Report No. 14985-SWA

Swaziland
Financial Sector Study

May 15, 1996

Macroeconomics, Industry, Trade and Finance Division
Southern Africa Department

CURRENCY EQUIVALENT

Currency Unit = Swaziland lilangeni
plural = emalangeni (E)

	emalangeni per US dollar
1975	0.8696
1980	0.7454
1985	2.5575
1990	2.5628
1991	2.7427
1992	3.0534
1993	3.3979
1994	3.5435
1995	3.6475

ABBREVIATIONS

ACCOSA	African Confederation of Savings and Credit Cooperatives
ADB	African Development Bank
BA's	Banker's Acceptances
BMEP	Business Management Extension Program
BWAS	Business Women's Association of Swaziland
CBS	Central Bank of Swaziland
CCA	Canadian Cooperative Association
CMA	Common Monetary Area
CU	Credit Union
DBSA	Development Bank of Southern Africa
EU	European Union
FIAS	Foreign Investment Advisory Service
FSE	Federation of Swazi Employers
GDP	Gross Domestic Product
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
MB	Meridien Bank
MEPD	Ministry of Economic Planning and Development
MITC	Manzini Industrial Training Center
MOF	Ministry of Finance
MSMEs	Medium, Small and Micro-scale Enterprises
NBFI	Non-Bank Financial Institution
NCD	Negotiable Certificates of Deposit
NPF	National Provident Fund
OTC	Over the Counter
PEU	Public Enterprise Unit
PTC	Post and Telecommunications Corporation
SACCOs	Savings and Credit Cooperatives
SARB	South African Reserve Bank
SASCCO	Swaziland Association of Savings and Credit Cooperatives
SACU	Southern Africa Customs Union
SBS	Swaziland Building Society
SBGT	Swaziland Business Growth Trust
SCC	Swaziland Chamber of Commerce
SDSB	Swaziland Development and Savings Bank
SEB	Swaziland Electricity Board
SEDCO	Small Enterprise Development Company
SIDC	Swaziland Industrial Development Company Limited
SME	Small and Medium Enterprise
SNPF	Swaziland National Provident Fund
SRIC	Swaziland Royal Insurance Corporation
SSL	Swaziland Stockbrokers Limited
TA	Technical Assistance
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions

FISCAL YEAR

Government = April 1 to March 31

SWAZILAND

FINANCIAL SECTOR STUDY

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Important Note: The bulk of this report was drafted over the period up to November 1995. The authorities in Swaziland have meanwhile implemented (and continue to implement) many recommendations of the report. At the time of the final review with the Swazi authorities it was agreed to not up-date the report to reflect events which have taken place in the first half of 1996. Hence, this report only purports to reflect the situation in the financial sector up to November, 1995

PREFACE

This financial sector report was written at the request of the Swazi authorities. It was designed as a cooperative piece of work to be undertaken by representatives of the Government of Swaziland and the World Bank. An initial mission was made to Swaziland in June 1994 with a team from the World Bank consisting of Simon Bell (task manager), Melville Brown, Martha Rose, Carel Oosthuizen, and Robert Wieland. This mission worked closely with a Swazi team comprising Preston Mhlongo, Busi A. Dlamini and Neo Shabangu from the Central Bank of Swaziland; Nomaxhule Maphalala from the Ministry of Finance; Sindi Mabuza from the Ministry of Economic Planning and Development; Vakashile Simelane from the University of Swaziland; and Maxwell M. Dlamini from the Ministry of Agriculture and Cooperatives.

A second mission was undertaken in May/June 1995 to follow up on outstanding issues and to cover areas which had not been adequately addressed in the first version of the report. The World Bank team on this occasion was comprised of Simon Bell, Elizabeth Adu, Hasan Imam, Hennie van Greuning, David Wilton, and Melville Brown.

Swaziland faces a period of significant change in the 1990s. The pre-conditions for high growth which were present in the mid to late-1980s have now largely disappeared and/or have reversed themselves. Growth in the first half of the 1990s has been sluggish and there is growing concern about the ability of the Government to re-adjust to these changing economic realities. Political and economic changes in neighboring South Africa have been, in large part, the reason for these changes -- and the dynamic of a new South Africa will continue to play an important role in Swaziland's future development.

This report addresses the role that the financial sector has played, and can play in providing the necessary growth dynamic within the Swazi economy. The report argues for an even greater integration of the Swazi economy with that of South Africa -- so that the country can take the fullest advantage of its proximity to the largest economy in Sub-Saharan Africa. There is a need to develop financial structures and institutions within Swaziland which can support enhanced growth for the future, while simultaneously taking full advantage of the very sophisticated financial system which exists in next door South Africa.

However, the financial sector is only a service sector -- and it alone will not provide the pre-requisites for future growth in Swaziland. For this, the Swazi authorities will have to develop an enabling environment which is supportive of private sector led investment and growth. This will require investing in infrastructure -- both physical and legal -- while allowing the private sector to play a more active role in all aspects of the economy.

The World Bank would like to thank the authorities of the Central Bank of Swaziland, the Ministry of Finance, and the Ministry of Economic Planning for the collaborative approach, and the support, that they have provided in the production of this report. This work was undertaken within the Macro, Industry and Finance Division of the Southern Africa Department of the World Bank. Ataman Aksoy (AF1MI), Praful Patel (AF1CO1), and Katherine Marshall (AF1DR), are the two managing Division Chiefs and the Department Director, respectively. Gene Tidrick (AF1DR) is the Lead Economist in the Department. Hennie van Greuning (FSD) was the Lead Advisor and the Peer Reviewer was Sibongile Mdluli -- Head of the Research Department of the Central Bank of Swaziland -- while she was on attachment to the World Bank on a six month program.

EXECUTIVE SUMMARY

1. ***The Swaziland Economy.*** With a total national income in 1993 of slightly over US$1.0 billion and a per capita national income of around US$880, Swaziland is a small, middle income, African country. It is, however, dwarfed by its larger and much richer neighbor -- South Africa -- which has a national income more than a 100 times larger (around US$105.6 billion) and a 1993 per capita national income of US$2,980. Nonetheless, the two economies -- along with the economies of Lesotho, Namibia, and to a lesser extent, Botswana -- have been inextricably linked for most of this century by a common geography, the world's oldest customs union agreement, and a common monetary agreement.

2. Significant changes have taken place in the region over the past several years which will impact on the entire sub-region in many ways. Most importantly, both of Swaziland's neighbors, South Africa and Mozambique, have experienced dramatic political changes which will necessarily affect political and economic developments in Swaziland. In April 1994, the first all race elections were held in South Africa and President Mandela received a strong mandate to govern. The country has now lost its pariah status within the world economy and it is seeking to attract investment and stimulate growth while attempting to address the imbalances which resulted from the previous political regime. In October 1994, Mozambique concluded a two year transition from civil war and unrest to the first multi-party democratic elections, in a peaceful manner. The newly installed government has demonstrated a commitment to rebuilding its economy from the ravages of war and is seeking foreign investment and technical skills to assist in unlocking the potential wealth of that country.

3. Further afield, other countries in the region -- Malawi, Zambia, Zimbabwe, Botswana, Namibia, and others -- are undergoing political and economic change. Increasingly the emphasis is upon private sector led growth, and increasingly the governments of the sub-region are seeking to establish an appropriate enabling environment to support such growth.

4. To some extent, Swaziland stands out as a laggard within a region of intense change. Society remains anchored in traditional systems and the economy has not responded nimbly to the changing realities that the country now faces. Swaziland's ability to adapt and change will be severely tested over the remainder of the 1990s, as the other countries of the region evolve to meet the changing demands of investors and the private sector.

5. To some observers, Swaziland appears to be basking in the heady days of the mid to late 1980s when foreign investors (largely dis-investing from South Africa) came into the Swazi economy for the benefits that it offered, when growth was double digit, the government budget was running a significant surplus, and Swaziland looked like the optimal place to undertake business activities in support of a larger southern African market. The changing political map has, however, dramatically changed that formula for success. Today, Swaziland's biggest concern will be to retain the investors which disinvested from South Africa into Swaziland in the 1980s to avoid sanctions in that country; it will need to dramatically improve its physical and legal infrastructure so that it is more supportive of private sector led growth; and it will need to address the problems caused by an increasingly militant labor force at a time when low cost and highly productive labor markets in countries such as Mozambique are beginning to open up. In short, the Swazi economy is faced with the need to swiftly adapt, or alternatively, to increasingly lag in a rapidly changing sub-region.

6. Swaziland's economic problems are evident in the economic data which are emerging in the 1990s. Whereas growth averaged around 6 percent per annum during the 1980s, this has fallen to less than 2 percent per annum since 1991. With a population growth rate of 3.4 percent, the country is losing significant ground in terms of per capita national income. This slow down in growth has been accompanied by a reversal in the country's balance of payments position as current account surpluses moved into deficit in the 1990s. The Government's fiscal position has correspondingly been weakened by slower economic activity and the surpluses of the previous decade have made way for large and growing deficits in the 1990s. Although the Government's cash reserves will stand it in good stead for some years to come -- unless there is a radical adjustment in fiscal policy, and a better adaptation to the new realities of Swaziland, these surpluses will be rapidly exhausted with very little left to provide continued support.

7. Concerns for what this may mean for the future of the Swazi economy are so great that, in late 1994, the Government, with the assistance of the World Bank and the International Monetary Fund, prepared a Shadow Stabilization Program for the country.

8. Clearly, Swaziland should seek to achieve internal adjustment before it has an adjustment program determined for it within a severely distressed economic environment. Key objectives for the Government will be to ensure stable macroeconomic management and orderly industrial relations. It is only with these pre-conditions that the Government will be able to revive net investment on a sustainable basis which can in turn promote growth and generate employment and increase income levels.

9. ***The Structure of the Financial System.*** This report examines the role of the financial sector in supporting private sector led growth in the Swazi economy. Swaziland's financial sector is small, but relatively well diversified and developed. The system is regulated and supervised by the Central Bank of Swaziland -- albeit in a relatively deregulated and liberalized financial environment. There are four privately owned commercial banks -- two well established British based banks (Barclays Bank and Standard Chartered) and two newer South African banks (Stanbic Bank and First National Bank). These banks have operated efficiently and reasonably well although they have all suffered adversely from lending to a narrow corporate client base. During the 1990s, the Government has had to deal with the demise of both BCCI and Meridien Bank in Swaziland. The Swaziland Development and Savings Bank is a Government owned development/commercial bank which was recently taken over by the Central Bank because of its poor performance. The SDSB, however, stands out as the one poor performer within a relatively well functioning financial system. The activities of the banks are supplemented by the Swaziland Building Society and the Swaziland Industrial Development Company which provide term lending for mortgage finance and industrial development, respectively.

10. Increasingly the financial sector is dominated by the contractual savings institutions (see data provided in Annex Two on Flow of Funds) -- represented by the Swaziland National Provident Fund, the Public Service Pension Fund, the Royal Swaziland Insurance Corporation -- but most important of all -- the privately managed pension and provident funds. The sector also supports a small and relatively inactive Stockbroking company whose main involvement within the economy to date has been in selling debt issues of various large Swazi based enterprises. Lastly, the Savings and Credit Cooperatives are increasingly emerging as a dynamic, and important, component of the financial sector with the capacity to more appropriately meet the financing needs of the small and medium scale sector.

11. ***The Central Bank -- Monetary Policy.*** Monetary policy management in Swaziland is characterized by its historic relationship with South Africa under the terms of the Common Monetary Agreement. Under this agreement, and its predecessor the Rand Monetary Agreement, there is an unrestricted (and unrecorded) flow of funds for both current and capital transactions within the area (encompassing Lesotho and Namibia as well as Swaziland and South Africa). Although Swaziland issued its own currency (the lilangeni) from 1974, which has since its introduction circulated at par with the rand, the changes introduced into the agreement at that stage allowed for the Swazi authorities to de-link from the rand.

12. The operation of the CMA and the linking of the lilangeni with the rand (at par) has resulted in a loss of monetary policy independence for Swaziland. Swaziland cannot alter the national money supply or manage base money. With (effectively) a common currency, the money supply is controlled from South Africa. Although the rand is not legal tender in Swaziland, it circulates along side the lilangeni -- with approximately 25 percent of the notes in circulation at any one time being rand. This means that Swaziland has virtually no ability to manage its own money supply, nor to have an independent exchange rate policy (as long as the lilangeni remains at par with the rand). The strong trading links, supported by the Customs Union agreement, plus the sheer size of the South African economy, makes de-linking from the rand highly problematic for a small economy such as Swaziland. Experience in Botswana (an ex-member of the CMA and still a member of the SACU agreement) which does have significant foreign exchange reserves, has shown that even an extremely strong economy cannot move significantly away from the rand (appreciate against the rand) without impacting adversely on the development of the local industrial base.

13. The Central Bank of Swaziland has tried to ensure that the local commercial banks hold their surplus reserves in Swaziland rather than in South Africa -- although this has been complicated by the surplus liquidity of the Swazi banking system, the lack of investment outlets for the banks within Swaziland, and the higher interest rates on offer in South Africa. To help ensure that the surplus funds of the banks remain in Swaziland, the CBS has instituted a Minimum Local Asset Requirement (MLAR) which requires that the banks hold 95 percent of total liabilities in the form of domestic assets. However, the efficacy of this requirement is far from certain, and it appears that several of the banks meet month end reporting requirements to the central bank by redirecting funds back from South Africa into Swaziland on the last day of the month. It is even more important to note that the large contractual savings institutions, which have been growing much faster than the commercial banks and now appear to rival the banks in terms of total assets (see Table 3, Annex 2), have until recently invested a large share of their total assets outside of Swaziland in a reasonably uncontrolled manner (with some notable exceptions).

14. The Central Bank has also attempted to follow a slightly more independent interest rate policy from that of South Africa. Interest rates -- deposit and lending rates -- have been kept several percentage points below those in neighboring South Africa since the 1980s. The supposed rationale has been to reduce the cost of capital in Swaziland and thereby make investment there more attractive. One unfortunate side effect of this policy, however, has been to provide a conduit of cheap Swazi funds, through Swazi based subsidiaries, to their South African parents -- thereby, *de facto,* subsidizing South African investment. In addition, the higher deposit rates on offer in South Africa have provided a powerful incentive for businesses, individuals, and the banks, to invest any excess funds in South Africa rather than in Swaziland. The policy has also resulted in negative real lending and deposit rates in Swaziland over much of

the past decade, with all the perverse effects that negative rates of interest generate. Fortunately, the CBS has moved to narrow the differential between the level of interest rates in the two countries -- a policy which they should continue to pursued vigorously.

15. ***The Central Bank -- Banking Supervision.*** The supervision and regulation of the banking system in Swaziland are particularly important issues for several reasons. First, Swaziland now has an unfortunate history of two failed, foreign, commercial banking institutions -- BCCI and Meridien Bank -- resulting, in part, from inadequate supervision and monitoring of the operations of the commercial banking sector. Second, and possibly more important over the longer term, is the small size of the economy, the large and dominant nature of several agricultural and industrial enterprises, and the potential for the banking sector to experience systemic failure as a consequence of the failure of one or two of these large enterprises.

16. Swaziland has already experienced difficulties arising from high exposure by the entire system to a single client. In the most dramatic case in recent years, the defaulting borrower had been adversely impacted by changes in tariffs imposed on textiles by the South African Government -- under the SACU agreement. Hence, a totally external event resulted in a serious impact on every one of the commercial banks, as defaults led to loan reschedulings, resulting in poor financial performance by the banks. Indeed, the impact of this particular case went well beyond the commercial banks, touching several of the contractual savings institutions which also had an exposure to the company in question. The structure, size, and concentrated nature of Swaziland's economy, make the possibility of such systemic risk reappearing in the future, a very real possibility. Hence, adequate monitoring for systemic risk by the central bank's banking supervision authorities will be key to assisting the maintenance of a healthy financial system.

17. There is also an important need for the supervisors in Swaziland to have a clear legal mandate to supervise and regulate all financial institutions operating within the economy -- including both on-site and off-site inspections -- and to be able to enforce their powers. Current uncertainties need to be clarified, specifically with respect to the Swaziland Development and Savings Bank, and the central bank's supervisory authority needs to be extended to all financial institutions (insurance, contractual savings institutions and cooperatives) to allow for a more holistic and consistent philosophy of regulation within the country. Greater strength in supervision could also be attained by performing consolidated supervision in a more formal manner. Under these arrangements, the Swazi supervisory authorities could rely more on the supervisory role played by parent banks and home country supervisory authorities, and could focus more on stringent disclosure and very strong corporate governance requirements regarding the role of directors and management.

18. ***The Commercial Banking Sector.*** Despite the problems, indicated above, Swaziland has a relatively strong and well run commercial banking sector. The financial sector, with its close linkages to the South African economy and financial sector has, in fact, developed to a level of sophistication which is beyond the level expected in a country of Swaziland's per capita national income. The commercial banking sector, in turn, tends to serve the high end of the market -- with a large share of lending portfolios going to large, foreign (albeit Swazi based) enterprises. Sensitive to the criticisms that they have encountered, the commercial banks have made an effort to interact more with a "Swazi" market.

19. Structurally, the four foreign owned commercial banks are sound with adequate, if minimal, levels of capital and conservative loan to deposit ratios (in some banks). The banks have been fairly liquid for some years. Although this has prompted calls for the banks to lend more aggressively into the Swazi economy, it is crucial that the commercial banks not be coerced into making inappropriate, and high risk lending decisions. The recent experiences with bad loans has already amply demonstrated the adverse consequences that lending decisions may have on the financial performance of a bank.

20. The contraction of the economy in the 1990s is reflected strongly in both the growth and the relative health of the commercial banks operating there. Over the past four years, for example, total assets, loans and advances, and total deposits, have all contracted in real terms. As a service sector for the general economy, the banking sector (and particularly the commercial banks) reflect the health of the overall economy. The picture which emerges from the past four years is one of stagnation and decline.

21. Despite this real decline in the level of banking activity in Swaziland, there have been several important dynamics at work within the banking sector. In 1991, the defunct branch of BCCI was purchased by Meridien Bank. In 1995, Meridien itself began to experience difficulties and was taken over by the central bank and subsequently sold to First National Bank of South Africa. Hence, within the private commercial banking sector, there are now (1995) two well established British banks, and two seemingly aggressive new South African banks. The two newer and smaller South African banks will certainly compete for the shrinking banking pie -- which at this stage is majority held by the two older and more established banks. The investment and trading linkages which exist between the firms operating in Swaziland (often with parents in South Africa) means that the South African banks are likely to be very well placed to conduct an aggressive competitive strategy with the two British based banks. Within this dynamic, Standard Chartered Bank continues to experience financial difficulties caused by bad loans (including the problem company discussed above) and it appears a very real possibility, in line with its operations throughout Africa, that Standard Chartered may ultimately withdraw from Swaziland as it increasingly focuses on a smaller number of key African countries.

22. It seems that there will be significant competitive pressures brought to bear on carving up a stagnant, or even shrinking, commercial banking pie -- and there are likely to be some casualties.

23. The exception to the above picture of well managed commercial banking is the Swaziland Development and Savings Bank. Established in 1965 as a Government owned development bank, the bank was intended to provide long term financing for all sectors of the economy -- but with an emphasis on agriculture, livestock and housing. However, the bank soon began to experience difficulties and the Government has been obliged to support the bank with several injections of new capital as well as provide ongoing liquidity through the placement of special deposits. Having failed to operate profitably as an agricultural based development bank, the SDSB attempted to become a universal bank and compete in the commercial banking market as well. However, a lack of basic lending skills and an ingrained social philosophy which dominates their underwriting, has contributed to failure in this area of operations as well. The result is an institution with extremely poor financial performance -- as a result of a badly performing loan portfolio.

24. In an attempt to address the problems of the bank, the Government has provided SDSB with a special status vis à vis the other commercial banks in the financial system. For example, there is an implicit understanding that deposits in SDSB are guaranteed by the Government; the bank has benefited from large Government deposits which have been injected to provide liquidity; and the bank has special treatment with respect to capital adequacy requirements, reserves and liquidity ratios. Despite all these advantages, the bank has still not been able to perform commercially -- and if the loan portfolio of the bank were to be properly classified and several questionable accounting practices were reversed, then the bank would, in all likelihood, be declared bankrupt. This is borne out by a recent in-depth study by Coopers & Lybrand which estimated that the unfunded loss position of SDSB is E80 million with an additional E135 million in non-performing credits whose recovery is highly doubtful.

25. These problems with the bank led, in early 1995, to its intervention by the Central Bank of Swaziland, which is now attempting to restructure the bank. Various options for the bank are under consideration. However, given the increasing competition for a shrinking commercial banking market, and the lack of professional competence of the SDSB in properly managing commercial banking activities, it is strongly recommended that the SDSB should abandon commercial banking activities and revert to its original development banking mandate. By operating within a very narrow band of development bank lending, the SDSB could more appropriately fill a gap in the provision of financial services which it could perform efficiently. To assist it in this process, however, the bank should be privatized -- retaining only, at best, a minority Government shareholding.

26. ***Development Finance Institutions.*** Swaziland operates with three important development finance institutions -- the Swaziland Industrial Development Company (SIDC), Tibiyo Taka Ngwane (Tibiyo), and the Swaziland Development and Savings Bank (SDSB). Each of these institutions operates with a different management structure, market philosophy, and client focus.

27. The Swaziland Industrial Development Company began operations in Swaziland in the 1980s as the National Industrial Development Corporation of Swaziland -- a wholly state owned enterprise. After a troubled start, the company was restructured in 1987, and private shareholders (CDC, DEG, FMO, IFC, PROPACO, Barclays and Standard Chartered) were brought into the company -- reducing the Government's shareholding to slightly under 35 percent.

28. Since that time, SIDC has demonstrated a strong record of growth and profitability, while acting as the premier private sector investment company in Swaziland. The Company is an investor in over 20 separate national and international corporations operating in Swaziland and has also developed a long-term loan portfolio in excess of E54 million, extended to approximately 51 different companies. As the major investment company in Swaziland, SIDC primarily promotes and finances private sector investment projects in all economic sectors -- but mainly at the bigger end of the market. A key feature of their business is to promote foreign investment into Swaziland and assist outside investors interested in local joint-venture operations. External shareholders' funds have been the primary source of financing for the company, but as the company matures, there will be a need for it to look to the domestic market for sources of funding. Raising funds through the sale of commercial paper in the local market, or applying to the central bank for approval to accept wholesale deposits are two alternatives currently under consideration -- although the former may well be preferable to the latter, at least

initially. Such options will need to be pursued if the SIDC is to be able to continue in its role as a major source of development finance within the economy.

29. Tibiyo Taka Ngwane was created in 1968 to promote economic development through direct investment in a variety of social and economically oriented projects that are designed to create jobs and preserve the cultural traditions of the Swazi Nation. Initial capital to finance Tibiyo's activities came from the royalty income of national mining operations. The company has expanded its investment portfolio rapidly through the reinvestment of dividend income as well as its ability to enter into some investments at no cost -- in the name of the "national interest". With total assets (1993) of E307 million and with share investments and loans in 19 separate companies valued at E172 million, the institution is an important financier within the economy. Recently, in line with its mandate to support Swazi culture and the development of the Swazi Nation, the company has become involved in supporting financing for small and medium scale enterprises. Tibiyo recently requested proposals from institutions within Swaziland for the management of an E8.0 million lending fund to MSME's. Tibiyo's interest and support in this new area will be watched with interest over the next couple of years. As the Government's own cash position becomes more constrained in the future, there will be increasing pressure to review the tax exempt status currently held by Tibiyo. This status confers a significant advantage to the institution which may well turn out to be an advantage which the Government can ill-afford to provide.

30. As indicated, the most problematic of the development finance institutions is the Swaziland Development and Savings Bank. Its poor financial health is largely a consequence of the politicized nature of the institution. The 1995 decision to intervene in the activities of the bank took courage -- but now that the bank has been intervened, every effort should be made to re-establish the bank on a commercially sound and sustainable footing for the future. The conclusions of this report are that the Swaziland financial sector could well use a development finance institution, of the type that a restructured SDSB could be, meeting the long term financing needs of the economy. This will, however, require drastic changes in the operation, activities, orientation, management, staffing, and ownership of the institution. Fortunately, the Swaziland Industrial Development Company provides an excellent example of how a defunct, Government owned, financial institution can be converted into a dynamic and effective development financing institution.

31. To this end, this report recommends a radical restructuring of the SDSB to refocus on becoming a pure development banking institution again. This will require moving out of commercial banking activities, cutting back on staff, bringing in new professional management, privatizing the institution, and seeking alternative sources of funding instead of customer deposits. As part of the restructuring process, the bank should recover (to the full extent of the law), all outstanding non-performing customer loans. To not pursue such delinquent borrowers adequately will put the newly formed institution at a serious disadvantage even before it commences operations as a new enterprise.

32. It is recommended that the SDSB should continue its savings collection post function -- for the important economic and social role that such an activity provides. However, these savings should not be used to fund the development finance activities of the bank. Instead, these deposits should be placed in low risk, preferably Government guaranteed, securities -- thereby obviating the need for the Government to provide explicit deposit insurance to the deposits mobilized by the SDSB. Instead, funds to finance the activities of the new SDSB should come

from Government budget subventions, foreign development bank loans, commercial paper issues, and shareholder funds.

33. ***Money and Bond Markets and Term Investments.*** Swaziland's money and debt markets are currently illiquid with very little trading actually taking place. However, the development of more liquid markets is of interest to the monetary authorities for three broad reasons: (a) the prospect of future budget deficits will require efficient and liquid markets to enable the Government to raise funds on better terms; (b) the development of such markets will also assist private borrowers and will provide better returns to savers as these markets compete for domestic savings; and (c) the development of such markets will assist the CBS in developing skills in the management of system reserve balances which will stand it in good stead if it ever decided to develop some policy independence from South Africa.

34. With a long history of high liquidity, and in the absence of other remunerative and liquid investment possibilities in Swaziland, the commercial banks in Swaziland have frequently resorted to using the money markets in South Africa. However, the extent to which the banks can do this is limited by several factors. First, the Swazi banks only invest in South Africa for short periods as South African paper does not qualify for the liquidity ratio in Swaziland. Second, some of the banks have global exposure limits to South Africa which limit the extent to which these banks (particularly the largest bank -- Barclays) can invest in South Africa. Third, the operation of the Minimum Local Asset Requirement dictates that foreign assets can be no more than 5 percent of total assets -- although it does appear that the MLAR is not a truly binding constraint on bank's behavior in Swaziland. These constraints effectively segment these two markets.

35. At the same time as much of this liquidity is kept captive within Swaziland, there is relatively little tradable debt on issue in Swaziland. As at March 1995, this amounted to E121.0 million in commercial paper issued by several private companies, several parastatals, and Government stocks and T-Bills. This generates very little secondary trade. However, if there was more control over the level of domestic liquidity, it is more likely that these instruments would be traded -- and if there was less liquidity, the banks would be more likely to begin to use these as liquidity management tools rather than just as investments.

36. In addition, as Swazi financial markets are not fully integrated with South African financial markets, through the operation of the MLAR, some "captive" Swazi funds are held in debt instruments which, for the main part, yield a lower return than do similar debt instruments in South Africa. Unfortunately, this yield differential with South Africa reduces the demand for Swazi debt and thereby limits the development of a secondary market. The South African debt market not only yields more than the Swazi market, but it is also considerably more liquid. For example, it can take 2 to 3 weeks to find a buyer and agree on a price for Swazi Government Stock in the secondary market whereas the equivalent South African transaction can be completed in a day.

37. The result of this situation is that larger wholesale investors place their funds in South Africa on their own account to obtain the higher rates of interest which are available there. On the other hand, smaller investors and savers find it administratively more difficult to enter the South African market and so are reliant upon returns on Swazi T-Bills or deposits. Lastly, banks in Swaziland, because they are over-liquid, are under no pressure to compete for funds -- resulting in a significant spread in interest rates between deposit rates and the discount rate. In

short, the cost of the low interest rate policy and the lack of management of domestic liquidity -- either by the active sale of T-Bills or by encouraging greater integration between the wholesale markets in Mbabane and Johannesburg -- is largely borne by smaller Swazi savers.

38. The report argues for the Swazi authorities to actively start developing a market in Swazi debt instruments for both investment and liquidity management -- but ensure that this is efficiently connected to the South African market. In order to actively manage domestic liquidity, the central bank would need to be able to develop a system for forecasting daily system liquidity (a capacity which would be greatly enhanced if the Ministry of Finance had good cash and debt management systems); it would need to consolidate all government transaction accounts at the central bank; begin regular auctions of T-Bills and open market operations to keep liquidity at desired levels; stop paying interest on excess reserves; cease to take funds on deposit; cease to offer overdrafts; and lengthen the settlement period for tenders. These changes will help create the correct incentives for more active interbank and T-Bill markets to develop in Mbabane by reducing the constraints which segment the Swazi and the South African markets. In addition, active management of domestic liquidity by the CBS will eliminate many of the distortions caused by captive funds by supplying debt instruments to absorb the supply of funds. The report recommends other steps which could also be taken to further reduce the existing degree of segmentation between the two markets, and thereby create opportunities for efficiency gains and generate greater competition for Swazi savings.

39. The contractual savings institutions are rapidly emerging as the most important source of domestic savings within the economy. This source of savings is particularly important given its inherent long term nature. Some of the contractual savings institutions, such as the National Provident Fund and the Insurance Corporation, have been obliged to invest a majority of their funds within Swaziland. The more dynamic component of the industry -- the private pension funds (but also including the Public Servant's Pension Fund) -- has been less controlled and has been invested almost exclusively in South Africa.

40. However, capital controls under the CMA have prevented the investment and diversification of long term savings beyond the CMA region. This has almost certainly reduced the longer term returns on these funds as well as exposed these funds to a higher degree of risk than a more diversified portfolio would have done. It is therefore recommended that Swaziland should approach its partners in the CMA to permit some share of these long term savings to be invested abroad. Creating a greater degree of competition within some of the institutions involved in this market (specifically the insurance industry) as well as ensuring a higher level of professional investment management advice are also important concerns for this sector. Lastly, attempts to restrict these funds flowing to the highest possible rate of return (within the confines of appropriate prudential concerns), should be as limited as possible. This relates particularly to requirements that contractual savings institutions invest a certain proportion of their funds in Swaziland rather than in alternatively more remunerative markets.

41. ***The Rural Financial System.*** The agricultural sector in Swaziland operates with a very distinctive bimodal pattern of ownership, production technology, and output which impacts upon financing relationships. Most smallholders are concentrated on Swazi Nation Land where their rights to land use are derived from tradition social relationships -- and they tend to produce food crops for home consumption and market any surpluses. Larger scale agricultural producers (primarily sugar, citrus and cotton) tend to be located on Title Deed Land, are capital intensive, enjoy access to well developed market channels, and have attained world competitive levels of

output. Although these relationships have become less precise in the 1990s, they still broadly characterize the system of agricultural production in Swaziland.

42. The large scale agricultural sector figures prominently in the overall macroeconomy of Swaziland. Commercial agriculture accounts for almost 72 percent of agricultural GDP and around 30 percent of total export earnings. The success of commercial agriculture, in terms of its continued competitiveness and profitability, has been self-reinforcing in terms of government policies and the financial market's application of funds. The producers in this sub-sector have enjoyed good access to financial services from the commercial banking sector -- accounting for almost a fifth of total commercial bank lending.

43. Small scale Swazi producers operating on Swazi Nation Land experience a quite different situation -- and relatively little funding from the commercial banks goes to support activities within this sector. To address this situation, the Government has utilized the SDSB to channel funds to this sector. The SDSB currently manages ten different programs aimed at providing finance to small-scale borrowers who would otherwise be denied access to loan funds as these borrowers are assumed to be too costly for formal, commercial financial institutions to serve. However, successive droughts, a lack of financial sophistication within this sector, and severe institutional weaknesses with the SDSB itself have raised serious concerns about the efficacy of these Government programs.

44. The significant successes achieved in lending to larger, commercially based agriculture, stand in stark contrast to the multiplicity of schemes which have been designed as support mechanisms for providing lending to smaller scale agriculture. Lending to a high risk sector which is prone to recurring droughts, particularly by an institution as weak as the SDSB, has not been successful in terms of providing sustainable financing options. Part of the mandate of a restructured SDSB should be to focus on the development of such sustainable financing mechanisms within the constraints, natural and otherwise, imposed by this sub-sector.

45. ***Finance for Micro, Small and Medium Scale Enterprises.*** The Swazi authorities have been mindful of the fact that the formal financial system has not dealt well with the micro, small, and medium scale sector in Swaziland -- which is almost always represented by Swazi citizens. Consequently, the Government has established financial support programs specifically directed at this sector, in an effort to assist their growth. In addition, several autonomous financial institutions and support organizations for the MSME sector have also been established. The overall impression is one of a low level but relatively dynamic sector with a good potential for growth -- and the required skills to lend the appropriate level of support to these small scale savers and borrowers.

46. The Central Bank of Swaziland has specifically been involved in two guarantee schemes -- one which guarantees export credits for MSME's and a second scheme which guarantees loans to small scale enterprises. The Export Credit Finance Guarantee Scheme was established in 1991 and provides both pre-shipment and post-shipment credit. The Small Scale Enterprise Loan Guarantee Scheme, established in 1991, was designed to support enhanced access to credit for indigenous Swazi entrepreneurs by encouraging the banks to provide business financing to these nominally "uncreditworthy" borrowers. Both schemes provide a guarantee (of between 75 to 85 percent of the loan), have mandatory interest rate caps, and have limits on the total amount of guarantee extendible to any one borrower. The Export Guarantee Scheme appears to have had a greater amount of success, with loan repayment rates of 82.6 percent -- although the market

penetration of this scheme appears to be declining with time. The Small Scale Enterprises Loan Guarantee Scheme has largely supported loans through the SDSB which, because of the condition of that institution, has led to a significantly higher default rate. Both schemes require some overhaul, with the small scale scheme requiring some fairly drastic rethinking. Certainly any guaranteed lending through the SDSB should be put on hold until that institution has been meaningfully restructured (as indicated above).

47. An extremely dynamic component of the financial sector are the Savings and Credit Cooperatives which exist in Swaziland. There are approximately 25 savings and credit cooperatives registered with the Ministry of Agriculture and Cooperatives with a total membership of around 13,500 individuals. As there are only around 110,000 deposit account holders in the five commercial banks, this means that the savings and credit cooperatives, as a whole, are probably serving around the same number of clients as the smaller of the commercial banks. Their coverage, in terms of total clients served, is therefore not insignificant. By the end of 1994, the 21 savings and credit cooperatives which provide information to the Swaziland Association of Savings and Credit Cooperatives had total savings and shares of almost E17 million. These cooperatives are dominated by five or six significantly larger institutions, with one in particular (Asikhutulisane), accounting for over 50 percent of the total assets of the entire cooperative movement.

48. Asikhutulisane is located at the Usutu Pulp Company and is undergoing tremendous growth. It has expanded its membership to anyone who resides within 30 kilometers of the town where the Pulp factory is based, it has a membership base of 5,500 people, and total assets at the end of 1994 of almost E10 million. Its biggest problem at the present time is coping with growth which is probably faster than its human resource base can deal with. There is an urgent need for the institution to recruit, or be supported by, technical assistance as it manages the transition from a community based organization to an institution with a wider focus. In addition, given the large number of depositors and the growing amount of funds held, it is highly recommended that this savings and credit cooperative should fall under the prudential supervision of the central bank rather than the Ministry of Agriculture and Cooperatives.

49. The Savings and Credit Cooperatives are an important, grass roots way for communities to provide adequate incentives to save, as well as loan facilities -- to both small savers and borrowers. The community nature of such institutions is an important element of their success. The Government should lend support to the further development of such grass roots initiatives -- without coming in with an over-bearing heavy hand to direct their operations -- as such initiatives represent an important, sustainable answer to the issues of small scale finance, which are likely to be more successful than the top down, Government driven initiatives which are frequently perceived as the answer to small scale financing problems in developing countries.

50. As indicated, Tibiyo is also taking a greater interest in supporting MSME initiatives and has recently made an E8.0 million fund available to support financial and other related services for this sector. Another player which has also recently emerged in this field is the Swazi Business Growth Trust (SBGT). The Trust was established in 1992 with funding from USAID and provides both finance and technical support and training to MSME enterprises. A major constraint for the SGBT has been sources of funding, but it may be possible for it to access some of the funding which was recently made available from Tibiyo.

51. Swaziland also supports a plethora of business support organizations -- many of which are specifically targeted at the needs of the MSME sector. For example, the Business Management Extension Program (BMEP) focuses on providing clients with training and some financing as a way to transform income generating activities into small enterprises. The Program has made 120 loans since 1986 for a total amount of E199,000. Although the program is small, it has had an important impact extending well beyond the level of the funding made available. There are several institutions which are specifically targeted at women entrepreneurs, including the Business Women's Association of Swaziland (BWAS) and the Imbita Women's Finance Trust -- serving the top and (professional) and the lower end (hawkers and street vendors) of the market in terms of support, advice, and some small amounts of credit. Other institutions such as the Small Enterprises Development Company (SEDCO), the Sibako Chamber of Commerce, and the Swaziland Chamber of Commerce and Industry, also exist to provide business support services.

52. Lastly, many Swazis also use the informal financial sector to obtain short term financing. Money lenders (or shylocks) operate in many areas on a reasonably extensive basis. Most clients are referred by word of mouth and often a current or former client of the money lender must act as a reference or guarantor. However, given the informal nature of this market it is difficult to obtain hard information -- especially as many money lenders are unwilling to be interviewed. While it is impossible to determine the volumes of savings and credit being channeled through the informal credit markets, anecdotal evidence would suggest that it is reasonably large. In addition, many Swazis save in informal ways -- particularly in the form of cattle. As well as being a traditional form of savings, these animals have other attributes including the fact that they can be used as work animals, for paying dowry, for milk, and as a symbol of wealth.

53. ***Housing Finance.*** Commercial banks in Swaziland undertake very little mortgage secured lending at the current time. The only exception to this is the Swaziland Development and Savings Bank which undertakes some mortgage financing on its own account, but even more under the auspices of a Government Public Service Housing Scheme.

54. By far the largest player in the mortgage finance market is the Swaziland Building Society which, in 1994, had more than twice the amount of mortgages outstanding as the entire commercial banking system (including the SDSB) combined. The SBS is capitalized by accumulated retained earnings and by long-term deposit instruments of varying maturity called permanent, fixed, and subscription shares. The Society has experienced rapid growth, with total mortgage lending increasing to almost E120 million at the beginning of 1995. Growth, although still high, has slowed somewhat from the late 1980s and early 1990s as the economy has slowed down generally and as the SBS has consolidated its financial position

55. The attraction of the SBS has been the interest break provided on interest income from that source, which has attracted a larger amount of longer term savings than what would otherwise have come into the institution. This has given the SBS somewhat of an unfair advantage in the mobilizing of long term funding over the commercial banks who maintain that they would also provide more longer term mortgage financing if they could offer their clients the same tax breaks as those afforded through the SBS. A proliferation of tax concessions may not be the most advantageous way of promoting more mortgage financing -- specifically in a constrained fiscal environment -- and there are certainly other ways in which mortgage financing could be stimulated. One such method could be the development of a secondary mortgage

market, which would provide financial institutions with liquid support for their mortgage lending and could thereby engender greater commercial bank interest and involvement.

56. Nonetheless, the two major constraints which will continue to impact upon home ownership in Swaziland for the foreseeable future do not relate directly to the issue of mortgage financing through the financial system. These relate to the availability of free hold land -- and issues of affordability. In addition, it should be noted that the capacity to pledge land as security impacts financial activities well beyond the housing finance market.

57. ***Closer Association of the Swazi Financial System with South and Southern Africa.*** For good or ill, the past, present and future of the Swaziland economy is inextricably linked with that of its large next door neighbor -- South Africa. The historical links have created an even closer linkage through the Common Monetary Agreement and the Southern African Customs Union. In the past, this close relationship has served Swaziland reasonable well, and Swaziland's development has not suffered in the same way as many other countries on the continent. In fact, the Swaziland economy has developed a level of sophistication which closely approximates that of its large, significantly more developed, neighbor.

58. There are potentially many benefits to be reaped from a close association with the economic powerhouse of the Southern African region. Within the financial sector, such advantages include access to a wide range of financial institutions and financial markets; easy access to highly developed technologies; access to financial know-how that is attuned to the needs of the region; access to banking institutions, money and capital markets which do not exist in Swaziland and at a higher level of development and sophistication. Naturally, as with any union, there are also potential costs to the relationship. The most important of these would seem to relate to a loss of economic independence and concern about the possibility of a serious economic downturn in South Africa caused by political/economic events.

59. The reality, however, is that Swaziland has very little room to maneuver -- even if the South African economy did start to consistently perform badly over a longer period of time. Some limited isolation from adverse economic developments may be possible, but it is almost certain that an adverse economic scenario in South Africa would mean adverse economic conditions for the entire sub-region. The limited capacity of even a very wealthy economy such as Botswana's to move away from the predominant influence of South Africa is instructive in this regard. The capacity of a smaller and weaker economy than Botswana's to conduct an isolationist economic policy in the face of rapidly declining economic circumstances in South Africa would be correspondingly limited.

60. A major recommendation of the report is that Swaziland should look upon its forced interdependence with the South African economy as an advantage rather than as a threat, and should make every effort to capitalize to the maximum possible extent on the forced linkage. Most importantly, the Government should seek to ensure greater coordination, cooperation, and consultation with the members of the CMA and SACU agreements -- to ensure that mutual interests are taken into account. Of particular importance at the current time is for Swaziland to take strong pro-active steps to protect the levels of revenue which it receives under the SACU agreement -- to the maximum extent possible. Within the context of the CMA, the Swazi authorities should also seek to diversify the nation's savings (foreign exchange reserves and savings held by contractual savings institutions) outside of the CMA area -- so as to diversify portfolio risks. There is also a need for more modern legislation, with consideration given to

unifying the legislative environment in Swaziland with that of South Africa so as to ease interactions between the two economies. Consideration could also be given to adopting the regulatory returns which are used in South Africa for supervisory purposes by the SARB -- and the establishment of stronger linkages through training and manpower development should be sought with the South Africa Reserve Bank (SARB). Potential benefits could also flow from a closer relationship between money, capital and equity markets in the two countries -- with the Swazi authorities plugging into resources such as the Johannesburg Stock Exchange -- which are available at close proximity.

61. It is through greater regional cooperation -- not only with South Africa -- but with all of the economies of the Southern African region, that Swaziland and the region stand to gain the most over the remainder of the 1990s.

62. ***Flow of Funds Analysis for Swaziland.*** Lastly, an effort has been made in this report to examine the flow of funds through the financial intermediaries within the Swazi economy over the period 1984 to 1994 (the most recent decade for which statistical information was available at the time of writing). This analysis is imprecise, due to a lack of sufficiently detailed data from all financial institutions, and it only covers financial flows through the financial system. Hence, financial flows not intermediated through the banks and non-banks in Swaziland are not captured by the analysis. In addition, several small, but nonetheless important institutions have been omitted from this analysis due to a lack of information -- the most important of these being the Savings and Credit Cooperatives discussed above.

63. The main finding arising from this analysis is that there were significant surplus funds (savings) in the Swazi economy -- which increased markedly over the ten year period from 1984 to 1994. The household sector and the Government sector were important net savers over this period. The majority of the funds flowing from the Swazi economy went to the external sector -- although the business sector was also a major recipient of funding from the domestic financial system.

64. The role of the Government was somewhat unusual in that it intermediated a large amount of its funds through the commercial banking sector and directly to the external sector -- rather than through the central bank. The movement of Government funds into and out of domestic commercial banks may well have compromised the capacity of the Central Bank to conduct monetary policy. On the other hand, utilizing the commercial banks as repositories for Government funds may have had beneficial effects in terms of smoothing out the impact of large Government payments into and receipts from the banking system -- on the overall capacity of the banking system to operate more effectively.

65. Now that the Government is faced with budgetary deficits, which it will need to urgently bring under control, but which could continue for some time, it will almost certainly become a dis-saver within the economy -- drawing down on the significant surpluses accumulated over the recent past. To the extent that the slower economic growth of the past several years continues to predominate, it is also likely that savings from all other sectors in the economy will also slow down. The slow down in the economy, to date, however, appears to have had a more adverse impact upon the commercial banks than upon the contractual savings institutions.

66. Over the period, the commercial banking sector declined in relative importance in terms of financial intermediation within the financial system. On the other hand, there was a significant

increase in the amount of funds which were channeled through contractual savings institutions. Whereas growth in the commercial banks appears to have been slowing down and even stagnating -- especially toward the end of the period under consideration -- the role of the contractual savings institutions, by contrast, increased significantly. This point is demonstrated by the fact that commercial banking assets have been declining in real terms over the past three years whereas the assets of the contractual savings institutions have grown at around 42 percent per annum in nominal terms, implying a real growth of about 30 percent per annum over the past eight years.

67. The rapid growth of the contractual savings institutions emphasizes the importance of properly legislating the use of the funds that they manage. The speedy promulgation of the Insurance Act -- which covers insurance, pension and provident fund business is of particular importance. It is somewhat of an anomaly that while so much attention has been put on the commercial banking sector in Swaziland, relatively little attention has been paid to the almost equally important, and more rapidly growing, contractual savings sector. The recent appointment of a Registrar of Insurance is a necessary first step in recognizing the importance of this sector. Developing an improved data base for the sector should also be a priority.

68. A large contractual savings sector is indeed an important asset for the Swazi economy. By its very nature, this sector is an important source of long term investible funds. It has been argued that these funds should be used for development in Swaziland. Whereas this certainly could be true, it is equally important that these funds should earn the maximum possible return to ensure properly protected pension benefits for contributors. It is therefore important that restrictions placed on the use of these funds should be as minimal as possible, after fully taking into account prudential concerns.

69. This naturally takes one full circle to the starting point of this Executive Summary -- the importance of enhancing the competitiveness and attractiveness of the Swazi economy as a place in which to invest. What is important for the authorities is to provide a supportive physical infrastructure, a modern legal infrastructure, a productive and well educated labor force, and other supporting elements of a strong enabling environment -- so that private investment decisions will result in attractive returns. The main message of this report is that, if the right enabling environment can be established to support private sector initiatives, then Swaziland has the luxury (not afforded to many African countries), of significant amounts of term financing to support such high return investments.

70. ***Priorities for Reform.*** This report has listed many recommendations for reform in the financial sector which are listed in their entirety in Annex 5. It is important, however, to also indicate which actions are more urgent than others. As already indicated, the most important issues facing the Swazi economy are those which lie outside of the financial sector, and involve dealing with the current macro-economic problems facing the Government (specifically in the area of fiscal policy), and the creation of an enabling environment for the development of the private sector. Nonetheless, the following nine issues are considered most important within the financial sector, if it is to promote growth and further development in Swaziland, in conjunction with real sector changes.

(a) **Liquidity Management.** The Central Bank of Swaziland should develop a market in which Swazi debt instruments are available for investment and liquidity management but which is also efficiently connected to the South African market. This would involve the more active management of Swazi liquidity in conjunction with efficient access to South

African money and capital markets. Initiatives to develop cash and debt management systems for the Government should be commenced immediately.

(b) **Banking Supervision.** Financial regulation and supervision should be coordinated, with one supervisory authority for all financial institutions -- preferably situated in the CBS. Within this context, the central bank should seriously consider the adoption of some common CMA financial regulatory returns, of which the SARB returns could possibly serve as a standard for all the member countries -- to facilitate effective monitoring within the region. By doing so, the central bank would ensure corporate governance and risk management concerns are fully addressed, and the information supplied could be better used to provide management information to the CBS and the banking system.

(c) **Minimum Local Asset Requirement.** In the light of a review of the effectiveness of the operation of the Minimum Local Asset Requirement (to determine whether it is having its desired effect) the monetary authority should consider the gradual relaxation of this constraint. The Government should also seek to stimulate the creation of new, longer term financial instruments for banks through, for example, the formation of a secondary mortgage market.

(d) **Interest Rates.** Every effort should be made to re-establish positive real deposit and lending rates in Swaziland as soon as possible and work towards convergence of these rates with the larger South African market.

(e) **Swaziland Development and Savings Bank.** The single most important institutional issue is the radical restructuring of the SDSB and its establishment as an institution which is self sustaining and commercially viable, operating with professional management. This will involve de-politicizing the bank, bringing in private sector partners, and reverting the institution to its original focus of providing longer term development finance, while maintaining its savings mobilization role and eliminating its commercial lending role. Any savings mobilized by a restructured SDSB should be placed in low risk, Government guaranteed securities.

(f) **Contractual Savings Institutions.** Given their growing importance within the Swazi economy, the Government should ensure that it regulates, supervises, and understands this sector better. This will include passing the Insurance Act, developing a better data base on the sector, and supervising their activities in a more comprehensive and consistent fashion.

(g) **Enhanced Coordination with South Africa.** Swaziland should seek to establish stronger channels of communication and coordination with the South African authorities, to ensure full coordination of monetary and fiscal policies within the CMA and the SACU agreement. This would also include the greater synchronization of financial legislation, regulatory reporting forms, and enhanced linkages with money and capital markets through the Johannesburg Stock Exchange.

(h) **Risk Diversification.** An effort should be made to reduce Swazi citizens' and Swazi companies' exposure to rand denominated assets. The Swazi authorities should approach their CMA partners and negotiate an exemption to permit some parts of pension and life insurance funds to be invested outside of the CMA. In addition, the

authorities should investigate the practical steps necessary to establish a unit trust through which Swazi nationals could obtain exposure to long term investments outside of the CMA.

(i) **Support for the Small and Medium Scale Sector.** The Government should continue to provide a strong supportive stance toward the development of financial activities which assist MSME development. This could include encouraging the donor community and the private sector to become more involved in existing initiatives which provide both finance and business support. Resources available through the international credit union system should be utilized to provide the necessary expertise to the savings and credit cooperatives. In addition, as these institutions mature, the Government should ensure that it has a frame work in place which would permit them to be adequately monitored by the monetary authorities.

CHAPTER ONE
THE SWAZILAND ECONOMY
AND THE STRUCTURE OF THE FINANCIAL SYSTEM

A. GDP AND SUB-AGGREGATES

1.1 Swaziland's macroeconomic performance and environment have experienced a remarkable turn around in recent years. During the mid 1980s GDP growth rates were high, about 6 percent per annum, primarily due to an upsurge in foreign investment (South African and other) triggered by the tightening of sanctions against South Africa. Membership of the South African Customs Union (SACU) provided Swaziland with ready access to the South African market while ACP preferences ensured highly concessional access to European markets. Export growth was consequently high. Rapid domestic investment (and employment of Swazis in South African mines) provided steady growth in employment. Fiscal management remained judicious -- resulting in large fiscal surpluses. Similarly the balance of payments remained very healthy permitting a rapid accumulation of net foreign assets.[1]

1.2 The 1990s, on the other hand, have produced a very pronounced down turn. Since 1991, average annual GDP growth has been less than 2 percent per annum (see Table 1.1 below), compared to a population growth rate of around 3.4 percent. Two serious droughts since 1990 have compounded this underlying trend but the trend itself is unmistakable. There has been a steady decline in agricultural production (about 10 percent of GDP) over the last decade, largely in the traditional agricultural sector (because of drought and structural constraints such as land tenure). More importantly, however, there has been a slow down in the manufacturing sector's production which in turn is related to a slowdown in private capital formation and the recession in South Africa (which absorbs about 40 percent of Swazi exports). After rapid growth in the previous decade, the private investment/GDP ratio has been declining to the point (9 percent of GDP in 1994/95) when it could be argued plausibly, in the absence of any data on depreciation, that net private investment has probably become negative. While South Africa could conceivably emerge from recession and thus exert a growth impetus on the Swazi economy, a sustainable turnaround can only result if the constraints on private capital formation are lifted. There are some signs of reinvestment in existing industries (e.g. sugar and pulp) but new investments have been minimal.

1.3 Simultaneously with the slow down in GDP growth and investment there has been an associated worsening of the unemployment situation. Official estimates suggest that between 1986 and 1991, paid formal employment increased by an average of 3.6 percent per annum while the number of unemployed grew by an average of 10 percent per annum. Unemployment in 1991 was estimated to have been about 16 percent of the labor force. However, the survey data on which such estimates were based did not factor in the incidence of under-employment. About two-thirds of those unemployed are between 15 and 34 years old, an expected pattern for a fast growing and young population. The unemployment rate in rural areas was almost twice as high as in the urban areas. More important perhaps are the developments after 1991 -- after the investment downturn took place. Given growth in the labor force of at least 3.6 percent per annum (assumed to be "at least" the same as the population growth rate) and hardly any growth

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[1] About 27 percent of GDP in mid-1990.

in formal employment due to the investment downturn, there has inevitably been a significant worsening of the unemployment situation.

Table 1.1: Main Macroeconomic Indicators

	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
GDP Growth Rate (% p.a.)	9.1	7.9	-0.1	1.2	2.5	3.0
Fixed Investment/GDP (%)	22.1	21.1	21.0	22.6	23.5	19.7
Private	15.4	13.7	11.4	12.5	13.0	9.1
Fiscal Balance/GDP (%)	5.9	6.9	4.6	-0.7	-5.2	-5.1
BoP Curr. Account/GDP (%)	5.4	2.7	0.5	-7.1	-7.7	-7.0
Money (M1) Growth Rate (%)	18.5	11.7	11.5	15.6	16.6	31.8
Retail Price Changes (%)	6.2	11.1	11.0	8.2	11.3	13.8
Employment Growth Rate (%)	5.8	1.2	-0.1	0.2	1.9	n.a.
Private Sector	7.3	1.0	-0.1	...	0.1	n.a.

SOURCE: Draft Development Plan, 1995/96-1997/98; MEPD; Central Bank of Swaziland: Quarterly Review, December 1994; World Bank estimates.

B. BALANCE OF PAYMENTS

1.4 There is an evident weakening of Swaziland's balance of payments. The recorded current account surpluses of the 1980s have now become substantial deficits, due to a widening trade deficit and similar movements in the services account. Net official reserves have continued on a downward slide -- recording falls of E155.4 million and E125.5million for calendar 1993 and 1994 respectively, with a balance remaining equivalent to 3.5 months' of imports. Although there has been somewhat of an export recovery in 1994/95, because of the upswing in wood pulp prices, such a recovery is not sustainable. There is a capacity constraint in the exports sector because of the investment trend which unless addressed, will not permit a sustainable export recovery. In addition, mine workers' remittances, which have long been a major factor in the Swazi economy (about 15 of the GDF), have plateaued and could decline in both nominal and real terms if South Africa's migrant labor policy becomes restrictive and as mine closings occur. Although investment income, reinvested earnings, tourist receipts, and official transfers (SACU compensatory component), also have a significant influence in Swaziland's current account in addition to the workers remittances -- these also appear likely to decline without some readjustment within the Swazi economy.

C. FISCAL OUTLOOK

1.5 The weakening balance of payments coincided with a deterioration of Swaziland's fiscal position. Deficits emerged in 1992/93, for the first time in almost a decade, and increased significantly in the following two years. Consequently, Government reserves (excluding the Capital Investment Fund (CIF) which was E71 million at the end of 1993 -- about 5 percent of total public expenditures), had declined considerably by January 1995. Even CIF deposits, which were E366 million at the end of 1993/94, are declining sharply and are likely to disappear

by 1996/97 if present expenditure trends continue. These developments are reflected in the Government's domestic debt operations. Treasury Bills are no longer a stabilization instrument, but rather a traditional financing instrument. About E30 million in T-Bills were issued in 1993/94 and 1994/95 and it is projected that about E55 million will be required in 1994/95.

1.6 The downturn in the fiscal situation has occurred despite an impressive 13 percent increase in revenues and grants between 1990/91 and 1994/95. SACU revenues (almost half the revenue and grants) in 1994/95 were about two-thirds higher than in 1990/91. Unfortunately, Swaziland's SACU revenues are likely to taper off as expected trade liberalization occurs in South Africa (thereby reducing the "compensatory factor"). Possible growth could, however, come from the domestic revenue base, through the adoption of a value added tax (VAT) in place of the current sales tax/excise, and through a rapid increase in investment and production in the manufacturing sector.

1.7 The deteriorating fiscal situation is thus a direct consequence of the very rapid rate of growth in public expenditure. Overall, expenditure increased by about 146 percent between 1990/91 and 1994/95 with current expenditures increasing by about 136 percent. Within current expenditures, subsidies and transfers increased much faster (about 207 percent) over this period. While capital expenditures increased by about 211 percent, these have not necessarily led to an improvement or expansion of physical infrastructure which now constitutes a growing constraint on private investment. Of particular concern has been the purchase of a new aircraft for Royal Swazi Airlines which remains a lossmaker and a major element contributing to the burgeoning budget deficit.

1.8 The rapid and unsustainable growth in public expenditures constitutes a very real threat to macroeconomic stability in Swaziland. Membership of the SACU/CMA provides Swaziland with a certain scope to pursue an expansionary budgetary policy, as demand pressures can translate into imports without necessarily running into a foreign exchange constraint or threatening currency convertibility. Drawing down its foreign assets or borrowing in the domestic and Rand Capital Market can absorb such excess demand. However, this cannot continue indefinitely. Swaziland's net foreign assets, as noted above, are equivalent to only about 3.5 months import cover -- hence any leeway is quite limited. There may be a greater scope for borrowing from the domestic commercial banks through larger issues of Treasury Bills (given their current liquidity), or direct borrowing from the Rand Capital Market. Swaziland's public debt remains low, about 20 percent of the GDP, so that borrowings can now be made at favorable terms. However, a sustained spate of deficits will, over time, diminish such access and ultimately lead to lending on less favorable terms.

1.9 The evolving fiscal situation has been of major concern to the Government which has sought advice and the help of the Bretton Woods institutions in identifying a policy frame work to arrest a probable adverse outcome. Accordingly, a *Shadow Stabilization Program* was prepared in September 1994 which suggests, as a consequence of continuing current fiscal trends, a deficit/GDP ratio of about 7 percent by 1997 -- and increasing steadily thereafter. Budgetary expenditures under a scenario of unchanged policies would be marked by an ever-growing "wage bill" which will progressively crowd out other current and capital expenditures. Funding of development activities and essential social services would be further compressed by the rapidly rising interest burden of a rising budget deficit.

