Central Bank of Lesotho

SUPERVISION ANNUAL REPORT OUTLINE FOR 2005

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PART I GOVERNOR'S REMARKS

The financial system in Lesotho has undergone significant changes since the Government introduced financial sector reforms, in the mid-nineties, to improve the system's structure and efficiency. The sector has improved in quantitative as well as qualitative terms. It may not be so multifaceted when compared to that of other Southern African Development Community (SADC) countries, but it has definitely grown to become more complex in recent years.

Supervisory strength at present is capable of meeting the existing challenges. Notwithstanding, effective and efficient supervision is necessary if the initiated reforms are to be a full success. More so as these reforms call for meeting a number of conditions, in particular permanent vigilance from the supervisory authority. This is a challenge that the Bank has accepted.

The year 2005 witnessed an unprecedented process of convergence within the financial industry particularly between banking and insurance. Therefore, this area of financial conglomerate where banking and insurance overlap, is a future challenge area for the Central Bank of Lesotho (CBL). The prominent forces towards convergence naturally go hand in hand with other requirements such as global financial reporting practices and much of this work may have a clear international character, an area that we have only just begun to investigate. In this context, the supervisory function of the CBL will become more demanding to ensure that accounting standards and prudential frameworks are naturally consistent.

Against the backdrop of financial sector reforms, the regulation and supervision of the industry has assumed greater importance, efforts are therefore being made for strengthening supervisory capability, quality manpower being the main focus of our recruitment policy; the legal framework is reviewed and modernised to address emerging supervisory challenges and fall in line with international standards of supervision. Additional steps are taken to strengthen the off-site surveillance system as an early warning system. A computer based system has been developed by the SADC region to analyse the off-site returns and issue warning signals to the banks wherever, warranted.

To stay the course of financial sector reforms, there is need to do more to reinforce the institutional environment and to promote non-bank financial sector development. The origin of this idea stems from the inability of existing banks to offer ranges of financial services to cater for the needs of the non-formal sector apart from the narrow range of traditional banking services. Efforts are concentrated where financial modernisation appears to have been the weakest. The Bank has initiated a process of facilitating entrance of locally based non-bank financial entities that would target financial services more towards the local community. The Bank has further intensified its efforts to contribute to strengthening institutional quality particularly of the legal system. The judicial system is susceptible to long delays resulting in poor legal enforcement of contracts and long recovery. Major strides were made, in the year under review to operationalise the Commercial Court.

The report will articulate the overview given above and I hope it will be helpful to all interested parties.

Part II - DIRECTOR'S OVERVIEW OF THE DEPARTMENT'S ACTIVITIES

In upholding the CBL's resolve to ensure safe and sound financial sector, this year the Department of Supervision engaged in activities which resulted in far reaching measures to strengthen the Bank's supervisory approach to the sector. I am therefore happy to say that during the year under review, the financial sector remained stable and continued to be strong as will be discussed in this report.

The banking and Insurance sub-sectors, which form the core of the financial sector continued to be stable. Banks performed well and reported high ratios. They remained highly capitalized and maintained capital ratios of well above 20%, as opposed to the regulatory requirement of 8%. A comment worth making here though is that while our banks remain stable and continue to gain strength, their reluctance to extend credit is of major concern to the CBL. This prompted the Bank to intensify their efforts of enhancing financial intermediation. Part VI of this report discusses this issue of financial intermediation. The insurance industry which, though operating within the outdated legislative framework remained stable during the year under review. A great deal of achievement was made in overhauling the insurance legislative framework, with the Regulations on technical provisioning being drafted and approved by the Bank.

On the licensing activity, I am also pleased to report that the Department experienced a positive development. The year 2005 saw an unprecedented interest in insurance brokerage, with an influx of applications received. Sixteen applications from prospective brokers were received, four of which were licensed and the rest still under licensing process. This interest was mostly sparked by the on-site inspection which revealed that some brokers practised without proper authorization. Despite this achievement, we have a word of caution on insurance intermediaries that we licence. The Department continued to receive complaints of violation of good business practices against the insurance. The review of these complaints clearly reconfirmed the notion that professionalism of insurance intermediaries is fundamental to the sound development of the industry.

On the credit intermediation activity, the Bank processed and approved fifteen licence applications for money lenders during the year under review.

On-site and Off-site Supervision

The Department executed on-site and off-site supervision activities according to the work plan for 2005. The activities confirmed the financial sector's stable and strong condition. Part III, (3.2 and 3.3) of this Report discusses the on-site examinations and off-site surveillance activities.

Streamlining the Legal and Regulatory Framework

In tandem with the initiatives aimed at strengthening the financial sector's development through entry of different types of financial institutions, CBL moved forward the program of amending and enacting laws impacting on the financial sector in 2005. This program was identified and set in motion in 2003 but efforts to finalise it were hampered by Government's intervention through the Millennium Challenge Corporation (MCC). MCC, a corporation sponsored by the Government of the United States, assists developing countries to develop and strengthen their private sectors, with a view to attracting foreign direct investment. Towards the end of the year 2005, a decision was taken by CBL to revive the process and it is expected to have it finalised in 2006.

As previously reported, the CBL has also undertaken the revision of the FIA 1999. The revision is aimed at achieving a tiered banking system. The benefits of such a system are numerous to our economy. For example, as our banking system is in the hands of foreign owners, a tiered system would open doors to local indigenous who could not meet the prudential licensing requirements under the current regime. Another piece of legislation which the CBL sponsored its development is the Anti-Money Laundering and Proceeds of Crime Bill. The Bill has been designed in line with the Financial Action Task Force (FAFT) Forty + Nine Recommendations on money laundering and financing of terrorism. Finally, the on-going review of the Insurance Act 1976 went ahead without a hitch during the year under review. It is hoped that the Bill will be passed into law next year. Part IV (Developments Related to Supervision) discusses Anti-money Laundering Law, while VII (Regulatory and Policy Developments) discusses the FIA and Insurance Bill.

Challenges in Supervision

In the year 2005, the Department was faced with challenges of intriguing nature, which prompted the CBL to take stock of and evaluate its entire supervisory infrastructure. Part V of this report discusses the challenges and measures, together with recommendations that would counteract the adverse impact that may be presented.

Financial Intermediation Initiatives

The foremost concern of the CBL at the present moment is lack of financial intermediation in the country. Financial intermediation is one activity which has a positive effect on economic growth. If people have access to credit, businesses will be opened, grow and become sustainable. Financial intermediaries broaden their customer base and increase their profit margins. Without doubt, CBL has a vast interest in the development of a credit market. Part VI discusses all the efforts undertaken by the Department in providing the conditions conducive to a vibrant credit market.

Capacity Building

At the administrative level, the CBL continued with capacity-building of the Department. A new staff member for the newly established Insurance Supervision Division was recruited. A new staff member for the Financial Institution Division was also recruited to replace a staff member who resigned.

CBL also continued to place emphasis on training of supervision staff. Supervision staff participated in training programmes organized by SADC, the Financial Stability Institute (FSI) and Macro Economic and Financial Management Institute (MEFMI). Supervision staff has also enrolled for an online course, FSI Connect run by the FSI.

Supervision staff also attended seminars, conferences and meetings organized by Common Monetary Area (CMA), Committee of Insurance, Securities and Non-Banks Association (CISNA), Eastern and Southern African Anti-Money Laundering Group (ESAAMLG), IAIS etc.

Conceivably, the peak of the Department's capacity building effort in the year under review was the successful hosting of the three regional organs, namely the Common Monetary Area (CMA), CISNA and SADC Sub-Committee of Banking Supervisors (SSBS). These organs held meeting, conference and seminar respectively.

Part III SUPERVISORY RESPONSIBILITIES

3.1 Licensing

3.1.1 Banks

There were no new licences issued during the period under review. However CBL continued to process applications of banking licences during the year. The processing of two applications, namely Kish City Bank and Mohloli Merchant Bank, progressed well and had now reached the final stages of licensing.

The Lesotho PostBank, though licensed in 2004, began operations during the period under review and is operating under a restricted license. Due to the restriction imposed on its activities, the PostBank's minimum capital was lowered from M10 million to M5 million.

3.1.2 Money Lenders

As indicated in the previous annual reports, there is evident growth in the money lending industry in Lesotho. It should be noted that during the period under review there were twenty two licensed money lenders. Moneylenders provide much needed financial services to a portion of the market that has little or no access to formal financial services. Licensing activity in this field is therefore alive. Nonetheless, a number of illegal money lenders, who charge exorbitant rates continue to emerge mainly because of inadequate monitoring of the money lending business.

3.1.3 Insurance Brokers

During the reporting period, the general insurance market was served by fourteen licensed brokers, five of which were newly licensed. For the past two consecutive years, there were only eleven licensed insurance brokers. However, during the reporting period, there was a significant turnaround with regard to the number of applications received for insurance brokering licences. The total number of licensed insurance brokers had increased to fourteen, with twelve applications pending submission of the outstanding requirements. This was mostly attributable to a number of insurance companies which had engaged unlicensed insurance brokers. The problem was established during on-site inspections and the respective insurers were given timeframes within which to rectify the situation. Follow-ups were also made with unlicensed insurance brokers to comply. This resulted in CBL receiving an influx of applications for insurance brokering licences.

However, much as it was appreciated that compliance by both the insurers and insurance intermediaries was being achieved, the number of insurance brokers that were licensed became an issue of concern to CBL. The problem was caused by the shortcomings in the current insurance legislation. The Insurance Act dates back to 1976. Since 1976, there have been substantial changes in the scope of operations by the insurance sector and the Act does not address the prevailing challenges in the insurance industry. One of the main weaknesses in the Act is the leniency it provides regarding the licensing requirements for insurance brokers. The following are a few examples of the licensing requirements for insurance brokers which are not covered in the Act:

(a) there are no capital and financial requirements except for bank deposits, which is a minimal amount that defeats the purpose of making such a deposit;

(b) there is no clear prescription regarding the qualifications for directors and key employees of brokers for purposes of fit and proper test;

(c) it is not an obligation for insurance brokers to ensure that the organisation, management and financial resources of the applicant are adequate for an insurance intermediary in the relevant category; and

(d) the licence fee is insignificant.

