Botswana Building Society Basel II Pillar III disclosure for the year ended 31 March 2016

March 2017

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Acronyms and other abbreviations

ALCO	Asset and liability committee
ALM	Asset and liability management
BCBS	Basel Committee on Banking Supervision
BBS	Botswana Building Society or the Society
BIS	Bank for International Settlements
BoB	Bank of Botswana
BRC	Board Risk Committee
CC	Credit Committee
CCF	Credit conversion factor
CCR	Counterparty credit risk
CET1	Common Equity Tier 1
CRM	Credit risk mitigation
EaR	Earnings at risk
Exco	Executive Committee
ICAAP	Internal Capital Assessments
IFRS	International Financial Reporting Standards
RWA	Risk-weighted assets
SA	The standardised approach

1.1 Table references

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1 The 2016 Botswana Building Society Pillar III disclosure report covers the period 1 April 2015 to 31 March 2016

On 28 January 2015 the Basel Committee on Banking Supervision ("BCBS") issued revised Pillar III disclosure requirements (“the revised Pillar III disclosures”). The Bank of Botswana (“BoB”) has taken cognisance of the revised Pillar III disclosures and on 8 September 2015 the Bank of Botswana issued the Guidelines on the revised international convergence of capital measurement and capital standards for Botswana (Basel II) ("the guidelines"). The disclosure templates contained within the guidelines became effective in Botswana on 1 January 2016 has been adopted by the Botswana Building Society (‘the Society”) within this disclosure report.

The Pillar III disclosure requirements as adopted by the Society are governed by the directives issued by the BoB and includes qualitative and quantitative tables for all risk applicable.

The revised Pillar III disclosures format has been generated for the first time based on 31 March 2016 data and includes limited comparatives, where available, to prior period disclosures. The approach is consistent with guidance provided by the BoB.

The BCBS has consulted further on Pillar III in a document titled: “Pillar III disclosure requirements - consolidated and enhanced framework - consultative document” (March 2016) and have issued “Frequently asked questions on the revised Pillar 3 disclosure requirements” (August 2016). The Society has and will consider these proposed requirements and frequently asked questions for future Pillar III publications when the required disclosures become applicable to the Society.

2 Board approved disclosure policy

The board of directors ("the board") of Botswana Building Society ("the Society" or "BBS") recognises that effective communication is integral in building stakeholder value and is committed to providing meaningful, transparent, timely and accurate financial and non-financial information to primary stakeholders. The purpose is to help these stakeholders make meaningful assessments and informed investment decisions about the Society.

The Society endeavors to:

- present a balanced and understandable assessment of its position by addressing material matters of significant interest and concern;
- highlight the key risks to which it considers itself exposed and its responses to minimise the impact of the risks; and
- show a balance between the positive and negative aspects of the Society's activities in order to achieve a comprehensive and fair amount of performance.

The board appreciates the importance of ensuring an appropriate balance in meeting the diverse needs and expectations of all the Society's stakeholders and building lasting relationships with them. The Society has developed a framework to ensure that it complies with all relevant public disclosure obligations and to uphold the board's communication and disclosure philosophy.

All public announcements and releases; annual, interim and quarterly disclosures are reviewed by Senior Management and recommended for approval by the board to their release. The reports go through a rigorous review and sign-off process by the board, executives, management, internal and external audit.

On an annual basis, company secretarial, finance, the executive, board sub committees (where applicable) and board will assess the appropriateness of all information that is publicly disclosed.

The Pillar III disclosures provided are in line with the requirements of the guidelines as issued by the Bank of Botswana.

As at **31 March 2016**, the board is satisfied that:

- The information provided in this report was subject to the same level of internal review and internal control processes as the information provided for financial reporting purposes.
- Disclosures on this report have been prepared in accordance with the board agreed internal control processes related to public disclosures.

Chairman of the Board

28 March 2017

3 Risk management

3.1 Introduction

The Society manages the enterprise wide risks assumed by the Society through the Risk Department. The Society has adopted the Basel II Risk Management Framework for the management of risks it is exposed to. It is also intended to enhance the Society's management of its capital. The Society has exposure to the following risks from its use of financial instruments:

- Capital risk
- Credit risk
- Counter party credit risk
- Market risk
- Operational risk
- Equity risk
- Interest rate risk
- Liquidity risk

The quantitative and qualitative disclosures of these risk are further disclosed in section 4 of this document.

3.2 Risk management framework

The Board of Directors has the overall responsibility for the establishment and oversight of the risk management framework. The board is supported by various sub-committees in the execution of its fiduciary duties and oversight of risk.

The Board Sub-committees and Board convene on a quarterly basis. The board comprises of nine non-executive directors and one executive director.

The Society has in place an enterprise-wide risk framework to ensure alignment to Basel II as well as ensuring that the Society meets best risk practices.

The Society's risk management policies are established to identify and analyse the risks faced by the Society, to set appropriate risk limits and controls, and monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Society through its training and management procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The following committees and departments assist the risk management department in fulfilling its duties:

- Operational Risk Management Committee
- Assets and Liabilities Committee
- Credit Approvals Committee ("CAC")
- Enterprise risk management
- Compliance department

- Internal audit department ("IA")

Definition of enterprise risk management

Enterprise risk management is the process, effected by the board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk targets, appetite and threshold, to provide reasonable assurance regarding the achievement of entity objectives.

