Botswana Building Society (BBS) Basel II Pillar III disclosure for the Year ended 31 March 2018

2018

Contents

1 The 2018 Botswana Building Society Pillar III disclosure report covers the period 1 April 2017 to 31 March 2018

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 cognizance 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 and have 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 include 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. 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") recognizes 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 2018**, 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.

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Chairman of the Board

Xx/xx/xxxx

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. Adoption of this approach is also intended to enhance the Society's management of its capital. The Society is currently exposed, but not limited to the following risks from its use of financial instruments:

- Capital risk
- Credit risk
- Counter party credit risk
- Operational 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 management practices.

The Society's risk management policies are established to identify and analyze 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 within 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.

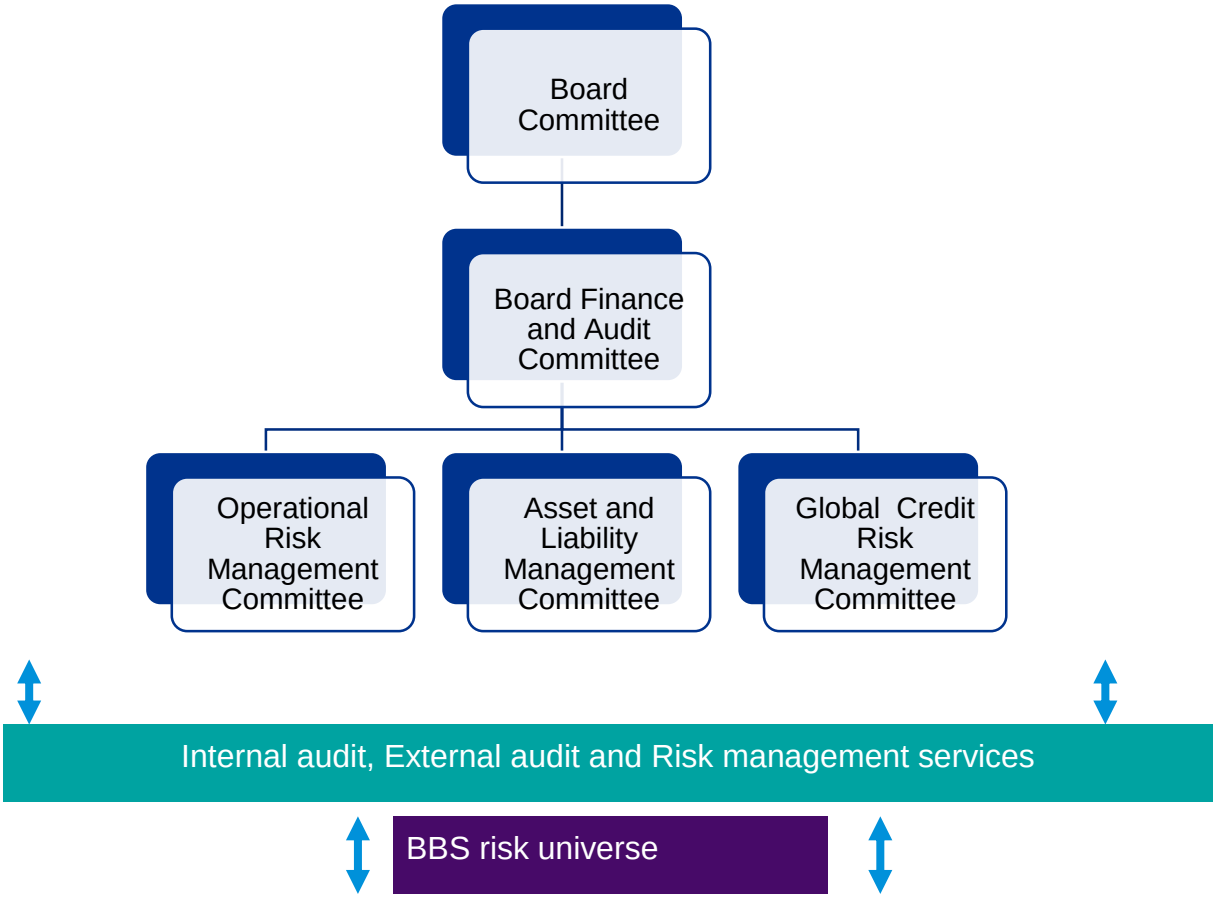
The Society's risk management objective is to ensure a proactive identification, understanding and assessment of risks, including activities undertaken that result in risks which could impact on business objectives. This is executed through various risk management and governance mechanisms and risk management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

3.3 Reporting of risk

The Board has overall responsibility for risk management and delegates the oversight responsibility for risk management to the Finance and Audit Committee. The Society utilizes 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. 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.