1.10 Financing needs under this scenario are estimated to be very large, E1.6 billion over the next five years, about two and half times the current stock of public debt. Deficit financing on this scale would result in a rapid depletion of international reserves, forcing Swaziland to seek foreign financing at a time when its fiscal position and overall macroeconomic stability would already have sharply deteriorated.

D. EXTERNAL DEBT AND THE GOVERNMENT'S BORROWING STRATEGY

1.11 Swaziland has followed a cautious borrowing policy over most of the post independence period which is reflected in the country's low debt/GDP ratio. Despite this, current account deficits in the 1980s did result in a sharp increase in external borrowings. Since 1987, with the re-emergence of substantial surpluses, the Government has used these funds to retire debt, resulting in a sharp reduction in the debt/GDP ratio from 50 percent in 1986 to 22 percent in 1993/94 (compared to an average for sub-Saharan Africa of 107 percent, and for all developing countries of 39 percent). Debt servicing represented only 2.6 percent of export revenues in 1993/94. This situation, however, may well reverse itself once again given recent economic trends -- especially once the cushion of excess Government reserves has been exhausted.

E. MONEY SUPPLY AND PRICE MOVEMENTS

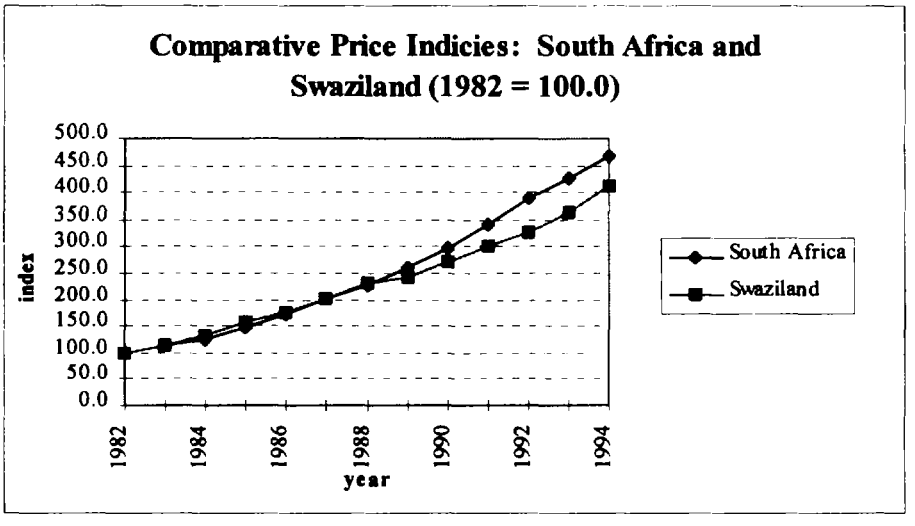
1.12 Largely as a consequence of the rising budgetary deficits, money supply (M1) has increased rapidly (see Table 1.1). As the Ministry of Economic Planning and Development notes in its 1995/6-1997/8 Development Plan, in most situations such rapid increases in M1 would be a matter of serious concern and would lead to a restrictive monetary policy. As of now, it is limited concern in Swaziland because inflation is, to a large extent, dependent on price and exchange movements in South Africa given the "openness" of the Swazi economy, (roughly 85 percent of imports are from South Africa), and the fact that the currencies of the two countries are at par. Nevertheless, such rapid movements in M1 should be of increasing concern because inflation is accelerating (Table 1.1) and the extent of increase in M1 may well become of greater concern to the other CMA partners.

1.13 In any economic union, there is usually an obligation to pursue convergent fiscal and monetary policies. In a union of ***unequals***, such as the CMA, comprising a dominant partner (South Africa) and significantly smaller partners (Lesotho, Namibia and Swaziland) presumably such an obligation is more pertinent for the dominant partner because of the scale of impact. Nonetheless, this does not fully absolve the obligation of the smaller partners to pursue responsible macroeconomic management. Although the CMA Agreement of 1974, as amended in April 1986, has no explicit provision for such convergence, there is usually consultation in the quarterly meetings as to the major directions of macroeconomic policy and the operation of the exchange and payments systems. As the CMA economies become more liberalized internally, as the remaining non-tariff barriers are removed (through the current process of renegotiation of the SACU trade regime), such a convergence will be increasingly required lest expansionary fiscal management destabilizes other economies within the union.

1.14 It is also a fact that, despite the theoretical expectation of a convergent price movement within the union, there has been a divergence between the price indices of Swaziland and South Africa. In addition, since 1993 the index for Swaziland has been increasing at a higher rate. There are at least two reasons which explain this occurrence. **First,** there are still non-tariff

barriers which restrict product movements within the union. For example, maize imports from South Africa are banned, by agreement, in an effort to permit higher Swazi maize prices to prevail. **Secondly,** while the rand is quasi-legal tender in Swaziland, the lilangeni does not enjoy the same status in South Africa. Thus inflationary pressures emanating from an expansionary fiscal and monetary policy in Swaziland cannot be exported to South Africa. The different weightings within the two indices have been suggested as a possible explanation for their diverging trends. In addition, the Swazi index is not seasonally adjusted like the South African index. While these factors might explain why the two indices would be different, they do not explain the widening divergence.

Chart 1.1



SOURCE: Ministry of Economic Planning and Development.

F. INDUSTRIAL RELATIONS

1.15 Swaziland's macroeconomic outlook is further clouded by current industrial relations problems. While exceptional wage demands in the public sector directly exacerbate budgetary deficits, such wage demands in the private sector undermine Swaziland's one clear advantage in relation to some of its neighbors (mainly South Africa) with respect to its relatively low real wages. Current Swazi wages for skilled labor are less than half those ruling in South Africa. This helps mitigate, to a considerable extent, Swaziland's disadvantages with respect to infrastructure. However, in recent wage negotiations, increases as high as 30 percent have been routinely obtained. Similar demands are currently being made and factory lock-outs and sporadic violence are becoming more common. The lack of professionalism manifest in the conduct of industrial relations so far by all the concerned parties, labor unions, employer groups and the Government, make the prospect of an orderly evolution uncertain. In the preparation of this report, employers unanimously cited the current industrial relations environment as a dominant deterrent and a major cause for concern.

G. INVESTMENT POLICY REGIME

1.16 The investment policy regime consists of the protective environment provided under the SACU trade regime, the legal framework provided by the Companies Act, and corporate taxation policy. The SACU trade regime has recently undergone considerable change as evident in the implementation by South Africa of its proposals to the World Trade Organization (WTO). The current tariff regime is a significant improvement on the hitherto highly variable nominal and effective rates of protection. If this is followed by the elimination of remaining non-tariff barriers and a quicker transition to low tariffs in South Africa, significant progress would be made toward a distortion-free trade regime. Similarly, progress is being made toward revising the out dated Companies Act, developing a new Securities Act, lowering the statutory corporate tax rate, and simplifying and making more transparent the investment approval process. Current anomalies with respect to the issuance of residence and work permits, vital for non-Swazi investors, is also under active consideration. Many of these changes are envisaged under the **Cross Border Initiative (CBI)** and are likely to be implemented soon.

H. GROWTH OBJECTIVES AND FINANCIAL INTERMEDIATION

1.17 The central objective of public policy in Swaziland should be to seek a revival of net investments on a sustainable basis and, through the process, create employment and increase incomes. As noted above, stable macroeconomic management and orderly industrial relations are crucial to the process. With a population growth rate of 3.6 per cent per annum, Gross Domestic Investment (GDI) will need to revert to earlier levels, about 25 percent, to have a visible effect on per capita GDP.[2] Required Gross Domestic Savings (GDS) will need to be in the region of 15 percent -- compared to less than 5 percent at the moment. The 15 percent target is slightly above the Sub-Saharan average, but well below the South Asian rate of about 20 percent. A reversal of current trends in public finance will be an essential element of this strategy.

1.18 The orders of magnitude suggested for GDI and GDS above are, of course, very optimistic and well beyond the Government's own projections which envisage an average GDP growth rate of less than 3 percent per annum over 1995-97 with consequently declining per capita GDP.[3] A crucial contributing factor is the projected decline, *in real terms*, of Foreign Direct Investment, which in the 1980s have often been close to 15 percent of GDP but in recent years has been practically negligible. It is unlikely that the halcyon days of the late 1980s for FDI will be recaptured given the increasingly competitive regional investment environment. Nonetheless, a major policy objective of the Government should be to restore FDI to at least 10 percent of GDP. Swaziland's disadvantages in terms of its investment policy regime are not insuperable and can be addressed with a reasonable chance of success. However, prospective changes in the SACU regime and those envisaged under the CBI will need to be supplemented by orderly industrial relations.

1.19 A large part of the investment during the late-1980s was highly capital-intensive. The discretionary dispensation of investment incentives, particularly through corporate taxes, had

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[2] The estimated GDP growth rate would be about 6 per cent on an assumed ICOR of 3.3.

[3] Draft Development Plan, 1995/96 - 1997/98, Ministry of Economic Planning and Development.

biased such incentives to the detriment of employment creation. Given the magnitude of the unemployment problem, a more labor-intensive pattern of industrialization will be necessary. This could come in the form of light industries in which Swaziland now has a foothold. Maintenance of Swaziland's wage/productivity advantage will be all-important. This will only come through sound management of industrial relations.

1.20 There also has to be renewed emphasis on private domestic investment, particularly in the area of small- and medium-scale enterprises. There is now a sense of movement in this area, particularly in small/micro enterprises, and it is essential that financial intermediation does not pose a constraint on their development. It is well-known that the commercial banking system does not address the needs of this sector. The recent collapse of the Swazi Development and Savings Bank, which was mandated to address such needs, is not reassuring for the future of development banking. However, the dynamism of the cooperative credit institutions and the active presence of some non-Government Organizations (NGOs) now being supported by Tibiyo offers hope that efficient intermediation, properly regulated, will not pose a constraint.

I. THE STRUCTURE OF SWAZILAND'S FINANCIAL SECTOR

1.21 For a small country, Swaziland has a small, but relatively well diversified and developed financial sector. Apart from the central bank, the majority of the sector is privately owned and operated in an economy which is relatively free of economic distortions.

1.22 **Central Bank of Swaziland**. The financial system is supervised by the central bank, which is charged with responsibility for monetary policy and banking supervision. The Central Bank of Swaziland was established in terms of its own founding act -- the Central Bank of Swaziland Order, 1974. The CBS operates in a relatively de-regulated financial environment. Interest rates are deregulated, and the central bank determines a discount rate which is rarely used, as most of the banks have excess liquidity -- therefore not needing to resort to the central bank as a source of funding. The central bank has a banking supervision department which supervises and regulates the activities of the deposit taking institutions within the economy. Under the terms of the Common Monetary Area, the CBS operates with the same foreign exchange regulations as neighboring South Africa. The bank operates two credit guarantee schemes -- one for small scale credit and another for exports. The central bank did, for a period, issue central bank paper but is now more involved in the issuance of Treasury Bills.

1.23 **Commercial Banks**. Swaziland has five commercial banks -- Standard Chartered Bank, Barclays Bank, Stanbic (owned by Standard Bank, South Africa), First National Bank, and the Swaziland Development and Savings Bank. The former four banks are majority owned by their parent banks, although all commercial banks (except First National), have a minority Swazi Government participation. In addition, Standard Chartered Bank has sold 15 percent of its shares to the general public in Swaziland, and Barclays Bank intends to also follow suit at some stage in the future.[4] The commercial banks are registered in terms of the Financial Institutions (Consolidation) Order (1975) although the SDSB was established under the terms of the Swaziland Development and Savings Bank Order (1973).

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[4] Barclays Bank had intended to issue shares to the public in 1990/91 but was dissuaded from doing so as a consequence of weakening economic conditions -- which had a negative impact on the bank's bottom line operating position.

(a) Barclays Bank is a subsidiary of the UK registered bank Barclays Bank PLC. Barclays Bank UK has a 60 percent shareholding in the bank and the remaining 40 percent is owned by the State. The bank operates through nine branches and four agencies.

(b) First National Bank is a newly established subsidiary of the South African based First National Bank which took over the operations of Meridien Bank in April 1995. The bank is 100 percent owned by its South African holding company. The bank operates through three branches and one agency.

(c) Standard Chartered Bank is a subsidiary of the UK registered bank Standard Chartered Bank. Standard Chartered UK hold 55 percent of the shares, the State owns 40 percent and the general public owns a further 5 percent. The bank operates through five branches and six agencies.

(d) Stanbic Bank is a subsidiary of the South African based Standard Bank Investment Corporation (Stanbic). Stanbic holds 70 percent of the shares, the Swaki group holds 20 percent, and the State holds the remaining 10 percent. The bank operates through four branches.

1.24 The commercial banks, including the Swaziland Development and Savings Bank, have over 25 branches nationwide and effectively dominate the formal financial sector, averaging over 57 percent of the total deposit funds raised from the public and 72 percent of all loans and advances within the system over the past five years.

1.25 The Swaziland Development and Savings Bank has assumed the savings deposit functions of the old post office system in Swaziland, and has gradually expanded its traditional role as an agricultural bank to include a full range of commercial banking functions to all sectors. It now reports that approximately 38 percent of its total loan portfolio is extended to the "business sector". It is wholly owned by the Government of Swaziland, and its deposits are fully guaranteed by the Government. It is virtually the only term lending bank in Swaziland at the current time. Its main sources of funding, apart from its deposit base, include Government funding/deposits and donor loans.

1.26 Over much of the 1980s, the commercial banks experienced high levels of liquidity. Faced with little alternative, remunerative application of these excess funds in Swaziland, the banks tended to invest in South Africa where returns were higher than corresponding rates prevailing in Swaziland at the time. Membership of the Common Monetary Area (CMA) allows for the free flow of funds between the two countries to be relatively simple. This has been made more attractive by the fact that the Swazi authorities have maintained a differential in interest rates between Swaziland and South Africa, although this differential has narrowed recently. Given the free flow of funds between the two countries, the concept of excess liquidity in the banking system may not be a true measure of financial resources which were "in excess" of the demand for loanable funds in Swaziland.

1.27 **Swaziland Building Society**. Housing finance needs in Swaziland are mainly provided by the Swaziland Building Society (SBS) which is registered in terms of the Building Societies Act (1962). The Building Society has experienced strong growth in the recent past with mortgage lending increasing to E122 million in the year to March 1995. Although some high

cost housing is financed by the commercial banks, their involvement in the housing mortgage market is relatively restricted at this stage.

1.28 **Swaziland Industrial Development Company Limited**. The SIDC is a joint venture development finance company which was established by the Government in conjunction with major international development finance institutions, to assist in Swaziland's development. The Company is involved in financing investment projects in mining, industry, agri-business, tourism, commerce, and the service sectors. In addition to loan and equity investments, the company is involved in the provision of industrial buildings for lease and the provision of advisory services. It accesses both local and international sources of financing for the projects in which it participates.

1.29 **Contractual Savings Institutions -- Pension and Provident Fund** business is conducted through the Swaziland National Provident Fund (SNPF), the Royal Swaziland Insurance Corporation, the Public Service Pension Fund, and a series of privately managed funds. The Swaziland National Provident Fund is a compulsory life assurance scheme for private sector employees which was established in terms of its own founding act the Swaziland National Provident Fund Act (1962). A large share of its assets are invested in real estate in Swaziland -- possibly over exposing itself in a rather il-liquid market, subject to potential market fluctuations. The Government began to fund its own Public Service Pension fund in 1993 from accumulated savings. The Public Service Pension fund is invested in South Africa. The most dynamic part of the sector, however, has been the large number of smaller pension and provident funds (estimated at around 200) which have tended to invest their resources (estimated at around E600 million in 1995) in South Africa -- although proposed legislative changes will require these pension funds to hold a minimum of 15 percent of their asset base in Swaziland. Taken as a group, these contractual savings institutions are emerging as the fastest growing and most dynamic component of the financial sector. If future growth continues as it has in the recent past, these institutions will soon surpass the commercial banks in terms of total assets managed.

1.30 **Insurance Business**. Up to the current time, insurance business has been mainly conducted through the Swaziland Royal Insurance Corporation (SRIC), established under the Swaziland Royal Insurance Corporation Order (1973). The Royal Swaziland Insurance Corporation also manages a small amount of pension and provident fund business -- as well as issuing life insurance policies. However, the Government has decided to de-monopolize the insurance industry and from 1995/6 will permit four new insurance companies to enter the market in direct competition with SRIC. Shares in SRIC have been sold to the general public, and it is the Government's intention to gradually divest itself of its share-holding in this company (the other shareholders in SRIC include six South African corporations). Excess funds collected by the Insurance Corporation, have largely been invested in Swaziland -- although, increasingly the Corporation is investing in South Africa.

1.31 **Swaziland Stockbrokers Limited**. Swaziland also has a Stockbroker (Swaziland Stockbrokers Limited -- SSL), which is involved in both debt and equity issues. SSL is registered in terms of the Financial Institutions (Consolidation) Order (1975) and is owned by the Government, the central bank, the Commonwealth Development Corporation, Barclays, Standard, SDSB, and First National. Equity issues have been limited, with only three issues to date -- Standard Chartered Bank, Royal Swazi Sugar, and Swaziland Spa Holdings. The general economic downturn in the 1990s has had an adverse impact on the performance on some of these companies (notably Standard Chartered) which has led to poor earnings and correspondingly

poor returns for shareholders (no dividends have been paid on Standard Chartered shares since 1991 -- and none is anticipated before 1996). Capital appreciation for some of the shares, has, however, been reasonably good.

1.32 Debt instruments have fared somewhat better than equity instruments. There have been three Government stock issues, one private stock issue, and three debenture issues. The most recent issues were for Swazi Breweries, Royal Swazi Sugar, and a recent issue of E16 million for the Post and Telecommunications Corporation (with a yield of 13.25 percent). Primary market activity in both debt and equity issues is largely confined to institutional investors and secondary market is thin.

1.33 **Cooperatives.** A number of Savings and Credit Cooperatives are also active in Swaziland particularly in the agricultural sector. The legislation pertaining to co-operatives is administered by the Ministry of Agriculture and Co-operatives. Co-operative societies are by law empowered to undertake deposit-taking activities, subject to certain conditions. This sector has been growing very rapidly in the recent past with several Cooperatives having assets over E1 million, and the largest having assets of around E9 million at the end of 1994.

1.34 **Other Financial Institutions**. There are, in addition, other financial institutions in Swaziland such as SEDCO -- the Small Enterprise Development Company -- which had a role in providing finance to the small scale sector in the first part of the 1980s; and the Swaziland Business Growth Trust (SBGT), developed with USAID support and registered in terms of the Financial Institutions (Consolidation) Order (1975). The latter is primarily responsible for providing financial business services as well as working capital, on a revolving basis, to small-scale enterprises.

1.35 **Traditional Banking Activities**. Some traditional banking activity takes place in Swaziland -- albeit on a limited scale. Village money lenders or *shylocks* as they are called in Swaziland operate -- as do rotating savings and credit associations (ROSCA's) which are known as *Stokvelds*. They are reputedly not as wide spread as they are in South Africa. Some of these informal credit organizations have developed into more formalized cooperatives, some of which are reasonably large and operating with excess funds.

1.36 Women's Clubs also exist which provide financial support for women (savings and lending services) in the same way as the ROSCAS. Married women are legally disadvantaged in their treatment within the banking system, as Swaziland has adopted the Roman Dutch Law of South Africa which treats married women as legal minors under the law. Unable to be sued in a court of law (as a legal minor), women cannot undertake many financial activities without the consent of their husbands -- including opening a new account, taking out a loan, and so on. Although the application of this discriminatory practice is seemingly not uniform, it nonetheless serves to place impediments to the development of an important group of entrepreneurs in Swazi society.

1.37 **Structure of the Financial System**. The structure of Swaziland's financial sector is shown in Table 1.2 and Chart 1.2. This Table and Chart indicate the predominant role that is played by the central bank and the commercial banks. The remainder of the financial system is largely accounted for by the pension and provident fund industry. Within the commercial banking sector, Barclays Bank dominates, being over twice as large as its next largest competitor -- Standard Chartered Bank.

Chart 1.2:

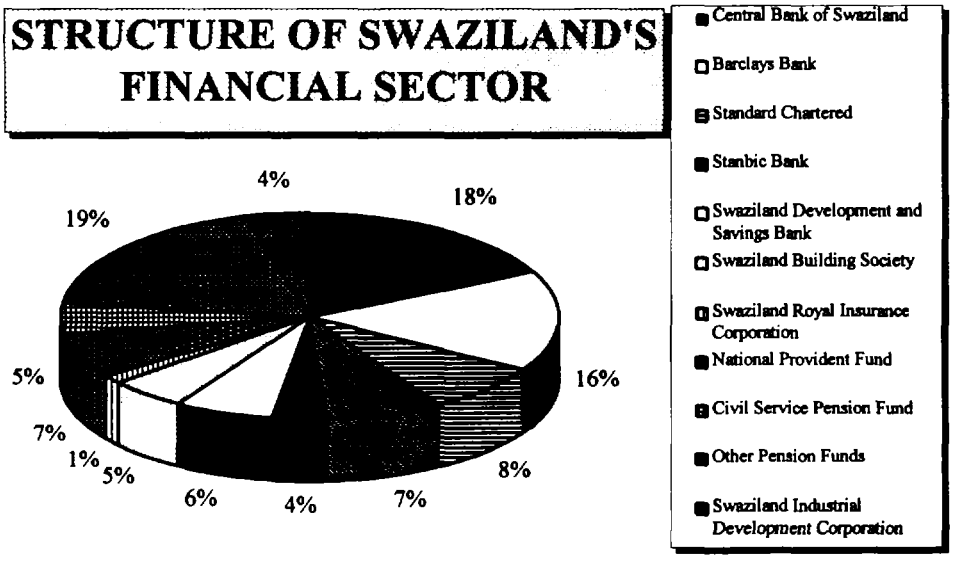


Table 1.2: Swaziland's Financial System
Distribution of Total Assets, 1994
(emalangeni)

	Total Assets	Percent
Central Bank of Swaziland	575,051,000	17.80
Commercial Banks	1,324,305,000	41.00
Barclays Bank	*(509.884,000)*	*(15.78)*
Standard Chartered	*(254,969,000)*	*(7.89)*
Stanbic (Standard Bank South Africa)	*(238,189,000)*	*(7.37)*
First National	*(116,881,000)*	*(3.62)*
Swaziland Development and Savings Bank	*(204,382,000)*	*(6.33)*
Swaziland Building Society	162,959,000	5.04
Swaziland Royal Insurance Corporation	42,159,000	1.31
Swaziland National Provident Fund	226,314,000	7.01
Public Service Pension Fund	162,394,000	5.03
Other Pension Funds	600,000,000	18.57
Swaziland Industrial and Development Corporation	137,000,000	4.24
TOTAL	3,230,182,000	100.00

CHAPTER TWO
THE CENTRAL BANK
MONETARY POLICY AND BANKING SUPERVISION

PART I. MONETARY POLICY

2.1 The Swazi economy is intimately linked with the South African economy by more than just geographical location. It is a member of the Southern Africa Customs Union (SACU) and the Common Monetary Area. Swaziland's close interlinkages with South Africa can also be seen in its level of trade. South Africa provides approximately 85 percent of Swaziland's imports and is the destination for around 45 percent of Swaziland's exports. Between 40 and 50 percent of fiscal revenues are derived from Customs Union receipts, and though there have been cut-backs in recent years, nearly close to 18,000 Swazis are employed in South Africa.

A. THE RAND MONETARY AREA AND THE COMMON MONETARY AREA

2.2 An important feature of monetary policy in Swaziland -- resulting from its close economic ties to South Africa -- is its participation in a Common Monetary Area with South Africa, Lesotho, and Namibia. This agreement was originally called the Rand Monetary Agreement (RMA) and provided for the circulation of the South African rand in the participating countries, while allowing for the issue of parallel national currencies by the smaller members, for circulation within their own territories. Swaziland chose to exercise this right in September 1974, and issued its own currency, the lilangeni, at par with the rand. Under the agreement South Africa was responsible for the management of the rand currency and the gold and foreign exchange reserves of the entire area and dealers in Swaziland were obliged to sell all foreign exchange, other than small working balances, to the South African Reserve Bank (SARB) in return for rand credited to their accounts.

2.3 The Agreement also provided for an unrestricted (and unrecorded) transfer of funds for both current and capital transactions, within the monetary area. This effectively limited the power of the Swazi monetary authorities to alter the national money supply. The amount of rand in circulation in Swaziland at any one time is unknown and thus uncontrolled. The agreement also gave Swaziland access to South African capital and money markets, and made the SARB a "lender of last resort" for the smaller member governments.

2.4 Monetary integration under the agreement implied a uniform exchange control system. Although exchange control authority rests with each member country, the exchange rate for the rand and the management of the pooled foreign reserves was determined by South Africa. South Africa, nonetheless, has a formal obligation to consult its partners when changes in exchange rates or regulations are imminent. Finally, the agreement stipulated that South Africa pay compensation based on the estimated circulation of the rand in Swaziland and Lesotho.

2.5 A number of changes were instituted in the agreement, the most important taking place in April, 1986, when the Common Monetary Area (CMA) replaced the RMA -- the change in name being necessitated by Swaziland's decision to have an option to de-link its currency from the rand. From that date, the rand ceased to be legal tender in Swaziland even though it has continued to circulate with the lilangeni. Swaziland continued, however, to retain the parity status of the lilangeni to the rand. In 1991, Namibia acceded to the CMA Agreement, on similar terms as Lesotho.

2.6 For the smaller countries, the CMA agreement and the subsequent changes constitute small, but crucial, steps toward more independent monetary arrangement and some discretion in monetary and foreign exchange management. As a result of these changes, the Central Bank of Swaziland was given some discretion in foreign exchange management, permitting the bank to deal more efficiently with any volatile behavior of the South African financial markets and hedge against major fluctuations in the value of the rand. At the same time Swaziland retained the right of access to the South African money and capital markets.

2.7 However, there are still two fundamental restrictions that remain for the CBS since the 1986 amendments. First, Swaziland has no control over its exchange rate as long as the lilangeni remains pegged at par to the rand. Second, the central bank is not empowered to make any fiduciary issue (issue currency unbacked by gold or foreign reserves). The disadvantage of this constraint is that it limits the capacity of the Government to affect the money supply by changes in the stock of notes and coins in circulation. The supply of emalangeni must be fully covered by convertible foreign assets including rand assets.

2.8 The RMA Agreement and the creation of a Monetary Authority in 1974; the creation of a central bank and the implementation of central bank functions in 1978; and finally the CMA agreement of 1986; constitute important steps toward more independent monetary arrangement. Despite these developments, the close ties between the Swazi and the South African economies remain, in terms of trade, factor, and financial markets. This imposes a constraint on Swaziland's ability to conduct an autonomous monetary and financial policy, irrespective of whether it remains a member of a formal monetary union or not.

B. MONEY SUPPLY AND THE INDETERMINATE MONETARY BASE

2.9 The main drawback of a common currency (or a currency at par) for Swaziland, is the loss of independence in monetary policy and an inability to alter the national money supply or to manage base money. With a common currency, the money supply is controlled from South Africa and Swaziland cannot create money on its own. As a consequence, budget deficits can only be financed by borrowing in domestic or international capital markets, and not through the creation of money by the monetary authorities. To date, this has not been a constraining issue, as the Government has been a net creditor with the banking system. In addition, rand asset holdings far exceed the emalangeni currency in circulation even when Swaziland was legally bound to maintain a 100 percent backing in rand.

2.10 The extent to which autonomy is scarified differs between member countries of the Agreement. In the CMA, the amount of rand in circulation in the whole area is determined by South Africa, whilst the emalangeni issues have to be backed by holdings of convertible foreign currencies including rand assets. At present, the stock of currency in circulation in Swaziland is made up of emalangeni and rand issued by the South African Reserve Bank. Although the total amount of rand in circulation in the whole CMA is known, the proportion circulating in Swaziland is unknown (reportedly about 25 percent of total notes at any one time). The rand is not legal tender but is freely used as a medium of transaction and held as liquid assets. This fact of the rand's presence in the transactions stream complicates Swaziland's monetary management. Rand are liabilities of the South African Reserve Bank, subject to, *inter alia*, South Africa's net foreign reserves level and budgetary deficit. In other words, rand in circulation in Swaziland are not subject to any control by the Central Bank of Swaziland. Thus effectively, the Swazi money supply is indeterminate because the monetary instruments that CBS can bring to bear on the

money supply cannot address a large segment of the *Base Money*. The normal notion of income velocity and its stability as a basis of monetary policy is thus hardly applicable to Swaziland. Thus, the data in Table 2.1, includes only emalangeni notes and coins because there is no accurate way of establishing the circulation of rand currency in Swaziland at any point in time. The broad money supply (M2) includes emalangeni currency in circulation, and all other deposits of households and enterprises with commercial banks, but excludes government deposits.

2.11 The share of emalangeni in the broad money supply, M2 increased during the first six years (1974 to 1980) to about 7.6 percent, a proportion which had grown to approximately 9.8 percent by December, 1994. The volume of emalangeni in circulation does not seem to have grown at the expense of rand even after the CMA agreement of 1986; its share of the broad money supply has remained relatively stable (at between 8 to 10 percent). For the entire period, the growth rate of "other deposits" has been significantly above the growth rate of GDP, indicating a high income elasticity of deposits.

Table 2.1: The Money Supply, 1980-1994
(E million, end of period)

Year	Emalangeni in Circulation	Other Deposits	Money Supply (M2)	M2/GDP
1980	11,902	121,808	133,704	0.32
1985	17,454	275,808	293,262	0.35
1990	48,190	641,478	689,668	0.29
1994	69,592	1,112,172	1,181,764	0.39

Source: CBS Quarterly Review and IFS

2.12 The ratio of M2/GDP is an indicator of the flow of bank loanable funds in relation to the size of the economy. The ratio of M2 (excluding rand) to GDP for Swaziland is also shown in Table 2.1. This ratio grew from 0.32 in 1980 to 0.39 by 1994. This is important as these assets represent potentially investible funds.

2.13 Hence, the availability of domestic bank loanable funds in Swaziland (classified as a lower middle income country) has been high during this period (above the ratio of 0.20 to 0.25 of several of the semi-industrial and less developed countries -- but lower than the 0.60 for industrial countries). If one included rand in circulation in the Swazi economy, in M2, then this ratio would be improved even further. Generally, there has been surplus liquidity in Swaziland over this period, and domestic savings have been channeled outside of the country as a capital outflow. This situation has persisted despite the attempts of the monetary authorities to require local institutions to hold capital and deposits in the form of local assets and to create institutional arrangements for long-term credit, and thus to transfer credit to domestic investments.

C. EMALANGENI ISSUES AND CONSTRAINTS

2.14 Under the CMA agreement of 1986, the currency issued in Swaziland can be backed not only by rand, but by all convertible currencies. Table 2.2 shows foreign assets (net of liabilities) of the Swaziland banking system from 1980 to 1994.

2.15 Although about 60 percent of Swaziland's exports are directed outside South Africa, most foreign transactions are carried out in rand without any exchange control. The balance of payments of the entire union with the rest of the world is regulated at the union level and the CBS must dispose part of its external assets into the common foreign reserve pool. Thus, Swaziland's non-rand foreign transactions contribute to the foreign exchange pool of the CMA. Nonetheless, the viability of its own balance of payments is as important to Swaziland inside the CMA as what it would be if the country was outside the union -- because it has to meet all its foreign currency obligations from its own foreign reserve resources. Emalangeni cannot be created without the CBS making a corresponding deposit of convertible foreign currencies or rand assets.

Table 2.2: Net Foreign Assets of the Banking System, 1980-1994
(E million, end of period)

Year	Net Foreign Assets	Commercial Banks	Central Bank
1980	113,843	3,014	80,510
1985	211,873	11,336	200,537
1990	636,319	111,678	524,641
1994	981,949	89,074	892,875

SOURCE: Central Bank of Swaziland, Quarterly Review

2.16 The net foreign assets of Swaziland's banking system change in any one year by an amount approximately equal to the overall surplus or deficit of Swaziland's balance of payments. When the first emalangeni were issued in September 1974, Swaziland's foreign assets consisted almost entirely of the rand deposits made as cover for emalangeni. However, the Monetary Authority of Swaziland (the precursor to the Central Bank of Swaziland), used various methods to get the commercial banks to transfer their substantial rand deposits held in South Africa (in excess of their working balances) back into Swaziland. The most important measure was the minimum local assets requirement (MLAR) imposed in 1975, requiring the banks to hold 95 percent of total liabilities in the form of domestic assets. The main objective of this requirement was to induce banks to invest their resources in domestic projects -- in order to stimulate development of the country. However, to the extent that banks could not find outlets for productive investments, the MLAR contributes to the concentration of the external assets of the system in the hands of the Central Bank.

2.17 As a consequence, the foreign assets of the CBS increased more than five fold between 1985 and 1994 -- to reach E892.9 million. Emalangeni in circulation followed the same trend and surpassed E10.0 million in 1980 and constituted about 14.8 percent of the CBS's foreign asset holdings (clearly indicating ample potential for creating additional emalangeni). Thus, in practice, CMA membership has not been a binding constraint on emalangeni issues. A constraint will, of course, occur only in the event of prolonged balance-of-payments deficits, since that would lead to an outflow of foreign currency, including rand.

Table 2.3: Domestic Credit and Net Foreign Assets (1980-1994)
(E million, end of period)

Year	1980	1985	1990	1994
Business Enterprises	73,697	117,800	311,986	569,843
Households	15,915	25,992	86,871	189,352
Private Sector, Total	89,612	143,792	398,857	759,195
Statutory Bodies	4,233	2,405	1,689	15,742
Government, Net	0	0	0	0
Domestic Sector, Total	93,845	146,197	400,546	774,937
Net Foreign Assets	113,843	211,873	636,319	981,949
Grand Total, Net	207,688	358,070	1,036,865	1,756,886

SOURCE: CBS Quarterly Review

D. NON-CONVERGENT FISCAL/MONETARY POLICY BY CMA MEMBERS

2.18 In addition, there is no obligation for any of the signatories to the CMA to pursue a convergent fiscal/monetary policy. However, given the unrestricted financial flows within the union it would be logical for the signatories to seek such convergence so as to avoid mutual destabilization. For example, an inflationary spiral in South Africa could easily translate into an inflationary spiral in Swaziland given the latter's import-intensity and the fact that the currencies are at par. Discretionary fiscal/monetary policy on the part of the smaller economies to achieve a stable macroeconomic environment will thus have a limited scope for success if South Africa is not agreeable to pursue the same policy. To deal with this situation, and the realities of their relationship with their large and economically dominant neighbor, it would be useful if the CMA member states sought to establish a stronger consultative process to achieve such a convergence in macroeconomic management (see Chapter 9).

E. MONETARY POLICY OBJECTIVES AND FINANCIAL INTEGRATION

2.19 Swaziland's most important economic goals include the strengthening of the domestic productive base, in particular the manufacturing sector, in order to provide employment and reduce Swaziland's vulnerability to external factors. A strong external sector and a healthy fiscal position in the second half of the 1980s tended, to some extent, to put long-run macro-economic policy issues into the background. However, the room for independent monetary stabilization in Swaziland is limited, as monetary policy effectiveness is reduced severely by monetary integration.

2.20 The very high propensity to import in Swaziland means that domestic policies influencing aggregate demand largely spill over to foreign trade and have only small direct multiplier effects within the domestic economy. Consequently, while demand management can be used as a policy for maintaining Swaziland's balance of payments position, it is not an efficient instrument for ensuring industrial growth or for attaining a low unemployment rate and stable wages and prices. Consequently, the emphasis of development policy should be on the

supply side of the economy -- through the mobilization/availability of capital and the provision of human resources.

2.21 A strong external sector, and a strong propensity to save, has meant that a high level of savings has built up within the Swazi economy over the past decade. In a normal environment, one would anticipate that this would put downward pressure on interest rates and increase the availability of credit. As a result, it becomes profitable to undertake new investment projects. The integration of the money and capital markets of Southern Africa, however, means that if interest rates decline in Swaziland while rates remain at higher levels in other parts of the CMA, then capital is likely to move out of Swaziland and into those countries offering a higher rate of return on financial assets. On the other hand, the possibility of being able to borrow in a large integrated capital market is a counter-balancing benefit for Swaziland, to the lack of capacity it has to move interest rates significantly away from the other members of the CMA -- specifically South Africa. The CMA agreement provides for the right of access of the Government, its public bodies, financial institutions and business enterprises to the South African capital and money markets. Swaziland may issue public securities (stocks, bonds, notes, bills and other securities issued by financial institutions subject to government supervision) as prescribed investments or approved securities in which South African institutions may invest (although there are limitations placed on the investment by South Africans in the issues of the LNS).

2.22 Lastly, encouraging domestic savings has not been a high priority given the large amount of savings which already exist in the Swazi economy. Nonetheless, this pattern of savings will almost certainly change over time and it is important that savers continue to save -- encouraged to do so by positive real returns. Although negative real returns have not had an obvious adverse impact on savings mobilization, to date, they have undoubtedly encouraged some Swazi's to continue to save in traditional forms (mostly cattle) rather than in financial forms, or alternatively, to invest in South Africa. It is important for the long run development of the Swazi economy that financial savings remain at reasonably high levels and that returns on savings are sufficiently high in real terms to ensure this result.

F. CURRENCY UNION PROSPECTS

2.23 A major issue for the success of a monetary union is the degree of integration of markets. Breaking away from the current monetary arrangements would appear to be a fairly impotent step for Swaziland given the high degree of integration in major markets (trade, capital and labor). Such a move is unlikely to have any benefits in ameliorating the negative effects of shocks anticipated in the near future, unless it is backed by a battery of administrative controls. In addition, the short-term inflationary adjustments, which could be made possible through an independent exchange rate policy, should not overshadow the medium to long-term objective of accelerating economic growth and creating employment through increased investment, and the expansion of exports through a diversification of products.

2.24 The main conclusion is that, in the current situation, income is maximized by promoting integration with South Africa and by not impeding labor flows to the developed core areas of that country[1]. Trade and capital mobility are key factors -- as Swaziland's main benefits of

[1] Although there are also undoubted costs to Swaziland of the free movement of labor as many highly skilled Swazis take up positions in South Africa attracted by the higher wages on offer there.

integration. This is important because, the limited domestic market, the small industrial sector, the relatively low productivity of domestic industry, and the lack of absorptive capacity in both the private and government sector in Swaziland, means that basing future development on its domestic economy would be a very difficult, and possibly short sighted, endeavor. Instead, in the interests of greater regional economic integration, through such institutions as SADC and under such initiatives as the Cross Border Initiative, the countries of the region should be looking at closer economic integration, and a greater harmonization of policy, with a larger number of regional participants (Zambia, Zimbabwe, Malawi, Botswana, Mozambique, Angola, and Tanzania).

2.25 For Swaziland, this means that continued membership of the CMA and other agreements which bind the economy closely to that of South Africa and the other smaller regional partners is likely to provide the best growth prospects. This would also imply a continuation of past exchange rate policies which provide a certain amount of economic discipline to the Swazi economy. Only in the circumstances where the South African economy began to experience serious economic difficulties -- associated with the implementation of unsound economic policies in that country -- should Swaziland contemplate breaking the ties which currently exist. Even in such an "worst case" scenario, the degrees of freedom available to the Swazi authorities will be severely limited given the pre-dominant size of the South African economy and the closeness of the economic relationships. Nonetheless, the rand remains a vulnerable currency -- as recent developments have shown -- and any rapid depreciation of that currency could have adverse implications for Swaziland.

G. INTEREST RATE POLICY

2.26 Swaziland's interest rate policy has been a major issue in relation to its growth objectives. As Charts 2.1, 2.2. and 2.3 below show, both the lending and deposit rates, except during 1989 and 1992, have been negative in "real terms." In addition, Swaziland's interest rate structure is below that of South Africa. For prime lending rates, the difference is narrowing but for deposit rates, the difference is widening. Negative lending and deposit rates have re-emerged over the last two years. The implications of this are of great consequence for Swaziland's growth prospects.

Chart 2.1

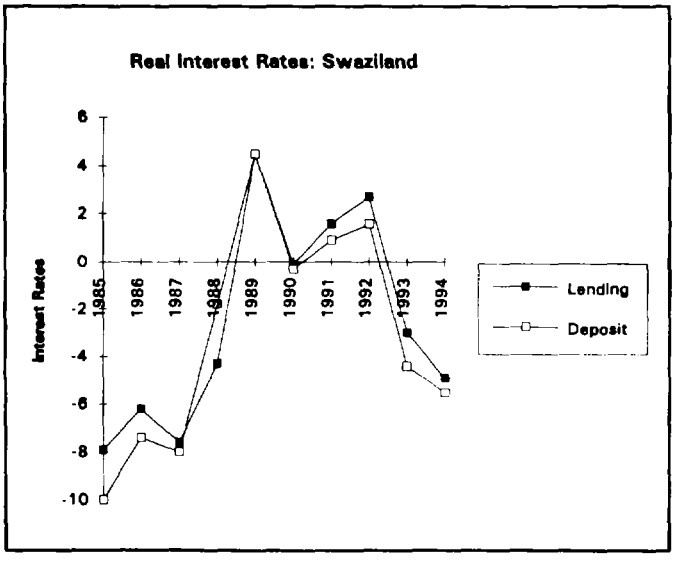


Chart 2.2

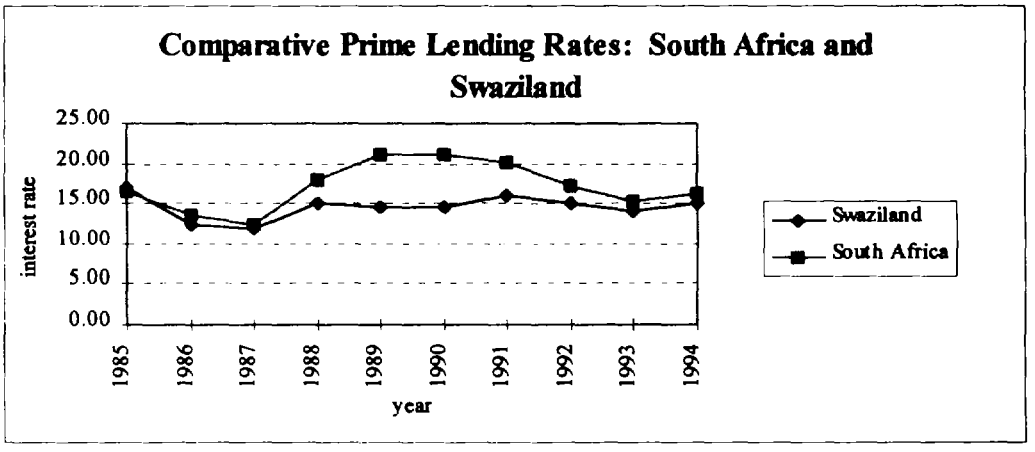
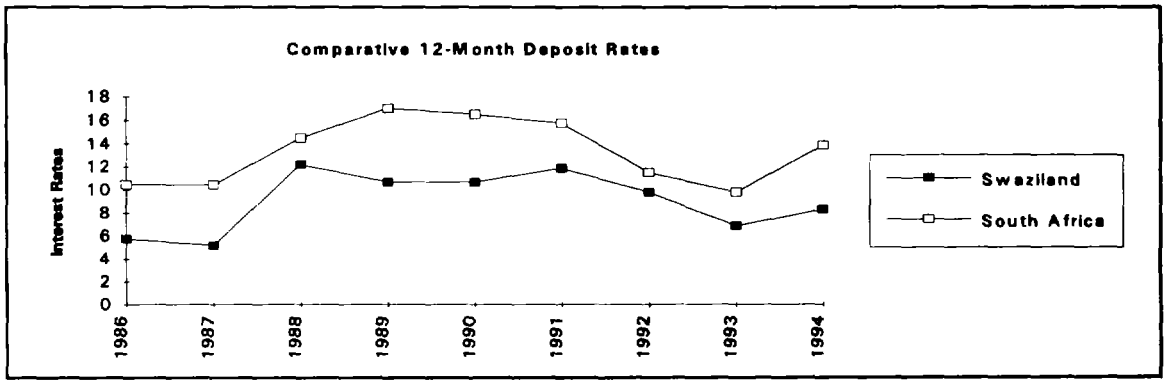


Chart 2.3



2.27 It has been suggested that the "negative real lending rates" which have existed in Swaziland for most of the last decade has been instrumental in creating a *capital-intensive bias* to the manufacturing base[2]. The nature of the industries which moved into Swaziland in the sanctions era which are inherently capital-intensive (Coca Cola for example), probably had a great deal to do with such an outcome. Whether the low cost of capital it was enough to overcome Swaziland's comparative wage advantage is an empirical issue subject to confirmation. Nevertheless, other things remaining equal, the "negative real lending rate" would certainly have encouraged such a bias. It is generally agreed that the margin of the Swaziland lending rate below that prevailing in South Africa (maintained as 250 basis points over the South African Discount Rate) has not been an effective instrument in promoting private investment in Swaziland. Instead borrowings by South Africa subsidiaries in Swaziland have been used to finance operations of their parent companies. If anything, such a policy has facilitated consumption rather than investment, as the accounts of the Swazi Bank suggest.

[2] Impressionistic at this moment, in the absence of necessary data.

2.28 With respect to the "negative real deposit rate," at a minimum, it had constrained mobilization of savings even if it did not affect the savings decision (i.e. the savings/GDP ratio). In addition, negative real returns on savings are likely to have had an impact on the savings portfolio of households -- encouraging them to save in traditional forms such as cattle rather than as financial savings. This is more true of the household sector since the larger depositors are likely to be less traditional and are also able to negotiate higher rates within the banking sector. In any case, corporate savings decisions are not usually as sensitive to interest rate fluctuations.

2.29 The re-emergence of negative real interest rates in the last two years is of major macroeconomic concern. As noted in Chapter One, there is a need to raise the domestic savings ratio so as not to constrain domestic investment necessary for positive per capita income growth. While the issue of the impact of the interest rate on savings is hardly settled, there is, however, a general consensus that it facilitates savings mobilization and intermediation, and therefore, promotes allocative efficiency of investible resources. The current policy of maintaining a negative return should, at least on this account, be reconsidered. Arguably, it could also promote the development of a savings habit among the informal sector. The emergence of a large number of non-Bank financial intermediaries and their rapid growth are hopeful signs.

2.30 Similarly, the policy of maintaining a differential lending rate from South Africa should also be reconsidered. It probably has a deleterious effect on the factor-intensity when the needs are for a *labor-intensive bias* to investments given Swaziland's high unemployment ratio. In any case, its effectiveness in promoting investment in Swaziland is entirely a matter of presumption judging from extensive discussions with the investors. The dominant considerations in the investors' decisions are: market access, a low wage rate and stable industrial relations, and corporate taxation. In the meantime, the pursuit of this policy has had the effect of promoting a transfer of investible resources from Swaziland to South Africa!

H. CONCLUSIONS ON MONETARY POLICY ISSUES

2.31 This review of monetary policy issues points to several important policy decisions which should be addressed. The main conclusions of this section are that:

(a) Swaziland has very little discretionary monetary policy capacity under existing arrangements and agreements which bind it closely to the South African economy -- mainly the CMA and the SACU agreement. Nonetheless, sheer relative sizes and relative proximity would dictate that, even without being a member of either of these agreements, Swaziland's future would be inextricably linked to that of South Africa. In such an environment, and with such a pronounced dependence, Swaziland should seek to extract the maximum possible advantage from its close relationship with South Africa.

(b) Unless economic policy management in South Africa deteriorates seriously, Swaziland should retain its membership of the CMA for the advantages which such membership affords. Even if economic management does deteriorate

significantly in South Africa, Swaziland's degrees of freedom to operate independently, will be severely constrained by existing economic realities.

(c) This implies that the lilangini should retain parity with the rand for the foreseeable future.

(d) The monetary authorities in Swaziland should undertake a serious review as to the effectiveness of the operation of the Minimum Local Asset Requirement to determine whether it is having the desired effect.

(e) Swaziland, along with the other smaller members of the CMA, should seek to establish stronger channels of communication and co-ordination with the South African monetary authorities, to ensure that there is strong co-ordination, and understanding, of economic policies within the CMA.

(f) Every effort should be made to re-establish positive real deposit and lending rates in Swaziland -- so as to provide real rates of return on financial savings, and to ensure that investment decisions are not distorted by an artificially low cost of capital.

(g) Attempts by the monetary authorities to maintain lower interest rates in Swaziland compared to South Africa should be discontinued.

PART II. BANKING SUPERVISION

2.32 The bank supervision department of the Central Bank of Swaziland is the only bank supervisory authority in Swaziland. With the assistance of the IMF, the department has implemented a legal and regulatory framework, consistent in most respects with international practice. This section discusses selected issues related to banking regulation and supervision. Items of a more descriptive nature, but still essential for a thorough understanding of the Swaziland regulatory structure, are dealt with in Annex A1.

I. CO-ORDINATING FINANCIAL SUPERVISION

2.33 Based on the Central Bank of Swaziland Order, 1974 and the Financial Institutions (Consolidation) Order (1975), the Registrar of Financial Institutions is empowered to supervise the financial sector which is not within the public sector -- but including the Swaziland Development and Savings Bank. Currently, only deposit-taking entities such as the registered banks, the Swaziland Development and Savings Bank and the Swaziland Building Society are being supervised, in varying degrees. It is, however, recommended that the issue of the supervision of entities which operate in the financial sector, other than the above, should also be addressed. Specific attention should focus on the supervision of (a) other deposit-taking entities; (b) insurance companies; and (c) financial markets and members thereof. It is also important to consider the issue of the co-ordination of supervisory activities -- should it be decided to split supervisory responsibilities between different authorities.

2.34 Given the limited number of people with appropriate skills and experience to perform supervisory functions, it is probably the correct decision to centralize these functions for the whole financial sector in one location. Although there is clearly no correct answer as to where the function should reside, the institution with the better resources and human skills should be given preference. In Swaziland's case, this would be the Central Bank.

2.35 As a relatively small country with relatively limited resources it is imperative that available skills and resources be optimized. In addition, it is important that Swaziland should create an environment which will facilitate international trade and investment. In this context, an important consideration is its adherence to standards and norms which are accepted internationally. It is therefore recommended that a policy decision be taken to the effect that, within the financial sector, international standards and norms which are generally accepted should be adopted and applied.

2.36 Currently, the focus of the Bank Supervision Department is on individual deposit-taking institutions. The responsibility for addressing systemic risk does not yet appear to have been addressed. Once there is a clear reporting structure related to all financial supervision and regulation, **systemic risk** will be much easier to address.

2.37 The risk that the system may be jeopardized by an, often avoidable, problem is very real. The consequences of such a risk becoming reality could be extremely harmful to the economy. A good example of this risk is the potential impact which the default of a member of the payments and settlements system could have on the economy. The function of assessing and supervising systemic risk should be performed by the Central Bank.

2.38 An elegant structure would be to create a Financial Supervision Department. Such a department could have three divisions covering Bank Supervision, Financial Services Supervision and Systemic Risk. The main focus of the latter division would be the payment and settlement system.

J. LEGAL BASIS FOR ENFORCEMENT OF FINANCIAL SUPERVISION

2.39 The law should specify that the head of the Financial Supervision Department should perform its duties under the control of the Board of the Central Bank. A clear mission statement requiring financial supervisors to create a legal and regulatory framework to optimize the quality and effectiveness of risk management in the financial system would focus their role of supervisors away from checking compliance with laws to a role which would enhance investor confidence and protection. It might also be appropriate to clarify that any decisions regarding liquidation or assistance to financial institutions be the sole prerogative of the Minister of Finance.

2.40 Although the legislation empowers the Central Bank to perform on-site supervision, this has not been accepted by all financial institutions. In addition, there does not appear to be a formal policy on on-site supervision. It is important that there be certainty on this issue. Hence it is necessary that the issue of the legal authority to perform on-site supervision should be included in all financial legislation. In addition, a formal policy, as well as standardized programs and procedures regarding on-site supervision for selected risk management areas (such as credit risk),

should be developed. When developing these policies, it will be important to be mindful of the issue of consolidated supervision.

2.41 If, in the Central Bank's opinion, an examination reveals that a financial institution is conducting its affairs in an unlawful or unsound manner, it may require the institution to take measures as determined by the Central Bank and/or appoint a person to advise the institution on measures to take to rectify the situation. Unfortunately, it does not appear as if this facility operates in practice as ***enforcement of legal powers*** do not appear possible in the current environment.

2.42 Another dimension related to the lack of enforcement is highlighted by the recent demise of Meridien Bank. The legal framework provides for limits on large as well as connected exposures, in addition to a local asset requirement -- all of which -- had they been applied and enforced, would have prevented the cost to the country of the recent bank failure. It will be important to review all legislation and regulation to ensure that the principles contained therein are clearly understood and applied.

2.43 Neither the Minister nor the Central Bank is empowered to conduct an inquiry into the affairs of any individual customer of a financial institution. No examiner is permitted to disclose to any person any information relating to the affairs of a financial institution which he has acquired in the course of discharging of his duties. This aspect needs to be reviewed in the light of closer ties between regulatory authorities in different countries -- especially in the region.

2.44 The continued need for the retention of separate legislation relating to building societies also needs to be reviewed. The trend appears to be for various financial institutions in this region to operate within each other's areas of expertise, which raises the question of level playing fields for different financial institutions when providing the same financial services.

2.45 The level playing field argument should also guide any future decisions concerning prudential requirements for the various banking and non-banking institutions in the country. Prudential requirements impose a cost on the financial system and should, therefore, not only be risk-based but also equitable - to ensure that an arbitrage between regulatory requirements does not lead to distortions in the financial system.

2.46 Some institutions fall outside the purview of the bank supervisors. For example, the Asikhutulisane Savings and Credit Co-operative has shown significant growth over the past few years. It no longer fits into the mold of a *typical* co-operative. For example, the common bond between its members has become somewhat tenuous. Currently, there is no statutory mechanism whereby a co-operative can be converted into a bank. In addition, there is no statutory vehicle which is of a mutual character and whose objects would encompass those of a co-operative. The legislation relating to building societies is too specific and limiting to accommodate such an entity. Hence, it would be useful to develop legislation which (a) creates a mechanism to enable a co-operative to convert into a mutual bank and (b) establishes the concept of a mutual bank, subject to the same discipline as a commercial bank. Certain transitional arrangements could be build into the legislation to ensure the smooth transition from one type of entity to another. For example, until such a converted entity has managed to raise its capital to a predetermined minimum level it should only be permitted to conduct a limited range of business. This aspect has to be addressed

urgently, because of the significant growth of such co-operatives, within an environment lacking proper regulation and supervision, exposing many ordinary citizens to potentially significant losses and consequent hardship.

K. PRUDENTIAL REQUIREMENTS

2.47 Corporate governance issues (such as rules relating to "fit and proper" shareholders, directors and management, as well as the role of internal and external auditors) could be addressed in financial legislation or the regulations dealing with prudential aspects. It must be ensured, however, that all the key aspects relating to the key players in the financial services sector be addressed adequately as part of the overall legal and regulatory framework.

2.48 The usefulness of the information submitted and the extent of its analysis depends, *inter alia*, on the nature of the information which is required. The current set of statutory returns requires only limited information which is relevant from a risk management perspective. Specific attention should be given to other risks to which banks are exposed with the aim of developing and incorporating appropriate returns which would reflect these risks in a meaningful way. It would be useful to launch a project to revise the bank supervision reports and mechanize the analysis and management information (including the presentation of graphic information), derived from them, in order to ensure that the supervisor is furnished with the information necessary to undertake his responsibilities.

2.49 Immediate attention should, however, be focused on all aspects relating to credit risk management in the banking sector. This implies new regulatory returns and rules for large and related exposures (to include connected parties and a revision of the current threshold for approval), insider or related party lending (to include shareholders) and classification and provisioning for bad and doubtful debts (to correspond with international practice). The system would also benefit from a better definition of and adherence to sectoral exposures by the banking sector. All large exposures above 10 percent of capital should still be reported and limited to 800 percent of capital, although the absolute enforcement of such limits could be difficult to achieve in Swaziland where corporates are so much larger than the banks.

2.50 In order to analyze and evaluate the nature, extent and quality of the management of the credit risk to which a deposit-taking institution is exposed, the supervisor should have access to information on: (a) provisioning policy and provisions; (b) classification policy of overdues and classification by asset category; (c) large exposures; (d) sectoral classification of exposures; (e) classification of assets in terms of the return earned on the assets. Currently, the statutory returns contain much of the above information. It is recommended that the following return be required by the supervisory authorities to determine the adequacy of provisions for doubtful debts and consequently the real value of loan portfolios:

2.51 Although significant progress has been made towards adopting international capital adequacy standards, banks should not be placed in a position where capital requirements can be manipulated. Average assets for the past quarter should therefore determine minimum capital requirements for each subsequent quarter.

Table 2.4: Classification of Assets

Classification of Assets	Amount	Amount Provided	Emalangeni	International Norm	Amount Required	Shortfall
Standard				1 percent		
Substandard				25 percent		
Doubtful				50 percent		
Loss				100 percent		
TOTAL						

L. UTILIZATION OF INFORMATION SUPPLIED BY THE BANKING SECTOR

2.52 Every financial institution is required to submit periodic, prescribed returns on their asset and liability position, off-balance sheet activities, as well as selected liquidity and currency - related information (on a monthly basis); and an analysis of its income and expenditure (on a quarterly basis) -- to the Central Bank. In addition, capital adequacy and large exposures are monitored. The Central Bank is, furthermore, empowered to call for any additional information that it may require for the purpose of the administration of the Act.

2.53 Monthly reporting to the board of directors includes a review of individual bank liquidity and an analysis of movements in and levels of various accounts, by individual institutions as well as aggregated movements. In addition, the central bank board currently receives information on the year-to-date results of the institutions; aggregated balance sheet information for the total banking sector; and individual applications for Central Bank approval in respect of all lending exceeding 10 percent (see note above regarding a proposed change in this requirement) of a bank's capital and reserves, and to firms with non-resident shareholders.

2.54 Apart from relying on external auditors very little direct verification is being done by the Bank Supervision Department. In addition, limited analysis is performed in respect of the information submitted on the statutory returns.

