), Head Supervisory Policies and Regulations Divisions (SPRD), Head Information Technology (IT) and Head Development Finance Division (DFD).

c) Project Team Members:

The team was made up of staff members from the above- mentioned divisions.

3.2.3 Project Approach

In order to complete this project in the most efficient and effective manner, inputs were obtained from the resident team members representing the business whilst also capitalising on existing documentation (where available) to assist in the project. At the end of each phase, which was marked by the production of a deliverable, the team presented the deliverable to the project stakeholders who assured the quality of the deliverables.

3.2.4 Project Deliverables

The deliverables of the project are discussed below

A) SPECIFICATION OF PROPOSED BSA RETURNS

This exercise involved identifying all the returns that will be used by the Bank Supervision Application together with the information that should be provided by those returns as well as the presentation format for each template. The exercise involved identifying additional returns required and those that are no longer relevant. It also entailed comparing the existing templates formats against the system's mandatory requirements of the reporting templates and modifying the existing ones accordingly.

B) SPECIFICATION OF PROPOSED CBL CUSTOMISATIONS

This exercise involved going through the system's Solution Specifications and User Manuals and identifying all areas that required custom lists and then providing relevant information per area.

C) SPECIFICATION OF PROPOSED WORKFLOWS

This exercise involved going through the system's Solution Specifications and User Manuals and identifying all the areas that required custom BSA related processes and then providing relevant workflows per area.

D) SPECIFICATION OF PROPOSED REPORTS

This exercise involved identifying all the required reports in relation to return data together with the information that should be provided in those reports as well as the presentation format for each report. The exercise involved identifying additional reports required and those that are no longer relevant.

E) SPECIFICATION OF PROPOSED ACCESS RIGHTS

This exercise involved identifying users and their groups for all users of the Bank Supervision Application. It also involved identifying all the possible functions of the system and specifying the users who should have access to perform the functionality in the system.

During the monthly Bankers' meetings, commercial banks were updated on the developments regarding the BSA.

By the end of 2003, most of the above-captioned project deliverables for the deployment of the BSA had been completed.

3.3 ON-SITE INSPECTION

3.3.1 Description

The legal framework governing banks and other financial institutions in Lesotho does not prescribe the frequency of examinations. This is governed by, among others, the need to maintain a safe and sound financial system and also to a large extent, the seriousness of the findings and deficiencies in the previous reports of examination.

The size and complexity of the institutions examined as well as the scope of the examinations determine the duration and size of the examination team. Institutions and activities that presented greater risks to the financial system took precedence where supervisory resources were scarce.

3.3.2 Objectives

The main objectives of on-site examinations were to evaluate the overall financial condition of the institutions examined as well as to determine compliance with pertinent laws, regulations, guidelines and directives. The on-site examinations involved an assessment of capital adequacy, asset quality, management, quality, earnings and liquidity.

3.3.3 Methods of On-Site Examinations

The examination approaches may vary from country to country depending, to a great extent, on the size and complexity of the institutions to be examined. Under a risk-focussed examination approach, the examination scope and procedures may be reduced if an institution's internal risk management processes are determined to be adequate or when risks are low. When internal risk management processes are considered weak, the examination scope and procedures are increased.

The risk-focussed examination approach requires an intensive pre-planning, continuous risk assessment and greater interaction with management.

The traditional approach focuses on the assessment of all the CAMELS components. This approach is applicable where institutions are not measuring and controlling risks. This is the approach that the On-Site Examination Section followed during 2003, as the financial institutions were not adequately measuring and controlling risks.

3.3.4 Institutions Subject to Examination by On-Site Examination Section

a) Banks

A full scope examination of all the three banks and their branches was conducted during the year. The examinations included an assessment of all the CAMELS components, which are:

- Capital adequacy
- Asset quality
- Management
- Earnings
- Liquidity
- Sensitivity to market risks.

The banks were generally found to be in a sound financial condition. They were adequately capitalized, liquid and continued to enjoy high returns. The on-site examination revealed some significant improvements in the weaknesses, which were revealed in the examinations, conducted in 2002. These areas included, among others, loan loss provisioning. Provision was found to be adequate, credit returns submitted to the Central Bank were accurate and issues raised in the previous examination were generally addressed. The examination also revealed that the bank's lending policies and procedures were not followed in some cases.

The banks continued to use their own internal loan classification criteria different from that prescribed by the Loan Portfolio Classification Regulations, 1999. However, they all conducted a qualitative review of their loan portfolios with the aim of aligning their provisioning to that required by the Loan Portfolio Classification Regulations, 1999.

A follow-up examination of one of the banks was conducted during the year, which was targeted at its loan book. Its main objectives were to determine the safety and soundness of the policies governing lending, to evaluate the adequacy of internal control system on lending operations, to verify the accuracy of prudential reports submitted to CBL and to determine the adequacy of provision for probable loan losses. Findings were as follows: Provision was adequate, credit returns submitted to Central Bank were accurate, issues raised in the previous examination were generally addressed, exposure to top twenty borrowers was 46.1% and lending policies and procedures were not followed in some cases.

b) Insurance Companies

A full scope examination of four insurance companies was conducted during 2003. Three of these companies were examined for the first time. The main objectives of the examinations were:

- To determine the financial condition of the institutions examined.
- To determine compliance with the Insurance Act, 1976 and it's implementing Regulations of 1985.
- To evaluate compliance with the principles of corporate governance.
- To assess the accounting and internal control systems.

- To evaluate the technical conduct of the insurance business.

The examinations revealed the following:

- Financial condition of two of the companies was considered satisfactory. The third company's financial condition could not be determined because its books of accounts were kept in South Africa. This company was examined for the first time in 2003.
- Non-compliance with some sections of the Insurance Act, 1976 and its implementing Regulations of 1985.
- Internal controls in some areas needed to be strengthened.
- Corporate governance of two of the companies needed to be strengthened.
- The general conduct of insurance business was considered satisfactory.

c) Collective Investment Schemes

During the period under review, there was only one collective investment scheme under the supervision of CBL that was examined. CBL supervises open-ended schemes of which Lesotho Unit Trust (LUT) was one. LUT is managed by Standard Bank Lesotho Unit Trust Management Company (Pty) Ltd.

Standard Bank Lesotho Unit Trust Management (Pty) Ltd which is 51% owned by Standard Bank Lesotho (SBL) and 49% by PMB/Harley and Morris, was incorporated on 2001 February 5 and started its operations on 2001 July 4. On 2001 August 16, LUT was officially launched with the aim of creating an investment opportunity for ordinary Basotho to invest in the privatised companies of Lesotho. As at end of the review period, LUT had already acquired shares in the following privatised companies; Lesotho Bank 20%, AON Lesotho 15% and Lesotho Brewing Company 4.7%.

The Central Bank of Lesotho (Collective Investment Schemes) Regulations were published on 2001 July 19, as a legal framework for regulating and supervising collective investment schemes with a view to encouraging the growth of such capital instruments without compromising the investor protection.

The staff of On-Site Examination Section of the Supervision Department conducted an examination of the LUT and its management company, SBL Unit Trust Management (PTY) LTD. The examination was in line with Regulation 44(2) of the Central Bank (Collective Investment Schemes) Regulations 2001. The main objectives of the examination were:

- To assess the overall financial condition.
- To determine compliance with the Collective Investment Schemes Regulations 2001.

The examination also included the assessment of management and the adequacy of internal controls as well as compliance with the provisions of the Trust Deed between the SBL Unit Trust Management (Pty) Ltd and its Trustee, AON Lesotho (Pty) Ltd. The following were examples of the findings revealed by the examination:

- The Trustee of SBL Unit Trust Management (Pty) Ltd was not registered by the Registrar as required by Regulation 37(2)(b) of the Collective Investment Schemes Regulations, 2001.
- The shareholding structure of SBL Unit Trust Management (Pty) Ltd had not been finalised.
- Regulation 10(1) of the Central Bank of Lesotho (Collective Investment Schemes) Regulations, 2001 which requires the manager to have prior written approval of the Registrar before changing its shareholders or directors was not complied with.