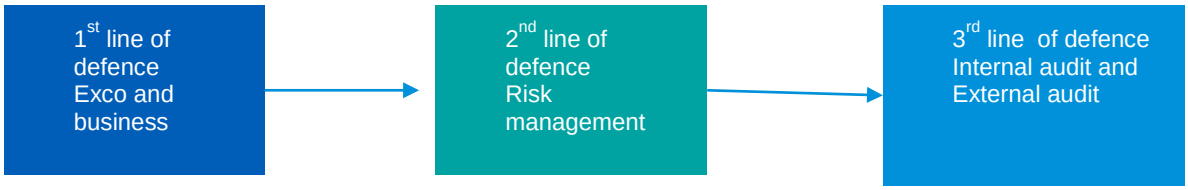
3.4 Risk appetite policy

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 that 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 senior management and the board. Risk appetite is 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) which are 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 P3.232 billion, of which P453.4 million of the gross amount relates to past due loans. The allowance for specific impairment was P39.3 million and the allowance for general impairment was P6.6 million.

The balance sheet size is P4 206.8 billion of which P777.9 million is fixed deposits with other banks. The fixed deposits with banks decreased by P424.1 million for the period under review. Capital increased to P1 146.6 million against RWAs of P1.970 billion.

Section 4:

Disclosure: Detailed Quantitative and Qualitative Disclosures of Risk Types

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	Under regulatory scope of consolidation	Balance sheet	Under regulatory scope of consolidation
	As at March 2018	As at March 2018	As at March 2017	As at March 2017
Assets				
Cash and balances at central banks	81,008	81,008	70,308	70,308
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	777,918	777,918	232,251	232,251
Loans and advances to customers	3,200,192	3,200,192	3,211,056	3,211,056
Reverse repurchase agreements and other similar secured lending	-	-	-	-
Available for sale financial investments	-	-	-	-

Current and deferred tax assets	-	-	-	-
Prepayments, accrued income and other assets	21,778	21,778	19,529	19,529
Investments in associates and joint ventures	-	-	-	-
Goodwill and intangible assets		-		-
of which goodwill	-	-	-	-
of which other intangibles (excluding MSRs)	29,227	29,227	9,282	9,282
of which MSRs	-	-	-	-
Property, plant and equipment	96,714	96,714	110,204	110,204
Total assets	**4,206,837**	**4,206,837**	**3,652,630**	**3,652,630**
Liabilities				
Deposits from banks	-	-	-	-
Items in the course of collection due to other banks	-	-	-	-
Customer accounts	1,274,795	1,130,984	1,130,984	1,130,984
Repurchase agreements and other similar secured borrowings	1,175,740	846,915	846,915	846,915
Trading portfolio liabilities	-	-	-	-
Financial liabilities designated at fair value	-	-	-	-
Derivative financial instruments	-	-	-	-
Debt securities in issue	-	-	-	-
Accruals, deferred income and other liabilities	596,014	596,014	579,144	579,144
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	**2,503,164**	**2,503,164**	**2,560,183**	**2,560,183**
Shareholders' Equity				
Paid-in share capital	945,716	945,716	872,709	872,709
of which amount eligible for CET1 CAPITAL		-		-
of which amount eligible for AT1		-		-
Retained earnings	23,412	23,412	36,270	36,270
Accumulated other comprehensive income	188,462	188,462	183,468	183,468
Total shareholders' equity	**1,161,902**	**1,161,902**	**1,092,447**	**1,092,447**

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 that capital requirements are 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

Basel III Common Equity Tier I Disclosure Template

Common Equity Tier I capital: instruments and reserves		
1	Directly issued qualifying common share (and equivalent for non-joint stock companies) capital plus related stock surplus.	945,716
2	Retained earnings	(23,412)
3	Accumulated other comprehensive income (and other reserves)	188,462
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**	**1,157,590**
	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)	
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 deductions	17,536
28	Total regulatory adjustments to Common equity Tier I	17,536
29	**Common Equity Tier I capital (CET1 CAPITAL)**	**1,140,054**
	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 I	
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% thresh	
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 deductions	
43	Total regulatory adjustments to Additional Tier I capital	
44	Additional Tier I capital (AT1)	
45	**Tier I capital (T1 = CET1 CAPITAL + AT1)**	**1,140,054**
	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 II	
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	6,577
51	**Tier II capital before regulatory adjustments**	**6,577**
	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% thresh	
	Significant investments in the capital banking, financial and insurance entities that are outside the scope of	
55	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)**	**6,577**
59	**Total capital (TC = T1 + T2)**	**1,146,631**
60	**Total risk-weighted assets**	**1,970,342**
	Capital ratios and buffers	
61	**Common Equity Tier I (as a percentage of risk weighted assets)**	57.86%
62	**Tier I (as a percentage of risk-weighted assets)**	57.86%
63	**Total capital (as a percentage of risk weighted assets)**	58.19%
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	
	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 III minimum)	
70	National Tier I minimum ratio (if different from Basel III minimum)	
71	National total capital minimum ratio (if different from Basel III 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 standardized approach (prior to application of cap)
77	Cap on inclusion of provisions in Tier II under standardized 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 instruments subject to phase out arrangements
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)