Initiatives were taken to address the foregoing problems. With regard to insurance companies engaging unlicensed insurance brokers, it was agreed between insurance companies and brokers that the insurance companies should not enter into agreements with any person, for placing insurance business with them, without such person producing a valid license and issuance of such a license verified by CBL. In relation to the second problem of impediments in the insurance legislation, CBL was being assisted by FIRST Initiative to overhaul the present Act to bring it in line with the international standards and practices.

3.2 ON-SITE EXAMINATION

3.2.1 Banks

Pursuant to Section 52 (1) of the FIA 1999, examinations of three commercial banks were conducted during 2005. The objectives, as stated by Section 52 (2) of the FIA were:

(i) To determine that the financial institutions were in a safe and sound financial condition.

(ii) To determine that the requirements of the FIA have been complied with in the administration of the banks' affairs.

In addition to the above objectives, the examination was intended to determine compliance with the directives issued pursuant to the previous examinations.

In determining the safety and soundness of the financial institutions, the examinations were based on the assessment of capital adequacy, asset quality, management capabilities, earnings, liquidity and sensitivity to market risks (CAMELS).

According to the assessment, the banks were found to be financially sound. They maintained regulatory ratios far above the minimum requirements. They were profitable, highly liquid and adequately capitalised.

The assessment also revealed that about 75.0% of the banks' investment mix was treasury bills and bonds and funds placed with other banks especially with their parent companies while lending constituted only 25.0%.

Despite good performance by the banks, poor financial intermediation still continued to be of concern to CBL. The loans to deposit ratio ranged from a mere 16.4% to 46.0%.

The banks' loan book continued to be highly concentrated on the top twenty borrowers. Total lending to this category amounted to more than one hundred percent of the paid up capital and statutory reserves of the banking industry.

An effort towards compliance with the provisions of the FIA and its implementing regulations was noted, on the part of banks. However, some instances of non-compliance with the directives issued pursuant to previous examinations such as non compliance with the Licensing Requirement Regulations and Section 25 of the Financial Institutions Act 1999 still occurred. Supervisory actions taken in such cases varied from issuing a warning to imposing a penalty.

An examination of two banks that entered the market in 2005 was limited to the assessment of their physical security. Except for a few weaknesses that required the attention of management, the banks' physical security was found to be generally satisfactory.

3.2.2 Insurance Companies

Pursuant to section 41 of the Insurance Act No. 18 of 1976, the CBL through its Insurance Supervision Division carried out inspection of two of four insurance companies during the year under review. The main objectives of the inspections were to determine: compliance with the Insurance Act 1976 and its implementing regulations 1985, and status of performance of the insurance companies in various risk areas of their operations in line with the International Association of Insurance Supervisors (IAIS) Core Principles. The Division has adopted a risk-based approach to insurance supervision so as to identify the major weaknesses before hand and recommend the remedial action before it is too late.

Unlike in the previous year the examined insurance companies complied with most sections of the Act and its implementing regulations. They further complied with most of IAIS Core Principles except for those on corporate governance and internal controls. The insurance industry's performance in 2005 improved when compared with 2004.
The Insurance Act 1976 does not give the Commissioner of Insurance powers to conduct on-site inspections of other players such as insurance brokers. It was, however, observed that during the inspection of insurance companies, some insurance brokers continued to keep premiums for a period exceeding the prescribed 60 days statutory period.
The Commissioner of Insurance companies issued the directives indicating the time frames within which the above deficiencies should be rectified.

3.2.3 Boliba Savings and Credit

The 2004 Supervision Report provided information about Boliba Multi-Purpose Cooperative (Boliba), an institution registered, regulated and supervised by the Commissioner of Cooperatives under the Cooperative Societies Act 2000. In that report, it was indicated that a mutual understanding had been reached with the Cooperative to allow the CBL to monitor its deposit taking and credit operation unit called Boliba Savings and Credit. To this end a compliance plan was drawn.

During the year under review, Boliba continued to submit its progress reports on measures taken towards the implementation of the plan aimed at transforming the operation into an institution capable of being supervised by CBL. From the reports and discussions in meetings held with the Board and Management of the Cooperative, it emerged that some progress was being made albeit, somewhat slowly. Among the reforms adopted by Boliba, it may be essential mention the empowerment of a Task Team established by the Cooperative to steer the transformation process; the establishment of a Credit Committee and the employment of a Chief Executive Officer and an Internal Auditor. There is still a lot of work yet to be done by the Cooperative. Nonetheless, with determination and discipline the goal is achievable.

3.3 Off-Site Surveillance

3.3.1 Banks

3.3.1.1 Issues of Exceptional Nature

a) Bank Supervision Application

In the last issue we reported about the deployment of the Bank Supervision Application (BSA), a system that enables banks to report electronically to the CBL. All teething problems were ironed out during the review period. The problems included, among others, (i) improper use of financial institution identity codes, (ii) wrong start and end dates, (iii) incorrect financial year, and duplication of returns to the CBL. Those mistakes led to the rejection of submissions by the system. Templates for dynamic reports had to be revised in order to align them with the system's specifications; related to the system implementation. In order to ensure smooth transition from the manual reporting system, the two systems were initially run parallel. The parallel run was stopped during the second quarter of 2005 as all the banks had gained confidence in reporting electronically.

The BSA is managed by the Bank Supervision Application Support Office (BSO), on behalf of all the central banks that jointly participated in its development. The BSO is housed at the South African Reserve Bank in Pretoria. During the course of 2005 the BSO started some work on the development of version II of the BSA. The enhancement of the BSA is aimed at addressing certain major deficiencies that are inherent in the original version. It is hoped that the development will be finalized next year.

(b) Lesotho PostBank

Since 2002 CBL has been represented in a Project Management Committee (PMC) whose main task was to assist in the re-establishment of Lesotho Post Bank (LPB). In accordance with the project plan developed in consultation with the PMC, LPB was expected to open eleven branches during the pilot phase. As at the end of 2005, ten branches had been opened and were operational. The branches were established in Maseru, Pitseng, Semonkong, Machache, Maputsoe, Thaba-Tseka, Mapoteng, Mapholaneng Quthing, and Katse.

3.3.1.2 Observed Trends -Performance Ratios

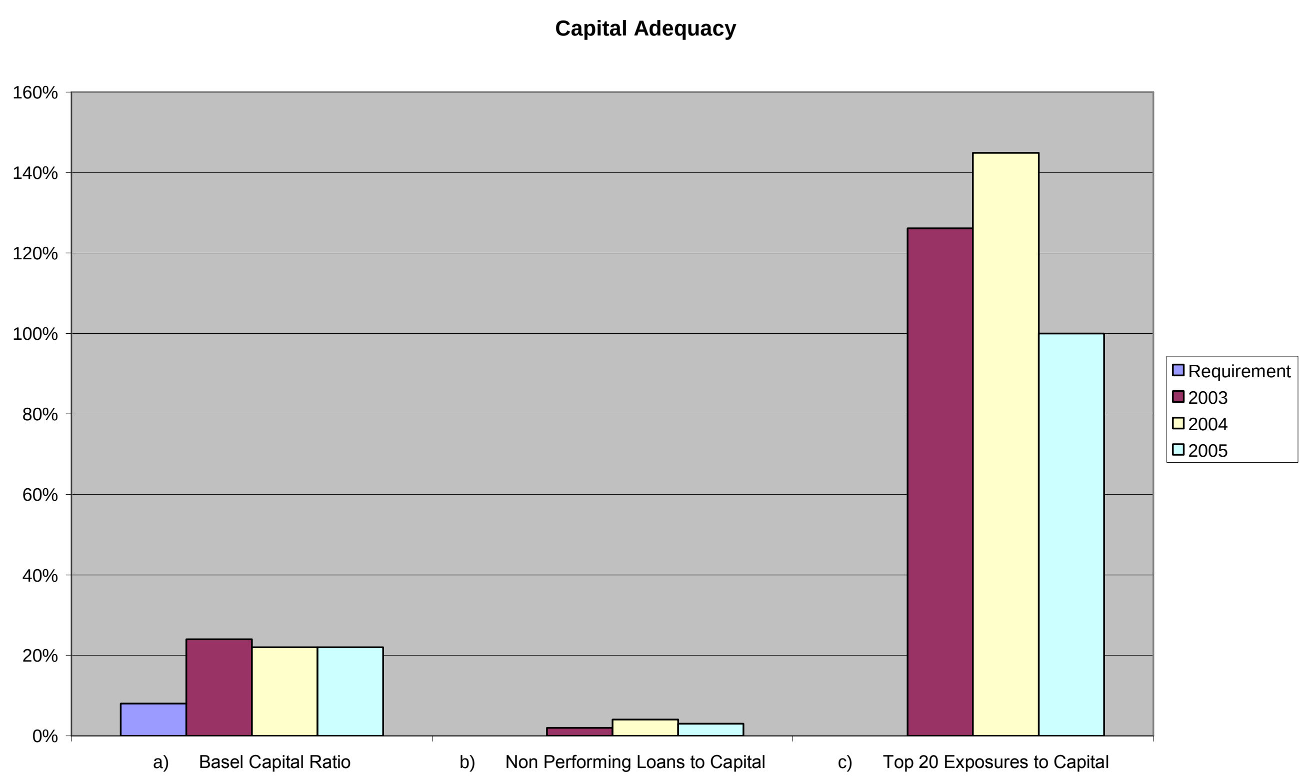
During the reporting period the performance indicators were satisfactory as supported by the ratios reflected in table A and Figures 1 to 4 below. The ratios include Capital Adequacy, Asset Quality, Liquidity and Solvency Ratios. During the period under review, banks reported high ratios, which was an indication of good performance.

