2020/21 RESEARCH BULLETIN

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Preamble

The Non-Bank Financial Institutions Regulatory Authority (NBFIRA) publishes the Research Bulletin annually to discuss developments in the local economy and how they affect the different sectors in the financial industry.

The 2020/21 Research bulletin will focus on the Botswana non-bank credit market and the major developments that arose in the market during this period.

Glossary of Terms

Corporate bonds: A corporate bond is debt issued by a company in order for it to raise capital.

Credit Bureaus: A credit bureau tracks the credit history of borrowers in order to generate credit reports and credit scores.

Financial inclusion: The availability and equality of opportunities to access financial services.

Finance Companies: A company concerned primarily with providing money, e.g. for hire-purchase transactions.

GDP per Capita: Is a metric that breaks down a country's economic output per person and is calculated by dividing the GDP of a country by its population.

Household debt: Household debt is defined as all liabilities of households (including non-profit institutions serving households) that require payments of interest or principal by households to the creditors at a fixed dates in the future.

Idiosyncratic risk: Uncertainties, and potential problems that are unique to an individual asset (such as the stock of a particular company), or asset group (such as stocks of a particular sector), or, in some cases, a very specific asset class (such as collateralized mortgage bonds).

Institutional investors: An institutional investor is an entity which pools money to purchase securities, real property, and other investment assets or originate loans.

Leasing Companies: Provides a physical asset or service for use by a commercial client or individual for an established period of time (sometimes with provisions to purchase asset at the end of the contract) in return for regular payments, known as financial leasing.

Micro-financing: Generally refers to the provision of basic financial services such as loans, saving accounts and insurances for low-income but economical active people.

Minimum Capital Requirement: Capital requirements are regulatory standards for financial institutions that determine how much liquid capital (easily sold assets) they must keep on hand.

Nominal GDP: Measures a country's gross domestic product using current prices, without adjusting for inflation.

Pawnshops: A person licensed to engage in the business of lending money on personal property that is physically delivered to him or her as a security for loan transaction or lending money upon goods, wares or merchandise pledged, stored or deposited as security or engages in the business of purchasing tangible personal property to be left in pawn, on condition that it may be redeemed by the seller for a fixed price within a fixed period of time.

Peri-urban areas: Zones of transition from rural to urban land uses located between the outer limits of urban and regional centres and the rural environment.

Promulgation: The formal proclamation or the declaration that a new statutory or administrative law is enacted after its final approval.

Small to medium enterprises (SME's): Are businesses that maintain revenues, assets or a number of employees below a certain threshold.

Unsecured personal loans: Any type of debt or general obligation that is not protected by a guarantor, or collateralized by a specific assets of the borrower in the case of a bankruptcy or liquidation or failure to meet the terms for repayment.

Usury Act: Regulations governing the amount of interest that can be charged on a loan.

The 2020/21 NBFIRA Research Bulletin

The theme for the current publication addresses the developments in the Botswana non-bank credit market. This market offers great opportunity for financial inclusion of the country's unbanked population as it is made up of formal and informal financial services providers with access to a wider population. The popularity emanates from the less onerous loan documentation requirements on borrowers compared to traditional lenders. However, the cost of credit is relatively higher than in the banking sector to mitigate the risk of default in loan repayments. The report further provides insightful information about the relevance of micro finance business to support small to medium size enterprises (SMMEs) development. Furthermore, thoughts of authors are expressed on consumer over indebtedness relief measures with a view to ignite debates and / or regulatory policy formulations by relevant organs.

The purpose of the Research Bulletin is to provide a forum where research relevant to the economy and the financial sector, with particular reference to the non-bank financial sector can be disseminated. Furthermore, for the staff to show case their regulatory expertise. Comments and suggestions on papers published in the Bulletin are welcome from the wider public and will published in future issues. The scope of the bulletin includes dissemination of information on developments, the regulatory policy changes and initiatives; as well as news and information of interest to the members of the public.

The Research Bulletin is published on an annual basis and, as and when necessary, several volumes maybe published in any one year.

The articles in this publication are contributed by staff of the Authority and guest authors who gave permission for publication of their work. Articles of relevance to the non-bank financial sector are welcome from members of the public for future publications. Views expressed are not necessarily those of the Authority but of the authors and their contributors.

I wish to acknowledge all our guest authors, and the regulated NBFIs, Board, Management and Staff of NBFIRA for working diligently in providing all the information required to make this publication a success.

The document is only published as a soft copy on the Authority's website in view of cost considerations.
Website: www.nbfira.org.bw

Mandate, Vision and Mission

MANDATE

The Non-Bank Financial Institutions Regulatory Authority (NBFIRA) aka ***the Regulatory Authority*** derives its mandate to regulate and supervise the non-bank financial institutions (NBFIs) from Section 8 of the NBFIRA Act (CAP46:08). In terms of the NBFIRA Act, the principal object of ***the Regulatory Authority*** is to foster the following:-

Safety and soundness of the NBFIs;
The highest standards of conduct of business by the NBFIs;
Fairness, efficiency and orderliness of the Non-Bank Financial sector;
Stability of the financial system; and
Reduction and deterrence of financial crime.

VISION, MISSION AND VALUES

To support its fundamental and principal object, t***he Regulatory Authority*** subscribes to the following vision, mission and values statement in order to embrace a culture of a high performance organization.

VISION

To be an efficient and effective regulatory and supervisory authority in line with international best practices.

VALUES

Integrity
We adhere to the highest ethical standards.
Transparency
We are open and frank in our operations.
Fairness
We consistently promote equal treatment in our dealings with all stakeholders.
Accountability
We are responsible to our stakeholders.
Diligence
We are thorough and persistent in the execution of our duties.

MISSION

To regulate and supervise the Non-Bank Financial Institutions for the purpose of contributing towards financial stability.

Editorial Commentary

The 2020/21 Annual Research Bulletin is themed around developments, policies and practices that support ***the Regulatory Authority*** in executing its regulatory mandate over relevant non-bank financial institutions. The objective of this issue is to provide insights into ***the Regulatory Authority's*** role of regulating the non-bank credit businesses under the provisions of the Act and to take stock of developments over the recent past. An article on development of microfinance institutions and products is shared by a guest author.

Credit is herein defined as the ability of a customer/borrower to access cash/funds with a promise to repay with interest and over a period of time. Credit is based on the trust that the borrower will make repayments in the future and in accordance with the terms and conditions contained in the loan contract/agreement. Banks, globally are a major player in the credit market and have developed stringent loan approval assessments and default risk mechanisms. Evidence has shown that income distribution is skewed in many countries and in turn, a significant portion of the population and enterprises are unbanked and do not qualify for traditional bank credit, especially in the developing markets.

"Microfinance is the provision of financial services to low-income clients who traditionally lack access to financial services. The long-term goal is to build comprehensive financial sectors that provide a broad range of everyday financial products to all segments of society. Microfinance requires a set of specialized tools to carry out the screening and monitoring of clients as well as to enforce repayment. Traditional banks require "hard" information such as audited statements, asset appraisals, tax receipts, and investment plans and use the threat of asset loss in cases of default. In contrast, a microfinance credit officer analyzes the cash flows generated by a household's (often numerous) micro-entrepreneurial activities. Close and frequent contact between both lender and borrower is key. Moreover, credit officers analyze the whole social and economic environment in which a micro-entrepreneur operates **[Christian Etzensperger, Responsibility Leading Social Investments"**

It is on this background that other formal non-bank financial institutions has overtime emerged to service mostly the unbanked communities with financial services including credit facilities. Development of a policy framework for micro-financing in support of an enabling environment for enterprises is receiving attention of the Botswana Government. Currenly, micro-financing in the true sense of mobilizing savings to provide credit is not yet developed and the credit providers in non-bank lending mostly service the formally employed. **Tokafala and Women's Finance House** under the regulatory purview of the central bank are the only financiers of SMMEs. Nonbank lenders in Botswana predominantly service the employed and includes: the life insurers, micro-lenders, pawnshops, finance and leasing companies which fall under the regulatory purview of NBFIRA. Information on life insurer businesses is not currently available and hence articles on this non-bank lending are excluded in this issue.