- and intangible assets) and other adjustments. CET1 Capital must be at least 4.5% 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

The composition of BBS Limited RWAs are as follow:

Table 4: Composition of RWA as at 31 March 2018

	Balance	Weighting	Weighted Balance
	BWP '000		BWP '000
Cash	5,383	0%	-
Other cash balances	75,625	20%	15,125
Fixed deposits with banks	777,918	20%	155,584
Properties In Possession	13,700	50%	6,850
Short term loans and advances to customers	87,442	0%	-
Residential loans secured	2,525,365	35%	883,878
Residential loans unsecured	73,755	75%	55,316
Past due for more than 90 and specific provision is less than 20% of loan	212,810	100%	212,810
Past due for more than 90 and specific provision is more than 20% of loan	19,014	50%	9,507
Commercial loans	229,859	100%	229,859
Past due exposure where specific provision is less than 20% of the loan.	37,125	150%	55,688
Intangible assets	29,227	100%	29,227
Property and equipment	96,714	100%	96,714
Other assets - staff loans	21,778	100%	21,778
Off-Balance sheet Commitments @ a conversion rate of 20%	70,744	20%	4,149
Credit Risk Weighted Assets			**1,787,607**
Operational Risk Weighted Assets			**182,735**
Total Risk Weighted Assets			**1,970,342**
Capital Adequacy Ratio			**58.19%**
Regulatory Requirement			**15.00%**

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. Commercial 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 Unimpaired capital require approval by the Board of Directors.

c. 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.

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

e. 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.

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

g. 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 amortized 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.

A loan is considered past due in an instance where a customer has not honored their contractual obligations as of due date, to service the principal and interest and therefore the loan falls into arrears.

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 test, to assess the level of impairment allowance required. 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 a threat to 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 is 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 realization 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 that are past due for 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, or 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 shares (being Paid up shares, Subscription shares, Indefinite Period Shares, term deposits, Fixed deposits and Lerako Savings account.

Quantitative disclosures

The following table represents the breakdown of the credit portfolio of the Society as at 31 March 2018.

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 impairments P'000	Net exposures before collateral P'000	Collateral P'000
1	Residential mortgages	2,873,965	120,705	2,753,260	16,610	12,463		28,44892	6,023,887
2	Commercial mortgages	270,949	16,411	254,538	571	9,643		260,735	654,786
	Sub total	**3,144,914**	**137,116**	**3,007,798**	**17,181**	**22,106**	**6,577**	**3,099,050**	**6,678,673**
3	Short term loans	87,442	-	87,442	-	-	-	87,442	87,442
4	**Total**	**3,224,318**	**307,897**	**2,916,421**	**13,222**	**22,106**	**6,577**	**3,186,492**	**5,414,756**

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	174,741
Total Gross Income for Year 2	182,819
Total Gross Income for Year 3	187,918
Aggregate Gross Income	**545,478**
Operational risk weight assets	**182,735**
Operational Risk Capital Charge: BIA	**27,274**

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.

Section 5:

Disclosure: Detailed quantitative and qualitative disclosures of risk types

5.1 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 2018							
Assets							
Cash and cash equivalents	75,625					5,383	81,008
Fixed deposits with banks	344,451	43,347					777,918
Short term loans and advances	87,442						87,442
Property in possession						13,700	13,700
Mortgage loans and advances	3,102,939		163	7,149	34,663	-45,864	3,099,050
Intangible assets						29,227	29,227
Property and equipment						96,714	96,714
Other assets	17,061					4,717	21,778
Total	**3,627,518**	**43,346**	**163**	**7,149**	**34,663**	**103,877**	**4,206,837**
Liabilities							
Customers' savings and fixed deposit accounts	718,974	536,210	14,078	5,533			**1,274,795**

	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						68,813	**68,813**
Borrowings	69,3250	111,290	75,000	59,500	236,700		**1,175,740**
Withholding tax						2,698	**2,698**
Paid up and subscription shares	52720						**527,201**
Indefinite period shares and reserves							-
Total liabilities	**3,097,015**	**(214,033)**	**89,078**	**65,033**	**236,700**	**71,511**	**1,157,590**
Net interest sensitivity gap	**53,0503**	**(214,033**	**(88,915)**	**(57,884)**	**(202,037)**	**32,366**	**-0**