The above findings were discussed with management who undertook to take corrective actions.

d) Money Lenders

No examination of moneylenders was conducted during the year because of the problem of understaffing.

e) Other Institutions Examined (Postal Services)

Pursuant to section 19(1) of the Financial Institutions Act, 1999, a special examination of the Postal Services Department of the Ministry of

Communications was conducted. The main objective of the special examination was to determine whether the Department was engaged in credit business.

The examination was prompted by a complaint lodged to the Commissioner of Financial Institutions by commercial banks in Lesotho that the Postal Services Department was engaged in extending credit without a license.

The examination revealed that Postal Services Department was engaged in extending credit through granting salary advances to civil servants of the Government of Lesotho since February 2000. In accordance with the provisions of the Finance Order 1988, the salary advances to civil servants were to be granted by the Minister of Finance. However, the Ministry of Finance delegated this responsibility to the Postal Services Department. The Treasury Department of the Ministry of Finance originally handled these operations.

There was no provision in the Finance Order 1988 which allowed Ministry of Finance to delegate its powers regarding the granting of credit (salary advances) to civil servants and there was no legislation which empowered the Postal Services Department to carry out this function. As a result the Commissioner had issued a directive to the Department to regularize the legal status of its credit business.

3.4 Liquidation of Lesotho Bank

The liquidation of Lesotho Bank that started on 31 January 2001 was extended by one year at the end of the initial period of two years. This was done to maintain the momentum of debt collection and to give the liquidators the opportunity to conclude some outstanding issues with Lesotho Bank (1999) Limited.

When Lesotho Bank was put under liquidation its loan book stood at M616.8 million. It must be noted, however, that this figure was yet to be verified with supporting documentation which was not readily available in most cases. During 2003 the verification process and collection efforts were intensified. The liquidators continued to perform reconciliations of the loan book, sort and reconstruct the debtors' files and rigorously pursue the debtors. Voluntary settlement arrangements were concluded with debtors that were willing to pay while legal action was taken against those that refused to honour their obligations. Certain properties were removed from the liquidation books and taken over by the Government of Lesotho while other properties and movable assets were re-possessed and sold by public auction. During the period 31 January 2001 to 31 December 2003 a substantial amount has been collected as loan and interest recoveries. A Total of M35 million was distributed in cash to the Government of Lesotho, the sole shareholder of the bank, over the period 31 January 2001 to 31 December 2003.

PART IV
REGULATORY AND POLICY DEVELOPMENTS

4.1 Ancillary Financial Service Providers Regulations

During the period under review, the Financial Institutions Supervision Technical Committee (FISTC) of CBL has granted its approval on the draft Ancillary Financial Service Providers (Licensing Requirements) Regulations. The Regulations are intended to govern auxiliary financial services in Lesotho, such as foreign exchange dealing services, electronic fund transfer services, money market dealing services, money market brokerage, and private equity fund management. Following the adoption of CBL, the Regulations were transmitted to the Office of the Parliamentary Counsel under the Attorney General's Chambers for further scrutiny and preparation for publication in the Government Gazette. The Regulations have to be tabled before Parliament for approval after fifteen days of their publication in the Gazette before they can come into force.

4.2 Insurance Sector Reform

Subsequent to the signing of the Technical Assistance Grant Agreement between CBL and Management Unit (MU) of FIRST Initiative, MU engaged two Consultants to provide technical assistance to CBL.

The purpose of the technical assistance is to provide CBL with legislative, regulatory and supervisory framework and capacity building that will enable the insurance industry to operate and develop in a sustainable and prudent manner. The technical assistance is also aimed at prudently meeting the demands of the economy for risk protection and stimulating growth in the investment sector.

The Consultants had completed Phase I of the Project in 2003 which involved development of a policy framework for the industry and legislative style including review of existing legislation and functioning of the industry. It also included the development of a detailed work plan for subsequent phases of the technical assistance. During the period under review, the following activities were covered under Phase I:

(a) review of the 1976 Insurance Act and its Regulations including any other laws and documentation that have impact on or are related to the insurance sector;

(b) review and discussion of the present level of supervision exercised by CBL including reports received from the participants in the industry and those based on the examination conducted, and a general assessment of the CBL's power to enforce and the capacity of supervisory staff to engage in effective supervision;

(c) conducting of a high level review of the main participants in the insurance industry (all the insurance companies and major brokers) based on the analysis of published data and interviews held with them, including the analysis of the market to determine the types of insurance business conducted, gaps in the market and the strengths and weaknesses of industry;

(d) canvassing the opinions of the main participants in the sector on policies related to strengthening the legislative and regulatory framework and supervisory regime;

(e) preparation of detailed policy recommendations for the establishment of a legal framework complying with the International Association of Insurance Supervisors (IAIS) Core Principles which Lesotho subscribes to;

(f) preparation of policy recommendations concerning measures that need to be taken to strengthen CBL's regulatory and supervisory capacity;

(g) meeting with the officers in the Attorney General's Chambers responsible for legislative drafting, and for briefing on the legislative procedures that have to be followed once the draft insurance bill is prepared;

(h) preparation of a work plan for implementation of subsequent phases of the technical assistance;

(i) a two day visit to the South African Financial Services Board aimed at consulting and gaining a better understanding of the regulation of insurance business in South Africa and to informally explore the possibilities for subsequent cooperation and assistance.

The above activities covered the entire scope of work under Phase I and have all been approved by CBL as having satisfactorily been completed. The Consultants have therefore been given a go-ahead to proceed to the Phase II of the Project, which mainly involves the drafting of the new insurance legislation.

4.3 Money Lenders Act 1993

As previously reported, the Central Bank of Lesotho (CBL) was still to pronounce itself on whether to continue to regulate this industry or not since the players do not take deposit of any kind. The main problem currently facing the money-lending business in Lesotho is that the money lending legislation is obsolete and needs modernising.

It is important therefore, for this activity to be formally part of the financial sector and recognised as such, that there is an urgent need to overhaul its enabling legislation. The development of a new legal framework would have to be preceded by the defining of the policy framework. The vision paper was a deliberate attempt to outline the policy framework.

The proposal raised in Vision Paper as regards money lenders, is that the Central Bank of Lesotho should supervise only those financial institutions that warrant prudential supervision and pose systemic risk. However, with respect to the business of money lending, it is proposed that the industry should be supervised under a self-supervisory body comprising the CBL, consumer representatives and money lenders representatives.

4.4 Vision Paper on the Regulatory and Supervisory Framework

The year under review saw the adoption of the Vision Paper coming to fruition. Following lengthy discussions and debate the Vision Paper was finally adopted by the Central Bank and is due to be presented before the Board for approval and implementation. While this document is still an internal document of the Bank, a decision was taken during the year under review, to begin preparations for unveiling this document to the stakeholders and general public. To implement this decision, preparations for the workshop began at the end of the year under review and it is anticipated that the workshop will be held in the first half of the next year.

The paper, which discusses the regulatory and supervisory framework of the financial sector in the country, also presents policy and regulatory model choices to both the Central Bank and the investors.

4.4 Amendments of Cooperative Societies Act 2000

In order to reconcile fundamental differences between the Cooperatives Societies Act 2000 and the Financial Institutions Act 1999 (FIA), various sections of the Cooperatives Act were identified for amendment. Some of these sections were discussed in our 2001 edition. The most crucial issue was the fact that a number of cooperative societies with savings and credit function have in fact been authorised to accept deposits from non-members.

It appeared that prospective operators who do not wish to be subjected to the minimum capitalisation and other licensing criteria under the FIA may choose to register under the Cooperative Societies Legislation which does not prescribe the same level of licensing and other prudential requirements. The central issue comes back to depositors protection. In as much as cooperative societies may accept deposits from members and non members, the question of whether the operations of cooperative societies are subject to the same degree of supervision as banks now becomes very relevant.