2.55 A bank supervisor needs to pursue a pro-active approach to the discharge of his responsibilities. Formally rating individual banks based on an analysis of the risks identified in the regulatory returns submitted by them, is a technique which supports such an approach. Individual banks should be evaluated on an objective, consistent and systematic basis, such as the CAMEL (the American system that evaluates Capital, Asset Quality, Management, Earnings and Liquidity) or alternatively some more appropriate rating system. Such ratings could form part of the information reported to the board. In addition to the ratings, other management information, such as graphs and reports to be discussed with the boards of directors of the supervised institutions, should be introduced.

M. CONSOLIDATED SUPERVISION.

2.56 At this stage, the Bank Supervision Department does not appear to be performing consolidated supervision in a formal manner. Consolidated supervision encompasses two distinct dimensions -- the first dealing with financial conglomerates in a specific country and the second with internationalization of banking and other financial activities. The first dimension will be easier to address if the Central Bank adopts the proposals indicated above concerning the monitoring of systemic risks. Given the failure of two foreign banks in the Swaziland system, in recent times, both of which could have been prevented had the minimum international standards been applied, the second dimension, requires urgent attention prior to licensing any further international banks.

2.57 The banking system in Swaziland has a number of parallels with that of New Zealand. The authorities in New Zealand have recently developed an interesting and somewhat novel approach to bank supervision, which results in a significantly reduced burden on the supervisory authorities. Under this approach, the bank supervisors acknowledge that the parent banks and home country supervisory authorities are already performing adequate supervision. Hence they do not perform supervision, *per se*, but insist on stringent disclosure and very strong corporate governance regarding the role of directors and management. It is highly recommended that the bank supervisory authorities within the Central Bank of Swaziland should review the relevance and applicability of a similar approach to banking supervision in Swaziland. It is also recommended that an action plan be developed for the purposes of ensuring that the Bank Supervision Department performs consolidated supervision in accordance with the guidelines of the Basle Committee.

N. CONSUMER PROTECTION

2.58 The Central Bank should also develop a policy proposal regarding depositor protection, for consideration by Cabinet. The ability to take quick decisions is often vital in order to achieve an optimal resolution of financial distress within a banking institution. Such a policy would constitute a framework for decision-making in the event of distress or failure of a registered deposit-taking institution. It must, however, be emphasized that deposit insurance is not a necessity and could indeed create problems of moral hazard -- any decisions regarding the extension of such protection will have to be carefully considered in the light of potential budgetary implications.

2.59 In the case of the Swaziland Development and Savings Bank, where deposits have been explicitly guaranteed, the ordinary unsophisticated investor is protected. To extend this protection in the system is therefore not warranted. The restructuring of this bank gives the authorities an opportunity to restructure the commercial activities to exclude lending and the ability to convert low interest retail deposits into wholesale government guaranteed bonds for development lending (see Chapter Four).

O. CONCLUSIONS ON BANKING SUPERVISION ISSUES

2.60 This review of banking supervision in Swaziland indicates that there are some important issues which need to be addressed. In addition, fundamental decisions need to be taken regarding

the regulatory framework and the supervisory structures in respect of the rest of the financial sector. The main conclusions of this section are that:

(a) Financial regulation and supervision should be co-ordinated to ensure a holistic and consistent philosophy of regulation, with one supervisory authority for all financial institutions -- preferably situated in the Central Bank of Swaziland. This implies that special dispensations for specific financial institutions should be discontinued.

(b) The powers of the Central Bank to conduct supervision (off-site and on-site) should be explicitly guaranteed in all financial legislation and enforcement of all regulations should be endorsed by the Ministry of Finance and the Courts.

(c) Prudential requirements should be reviewed to ensure that corporate governance and risk management are fully addressed.

(d) Information supplied by the banking system should be better utilized for analysis and follow-up as well as to provide management information to the Central Bank and the banking system.

(e) Consolidated supervision should be addressed in conjunction with the appointment of one central supervisory authority -- in addition to fulfilling the requirements of the Basle Committee on Banking Supervision regarding minimum international standards of supervision.

(f) Consumer protection should be addressed, not by automatically assuming that a blanket deposit insurance scheme is the answer, but by limiting such protection only to deposits that are invested in government backed securities.

CHAPTER THREE
THE COMMERCIAL BANKING SECTOR

A. BACKGROUND

3.1 The Swazi economy is closely linked with South Africa and the commercial banking sector has traditionally operated in a "free market" environment where there has been a free flow of funds between the two countries. This inter-locking relationship includes the ability to transfer funds to take advantage of interest rate differentials under situations of excess liquidity, cross border investment opportunities, and trade finance transactions.

3.2 Economic instability and political uncertainty in South Africa in the 1980s, led to an increase in corporate investment in Swaziland, while higher interest rates available in South Africa led to the transfer of excess funds to seek greater returns outside of Swaziland. Both of these phenomenon have declined over the recent past as inter-market interest rate differentials have narrowed, new investment opportunities in Swaziland have declined, and the economic/political environment in South Africa has improved. This general slowdown in economic activity is reflected in commercial bank activities within Swaziland. The 1994 operating period for the commercial banks was characterized by a continued weak demand for corporate credit, high liquidity levels within the banks, and minimal growth in deposit. Interest rates showed minimal movement over the year, increasing only a half point from October 1994. However, by the end of July 1995, interest rates had risen, on average, by 1.25 - 1.75 percentage points and the discount rate had increased to be at par with the South African rate (for the first time since 1985).

3.3 During 1994, total assets of the banking system and domestic deposits recorded slight nominal gains but these indicators of sectoral depth have actually been negative in real terms for the past few years. A review of total assets, loan and advances, and deposits in the commercial banks for the past three years reveals that the commercial banking sector has actually been contracting in real terms. Table 3.1 shows this trend for the period December 1992 through April 1995.

Table 3.1: Movement in Commercial Bank Assets, Loans and Deposits (E'000)

	1992	1993	1994	April 1995	Average Annual Nominal Growth	Average Inflation Rate over Period	Average Annual Real Growth
Total Assets	1,190,318	1,291,585	1,458,992	1,528,354	11.90%	13.50%	-1.60%
Loans & Advances	574,006	701,882	774,937	788,364	12.80%	13.50%	-0.70%
Total Deposits	946,073	1,020,208	1,165,907	1,176,560	8.30%	13.50%	-5.20%

3.4 In 1994, loans and advances were subject to erratic movements and overall growth was marginally positive. Credit extended to the industrial sector reversed the previous year's decline and grew in nominal terms by approximately 12 percent. However, by April 1995 loans to the industrial sector had once again declined -- below December 1994 levels. Personal credits have, on the other

hand, grown dramatically since 1993 as banks continue to emphasize development of their retail business. The overall structure of the deposit base has remained basically static with time deposits showing a slight decline, accounting for 59.3 percent of the total at end 1994. The share of demand deposits and savings accounts were 20.9 percent and 19.8 percent respectively. However, based on quarterly data provided to the central bank, the majority of the deposits held are essentially short-term in nature. Even those accounts held as fixed maturity, interest bearing, time deposits are, in fact, short-term in nature. Table 3.2 shows the deposit profile of the commercial banks, on a consolidated basis, at end March 1995.

Table 3.2: Quarterly Analysis of Deposits Classified by Depositor and Type of Deposits (March quarter, 1995 -- E'000)

	Current Deposits	Savings Deposits	Short Term Time Deposits	Medium Term Time Deposits	Long Term Time Deposits	GRAND TOTAL
1. Swaziland Central Government	888	0	24,527	61,000	0	86,415
2. Local Gov't and Town Councils	1,574	0	1,702	54	72	3,402
3. Statutory Bodies	22,610	327	144,978	18,462	10,277	196,654
(a) Non-Fin'l Statutory Corporations	17,028	144	80,104	16,486	10,094	
(b) Public Financial Institutions	5,582	183	64,874	1,976	183	
4. Private Financial Institutions	3,395	24	15,707	4,043	0	23,169
5. Resident Businesses	156,635	9,951	269,233	6,021	3,179	445,019
(a) Swazi Owned or Controlled	78,558	9,427	138,412	4,310	3,013	
(b) Foreign Owned	78,077	524	130,821	1,711	0	
(ii) Within the CMA	72,662	363	50,448	1,711	166	
(iii) Outside the CMA	5,415	161	80,373	0	0	
6. Residents	63,235	221,500	79,390	14,981	20,351	399,457
(a) Swazi Nationals	41,419	199,460	62,224	13,033	19,997	
(b) All Other	21,816	22,040	17,166	1,948	354	
7. Non-Residents	7,956	5,858	20,453	83	227	34,577
(a) Businesses	5,507	5,583	1,147	0	0	
(b) Other	2,449	275	19,306	83	227	
8. Total	256,293	237,660	555,990	104,644	34,106	1,195,872
9. Number of Accounts	17,807	80,644	4,256	3,300	3,127	109,134

SOURCE: Central Bank of Swaziland, "Consolidated "C"" Form.

3.5 Of the total deposits of E1,195.9 million, only E34.1 million (less that 3 percent) are time deposits with a maturity greater than one year. Only 11.7 percent of total deposits in commercial banks have maturities of 6 months or longer. Two issues are clear: (a) for prudential reasons, the commercial banks should not hold any significant portion of their loan portfolio as long term credits, and (b) their interest margins should show a positive impact from this fundamentally low cost funding base. In addition, this table indicates that the majority of the actual number of accounts held in the banking system are either savings accounts, 73.9 percent of the total, or current deposits, 16.3 percent of the total. Swazi Bank reports the greatest number of savings accounts at 68,392 with a total balance of E67.5 million. This implies a large number of very small savers as the implied average account balance is approximately E986.

3.6 Although Table 3.1 shows that neither the credit nor the deposit base of the banks has grown in real terms over the past two and a half years; the banking system continued to be highly liquid during 1994 -- with the notable exception of SDSB. This trend was continued in the first four months of 1995 with the banks holding 28.2 percent of total assets in a liquid form, well above the 17.5 percent ratio

required by the CBS. Loan to deposit ratios continue to decline and are now at a very conservative 64.7 percent level.

3.7 All banks continue to be highly liquid -- although SDSB was recently unable to meet even its special 10 percent liquidity ratio. SDSB is the only bank which, for liquidity reasons, found it necessary to borrow from the Central Bank on a regular basis through a series of bankers' acceptance transactions. Yet this phenomenon was much more the result of non-performing credits than real market expansion. It should be noted as well that the recent purchase of Meridien Bank in Swaziland was a direct result of temporary illiquidity, caused by problems within its holding company operation of funds that the local office held offshore.

3.8 There continues to be concern over the possible exposure of the Swazi commercial banks to systemic failure given the relatively shallow financial sector and the natural concentration of creditworthy borrowers. In addition, recent economic developments indicate a continuing recessionary trend in several key areas which will affect future performance. The poor operational performance and high level of loan losses within the SDSB, the country's only development bank led, in early 1995, to its intervention by the Central Bank and a new program for its restructuring.

3.9 The low loan to deposit ratio of some banks within the banking system reflects a decline in loan asset growth over the past year, coupled with a slight increase in deposit mobilization during this period. Profitability for the year ending in December 1994 was flat and continues to be negatively impacted by narrowing net spreads (gross interest rate margins remain quite positive), increased labor costs, and several significant corporate defaults and loan restructurings. Total shareholder equity of the five commercial banks remains barely above the regulatory minimum with several banks showing obvious weaknesses in their capital structure.

3.10 Table 3.3 outlines the relative size and capitalization of the five Swazi commercial banks, as of April 30, 1995.

Table 3.3: Structure and Capitalization of Swaziland's Commercial Banks (E'000)

Bank Total	Total Assets	Total Deposits	Shareholders Equity
Barclays	600,517	486,765	40,198
Standard Chartered	271,394	235,482	16,465
First National Bank (Meridien)	138,415	91,796	35,189*
Stanbic	250,230	182.736	23,455
SDSB	267,798	219,863	18,304**
TOTAL	1,528,354	1,216,642	133,611

Capital accounts include retained earnings (losses) from prior periods and income (loss) for the year to date.

* FNB capital account includes E30 million as subordinated deposit from the central bank as part of the restructuring of Meridien Bank in April 1995.
** The capital account of SDSB is actually negative and the bank is under central bank intervention as of May 1995
SOURCE: Central Bank statistics.

3.11 Barclays Bank is the largest of the five banks with 39 percent of total assets and 40 percent of deposits. Barclays also has the highest amount of foreign assets and liabilities of the five banks, reflecting their position as primarily that of a corporate bank engaged in trade activities through South Africa. The capital accounts of Standard Chartered Bank, Meridien Bank and SDSB all have been negatively impacted by prior operating losses; although each for different reasons. With the recent entry of First National Bank of South Africa into the market, through the purchase of Meridien Bank, the traditional dominance of Barclays Bank is likely to come under increased competitive pressure. While all five banks have shown an ongoing ability to mobilize new deposits, the corporate lending market has actually become smaller in the recent past and the banks are now competing more vigorously within a shrinking or declining commercial lending market.

3.12 Each bank's financial position, operating performance, and market philosophy is discussed below. Tables 3.8 and 3.9 at the end of the chapter also provide more detailed financial statements for each of the banks, based on the latest financial data provided to the Central Bank.

B. BUSINESS ENVIRONMENT

3.13 Swaziland presents a challenging business environment in which to operate a commercial bank. The small size of the country, its geographic location, history, and the interdependency of its economy with that of South Africa, have all contributed to the development of its financial system. Commercial bank operations have been further complicated by a lingering economic recession combined with double digit inflation, an increasing budget deficit, and a devastating drought over the past two years. These factors have had a noticeably negative impact on loan repayments from the agribusiness sector, and continued uncertainties over the level of future export earnings.

3.14 Over the past fifteen years, Swaziland has developed a financial sector which, in some respects, could be considered overly sophisticated for its mainly rural population and its level of per capita income. As a consequence of an economy which has developed primarily through foreign investment in large agro-business estates and light manufacturing, the commercial banking market tends to be concentrated among a few, mostly foreign controlled, large corporate clients. With five commercial banks and several large investment financing companies operating in a relatively narrow (and shrinking) corporate market, a strong argument can be made that the commercial banks are recycling the same client base and that the country is in fact "overbanked" in this segment of the market.

3.15 The commercial banks do offer retail services to a small base of urban clients, but the actual level of loans advanced to private individuals remains quite low. Competition for a few creditworthy borrowers is keen and the financial risks inherent in a banking system with a high concentration of credits are already apparent. Several of the banks, particularly Standard Chartered, have suffered significant loan losses because of the failure of one or two large borrowing customers over the recent past.

3.16 While there are some interests which would like to see the commercial banks fully commit their excess liquidity and act more as development financing institutions, this is not a proper course of action. The commercial banking system in Swaziland is, for the main part, successful, profit driven, and directed with a level of management expertise too rarely found in other African countries. In addition, analysis of the overall financial system indicates that virtually all sectors of the Swazi economy are being served by some form of formal financial intermediary. The Swazi financial markets are served by

a fairly extensive network of cooperatives, small business funds, credit unions, building societies, development institutions, as well as commercial banks.

3.17 It is possible that not all these intermediaries are undertaking their work in an efficient manner, but there does not appear to be any sustainable argument that the commercial banks are singularly responsible for any lack of credit access by individuals or the lower-end of the market. The commercial banks should remain in their particular market niche -- even if they are highly liquid and their traditional market is stagnant -- and not be forced to fulfill any imposed social or developmental goals which are beyond their scope. There are, anyway, a number of specialized financial institutions and government sponsored funds, including SDSB, which are available to address the lower end of the financial market and fulfill social and development goals.

3.18 Four of the five commercial banks are majority foreign-owned by large international financial institutions. Consequently, these banks are managed by expatriates seconded by their parent companies. These managers bring different operating methodologies and corporate philosophies regarding lending markets, credit criteria and customer relations in general. These banks are very aware of their primary obligation to their depositors and shareholders and believe that their real role in the development of the country lies with being efficient and profitable financial intermediaries rather than a hybrid of the traditional development bank.

3.19 An analysis of the types of loans and advances granted by the commercial bank shows that they are, in fact, extending credit throughout the Swazi economy. Recent data indicates that over 47 percent of total loans extended are placed with Swazi resident businesses. Corporations operating from Swaziland and owned or controlled by foreign investors from within the CMA account for an additional 21 percent of the total loan portfolio of the banks. At the end of 1994, personal loans advanced to individual Swazi residents accounted for a respectable 25 percent of the total lending of the banks.

3.20 Table 3.4 shows the structure of the loans and advances portfolio of the commercial banks, as of April 30,1995. This table shows that the banks are widely diversified and are "efficient" in performing the type of intermediation function one would expect from private sector financial institutions. With the exception of SDSB, the commercial banks have a well defined spread of their financial risks throughout the Swazi economy. Table 3.9 provides a detailed classification of the business loans advanced by the commercial banks to the various industrial sectors.

3.21 Lastly, management of the commercial banks is having to deal with an increasingly active union movement among their employees. This unionism has been the fundamental force behind a significant increase in employee salary and benefit expenses as well as two short lived strikes to protest recent reductions in staff. An analysis of the ratio of overhead expenses to net profits over the past three years shows a disturbing upward trend. Average annual salary and benefit increases among the five banks have exceeded 18 percent; apparently driven by the labor unions. In addition, all banks are heavily exposed with unsecured personal loans to their staff -- in some cases reportedly in excess of five times annual salary. This dangerous situation is also apparently the result of attempts to maintain calm labor relations.

Table 3.4: Schedule of Loans and Advances

	Barclays	Standard	Stanbic	Meridien First Nat. Bank	SDSB	TOTAL
Local Government Entities	919	0	142	2,684	0	3,745
Non-Financial Corporations	664	306	1,351	628	0	11,256
Public Financial Corporations	0	8,307	1,351	509	0	10,167
Swazi Resident Businesses	86,467	13,542	93,319	18,132	135,435	346,895
Foreign Owned Resident Businesses						
Within the CMA	35,458	83,241	13,345	23,417	11,488	166,949
Outside the CMA	17,687	1,396	36,840	0	0	55,923
Swazi Resident Nationals	54,866	41,470	7,758	16,169	54,543	174,806
Non-Swazi Residents	8,185	1,498	12,754	795	0	23,232
Non-Resident Businesses	0	2,424	1,522	1,549	0	5,495
Non-Resident Individuals	0	2	61	0	0	63
TOTAL	204,246	152,186	167,092	63,374	201,466	788,364

SOURCE: Central Bank statistics.

C. BARCLAYS BANK

3.22 Barclays Bank of Swaziland is a 60 percent owned subsidiary of Barclays Bank PLC. The Government of Swaziland is a 40 percent minority shareholder. At the end of 1994, total share capital was E17.3 million -- which includes the capitalization of the revaluation reserve of E2.7 million previously created through the revaluation of fixed assets in 1992. This is a controversial accounting technique which is nonetheless an accepted local practice -- nonetheless, this is surprising as it is in conflict with internationally accepted practice. The total capital base is E27.9 million when statutory reserves and retained earnings are included. This is a minimal increase in capital from the 1993 level of 27.2 million and reflects management's philosophy to maintain only the absolute minimum level of required local capital and statutory reserves. Dividend payouts were again high in 1994.

3.23 Barclays is primarily a corporate bank with a well established lending position among the major sugar producers and forestry/pulp companies. Merchant banking activities have also been an important part of the bank's business. In 1993 the bank underwrote, and guaranteed, a large debenture issue for Swaziland Sugar Assets Corporation and was the placing agent for a share rights issue by Lonrho Sugar Corporation. There were no such capital market activities during 1994. A large percentage of Barclays' loans consist of short-term working capital for agro-business operations.

3.24 Barclays has a strong deposit base -- representing 40 percent of total deposits in the commercial banking sector as of April, 1995. Nonetheless, deposit growth has been flat over the past two years with the bank actually showing a slight decline in deposit balances in April from year-end 1994. The total

number of customer's accounts remains at the previous average of approximately 56,600. The majority of these accounts (95.6 percent), are short term time deposits with maturities of three months or less and except for current account balances on which no interest is paid, they yield a fairly low fixed rate of interest. However, as total time deposits represent only 44 percent of the total number of customers accounts, it is apparent the bank has a large customer base with low account balances as well.

3.25 Barclays is the largest of the commercial banks with total assets in 1994 of E522.1 million. Loans and advances accounted for E298.6 million while deposits were E427.8 million. Net profits after taxes for the year were E8.6 million, an increase of 16.2 percent over 1993 earnings. While Barclays reported a fairly impressive 1.8 percent return on average assets for the period, a comparative analysis of the income statement shows that interest earnings for the period were relatively flat and barely increased proportionately with reported growth in the loans and advances account. Most of the increase in 1994's profits appears to have come from increased commissions, a significant recovery from previously written-off accounts, a constant level of interest expenses, and minimal charges to provisions for doubtful accounts.

3.26 For the past three years the bank has paid a significant dividend to its shareholders. Consequently the capital account has grown only slightly through the addition of statutory reserves and retained earnings. For 1994, the bank has proposed a total dividend of 53.6 cents per share, (45.5 cents per share in 1993), which would mean a total payout of E7.8 million or over 90 percent of net profits after tax. There has been an extremely high payout policy over the past two years and this may prove to be overly liberal in the long run if the bank's growth should become restricted due to capital adequacy limits. The bank calculates its risk asset/capital ratio at 8.5 percent as of year end 1994, but the method of calculation for this result is suspect.

3.27 In addition, Barclays has, since its incorporation in Swaziland, paid a fairly sizable service fee to its London head office. This fee was E571,000 (approximately 7.7 percent of net profits), in 1993, and increased to E941, 000 (10.9 percent of net profits), in 1994. This fee is obviously performance related and is paid as an operating expense -- which further reduces the bank's local tax liability. Given the vague nature of the *services* rendered by the bank's head office/shareholder and the method of calculation for the actual amount paid out annually, an argument can be made that this payment is actually a repatriation of investment to the foreign shareholder -- without similar benefit to the Government as a 40 percent shareholder.

3.28 As a result of the a high dividend payout ratio, the bank capitalization has hardly increased in recent years. At end 1994, total capital and reserves stood at E27.9 million -- E800,000 higher than their 1993 level. By management's calculations this level of capitalization represents a capital adequacy ratio of 8.5 percent against the 1995 regulatory requirement of 8 percent. Without the benefit of the Central Bank formula utilized, the only calculation that can be made from the annual report figures is a 5.3 percent ratio of total capital and reserves to total assets (not including off balance sheet items), and a 6.5 percent ratio of capital to deposit liabilities. The Financial Institutions Act requires a ratio to be 5 percent of capital to deposit liabilities to the public.

3.29 Hence, while Barclays Bank may be considered to have a positive capitalization level for a financial institution of this nature with its particular composition of risk assets and deposit liabilities, the institution is nonetheless below the generally accepted 8 percent capital adequacy ratio. It appears that the bank's growth could be restricted in the near term future if it is to maintain the capital adequacy ratios established by the Central Bank.

3.30 Barclays changed its senior management in 1995 and the new Managing Director has expressed cautious optimism regarding the near term future for the bank's operations in Swaziland. He recognizes the beginnings of a new level of market competition with the entry of FNB and is prepared to undertake measures designed to maintain the bank's pre-dominant market position. This may prove to be a difficult task as FNB South Africa is the corporate bank for several of Barclays traditional Swazi customers. While prepared to compete, the new manager has also stated that the bank will constantly review its costs and profitability margins as well as update and improve on its "1950's" style of banking. These issues will be determining factors in the bank's future strategic and marketing plans.

3.31 Management has expressed its concern about the growing government budget deficit and the lack of sufficient incentives to promote further foreign investment in the country. However, they remain bullish about the corporate banking opportunities in the country and the availability of domestic funds for future investment. They foresee slow but steady growth in both deposit mobilization and lending activities. It is apparent that the future of the bank's successful operations in Swaziland will depend on a revival of the corporate lending market and their ability to adapt to a new level of competition.

D. STANDARD CHARTERED BANK SWAZILAND, LTD.

3.32 Standard Chartered Bank currently operates four branches and six smaller agencies in Swaziland -- although indications are strong that management plans to restructure and downsize this network in the near future. Standard Chartered is the only commercial bank to have gone public with a share issue through the local stock exchange. In 1991 the bank increased its capital slightly and sold 15 percent of its new capital base to the public. The bank's parent, Standard Chartered, London, now owns 55 percent of the bank and the Government holds the remaining 30 percent. Since its public issue the bank has not performed as expected and no dividends have been paid to shareholders since 1991.

3.33 Standard Chartered had a total assets base of E254.9 million at the end of 1994 with total deposits of E228.5 million. The bank was marginally profitable in 1994, with reported pre-tax profits of only E692, 000. No tax was paid in 1994 and, in fact, the bank reports that there is a tax loss carry forward available to them in excess of E4.0 million. The bank suffered a large loan write-off in 1992 and the retained loss position in the capital account remains at negative E4.9 million. Concentrated efforts were continued during 1994 to restructure weak credits and closely monitor operating expenses.

3.34 The bank grew rapidly during the late 1980s and early 1990s and was heavily exposed to the sugar and textile industries. Recent data indicates that the bank's current credit concentration remains in the manufacturing sector, primarily with fruit and vegetable production and processing companies. In the past, the bank made several very large loans and reported that at one time less than 20 percent of the credits extended accounted for over 90 percent of the loan funds advanced. Standard Chartered was particularly hard hit by the financial problems of Natex, a large textile manufacturer, which led to a significant loss for Standard Chartered in 1992.

3.35 The bank wrote off approximately E7.9 million in bad debts in 1992, mostly from their exposure to Natex. The debt restructuring agreement for this borrower, which was only completed in mid-1993, has subsequently been re-negotiated and continues to cause a further drag on earnings. In its latest report, management states that future recoveries of any significance remain problematic and that the bank has also experienced poor performance from several small scale business borrowers over the past two years. The negative impact of a high level of non-performing credits is obvious as the bank charged E2.5 million and E2.8 million to the provisions account in 1993 and 1994 respectively.

3.36 To counter the negative impact of poor performance in the corporate sector, the bank began a concentrated expansion effort in the retail/personal banking area. It launched what, at least initially, appeared to be a highly successful personal loan scheme for individual borrowers (called "No-Nkinga" credits), with terms as long as five years. This program, recognized by management as being of a higher risk, attracted some 3,500 new loan customers with total advances in excess of E40.0 million. Customers are required to make scheduled loan payments through a combination of direct payroll deposits into a bank account and direct monthly payment deductions. Interest was discounted in advance, providing an effective yield to the bank of 22 percent per annum. The marketing of this program was successful during 1993, but management reports that actual repayments were very poor and the program was discontinued in 1994. The impact of this program to the increase in the provisioning account is not yet quantified, but is believed to be significant.

3.37 The bank also introduced expanded options for its network of ATMs which increased the variety of transaction opportunities for customers and has reportedly been responsible for improved customer service through the reduction of congestion in bank offices. The bank reports over 20,000 small savings accounts which can now be accessed through the ATMs with a significant savings in transaction and staff expenses.

3.38 Unfortunately, Standard Chartered does not appear to be returning to expected levels of profitability, reporting net earnings of E391,000 for 1993 and only E692,000 for 1994. During 1994, total loans declined slightly while deposits increased by 18.4 percent to E237 million. However, since the beginning of 1995, deposits have shown a steady decline to E213 million as of the end of April. In 1994, operating costs appeared to be well controlled, however, the bank must continue to perform well above its peers in a difficult market in order to restore its capital base through the generation and retention of profits.

3.39 At end 1994, total capital and reserves were E15.1 million representing a capital to total assets ratio of 5.7 percent. As of this date, the bank met the minimum required 5 percent ratio of unimpaired share capital to liabilities to the public and barely met the current 7 percent (increasing to 8 percent in 1995), ratio of capital to risk assets. With its retained loss position and continued poor earnings record, it is virtually certain that the bank will be unable to meet the required 8 percent capital adequacy ratio by year-end 1995 without a further injection of new equity funds from shareholders.

3.40 As the only financial institution listed on the local stock exchange, the financial performance of Standard Chartered and the dividend yield of its shares have been closely followed by the investor public. Unfortunately, loan losses and the need to increase provisions have prevented the bank from paying any dividends in recent years. In 1992 the bank reported a net loss of E6.2 million which, even after the modest profits of 1993 and 1994, leaves the bank with an accumulated loss position of E4.0 million. These losses were effectively covered through the provision accounts which were increased by E12.8 million over the three years 1992 to 1994.

3.41 It is disturbing to note that while the bank suffered these losses and poor earnings, *and paid no dividends to its shareholders*, it continued to pay a very high service fee (similar in structure to that paid by Barclays Bank), to its related group companies. In 1992, this fee payment was E462,000, despite the losses incurred; E421,000 in 1993 (108 percent of reported net profits); and E492,000 in 1994 (71 percent of net profits for the year). When an institution is experiencing the level of operational difficulties that the Swazi office of Standard Chartered is, the continued payment of service fees to the head office is a questionable practice.

3.42 The future of Standard Chartered operations in Swaziland are in doubt and already there are strong indications that they may cease operations in the near future if they are unable to return to a normal level of profitability. The bank has recently replaced its Managing Director, for the second time in less than two years, and market rumors are that this individual has a mandate to improve the situation dramatically or begin the process of selling the institution. There is no doubt that the bank is in a difficult position -- at a time when the ability of ***any*** financial institution to affect a real turnaround would be most difficult.

3.43 Quality lending opportunities have reduced significantly from past levels as the finite number of "bankable" corporations has remained static, large scale individual credit facilities have proven to be of a high risk/ high default nature, the level of commercial banking competition in all market areas has been significantly increased, and the ability of many of the South African affiliated companies to access credit facilities either directly or indirectly from their parent companies or through South African affiliated banks has also improved.

3.44 In sum, it is questionable whether this bank will be able to reverse the low earnings trend of the recent past, significantly reduce its non-performing portfolio, and contribute earnings at expected levels through profitable growth in a small, stagnant and highly competitive market in the near future. The possible consequences of an exit of this institution from the Swazi market are discussed in the conclusions of this section.

E. STANBIC BANK SWAZILAND

3.45 Stanbic Bank (an abbreviation derived from the Standard Bank Investment Company of South Africa, or SBIC), has been operating in Swaziland since 1988 as Union Bank of Swaziland. The name was changed in 1994 as a result of the acquisition of the ANZ Grindlays Africa group by SBIC. The current shareholding of Stanbic bank is SBIC 70 percent, Swaki Ltd. 20 percent, and Government 10 percent. The bank actually has further indirect government ownership as Swaki Ltd. also has government ownership through its various shareholders. Management also reports that Standard Bank of South Africa initiated this recent name change, in part, to avoid customer confusion with the Standard Chartered Bank group.

3.46 Stanbic is a medium sized commercial bank which has a greater proportion of its loan portfolio advanced through specialized leasing and hire purchase transactions than the other banks. Total assets in 1994 were E243 million representing a modest 7 percent increase over 1993. Total assets actually decreased in 1993 as the result of significant repayments of advances previously made to subsidiary companies. Oddly, the bank's 1994 balance sheet still reflects these inter-company loans with the bank carrying a net liability of E13.3 million due to unspecified subsidiary companies; up slightly from the 1993 position. Simultaneously, loans to the public increased by 12 percent to E168 million during the year. The loan portfolio appears to be almost evenly divided between business loans and advances under installment sales and lease contracts.

3.47 Total deposits increased marginally in 1994 to E197 million, but have since declined to E183 million at the end of April 1995. Retail deposits continued to grow while wholesale deposits and large corporate accounts were curtailed in line with a decreased demand for credit. This modest growth in deposits, along with the change in the mix of deposits toward low cost current accounts, combined to cause a continued decline in interest expenses for the year. As a result, net interest margin increased slightly from E15.3 million in 1993 to E16.2 million in 1994. The bank's plans to actively solicit new

deposit accounts during the year do not appear to have been very successful as the deposit base continues to demonstrate high volatility without sustained growth.

3.48 In 1994, Stanbic achieved a 31 percent increase in net profits, mainly as a result of a flat position on interest expenses and a decrease in the provision for doubtful accounts. There continued to be significant increases in staff expenses and general operating expenses. The bank made another fairly large payment to its specific provision account of E916, 000 -- due most likely to continued problems with the Natex workout. At end 1994, provisions for bad and doubtful accounts were E9.8 million representing 5.5 percent of total loans. This figure may be well within normal bank guidelines but it is disturbing to note that E7.9 million (81 percent), is for specific provisions and probably concentrated in one account -- Natex. Actual write-offs against the provision account were E867,000, a significant increase over the 1993 charge. Operating costs rose for the second consecutive year through both increased staff expenses and increases in depreciation charges, management fees (similar head office charges as paid by the other banks), and a substantial increase in "other expenditures".

3.49 The bank appears to be well capitalized in the context of the Swazi financial system with a 9.0 percent ratio of capital to risk assets. Management reports that the ratio of capital to risk assets is well above the regulatory requirements set for 1995. Return on average assets for 1994 was 1.4 percent which is a good level and only slightly lower than Barclays Bank. If the bank is to continue to generate current profit levels, it would appear that future loan growth can be supported from the existing capital base for several years. However, the nature and sustainability of the income stream for this bank is of concern as a 6.5 percent increase in the asset base only generated a 6.1 percent increase in net interest income. Most of the 1994 earnings increase came from the reduction in loan loss provisions over the prior period and as a result of the beneficial impact of zero growth in interest expenses.

3.50 Stanbic Bank is an active participant in the Small Scale Enterprise Loan Guarantee Fund promoted by the Government and operated through the central bank. Management has been involved in assisting small scale entrepreneurs establish new businesses, as well as related business management training. The bank reports that they are necessarily conservative in granting credits under this program and to date performance has been good. However, the records of the Guarantee Fund reveal that Stanbic have pending claims against the insurance of E230,000 which is over 30 percent of the bank's total credit extensions under this scheme. The bank also reports a close liaison and positive working relationship with the Small Business Growth Trust (SBGT).

3.51 Bank management continues to express a strong positive outlook for continued bank growth and profitability. However, the overall performance of Stanbic's operations in Swaziland have been disappointing, particularly given the strong potential for greater market penetration to be derived through the support of its large South African parent bank. The bank has made a positive impact on the market but its performance has been mediocre and real growth has been flat over the past three years. Stanbic appears to be in a vulnerable position regarding its ability to maintain its market share in an increasingly competitive market.

3.52 Management believes that the manufacturing and industrial sectors will enjoy moderate growth during 1995 based upon the consolidation that has occurred as well as the greater stabilization of the South African economy after the successful elections of last April. The outlook for the agricultural and livestock sectors will depend on continued relief from drought conditions which have plagued the region over the past two years. Management has also expressed concern over the construction and service sectors based upon projected cuts in government spending in these areas. The bank's main

focus will continue to be an expansion of its retail markets and the development of new deposit products.

F. MERIDIEN BIAO BANK LTD/FIRST NATIONAL BANK OF SOUTH AFRICA

3.53 Meridien Bank entered Swaziland through the acquisition of two local institutions. It firstly purchased the BIAO subsidiary in early 1991 and the in December 1991 purchased the defunct BCCI branch from the Central Bank. BIAO Swaziland was a very small bank with total assets of E15 million and an accumulated loss in excess of E3 million. The local BCCI branch was a poorly managed institution which was closed down by the Ministry of Finance in mid-1991, following the collapse of the worldwide BCCI network. Unfortunately, the Meridien system itself also failed in early 1995. The Swaziland operations have now been acquired by First National Bank of South Africa.

3.54 It appears that Meridien overpaid for BCCI as the reported net asset value of E1.2 million was later revealed to be a loss of over E5 million. Management reported that the purchase price paid to the Central Bank (the previous shareholders received nothing), was E1.7 million for which they assumed both the residual loan assets and all customer deposit liabilities.

3.55 Unlike the other three foreign controlled commercial banks, Meridien was not owned by a long standing international bank with an established headquarters in London or South Africa. Meridien is majority owned by Meridien BIAO SA, a Luxembourg based holding company which was created in 1991 through a merger of the Meridien group of banks, operating throughout Africa. This organizational structure caused the organization some problems as regard the location of its head office and which regulatory body, if any, had overall supervisory responsibility for the consolidated group and, in fact, was a major factor in its ultimate collapse.

3.56 Before its purchase by FNB in April 1995, Meridien Bank operated fairly aggressively in Swaziland and exhibited strong balance sheet growth. The bank became a strong competitor in the local market and FNB has basically continued business from the base built up over the past two and a half years. Loans and advances, net of provisions, grew from E30.3 million in September 1992, to E63.4 million as of April 1994. The institution was successful in recovering some of the written-off loans from certain BCCI credits -- mostly through prolonged and expensive legal action.

3.57 Similarly, the bank has made significant progress with respect to deposit mobilization -- successfully overcoming a negative image inherited from the takeover of BCCI. As the deposit base was mainly corporate based, the bank initiated a marketing program and new savings products to increase its retail deposit base. This growth (as well as the initial negative impact on the deposit base of the takeover of Meridien by FNB), is shown in Table 3.5.

3.58 The financial performance of the bank has been adversely affected by the high level of non-performing loans assumed at the time of the BCCI takeover and the funding of the provision account to proper levels. Nonetheless, the bank reported a small net income position for 1992 and 1993. However, for the fiscal period ended December 1994, the institution reported an operating loss of E3.3 million.

3.59 Meridien Bank Swaziland was a leader in inter-African trade financing, taking advantage of the extensive branch network of the Meridien organization. They financed a high level of trade from South Africa to other African countries through the Swaziland branch. Many of these letters of credit were cash collateralized in US dollar deposit accounts in favor of the Swaziland office held in the importers'

country. These accounts inflated the bank's balance sheet through Nostro balances and caused confusion with the CBS as to the limits of external assets that the bank may hold (limited to 5 percent of total liabilities to the Swazi public).

Table 3.5: Meridien Bank -- Growth in Deposit Base

	January 1992	September 1993	December 1993	December 1994	April 1995*
Current Accounts	5,143	10,230	22,818	10,808	10,213
Savings Accounts	2,654	8,540	9,820	11,200	10,169
Call Deposits	...	55,870	64,798	87,007	59,244
Time Deposits	52,145	18,760	12,011	29,002	16,041
TOTAL	59,942	93,400	109,447	138,017	95,667

* Actual deposit base immediately after the transfer of the institution to FNB, reflecting the negative impact of the closing of Meridien as well as management's policy to reduce deposit liabilities during the uncertain period of the previous two months. Management reports that since the takeover by FNB, deposit customers have returned and total deposits as of May 25th are in excess of E 126 million.
SOURCE: Internal bank statistics / Central Bank data

3.60 The bank subsequently explained that the actual source of their offshore deposits were originally from outside Swaziland and were coverage for letter of credit transactions. There were no local deposits or assets being transferred abroad and consequently they received central bank approval to continue this business. The exception to policy proved to be a key element in the subsequent illiquidity of Meridien Bank as the institution's holding company began draining funds from the African banking network for its own non-banking use and soon proved unable to repay and reliquify the system.

3.61 Meridien Bank Swaziland initially became illiquid for these reasons in late February 1995 and subsequently required assistance from the central bank. As the systemic problems of the Meridien group became known, the liquidity problems of the local operation were further exacerbated by the insistence of a large withdrawal of deposits placed by Tibiyo Taka Ngwane which was a 17 percent shareholder in the bank. As a result of negotiations with the central bank, Tibiyo agreed to limit its withdrawal, but even this placed a considerable strain on the bank. The central bank, in coordination with bank management, put the institution into a voluntary receivership and negotiated a sale of the bank to FNB in late March, 1995.

3.62 It is important to note that primary driver of this bank crisis, was a systemic failure of the Meridien network -- other offices in other countries were also closed and sold -- and was not caused by operational losses or poor lending practices within the local office. The negative asset position of Meridien Bank was determined to be E30 million which is slightly above the actual amount of funds owed to the institution by the holding company or other Meridien offices.

3.63 First National Bank of South Africa bought 100 percent of the Meridien operation for a payment of E3 million, basically as a fee for the license. Neither Meridien Biao, the Government of Swaziland, or Tibiyo received any compensation for their holdings. Although FNB received an open option to operate the bank as a branch of the South African bank, they have opted, for internal reasons, to initially run the bank through a 100 percent owned Swaziland subsidiary corporation. It is uncertain

if they will change the operational structure to a branch in the future although management has expressed the opinion that such a change is certainly a viable option which will be subject to study.

3.64 The mechanism for the resurrection of the bank as a subsidiary operation of First National Bank of South Africa (FNB), is essentially an assisted sales/transfer agreement. The central bank placed a long-term "quasi-capital" deposit of E30.0 million with the new FNB operation -- to be repaid through a combination of future profits and recovery of amounts owed by the Meridien system with a final maturity in 2001. At maturity, any shortfall in the repayment of this deposit due to poor profit performance and/or lack of recovery from Meridien, FNB is to purchase all rights to this deposit from the central bank for E1. In other words, ***the central bank is at risk and will suffer any actual shortfalls and losses realized at maturity.*** During the life of this deposit, the central bank is paying FNB interest at the rate of 1 percent below the reserve account rate paid by the central bank -- currently 5 percent.

3.65 All future tax payments which would normally be payable on the bank's future profits (corporate tax is 37 percent), will not be paid to the tax authorities but directly to the central bank. There is a complicated formula in the agreement regarding additional reimbursement to the central bank of any future "tax savings" which may be realized by FNB because of this loss position. Additionally, FNB can reduce the deposit balance at anytime through the recovery of funds owed to the Meridien operation from the Meridien system.

3.66 Management reports that the probability of recovery of at least E20 million is very good and that the actual loss position of the institution is likely to be around E8 million. They have no doubt that the new FNB operation can generate sufficient profits over the next 6 years to generate the level of "tax revenues" necessary to repay this deposit in full. A rough calculation of this repayment scheme (in a worst case scenario), shows that the bank would have to generate an annual profit of at least E13.5 million in order to have the necessary E5 million in annual tax liabilities to repay E30 million in six years. Not even Barclays Bank has been able to achieve this level of annual earnings, but this scenario assumes no additional recovery from the funds owed the bank through the Meridien system.

3.67 Given the competitive strengths of the FNB network, the high level of the bank's customer service and technological systems, as well as the management and marketing support from the parent bank, there is little doubt that FNB Swaziland will be a profitable operation. Likewise, it seems most probable that FNB will recover some funds from the Meridien system. Consequently the bank's ability to repay this deposit as structured appears fairly solid.

3.68 Nonetheless, the central bank should recognize that this sale/transfer transaction does carry a level of real costs to the government, even if the deposit is repaid in full within the next few months. By placing this deposit into the new FNB operation in this manner, the government has effectively made an extraordinary allocation of its available budget funds. There could very well be a separate and better use of these monies within the economy in the near future and it is highly unlikely that they will be available for any alternative use soon.

3.69 In addition, although not an easily quantifiable figure, the government received no payment for the value of their investment in Meridien Bank. This should properly be a paper loss at this stage as the government and Tibiyo's shareholdings were actually a carry overs from their investments in BCCI and should have been written down long ago. To the extent that these shareholders were actually valuing this investment and carrying it as an asset on their books, this is a real loss for whatever value they showed, in an accounting sense.

3.70 Most importantly, the government should recognize its contingent liability in this case and the fact that they are at risk to lose the entire deposit amount, plus interest, in a worst case scenario. This could mean a cash loss in the range of E40 million, which is approximately 50 percent of the perceived losses in the Swaziland Savings and Development Bank, which the government will also have to absorb. Although this is probably an unlikely scenario the government should nonetheless realize the potential consequences of its agreement to this type of restructuring and sales agreement -- as well as the real impact of the weaknesses of their bank supervisory system which allowed Meridien to be granted a license in the first place, followed by the granting of subsequent significant exemptions to their local asset ratio policy.

G. SWAZILAND DEVELOPMENT AND SAVINGS BANK

3.71 The Swaziland Development and Savings Bank (SDSB), was established in 1965 as a government financial institution for the development of the Swazi economy. The bank is the main source of long term lending in the country with an emphasis on the agricultural, livestock, and housing sectors. It is also the lead bank for various financing schemes directed towards public servants. Performance over the years has followed a typical pattern of government controlled development banks in Africa. The bank grew dramatically in asset base, staff expenses, and arrears -- suffering very high losses in virtually all areas of lending. The Government has been obliged to support the bank with several injections of new capital as well as provide ongoing liquidity through the placement of special deposits.

3.72 Since its inception the bank has been the subject of several specific banking acts and King's orders. The net result has been to cause considerable confusion as to the actual banking goals of the institution, which order holds preference, and which regulatory body has authority over the institution. The King's Order-in-Counsel of 1973 grants SDSB a number of exemptions from the regulations governing other commercial banks in the country, while simultaneously broadening its mandate to act as a commercial bank. Most importantly, this Order *strongly implies* that all deposits held by SDSB are guaranteed by the Government. This form of deposit guarantee increases the Government's direct financial risk through this bank by at least E170 million. There is no implied or direct deposit insurance program for any other financial institution in Swaziland.

3.73 The revision to the Financial Institutions Act in 1975 specifically includes SDSB in the new regulations to the extent "*it is not inconsistent with any law regulating the affairs of said bank*" and repeals the previous King's Order. The vagueness of these regulations has allowed the management of SDSB to continue to operate as an independent agency, uncertain as to which regulations apply to the operation of the bank, using the Government as its primary funding source, and operating under special exemptions in such basic areas as capital adequacy requirements, reserves, and liquidity ratios. The Board of Directors has traditionally been comprised of senior government officials including several government Ministers.

3.74 The past poor financial performance of SDSB is well documented. The bank publishes audited financial reports, and despite reported profits over the last three years, the financial structure of the institution has continued to deteriorate. The quality and actual performance of the loan portfolio is highly suspect and while the bank has been pressured to write-off record amounts in the last two years, it continues to carry, and accrue interest on, a large non-performing portfolio. If the loan portfolio were to be properly classified, and several questionable accounting practices reversed, the bank would, in all likelihood, be declared bankrupt.

3.75 Having failed to operate profitably as an agricultural-based development bank, SDSB attempted to become a universal bank and compete in the commercial banking market as well. The lack of basic lending skills and the ingrained social philosophy which dominates their underwriting have contributed to failure in this area as well. The bank has granted a number of "business loans" to high risk propositions with related high failure rates. Past due commercial credits appear to be almost as great as those within the traditional development portfolio.

3.76 Any action to further re-capitalize the bank, undertake a radical restructuring, privatize, or merge/liquidate the institution, is likely to be a most difficult political decision. As a result of repeated losses, chronic illiquidity, as well as strong criticism enunciated in a recent report by Coopers & Lybrand, the recently appointed Minister of Finance finally took the necessary action in May 1995, and appointed the central bank as the new manager of the institution. The incumbent Managing Director was replaced by an experienced expatriate banker who had previously worked in Swaziland. A new inter-agency restructuring team was named and given broad powers to radically restructure the bank. There are several possible scenarios for the restructuring -- all of which will be difficult to structure and implement. Further discussion of the "restructured" SDSB and recommendations regarding its future role in the financial sector, is presented in Chapter Four.

3.77 Table 3.6 below, presents selected financial highlights of SDSB since 1991. These financial highlights, available only through March 31, 1994 on an audited basis, illustrate that, despite annual growth in loans and deposits, the bank's profit performance has continued to deteriorate. Loan losses have increased and the bank has been forced to borrow beyond its deposit base to meet its basic funding requirements and to also be granted concessionary liquidity ratios.

Table 3.6: Swaziland Development and Savings Bank Financial Highlights (E millions), as of March 31

	1991	1992	1993	1994*
Total Assets	124.3	162.2	230.2	250.7
Loans and Advances	75.3	104.9	151.9	179.6
Customer Deposits	109.2	125.6	181.4	206.9
Borrowings	...	10.0	14.5	7.1
Capital and Reserves	6.2	18.5	18.6	18.6
Operating Profit	0.4	0.5	1.9	(10.1)
Net Movement in Provisions for Doubtful Debts	0.01	0.5	1.8	n/a
Net Profit	0.4	0.05	0.05	n/a

* From unaudited/internal financial reports.
SOURCE: Swaziland Development and Savings Bank Annual Reports

3.78 The increase in the capital and reserves that appears in 1992 represents a E12.3 million revaluation of fixed assets -- primarily the head office building. This revaluation reserve accounts for an unprecedented 66 percent of the bank's total capital account. The amount credited to the reserve is also highly suspect as the value given to the head office building may not represent the actual value of the building, especially given the current downturn in real estate transactions.

3.79 In reality the bank is severely undercapitalized and does not meet even minimal capital adequacy requirements, particularly when the revaluation reserve is properly accounted for. During 1994, management requested, but did not receive, an additional E10 million in capital from the Government. It is interesting to note that a condition of the new E38 million line of credit from the African Development Bank (AfDB), which has not been met to date, calls for the government to re-capitalize the bank to at least a 4 percent capital to assets level. Table 3.7 provides a breakdown of the bank's loan portfolio by type of activity.

Table 3.7: Swaziland Development and Savings Bank Loan Portfolio (E million and percent), as of March 31

	1991	%	1992	%	1993	%
Agriculture	19.8	21	29.2	21	53.9	27
of which						
Commercial Loans	17.2		23.5		39.7	
Concessional Loans	2.6		5.7		14.2	
Business	40.3	42	56.2	41	77.5	38
Housing	23.8	25	39.7	29	54.4	26
of which						
Civil Service Fund	13.3		22.5		30.5	
General Housing	9.4		15.8		18.8	
Other Housing	1.1		1.4		2.1	
Other Credits	11.2	12	10.6	9	18.1	9
TOTAL	95.1	100	135.7	100	200.9	100

SOURCE: Swaziland Development and Savings Bank

3.80 A review of the bank's latest financial data, submitted to the central bank, reveals a further weakening in its financial structure. In the March 1995 quarterly report, the institution reported a loss for the year of E3.4 million as well as a deficiency in their liquidity position of -E12.9 million. These levels are, in turn, considered to be under-reported.

3.81 In March, 1993, the bank reported E25.9 million in interest income on total loans (before provisions) of E156.3 million. No comparative data is available since that date. This return implies a gross interest rate of 16.6 percent on the non-concessional loan portfolio. This is well below the average lending rate in the market during the year when the average commercial loan rate for SDSB was 24 percent. Hence, the reported level of interest income strongly implies that a significant portion of the loan portfolio is non-performing.

3.82 The bank's 1993 annual report states that 4.7 percent of the regular loan portfolio has been classified by management as non-performing. However, this figure is too low to account for much of this lost interest income. At an average interest rate of only 21 percent, the bank should have received interest income in excess of E33 million (even deducting the E7.4 million in non-performing credits, this imputed interest rate should yield approximately E31 million in interest income).

3.83 There is no useful comparative financial data available on SDSB subsequent to the 1994 internal figures and given the past unreliability of this data and the subsequent central bank intervention of the institution -- further analysis is not considered useful. The more important area of discussion is the future of this institution -- the best form of organizational structure, the costs to the government for this restructuring, and the future development financing role of the "restructured" SDSB. These issues are reviewed in detail in Chapter Four.

3.84 Based on the Coopers & Lybrand report, which provides the most in-depth analysis and accurate assessment available as to the actual depth of the structural and operational problems of the bank, the estimated unfunded loss position of SDSB is E80 million with an additional E135 million in non-performing credits whose recovery is highly doubtful. It is commonly believed that the situation is significantly worse than what these figures would suggest and that the ultimate losses -- ***which must be recognized by the government*** -- are, in fact, much greater.

3.85 The reality is that the bank's management and operational capacity is extremely weak, its lending programs a failure, its accounting practices and internal controls unsafe and unsound, and its future sustainability highly problematic. The Government is now extremely overexposed, both in terms of its direct equity investment and its liability for customer deposits. The Government will continue to become even more exposed unless immediate and radical action is taken. The restructuring, recapitalization, possible privatization, or winding down of SDSB should be a paramount Government priority. A discussion of this restructuring process and recommendations for the future operations of SDSB are included in the next chapter on development financing.

H. CONCLUSIONS AND RECOMMENDATIONS

3.86 This review of the Swaziland commercial banking sector has shown that although the overall financial system is sound and functioning fairly efficiently, the commercial banks are undergoing fundamental change and now find themselves competing strongly in a contracting market. Traditionally and structurally, the commercial banks operating in Swaziland have been closely linked with South Africa and their financial performance has been greatly influenced by economic events in that country.

3.87 The financial performance of the four commercial banks which are majority owned by foreign banks has been mixed in recent years. These banks have been affected by both external economic factors and the impact of internal operational factors. The Swazi economy is still suffering from the effects of an economic downturn in which credit demand from the industrial sector declined, while the agricultural sector has suffered from a lingering drought. Internally, the banks have experienced increases in operating costs (particularly staff expenses), greater provisioning for non-performing credits, and in one case the complete sale of a bank to another South African institution -- with a negative cost impact on the government. As a result of these factors, as well as several significant corporate loan restructurings, the overall profitability of the commercial banks has stagnated in recent years.

3.88 Structurally, these four banks are sound with adequate, if minimal, levels of capital and conservative loan to deposit ratios. The banks have been highly liquid for several years, causing criticism in some circles that they are not lending efficiently into the local economy. The profile of their loan portfolios reveals, however, that their exposure is in fact well diversified throughout the economy. Market analysis has also shown that real growth in credit and deposits has been negative, reflecting the fact that the traditional market for commercial banking operations has actually contracted over the past three years -- while the overall financial sector is well covered by a variety of formal financial institutions, ranging from cooperatives through development finance institutions, to the commercial banks.

3.89 The Swaziland Development and Savings Bank is a unique case within the Swazi financial sector. SDSB is a 100 percent government-owned development/commercial bank which exhibits all of the classic structural and operational deficiencies of such institutions. The quality of the loan portfolio is highly suspect and a review of the published and internal financial statements reveals that the institution is technically bankrupt. It is encouraging to note that the Government has recently taken the difficult political decision to intervene in the bank's operations and begin the process of restructuring the institution.

3.90 This restructuring process must include a realistic review of the bank's development goals, recognition of the actual losses and continuing financial exposure, future investment and funding that will be required from the government budget, and lastly, seriously consider the rapid privatization of this institution. Experience elsewhere has indicated that merely restructuring these types of development banks with the same ownership structure and the same mandate -- will only lead to a repetition of the same problems. The management style and operational process of the development bank ***must be de-politicized*** if there is to be any possibility of a successful restructuring of this institution.

3.91 It is strongly recommended that the restructured institution be allowed to operate only in a very narrow band of development lending where it can fill a gap in the service sector and can perform efficiently. It is especially recommended that the restructured institution ***not*** attempt to be a commercial bank as well as a development institution.

Table 3.8: Financial Statements of the Swazi Commercial Banks as of April 30, 1995

	Barclays	Stanbic	Standard	First Nat. Bank	SDSB
Assets					
Cash in local currency	5,940	2,669	3,280	726	3,373
Foreign balances	146,936	7,560	38,541	29,124	3,075
Due from CBS/reserves	97,163	42,535	37,138	30,000	6,716
Government Securities/T-Bills	38,700	0	0	0	0
Loans and Advances	204,246	167,092	152,186	63,374	201,466
Investments in Swazi Companies	475	0	475	25	550
Domestic Bills Receivable	70,001	0	13,395	0	0
Private Sector or Gov't. BA's	0	0	0	0	6,890
Inter-Bank and Inter-Branch Clearing Items	12,233	17,380	13,652	1,887	11,774
Fixed Assets	18,502	6,780	9,029	8,200	24,391
Other Assets	5,904	2,683	3,698	5,079	9,603
TOTAL ASSETS	590,100	242,672	259,394	128949	206,773
Liabilities					
Foreign Liabilities/due to CMA banks	44,928	29,584	2,852	570	4,234
Due to Other Foreign Banks	8,891	3	665	5,708	0
Deposits in Foreign Currency	16,890	0	22,431	761	0
Domestic Deposits					
Current Accounts	137,431	57,344	52,407	10,410	14,575
Savings Accounts	98,361	19,192	44,309	10,377	51,677
Time Deposits	224,083	102,200	104,335	60,822	92,586
Government Time Deposits	0	0	0	2,359	12,890**
Bills Payable	86	3,638	0	974	0
Other Liabilities	19,232	7,256	15,930	1,819	12,507
TOTAL LIABILITIES	549,902	219,217	242,929	93,760	188,429
Capital and Reserves					
Issued Share Capital	14,605	9,576	9,177	10,100	9,861
Statutory Reserves	10,211	2,079	6,268	27	0
Capital reserve/ Share premium and Dividends payable/ LT Govt. deposit	4,861	10,126	3,696	33,728*	15,374***
Retained Earnings (Loss)	9	0	-4,034	-6,874	-6,561
Income (Loss) year to date	10,512	1,674	1,358	-1,792	-370
TOTAL CAPITAL & RESERVES	40,198	23,455	16,465	35,189*	18,304
TOTAL LIABILITIES & CAPITAL	590,100	242,672	259,394	128,949	206,733

* Includes E30 million in long term CBS deposit (quasi-capital) placed into bank at time of ownership transfer

** Includes E7 million in contra account Bankers' Acceptances due to CBS.

*** Includes E12 million in revaluation reserves.

SOURCE: Central Bank statistics.