I wish to express my sincere gratitude to guest authors, who contributed articles from a financial literacy perspective to this edition. Mr Patrick Dogbe is a microfinance expert in the republic of Ghana.

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The Difference Between Micro-Finance and Micro-Lending

Article by Lending Activities Department

Introduction

Micro-financing began in the mid-1800 when the theorist Lysander Spooner was writing about the rewards of offering micro loans to entrepreneurs and farmers as poverty alleviation practices (Das, 2018). Nonetheless, Dr Muhammad Yunus pioneered the birth of “modern micro-finance” in the 1970s in the rural parts of Bangladesh where he started the “micro-credit” movement (Das, 2018).

How is micro-finance different from micro-lending?

The difference between micro-finance and micro-lending arises from the fact that one is a component of the other. Micro-lending often referred to as micro-credit is a component of micro-finance. It is a component confused with micro-finance as the two are synonymously used to refer to microloans issued by lending entities. Micro-lending evolved as a provision of small loans to the low-income people including the enterprises they owned. It was later replaced by term micro-finance which involves providing formal financial services which includes savings, credit insurance, money transfers and other micro-financial services, to low-income household and small enterprises to support their economic activities as well as their household financial management and consumer needs. Therefore, the ease of differentiating the two terms may be derived from the notion that micro-finance refers to “credit plus” whilst micro-credit is “credit only”.

Historically micro-lending has been the foundation of many micro-finance models since the credit provider caters for low-income clients both the unemployed and informal entrepreneurs. In other developed and developing nations, micro-lending is practiced as lending for the purposes of entrepreneurship development whilst in some other developing countries such as Botswana and Namibia micro-lending started as practice to lend for consumption purposes and it is salary-based lending. However, in Botswana the micro-lending model has now developed to the extent that micro-lenders offer long-term loans of higher amounts. These loans are not limited to low-income individuals but to everyone who can afford them, including high net individuals.

In Botswana, non-bank lenders include Micro-Lenders, Pawnshops, Finance Companies and Leasing Companies. Micro-Lenders are licensed to operate micro-lending business whilst, Pawnshops, Finance Companies and Leasing companies are exempted to operate by NBFIRA as per the set terms and conditions. Micro-Lenders issue consumption loans to individuals. Finance Companies offer loans to companies particularly the Small Medium and Micro Enterprises (SMMEs) to perform projects. Leasing Companies rent out equipment to these SMMEs for production purposes. Pawnshops allow individuals to borrow money and require movable property as collateral.

NBFIRA regulates credit providers that are listed in the NBFIRA Act, 2016, through the Lending Activities Department and the Insurance Department. Other credit providers such as banks, savings and credit cooperative societies(“saccos”), hire purchases amongst others, are regulated by different authorities such as Bank of Botswana and Ministry of Investment Trade and Industry.

Conclusion

Micro-finance encompasses microloans, microsavings and microinsurance. Micro-Lending a subset of micro-finance involves the advancement of microloans. Some aspects of micro-finance, such as micro-insurance and micro-lending is regulated and supervised by NBFIRA, whilst some aspects are regulated and supervised by the Bank of Botswana.

Bibliography

Das, R. C. (2018). Microfinance and Its Impact on Entrepreneurial Development, Sustainability, and Inclusive Growth. United States of America: IGI Global.

http://wfhb.org.bw/

Pawnshops in Botswana

Article by Lending Activities Department

The business of pawning is not a new phenomenon but has been in practice for centuries. Pawnshop or pawn brokering business can be traced back to at least 3000 years ago in ancient China, as well as Greek and Roman era early civilizations. It is also alleged that Queen Isabella of Spain pawned her royal jewelries and funded Christopher Columbus' journey to discover the new world, which ultimately led to the discovery of the United States of America (https://humboldtpawn.com).

The history of pawnshop business in Botswana, unfortunately, has not been extensively documented but it is a common business practice that has been in existence for several years.

The NBFIRA Act, 2016 defines a pawnshop as "a person licensed to engage in the business of lending money on personal property that is physically delivered to him or her as a security for loan transaction or lending money upon goods, wares or merchandise pledged, stored or deposited as security or engages in the business of purchasing tangible personal property to be left in pawn, on condition that it may be redeemed by the seller for a fixed price within a fixed period of time''.

The above definition excludes the pawning of immovable property such as land, and limits pawn items to those that can be physically delivered to the pawn business. This was further confirmed by a high court ruling in Botswana in case, Johannes Jurgen Fourie (applicant) vs. Andina Masedi and Tothodzani Mathamani (respondents) 2018, where the pawning of immovable property was declared unlawful. The applicant had sought a court order for the transfer of the respondents' residential plots into his possession after they had failed to repay him for a P50 000 loan, where two residential plots were pledged as security(https://www.sundaystandard.info/court-declares-pawning-of-immovable-property-unlawful/).

Pawnshops in Botswana (Cont.)

Pawnshop business is similar to micro lending in that both business types are limited to issuing micro loans to borrowers. The major difference between the two business types is that in pawn business, credit or affordability is based on the value of an item pawned or pledged as collateral by the borrower so that in the event of default on repayment the item will be forfeited. On the other hand, micro lending loans are unsecured and affordability is based on consumer's income or salary earnings.