The following principles are adopted by the Society:

- A sound risk governance culture has to be fostered in all business units covering identification, managing and reporting of risks.
- Policies, standards, procedures and systems will be continuously developed to maintain and enhance the management of risk.
- Business units accept accountability for the identification, management, measurement and reporting of risks. Enterprise risk management is responsible for policy improvement, providing guidance in terms of best practice, ensuring consistent implementation in the Society, developing risk profiles and reporting of material exposures or trends to the business, board and regulatory authorities.
- The Basel II and III principles are applied when identifying, managing, monitoring and reporting risks as well as calculating regulatory capital.
- All risk categories are managed within acceptable levels on a cost effective basis (cost of risk management does not exceed the reward).

The Society's risk management strategy is to embed a risk culture and support business units within the Society. The key focus is to ensure that business units operate within risk parameters which will lead to sustainable business and enhanced risk management practices. The Society's management approach is an approved enterprise-wide risk management methodology and philosophy to ensure adequate and effective risk management. In addition, the methodology also provides regulatory principles and a risk management approach that ensures the following core principles are met:

- Clear assignment of responsibilities and accountabilities;
- Common enterprise-wide risk management framework and process;
- The identification of uncertain future events that may influence the achievement of business plans and strategic objectives; and
- The integration of risk management activities within the Society.

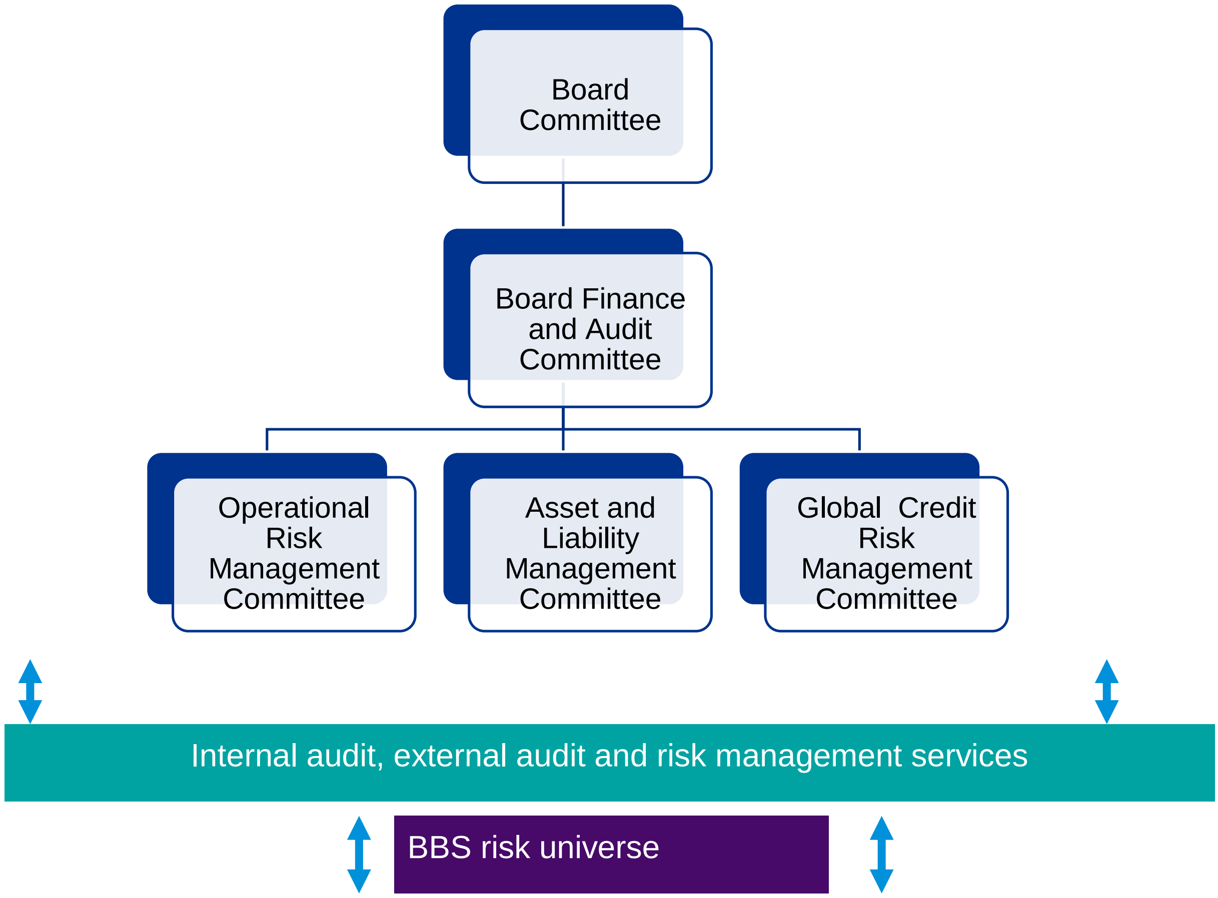
The Society's risk management objective is to ensure a proactive identification, understanding and assessment of risks, including activities undertaken that result in risks which could impact on business objectives. This is executed through various risk management and governance mechanisms and risk management oversight bodies.

3.3 Reporting of risk

The Board is overall responsible for risk management and delegates the oversight responsibility for risk management to the Finance and Audit committee. The Society utilises and firmly applies a holistic and integrated risk management approach. Included in the risk management mechanisms is the principle of "three levels of defense". Business units and risk management services, together with internal and external audit, participate in the holistic approach to risk management. Each business unit is responsible for its own risk management and the reporting of its risk profile i.e. assessment, monitoring, control or mitigation and corrective action and policies to address areas of non-compliance, must be an agenda item of the Operational risk management committee. In partial fulfilment of that responsibility, the Board approves the overall business strategy, which includes the overall risk policy and management of procedures.