(a) Capital Adequacy Ratio

The Central Bank of Lesotho embraces Basel I Capital Accord and it requires banks to maintain minimum capital equivalent to 8 percent of risk weighted assets. In Lesotho, Basel I has not yet been fully implemented to include the 1996 amendment which relates to market risk. During the reporting period the banking sector remained highly capitalised as reflected by table A and Figure 1. The Basel Capital ratio was 22 per cent of risk weighted assets; the same level as in 2004. In addition to other factors, the high capital adequacy ratio can be somewhat attributed to the reluctance of the banks to lend to the public and lack of participation in local economy due to risk aversion behaviour, thus keeping only relatively low risk assets in their portfolio.

The ratio of non performing loans to capital registered a marginal decline of 1 per cent from 4 per cent reported in 2004, to 3 per cent in 2005. The exposure of banks to top 20 borrowers dropped significantly from a high of 144 per cent to 100 per cent at the end of 2005. Despite the decline recorded in December, the banks remained highly exposed to the top 20 borrowers. The high loan concentration in few borrowers exposes banks to a high risk of losing money in the event of default. In an effort to promote proper risk management, the regulator encourages loan diversification rather than concentration on few borrowers.

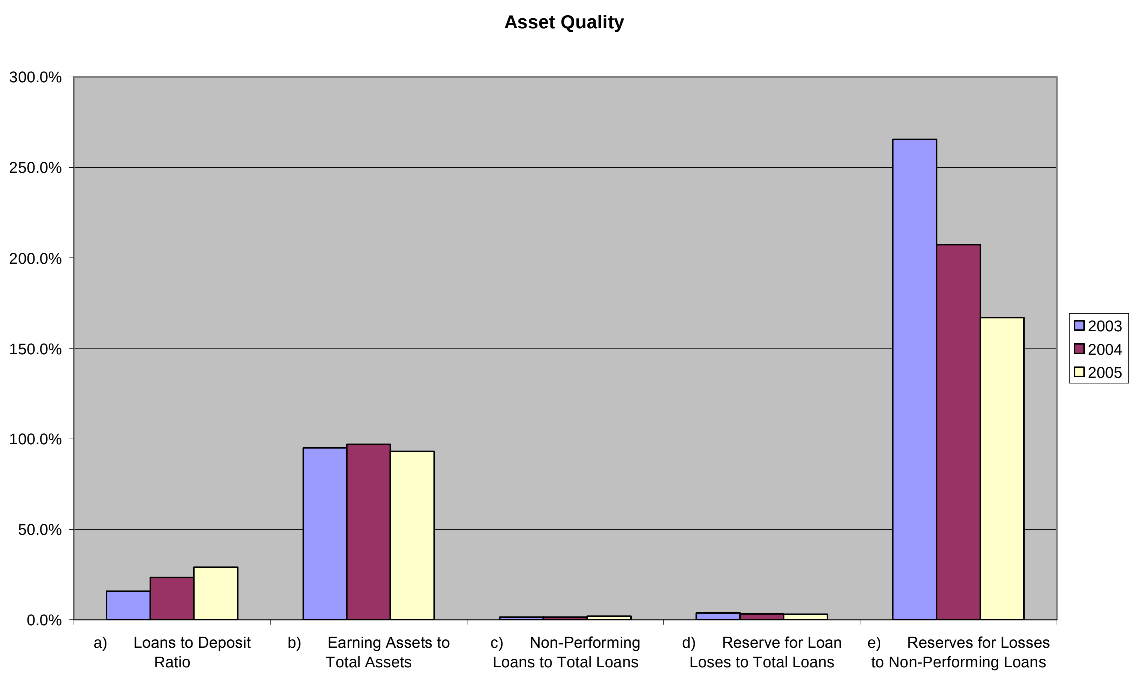
Figure 1



(b) Asset Quality

The banking industry had high quality assets during the period under review. The ratio of earning assets to total assets was 93 per cent, a small decline from a high 97 per cent reported in 2004. Reserve for loan losses as a percentage of non-performing loans exceeded 100 per cent at the end of December 2005 to stand at 167 per cent. The ratio of non-performing loans to total loans rose marginally from 1.5 per cent in December 2004 to 2 per cent at the end of December 2005. Loans to deposit ratio rose moderately from 23 per cent in the preceding period to 29 per cent at the end of December 2005. However, the rise in the ratio of loans to deposit did not necessarily reflect an improvement in financial intermediation in Lesotho as a substantial part thereof was simply an increase in the size of lending to one client.

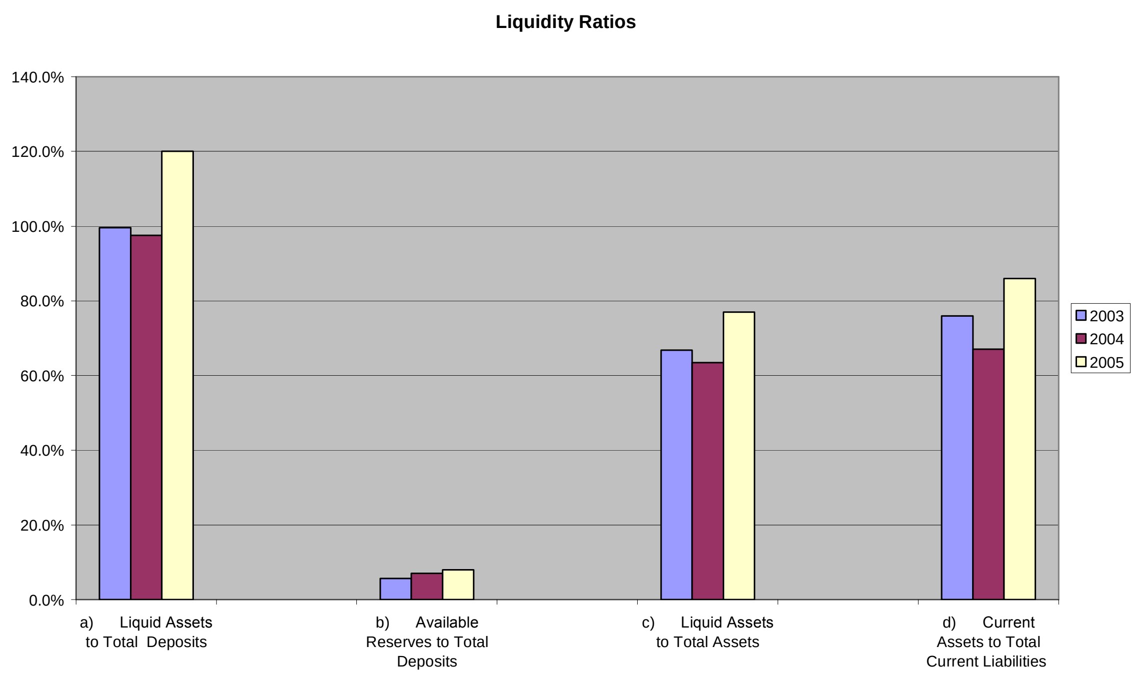
Figure 2



(c) Liquidity Ratios

The Lesotho banking sector is characterised by high liquidity. At the end of the reporting period 77 per cent of the assets were liquid; an increase of 3.2 per cent when compared to the same period in 2004. For the past three years the ratio of liquid assets to deposits consistently exceeded 95 per cent; an indication that banks were in a position to meet their obligations to depositors. The current liabilities were adequately covered by the current assets with a high ratio of 86 per cent, compared to 67 per cent reported in December 2004.

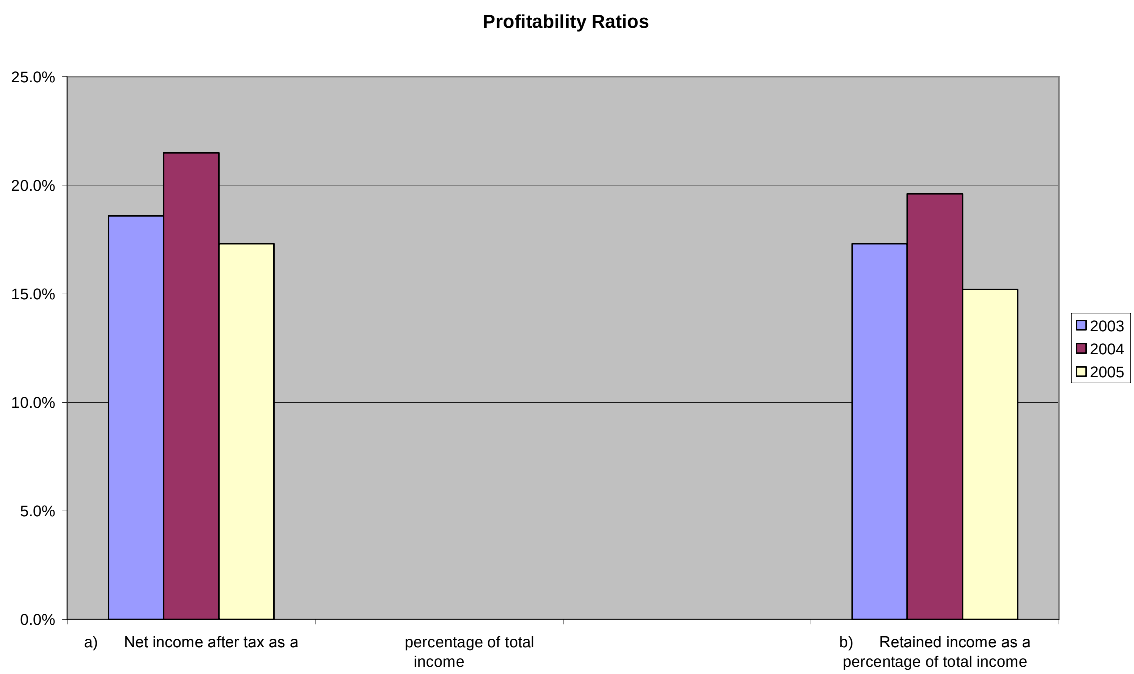
Figure 3



(d) Profitability Ratios

There was a decline in the ratios of profitability reported by the banks at the end of 2005. Net income after tax as a percentage of total income dropped by 4.2 per cent from 21.5 per cent in 2004 to 17.3 per cent at the end of 2005. Retained income as a percentage of total income dropped slightly by 4.4 per cent. The decline was due to declaration of dividends from retained earnings by some banks.