Table 3.9: Classification of Loans to Businesses by Industry as of April 30, 1995

	Barclays	Standard	Stanbic	First Nat. Bank	SDSB	TOTAL	percent share
Agriculture and Forestry	40,240	21,443	9,470	0	14,783	85,936	15.08
Sugar cane	31,153	0	4,824	0	3,737	39,714	
Citrus	86	225	409	0	365	1,085	
Pineapple	26	21,071	11	0	80	21,188	
Cotton	544	0	32	0	1,721	2,297	
Livestock and Dairy	1,875	0	2,129	0	1,904	5,908	
Forestry	4,835	0	309	0	929	6,073	
Other	1,721	147	1,756	0	6,047	9,671	
Mining	2.918	0	396	0	0	3,314	0.58
Iron Ore	0	0	0	0	0	0	
Asbestos	0	0	79	0	0	79	
Coal	2,701	0	286	0	0	2,987	
Other	217	0	31	0	0	248	
Manufacturing	23,331	44,607	48,642	3,783	18,458	138,821	24.36
Meat Processing	1,441	0	124	53	0	1,618	
Sugar and Molasses	0	71	588	0	261	920	
Fruit and Vegetables	4	8	317	0	45	374	
Alcohol and Tobacco	18	0	33	55	0	106	
Soft Drinks and Other	753	1,190	66	0	0	2,009	
Textiles	15,139	8,506	18,458	172	749	42,735	
Cotton Ginning	1,436	0	5	0	120	1,561	
Wood Products	235	11,821	1,318	1,208	17,201	31,783	
Pulp and Paper	3,662	2,149	15,757	2,174	82	23,824	
Other	643	20,862	12,265	121	0	33,891	
Construction	26,733	5,221	9,420	4,684	46,598	92,656	16.26
Commercial/Industrial	17,137	2,081	1,977	4,661	0	25,856	
Housing	586	1,926	1,739	0	46,598	50,849	
Other	9,010	1,214	5,704	23	0	15,951	
Distribution and Tourism	20,244	4,109	30,696	17,668	46,358	119,075	20.90
Wholesale Trade	1,827	1,001	1,990	4,679	188	9,685	
Retail Trade	14,617	462	24,267	11,676	38,587	89,609	
Hotels, etc.	1,603	0	383	34	5,582	7.602	
Restaurants, etc.	1,230	315	1,788	843	583	4,759	
Other	967	2,331	2,268	468	1,418	7,420	
Transport and Communications	2,596	2,212	8,034	4,180	16,269	33,291	5.84
Community and Social Services	8,350	696	10,055	851	4,362	24,314	4.27
Other Business N.E.I.	15,200	19,891	26,791	10,383	95	72,360	12.70
TOTAL	139,612	98,179	143,504	41,549	146,923	569,767	100.0

SOURCE: Central Bank statistics.

CHAPTER FOUR
DEVELOPMENT FINANCE INSTITUTIONS

A. DEVELOPMENT FINANCE

4.1 Development finance institutions (DFIs), in their many forms, have been the subject of a number of World Bank studies, publications, and credits over the past four decades. Over this period, the Bank has both advocated and criticized the role and operational structure of these institutions. Originally, the ideal DFI was to be a profitable intermediary in the financial sector, lending long-term and investing in the equity of industrial enterprises. It was to have been a privately owned institution, independent in its operations, yet able to pursue a lending policy which was in agreement with the government's development policies.

4.2 For many years DFIs were considered to be "substitute" financial institutions, necessary to provide the impetus to industrial growth in underdeveloped countries, during the "great spurt" phase of the industrialization process. This approach may explain why DFIs did so well in certain countries, in certain periods, and so poorly in others. A number of countries having simply never experienced the desired growth levels in the industrial sector. Overall, experience with DFIs in a number of different countries, and in a variety of economic contexts, has been decidedly poor -- based primarily on the exceedingly poor financial and management performance of these institutions.

4.3 During the 1980s, the World Bank began to emphasize financial sector growth criteria and the DFI system was seen as an impediment to the development of a liberalized and commercially driven financial sector. The Bank continued to lend to the DFIs, while channeling an increasing share of funding through commercial banks, and using a two-tier system with apex organizations to reach the small and medium enterprise (SMEs) sector which was previously serviced directly by the DFIs directly. Financial components of Sectoral Adjustment Loans (SALs) and Financial Sector Adjustment Loans (FSALs) became the major instruments for financial sector reform.

4.4 The general conclusion of the World Banks' involvement with traditional DFIs over the past 30 years is that these institutions: (a) have little to contribute to the development and reform of the financial sectors of developing countries and actually represent a poor performing constraint within most financial systems, and (b) they may play an important and useful role in assisting real sector growth when the financial sector is generally underdeveloped, if they stay within well defined market niches, and are used to achieve specific economic and social goals with their true financial costs to the system transparently presented within the national accounts.

4.5 Recently, the World Bank has advocated that DFIs should be considered and analyzed in the context of the whole financial sector (accepting that this sector will demonstrate different characteristics in different countries), that negative real interest rates and excessive use of directed credits adversely affect the mobilization of savings and the efficient allocation of credit, and that the success of SME lending projects depends on the policy framework in effect. It is now understood and accepted that DFIs can play an important developmental role in SME lending, agricultural based rural financing, and specialized credit, in those markets where commercial banks cannot be expected to undertake undue risks, and where there is a well defined market niche for such development finance institutions.

4.6 Any discussion of DFIs is necessarily related to the concept of directed credit and specialized "target markets". When directed credit schemes are accepted as being a useful part of a country's developmental policies, the issue becomes one of whether or not the commercially driven and established financial markets fail to provide access to the levels of credit necessary to sustain proper economic growth to certain segments of the market, i.e. the micro, small, and medium enterprises. When the use of directed credit to the SME sector is justified, assistance can be directed either through existing financial institutions or through specialized DFI structures.

4.7 Establishing or continuing to subsidize a DFI may have negative effects on the development of the commercial banking sector if special concessions or subsidies are granted to the DFI. In general, it appears that the use of directed credits and concessionary terms for DFIs as financial intermediaries is a preferred solution only if the government has made a real sector decision that such development financing is required under current economic conditions and a realistic allocation of government resources has been made in the budget process. In addition, the commercial banking sector must be unable, or unwilling for logical credit risk management and profitability reasons, to provide the required types of directed credits to specific target groups.

4.8 There is a very strong belief that modern DFIs can only become sustainable and continue their specialized role in a country's economic development if they are independent from excessive government influence and control. The key element in this equation is ownership, and an independent bank supervisory system, with powers to properly supervise DFIs on the same basis as it supervises the commercial banking system.

4.9 There is a strong case, based on worldwide experience, that strongly suggests that the only successful DFIs are those which are privately owned and independently managed -- with a mixed government and multinational development agency ownership profile being the most desirable. It is now generally agreed that DFIs should compete in the financial sector with other financial sector institutions on equal terms. However, if the services of the DFI are available from other institutions, such as commercial banks or finance companies, then it is difficult to defend or justify the need for government operated or supported DFIs in these activities. These institutions should **only be continued if** they fill a particular gap and service need in the financial markets.

4.10 In the context of Swaziland, one sees several distinct types of DFIs, from the sophisticated multinational investment institution (SIDC), to the traditional and, as expected, financially bankrupt government controlled development bank (SDSB). There has also developed a fairly complete system of non-bank financial institutions and contractual savings vehicles which, to one degree or another, are providing a developmental role within the financial sector. Additionally, Swaziland has a unique vehicle in the Tibiyo Taka Ngwane organization which introduces the element of the Swazi Kingdom and the concept of national land ownership and traditions into the social and financial equation.

4.11 The following section describes the operations of three of the major developmental finance institutions in Swaziland and provides recommendations for the future restructuring and operations of the recently intervened Swaziland Development and Savings bank, SDSB.

B. SWAZILAND INDUSTRIAL DEVELOPMENT COMPANY LTD. – (SIDC)

4.12 As a major institution in the development finance sector of Swaziland, the SIDC began operations in the 1980s as the National Industrial Development Corporation of Swaziland -- a state-

owned enterprise. The current international ownership structure developed in October 1987 with the merger of the failed government operation into a multi-national investment corporation, dedicated to the assistance and promotion of economic development in Swaziland.

4.13 Over the past seven years of operation, SIDC has demonstrated a strong record of growth and profitability while acting as the premier private sector investment company in the Swazi economy. The company is an investor in over 20 separate national and international corporations operating in Swaziland and has also developed a long-term loan portfolio in excess of E54 million, extended to approximately 51 different companies. In general, SIDC's investments and loans have been extended to the "high" end of the market (the larger multinational corporations), although management reports some loans as low as E 60,000.

4.14 As the major investment company in Swaziland, SIDC promotes and finances primarily private sector investment projects in all economic sectors. Management reports that a key feature of their business is to promote foreign investment into Swaziland and assist outside investors interested in local joint-venture operations. To this end they have established a strong working relationship with the Center for the Development of Industry (ACP-EC), in Brussels.

4.15 The company offers equity participations (17.6 percent of their portfolio), long term loan financing (55.2 percent of their portfolio), and the lease of factory space through its investment in land and buildings (27.2 percent of the portfolio). The loan portfolio is made up of a number of credits with maturities up to 12 years, usually at a fixed interest rate. The reported minimum loan size is E100,000 -- but exceptions for smaller credits have been made in special cases. This portfolio mix is essentially the same as reported in 1993 and management reports that while 1994 was a "very active" period for the company, most growth was in the lending area with little new equity investments being undertaken.

4.16 The company carries its equity investments on the balance sheet at cost, with adjustments or write downs made only when there is a perceived permanent loss in value. All equity investments in which SIDC holds a 20 percent or greater ownership position are reported on the balance sheet at an adjusted equity cost basis of E12.9 million. The auditors have subsequently placed a market value for these investments at E 32.1 million as of June 1994, based on equity accounting procedures.

4.17 A review of the company's equity investment portfolio reveals the diversity of their investment philosophy as well as the fact that most investments are in large multinational joint-venture commercial operations. SIDC is a 50 percent investor in such companies as: Mbabane Development Corporation, Swaki Investment Corporation, Metro (Swaziland), and The Cement Organization. In addition, it is a major shareholder in Swaziland United Bakeries and Swatex Holdings. Its long-term loan portfolio is well disbursed throughout the Swaziland commercial sector.

4.18 Management reports that with the current slowdown in new equity investment into Swaziland they have concentrated more on lending activities. They have reviewed their overall lending policies and report that most new credits are for a period of 6 to 7 years, a decrease from 12 years, and that interest rates charged are now adjustable at least once a year at an average rate of local prime plus 1 percent. This would currently mean a very competitive loan rate for the best customer of 17.75 percent, which is better than usually available from the local commercial banking sector for such credits.

4.19 As of May 1995 the capital structure of this important investment company had been increased several times and consists of the following shareholdings:

Table 4.1: SIDC--Share Capital
(E thousand)

Shareholder	Total Share Capital*	% Ownership
Swazi Government	8,425	34.9
CDC	2,625	10.9
DEG	5,320	22.1
FMO	2,457	10.2
IFC	3,314	13.7
PROPACO	1,225	5.0
Barclays Bank	375	1.6
Standard Chartered Bank	375	1.6
TOTAL	**24,116**	**100.0**

* includes both A and B (voting and non voting) shares

4.20 As of June 1994 (the latest available financial statements), SIDC reported a net investment position (investments and loans), of E82.4 million. This is net of a specific provision of E3.3 million made during the year. It is, in fact, management policy to maintain a loan loss provision account of at least 5 percent of total risk assets. As of June 1995, total provisions against risk assets were E12.4 million of which E5.4 million (43.5 percent), relates to exposure investments in Natex. This level of provisioning has proven to be most prudent over the years as actual write-offs have been much lower than annual contributions to date.

4.21 In 1994, SIDC reported an 18 percent increase in gross income and a net income increase, before taxation, of 46 percent. Actual 1993/4 profits after tax increased to E6.4 million which raised retained income to an impressive level of E15.0 million. Proposed dividends for the year are E947,900 or 27 cents per share. Management reports that profits for the period ending in June 1995 will be slightly ahead of 1994 levels.

4.22 On a flow of funds basis, it is interesting to note that SIDC is definitely a case of external capital sources being utilized within the Swazi economy. The international shareholders have increased their capital in the company regularly and these funds have been the primary basis for the company's local investment. SIDC does not, at this time, accept local deposits and has to date received all of its funding through capital and external borrowing. All investments and loans are to Swazi operations and the company does not hold any assets in South Africa.

4.23 Management reports that while they are currently liquid, funding is always an issue. They are currently reviewing some internal procedures and will try to attract more local funds and may undertake a sale of commercial paper or a bond issue on the local exchange in the not too distant future. They also plan to solicit the central bank for approval to gather local funds in various forms,

but do not wish to become a commercial bank with current accounts or develop a large retail customer base.

4.24 As a development institution, SIDC will continue to be a major force in the Swazi market -- and with its professional management team and international shareholder group, should be seriously studied as the best example of a successful investment/development operation in Swaziland for its particular market group.

C. TIBIYO TAKA NGWANE

4.25 Tibiyo was created as a legal entity in 1968 by the late King Sobhuza II to promote economic development in the country through direct investment in a variety of social and economic oriented projects that are designed to create jobs and preserve the cultural traditions of the Swazi Nation. The stated aims and objectives of Tibiyo Taka Ngwane are a mixture of social and economic development goals which make this a unique, non-bank type, of development finance institution which can make a strong impact if it is administered properly.

4.26 Tibiyo has a financial and administrative structure which is unique to Swaziland. The company's initial capital was derived from the royalty income of national mining operations which was subsequently employed to gain an investment position in a number of operating companies, primarily in the agricultural sector. The company has expanded its investment portfolio rapidly through the reinvestment of dividend income as well as the ability to achieve a "no cost" investment position in certain industries in the name of "national interests".

4.27 As of April, 1993, (the latest financial statements available), the total assets of the company were E307.0 million with share investments and loans in 19 separate companies valued at E172 million. Tibiyo holds in trust within its portfolio a total of E27.4 million in land and improvements acquired on behalf of the Swazi nation as a result of its unique charter and mandate to "invest and administer in trust for the Swazi Nation those assets which will improve the standard of living and education of the Swazi people and preserve the national traditions".

4.28 The reported annual surplus in 1993 was E41.6 million which is broken down as shown in Table 4.2. Although the company's investment portfolio has been diversified over the years, equity investments remain largely in the agricultural and agro-processing sectors. Table 4.3, provides a breakdown of Tibiyo's investment portfolio as of April, 1993.

4.29 Although the latest detailed investment schedule available is for 1993, the company reports that the overall investment portfolio has experienced very little growth since this time, due mainly to the economic slowdown during 1994. Management reports that investment profits for the 1993/4 fiscal period were basically equal to 1993 reported levels. Profits for the 1994/5 operating period have reportedly improved by 10 to 15 percent over 1993 levels but will require additional adjustments to include the write-off of the company's investment in Meridien Bank.

4.30 As of March 1995, Tibiyo held a total book investment in Meridien Baio Bank of E3.5 million which must be considered a total loss as a result of the failure of this institution and the subsequent sales agreement with FNB. Tibiyo reports a total capital reserve position in excess of E89 million which has been increased since 1993 and is more than sufficient to absorb this loss.

4.31 Management reports that their experience with Meridien Bank and several other investments has prompted a complete portfolio review in which they plan to further analyze those investments which are operating efficiently and divest those which prove to be unprofitable. They also plan to sell their shares in several companies which are profitable but no longer "fit" their re-defined development/investment profile. They plan to take a more pro-active management role in a number of their agricultural and production investments in order to improve efficiencies and long term profitability.

4.32 In 1993, the King mandated Tibiyo to examine its role in the development of SMEs within the country and their access to term financing. Consequently, by mid-1994, Tibiyo had allocated a total of E5 million to SDSB to fund on-lending to small and medium enterprises by that institution. In addition, Tibiyo management has recently announced that it will fund an additional E8 million in credits directed to the small and medium enterprise sector and is currently reviewing bids from several organizations who would actually manage the disbursement of these funds.

4.33 There is obviously a continuing role for Tibiyo within the development finance markets of Swaziland. The company has the size and institutional strength to be a very strong influence within the Swazi financial sector, as an investor on a large scale, as a provider of funds for small and medium enterprises, and as a vehicle for social development programs.

Table 4.2 Tibiyo Income Statement for year ended April 1994
(E million)

	E mill
Investment Income from Projects	22.7
Interest Income Received	8.7
Dividend Income from Investments	35.6
Share or Partnership Earnings-equity Accounting	28.9
Less Direct Operating Expenses	(35.9)
Sundry Income	0.9
Investment Write Offs	(0.7)
Indirect Operating Expenses	(12.7)
Net Income	**47.3**
Share of Associated Companies Income	6.9
TOTAL INCOME	**54.3**
Distributions to Reserves, Assistance to Swazi Nation, and Other Payments	(12.7)
Operating Surplus for the Year	**41.6**

Table 4.3: Schedule of Investments--Tibiyo (as of April 30, 1993)

Listed Companies	**Cost/Carrying Value**
Lonhro Sugar Ltd.	45,000
Standard Chartered Bank	722,000
	817,704
Listed Associated Companies	
Swazispa Holding Ltd.	13,977,230
Royal Swaziland Sugar Corporation	61,426,400
	75,403,630
Unlisted Associated Companies	
Dokolwayo Diamond Mine	1
Meridien Bank Swaziland	1,488,142
Mhlume Sugar Company	18,872,000
Sinumye Plaza Ltd.	1,546,025
Swaziland Breweries Ltd.	6,890,400
TF Trading Ltd.	1
Tibiyo Insurance Brokers Ltd.	495,002
Ubombo Ranches Ltd.	25,876,546
Unitrans Swaziland Ltd.	5,192,400
	60,360,517
Subsidiaries at written down value	
Langa National Brickworks Ltd	1
Jubilee Printing and Publishing Ltd.	1
The Royal Swazi National Shipping Co.	1
The Swazi Observer Ltd.	1
	4
Partnerships	
Inyoni Yami Irrigation Scheme	19,699,500
Bhunu Mall Investment	11,078,020
	30,747,520
Other Investments	
Swaziland Building Society-permanent shares	9,500,000
13 percent Government Stock	17,000
14.75 percent Swaziland Electricity Board Stock	233,100
The Southern Life Association Ltd.	500,000
Sanlam	2,500,000
Swaziland Brewers Ltd. - Debentures	4,161,000
	16,911,100
Loans to Related Companies	
Inyoni Yami Swaziland Irrigation Scheme	538,330
Simunye Plaza Ltd.	549,900
Langa National Brickworks Ltd.	12,090,000
	13,178,230
Deduct: Provision for Loss	(8,970,000)
Sub-total	**4,208,230**
Deposits with Financial Institutions (at call)	
Call	45,045,125
Fixed	32,797,723
Total Investments and Deposits	**266,291,553**

D. SWAZILAND DEVELOPMENT AND SAVINGS BANK (SDSB)

4.34 SDSB has acted as the traditional, government-owned, development finance institution in the Swazi economy. The institution's structure and financial operations are described in detail in Chapter Three, on commercial banking, while the bank's current restructuring program and its recommended future role in development finance are more fully discussed below.

4.35 The accumulated losses (estimated to be ***at least*** E85 million), and known operational inefficiencies (reported non-performing credits are in excess of E130 million), of SDSB resulted in the Minister of Finance initiating, in coordination with the Central Bank, a complete intervention in the bank's administration-in May 1995. This was recognized as a very difficult, but necessary, political decision which resulted in a certain level of criticism being aired publicly. This was, in fact, a direct reflection of just how "politicized" the operation of this institution had become.

4.36 The Ministry of Finance and the Central Bank have formed a new administration group which is primarily implemented through the "Implementation Committee". This committee has replaced the former Managing Director and has hired an experienced expatriate banker to manage the restructuring exercise for the first six months. The new management committee in charge of the restructuring of SDSB consists of representatives from:

(a) The Ministry of Finance (up to two positions)
(b) The Central Bank of Swaziland (up to two positions)
(c) SDSB management (up to two positions--including the new Managing Director)
(d) Coopers & Lybrand Team (up to two positions)

4.37 The Implementation Committee has retained Coopers & Lybrand to assist in the restructuring, primarily through the implementation of a number of the recommendations set out in their 1994 in-depth study of the institution. The core restructuring program is divided into three distinct phases:

Phase 1:	Strategic review and business plan
Phase 2:	Planning for restructuring
Phase 3:	Restructuring implementation
Ongoing:	Fast track restructuring, monitoring and evaluation

4.38 In addition, the Managing Director of the bank is expected to initiate an immediate program for increased debt collection, strategic planning, and revised lending procedures. The Coopers team is leading a ten-week "fast track" program which will assist the Managing Director in these tasks as well as undertake the following activities:

(a) Collection of non-performing loans -- with assistance from an external legal team
(b) Restructuring (as necessary) of the top management team
(c) Investigations into allegations of fraud and misconduct
(d) Determination of the profitability of the current branch network
(e) Development and introduction of new lending policies and procedures

4.39 These five tasks have been "re-prioritized" and listed in their perceived order of importance. It is most important that the restructuring process be seen as a "real effort" by the marketplace and a strong, unbiased, and visible collection effort against all non-performing

borrowers must be an essential element of this restructuring program. Likewise, it is imperative that the Implementation Committee take immediate action to "cleanse" the institution of those members of the past management team which are responsible for the gross mismanagement of the institution and consequently its accumulated losses. While actual recovery on non-performing credits will be most difficult and will take much longer than the planned ten week period, the process must be begun immediately and the legal team should be permitted to continue this effort to its conclusion.

4.40 While the financial rehabilitation of the institution -- determining the final loss position, adjusting the capital account, and restructuring the loan portfolio -- is important, the key to this, and any similar, restructuring program is **determining the future strategic direction and market niche** for the bank. At inception SDSB was structured as a rural finance and agricultural bank, with the ability to collect rural savings. However, as accumulated losses began to negatively impact the bank's overall profitability, management tried to reorient their operations to include commercial banking activities.

4.41 As a major component of its corporate plan, SDSB embarked on a program to expand its commercial lending in direct competition with the four local commercial banks and reported total *business loans* of E107.1 million as of March 1994. The majority of these credits however, (E77.2 million -- 72 percent), are actually current account overdrafts, special advances, and personal loans which are poorly documented and do not include any established repayment schedule. The quality and ultimate collectability of these uncollateralized and poorly documented advances is highly suspect.

4.42 Over the past three years, SDSB has operated inefficiently as a highly illiquid "mixed purpose" financial institution without a clear strategic direction, improper lending procedures and controls, and poor management techniques. In an attempt to be a competitive development institution as well as a commercial bank, SDSB extended a number of insider loans, misapplied the customer deposit base that it had collected from the rural sector, and failed to collect and/or properly account for interest income from several international lending programs that they were supposed to manage.

4.43 For the reasons described above, as well as the current status of the commercial banking sector in Swaziland (i.e. the size, strength, and operational efficiencies of the South African and British institutions operating in the country, and the relatively sophisticated level of competition for a decreasing market share among these banks), it is strongly recommended that the restructured SDSB **should not include** any commercial banking function. Nonetheless, as there continues to be a market driven need for continued access to rural and agricultural based financing programs, there is a rationale for the continued existence of an SDSB type institution in the financial sector. However, the restructured Swazi Bank should be **solely a development banking institution** -- preferably with private sector and foreign participation in its share capital.

E. FUTURE ROLE OF SDSB

4.44 Assuming that the government continues to exhibit the political will to truly restructure the SDSB, including the ability to absorb the high level of financial losses which will surely be identified, the "new" SDSB should be structured to operate within a fairly narrow and well defined market niche. It is strongly recommended that a restructured SDSB should revert to its original mandate of providing a savings collection system for small savers in the rural areas, while at the

same time administering external lines of credit on behalf of the Government (such as those in existence from the African Development Bank and IFAD), and undertaking only a limited amount of well defined term lending activity.

4.45 The management of a restructured SDSB will have enough difficulties and will require a full time effort from a number of parties just to bring the bank back to an acceptable level of efficiency and sustainability. The bank should work only in the traditional development finance areas which should be its targeted market. As a brief review of the current arrears and problems they have in the their existing portfolio demonstrates, the "new" bank should **not** continue to attempt to become a commercial financing institution as well. The following section briefly describes the current development financing portfolio of the institution and the problems which must be addressed.

4.46 SDSB currently administers two subsidized loan funds for the agricultural and housing sectors and has been the leading lender under the Government's Small Scale Enterprise Loan Guarantee Fund. The Agricultural Development Loan Fund reported advances of E25.7 million, through approximately 3,000 separate loans, as of March 1994. This special loan program is an integral part of the Government' agricultural policy and is primarily funded through a series of grants and concessional loans from international agencies to the Swazi Government. While this subsidized loan program reports a E224,000 surplus for the year, it actually had an accumulated deficit from prior years' losses of E1.3 million -- reflecting the institution's poor management of these loan funds.

4.47 The bank reports that the long term loans extended under the agricultural loan program do not call for an interest or principal repayment until maturity, which is often as long as three years. The bank continues to accrue interest on these credits into income until six months *past* the maturity date -- before any accounting adjustment is made and/or extraordinary collection efforts begun. Management was unable to provide any timely data concerning the quality of these credits or actual repayment performance, although they have in the past stated that no specific provisions are taken for these credits despite the fact that past performance indicates that these loans have an extremely high default rate. As the agricultural portfolio continued to grow during the 1994/5 operating period, to a record level of E25.7 million, it is obvious that there are losses which must be recognized. Many of these loans will have to be restructured with more realistic terms and conditions as well as an increased level of management oversight.

4.48 SDSB also manages the Government Civil Service Housing Loan Fund which has extended around E40 million in long term housing credits. This fund currently reports a deficit in the revolving balance of the fund of E895,000, which the government is supposed to replenish from budget allocations. This fund appears to show a poor return and weak management record. The bank also extends housing credits on behalf of a number of institutions and government agencies for which they receive funding through the collateralization of long term deposits. Total housing loans granted by the bank, including those extended through the Civil Service Fund was E69.9 million, approximately 30 percent of the total loan portfolio of the bank in 1994. No data was available to detail the actual performance of these credits.

4.49 The bank is a major participant in the Small Scale Enterprise Guarantee program and has extended some 248 credits totaling E5.3 million since the inception of this scheme in 1990. Loans outstanding under this program were E4.1 million as of March 1995 with no past dues or guarantee claims reported. These are very high risk loans granted to Swazi nationals who wish to start up new

business enterprises. The fund guarantees only 75 percent of the credit and the remaining 25 percent must be in cash or some other form of collateral -- the banks being 100 percent secured -- despite this, most commercial banks have been slow to extend credits under this program.

4.50 SDSB is the largest creditor under this program with over 53 percent of the total loans granted. When the claims record of the other institutions are analyzed, it becomes apparent that Swazi Bank has probably not managed these borrowings properly nor provided reliable data concerning loan repayments under this program. There is in fact a high potential for additional losses in this portfolio -- whether or not guarantees have ever been called. Nonetheless, this type of lending is considered to be best directed through a development financial institution and the continued participation (with a more efficient loan administration program in place), should be part of the restructured bank's strategic plan.

4.51 On the liabilities side, SDSB has accepted customer deposits totaling E162.6 million. An analysis of these accounts reveals that the bank has a very high percentage of its deposit base in very small individual accounts from the rural sector. Management reports that the institution has several thousand current and savings accounts with balances of less than E1,500. These are very expensive accounts to maintain and contribute heavily to the bank's high overhead costs, even though the total reported interest expense for 1994 (E15.1 million), would imply a very reasonable 9.3 percent annual interest rate paid on this deposit base. Of E65.4 million in term deposits, the Government has placed slightly more than E60 million with the bank in an attempt to resolve its chronic liquidity problems.

4.52 Given the high level of loan losses that will have to be realized during the current restructuring, it appears certain that the Government, as sole shareholder of the institution, will be required to write-off this deposit and most likely inject a further E20 to 30 million in order to cover losses and recapitalize the bank. The "new" SDSB, if it continues operations only in a specialized role as a development finance institution should not require more that an E10 to 15 million capital base. However, the government must be prepared to **inject new capital funds** into the bank in order to increase the liquidity of the bank and allow for future lending operations.

4.53 It is important that the restructured institution retains any future savings collection function separate from its lending activities. Also, SDSB should **not** receive any special status regarding any direct or implied government guarantee for its deposits, as is now the case. Savings collected from small rural and urban savers should not be mixed into the funding base for loan assets or the development lending activities of the institution.

4.54 The development financing activities of the "new" SDSB should only be financed by the bank's own sources of funds (capital, bond issues, and loans from shareholders). In addition, the bank should only invest customer deposits into government treasury bills and/or bonds which could in turn partially source the banks lending activities. This would serve to place the small savings deposits into safe government paper and provide a buffer between deposit mobilization activities and the risks inherent in the institution's development loan portfolio.

4.55 A final area of concern in the performance and long term sustainability of SDSB is the high level of staff and operating expenses for an institution of this size. This will be a major concern for management in the future -- and it would appear almost certain that a major downsizing exercise **must** be undertaken as part of the restructuring of the bank. Employees salaries and benefits totaled E11.7 million in 1994 -- a 21 percent increase over their level a year earlier. This level of

expenses is inconsistent with the bank's staffing levels which increased from 391 people in 1993 to 400 in 1994. Likewise other operating expenses were high (E5.3 million for 1994). Combined salaries and overheads of E17.7 million in 1994 were an extraordinarily high 49.2 percent of total interest and commission earnings, reflecting the gross inefficiencies in the administration of this institution -- thereby accounting for the severe reduction in operating profits.

4.56 It is obvious that the restructured bank cannot continue to operate in this manner in the future, with substantial increases in overheads and diminishing returns in interest income. Management will be required to dedicate considerable effort to improve the operational efficiencies of the institution. The "new" downsized SDSB should probably be able to efficiently conduct its operations at a reduced staff level of 250 to 300 people.

F. CONCLUSIONS AND RECOMMENDATIONS

4.57 The Swaziland Industrial Development Corporation plays an important and useful role within the Swazi financial system. The 1987 restructuring of the institution provides important lessons for a possible restructuring of the Swaziland Development and Savings Bank. Most importantly, the institution appears to have been largely de-politicized, it is now run by competent management, and it has been partially privatized -- all key elements in the ultimate success of the institution.

4.58 Funding for the SIDC may well appear as a key constraint for the future, and avenues such as the sale of bonds and other institutional paper -- and the possible acceptance of term deposits should be examined by the Corporation as ways in which funding constraints can be addressed for the future.

4.59 Tibiyo Taka Ngwane has also played an rather unique, but important role within the Swazi financial system and the economy and society generally. This seemingly well run institution appears to have successfully combined cultural, social, and financial objectives. The Government may, however, need to re-examine the taxation policy which it applies to this institution. Recent moves to support SME credit are being watched with cautious optimism.

4.60 The Swaziland Development and Savings Bank has a role to play in the Swazi financial system -- but will need to be radically restructured. This will require moving out of commercial banking activities, cutting back on staff, bringing in new professional management, partially privatizing the institution, and seeking sources of funding other than customers deposits. In the restructuring process, the SDSB should ensure that it recovers, to the full extent of the law, all outstanding non-performing customer loans. To not pursue such delinquent borrowers adequately, will put the newly formed institution at a serious disadvantage even before it commences operations as a new enterprise.

4.61 It is further recommended that the SDSB should continue its savings collection post function for the important economic and social role that such an activity provides. However, these funds should not be used to fund the development finance activities of the bank. Instead, these deposits should be placed in low risk, preferably Government guaranteed securities. Alternatively, funds to finance the activities of the new SDSB should come from Government budget subventions, foreign development bank loans, and shareholder funds.

CHAPTER FIVE
MONEY & BOND MARKETS & TERM INVESTMENTS

A. BACKGROUND

5.1 The money and debt markets in Swaziland are presently illiquid -- very little trading takes place. There is no readily discernible yield curve for either the short or long term. Nonetheless, the development of more liquid markets is of interest for three broad reasons:

(a) The prospect of budget deficits in future, in contrast to the surpluses of the recent past, raises the issue of how the government can sell a volume of debt on the best possible terms. Efficient and liquid markets will enable the Government to raise funds on finer terms and so, at the margin, reduce the impact of the financing cost on the budget. Table 5.1 shows the projected growth of the deficit under two scenarios.

Table 5.1: Overall Budget Surplus/Deficit (E million)

	1990/1	1991/2	1992/3	1993/4	1994/5	1995/6 proj	1996/7 proj	1997/8 proj	1998/9 proj	1999/00 proj
Base Case	165.2	122.9	-20.7	-183.7	-205.3	-75.0				
Adjusted	165.2	122.9	-20.7	-183.7	-205.3	4.0	-107.2	-252.7	-283.4	-323.4

SOURCE: IMF Aide Memoire, September 1994

(b) Market development will not only benefit the Government. A developed market will assist private borrowers to achieve better terms and longer maturities on borrowings, while competition for savings between the debt market and banks is likely to increase returns to savers. Deposit rates in Swaziland are in general lower than those in South Africa due to a lack of competition for funds caused by an excess of reserve balances and some segmentation between the Swazi and South African markets.

(c) Developing money and debt markets will mean that the Central Bank of Swaziland will have to become more active in managing system reserve balances. The skills required for this are the same skills the Central Bank will require in future if it ever requires some policy independence from South Africa. Policy independence is impracticable at present due to membership of the Common Monetary Area (see Chapter Two).

5.2 The development of debt and foreign exchange markets in Swaziland will take place within the framework of the Common Monetary Area (CMA). Swaziland's membership of the CMA offers an uncommon opportunity to obtain access to much deeper and more liquid markets than could develop in Swaziland alone. In addition, membership of the CMA will have a large influence on the form of the markets which develop.

5.3 As long as Swaziland is a member of the CMA its debt markets cannot be fully independent from that of South Africa. In particular, Swazi interest rates cannot be too

dissimilar to South African rates and liquidity conditions in Swaziland cannot be insulated from flows to and from South Africa. Attempts to insulate the Swazi market by regulation (some of which currently exists) will lead to arbitrage -- and compliance costs are unlikely to succeed or, more importantly, generate a net benefit to Swaziland.

B. MONEY & DEBT MARKETS

5.4 **Domestic Interbank Market.** Swaziland has quite an active interbank market based, however, not in Mbabane but in Johannesburg. The interbank market in Mbabane is moribund at present. Occasional transactions occur in the range of E1-10 million. Transactions are usually overnight and unsecured. The exception to this pattern are the transactions of the Swaziland Development and Savings Bank (SDSB) which, due to weak liquidity and a weak balance sheet, borrows on secured terms and occasionally for periods of up to 30 days. SDSB is partially segmented from the market -- some banks have suspended their exposure limits to it and others lend only on the basis of guarantees from the Central Bank of Swaziland (CBS).

5.5 The interbank rate has been established by agreement among the banks at a margin below the discount rate. The same rate is applied for terms ranging from call to 30 days. Given the lack of a market the main purpose of this agreement appears to be operational simplicity.

5.6 The main reason for the lack of interbank activity is the over-liquid state of the market. Banks have sizable reserve balance 'equivalents' (assets in South Africa which can be quickly transformed into reserve balances in Swaziland) in excess of those required to meet reserve requirements and transactions needs. The average excess holding of reserve balances and 'equivalents' over the last two years has been close to E100 million. Based on interest rate differentials this costs Swazi banks between E2-5 million per annum. Some or all of this cost is passed on to clients.

5.7 Banks find the balances they keep at the CBS to meet the reserve ratio (6 percent calculated as an average over the month) to generally be adequate in meeting daily clearing needs. Adverse bank clearings appear to be in a modest and manageable range. Part of this is due to the good relationships banks reported with their larger clients, enabling them to receive advance advice of most large clearings. To meet expected withdrawals banks typically repatriate funds from South Africa. The return of South African funds takes two days -- same day value is possible although discouraged by the CBS.

5.8 Chart 5.1 compares estimated demand for reserve balances with holdings of reserve balances and 'equivalents'. Demand for balances at the CBS is estimated as the average of daily balances at the CBS excluding the first 3 and last 3 days of each month, when funds to meet the liquidity ratio are present. Total funds kept in the form of reserve balances or 'equivalent' are estimated from banks end of month balances at CBS.

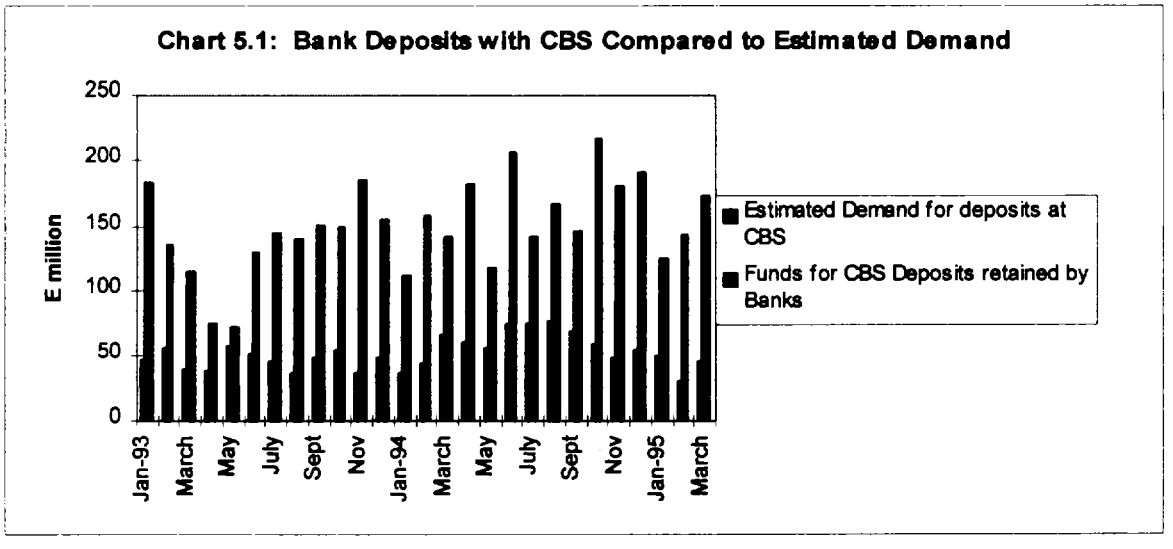
5.9 The excess of reserve balances and equivalents exists due to a combination of factors:

(a) In as much as the deficit is not financed by the draw-down of credit balances, then reserve money is being created by the deficit and CBS foreign exchange purchases.

(b) CBS is not attempting to control domestic liquidity as part of monetary policy operations. i.e. it is not actively selling T-Bills or entering into repurchase agreements in order to control the quantity of reserve money.

(c) T-Bills are sold to meet Government financing needs which, to date, are of a short term bridging nature. T-Bill sales are not large enough to reduce reserve assets to close to the level demanded to meet the reserve requirement and transactions needs. There is thus an over-supply of reserve assets.

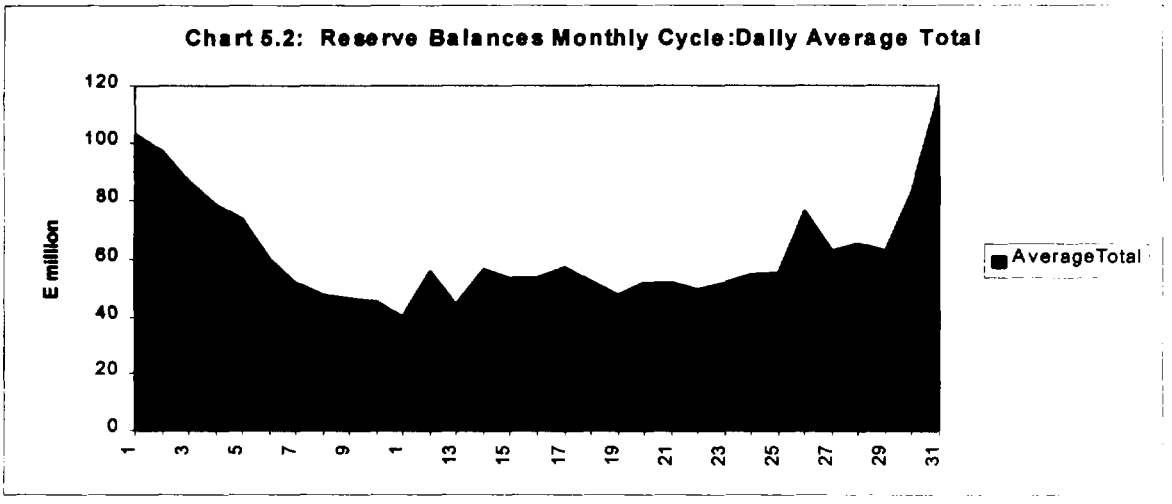
(d) The liquidity ratio (17.5 percent calculated at month end) can be met by holding till cash, cash balances with the CBS, Swazi T-Bills and some other types of Swazi debt instruments. The supply of qualifying debt instruments is insufficient. Consequently Swazi banks require reserve assets (cash at the CBS) in excess of the amount needed to meet the reserve requirement in order to meet the liquidity requirement.



5.10 Excess reserve balances at the CBS earn 6 percent on the average balance over the month. Call funds in South Africa earn around 13 percent creating a clear incentive to place excess reserve balances in South Africa. Consequently all banks make a practice of using the Johannesburg money market for managing their liquidity -- repatriating funds to Swaziland at month end in order to meet liquidity requirements. The resulting liquidity peak at the beginning and end of the month is clearly shown in Chart 5.2.

5.11 Swazi banks' use of the money market in Johannesburg is limited by three factors:

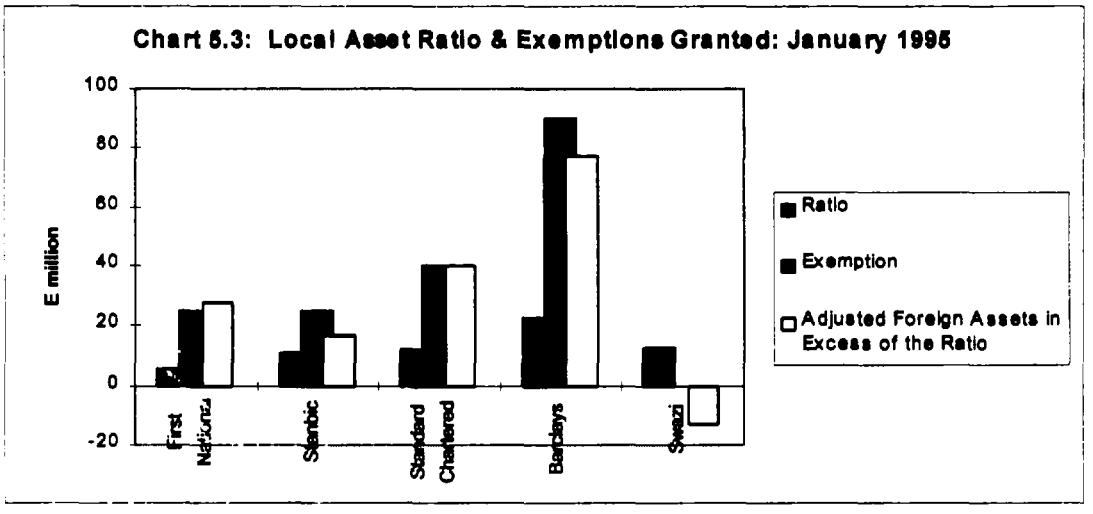
(a) Swazi banks place funds for short periods in Johannesburg only. They do not purchase South African T-Bills or other short term debt instruments. This is costly. T-Bills yield 1 percent more than call funds and commercial paper yields even more. Banks do not purchase South African paper as it does not qualify for the liquidity ratio.



(b) The banks, particularly the British-based banks, have exposure limits to South Africa. These limits are set in the context of the bank's global exposure limit to South African risk, of which the Swazi operation has a share. These limits appear to be binding in the case of Barclays, which is a factor driving its demand for Swazi T-Bills and its dominance in T-Bill tenders.

(c) The Local Asset Ratio (LAR) limits banks foreign assets to 5 percent of total assets. All banks except SDSB have substantial exemptions to this ratio to the extent that no bank considered the LAR to be a binding constraint. Proof that the LAR is not a binding constraint is shown in Chart 5.3. Foreign asset positions in excess of the LAR are generally within the exemptions granted to each bank. 'Adjusted foreign assets' in Chart 5.3 refers to the foreign asset position reported at the end of the month ***plus*** an adjustment for end of month transfers to Swaziland calculated as the difference between end of month and average reserve balances.

5.12 The binding constraints on Swazi banks' use of the South African market appear to be the liquidity ratio (compounded by lack of domestic short term instruments, which the CBS can always prescribe or designate as qualifying assets for liquidity purposes) and the internal bank limits set on South African exposures.



5.13 **Primary and Secondary Debt Markets.** There is relatively little tradable debt on issue in Swaziland. Table 5.2 lists the tradable debt issues currently available. T-Bills trade over the counter while other issues are listed on the Swaziland Stockmarket (SSM). In addition to these tradable issues bankers acceptances (BAs), negotiable certificates of deposit (NCDs) and promissory notes exist but do not trade. If there was more control over the level of domestic liquidity, it is more likely that these instrument would be traded. If there was less liquidity, the banks would be more likely to begin to use these as liquidity management tools rather than just as investments.

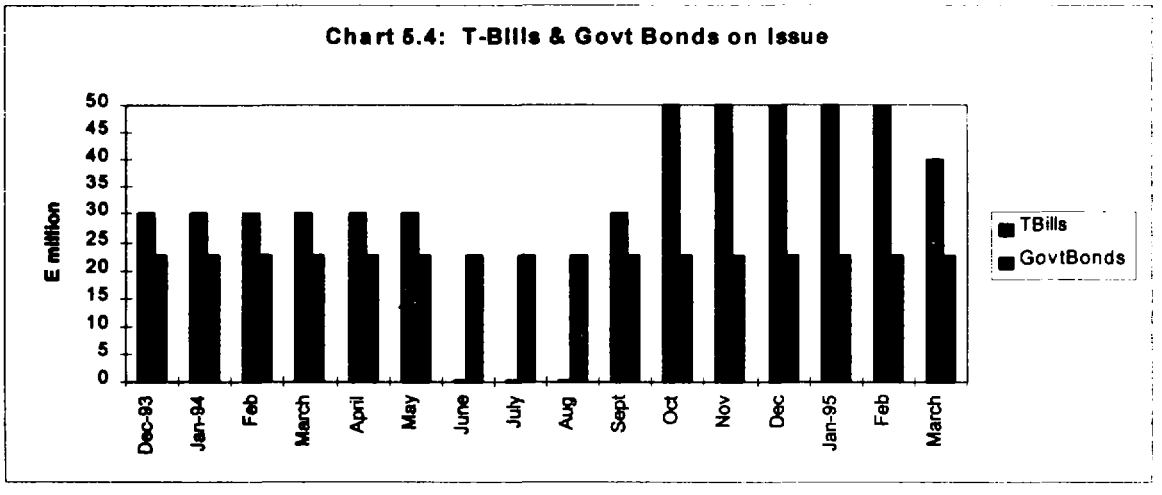
Table 5.2: Tradable Debt Issues, E million

	Nominal Amount on Issue March 1995	Reported Trade in 12 months to October 1994
Treasury Bills	40.0	nil
Government Stock	22.5	1.5
Electricity Board Stock	15.0	nil
Swaziland Brewers Debenture	15.0	) .
Swaziland Post & Telecommunications Debenture	16.0	) 1.2
Swaziland Sugar Debenture	12.5	) .
TOTAL	121.0	2.7

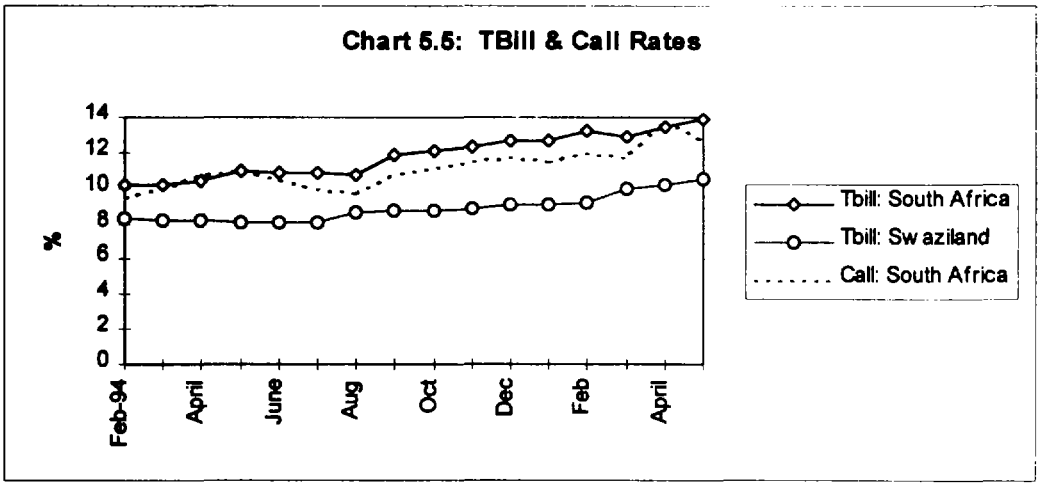
5.14 The three debenture issues were made in 1992 and 1993 -- and no issues have been made since then. Issue of private debt may be affected by the prolonged period of excess liquidity which has encouraged a gray market in direct company to company lending.

5.15 The volume of T-Bills and Government stock on issue for the last two years is shown in Chart 5.4. The low issue volumes for T-Bills and Government Stock reflect the recent surpluses of the Government. No new issues of Government stock have been made in recent years. T-Bills are issued as the Ministry of Finance requires funds. Recent tenders have been held once or

twice a month largely to roll-over maturing issues. Notice of T-Bill tenders is given in the newspaper -- with no other notice being given. Several banks were unaware of the timing of the most recent auction or of the amount offered, reflecting their lack of demand for Swazi T-Bills as well as the method of notification. Successful bids are settled the day of the auction.



5.16 The primary market in T-Bills is distorted by the excess liquidity in the banking system and the fact that the market is only partially integrated with that of South Africa. As the Swazi and South African markets are not fully integrated some of the excess liquidity is 'captured' in Swaziland. The alternative returns currently (1995) available to these captive funds are: 6 percent on average excess reserves paid by the CBS; a slightly higher rate paid by the CBS on term fund deposited with it (which CBS then invests in South Africa, thereby making a regulatory arbitrage); and T-Bills. The low alternative returns exert downward pressure on the T-Bill rate. As a result, over the last year Swazi T-Bills yielded 1.5-3.5 percent less than call funds in South Africa and 2-4 percent less than South African T-Bills, as shown in Chart 5.5. This large difference in rates is a strong inducement for non-captive funds to invest in South Africa.



5.17 The effect of captive demand combined with easy substitutability (for non-captive funds) between South African and Swazi cash balances is demonstrated starkly in the profile of

successful bidders in Swazi T-Bill tenders. Over the period, October 1994 to June 1995, Barclays Bank purchased approximately E140 million of these issues, whereas the next closest purchaser (the Motor Vehicle Insurance Fund) purchased slightly over E20 million. The dominance of Barclays and the virtual absence of other banks, despite the excess of reserve balances and 'equivalents,' is important. Barclays faces greater constraints to using the South African market than the other banks due to a more restrictive bank position on global exposures to South Africa. Barclays is thus, to some extent, a captive bidder for Swazi T-Bills. Those more able to access the South African market obviously prefer to do so.

5.18 The secondary market for all Swazi debt issues is highly illiquid. The yield difference with South Africa reduces demand for Swazi debt and greatly limits the development of a secondary market. The South African debt market not only yields more than the Swazi market but is also considerably more liquid. For example, it can take 2-3 weeks to find a buyer and agree on a price for Swazi Government Stock in the secondary market. The equivalent South African transaction can be completed in a day.

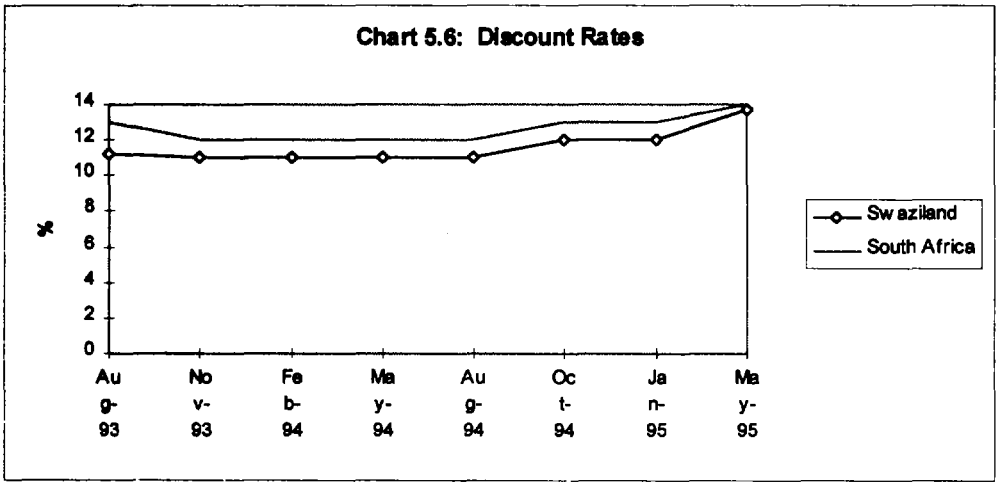
5.19 The small supply of government stock causes end holders to buy and hold until maturity. Excess liquidity means that T-Bills are primarily purchased as an investment rather than as a liquidity management tool. There is rarely a need to sell T-Bills to raise liquidity. Further, the relatively large gap between the T-Bill yield and the discount rate of around 3.5 percent (see Chart 5.7) makes discounting T-Bills very expensive and encourages banks to search for alternative liquidity management tools, which they find in South Africa. South African assets are sufficiently easy to transform into Swazi reserve balances to be an acceptable tool for managing a bank's liquidity position in Swaziland.

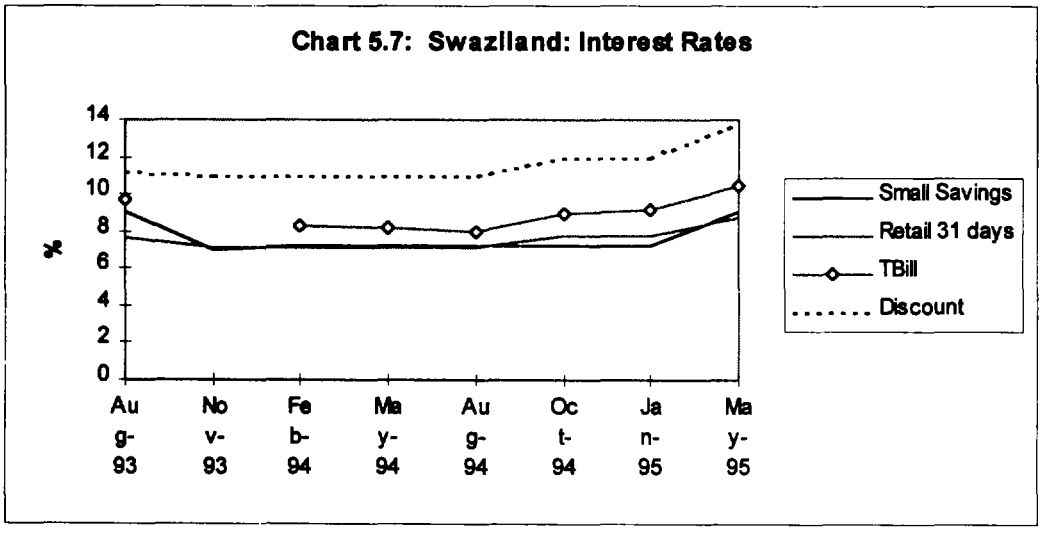
5.20 The supply of T-Bills is also too small to encourage a market. Stanbic had previously tried to establish a rediscount market, largely between themselves and Barclays. The T-Bills being used for this purpose matured and Stanbic did not obtain new bills to repeat the exercise.

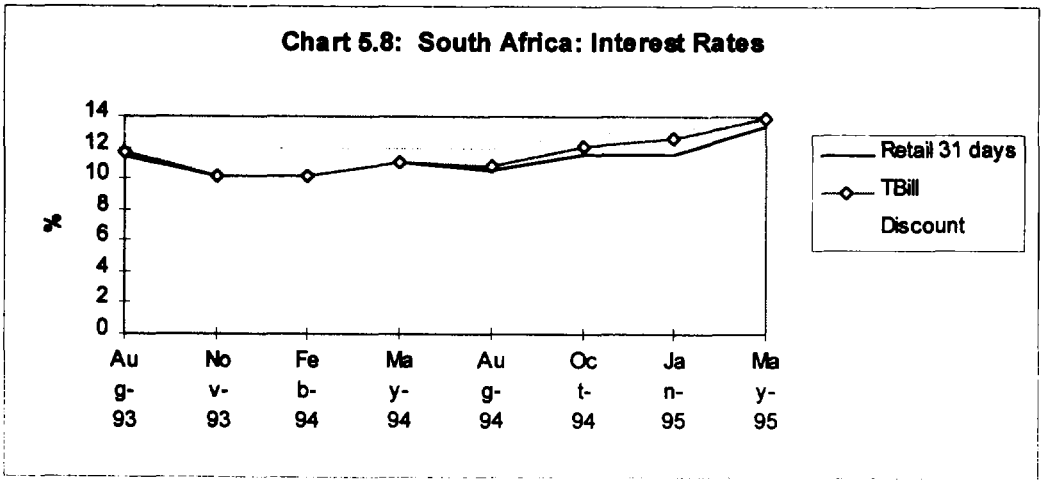
5.21 **Interest Rate Levels and Interest Rate Transmission Mechanism.** Past policy in Swaziland has been to keep Swazi interest rates below those in South Africa in order to attract investment. This has been achieved by setting the Swazi discount rate a margin below the discount rate in South Africa and by accepting excess liquidity from the Swazi banking system. The difference between the two discount rates has narrowed over the past few years (see Chart 5.6) and in March 1995 it fell to only 0.25 percent. However, yields on T-Bills and deposits in Swaziland are a much larger margin below the Swazi discount rate than comparable South African yields are below the South African discount rate, as shown in Charts 5.7 and 5.8.

5.22 Swazi rates are further below the discount rate than South African rates because of the differing liquidity conditions in the two markets. In South Africa the Reserve Bank (SARB) is attempting to raise interest rates by creating shortages in the money market. It does this by absorbing liquidity, forcing the banks to re-liquify themselves by borrowing from the SARB at the discount rate (or discount plus 1.5 percent for security with over 91 days to maturity) on security of T-Bills, government bonds, Land Bank bills and SARB bills. The South African banks are thus short of liquidity and in debt to the SARB at a funding cost of between 14-15.5 percent. As shown in Chart 5.8 interest rates have been drawing closer to the discount rate in South Africa as pressure on banks grows to compete for cheaper funds. This pressure would have had more impact sooner except that the largest South African banks reached an agreement to co-exist in the wholesale market rather than compete for funds. This agreement has held for

some time because of the very similar liability structures of the banks (they have large exposures to interest rate sensitive wholesale funds) which gives them a sufficient common interest to not break the agreement.







