



Central Bank of Lesotho

SUPERVISION ANNUAL REPORT 2004

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PART I GOVERNOR'S REMARKS

The regulatory and supervisory frameworks of the financial sector in Lesotho, have undergone reviews and changes keeping pace with the reforms introduced in 1998. The various aspects of the reform programme have been elaborated upon in great detail in the past years' Supervision Annual Reports (1999-2003). The 2004 Supervision Annual Report, therefore, attempts to offer our views on the progress the financial sector has made to rebuild its strength, and what needs to be done to ensure that the sector remains strong and generally accommodates the economic growth of the nation.

The current condition of the financial sector is much improved from only a few years ago. This situation has been brought about by a host of factors that are primarily driven by well developed and adequate frameworks that meet international standards. The supervision has been enhanced whereby each financial institution is examined comprehensively at least once a year. Financial institutions have notably played their explicit role of complying with prudential regulations.

Banks in Lesotho are adequately capitalised and profitable, strides have been made in establishing and maintaining sound credit standards. Despite the high exposure to parent companies and top twenty borrowers, banks mostly comply with lending limits regulations. Banks now exercise prudence in complying with the regulatory provisions, needless to say that there is sluggish growth of the loan portfolio.

Licensing of one more commercial bank and the Lesotho Post Bank (LPB) has already had an influence on banks that are now aggressively competing for loans, relaxing their credit standards and providing a wide range of financial services.

Institutional arrangements to enhance rural sector banking developments have been put in place through linking rural savings groups with mainstream banking institutions.

As a result of the intensive supervision through both on site inspection and off site monitoring, the insurance industry has been awakened to the essential elements that are required for a good corporate governance system.

Although the reform programme has had highly salutary effects, managing the process and adapting it to new market practices will remain a challenge for us. It can easily be predicted that financial institutions will take new directions in order to perform their essential economic function. Competition in financial markets will also continue to grow as the number and types of financial service providers multiply. Consequently, we will have to constantly review our supervisory policies and techniques so as to keep pace with sector's practices. Our continued ability to recruit, reward and maintain supervisory staff with appropriate technical skills will be greatly challenged.

For its part, the Central Bank of Lesotho (CBL) is taking steps to ensure that the supervision staff has the proper training and guidance and that the staff continues to participate actively in regional and international efforts that advance sound supervisory policies and procedures.

PART II OVERVIEW OF THE SUPERVISION DEPARTMENT ACTIVITIES

As in the preceding year, the Department of Supervision undertook its functions to regulate and supervise financial institutions licensed in Lesotho. Challenging developments were witnessed during the performance of these functions. These developments pointed to the emergence of various investors wishing to enter the financial sector. The sustained peace and stability in the country has caused further developments in the country's financial sector. However, this image is not without foundation as the financial sector has generally remained buoyant during the period under review.

The Department found itself sandwiched between pressure on the one side from the potential investors and lack of appropriate legislative framework for some areas of investors' interest. As a result, a review of supervisory law, to address the emerging supervisory challenges, had to be undertaken. A Vision Paper on the regulatory and supervisory frameworks was, therefore, presented to the stakeholders to solicit their inputs and to enable the CBL to proceed with implementation of the necessary actions. The final document incorporating the stakeholders' views was presented to the Minister of Finance and Development Planning to solicit Government's approval.

To further accommodate the expression of interest referred to earlier, studies were made by the Department on issues like how countries around the world supervise foreign branches and subsequently the Foreign Branching Regulations were issued. The Ancillary Financial Service Providers Regulations that were gazetted in December 2003 were passed by Parliament in February 2004. These Regulations give guidance to persons or institutions interested in providing ancillary financial services. During the year, circulars, guidelines and regulations were issued in response to various developments.

The general progress made in 2004 on the review of the legislative environment has been noticeable. Drafts of the following pieces of legislation were in progress by the end of the year: Insurance, Foreign Financial Transactions, and Anti-Money Laundering Bills.

These Bills will pave the way for continued foreign investor participation in the national economy.

Enhanced supervision has had a significant impact on the performance of the financial sector. The enhancement has been effected through technological developments in the supervisory framework such as the Bank Supervision Application (BSA) and the Cross Border Foreign Exchange Transactions Reporting System (CBFET). Implementation of the electronic reporting systems has put the CBL on par with other central banks within the Southern African Development Community (SADC). Furthermore, creation of an Insurance Supervision Division (ISD), in 2004, strengthened supervision of the insurance industry.

As the CBL is a member of regional and international fora, the Department continued to participate actively in initiatives aimed at strengthening and harmonizing supervisory standards, and developing and implementing strong supervisory practices. Collaboration with regional and international bodies has had a tremendous impact on upgrading the CBL's supervisory capacity.

PART III SUPERVISORY RESPONSIBILITIES

3.1 LICENSING

3.1.1 Banks

The banking industry in Lesotho is highly concentrated, comprising of three banks, two of which belong to the same group. This had led to lack of competition in the industry. The CBL took cognizance of this situation and acknowledged the need to create an environment conducive to competition. The three banks in the country are locally incorporated companies but subsidiaries of foreign banks and for some time no other foreign bank expressed interest in establishing a subsidiary. The Bank had to look at other means, such as foreign branching to attract interest. Foreign branching is permitted under the Financial Institutions Act (FIA) 1999.

The Act and its implementing regulations treat branches of foreign banks like subsidiaries and local companies, Section 8 of the Act prescribes a minimum capital of M10 million or such required capital which may be prescribed by the Commissioner from time to time. A study was conducted in other countries whereby it was revealed that some countries do not permit foreign branching. Those that permit foreign branch impose stringent requirements.

Following this study, Regulations governing branches of foreign banks were drafted and will be enacted in the new year. In addition to the newly licensed commercial bank, the CBL received applications for merchant banking. During the year under review, three merchant banking applications were received. Merchant banks, among others, raise long term loans for foreign governments and major commercial enterprises. They also give advice on the issue of bonds and stock.

The CBL, in its endeavours to create a competitive environment in the banking industry, took an initiative of attracting more banks to invest in the country by approaching two South African based banks namely, First National Bank (FNB) and ABSA Bank. Also

recognizing the need to extend banking services to the low income earners nation wide, Lesotho Government in collaboration with the CBL re-established Lesotho Post Bank.

Following the initiatives, FNB South Africa showed interest to open a branch in Lesotho and was issued a license to operate as a foreign branch of FNB South Africa at the end of 2004. Subsequent to licensing of FNB, Lesotho Post Bank (LPB) was licensed to operate under a restricted license, which allows the Bank to take deposits only. The closure and liquidation of the two State owned banks created a vacuum was in the mobilization of small-scale household savings, especially in the rural areas. The purpose of re-opening of Lesotho Post Bank was to provide a wide range of financial services starting initially with a savings and withdrawals facility. Over time, the automatic telling machines (ATMs), lending and Giro Service (Payment System) will be introduced to complement the passbooks. Consequently, in December 2004, the number of licensed banks came to five.

3.1.2 Money Lenders

Money Lending can be defined as the provision of financial services, mainly credit to people who are unable to obtain credit from formal banks because their only security is the fact that they have a regular source of income. Money lenders are not deposit taking institutions and are therefore self funding, unlike the formal banks.

The Money Lenders Act 1989 (as amended) has remained stagnant and failed to take into account developments in the industry. Furthermore due its old age and impracticability, the Act has also failed to provide for more comprehensive and enhanced supervision of the industry. Consequently, there is lack of a coordinated system of deterrence against abuse within the industry.

There are a number of unlicensed money lenders in the industry charging interest rates as high as 40% per month whom the law does not reach. Crucially, however, is the fact that even those that have been licensed still charge high rates in order to sustain the high credit risk prevalent in this industry. The interest rate provided in the law is rather low

(25% per annum) considering the fact that money lenders use their own capital and do not require collateral. The interest rate has also resulted in the distortion of the money lending business because lenders do not comply with the prescribed rate, and borrowers driven by desperation, agree to the unlawful rates. At the end of the year under review, there were twenty three money lenders. (see appendix 5).

It is in the light of such problems that the CBL decided to revise the Act with the objective of modernizing it as well as ensuring that the industry can operate within a firm legal base.

3.1.3 Ancillary Financial Service Providers

During the period under review, promulgation of the Ancillary Financial Service Providers (Licensing Requirements) Regulations pursuant to section 12 of the Financial Institutions Act 1999 was completed. The Regulations were published in the Government Gazette Supplement No. 2 to Gazette No. 112 of 19 December 2003 by the Government Printer. In accordance with section 27 of the Interpretation Act 1977, the Regulations were laid in Parliament on 12 February 2004 and passed on 26 February 2004. Subsequent to this promulgation, the Supervision Department embarked on the educational campaign using the media.

The objective of the Regulations is to establish clear and objective criteria for the regulation and supervision of the persons/ institutions who/which will be licensed to provide auxiliary financial services.

The Department of Supervision had been approached by a number of individuals who had shown keen interest in establishing forex bureaux. Most of these potential investors were more interested in selling and buying rand in exchange for loti than the other currencies. However, in terms of the Central Bank of Lesotho Act 2000 and the Currency Act 1978, rand legal tender in Lesotho and, therefore, this line of business is not permitted by law.

The result of this had caused the majority of applicants for the forex bureaux to loose interest in pursuing their applications.

It is worth noting that, during the period 1997 to 2002, CBL addressed a number of enquiries and received some written applications to operate forex bureaux. All the applicants were informed that the CBL was in the process of promulgating the appropriate law to license such kind of business. After the gazettal of the Regulations in 2004, some follow up letters were sent to all the applicants notifying them of the existence of the Regulations to enable them to further pursue their applications. Very few of the applicants were in the process of preparing the necessary documents for submission to meet the criteria for eligibility under the Regulations.

3.2 ON-SITE EXAMINATIONS

3.2.1 Banks

Banks licensed under the Financial Institutions Act (FIA), 1999 are required to fully comply with the Act and its implementing regulations. The policy of the CBL is that each bank must be examined at least once a year. It was on this premise that on-site examination of the three banks was conducted during 2004. The examinations conducted were based on the traditional approach which focused on the assessment of all the CAMELS components. No targeted or follow-up examinations were conducted. The examinations conducted revealed that although banks were generally found to be in compliance with the Act, non-compliance was evidenced in the following areas:

- i) Section 25 (1) (d) of the FIA, 1999 regarding the single borrower's limit.
- ii) Regulations 24 (2) and 26 (1) of the Financial Institutions (Loan Portfolio Classification) Regulations 1999.
- iii) Regulation 26 (1) and (2) of the Financial Institutions (Licensing Requirements) Regulations, 1999.