It was in the light of this concern that a proposal to revisit the Cooperative Societies Act 2000 was made. The amendments of the Cooperative Societies Act 2000 were tabled before Parliament in 2003, but had to be withdrawn due to some technical issues. Following this withdrawal, the Central Bank of Lesotho and the office of the Commissioner of Cooperatives Societies will be holding meetings on the draft amendments to come up with a solution to those technical issues.

Dialogue between the two offices will continue in the new year (2004).

PART V
FINANCIAL INTERMEDIATION INITIATIVES

5.1 Export Finance

During the year under review the bank continued to administer two Funds aimed at the development of the private sector i.e. the Export Finance and Insurance Scheme and the Development Fund.

(a) Export Finance and Insurance Scheme

In order to carry out its function the Bank has established the Export Finance and Insurance Scheme whose objectives are to:

i) provide working capital for production of exportable goods and services to Lesotho based exporters;
ii) give Lesotho based exporters a competitive advantage in international markets and establish internationally competitive industrial projects;
iii) encourage commercial banks to extend credit to exporters;
iv) stimulate development of new products and services with good potential for growth and;
v) attract more foreign exchange earnings in order to improve the balance of payments current account and
vi) create employment for Basotho.

A vigorous publicity campaign was embarked upon to ensure that both small scale and large scale enterprises know about the scheme and understand its requirements. Methodology of the campaign included newspaper and radio advertisements, public addresses in the districts and individual visits to workshops and factories. During the visits promotional brochures were distributed.

b) Development Fund

The Development Fund is aimed at enhancing the development and growth of the private sector, which will result in more job creation and poverty reduction.

Following broad consultations which culminated in a workshop attended by all stakeholders, the policy paper for establishment of the Development Fund was completed and submitted to the Honourable Minister of Finance and Planning for Government's consideration.

5.2 Rural Finance

During the year 2003, Rural Finance Division in furtherance of the policy for rural financial intermediation and in fulfilment of its objectives embarked on the following activities.

a) **Sensitisation of Stakeholders -** meetings with stakeholders were convened as part of the sensitisation efforts to bring to the fore front all players featuring in rural financial service provision. Both indigenous and international Non Govermental Organisations (NGOs) were met with the purpose of mapping together the required interventions and devising a coordinated approach. In this regard, all concerned parties expressed commitment towards ensuring the successful implementation of the Financial Intermediation policy through various means of which, training of Rural Savings and Credit Groups (RSCGs) was given the highest priority. This was one effort towards achieving a thorough understanding of the necessary ingredients in credit training and administration.

b) **Establishment of the Credit Guarantee Fund** - the CBL Board of Directors approved a sum of M2.5 million for the establishment of a Credit Guarantee Fund (CGF) that will cover the exposure of banks. This is aimed at ensuring implementation of the linkage banking programme.

c) **Launch of the RSCGs Scheme** - the Scheme was officially launched during the period under review with further developments embracing opening of the CGF account with CBL. On the same breath, a Steering Committee which is representative of stakeholders held its first meeting to address salient issues of the Scheme's take-off.

d) **Familiarisation visits to RSCGs** - members of the Steering Committee were taken to districts on familiarisation tours to visit RSCGs within their respective places of business. The visits facilitated a deeper understanding and appreciation of the groups'operations in line with the requirements for linkage banking programme. Through such interventions, committee members and groups acquired knowledge on activities, products and future plans earmarked for the linkage banking process. In the same spirit, it can be deduced that a proactive step towards developing institutional underpinning of an effective rural financial intermediation policy was taken. The year under review has thus been a period of greater activity in preparing for the start of events.

e) The African Rural and Agricultural Credit Association (AFRACA) Executive Committee meeting.

In the year 2002, CBL was appointed to the position of Deputy Chairman in AFRACA Executive Committee. As per practice, the institution that has been elected to this seat is supposed to host the meeting of the Executive Committee. In line with this practice, the division facilitated the hosting of AFRACA Executive Committee meeting, which was held in Maseru in June 2003. Pertinent issues discussed covered the following:

- The need to revive the Central Africa Sub-Region.
- AFRACA's Diplomatic recognition by the Kenyan Government.
- New membership fees.
- Review of AFRACA constitution.
- AFRACA Strategic Plan for 2003/2008.
- Themes for the Sub-Regional workshops 2003/2004.
- AFRACA audited accounts 2002.

f) Participation in AFRACA sponsored seminars and exposure programme. The division participated in microfinance seminars in Sri-Lanka and Ethiopia, and in an exposure programme at the Bank of Ghana. The attachment provided appreciation of rural banking in the context of Ghana. The division through such exposure programmes, is armed with the tools necessary for rural financial intermediation.

5.3 Credit Bureau

The proposal for the establishment of the credit bureau was tabled before Cabinet by the Ministry of Trade and adopted during 2003. Following the adoption, the Ministry of Trade engaged in consultations with the Central Bank with a view to formulating Regulations for licensing of the operators of the credit bureau. At the same time, prospective operators were invited to submit their licence applications to the Ministry of Trade.

The stakeholders of the project also took a decision that prior to the start of the project, it would be necessary to embark on a massive public education campaign. The objective of the public education campaign will be to clear off any negative perceptions that the public might have about the credit bureau and to inform the public about:

- The benefits of having a credit bureau;
- The duties and obligations of a credit bureau company;
- The rights of the public in respect of information concerning their credit history.

In light of the above and in order to ensure the success of the project, the stakeholders agreed that it would be best if a professional public relations company carried out such a campaign. The stakeholders further agreed in principle to equally share the costs of the campaign, estimated in the range of M50,000 and M100,000. The stakeholders held a meeting on Thursday 9th October 2003, where they agreed on the Terms of Reference for the campaign and modalities for the procurement of the services of a public relations company.

Pursuant to a decision to procure services of a professional public relations company, the stakeholders held a further meeting on the 11th December 2003 to consider tenders for the campaign. There were five bids submitted for consideration, namely:

- Gemini Professional Services
- People's Choice (PC) FM
- Chebelo-Pele Consultants (Pty) Ltd
- Pheko Mathibeli & Lebohang Lejakane
- Keendom Design & Communications

The tender was awarded to Gemini Professional Services, subject to ratification by stakeholders who were absent from the meeting but had nonetheless pledged to share costs of the campaign.

5.4 Post Office Savings Bank

The Project Management Committee (PMC) continued to pave way for the establishment of the Lesotho Post Bank even though the activity was sluggish resulting from certain structural impediments. The PMC carried out the following activities during 2003:

(a) Site Visit of Pilot Sites

The PMC visited ten Post Offices with the objective of establishing whether they comply with the security guidelines as prescribed by the Central Bank of Lesotho (CBL). The Post Offices which were visited are the following: Pitseng, Maputsoe, Mokhotlong, Mapholaneng, Thaba-Tseka, Sehonghong, Machache, Semonkong, Quthing and Mount Moorosi.

(b) Refurbishment of Pilot Post Offices

The site visits were followed by a preparation of a comprehensive report which was submitted the Director of Lesotho Postal Services. The report was to serve as a basis for enabling the Director to make a plan for the refurbishment of the Post Offices which have been selected to participate in the pilot phase.

(c) Registration as Public Company

The cabinet granted approval that the Post Office be registered as a public company. The shares were allocated to the shareholders in the following proportions: Minister of communications 700 shares, Minister of Finance 50 shares, Attorney General 50 shares, Principal Secretary Communications 50 shares, Principal Secretary Finance 50 shares, Director Lesotho Postal Services 50 shares and Legal Officer 50 shares. The shares allocated to the Government was with the understanding that after the project has taken off, the Government would relinquish the 60 per cent of the shares and remain with 40 per cent.

(d) Service Contract

The service contract between the Lesotho Post Bank and the Lesotho Postal Services was drafted and finalised in November 2003.

(e) Business Plan

The PMC drew an abridged business plan for the pilot phase for onward submission to the Cabinet. The business plan was approved by the Cabinet in November 2003. Following the Approval of the business plan the Ministry of Communications was given a go ahead to apply for a banking license.