5.23 By contrast, in Swaziland, there is a liquidity surplus. This surplus cannot be fully absorbed into the South African market because of the constraints (liquidity ratio, exposure limits on South Africa) explained above. Swazi wholesale interest rates are thus lower than South African rates. However, those investors able to invest in the South African market do so. This group includes not only financial institutions but also companies and possibly a few wealthier individuals. Banks report that many companies required South African rates on their deposits or they took their funds to South Africa.

5.24 The result of this mix of factors is:

(a) Larger wholesale investors can obtain South African rates of interest on their funds, even though there are some constraints which prevent full participation in the market.

(b) Smaller investors and savers find it administratively more difficult to access the South African market and so are reliant on returns on Swazi T-Bills or deposits. Swazi T-Bills yield 2-4 percent less than South African T-Bills due to constraints preventing market integration.

(c) Banks in Swaziland are over-liquid and so are not under pressure to compete for funds. Swazi T-Bills are the only market instrument available to compete for deposits. Further, there is no wholesale money or debt market to compete with banks for funds in Swaziland. Consequently deposit rates are a greater margin below the discount rate than they are in South Africa. It is worth noting that in South Africa the development of a wholesale debt market, and in particular money market unit trusts, has given more savers access to wholesale market interest rates and placed considerable competitive pressure on banks.

5.25 In short, the cost of the low interest rate policy and the lack of management of domestic liquidity (either by active sale of T-Bills or by encouraging greater integration between the wholesale markets in Mbabane and Johannesburg) is largely borne by smaller Swazi savers.

5.26 There is an active sentiment in Swaziland that Swazi capital should stay in Swaziland. It should be kept in mind that the capital being referred to ultimately belongs to individuals not to the intermediaries they use. These individual Swazi savers need access to the lowest risk, highest returning investments available. If it is felt that Swazi projects are being denied funding or that Swazi individuals do not have adequate access to credit then the specific reasons for this should be investigated and targeted solutions identified. Projects with social benefits rather than commercial returns should be funded out of tax revenues (for transparency) or from subsidized credit from non-commercial agencies. Access to credit may be improved by developing alternative intermediation channels more suited to poorer less educated individuals and by programs aimed at increasing the business skills of small and medium businessmen to enable them to connect with the formal banking sector (the BUDS scheme proposed for Uganda is an example of such a scheme). Addressing these issues through regulatory capture of funds is an unfocussed and distortionary approach which disadvantages savers, encourages poor allocation of capital and does not address root causes.

5.27 A transmission mechanism does exist between wholesale interest rates and retail deposit rates in Swaziland. This can be seen in Chart 5.7 where the T-Bill rate follows the discount rate and is in turn followed by deposit rates. This suggests that a more dynamic market in Swazi T-

Bills (one less dominated by captive bidders) would lead to a rise in T-Bill rates which would then feed through to deposit rates.

C. DEVELOPMENT OF LIQUID MONEY AND DEBT MARKETS

5.28 The key to developing market liquidity will be to control the level of excess reserve balances in the system; provide a supply of short term debt instruments which can be used for both investment and liquidity management by banks; and create an environment in which new forms of intermediation can develop to create more competition in the market for wholesale funds.

5.29 Swaziland's potential to ensure that Swazi financial institutions and investors have access to liquid markets is enhanced by its membership of the CMA. Membership of the CMA and close ties with South Africa give Swaziland a greater range of choice in the way markets are developed. Three basic choices are available:

(a) A market that is as insulated from South Africa as membership of the CMA permits.

(b) A market in which Swazi debt instruments are available for both investment and liquidity management but which is also efficiently connected to the South African market.

(c) A market in which Swazi debt instruments are available for investment but in which it is explicitly intended that liquidity management be mainly conducted using the South African market.

5.30 Operationally these choices are distinguished by the extent of the regulatory constraints to cross-border investment between Swaziland and South Africa and by the extent to which the CBS actively manages liquidity conditions in Swaziland.

5.31 **Insulating the Market from South Africa.** The first option requires the erection of cross-border constraints to investment to the extent that these are permitted by the CMA. The present liquidity ratio (in the absence of sufficient eligible assets), the LAR and the proposal to require Swazi pension funds to invest a minimum of 15 percent of their funds in Swaziland -- are examples of the types of regulatory constraints that could be considered. The explicit intent of regulatory constraints would be to create a pool of funds which were captive in Swaziland -- as opposed to regulations intended to put prudential limits on the risks financial institutions can take which may, for different reasons, also create a pool of captive funds. The motivation behind the regulation is very important to distinguish.

5.32 Creating constraints to cross-border investment would enable the Swazi authorities to achieve some difference in interest rates between Swaziland and South Africa. By altering liquidity conditions in Swaziland the authorities could affect the supply and demand conditions in the market facing the holders of captive funds. This approach to creating a money and debt market has several disadvantages attaching to it and is not recommended. The problems include:

(a) Under the CMA free capital flows will still occur for funds not captured by the regulations. The lower Swazi interest rates are relative to South African interest rates the greater the incentive will be for anyone able to shift funds to South Africa to do so.

This will happen to a larger degree between Swaziland and South Africa than between other countries because of the very low exchange rate risk. This movement of capital will limit the extent to which Swazi interest rates can differ from South African rates. Outward flows of capital will tend to raise Swazi interest rates by both reducing the supply of liquidity in Swaziland and by running down Swazi foreign reserves which will pressure the authorities to let interest rates rise to conserve foreign reserves.

Larger investors will continue to benefit from this rather than smaller investors. As noted, smaller savers are currently disadvantaged by the existing degree of segmentation between the Swazi and South African markets.

(b) A lower interest rate may stimulate business investment and will reduce the Government's cost of borrowing. However, this will be at the expense of those savers whose funds are captured by regulation. It would be particularly undesirable if the Government were to use a captive market to fund its future deficit -- as this amounts to a regulatory tax.

(c) Lower priced capital (due to regulatory capture) will stimulate demand for capital, but if the banks and pension funds are to retain sound balance sheets and deliver livable pensions the quality of the investment proposals needs to be adequate. Lower price will stimulate demand but not necessarily ***quality*** demand.

5.33 **Active management of Swazi liquidity and an efficient link with South Africa.** The CBS would manage reserve balances so that the supply was approximately equal to the amount required to meet reserve requirements and the transactions demand of banks. Equating supply and demand would force the banks to manage their liquidity positions more actively, leading to a more active interbank market in Mbabane.

5.34 In order to actively manage domestic liquidity the CBS would need to:

(a) Develop a system with which to forecast daily system liquidity in order to determine the size of interventions with reasonable accuracy. The CBS's ability to do this will be much greater if the Ministry of Finance (MOF) has good cash and debt management systems. The MOF does not have such systems at present. In future these systems will be increasingly necessary as the government's need to interact with financial markets increases. Proper cash and debt planning will enable the government to interact with markets more effectively through planning the size, timing, maturity and currency of debt issues. Good planning will reduce the government's cost of funds.

(b) The banking practices of the government also need to be coordinated if the CBS is to be able to manage system liquidity. At present the government has accounts with several banks, most notably SDSB. For CBS to control system liquidity it is important that ministries not be able to shift funds between commercial bank accounts and accounts at CBS without prior notice. In order to minimize government funding costs it will also be necessary to take account of these balances when determining the amount of financing the government needs to undertake.

(c) Begin regular auctions of T-Bills and open market operations (including repurchase agreements used to inject liquidity when needed) as the method by which liquidity is

kept at the desired level. This is a shift away from the present role of auctions as purely a funding mechanism for Government; domestic liquidity resulting from CBS foreign exchange transactions will also need to be managed.

(d) Stop paying interest on excess reserves. If banks have the opportunity to manage their liquidity through interaction with either the CBS or the South African market there is no need to compensate them for excess reserve balances.

(e) Cease to take funds on deposit; there is no need for this if the banks have the opportunity to manage their reserve balances. In any event the current CBS practice of accepting deposits for 7 days or more, which it then invests in South Africa at a profit, provides inappropriate incentives to the CBS. It is, in effect, a regulator indulging in regulatory arbitrage.

(f) Cease to offer overdrafts. The CBS currently permits overnight overdrafts at 1 percent above the discount rate. Once the supply of T-Bills increases all advances of CBS funds should be based on the security of, or discounting, T-Bills. This is a natural way to both limit banks' recourse to CBS funding (and stimulate trading in the market) and increase demand for Swazi T-Bills. To further enhance the position of T-Bills the CBS should cease to discount sugar company promissory notes and other commercial paper. This business should be left to commercial financial institutions who are in the business of pricing credit risk.

(g) Lengthen the settlement period for tenders. Tenders are settled on a same day basis at present. In future, in an environment where system liquidity is not in excess supply, same day settlement will cause liquidity management problems for bidders and may reduce the demand in the tenders.

5.35 Acting on the seven points above will create the correct incentives for more active interbank and T-Bill markets to develop in Mbabane. More activity in these market will also stimulate trading in BAs and NCDs which presently exist but do not trade due to the surplus of liquidity. A market in private paper would lower firms funding costs at the margin and provide a greater range of investment opportunities. Greater liquidity in local markets will bring benefits in the form of a transparent Swazi yield curve which will assist the development of markets in BAs and NCDs. A transparent yield curve may also enable some forward foreign exchange business to be conducted in Mbabane. At present all forward foreign exchange is conducted out of Johannesburg against the rand. Local banks (or their client, depending on the structure of the contract) thus have a mis-match between emalangeni and rand on forward contracts.

5.36 Active management of domestic liquidity by the CBS will eliminate many of the distortions caused by captive funds by supplying debt instruments to absorb the supply of funds. This will be the case even if the causes of segmentation between the Swazi and South African markets are not removed.

5.37 Active management of domestic liquidity also has the advantage that it will enable the CBS to develop many of the skills required to run an independent monetary policy. Swaziland's present situation inside the CMA precludes a monetary policy independent to that of South Africa (see Chapter Two). If a decision was ever made to break from parity with the rand -- or to leave the CMA -- the ability to manage domestic liquidity conditions would be required.

5.38 Reducing the constraints which segment the Swazi and South African markets will create the opportunity for efficiency gains and greater competition for Swazi savings, which will increase the return to Swazi savers. Several steps can be taken to reduce the existing degree of segmentation:

(a) The need to meet the liquidity ratio is currently responsible for the monthly pattern of shifts in reserve balances. The ratio should be reviewed within the context of adequate prudential regulation of banks. If the recommendations relating to the enhancement of risk oriented prudential regulations are implemented (especially as they relate to liquidity risk management; see Banking Supervision section of Chapter Two) then the liquidity requirement should be reduced. A reduction in the liquidity ratio would permit banks greater flexibility in using the South African market for liquidity management.

(b) This chapter assumes that the Swazi Government's forecast deficit profile will necessitate an increase in debt issues, including T-Bills. If the supply of Swazi debt eligible to meet the liquidity requirement is not likely to increase in the next year to a level adequate to cover demand, consideration should be given to allowing South African Government T-Bills to qualify for a part of the liquidity requirement until such time as the supply of eligible Swazi debt is adequate.

(c) The reserve requirement in Swaziland is 6 percent compared to 1 percent in South Africa. Swazi banks thus have a higher cost structure than South African banks. Contingent on the needs of adequate prudential supervision consideration should be given to lowering the reserve asset ratio to bring it into line with South Africa.

(d) The LAR is not a binding constraint on any bank, except SDSB, due to the exemptions given. The LAR should be replaced by prudential regulations covering open foreign exchange positions and currency mis-matches, as suggested by the IMF in its Aide Memoire of January 1995. These regulations would need to take into account the difference in risk between an emalangeni/hard currency mismatch and an emalangani/rand mis-match.

(e) Legislation providing a legal basis for the operation and supervision of unit trusts should be introduced. Unit trusts have played an important role in South Africa in increasing competition for savings and could perform the same role in Swaziland.

5.39 Reducing the segmentation between the two markets will benefit the Government in future debt raising efforts, particularly as the volume of Swazi Government debt on issue grows. While the government issues only small amounts of debt it may be able to continue to fund itself in Swaziland at yields lower than those in South Africa. Two factors would enable it to do this, even in the absence of captive funds. Firstly, an exchange rate risk exists between the emalangani and the rand even though the two currencies have always traded at par. Swazi financial institutions will thus have a demand for emalangani denominated debt to reduce the risk of this currency mismatch. While emalangani debt is in short supply it may well attract a better yield than rand debt. The second factor is the state of the Swazi Government's balance sheet compared to the South African Government's balance sheet. While Swaziland has better financial ratios than South Africa (in terms of debt to GDP and the fiscal deficit to GDP), it could hope to fund itself at lower cost despite being a smaller and less diversified economy.

5.40 However, the more debt the Government of Swaziland needs to issue the less these two factors will be in its favor. There will be some level of debt issue at which the extra depth and liquidity of the South African market will be of benefit to the Swazi government in terms of reducing its marginal cost of funds. At this level of debt issue a lack of segmentation between the two markets will be beneficial as it will make it easier to attract South African and other capital to purchase Swazi debt.

5.41 **An efficient link with South Africa without active management of domestic liquidity.** This is an option open to Swaziland because of its membership of the CMA. The CBS would sell government debt on behalf of the MOF, as funding needs dictated, but would not actively intervene to manage system liquidity. The steps suggested above to reduce segmentation between the Swazi and South African markets should be taken to permit banks to more efficiently manage their liquidity using the Johannesburg market. The Swazi money market would effectively be based in Johannesburg.

5.42 This option has the advantage of saving the government the administrative cost of liquidity management and also the cost of sterilizing liquidity resulting from foreign exchange transactions.

5.43 The disadvantages of this option are that the Swazi authorities will not develop the skills required to manage domestic liquidity. In order to obtain the benefits of liquid markets the Swazi money and debt markets will need to become, for all practical purposes, the South African markets. This will require full integration and coordination of banking and capital market regulations. It will also make it even more difficult for Swaziland to change the value of the emalangani against the rand or leave the CMA.

D. LONG TERM SAVINGS

5.44 A recent study by the Insurance Commissioner indicates that funds belonging to Swazi residents invested long term by insurance, life and provident firms amount to around E1.2 billion. The majority of these funds are invested in South Africa -- and none of them are invested in equities or bonds in hard currencies.

5.45 Four general observations may be made on long term savings in Swaziland:

(a) Capital controls under the CMA have prevented the investment and diversification of long term savings beyond the CMA region.

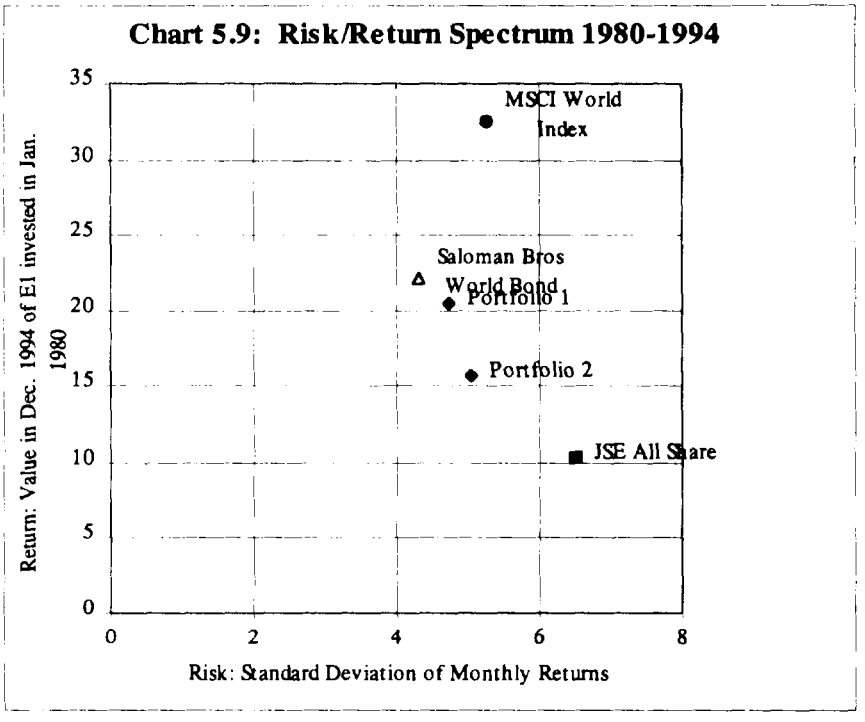
(b) There is a lack of competition for long term Swazi savings. Royal Swaziland Insurance Corporation (RSIC) has had an official monopoly on life insurance in the post-Independence period. In fact many policies have been underwritten in South Africa because of the much more attractive terms available from South African insurers. It is proposed to permit the entry of one life and one non-life insurance company into Swaziland in the immediate future. There are no unit trusts or investment managers based in Swaziland -- most Swazi funds are managed out of South Africa. Only one South African investment manager is registered in Swaziland -- Swazi Portfolio Managers, a subsidiary of Investec.

(c) Investment management skills are relatively under-developed. In addition to there being no investment managers based locally the major Swazi institutions (RSL and the Swazi National Provident Fund) have only recently begun to receive professional investment management advice. These institutions are restructuring their portfolios based on this advice. This is leading to a general intention to invest more in South Africa, in future, for reasons of return, diversification and lack of liquid Swazi assets.

(d) At the same time as professional advice is leading local institutions to consider investing more in South Africa, popular sentiment is leading to legislation requiring a minimum investment in Swaziland of 15 percent for pension and life funds. The sentiment behind this appears to be nationalistic rather than based on risk and return analysis.

5.46 The lack of diversification in the investment of Swazi long term savings has already been recognized as an issue (*Review of the Swaziland Monetary System*, January 1994; and *The Development of an Effective Financial Strategy for Swaziland*, August 1994). Chart 5.9 illustrates the effect of the lack of diversification on the risk/return profile of Swazi pension and life funds over the last fifteen years. Using the Johannesburg Stock Exchange All Share Index (gross basis) as a proxy for Swazi portfolios Chart 5.9 compares the performance of this Index in risk/return terms with the Morgan Stanley Capital International World Share Index; the Saloman Brothers World Bond Index; and two mixed portfolios, Portfolio 1 with 50 percent invested in the MSCI and 50 percent in the JSE, and Portfolio 2 with 10 percent in the SBWB, 20 percent in the MSCI and 70 percent in the JSE.

5.47 The JSE All Share is dominated by all four comparators over the period. E1 invested in the JSE in January 1980 was, in December 1994, worth E10.4 compared to E32.5 for the MSCI, E22.1 for the SBWB, E20.5 for Portfolio 1 and E15.6 for Portfolio 2. A significant part of the return on the foreign investments came from the depreciation of the rand. The volatility of monthly returns on the JSE was also higher than the volatility of the four comparators.



5.48 These results are in accord with the expectations of portfolio theory -- diversification leading to higher and/or more stable returns. The generality of the result should hold over *similarly long* future periods even though the specific result shown in Chart 5.9 cannot be expected to hold in future. In particular the reintegration of South Africa into world markets will affect the future performance of the JSE. This is likely to reduce the risk-reduction benefit from diversification as South African markets begin to move more in step with world securities markets. The possible impact on returns is not so clear. An inflow of foreign capital has already increased the valuation of the JSE in the last few years while a future loosening of capital controls will see an outflow of previously captive South African funds.

5.49 The investment case in favor of obtaining access to offshore investments for Swazi national's long term savings appears strong. Three methods have been advocated to obtain this access:

(a) A direct approach to Swaziland's partners in the CMA to permit some value or percentage of the pension and life funds of Swazi nationals to be invested abroad. Swaziland has the right to negotiate this under the CMA. ***It is strongly suggested that the Swazi authorities make this approach***. A clear exemption for some part of Swazi pension and life funds would open the way for market competition for this offshore investment business.

(b) The Government of Swaziland has the right to hold part of its foreign reserves offshore. It has been suggested that the Government could establish a unit trust structure as a vehicle. Funds in the unit trust could be invested in either bonds or equity and would be managed by professional investment managers. Pension or life funds could purchase units in the structure.

This concept has potential as a means to obtain exposure to foreign assets. It is regarded as a second-best solution however as it is a regulatory arbitrage and is thus less transparent and less open to competition in the provision of management services than a clear exemption would be. The unit trust structure would need to be established in a way that made the ownership and sharing of gains and losses completely transparent. Complete freedom from political intervention would also be required. Professional management of the unit trust investments is also important and this should cover the management of a number of risks including, but not limited to: (a) benchmark asset allocation to establish overall risk position; (b) country selection; (c) currency risk; (d) credit risk and quality of individual assets.

(c) A second suggestion that also utilizes the government's right to hold offshore assets as a means around the blockage on private capital flows -- involves the issuance of Government bonds backed by hard currency assets. Ownership of these bonds would provide a *de facto* hard currency exposure. However, such a bond issue concept is not recommended as a satisfactory way in which to obtain exposure to foreign assets. A bond issue would show as part of the Government's outstanding debt and may affect its credit rating and cost of funds in future. A bond issue is also lacking in transparency. The return on the bond would need to be directly linked to the interest and capital return on the underlying assets -- a formula for this may be hard to construct in a bond document -- and the fact that it is called a 'bond' may mislead investors as to the relative safety of the instrument. There is a risk that misperceptions may cause the government to acquire an implied (if not legal) liability to bond holders in the event of a capital loss on the underlying assets. A look at the standard deviation of the Saloman Brothers World Bond Index in Chart 5.9 shows that international bonds are not a risk-free investment.

5.50 The proposal to allow one new life insurance company and one non-life company to conduct business in Swaziland is a step in the right direction to create greater competition for Swazi long term savings. The promotion of even greater competition by opening the market further than is proposed would be desirable. Competition could also be encouraged by creating the legal framework for unit trusts in Swaziland.

E. SUGGESTED SEQUENCING FOR MARKET DEVELOPMENT

5.51 **Over the Next Two Months:**

(a) The Swazi authorities should approach their CMA partners and negotiate an exemption to permit some part of the pension and life insurance funds belonging to Swazi nationals to be invested outside the CMA. As a backstop, in the event that these negotiations are unsuccessful, the authorities should investigate the practical steps necessary to establish a unit trust through which Swazi nationals could obtain exposure to long term investments outside the CMA.

(b) The MOF should start initiatives in developing cash and debt management systems.

(c) The CBS should decide the approach to money and debt market development that it prefers. The suggestion for sequencing that follows assumes that the CBS will favor an

approach combining active management of Swazi liquidity with developing more efficient links with South African markets.

5.52 **Within Three Months**

(a) The CBS will be coordinating with the MOF to develop a system for forecasting system liquidity. This system will be used to plan the timing and maturity of T-Bill issues and Government Stock issues.

(b) A plan will be agreed to rationalize the current system of government accounts at commercial banks. The objective of this rationalization is to improve both debt management and the ability of the CBS to manage system liquidity.

(c) Initiate work on developing the legislative framework for unit trusts.

5.53 **Within Six Months**

(a) The CBS will have decided on its methodology for managing system liquidity. This will cover issues such as: how much sterilization of foreign exchange operations will be undertaken; how the segmentation caused by the liquidity ratio is to be overcome if the supply of eligible Swazi assets is not likely to rise to meet demand in the near term; establish the ability to tender repurchase agreements; determine how tenders can be more widely advertised.

(b) Work underway to bring the reserve asset ratio, the liquidity ratio and the local asset ratio into one prudential regulatory framework based on risk oriented prudential regulations.

5.54 **Within a Year**

(a) CBS to begin to control the level of reserve balances in Swaziland through the use of T-Bill auctions and auctions of repurchase agreements.

(b) Access to the discount window should be via the sale or security of T-Bills only.

(c) Settlement period for tenders should be lengthened to four working days.

(d) CBS to stop paying interest on excess reserves and to cease to take term deposits.

(e) CBS to cease offering overdrafts. Any overdrafts should attract a highly penal interest rate.

CHAPTER SIX
THE RURAL FINANCIAL SYSTEM IN SWAZILAND

6.1 Although direct government intervention in the economy has *generally* been limited to the provision of public goods and to support for health care and education -- it has attempted to play an active role in the development of the rural economy. Government investment spending for agriculture has traditionally been a significant proportion of economic services expenditure and has, over the last four years increased at an average annual rate of 26.8 percent per annum. This expenditure (10 percent of total government capital spending on average for the past four years) has funded irrigation development, research facilities, and market development for commercial agriculture.

6.2 In 1992, agriculture accounted for 14 percent of Swaziland's GDP, of which almost 60 percent was accounted for by sugar and citrus production from Title Deed Land (TDL). In addition to agricultural crops, forestry is an important component of Swaziland's primary production accounting for 20 percent of exports and 1.5 percent of total GDP and it also is undertaken primarily on TDL. Although agriculture represents a significant component of the Swazi economy, it forms a much smaller share of GDP than it does in the rest of sub-Saharan Africa. For comparative purposes, the weighted average share of total GDP represented by agriculture, in sub-Saharan Africa, was 32 percent in 1992[1]. This indicates that Swaziland has probably been more successful than other African countries in diversifying their economic base away from agriculture -- with important ramifications for overall development.

A. OVERVIEW OF THE AGRICULTURAL SECTOR

6.3 The agricultural sector in Swaziland has a very distinctively bimodal pattern of ownership, production technology and output. Smallholders are concentrated on Swazi Nation Land[2] (SNL) where their rights to land use are derived from traditional social relationships; they tend to produce food crops for home consumption (mainly maize) and market any surpluses; they use labor intensive production technologies and, therefore, use relatively less capital; and they have relatively lower levels of output per unit area. Larger scale agricultural producers (primarily sugar, citrus and cotton) tend to be located on TDL; use capital intensive production technologies; enjoy access to well developed market channels; and have attained world competitive levels of output per unit area. Programs and initiatives targeting smallholders on SNL have been viewed as development efforts and most growth in export earnings and production efficiency have come from the estate sector. Currently, about 72 percent of agricultural production comes from commercial producers and only 28 percent is produced on SNL by Swazi Farmers[3].

6.4 However, this correlation between historical production patterns, land tenure and Swazi farmers is becoming less pronounced in the 1990s. Now, due in part to government support and

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[1] World Development Indicators, 1992 World Development Report, World Bank.

[2] Swazi Nation Land constitutes approximately 56 percent of the total land area in Swaziland and is home to about 66 percent of the population. (Rural Development in Sub Saharan Africa: The Case of Swaziland, by Shinegirl T. Motsa, School of Social Sciences, Flinders University, Australia, 1989.)

[3] Economic Review page 6.

in part to the natural evolution of economic conditions, these relationships are becoming less exact. More smallholders are producing cotton and sugar as cash crops and serving as outcroppers for citrus operations. More are gaining leasehold, or even freehold, title to property in TDL, and more small farmers are enjoying access to irrigation. While these changes in production patterns and ownership enjoy wide political support, and significant government backing, there are also centers of support for the *status quo* on SNL, and concerns over the future allocation of increasingly scarce water resources. In addition to the physical constraints, there are financial and institutional constraints to the furtherance of this process.

6.5 The current system of resource management and allocation on TDL will have to change -- in the face of land and water constraints. It is not clear what form this change will take and it is not clear how the financial system can support a large-scale transition in ownership and production given recent experience in lending for large and small-scale commercial production schemes. Despite this evolving situation in the agricultural sector, the traditional bimodal pattern remains significant and has an important impact upon financial sector relationships within the sector.

6.6 **The Smallholder Sector.** During the 1970s and 1980s, the government attempted to boost rural economic activity and improve rural welfare through its Rural Development Areas (RDA) program. This effort focused on SNL and sought to achieve equitable and sustainable economic development for Swazis living on those lands. Development activities undertaken through the program included infrastructure development, improved provision of health and education services, and promotion of agricultural development through extension and research. Donors supplemented Government RDA efforts with considerable grant and loan funding and with technical assistance. Achievements under these programs, however, were mixed. While advances were made in the provision of extension services and in the development of roads and irrigation works, production of food crops has not expanded as much as what had been anticipated.

6.7 ***Food crops.*** A major problem constraining the success of the government's food crop production plans appears to have been the fact that, while improved maize seed and increased use of fertilizer tended to increase yields per hectare and per labor unit, farmers' response to this increase has been to crop less area. Thus, total maize production in Swaziland was fairly flat between 1983 and 1992 with fluctuations attributable more to weather than to cropped area or technological factors. Using survey data collected in 1985 Sithole[4] found significant factors in the reduction of maize acreage including: labor shortages during parts of the cropping cycle; low prices for maize; and the perceived lack of market channels for smallholder maize production. Later efforts to increase maize production such as the IFAD/ADB Smallholders Marketing and Credit Project have also fallen far short of expectations. Actual production of maize in the final two years of the above mentioned project were only 45 percent of production targets.

6.8 Government efforts to support the development of the food crop sub-sector in 1994 focus on research and extension and on seed variety improvements. In addition, donor financing has been obtained for a smallholder agricultural development program that will attempt improved

[4] "Factors Influencing the Reduction of Maize Acreage on Swazi Nation Land", Vincent Majozi Sithole, Masters Thesis, University of Alberta, Edmonton, 1986.

cultivation practices, develop irrigation schemes, and support group development among small-scale farmers on SNL.

6.9 ***Cash crops.*** The production and value of cash crops grown on SNL have also varied, although with some upward trend, over the past decade. Cotton grown on SNL increased from 20,000 tonnes in 1985/6 to 26,000 tonnes in 1990/1 but then dropped precipitously in 1992, due to drought. Figures for production on SNL versus TDL land are not available but it is likely that smallholders on SNL have been harder hit by the drought, since the bulk of their production is undertaken on unirrigated land. Citrus production over the years for which data are available (1988 - 1992) has been flat and, again, desegregated figures for smallholder and large holder production are not available. Sugar production has risen slightly over the six years from 1988 to 1993 -- however, smallholder production only accounts for 2 percent of total marketed production.

6.10 ***Livestock.*** Livestock - primarily cattle - are important both economically and socially in Swaziland. In Swazi culture, cattle are a symbol of wealth and a store of value as well as a means for obtaining protein. Until recently, cattle were also useful as collateral for loans from the Swazi Development and Savings Bank. Despite all these uses there are significant problems in the livestock sub-sector, mainly relating to overstocking. Since most grazing land in Swaziland is communally owned, the classic model of the "Tragedy of the Commons" is particularly relevant. Under this model, private interest and public welfare diverge by virtue of private ownership of cattle (more is better) and public ownership of range land (more is worse). In fact, cattle grazed on SNL have continued to increase, while cattle grazed on TDL land have been constant over recent years. The percentage share of SNL cattle in the total Swazi herd increased from 80 percent in 1990 to 83 percent in 1991. Overgrazing is an increasing problem and the drought in 1992 resulted in a large increase in mortality among the SNL herd.

6.11 **Large Scale Agricultural Production on TDL.** As indicated, commercial agriculture accounts for almost 72 percent of agricultural GDP. While most of the production on SNL is food crops -- most of the production on TDL is commercial products for export. Therefore, the dominance of commercial agriculture in GDP figures does not capture the even higher contribution that that sub-sector is making to the Swazi economy in terms of export earnings.

6.12 According to provisional figures[5] sugar accounted, on average, for over 28 percent of Swaziland's export income over the years 1988 -1992. This significant portion of export income was produced almost entirely on TDL by large-scale commercial producers. The wood products and pulp and paper industries accounted for a further 15 percent of exports over the same period. This too was largely produced on TDL by a small group of producers and processors. Hence commercial agricultural producers in Swaziland are an important source of foreign exchange earnings for the country.

6.13 The success of commercial agriculture, in terms of its continued competitiveness and profitability, has been self-reinforcing in terms of government policies and the financial market's application of funds. By maintaining its membership in SACU and reducing barriers to trade in agricultural products, Swaziland has helped its commercial agricultural sector produce for wider markets. Government has also invested heavily in supporting infrastructure such as roads and

[5] Economic Review (Draft; 1994)

irrigation works. By supporting commercial agricultural producers, government has helped to provide an environment in which they could prosper -- depending on world market prices and their own production capabilities.

6.14 In addition to government support for the sub-sector, the financial system has also supported commercial agricultural producers. These producers, in general, have enjoyed good access to financial services from the commercial banking sector. Table 6.1 shows April 1994 figures for bank lending to agriculture. Except for Standard Chartered and FNB/Meridien (which has been deleted in the table due to its insignificance), these banks have all committed a sizable proportion of their loans to agricultural purposes.

6.15 These loans have been made under normal banking procedures -- without recourse to special government programs in support of lending to agriculture. Even in the case of the Swaziland Development and Savings Bank (SDSB), the lending figures are for loans made to commercial agricultural concerns and exclude lending made under targeted lending programs aimed at serving *development* goals. In addition to the banks, investment funds such as CDC, Tibiyo, and the publicly mandated agricultural enterprises (National Maize Corporation, Dairy Board) have made investments in commercially oriented activities. Considerable (though, as yet, unquantified) financial resources flow into the sector from direct foreign investment.

Table 6.1: Commercial Agricultural Lending by the Banks

	Barclays	Standard	Stanbic	SDSB	TOTAL
Total Loans	156,644	110,931	117,966	137,106	569,540
Agriculture Loans	38,110	324	19,100	37,297	94,831
Agriculture/Total	24.33%	2.92%	16.19%	27.20%	16.65%

SOURCE: Central Bank Statistics

6.16 **Small Scale Production on TDL.** Swazi farmers are increasingly gaining access, either through loans or through property transfers, to land ownership on TDL. There has been considerable turn-over in TDL ownership with both private investors and large institutions (Tibiyo) purchasing rural TDL for agricultural production. Tibiyo has had a program wherein agricultural TDL properties purchased by them are made available to Swazi farmers who can either buy the land outright or are able to qualify for the government's loan program managed by SDSB.

6.17 The increase in smaller-scale Swazi farmers who either own or hold long term leases to their property is a positive development for those farmers, who now have both collateral and an investment that will generate a return. It is a positive development, as the spread of land ownership is normally linked with a broadening of the distribution of wealth. It is also a positive development for the Government, as it is explicitly committed to having Swazi farmers better represented in the ranks of commercial agriculture and it is recognized that land ownership may be a precondition for this.

6.18 It is not at all clear, however, that the process is without problems. The Government is currently funding a program through the SDSB that makes loan funds available to Swazi farmers to purchase property on TDL. This loan program only commenced in 1992/3 and therefore does not yet have a long history. The March, 1994 Managers Report, however, does show that arrears[6] under the program are currently running at 94 percent. This is a source of concern -- and it may indicate that returns to small- and medium-scale agriculture are not sufficient to service the level of debt incurred when paying current prices for TDL property.

B. RURAL FINANCIAL MARKETS

6.19 The preceding discussion provides background and suggests the types of constraints which impact upon the provision of financial services to agriculture. By integrating information about the structure of agricultural production it is possible to more precisely target opportunities for rural finance.

6.20 **Smallholder Agricultural Finance -- Demand Issues.** In some of the more remote areas of Swaziland, subsistence production and barter trade appear to account for a larger share of the local economy than does the money denominated market for goods and services. This lack of monetization is a good indicator for the evaluation of credit risk in such areas. Bringing formal sector banking to such areas has, around the world, proven to be a large and expensive task -- and this general truth is borne out in Swaziland.

6.21 Rural farmers are generally able to depend on social relationships for assistance that mirrors, in some respects, financial services. When the entire group is in a difficult position, however, such relationships can only provide limited assistance. Swaziland's geography and road infrastructure mean that the rural population has relatively easy access to such urban services as pawn broking and money lending, and these financial services can be utilized by rural people in need. In addition, formal sector banking has been brought to many rural areas via the SDSB.

6.22 In an effort to support development in poor and underdeveloped areas of Swaziland, the SDSB currently manages ten different programs aimed at providing finance to small-scale borrowers who would otherwise be denied access to loan funds. These borrowers are assumed to be too costly for formal, commercial financial institutions to serve -- both in absolute terms and in terms of alternative lending opportunities. The absence of good loan security, the vulnerability of their production to natural events such as drought, and high transactions costs relative to loan size, all provide understandable reasons for profit-oriented financial institutions to eschew this client base. The SDSB was established largely to overcome these constraints to finance for small-scale rural producers and to thereby support the development goals of the Government.

6.23 In addition to the supply side factors of risk and high average costs, the market for rural finance in Swaziland faces a number of other constraining factors including: effective demand; understanding of credit; and non-transferability of land -- all of which are interlinked. Effective demand for credit among smallholders is low, in part, because of the lack of monetization discussed above and in part due to the low level of return on many types of small scale

[6] Computed as (Amount due - Amount paid)/Amount due.

agricultural investments. Credit demand is also low, however, because the general farming population is not aware of what is available through the formal (SDSB) banking system and is not able to access existing programs.

6.24 On the other hand, some farmers have been willing and able to make the step into commercial farming. It is not clear, however, how many more farmers exist in the general population with the skill and motivation levels of these farmers. From the vantage point of SDSB branch loan officers, aggressive farmers who adopt modern technologies in pursuit of higher profits are not very common. In fact, many farmers, particularly on SNL, continue to practice traditional agricultural methods despite the considerable investment in research and extension by the Ministry of Agriculture and Cooperatives. The sustainability of SDSB's agricultural development program will depend on the number of such farmers who can find profitable investments and who want to borrow from SDSB.

6.25 **Supply Side Factors and Issues: Swazi Bank.** While the total volume of formal agricultural finance -- measured by loans to smallholders -- appears to have grown considerably over the past decade, financial intermediation has not made commercially sustainable inroads into the smallholder sub-sector in Swaziland. This is demonstrated by the fact that, although considerable lending has been undertaken by the SDSB to the sub-sector, this has not been remunerative in a commercial sense and would not, short of government subventions and loan funding, be taking place.

6.26 The principal argument for continuing government support for smallholder lending is that -- even if it is not financially self-sustaining -- such lending generates positive externalities that further the development of the sector. This should lead, among other things, to higher overall improved technology adoption rates, production levels, and income levels in the areas that have enjoyed access to such financial services vis a vis those areas that have been deprived of such access. Such increases in production and income should then be compared to the true costs of providing access to formal finance for producers and a determination made as to whether the additional production/income achieved justified the payment of those costs.

6.27 It is beyond the scope of this report to undertake the first part of such an experiment. However, it is possible to measure the costs of providing loan funds for some small holder lending operations. SDSB, in its financial statements for the year ended March, 1993, groups its concessional lending for smallholders under the heading "agricultural development fund". In the notes to these accounts, the Bank provides details on expenditure and income attributable to such lending. Lending costs can be broken out into three categories: cost of funds; administrative costs; and commercial risk (loan loss) costs. The notes to the financial statements make it possible to determine costs and payment of those costs out of income.

6.28 Liabilities of the Agricultural Development Fund (primarily grants and concessionary loans from domestic and international donors) were E21.4 million. Advances to customers during the year were E14.2 million[7]. Interest (and fee) income earned on this loan portfolio was E865,100 while the non-financial costs of administering the program were E824,086. In terms

[7] It is assumed in this analysis that all of the loans made under this program were seasonal crop loans that would have been provided in April of 1993 and were scheduled to be repaid at the end of the cropping season. In this way, interest income earned in 1993 can be attributed to loans made in 1993.

of administrative costs, therefore, income exceeded expenditure by only E41,014. However, administrative costs were only one of three cost components to the lending. The costs of obtaining funds for lending are typically, in commercial lending, an important component of overall costs.

6.29 In the case of the agricultural development fund, it is difficult to assess the cost of funds because the bulk of these funds were received by the bank through the government and carry little or no interest cost to SDSB. To the extent that these funds might have been applied to other uses, however, it is possible to impute the cost of these funds to the economy as their opportunity cost. That is, the return that they would have earned in a second-best application. A conservative and simple standard for assessing the opportunity cost of funds granted to the agricultural development fund is to use the interest rate on deposits. In other words, what income would have accrued from depositing the agricultural development fund in an interest bearing account in one of the other commercial banks? At the 31 day deposit rate effective over 1992, the (non-compounded) interest income deriving from the total agricultural development fund would have been E 1,860,147. Treating this income foregone as a cost, the net income from the use of the fund is highly negative at -E1,819,133.

6.30 In assessing the full costs of the agricultural development program, one must also take into consideration losses due to non-repayment of loans. Accurate data on actual and/or anticipated loan losses were not available, however, in the SDSB Annual Report, it is noted that in the 1993 lending program, "... most of them [the borrowers] did not repay their loans". If it is conservatively estimated that 51 percent of the 1993 borrowers did not repay their loans, and if loan sizes were normally distributed among repaying and non-repaying borrowers, then E7.1 million worth of loans would have been at least temporarily in default.

6.31 Given that traditional collateral is a problem, it is likely that (unless repayment can be made from future earnings), little of these loan funds will be recovered. Consequently, the economic cost of lending through the agricultural development fund in 1993, was probably around E8.9 million.

6.32 It can be argued that, since the SDSB does not have to pay interest charges on their loans, the E1.86 million charge for interest costs is not appropriate. Although this is correct in strictly financial terms, this analysis has attempted to assess the full economic costs, in order to compare them with the unknown economic benefits of agricultural development lending. It can also be argued that 1993 was an exceptional year during which climatic conditions undermined agricultural investments. It should therefore be possible to restructure the bulk of the investments that failed due to lack of rain and keep those loans on the books. Nonetheless, it is not clear that, over the long run, such restructuring achieves anything other than load increasing levels of debt onto farmers and put off the day of reckoning for the lending institution.

6.33 The above analysis aggregates all of the concessional lending for smallholders made by SDSB -- all ten different loan programs which are part of the agricultural development fund. It is possible that some of these have come closer to achieving sustainability than others. It is also likely that avenues exist or can be found that will reduce the economic and the financial costs of development lending. The remainder of this chapter examines more closely the specific programs and opportunities for agricultural finance so as to identify means for achieving the objectives of the agricultural development fund without incurring the costs identified above.

C. AGRICULTURAL DEVELOPMENT FUND PROGRAMS

6.34 The ten programs currently managed within SDSB to assist smallholders are funded from various concessionary sources and are managed separately from the Bank's commercial loan operations. They are not, as evidenced by the management reports summarized below, commercial lending operations.

6.35 **Farm Purchase Program** The first program is the Government-supported Farm Purchase Program. Although this program is relatively new, it is already experiencing some difficulties. As shown in Table 6.2, if the arrears implied by the repayment rates are taken as a trend, this program is not sustainable -- and faces serious difficulties.

Table 6.2: Debt Payments on Farm Purchase Program Loans (E)

Branch	Number of Loans	Amount Paid	Amount Due	percent repayment
Mbabane	20	605	1,013,615	0.06%
Manzini	9	93	153,405	0.06%
Matata	2	24,684	35,000	70.53%
Nhlangano	11	50,421	85,518	58.96%
Siteki	1	0	35,650	0.00%
TOTALS	43	75,803	1,323,188	5.73%

6.36 The arrears on the farm purchase loan program are all the more disappointing because there are sound economic and social reasons to seek medium scale Swazi ownership of such land. It is possible that the principal obstacle to improved repayment has been poor rainfall over the past two years but one would need to examine this explanation carefully. It is generally difficult to purchase farm land through the proceeds of its production -- especially in a start-up situation. Given the riskiness of agriculture and the narrowness of some agricultural margins, the use of a loan program coupled with Tibiyo's farm purchase program may be insufficient to increase Swazi ownership of medium-scale farms. It may be necessary to consider additional support for farm purchases.

6.37 **European Development Fund.** This program provided E5.8 million for 444 loans in 1993. In 1992 there had been 455 loans for a total of E3.87 million. EDF loans were made for a variety of agricultural production purposes, with small farmers being the target borrowers. While lending under this program has been quite robust over the past two years, repayment rates have been very poor. The EDF loan to the SDSB is highly concessional (with an interest rate of 0.75 percent per anum repayable over 30 years), and the pressure to ensure repayment is consequently lessened. Paired with the social, political and human incentives to help small farmers become more successful and wealthier, this low cost of funds fits in with the traditional pattern of *agricultural development finance.*

Table 6.3: Payments on European Development Fund Loans (E)

Branch	Number of Loans	Amount Paid	Amount Due	percent repayment
Mbabane	80	13,810	673,092	2.05%
Piggs Peak	69	49,651	276,607	17.95%
Manzini	1,150	123,291	1,023,898	12.04%
Matsapha	18	12,758	73,395	17.38%
Simunye	14	623,128	4,639,189	13.43%
Siteki	21	9,309	78,812	11.81%
TOTALS	1,378	834,539	6,826,710	12.22%

Table 6.4: Payments on IFAD Loans (E)

Branch	Number of Loans	Amount Paid	Amount Due	percent repayment
Mbabane	192	25,162	214,998	11.70%
Piggs Peak	6	237,870	170,350	139.64%
Manzini	531	34,098	625,314	5.54%
Matsapha	4	2,376	529	449.15%
Matata	27	43,606	77,318	56.40%
Simunye	10	91,364	1,208,174	7.56%
Nhlangano	289	16,517	512,492	3.22%
Siteki	23	3,455	25,936	13.32%
TOTALS	890	429,286	2,620,113	16.38%

6.38 **The IFAD Small Farmers loan program.** This loan program provides small seasonal loans to Swazi smallholders, primarily for seasonal inputs. At the end of the 1993 fiscal year, SDSB showed an outstanding portfolio E1,857,000 for a total of 1,133 loans. According to the notes to the financial statements, this interest free source of funds appears to be a grant from the government to SDSB[8]. It is clear from Table 6.4, below, that loans made under this program are not being repaid adequately -- even though this scheme has the second highest repayment rate of

[8] See page 32, Note 4.5 in the SDSB Annual Report for 1993.

any of the SDSB programs. It is not apparent from the available data whether this poor repayment rate is due to climatic conditions or whether the loans were not bankable in the first place.

6.39 **The African Development Bank Line of Credit Fund.** This program provides loans to farmers cultivating crops on TDL and sugar cane producers on SNL. Lending under the program was E4.8 million as of March, 1993. This program, with a repayment rate of over 26 percent, represents the highest repayment rate of any of the programs included in the Manager's Monthly Reports. The project has been assisted by two consultants who were originally meant to be helping to develop loan appraisal measures (e.g., developing farm models for various crops), but who, due to problems with repayment, find themselves helping to collect on loans due. This loan fund was only initiated in 1993, so there may be a period of adjustment during which the project needs to brought into alignment with actual conditions in the smallholder agricultural sector.

Table 6.5: Arrears on AfDB Production Loans (E)

Branch	Number of Loans	Amount Paid	Amount Due	percent repayment
Piggs Peak	6	237,870	170,350	139.64%
Manzini	24	815,309	2,690,012	30.31%
Matsapha	10	196,890	306,586	64.22%
Matata	18	86,429	886,963	9.74%
Simunye	2	162,782	262,830	61.93%
Nhlangano	16	5,835	413,132	1.41%
Siteki	4	27,796	1,119,561	2.48%
TOTALS	80	1,532,911	5,849,434	26.21%

6.40 **Seasonal Loans, Government Agricultural Support, Farm Equipment, and Cattle & Livestock Loans.** Repayment rates for these four loan programs are provided in consolidated tabular form without comment, in Table 6.6. As with the preceding tables, these are evidently programs that are not sustainable at current repayment rates unless constant infusions of new loan funds are made available.

Table 6.6: Seasonal Loans, Government Agricultural Support, Farm Equipment Loans, Cattle and Livestock Loans

Branch	Number of Loans	Amount Paid	Amount Due	percent repayment
Seasonal Loan Program	680	70,653	2,540,551	2.78%
Government Agricultural Support Program	775	362,639	3,014,213	12.03%
Farm Equipment Loans	44	3,979	342,351	1.16%
Cattle and Livestock Loans	81	39,056	479,505	8.15%
TOTALS	1,580	476,327	6,376,620	7.47%

D. CONCLUSIONS AND RECOMMENDATIONS FOR FURTHER STUDY

6. 41 The bimodal production, ownership and output patterns described in this chapter, have important implications for agricultural finance in Swaziland. Access to finance has been perceived by policy makers as a means of helping less well endowed Swazi farmers increase production and income levels. Supplemented by technical assistance and improved access to inputs and output markets, credit has been seen as an essential input for jump-starting agricultural development. The conclusion of this chapter, however, is that broad-based and sustainable increases in production and income do not appear to have been created by these efforts.

6.42 While the system of special programs for smallscale agriculture has not been particularly successful, finance for larger scale, commercially viable, agricultural operations has been provided by the free functioning of the financial system -- without need for redress to *special* programs -- while producing positive returns for the economy. However, programs which can meet the objective of improving the income earnings of smaller-scale Swazi farmers, on a self sustaining basis, have not been developed. Consequently, it is timely to re-examine the experiment that motivated these programs and to seek alternative approaches to providing means for improving the production and income levels of small-scale Swazi farmers.

6.43 The SDSB has taken the tactical approach of limiting losses from development lending by segregating this portfolio and by expanding its commercial lending. It thereby hoped to cross-subsidize its development portfolio with earnings from more remunerative commercial lending. However, as demonstrated in Chapters 3 and 4, the capacity of the SDSB to continue operating on this basis is highly questionable and, in fact, Chapter Four recommends a reversion, by the SDSB, to a purely development financing function. In fact, the institutional weaknesses of the SDSB are bound to have played some role in the overall weakness of the agricultural portfolio that it managed. Alternatively, a new SDSB, with only a development finance focus, could make greater efforts to improve loan repayment performance through group lending schemes and innovative forms of loan project development.

6.44 Some innovative approaches to loan project development are already in evidence in Swaziland. For example, some loan officers are selecting promising farmers and allowing them to manage investments that were, by-and-large, both funded and conceived by the loan officer. In these cases, the total project costs were covered by the loan and that at the end of the loan term, income from the project would largely repay the loan and leave some residual for the farmer/manager of the project. Since these projects were being undertaken on SNL, the result of this approach could be to improve income for the manager during the life of the project, but at the end of the loan term he/she would not have created an asset that could continue to provide a return independent of a new loan.

6.45 This is a subtly different approach to the idea that credit could provide sustained advance of productive assets for borrowers, and, thereby, an increase in their wealth. The loan officer under this model becomes an investor, using concessionary funds to finance increased production (in the observed examples sugar cane and vegetables), and the borrower becomes a project manager who benefits from careful husbandry of project resources, but only so long as the loan project continues. It is an innovative approach, though it is not clear to what degree it is an explicit institutional strategy, nor can it yet be assessed in terms of its commercial sustainability. It does work within the constraints imposed by communal property ownership and as an attempt to find something that will work without transforming land ownership patterns, it should be tracked.

CHAPTER SEVEN
FINANCE FOR THE MICRO/SMALL AND MEDIUM SCALE SECTOR

7.1 While the majority of individual Swazi nationals have at least minimal access to some type of credit services, many do not meet the minimum requirements for loans and other risk services from the commercial banking sector. The commercial banks are reluctant to broaden their credit services or deposit delivery too widely if such action would involve higher transaction costs and an unacceptable additional level of loss. However, there are several financial incentive programs which have been developed to assist the commercial banks justify their involvement in the lower end of their normal market activities. In addition, non-traditional borrowers and small and micro enterprises are able to access credit through a number of organizations such as cooperatives, development finance institutions, and small business credit agencies.

7.2 This chapter reviews the main financing and institutional support arrangements which have been established to assist the development of micro/small and medium scale enterprises in Swaziland.

A. CENTRAL BANK PROGRAMS

7.3 To increase the level of lending provided by the commercial banks to small and medium scale businesses, the Central Bank of Swaziland has developed two guarantee programs: (a) The Export Credit Finance Guarantee Scheme and (b) The Small Scale Enterprises Loan Guarantee Scheme. Under these programs, participating banks can apply for guarantee coverage on loans they extend to qualifying businesses under certain conditions including: the borrower's asset base, maximum loan size, loan term, interest rates, and loan purpose. The banks have the responsibility of analyzing and approving all credit applications under these guarantee schemes using their own internal lending criteria, although each fund does review the guarantee applications and can reject coverage if the established conditions are not met. The concept of credit insurance is not new -- and similar programs can be found in practice worldwide.

7.4 **Export Credit Finance Guarantee Scheme**. This fund was established in 1991 supported by technical assistance from the International Trade Center UNCTAD/GATT (ITC) to promote export trade from Swaziland. The fund is managed by the Central Bank, and is targeted at meeting the short term working capital requirements of small and medium size exporters. Part of the logic for establishing this fund was to provide a mechanism which would encourage the commercial banking sector to finance smaller loans to a segment of the market that they did not previously serve. There had been a strong perception that the banks were avoiding this type of customer and were "hoarding" their excess liquidity. This perception continues even though the banks have participated in this program since 1992. The real reasons for their continued excess liquidity is discussed more fully in the chapters on commercial banking and money market policies.

7.5 There are two basic types of loans which can be extended under this program: pre-shipment financing which is designed to cover a broad range of working capital and production costs, and post-shipment credit which is closely tied to the actual export of goods with the normal trade documentation in effect. Pre-shipment loans can be guaranteed by the fund up to a maximum of 75 percent of the total loan amount, while post-shipment loans can receive a

guarantee up to 85 percent of the loan amount. While there are no minimum loan levels, the maximum guarantee that can be issued to any one exporter is E2.5 million, a level which is periodically reviewed. It appears that actual approvals are normally closely tied to actual pre-shipment orders or long-term export contracts.

7.6 There is also a maximum interest rate which can be charged by the banks under this program which is the prime rate -- 16.25 percent in mid-1995. This maximum rate is applicable to the entire loan amount and not just the 75 percent guaranteed portion. This pre-determined interest rate cap is a significant disincentive for the commercial banks and somewhat dampens their enthusiasm for the program. The program's basic incentives are really only apparent for the exporter as a prime rate credit is rarely available to such small scale borrowers.

7.7 The financing institutions recognize that this credit insurance scheme does not really cover their entire credit risk exposure and there continues to be the normal administrative and transaction costs (probably higher than normal), involved in this type of lending. The financing institution must fund the entire loan amount, analyze the credit risk involved in the actual trade transaction, and dedicate a high degree of management effort administering these type of clients. Obviously, the government considers this below market interest rate cap as an incentive for the promotion of non-traditional exports and for the increased use of the fund's services.

7.8 The fund requirements presume that the exporter has an account relationship with a commercial bank, operates proper accounts, and possesses a level of fixed assets or inventory over which the bank can place a lien for at least its 25 percent credit exposure. This is seemingly not always the case -- and the fund management reports only a small number of very small loans (less than E5,000), which have been extended to individual market traders who sell native handiwork in cross boarder trade fares. Any claims against the fund by the bank for non-payment by the exporter must be filed within two months of default and the bank is required to cede any excess security position above its' exposure level to the central bank (to the fund itself).

7.9 There is also a rediscount facility through the central bank available to any financing institution which may experience a liquidity shortage as a result of increased credit extensions under this scheme. The banks receive a credit against their central bank reserve requirement levels by raising a special promissory note which would in turn be discounted by the central bank at the prevailing discount rate. However, such transactions have not taken place since the inception of this program as the banks have remained extremely liquid over this period.

7.10 The guarantee premium charged by the guarantee fund ranges from 0.53 percent to 2.33 percent depending on the type of credit insured and the length of time that the coverage is required. In addition there is a nominal issuance and renewal fee of E25.00 charged whenever a guarantee is issued or extended. The fund debits these fees and premium charges to the account of the funding bank at the central bank but these costs are ultimately passed onto the exporter. Claims can be made on the fund in cases of default by the exporter.

7.11 In 1991 the Swazi Government established the fund with a E5.5 million initial capital injection. The fund was not established as a separate legal entity but "housed" as a department of the central bank for administrative purposes. The fund began full operations in October 1991.

7.12 An additional E8.0 million in capital has subsequently been paid in by the government -- increasing the fund to E13.5 million. Through investment returns the fund had grown to approximately E15.0 million by the end of April 1995. As the fund is allowed to leverage its guarantee exposure by three times, it is now able to extend guarantees up to a total of E45 million, covering export loans of E60 million. As actual growth of fund usage over the past three years has lagged behind its capital growth, the government has re-assessed the fund's capital requirements and has not included the fund in this year's budget allocation.

Table 7.1: Analysis of Lending Activity
Export Credit Guarantee Fund Scheme,
historical information and information as of April, 1995

	Total No. of loans granted	Total Loan Amounts granted	% No. Loans	Total amount of guarantees issued	Total Average loan size	No. of loans as at 4/30/95	Loans as at 4/30/95	Guarantees in force as at 4/30/95
SDSB	24	7,255,182	8.4%	5,442,107	302,299	2	1,750,000	1,312,500
Meridien/ FNB	22	3,421,103	3.9%	2,605,828	155,505	0	0	0
Barclays	25	15,394,578	17.7%	11,545,259	615,783	4	2,896,790	2,172,593
Standard	90	55,488,869	63.9%	43,906,221	616,543	11	10,118,483	8,071,424
Stanbic	14	5,294,647	6.1%	4,275,450	378,189	0	0	0
TOTAL	175	86,854,479	100%	67,774,865	413,663	17	14,765,273	11,556,517

SOURCE: Central Bank of Swaziland, April, 1995.

7.13 By the end of April 1995, there had been a total of 175 separate credits supported by this guarantee program for a total of E86.9 million. Although the average loan amount for the entire program is E413,663, actual credit extensions have ranged from as small as E1,771 to as high as E2.0 million. Fund records indicate that 46 percent of the total number of loans have been for under E100,000, while at the other extreme, just under 19 percent of all loans have been for amounts over E1.0 million.

7.14 Since the inception of the program, loan repayments have averaged 82.6 percent and total defaults have been E978,559. The guarantee fund has paid claims amounting to E544,591 since 1992. This represents a very modest loss rate of 0.8 percent on the total fund exposure over the past two and a half years of operation. The fund, through the Central Bank has initiated court proceedings to recover these monies but management reports that the prospects for future settlements appear slim.

7.15 A review of the overall performance of the export guarantee scheme reveals several structural problems and disturbing operational trends. Usage of the fund grew rapidly at the inception of the program, mainly because of strong central bank pressure on the commercial banks to participate. The structure of the program, which is designed to meet the needs of the small exporter, means that most loans and guarantees are rather small in size. While this is one

of the primary social goals of the program, such credits rarely fall into the category of "usual trade transactions" and cannot normally be administered efficiently by commercial banks. When these small export credits are further compromised by maximum loan limitations and interest rate caps, most commercial banks are reluctant to continue in the program.