3.4 Risk appetite policy

All risks faced by the Society are reviewed on an annual basis and the major groups of risks (before and after the application of mitigating controls) are set out and described below. Management of the business units and the Society's board are satisfied that these risks are being managed adequately to ensure the desired outcome is achieved. The diagram below depicts the risk universe faced by the Society, as well as the appropriate level of role and responsibility associated with the specific risk.



Accounting and taxation	Liquidity (concentration)	Market	Business continuity	People and transformation
Compliance	Capital	Operational	Reputational	Social and environmental
New Business	Interest rate	Information technology	Credit (counterparty)	Logistics and merchandising

Through a holistic and integrated risk management approach. The Society has included in the risk management mechanisms a principle of "three levels of defense". Business units and risk management services, together with internal and external audit, participate in the holistic approach to risk management.

Risk appetite is an articulation and allocation of the risk capacity or quantum of risk the Society is willing to accept in pursuit of its strategy, duly set and monitored quarterly by Exco and the board, and integrated into the strategy, business, risk and capital management plans.

As a general rule the 'materiality threshold' the Society applies in its day to day business and risk management is a conservative one, aligned with International Financial Reporting Standards (IFRS) and that used by our external auditors, endorsed by our Finance and Audit Committee.

'Materiality' is defined in the following terms: 'Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point, rather than being a primary qualitative characteristic which information must have if it is to be useful'.

The Society's risk appetite culture is inherently conservative. We measure and express risk appetite in terms of quantitative risk metrics and qualitatively. The quantitative metrics include earnings at risk (EaR) (or earnings volatility) and, related to this, the 'chance of regulatory insolvency', 'chance of experiencing a loss' and economic capital adequacy. These comprise our 'risk appetite metrics'. In addition, a large variety of risk limits, triggers, ratios, mandates, targets and guidelines are in place for all the financial risks (e.g. credit, market and Asset and liability management ("ALM") risks.

It is established with reference to the strategic objectives and business plans of the Society, including the achievement of financial targets, payment of dividends, funding of capital growth and maintenance of target capital ratios.

Qualitatively, we also express risk appetite in terms of policies, procedures, statements and controls meant to limit risks that may or may not be quantifiable.

The Societies' risk appetite is defined across five broad categories as set out in our board approved Risk Appetite Framework, namely:

- Core risk appetite metrics;
- Specific risk-type target setting (clarifying across our businesses the mandate levels that are of an appropriate scale relative to the risk and reward of the underlying activities so as to minimise concentrations and other risks that could lead to unexpected losses of a disproportionate scale);
- Stakeholder targets (such as target debt rating for economic capital adequacy and dividend policy);
- Policies, procedures and controls; and
- Zero-tolerance statement

3.5 Salient highlights for the year

The gross loans and advances portfolio was P3.179 billion, of which P325.2 million of the gross amount relates to past due loans. The allowance for specific impairment was P22.0 million and the allowance for general impairment was P5.5 million.

The balance sheet size is P4 087.4 million of which P656.3 million is fixed deposits with other banks. Fixed deposits increased by P369.8 million for the period under review. Capital increased to P1 078.2 million against RWAs of P1 996.2 million.

Section 4:

4 Disclosure: Detailed quantitative and qualitative disclosures of risk types

4.1 Scope of application – Regulatory consolidation

4.1.1 Qualitative disclosure

The Society is a standalone entity hence the quantitative disclosures to follow applies to the Society only. There are no differences in the basis of consolidation for accounting and regulatory purposes.

4.1.2 Quantitative disclosure

The table below reflects the reconciliation between the Annual Financial Statements and the regulatory scope of consolidation.

Table 1: Expanded Regulatory Balance Sheet

	Balance sheet as in published financial statements	Under regulatory scope of consolidation
	P’000	P’000
Assets		
Cash and balances at central banks	130 027	130 027
Items in the course of collection from other banks	-	-
Trading portfolio assets	-	-
Financial assets designated at fair value	-	-
Derivative financial instruments	-	-
Loans and advances to banks	656 347	656 347
Loans and advances to customers	3 163 439	3 163 439
Reverse repurchase agreements and other similar secured lending	-	-
Available for sale financial investments	-	-
Current and deferred tax assets	-	-
Prepayments, accrued income and other assets	20 308	20 308
Investments in associates and joint ventures	-	-
Goodwill and intangible assets		-
of which goodwill	-	-
of which other intangibles (excluding MSRs	7 766	7 766

	Balance sheet as in published financial statements	Under regulatory scope of consolidation
of which MSRs	-	-
Property, plant and equipment	109 554	109 554
Total assets	**4 087 441**	**4 087 441**
Deposits from banks	-	-
Items in the course of collection due to other banks	-	-
Customer accounts	1 305 842	1 305 842
Repurchase agreements and other similar secured borrowings	1 109 574	1 109 574
Trading portfolio liabilities	-	-
Financial liabilities designated at fair value	-	-
Derivative financial instruments	-	-
Debt securities in issue	-	-
Accruals, deferred income and other liabilities	593 826	593 826
Current and deferred tax liabilities	-	-
Of which DTLs related to goodwill	-	-
Of which DTLs related to intangible assets (excluding MSRs	-	-
Of which DTLs related to MSRs	-	-
Subordinated liabilities	-	-
Provisions	-	-
Retirement benefit liabilities	-	-
Total liabilities	**3 009 242**	**3 009 242**
Paid-in share capital	846 970	846 970
of which amount eligible for CET1 CAPITAL		-
of which amount eligible for AT1		-
Retained earnings	52 549	52 549
Accumulated other comprehensive income	178 680	178 680
Total shareholders' equity	**1 078 199**	**1 078 199**