(f) Staff Recruitment

The PMC drew the terms of reference and job descriptions for senior management of the Lesotho Post Bank in preparation for recruitment during the following year.

5.5 Commercial Court

CBL and the High Court of Lesotho having agreed on the training of the commercial lawyers as a measure of enhancing the performance of the Commercial Court, both organisations jointly secured some funding for a six day Trial Advocacy Course. The funds were sourced through the assistance of the Privatisation Unit from the Lesotho Utilities Reform Project under the auspices of the World Bank. The Course was held from 6-11 October 2003 at the High court of Lesotho, Palace of Justice. The resource persons were drawn from the Black Lawyers Association in the Republic of South Africa while the participants were from the public service, private sector and non-governmental organisations.

The purpose of the course was to assist commercial lawyers with a better understanding of the rules and procedures of the Commercial court in order to enhance and accelerate its operations, and avoid delays in adjudicating commercial cases.
The programme for the course consisted of simulated trial experiences which were videotaped. One of the cornerstones of the programme was the individual attention given to class participants. Each participant was expected to perform the exercise before the group and was given a feedback from the facilitators in a classroom setting. Thereafter, each participant was given a video critique of his or her performance. The video critique was individualised and provided another opportunity for the participant to assess his or her performance and to see how his or her performance could be improved.

PART VI

GROWTHS AND TRENDS

6.1 BANKING INDUSTRY

The banking industry currently comprises three normally operating banks, namely Lesotho Bank (1999) Ltd, Standard Bank Lesotho Ltd and Nedbank (Lesotho) Ltd. Standard Bank Lesotho Ltd is a major shareholder in Lesotho Bank (1999) Ltd. with ownership amounting to 70%, and together the two banks form the Standard Bank Lesotho Group. There is another bank, old Lesotho Bank under liquidation, which operates under a restricted license prohibiting it from engaging in deposit taking and granting credit to the public.

6.1.1 Total Assets

Total assets in the banking industry grew to M3,216 million as at December 2003, a M76 million increase in absolute terms, compared to M3,140 million reported in December 2002. The reported rise was largely dependant on the M674 million increase in investments, although it was highly reduced by a M579 million drop in loans and advances. The fall in loans and advances resulted from a reduction in loans and advances of the old Lesotho Bank under liquidation, which either meant that loans are being recovered or are being written off.

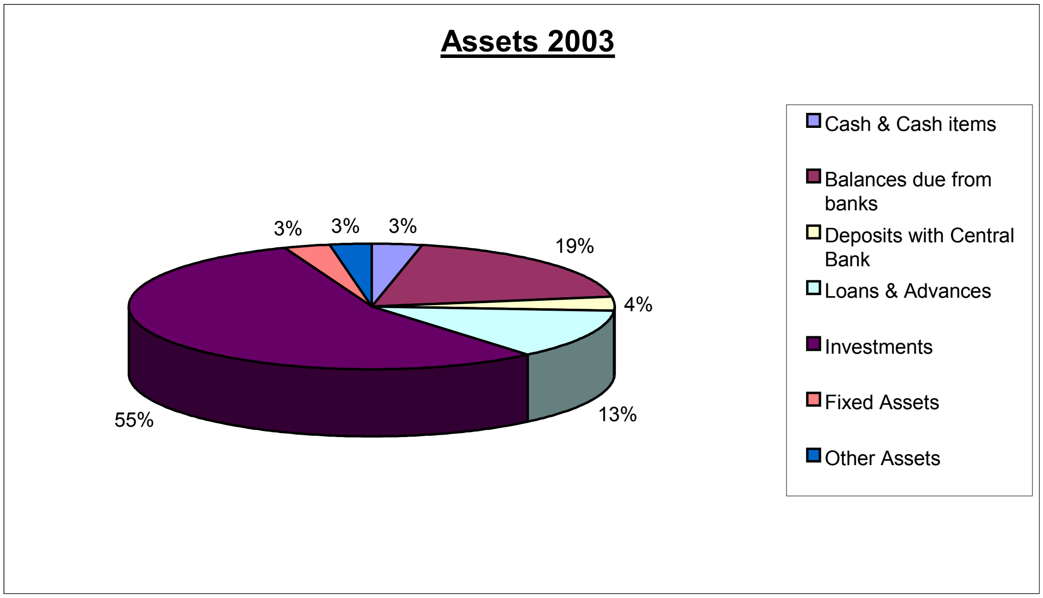
Table 1
BANKING INDUSTRY

(In million Maloti)	1998	1999	2000	2001	2002	2003
Total Assets	2,165	3,012	2,885	2,908	3,140	3,216
% change	13%	39%	-4%	1%	8%	2%
Total Deposits	1,688	1,592	1,607	1,785	1,957	2,055
% change	18%	-6%	1%	11%	10%	5%
Number of Banks	4	5	4	4	4	4
Operating Normally	2	3	3	3	3	3
Under Conservatorship	1	-	-	-	-	-
Under receivership/liquidation	1	1	-	1	1	1
Restricted licence	-	1	1	1	1	1

Deposits rose by 5% from M1,957 million as at December 2002 to M2,055 million as at December 2003.

Figure 1 shows the components of total assets. Investments in securities comprised the largest part of assets at a massive 55% of total assets, followed by balances due from banks at 19%. Loans and advances comprised 13% of total assets, showing a substantial 19% decrease compared to 32% reported in the previous year. Both fixed and other assets accounted for 3% of total assets, and cash items comprised the same percentage. It should be noted that only 11% of the total loan portfolio belonged to normally operating banks, and the rest comprised loans of the old Lesotho Bank in liquidation, which are bad loans, hence the reported decline.

FIGURE 1: TOTAL ASSETS AS AT 31 DECEMBER 2003



The industry's preference to invest in risk free government securities continued in the year 2003 as indicated by Table 2 below, although an 8% decline was reported in 2003. Another area of preference was placement of funds with other banks, especially with related banks. Loans and advances dropped by 58%, but as already highlighted above, this was largely due to a reduction by the old Lesotho Bank under liquidation. The normally operating banks recorded growth in loans and advances to the tune of 13% during the financial year ended 31 December 2003.

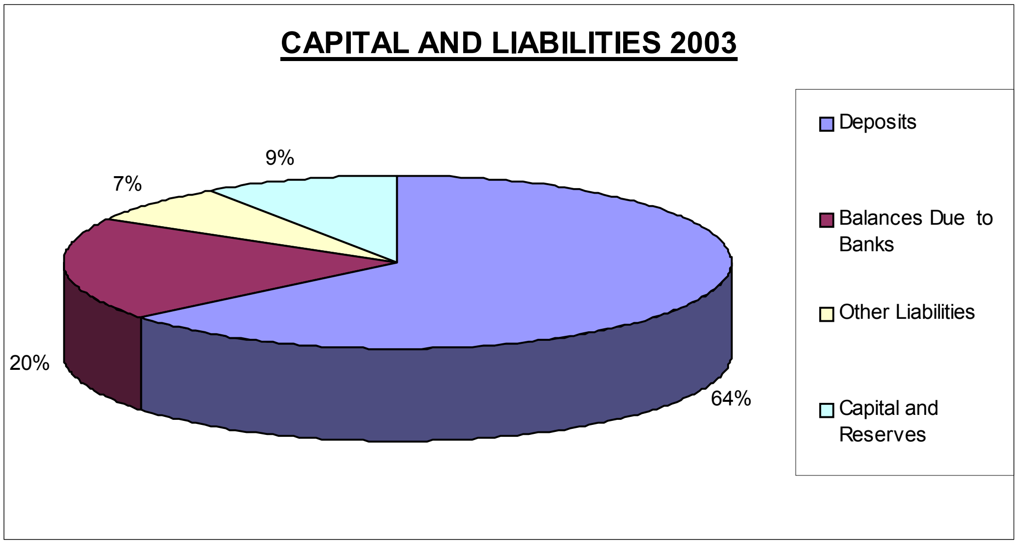
Table 2
BANKING INDUSTRY — GROWTH IN SELECTED ACCOUNTS AS AT DEC 31

Selected Accounts	(In Million Maloti)			(% of Total Assets)				% Change
(In Million Maloti)	2001	2002	2003	2000	2001	2002	2003	2003/2002
Due from Banks	464	608	617	16%	21%	21%	20%	1%
Loans and Advances	849	996	417	29%	34%	34%	13%	-58%
GOL Securities	690	1102	1012	24%	38%	38%	32%	-8%

6.1.2 Capital and Liabilities

Total deposits comprised 64% of total capital and liabilities as at December 2003. Balances due to banks was the second largest liability and comprised 20% of total capital and liabilities. Capital and reserves remained intact at 9% as shown in Figure 2 below.