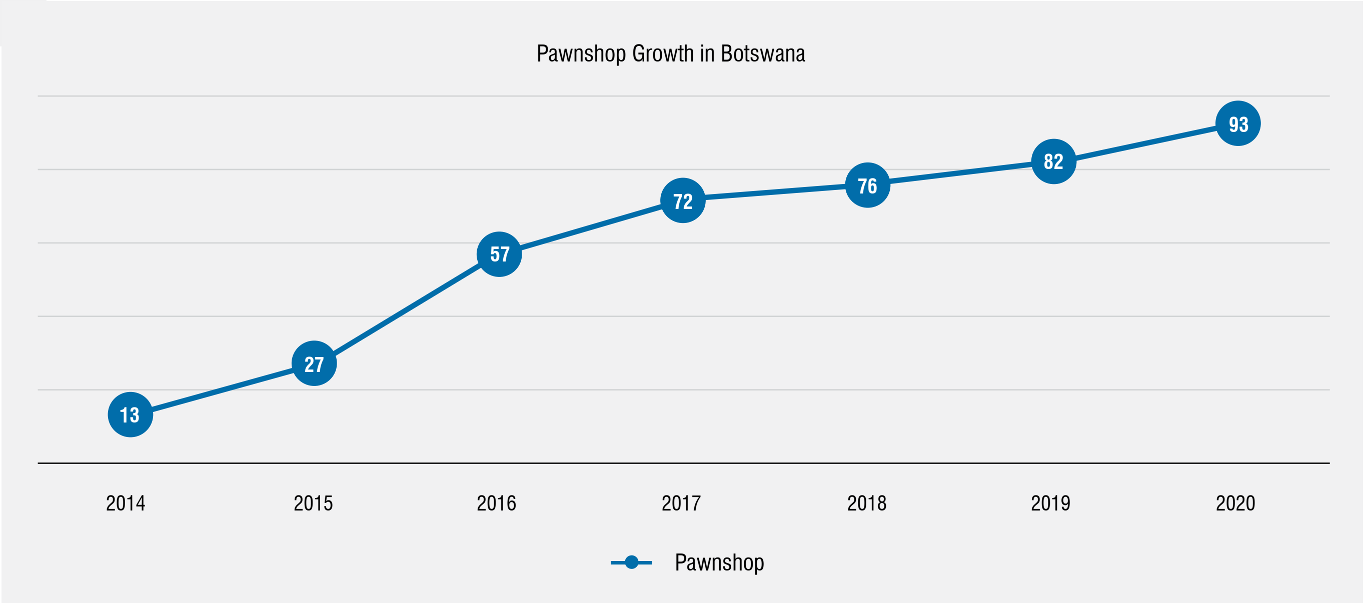
Regulatory Framework

Pawnshops were initially not recognised as non-bank financial institutions (NBFIs) in NBFIRA Act, 2006 which has been repealed and replaced by NBFIRA Act, 2016, which recognises them as NBFIs. However, there are currently no specific regulations promulgated for the sector. The Authority currently issues exemptions to entities to operate as pawnshop business, pending the promulgation of relevant legislation. Such exemptions are conditional on the entities adhering to the terms and conditions accompanying the exemption letter, the NBFIRA Act, 2016 and other financial services laws. NBFIRA has recently completed the first draft of the Non-Bank Lenders Bill, which is a consolidation of the regulatory frameworks for micro lending, pawnshop, finance and leasing entities in Botswana. NBFIRA has commenced industry consultations on the proposed bill with sector participants and other relevant stakeholders.

Growth of Pawnshops in Botswana

Figure 1 below shows pawnshop growth in Botswana during the period 2014-2020.

Figure 1: Pawnshop Growth in Botswana



Source: NBFIRA

As at December 31, 2020, there were 93 exempted pawnshops in Botswana.

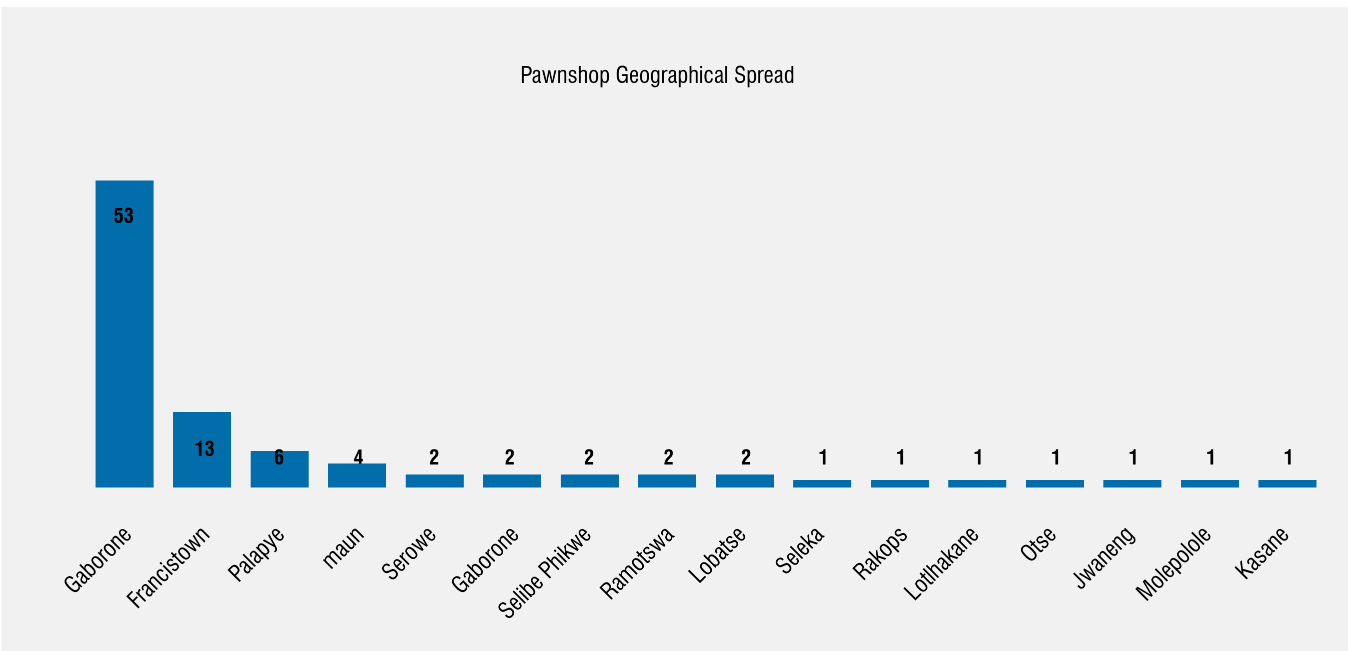
Exempted pawnshops increased by six fold (615%) between 2014 and 2020 that is; from 13 pawnshops to 87, respectively. The most significant increases were noted in 2015 and 2016 as the numbers grew by 14 and 30, respectively. From the year 2017 to 2020, the number of new entrants in the pawn industry has been increasing at a diminishing rate.

Pawnshops in Botswana (Cont.)

Geographical Spread of Pawnshops in Botswana

Figure 2 below shows the geographical spread of pawnshop in Botswana as at December 31, 2020

Figure 2: Geographical Spread of Pawnshops in Botswana



Pawnshops in Botswana are mostly concentrated in urban and peri-urban areas, with 56% and 13% based in Gaborone and Francistown respectively.

Industry Financial Performance

The financial performance of pawnshops is measured by the loan book values (accounts receivables), that is; the total of all outstanding loans in the company books at the end of the reporting period. As at December 31, 2019, NBFIRA reported a P14.69 million loan book value for 15 pawnshops, which had submitted data for that reporting period. This is a clear indicator that the total industry loan book value is higher, as more data is yet to be collected.

Common Pawnshop Products in Botswana

The common products that exempted pawnshops accept as pawn items are household goods such as electronics, and motor vehicles. A relatively new pawn arrangement is the pawn-and-drive product, which has proven to be the most preferred among borrowers. In this arrangement, clients pawn their vehicles and in place of keeping the pawned vehicles, as has been the custom historically, pawnshops take custody of the vehicle registration book (commonly known as blue book) and allow the client to use the vehicle for the duration of the loan. In the event that the client fails to honour the terms and conditions of the agreement, the vehicle is repossessed.

This arrangement has proven to be attractive to clients in that they continue to enjoy the convenience of using their vehicles for the duration of the loan. It is also preferred by pawnshops as it cuts storage costs which the pawnshop would incur in the traditional setting, where the pawnshop would typically be in possession of the pawned vehicle.

7. Pawnshops in Botswana (Cont.)

Conclusion

Pawnshops are fast growing in Botswana and are recognised as Non-Bank Financial Institutions in the NBFIRA Act, 2016. However, there are still no specific regulations promulgated for the sector; and NBFIRA is in the process of developing the relevant regulatory framework for pawnshops and other non-bank lenders in its regulatory ambit.

The pawnshop business is a major contributor towards the financial inclusion agenda, as loans are granted to borrowers who can pledge collateral in the form of moveable property, in exchange for the loans. Pawnshops are spread throughout the country in urban, peri-urban areas; however, only 3% are located in rural areas.

Finance and Leasing in Botswana

Article by Lending Activities Department

Introduction

Anyone in charge of running an enterprise will attest to the fact that at some point in their journey they needed "something borrowed". As an upper middle income economy that aspires for a first class country status, Botswana needs to be self-reliant. The journey to self-reliance requires sustainable and resilient enterprises and hence the need for vibrant finance and leasing businesses in Botswana.