4.2 Regulatory capital and requirements

4.2.1 Qualitative disclosures

To monitor the adequacy of its capital, the Society uses ratios established by the BoB which measure capital adequacy by comparing the Society's eligible capital with its reported assets and commitments at weighted amounts to reflect their relative risk. The regulator has advised all financial institutions to ensure capital requirements to be based on the Basel II framework. The Society started complying with Basel II reporting requirements in January 2016.

The table below shows a summary of the minimum regulatory capital requirements.

Table 2: Capital Adequacy Requirements (all numbers in percent)

	Common Equity Tier1	Additional Tier I	Tier I Capital	Tier II Capital	Total Capital
Minimum	4.5	3	7.5	7.5	15

Regulatory capital is divided into three main categories, namely common equity tier 1 ("CET1"), tier 1 and tier 2 capital as follows:

- Common equity tier 1 capital comprises shareholders equity and related eligible non-controlling interest after giving effect to deductions for disallowed items (e.g. goodwill and intangible assets) and other adjustments. CET1 Capital must be at least 4.5 percent of risk-weighted assets, at all times.
- Additional tier 1 capital includes qualifying capital instruments that are capable of being fully and permanently written down or converted into common equity tier 1 capital at the point of non-viability of the firm and other additional tier 1 instruments, which no longer qualify as additional tier 1 capital and are subject to grandfathering provisions and related eligible non-controlling interest. The tier I capital ratio shall be calculated as the adjusted Tier I capital, divided by the total risk-weighted assets of the Society. The Tier I capital ratio must be at least 7.5% of risk-weighted assets at all times.
- Tier 2 capital comprises qualifying subordinated debt and related eligible non-controlling interests and other tier 2 instruments, which no longer qualify as tier 2 capital and are subject to grandfathering provisions. Total capital (tier 1 capital plus tier II capital) to risk-weighted assets must be at least 15% of risk-weighted assets at all times.

For prudential supervisory purposes, Tier 1 capital consists of indefinite period shares together with the general, statutory and retained earnings reserves. The Society's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain growth of the business. The objective is to strike a balance between the higher returns that might be possible with greater earnings and the advantages and security afforded by a sound capital position. The Society is required to hold certain amounts of permanent capital (Indefinite shares) as a proportion of borrowings as per Section 41 of the Building Societies Act. However due to the Society's structure, the capital adequacy ratio is high as a result of the requirements of the Building Societies Act (Section 41) which requires the Society to hold certain amounts of permanent capital (Indefinite shares) as a proportion of borrowings.

Botswana Building Society operates as a mutual body, owned by its members who hold any of the following types of shares:

- Fixed period paid up shares;
- Subscription shares; and
- Indefinite period shares.

For the purpose of calculating capital adequacy ratio only Indefinite period shares qualify as permanent share capital based on their characteristics as governed by the Building Societies Act and the Botswana Building Society's rules.

4.2.2 Quantitative disclosure

The table below reflects the breakdown of the Society's capital and reserves and is in a prescribed format as per the guidelines of the BoB.

Table 3: Basel II Common Equity Tier I Disclosure

Common Equity Tier I capital: instruments and reserves		P'000
1	Directly issued qualifying common share (and equivalent for non-joint stock companies) capital plus related stock surplus	846 970
2	Retained earnings	52 549
3	Accumulated other comprehensive income (and other reserves)	178 680
4	Directly issued capital subject to phase out from CET1 CAPITAL (only applicable to non-joint stock companies	-
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1 CAPITAL)	-
6	Common Equity Tier I capital before regulatory adjustments	1 078 199
Common Equity Tier I capital: regulatory adjustments		
7	Prudential valuation adjustments	-
8	Goodwill (net of related tax liability)	-
9	Other intangibles other than mortgage-servicing rights (net of related tax liability	7 766
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability	-
11	Cash-flow hedge reserve	-
12	Shortfall of provisions to expected losses	-
13	Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)	-
14	Gains and losses due to changes in own credit risk on fair valued liabilities	-
15	Defined-benefit pension fund net assets	-
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	-
17	Reciprocal cross-holdings in common equity	-

18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	-
19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	-
20	Mortgage servicing rights (amount above 10% threshold)	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability	-
22	Amount exceeding the 15% threshold	-
23	of which: significant investments in the common stock of financials	-
24	of which: mortgage servicing rights	-
25	of which: deferred tax assets arising from temporary differences	-
26	National specific regulatory adjustments	-
27	Regulatory adjustments applied to Common Equity Tier I due to insufficient Additional Tier I and Tier II to cover deduction	-
28	Total regulatory adjustments to Common equity Tier	7 766
29	Common Equity Tier I capital (CET1 CAPITAL)	1 070 433
Additional Tier I capital: instruments		
30	Directly issued qualifying Additional Tier I instruments plus related stock surplus	-
31	of which: classified as equity under applicable accounting standards	-
32	of which: classified as liabilities under applicable accounting standards	-
33	Directly issued capital instruments subject to phase out from Additional Tier	-
34	Additional Tier I instruments (and CET1 CAPITAL instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	-
35	of which: instruments issued by subsidiaries subject to phase out	-
36	Additional Tier I capital before regulatory adjustments	-
Additional Tier I capital: regulatory adjustments		
37	Investments in own Additional Tier I instruments	-
38	Reciprocal cross-holdings in Additional Tier I instruments	-
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	-