Figure 4



Commercial Banks
Performance Ratios
As At End of Period

Table A	Requirement	2003	2004	2005	Variance 2003/2002	Variance 2004/2003
Performance Ratios						
I. CAPITAL ADEQUACY						
	Requirement	**2003**	**2004**	**2005**		
a) Basel Capital Ratio	8%	24.0%	22.0%	22%	-2.0%	.0.0%
b) Non Performing Loans to Capital		2.0%	4.0%	3%	2.0%	-1.0%
c) Top 20 Exposures to Capital		**126.1%**	144.9%	100%	18.8%	-44.9%
II Asset Quality						
		2003	**2004**	**2005**		
a) Loans to Deposit Ratio		15.7%	23.4%	29%	7.7%	5.6%
b) Earning Assets to Total Assets		95.0%	97.0%	93%	2.0%	-4.0%
c) Non-Performing Loans to Total Loans		1.4%	1.5%	2%	0.1%	0.5%
d) Reserve for Loan Losses to Total Loans		3.7%	3.2%	3%	-0.5%	-0.2%
e) Reserves for Losses to Non-Performing Loans		265.6%	207.4%	167%	-58.2%	-40.0%

III Liquidity Ratios					
	2003	**2004**	**2005**		
a) Liquid Assets to Total Deposits	99.6%	97.5%	120%	-2.1%	23.0%
b) Available Reserves to Total Deposits	5.7%	7.0%	8%	1.3%	1.0%
c) Liquid Assets to Total Assets	66.8%	63.5%	77%	3.2%	13.7%
d) Current Assets to Total Current Liabilities	76.0%	67.0%	86%	-9.0%	19.0%
IV Profitability Ratios					
	2003	**2004**	**2005**		
a) Net income after tax as a Percentage of total income	18.6%	21.5%	17.3%	2.9%	-4.2%
b) Retained income as a percentage of total ncome	17.3%	19.6%	15.20%	2.3%	-4.4%

3.3.1.3 Large Cash and Suspicious Transactions

Large Cash Transactions

A myriad of transactions above the threshold of M100,000 were reported as large cash transactions. The reports are submitted in compliance with Section 17 of the Financial Institutions (Anti-Money Laundering) Guidelines 2000. These included cash deposits, withdrawals, inward and outward transfers and near cash items like traveller's cheques, cheques and bank drafts.

Even though a comprehensive analysis of the transactions could not be carried out due to technical problems, some clear patterns could be observed. Very large amounts were transactions made by corporates, big retailers, parastatals, government ministries and resident foreign missions and foreign funded agencies.

Inward transactions involving foreign exchange were made by foreign governments funding their embassies or donor funded projects, and exporting companies receiving proceeds for their exports. Outward transfers involved repatriation of profits and dividends to non-resident beneficiaries, insurance or re-insurance premiums paid by local insurers to overseas companies and local manufacturers paying for imports of raw materials.

Intra-country transactions involved large payments and transfers by the retail trade, corporates, parastatals and government ministries. There was also a high volume of regional transfers. Since most of the large retailers are branches of South African based companies many of them make regular transfers to their parent companies in South Africa. Apart from the inter-company transfers, there were transfers to the banking sector by those entities which prefer to conduct their banking with financial institutions in South Africa.

Suspicious Transactions:

In terms of Section 11 of the Financial Institutions (Anti-Money Laundering) Guidelines 2000 all financial institutions are required to report to the Central Bank of Lesotho and the Law Enforcement Agencies any suspicious transaction by or on behalf of their clients regardless of the amount involved. During the year under review ten (10) suspicious transactions involving M17,759,348 were reported to the Law Enforcement Agencies for investigation and prosecution should transgression of the law be discovered. Two (2) cases were found to be lawful transactions and the rest are still under investigation by the Criminal Investigation Division (CID) of the police.

Although many cases were reported the greatest challenge is to have them thoroughly investigated. Both the CID and the Directorate for Commercial and Economic Offences (DCEO) lack adequate resources, material and human, to investigate these sophisticated crimes. The DCEO has an additional handicap in that it can only investigate suspected criminal activity involving civil servants. The CID has a serious shortage of man power. They also do not have the expertise and the necessary equipment to conduct the investigations.

3.3.2 Insurance Companies

The off-site surveillance involves the receipt, review and analysis of the financial statements and other statutory prudential returns submitted by insurance companies and insurance brokers to the Commissioner of insurance.

During the year under review, the off-site surveillance revealed that all the insurance companies made profits except one which made losses. The industry continued to submit the returns to CBL as required by the provisions of the Insurance Act 1976 and its implementing regulations. Most sections of the Insurance Act 1976 as well as its implementing Regulations were complied with during the period under review.

Part IV - DEVELOPMENTS RELATED TO SUPERVISION

4.1 Economic Overview

4.1 Recent Economic Developments

The Lesotho economy is estimated to have grown at a rate of 1.2 per cent in 2005 compared with 3.1 per cent realised in the previous year. The downward trend largely reflected the poor performance of the secondary sector, as manufacturing output contracted. The manufacturing sub-sector has largely been driven by textile and clothing industries in Lesotho since 2001. However, their performance deteriorated, owing to the end of the Agreement on Textile and Clothing (ATC) in January 2005. The expiry has resulted in increased competition from low-cost producers in China and other Asian economies. Furthermore, the weak performance was compounded by the relatively strong rand hence loti vis-à-vis the US dollar, which hampered textile and clothing exports to the US. Gross National Income (GNI), in real terms, was estimated to register a lacklustre growth of 0.3 per cent in 2005, in contrast with 6.1 per cent increase realised in 2004. The low growth rate was a result of the decline in net factor income from abroad. A major source of net factor income from abroad is miners' remittances emanating from the South African mining industry.

Inflationary pressures continued to remain relatively subdued in 2005. Overall inflation rate recorded an average of 3.5 per cent, down from 5.1 per cent registered in 2004. The slow-down in inflation continued to benefit from the generally low level of inflation in SA, given the close trade links between the two economies. Nonetheless, oil and food price developments remain potential threats to the inflation outlook. The price of brent crude oil hovered around US$65 per barrel, which posed a serious threat to oil importing countries such as Lesotho. Furthermore, shortages in food production (and hence higher food prices), are expected to pose a threat given that food inflation accounts for about 39.8 per cent in the Consumer Price Index (CPI) basket.

The external sector position is expected to continue to improve in 2005. According to the projections by the CBL, the overall surplus in the Balance Of Payments (BOP) is expected to increase from M10.6 million in 2004 to M260.0 million in 2005. The expected improvement in the country's BOP position resulted from positive developments in the current account. The current account deficit is estimated to narrow significantly in 2005, owing mainly to a 14.0 per cent increase in current transfers, which were driven largely by the receipt of the SACU revenue windfall. Furthermore, net payments on services are anticipated to decline by 15.9 per cent in 2005. These outweighed the impact of the deterioration in the capital and financial account. The transactions balance, which is the measure of change in reserves without the effect of exchange rate movements, was also estimated to narrow from a surplus of M175.7 million in 2004 to that of M151.2 million during the review year.

Government budgetary operations for the 2005/06 fiscal year are projected to result in a surplus equivalent to 1.5 per cent of Gross Domestic Product. The increase is attributed to14.6 per cent growth in SACU revenue. This was despite 26.7 per cent growth in total government expenditure.

4.1.1 Financial Sector Activities

At the end of December 2005, broad money supply (M2) grew at a faster rate of 9.1 per cent compared with last year's slower increase of 3.3 per cent. The increase in money supply in 2005 was attributable to an increase in domestic credit including net claims on Government, as well as net foreign assets.

The increase in domestic credit was reflected by the growth in total credit, excluding net claims on government and non-performing loans. This rose by a considerable 61.8 per cent at the end of the year 2005 from its previous increase of 11.6 per cent at the end of 2004. The increase was propelled by a huge growth registered by credit to the private sector, which overshadowed the fall in credit granted to statutory bodies. The net foreign assets of the overall banking system increased by a slower 7.0 per cent in 2005, compared with a 13.7 per cent increase recorded at the end of 2004. The main drivers of this increase were net foreign assets of both the commercial banks and the Central Bank. The net foreign assets of commercial banks and the CBL went up by 1.5 per cent and 9.2 per cent, respectively.

Major money market rates in Lesotho generally followed downward trends in line with regional trends. This situation was at the back of subdued inflationary pressures to the economy. Despite the threats of oil price hikes, inflation remained under control during the year under review.

At the end of 2005, the average prime lending rate in Lesotho stood at 11.50 per cent. At this level, the rate was 67 basis points below last year's record. Similarly, commercial banks' deposit rates followed downward regional trends. For example, the one year deposit rate was 5.0 per cent at the end of 2004, but declined by 25 basis points to 4.75 per cent at the end of 2005. The 91-day treasury bills rate dropped by 91 basis points from 7.86 per cent in December 2004 to 6.95 per cent in December 2005. At this level, the rate had reached a year on year historical low since the inception of the open market operations in September 2001. As expected, the rate was still exceeding its counterpart in SA, indicating possibly differing liquidity levels, as well as the different frequencies at which the auctions are conducted in the two economies.

4.2 Lesotho National Payment Modernisation Project

4.2.1 Legal and Regulatory Framework

The Central Bank of Lesotho requested technical assistance from the International Monetary Fund (IMF) to review the Lesotho National Payment System (LNPS) legal framework. The IMF accepted the request and sent a legal expert in October 2005 for a fact finding session. The expert prepared a mission report which identified a need to develop LNPS legislation. He also identified a number of sections from the existing Acts that would need to be amended to align with proposed LNPS legislation. The mission report has been reviewed internally and adopted and was used as the basis for the development of the new NPS Act and amendments to the existing pieces of legislation.