Non-state owned businesses are the necessary complement that is pivotal to transitioning Botswana into a self-reliant economy. As with any other developing country Botswana is characterized by small to medium enterprises (SME's) in comparison to large enterprises. Both large to small enterprises require capital to be resilient and sustainable, unfortunately SME's find it challenging to access mainstream financing offered by banks and other commercial financing institutions due to associated risks. These risks stem from lack of prior historical performance and established business structures that make up major enterprises. The exclusion has not left the SME's without a market to lease or finance them as there are other market participants that cater for them.

In Botswana, the market for financing and leasing is made up of Government owned institutions such as Citizen Entrepreneurial Development Agency (CEDA), Botswana Development Corporation (BDC) and Local Enterprise Authority (LEA), development banks such as National Development Bank, Botswana Building Society (BBS), and commercial banks such as First National Bank, ABSA Bank and Standard Chartered Bank and privately owned institutions such as Norsad Finance, Ticano and Scania Finance.

Government owned leasing and financing entities are funded by the government through the national budget and government bonds. Banks finance enterprises from bank deposits and corporate bonds in the capital markets. Privately owned finance and leasing entities extend lending through funds acquired from institutional investors, corporate bonds, loans and shareholder savings.

What is Finance and Leasing

In simple terms a leasing business is involved in the activity of lending out intellectual or physical property with an expectation to receive from the borrower (lessee) an expected periodic cashflow based on the cost of leasing the property. Leasing can be broadly divided into two types of activities;

- "Operating lease" is where the lessee is expected to periodically pay a fee to the lessor for the use of resource under lease without ever having the option to own the leased resource.
- "Financing lease" is where the lessee is expected to periodically pay a fee to the lessor for the use of resource under lease with the expectation or right to own the resource during or at the end of the lease period.

Finance and Leasing in Botswana (Cont.)

A financing activity seeks to provide capital and/working capital to enterprises at a fee also known as cost of lending the funds. The expectation of the financier is to redeem the cost of lending the funds and initial capital lent out at the end of the contract.
Some of the activities involved under financing are;

- “Factoring” means a financial transaction in which a firm sells its accounts receivable invoices to a third party at a discount, in order to receive immediate funds to continue its business;
- “Loan syndication” means a lending process in which a group of lenders work together to provide funds to a single large amount borrower;
- “Project finance” means the funding of projects that are typically infrastructure-heavy, capital-intensive or related to public utilities and treated as distinct entities from its parent company; and
- “Purchase Order Financing” means a short-term commercial finance option that provides funding to pay suppliers upfront for verified purchase orders.

Non-bank financial institutions (nbfi’s) that are involved in finance and leasing activities fall under the regulatory purview of the Non-Bank Financial Institutions Regulatory Authority (NBFIRA) as stipulated in the NBFIRA Act of 2016. Currently NBFIRA does not regulate operating leases

Statutory Framework

Currently financing and finance lease (leasing) activities do not have specific regulations and their operators only need to acquire an exemption from NBFIRA to undertake such activities. Therefore, exemption requirements have been developed to guide the operation of such activities in the absence of industry specific regulations. As part of the exemption requirements, individuals with interest of managing and controlling finance and leasing entities are required to undergo fit and probity assessment before and during the validity of their exemption, as required by the NBFIRA Fit and Proper Rules of 2018. In pursuit of providing a sound and safe market for these sectors whilst industry Specific legislation are still being developed, NBFIRA continually engages with regional and international bodies such as: Committee for Insurance, Securities and Non-Banking Authorities (CISNA) and Consultative Group to Assist the Poor (CGAP).

The Growth of the Financing and Leasing Companies

The table below indicates the number of exempted finance and leasing entities in Botswana as registered by NBFIRA in the past five (5) years from 2016 to 2020.

Table 1: Number of Finance and Leasing Entities

Sector Type	2020	2019	2018	2017	2016
Financing Entities	54	39	29	20*	11*
Leasing Entities	5	5	5		

Source: NBFIRA Annual Report, *Combined figures

From 2016 to 2017 Finance and Leasing entities were reported as one figure and in the same period, the entities grew by 82%. From 2018 onwards the two sectors were reported individually. Financing entities increased by 34.5% from 2018 to 2019. Furthermore, the sector continued to experience a sharp increase in exempted entity numbers of about 38.5% from 2019 to 2020. This sharp increase amongst many can be attributable to a government directive issued in 2014 that required local authorities and parastatals to procure products from local suppliers, thus increasing demand for financing.

Following the separate reporting of Leasing entities from Financing entities, the sector did not register any new exemptions from 2018 to 2020. The stagnation of leasing entities can be attributable to the capital output required to set up such an entity, as it first requires an entity to acquire the asset that will be later leased. It should however be noted that the reasons for the stagnation are inconclusive.

Conclusion

Finance and Leasing entities are projected to increase in tandem with the need of the economy to move from sustenance economy to a fully-fledged capitalist economy. NBFIRA is closely monitoring the trends both locally and internationally as it seeks to develop a regulatory framework that will accelerate growth whist ensuring efficiency, effectiveness, soundness and safety of the sectors.

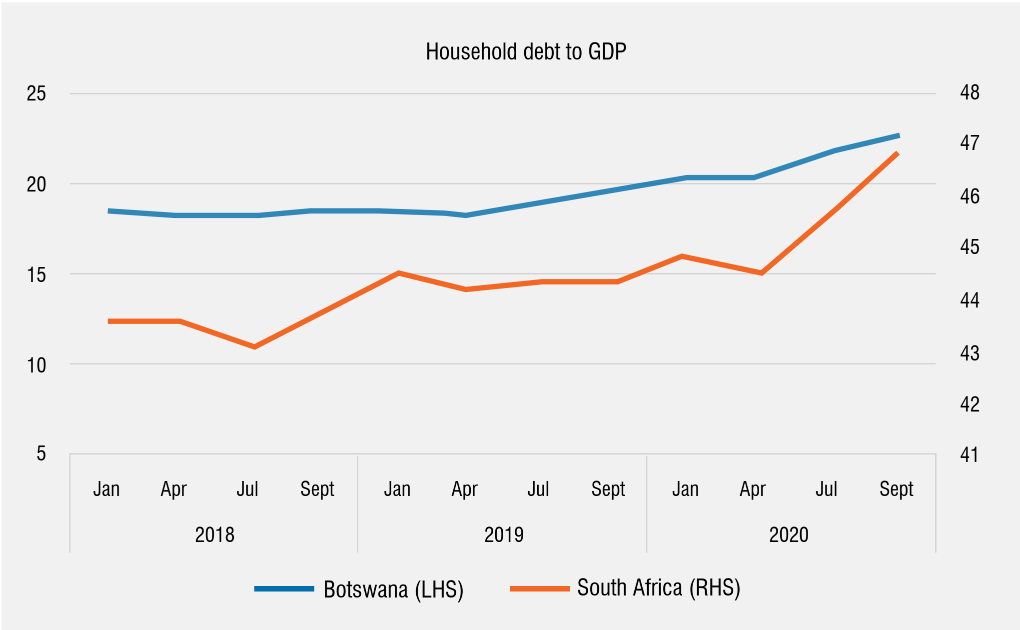
Debt Relief Measures

Article by Research Department

Background Information

Botswana household debt to nominal GDP ratio increased to an all-time high of 22.7 percent in September 2020. This ratio is calculated from the monthly household debt and nominal GDP figures published by the Bank of Botswana and Statistics Botswana, respectively. This credit statistics excludes credit by non-bank financial institutions, retailers and utility corporations. Figure 1 below shows that the ratio portrays a similar growth pattern to the South African household debt to Nominal GDP ratio.

Figure 1: Household Debt to Nominal GDP Ratio



Debt Relief Measures (Cont.)