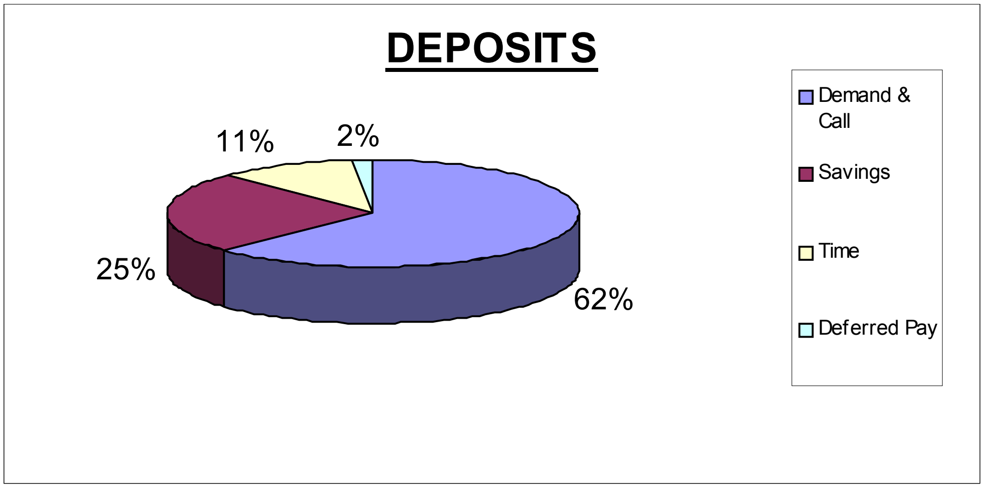
FIGURE 2: CAPITAL AND LIABILITIES- DECEMBER 2003



6.1.2.1 Total Deposits

Demand and call deposits comprised 63% of total deposits. Savings dropped marginally from 27% as at December 2002 to 25% as at December 2003. Time deposits accounted for 11% and deffered pay comprised the remaining 2%. The composition of total deposits is illustrated in Figure 3 below.

FIGURE 3: DEPOSITS



6.1.3 Compliance Ratios

Table 3 below shows four statutory ratios, namely reserves, liquid assets, minimum local assets, and capital adequacy ratios. The ratio of available reserves to required holding increased by 9% to 121% during the review period, and the ratio of available liquid assets to required holdings also improved by 10%. Minimum local assets regulations were reviewed during the financial year 2003, and the requirement was reduced from 25% to 10%. This amendment together with the increased Government Securities led to a sharp rise in available minimum local assets to required holding ratio. This ratio declined from 75% to 473% as at December 2003. Banks remained adequately capitalised to cover the risk weighted assets at 24% as at December 2003, in relation to Basel capital requirement of 8%. However, the Central Bank of Lesotho is currently undertaking a study of Basel Capital Accord II which is anticipated to be implemented in 2007 This will look further into the issue of whether the 8% requirement is still adequate or not.

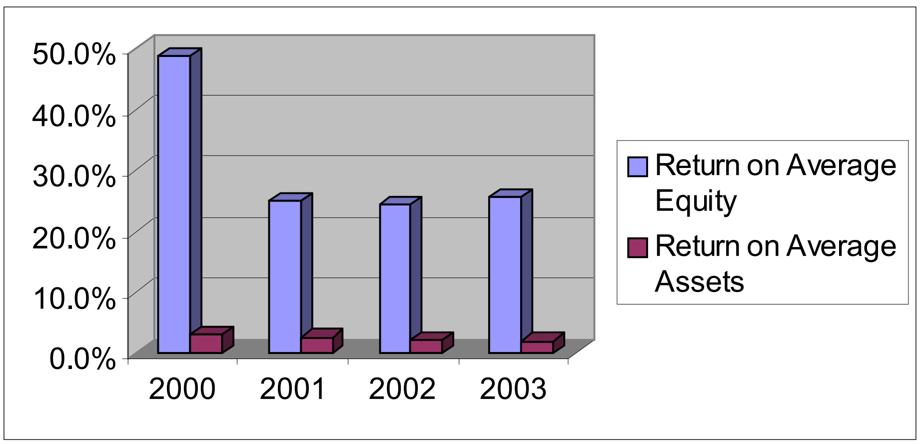
Table 3	COMPLIANCE RATIOS				
Statistical Ratios	**2000**	**2001**	**2002**	**2003**	**Variance**
Available Reserves to Required Holdings	106%	104%	112%	**121%**	**9%**
Available Local Assets to Required Holdings	146%	178%	279%	**752%**	**473%**
Available Liquid Assets to Required Holdings	216%	181%	162%	**172%**	**10%**
Basel Capital Ratio	34%	33%	25%	**24%**	**-1%**

6.1.4 Profitability

Profitability ratios are illustrated in Table 4 and Figure 4 below. The three normally operating banks remained profitable in the year ended December 2003, and annual profits grew by M20 million to M73.4 million. Consequently, the return on average equity increased to 25.7%, while the return on average assets fell marginally to 2% in 2003 from 2.2% reported in 2002.

Table 4	PROFITABILITY RATIOS			
	2000	**2001**	**2002**	**2003**
Return on Average Equity	48.7%	24.9%	24.4%	**25.7%**
Return on Average Assets	3.0%	2.6%	2.2%	**2.0%**
Net Income After Tax	62.2m	57.4m	53.1m	**73.4m**

FIGURE 4: PROFITABILITY RATIOS



6.2 INSURANCE INDUSTRY

During the year 2003, the number of insurance companies was maintained at seven. The six fully operational insurance companies comprised Lesotho National General Insurance Company, Lesotho National Life Assurance Company, Metropolitan Lesotho, Alliance Insurance Company, Sentinel Insurance Company and Customer Protection Insurance Company. The license of Star Lion Insurance Company which had been awarded in the previous year, was not renewed due to non-compliance of certain provisions of the Act and CBL undertook to assist them in coming up with the compliance plan instead of just renewing their license and deserting them. All these insurance companies maintained different financial year ends, hence the lack of industry figures as at December 2003.

Efforts to enhance the regulation and supervision of the insurance industry continued in 2003. The Financial Sector Reform and Strengthening Initiative (FIRST) Consultants, who are mandated to develop a legislative and supervisory framework and capacity in insurance, started implementation by first of all reviewing the existing legislation and functioning of the industry and then developing a policy paper framed alongside the

Insurance Core Principles upon which the new draft bill would be based. Subsequent developments would follow in the coming year.

6.3 *MONEY LENDERS INDUSTRY*

Money lenders started using the prescribed reporting requirements from the Central Bank of Lesotho. It has been decided that more emphasis be placed on those large money lenders with prospects of growing into cooperatives banks or microfinace institutions, in order to improve the process of financial intermediation, especially in the rural areas. The Central Bank of Lesotho has requested technical assistance from GTZ of Germany regarding the development of Microfinance Institutions Regulation.