4.4.2 Real Time Gross Settlement (RTGS)

A request for proposal was issued in July 2005 for the establishment and installation of RTGS system at the Central Bank of Lesotho. Montran was selected as the successful bidder for the installation of the RTGS system which would be expected to commence in January 2006. It was targeted that the implementation of RTGS would commence in August 2006.

The RTGS system would assist players in reducing settlement risk and other inherent payment and settlement risks.

4.2.3 Automated Clearing House (ACH)

RTGS is mainly meant to deal with large value time critical transactions and the low value high volume transactions shall be dealt with by the ACH. Currently these transactions are handled by the Clearing House, and the clearing process currently takes up to 7 (seven) days for the payee to receive value. The ACH is aimed at reducing this time lag to same settlement. The implementation of an ACH project would commence subsequent to the RTGS deployment. The Millennium Challenge Corporation (MCC) tentatively agreed to finance the ACH subject to the viability of this project. It therefore appointed FIRST Initiative to undertake a feasibility study for the establishment of the envisaged ACH. FIRST was also mandated to determine whether there is a business case for the establishment of the ACH.

4.3 Capital Account Liberalizations

Liberalisation of the capital account in June 2003 was partly in response to demands by the private sector that some restrictions which were then in force posed a serious constraint on trade. The expectation was that relaxed controls, with some restrictions abolished would present new investment opportunities that would be attractive to companies and private individuals. Liberalisation is also expected to increase growth of existing businesses.

However, until the end of 2005 there was no discernible enthusiasm to take advantage of the introduction of Customer Foreign Currency (CFC) accounts by Corporates. Neither was there any rush by private individuals to access the Foreign Currency Accounts (FCAs) facility. On average monthly reports submitted during 2005 indicate that Seven (7) individuals operated FCA accounts while fifteen (15) Corporates operated CFC accounts. These are foreign currency accounts in which foreign currency may be held by holders of accounts for up to 180 days without complying with the mandatory requirement to convert any foreign exchange holding to local currency within 30 days. There was no economic activity that involved any of the other liberalisation measures introduced in 2003.

4.4 ANTI-MONEY LAUNDERING

4.4.1 Legislation

The Money Laundering and the Proceeds of Crime Bill 2005 was prepared by the Anti-Money Laundering Task Team and presented to the International Monetary Fund (IMF) for expert scrutiny. The IMF made its comments, which were incorporated into the Bill.

4.4.2 Progress Report on Lesotho Mutual Evaluation

The ESAAMLG visited Lesotho in 2004. Following the ESAAMLG evaluation on the country's compliance with the Financial Action Task Force 40 + 9 Special Recommendations, Lesotho received its Mutual Evaluation Report in 2005. The report highlighted the deficiencies in the legal, regulatory, institutional and enforcement regimes. The report recommended action to be taken to remedy the deficiencies.

The Mutual Evaluation Report was presented by the ESAAMLG Secretariat to the Council of Ministers meeting held at Mbabane, Swaziland on Thursday, 6th October 2005 and was adopted.

4.4.3 The Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT) National Strategy

In order to enhance commitment in the implementation of the AML/CFT measures, ESAAMLG member countries were to develop and implement AML/CFT national strategies that meet the international standards as informed by their mutual evaluations. The required international standards include criminalization of money laundering and terrorist financing, and establishment of Financial Intelligence Units to receive and analyze suspicious transaction reports.

The Task Team drafted the AML/CFT National Strategy which will be endorsed by the Honourable Minister of Finance before being tabled to the Council of Ministers meeting to be held in Zimbabwe in August 2006.

The AML/CFT National Strategy prioritised issues to be addressed as the enactment of the Anti-Money Laundering Proceeds of Crime Bill, enactment of AML/CFT Regulations and harmonisation of all relevant legislation to AML/CFT.

4.5 Deposit Insurance Scheme

It was reported in the previous reports that the CBL decided to establish the deposit insurance scheme. This decision augmented other initiatives taken by the CBL to enhance financial intermediation. With a decision to tier the banking system, it was recognized that small unsophisticated depositors would need more protection than what was available in the market, hence the decision to introduce deposit insurance scheme. A task team was established to implement the Bank's decision. The team undertook study tours to a number of countries with the objective of making comparative analysis of ways of establishing and operating deposit insurance schemes. Subsequent to the visits, the Task Team was mandated to prepare a blueprint on the establishment of the deposit insurance scheme in Lesotho, which was submitted to the Management of CBL for consideration.

Due to operational hurdles, the process was halted. However, with the tiering of the FIA at such an advanced stage the process will be revived. The intention is to establish the scheme simultaneously with the tiering of the FIA.

Management of CBL will consider the Blueprint next year.

4.6 Basel II

BASEL II IMPLEMENTATION

In 2005, the established Basel II Task Team continued with the task of preparing for the evaluation of the suitability of the new Capital Accord in Lesotho and to plan for the transition to the new Accord, in preparation for its adoption. The evaluation meant a critical look at the three pillars of the accord, namely, minimum capital requirements, supervisory review process and market discipline. In order to prepare for the evaluation task, CBL had identified the need to bring all members of the task team to the same level of appreciation of the new Accord. This was done by arranging a series of presentations by CBL staff members to the team. The presentations done up to this point highlighted the similarities and differences between Basel I and Basel II as well as the strengths and weaknesses of the two Accords. The presentations revealed diverse levels of understanding, especially with non-bankers.

In addition to the presentations made by CBL staff members, a seminar was organised where commercial banks invited specialists from their parent companies in Johannesburg to provide further explanations of the Accord and to brief the team members on the developments taking place in South Africa regarding Basel II. Experts from First Rand Group and Nedcor Group addressed the team members. From the seminar, it became clear that the banks in South Africa had done a lot of work in the preparation for the new Accord so as to meet the implementation date set by the Reserve Bank of South Africa.

The process of training the task team has been a slow one as the CBL members were involved in other projects. This training needs to continue into 2006 before any meaningful recommendations can be made by the Task Team members.

4.7 Cross Border Foreign Exchange Transactions Reporting System

The Cross Border Foreign Exchange Transactions Reporting System Project was launched in March, 2004. According to the project plan the system was scheduled to go life in August 2005, but due to technical problems, the banks with the exception of one, could not submit data as expected.

The system requires the reporting of all cross border transactions, irrespective of the monetary value. The Reporting System is based on the principle of “same source reporting" which requires the extraction of relevant data from the Authorised Dealers' accounting processes.

Series of meetings were held between the staff of the Division, Information and Communication Technology (ICT), the representatives of commercial banks and the South African Reserve Bank (SARB) Team in order to formulate strategy on how to follow the project plan successfully. In the subsequent meetings with the SARB Team and the banks, operations manual, integrated form, validation and error codes were introduced. Most of the technical issues were attended to by the Team and the ICT personnel. Some reports were introduced into the system.

Currently, banks now report through the system, with the exception of one bank which is encountering system problems. We believe that the information captured will provide a fair picture of inward and outward data flow. Once all the banks are onboard the Division will be able to provide the quarterly Balance of Payments (BOP) statistics to Research Department, Financial Institutions Technical Committee (FISTC) and SARB, as is a requirement.

Part V CHALLENGES IN SUPERVISION

5.1 Compliance with the Minimum Local Assets Requirement (MLAR) in terms of the Insurance Act 1976

As reported in the past reporting period, the challenge of lack of long term investment avenues for life insurers prompted the CBL to recommend an amendment of Regulation 7 of the Insurance Regulations 1985 to the Minister of Finance. The effect of the amendment is to reduce the MLAR from the prescribed 30% to 10% with the objective of facilitating compliance with the requirement by insurers. Consequently, a recommendation regarding the proposed amendment was made to the Minister. However, the Minister was of the view that MLAR should be decreased to 15% as an interim measure until long term investment vehicles were put in place to address the insurers' concerns. In the meantime, CBL continues to monitor the revised MLAR to determine whether compliance problems still persisted.

Following the approval of the Minister of Finance, Regulation 7 of the Insurance Regulations 1985 was amended pursuant to section 64 of the Insurance Act 1976. The Regulations were published in the Government Gazette No. 112 of 17 November 2005 by the Government Printer. In accordance with section 27 of the Interpretation Act 1977, the Regulations would be laid in Parliament. If, after a period of ten days of their laying in Parliament, there would be no motion of disallowance, the regulation would become effective.

5.2 The Lesotho Unit Trust

Following the Government of Lesotho's policy to privatize the state owned enterprises, it became apparent that ordinary Basotho lacked the financial capacity to participate in the process of acquiring shares of those privatized entities. Since one of the main reasons of privatization process was to empower and enrich Basotho by transferring ownership of the state owned enterprises to them, the Government had to come up with a strategy that would enable Basotho to participate in the privatization process. Among various strategies discussed, the Unit Trust was considered as the most appropriate vehicle for facilitating the participation of Basotho in the sale of shares previously held by Government in parastals.

The Privatization Unit (PU), on behalf of Government commissioned the firm of accountants and auditors, KPMG (in joint venture with Harley & Morris) to form and operate the Lesotho Unit Trust (LUT). KPMG subsequently changed its name to PMB. PMB invited the Standard Bank Unit Trusts to join their team as managers of the Lesotho Unit Trust. This arrangement resulted in the incorporation and registration of the SBL Unit Trust Management (Pty) Ltd. (SBLUT Management Company). The terms of reference of PMB included the drafting of the Unit Trust Deed, guidelines on application procedures and identifying a Trustee outside the Standard Bank Group. AON (Lesotho) was identified and requested to fill the role of a Trustee. LUT was thus launched in 2001.