	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 2017							
Assets							
Cash and cash equivalents	65 696	-	-	-	-	4 612	**70 308**
Fixed deposits with banks	36 009	196 242	-	-	-	-	**232 251**
Short term loans and advances	81 600	-	-	-	-	-	**81 600**
Property in possession	-	-	-	-	-	11 792	**11 792**
Mortgage loans and advances	3 059 238	462	4 557	8 531	44 876	-	**3 117 664**
Intangible assets	-	-	-	-	-	9 282	**9 282**
Property and equipment	-	-	-	-	-	110 204	**110 204**
Other assets	15 309	-	-	-	-	4 220	**19 529**
Total	**3 257 852**	**196 704**	**4 557**	**8 531**	**44 876**	**140 110**	**3 652 630**
Liabilities							
Customers' savings and fixed deposit accounts	589 552	531 403	614	9 415	-	-	**1 130 984**
Other liabilities	-	-	-	-	-	70 525	**70 525**
Borrowings	362 178	113 537	75 000	-	296 200	-	**846 915**
Withholding tax	-	-	-	-	-	3 140	**3 140**

Paid up and subscription shares	508 619	-	-	-	-	-	**508 619**
Indefinite period shares and reserves	872 709	-	-	-	-	219 738	**1 092 447**
Total liabilities	**2 333 058**	**644 940**	**75 614**	**9 415**	**296 200**	**293 403**	**3 652 630**
Net interest sensitivity gap	**924 794**	**(448 236)**	**(71 057)**	**(884)**	**(251 324)**	**(153 293)**	-

5.2 Liquidity risk

5.2.1 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.

5.2.2 Quantitative disclosure

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

Table 8: Quantitative disclosures of liquidity risk

At 31 March 2018	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	81,008	-	-	-	-		**81,008**
Fixed deposits with banks	344,451	83,594	349,873		-	-	**777,918**
Short term loans and advances to customers	3,335	5,295	14,237	64,575		-	**87,442**
Property in possession	-					13,700	**13,700**
Mortgage loans and advances to customers	36,896	73,594	327,932	1,646,230	1,060,262	-45,864	**3,099,050**
Intangible assets	-					29,227	**29,227**
Property and equipment	-					96,714	**96,714**
Other assets	432	864	3,859	11,906		4,717	**21,778**
Total	**466,122**	**163,347**	**695,901**	**1,722,711**	**1,060,262**	**98,494**	**4,206,837**
Liabilities							
Customers' savings and fixed deposit accounts	504,632	163,541	579,631	26,991		-	**1,274,795**
Other liabilities	-					68,813	**68,813**

At 31 March 2018	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
Borrowing	162,609	23,339	159,613	479,729	350,450	-	**1,175,740**
Paid up and subscription shares	527,201				527,201	-	**527,201**
Indefinite period shares and reserves	-		945,716			-	**945,716**
Withholding tax	-					2,698	**2,698**
Statutory reserve	-	-	-	-		124,462	**124,462**
General market risk reserve	-	-	-	-	-	64,000	**64,000**
Retained earnings	-	-	-	-	-	23,412	**23,412**
Total liabilities	**667,241**	**186,880**	**1,684,960**	**506,720**	**877,651**	**283,385**	**4,206,837**
Net liquidity gap	**(201,119)**	**(23,533)**	**(989,059)**	**1,215,991**	**182,611**	**(184,891)**	**0**

5.3 Remuneration

5.3.1 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 related 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 are remunerated in the following manner:

- Salaries and wages
- Pension fund contributions or gratuity where applicable
- Pension fund contributions or gratuity where applicable
- Bonus accrual
- Leave pay accrual

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.

5.3.2 Quantitative disclosures

The Human Resources and Remuneration Committee met five (5) times for the period 1 April 2017 to 31 March 2018. The table below sets out the member of the remuneration committee, number of meetings attended and remuneration received for the period mentioned.

Table 9: Quantitative disclosure of remuneration: Remuneration committee

5.3.4 Quantitative disclosures

The Human Resources and Remuneration Committee met five (5) times for the period 1 April 2017 to 31 March 2018. The table below sets out the member of the remuneration committee, number of meetings attended and remuneration received for the period 1 April 2017 to March 2018.

Table 9: Quantitative disclosure of remuneration: Remuneration committee

Member	Number of meetings attended	Remuneration P'000
G. Thipe	7	81.8
R. Molosiwa	7	45.0
T. Fantan	6	53.3

The following table represents the breakdown of BBS Limited's remuneration as at 31 March 2018.

Table 10: Quantitative disclosure of remuneration: Remuneration breakdown

	Executive management P'000	Remainder of staff P'000	Total P'000
Salaries and wages	10,545	44,195	54,740
Pension Fund contributions	-	5,045	5,045
Bonus accrual	2,015	5,071	7,086
Leave pay accrual	247	1,986	2,233
Fair value adjustments – off market staff loan	7	20	27
Sub total	**12,814**	**56,317**	**69,131**
Post-employment benefits	1,700	-	1,700
Total	14,514	56,317	70,831
Staff complement	10	209	205