Studies have shown that “a large fraction of South African consumers are highly leveraged, inadequately insured, and/or own little to no assets of value, which increases their exposure not only to idiosyncratic risk but also to severe indebtedness and/or default. This scenario can present negative ramifications that lead well beyond the confines of individual households.” Thankfully, efforts were made to remedy the situation through the legal debt relief mechanisms in the National Credit Act, and further efforts are proposed to remove the snags. [Journal of Financial Planning] Lessons from this experience would assist with a proactive response.

During the year to September 2020, commercial bank credit increased by 4.4 percent to P63.8 billion. As a percent of GDP, credit has grown steadily between 2009 and 2019 recording an average growth rate of 29.8 percent over the 11-year period. Lending was largely driven by household borrowing which was underpinned by accommodative monetary policy stance of the Bank of Botswana during 2019. Household credit has soared by more than 7 percent, from P38.5 billion in September 2019 to a high figure of P41.3 billion recorded in September 2020 [National Financial Stability Report, October 2020).

The proportion of unsecured personal loans are by far the main contributors of household credit. Unsecured loans contributed 70.8 percent of the total household credit in September 2020. [Botswana Financial Stability Report, September 2020]. The vast majority of Batswana are borrowing money to pay for day-to-day expenses, rather than to invest in assets, like land or property [Armstrongs]. Notwithstanding, this consumer behavior debt problems are seen as an inevitable feature of the credit market. Empirical studies show that there are always unfortunate stressor events that are beyond the control of the lenders and the borrowers; such as economic downturns, job losses, illnesses, deaths or divorces. These play a large part not only in the accumulation of debts but also in the erosion of the debt repayment capacity by disrupting income streams. For example, in 2008 a crash in the Botswana property market led to a rise in arrears and loan repayment defaults. The country is yet again faced with the consequences of the covid -19 outbreak since emergency measures of April 2020 which is expected to result in business failures and rising unemployment and hence loss of incomes to service debts. Notwithstanding these, some borrowers are exposed to over-indebtedness because of self- incriminating actions like over borrowing from numerous credit providers to finance consumption (flashy weddings, funerals, cars etc.); how then can they be rehabilitated?

It is on this background that this articles reviews what obtains on the ground in terms of over-indebtedness relief measures and the consequences of certain remedial measures such as credit scoring and asset repossessions. It further explores what more will need to be done to support both the households and companies with debt relief.

Debt Relief Measures (Cont.)

Credit Information Reference Measures

A significant number of credit providers in Botswana subscribe to Credit Bureaus and exchange credit performance information to facilitate credit scoring points for borrowers. The adverse effects of a poor credit score is that consumers who do not honour loan agreements end up with dodgy credit histories, and below-average credit scores [Lanmda, Botswana]. Creditors like banks, pay day loan providers and microlenders use credit records to assess the risk of lending clients' money, and to calculate the rate of interest on loans. As a result Batswana with poor credit scores pay a lot more to borrow money from banks and other loan providers – that's if they qualify for an unsecured loan at all.

Credit information referencing is actually advantageous for credit management, and in particular credit affordability assessments. In fact, the Government is in the process of developing a central credit reference information system and its legal framework. Promulgation and commencement of the laws and supporting regulation will facilitate holistic credit affordability assessments and reviews.The laws will ensure that credit providers submit information ranging from exposures to banks, non-bank lenders, subscriptions, premiums, utility companies bills, hire purchase providers etc. While this development is expected to enhance loan affordability enhancements, the reader should be mindful of unfortunate events discussed above which render a good credit sour. There is a saying that many "bad loans started as good loans", how then do we assist those caught up in this syndrome. In case of secured advances, is it morally right to repossess a family home for the borrowers, predicament. Evidently even lenders are not interested in the possession of collateral but the repayment of their principal issued plus interest as often selling the asset may be below its market value. What then, are the measures that could be introduced to lessen the burden on both the well-intentioned borrowers and lenders?

Over In-debtedness Relief Measures

The words "over indebtedness" are used in this context to denote failure to generate enough income to service contractual agreements. It is noted that the proposed credit information referencing will improve loan legibility assessments and thus reduce over extension of credit at the initiation point, safe for existing and outstanding exposures. However, these existing accommodations and future relapses in credit servicing ought to be managed through a statutory instrument which goes beyond the credit information referencing statutes but augments the consumer protection act. The credit servicing act or provisions in the Consumer Protection Act may provide for discouraging reckless lending practices, the establishment or licensing of credit servicing firms and licensing of debt counselors. The credit servicing act or provisions should amalgamate by the Consumer Protection Act into a credit servicing Act administered by a chosen financial regulatory authority or under the Consumer Protection Department of the MITI. Irrational credit practices should not escape punishment of the lender. In that regard the Regulator should receive credit defaults of Six months or more from the Credit reference information system and review the loan initiation documents to establish recklessness in credit assessments or not of the lending institution. To facilitate cash-flow generation by lenders, the Regulator may also issue licenses to firms authorized to buy credit portfolios and repackage them for easier repayments. In addition, the credit servicing act / provisions may provide for the licensing of debt counsellors who provide counselling services and conduct debt restructuring negotiations and management of the troubled borrowers' monthly disposable incomes. In addition, to revisiting the circumstances of the troubled borrowers, for example unexpected child maintenance claims, the debt counselling may like in the case of South Africa allow grace periods for justifiable repayment disruptions such as costs related to deaths of immediate family members for which the borrower is the principal financier of funeral costs.

It is further recommended that other best practices in credit servicing management be incorporated in the act such as The Truth in Lending of the USA. In the Truth in lending the full cost of credit is disclosed to the borrower which provides the opportunity to shop around for cheaper credit among the creditors. Although Botswana has such disclosures for the banking sector this is not so for other credit providers.

Lessons from South Africa on Consumer Debt relief Measures

In the case of South Africa the consumer debt relief statutory provisions are contained in the National Credit Act, 2005, the mandate of which is wide and all-embracing with a view to achieving a centralized credit regulation. The purpose of the South African National Credit Act 34 of 2005 and I quote below is,

"To promote a fair and non-discriminatory marketplace for access to consumer credit and for that purpose to provide for the general regulation of consumer credit and improved standards of consumer information; to promote black economic empowerment and ownership within the consumer

Debt Relief Measures (Cont.)

credit industry; to prohibit certain unfair credit and credit marketing practices; to promote responsible credit granting and use and for that purpose to prohibit reckless credit granting; to provide for debt re- organization in cases of over indebtedness; to regulate credit information; to promote for registration of credit bureaux, credit providers and debt counselling services; to establish national norms and standards relating to consumer credit; to promote a consistent enforcement framework relating to consumer credit; to establish the National Credit Regulator and the National Consumer Tribunal; to repeal the Usury Act, 1968, and the Credit Agreements Act, 1980; and to provide for related incidental matters."

Evidently the South African Credit Act, 2005 (amended with Consumer Protection Act, 2008) establishes the National Credit Regulator and a National Consumer Tribunal for purpose of centralized consumer credit regulation and mitigation of regulatory decisions. In the case of Botswana credit providers are regulated by separate authorities, for example, central bank for banks; NBFIRA for authorized NBFIs, MITI for Retail, BOCRA for mobile service providers etc. Moreover, Consumer Protection Act is administered by the MITI, withstanding this difference in approach we believe there are very good lessons to derive from the South African approach to consumer debt relief, especially when enhanced by practices elsewhere in the international arena. The South African NCA seeks to reduce over-indebtedness and to address and alleviate debt already incurred. Prior to the NCA troubled debtors were either subjected to the provision of the Insolvency Act No 24 of 1936 or the Magistrates' Court Act. The latter is what currently prevails in Botswana with the Insolvency Act etc. The moral hazard of this arrangement is that families can be made homeless through realization of collateralized residential properties by credit providers when alternative, yet prolonged loan repayments can be arranged. Secondly, credit providers are not in the real estate business and are forced to dispose of such properties at prevailing low market prices and at significant legal costs.