7.16 Continued market penetration and the dispersion of new credit access through the financial sector is increasingly weak. Meridien Bank ceased active participation in the program over 18 months ago and there is no indication that FNB will voluntarily revive their involvement. Stanbic had extended a total of 14 credits under this program but only banked 3 separate clients under these credit. These customers have paid off their loans and there has been no further participation by this bank. Nonetheless, the program can be considered to have successfully promoted some new exports -- albeit in very small amounts (a total of E 86.9 million in loans over 31 months).

7.17 In addition, the low level of guarantee losses and the "turnover" of loan repayments by the small scale exporters involved has been impressive. Over 82 percent of the loans granted have been repaid and of the total claims against the fund, it appears that some 67 percent was from one bank (Standard Chartered). This strongly implies that the perceived credit risks inherent in these small transactions are not excessively high and that the program is, for the most part, actually dealing with established businesses which, while they may be small traders, do in fact pre-pay their borrowings.

7.18 In conclusion, there is a role for this export credit program within the Swazi financial sector. However, in light of the relatively poor response from the commercial banking sector, the lack of recent growth in fund usage, and the ongoing desire to make this program available mainly to the low end of the market, it is recommended that the program goals and administrative structure be further reviewed. For example, there are no compelling reasons for this program to continue under the direct control of the central bank. The administration of such a program is not a normal central banking function. Alternatively, it is recommended that a new specialized and separately incorporated financial institution be created, into which this scheme, the Small Scale Enterprise Loan Guarantee Scheme, and the newly created Public Sector Guarantee Fund can be placed and centrally administered.

7.19 The management of the Export Credit Finance Guarantee Scheme should also review issues of the maximum size of loan guarantees available for any single borrower -- as it appears that a significant group of small scale exporters, who are considered creditworthy by the commercial banks, are actually in need of working capital and export financing above the current E2.5 million limit. At the same time the fund management should seriously consider allowing the Small Business Growth Trust (SBGT) to become an eligible financing institution for this program. SBGT credits have recently been included in the Small Scale Enterprises Loan Guarantee Scheme and this non-bank financial institution is an appropriate vehicle for servicing the lower end of the export market. The SBGT should also be considered as a partner in the marketing development of the fund through its ability to provide credit training to small scale businessmen who become the borrowers under these programs.

7.20 **Small Scale Enterprise Loan Guarantee Scheme**. The Small Scale Enterprise Loan Guarantee Fund was established to actively support enhanced access to credit for indigenous

Swazi entrepreneurs, by encouraging the banks to provide business financing to nominally "uncreditworthy" borrowers through the theoretical reduction of their financial risk under a credit guarantee program.

7.21 Similar in structure to the export guarantee program, the small scale enterprises scheme was created as a department in the central bank in 1990 "to make better use of surplus liquidity available at banks for a specific development purpose". From its inception, the goals of the guarantee program were mixed -- with the belief that the commercial banks were not fulfilling their "social and developmental" roles. Many of the banks felt that this program was forced upon them with extreme pressure from the central bank.

7.22 The guarantee fund was capitalized with E4.0 million which can be leveraged three times -- hence the fund can issue guarantees up to E12 million representing a 75 percent coverage of the total of small business loans extended by the five banks. Although the initial maximum loan limit was E50,000, this has been increased to E100,000, with the banks requiring 25 percent collateral. Eligible businesses are not permitted to have more than E300,000 in assets -- an increase from E150,000 when the lower loan limit was in place. The maximum interest rate that can be charged is fixed at 1 percent above prime, with a maximum term of 5 years. The scheme anticipates that the banks will use their standard evaluation criteria to ensure that business proposals are viable and financially sound.

7.23 Since its inception most of the lending activity under the Small Scale Enterprise Loan Guarantee Scheme has been undertaken by Swazi Bank which can be seen as an extension of its original development role. By March 1995, Swazi Bank had extended a total of 248 separate loans under this program, representing 53.8 percent of all the loans guaranteed under the fund. Table 7.2 gives a breakdown of the participation of the various lending institutions in this guarantee program.

7.24 Repayment performance under this scheme has been weak with a reported gross default rate in excess of 28 percent. This default figure only includes the actual insurance claim amounts which the fund has paid into a suspense account for future resolution. The potential level of defaults, and therefore losses to the guarantee fund, will most likely increase, as total guarantees reported in various stages of default by the bank are over E2.0 million -- which represented 38 percent of the total guarantees outstanding at the end of March, 1995. In addition, there are many cases, particularly from Swazi Bank, where there are obvious defaults but no documentation or claim has been submitted to program management. The Central Bank is concerned about the nonperformance of this initiative, and believes the underlying problem is the absence of a "proper relationship" between the borrower and the lender. This situation can be partially attributable to the following issues:

Table 7.2: Analysis of Lending Activity
Small Scale Enterprises Loan Guarantee Scheme

	Number of Loans 1.	Total loans granted 2.	Loan amounts repaid 3.	Loans outstanding 3/31/95 4.	Guarantees outstanding 3/31/95 5.	Guarantee claims paid into suspense a/c for defaults	Gross default rate 5/6 as %
SDSB	248	5,338,717	1,285,234	4,053,483	3,040,114	0	0
Meridien/ FNB	21	518,747	63,809	394,551	295,914	140,693	47.5%
Barclays	37	1,144,040	531,124	542,165	406,627	36,892	18.8%
Standard	75	2,236,760	700,031	1,417,463	1,063,076	90,755	8.5%
Stanbic	19	677,950	165,253	477,847	358,387	230,971	64.4%
SBGT class A	8	350,500	0	350,500	262,875	0	0
class B	12	294,448	0	294,448	220,836	0	0
TOTAL	420	10,561,162	2,745,451	7,530,430	5,647,829	499,311	average 28.7%

SOURCE: Central Bank of Swaziland, April, 1995.

(a) The commercial banks are not really interested in this high risk and high cost program which they feel was forced upon them. Theoretically the banks have zero financial risk as the guarantee covers 75 percent of the loan, while the borrower is required to collateralize the remaining 25 percent with a cash deposit. However, there is a high level of management and transaction costs in servicing a group of borrowers who will only rarely ever "graduate" into a prudent long-term banking relationship with the bank.

(b) This program, by its very design, has attracted non-traditional customers, many of whom are new to business and need more than just financing (training, resource development, technical assistance, and so on) in order to ensure the success of their business plans. Once these SMEs no longer have a financial constraint, the other limiting factors to their growth (such as business skills and education, product demand, niche, and quality) need to be addressed -- and become much more recognizable constraints.

(c) Many borrowers developed the impression that this was a grant program rather than a loan program, and did not fully understand that the loans had to be repaid. Through lack of training, as well as weaknesses in the loan administration procedures of the banks (particularly Swazi Bank), this attitude continues to prevail.

(d) The traditional commercial banks have not changed their systems to accommodate the needs of this type of borrower -- who are generally inexperienced in dealing with a formal financial institution, require additional education in credit procedures, much closer monitoring, and a different style of communication. This can be an expensive program for a bank to undertake.

(e) Swazi Bank, which is extremely weak and has recently been intervened by the central bank, has made the majority of the loans under this scheme. Although a development institution such as this would be a proper vehicle for this type of lending, much of the blame for the high default rates can be seen as a consequence of this institution's inefficiencies. The guarantee fund could easily loose up to 78 percent of its base capital if the total of the Swazi Bank portfolio proves to be in default -- an entirely possible scenario.

The non-performance of this type of lending raises serious questions about the capacity of Swazi Bank to provide financial development services to MSMEs. As the financial institution with the strongest link to the Swazi people, one would have anticipated that it would have played a more important role in providing financial services -- while educating it's customer base and developing a long term relationship which can lead to greater economic growth. At the present time, the Central Bank is effectively subsidizing, through the loan guarantee fund, the institutional weakness and losses at Swazi Bank.

(f) Most of the loan funds went out in larger loan amounts, making it extremely difficult for first time borrowers to compensate and correct any business mistakes or judgment errors that may have occurred. At Swazi Bank, 52 percent of the loans extended are at, or close to, the maximum amount.

7.25 The central bank and program management have recently approved the participation of the Swazi Business Growth Trust (SBGT) as a lender under the guarantee program. The SBGT had granted a total of 20 loans in the first six months which they have divided into two classes based on loan size. Class A loans are larger credits in excess of E35,000, while Class B loans are for smaller borrowers. Given the training needs of the borrowers themselves, the involvement of the SBGT is most encouraging as this group is very mush involved in the development of small entrepreneurs through training programs. The SBGT is a more appropriate vehicle for this type of development lending than the commercial banks and it is hoped that its participation in the program will expand in future. A possible development could be for the commercial banks to transfer their lending portfolio under this program to the SBGT for administration and to participate in this program in future through the extension of a modest line of credit directly to the SBGT which would fund their direct on-lending to the targeted small businesses. This would cause a concentration of the guarantee fund expose to one lending institution, but it could also improve the default rate as more loans are granted through one specialized MSME lending institution.

7.26 Table 7.3 provides a breakdown of Swazi Bank's loan portfolio under this program -- as the largest participant -- by branch and loan size. An analysis of 181 of their loans shows a majority (57 percent) of all of the loans were made in Mbabane, with Manzini receiving an additional 15 percent. These 131 borrowers (70 percent of the total) received 78 percent of the E4.2 million that had been lent as of March, 1994. The largest volume of loans (28 percent) was in the E45,000 to E50,000 range where 51 loans were made, followed by 38 loans (21 percent) made in amounts of E5,000 and below. This indicates a demand for both very small and relatively large loans, by this sector.

Table 7.3: Swaziland Development and Savings Bank Small Scale Enterprises Loan Guarantee Scheme (E thousands)

	Total No.	Total Amt.	0-5K	5-10K	10-15K	15-20K	20-25K	25-30K	30-35K	35-40K	40-45K	45-50K
Mbabane	104	2,676	76	93	178	121	0	210	103	159	90	1,646
Manzini	27	645	25	40	15	77	50	30	0	160	0	248
Nhlangano	17	247	9	62	27	20	49	30	0	0	0	50
Siteki	4	27	7	20	0	0	0	0	0	0	0	0
Piggs Peak	10	146	14	30	12	20	0	30	0	40	0	0
Simunye	7	177	5	0	30	20	22	0	0	0	0	100
Matsapha	11	305	15	10	0	0	25	30	35	40	0	150
Matata	1	3	3	0	0	0	0	0	0	0	0	0
Total	181	4,226	154	255	262	258	146	330	138	399	90	2,194
percent			21	17	9	7	3	6	2	6	1	28
number			38	31	17	12	5	11	4	10	2	51
% no.			4	6	6	6	3	8	3	9	2	52

SOURCE: Central Bank of Swaziland, June 1994.

7.27 The March, 1994 figures show a current loan balance of E3.9 million on the E4.2 million lent out -- indicating that only E 300,000 has been received in repayments (7 percent). It seems evident that there is an even higher delinquency than indicated in the Central Bank statistics which showed a 20 percent repayment as of June 1994. However, these amounts can be misleading since they represent all loans, some of which have been made quite recently. With the recent intervention of Swazi Bank by the central bank, it is hoped that collection efforts under this program will be enhanced and that they will be able to obtain better repayments from their borrowers. If not, the loan guarantee scheme faces a very large loss situation.

B. OTHER FINANCIAL INSTITUTIONS

7.28 In the gap between the formal financial institutions and the informal sector (money lenders and shylocks), several other types of institutions have developed. The Swaziland Savings and Credit Cooperatives (SACCOs) provide a range of financial services to their members, while Swazi Business Growth Trust (SBGT) offers loans for small and micro-scale enterprises. Tibiyo Taka Ngwane and Swaziland Industrial Development Company (SIDC) also invest in business ventures on either a debt or equity basis. The European Union, as part of their

work with the Ministry of Economic Planning and Development, provides financing for a variety of small scale rural and community projects, several of which involve income generation.

7.29 **Swaziland Savings and Credit Cooperatives.** In Swaziland, the Savings and Credit Cooperatives (SACCOs) are registered at the Ministry of Agriculture and Cooperatives and regulated by the 1964 Cooperative Societies Act -- which is under revision. The Swaziland Association of Savings and Credit Cooperatives (SASCCO) provides training and bookkeeping services to members, as well as representation at the national level and within the international credit union system. Currently there are approximately 25 savings and credit cooperatives registered with the Ministry of Agriculture. Of these, 21 have provided statistics to the Swaziland Association of Savings and Credit Cooperatives (SASCCO). This data is summarized in Table 7.4.

7.30 At the end of 1994, the 21 affiliated savings and credit cooperatives affiliated with SASCCO, had E16.4 million in shares and savings, with 81 percent, or E13.6 million loaned out to members. Around 13,500 people belong to the SACCOs, with three of the organizations (SNAT, Green Pastures, and Asikhutulisane) accounting for 63 percent of all members, and Asikhutulisane alone representing 40 percent of the total membership. Recent growth has been extremely rapid. Between 1992 and 1993, for example, there was a 35 percent growth in shares and savings, followed by growth of 32.4 percent in 1994. Thirteen SACCOs, more than half of the cooperatives in the analysis showed an increase, with Asikhutulisane, the country's largest financial cooperative increasing by 57 percent (E3.5 million) (compared to 21 percent or E 1.27 million the proceeding year).

7.31 There are limitations on the amount of financial expertise, management, supervision and monitoring that currently exist within the system. This has tended to not keep pace with the organizational growth which is occurring as the SACCOs change into more formal financial institutions. The staff working with SASCCO, as volunteers or in a paid capacity (staff, Board, and Committee members), need to upgrade their skills. It is also important to provide improved external auditing procedures to ensure financial safety and soundness given the large numbers of members involved, and the considerable size of their savings and shares.

7.32 Most of the savings and credit cooperatives are work place based, with membership restricted to employees. These savings and credit cooperatives use the check-off system, which minimizes transactions since it can be undertaken through payroll deductions.

7.33 The Swaziland Association of Savings and Credit Cooperatives (SASCCO) was registered in 1988, but only commenced operations in 1992 with assistance and funding from the African Confederation of Savings and Credit Cooperatives (ACCOSCA). ACCOSCA is based in Nairobi and, as part of the international credit union system, is a member of the World Council of Credit Unions (WOCCU) based in Madison, Wisconsin.

7.34 SASCCO supports itself from membership dues paid by affiliated savings and credit cooperatives, as well as from grants received from ACCOSCA from funding by the Konrad Adenaur Foundation. However, ACCOSCA may not be able to continue it's funding of the organization, and SASCCO is hopeful that the Canadian Cooperative Association (CCA) will be able to provide institutional support in the future.

Table 7.4: Statistical Data on Swaziland Savings and Credit Cooperatives[1]

	Number of Members 1994	Shares 1994	Savings 1994	Shares and Savings	Loans 1994
Asikhutulisane	5,500	8,037,530	1,633,224	9,670,754	8,032,709
Green Pastures	1,000	53,595	1,398,234	1,451,829	1,210,934
Lubane	600	41,294	1,343,925	1,385,219	1,220,409
S.N.A.T.	2,000	60,920	880,456	941,376	432,631
Sibonelo	700	123,205	766,049	889,254	675,434
Temnotfo	400	6,000	450,000	456,000	473,416
Asihlumisane	700	22,730	331,032	353,762	196,702
Mhlume Workers	500	18,425	326,992	345,417	185,836
Saphumula	500	12,000	327,731	328,931	339,731
Sewela	184	5,034	244,767	249,801	275,128
Kusile	203	4,200	159,890	164,090	131,208
Lukhotse	130	6,100	148,409	154,509	102,000
Phaphamani	200	16,952	130,893	147,845	123,263
Inqaba YeMaswati	200	16,182	100,922	117,104	90,867
Sizabantu	88	5,880	59,948	65,828	60,286
Siyakhula	56	2,760	44,054	46,814	42,229
Asidle-Sonkhe	100	540	35,387	35,927	41,871
Takheni	25	6,813	8,376	15,189	6,773
Mahamba Ntamakuphila	100	742	2,014	2,756	506
Imphumelelo	180	-	-	-	-
Catfuta	100	-	-	-	-
TOTAL	13,510	8,440,902	8,392,303	16,833,205	13,641,933

SOURCE: Swaziland Association of Savings and Credit Cooperatives papers.

[1] This information was compiled from the Swaziland Association of Savings and Credit Report (1992), as well as a December 1994 update. Data was compared with the financial statements for several of the SACCOs and there are some discrepancies. Hence this table should not be regarded as financially exact. However, it does provide a useful overview of the system.

7.35 SASCCO provides training and bookkeeping services to it's members. ACCOSCA, in an institutional analysis conducted in June 1992 made several recommendations to improve the service capabilities and financial self-sufficiency of SASCCO. Several of these have been implemented, with staff attending regional credit union training sessions. Life savings and loan protection insurance is now provided through CUNA Mutual and most of the societies will be participating. SASCCO was expecting to get a technical service officer in mid-1995 who would provide training to Cooperative members. Training is considered a very important issue by SASCCO's management. The Association provides training to its members via seminars on an on-going basis. In addition, the Africa Revitalization Program -- which is a World Council and ACCOSCA sponsored program -- is developing an initiative which is designed to turn the cooperatives into modern credit unions by making them act more professionally. This is a five year program which commenced in October 1994 -- targeted at eight African countries -- of which Swaziland is one.

7.36 ***Regulation.*** The credit unions are regulated by the Ministry of Agriculture and Cooperatives, which is responsible for the organization, development, registration, training, monitoring, and supervision of all cooperatives. The Savings and Credit Cooperatives (SACCOs) are not treated differently from other cooperatives, and follow the 1964 Co-operative Societies Act, although this is currently being revised. Given the demands made on the Ministry, it would be advisable to allow an outside audit service (perhaps in collaboration with SASCCO) to provide the monitoring needed to ensure that the larger cooperatives operate in a sound and safe manner, while identifying additional training needs. In addition, as recommended in Chapter Two, savings and credit cooperatives (especially those which reach a certain size -- such as Asikhutulisane), should fall under the direct supervision and regulation of the Central Bank of Swaziland's banking supervision department.

7.37 ***Asikhutulisane.*** The largest credit union in Swaziland is Asikhutulisane, located in Bhunya, the Usutu Pulp Company community. Originally established in 1985 by Usutu Pulp staff working as volunteers, and housed within the company, the SACCO now has it's own building and paid staff, although significant work is still done by members of the Board and other volunteers. Asikhutulisane is undergoing tremendous growth, and as a community based savings and credit cooperative, their membership is open to anyone who resides within 30 kilometers of the town. As of December, 1994 the total assets at their disposal were E9.7 million -- from a membership base of 5,500 people.

7.38 Although Asikhutulisane follows general credit union operating principles, it has an interest rate policy that constrains the sustainability of the organization. Unless only short term loans are made, the interest rates charged on loans cannot cover the operational costs of the organization, including member dividends on shares and savings on deposit with the organization.

7.39 Current interest rates are 20 percent on shares, and 12 percent on savings. With 77 percent of deposits in shares, Asikhutulisane cannot survive if it charges below 25 percent interest rates on loans (most SACCOs need at least a 5 point spread). However, current loan policies follow a schedule that charges 3 percent per month for the first three months, with a 1 percent increase for each additional month up to three years. This implies that a 3 year loan has

an annual interest rate of 14 percent, while a 1 year loan has a rate of 18 percent. It is only the short term loans, therefore, that allow the organization to meet their annual costs. This type of policy limits the organization, and currently they can only provide short term loans for 1 to 3 months at 3 percent per month. These short term borrowers are subsidizing the long term borrowers as well as the shareholders.

7.40 There are other policies that contribute to the growth the organization has achieved. Savings and annual interest and dividends are distributed to members annually after the November General Meeting. However, members are encouraged to convert their savings into shares, which can only be withdrawn when a member resigns from Asikhutulisane. Loan amounts are determined based on the amount of funds a members has in the SACCO, with the maximum amount equal to three times their total amount of savings and shares.

7.41 Asikhutulisane needs technical assistance to help them plan their growth, and develop financial management and interest rate policies. They have a main office, and use space in Mbabane and Manzini to provide services to their members. They would like to put up a complex in these other locales to expand their services to current as well as new members. In conclusion, it is important that this large, and very rapidly growing credit cooperative, should obtain external support to assist it during this period of very rapid growth. In addition, given the amount of resources involved, and the number of individuals with savings at risk, the CBS should seriously considering including cooperatives of a certain size, in their bank supervisory net.

7.42 **Tibiyo Taka Ngwane.** Tibiyo was created in 1968 by the late King Sobhuza II to promote economic development by investing in viable projects that created jobs and preserved the culture of the Swazi people. The current value of its investments is E266 million[2]. Although it has traditionally been mainly interested in large business ventures, in 1993, the King mandated that Tibiyo examine the role of SMEs. Subsequently, Tibiyo has organized a series of meetings of all the groups involved in finance and technical assistance for SMEs. Discussion has focused on the way that Tibiyo can participate in the development of the small scale business sector.

7.43 Several issues have arisen from these meetings. There are various groups working in the sector, and there is a need to increase co-ordination amongst institutions to avoid duplication and improve service delivery. Another issue raised is whether the main financial constraint for SME's is access to capital versus availability of capital. In Swaziland, there is funding available for well run businesses that need to finance their expansion and growth, however, there is a larger group of businesses that are very small, and/or poorly operated, and that need training and technical assistance before they qualify for capital -- implying that access is more of a problem than availability.

7.44 More recently, Tibiyo has gone out to tender on a program of E8.0 million to support lending programs to MSMEs. By mid-1995, these proposals were still under consideration from a series of domestic financial institutions which had made application for the use of these funds.

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[2] Tibiyo Taka Ngwane 1993 Annual Report.

7.45 **Swazi Business Growth Trust (SBGT).** SBGT is an NGO that provides training, finance, and business advisory services to help develop businesses in Swaziland. Established in 1992, with funding from USAID, the Trust has recently established a financial institution -- the Growth Trust Corporation -- to further expand its institutional capacity to provide financial services.

7.46 SBGT has established a formal system whereby clients can obtain loans. Initially, they are required to attend a training session, for one day, which teaches basic business skills in cash flow, market analysis, and loan repayment. Loans are made within two weeks of the loan application being received by the organization -- and with all recipients receiving E2,000 as their first loan. If this is repaid, the next loan can be for E3,500, which can then be increased to E5,000, and then to E7,500. Loans currently (1995) attract interest of 33 percent, with repayment due over a twelve week period. The businesses receiving loans are required to attend a meeting six weeks after the start date of their loan from SBGT -- to check on progress and access any technical assistance that may be appropriate. SBGT also provides other types of loans, including franchise finance from E20,000 to E150,000, and working capital and invoice finance from E5,000 to E35,000.

7.47 As of June 1994, SBGT had made 208 loans with a value of E902,000. Of these, 26 loans (12.5 percent) were overdue, owing E114,800. This overdue amount reflects the loan amount and interest charges. However, only 5 loans (E16,400), or less than 2 percent of the total amount of money loaned, were past due more than 90 days.

7.48 SBGT has an interesting method of operating as it does not have the capability to handle actual loan transactions. The Trust has developed a "SmartCard" which allows clients to make payments to their SBGT account, through participating banks. This facilitates record keeping for SBGT, and minimizes transaction times, since a client can go to a bank that is geographically convenient.

7.49 SBGT is funded by USAID and has received US$6 million to cover operational costs. It has also received E1 million from the Government of Swaziland which was used as the capital base for the loan fund. The Development Bank of Southern Africa (DBSA) has committed E5 million to the Trust, but requires that SBGT obtain additional funds or commitments to guarantee this loan. The Growth Trust had also made application to Tibiyo for the administration of the E8.0 million made available from that source.

7.50 **Swaziland Industrial Development Company (SIDC).** SIDC is a private development finance company established as a joint venture between the Government of Swaziland (35.2 percent) and major international development finance institutions. SIDC promotes and finances investment in industry, mining, agri-business, tourism, commerce and service activities. Every year SIDC invests E10-15 million in a variety of business ventures, with about 50 percent of this money going to existing customers who are expanding. Most of the projects are referred to SIDC offices in Mbabane. SIDC loans are usually for capital projects, and their minimum commitment is E100,000, although they have financed good proposals requiring as little as E50,000.

Table 7.5: Capital Available to Medium, Small and Micro-Scale Businesses (mid-1995)

	Amounts
Tibiyo	E8.0 million
Savings and Credit Cooperatives	E16.7 million
CBS SME Loan Guarantee Scheme	E4 million (can leverage guarantees of E12.0 million)
CBS Export Credit Guarantee Fund Scheme	E15 million (can leverage guarantees of E45.0 million)
SB Growth Trust	E1 million (further funds possibly available from the Development Bank of SA and Tibiyo)
BMEP	E200,000
BWAS	E73,000
Imbita	E30,000

C. BUSINESS SUPPORT ORGANIZATIONS

7.51 There are various business support and development organizations which sponsor lending programs. These include the Business Management Extension Program (BMEP), Imbita Swaziland Women's Finance Trust, the Business Women's Association of Swaziland (BWAS), and other NGOs that are relatively small scale. There are also several business support organizations including the Small Enterprise Development Company (SEDCO), Sibako Chamber of Commerce, and the Swaziland Chamber of Commerce and Industry.

7.52 **European Union**. Under the Ministry of Economic Planning and Development the EU provides financing for a variety of small scale rural and community projects. For the most part these are capital projects to provide facilities, basic infrastructure, and the technical assistance necessary for these to be successfully operated and used. The EU works closely with NGOs -- which are implementing 25 percent of these projects. They have provided about E2.0 million in financing, with a maximum to any one project of E250,000. Of this, E354,000 has gone to six income generating projects. All of their work is done with community groups, and they refer individuals who do not meet their criteria to appropriate programs and banks.

7.53 **Business Management Extension Program (BMEP)**. BMEP was started in 1986 by the management of the Manzini Industrial Training Center (MITC) as a way for school drop-outs to learn vocational and business management skills (woodwork, metalwork, sewing, upholstery, electrical). They now focus on providing clients with training and some financing as a way to transform income generating activities into small enterprises. Since 1990 they have received funding from USAID, but their 1992 grant of US$400,000 ran out in November 1994.

7.54 BMEP has established a system whereby entrepreneurs can obtain technical assistance as well as loans. They have made 120 loans for a total of E199,000. Their repayment rate is around 80 percent. The Program experienced some initial problems but these now seem to have been resolved. BMEP has taking it's role as a lending organization seriously, and has engaged a lawyer to help collect from delinquent borrowers.

7.55 In an effort to emphasize sustainability, BMEP is now charging fees for their training courses, and are increasing the contracts they have to provide training, working with groups involved with income generating projects as well as individual entrepreneurs. BMEP also has a facility which provides space for small businesses while generating rental income.

7.56 BMEP is particularly concerned with the type of education needed to support strong SMEs, and has examined the most effective ways of providing that learning experience, working with adults as well as exploring how some of the concepts can be initiated within the national student curriculum.

7.57 **Business Women's Association of Swaziland (BWAS).** The membership of this organization is entirely women who are in business, or interested in forming a business. Current membership is 3,000 -- 30 percent of whom are in Mbabane, where the office is located. BWAS has nine branches which meet regularly to discuss business. They have established a savings and credit scheme, and have accumulated E73,000 which is loaned out to members after they have been saving a regular E20 contribution for 6 months. A person cannot borrow in excess of double their savings, with a maximum loan size of E3,000. Loan interest is 5 percent per month for a term of six months, with a 2 percent penalty for late payment. Savers are paid 12 percent on their deposits.

7.58 The organization is hoping to expand and increase its financial services. As a registered non-profit organization, it is looking for additional funding to increase the size of the loan fund as well as cover the costs of hiring staff. An initial grant of E50,000 from CARE International helped to establish the office and provide some funds for the loan fund. BWAS has coordinated with other NGOs such as SBGT in providing business training seminars to their membership.

7.59 **Imbita Women's Finance Trust.** This organization is an affiliate-in-formation of Women's World Banking. They have provided loans to 27 women, working in partnership with Swazi Bank to administer an initial fund, established by the Trust, of E100,000, which is guaranteed by a deposit by Imbita of E30,000. A maximum loan has been set at E1,500. There have been problems in loan administration and loan collection, and lending was halted in 1994 to address these problems.

7.60 Of their membership of 2000 women, about 300 are active, primarily in Manzini. Many of these women are in business as hawkers (street vendors), with the rest engaged in agriculture and small scale production.

7.61 Working with a volunteer from Skillshare, Imbita has recently received E500,000 in funding from the Overseas Development Agency (ODA) and Cebemo (Netherlands) to cover the administrative costs of establishing a credit facility (savings and lending program) for women to support micro-enterprises and increase income generating capacities.

7.62 Although these two women's organizations (BWAS and Imbita) have similar purposes, they are interested in keeping themselves separate and serving their separate constituencies. Imbita mainly works with street vendors, hawkers, and small scale agriculture, while BWAS appeals more to women with a higher degree of formal education, several of whom have salaried jobs as well as a small business venture. Both organizations have collaborated with SBGT to provide training programs, and would like to work with the banking system to increase the financial resources available to women.

7.63 **SEDCO-Small Enterprise Development Company**. SEDCO provides technical assistance and subsidized facilities to small business. They have 7-8 estates located throughout the country, leasing space to 160 businesses. SEDCO has had organizational problems for a number of years and is currently being restructured. As part of this restructuring exercise, its estates are being restructured to function more like business incubators -- with the expectation that small businesses leasing space will have 5 years to graduate out to commercial premises, or pay full cost for their space and the services they receive.

7.64 There is no data available on the financial services needs of the businesses using SEDCO space and services. However, of these 160 businesses, it is estimated that 25 percent use informal sources of financing such as shylocks.

7.65 **Sibako Chamber of Commerce**. Sibako was founded in 1986/87 and has a membership of about 2,000 people -- including farmers, retailers, manufacturers, transport and service businesses, as well as vendors. Of these, about 15 percent are currently active in the organization. Less than half the membership have significant business ventures. More than 50 percent of Sibako's membership is women.

7.66 The original objectives of the organization were to provide a forum for members to exchange ideas and share experiences. The organization is an alternative to the Swaziland Chamber of Commerce which does not provide concrete hands on training and services. Sibako has been involved in assisting members draw up project proposals, establish the viability of projects, and help obtain bank financing. It appears that their close relationship with loan applicants also includes assistance with loan supervision.

7.67 Sibako is currently developing new program ideas as to how it can most effectively work with its membership as only 15 percent of their 2,000 members are active, and their services seem to overlap with those of Imbita, BWAS, SBGT, and BMEP. The Chamber would like to establish a loan fund at subsidized interest rates, but have not undertaken the analysis needed to ascertain if there is sufficient need, and justifiable benefit for such an operation. Also, Sibako does not appear to have the operating capacity and financial expertise to undertake this type of program, nor has it established any types of collaborative arrangements with either financial institutions or other NGOs which could make it more viable.

7.68 **Swaziland Chamber of Commerce and Industry**. The Chamber of Commerce provides it's membership with information about general business development. With 300 members, of whom only 5-10 are local Swazis, they focus on issues important to the more established, bigger businesses in Swaziland. They have participated in seminars held for new

businesses and offered basic business advice. The Chamber is not involved with finance issues since none of their members are dissatisfied with the financial services currently available to them.

D. THE INFORMAL FINANCIAL SECTOR

7.69 Many Swazis use the informal financial sector (shylocks) to obtain short term financing, and also to accumulate savings in the form of cattle. The shylocks operate in many arenas and on a fairly extensive basis (one store in Mbabane advertises "Shylock Services"). Loans are relatively easy to obtain and there is no formal application procedure. Most people seem to be referred by word of mouth, and often a current or former client of the money lender must act as a reference or guarantor (co-signer who agrees to pay the loan in case of default). Given the informal nature of this market, it is difficult to obtain firm data and information about the extent, size and coverage of these activities. Few money lenders are willing to be interviewed. Nonetheless, it does appear that, once a person starts to use the services of a moneylender, it frequently becomes difficult for them to repay the outstanding balance, and many borrowers end up only making the interest payments on the loan.

7.70 Many Swazi's "save" by investing in cattle -- and this is frequently considered to be safer than a bank. In addition, cattle have other useful attributes including the fact that they can be used as work animals (draft), for paying dowry, for milk, and as a symbol of wealth. However, they cannot be used as collateral since there are problems of asserting ownership since many of the animals are not branded. In addition, cattle can be relatively easily stolen and can die from drought or sickness -- thereby making them a less acceptable form of collateral.

7.71 There appears to be a significant amount of capital circulating within the informal financial sector -- although this is obviously difficult to quantify. Nonetheless, based upon strong anecdotal evidence the amounts of money are large. Indeed, in neighboring countries where detailed survey work has been undertaken, the presence of significant savings and lending activities in the informal sector, has been documented. If organizations such as the savings and credit cooperatives as well as the NGOs could develop financial services that respond to the needs of the "nontraditional" smaller customer, there is potential to bring larger numbers of people and additional capital into the formal financial sector, thereby further developing the economy.

E. CONCLUSIONS AND RECOMMENDATIONS

7.72 **Institutional Development**. There is a gap in the financial system where the financial and technical assistance needs of MSMEs are not being met. To meet this need, a series of institutions and programs have been developed, so that the legitimate needs of this sector can be met. The Central Bank has encouraged the banks to make loans by providing guarantees under two separate programs. However, the problems experienced with these schemes highlight the need to provide more structure and additional resources to any financial service program targeting nontraditional customers.

7.73 The Non-Government Organizations (NGO's) and the Savings and Credit Cooperatives (SACCOs) also attempt to address the service delivery gap, and provide "user friendly"

operations. This has involved educating a customer base while running a financial operation. NGOs based on external funding have been able to develop institutional capacity to manage their operations, although this could change if these institutions lose their external funding. The SACCOs on the other hand have had a bottom up development approach, and there is a need for them to receive technical assistance to support their operations -- especially as they increase in size. Some of the larger of these institutions are now facing issues relating to their transition from community based organizations to national financial institutions.

7.74 Swazi Bank is also an important financial institution providing services to SMEs. However, the bank is institutionally weak, and in reality, is unable to provide any loans outside of the Central Bank's Guarantee Schemes. The Bank needs help, and this has to be addressed in the context of the larger issue of how the financial development needs of Swaziland will be met (see Chapter Four).

7.75 The Swazi Business Growth Trust (SBGT) and the Business Management Extension Program (BMEP), funded by USAID are moving in distinct directions. Each need to address issues of sustainability, as well as service delivery since they both integrate finance and training for SMEs. SBGT in particular has built a large organization heavily dependent on outside donor funding. Nonetheless, its ability to provide training and financing may help create linkages which are now missing.

7.76 Imbita and the Business Women's Association of Swaziland (BWAS), although young organizations, may be able to reach out to women to help them develop businesses and increase their income generating capacity while providing greater self-sufficiency, personal growth and leadership opportunities. As local Swazi organizations, their work will complement that of the outside NGOs such as the European Union which can provide larger amounts of money for capital projects developed as part of organized group activities.

7.77 The business support organizations are important, but these need to better define and improve their services if they are to be of maximum assistance to MSMEs. The Swaziland Chamber of Commerce, although well intentioned, needs to consider how it could serve in a mentoring capacity for Swazi businesses that have superior potential. Sibako Chamber of Commerce is in a state of transition. It needs to develop programs to support business development (market development, group purchasing) rather than compete with NGO finance and training activities.

7.78 Given the recent growth of the NGOs, the role of Tibiyo Taka Ngwane in coordinating the various institutions involved in this sector, is increasingly important. Tibiyo also has the financial resources to address the gaps that exist within the sector to provide financial training, technical assistance, loans, and other resources.

7.79 The banks also have an opportunity to reach an under served segment of the market that may be more profitable than is commonly perceived. Although there are not many medium sized businesses, several of the banks (particularly Stanbic) have begun to provide finance/training packages. However, there is a need for better "relationship" banking. For the small and micro-scale businesses, several of the NGOs would like to use commercial banking services to educate and screen potential borrowers -- while the NGO's supported these activities

by providing their own funds to guarantee lending, and introduce new technologies (such as the SBGT SmartCard). Not only would this minimize the transaction costs of the small borrower, but it also could provide an entire new generation of bank customers.

7.80 **Financial Constraints Affecting MSMEs.** Financial constraints are often defined as the primary problem affecting the development of small and micro-scale business This is a consequence of the fact that participants in the sector often do not meet collateral or minimum transaction size requirements, have no repayment history, and have not integrated into the formal financial system in ways other than establishing savings accounts. However, once this constraint is addressed, people then realize that this was not the primary constraint. In fact, lack of business and technical knowledge is often significantly more important.

7.81 The programs which have been established in Swaziland have begun to address the issue of financial constraints for small and micro-scale enterprises and most of these programs connect technical assistance to financial transactions. Even the savings and credit cooperatives provide some member education so that they understand their obligations.

7.82 Each of these programs has their own set of requirements, which adds to the cost of the transaction (for both the borrower and the lender), but in many cases successful repayment of loans is assured. Several of the programs also charge above market rates and only provide short term loans. For example (a) The Central Bank Loan Guarantee Scheme requires borrowers to guarantee 25 percent of the loan, which eliminates borrowers without resources (micro-enterprises or those businesses experiencing extremely rapid growth); (b) SBGT requires participants to attend a training program, and has a set schedule of loan amounts available on a short term basis at above market rates; (c) Asikhutulisane requires members to have accumulated shares and savings, and the maximum amount lent is 3 times this amount; (d) BWAS has a membership requirement, a savings requirement, and charges high interest rates. If these financial institutions are to be viable, they will need to balance their requirements with the needs of the SMEs. In the case of the NGO sponsored institutions, sustainability may only be possible with continued grant funding to cover the costs of their other services.

7.83 Overall, Swaziland needs to increase financial services to **MSMEs,** while educating the public as to how these services can and should be used. This can be done by strengthening existing institutions and programs.

7.84 **Banking Sector.** Banks should be encouraged to increase their services to **MSMEs.**

(a) The Central Bank should establish minimum standards for lending institutions involved with the Small Scale Guarantee Scheme to improve loan performance and participation. Greater use of institutions such as SBGT which provide credit and training may be a key. The Export Credit Guarantee Scheme, while expanding, could also require banks to provide more of their capital to businesses which successfully pay back and then require additional financing.

(b) Swazi Bank needs to reformulate it's lending to MSME's to improve loan performance and obtain better repayment while still providing small loans.

(c) Collaboration with **NGOs** and **SACCOs** could increase outreach while minimizing transaction costs.

7.85 **Savings and Credit Cooperatives**. There is a need to:

(a) Increase the financial expertise, management, supervision and monitoring within the system (for the **SACCOs; National Federation; and Ministry**).

(b) The new Act being developed by the Ministry should be reviewed. It is necessary to improve the supervision and regulation of the savings and credit cooperatives by the Central Bank of Swaziland -- especially for the larger organizations.

(c) There needs to be regular auditing and training made available to ensure compliance with prudential and accounting requirements.

(d) Asikhutulisane, the largest savings and credit cooperative, needs technical assistance and support to help manage the transition from a community based organization to a national financial institution.

(e) Utilize the resources available through the international credit union system to assist in providing necessary expertise.

7.86 **Other Financial Institutions.** These organizations balance their need for self-sufficiency with a mandate to provide financing that is more socially driven.

(a) The financial institutions may be able to develop collaborative programs with some of the business support **NGOs**. They may also want to include the banks in discussions on how financial services can be increased to **MSMEs**.

(b) **SBGT**, as the most recent institution to be established needs to dramatically increase in scale to achieve self-sufficiency -- balancing its mandate to work with small and micro-scale businesses with the profitability provided by larger volumes of businesses. Success will depend on its ability to serve the market in a cost efficient manner, providing loans and expertise better than the money lenders while facilitating (and/or developing) other financial services required by its clients.

(c) These organizations need to identify ways to provide equity capital for those businesses which have the capacity for growth but can only obtain debt from the formal sector.

7.87 **Business Support Organizations.** Improve the collaboration between **NGOs** to avoid duplication, minimizing costs, and increase services to the Swazi people. **MSMEs** need training support, technical assistance and management advice, as well as financial services.

(a) The business support organizations need to better define and improve their services to **MSMEs**. The Swaziland Chamber of Commerce is a well intentioned organization, but it's membership base needs to think about how they can serve in a mentoring capacity for Swazi businesses that have superior potential. Sibako Chamber of Commerce

appears to be in a state of transition and needs to develop the types of programs to support business development (market development, group purchasing) rather than compete with **NGO** finance and training activities. The restructuring of **SEDCO** could also permit it to expand and improve support services.

(b) Training organizations such as **BMEP** need to be sustainable as they expand their adult training programs as well as influence the national student curriculum.

Table 7.6: Comparison of Financial Services, to the MSME Sector

	Capital for MSME's	Loan Amount	Loan Terms	Interest Rates
Tibiyo	E8.0 million		n.a.	n.a.
SIDC	unknown	min E100,000	Average 8 years	15-16%
SACCOs	E16.8 million	multiple of shares		3% per month 9% + 1% each additional month (36 m. = 42%=14%/year)
Asikhutulisane	E9.7 million	Average E5,000; up to 3 times shares	1-3 months 4-36 months	
CB Export Scheme	E15 million (can leverage E45 million)	Up to E2 million		
CB Small Scale	E4 million (can leverage E12 million)	Up to E100,000	1 to 5 years	
Swazi Bank	E4.7 million	Up to E50,000		19%
SBGT	E1 million (other sources of financing likely shortly)	E2,000-E7,500	90 days	33% + 10% fee
BMEP	E200,000	E750 - E3,500		21%
BWAS	E73,000	Up to E3,000	6 months	5% per month
Imbita	E30,000	E1,500		30%

CHAPTER EIGHT
HOUSING FINANCE

8.1 The Swaziland Building Society (SBS) is prominent among the financial institutions in Swaziland involved in mortgage lending. SBS has played a significant role in providing mortgage lending to middle and lower-income groups -- it has grown at an average rate of 22 percent per annum over the last five years and has managed to maintain a satisfactory rate of return on capital. However, since the SBS must depend on retained earnings to increase its capital base, growth rates similar to those in the recent past are not sustainable from a prudential point of view. The Building Societies Act has recently been amended to allow the building society to diversify its lending and deposit structures. Given its size, and the limitations imposed upon it for continuous rapid growth, support for mortgage lending must also come from the remainder of the financial system.

8.2 Currently, commercial banks in Swaziland undertake very little mortgage secured lending. However, new capital adequacy requirements have been set by the Central Bank, in conformity with the Basle Accord which may have some beneficial impact upon mortgage lending by commercial banks. Under these risk weighted capital requirement, mortgage lending only requires a 50 percent capital backing compared to 100 percent capital backing for most other loans. Thus, in order to minimize capital requirements, banks may be more attracted to mortgage lending. Such a trend has taken place in South Africa in the recent past. At less than 1 percent, currently, very little bank lending is for mortgages (especially compared to South Africa, for example, where mortgage financing represents about 40 percent of total commercial bank credit). Nonetheless, with the right incentives, it is conceivable that commercial banks could increase their mortgage lending to 10 percent of total lending, which could translate to over E30 million of approvals per year. The SBS at present has a new mortgage commitment level of about E24 million per year. This amount, plus additional funds from the Building Society could go a long way toward meeting future housing mortgage demands. Pension funds also have significant resources which could also be a source of long- and medium-term resources for the nascent capital market in the country, and for the creation of a secondary mortgage market. Commercial banks have expressed interest in establishing mechanisms for securitizing mortgages to tap these resources and those from other investors.

A. MIDDLE AND LOW INCOME HOUSING

8.3 The National Housing Board (NHB) was created as a parastatal in 1988 to take over the functions of the Industrial Housing Company (IHC). The principal business of the IHC had been to develop and manage the Government's rental housing units.[1] The NHB's mandate is to develop affordable housing solutions and to continue managing the Government's rental housing stock, but only as a secondary business. As a financially independent developer and manger of real estate the NHB is mandated to cover all of its costs by charging appropriate development fees as part of the total project costs of the new projects it develops -- and by charging rent for property it owns. Thus, NHB's role is that of a developer of affordable housing projects -- not that of a financial institution for mortgage lending -- although it can assume short-term debt to finance its construction activities. Beneficiaries of NHB projects seek mortgage financing directly from financial sector institutions. Using this approach, the NHB has carried out several

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1 Although IHC was performing satisfactorily, its mandate was limited and dependent on Government loans for the development of rental properties. As rents received were insufficient to repay loans the debt service was waived by the Government. However, the end result was that few units were produced and its main objective (to provide low-income housing) was largely unmet.

housing schemes. These have tended to be mainly for Government employees in the middle-income range and mortgage loans for the beneficiaries of these estates have been provided by a number of financial intermediaries.[2] While the technical capacity exists, questions remain as to NHB's ability to reorient itself to cater to the lower-level income household market at the pace required.

B. THE HOUSING FINANCE INSTITUTIONS

8.4 Housing mortgage loans in Swaziland have mainly been provided by two financial institutions: the Swaziland Building Society (SBS) and the Swaziland Development and Savings Bank (SDSB). In addition, commercial banks have been involved in mortgage finance -- albeit on a small scale considering their large asset base. The commercial banks have also tended to lend to higher income groups.

8.5 The **Swaziland Development and Savings Bank (SDSB).** In 1995, SDSB's portfolio was 10 percent in agriculture, 32 percent in commerce, 13 percent in manufacturing,, 32 percent in housing, and 13 percent in "other" activities. Of the housing portfolio, well over half was for the Government's Civil Service Housing Scheme which is managed on an administrative basis (with no credit risk to SDSB). However, as indicated in Chapters Three and Four, the SDSB has been plagued by poor profitability, a weak portfolio, and declining liquidity. Until these problems have been addressed, the SDSB can only continue to serve as a channel for mortgage finance funding, since it does not have the liquidity to contribute significantly to mortgage lending from its own resources.

8.6 The **Swaziland Building Society (SBS)** is capitalized by accumulated retained earnings and by long-term deposit instruments of varying maturity called permanent, fixed and subscription shares. To date SBS has concentrated on providing mortgage financing to mainly middle-income families and individuals. As a specialized institution it is the single most important source of mortgage financing available in Swaziland. SBS's financial performance is exemplary. Over 1990-95, SBS's total assets have grown at an average rate of 22 percent annually -- considerably above the rate of inflation. At the same time, SBS has managed to maintain high levels of liquidity, a sound portfolio quality (no repossessions to date) and a high net income, (averaging almost 28 percent of reserves and retained earnings annually for 1990-95), and modest administrative costs, averaging only about 3 percent of total assets (see Table 8.1).

8.7 SBS's mortgage portfolio has grown from E22 million in 1988 to almost E120 million in 1995[3], and is now more than twice the mortgage portfolio of the SDSB and the commercial banks combined. SBS deposit interest rates are comparable to those paid by commercial banks, but its gross spread tends to be lower (4 to 5 percent of average assets -- compared to 6 percent for commercial banks). However, SBS is unique in providing long-term deposit instruments in the form of permanent and fixed shares[4] which pay higher interest rates than savings and time deposits available from commercial banks and the SDSB.

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2 For a recently completed NHB housing scheme 55 percent of the mortgages were financed under the Civil Service Scheme (Channeled through the SDSB), 18 percent were financed by commercial banks, and 9 percent and 3 percent by SBS and directly by SDSB, respectively.

3 The SBS has about 1,500 mortgages.

4 Dividends on shares are tax free up to E10,000. Tax is due on interest earned on savings and fixed term deposits. SBS is exempt from income tax.

Table 8.1: Swaziland Building Society
Audited Financial Statements, 1988 to 1995

	1988	1989	1990	1991	1992	1993	1994	1995
Income Statement								
Interest Income	3,248	4,207	6,756	10,410	15,304	17,634	18,493	19,875
Interest/Dividend Expense	2,025	2,824	4,701	7,187	11,175	12,855	12,587	13,859
Gross Spread	1,223	1,383	2,055	3,223	4,129	4,779	5,906	6,016
Other Income	190	346	429	678	597	996	1,550	1,711
Administrative Expenses	1,040	1,267	1,648	2,455	3,263	4,174	4,785	5,781
Depreciation	125	142	215	352	453	527	676	589
Provisions	0	0	0	0	0	0	0	0
Net Income	248	320	621	1,094	1,010	1,074	2,237	2,249
Transfer to Reserves	245	317	621	1,110	1,011	1,057	2,274	2,243
Retained Earnings	3	3	0	-16	-1	78	41	47
Ratios								
Gross Spread as % of Average Total Assets (ATA)	4.00	3.89	4.14	4.45	4.15	3.79	4.14	3.87
Administrative Costs as % of ATA	4	4	3	3	3	3	3	4
Net Income as % of Average Reserves	16	18	28	35	24	21	32	25
Interest Income as % of Avg Mortgages, Loans, Cash	13	13	15	15	17	15	14	14
Interest/Dividend Expenses as % of Avg Deposits & Shares	8	9	10	10	12	11	10	9
Spread	5	5	5	5	5	5	5	5

SOURCE: Swaziland Building Society, Annual Reports, 1988 to 1995.

8.8 Most of the recent growth of SBS has been financed by increases in savings deposits and fixed period shares, at the expense of reserves and permanent shares. Thus, long-term funding, in the early part of the 1990s, represented a lower percentage of total funding than what it had done in previous years. Amendments to the Building Society Act now require that SBS's capital (reserves, retained earnings and permanent shares) be at least 25 percent of the sum of savings and fixed deposits, plus shares expected to be redeemed within 3 years. In accordance with the amendments introduced to the Building Society Act, capital adequacy is based on the Basle Convention in compliance with the Central Bank's capital adequacy requirements. On this basis, SBS's capital adequacy decreased as a result of recent rapid growth up to 1993. However, SBS reserves and retained earnings rose to represent 8 percent of risk assets (mortgages) in 1994 and 1995 (see Table 8.2). From a prudential point of view, further growth in SBS's assets will need to be accompanied by a commensurate growth in its capital base.

8.9 In addition, recent rapid growth also demands a strengthening of SBS's institutional structure.[5] The SBS has taken measures to increase it mortgage handling capacity by introducing a computerized system, streamlining application procedures, increasing the number of qualified

[5] At present SBS has 5 branches, the Manzini area office and the head office in Mbabane supporting over 63,000 client's savings, fixed deposits and share accounts and approximately 1,300 mortgages. SBS has a staff of 84.

staff and expanding the physical premises. When all of the financial, physical and operational improvements are in place, SBS expects to be able to increase its processing capacity to about 900 mortgages per year, by 1996, from about 430 in 1994 (about E43.6 million per year). SBS's approach to reaching the lower-income strata with mortgage lending would be primarily through employer-assisted schemes. Under some schemes, companies provide financing to SBS to on-lend to their employees. Both the lending interest rate to SBS and to the beneficiaries have been pre-negotiated so that the mortgage interest rate is subsidized and becomes additional compensation to employees.

Table 8.2: Swaziland Building Society Balance Sheet, 1988 to 1995

	1988	1989	1990	1991	1992	1993	1994	1995
Assets								
Cash with Banks	6,287	7,649	16,288	16,601	28,639	24,171	31,806	29,284
Debtors & Interest Receiv'l	180	269	415	688	696	404	361	416
Mortgages	21,984	27,554	39,528	61,468	75,751	100,167	101,809	118,930
Short Loans	0	7	55	521	1,139	1,709	2,246	3,012
Investments	1,304	869	709	709	709	709	209	69
Fixed Assets	2,234	2,733	3,178	4,565	7,356	10,416	11,216	11,248
TOTAL ASSETS	31,989	39,081	60,173	84,552	114,290	137,576	147,647	162,959
Liabilities								
Fixed Deposits	9,710	10,586	21,059	27,772	29,866	30,497	29,770	32,938
Ordinary Savings	4,620	6,493	9,017	27,601	17,715	57,334	64,551	70,823
Special Savings	4,332	5,561	5,981		25,921			
Interest Payable	579	1,037	1,713	2,404	2,697	2,328	1,970	1,762
Total Deposits	19,241	23,677	27,770	57,777	76,199	90,159	96,291	105,523
Permanent Shares	7,611	9,142	11,464	13,568	17,501	26,214	28,164	32,657
Fixed Period Shares	1,850	2,202	6,121	5,655	10,223	8,330	8,073	7,853
Subscription Shares	905	1,176	1,910	3,399	4,988	6,077	6,263	5,848
Total Shares	10,366	12,520	19,495	22,622	32,712	40,621	42,500	46,358
Dividends Payable	490	672	88	177	283	455	296	282
Creditors and Accruals	226	219	213	275	385	556	538	572
Reserves	1,591	1,908	2,529	3,639	4,650	5,707	7,981	10,176
Retained Earnings	75	78	78	62	61	78	41	48
TOTAL LIABILITIES	31,989	39,074	60,173	84,552	114,290	137,576	147,647	162,959
Ratios								
Growth in Total Assets (%)	21	22	54	41	35	20	7	10
Liquid Ratio (2)	24	22	28	20	26	18	22	18
Reserves & Retained Earnings as % of Risk Assets	8	7	7	6	6	6	8	8

SOURCE: Swaziland Building Society, Annual Reports, 1988 to 1995

8.10 As a result of perceived competitive pressures from the banking sector and relatively lower and more volatile margins compared to other deposit taking institutions, SBS contracted a management study in 1991 to review strategic directions for the Society. The study's recommendations resulted in the introduction of a number of changes to the Swaziland Building Society Act to (a) allow SBS access to relatively cheaper funding available through call, time and fixed deposits of less than one year maturity; (b) expand the scope of housing and

construction lending to include both low cost housing and joint venture financing of bigger projects; (c) increase its capital to allow for long-term growth and to provide for greater protection against credit risk; (d) allow the same alternative investment opportunities abroad as are available to commercial banks; and (e) improve risk management and reporting requirements with CBS. The end result of these changes has been to "level the playing field" vis-à-vis the other banking institutions in many areas (except for tax exemptions to share investors and SBS's tax exempt status).[6] It is expected that, with these changes, SBS will be able to continue its growth. Importantly, it could be the major player in the provision of mortgage financing to small and medium scale house builders and buyers.

8.11 **Commercial Banks**. The four main commercial banks (Standard Chartered, Stanbic, Barclays and First National) are majority owned by large foreign banks, local investment companies and pension funds, with some minority Government ownership (except FNB). The commercial banks are competently staffed, well-organized with modern accounting and management information systems, and operate through more than 20 branches in Swaziland. The commercial banks have traditionally engaged in short term financing. In Swaziland a significant part of their operations are with larger companies, and the largest share of their portfolio is in manufacturing. The financial structure of the commercial banks is characterized by relatively few, large, short-term deposits (savings deposits represent less than 17 percent of total deposits). On the other hand, the assets of the banks are mainly short-term loans and advances.

8.12 In terms of housing finance, none of the commercial banks have a significant mortgage portfolio. Land ownership is of particular concern.[7] Without a firm title of a transferable long-term lease, banks will generally not provide financing. As with SBS, the commercial banks have been involved in financing mortgage lending through company housing schemes -- whereby the company provides additional guarantees, if required. Collection is typically undertaken through the company payroll. Banks are willing to continue with this type of lending as they consider it a safe type of lending with minimum administrative costs.

8.13 Banks may be prepared to increase their mortgage lending portfolio in the light of the new capital adequacy requirements. In South Africa, commercial bank lending increased rapidly following the introduction of the Basle criteria for capital adequacy -- which applies a weight of only 50 percent to mortgage loans, compared to 100 percent for other types of lending. This means that banks are able to support a larger portfolio with the same capital base. The banks are also concerned that the amendments to the Building Society Act will allow the SBS to compete for short-term deposits while keeping a comparative advantage in tax breaks, particularly for long-term share deposits. Commercial banks feel that to "level the playing field" either these tax incentives should be removed or the same tax breaks given to their longer-term depositors. The commercial banks may well be prepared to issue medium to long-term "housing certificates" with the same tax break given to SBS shares.

8.14 Nevertheless, even without these longer-term instruments, commercial banks have some room in their borrowing maturity risk profile to increase mortgage lending. Loans and advances

[6] In RSA the building societies offer limited tax-free investment, and are not tax-exempt on their income. The building societies have gone into traditional commercial banking and the commercial banks have become the main providers of mortgage financing in the country.

[7] Commercial banks seem to be particularly concerned about the Land Decree of 1988 which in effect removes the security of tenure to freehold land, as the King is empowered to cancel any registered right in land including the right to mortgage. This decree has never been used, but the threat still exists.

have been increasing at a compounded annual rate of about 13 percent in the 1992-1995 period, which translates to about E72 million per year. If only 10 percent of this amount was for mortgage financing, this would result in E7.2 million in new mortgage loans per year. In addition, the commercial banks have expressed some interest in securitizing mortgages -- possibly through a trustee company which would market mortgage-backed bonds to the pension funds[8] and other investors. This, of course, can only work if attractive yields can be earned by potential investors. It would therefore be difficult to set up such an arrangement with any subsidized interest rate scheme, such as the Government's Civil Service Housing Scheme.

8.15 In order to implement a secondary mortgage market, existing legislation would need to be reviewed to determine amendments or new legislation that would be required to regulate and stimulate the formation of such a market. Also the appropriate mechanisms would need to be designed in collaboration with the commercial banks and the Swaziland Building Society. Given current conditions in Swaziland, and the prospects of a larger demand for mortgages generated through the World Bank's Urban Project, the creation of a secondary mortgage market appears feasible, subject to the results of the above studies.[9]

C. DEMAND FOR HOUSING AND AFFORDABILITY

8.16 The main constraint to housing development is the availability of land. Swazi Nation Land, which is held in trust by the King, covers about 60 percent of the country and is, at the moment, not accepted as collateral by financial institutions. Most of the land surrounding urban areas is Swazi National Land and is occupied by Swazi nationals who do not have title and therefore access to mortgage financing. Under current Government plans, a total of about 11,000 serviced sites are to be developed in two phases. Although the King has indicated that the required land for the proposed project will be available, there are indications that the land titling or leasing process will not be easy. Given the existing magnitude of the housing demand, the land issue needs to be resolved, while at the same time stimulating the system to provide the appropriate financing.

8.17 In the past, the Government has provided subsidized financing -- principally through the SDSB. However, given anticipated budgetary constraints this is not a viable solution for the longer-term. Unfortunately, because of the Government's interest subsidy for housing, Government workers (which represent a significant percent of the workforce) have become accustomed to houses which they would otherwise not have been able to afford. A process of educating people to accept "affordable" housing will be necessary if the housing shortage is to be resolved. It must be made clear that any subsidized housing scheme is, in fact, additional compensation to the employee which can and should be quantified. The Government's Civil Service Scheme until now has been limited because of the unavailability of land for housing, but if a significant number of new sites are developed (as proposed), the demand for finance could expand very rapidly. It is important to impute the actual cost of the scheme to the Government and the implications for the Government budget. In some countries, not only is this cost quantified, but it is accounted for as additional taxable income.