Furthermore, the examinations conducted revealed the following observations:

- i) The Banks were in a sound financial condition. They were highly liquid, profitable and adequately capitalised with two banks holding the Capital Adequacy Ratios of more than 4 times the required minimum of 8%. The ratios of non-performing loans to total portfolios had decreased significantly from as high as 17.5% in 2003 to as low as 0.5% in 2004, indicating an improvement in the management of credit.
- ii) The banks' major sources of income were derived from Lesotho, South Africa and Swaziland Governments treasury bills and bonds and call accounts with banks in South Africa, especially their parent companies. Income from lending activities contributed only 13.1% of total income on the average.
- iii) The loans to deposit ratios of the banks ranged from 12.4% to a maximum of 17.3%.
- iv) Non-compliance with the FIA, 1999 and its implementing regulations was still common.

Banks are also required to comply with directives issued pursuant to previous examinations conducted. There has been an improvement in this regard although not to the expectation of the CBL

A penalty was imposed on one of the banks for non-compliance with the directives issued pursuant to a previous examination and non-compliance with the Act.

The Policy and Exchange Control Division joined the examination section of the Financial Institutions Supervision Division during the second half of 2004 on the full scope examination of one of the banks operating in Lesotho. The purpose of the examination was to determine compliance with the Exchange Control Regulations 1989 and the Exchange Control Rulings 2003. The situation of export proceeds submitted by

this bank's exporters revealed an unsatisfactory state that resulted in a targeted examination by the Division to reconcile outstanding export proceeds for the period. The exercise was completed successfully.

The Division plans to examine other banks during 2005.

3.2.2 Insurance Companies

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

The two companies inspected did not comply with some sections of the Act and its implementing regulations. They further did not comply with IAIS Core Principles especially those on corporate governance and internal controls. The on-site inspection also revealed that the industry risk absorption capacity increased as evidenced by the significant decrease in premiums ceded to the re-insurers by 32%. The insurance industry's performance in 2004 improved when compared to 2003.

The Insurance Act 1976 does not give the Commissioner of Insurance the powers to conduct on-site inspections of other players such as insurance brokers. It was, however, observed that during the inspection of insurance companies, some insurance brokers did not remit premiums due to insurers during the prescribed 60 days statutory period.

The Commissioner of Insurance companies issued the directives indicating the time frames within which the above deficiencies should be rectified.

3.2.3 Money Lenders

The Supervision Department is faced with a problem of money lenders who do not comply with the Money Lenders Act 1989 as amended. However, this Act is obsolete and provides limited options of supervisory actions that the Department can take to enforce compliance.

Due to shortage of resources, only one money lender out of the twenty-five registered was examined. The problems encountered during this examination, which are common to most money lenders were:

- i) Lack of proper records, both accounting and client related.
- ii) Non-compliance with the Money Lenders Act.

Based on the previous examinations conducted, it was observed that these problems are common to almost all money lenders. However, CBL is in the process of modernizing the Money Lenders Act to address this problems.

3.2.4 Other Institutions

3.2.4.1 Postal Services Department

In 2003, a special examination of the Postal Services Department of the Ministry of Communications, Science and Technology Postal Services Department was engaged in credit extension without a licence. It was revealed that the Department was engaged in credit granting through salary advances to civil servants. This activity was delegated to the Ministry of Communications, Science and Technology by the Ministry of Finance and Development Planning, though there was no empowering provision to delegate the powers of the Finance Order 1988.

A follow-up examination of the Postal Services Department of the Ministry of Communications, Science and Technology was conducted in September 2004. The main objective of the follow-up examination was to establish the progress made on the directives issued pursuant to the previous examination conducted as at 2003 April 30. The follow-up examination revealed that a number of issues raised in the previous examination had been attended to, including the process of regularising the legal status of the salary advance scheme.

3.2.4.2 Boliba Savings and Credit

In March 2003, Boliba Savings and Credit submitted an application to the CBL to be licensed as a financial institution capable of being supervised by it. In a meeting held between CBL and Boliba, it was agreed that before CBL could pronounce itself on the application, it was essential to conduct an on-site examination of the Cooperative to assess the level of operations and its readiness to transform into a financial institution capable of being supervised by the CBL. The assessment was made based on the Financial Institutions Act 1999 and its implementing regulations.

Boliba Savings and Credit Cooperative Society is a wholly owned subsidiary of Boliba Multi-Purpose Cooperative Society. Boliba Multi-Purpose Cooperative Society was licensed by the Commissioner of Cooperative Societies under the Cooperative Societies Act 2000 and therefore was not subject to supervision by the Central Bank of Lesotho. Under this Act, cooperative societies are authorised to solicit deposits from the public including non-members up to a maximum of one million Maloti (M1 000 000.00). This is in conflict with Section 10 (4) of the Financial Institutions Act 1999 which prohibits any financial institution other than a bank to accept any deposits or funds from the public repayable on demand by cheque, draft or order drawn on the financial institution.

The examination revealed that Boliba Savings and Credit was not ready to transform into a financial institution to be supervised by the CBL. The weaknesses observed, in summary, were as follows:

- i) Weak internal control systems.
- ii) Lack of board and management oversight.
- iii) Poor credit administration.

As Boliba Savings and Credit was considered to be playing an important role of providing financial intermediation in the country, the CBL decided it was going to work closely with the institution to transform it into a cooperative bank. However, an appropriate legal framework needed to be developed. The CBL in its endeavour to put in place the legal framework had sought technical assistance to assist in developing proper systems and institutional framework for the cooperative banks. In the meantime, a compliance plan was drawn up by CBL which was staggered into short term and medium term plans for implementation by Boliba (short term interpreted as 3 months while medium term as at least six months) with the requirement to furnish monthly progress reports.

3.3 OFF-SITE SURVEILLANCE

3.3.1 Banks

3.3.1.1 Issues of Exceptional Nature

During the reporting period, the Supervision Department undertook additional assignments on top of normal duties which fall within the armpit of the Department. These special activities included, among others, Serving in the Task Team on the New Basel Capital Accord and deploying the Bank Supervision Application.

(a) Task Team on the New Basel II Capital Accord

The main objective of establishing the Task Team was to advise the Maseru Clearing Bankers' Committee i.e. (CBL, First National Bank, Nedbank, Lesotho Bank and Standard Bank) on whether to adopt the new Capital (Basel II) Accord or remain with the

old Capital Accord. The Task Team comprised CBL, commercial banks and the Lesotho Institute of Accountants. The Task Team looked into, among others, its terms of reference, the elements of Basel I Capital Accord and the new Basel II Capital Accord.

(b) Bank Supervision Application

The Bank Supervision Application (BSA) is a system that enables banks to report electronically to the CBL. The Deployment Team from the Southern African Development Community (SADC) member states was in Maseru in July 2004, installing the BSA. The Team was made up of two Information Technology experts from Mozambique and Angola. The main function of the team was to deploy and configure the BSA system. The deployment of the system was completed in August the same year. A trial run for the Banks began in September 2004 whereby they started reporting electronically as well in the hard paper form. The system was welcomed by the banking community because in the long run it would reduce both the work load and the operating costs.

3.3.1.2 Observed Trends - Performance Ratios

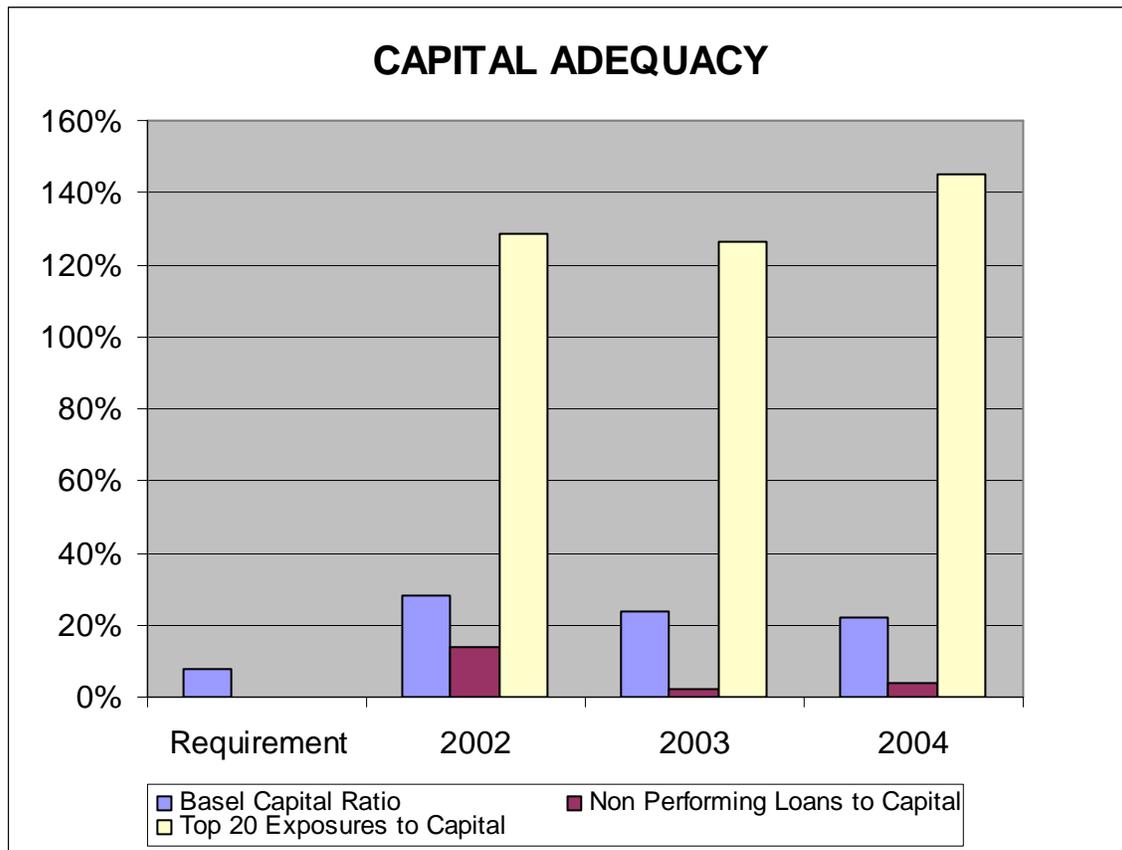
We measure the performance of the banks using various instruments like ratios. The ratios employed include Capital Adequacy, Asset Quality, Liquidity and Solvency Ratios. During the period under review, banks reported high ratios and that was an indication of good performance.

(a) Capital Adequacy Ratio

In 2004, banks remained adequately capitalised as evidenced by the ratios in Table A. The minimum ratio which the banks must keep is 8% of risk weighted assets as dictated by Basel I Accord Capital Standards. During 2004, the banking industry maintained capital adequacy ratios which were above 20%. Non performing loans to Total Capital ratio, was very low at 2% in December 2003. It grew moderately to 4% in December 2004. As a result of a low ratio of non-performing loans to capital, the banking industry will not encounter much credit risk in case of default by some borrowers. The top twenty borrowers put much strain to the capital base as in some cases they were higher than the

capital itself. At the end of 2004, top twenty borrowers accounted for 144.9 per cent of capital and reserves, in case of default by that group the entire capital will be eroded. Measures are being taken by CBL as the regulator to encourage the banks to diversify their loan books by exploring the retail sector. Currently, the banking industry is extending credit to corporate clients because they consider the retail customers to be too risky.