PART VII
DEVELOPMENTS RELATED TO SUPERVISION

7.1 ECONOMIC ISSUES

a) Recent Economic Developments

During the year 2003, Lesotho's economic growth, measured by real gross domestic product (GDP), was estimated to have slowed down to 3.3 per cent from 3.8 per cent realised in 2002. The deceleration in real GDP resulted mainly from the disappointing performance by the secondary sector and the continuing deterioration of the primary sector. At the same time, real gross national income (GNI) is expected to have grown by 2.7 per cent compared with 1.5 per cent in 2002. In Lesotho, GNI is relatively more important because of the significance of net factor income from abroad. The Basotho mineworkers' remittances from South Africa remained strong during the review period despite the strengthening of the rand against major currencies.

The manufacturing sub-sector, which was the main growth driver in 2002, was negatively affected by the weak global demand coupled with the appreciation of the rand during 2003. The US economy, which is the recipient of the bulk of Lesotho's manufacturing products, was slow to pick up and only showed strong signs of recovery during the third quarter of 2003. Furthermore, the rand, to which the loti is pegged, strengthened considerably against major currencies during the year. This reduced the domestic currency value of Lesotho's exports, in addition to rendering them less competitive in foreign markets. The construction sub-sector, which was the mainstay of Lesotho's economic growth during the 1990s, was adversely affected by the slow implementation of Government projects and the continuing tapering off of the Lesotho Highlands Water Project (LHWP) related activity.

The continuing drought conditions in the country are expected to have impacted negatively on the primary sector. Although the Government intervened by providing farmers with agricultural inputs, the absence of rainfall was worse than anticipated. In contrast, the tertiary sector is expected to have contributed significantly to growth, mainly, from wholesale and retail, and posts and telecommunications sub-sectors, as well as education and health.

Price developments in Lesotho during the review period continued to follow those in South Africa. Inflation, as measured by consumer price index (CPI), averaged 7.2 per cent in 2003 compared with 11.9 per cent in 2002. The observed downward trend in inflation was mainly due to the decline in prices of food and the appreciation of the currency. The price of the staple food, which fell considerably during the year and the strengthening of the local currency exerted downward pressure on domestic and imported inflation, respectively.

The external sector position is envisaged to have deteriorated, resulting in a decline in gross reserves from 6.4 months to 5.5 months of import cover. Despite a modest improvement in the current account of the balance of payments, gross international reserves fell mainly due to the strengthening of the local currency against major currencies. The loti appreciated by 25.2 per cent against the US dollar and 13.5 per cent against the Euro during the year. The deterioration of the capital and financial account also contributed to the worsening of the external position.

Preliminary indications are that government budgetary operations for the fiscal year 2003/04 resulted in an overall deficit of M246.8 million, equivalent to 2.9 per cent of GDP. The budget outlook for the review period was rather expansionary by design mainly due to the decline in Southern African Customs Union (SACU) revenue, which could not be matched by a commensurate reduction in expenditures. The latter comprised mostly of long term expenditure commitments such as education and health. This deficit is expected to be financed from local resources. About half would be by drawing down government deposits with the CBL and the other half through the issuance of domestic debt.

The stock of debt declined from 65.6 per cent of GNI at the end of 2002 to an estimated 54.9 per cent at the end of the review period. The decrease in the country's debt stock resulted mainly from a reduction in external debt component. The decline in external debt was mainly due to revaluation movements as the local currency strengthened significantly against major currencies during the year. However, the ratio of domestic debt to GNI rose to 11.4 per cent of GNI from 10.1 per cent in the previous year. Upward pressure on domestic debt emanated from the issuance of treasury bills for both monetary and fiscal policy purposes.

b) The Impact on Financial Sector Activity

The performance of the financial sector in 2003 mirrored the impact of the overall economic activity. Net foreign assets (NFA) of the banking system declined mainly due to the revaluation loss resulting from the appreciation of the local currency against major currencies. This resulted in the slow down in money supply growth during the year. However, increased Government borrowing kept domestic interest rates relatively high despite the regional downturn in interest rates.

The broad measure of money supply, M2, grew by 6.0 per cent in 2003 compared with 8.8 per cent in the previous year. The observed slowdown in money supply growth was mainly due to the decline in NFA and net domestic credit. The deceleration in the growth rate of money supply was also in line with the downward trend in inflation experienced during the year.

As already indicated, the banking system's NFA declined by 10.8 per cent, during the review period, following a 26.9 per cent decrease in 2002. CBL's NFA declined by 11.1 per cent while commercial banks NFA' fell by 9.2 per cent. The former was mainly influenced by the appreciation of the local currency against major currencies while the deterioration in the latter reflected a shift in foreign currency investments to increased holding of domestic treasury bills by the local commercial banks. The rather expansionary fiscal policy, which generated excess liquidity within the economy, led to a rise in the stock of treasury bills, mostly, as a monetary policy instrument to mop up increased liquidity. A relatively smaller amount of treasury securities were also required to finance part of the fiscal deficit.

Net domestic credit, excluding the non-performing loans, more than doubled from M107.0 million at the end of 2002 to M289.5 million at the end of 2003. This was mainly a reflection of Government activity as gross claims increased considerably whereas deposits remained almost unchanged, thereby resulting in a rise of 48.2 per cent in net claims on Government. Growth in private sector credit, on the other hand, was sluggish and registered 7.7 per cent vis-à-vis 22.9 per cent in 2002.

Domestic interest rates maintained a downward trend, in line with rates in the region, during the review year. The yield on the 91-day treasury bill, which is the main rate in the economy, declined from 12.19 per cent at the end of 2002 to 9.83 per cent at the end of 2003. The average prime-lending rate also fell from 17.67 per cent to 12.5 per cent while the average savings deposit rate dropped from 3.44 per cent to 1.95 per cent. Nonetheless, rates in Lesotho remained above the comparable rates in South Africa, as the relatively strong Government financing requirements maintained upward pressure on domestic rates.

7.2 Lesotho National Payment System Modernisation Project (LNPS)

The year under review saw progress of the Lesotho National Payment System (LNPS) Modernisation Project moving ahead steadily. Though in terms of the annual work programme for the year in question it had been indicated that Lesotho would have implemented a suitable solution by the end of the year, this could not be achieved. The stocktaking and situational analysis exercise took longer than expected, the reason being that the assignment was shared amongst different expert teams comprising the LNPS Sub-Committees and the CBL through its National Payments System (NPS) Division, thus needing collaboration and coordination of the different bodies.

The stocktaking and situational analysis exercise was completed during the year under review. The results of this exercise, al in all, indicated to the need for the reform of the payment system. It particularly brought to the fore the lack of payment system infrastructure, especially in the rural areas of Lesotho, the narrow base of payment instruments, manual processing of paper-based funds transfer system, and lack of suitable large-value transfer system and time-critical payment transactions.

Based on these results, a vision was formulated and was adopted by the LNPS Council. This Council is the supreme decision-making body on matters related to payment system reforms and consists of the Governor, the Chief Executive Officers of Commercial Banks, the Chief Executive Officers of the Telecommunications and Energy Industries, and the Principal Secretary for the Ministry of Finance and Economic Planning.

The vision is stated as follows: "By 2015, Lesotho will have a widely accessible, secure, reliable and efficient payment and settlement system. The system shall facilitate and support Lesotho's development objectives".

The vision paper also outlined the main objectives of the reform process, and deadlines were set for the achievement of each specific objective.

Towards the end of the year a draft strategic framework was prepared. This identified future characteristics of the new payment system, the critical success factors against which the successful implementation of the reform process would be measured, and the fundamental principles that will guide the development, deployment and management of the new system.

7.3 Capital Account Liberalisation

In March 1998, Lesotho acceded to Article VIII of the International Monetary Fund (IMF's) Article of Association. By so doing the controls on current account international transactions were abolished. However, controls on the capital account were maintained for several reasons stated below:

1. Firstly, the controls serve to preserve the level of foreign currency reserves. Given the fixed exchange rate system within Common Monetary Area (CMA) region, a fully liberalized capital account regime could result in the depletion of member's external reserves as the higher demand for foreign currency than its supply would be met by drawing down the reserves.