40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-
41	National specific regulatory adjustments	-
42	Regulatory adjustments applied to Additional Tier I due to insufficient Tier II to cover deduction	-
43	Total regulatory adjustments to Additional Tier I capita	-
44	Additional Tier I capital (AT1)	-
45	Tier I capital (T1 = CET1 CAPITAL + AT1)	-
Tier II capital: instruments and provisions		
46	Directly issued qualifying Tier II instruments plus related stock surplus	-
47	Directly issued capital instruments subject to phase out from Tier I	-
48	Tier II instruments (and CET1 CAPITAL and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier II)	-
49	of which: instruments issued by subsidiaries subject to phase out	-
50	Provisions	-
51	Tier II capital before regulatory adjustments	-
Tier II capital: regulatory adjustments		
52	Investments in own Tier II instruments	-
53	Reciprocal cross-holdings in Tier II instruments	-
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	-
55	Significant investments in the capital banking, financial and insurance entities that are outside the scope og regulatory consolidation (net of eligible short positions)	-
56	National specific regulatory adjustments	-
57	Total regulatory adjustments to Tier II capital	-
58	Tier II capital (T2)	-
59	Total capital (TC = T1 + T2)	-
60	Total risk-weighted assets	1 966 189
Capital ratios and buffers		
61	Common Equity Tier I (as a percentage of risk weighted assets)	65%
62	Tier I (as a percentage of risk-weighted assets)	

63	Total capital (as a percentage of risk weighted assets)	
64	Institution specific buffer requirement (minimum CET1 CAPITAL requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB buffer requirement, expressed as a percentage of risk weighted assets)	
65	of which: capital conservation buffer requirement	
66	of which: bank specific countercyclical buffer requirement	
67	of which: G-SIB buffer requirement	
68		
Common Equity Tier I available to meet buffers (as a percentage of risk weighted assets)		
	National Common Equity Tier I minimum ratio (if different from Basel II minimum)	
70	National Tier I minimum ratio (if different from Basel II minimum)	
71	National total capital minimum ratio (if different from Basel II minimum)	
Amounts below the thresholds for deduction (before risk-weighting)		
72	Non-significant investments in the capital of other financials	-
73	Significant investments in the common stock of financials	-
74	Mortgage servicing rights (net of related tax liability	-
75	Deferred tax assets arising from temporary differences (net of related tax liability	-
Applicable caps on the inclusion of provisions in Tier II		
76	Provisions eligible for inclusion in Tier II in respect of exposures subject to standardised approach (prior to application of cap)	-
77	Cap on inclusion of provisions in Tier II under standardised approach	-
78	Provisions eligible for inclusion in Tier II in respect of exposures subject to internal ratings-based approach (prior to application of cap)	-
79	Cap for inclusion of provisions in Tier II under internal ratings-based approach	-
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2015 and 1 Jan 2020)		
80	Current cap on CET1 CAPITAL instruments subject to phase out arrangements	-
81	Amount excluded from CET1 CAPITAL due to cap (excess over cap after redemptions and maturities	-
82	Current cap on AT1 instruments subject to phase out arrangements	-
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities	-

84	Current cap on T2 due to cap (excess over cap after redemptions and maturities)	-

The composition of the Society's RWAs are as follow:

Table 4: Composition of RWA
At 31 March 2016

	Balance P'000	Risk Weight	Weighted Value P'000
Risk weighted assets			
Cash	5 189	20%	1 038
Other cash balances – claims from banks	124 838	20%	24 968
Fixed deposits with banks	656 347	20%	131 269
Properties in possession	11 414	100%	11 414
Short term loans and advances to customers	79 385	20%	15 877
Long term loans and advances to customers	3 072 640		-
Residential loans - Loan to value less than 90%	2 659 564	35%	930 847
Residential loans - Loan to value more than 90%	34 735	75%	26 051
Past due for more than 90 days and specific provision is less than 20% of loan	114 311	100%	114 311
Past due for more than 90 days and specific provision is more than 20% of loan	8 913	50%	4 457
Past due non-qualifying exposure where specific provision is less than 20% of the loan	1 135	150%	1 703
Commercial loans	227 619	100%	227 619
Past due exposure where specific provision is less than 20% of the loan	19 170	150%	28 755
Past due exposure where specific provision is equal to or greater than 20% but less than 50% of the loan	7 193	100%	7 193
Intangible assets	7 766	100%	7 766
Property, plant and equipment	109 554	100%	109 554
Other assets	20 308	100%	20 308
Total risk weighted assets for credit risk	**4 087 441**		**1 663 130**
Operational risk RWAs			333 059
Total RWAs			**1 996 189**
Capital adequacy ratio			**54.01%**

	Balance P'000	Risk Weight	Weighted Value P'000
Regulatory requirement			15.00%

The Society has complied with all externally imposed capital requirements throughout the period. The capital adequacy ratio was 54.01% as at 31 March 2016, based on Basel II requirements. The high ratio is as a result of the requirements of the Building Societies Act (Section 41).