Chart A

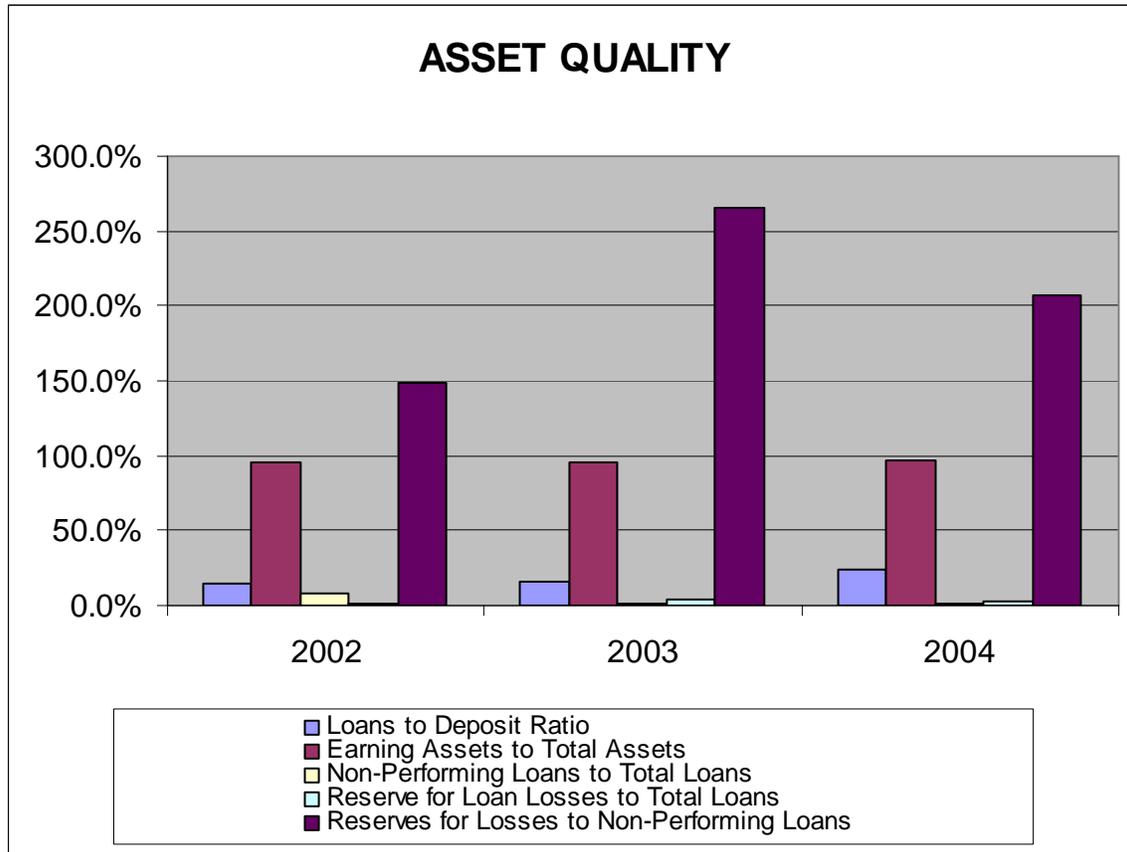


(b) Asset Quality

The banking industry was not willing to extend credit to its customers as reflected by low ratios of loans to deposits as reported in Table A. More than 90% of the assets are made up of the earning assets indicating that the banking industry had a very high earning potential. The ratio of non-performing loans to total loans was very low at less than 3% at the end of December 2003 and 2004. The low ratio of non-performing loans reflected

that the banking industry had a superior quality of assets. The reserve for loan losses far exceeded the non-performing loans as indicated in table A.

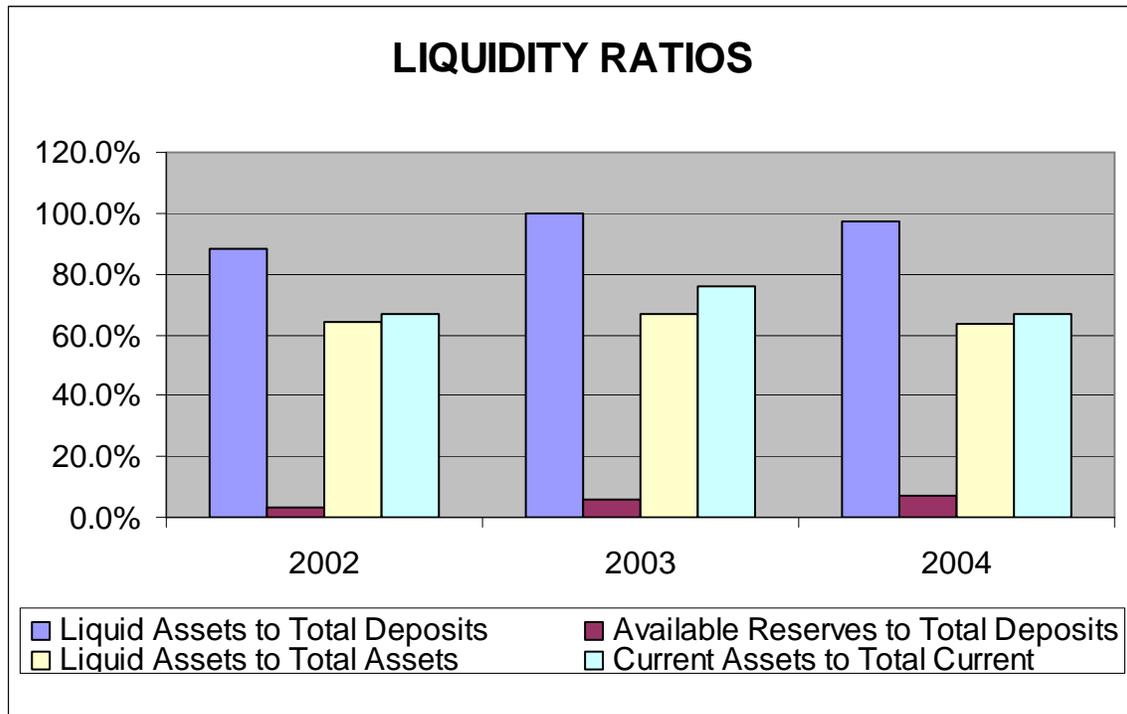
Chart B



(c) Liquidity Ratios

The banking industry was characterised by high liquidity as the banks were very reluctant to give out loans, particularly to the small retail borrowers who constituted the majority of the depositors. The ratio of liquid assets to total deposits exceeded 80%. At this level the banks would meet withdrawal needs of their customers with ease and thus avoiding the risk of having bank runs. Banks are required to keep a reserve account with CBL in an amount of 3% of deposit liabilities accordance with liquidity requirement Regulations 2000. In a number of cases the ratio of available reserves to deposits ranged between 3 and 7 per cent and that showed good management of liquidity.

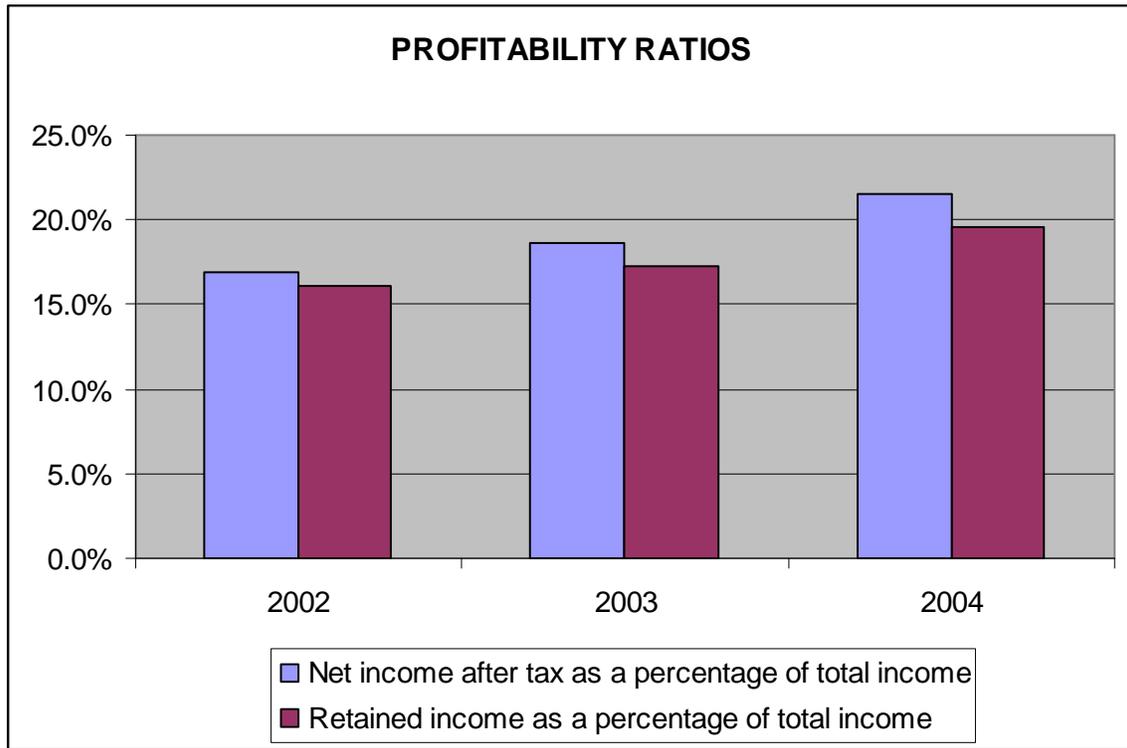
Chart C



(d) Profitability Ratios

The profitability of the banking industry increased steadily over the years whereby retained income for the three years ending 2004 grew moderately from 16% of total income to 20%. (see Chart D.)

Chart D



**Table A - Commercial Banks
Performance Ratios**

	2002	2003	2004	Variance 2003/2002	Variance 2004/2003
Performance Ratios					
I. CAPITAL ADEQUACY					
a) Basel Capital Ratio	25.0%	24.0%	22.0%	-1.0%	-1.0%
b) Non Performing Loans to Capital	14.0%	2.0%	4.0%	-12.0%	2.0%
c) Top 20 Exposures to Capital	128.6%	126.1%	144.9%	-2.5%	8.8%
II Asset Quality					
a) Loans to Deposit Ratio					
b) Earning Assets to Total Assets	14.8%	15.7%	23.4%	0.9%	7.7%
c) Non-Performing Loans to Total Loans	95.0%	95.0%	97.0%	0%	2.0%
d) Reserve for Loan Losses to Total Loans	7.8%	1.4%	1.5%	-6.4%	0.1%
e) Reserves for Losses to Non- Performing Loans	1.6%	3.7%	3.2%	2.1%	-0.5%
	148.7%	265.6%	207.4%	116.9%	-58.2%
III Liquidity Ratios					
a) Liquid Assets to Total Deposits	88.1%	99.6%	97.5%	11.5%	-2.1%
b) Available Reserves to Total Deposits	3.5%	5.7%	7.0%	2.2%	1.3%

	2002	2003	2004	Variance 2003/2002	Variance 2004/2003
c) Liquid Assets to Total Assets	64.4%	66.8%	63.5%	2.4%	-3.3%
d) Current Assets to Total Current Liabilities	67%	76%	67%	9%	-9%
IV Profitability Ratios					
a) Net income after tax as a percentage of total income	16.9%	18.6%	21.5%	1.7%	2.9%
b) Retained income as a percentage of total income	16.1%	17.3%	19.6%	1.2%	2.9%

3.3.1.3 Foreign Exchange Transactions

The CBL continued to receive from Authorised Dealers returns on individual foreign exchange transactions in amounts of M200,000 and above as prescribed in the Exchange Control Rulings 2003. As far as the operation of Foreign Currency Accounts (FCAs) is concerned, only three commercial banks submitted returns. One bank did not submit returns as they had no FCAs during the period under review.