Since its inception, LUT operated smoothly, until during the year under review when it started experiencing problems associated with (1) inadequate investment avenues, (2) disagreement among SBLUT Management Company about the general administration of the fund and (3) pricing and disposal mechanism of the underlying securities. All these problems, which affected all stakeholders culminated into the capping of LUT in November. Negotiations seeking solutions to the problems are still underway between all concerned.

Despite its operational problems, LUT cultivated a culture of savings among Basotho and triggered interest among investors to exploit the collective investment scheme opportunity for the first time. As the Registrar of Collective Investment Schemes, the CBL received numerous inquiries from prospective investors about the possibility of establishing unit trusts. Similarly, the CBL recognized the need to fill the gap created by the capping of LUT, which might break the savings momentum demonstrated by the rapid growth of LUT. Consequently, the Central Bank approved the registration of a foreign collective investment scheme, STANLIB as a temporary measure until LUT problems are resolved. The Central Bank was awaiting three more applications from investors who were found to possess a serious intent to establish a collective investment scheme.

In addition to recognizing the need to maintain the savings drive, the CBL also acknowledged that the problems emanating from LUT could not be easily resolved because of the inadequate and irrelevant regulatory framework. As of now, collective investment schemes are governed by Collective Investment Schemes Regulations, which proved unable to cope with the above mentioned developments in the market. As a result the need for a relevant securities law and implementing regulations was identified and a recommendation to the Central Bank to facilitate its enactment was made by the Department.

5.3 Money Lenders

Section 9A (1) of the Money Lenders (Amendment) Act 1993 requires, every person whose business is that of money lending, to submit to the Commissioner in duplicate, not later than the twenty-first day of each month, a statement showing the assets and liabilities of his places of business in Lesotho as at the close of business day of the preceding month together with such other information that the Commissioner may require. This has become a challenge in that, throughout the year money lenders did not comply with this provision of the Act as some reports were either not submitted on time or not submitted at all. In most instances reports were submitted at the time when the money lenders' licenses were due for renewal. Some reports were questionable as they did not present reasonable or realistic figures. This behaviour has proven not conducive for financial performance analysis as it has become difficult to rely on the figures as submitted. Money lenders provide finance to borrowers that generally do not qualify for bank. credit. Their transactions, therefore, form an integral component of the financial system as a whole.

The asset size of the larger money lenders that submitted their statements of assets and liabilities as at 31 December 2005 amounted to M16.0 million. Loans accounted for about 72 percent of the asset base.

The Money Lenders (Amendment) Act 1993 does not give sufficient power to the Commissioner to impose any penalties for non compliance or breach of the provisions of the Act and as a result, money lenders cannot be compelled to submit reports. Penalties can only be imposed by the courts of law.

During the year an on-site inspection of the operations of one money lender was undertaken. As is common within the industry, the money lender did not maintain a full set of accounting books as required by the law. Similarly, interest charges imposed were more than 3 times higher than the 25 per cent per annum allowed by law. In the past workshops were held to improve relations with the money lenders but judging from the situation that prevails presently, it is evident that more has to be done to cultivate professionalism in the industry.

Whether there is still a need for CBL to regulate the money lending industry is debatable. On the one hand, there is an argument that money lenders do not pose any systemic risk because they utilise their own funds to ensure continuity of their business, consequently, they should not be regulated. On the other hand, there is a belief that the financial sector as a whole should be subjected to some form of regulation in order to ensure stability. CBL takes interest in the money lending industry and is working towards reforming the organised money lenders into microfinance institutions. Progress made in the area of microfinance is discussed under Part VI of this report.

PART VI FINANCIAL INTERMEDIATION INITIATIVES

6.1 Export Finance and Insurance Scheme

In the late 1990s however, it was observed that access to the Export Development Scheme was more to the foreign large scale exporters than to the indigenous small scale exporters. This shortcoming prompted the revision of the scheme in 2001.

Under the revised Scheme, for the first time registered societies in the export business were made eligible and 60% of the Export Development Fund was apportioned to SMEs and registered societies. Despite this large portion of the Fund which has been earmarked for indigenous exporters and that exportable items are already available, no applications were received to access the Scheme from this group. This was therefore taken as an indicative of lack of ability of this group to meet both the export market and the Scheme requirements.

In 2005, the CBL embarked upon a countrywide promotion campaigns to sensitise the public about the Scheme and address the small exporters' lack of ability. In these campaigns, indigenous existing and potential exporters were advised to form cooperatives which will enable them to meet the requirements of both the export markets and the Scheme.

The potential exporters of tapestry were being made aware of the high quality of their products, which has earned them an enviable reputation in the world market. Their tapestry has been classified as made out of the finest wool and mohair. The designs ranging from village scenes to geometric and abstract patterns make them even more attractive in the international market. However, low production disqualifies them from participating in the market that is already available to them. Thus producing in quantities which meet the requirements of the exporter market in itself will make them qualify for the Scheme.

Basotho women were also encouraged to do knitting for the export market. The innate skill of the Basotho women finds ultimate expression in knitting. They produce a variety of knitwear products from their homes on an individual basis. This knitwear has got a distinctive character which is evident in the hand-washable jerseys which are made of 100% pure wool in natural colour. Again these knitters were encouraged to form cooperatives so as to be able to meet the requirement of both the export market and the Scheme.

Craftsmen and women are encouraged to form cooperatives as well so as to meet the requirements of both the export market and the Scheme. These craftsmen and women produce a variety of colourful and functional baskets, mats, crochet garments and other traditional beadwork.

Utilising the finest stone ware clay and minerals available which are specially prepared to meet very stringent standards, the beautiful stone ware are individually hand-crafted by highly skilled Basotho craftsmen and women.

With this initiative, it is envisaged that by the end of 2006, there will be societies and cooperatives which would be qualified to meet both the export market and the Scheme requirements.

6.2. Developments in Microfinance

6.2.1 Developing Microfinance Policy

For some time now lack of financial intermediation has been of primary concern to the CBL. Around the world, credit intermediation and access to financial services have long been regarded as effective economic device of poverty alleviation. In Lesotho, poverty is particularly acute in the rural areas where lack of credit and financial services are prevalent. In the urban areas where financial services are available, credit extension still does not come easily for an average person because of a culture of non-payment among Basotho. Due to non-payment culture the banking sub-sector has not engaged in micro-finance in any significant way. The lack of interest from the formal credit service providers led to the burgeoning of moneylenders and what is notoriously known as the loan sharks.

In view of the above, the CBL took a policy decision to develop and strengthen microfinance industry in the country by reviewing policy and legal framework. In pursuit of this objective, the Bank requested technical assistance from GTZ and African Regional Agricultural Credit Association (AFRACA) to develop a policy on microfinance, legal framework and enhance capacity of the Central Bank to supervise the sector. The request was honored by both donors and a mission of two consultants visited the country on 24 March 2005 for two weeks. The brief of the mission was to assess the viability of microfinance industry in Lesotho. During their visit, the mission held conferences with two big moneylenders and one Cooperative, namely, Letsema, Mammoth and Boliba Savings and Credit. The mission also undertook evaluation exercises on these three entities.

The assessment carried out by the mission confirmed that microfinance activity was feasible in Lesotho, and in order to support the development of sustainable microfinance sector, which meets the demand of urban and rural poor, the mission also identified short-term to long-term measures as follows:

1. **Short-Term Measure**

The Money Lenders Act 1989 should be revised in order to create a more effective legal framework, to streamline the money lending business as well as to protect consumers. The revision should entail the following:

- removing of interest rate ceiling (25% per annum)
- removing all other prohibitive requirements (allowing advertisements)
- empowering the CBL to enforce compliance (no court ruling required)
- creating a set of non-prudential requirements i.e. registration and its requirements, disclosure and justification of interest rate calculation etc.

2. Medium to long-team measure

The Report recommended a tiered banking sector, namely,: (1) banks, (2) microfinance deposit taking institutions (3) credit only service provider (4) informal savings and credit groups.

6.2.2 Rural Savings and Credit Group Scheme

During the year under review, other developments relating to outreach were attempted through a series of sensitisation campaigns where rural communities were informed about the operation of the Rural Savings and Credit Groups Scheme (RSCGs). That was a continuous exercise aiming at nationwide coverage. Further developments were on the translation of the RSCGs Blueprint into Sesotho, which has been the result of public outcry for a policy version of Sesotho. A consultant in this regard, was contracted to translate the document into Sesotho language.

Lending under the group methodology commenced through the guarantee of the CBL managed Credit Guarantee Fund (CGF). Three groups' loans to a total of M81060.00 from the districts of Quthing and Berea engaging in poultry to include broilers and layers were approved under the guarantee of the CBL. Performance of the loans at the year end was quite satisfactory. Applications for finance kept coming in with appraisal at various stages of development.

The Credit Guarantee Fund grew by 2.72% from M2, 500,000.00 to M2,568,098.18 in interest during April to December 2005. The reported growth was a result of an investment in Treasury bills and Call deposits made through the assistance of the Financial Markets Department.

Training of groups to prepare them to access credit is key to the operations of the scheme. In view of this, involvement of NGOs as trainers of groups was seen essential. During the period, a budget for training fees was prepared and submitted to the Board for its approval. NGOs ready to undertake this training have in principle agreed to start as soon as arrangements are finalised.

CBL participated in microfinance activities during the period where views on poverty issues were exchanged and experiences shared. This includes participation of the division personnel at a microfinance seminar held in Cape-Town in August 2005 and a study programme in microfinance organised by AFRACA and hosted by Bank of Tanzania (BOT). The country had just started implementation of the tiered microfinance policy within which practicing institutions were expected to register for regulation by the BOT.

Best practicing microfinance institutions and rural community groups of cooperatives and rural savings and credit associations were visited by the study groups. In addition, the CBL hosted a Sub-Regional Workshop organised by the African Rural and Agricultural Credit Association (AFRACA) under the theme "Intergrating Financial Services into Poverty Reduction Strategies". Country papers were presented and CBL presented a case for Lesotho.