4.3 Credit risk

4.3.1 Qualitative disclosures

Credit risk is the risk of financial loss to the Society if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Society's loans and advances to customers, balances with banks and investments in debt securities. For risk management reporting purposes, the Society considers and consolidates all elements of credit risk exposure (such as individual obligator default risk and sector risk).

For management of credit risk, the Society structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower. Such risks are monitored by the Credit Approvals Committee. The Board approves management's lending limits and monitors loans and advances that are not performing.

The Board of Directors has delegated responsibility for the management of credit risk to Senior Management. The Risk department is responsible for oversight function of the Society's credit risk, which includes the following:

a) Formulating credit policies in consultation with the business units, covering collateral requirements, credit assessments, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.

b) Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to the Credit underwriting unit which reports to the Head of Operations. Larger facilities require approval by the Credit Approvals Committee and the Global Credit Risk Management Committee. Any loans which are more than 5% of the Society's capital require approval by the Board of Directors.

a) Reviewing and assessing credit risk. The Society assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals of facilities are subject to the same review process.

b) Limiting concentration of exposure to counterparties, geographies and industries (for loans and advances).

c) Developing and maintaining the Society's risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The responsibility for setting risk grades lies with the Global Credit Risk Management Committee.

d) Reviewing compliance of business units with agreed exposure limits, including those for sector and individual exposure. Reports are provided to the Board every quarter.

e) Providing advice, guidance and specialist skills to business units to promote best practice throughout the Society in the management of credit risk.

Assets carried at amortised cost

The Society assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets are impaired. A financial asset or group of financial assets are impaired and impairment losses incurred if and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset ("a loss event") and prior to the financial year-end-date, and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Impairment of financial assets

The Society assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets are impaired. A financial asset or group of financial assets are impaired and impairment losses incurred if and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset ("a loss event") and prior to the financial year-end-date, and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Past due but not impaired loans

Loans where contractual interest or principal payments are past due but the Society believes that impairment is not appropriate on the basis of the level of security/collateral available and/ or the stage of collection of amounts owed to the Society.

Non-performing loans

Non-performing loans are loans on which an event of default has occurred for 90 days or more consecutively, and the loans are not accruing interest or principal repayment. This will trigger an immediate impairment. However an impairment is not recorded for non-performing loans that are fully secured.

Allowances for impairment

The Society establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are the specific loss component that relates to individually significant exposures, and the collective loan loss allowance established for Society's homogeneous assets in respect of losses that have been incurred but have not been identified.

Impairment policy

The Society writes off loan balances (and any related allowances for impairment losses) when the Society determines that the loans are uncollectable. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to settle the entire exposure. Based on its past due status, loan balances are classified as either, special mention, substandard, doubtful or loss.

Special mention

Included in the category of special mention are credit exposures in respect of which the obligator is experiencing difficulties that may be threaten the Society's Position. Ultimate loss is not expected, but may occur if adverse conditions persists. Loans and advances past due more than 30 days are classified as special mention.

Substandard

Any credit exposure that reflects an underlying, well defined weakness that may lead to probable loss if not corrected should be included in the category of substandard. The risk that such credit exposure may become an impaired asset is probable, and the Society is relying, to a large extend, on available security.

The primary source of repayment are insufficient to service the remaining contractual principal and interest amounts, and the Society has to rely on secondary sources for repayment, which secondary sources may include collateral, the sale of fixed assets, refinancing and further capital. Loans and advances past due more than 60 days are classified as substandard.

Doubtful

Credit exposure in the category of doubtful is considered to be impaired, but is not yet considered final loss due to some pending factors, such as a merger, new financing or capital injection, which factors may strengthen the quality of the relevant exposure.

Doubtful credit exposures exhibit not only all the weaknesses inherent in the credit exposures classified as substandard but also have the added characteristics that the said exposures are not duly secured. The said weaknesses make collection in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is high, but due to certain important and reasonably specific factors that may strengthen the asset, the classification of the asset as an estimated loss is deferred until a more exact status may be determined. Loans and advances past due more than 90 days are classified as doubtful.

Loss

Credit exposures classified as loss are considered to be uncollectable once collection efforts, such as realisation of collateral and institution of legal proceedings, have been unsuccessful. The relevant exposures are considered of such little value that the said exposure should no longer be included in the net assets of the Society. Loans and advances past due more than 120 days are classified as loss.

Credit risk mitigation

Collateral valuation

The Society seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Society's quarterly reporting schedule. Some collateral, for example, cash or securities relating to margining requirements, is valued daily. To the extent possible, the Society uses active market data for valuing financial assets held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties including mortgage brokers, housing price indices, audited financial statements and other independent sources.

Main types of collateral

The Society holds collateral against loans and advances to customers in the form of mortgage interests over property, cash and guarantees. Estimates of collateral fair values are assessed at the time of borrowing and are updated every three years, when a loan is individually assessed as impaired or when the customer requests further facilities against the same bond.

Short term loans

Short term loans are for periods between twelve and sixty months and are secured by Paid up shares and Subscription shares.

4.3.2 Quantitative disclosures

The following table represents the breakdown of the credit portfolio of the Society as at 31 March 2016.