In terms of the Exchange Control Regulation 7, anybody who receives or becomes entitled to receive foreign currency must offer it for sale to the Minister or an Authorised Dealer within 30 days. However, the introduction of the FCAs relaxed the strict time limit of 30 days within which the foreign currency should be sold. The operators of a Customer Foreign Currency (CFC) or FCAs are permitted to retain the foreign currency in either of these accounts for 180 days before they have to sell it to the Minister or to an Authorised Dealer. During the reporting period, the operators of CFCs i.e. bodies corporate or legal entities remained steady at 20 while the operators of FCAs i.e. natural persons, declined significantly from 15 to 6 in 2004. This was due to the closure of accounts by the owners.

3.3.1.4 Large Cash and Suspicious Transactions

In terms of Section 17(1) and Section 18, respectively, of the Financial Institutions (Anti-Money Laundering) Guidelines 2000, financial institutions have to submit returns on large cash transactions and near cash items above M100,000 and suspicious transactions of any amounts. When the BSA system was introduced, it was decided that both large cash and suspicious transactions reports be submitted electronically to CBL. Although some technical problems were encountered in the process, the banks were requested to submit those reports electronically from August 2004 onwards.

At the end of the reporting period, twelve suspicious transactions were reported and were investigated by the police. The large cash transactions reports had been stored in the CBL's data base for analysis to determine trends.

3.3.2 Insurance Companies

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

During the year under review, the off-site surveillance revealed that all the insurance companies made profits while in the previous year one company made losses. The share capital of the industry increased significantly by 120%. The major reason for this increase was to absorb losses which were made in the previous year. The management expenses in the industry were also reduced by 6.6% in the year under review.

3.3.3 Money Lenders

The Money Lenders were ranging from individual businesses to large companies. The Money Lenders Act 1989 (as amended) requires the Money Lenders to submit a balance sheet to the CBL on a monthly basis. The money lenders, however, do not comply with this regulatory requirement. The existing law does not empower the CBL to impose penalties on money lenders for non compliance.

Total assets of the industry amounted to M14.0 million during the period under review out of which M11.6 million constituted loans and advances as can be seen from table b.

Table B Money Lenders Balance Sheet Analysis December 2004

1. Balance Sheet Accounts	Money Lender 1	Money Lender 2	Money Lender 3	Money Lender 4	Money Lender 5	Money Lender 6	Total
I. Total Assets	8,542,463	324,131	1,164,723	637,444	3,328,754	120,267	14,027,782
1. Cash on hand	500	500	8,595	-	78,291	10,000	97,886
2. Deposit with Banks	315,298	8,602	82,211	11,380	-9,511	16,245	424,226
3. Loans and Advances	8,067,223	182,862	26,500	580,829	2,707,609	94,021	11,659,045
4. Investments	-	81,000	961,357	-	224,158	-	1,266,515
5. Fixed Assets	159,442	41,167	68,160	45,235	100,494	-	414,498
6. Other Assets	-	10,000	17,900	-	137,711	-	165,611
II. Total Liabilities	3,273,358	293,858	49,375	77,170	131,230	-	3,828,963
1. Repayable Funds Received	-	252,858	-	50,000	2,750	-	305,608
2. Other Borrowings	1,083,178	-	-	26,970	128,480	-	1,238,628
3. Other Liabilities	2,190,180	41,000	49,375	200	-	3,972	2,284,727
III. Total Capital	5,269,105	30,273	1,115,348	560,274	3,107,524	116,295	10,198,819
1. Owners' Equity	1,000	-	5,000	1,000	664	60,804	68,468
2. Paid up Surplus	4,775,901	-	985,000	488,000	3,534,292	-	9,783,193
3. Retained Earnings	-182,345	53,752	121,765	102,867	-395,234	20,437	-278,758
4. Currents Profits	674,549	-23,479	3,583	-31,198	-32,198	35,054	625,916
IV. Total Capital And Liabilities	8,542,463	324,131	1,164,723	637,444	3,238,754	120,267	14,027,782

PART IV DEVELOPMENTS RELATED TO SUPERVISION

4.1 ECONOMIC OVERVIEW

4.1.1 Economic Issues

Economic growth, as measured by real gross domestic product (GDP), was projected at 3.4 per cent in 2004 compared with 3.3 per cent growth registered in 2003. The improvement in the overall economic activity was largely boosted by the strong recovery in the mining and quarrying sub-sector. Nonetheless, the secondary sector, which remains the engine of economic growth in Lesotho, slowed down in 2004.

The secondary sector comprises the manufacturing, electricity and water, building and construction sub-sectors. In 2004, this sector was estimated to have further slowed-down. It was estimated to have recorded 4.5 per cent growth compared with 4.7 per cent registered in 2003. All components of the secondary sector have declined in 2004. This sector has largely been driven by the manufacturing sub-sector since the inception of African Growth Opportunity Act (AGOA) in 2001. However, performance of the latter has deteriorated considerably in recent years. The strengthening of the loti against the US dollar continued to hamper textile and clothing exports to the United States, hence, the slow-down in activity. This was further compounded by closure of some textile and clothing firms in the fourth quarter of 2004.

The external sector position showed some recovery in 2004. The overall balance registered a surplus of M10.6 million following a deficit of M517.0 million in 2003. The current account deficit was estimated to narrow significantly in 2004, owing mainly to the increase in current transfers and net income inflows as well as the fall in net payments on services. The transactions balance was estimated to change from a deficit of M70.2 million in 2003 to a surplus of M153.7 million during the review year.

The overall fiscal surplus equivalent to 3.1 per cent of GDP was estimated to be realised by the end of the 2004/2005 fiscal year. The surplus was mainly a result of the 23.9 per cent increase in revenue that was primarily facilitated by the exceptional increase in Southern Africa Customs Union (SACU) revenue during the year. This

enabled the Government to repay part of the long term domestic debt to the tune of M273 million, which had been issued for the restructuring of the banking system in 1999. The Government was also able to accumulate some deposits with the banking sector to become a net re-payer of foreign public debt.

The overall debt stock continued to decline during the fourth quarter. The decline resulted from the fall in both domestic and foreign indebtedness. The appreciation of the local currency against the major international currencies, in which, foreign debt is denominated, led to a decline of external debt by 2.3 per cent. Domestic debt was reduced by 2.9 per cent on account of the reduced non-bank holding of treasury bills.

4.1.2 Financial Sector Activities

Broad Money supply (M2)¹ grew at a lower annual rate of 3.3 per cent during the period under review compared with last year's increase of 6.0 per cent. The growth in money supply was in line with the end of year inflation rate of 4.8 per cent. Credit extended by Commercial banks grew by 11.6 per cent at the end of the year 2004 from its previous level at the end of 2003. This excluded net claims on Government and non-performing loans.

The net foreign assets of the banking system increased by 14.8 per cent in 2004, compared with a 10.9 per cent decline at the end of 2003. The driver was a noteworthy jump in the net foreign assets of the commercial banks. The CBL net foreign assets remained virtually unchanged at the end of the review year. The revaluation loss in the CBL's net foreign assets occurred as the local currency appreciated against currencies in which its non-rand financial assets were held, namely the euro, the US dollar and the British Pound. Commercial banks' net foreign assets sky rocketed by 84.0 per cent due to the fact that foreign assets rose by 49.7 per cent while foreign liabilities sunk by an enormous 40.8 per cent.

During the period under review, major money market rates in Lesotho generally followed a downward trend which was in line with the trend observed regionally. At the end of 2004, the average prime lending rate in Lesotho stood at 12.17 per cent, which was lower than the 12.5 per cent recorded at end of 2003. The changes in this

¹ M2 is defined as the sum of currency in circulation, demand, savings and time deposits with the commercial banks as well as demand deposits at the central bank.

rate followed those in South Africa's prime lending rate that declined slightly from 11.5 per cent in 2003 to 11.0 per cent in 2004. In line with other rates in the economy, commercial banks' deposit rates fell, albeit marginally. The one year deposit rate was 6.0 per cent at the end of 2003, but declined to 4.0 per cent at the end of 2004, 80 basis points below inflation rate. Hence, real interest rates for commercial bank clients remained negative.

4.1.3 Financial Sector Development

During the year under review, developments in this sector included the introduction of Debit and Credit cards. This has been accepted by individuals and retailers alike. The number of shops that accept Debit Cards has increased rapidly. This is found to be the safer means of conducting business as there is less cash involved during transactions. Customers do not carry cash with them, while retailers have reduced amount of cash they keep in the stores.

This would pose a challenge in the area of Monetary Policy implementation for CBL. This innovation has a direct impact on Policy variables such as M2. For instance, currency outside the banking sector will decline with this technology gaining momentum. It will also affect reserve requirements through overdrafts and Banks' loans for credit card holders. Reserve requirements may have to be revised to cater for digital money balances.

4.2 Lesotho National Payment Modernisation Project

A safe and efficient payment infrastructure is vital to the financial stability of any economy. The returns on this, though not easily quantified, may be realised through avoidance of crises and improved capacity of a financial system to absorb shocks and to better handle financial distress. The payment infrastructure not only refers to payment system, but also covers the securities and foreign exchange settlement systems.

The CBL is committed to the reform and modernisation of the Lesotho payment system. The payment and settlement system forms the core of financial systems and economic activity.

The modernisation and reform process of the Lesotho National Payment System (LNPS) continued during the year under review. A decision was taken towards the end of last year that the LNPS Modernisation Project should solicit technical assistance for the business analysis and conceptual design phase. As a result, Bankserv consultants were engaged during the second half of the year. The assignment was carried out as a joint-venture with Perago Financial Systems Enablers.

The project scope covered the following main components:

- (a) Produce a high level architecture of the current payment and settlement system,
- (b) Produce a high level architecture of the envisaged payment and settlement system,
- (c) Identification of strategies to be followed to align the current payment and settlement system with the one envisaged,
- (d) Break-down of the strategies into implementable individual projects,
- (e) Break-down of the conceptual design into business specifications.