6.3 Credit Information Registry (CIR)

Following the adverse decision taken by Trans Union not to set up a credit bureau in the country and recognizing the essence of such a bureau, the CBL took a policy decision to establish a Credit Information Register (CIR) for banks. A CIR is a type of a credit bureau and commonly housed within the CBL. It collects the credit information which comprises loan and contingent liabilities profiles of the borrower.

Financial intermediation fares better in the environment where credit discipline is sacrosanct and nothing instills credit discipline into the borrowers better than the knowledge that a credit bureau of any kind exists. A CIR further facilitates banks' process of giving credit by enabling them to access credit information in order to evaluate loan applications.

During the year under review Supervision Department conducted a research and prepared a paper on the CIRs within the Central Banks in Latin America, Europe and Africa. The research was to cover in particular, existence of CIRs in countries similar to Lesotho's situation where no national identification system exists. The research revealed among others the following -

1. The concept of credit bureau is based on a national identification system and as a result it can not exist in a country with no national identity systems. The problems presented by lack of National ID System in Lesotho will be eradicated in the near future since the country's Legislature has passed the National Identity Cards Act 2004, which establishes the national identity system. We have learnt that preparations for implementation of this Act are advanced. Incorporated persons never experienced the problems as upon incorporation they are assigned a unique registration number by the Registrar of companies. The company's registration number has the same characteristics as the national ID number, the most important being it could never be used by another company even after the original owner ceases to exist.

2. Absence of an effective CIR can inject a moral hazard in a society because even borrowers with capacity to pay tend to show unwillingness to pay. With no structure or process to enforce the loan contracts against them, the temptation to renege on promise to pay proves too much to resist.

4. CIR enhances access to credit and assists in the management of the borrower's reputation risk. A list of negative information contained in the CIR, often referred to as a 'blacklist' can encourage borrowers to perform their loan obligations so as to stay off the list. The existence and use of such database act as an incentive to borrowers to build and maintain the reputation of willingness to pay.

5. The setting up of a CIR requires massive technological investment. CIR is intensively technology driven because of the need to collect, scrub, store, retrieve and disseminate huge amounts of information to large group of users simultaneously.

6. CIRs do not include credit information from commercial retailers. Mostly, they deal with bank credit information.

The paper was approved by FISTC and the Management of the CBL in August 2005. These two organs further decided that technical assistance be sourced from the World Bank with regard the establishment of a CIR within the CBL. A formal application for the technical assistance was made. The CBL's request was met with success and FIRST Initiative was commissioned to render the technical assistance.

6.4 Commercial Court

As indicated in the last reporting period, it had transpired from a number of meetings with the judicial officials that, although the judiciary has the necessary infrastructure for a commercial court, there still exist a number of impediments to its performance. This had resulted in the High Court of Lesotho, with the support of the CBL, taking a number of initiatives to assist the Commercial Court to address those impediments. The initiatives included, among others, proposal to send the officials of the Commercial Court for attachment programmes to the other commercial courts which are well established and performing well.

The objective behind the proposed study tours was to equip the nominees with the knowledge on how to address the impediments encountered by the Commercial Court of Lesotho. The Commercial Court of Uganda was identified as one of the Commercial Courts that are at an advanced stage in this regard. Consequently, it was recommended that a study tour be undertaken to this Court. The recommendation was tabled before the FISTC of the CBL, which adopted it in its meeting of 31 March 2005.

Following this decision, a study tour was undertaken to the Commercial Court of Uganda in Kampala, from 4 to 8 July 2005. The delegation consisted of the Assistant Registrar at the High Court and Section Head – Insurance and Other Licensed Institutions, Central Bank of Lesotho and was headed by the Judge of the High Court. The report on the study tour came up with the following recommendations:

(a) that the High Court (Amendment Rules) LN No 24 of 2000 be reviewed to provide for the establishment of a Commercial Court as a separate division from the High Court of Lesotho, and to redefine the jurisdiction of the Commercial Court in order for the Court to deal only with cases of commercial nature. Alternatively, a new piece of legislation be promulgated to cater for the same;
(b) that the present legislation relating to arbitration and mediation be reviewed to fuse it with the procedures of the Commercial Court, and alternative dispute resolution procedures be used along side litigation;
(c) that, at the initial stage, at least two judges be appointed to the Commercial Court;
(d) that the present case management be reviewed to put in place a new strategy of managing cases such as computerized courts administration system;
(e) that further study tours be undertaken to other countries for further exposure and comparison purposes;
(f) that a task team be constituted to look into the implementation of the above recommendations.

The foregoing recommendations were adopted by both the High Court of Lesotho and the CBL.

The adoption was followed by preparation of the Cabinet Memorandum by the Task Team, which comprised the delegation that undertook the study tour to the Commercial Court of Uganda. The Memorandum highlighted the impediments that hinder the Commercial Court to perform well, and recommended the solutions that could be put in place to curb the problems in order to underpin and accelerate the performance of the Commercial Court. The Memorandum also suggested that the report of the study tour to the Commercial Court of Uganda be adopted as a working document to achieve this objective.

It was believed that approval of the recommendations made to the Cabinet Ministers would enhance the performance of the Commercial Court which, in turn, would strengthen the financial system.

PART VII - REGULATORY AND POLICY DEVELOPMENTS

7.1 Insurance Sector Reform Project

It was reported in the previous report that, following the approval by CBL of the deliverables submitted by FIRST Initiative Consultants under Phase 1 of the Lesotho Insurance Sector Reform Project, the Consultants were given a go-ahead to proceed to the Phase 2 of the Project. Phase 2 mainly involves the drafting of the new insurance legislation and included the development of a detailed work plan for subsequent phases of the technical assistance.

We continued to encounter unavoidable delays during this reporting period. As a result, the Consultants had not as yet finalised the Insurance Bill. However, during the reporting period, two subsequent drafts of the Insurance Bills were produced. The second draft was developed by the CBL based on the Consultant's first draft and its own inputs. This was followed by a third draft Insurance Bill, which was produced after a lengthy discussion on the second draft between CBL and the Consultants. Despite the lengthy discussions on the Bill, both CBL and the Consultants had further comments on the third draft Bill, which both parties had to address and agree upon, before the Consultants could finalise the Bill. The discussions will be completed early next year, and be followed by finalisation of the Insurance Bill for distribution to the stakeholders for their comments.

The Consultants, working in collaboration with CBL, had also produced first drafts of four sets of Insurance Regulations on technical provisions. The Regulations will also be finalised during the next reporting period.

The last stage of Phase 2 of the Project will involve drafting of the Codes of Practice which include market integrity. The Codes cover topics such as selling methods and corporate governance.

7.2 Amendments to the Financial Institutions Act 1999

Following a decision taken in the previous year to amend the FIA 1999, the Department began the exercise in earnest during the beginning of the year under review. The amendments focused on insertion of tiering provisions into the FIA, amendment of Section 8 to accommodate capital levels of lower tiers, amendment of Section 25 to include lower tiers and insertion of insolvency provisions. The initial draft was finished in April 2005 and submitted for discussion before the FISTC.

During the debate on the proposals for amendment before FISTC, several issues such as capital, Section 25 and classification of tiers II & III came to fore. Consequently, the FISTC instructed the Supervision Department to seek clarification and conduct further research on the following:

- The basis of statutory minimum capital especially for tiers II & III and whether the minimum regulatory capital of 8% was still adequate;

- Whether inclusion of 'investments' within Section 25 was appropriate only for tier II and not tier I banks and whether fixed property should be included in the list of exemptions prescribed under Section 25; and

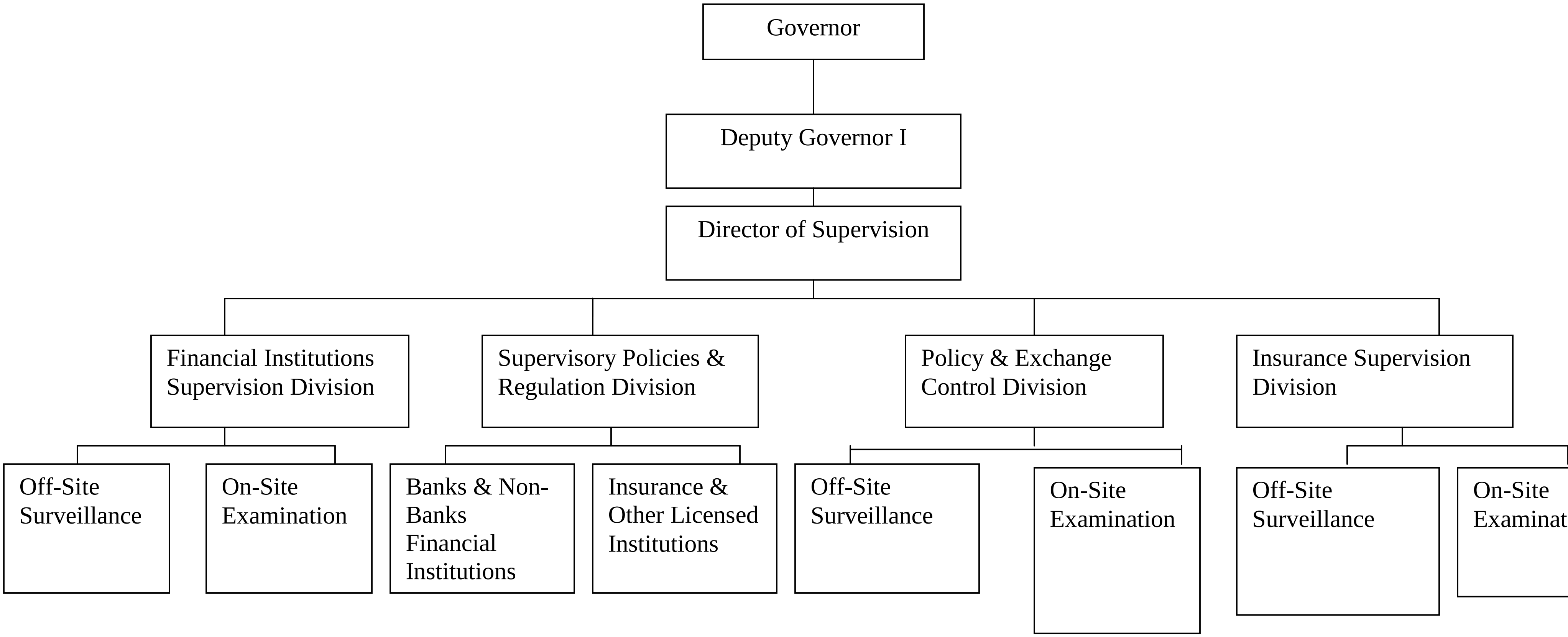
- Classification of tier II & III institutions.