The South African Approach to Consumer Debt Relief

The South African consumer debt relief is made of two intertwined processes. The initial process, which is conducted by the debt counsellor, entails fact finding to determine whether there are grounds to declare the debtor over-indebted or at the risk of being. Second stage involves the court of law and its determination, based on the recommendation of the debt counsellor, to declare debtor over-indebted and subsequently to re-structure the repayment of claims by the creditor. However, a debt counsellor may also reject the application for over indebtedness if no soundproof is not supplied.

Upon the commencement of the review process certain restriction applies to all parties involved. For instance, debtors are prohibited from entering into new credit agreements except consolidation of existing debt. Freedom of the debtor comes only upon receipt of a clearance certificate. The creditor on the other hand is also barred from enforcement of subject credit agreements including rights to security assets. The creditors sometimes challenge the court rulings necessitating further court interventions.

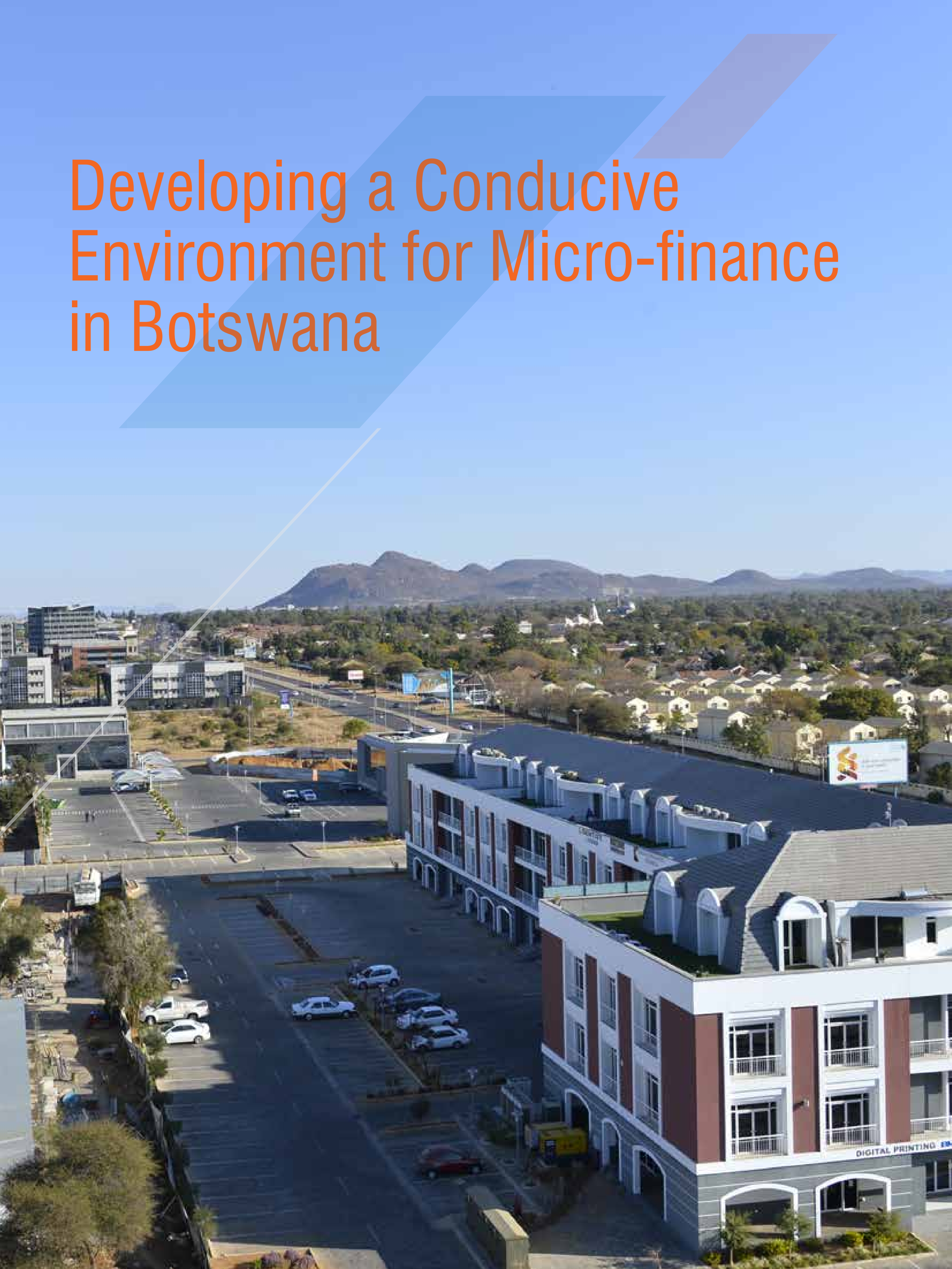
Further improvement of the South African legislation is envisaged to improve on shortfalls of the current NCA.

Conclusion and Recommendations

It is indeed imperative and a duty that consumers should to pay their financial obligations, and infact, the vast majority of them have every intention to repay their loans. It is, unanticipated negative events such as illness, divorce, or loss of income through that often make this impossible.

Leaving defaulting debtors at the mercy of their creditors is not only harmful to both parties but the welfare of the nation. Studies have shown that traditional safety nets (e.g., unemployment benefits), market forces, or restrictions on lending are often insufficient to counteract the causes and/or consequences of severe debt distress. There is consensus, that it is imperative for authorities to activate legal means through which consumers facing severe debt distress can be able to discharge some of that debt in order to reclaim their financial health.

Developing a Conducive Environment for Micro-finance in Botswana



Developing a Conducive Environment for Micro-finance in Botswana (Cont.)

An Article By Patrick Awuku DOGBE
Guest Author
(Certified Expert in Micro-finance, Certified Expert in Financial Inclusion Policy, Author of Regulatory Policy Framework for Microfinance Institutions in Botswana)

Introduction

There is no gain saying the fact that microfinance is a critical element of an effective poverty reduction strategy in many developing countries. A well-managed and improved access and efficient provision of savings, credit, remittances and insurance services can enable the poor to smoothen their consumption, manage their risks better, build their assets gradually, develop their microenterprises, enhance their income earning capacity, and enjoy an improved quality of life. Micro-finance services can also contribute to the improvement of resource allocation, promotion of markets, and adoption of better technology; thus, promoting economic growth and development.

Without a conducive environment for micro-finance activities, most poor households continue to rely on meager self-finance or informal sources of microfinance, which limits their ability to actively participate in and benefit from many development opportunities. Micro-finance can provide an effective way to assist and empower poor women, who make up a significant proportion of the poor and suffer disproportionately from poverty. Micro-finance can contribute to the development of the overall financial system through integration of financial markets.

This article will highlight the various ways that relevant authorities could create a conducive environment for micro-finance activities in Botswana.

Regulation of Financial Sector in Botswana and Financial Inclusion

The Botswana financial system is regulated by the Ministry of Finance and Economic Development (MFED) through Acts promulgated by Parliament. The MFED operates through two regulatory agencies for prudential, market conduct and other purposes. First, the Bank of Botswana, the central bank, is empowered by the Bank of Botswana Act (CAP55:01) to inter alia, regulate and supervise the deposit taking institutions, provide oversight of the national payments systems and overall responsibility for the national financial stability. Second, the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), is mandated by the NBFIRA Act (2016) to regulate and supervise the non-bank financial institutions including, insurance, pensions, capital markets and non-bank lender (including Micro Lenders, Pawnshops, Finance and Leasing entities). Both regulators are agents of the in the administration of the Acts promulgated by Parliament.