The consultants were mandated to draw on the Vision and Strategy Framework document produced by the LNPS Modernisation Project team and the Bank of International settlement (BIS) Core Principles for Systemically Important Systems.

The consultants' approach to the assignment was by way of scheduled workshops where participants were drawn from the CBL, commercial banks, the Ministry of Finance and Development Planning, Telecom Lesotho, Lesotho Telecoms Regulatory Authority, Lesotho Electricity Corporation, Lesotho Postal Services, and other stakeholders. The workshops followed this pattern:

- (a) Introduction of the subject matter
- (b) Information gathering by way of interviews and brainstorming sessions by participants and consultants
- (c) Documentation of deliberations and improvement of this by consultants, followed by documented comments by participants
- (d) Presentation of the report to the NPS Council
- (e) Adoption of the final report by the NPS Council

Subsequent to the workshops, the consultants prepared and submitted the following deliverables in terms of the Consultancy Agreement:

- (a) Review of the current payment system Report

In large part, this reaffirmed the findings of the Stocktaking and Situational Analysis previously carried out by the LNPS Project team. It covered participants in the system, trading instruments, the infrastructure, Central Bank operations, cash management, cheques and debit clearing, funds transfer processes, card and Automated Teller Machines (ATM) operations, Foreign Exchange operations, Common Monetary Area (CMA) and Cross Border transactions, and risks and risk controls.

- (b) Envisaged Payment System Report

This is the Strategic Framework document that forms the blue print of the payment system reform process. It covers the expanded vision statement, the high level conceptual design of the envisaged payment system, and the conceptual architecture. It also covers the high level business requirements, the stakeholders, role players and the NPS structure, together with the implementation strategies and projects, the implementation approach, and the high level implementation schedule.

(c) Business Process Model

This defines the end-to-end flow of payment instructions and depicts the integration of payment streams that will participate in the Lesotho NPS. It details functions of each payment stream and their part in the payment clearing and settlement process.

Based on the work of the consultants, the following are the main strategies that were identified:

- a) To make the strengthening of the domestic financial infrastructure top priority;
- b) To put in place a robust legal and regulatory framework to support the new payment system;
- c) To implement a Real-Time Gross Settlement (RTGS) system for large-value and time-critical payments;
- d) To implement a generic Automated Clearing House (ACH) for retail or low-value payments;
- e) Establish the Debit Card payment stream as the backbone of the future retail payment instruments;
- f) Address cross-border issues;
- g) Optimise traditional payment streams (e.g. cash and cheques)
- h) Deal with specific sector requirements (government payments, financial markets, the unbanked population) in a focused manner.

The rationale or philosophy that would be followed in the implementation of the strategies and projects is in line with the Pareto principle, that is, focus on the areas where it will have the most impact (early wins). It was decided to start with those payment reforms that give most benefit to the corporate clients and the economically active population, then move on to payment needs of the unbanked population.

A high-level project schedule was prepared and this outlines the various projects and estimates of the duration. The bulk of the reform process will kick-off in 2005, starting with the reform of the legal and regulatory framework. This will be followed

by the introduction of the RTGS system, then the Automated Clearing House. It is expected that by 2008 about 80% of the projects would have been implemented.

4.3 Capital Account Liberalisation

The gradual relaxation of exchange controls in the past few years has increased the threshold with which commercial banks could execute transactions on behalf of their clients without reference to the Central Bank. As a result, few applications were submitted for prior approval by the Central Bank in 2004. The total amount approved was M56.5 million covering repayments of loans, current and capital transfers and dividends. By local standards, this is still a significant amount.

The CBL embarked on the modernisation of the exchange control legislation so that it could be compliant with the obligations of Article VIII of the International Monetary Fund (IMF). This Article stipulates general obligations for members to refrain from imposing restrictions on making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without the IMF approval.

4.4 Anti-Money Laundering

The Finance and Law Ministers from nine countries in the Eastern and Southern Africa Region, on behalf of their Governments, agreed on the 27 August, 1999 at Arusha, Tanzania to establish the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG).

The group is governed by Ministers representing each of the member countries with the aim of combating the laundering of the proceeds of all serious crime. The ESAAMLG at Ministerial and Senior Officials Level, brings together representatives from legal, financial and Law enforcement sectors to ensure the development of comprehensive national and regional anti-money laundering strategy.

By agreeing to join the group, participating Governments resolved individually and collectively,

- To work towards the highest international standards in the fight against the laundering of the proceeds of those crimes referred to in relevant multilateral agreements and initiatives which deal with combating serious crime and to implement 40 + 9 Recommendations of the Financial Action Task Force in the fight against money laundering and financing of terrorism.
- To institute an evaluation process, including mutual evaluation, to assess the measure in place in each member state and their effectiveness, and to identify the gap between existing measures and endorsed standards.

As the member, Lesotho was evaluated by the ESAAMLG evaluators during the months of June and July, 2004.

The purpose of the assessment was to ascertain whether Lesotho complied with the international standards in the fight against money laundering and the financing of terrorism. The assessment was successfully completed and the country awaits the mutual evaluation report.

The draft Money Laundering and the Proceeds of Crime Bill which is still under review by the relevant ministries will be tabled to Parliament before the end of 2005.

4.5 Deposit Insurance Scheme

Having agreed with CBL and other stakeholders that there was a need to establish a deposit insurance scheme in Lesotho, CBL, through its Supervision Department, embarked on a number of study tours to countries that have established well functioning schemes in the region.

As earlier reported in 2003, it became apparent from the initial tours to the Deposit Insurance Schemes in Kenya and Tanzania that further studies were necessary, and two more countries, Nigeria and the Philippines, were visited. These study tours were undertaken by Task Team formulated to oversee all the activities relating to the proposal to establish the scheme in Lesotho. The tours afforded members of the Task

Team more exposure in the subject matter and enabled them to make a comparative analysis.

Subsequent to these visits, the management of CBL gave the Task Team a go ahead to proceed to the next stage of the assignment, which involved preparation of the blueprint on the establishment of the deposit insurance scheme in Lesotho. This resulted in a Draft Blueprint being produced.

The Blueprint has identified the essential characteristics of an effective deposit insurance scheme that will promote public confidence and contribute to financial stability. The proposed features of the scheme include an explicit, clear, well-publicised framework, mandatory participation, limited coverage and the ability of the deposit insurer to access necessary resources. Also critical is a robust information-exchange arrangement among all participants in the financial safety-net. If the scheme will be finally approved by all the relevant authorities, it is envisaged that it will serve its primary purpose of protecting small, unsophisticated depositors, in order to enhance the process of financial system stability, prevent bank runs, and promote public confidence in the banking sector of the Lesotho.

4.6 Creation of Insurance Supervision Division

Insurance Supervision Division (ISD) was created in January 2004 with the purpose of supervising the insurance industry in Lesotho. Upon creation, the Division was responsible for supervising six insurance companies, eleven insurance brokers and 73 insurance agents. The Division performed both on-site and off-site supervision of the licensed insurance companies.

4.7 Basel II

In June 2004, the Basel Committee on Banking Supervision issued a revised framework for capital measurement and capital standards for banks. This new capital

accord, generally referred to as Basel II, is to be implemented in the G10² countries by the end of 2006. The adoption of Basel II is not mandatory outside the G10 countries. However, supervisory authorities worldwide are encouraged to adopt the revised framework at such time as they believe is consistent with their broader supervisory priorities. It is therefore appropriate for each jurisdiction to carefully consider the benefits of the revised framework in the context of its domestic banking system. Furthermore, each jurisdiction has to decide on whether or not to embrace the new accord, and to consider the timetable and approach to implementation.

Taking cognizance of this situation CBL, established a task team of stakeholders to evaluate the suitability of the new framework for banks in Lesotho and to plan for the transition to the New Accord if it is to be adopted. The task team consists of CBL, banks and firms of accountants operating in Lesotho. The team started its work with CBL providing an overview of both Basel I and Basel II Accords so as to bring all the members to the same level of appreciation.

In order to be able to give appropriate advice to the CBL, the team has to deepen its understanding of the new Accord. The team is faced with a mammoth task of thoroughly examining each of the three pillars of the Accord, namely, Minimum Capital Requirements, Supervisory Review Process and Market Discipline. While the staff of CBL is expected to provide training, all efforts will be made to invite experts to conduct seminars for the team in 2005. Benefits are also expected to be derived from experiences of different commercial banks operating in Lesotho, emanating from preparations embarked upon by their parent banks in South Africa. South Africa has already opted to embrace the Accord and understandably, the subsidiaries of South African banks in Lesotho will have to comply with the new requirements because the Accord applies on a consolidated basis. Obviously the year 2005 should be quite a busy year for the team.

² Group of Ten Countries consists of Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States of America.

4.8 Cross-Border Foreign Exchange Transactions Reporting System Project

In an effort to improve the liberalisation process towards the removal of exchange controls, the CBL took the initiative to join other Common Monetary Area (CMA) member countries in the launching of Cross Border Foreign Exchange Transactions new Reporting System Project. The purpose of the Project is to introduce comprehensive data capturing of the inflows and outflows of information outside the boundaries of Lesotho.

The new Balance of Payments Reporting System will replace the Forms A and E and will require the reporting of all cross-border customer transactions irrespective of the monetary value.

According to the plan, the Project is envisaged to be completed within 332 days commencing on 3 March 2004. There were several visits to Lesotho by the South African Reserve Bank (SARB) Team which assisted in the introduction and installation of the Reporting System. During the visits undertaken in 2004, several issues were considered such as the Business and Technical Specification, and Operations Manual to be used by the banks. These documents were discussed, comments incorporated and documents finalised. The Project is on-going.

The Project was launched early in March 2004 and was projected to be completed by August 2005.

PART V CHALLENGES IN SUPERVISION

5.1 Challenges Relating to Insurance

5.1.1 Compliance with the Minimum Local Assets Requirement

During the reporting period, CBL was approached by one of the insurance companies licensed and operating in Lesotho regarding their compliance with the Minimum Local Assets Requirements (MLAR). It was brought to the attention of CBL that,

although this insurance company had already invested heavily in the local markets, its investments still did not meet the MLAR. The rationale behind the MLAR is to ensure that the insurance companies are liquid enough to meet their claims as and when they arise.

In terms of section 64 (c) of the Insurance Act 1976, the Minister of Finance and Development Planning is vested with the power to make regulations regarding the manner of investing the assets of an insurer in approved securities and otherwise, and the method of valuation of these assets. Pursuant to this section, the Minister promulgated the Insurance Regulations 1985.

Regulation 7 of the Insurance Regulations 1985 deals with investment relating to life insurance business for purposes of meeting the MLAR as required under section 29 of the Insurance Act. The Regulation makes it mandatory for an insurer to keep, at all times invested in Lesotho, assets in amounts having a total market value of not less than 30 per cent of the actuarial valuation of the liabilities under policies issued by such an insurer. Regulation 8, on the other hand, provides for investment of assets in Lesotho relating to general insurance business in accordance with the manner prescribed by the Regulations. Unlike Regulation 7, Regulation 8 further gives the Commissioner a discretionary power to authorise variation regarding the manner of investment.