The Department prepared a paper on the above issues and presented it to FISTC for approval. The paper made a comparative study of the above issues among SADAC Countries and a few others. Based on the comparative analysis borne by the study further improvements were made to proposed provisions relating to capital levels of lower tiers, Section 25 especially with regard to the proposed lower tiers and proposed new insertions on tiering of the banking industry.

The new draft proposals were then submitted to FISTC for further discussion in July. FISTC favourably considered the draft and adopted it. After the approval, FISTC decided to submit the draft amendments to the IMF with a request to further augment and enhance the draft. In November, the Bank's request met with approval from the IMF and the IMF Legal Department began desk research into draft immediately. The IMF Legal Department notified the CBL that the report on the research would be issued in April the following year.

Appendix 1

SUPERVISION DEPARTMENT ORGANISATIONAL STRUCTURE



Appendix 2

LIST OF LICENSED BANKS IN LESOTHO AS AT 31 DECEMBER 2005

NAME OF INSTITUTION	NAME AND TITLE OF CHIEF EXECUTIVE	POSTAL ADDRESS	TELEPHONE/ FAX	BRANCH NETWORK
1. Lesotho Bank (1999) Ltd	Mr. C. Addis Managing Director	P. O. Box 1053 Maseru 100	(+266) 22315737 (+266) 22310268	14
2. Nedbank (Lesotho) Ltd	Mr. K. Reid Managing Director	P. O. Box 1001 Maseru 100	(+266) 22312696 (+266) 22310025	3
3. Standard Bank Lesotho Ltd	Mr. C. Addis Managing Director	P. O. Box 115 Maseru 100	(+266) 22312423 (+266) 22310025	5
4. First National Bank Branch in Lesotho	Mr. R. Hudson Chief Executive Officer	P. O. Box 11902 Maseru 100	(+266) 22222200 (+266) 22222222	0
5. Lesotho Post Bank	Mr. M. Vumbukani Chief Executive	Private Bag A121 Maseru 100	(+266) 22317842 (+266) 22317832	9

Appendix 3

LIST OF LICENSED INSURANCE COMPANIES IN LESOTHO AS AT 31ST DECEMBER 2005

NAME OF INSURANCE COMPANY	NAME AND TITLE OF CHIEF EXECUTIVE	POSTAL ADDRESS	TELEPHONE/ FAX	AGENT	BRANCH NETWORK
1. Lesotho National General Company	Mr. R. Letsoela General Manager	Private Bag A65 Maseru 100	(+266) 22313031 (+266) 22310008	0	2
2. Lesotho National Life Assurance Company	Mr. R. Letsoela General Manager	Private Bag A65 Maseru 100	(+266) 22314144 (+266) 22310008	23	2
3. Alliance Insurance Company Ltd	Mr. J. Pienaar Managing Director	P. O. Box 01118 Maseru 100	(+266) 22312357 (+266) 22311381	7	0
4. Metropolitan Lesotho Ltd	Mr. T. Mphahlele Managing Director	P. O. Box 645 Maseru 100	(+266) 22323970 (+266) 22317126	156	3
5. Sentinel Insurance Ltd	Mr. T. McAlpine General Manager	P. O. Box 699 Maseru 100	(+266) 22327940/1 (+266) 22314738	0	0

Appendix 4

LIST OF LICENSED INSURANCE BROKERS IN LESOTHO

AS AT 31 DECEMBER 2005

NAME OF INSURANCE BROKERS	NAME AND TITLE OF CHIEF EXECUTIVE	POSTAL ADDRESS	TELEPHONE/ FAX
1. AON Lesotho (Pty) Ltd	Mrs. L. Mohapeloa Managing Director	P. O. Box 993 Maseru 100	(+266) 22313540 (+266) 22310033
2. Insurcare Brokers (Pty) Ltd	Mr. M. Mohasi Managing Director	P. O. Box 11007 Maseru 100	(+266) 22321973 (+266) 22310669
3. Lesotho Insurance Brokers (Pty) Ltd	Mr. V. Van Roselveldt Managing Director	P. O. Box 01052 Maseru 100	(+266) 22322060 (+266) 22325489
4. Maluti Insurance Brokers (Pty) Ltd	Mr. Andre Mentz Managing Director	P. O. Box 1515 Maseru 100	(+266) 22310557
5. Mamoth Insurance Brokers (Pty) Ltd	Mr. R. Theko Managing Director	P. O. Box 1659 Maseru 100	(+266) 22322380 (+266) 22310897
6. Prosperity Insurance Brokers (Pty) Ltd	Mr. S. Siimane Chief Executive Officer	P. O. Box 14173 Maseru 100	(+266) 58842861
7. Thebe Insurance Brokers (Pty) Ltd	Mr. D. Maling Managing Director	P/Bag A244 Maseru 100	(+266) 22313018 (+266) 22310513
8. Southway Insurance Brokers Lesotho (Pty) Ltd	Mr. A. Du Plessi Managing Director	P. O. Box 4564 Maseru 104	(+266) 62032037
9. DIB International (Pty) Ltd	Mr. Du Randt Managing Director	P. O. Box 478 Maseru 100	(+266) 22312576
10. ABC Insurance Brokers (Pty) Ltd	Mr. S. Makape Managing Director	P. O. Box 9036 Maseru 100	(+266) 22324061 (+266) 22310970
11. Vicgera Insurance Brokers	Mr. Victor Nkala Managing Director	P.O. Box 01142 Maseru West 105	(+266) 58902605

12. Mokant Insurance Brokers (Pty) Ltd.	Mr. Moise Mopeli Principal Broker	P.O. Box 15609 Maseru 100	(+266) 63015544
13. Borata Insurance Brokers (Pty) Ltd.	Mr. Liau J. Motale Principal Officer	P.O. Box 13407 Maseru 100	(+266) 62749154/ 58749454
14. Multi-Vision Insurance Brokers (Pty) Ltd.	Mrs. Doreen Brown Principal Brokers	P.O. Box 9646 Maseru 100	(+266) 63007108

Appendix 5

LIST OF LICENSED MONEY LENDERS AS AT 31 DECEMBER 2005

1. V. T. Tlali	P. O. Box 942, Butha-Buthe 400
2. B. M. Ntsie	P. O. Box 118, Mokhotlong 500
3. Edu-Loan	P. O. Box 1932, Maseru 100
4. Financial Services Holding Lesotho Pty	P. O. Box 13371, Maseru 100
5. Afrisure Personal Loans Lesotho (Pty) Ltd	P. O. Box 9717, Maseru 100
6. T. Lekata	P. O. Box 132, Maseru 100
7. M. S. Koetje	P. O. Box 15, Ha Mamathe, Lesotho
8. A. M. Kome	P. O. Box 7699, Maseru 100
9. T. Motselekatse	P. O. Box 317, Maseru
10. Batho-Pele Financial Services (Pty) Ltd	P. O. Box 15715, Maseru
11. J. H. Kente	P. O. Box 108, Mohales Hoek
12. Mokorotlo Financial Services (Pty) Ltd	P. O. Box 10286, Maseru 100
13. M. T. Mojapela	P. O. Box 901, Butha-Buthe 400
14. P. Ntale	P. O. Box 859, Butha-Buthe 400
15. African Credit	Private Bag A432, Maseru
16. TCL Loans	P. O. Box 14367, Maseru
17. M. Panya	P. O. Box 599, Mafeteng 900
18. E. T. Mojapela	P. O. Box 1666, Maseru 100
19. M. Makoa	P. O. Box 705, Leribe
20. J. M. Motlalane	P. O. Box 10011, Maseru 100
21. Makhulong Financial Services	P. O. Box 15609, Maseru 100
22. Star Lion Gold Coin Investment	P. O. Box 12634, Maseru 100
23. Letsema Investment Holding (Pty) Ltd	P. O. Box 2470, Maseru 100
24. Bathusi Solutions	P. O. Box 928, Maseru 100
25. F. M. Tsenoli	P.O. Box 4032, Sebaboleng 104
26. M. V. Rammoneng	P.O. Box 2084, Maseru 100

27. Liharata Cash Loans	P.O. Box 470, TY 200
28. Feed the Nations	P.O. Box 7178, Maseru 100
29. T. M. Lebusa	P.O. Box 583, Maseru 100
30. E. T. Mojapela	P. O. Box 1666, Maseru 100
31. E. T. Mafeke	P. O. Box 219, T.Y 200
32. L.S. Nokana	P. O. Box 588, Maputsoe 350
33. P. M. Makakole	P. O. Box 7363, Maseru 100
34. Sechaba Personal Financial Advisors	P. O. Box 16101, Maseru 100
35. M. R. Naheng	P. O. Box 901, Butha-Buthe 400
36. Motsoako Financial Services	P.O. Box 15609, Maseru 100
37. Lebohang Leqela	P.O. Box 2, Mafeteng 900
38. Senettam Financial Services	P.O. Box 749, Maseru 100
39. Mamoth Multi-Financial Services	P.O. Box 0690, Maseru 100
40. Nako Sethole	P.O. Box 206, Maputsoe 350
41. Seoe Ntoi	P. O. Box 54, Peka 340
42. G. Thamaha	P. O. Box 298, Butha Buthe 400
43. Budget Solutions	P. O. Box 1091, Maseru 100