2. Secondly, the controls guard against sudden and unexpected large depletion of savings in capital outflows, which may adversely affect confidence in the country's ability to honour its foreign currency obligations.
3. Finally, the controls were maintained to harmonize Lesotho's exchange control regime with that prevailing in the rest of CMA in accordance with the Multilateral Agreement among Lesotho, Namibia, South Africa and Swaziland.

The stable political environment driven by introduction of a more representative electoral model and peaceful 2002 general elections, favoured the relaxation of controls. The ultimate reason that influenced the decision to relax capital account transactions was that other CMA members had moved ahead with limited liberalization and Lesotho was left in a less competitive position.

The areas that were found to be similar to capital reforms undertaken in other CMA member countries are reflected below:

1. ***Capital Transfers by Private individuals (Natural Persons resident in Lesotho).***

   Lesotho residents are allowed to transfer capital abroad if it is income earned abroad or own foreign capital introduced into Lesotho on or after 27 June 2003. Prior approval by the Central Bank of Lesotho is no longer required for capital transfers with maturity in excess of 365 days.

2. ***Foreign Investments by Private Individuals (Natural Persons resident in Lesotho)***

   Individual above the age of 18 years and in possession of Income Tax Certificate are allowed to invest outside the CMA directly or through an agent, an amount not exceeding M250,000.00 per month.

3. ***Direct Investment by Corporates in Countries Outside CMA***

   Business entities (Corporates) are allowed to invest M50million in Southern African Development Community (SADC) countries and M30million elsewhere.

4. ***Customer Foreign Currency Accounts (CFCs) or Bank Administered Accounts***

   Exporters/Importers and other Corporates are allowed to open C.F.C. accounts, which will be operated through and in full cognizance and approval of the bank concerned.

The individuals are also allowed to open Foreign Currency Accounts (FCAs) which will be operated in a similar fashion as the CFC Accounts.

7.4 Anti-Money Laundering

As a measure to fight against money laundering, the Central Bank of Lesotho took an initiative and established an Anti-Money Laundering Task Team under its chairmanship in the year 2000.

Initially the Task Team members were composed of representatives of Government ministries/departments, non-governmental organisations and other related institutions in the country. After 11 September 2001, it became pertinent to include other sectors to assist, not only in anti money laundering activities but also combating terrorist financing.

The Anti-Money Laundering Task Team objectives are:

- to invite inputs and coordinate efforts by all stakeholders in formulating strategies on countering Money Laundering activities.

- to participate effectively in the drafting of the Money Laundering Bill and strive for its presentation to the responsible Minister.

- to devise a Plan of Action to guide in the implementation of the Team's recommendations.

The Financial Institutions (Anti-Money Laundering) Guidelines 2000 were issued to the banking sector. The drafted Money Laundering and Proceeds of Crime Bill 2003 was submitted to the Ministries of Finance, Justice and Human Rights, for review. It is our hope that the Bill will be enacted before the end of the year 2004. This will enable the judiciary to ease the burden of relying on other pieces of legislation in the absence of Money Laundering law.

7.5 Deposit Insurance Scheme

The Financial Institutions Supervision Technical Committee (FISTC) of the CBL, at its meeting of 3 May 2002, approved a paper on Deposit Insurance Scheme. The purpose of the paper was to highlight the necessity of establishing a scheme of deposit insurance in normal times and for the protection of deposits during a financial crisis.

Following the adoption of the paper as a working document by Board, CBL decided to hold a stakeholders workshop to sell the idea and solicit more inputs on the subject matter. A Task Team was also established to oversee all the activities relating to the proposal to establish a deposit insurance scheme. The Workshop was held on Wednesday, 7 May 2003. Participants were invited from all the relevant institutions or organisations in the country. The keynote speaker was Mr. Titus Mulindwa from the Bank of Uganda.

CBL was prompted to embark on this study as a result of the collapse of the two state-owned banks, namely, the Lesotho Agricultural Development Bank and the former Lesotho Bank in the late 1990's. To save the situation, the Government of Lesotho had to compensate all the depositors of these Banks in order to preserve public confidence in the banking sector. All the depositors were compensated to the full extent of their balances which costed the Government millions of Maloti. A concern was raised emanating from this unfortunate turn of events, whether the Government is in the position to come to the rescue of the depositors should another deposit taking institution face the same problem and collapse. It was noted that common sense dictates that the Government would be obliged to provide compensation to the depositors for the sake of protecting the financial system as well as the economy of the country as a whole. Much as it was acknowledged that the Government has set a precedent by intervening, it was pointed out that the Government could not afford to compensate depositors in perpetuity, and hence a need to prevent the present implicit deposit protection from continuing. It was observed that one measure that could be taken to avoid this problem of unlimited liability on deposit could be the establishment of a deposit insurance scheme.

The justifications for setting up such a scheme were given as follows:

a) provision of consumer protection especially to small depositors by providing a mechanism for the immediate pay out of their deposits;

b) enhancing public confidence and systemic stability in the financial sector by facilitating a compatible system that will deal with bank failures;

c) increasing savings and encouraging economic growth;

d) defining the boundaries between the explicit government safety network and the implicit one; and
e) serving as a mandate for the financial institutions to contribute to their failures.

It was shown, however, that a deposit insurance scheme has its own advantages and disadvantages, hence CBL had invited the stakeholders to assist by considering the following issues:

a) how much such a scheme should be funded;
b) the pros and cons of a deposit insurance scheme;
c) whether there is in fact a need to establish such a scheme in Lesotho;
d) if indeed there is such a need for the scheme, what nature and form such a scheme should take;
e) which institutional and legal arrangements should be put in place for such a scheme; and
f) any other aspects of the scheme that stakeholders could find necessary to debate.

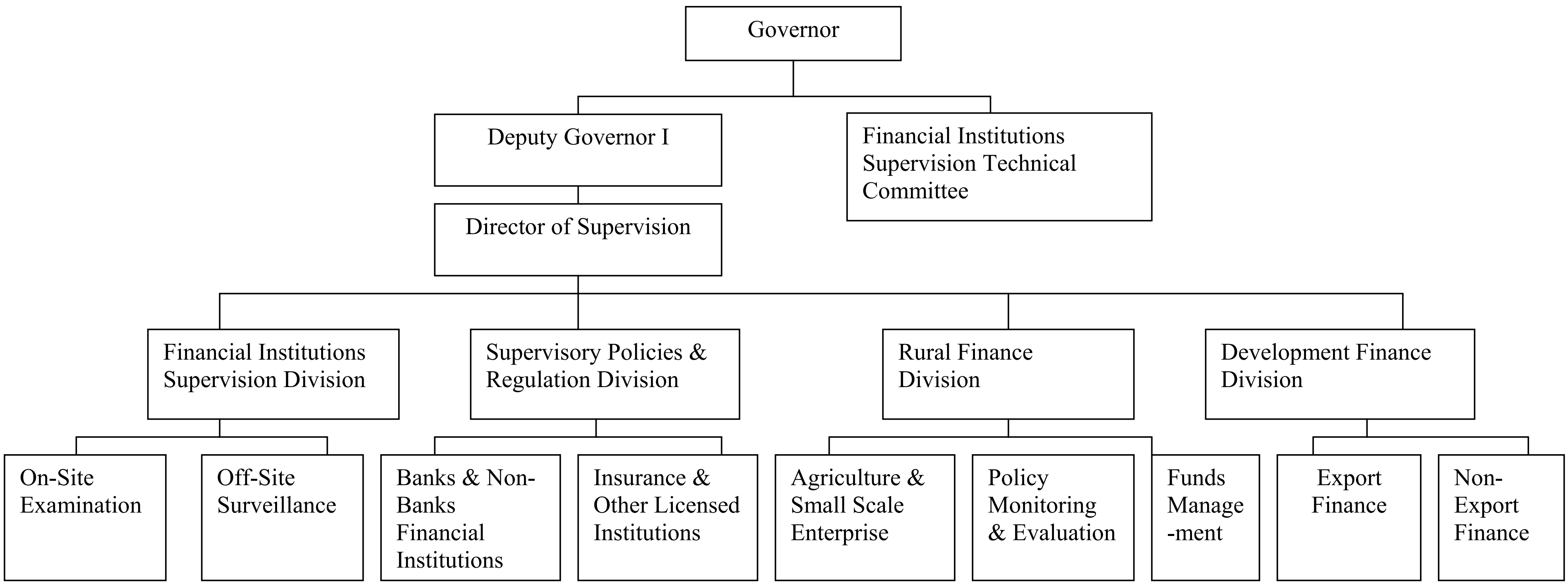
The workshop unanimously agreed that, in order to build confidence in the financial sector, there was a need to set up an explicit deposit insurance scheme in Lesotho for all deposit taking institutions. As a starting point, the scheme should be housed at the CBL until it is sustainable enough to be moved to an independent body. Secondly, it was resolved that the Government could be requested to contribute some initial capital to kick-start the scheme. Lastly, it was recommended that participation in the scheme should be as inclusive as possible to cover all deposit taking institutions.