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[8] The National Provident Fund (the country's largest) has expressed interest in buying such mortgage backed instruments, provided that the yield is attractive and the loan servicing is carried out by others.

[9] The possibility of setting up a rediscount window earmarked exclusively for mortgages to the target beneficiaries has been discussed with the CBS, however, with present levels of liquidity, this approach appears unnecessary at this time.

8.18 Based on a recently updated urban housing survey,[10] about 60 percent of the working population has a family income of less than about E824 (about US$290). Assuming that this is average target group for middle income home buyers -- with an interest rate of 15 percent and an amortization period of twenty years -- the maximum house price that this group would be able to afford is about E27,000. This would result in a mortgage of about E20,000 (with 25 percent down payment) and monthly repayments of E267 representing about 32 percent of monthly income (see Table 8.3 for other calculations). The volume of total lending required for the Government/World Bank project -- assuming a two-phased approach with the first phase of about 6,000 services sites completed by 1997 -- would be E120 million (E20,000 x 6,000), which could feasibly be financed if the commercial banks become actively involved. Following the implementation of SBS's institutional and financial improvements the society would also be able to play a more active role. Nonetheless, it remains crucial to stimulate the interest of the remainder of the banking system in mortgage lending.

D. CONCLUSIONS

8.19 A number of actions could be carried out by the Government and the Central Bank of Swaziland to stimulate the banking system to undertake more mortgage lending:

(a) expedite the implementation of the Basle Accord which bases capital adequacy on the risk weighting of banks' assets (with a lower risk weighting for mortgage finance);

(b) stimulate the creation of new longer-term deposit instruments for banks by allowing them to issue, for example, "housing certificates" with the same tax status provided to "share" investors in the SBS;

(c) carry out a study of existing legislation to determine amendments or new legislation needed to regulate and stimulate the capital market and the formation of a secondary mortgage market;

(d) in parallel with (c) carry out, in collaboration with commercial banks, SBS and the stock market, the design of a secondary mortgage market mechanism to allow the recycling of funds to the banking system (including (SBS); and

(e) assist SBS and the commercial banks, to carry out the necessary institutional and financial improvements to increase their mortgage lending capacity, particularly to target income groups.

[10] Carried out by Dr. Maeka Hoek Smit.

Table 8.3: Housing Loan Repayment Schedules
(assuming 15 percent annual interest rate and 25 percent down payment)

Monthly Payment as a percent of these Monthly Individual Incomes (based on Government scale)

	Total Sales Price E	25% Down Paymt E	Loan Am'nt E	Mths to repay loan	Mths to save Down Pment	Mthly Pay ment E	456 4	488 5	523 6	559 7	599 8	663 9	735 10	824 11	912 12	1010 13	1103 14	1234 15
A Enhanced	15,000	3,750	11,250	240	25	148	32%	30%	28%	27%	25%	22%	20%	18%	16%	15%	13%	12%
B Enhanced	17,000	4,250	12,750	240	25	168		34%	32%	30%	28%	25%	23%	20%	18%	17%	15%	14%
C Enhanced	19,000	4,750	14,250	240	25	188				34%	31%	28%	26%	23%	21%	19%	17%	15%
D Enhanced	21,000	5,250	15,750	240	25	207					35%	31%	28%	25%	23%	21%	19%	17%
E	23,000	5,750	17,250	240	25	227						34%	31%	28%	25%	22%	21%	18%
E Enhanced	25,000	6,250	18,750	240	25	247							34%	30%	27%	24%	22%	20%
F	27,000	6,750	20,250	240	25	267								32%	29%	26%	24%	22%
F Enhanced	30,000	7,500	22,500	240	25	296									32%	29%	27%	24%
G	32,000	8,000	24,000	240	25	316									35%	31%	29%	26%
G Enhanced	35,000	8,750	26,250	240	25	346										34%	31%	28%
X	40,000	10,000	30,000	240	25	395												32%
Y	50,000	12,500	37,500	240	25	494												
Family Incomes							456	488	523	559	599	663	735	824	912	1010	1103	1234
Income Percentiles for Mbabane/Manzini							34th	38th	41st	43rd	46th	49th	53rd	60th	64th	69th	73rd	79th
Government Salary Scale (% below given grade)							2.6	6.3	8.2	10.5	10.6	12.6	16.1	22.2	45.2	49.8	57.5	73.4

Notes:

1. Up to 35 percent of monthly family income may be available to repay a loan.
2. Target family income E559 to E1,103 equal to $200 up to $394.
3. "Months to Save" is the down payment divided by the normal monthly payment.
   Higher income participants will be able to save the minimum down payment in a shorter period.
4. Does not include monthly or annual charges for water, electricity, insurance, ground rental, and other services.
5. First income distribution data based on Maeja Hoek Smit's Housing Survey update of 1992
   carried out in low income housing areas in both Mbabane and Manzini.

CHAPTER 9
CLOSER ASSOCIATION OF THE SWAZI FINANCIAL SYSTEM WITH SOUTH AND SOUTHERN AFRICA

A. IMPACT OF A CHANGING SOUTH AFRICA

9.1 The Swaziland economy is equivalent to slightly less than one per cent of the South African economy and its per capita income in 1993 was approximately 40 percent of the per capita income of South Africa. Strong linkages exist between the two economies, particularly in the area of trade. Swaziland is landlocked with roughly seventy five per cent of its borders shared with South Africa, the balance being the border with Mozambique.

9.2 The single most important factor to be taken into account in nearly all business decisions taken in Swaziland, is the impact of South Africa on the outcome of the decision. South Africa constitutes perhaps the most important risk and the most important opportunity in every situation. In summary, economic events in South Africa frequently have a very significant impact on the economy of Swaziland.

9.3 From a Swazi perspective, the dramatic changes which have occurred in South Africa since April 1994 (when South Africa had their first all-race elections), must cause some concern. For example, there is concern that the new government in South Africa will renegotiate certain trading relationships, especially those relating to the Common Monetary Area (CMA) and the Southern African Customs Union (SACU). Once the arguments for and against closer linkages with South and Southern Africa have been considered, the inevitable conclusion is that Swaziland has relatively little choice but to accept greater integration into the regional economies (not just South Africa) and position itself to capitalize on the close association.

B. THE COMMON MONETARY AREA AND ITS IMPACT ON MONETARY POLICY DEVELOPMENT

9.4 Between 1910 and 1960 there were no restrictions on the transfer of money and capital within the area encompassing South Africa, Swaziland, Lesotho and Botswana -- the currency in use was the pound sterling -- with the South African rand replacing sterling in 1961. This arrangement was formalized in 1974, in an attempt to overcome the lack of monetary discretion in the smaller countries, the net outflow of savings from those countries to South Africa, and the lack of institutionalized consultation. The agreement was subsequently amended in 1986 and in 1992 (to allow for Namibia's participation).

9.5 The objectives of the original agreement were to:

(a) maintain a common monetary area
(b) formalize monetary arrangements in the region
(c) provide for sustained economic development in the region, through the unimpeded flow of funds
(d) promote economic development in the less advanced member countries - through their access to the South African capital and money markets (under certain conditions which have been designed to avoid crowding out South African borrowers)
(e) afford all parties equitable benefits from the development of the region as a whole
(f) enable each party to exercise monetary policy and to control its financial institutions
(g) allow South Africa to retain overall control of rand currency issue, gold reserves and foreign exchange reserves for the region as a whole.

9.6 Changes to the agreement have allowed Swaziland the freedom to determine the external value of its currency on the basis of its own economic circumstances and to remove the requirement for a rand backing of its national currency (see Chapter Two). In addition, foreign exchange reserves were separated from those of South Africa and foreign exchange regulations could also be altered without prior consultation. The objectives of the 1974 agreement have been largely achieved with Swaziland's degree of monetary discretion increasing, and its ability to control its own financial institutions enhanced.

9.7 Complete monetary control, however, is not achievable in a monetary union because of the existence of regional currency convertibility, fixed exchange rates and regional capital mobility. The exercise of monetary discretion by Swaziland must therefore revolve around the manipulation of the internal interest rate structure and influencing the liquidity position of the financial sector.

C. THE SOUTHERN AFRICAN CUSTOMS UNION – FISCAL POLICY DIMENSIONS

9.8 The first formal agreement which laid the foundations of SACU was signed in 1910 when the Union of South Africa was formed. This agreement has been amended and renegotiated in 1911-13, 1969 and 1975. The major objectives of the 1910 agreement required the free flow of goods among the member countries, a common tariff, with the smaller countries (including Swaziland) agreeing to maintain a custom duty structure similar to that in South Africa at all times.

9.9 The objectives of SACU are, *inter alia*, to encourage economic development in the area as a whole, to promote development and industrial diversification in the lesser developed members as well as sharing equitably the benefits of trade. More specifically, the agreement allows for:

(a) The free movement of goods
(b) Freedom of transit
(c) Industrialization of the smaller countries behind protective tariffs for the region as a whole and certain South African industries for limited periods
(d) Preferential sharing of pooled custom union revenues (comprising levies on imports from outside the union and excise duties on goods produced within the union)

9.10 The agreement implies a loss of fiscal discretion as well as price raising effects in the smaller countries when cheaper sources of supply in the rest of the world became inaccessible or more expensive.

9.11 The union does appear to have achieved its stated objectives and the African Development Bank concluded in a 1993 report[1] that the agreement has not retarded growth and development in Swaziland, and the other small countries, in any significant way -- with Swaziland actually increasing its share of secondary production (including manufacturing). Yet, diversification of the smaller economies has lagged far behind that of South Africa.

9.12 The implications of the union include the fact that prices charged in this area are typically higher than in the rest of the world as a result of the protective tariff wall and revenue-raising excise duties. The net importer position of the smaller countries in the region means that South African industries could have effectively been subsidized by residents of the smaller countries.

9.13 In addition to the customs union agreement which has allowed for the greater mobility of goods across borders, migrant laborers have also had access to South African labor markets (mainly the mines) remitting approximately R40 million per annum during the 1980s.

[1] ***Economic Integration in Southern Africa,*** Volume I, 1993, African Development Bank.

D. ARGUMENTS IN FAVOR OF CLOSER LINKAGE WITH A CHANGING SOUTH AFRICA

9.14 South Africa is the economic powerhouse of the Southern African region -- and arguably of Sub-Saharan Africa. In most areas, the sophistication of its financial sector compares favorably with that of the developed economies. This holds the potential for relatively easy access to capital markets by its neighbors. A prerequisite, however, is that the necessary financial infrastructure and discipline, as well as the appropriate legal and accounting frameworks should be in place in Swaziland.

9.15 In view of the political changes which have taken place in South Africa, the perceptions of international investors regarding the investment potential of South Africa has improved significantly. To some extent this will be to the detriment of Swaziland, as potential non-South African investors could possibly now prefer to invest in South Africa, rather than in Swaziland.

9.16 However, from a macro perspective, Swaziland probably has more to gain from the recent improvement in the investment potential of South Africa, over the longer term. Factors such as the enhanced growth potential of the South African economy, its technological expertise and infrastructure, the growing internationalization of South Africa and the spin-off benefits from the South African Reconstruction and Development Program point to a rosier future for the region. In addition, South Africa has followed a conservative monetary policy in recent years -- aimed at the internal and external stability of the currency -- with the benefits of this policy automatically flowing through to Swaziland.

9.17 South African investors, on the other hand, are perhaps of late also less keen to invest in Swaziland, owing to the fact that investment into Swaziland was often motivated by the need to overcome the problems caused by the pariah status of South Africa. This motivation has now fallen away.

9.18 The benefits that could be derived from a closer linkage could be summarized as follows:

(a) access to a wide range of financial institutions and financial markets
(b) reduction of development costs for computer systems and other technology
(c) access to financial know-how that is attuned to the needs of the region
(d) utilizing the financial infrastructure in South Africa rather than developing similar structures in Swaziland - obtaining economies of scale in the region

E. ARGUMENTS AGAINST CLOSER LINKAGE WITH SOUTH AFRICA

9.19 In any economic union, the potential for adverse political developments in a neighboring country should always be considered. If the neighbor to which the country is linked is stable in all respects, less emphasis need to be placed on this aspect. South Africa, however, has only recently emerged into a democratic culture and the politics of protest might have adverse consequences for some time to come. Too close a link, at this stage, could result in the importation of instability into Swaziland.

9.20 Close linkage could result in losing control over a country's own financial management. Much greater independence could be achieved in formulating monetary and other financial policy, if the financial environment is sufficiently delinked. Delinking from South Africa, could enable Swaziland to hold a greater amount of hard currency assets -- although this is a goal that should be pursued, even if the status quo is maintained. At the same time, import costs could be lowered, but exports might become uncompetitive.

9.21 However, with significantly smaller levels of reserves than Botswana, Swaziland does not have the same flexibility in coming to a decision on delinkage. A realistic approach would be to acknowledge that Swaziland is an island in a sea surrounded by South Africa, and that it will therefore always be closely associated with that country. This reality and the potentially negative impact that it will necessarily have on national independence, should be turned into an advantage by searching for all the areas where Swaziland can turn its somewhat forced linkage into a competitive advantage. The following areas of linkage can be identified:

(a) **financial sector:** (i) monetary policy; (ii) fiscal policy and the Customs Union; (iii) exchange control; (iv) the legislative environment; (v) financial regulation and supervision; (vi) money, capital and equity markets; (vii) investment policy - inwards and outwards

(b) **other:** (i) exports of manufactured goods; (ii) imports of South African products; (iii) tourism; (iv) migrant labor

9.22 Financial sector aspects (related to the topics from monetary policy to financial regulation) are discussed below.

F. CAPITALIZING ON THE FORCED LINKAGE

9.23 It is vital that Swaziland should pursue policies, provide infrastructure and implement an investment regime which are conducive to attracting foreign investment into the country. As a developing country, Swaziland is in need of capital. The question that has to be answered, however, is why Swazi and other institutional investors would choose to invest in Swazi enterprises if they can get better returns in South Africa?

9.24 In attempting to answer these questions, the Ministry of Finance's request for specific emphasis on the following areas are to be noted:

(a) where should the financial sector be going?
(b) what institutions and instruments should be in place?
(c) what should the interrelationship and interdependence with South Africa be?
(d) how could the financial sector be broadened and deepened?

9.25 **Monetary policy.** Future arrangements regarding the Common Monetary Area should focus on a higher level of monetary integration, with the provision that fiscal and monetary policies in South Africa remain within tight parameters -- which the smaller countries have a say in defining. It must be emphasized that policy co-ordination implies more than simple consultation. It requires that all partners be willing to forego a measure of sovereignty in the interest of maximizing benefits to the region. Concerns which had existed prior to 1974, therefore, need to be revisited from time to time to ensure that they are not lost sight of in future decision making.

9.26 Even if the need for an independent monetary policy becomes less obvious, the ability to conduct economic research and formulate policy should remain intact.

9.27 **Fiscal policy and the customs union.** The inherent stability of the union as portrayed by its long life-span, suggests that member countries could strive for an even higher form of regional economic integration. In this regard greater access to the financial facilities of the Development Bank of Southern Africa should be an integral result of closer co-operation.

9.28 The continuous contact among the representatives of the member countries should lead to greater co-ordination of fiscal and monetary policies to ensure that any adverse impact of changes in fiscal policy in South Africa be minimized.

9.29 Some commentators have expressed the opinion that the Customs Union Agreement is skewed in favor of Swaziland, and that South Africa might wish to renegotiate the agreement in order to redress the imbalance. Other commentators, of course, argue the contrary and feel that the sum balance of the agreement has been to favor development in South Africa over the development of the smaller participating countries. However, given that the receipts which accrue to Swaziland from this agreement are equivalent to almost the total amount of its budget income from sources within Swaziland, the importance of this source of revenue cannot be overstated. Hence, pro-active action to address any threatened reduction in revenue from this source is required as a matter of great urgency.

9.30 Fiscal restraint in Swaziland should provide it with a competitive advantage in a region where pressure will continue on neighboring governments -- particularly South Africa -- to address past discrepancies.

9.31 **Exchange control.** The question of exchange control is also of particular importance -- especially the concern that Swazi citizens and Swaziland registered companies are not able to hedge their exposure to the South African economy by making investments outside of the Common Monetary Area. It is of vital importance that Swaziland should develop appropriate responses to the threat that an over exposure to South Africa, poses to Swaziland. In addition, appropriate responses should also be developed to the potential abolition of exchange control by South Africa.

9.32 **The legislative environment.** The Ministry of Finance wishes to establish a legal framework that is conducive to an environment facilitating development and growth. However, changes to financial (and other) legislation appears to be difficult to achieve in the current environment. The process for approval of new legislation (including amendments) should therefore be reviewed to ensure that the process remains responsive to changes in the financial environment. In this regard the outdated Company Legislation and the Insurance Legislation should be specifically addressed as a matter of some urgency.

9.33 One way of achieving faster legislative responses to the changing financial environment, is to synchronize, to the extent possible, financial legislation in Swaziland with South African legislation. This could help ensure ease of entry for branches of companies already established in that country, possibly by specifically allowing branches of financial intermediaries (such as banks, insurance companies, financial brokers) the right to operate in Swaziland -- subject to a screening of the integrity and competence of the management of such intermediaries.

9.34 The benefit of such an approach would be to reduce the development and research costs related to new financial legislation and ensure compatibility for any company wishing to establish itself in the region. In addition Swazi citizens will benefit from the better banking services that increased competition and international participation will produce.

9.35 **Financial standards regulation and supervision.** Bank supervisors in Southern and Eastern Africa have already agreed on a common philosophy to financial regulation and supervision and have established a co-operative training venture that is offering its second round of courses during 1995.

9.36 As financial regulatory returns in Swaziland are currently in need of review, the authorities are presented with an opportunity to reduce time and costs, by adopting regulatory (prudential) returns that correspond with those of South Africa, enabling duplication of computer processing systems already in use in that country. In addition, the actual bank supervisory procedures could be limited to liquidity monitoring (if branches are allowed), as the home country would take responsibility for solvency monitoring, in terms of the Basle Concordat. This approach, suggested for the banking environment, could be further replicated for other financial intermediaries.

9.37 By already ensuring that the accounting and auditing profession adheres to the same standards as their South African and international counterparts, Swaziland must simply continue to require ***and enforce*** high standards of auditing, and good disclosure, in terms of the International Accounting Standards.

9.38 **Money, Capital and Equity Markets.** South Africa has well developed financial markets. The trend internationally is to minimize the number of regional financial markets (as per the German stock market experience) in favor of electronic trading in a centralized exchange. Swaziland could link itself to the Johannesburg Stock Exchange (by listing its securities on that exchange) and money and capital markets -- thereby placing itself in a position whereby it could be considered by international fund managers and other investors. Not only are the potential benefits of attracting international capital obvious, but investment in local infrastructure can then be more efficiently allocated.

9.39 Linking to the South African markets does not, however, imply that the development of appropriate financial instruments for the funding of local projects would be ignored. Indeed, the contrary is true. The harmonization of financial legislation for the issue of financial instruments such as commercial paper and bonds will bring benefits, not only to Swazis looking for capital outside of the country, but also for Swazi investors investing in their own country (within internationally accepted prudential norms).

9.40 **Investment Policy -- inwards and outwards.** To facilitate investment and to assist the establishment of new businesses, consideration should be given to a one-stop investment center, where all permits, including work and residence permits for expatriate employees, could be obtained within a specified period -- after which approval becomes automatic if no response is received to the contrary.

9.41 Investment is not encouraged by the requirement that assets must be employed locally -- the business environment and infrastructure must be conducive. By creating an open environment, encouraging free capital flows, and minimum taxes on financial instruments -- while at the same time improving infrastructure and stability -- appropriate signals will be sent to the investing community.

9.42 Contractual savings, in the past, have however been mainly invested in South Africa, as a result of considerations such as exchange control and the limited avenues for investing locally. As a result, the exposure to South African risk is very high. In principle, this is a very unhealthy situation. This issue will need to be addressed, possibly by instituting a limit on exposures to South Africa and other countries in the region.

G. CONCLUSIONS AND RECOMMENDATIONS

9.43 The major conclusion of this chapter is that Swaziland's economic past and future is inextricably linked to that of its large neighbor -- South Africa. With an economy less than one hundredth the size of that of South Africa, long established trading and investment linkages, and strong cultural affiliations, Swaziland realistically does not have a future which does not include South Africa. Although this will

certainly be problematic should serious economic difficulties arise in South Africa, Swaziland should consider its proximity to the largest economy in Sub-Saharan Africa as less of a threat and more of a positive benefit. Indeed, Swaziland's integration within the region should extent far beyond greater integration with just South Africa. It should also be looking at enhancing integration with all the countries of the region -- with some emphasis also on its other emerging neighbor -- Mozambique. Such linkages are likely to better enhance Swaziland's growth prospects over the medium term, than would an inward looking or isolationist set of policies.

9.44 The following specific recommendations flow from this chapter in terms of strengthening the linkage of the Swazi economy with that of its neighbors -- with particular emphasis on the connection with the large South African economy:

(a) Continued involvement in the CMA should require the participating countries to work together more for better coordination of monetary policies. To this end, it is recommended that there be a heightened level of consultation and coordination between the participants of this agreement.

(b) In common with the CMA, the members of the SACU agreement should strive to ensure greater coordination, cooperation and consultation. In particular, the Swazi authorities should take strong pro-active steps to protect the revenues which it receives under the SACU agreement -- given the considerable importance of this revenue source for the country.

(c) Swaziland should review ways in which it can reduce Swazi citizens and Swazi companies to an over-exposure of rand denominated assets. This is particularly important for the contractual savings institutions based in Swaziland. In addition, the authorities should be actively considering how it could and should respond to the potential abolition of exchange control by South Africa.

(d) There is an important need for the Swazi authorities to speed up the process whereby they make legislative changes. Significant pieces of legislation have remained un-revised as they await re-drafting or review by the government. The Swazi authorities should also seriously consider the greater synchronization of financial legislation with that of South Africa.

(e) The CBS should seriously consider the adoption of the SARB's financial regulatory returns.

(f) The CBS and Swaziland Stockbrokers should examine ways in which Swaziland could link itself more closely to the Johannesburg Stock Exchange and to money and capital markets in South Africa.

(g) To promote greater investment in Swaziland, the authorities should develop a one-stop investment center for the granting of all approvals and licenses.

CHAPTER 10
FLOW OF FUNDS ANALYSIS FOR SWAZILAND

A. BACKGROUND TO THE FLOW OF FUNDS ANALYSIS

10.1 A flow of funds analysis is an attempt to review the main financial flows which are taking place within an economy -- with emphasis on those financial flows which are intermediated by the domestic financial institutions within that country.

10.2 The analysis within this chapter is based upon four main classes of financial intermediaries in Swaziland (a) the commercial banks -- including Barclays Bank, Standard Chartered, Swaziland Development and Savings Bank, Stanbic, and First National Bank; (b) the Central Bank of Swaziland; (c) the Non-Bank Financial Institutions -- which include the Swaziland Building Society and the Swaziland Industrial Development Corporation; and (d) the Contractual Savings Institutions -- including the Swaziland National Provident Fund, the long term business of the Swaziland Royal Insurance Corporation, the private pension funds, and the Public Service Pension Fund.

10.3 The analysis reviews sources and uses of finance within the economy, breaking down the providers (the sources) and the users (the uses) into five broad sectors -- (a) households, (b) firms/businesses, (c) parastatals, (d) the Government, and (e) the foreign sector. In addition, there are various financial flows ***between*** financial institutions which are also acknowledged in this analysis.

10.4 Although data sources are reasonably good in Swaziland, some of the categorizations and data for some of the institutions is not particularly good. For example, it is not always possible to classify precisely the source of some of the funds flows within the economy. In addition, data from different sources was not always consistent. More importantly, however, information on the contractual savings institutions is not particularly robust. The only survey undertaken of the private pension funds was undertaken in 1992 and it is understood that this survey did not have as comprehensive a coverage as possible. A second, more comprehensive survey was being undertaken at the time that this report was prepared, and its findings may alter the magnitudes of these flows to some degree. Nonetheless, it is generally acknowledged, based upon the known volumes of contractual savings which are placed with fund managers in South Africa, that the growth of this source of funding has been substantial -- and that it is almost certainly much higher than the data would indicate which has been collected to date.

10.5 Based upon the above, the following analysis should be dealt with cautiously. Although the broad indications indicated by the analysis are undoubtedly correct, the actually numbers may not be. It is therefore important that any interpretation be based upon the broad movements of funds rather than upon the specific numbers contained in this chapter.

10.6 The analysis covers the decade -- 1984 to 1994 -- as December 1994 information was generally the most recently available information for most institutions (it should be noted, however, that some institutions have audited accounts for March, June or September -- in which case the information for the year ending closest to December 1994 was taken). The analysis then divides the flows into the first five years of the decade (1984 to 1989) and the second five years of the decade (1989 to 1994) to ascertain whether there has been a variation in the funds flow during the period under consideration. Unfortunately, this break is not the best possible categorization to make, as the late 1980s and the very early 1990s spanned a period of strong growth -- which will be

captured in both sub-sets of data and will thereby mask developments which are more characteristic of the recent slump in economic activity. It would therefore be useful to repeat the same exercise in several years time when the "boom" period can be contrasted very distinctly with the years that followed.

B. THE PERIOD 1984 TO 1994

10.7 **The Sectors.** Chart 10.1 -- which is based upon the tables presented in Annex 2 shows the broad sources and uses of funds in the Swazi financial system over the past decade. Several broad conclusions can be drawn from this Chart. The Household Sector was a significantly large saver within the economy over this period. According to this Chart, households saved E737,010 over this period, but only used E229,699 from the financial system over the same period. Hence, the household sector used as loans from the financial system, around 30 percent of what they saved. In addition, the Chart underestimates household savings as this sector also saved in other forms which have not been captured by the analysis. For example, many Swazi savers in rural areas save in traditional forms -- most notably in the form of cattle. In addition, there is a small but growing Savings and Credit Cooperatives sector which is not captured in the data. Consequently, the household sector has been an important source of savings within the entire economy. Most household savings went into the commercial banking system over this period, although savings in the contractual savings institutions from this sector were also significant. Most borrowing by the sector also comes from the commercial banking sector, although the non-bank financial institutions were also important -- most notably the Swaziland Building Society.

10.8 The business (firm) sector was a net dis-saver within the economy over the period under consideration. Most business savings were with the contractual savings institutions, although the commercial banking sector also figured prominently. A smaller amount of business savings was with the non-banking sector. As with the household sector, the commercial banks were the main source of financing for this sector -- providing over half of all funding. The contractual savings institutions were also a major source of funds over the period -- largely coming from the investment of the pension and provident funds in the business sector in Swaziland.

10.9 According to the data, the parastatal sector was a large saver within the economy. This however, may mask a lack of clarity in the data on sources and uses of funding for the parastatal sector vis à vis the Government sector. Again, the majority of savings was with the commercial banking system -- which was also the only institutional source of funding for the sector over the period. In addition, however, the parastatal sector was funded directly from the Government sector and was increasingly accessing the money markets (as with the 1993 Post and Telecommunications Corporation bond issue of E14 million) -- both of which are not captured in the data.

10.10 The Government sector was by far the largest net saver in the economy over the decade. It is interesting to note that, by far, the majority of the Government's savings was not intermediated through the domestic financial system, but placed on account externally (mainly in the Republic of South Africa) directly by the Government. These funds subsequently formed part of the Capital Investment Fund (note that the Government's contribution to the Public Service Pension Fund are not captured in these numbers, but rather in the flows through the contractual savings institutions) and some of the Government external savings. Within the domestic financial system, the majority of the Government's savings were funds flowing to the Public Service Pension fund which was established in 1993. Very little additional Government savings was intermediated domestically. In fact, it is interesting to note that, over this period, a larger flow of funds was placed in the commercial banking system within Swaziland than with the Government's own banking institution

-- the Central Bank of Swaziland. According to the data, Government flows to the commercial banks was almost twice as much as Government flows to the central bank -- a strange anomaly with an inevitably pernicious impact upon the central bank's ability to conduct an independent monetary policy.

10.11 The foreign sector was, by far, the smallest saver within the domestic financial system -- but was the largest recipient of funds from the financial system. Including Government savings which were not intermediated through the domestic banking system, but placed directly overseas, the ratio of funds absorbed by the external sector to funds saved by the sector was between eight and nine times. By far the largest contributor to the external sector was the contractual savings institutions which accounted for around 45 percent of all external flows. The Central Bank of Swaziland represented the second most important source of funds -- accounting for around 24 percent, followed by the Government which accounted for 22 percent.

10.12 **The Financial Intermediaries.** Over the ten year period, roughly E2,404,234,000 was intermediated through domestic financial institutions in Swaziland. The most important domestic institutions intermediating funds were the commercial banks which intermediated over E1 billion -- or 42 percent of the total. Also very significant were the contractual savings institutions which intermediated around E0.9 billion of funds -- or 38 percent of the total. The Central Bank of Swaziland and the non-bank financial institutions were relatively less important in terms of intermediating the flows of funding through the domestic financial system. This reflects the fact that the Government did not utilize the Central Bank of Swaziland significantly over the period as a banker to Government, but rather placed its excess funds externally on its own account. In addition, as indicated above, the Government placed more funds in the commercial banking system over this period than what it placed in the central bank. The relatively low level of intermediation for the non-banks also reflects, in part, the fact that the Swaziland Development and Savings Bank has been classified as a commercial bank for the purposes of this analysis despite the fact that the institution played a dual role as a commercial and a development banking institution over this period. Nonetheless, even re-classifying a notional amount of the SDSB's sources and uses of funds to the NBFI classification is unlikely to have a significant impact on the dominant role played by the commercial banks and the contractual savings institutions within the financial sector.

C. THE SUB-PERIODS 1984 TO 1989 AND 1989 TO 1994

10.13 The point of reviewing two sub-periods within the ten year period is to try and identify trends which were more pronounced in the earlier period and/or the latter period, to provide an indication of how flows of funding with the economy may be changing over time and to examine which sectors and which financial intermediaries may be becoming relatively more or less important in terms of sources of funds, uses of funds, or as financial intermediaries. These trends are likely to be masked by a review of a longer period of time. The analysis for Swaziland over these two periods does indeed point to a rapidly evolving financial and real sector vis a vis flows of funding. The flow of funds charts for these two periods are presented in Charts 10.2 and 10.3.

10.14 **The Sectors.** In the first five years of the decade under consideration the household sector was a less important source of funds for the financial system than the business sector -- in contrast to the period as a whole. Household savings increased considerably in the second half of the decade -- as did the household sector's utilization of funds from the financial sector. Nonetheless, in both periods the household sector was a significant net saver within the system. However, over the period, the contractual savings institutions became an increasingly more important target for household savings rather than the commercial banking sector. Nonetheless commercial banks

retained their predominant position as a repository of household savings over both of the periods under consideration.

10.15 The position of the business sector, however, did change over the period. In the first half of the decade, the business sector was a small net saver in the financial system -- sources of funds from this sector were slightly greater than the usage of funds by the sector. This situation changed during the second half of the period with the business sector becoming a significant net dis-saver from the system making it a net dis-saver over the entire period. Borrowing from the business sector is likely to reflect the better economic environment which existed in the later part of the 1980s and very early part of the 1990s which is likely to have had a lagged impact upon usage of funds by the business sector on the financial system. Over this period, the contractual savings institutions became a significantly more important repository for the savings of the business sector. Whereas in the first five years, commercial banks were the predominant repository of business sector savings, these were overshadowed by the contractual savings institutions in the second five year period. In fact, business sector savings in the commercial bank system actually declined in nominal terms over the two periods. In terms of funding for business sector operations, the commercial banking sector was most important in both periods -- although non banks and contractual savings institutions also contributed. Over the two periods, the relative importance of the contractual savings institutions increased significantly as pension and provident funds sought profitable business opportunities within Swaziland -- most notably the Swaziland National Provident Fund, but also other participants within the industry.

10.16 The parastatal sector remained a large net saver over both of the periods. However, given the quality of the data and the lack of distinction in some financial institution balance sheets between the activities of Government and the parastatals, it would be wise to not attribute too much weight to the data on this sector. Nonetheless, it is interesting to note that in the second half of the period, the parastatal sector appeared to be accessing the commercial banking sector more as a source of finance. As Swazi parastatals become more commercialized one would anticipate that the call by this sector on the domestic financial system, rather than the Government budget, will increase over time.

10.17 Government savings increased significantly between the two periods. However, there was a significant change in where Government savings were placed over the two periods. In the period 1984 to 1989, the Central Bank of Swaziland was the most important repository of the Government's funds -- as banker to the Government. During this period, smaller balances were maintained in both the commercial banking system and external to Swaziland. In the second period, however, there was a flow of Government funds ***out of*** the Central Bank and, while deposits did increased over this period, the major beneficiary in the increased level of Government savings was the external sector. Hence the utilization of the Central Bank of Swaziland as a banker to the Government appears to have declined over the period, as the Government effectively dis-saved with the central bank.

10.18 In the second five years, funding from the external sector increased within the domestic Swazi financial system, while it correspondingly also became an even more important repository for the funds of Swazi-based savers. Savings accruing to the external sector increased from around E439 million in the first five year period to E996 million in the second five years. Between the two periods, the source of funds accruing to the external sector also changed dramatically. Whereas in the first five year period the central bank and the commercial banking sector were significantly more important, during the last five years, it was the contractual savings institutions and the Government which emerged as the most important source of funds for this sector.

10.19 **The Financial Intermediaries.** In the first sub-period, the commercial banks predominated in terms of financial intermediation. Over half of the sources (52 percent) of funding was intermediated through the commercial banks. During the second period, this had fallen to around 40 percent. More dramatic, however, was the relative increase in importance of the contractual savings institutions in terms of intermediating funds through the economy. In the earlier period, around 17 percent of all sources of funding intermediated through the domestic financial system went through the contractual savings institutions, in the second period this had increased to around 46 -- overtaking the commercial banking sector in relative importance. Given the recent trend in the slow down in balance sheet assets in the commercial banks, it is expected that this trend would have accelerated over the later part of the last five year period. It is also interesting to note that the central bank actually declined in importance in terms of the nominal amount of funds that it intermediated.

D. CONCLUSIONS AND POLICY IMPLICATIONS

10.20 The main conclusion of this analysis is that there was a significant surplus of funds (savings) from the Swazi economy which increased significantly over the ten year period 1984 to 1994. The household sector and the Government sector were important net savers over this period. The majority of the funds flowing from the Swazi economy went to the external sector -- although the business sector was also a major recipient of funding from the domestic financial system.

10.21 The role of the Government was somewhat unusual in that it intermediated a large amount of its funds through the commercial banking sector and directly to the external sector -- rather than through the central bank. As indicated, this may have compromised the capacity of the Central Bank of Swaziland to conduct monetary policy within Swaziland. The movement of Government funds into and out of domestic commercial banks certainly had an impact on the conduct of monetary policy (see Chapter Five). It would be useful for the Ministry of Finance and the Central Bank of Swaziland to re-examine the role of the latter -- so as to clarify what is expected from the prime monetary policy institution within the country -- to determine whether the Government is supporting the bank in a way which permits it to undertake these agreed functions.

10.22 Now that the Government is faced with budgetary deficits, which could continue for some time, it will become a dis-saver within the economy -- drawing down on the significant surpluses accumulated over the recent past. It should be noted, however, that the Government has effectively denied itself access to a large proportion of these funds, for general budgetary purposes, through the creation of the Capital Investment Fund and the Public Service Pension Fund which effectively earmarks a large proportion of these external savings for specific purposes.

10.23 To the extent that the slower economic growth of the past several years continues to predominate, it is highly likely that savings from all other sectors in the economy will also slow down. A slow down in the economy, to date, however, appears to have had a more adverse impact upon the commercial banks than upon the contractual savings institutions.

10.24 Over the period, the commercial banking sector declined in relative importance in terms of financial intermediation within the financial system. On the other hand, there was a significant increase in the amount of funds which were channeled through contractual savings institutions. Whereas growth in the commercial banks appears to have been slowing down and even stagnating, especially toward the end of the period under consideration -- the role of the contractual savings institutions, by contrast, increased significantly. This point is demonstrated by the fact that

commercial banking assets have been declining in real terms over the past two years whereas the assets of the contractual savings institutions have grown at around 42 percent in nominal terms, implying a real growth of about 30 percent per annum over the past eight years.

10.25 The rapid growth of the contractual savings institutions emphasizes the importance of properly legislating the use of the funds that they manage. The speedy promulgation of the Insurance Act -- which covers insurance, pension and provident fund business is of extreme importance. It is somewhat of an anomaly that while so much attention has been put on the commercial banking sector in Swaziland, relatively little attention has been paid to the almost equally important, and more rapidly growing, contractual savings sector. The recent appointment of a Registrar of Insurance is an important first step in recognizing the importance of this sector. Developing an improved data base for the sector will also be necessary.

10.26 A large contractual savings sector is indeed an important asset for the Swazi economy. By its very nature, this sector is an important source of long term investible funds. It has been argued that these funds should be used for development in Swaziland. Whereas this certainly could be true, it is equally important that these funds should earn the maximum possible return to ensure properly protected pension benefits for contributors. As discussed previously, it is important that restrictions placed on the use of these funds should be as minimal as possible, after fully taking into account prudential concerns.

10.27 Last, the above analysis has not captured all the flows within the economy. One important omission is the growing Savings and Credit Cooperative fund movement. Although the numbers are relatively small, this is a further source of funding -- which is growing very rapidly -- and is important for the support that it can potentially provide to activities in the small and medium scale sector.

Table 10.1: Flow of Funds, 1984 to 1994, E million

Flows from Sources

SOURCE		To Financial Institutions		From Financial Institutions
1. Households	Comm Banks 371,732 NBFI's 82,803 Cont'l Savings 282,475 **TOTAL 737,010**	Central Bank 4,830 NBFIs 39,291 Cont'l Savings 21,558 **TOTAL 65,679**	Commercial Banks **1,020,809**	
2. Firms	Comm Banks 297,854 NBFI's 52,359 Cont'l Savings 350,657 **TOTAL 700,870**	Comm Banks 111,207 **TOTAL 111,207**	Central Bank of Swaziland **258,679**	
3. Parastatals	Comm Banks 194,451 Cont'l Savings 93,506 **TOTAL 287,957**	Cont'l Savings 2,466 **TOTAL 2,466**	Non-Bank Financial Institutions **203,384**	
4. Government	Comm Banks 77,276 Central Bank 43,375 NBFI's 27,704 Cont'l Savings 168,238 Foreign 335,375 **TOTAL 651,968**	Comm Banks 27,273 NBFIs 1,133 **TOTAL 28,406**	Contractual Savings Institutions **923,282**	
5. Foreign	Comm Banks 13,817 Central Bank 104,097 NBFI's 38,052 **TOTAL 155,966**			

Flows to Users

USES	
1. Households	Comm Banks 162,247 NBFI's 67,452 **TOTAL 229,699**
2. Firms	Comm Banks 452,200 Central Bank 7,150 NBFIs 99,124 Cont'l Savings 247,219 **TOTAL 805,693**
3. Parastatals	Comm Banks 9,843 **TOTAL 9,843**
4. Government	Comm Banks 30,881 Central Bank 39,305 Cont'l Savings 9,943 **TOTAL 80,129**
5. Foreign	Comm Banks 132,769 Central Bank 359,225 Cont'l Savings 677,828 GOVERNMENT 335,375 **TOTAL 1,505,197**

Table 10.2 **Flow of Funds, 1984 to 1989, E million**

Flows from Sources

SOURCE		To Financial Institutions		From Financial Institutions		USES		
Comm Banks	88,099	1. Households				1. Households	Comm Banks	38,160
NBFTs	12,716						NBFTs	9,199
Cont'l Savings	46,798						TOTAL	47,359
TOTAL	147,613							
		Central Bank	692	Commercial Banks				
		NBFIs	11,110	405,826				
		Cont'l Savings	10,785				Comm Banks	127,956
Comm Banks	171,727	2. Firms				2. Firms	Central Bank	1,996
NBFTs	8,525						NBFIs	37,438
Cont'l Savings	55,031						Cont'l Savings	49,227
TOTAL	235,283						TOTAL	216,617
		Comm Banks	69,932	Central Bank of Swaziland				
		TOTAL	69,932	170,173				
Comm Banks	95,712	3. Parastatals				3. Parastatals	Comm Banks	-665
Cont'l Savings	11,293						TOTAL	-665
TOTAL	107,005							
		Cont'l Savings	3,137	Non-Bank Financial Institutions				
		TOTAL	3,137	66,512				
Comm Banks	22,121							
Central Bank	103,923							
NBFTs	12,516	4. Government				4. Government	Comm Banks	2,631
Cont'l Savings	706						Central Bank	-695
Foreign	10,575						Cont'l Savings	11,217
TOTAL	149,841						TOTAL	13,153
		Comm Banks	18,275	Contractual Savings Institutions				
		NBFIs	3,137	135,240				
		TOTAL	21,412					
Comm Banks	5,580	5. Foreign				5. Foreign	Comm Banks	137,327
Central Bank	-3,682						Central Bank	230,908
NBFTs	29,618						Cont'l Savings	59,989
TOTAL	31,516						GOVERNMENT	10,575
							TOTAL	438,799

Flows to Users

Table 10.3: Flow of Funds, 1989 to 1994, E million

Flows from Sources

SOURCE

Comm Banks	283,633
NBFI's	70,088
Cont'l Savings	235,678
TOTAL	**589,399**

1. Households

Comm Banks	126,127
NBFI's	43,834
Cont'l Savings	295,626
TOTAL	**465,587**

2. Firms

Comm Banks	98,739
Cont'l Savings	82,214
TOTAL	**180,953**

3. Parastatals

Comm Banks	55,155
Central Bank	-60,548
NBFI's	15,187
Cont'l Savings	167,532
Foreign	254,357
TOTAL	**431,683**

4. Government

Comm Banks	8,237
Central Bank	107,779
NBFI's	8,435
TOTAL	**124,451**

5. Foreign

To Financial Institutions

Central Bank	70,877
NBFIs	28,181
Cont'l Savings	23,979
TOTAL	**123,037**

Commercial Banks **694,928**

Comm Banks	41,275
TOTAL	**41,275**

Central Bank of Swaziland **88,506**

Cont'l Savings	1,133
TOTAL	**1,133**

Non-Bank Financial Institutions **138,677**

Comm Banks	0
NBFIs	0
TOTAL	**0**

Contractual Savings Institutions **781,050**

Flows to Users

From Financial Institutions

USES

1. Households

Comm Banks	124,087
NBFI's	58,254
TOTAL	**182,341**

2. Firms

Comm Banks	324,244
Central Bank	5,154
NBFIs	61,685
Cont'l Savings	197,992
TOTAL	**589,075**

3. Parastatals

Comm Banks	10,508
TOTAL	**10,508**

4. Government

Comm Banks	28,250
Central Bank	40,000
Cont'l Savings	-1,274
TOTAL	**66,976**

5. Foreign

Comm Banks	-4,558
Central Bank	128,317
Cont'l Savings	617,839
GOVERNMENT	254,357
TOTAL	**995,955**

ANNEXES

BANK REGULATION AND SUPERVISION

A. THE DEPOSIT TAKING SECTOR

1. **The Banking System** consists of four banks which are all subsidiaries of foreign controlled banking groups. These banks perform the functions of typical high street banks, and refer to themselves as commercial banks. The bias in the lending activities of these banks is toward the corporate sector, as opposed to the man in the street. The registered private sector banks include:

(a) Barclays Bank, a subsidiary of the UK registered bank Barclays Bank PLC. Barclays Bank UK has a 60 per cent shareholding in the bank, and the balance of the shares is held by the State. The bank operates through nine branches and four agencies.

(b) Stanbic Bank, a subsidiary of the South African based Standard Bank Investment Corporation (Stanbic). Stanbic holds 70 per cent of the shares, with the Swaki group and the State holding, respectively, 20 and 10 per cent of the shares of the bank. The bank operates through four branches.

(c) Standard Chartered Bank, a subsidiary of the UK registered bank Standard Chartered Bank. Standard Chartered UK holds 55 percent of the shares. The State holds 40 per cent of the shares, and the public 5 per cent. The bank operates through five branches and six agencies.

(d) First National Bank , a wholly-owned subsidiary of First National Bank in South Africa. The bank operates through three branches and one agency.

2. **Swaziland Development and Savings Bank** operates as a development bank and a commercial bank. It is registered in terms of its own act of Parliament and is wholly owned by the State. It is currently (1995), managed by a receiver appointed by the Central Bank .

3. **The Swaziland Building Society.** Currently there is only one registered building society, the Swaziland Building Society, a mutual building society. It is almost exclusively focused on the traditional business of a building society, providing long term finance to the man in the street for the purchase of residential dwellings.

B. REGULATORY FRAMEWORK AND SUPERVISORY STRUCTURES

4. The regulatory framework refers to the statutory framework. Supervisory structures refer to the structures which have been established in order to give effect to, and ensure compliance with, the regulatory structures. Regulation and supervision can, as a matter of principle, be effected by way of one of the following vehicles of regulation and by way of the following supervisory structures, namely

(a) General (often functionally-based) legislation
(b) Specific (often institutionally-based) legislation
(c) External agency supervision
(d) Self-regulation and supervision
(e) Moral suasion

(f) Self-imposed regulation and supervision

5. **Supervision.** The Central Bank of Swaziland Order, 1974, (with the Financial Institutions (Consolidation) Order, 1975, the Swaziland Development and Savings Bank Order, 1973 and the Building Societies Act, 1962) makes provision for the supervision of certain entities within the financial sector. The Governor of the Central Bank is designated as the Registrar of Financial Institutions. The day to day execution of the function of supervision is performed by the Bank Supervision Department, located in the Central Bank.

6. The principal objects of the Central Bank include the promotion of "monetary stability and a sound financial structure" and the fostering of "financial conditions conducive to the orderly and balanced economic development of Swaziland." Both of these are relevant to the supervisory function. The objective of promoting a sound financial system encompasses a responsibility which goes wider than the banking sector only -- it encompasses the total financial system. A sound financial system is normally understood to mean a stable and efficient financial system. Therefore, it implies that there should be a healthy balance between stability and efficiency, the two ultimate regulatory objectives.

7. **Licensing of Institutions.** Only local financial institutions which are companies may be granted a license in terms of the Act. No entity may accept funds from the public unless it has been appropriately licensed and only a licensed institution may use the term "bank". The application for licensing, which must be in writing, should incorporate, *inter alia*, the following documentation:

(a) Memorandum and articles; and, in the case of a foreign institution, such similar documentation, as well as documentation to establish the manner of control and regulation
(b) Full particulars of the business it intends to carry out.
(c) Such other information which the Central Bank may require.

8. The extent to which the Registrar of Financial Institutions is empowered to address the issue of the "fitness and properness" of the key players involved in a deposit-taking institution, is very limited. The legislation specifically provides that no person who is an insolvent or who has been convicted of an offense involving dishonesty or fraud shall be permitted to be a director or manager of a financial institution. Similarly, no person who has been a director or a manager or otherwise directly or indirectly concerned in the management of any financial institution which has been wound-up shall, without the written authority of the Central Bank, act as a director or manager of any financial institution. Also note that the Central Bank, by implication, has a right of veto in respect of the appointment of the external auditor.

9. In considering an application the Central Bank may conduct necessary investigations into the applicant's financial status and history, the character and experience of its management, the adequacy of its capital structure, the convenience and needs of the community it intends to serve, the earning prospects, and the public interest.

10. In granting a license, the Central Bank may impose conditions. The Central Bank is required to furnish reasons in instances where it has refused to grant a license. The Central Bank may revoke the license of any financial institution if:

(a) It fails to commence operations within one year of the granting thereof.
(b) It exceeds the terms of its license or fails to comply with the conditions thereof.
(c) It is in breach of any other provisions of the Act.
(d) It ceases to carry on the business for which it is licensed.

11. **Style and Supervisory Approach.** The style of supervision practiced by the relevant authorities in Swaziland is of a collegial nature, as opposed to being adversarial in nature. Supervision is primarily based on an off-site supervisory approach, supplemented with on-site supervision as and when problems are experienced or anticipated.

12. Apparently, because of some uncertainty about whether or not the Central Bank has the powers to legally carry out on-site supervision as a matter of course, this is not a regular feature of the activities of the Bank Supervision Department. Over the past few years, on-site supervision has only been performed in respect of BCCI Swaziland (in 1992) and the Swaziland Development and Savings Bank (1991 and 1993). No standardized procedures exist regarding on-site supervision. In addition, no standardized examination program exists for this purpose. From a review of the relevant legislation, however, it would appear that there can be little doubt that the Central Bank is empowered to perform on-site supervision as a matter of course.

13. The supervisory authorities could usefully clarify their belief in market forces and take a stand in favor of a consultative approach to regulation as well as a commitment to providing information to the market place.

14. As banking can be defined as the management of a series of risks, the regulatory approach should be contained in a model whereby a number of key players (corporate governance) must be held accountable for managing various dimensions of a series of risks. These responsibilities should be contained in the legislation and regulations governing the banking sector. The key players and risks that they should be responsible for managing are discussed in the following sections.

C. CORPORATE GOVERNANCE.

15. People ultimately determine the soundness and efficiency of the banking sector. The most significant manner in which the contribution of the key players involved in the banking sector to the soundness and efficiency of the banking system can be determined is to evaluate the system of corporate governance. The term "corporate governance" refers to the system of checks and balances which exists between the various role players involved in an enterprise. The ultimate objective of such a system is to promote a healthy balancing of risk and reward.

16. The key players in the financial sector in Swaziland, with respect to Corporate Governance, include:

(a) Politicians -- the political responsibility in terms of the Act is vested in the Council of Ministers, the Prime Minister and the Minister for Finance and Economic Planning and any decision of the Central Bank is subject to appeal to the Minister.

(b) Shareholders -- directly or indirectly appointed directors, management, audit committee, internal auditors, and external auditors. Due to the fact that the company is a separate legal persona, the shareholders do not attract personal responsibility for the liabilities of the company, except in exceptional circumstances.

(c) Directors -- local financial institutions are managed by boards of directors. The board of directors is ultimately in control of a company and is the organ through which the company acts. The board carries the ultimate responsibility for ensuring the success of the enterprise. The common law requires directors to maintain the utmost good faith towards the company in the discharging of their

responsibilities, and the provisions of the Companies Act -- and applies to directors of locally incorporated financial institutions. The Board has the responsibility of laying down policy and of appointing the chief executive officer.

(d) Management -- is responsible for the implementation of policy laid down by the board. This it does in terms of the delegated authority from the board to control and manage the day-to-day activities of the company. The relevant Acts do not contain any specific prescriptions pertaining to executive management

(e) Audit Committee -- currently the relevant Acts do not require that a deposit-taking institution should appoint an audit committee.

(f) Internal Audit -- the relevant Acts do not contain any prescriptions relating to internal auditors.

(g) External Audit -- every bank is required to appoint an independent auditor, satisfactory to the Central Bank, who is required annually to express an opinion on the questions whether the annual financial statements of the institution have been prepared " ... in accordance with standard banking practice, whether they fairy reflect the financial institution's affairs...". If the financial institution fails to appoint an auditor, then the Central Bank has the power to appoint one.

(h) Public -- this constitutes a "catch-all" and includes the current depositors as well as potential future depositors. In view of the absence of any specific prescriptions in this regard, they are required to perform their own risk management. This follows from the fact that, with one limited exception relating to a specific institution, no deposit insurance scheme exists in Swaziland. Therefore, the principle of caveat depositor applies. Also included in this grouping are entities such as rating agencies, the financial media and financial analysts who directly or indirectly perform the risk evaluation for the public, by providing them with relevant and reliable information and analyses.

(i) Supervisory authority -- the Governor of the Central Bank is, in terms of the Central Bank of Swaziland Order, 1974 designated as the Registrar of Financial Institutions under the Financial Institutions (Consolidation) Order, 1973. The implicit duty of the supervisory authority is to administer the relevant legislation and to ensure compliance therewith. The Bank Supervision Department has not as yet explicitly determined a mission or philosophy to guide it. Their mission should be to make the limitations and responsibility of supervisors clear and commit the authorities to creating a legal and regulatory environment in which the quality and effectiveness of risk management will be optimized. Once this mission is achieved, bank supervisors can be confident that they will make a contribution to a healthier banking system in which depositor's funds will be safer -- but also acknowledging that supervisory authorities alone can never prevent bank failure - they are only one of the players in the risk management process.

(j) Courts -- the High Court is empowered to hear applications to have a seizure notice lifted.

D. RISK MANAGEMENT

17. Banking is the business of managing risks. The risks to which a bank is typically exposed, include the following:

(a) Balance sheet structure and the changes therein -- although not traditionally defined as a risk per se, supervisors and management should closely monitor structural changes in the balance sheet as most of the other risks to be monitored, will flow there from.

(b) Solvency risk -- is the risk of insolvency, that is, the risk that the liabilities of the organization will exceed its assets. This constitutes a "catch-all" risk, in the sense that a severe financial loss, suffered as a result of an exposure to any other risk, could ultimately lead to the insolvency of the institution. A bank is required to reflect its capital position and the composition thereof to the Central Bank. Banks are also required to furnish an analysis of movements on the capital accounts. Prescriptions pertaining to the computation of risk assets, and capital and reserve requirements based on the risk assets approach as contained in the capital convergence document of the Basle Committee on Bank Supervision have been published, but should be refined to ensure compliance at all times during the year and not only on specific dates.

(c) Measuring profitability enables one to establish whether the enterprise has managed to increase its capital by generating capital internally. Profits constitute the main source of new capital. Losses reduce capital and also affect the adequacy of capital. Banks are required to provide a detailed income statement to the Bank Supervision Department on a quarterly basis. This information reflects, inter alia, gross interest income and interest expense by category, net interest margin, provisions for bad debts and non-interest income and expenses. In addition, the board report prepared by the Bank Supervision Department contains information on the profitability of the banks.

(d) Liquidity risk -- can be defined as the risk that the institution will not be in a position to meet its obligations when they fall due, notwithstanding the fact that the institution may still be solvent. It is important to recognize that compliance with the statutory requirement regarding the holding of liquid assets does not necessarily imply that the institution has adequately addressed the issue of liquidity risk. Banks are also required to furnish information on their liquidity position to the Central Bank.

(e) Credit risk -- is the risk that a counterparty, which is being funded in terms of a financing agreement, will not discharge fully and timeously its obligations, strictly in accordance with the terms of the agreement. In order to analyze and evaluate the nature, extent and quality of the management of the credit risk to which a deposit-taking institution is exposed, it is recommended that the supervisor should have access to, or as a matter of course obtain information on, as a minimum, the following: (a) provisioning policy and provisions; (b) classification policy of overdues and classification by asset category; (c) large exposures; (d) sectoral classification of exposures; (e) classification of assets in terms of the return rendered by the assets/earned on the assets. Currently, the statutory returns contain much of the above information. It is recommended that the following return be required by the supervisory authorities;

Classification of Assets	Amount	Amount Provided	Emalangeni	International Norm	Amount Required	Shortfall
Standard				1 percent		
Substandard				25 percent		
Doubtful				50 percent		
Loss				100 percent		
TOTAL				----		

(f) Interest rate risk -- is the risk that changes in market interest rates can impact adversely on an institution. Currently, the statutory returns to be rendered to the Central Bank do not contain any requirement to furnish interest rate risk related information.

(g) Market risk (which includes currency risk) -- is the risk that a change in market prices can have an adverse effect on an institution. Currently, the statutory returns to be rendered to the Central Bank do not contain any requirement to furnish market risk related information.

(h) Operational risk. -- refers to the aspects of the business of an institution which do not have a direct financial impact on that institution, but which ultimately result in a financial impact. Typical examples include human resources and information technology. Currently, the Bank Supervision Department does not appear to address this aspect, except in the event of on-site examinations.

E. FINANCIAL PRUDENTIAL REQUIREMENTS AND PRESCRIPTIONS

18. **Capital Requirement.** Licensed financial institutions are required to maintain prescribed minimum capital and reserves at least equal to the greater of E1 million or five per cent of its liabilities to the public in Swaziland. The framework for determining the required capital, as proposed by the Basle Committee on Banking Supervision, (i.e. qualifying capital to risk weighted assets of at least eight per cent) has been adopted by Swaziland. The only exception to this practice is the Swaziland Development and Savings Bank which is not subject to any capital requirement.

19. It is important for Swaziland to adopt and maintain international standards in the sphere of the financial sector. In itself, compliance with such standards will not cause international investors to divert their funds from elsewhere in order to invest in Swaziland. However, in a situation where a foreign investor is in the process of considering an investment in Swaziland, non-compliance with such standards would be considered a negative factor. Consistent compliance during the entire financial year is therefore of great importance.

20. **Reserve Balance Requirement** -- The Central Bank may also prescribe the maintenance of required reserves, including marginal required reserves, against such deposit and other similar liabilities as may be specified by the Central Bank for this purpose. Such required reserves shall be maintained by way of cash holdings or by way of deposits with the Central Bank. No interest is paid by the Central Bank on any such required reserves.

21. The Central Bank may prescribe different reserve ratios for different classes of deposit and other similar liabilities and may prescribe the method of their computation as long as the financial institution holds a total amount of reserves in excess of twenty-five per cent of its total deposit and other similar liabilities and the method of computation of the prescribed reserve ratios is uniform for all banks and for all other financial institutions of the same class. The Central Bank may impose penalties on any financial institution which fails to maintain required reserves in the appropriate ratio prescribed.

22. As a monetary policy instrument this reserve requirement has an impact only at the margin, that is, only the change in the requirement has relevance from a monetary policy perspective. The absolute level of the requirement, therefore, has little if any significance from that perspective. Currently, the reserve requirement is equal to six per cent of the specified base, which may include deposits and other similar liabilities.

23. **Liquid Asset Requirement** -- The Central Bank may also prescribe that every financial institution shall maintain liquid assets amounting to a prescribed percentage of the total, or specified categories, of its liabilities to the public. A cap of thirty percent applies, which can be exceeded only with the approval of the Minister.