Although the insurer in question has already invested quite substantially in the local markets, its investments still do not satisfy the 30 per cent MLAR due to the undeveloped financial sector in Lesotho. If the insurance company was to increase its investments to meet the MLAR, it would have been faced with the problem of over exposure and over concentration. This move would not have been in line with the following investment principles, which the insurers should take cognisance of:

- a) as a general rule, assurance contracts are long term in nature, and the underlying assets investment mechanisms should reflect this term;

- b) sound risk management practices require the investor to match the nature of the assets to the nature of the liabilities;
- c) the risks inherent in investing the assets should be well spread by adopting a diversified approach and avoid undue concentration in any particular asset class.

In light of the above discussions, CBL was bound to recommend to the Minister the amendment of Regulation 7 of the Insurance Regulations 1985 so as to reduce the MLAR from the prescribed 30% to 10%. Consequently, a recommendation regarding the proposed amendment was made to the Minister for his consideration. If the amendment would be approved and effected, it would enable the insurers to meet the requirement. In the meantime, efforts are being made to put in place further suitable direct investment opportunities including creation of a capital market for long-term borrowings which the CBL is pursuing vigorously.

PART VI FINANCIAL INTERMEDIATION INITIATIVES

6.1 Development Finance

CBL continued to administer the Export Development Fund (which provides back up support to the Export Finance and Insurance Scheme).

6.1.1 Export Finance and Insurance Scheme

During the year under review, three garment exporting companies were guaranteed to the tune of M2.5 million each and all three were on schedule with repayments.

CBL undertook publicity campaigns to promote the Scheme during the year under review and the following were discovered:

- most of the indigenous entrepreneurs were in garment manufacturing,
- handicraft producers were the most potential exporters,
- most of the indigenous entrepreneurs were concerned with the minimum loan requirement of M50,000 and requested that it be lowered as their working capital requirements were below M50,000.

CBL is working closely with the Ministry of Trade and Industry, Cooperatives and Marketing to encourage local entrepreneurs to pool their resources by forming cooperatives and to strengthen the existing cooperatives.

6.2 Developments in Micro Finance

Micro-finance in Lesotho is one of the most important avenues of poverty alleviation. However, lack of adequate extension of financial services by the formal banking sector inhibits growth of the sector. The formal banking sector has over the years perceived the informal sector as risky and not commercially viable. There are, however, numerous constraints facing this sector and these impinge on limited outreach, limited access to funds, unhealthy competition and lack of performance standards.

In an effort to enhance the sector's performance and perhaps facilitate service delivery, CBL took a policy decision to promote financial intermediation to rural communities in the country. The policy took advantage of the existing informal financial sector in the form of Rural Savings and Credit Groups (RSCGs). These RSCGs have attempted to close the existing financial gap between the formal banking sector and the informal sector by improvising their own sources of funds through savings mobilisation. This gap has been met through micro-finance arrangements of savings before credit in conjunction with the application of simple technologies to deliver financial services to the rural poor.

The objective of this policy is to encourage rural sector borrowing from the formal banking sector with the view to raise incomes and living standards of the rural communities. In order to achieve this objective, the following strategies apply:

- Use of RSCGs as channels of credit to the rural people. The advantage of this is to bring about a reduction in both covariant risk and transactions costs for the formal banking sector. For effective implementation of this strategy, these groups have to undergo

formalisation by way of registration under the Societies Act of 1966 as amended.

- Following this formalisation, the groups are then linked with the banking sector under a linkage-banking programme.
- Training of the groups in following proper business practices, supervision of member income generating activities with emphasis on basic bookkeeping and accounting.

During the year under review, CBL endeavoured to empower rural communities to engage in self sustaining economic activities through the following:

- Public Awareness Campaigns

The public was sensitised about the operation of the Rural Financial Intermediation Policy in the country. Electronic media was used to facilitate information dissemination. For a better countrywide outreach, the local newspapers and public gatherings were used.

- Credit Guarantee Fund (CGF) Investment Criteria

An investment criteria for the CGF account was drafted. The criteria explored possible means for earning good returns on the Fund. This was prompted by the need to grow the Fund and provide financial back up in capacity building.

- Invitation to bid for RSCGs' training

Training of RSCGs is a pre-requisite to entry into the Rural Savings and Credit scheme. In an effort to satisfy this condition, indigenous and international Non Governmental Organisations (NGOs) were requested to bid for groups' training. In order to meet this requirement, NGOs were asked to submit profiles indicating amongst others, financial track record, a proper system of bookkeeping, basic financial management capability and approach in promoting and working with groups. The above criteria was

used in the selection process. Submission of profiles and analysis thereof was duly done during the period under review.

- Drafting of the Memorandum of Understanding (MoU) between the CBL and Non Governmental Organisations (NGOs).

A contractual agreement between CBL and NGOs specifying terms and conditions for RSCGs' training was drafted during the period. The copy was dispatched to contracting parties for their comments.

- RSCGs Steering Committee Familiarisation Visits

As a means of facilitating appreciation of group activities for self sustainance, members of the Steering Committee undertook exposure visits to both southern and northern districts of Lesotho.

- Sesotho Version of the Blueprint for RSCGs

During the year under review, the first draft of the Blueprint was translated into Sesotho after a public outcry for a Sesotho version. The document is currently under consideration.

- Micro-finance Reference Group

Sustainability of services to the poor and improvement of the livelihood for the microfinance sector have been issues of major concern. Ways and means of addressing these concerns were imperative and, as a result, a Micro-finance Reference Group that identified issues crucial to the sector was formed during the period. CBL was a member of that group whose main task was to devise strategies for improving financial services for the poor and vulnerable communities.

- Executive Committee Meeting of the African Rural and Agricultural Credit Association (AFRACA). CBL hosted the 14th General Assembly of AFRACA in November 2004.

6.3 Credit Bureau

Following approval by the Stakeholders Committee, Gemini Professional Services was awarded a tender to engage in an educational public campaign on the establishment of a credit bureau in Lesotho. The overall objectives of the campaign were:

- a) to sensitise and educate the public about the necessity, nature, functions and the benefits of a credit bureau; and
- b) to enhance the public's positive perceptions by way of sensitisation about the rights and obligations of the credit bureau.

The campaign was scheduled to run over a period of three to four months, which commenced in August 2004. It was funded by members of the Stakeholders Committee.

The campaign was carried out through media conferences, print media as well as holding the radio talk shows and television interviews. The presentations were made, among other groups, to the academics, media practitioners, government officials, diplomatic corps, commercial umbrella bodies and independent companies, National Security Services and the Lesotho Association of Teachers.

Most people were in favour of the establishment of the credit bureau. However, a number of challenges were faced during the campaign, which had a negative impact on its success. Among others, bureaucratic procedures regarding holding of meetings and rallies were found to be the main problem, which caused unnecessary delays. As a result of these impediments, the campaign was not completed within the set timeframe, and was extended from November 2004 to March 2005. The other challenge that came about was the negative response shown by some individuals on the idea of establishing a credit bureau in Lesotho. This was caused mainly by lack of understanding of the operations of the credit bureau and bad experiences encountered elsewhere relating to the credit bureau.

Earlier in the reporting year, Guidelines for the Credit Reporting Agencies in Lesotho were drafted by the Ministry of Industry, Trade and Marketing in collaboration with the CBL. The Guidelines were made in terms of the powers vested in the Trading Enterprises Board by Section 4 (1) (f) of the Trading Enterprises Order of 1993. The Guidelines were intended to achieve the following:

- a) to lay out the criteria to be met by companies wishing to carry out credit reporting business in Lesotho; and
- b) to generally provide for the conduct of credit reporting agencies in Lesotho in a manner that protects the interests of consumers and yet contributes to the improvement of credit allocation and credit decisions.

The Guidelines were approved by the Trading Enterprises Board of the Ministry of Industry, Trade and Marketing in April 2004.

Following the approval of the Guidelines, one application for a credit reporting agency was approved, and the company was issued a licence by the Licensing Board of the Ministry of Industry, Trade and Marketing in June 2004. The company was expected to commence its operations in September 2004. This company was also appointed by the CBL to act as its agent under the Agency Agreement. In terms of this Agreement, the company was mandated to act on behalf of the CBL to collect data from the banks as the law only allows the CBL to collect such financial information.

However, at the time the company was expected to start operating, it applied for deregistration of its licence. As a result, the signing of the Agency Agreement also did not take place. Despite all these problems, the educational campaign continued, as some other companies continued to express interest in operating a credit bureau and submitted their application to the Ministry of Trade.

6.4 Commercial Court

Following successful participation in the Trial Advocacy Course which was held in October 2003, it was believed that the course had made a difference and, as a result, there has been some tremendous progress in the operations of the Commercial Court. The objective of the Course was not only to provide some guidelines but also to serve as an incentive to the commercial lawyers with regard to their enthusiasm in handling the commercial cases.

However, the court system is still suffering from severe and increasing load which often results in cases being delayed by a year or more between the completion of pleadings and the hearing on the case. The operations of the Court seem to have been hampered by administrative and technical rigidities, which disabled the Court to expedite adjudication of cases arising from transactions of a commercial nature such as banking and finance including small business loans, suretyship, insurance, negotiable instruments, international trade and credit. This had resulted in banks in Lesotho having shown their dissatisfaction with the performance of the Court. They had raised their concern several times that they are still suffering from severe and increasing delays in cases lodged with the Commercial Court.

CBL, in its endeavour to assist the banks in finding a solution to the problem of delays, had been holding a number of meetings with the officials of the Commercial Court. It transpired from these meetings that, although the judiciary has the necessary infrastructural set up and other logistical means to successfully implement this decision, the Court has a number of major impediments, which hampers its performance. The following major setbacks facing the Court had been identified:

(a) Section 11 (2) of the High Court Act 1978

One of the major problems encountered by the Commercial Court is the policy of the High Court of Lesotho provided in section 11 (2) of the High Court Act 1978. The section gives priority to the criminal cases over all other cases. Accordingly, the largest numbers of cases adjudicated by the High Court of Lesotho are criminal cases. The result of this is that the High Court ends up dealing with more cases that are not of a complex

character as it should. This therefore defeats the expectation and objective of the High Court to deal with very complex matters whether criminal or civil. The ultimate result is that, the policy has a negative impact on the Commercial Court as the Court is part of the High Court and its assigned Judge still presides over cases adjudicated at the High Court.

(b) Court Procedures

Another impediment came about after the introduction of the Commercial Court Rules which lay the procedures for the Court. Orientation to the new system turned out to be problematic as the legal practitioners had shown some resistance to the new procedures. As a result, reluctance of practitioners to transfer cases into the commercial cases register was highly notable. This problem was compounded by lack of expertise on the part of the registrars who were unable to identify cases that should be enrolled into the commercial cases register. Consequently, less than one percent (1%) of the commercial cases was posted in the commercial cases register because of improper selection of registers.