Financial inclusion has been on the agenda of the Botswana Government since NDP 10 and NDP 11 outlines implementation steps. In turn, both regulatory agencies have a duty to provide a conducive regulatory and supervisory environment for financial inclusion to take root through the provision of financial services to the majority of the population at a low cost. Alternatively, a dedicated micro-finance regulator may be considered and, thus give birth to micro-finance institutions.

International Best Practices in the Microfinance Sector

For micro-financing activities to get the needed boost, Botswana, may consider best practices on the international front especially in African countries like Kenya, Nigeria, Ghana, Tanzania, Uganda, Zimbabwe, etc. This article discusses international best practices that maybe considered by Botswana for a way forward, namely:-

a) Regulatory Authority
b) Tiered Approach to Regulation & Supervision
c) Minimum Capital Requirement
d) Types of Institutions with Permitted & Non-Permitted Activities
e) Regulation of Interest Rates
f) Limitations on foreign ownership

Developing a Conducive Environment for Micro-finance in Botswana (Cont.)

Regulatory Authority

In all the six countries mentioned above, the Regulatory Authority of MFI is the Central Bank, and this corresponds to international best practice. It is therefore recommended that the Bank of Botswana should regulate, promote and ensure orderly growth of MFIs in Botswana. This implies that NBFIRA may have to relinquish the regulation of MFIs to the Bank to avoid any duplication of responsibilities. A non bank MFI regulatory function maybe established in the Bank of Botswana's Supervision/Regulatory Department. With this arrangement, Commercial Banks that want to downscale into micro-finance or intend to have Micro-finance Units could also do so without any regulatory arbitrage.

Tiered Approach to Regulation & Supervision

A practice whereby firms capitalize on loopholes in regulatory systems in order to circumvent unfavourable regulation

The tiered approach to supervision is conducive to the development of a sound microfinance sector especially as it gives room for more flexibility to microfinance activities, which are still in an experimental stage.

I recommend the following Tier-System for Botswana:

MFI Tiers	Type of MFI	Form of Supervision	Supervising Body
Tier 1	Banks which will downscale into micro-finance or have Micro-finance Units	Prudential Supervision	Bank of Botswana
Tier 2	Savings & Loans Companies	Prudential Supervision	Bank of Botswana
Tier 3	Micro-finance Banks (i.e. Deposit-Taking MFIs)	Prudential Supervision	Bank of Botswana
Tier 4	Credit-Only MFIs, Credit Union Co-operatives, Financial NGOs (Credit-Only)	Non-Prudential	Bank of Botswana
Tier 5	Micro-lenders, Term-lenders,	Non-Prudential	Bank of Botswana.

Minimum Capital Requirement

Minimum capital requirements maybe tiered for Micro-finance Institutions in Botswana to develop and should correspond to the tiered system of regulation and supervision discussed above.

MFI Tiers	Type of MFI	Minimum Capital for Licensing
Tier 1	Banks which will downscale into micro-finance or have Micro-finance Units	BWP 5 million
Tier 2	Savings & Loans Companies	BWP 1.5 million
Tier 3	Micro-finance Banks (i.e. Deposit-Taking MFIs)	BWP 1 million
Tier 4	Credit-Only MFIs, Credit Union Co-operatives, Financial NGOs (Credit-Only)	BWP 500,000
Tier 5	Micro-lenders, Term-lenders,	BWP 50,000

This minimum capital shall be un–encumbered (i.e. it should not be burdened with any conditionalities, e.g. loan capital which w This minimum capital shall be un–encumbered (i.e. it should not be burdened with any conditionalities, e.g. loan capital which will attract interest to the MFI, thereby increasing its cost of funds). This capital should be free equity capital. This capital shall be used for MFI's operations and shall not be kept fixed in a Bank Account as it currently pertains with Term or Cash Lenders under the NBFIRA Regulations. Fixing it in a Bank Account will deprive the MFI of operational cash and does not match up with best practice.

In conclusion, the financial sector globally is undergoing a transformation driven by digitization which has increased number of players, product innovation and greatly improved efficiency of service delivery and reduced cost. This fintech innovation ought to be embraced as it acts as a catalyst for more inclusive economic participation. Small players have a big role to play in financial inclusion and tiered regulatory requirements stimulates more innovation.

The History of Micro lending In Botswana

An extract from a Masters Degree thesis by Mr. Mbiganyi Modise

Background of Study

Prior to the promulgation of the Micro Lending Regulations 2012, the micro lending industry was falling under the jurisdiction of the Bank of Botswana (BOB), but was not explicitly regulated by Bank of Botswana. Further that these firms had to register their trade names with the Ministry of Trade and Industry. During that time, the industry experienced a number of challenges (Porteous, 2003), which amongst others include the following:

- No information was collected from micro lenders in Botswana for monitoring purposes and very little was known of the size and characteristics of the industry. There were natural persons transacting micro lending business and unincorporated lenders were not required to report on their business or to submit detailed financial reports and information on their business. The only restriction was that the micro lenders were not allowed to take deposits as this is a regulated banking activity (Banking Act, 1995).

- Botswana did not, and still does not have a Usury Act to cap the interest that may be charged on micro lending loans (Porteous 2003). According to Balopi et al (2014), due to prolonged absence of regulations, the micro lending sector players engaged in undesirable and unethical practices which compromised the rights of the consumers. Consumer Watchdog (2016) affirms the industry players' manipulative practices by citing receipts of numerous complaints from the consumers concerning high loan interest rates. Further that no legislation existed to define or regulate micro lenders activities. Although frowned upon,there were no statutes to protect consumers as the micro lenders insisted on retaining the borrower's bankcard and PIN to withdraw loan paymentsas soon as the salaries are paid.

The Financial Sector Review (2009/10) reports that some of the micro lenders were members of the Micro Lenders Association of Botswana (MAB), a self-regulated body, founded in 1998 to promote the interests of small-scale lenders and to monitor the activities of members to ensure consistent generally accepted business practices. Since this was just an association, it was not mandatory to take any legal steps against members except those relating to non-compliance with the association code of conduct. Governing rules required members to trade from proper business areas, and to charge not more than 30 percent interest on outstanding loan balance per month. The Association also required members to use Compuscan, a central online database of loans based South Africa, which is meant to check credit history of all potential borrowers to make sure that they don't already have an outstanding loan from another lender. In addition, the Association required its members to display openly the Association's Code of Conduct in their trading premises.

The Micro Lending Regulations were promulgated in March 2012 with the aim of ensuring that consumers are protected against lenders who are involved in undesired lending practices. Jefferis (1999) defines micro lenders as companies that make relatively small loans to borrowers, who are often not eligible for loans from the commercial banks. These micro-loans are processed fast, with relatively little bureaucracy involved, however rates of interest charged are too exorbitant, and lenders take borrowers' ATM cards as collateral.

The micro lending sector remained unregulated for a long time in Botswana. In comparison to Botswana, other countries started regulating and supervising micro lenders as tabled below;

Table 1.1: History of Introduction of Micro Lending Regulations by Country

Name of Country	Year
Botswana	2012
Kenya	2008
Namibia	2006
South Africa	1968
United States	1950

Source: Article by Balopi et al, 2014

The History of Micro lending In Botswana (Cont.)

By 1953, the major federal regulatory agencies and the regulatory structure that has characterized the U.S financial system for the past fifty years were in place (Business Forum, 1983). The above table shows that the regulation and supervision of micro lending industry in Botswana was introduced in 2012, several decades after some jurisdictions across the globe.

With the introduction of the Micro Lending Regulations 2012, all micro lenders are now required to have proper efficient and effective systems in place to ensure that they do not overcommit their customers. Further to submit information from operations from time to time to the regulator, NBFIRA. However, the regulations still do not cap the loan interest rates. Porteous (2003) asserts that it is important that micro lenders submit detailed financial information on their businesses to NBFIRA, and that loan interest rates are capped as micro lending industry provides financial access to a significant number of citizens. In South Africa interest rate ceilings on small loans were removed by Usury Act in 1992 based on loan threshold of ZAR6, 000 in order to stimulate business environment. The lifting of the interest rates capping resulted in rapid growth in the micro lending industry which consequently led to further revision of loan threshold to ZAR10,000 (Reza, 2004).