24. Assets which qualify as liquid assets include notes and coins, demand and call balances held at Swaziland registered financial institutions, securities issued by the Central Bank with a maturity not exceeding one hundred and eighty days, treasury notes and bills issued by the Government, and such other assets approved by the Central Bank.

25. The Swaziland Development and Savings Bank is required to maintain liquid assets amounting to not less than ten percent of total deposits. The corresponding figure for all other banks is seventeen and a half per cent.

26. **Large Exposures** -- financial institutions are not permitted, subject to certain exceptions, to have a large exposure to a single counter party which exceeds ten per cent of its capital and reserves.

27. If the Central Bank determines that the interests of a group of two or more persons is so interrelated that they should be considered as one, the total indebtedness of such a grouping is combined and considered to be that of a single counter party for the purposes of determining whether it is a large exposure.

28. This requirement is basically in line with international norms. The trend is toward making the limit a "hard", as opposed to a "soft", limit. In the EU, the aggregated total of all large exposures may not exceed a figure equal to eight times capital. It is suggested that Swaziland may consider implementing a similar provision. What would need to be borne in mind, however, is that a small number of relatively large corporates dominate economic activity in Swaziland. These corporates are also the principal clients of the banking sector, and some of them dwarf the banks.

29. **Other Financial Requirements and Prescriptions** -- Incorporated in the legislation are a number of other financial requirements to which registered institutions are subjected. These requirements do not constitute a norm by international standards.

(a) **Prescribed Investments** -- the Central Bank may prescribe that every financial institution maintain in Swaziland specified investments of an amount to be determined as a percentage of its liabilities to the public in Swaziland and of its minimum required capital.

(b) **Minimum Local Assets to be Maintained** -- the Central Bank may prescribe that every financial institution shall maintain local assets in Swaziland in an amount to be determined as a percentage of its liabilities to the public and of its minimum required capital. Currently the percentage is ninety-five per cent. This requirement is in line with the concept of maintaining a matching of the risk on the asset side of the balance sheet with the risk on the liabilities side of the balance sheet.

(c) **Exposures Secured by a Financial Institution's Shares** -- No financial institution is permitted, except with the prior written approval of the Central Bank, to incur an exposure against security of its own or another financial institution's shares.

(d) **Unsecured Exposures to Directors** -- A financial institution is not permitted, except with the written approval of the Central Bank, to have unsecured exposures in excess of E50,000 to its directors, whether directly or indirectly.

(e) **Exposures to Officers of Employees** -- A financial institution is not permitted to have an exposure to any officer or employee which in aggregate exceeds one year's emoluments of such person.

(f) **Wholesale or Retail Trade** -- A financial institution is not, as a regular feature of its business, permitted to engage in wholesale or retail trade.

(g) **Equity Interests** -- A financial institution is not permitted, subject to limited exceptions, to invest in the equity of any financial, commercial, agricultural, industrial or other undertaking as a regular feature of its business.

(h) **Immovable Property** -- A financial institution is not permitted to purchase, acquire, or lease immovable property as a regular feature of its business except as may be necessary for the purposes of conducting its business.

30. **Transparency and Disclosure** -- Every financial institution is required to prepare annual financial statements. These statements must be published in the Gazette and in at least one newspaper which circulates generally. In addition, the financial institution is required to exhibit in a conspicuous position in each of its places of business in Swaziland a copy of such a report. Appropriate levels of disclosure and transparency of the decision-making process are vital cornerstones of the concept of accountability, an indispensable component of a sound and efficient financial system. However, financial institutions are not required to have their annual financial statements compiled in accordance with generally accepted accounting practice.

31. **Investor Protection and Deposit Insurance.** Currently, there is no explicit deposit guarantee fund in existence in Swaziland. However, it is provided that any deposit made with the Swaziland Development and Savings Bank shall be secured upon the public revenues of Swaziland. Furthermore, if the funds of the institution is at any time insufficient to meet the claims of the depositors, the Minister shall be empowered to authorize payment of the deficit out of the Consolidated Fund. This boils down to an implicit deposit guarantee.

32. **Illegally Carrying on Banking Business.** The Central Bank is empowered to act against any person who transgresses the Act. This includes the power to examine the records of a suspected transgressor, and to require a transgressor to repay funds which have been illegally obtained.

33. **Institutions being Supervised.** Currently the following deposit-taking institutions are being supervised by the Bank Supervision Department of the Central Bank:

(a) The four banks registered in terms of the Financial Institutions (Consolidation) Order -- Barclays Bank, First National Bank, Standard Chartered Bank, and Stanbic Bank.

(b) The Swaziland Development and Savings Bank incorporated in terms of its own founding Act.

(c) The Swaziland Building Society -- registered in terms of the Building Societies Act, 1962.

F. THE BANK SUPERVISION DEPARTMENT

34. The Department of ten staff currently (1995) consists of a director, a manager, two senior examiners, three examiners, two examination clerks, a secretary, a typist/clerk, and a messenger. Unfortunately no internal training capacity exists currently within the CBS. One staff member did, however, attend the September 1994 East and Southern African Group of Supervisor's training course held in Pretoria, South Africa. The Governor is supportive of the function and sensitive to the need for training.

G. FINANCIAL SECTOR LEGISLATION OTHER THAN THAT PERTAINING TO DEPOSIT TAKING

35. A review of the legislation indicates that it sets a basic regulatory framework for the financial sector. However, in the case of the Companies Act there is a pressing need to have the legislation updated, in view of the important developments which have taken place in the area of company law during the past eighty years.

36. The Companies Act dates from 1912, and has not kept pace with developments in this field. It is recommended that the Companies Act be updated as a matter of priority, in order to ensure that it can accommodate the demands of the times.

37. The Financial Institutions (Consolidation) Order, 1975 is currently being used as the source legislation to regulate securities business. As this legislation is not appropriate for this purpose it is recommended that a separate piece of legislation be drafted to cater for the needs of a modern securities industry.

ANNEX TWO

Table 1: Flow of Funds, Swaziland Commercial Banks
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	89,547	177,646	461,279	88,099	283,633	371,732
2.	Firm Deposits	81,810	253,537	379,664	171,727	126,127	297,854
3.	Parastatal Deposits	38,534	134,246	232,985	95,712	98,739	194,451
4.	Other Bank Deposits	337	1,116	4,283	779	3,167	3,946
5.	CBS Deposits	1,170	100	6,000	-1,070	5,900	4,830
6.	Government Deposits	13,603	35,724	90,879	22,121	55,155	77,276
7.	Non-Resident Deposits	0	5,580	13,817	5,580	8,237	13,817
8.	Equity	26,652	46,992	92,329	20,340	45,337	65,677
9.	Other Liabilities	30,880	74,183	177,756	43,303	103,573	146,876
	Total Liabilities	282,533	729,124	1,458,992	446,591	729,868	1,176,459
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	27,105	65,265	189,352	38,160	124,087	162,247
2.	Firm Loans	117,643	245,599	569,843	127,956	324,244	452,200
3.	Parastatal Loans	5,899	5,234	15,742	-665	10,508	9,843
4.	Other Bank Loans	653	2,059	5,000	1,406	2,941	4,347
5.	CBS Loans	79,997	149,929	191,204	69,932	41,275	111,207
6.	Government Loans	7,119	9,750	38,000	2,631	28,250	30,881
7.	Non-Resident Loans	7,311	144,638	140,080	137,327	-4,558	132,769
8.	Fixed Assets	16,240	35,813	106,741	19,573	70,928	90,501
9.	Other Assets	20,566	70,837	203,030	50,271	132,193	182,464
	Total Assets	282,533	729,124	1,458,992	446,591	729,868	1,176,459

1/ Parastatal deposits include local government, town councils and statutory corporations.

Table 2: Flow of Funds, Central Bank of Swaziland
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	0	0	0	0	0	0
2.	Firm Deposits	0	0	0	0	0	0
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	0	0	0	0	0	0
5.	Commercial Bank Deposits	80,561	151,438	194,153	70,877	42,715	113,592
6.	Government Deposits	6,936	110,859	50,311	103,923	-60,548	43,375
7.	Non-Resident Deposits	10,451	6,769	114,548	-3,682	107,779	104,097
8.	Equity	4,501	5,514	6,867	1,013	1,353	2,366
9.	Other Liabilities	60,562	121,818	209,172	61,256	87,354	148,610
	Total Liabilities	163,011	396,398	575,051	233,387	178,653	412,040
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	3,476	5,472	10,626	1,996	5,154	7,150
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	0	0	0	0	0	0
5.	Commercial Bank Loans	1,170	2,932	5,649	1,762	2,717	4,479
6.	Government Loans	695	0	40,000	-695	40,000	39,305
7.	Non-Resident Loans	150,429	381,337	509,654	230,908	128,317	359,225
8.	Fixed Assets	0	0	0	0	0	0
9.	Other Assets	7,241	6,657	9,122	-584	2,465	1,881
	Total Assets	163,011	396,398	575,051	233,387	178,653	412,040

Table 3: Flow of Funds, Contractual Savings Institutions
Swaziland Royal Insurance Corporation, Swaziland National Provident Fund,
the Public Service Pension Fund, and "Other" Pension Funds
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	28,766	75,563	311,241	46,798	235,678	282,475
2.	Firm Deposits	30,845	85,876	381,502	55,031	295,626	350,657
3.	Parastatal Deposits	2,851	14,144	96,358	11,293	82,214	93,506
4.	NBFI Deposits	0	0	1,133	0	1,133	1,133
5.	Commercial Bank Deposits	832	4,126	28,104	3,294	23,979	27,273
6.	Government Deposits	178	884	168,416	706	167,532	168,238
7.	Non-Resident Deposits	0	0	0	0	0	0
8.	Equity	671	6,357	2,833	5,686	-3,524	2,162
9.	Other Liabilities	5,837	9,451	43,515	3,614	34,064	37,678
	Total Liabilities	69,980	196,401	1,033,102	126,422	836,701	963,122
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	24,531	73,758	271,750	49,227	197,992	247,219
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	2,236	5,373	4,702	3,137	-671	2,466
5.	Commercial Bank Loans	9,229	27,504	30,787	18,275	3,283	21,558
6.	Government Loans	11,841	23,058	21,784	11,217	-1,274	9,943
7.	Non-Resident Loans	15,150	75,139	692,978	59,989	617,839	677,828
8.	Fixed Assets	10,843	6,439	22,547	-4,404	16,108	11,704
9.	Other Assets	-3,849	-14,870	-11,446	-11,021	3,424	-7,597
	Total Assets	69,981	196,401	1,033,102	126,420	836,701	963,121

Table 3A: Flow of Funds, Swaziland Royal Insurance Corporation (E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	1,060	3,633	13,364	2,573	9,731	12,304
2.	Firm Deposits	1,060	3,633	13,364	2,573	9,731	12,304
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	0	0	1,133	0	1,133	1,133
5.	Commercial Bank Deposits	0	0	0	0	0	0
6.	Government Deposits	0	0	0	0	0	0
7.	Non-Resident Deposits	0	0	0	0	0	0
8.	Equity	500	5,835	1,500	5,335	-4,335	1,000
9.	Other Liabilities	678	0	12,799	-678	12,799	12,121
	Total Liabilities	3,298	13,100	42,159	9,802	29,059	38,861
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	483	761	29,631	278	28,870	29,148
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	464	1,601	1,702	1,137	101	1,238
5.	Commercial Bank Loans	1,952	11,268	15,510	9,316	4,242	13,558
6.	Government Loans	4,404	12,758	7,784	8,354	-4,974	3,380
7.	Non-Resident Loans	0	0	1,934	0	1,934	1,934
8.	Fixed Assets	617	1,154	824	537	-330	207
9.	Other Assets	-4,621	-14,442	-15,226	-9,821	-784	-10,605
	Total Assets	3,299	13,100	42,159	9,801	29,059	38,860

Table 3B: Flow of Funds, Swaziland National Provident Fund (E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**	**Sources of Funds**			**Flow of Sources**		
1.	Household Deposits	21,765	42,465	97,133	20,700	54,668	75,368
2.	Firm Deposits	21,765	42,465	97,133	20,700	54,668	75,368
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	0	0	0	0	0	0
5.	Commercial Bank Deposits	0	0	0	0	0	0
6.	Government Deposits	0	0	0	0	0	0
7.	Non-Resident Deposits	0	0	0	0	0	0
8.	Equity	171	522	1,333	351	811	1,162
9.	Other Liabilities	5,159	9,451	30,716	4,292	21,265	25,557
	Total Liabilities	48,859	94,902	226,314	46,043	131,412	177,455
B.	**Uses**	**Uses of Funds**			**Flow of Uses**		
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	21,375	59,737	151,784	38,362	92,047	130,409
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	1,772	3,772	3,000	2,000	-772	1,228
5.	Commercial Bank Loans	7,277	16,236	15,277	8,959	-959	8,000
6.	Government Loans	7,437	10,300	14,000	2,863	3,700	6,563
7.	Non-Resident Loans	0	0	16,750	0	16,750	16,750
8.	Fixed Assets	10,226	5,285	21,723	-4,941	16,438	11,497
9.	Other Assets	772	-428	3,780	-1,200	4,208	3,008
	Total Assets	48,859	94,902	226,314	46,043	131,412	177,455

Table 3C: Flow of Funds, Public Service Pension Fund
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	0	0	0	0	0	0
2.	Firm Deposits	0	0	0	0	0	0
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	0	0	0	0	0	0
5.	Commercial Bank Deposits	0	0	0	0	0	0
6.	Government Deposits	0	0	162,394	0	162,394	162,394
7.	Non-Resident Deposits	0	0	0	0	0	0
8.	Equity	0	0	0	0	0	0
9.	Other Liabilities	0	0	0	0	0	0
	Total Liabilities	0	0	162,394	0	162,394	162,394
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	0	0	0	0	0	0
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	0	0	0	0	0	0
5.	Commercial Bank Loans	0	0	0	0	0	0
6.	Government Loans	0	0	0	0	0	0
7.	Non-Resident Loans	0	0	162,394	0	162,394	162,394
8.	Fixed Assets	0	0	0	0	0	0
9.	Other Assets	0	0	0	0	0	0
	Total Assets	0	0	162,394	0	162,394	162,394

Civil Service Pension Fund was established in March 1993. Hence no data exists for the two earlier years (1984 and 1989).

Table 3D: Flow of Funds, Other Private Pension Funds
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**	**Sources of Funds**			**Flow of Sources**		
1.	Household Deposits	5,941	29,466	200,745	23,525	171,279	194,804
2.	Firm Deposits	8,020	39,779	271,006	31,759	231,227	262,985
3.	Parastatal Deposits	2,851	14,144	96,358	11,293	82,214	93,506
4.	NBFI Deposits	0	0	0	0	0	0
5.	Commercial Bank Deposits	832	4,126	28,104	3,294	23,979	27,273
6.	Central Bank of Swaziland	178	884	6,022	706	5,138	5,844
7.	Non-Resident Deposits	0	0	0	0	0	0
8.	Equity	0	0	0	0	0	0
9.	Other Liabilities	0	0	0	0	0	0
	Total Liabilities	17,823	88,399	602,235	70,577	513,836	584,412
B.	**Uses**	**Uses of Funds**			**Flow of Uses**		
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	2,673	13,260	90,335	10,587	77,075	87,662
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	0	0	0	0	0	0
5.	Commercial Bank Loans	0	0	0	0	0	0
6.	Government Loans	0	0	0	0	0	0
7.	Non-Resident Loans	15,150	75,139	511,900	59,989	436,761	496,750
8.	Fixed Assets	0	0	0	0	0	0
9.	Other Assets	0	0	0	0	0	0
	Total Assets	17,823	88,399	602,235	70,576	513,836	584,412

Based upon numbers provided by the Central Bank of Swaziland -- increased by 35 percent to reflect under-reporting.

Assumes 15 percent of pension and provident funds are kept in Swaziland -- based on October 1992 survey.

Assumes that employer pays two thirds contribution and employee pays one third.

Assumes commercial bank pension funds represent 7 percent of total and CBS pension fund 1.5 percent of total based upon proportions in the October 1992 pension and provident fund survey.

Assumes 24 percent from parastatals.

Table 4: Flow of Funds, Swaziland Building Society and Swaziland Industrial Development Corporation (E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	5,526	18,242	88,329	12,716	70,088	82,803
2.	Firm Deposits	9,431	17,956	61,790	8,525	43,834	52,359
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	1,002	0	0	-1,002	0	-1,002
5.	Commercial Bank Deposits	0	0	100	0	100	100
6.	Government Deposits	10,904	23,420	38,608	12,516	15,187	27,704
7.	Non-Resident Deposits	13,117	42,735	51,169	29,618	8,435	38,052
8.	Equity	435	4,318	25,536	3,883	21,218	25,101
9.	Other Liabilities	502	1,118	2,334	616	1,216	1,832
	Total Liabilities	40,917	107,788	267,866	66,871	160,078	226,949
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	7,334	16,532	74,786	9,199	58,254	67,452
2.	Firm Loans	34,154	71,593	133,278	37,438	61,685	99,124
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	0	0	0	0	0	0
5.	Commercial Bank Loans	1,579	12,689	40,870	11,110	28,181	39,291
6.	Government Loans	1,999	2,000	2,484	1	484	485
7.	Non-Resident Loans	79	0	0	-79	0	-79
8.	Fixed Assets	1,545	3,507	12,275	1,962	8,768	10,730
9.	Other Assets	-5,773	1,467	4,173	7,240	2,706	9,946
	Total Assets	40,917	107,788	267,866	66,871	160,078	226,949

Table 4A: Flow of Funds, Swaziland Building Society
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	5,526	18,242	88,329	12,716	70,088	82,803
2.	Firm Deposits	9,239	17,956	61,790	8,717	43,834	52,551
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	0	0	0	0	0	0
5.	Commercial Bank Deposits	0	0	0	0	0	0
6.	Government Deposits	0	0	0	0	0	0
7.	Non-Resident Deposits	0	0	0	0	0	0
8.	Equity	1,161	1,986	10,506	825	8,520	9,345
9.	Other Liabilities	417	891	2,334	474	1,443	1,917
	Total Liabilities	16,343	39,074	162,959	22,731	123,885	146,616
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	7,334	16,532	74,786	9,199	58,254	67,452
2.	Firm Loans	4,744	11,022	47,572	6,277	36,550	42,828
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	0	0	0	0	0	0
5.	Commercial Bank Loans	670	5,649	24,203	4,979	18,554	23,533
6.	Central Bank of Swaziland	1,999	2,000	2,484	1	484	485
7.	Non-Resident Loans	79	0	0	-79	0	-79
8.	Fixed Assets	1,386	2,733	11,248	1,347	8,515	9,862
9.	Other Assets	131	1,138	2,666	1,007	1,528	2,535
	Total Assets	16,343	39,074	162,959	22,731	123,885	146,616

Assumes 80 percent of shareholding held by institutional investors.
Assumes that 75 percent of fixed savings are held by institutional investors.
Assumes that all savings deposits are held by individuals.
Assumes 60 percent of mortgages are residential and 40 percent are commercial.
Assumes 100 percent of loans are personnal.

Table 4B: Flow of Funds, Swaziland Industrial Development Corporation
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**	**Sources of Funds**			**Flow of Sources**		
1.	Household Deposits	0	0	0	0	0	0
2.	Firm Deposits	192	0	0	-192	0	-192
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	1,002	0	0	-1,002	0	-1,002
5.	Commercial Bank Deposits	0	0	100	0	100	100
6.	Government Deposits	10,904	23,420	38,608	12,516	15,187	27,704
7.	Non-Resident Deposits	13,117	42,735	51,169	29,618	8,435	38,052
8.	Equity	-726	2,332	15,030	3,058	12,698	15,756
9.	Other Liabilities	85	227	0	142	-227	-85
	Total Liabilities	24,574	68,714	104,907	44,140	36,193	80,333
B.	**Uses**	**Uses of Funds**			**Flow of Uses**		
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	29,410	60,571	85,706	31,161	25,135	56,296
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	0	0	0	0	0	0
5.	Commercial Bank Loans	909	7,040	16,667	6,131	9,627	15,758
6.	Government Loans	0	0	0	0	0	0
7.	Non-Resident Loans	0	0	0	0	0	0
8.	Fixed Assets	159	774	1,027	615	253	868
9.	Other Assets	-5,904	329	1,507	6,233	1,178	7,411
	Total Assets	24,574	68,714	104,907	44,140	36,193	80,333

Table 5: Flow of Funds, Government of Swaziland
(E millions)

		1984	1989	1994	1984/89	1989/94	1984/94
A.	**Sources**		**Sources of Funds**			**Flow of Sources**	
1.	Household Deposits	0	0	0	0	0	0
2.	Firm Deposits	0	0	0	0	0	0
3.	Parastatal Deposits	0	0	0	0	0	0
4.	NBFI Deposits	0	0	0	0	0	0
5.	Commercial Bank Deposits	0	0	0	0	0	0
6.	Government Deposits	0	0	0	0	0	0
7.	Non-Resident Deposits	0	0	0	0	0	0
8.	Equity	0	0	0	0	0	0
9.	Other Liabilities	0	0	0	0	0	0
	Total Liabilities	31,114	227,601	476,565	0	0	0
B.	**Uses**		**Uses of Funds**			**Flow of Uses**	
1.	Household Loans	0	0	0	0	0	0
2.	Firm Loans	0	0	0	0	0	0
3.	Parastatal Loans	0	0	0	0	0	0
4.	NBFI Loans	0	0	0	0	0	0
5.	Commercial Bank Loans	13,603	35,724	90,879	22,121	55,155	77,276
6.	Central Bank of Swaziland	6,936	110,859	50,311	103,923	-60,548	43,375
7.	Non-Resident Loans	10,575	81,018	335,375	70,443	254,357	324,800
8.	Fixed Assets	0	0	0	0	0	0
9.	Other Assets	0	0	0	0	0	0
	Total Assets	31,114	227,601	476,565	196,487	248,964	445,451

Government deposits abroad, in 1994, were represented by the Capital Investment Facility and balances invested externally on the Government's own account.
Civil Service Pension Funds are taken into account in the Contractual Savings table.

ANNEX THREE

LEGAL AND REGULATORY FRAMEWORK FOR THE FINANCIAL SECTOR

A. INTRODUCTION

1. Swaziland has relatively well developed laws and an adequate judicial system. The legal system is based on Roman-Dutch common law, and legal developments in South Africa are followed closely. The judicial system and the legal profession appears to be relatively sophisticated, at the High Court and Court of Appeal level, but concerns were raised about the level of competence of the magistracy. In addition, recent concerns have been expressed by the legal profession, as there are only two High Court judges (out of the establishment of five), one of whom has little experience in civil matters. To alleviate the case load, the Government has made arrangements with the South African judiciary, whereby judges spend three months at a time in Swaziland hearing cases. Though no statistics were given, practicing attorneys felt that civil matters were dealt with quite expeditiously and competently at the High Court level. They were less sanguine about the performance of the magistrates, who handle smaller cases.

2. Some of the legislation governing commercial matters is quite modern, for example the Financial Institutions Order which was enacted in the 1970s. However, the Companies Act was enacted in 1912 and, even though there have been several attempts to modernize the Act *since then*, nothing has been achieved yet. Presently, a committee established by the Government is in the process of coming up with a new draft, but this has been going on for several years. While several parties expressed the need for more modern companies legislation, they felt they could manage with what existed. The main areas of concern with the old legislation, are in the area of limited liability protection, which has been interpreted quite widely, allowing directors to hide behind the veil of incorporation. Several of the procedures in the Companies Act, particularly dealing with insolvency and the winding-up procedures require streamlining. Modernization would provide for new developments in the company law that have taken place since 1912.

3. In litigation where security is available, this security can quite easily be realized in the courts. However, the major concern has to do with the land tenure system in Swaziland and the consequent lack of secure title in the majority of situations. There are three forms of land tenure in Swaziland, namely freehold, crown grants and Swazi Nation Land, (SNL) (which is land held in trust by the King of Swaziland for the Swazi Nation). SNL is the most common form and accounts for about sixty percent of rural and peri-urban land. It is normally allocated by traditional chiefs, on behalf of the King, to Swazi nationals, but it does not confer permanent rights and thus cannot be used as security for raising capital. Long-term leasehold agreements for SNL are being granted, on a pilot basis, under the recently approved Urban Development Project. This is a first step, in a long-term process, which it is hoped, will enable SNL to be used as security for loans.

4. With regard to other recent developments, presently there is a bill before Parliament for the liberalization and regulation of the insurance industry, as well as, the regulation of pension and

provident funds. In addition, with the assistance of USAID, the Ministry of Finance has been working on producing legislation to regulate capital markets. There is a small stock exchange in Swaziland, which is organized by Swazi Stockbrokers, registered as a financial institution under the Financial Institutions Order, 1974. The Swazi Stock Exchange is small, and given the size of the market, one wonders whether it is really necessary at this point to enact regulatory provisions, when there are other areas of legal reform that should be addressed more urgently. Presently Swazi Stockbrokers act as stockbrokers, run the exchange and sit on the stock exchange council. It will be important to, at least, separate the functions, but it would seem unnecessary to develop an elaborate regulatory framework at this time.

5. One growing area, which raises concern but is outside of the prudential supervision of the Central Bank of Swaziland, is the cooperatives which report to the Minister of Agriculture and Cooperatives. Increasingly these institutions have become major deposit takers, but with no financial supervision and minimal reporting requirements -- to a ministry without the necessary expertise to ensure their effective supervision.

B. FINANCIAL SECTOR

6. The legal and regulatory framework for the financial sector in Swaziland is quite comprehensive. The sector is regulated by the Financial Institutions (Consolidation) Order, 1975, and the Monetary Authority of Swaziland Order, 1975, F.I. Order as amended by the Monetary Authority (Amendment) Act, 1979, which changed the name of the Monetary Authority to the Central Bank of Swaziland. There were further amendments in 1982 and 1986.

7. **The Central Bank.** The principal objectives of the Central Bank of Swaziland (CBS) are to:

(a) issue and redeem notes and coins which are legal tender within Swaziland;
(b) promote monetary stability and a sound financial structure; and
(c) to foster financial conditions conducive to the orderly and balanced economic development of Swaziland.

8. The powers of the CBS are vested in a board of directors which is responsible for the policy and general administration of the CBS. Further, the board may make by-laws and issue directives to regulate the conduct of its business. The Governor is chairman of the board, the chief executive officer of the CBS, and except as otherwise provided, can act, contract, sign instruments and documents on behalf of the CBS, and on behalf of CBS, perform the duties and functions of licensing financial institutions under the Financial Institutions Order mentioned above.

9. The CBS maintains the external reserve of Swaziland with the approval of the Minister of Finance and conducts operations in gold and foreign exchange. It may open accounts for, and accept deposits, from financial institutions, determine the required reserves for banks and other financial institutions, and with the approval of the Minister, prescribe and regulate interest and

credit. The CBS may, also at an appropriate time and in agreement with banks, organize facilities for the clearing of checks and other instruments for effecting payments.

10. The CBS also serves as adviser to Government on monetary and financial matters, may open accounts for and accept deposits from Government, may underwrite, buy, sell, or deal in securities issued or guaranteed by Government. As agent for Government, undertake the issue, placement and service of any Government securities, including treasury bills. Act as agent for Government in the administration of any law in force relating to exchange control, and upon designation by the Minister serve as depository of, and the fiscal agency through which, dealings shall be conducted with, any international financial institution of which Swaziland is a member.

11. **Financial Institutions.** The financial sector is regulated by the CBS Order and the Financial Institutions (Consolidation) Order, 1975 (F.I. Order). This provides for the licensing of financial institutions (banks and others), stipulates financial requirements and limitations, requirements with regard to audit, information and examination, seizure of financial institutions, winding-up, etc. The F.I. Order defines a "bank" as "any financial institution, the operations of which include the acceptance of deposits subject to withdrawal or transfer by check". However, the other definitions in the F.I. Order appear somewhat confused as the definitions of "financial institutions" states that it means "any person carrying banking business". But at the same time the definition of "credit institution" means any financial institution other than a bank. The above definitions need to be clarified. For example, Swaziland Stockbrokers has been licensed as a financial institution. It is important that definitions be clarified, especially if new non-bank financial institutions are going to be brought into the financial sector and under the supervision of the CBS. These will have to be licensed and properly supervised by the CBS.

12. The F.I. Order specifically states that, it does not apply to building societies within the meaning assigned to it in the Building Societies Act No. 1 of 1962; cooperative societies under the Cooperative Societies Act No. 28 of 1964; and an insurer as defined in the Control of Insurance Order No. 33 of 1973. The Order also allows the Minister of Finance, after consultation with the Prime Minister, to exempt any class of credit institution from all or part of the provisions relating to the registration of shares, limitation of 20 percent on voting share in a local financial institution, capital and reserve requirements and limitations on specified operations and activities.

13. **Licensing Provisions.** In order for a financial institution (either local or foreign) to transact business in Swaziland, they have to be licensed in terms of the Order [1]. The F.I. Order gives CBS the power to investigate persons carrying on business as a financial institution without a license, and prohibits the use (except with the consent of CBS) of the word "bank" in the name, description or title under which the person is transacting business, unless it is a licensed financial institution, its agent, or a licensed agent. The F.I. Order requires that all local financial institutions be registered under the Companies Act, No. 7 of 1912. Applications for licenses are to be in writing to the CBS, with the documentation described in Section 11 of the F.I. Order. For a license

[1] Barclays Bank of Swaziland Ltd, Standard Bank Swaziland Limited and the Swazi Development and Savings Bank were deemed to be licensed in terms of the F.I. Order, as they already existed at the time the Order came into effect.

to be granted, the requirements with regard to capital and reserve accounts, stipulated in the F.I. Order, have to be fulfilled. If the CBS refuses to grant a license it has to furnish the applicant with a written statement outlining the reasons for its decision. There is, however, a proviso that if the Minister of Finance certifies to CBS that the granting of such license is not in the public interest, such certification is regard as final, and no other reason for refusal need be furnished to the applicant. Every licensed financial institution pays an annual fee to CBS. The Order regulates the place of business, term of license, the maximum voting share for any person, consolidation, transfer of assets, alterations to authorized share capital or paid-up capital, changes in name, or amendment to its memorandum or articles of association. Under certain, clearly defined, circumstances the CBS may revoke the license of any financial institution[2].

14. Section 15, provides for the licensing of agents of financial or investment institutions (not licensed in Swaziland, who represent or undertake any activity on behalf of Swaziland. The minimum amount of unimpaired capital, either paid-up (local financial institutions) or assigned (foreign financial institutions) to be maintained by financial institutions is specified in Sections 18 (1)(a)(i) or 18 (1)(b)(i). In addition, every financial institution is required to maintain a Reserve Account, before declaring a dividend or transferring a profit to its shareholders. The F.I. Order, *inter alia*, provides that financial institutions maintain certain minimum local assets and minimum liquid assets[3]. Financial Institutions shall be in breach of the Order if they fail to furnish information on the above matters to CBS within a reasonable period. There are limitations on specified operations and activities -- including lending more than 10 percent of the unimpaired paid-up or assigned capital and unimpaired balance in the Reserve Account to one borrower[4].

15. Part IV of the F.I. Order deals with audits, information and examination. Every financial institution is obligated to annually appoint auditors (satisfactory to the CBS), to audit its accounts. They are obligated to keep financial records, and not later than three months after the end of its financial year, prepare a balance sheet, and profit and loss account, and send copies to the CBS within a specified time period. In addition, financial institutions are required to send to the CBS monthly and quarterly returns[5].

16. Under Section 33, of the F.I. Order, the CBS may cause examinations to be undertaken of any financial institutions. For the purpose of such examinations, financial institutions are obligated to produce records and information as the examiner requires. The CBS has certain powers to require action by the financial institutions after examinations have taken place[6].

17. The powers conferred on the CBS to perform examinations is not as explicit as it should be. The Bank Supervision Department of the CBS is uncertain that it can perform on-site examinations. In order to provide the CBS, unequivocally, with the power to perform examinations

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[2] Section 14 of the Financial Institutions Order.
[3] Sections 21 and 22 of the Order.
[4] Section 24 of the Order.
[5] Section 31 of the Order.
[6] Section 36 of the Order.

regularly, and on-site if required, there is need for explicit provision to be made in the legislation for these powers. The CBS should have the power to undertake examinations under all circumstances.

18. The provisions with regard to seizure of a financial institution, require that the CBS act only upon the prior approval of the Minister and by application to the High Court, for an order to take possession of any financial institution under the circumstances specified in Section 45. These include situations where there is impaired capital, business being conducted in an unlawful or unsound manner, continuation of activities detrimental to the interests of depositors, and refusal to permit examination. Once the CBS takes possession of a financial institution, it is vested with the full and **exclusive** powers of "management, administration and control" of the financial institution concerned, including the power to continue or discontinue its operations[7]. Once the CBS takes possession of a financial institution, it has sixty days (or such longer period as the High Court may permit), within which to either terminate the seizure by restoring the institution to its board of management or owners -- or petition for a winding-up order under the Companies Act[8].

19. The F.I. Order also provides for the application of the provisions of the Companies Act relating to the winding-up of companies. The provisions[9] the F.I. Order refers to, include the role of the CBS, when there is a winding-up under the Companies Act. In any voluntary winding-up of a licensed financial institution the prior consent of the CBS must be obtained, further, where there is a judicial winding-up, there has to be a prior report by the CBS to the Court on the situation of the financial institution concerned.

20. **Swaziland Development and Savings Bank.** In addition to the banks regulated by the Financial Institutions Order, the Swaziland Development and Savings Bank (SDSB) is established and governed by its own Order -- the Swaziland Development and Savings Bank Order, No. 49 of 1973 -- as amended in 1993. The SDSB, according to this legislation, is to be administered, managed and controlled subject to the Order and the provisions of the Financial Institutions Order, 1974. The main objects of the bank are to "conduct the business of banking in all its aspects" including, *inter alia,* promoting economic development, mobilizing savings and resources for development purposes, advance loans to citizens or companies, or cooperatives registered under the laws of Swaziland, accept deposits, operate savings, or combined life assurance and savings schemes, establish or promote agricultural and rural industries. The Board of Directors consists of a chairman, (the Principal Secretary, Ministry of Finance), and six other members appointed by the Minister of Finance five of whom shall not be public servants, appointed on the basis of their skills in banking, financial, commercial and agricultural matters. The chairman is appointed by and serves at the will of the Minister. The Managing Director (MD) is appointed by the Minister in consultation with the Cabinet Standing Committee and Board of Directors. The MD is the Chief Executive Officer. The F.I. Order includes the SDSB in the regulation of the financial sector, but only to the extent "it is not inconsistent with any law regulating the affairs of said bank" -- the

[7] Section 48 of the Order.
[8] No. 7 of 1912.
[9] Sections 52 through 61.

SDSB Order. This provision provides for some ambiguity/uncertainty as to the extent of the application of the F.I. Order and the powers of the CBS over the SDSB. The Order exempts the income of the SDSP from any income tax. Further, the SDSB may be wound up voluntarily (with the consent of Ministers). The SDSB may also be wound up by the High Court on the application of a creditor or shareholder in circumstances in which the court would order the winding up of a company under the Companies Act, No. 7 of 1912.

21. Having financial institutions which are not subject to all the provisions of the F. I. Order, not only makes for a confused regulatory environment, particularly with regard to supervision of the bank by the CBS, but also provides a sense of favoritism (creates an "unlevel playing field"). In addition, because of the ambiguity, the SDSB might act imprudently or find itself subject to pressures to make decisions not based on a commercial basis. In order to avoid such situations and ensure even handed regulation and supervision of all financial institutions, it is important that they are all subject to the same rules and regulations. Thus it is recommended that all banks (whether Government-owned or otherwise) be converted to companies incorporated under the Companies Act, 1912, and be subject to the same rules of the Financial Institutions Order, without exception.

C. CONTRACTUAL SAVINGS

22. **Insurance and Pension Funds.** Contractual savings institutions in Swaziland could form a major source of long-term loanable funds for the domestic economy. The main such institutions in Swaziland are the Swaziland Royal Insurance Corporation (SRIC) and the Swaziland National Provident Fund. In addition there is a contributory civil service pension fund scheme, as well as, private sector pension funds.

23. The SRIC was established by the Swaziland Royal Insurance Corporation Order, No. 32 of 1973, with majority Government ownership and enjoys a monopoly status. The Government has taken the decision to end this monopoly, and new legislation regulating the insurance industry and pension funds is before Parliament. It had been expected that the legislation would have been enacted during 1994, however it has been delayed in Parliament for several months. The draft legislation (Insurance and Pension Funds Act) aims at accomplishing the stable demonopolization of the insurance sector, fostering an efficient and competitive insurance industry, protecting the interests of policy holders and beneficiaries, promoting investment and savings, and providing for the registration and regulation of pension funds.

24. The draft legislation, provides that only a licensed insurer under the Act, can carry on insurance business in Swaziland. The legislation also provides that only registered pension funds can operate, in Swaziland. To provide for the regulation of the industry, the draft legislation provides for the establishment of the Office of the Registrar, to be headed by the Registrar, subject to the supervision of the Governor of the CBS. In addition, the draft legislation provides for an Advisory Council for Insurance and Pension Funds, to be chaired by the Registrar. The council is to advise the Registrar on the performance of his functions under the legislation, and such other issues as may be requested by the Registrar, Governor of the CBS or the Minister of Finance. The

legislation also provides, *inter alia*, that the costs of regulation will be borne by the insurance industry and that the Registrar has the power to investigate and impose appropriate penalties.

25. The main part of the draft legislation provides for the licensing of insurance companies, the requirements for registration, and the circumstances under which registration can be refused by the Registrar. The draft legislation prescribes conditions under which insurers may operate, including officers, financial requirements, reporting requirements, investments. The draft, for the first time in Swaziland, provides for the regulation of insurance brokers and agents and their licensing. There is also the provision of rules for operations, record keeping requirements, auditing/recording requirements, and other matters for brokers and agents.

26. Under the draft legislation every pension fund in Swaziland has to be registered with the Registrar. In addition, the pension fund rules have to cover the matters specified in Section 52 (1) (a) through (m) with regard to its operations. Record keeping requirements, audits, actuarial reviews, and other reporting requirements are also covered. Section 61 (1) (a) of the draft legislation provides that two years after date of commencement of the Act, **each pension fund** must maintain at least fifteen percent of its total assets (as defined by the Minister of Finance on the advice of the Registrar) in domestic investments. It further provides in Section 61 (1) (b) that this percentage may be increased by the Minister of Finance, if he determines (after consultation with the Governor of the CBS and with the approval of the Cabinet) that it is in the public interest and will not adversely affect the interests of members and their beneficiaries. The draft legislation also prohibits investment in (a) any business of any employer who is a sponsor of the pension fund concerned, or (b) if such investment exceeds ten percent of the assets of the fund. There are exemptions in Section 64 for foreign pension funds, or for pension funds established by statute and operating under the Ministry of Labor and Public Service.

27. **Swaziland National Provident Fund (SNPF).** The SNPF was established in 1974, pursuant to the Swaziland National Provident Fund Order, 1974, to provide benefits for employed persons when they retire from regular employment. Section 7 of the Order defines "eligible employees" as any person employed under a contract of service, who is not a casual employee, a citizen of Swaziland, or in an excepted employment (as mentioned in the second Schedule to the Order). All contributing employers must be registered. Once an employer is registered, he has certain obligations, including filing returns on eligible employees. Sections 14, 15, and 16 give details of certain statutory contributions as well as special contributions. In addition, the employee's share is specified by the Minister. The Order in Section 24, describes the various types of benefits, namely age, invalidity, emigration and survivors, and provides for the payment of benefits under the prescribed circumstances.

D. HOUSING FINANCE

28. Housing finance in Swaziland is provided by the Swaziland Building Society (SBS), the SDSB and on a smaller scale, the commercial banks, who have tended to lend to higher income groups. The National Housing Board (NHB), created as a parastatal in 1988, is supposed to

develop affordable housing solutions and manage the Government's rental housing stock. However it does not provide financing. Thus beneficiaries of NHB projects seek mortgage financing directly from financial sector institutions.

29. SBS is regulated by the Building Societies Act, 1962, as amended, and is the only building society presently operating in Swaziland. Building societies have to be registered under the Act in order to carry out business in Swaziland. The Governor of the CBS is the Registrar of building societies. Section 7 of the Order, prescribes the matters which need to be covered in the rules of a building society, e.g. name, principal objects, how funds will be raised, and so on. The effect of registration is to make a building society a body corporate, capable of suing and being sued. A certificate of registration of a building society, requires that the society, if registered as a company, should be struck off the companies register.

30. Building societies may, *inter alia*, acquire ownership of land, up to a value of 10 percent of its listed assets, receive savings and fixed deposits, borrow money, issue shares, lend or advance money to members, invest in bills, and so on. Section 19 lays down conditions with regard to savings deposits and fixed deposits. Sections 22 and 23 lays down conditions related to the maximum shareholding by individuals. There are also restrictions on borrowing, requirements to hold a daily amount as security for repayments to members. Further, Section 42 states that the Registrar may, from time to time, prescribe that a building society should maintain certain minimum local assets in Swaziland. The legislation provides for certain reporting requirements and the keeping and auditing of financial accounts. The Registrar can investigate the affairs of a building society, either on the application of its members of under the circumstances provided for in Section 57, e.g. failure to make any return required by the Act, etc. For the purposes of the investigation the officers of the building society must produce all securities, accounts, books etc., and be prepared to give evidence on oath in relation to the business.

E. COOPERATIVES

31. One area of concern within the financial sector is the growing savings within the Savings and Credit Cooperatives. These are outside the control and supervision of the Central Bank and are not subject to the requirements in the Financial Institutions Order applicable to banks and other financial institutions. These cooperatives are registered at the Ministry of Agriculture and Cooperatives and are regulated by the Cooperative Societies Act. This legislation is currently under review. There has been recent rapid growth in the number, as well as the amount of money handled by these cooperatives. There is little financial expertise, management supervision, and monitoring, currently within the cooperatives -- although the Swaziland Association of Savings and Credit Cooperatives, provides training and bookkeeping services to members. Given these developments, the continued supervision of what are "financial institutions" by the Ministry of Agriculture (which neither has the requisite skills nor manpower, nor should it try to acquire them) is an anomaly, that needs to be corrected urgently, in order to forestall any possible failures on the part of these credit and savings cooperatives.

32. The Cooperative Societies Act, 1964, governs cooperative societies of all types; including savings and credit cooperatives. All societies have to be registered with the Registrar of Cooperatives, who is appointed by the Ministry of Agriculture. Parts VI and VII of the Act deal with the property and funds of a registered society, including financial provisions, loans to members, investment of funds and disposal of profits; and audit, inspection and inquiries. None of the provisions require the level of reporting or the restrictions on investment that are applicable to financial institutions under the Financial Institutions Order. In addition, the Registrar does not have the qualified staff to provide the type of specialized supervision required of financial cooperatives as opposed to other types of cooperatives. The Act, of course, provides for the usual procedures for liquidation and other situations where cooperatives are closed down.

F. RECOMMENDATIONS

33. Clear provisions must be enacted to provide adequately for on-site and off-site examination by the Bank Supervision department of the Central Bank -- as well as handling of failed or failing banks.

34. Enactment of a new Companies Act.

35. Legislation should be enacted to bring savings and credit cooperatives under the supervision of the Central Bank.

ANNEX FOUR

TAXATION OF FINANCIAL INSTITUTIONS AND INSTRUMENTS

1. Financial Institutions in Swaziland are taxed on their taxable income -- with tax payable to the Government of Swaziland (GOS). The corporate tax rate is 37.5 percent for the service industry. Public enterprises are exempt from company tax because Government has at least 50 percent shareholding in these corporations. The Swaziland Development and Savings Bank, the Swaziland Royal Insurance Corporation, the Swaziland National Provident Fund, and Tibiyo Taka Ngwane are therefore all exempt from the payment of corporate tax.

The Stamp and Transfer Duty

2. There is a stamp duty on financial instruments that is borne by customers who have access to financial services.

3. Items affected by the stamp duty are:

(a) (i) Bill of exchange of promissory note payable on demand;

(ii) Fixed deposit receipts, including certificates or other instruments whereby a fixed deposit is expressed to have been received.

(b) (i) Bill of lading for the carriage or transport of any goods by sea;

(ii) Warehouse receipt;

(c) Broker's note:

(i) in respect of the sale or purchase of moveable property other than marketable security;

(ii) in respect of sale or purchase of any marketable security;

(d) Bonds; a mortgage bond hypothecating immovable property or any interest therein and a general or special bond passed before a notary public, where the total amount of the debt secured does not exceed E30,000.

(e) Lease or agreement of lease; including an instrument intended or operating as a lease or sub-lease;

(f) Marketable Securities: in respect of the original issue by a company registered within Swaziland of shares, stocks or debentures issued;

(g) Securities or surety-ship; any instrument of security or pledge or any act of surety-ship, indemnity, or guarantee not otherwise with duty.

LIST OF RECOMMENDATIONS

A. MONETARY POLICY

- Swaziland should seek to extract the maximum possible advantage from its close relationship with South Africa.

- Unless economic policy management in South Africa deteriorates seriously, Swaziland should retain its membership of the CMA. Even if economic management does deteriorate significantly in South Africa, Swaziland's freedom to operate independently, will be severely constrained.

- The lilangini should retain parity with the rand for the foreseeable future

- The monetary authorities in Swaziland should review the effectiveness of the operation of the Minimum Local Asset Requirement to determine whether it is having the desired effect.

- Swaziland should seek to establish stronger channels of communication and co-ordination with the South African monetary authorities, to ensure that there is full co-ordination, and understanding, of economic policies within the CMA.

- Every effort should be made to re-establish positive real deposit and lending rates in Swaziland.

- Efforts by the monetary authorities to maintain lower interest rates in Swaziland than in South Africa should be discontinued.

B. BANKING SUPERVISION

- Financial regulation and supervision should be co-ordinated, with one supervisory authority for all financial institutions -- preferably situated in the Central Bank of Swaziland.

- Special dispensations for specific financial institutions should be discontinued.

- The powers of the Central Bank to conduct supervision (off-site and on-site) should be explicitly guaranteed in all financial legislation and enforcement of all regulations should be endorsed by the Ministry of Finance and the Courts.

- Prudential requirements should be reviewed to ensure that corporate governance and risk management are fully addressed.

- Information supplied by the banking system should be better utilised for analysis and follow-up as well as to provide management information to the CBS and the banking system.

- Consolidated supervision should be addressed in conjunction with the appointment of one central supervisory authority.

- Consumer protection should be addressed, not by automatically assuming that a blanket deposit insurance scheme is the answer, but by limiting such protection only to deposits that are invested in government backed securities.

C. COMMERCIAL BANKING

- SDSB's restructuring must include a realistic review of the bank's development goals, recognition of the actual losses and continuing financial exposure, and future investment and funding that will be required from the government budget.

- The Government should seriously consider the rapid privatization of the SDSB.

- The SDSB will have to be ***de-politicized*** if the bank is to be successfully restructured.

- A restructured SDSB should only operate in a very narrow band of development lending where it can fill a gap in the service sector and can perform efficiently.

- The restructured institution should ***not*** attempt to be a commercial bank as well as a development institution.

D. DEVELOPMENT FINANCE INSTITUTIONS

- Funding for the SIDC is likely to become a future constraint and avenues such as the sale of bonds and other institutional paper -- and the possible acceptance of term deposits -- should be examined by the Corporation.

- The Government should re-examine its taxation policy with respect to Tibiyo Taka Ngwane.

- The Swaziland Development and Savings Bank should be radically restructured. It should move out of commercial banking; cut back on staff; bring in new professional management; partially privatize the institution; and seek sources of funding other than customers deposits.

- In the restructuring process, the SDSB should recover, to the full extent of the law, all outstanding non-performing customer loans.

- The SDSB should continue its savings collection post function. However, these funds should not be used to fund the development finance activities of the bank. These deposits should be placed in low risk, Government guaranteed, securities.

- Funds to finance the activities of the new SDSB should come from the Government budget, foreign development bank loans, and shareholder funds

E. MONEY AND CAPITAL MARKET DEVELOPMENT

- The Swazi authorities should approach their CMA partners and negotiate an exemption to permit some part of pension and life insurance funds belonging to Swazi nationals to be invested outside the CMA. In addition, the authorities should investigate the practical

steps necessary to establish a unit trust through which Swazi nationals could obtain exposure to long term investments outside of the CMA.

- The MOF should start initiatives to develop cash and debt management systems.

- It is recommended that the CBS should decide upon an approach to money and debt market development that combines active management of Swazi liquidity with developing more efficient links with South African markets.

- The CBS should coordinate with the MOF to develop a system for forecasting system liquidity. This system would then be used to plan the timing and maturity of T-Bill issues and Government Stock issues.

- A plan should be agreed to rationalize the current system of government accounts at commercial banks. The objective of this rationalization is to improve both debt management and the ability of the CBS to manage system liquidity.

- The authorities should develop the legislative framework for the establishment of unit trusts.

- In deciding upon its methodology for managing system liquidity the CBS should also consider how much sterilization of foreign exchange operations will be undertaken; how the segmentation caused by the liquidity ratio is to be overcome; establish the ability to tender repurchase agreements; and determine how tenders can be more widely advertised.

- Bring the reserve asset ratio, the liquidity ratio and the local asset ratio into one prudential regulatory framework based on risk oriented prudential regulations.

- The CBS should control the level of reserve balances in Swaziland through the use of T-Bill auctions and auctions of repurchase agreements.

- Access to the discount window should be via the sale or security of T-Bills only.

- The settlement period for tenders should be lengthened to four working days.

- The CBS should stop paying interest on excess reserves and cease to take term deposits.

- The CBS should cease offering overdrafts (any overdraft arrangements entered into should attract a highly penal interest rate).

F. RURAL FINANCE

- Broad based and sustainable increases in agricultural production and income levels have not resulted from the Government's various schemes to improve access to finance for less well endowed Swazi farmers.

- The Government should re-examine the experiment that motivated these funding programs and seek alternative approaches to providing means for improving the production and income levels of small-scale Swazi farmers.

- The SDSB should be restructured as a pure development banking institution. This will permit it to make greater efforts to improve loan repayment performance; and investigate group lending schemes and other innovative forms of loan project development.

G. MICRO/MEDIUM AND SMALL SCALE ENTERPRISES

- The Central Bank should establish minimum standards for lending institutions involved with the Small Scale Guarantee Scheme to improve loan performance and participation.

- Swazi Bank needs to reformulate it's lending to MSME's to improve loan performance and obtain better repayment rates.

- Government institutions should seek to enhance collaboration with NGOs and SACCOs in an attempt to increase outreach while minimizing transaction costs.

- The Government should, as a matter of urgency, increase the financial expertise, management, supervision and monitoring of the Savings and Credit Cooperatives.

- The Cooperatives Act should be reviewed and should allow for supervision and regulation -- especially of the larger credit cooperatives -- by the central bank.

- There needs to be regular auditing and training made available to the savings and credit cooperatives to ensure compliance with prudential and accounting requirements.

- Asikhutulisane should be provided with technical assistance and support to help it manage the transition from a community based organization to a national financial institution.

- Resources available through the international credit union system should be utilized to assist in providing necessary expertise to the savings and credit cooperatives.

- SGBT needs to dramatically increase in scale to achieve self-sufficiency -- balancing its mandate to work with small and micro-scale businesses with the profitability provided by larger volumes of businesses.

- Financial institutions should attempt to identify ways of providing equity capital for those businesses which have a capacity for growth but can only obtain debt from the formal sector.

- The business support organizations need to better define and improve their services to MSMEs. The Swaziland Chamber of Commerce should consider how it could serve in a mentoring capacity for Swazi businesses. The Sibako Chamber of Commerce needs to develop the types of programs to support business development (market development, group purchasing) rather than compete with NGO finance and training activities.

- Training organizations such as BMEP need to be sustainable as they expand their adult training programs as well as influence the national student curriculum.

H. HOUSING FINANCE

- The CBS should expedite the implementation of the Basle Accord which bases capital adequacy on the risk weighting of banks' assets (with a lower risk weighting for mortgage finance).

- The Government should seek to stimulate the creation of new longer-term deposit instruments for banks, by allowing banks to issue, for example, "housing certificates" with the same tax break provided to "share" investors in the SBS.

- The Monetary Authorities should carry out a study of existing legislation to determine amendments or new legislation needed to regulate and stimulate the capital market and the formation of a secondary mortgage market;

- The Government should design, in collaboration with commercial banks, SBS and the stock market, a secondary mortgage market mechanism to allow the recycling of funds to the banking system.

I. LINKAGES

- The Swazi authorities should seek to promote a heightened level of consultation and coordination between the participants of the CMA agreement.

- In addition, the members of the SACU agreement should strive to ensure greater coordination, cooperation and consultation.

- The Swazi authorities should take strong pro-active steps to protect the revenues which it receives under the SACU agreement.

- Swaziland should review ways in which it can reduce Swazi citizens and Swazi companies to an over-exposure of rand denominated assets. This is particularly important for the contractual savings institutions.

- The authorities should actively consider how they could and should respond to the abolition of exchange controls by South Africa.

- The Swazi authorities should speed up the process whereby legislative changes are made.

- The Swazi authorities should seriously consider the greater synchronization of financial legislation with that of South Africa.

- The CBS should seriously consider the adoption of the SARB's financial regulatory returns.

- The CBS and Swaziland Stockbrokers should examine ways in which Swaziland could link itself more closely to the Johannesburg Stock Exchange and to money and capital markets in South Africa.

- The authorities should develop a one-stop investment center for the granting of all investment approvals and licenses.

J. FLOW OF FUNDS ANALYSIS

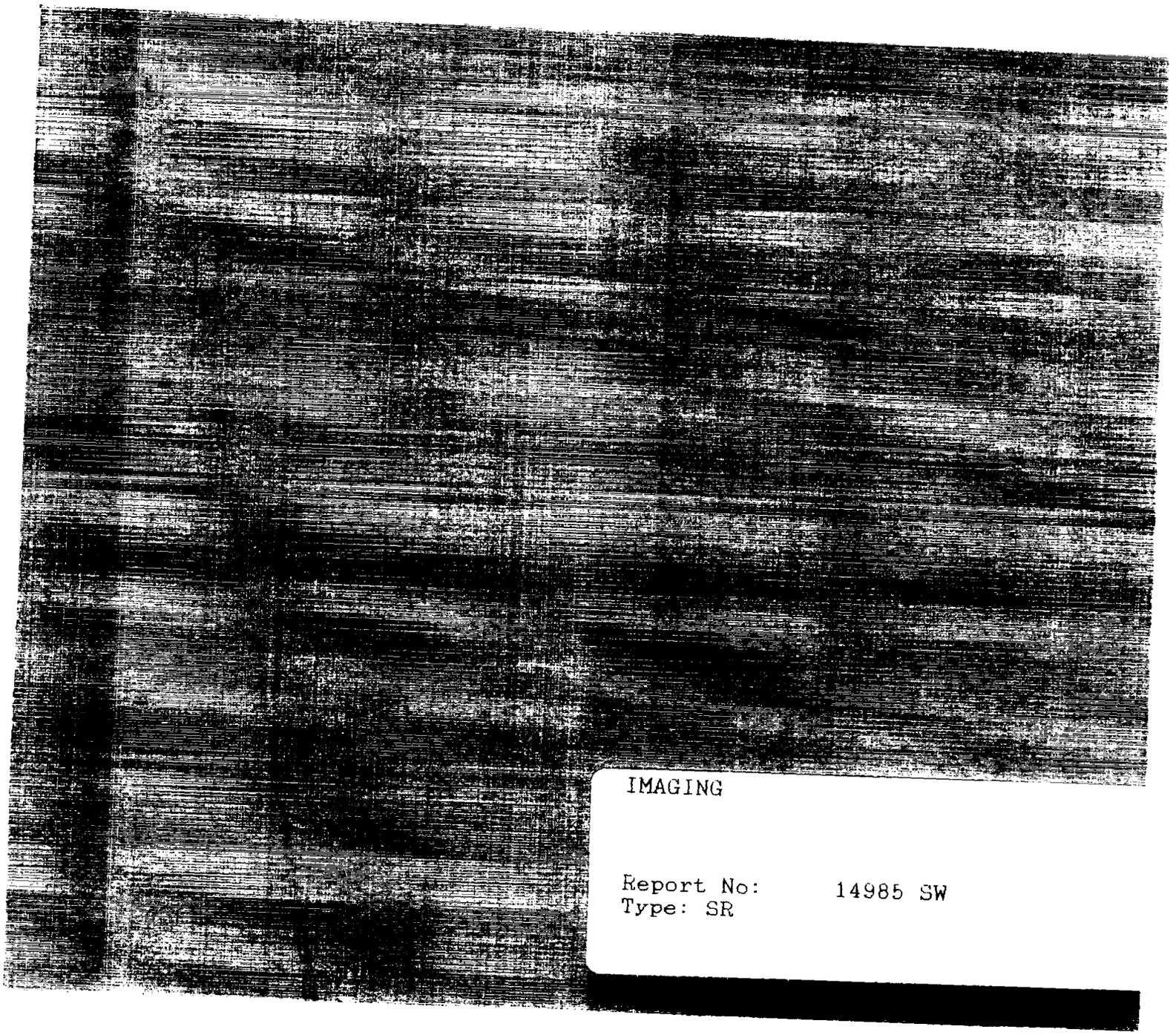
- The Swazi authorities should re-examine the role of the Central Bank of Swaziland and clarify what is expected from this institution. The Government should then support the central bank to ensure that it can actually undertake the functions demanded of it.

- The rapid growth of the contractual savings institutions emphasizes the importance of properly legislating the use of the funds that they manage. This demands the speedy promulgation of the Insurance Act.

- The Registrar of Insurance should be fully supported -- and his office should work to develop an improved data base for this important sector.

- Long Term contractual savings should earn the maximum possible return -- hence any restrictions placed on the use of these funds should be as minimal as possible.

- Savings and Credit Cooperatives are emerging as a small, but important, component of Swaziland's financial sector. The monetary authorities should therefore make certain that an adequate regulatory and supervisory framework is in place to ensure that depositor's funds are not put at undue risk.



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