Notably, this was defeating the rationale behind the establishment of the Commercial Court, which was clearly a step towards promoting financial stability and encouraging private sector lending in the country.

In consequence of the foregoing difficulties, and in order to underpin and accelerate the performance of the Commercial Court and the orderly development of the private sector in Lesotho, the High Court of Lesotho, with the support of the CBL, undertook a number of initiatives to assist the Commercial Court. The initiatives included, among others, proposal to tap experiences through attachment/exposure programmes at the commercial courts, which are at an advanced stage and performing well, during the course of next year.

It is believed that the proposed study tours will equip the nominees with the knowledge on how to address the foregoing impediments encountered by the Commercial Court of Lesotho, with a view to ensuring that it operates efficiently and effectively. This move would be beneficial to the financial sector as the improvement

of the performance of the Commercial Court is directly linked and perfectly timed with the current efforts to strengthen the financial system. With regard to the commercial banks and other financial institutions giving credit, maximizing the performance of the Commercial Court would assist them by instilling credit discipline on the borrowing public by applying swift justice to the bad debtors.

PART VII REGULATORY AND POLICY DEVELOPMENTS

7.1 Insurance Sector Reform Project

Following approval of CBL of the deliverables submitted by FIRST Initiative Consultants under Phase 1 of the Lesotho Insurance Sector Reform Project, the Consultants had been given a go-ahead to proceed to the Phase 2 of the Project. Phase 2 mainly involves the drafting of the new insurance legislation while Phase 1 involved development of a policy framework for the industry and legislative style, including review of existing legislation and functioning of the industry. It also included the development of a detailed work plan for subsequent phases of the technical assistance.

Phase 2 of the Project involves the following three main activities:

- a) Drafting of enabling legislation and regulations. This stage would entail preparation of the initial legislative drafts and regulations for presentation to CBL and to Government, particularly the Office of the Attorney General and the Office of the Parliamentary Counsel.
- b) In the second stage, the Consultants would hold a workshop with the main participants in the insurance sector and, with the CBL Supervision Department and relevant Government's Ministries staff to solicit their inputs before submitting the final draft.
- c) Lastly, it would be the drafting of the Codes of Practice which would include market integrity. The Codes would cover topics such as selling methods and corporate governance.

However, due to unavoidable delays encountered during the reporting period, out of three activities listed above, the Consultants were only able to come up with the first Draft Insurance Bill which was considered by CBL and inputs were made. CBL and

the Consultants would be meeting early next year to discuss the Draft Bill in preparation for the stakeholders' workshop.

7.2 Financial Institutions Act 1999

As mentioned in the previous Supervision Annual Report, one of the core functions of the Supervision Department is to ensure that the legal and regulatory framework for the financial sector is relevant and up to date to cope with developments in the market. To deliver on this mandate the Supervision Department has to review laws governing the financial sector on an on-going basis and making amendments to them if necessary.

In the year under review, the CBL took significant supervisory and regulatory decisions which necessitated the review of the Financial Institutions Act 1999 (FIA) and legislation impacting on CBL's jurisdiction. In line with developments in the banking sub-sector, Regulations governing supervision of foreign branches and mergers were drafted and submitted for tabling before Parliament.

7.2.1 Amendments to the Financial Institutions Act 1999

Following a decision taken by the CBL to expand and make banking services accessible, the Department undertook extensive research into alternative financial service providers. To execute this decision the Department began by developing a working paper with the aim of designing a strategy of accommodating the desired changes in the financial sector within the Financial Institutions Act (FIA). The working paper will focus on the justification for the amendments and rationale behind the minimum capital prescribed by the FIA. The aim of the amendments can be summarised as follows:

1. Insertion of certain provisions into the FIA to allow lower tiers of financial institutions.
Amendment of Section 8 of the FIA to accommodate lower tiers of financial institutions.
2. Amendment of Section 25 of the FIA to clarify and reflect the existing practices.

3. Insert provisions that will grant the Commissioner increased powers in the event of liquidation of banks.
4. Insert definitions of some provisions and amend the existing certain definitions.

The amendments will be drafted after adoption of the working paper by Financial Institutions Supervision Technical Committee (FISTC). It is expected that the draft amendments will be passed into law during the course of next year.

7.2.2 Regulations made under the Financial Institutions Act 1999

(i) *Financial Institutions (Merger and Transfer of Assets and Liabilities) Regulations.*

Although these Regulations were not passed during the year under review, the Department drafted and submitted them to the Parliamentary Counsel. It is expected that they will take effect in the first half of next year for final scrutiny and gazzettal.

These Regulations were made under Sections 18 (4) and 71 of the FIA. The Regulations provide a framework for mergers and transfer of assets and liabilities of financial institutions. The Regulations promote competition and ensure that no merger or transfer will hamper competition in the market. The draft contains important provisions on monopoly, cartels and uncompetitive acts.

(ii) *Financial Institutions (Conditions for the Conduct of the Business of a Bank by a Foreign Institution by means of a Branch in Lesotho) Regulations*

These Regulations were drafted and submitted to the office of Parliamentary Counsel for perusal and comments. It is also expected that the Regulations will become effective in the coming year.

The Regulations contain important regulatory provisions on licensing and prudential regulation of a foreign branch. They also stipulate additional requirement of an undertaking by the parent guaranteeing the financial soundness

of the branch. In addition to providing the framework for conduct of banking business by a foreign branch, the Regulations aim to minimize the risks attaching to supervision of a foreign branch.

7.3 Foreign Financial Transactions Bill

Following liberalisation of the capital account transactions in Lesotho, the Exchange Control Act No.11 of 1987 became obsolete and hence there is need for review. Liberalisation has reduced most of restrictions. The Act in its present form retains restrictions, on both current and capital account transactions.

The Act did not have provisions on reporting system on cross-border transactions which is one of the integral parts of liberalisation. The Legal Sub-Committee developed the draft of the Foreign Financial Transactions Bill (FFTB) which standardised foreign exchange trade.

The purpose of the new exchange control legislation was to move away from the old prohibitive regulatory framework. The characteristics of the new law include, among others, a user friendly instrument that would portray Lesotho as a destination for foreign direct investment and other capital inflows.

7.4 Vision Paper

Following the adoption of the Vision Paper by the CBL, the Department submitted it to the Minister of Finance and Development Planning for onward transmission to Cabinet. Cabinet is expected to approve the Vision Paper working document. After Cabinet's approval, the CBL will begin to implement the Vision Paper.

7.5 Legislation Impacting on the Financial Sector

As the CBL identified a need to amend all legislation in its custody, it also noted the necessity for the laws impacting on the financial sector to be upgraded and those not in existence to be enacted. The CBL identified the following laws and recommended that they be upgraded or enacted in line with the developments in the financial sector:

- ***Consumer Protection Law/Finance Charges Act*** - There is no law in Lesotho, which governs finance charges and interest rates levelled on contracts of credit sales. This lack of control has led to sellers becoming some sort of loan sharks and charging unconscionable rates. Consumers of goods are not protected against these unscrupulous practices. It was recommended that the law, which governs finance charges, be passed to offer protection to credit consumers. Normally the custodian of such a law is the Ministry of Finance but the input of the Central Bank is vital as the range set for the finance charges is based on the country's economic performance.
- ***Data Protection Law*** - The Central Bank as the regulator of financial institutions and the country's monetary policy collects information for its own use and public consumption. The information collected may refer to the institutions or individuals. The use of such information is important and must be controlled as it can expose the CBL to litigation. We recommended that a statute on the use and protection of data be passed for the CBL and other Government Agencies involved with information collection. This law should strike a balance between freedom of expression and true information that might be detrimental to the public interest.
- ***Hire-Purchase Act 1974(as amended)*** - The problem presented by the obsolescence of this Act is its failure to stimulate the development of credit instalment institutions. We recommended a total overhaul of the HP Act. The Act must be repealed and replaced with a credit instalment statute, which would embrace all forms of credit sale financing.
- ***Societies Act 1966*** - The CBL has instituted a programme of linkage banking. The programme is designed to link Rural Savings and Credit Groups (RSCGs) with commercial banks to enable them to access banking services. Most of these groups are registered and governed under this Act. The groups have bankable projects that require credit funding but due to their informal and loose constitutional structure, they are unable to access bank credit. In year 2000, this Act was amended to allow these groups to make and declare profit

in an effort to make them appealing to banks. However, the banks require more formality from the RSCGs than afforded under the Act. For instance the groups are communal owned, and banks are sceptical about structures that lack proprietorial commitment. We recommended that the revision of the Act with the objective of giving the groups a proprietorial composition would facilitate the linkage programme started by the CBL.

- ***Companies Act 1967***- This Act prescribes incorporation and registration requirements for the companies. It also permits a company to have different, unrelated and distinct objects. This prescription had presented practical problems to the Central Bank as different objects are licensed by different Government Agencies. This gives rise to an opportunity to evade the Bank's regulatory net by being licensed by a different agency for one object and carrying out other registered objects (including those that are supposed to be licensed by the Bank) under the same licence. Another problem is that, it would be difficult for the Bank to monitor progression of some institutions into its regulatory net, if the development of such institutions was disorderly and not organised. We recommended that the Companies Act be amended to allow only one main object, with ancillary ones. It is also recommended that the Act should have separate provisions for the treatment of a 'holding company', with numerous diverse objects. These provisions must take into account the differentials between ordinary companies and holding companies. The amendment will make supervision of companies by relevant authorities relatively easy and will reduce the problem of regulatory arbitrage already alluded to.
- ***Stamp Duties Act 1966*** - The Act governs, amongst others, the stamp duty levied on public documents dealing with property rights. In a country like Lesotho where the bulk of the population does not possess liquid assets, property is used as bank collateral for mobilization of capital or finance. The stamp duty on public documents was increased by 100% in 2000. This increase was excessive on the deeds of mortgage and transfer, which were already high at 1% and 1.5% of the deed amounts, respectively. The increase