NBFIRA reveals in an interview with Benza (2012) that 991 (nine hundred and ninety one) micro lenders were registered with the Micro Lenders Association of Botswana, Bank of Botswana, and Ministry of Trade and Industry. The operations of these micro lenders were unregulated until 2012 when the micro lending regulations were promulgated and implemented. All these 991 unregulated lenders were required to apply for licensing with NBFIRA at the time of implementation of the Micro Lending Regulations 2012, however, about 351 (three hundred and fifty one) of these micro lenders were granted temporary licensing exemptions by NBFIRA which expired upon implementation of the Micro Lending Regulations 2012 in March 2012 (personal communication, March 10, 2016).

After the promulgation of Micro Lending Regulations 2012, of the 991 operators who were required to formalize their licensing with NBFIRA, only 248 applied for licensing of which 29 applicants withdrew their licensing applications citing unwillingness to comply with the micro lending regulations requirement which they felt was unjustified because of NBFIRA's inability to take legal actions against the unlicensed operators. In addition, the 29 micro lenders complained that they were never consulted about the implementation of the regulations, and that the regulations were too harsh and less beneficial for their operations (personal communication, March 10, 2016).

The remaining 219 licensed micro lenders also accused NBFIRA of its inability to take regulatory actions against the illegal operators. They believed that for as long as NBFIRA does not take any legal action against these unscrupulous operators, the implementation of the Micro Lending Regulations 2012 will not achieve its intended purposes. Further that there is no motivation for licensed operators to continue operating because of the high number of unlicensed operators. Thus they considered themselves not only prejudiced but disadvantaged because of the fees associated with the licensing regulations which do not apply to their unlicensed counterparts. This explains the declining trend from the initial 991 unlicensed operators to 248 licensed operators including 29 withdrawn applicants. **(Appendix A)**

The licensed micro lenders customers also complained about the systematic loan processing that the regulations are imposing on the micro lenders citing prolonged turnaround time compared to the service they received from unlicensed lenders. Further that while NBFIRA's intentions to protect their interests by prohibiting retention of ATM cards by the micro lenders, this disadvantages both the lenders and their customers. Lenders complained of the increasing rate of delinquent customers, unsecured debt exposure and prolonged debt collection period, while their customers complained about limited access to micro lending facilities. The micro lenders preferred to deal with customers who willingly gave them their ATM cards as loan collateral, and those unwilling to do so were denied the requested loan facilities.

However, NBFIRA is of the view that these industry players are playing a game of hide and seek in order to compromise the regulations thereby rendering them ineffective (personal communication, March 10, 2016). Benza (2014) concurs with NBFIRA's viewpoint, that it is not uncommon for unlicensed micro lenders to evade the new stringent regulations (license and supervisory fees inclusive) that govern their operations.

The History of Micro lending In Botswana (Cont.)

According to Lesemela (2014), micro lenders are still facing difficulties with compliance since the introduction of industry regulations in 2012 due to the fear and/ or lack of understanding of regulations, a development that has exposed customers to unscrupulous lenders.

The Micro Lending Regulations 2012 require NBFIRA to conduct pre-licensing inspections for all applicants to ensure compliance to the requirements of the regulations. This experience is not different from that of neighbouring countries (Namibia and South Africa) which introduced or revised regulations intended to protect consumers and improve the industry players' ways of operating. According to Monterio (2007):

"The implementation of the National Credit Act in South Africa was not an easy feat. The regulations required complete changes in credit application procedures, ranging from application forms printed in two official languages to provide quotations on affordability test and to train thousands of employees. In addition, new IT systems and credit scorecards were introduced".

The most interesting question that one can ask is, "what happened to the remaining 743 (991 less 248) unlicensed micro lenders? Are they still operating or have they abandoned their operations? Rumours say that these operators are still operating unlicensed disguised as friendly society, and that NBFIRA is failing to track them and close down their businesses (personal communication, March 10, 2016).

In Namibia, the micro lending industry has grown rapidly and almost 400 registered micro-lenders across the country supplying close to N$2 billion (Louw, 2013). As, shown in Table 1.2 below, the population size and economy of Namibia are relatively the same as those of Botswana, hence this research opted to use Namibia to compare the challenges faced by NAMFISA with those faced by NBFIRA when introducing and implementing the Micro Lending Regulations 2012.

Table 1.2: Comparison of Botswana vs Namibia

Factor	Botswana	Namibia
GDP	15, 813 M$	13, 632 M$
GDP per Capita	7, 123 $	5, 673 $
Population	2, 219, 937	2, 402, 858

Source: http://countryeconomy.com/countries/compare/botswana/namibia

From the above Table 1.2, the GDP, GDP per Capita and the population of Botswana and Namibia are relatively the same, hence the comparison. Graig (2012) reports that in Namibia, NAMFISA had outlawed the practice of retaining bank cards and even personal identification numbers (PIN) of borrowers by micro-lenders since 2002. Micro-finance businesses in Namibia however felt the moratorium places their businesses under threat. Potgieter (2011) appeals and pleads that micro-lenders "would not be able to continue business with their clients" without appropriate collateral being in place. However, the suggested appropriate collateral did not cover retention of bank cards and personal identification numbers. NAMFISA pleaded with the Namibia Finance Minister to allow the operators to collect the payments from borrowers through the use of the ATM cards, that is, card swiping (Graig, 2012, as cited in Dilotsotlhe, 2013). Potgieter (2011) contends that the public understands that micro lenders in Namibia did not have viable alternative collection mechanisms because the normal bank debit-orders do not work with micro lenders. This was also echoed by Botswana micro lenders during NBFIRA pre-licensing inspections. Most of the micro lenders cited that the prohibition of retention of customers ATM cards would impact their businesses adversely to the extent that will result in significant loss of money (personal communication, February 13, 2015).

According to the NBFIRA Annual Report (2014), subsequent to the implementation of the Micro Lending Regulations 2012, the number of consumer complaints skyrocketed by 94% from 46 in 2013 to 95 in 2014. The various complaints received by NBFIRA differed, for example, micro lenders retaining their (customers) ATM cards, excessive interest rates and illegal collection mechanisms used by the lenders, just to mention but a few. "

The History of Micro lending In Botswana (Cont.)

Conclusion and Recommendations

The microlending business has to-date matured in both business conduct and compliance to regulations. An appeal is being made to the members of the public to refrain from using unlicensed microlenders and to report such through the NBFIRA Whilstle Blowing Tipoffs Anonymous at the following contact details:

Website: www.tip-offs.com
Toll-Free Number: 16133
Email: nbfira@tipoffs.com
Postal address: P.O. Box 448, Gaborone

Appendix A: Geographical Spread of Micro Lenders in Botswana

Location	Number of Micro Lenders	Location	Number of Micro Lenders
Gaborone	97	Palapye	12
Francistown	40	Lerala	1
Maun	13	Selebi Phikwe	14
Letlhakane	15	Jwaneng	13
Gabane	1	Selebi Phikwe	14
Bobonong	1	Kanye	6
Mmadinare	3	Tutume	1
Manyana	1	Gabane	1
Kasane	2	Shakawe	1
Ghanzi	2	Lobatse	3
Serowe	3	Mahalapye	4
Moshupa	2	Mochudi	6
Ramotswa	1	Maunatlala	1
Masunga	3	Shakawe	1
Molepolole	2		

Source: NBFIRA Lending Department 2014