Table 5: Quantitative disclosures on credit risk

		Total gross exposures P'000	Defaulted and impaired P'000	Non defaulted and not impaired P'000	Interest in suspense P'000	Specific impairments P'000	General (collective) impairments P'000	Net exposures before collateral P'000	Collateral P'000
1	Residential mortgages	2 749 219	59 816	2 689 403	9 298	9162		2 730 759	4 454 216
2	Commercial mortgages	350 888	17 137	333 751	1 323	2 195		347 370	738 572
	Sub total	3 100 107	76 953	3 023 154	10 621	11 357	5 489	3 078 130	5 192 788
3	Short term loans	79 385	-	79 385	-	-	-	79 385	79 385
	Total	**3 179 492**	**76 953**	**3 102 539**	**10 621**	**11 357**	**5 489**	**3 157 515**	**5 272 173**

4.4 Counterparty credit risk

4.4.1 Qualitative and quantitative disclosures

Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. The Society is currently not exposed to counterparty credit risk.

4.5 Market risk

4.5.1 Qualitative and quantitative disclosures

Market risk is the risk of losses in positions arising from movements in market prices. Market risk The Society is currently not exposed to any market risk.

4.6 Operational risk

4.6.1 Qualitative disclosures

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Society's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Society's operations and are faced by all business entities. The Society's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Society's reputation with overall cost effectiveness and to avoid control procedures that restricts initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to Senior Management within each business unit. The Senior Managers are members of the Operational Risk Management Committee which meets on a quarterly basis to consider the consolidated Operational Risk Report and monitor progress on any outstanding matters.

Operational risk capital charge is calculated using the basic indicator approach and is driven by the levels of income over a three-year average period, applying specific factors applicable to the nature of the business generating the income.

4.6.2 Quantitative disclosures

The following table reflects the capital adequacy requirement as per the prescribed guidelines.

Table 6: Quantitative disclosures of operational risk

	Gross income P'000
Total Gross Income for Year 1	314 746
Total Gross Income for Year 2	341 682
Total Gross Income for Year 3	337 778
Aggregate Gross Income	**994 206**
Operational risk weight assets	333 059
Operational Risk Capital Charge	49 710

4.7 Equity risk

4.7.1 Qualitative and quantitative disclosures

Equity risk, the risk that stock or stock indices/prices or their implied volatility will change The Society is currently not trading in any equity instruments.

4.8 Interest rate risk

4.8.1 Qualitative disclosures

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the cash flows or fair values of financial instruments because of a change in market interest rates. Interest rates are managed principally through monitoring interest rate gaps and by having pre-approved limits for re-pricing bands. ALCO is the monitoring body for compliance with these limits and is assisted by Treasury in its day-to-day monitoring activities. The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Society's financial assets and liabilities to various standard interest rate scenarios. Interest rate movements affect reported equity as increases or decreases in net interest income and the fair value changes are reported in profit or loss. A repricing gap analysis is used to quantify the impact of interest rate changes to accrued or reported earnings. Interest rate-sensitive assets, liabilities and off-balance sheet items are placed in time bands (gap intervals) based on their repricing characteristics.

Overall non-trading interest rate risk positions are managed by Treasury, which uses investment securities, advances to banks and deposits from banks to manage the overall position arising from non- trading activities.

Interest rate - sensitivity analysis

A principal part of management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios. The Society aims to mitigate the impact of prospective interest rate movements which could reduce future net interest income.

To estimate earnings exposure, the liabilities in each time band are subtracted from the corresponding assets to produce a repricing 'gap' for that time band. This gap can be multiplied by an assumed change in interest rates to yield an approximation of the change in net interest income that would result from such an interest rate movement. Note that the analysis is static (i.e. assumes a flat / constant state balance sheet), assumes a parallel shift in rates. The scenarios are run only for assets and liabilities that represent the major interest-bearing positions. Based on the simulations performed, the impact on pre-tax profit of a shift by 50 basis points would be a maximum increase of P905 thousand (2015: P831 thousand) or decrease of the same amount respectively. The simulation is done on a monthly basis to verify that the maximum loss potential is within the limit set by management.

4.8.2 Quantitative

The following table represents the Society's net repricing gap.

Table 7: Quantitative disclosures of interest risk

	0 to 3 months P'000	3 to 12 months P'000	1 to 2 years P'000	2 to 5 years P'000	Over 5 years P'000	Non-interest bearing P'000	Total P'000
At 31 March 2016							
Assets							
Cash and cash equivalents	124 839	-	-	-	-	5 188	130 027
Fixed deposits with banks	215 181	168 796	257 300	15 070	-	-	656 347
Short term loans and advances	79 385	-	-	-	-	-	79 385
Property in possession	-	-	-	-	-	11 414	11 414
Mortgage loans and advances	3 029 186	36	4 161	6 417	32 840	-	3 072 640
Intangible assets	-	-	-	-	-	7 766	7 766
Property and equipment	-	-	-	-	-	109 554	109 554
Other assets	13 577	-	-	-	-	6 731	20 308
Total	**3 462 168**	**168 832**	**261 461**	**21 487**	**32 840**	**140 653**	**4 087 441**
Liabilities							
Customers' savings and fixed deposit accounts	576 342	237 896	408 889	82 715	-	-	1 305 842

	0 to 3 months P'000	3 to 12 months P'000	1 to 2 years P'000	2 to 5 years P'000	Over 5 years P'000	Non-interest bearing P'000	Total P’000
Other liabilities	-	-	-	-	-	86 928	86 928
Borrowings	280 643	215 968	253 702	77 061	282 200	-	1 109 574
Withholding tax	-	-	-	-	-	3 546	3 546
Paid up and subscription shares	503 352	-	-	-	-	-	503 352
Indefinite period shares and reserves	-	846 970	-	-	-	231 229	1 078 199
Total liabilities	**1 360 337**	**1 300 834**	**662 591**	**159 776**	**282 200**	**321 703**	**4 087 441**
Net interest sensitivity gap	**2 101 831**	**(1 132 002)**	**(401 130)**	**(138 289)**	**(249 360)**	**(181 050)**	**-**

4.9 Liquidity risk

4.9.1 Qualitative disclosures

Liquidity risk is the risk that the Society will encounter difficulty in meeting obligations arising from its financial liabilities. The Society’s approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Society’s reputation. The Society is exposed to daily calls on its available cash resources from deposits, maturing shares and loan draw downs. The Society does maintain cash to meet all these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high degree of certainty.