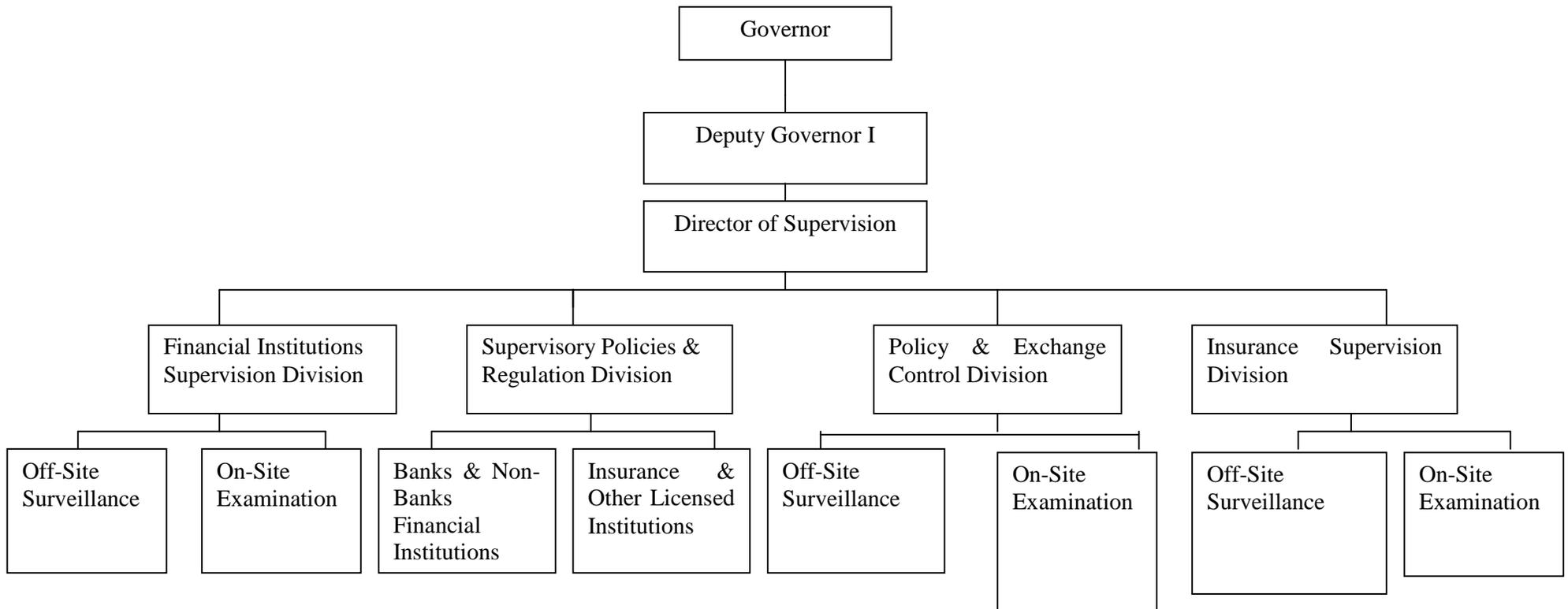
has also made bank finance very expensive and unaffordable. Banks have to comply with the lending requirements under the FIA 1999 and insist on collateral in advance of the credit granted. We recommended a review of this law, which would take into account different categories of public documents and have them properly evaluated for tax. This would increase Government revenue and promote financial intermediation.

- ***Insolvency Proclamation 1957*** – the Proclamation provides the framework for dealing with the sequestration of individuals, while liquidation of companies is governed by the Companies Act. However where the Companies Act is silent on some aspects of insolvency, the provisions of the Proclamation apply mutatis mutandis to companies. The Proclamation is obsolete and irrelevant to the developments in the financial sector. We recommended that the statute be overhauled to take into account developments in the financial sector.
- ***Pensions (Administration of Pension Funds) Law*** - Lesotho has no law on administration of pension funds, retirement funds or other employee benefits. Such benefits invested with an insurance company are treated just like ordinary funds of the company. There is no law, which sets minimum criteria, procedures for administration and winding up. We recommended that Government should pass the law that would govern administration of pension funds and other employee benefits.
- ***Competition Law*** - Lesotho has no law on competition and as a free market economy requires a law that maintains and promotes competition among traders and consumers. Since controls are abolished in every aspect of trading and Government intervention in trade is minimal, it is imperative that monopolistic practices are outlawed by an act of Parliament. We recommended that the law of competition, which will embrace two distinguishable legal spheres, namely, the law of maintenance and promotion of competition and the law of unlawful competition be passed.

(v) Amendments to the Cooperative Societies Act 2000

Efforts by the Banks to move forward the amendments bore fruit during the year under review. The Ministry of Trade, Industry, Cooperatives and Marketing which is the custodian of the Cooperatives Societies Act 2000, specially assigned the Ministry's senior Legal Officer to oversee the passing of the amendments. At the end of the year the draft amendments had left the Ministry and submitted to the Parliamentary Counsel for preparation to be tabled before Parliament.

**SUPERVISION DEPARTMENT
ORGANISATIONAL STRUCTURE**



Appendix 2

LIST OF LICENSED BANKS IN LESOTHO AS AT 31 DECEMBER 2004

NAME OF INSTITUTION	NAME AND TITLE OF CHIEF EXECUTIVE	POSTAL ADDRESS	TELEPHONE/ FAX	BRANCH NETWORK
1. Lesotho Bank (1999) Ltd	Mr. C. Addis Managing Director	P. O. Box 1053 Maseru 100	(+266) 22315737 (+266) 22310268	14
2. Nedbank (Lesotho) Ltd	Mr. K. Reid Managing Director	P. O. Box 1001 Maseru 100	(+266) 22312696 (+266) 22310025	3
3. Standard Bank Lesotho Ltd	Mr. T. Mosala Executive Director	P. O. Box 115 Maseru 100	(+266) 22312423 (+266) 22310025	5
4. Lesotho Bank (Under Liquidation)	Liquidators – KPMG Harley & Morris Joint-Venture Represented by A. S. McAlpine & S. C. Harley	P. O. Box 775 Maseru 100	(+266) 22313840 (+266) 22310076	0
5. First National Bank Branch in Lesotho	Mr. R. Hudson Chief Executive Officer	P. O. Box 11902 Maseru 100	(+266) 22222200 (+266) 22222222	0
6. Lesotho Post Bank	Mr. M. Vumbukani Chief Executive	Private Bag A121 Maseru 100	(+266) 22317842 (+266) 22317832	0

Appendix 3

LIST OF LICENSED INSURANCE COMPANIES IN LESOTHO AS AT 31ST DECEMBER 2004

NAME OF INSURANCE COMPANY	NAME AND TITLE OF CHIEF EXECUTIVE	POSTAL ADDRESS	TELEPHONE/ FAX	AGENT	BRANCH NETWORK
1. Lesotho National General Company	Mr. R. Letsoela General Manager	Private Bag A65 Maseru 100	(+266) 22313031 (+266) 22310008	S 50	2
2. Lesotho National Life Assurance Company	Mr. R. Letsoela General Manager	Private Bag A65 Maseru 100	(+266) 22314144 (+266) 22310008	29	2
3. Alliance Insurance Company Ltd	Mr. J. Pienaar Managing Director	P. O. Box 01118 Maseru 100	(+266) 22312357 (+266) 22311381	8	0
4. Metropolitan Lesotho Ltd	Mr. T. Mphahlele Managing Director	P. O. Box 645 Maseru 100	(+266) 22323970 (+266) 22317126	112	3
5. Customer Protection Insurance Company	Mr. J. Dritz Managing Director	P. O. Box 201 Maseru 100	(+266) 22312643	0	0
6. Sentinel Insurance Ltd	Mr. T. McAlpine General Manager	P. O. Box 699 Maseru 100	(+266) 22327940/1	0	0

Appendix 4

LIST OF LICENSED INSURANCE BROKERS IN LESOTHO

AS AT 31 DECEMBER 2004

NAME OF INSURANCE BROKERS	NAME AND TITLE OF CHIEF EXECUTIVE	POSTAL ADDRESS	TELEPHONE/ FAX
1. AON Lesotho (Pty) Ltd	Mrs. L. Mohapelo Managing Director	P. O. Box 993 Maseru 100	(+266) 22313540 (+266) 22310033
2. Insurcare Brokers (Pty) Ltd	Mr. M. Mohasi Managing Director	P. O. Box 11007 Maseru 100	(+266) 22321973 (+266) 22310669
3. Lesotho Insurance Brokers (Pty) Ltd	Mr. V. Van Roselveldt Managing Director	P. O. Box 01052 Maseru 100	(+266) 22322060 (+266) 22325489
4. Maluti Insurance Brokers (Pty) Ltd	Mr. Andre Mentz Managing Director	P. O. Box 1515 Maseru 100	(+266) 22310557
5. Mammoth Insurance Brokers (Pty) Ltd	Mr. R. Theko Managing Director	P. O. Box 1659 Maseru 100	(+266) 22322380 (+266) 22310897
6. Prosperity Insurance Brokers (Pty) Ltd	Mr. S. Siimane Chief Executive Officer	P. O. Box 14173 Maseru 100	(+266) 58842861
7. Thebe Insurance Brokers (Pty) Ltd	Mr. D. Maling Managing Director	P/Bag A244 Maseru 100	(+266) 22313018 (+266) 22310513
8. Southway Insurance Brokers Lesotho (Pty) Ltd	Mr. A. Du Plessi Managing Director	P. O. Box 4564 Maseru 104	(+266) 62032037

9. DIB International (Pty) Ltd	Mr. D. du Randt Managing Director	P. O. Box 1517 Maseru 100	(+266) 22312576
10. ABC Insurance Brokers (Pty) Ltd	Mr. S. Makape Managing Director	P. O. Box 9036 Maseru 100	(+266) 22324061 (+266) 22310970
11. AON Consulting Lesotho (Pty) Ltd	Mrs. L. Mohapelo Managing Director	P. O. Box 993 Maseru 100	(+266) 22313540 (+266) 22310033

Appendix 5

LIST OF LICENSED MONEY LENDERS AS AT 31 DECEMBER 2004

1. V. T. Tlali	P. O. Box 942, Butha-Buthe 400
2. B. M. Ntsie	P. O. Box 118, Mokhotlong 500
3. Edu-Loan	P. O. Box 1932, Maseru 100
4. Financial Services Holding Lesotho Pty	P. O. Box 13371, Maseru 100
5. Afrisure Personal Loans Lesotho (Pty) Ltd	P. O. Box 9717, Maseru 100
6. T. Lekata	P. O. Box 132, Maseru 100
7. M. S. Koetje	P. O. Box 15, Ha Mamathe, Lesotho
8. A. M. Kome	P. O. Box 7699, Maseru 100
9. T. Motselekatse	P. O. Box 317, Maseru
10. Batho-Pele Financial Services (Pty) Ltd	P. O. Box 15715, Maseru
11. J. H. Kente	P. O. Box 108, Mophale's Hoek
12. Mokorotlo Financial Services (Pty) Ltd	P. O. Box 10286
13. T. Mojabela	P. O. Box 563, Butha-Buthe
14. P. Ntale	P. O. Box 859, Butha-Buthe 400
15. African Credit	Private Bag A432, Maseru
16. TCL Loans	P. O. Box 14367, Maseru
17. M. Panya	P. O. Box 599, Mafeteng 900
18. E. T. Mojabela	P. O. Box 1666, Maseru 100
19. M. Makoa	P. O. Box 705, Leribe
20. J. M. Motlallane	P. O. Box 10011, Maseru 100
21. Makhulong Financial Services	P. O. Box 14401, Maseru 100
22. Star Lion Gold Coin Investment	P. O. Box 12634, Maseru 100
23. Letsema Investment Holding (Pty) Ltd	P. O. Box 2470, Maseru 100
24. P. M. Props (Pty) Ltd	P. O. Box 928, Maseru 100