The workshop also established a need for more studies on similar schemes to add on the experience from Uganda. Other countries such as Namibia, Zimbabwe, Kenya, and Tanzania were recommended with a hope that they could have better and more sustainable schemes. FISTC approved this recommendation and it was decided that Kenya and Tanzania were the best places to be visited. It was learned from both study tours that there are well-established deposit insurance schemes in other countries such as United States of America, Canada, the Philippines and Nigeria which could afford CBL more exposure in the subject matter.

The recommendation for further tours to the above-mentioned countries was to be tabled before FISTC for approval.

Appendix 1

ORGANISATIONAL STRUCTURE
SUPERVISION DEPARTMENT



Appendix 2

LIST OF BANKS IN LESOTHO AS AT 31 DECEMBER 2003

NAME OF INSTITUTION	TITLE AND NAME OF CHIEF EXECUTIVE	POSTAL ADDRESS	TEL NO. FAX: CODE (O9266)	BRANCH NETWORK
1.Lesotho Bank (1999) Ltd	Mr. D. Allan Managing Director	P. O. Box 1053 Maseru 100	22315737 22310268	14
2. Nedbank (Lesotho) Ltd	Mr. P. Opperman Managing Director	P. O. Box 1001 Maseru 100	22312696 22310025	3
3. Standard Bank Lesotho Ltd	Mr. V. Kennedy Executive Director	P. O. Box 115 Maseru 100	22312423 22310068	5
4. Lesotho Bank Under Liquidation	Liquidators – KPMG Harley & Morris Joint-Venture, Represented by A. S. McAlpine & S.C. Harley	P. O. Box 7755 Maseru 100	22313840 22310076	

Appendix 3

LIST OF INSURANCE COMPANIES IN LESOTHO AS AT 31 DECEMBER 2003

NAME OF INSURANCE COMPANY	TITLE AND NAME OF CHIEF EXECUTIVE	POSTAL ADDRESS	TELEPHONE FAX:	AGENTS
1. Lesotho National General Insurance Company	Mr. R.J. Letsoela Chief Executive a.i.	Private Bag A65 Maseru 100	(+266) 22313031 (+266) 22310008	50
2. Lesotho National Life Assurance Company	Mr. R.J. Letsoela Chief Executive a.i.	Private Bag A65 Maseru 100	(+266) 22313031 (+266) 22310008	
3. Alliance Insurance Company Ltd	Mr. J. Pienaar Managing Director	P. O. Box 01118 Maseru 100	(+266) 22312357 (+266) 22311381	0
4. Metropolitan Lesotho Ltd	Mr. T. Mphahlele Managing Director	P. O. Box 645 Maseru 100	(+266) 22323970 (+266) 22317126	373
5. Customer Protection Insurance Company	Mr. J. Dritz Chairman	P. O. Box 201 Maseru 100	(+266) 22312643	-
6. Sentinel Insurance Ltd	Mr.A.S. McAlpine, Director	P. O. Box 699 Maseru 100 Lesotho	(+266) 22327940/1	0
7. Star Lion Insurance (Pty) Ltd	Mr. L. Thebe-ea-Khale, Managing Director	P. O. Box 12634 Maseru 100	(+266) 22325185	0

Appendix 4

LIST OF INSURANCE BROKERS IN LESOTHO AS AT 31 DECEMBER 2003

NAME OF INSURANCE BROKERS	POSTAL ADDRESS	TELEPHONE FAX
1. AON Lesotho (Pty) Ltd	P. O. Box 993 Maseru 100	(266) 22313540 (266) 22310033
2. Insurcare Brokers (Pty) Ltd	P. O. Box 11007 Maseru 100	(266) 22321973 (266) 22310669
3. Lesotho Insurance Brokers (Pty) Ltd	P. O. Box 01052 Maseru 100	(266) 22322060 (266) 22325489
4. Maluti Insurance Brokers (Pty) Ltd	P. O. Box 1515 Maseru 100	(266) 22310557
5. Mamoth Insurance Brokers (Pty) Ltd	P. O. Box 1659 Maseru 100	(266) 22322380 (266) 22310897
6. Prosperity Insurance Brokers (Pty) Ltd	P. O. Box 14173 Maseru 100	(266) 58842861
7. Thebe Insurance Brokers (Pty) Ltd	P/Bag A244 Maseru 100	(266) 22313018 (266) 22310513
8. Southway Insurance Brokers Lesotho (Pty) Ltd	P. O. Box 4564 Maseru 104	(266) 62032037
9. DIB International (Pty) Ltd	C/O Naledi Chambers Incorporated P. O. Box 478 Maseru 100	(266) 22312576
10. ABC Insurance Brokers (Pty) Ltd	P. O. Box 9036 Maseru 100	(266) 22324061 (266) 22310970
11. AON Consulting Lesotho (Pty) Ltd	P. O. Box 993 Maseru 100	(266) 22313540 (266) 22310033

Appendix 5

LIST OF MONEY LENDERS IN LESOTHO
AS AT 31 DECEMBER 2003

NAME	POSTAL ADDRESS
1. African Credit (Pty) Ltd	P/Bag A418, Maseru 100
2. Mary Palesa Makakole	P. O. Box 1650, Maseru 100
3. Makhulong Financial Services	P. O. Box 14401, Maseru 100
4. Thuso Loan Services (Pty) Ltd	P. O. Box 9506, Maseru 100
5. TCL Loans	P. O. Box 14367, Maseru 100
6. Star Lion Gold Coin Investments (Pty)	P/Bag A332, Maseru 100
7. Masekoala Motanyane	P. O. Box 60, Maseru 100
8. Letsema Investment Holdings (Pty)	P. O. Box 2470, Maseru 100
9. Tumane Mojapela	P. O. Box 563, Butha-Buthe 400
10. SMT Investment Co. (Pty) Ltd	P. O. Box 1710, Maseru 100
11. Vigilius Lerata Pekane	P. O. Box 0459, Maseru West 105
12. Letsete Financial Services	P. O. Box 0936, Maseru West 105
13. Moeketsi Kabelo	P. O. Box 4576, Maseru 100
14. Mokorotlo Financial Services (Pty)	P. O. Box 10286, Maseru 100
15. Mantšo Panya	P. O. Box 599, Mafeteng 900
16. Afrisure Personal Loans Lesotho(Pty)	No. 10 BNP Centre, Maseru 100
17. Mabeane Samuel Koetje	P. O. Box 15, Ha Mamathe
18. Maria Mahloane	P. O. Box 22, Butha-Buthe 400
19. Motjoka Jeremia Mokhoro	P. O. Box 473, Mohale's Hoek
20. Tsoloane Lekata	P. O. Box 132, Maseru 100
21. Edu-Loan Lesotho (Pty) Ltd	P. O. Box 1939, Maseru 100
22. Mamoth Financial Services	P. O. Box 1659, Maseru 100
23. Joel M. Motlalane	P.O. Box 10011, Maseru 100
24. T.V. Tlali	P.O. Box 942, Butha-Buthe
25. B.M. Tsie	P.O. Box 118, Mokhotlong