The Society sets limits on the minimum proportion of maturing funds available to meet such calls and borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The liquidity position of the Society is monitored on a daily basis. For regulatory purposes, the Building Societies Act, Section 42, requires the Society to maintain certain proportions of its liabilities in liquid assets. The Society also submits a monthly report to the Central Bank which includes the liquidity position. Such a position is reflected through the net liquidity gap whcih reflects the net exposure of Assets versus liabilities per the various time bands on a maturity ladder. A net mismatch figure is obtained by subtracting liabilities from assets in each time band.

4.9.2 Quantitative disclosure

The following table represents the Society's net liquidity gap.

Table 8: Quantitative disclosures of liquidity risk

At 31 March 2016	On demand P'000	1 to 3 months P'000	3 to 12 months P'000	1 to 5 years P'000	Over 5 years P'000	Non financial instruments P'000	Total
Assets							
Cash and cash equivalents	130 027	-	-	-	-	-	130 027
Fixed deposits with banks	215 181	168 796	257 300	15 070	-	-	656 347
Short term loans and advances to customers	2 357	4 638	19 771	52 619	-	-	79 385
Property in possession	-	-	-	-	-	11 414	11 414
Mortgage loans and advances to customers	35 600	71 154	318 856	1 646 473	1 000 557	-	3 072 640
Intangible assets	-	-	-	-	-	7 766	7 766
Property and equipment	-	-	-	-	-	109 554	109 554
Other assets	323	647	2 906	9 701	-	6 731	20 308
Total	**383 488**	**245 235**	**598 833**	**1 723 863**	**1 000 557**	**135 465**	**4 087 441**
Liabilities							
Customers' savings and fixed deposit accounts	558 165	240 503	415 991	91 183	-	-	1 305 842
Other liabilities	-	-	-	-	-	86 928	86 928
Borrowings	6 085	43 709	395 239	379 411	285 130		1 109 574

At 31 March 2016	On demand P'000	1 to 3 months P'000	3 to 12 months P'000	1 to 5 years P'000	Over 5 years P'000	Non financial instruments P'000	Total
Paid up and subscription shares	-	-	-	503 352	-	-	503 352
Indefinite period shares and reserves	-	-	-	-	-	846 970	846 970
Withholding tax	-	-	-	-	-	3 546	3 546
Statutory reserve	-	-	-	-		114 680	114 680
General market risk reserve	-	-	-	-	-	64 000	64 000
Retained earnings	-	-	-	-	-	52 549	52 549
Total liabilities	**564 250**	**284 212**	**811 230**	**973 946**	**285 130**	**1 168 673**	**4 087 441**
Net liquidity gap	**180 762**	**38 977**	**212 397**	**749 917**	**715 427**	**1 033 208**	**-**

4.10 Remuneration

4.10.1 Qualitative disclosures

The Society has established the Human Resources and Remuneration Committee ("Committee") to assist the Board of Directors ("Board") in human resources, as well as remuneration reacted matters.

The Society subscribes to the principle of performance-based rewards and recognises that to achieve strategic business objectives and remain competitive in its human capital practices, it must periodically review its policy on remuneration and reward. To this end, this Policy has been revised to modernise the pay practices of the institution in line with local trends and best practice. The Policy now underpins and fully supports the Society's strategies and business plans by enhancing the institution’s employee value proposition for competitiveness in the labor market.

All executive management and employees of the Society is remunerated in the following manner:

- Salaries and wages
- Pension fund contributions or gratuity where applicable

- Bonus accrual
- Leave pay accrual
- Fair value adjustments – off market staff loans

All remuneration paid is on fixed basis and no remuneration is deferred except for the gratuity which is payable at the end of the contract or upon termination.

4.10.2 Quantitative disclosures

The Human Resources and Remuneration Committee met five (5) times for the period 1 April 2015 to 31 March 2016. The table below sets out the member of the remuneration committee, number of meetings attended and remuneration received for the period 1 April March 2016.

Table 9: Quantitative disclosure of remuneration: Remuneration committee

Member	Number of meetings attended	Remuneration P'000
Pius K. Molefe	5	27
Tsetsele C. Fantan	4	27
Mareledi Segotso	5	27
Gerald N. Thipe	5	27

The following table represents the breakdown of the Society's remuneration as at 31 March 2016.

Table 10: Quantitative disclosure of remuneration: Remuneration breakdown

	Executive management P'000	Remainder of staff P'000	Total P'000
Salaries and wages	14 112	34 814	48 926
Pension Fund contributions	-	4 430	4 430
Bonus accrual	1 792	3 941	5 733
Leave pay accrual	212	868	1 080
Fair value adjustments – off market staff loan	292	1 170	1 462
Sub total	16 408	45 223	61 631
Post-employment benefits	4 522	-	4 522
Total	**20 930**	**45 223**	**66 153**
Staff compliment	**10**	**190**	**200**