TECHNICAL ASSISTANCE REPORT

KINGDOM OF LESOTHO

Report on the Financial Soundness Indicators Technical Assistance Mission (April 27–May 04, 2023)

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Acronyms and Abbreviations

AFR ....IMF's African Department

ARBA…...Aggregate Resident Based Approach

BCBS...... Basel Committee on Banking Supervision

Bp .... Basis points

CBL ....Central Bank of Lesotho

CBCSDI…Cross-Border, Cross-Sector, Domestically Incorporated Consolidation Basis

DL...........Domestic Location Basis

DTs.........Deposit takers

FC ....Foreign currency

FSI-SRs...FSI Sectoral Financial Statements Template

FSIs ....Financial soundness indicators

2019 FSIs Guide…Financial Soundness Indicators Compilation Guide 2019

FSIC ....Financial Soundness Indicators Institutional Coverage Report

FSM........Financial Soundness Indicators Metadata

FVOIC ....Fair Value Through Other Comprehensive Income

FVPTL ....Fair Value Through Profit and Loss

IAS..........International Accounting Standards

ICs ....Insurance corporations

ICS ....Integrated Collection System

IFRS ....International Financial Reporting Standards

ISIC ....International Standard Industrial Classification of All Economic Activities

NLICs…..Nonlife insurance corporations

LICs…….Life insurance corporations

IMF ....International Monetary Fund

NC ....National currency

NOP........Net open position

NPLs.......Nonperforming loans

OCI ....Other comprehensive income

OFCs...... Other financial corporations

PFs .... Pension funds

ROA........Return on Assets

ROE........Return on Equity

RWAs .....Risk-Weighted Assets

STA ....IMF's Statistics Department

TA........... Technical assistance

Summary of Mission Outcomes and Priority Recommendations

1. **At the request of the Central Bank of Lesotho (CBL), and with the support of the International Monetary Fund's (IMF's) African Department (AFR), the Statistics Department (STA) conducted a remote technical assistance (TA) mission on the compilation of financial soundness indicators (FSIs) during April 27–May 04, 2023.** The mission (i) assisted CBL staff in compiling FSIs using the new FSIs report forms to ensure consistency with the IMF's *2019 FSIs Compilation Guide* (*2019 FSIs Guide*); (ii) reviewed available source data, institutional coverage, and accounting and regulatory frameworks used in the production of FSIs for deposit takers (DTs) and insurance corporations (ICs); and (iii) agreed with CBL officials on a work plan to compile and report FSIs to STA in the new FSIs report forms.

2. **Prior to the mission, the CBL compiled a set of FSIs for its own macro prudential supervision and for reporting to STA for dissemination in the IMF's FSI website.** The CBL compiled 11 core and eight additional FSIs for DTs, which were not yet aligned with the *2019 FSIs Guide's* definition (see Appendix II). The mission, together with CBL staff, compiled on a quarterly basis (i) two new core and one additional FSIs for DTs; and (ii) five additional FSIs for ICs, of which one relates to the size of the OFC subsector (ICs) for reporting to the IMF. In addition, the mission also aligned the definitions of several FSIs for DTs to ensure consistency with the *2019 FSIs Guide* (Annex 2).

3. **The mission, in collaboration with CBL staff, updated the existing bridge tables to compile FSIs for DTs and developed new ones for ICs respectively for reporting to STA from the source data.** The bridge tables cover the mapping of income and expense statements, balance sheets, and memorandum/supervisory series for DTs and ICs to the new FSI templates. The use of the bridge tables is to ensure greater consistency in the compilation of FSIs and facilitate the adoption of the new report forms. Source data for compiling FSIs for DTs and ICs are adequate and generally meet the criteria established by the *2019 FSIs Guide* for publication in the IMF website.

4. **The regulatory and accounting frameworks are broadly consistent with Basel I and International Financial Reporting Standards/International Accounting Standards (IFRS/IAS), respectively.** The capital adequacy ratios and risk weighted assets of banks followed mainly the Basel I framework. Commercial banks operating in Lesotho have already adopted IFRS9 since 2018 for the valuation of their financial instruments and relied on a mixture of supervisory method and IFRS9's expected credit loss model to calculate the minimum provisioning requirements. Further, the definitions of nonperforming loans (NPLs) are also broadly consistent with the *2019 FSIs Guide* and interests are not accrued on the NPLs.

5. **Currently, the CBL compiles the FSIs for DTs using Domestic Location (DL) basis, while the FSIs for OFCs subsector (including ICs) are compiled using Aggregate Resident Based Approach (ARBA).** The institutional coverage of DTs is geared towards commercial banks only. For insurance sector, the coverage includes six life insurance corporations (LICs) and four nonlife insurance corporations (NLICs).

6. **The mission also identified a few areas for improvements in terms of data collection and methodological framework.** While the definition of customer deposits has been realigned with the methodology in the *2019 FSI Guide*, the mission recommended to the authorities to realign the definition of large exposures and short-term liabilities as well. The mission reiterated the 2014 FSI mission's

recommendation of including the rand positions in net open position in foreign currency, foreign currency denominated loans, and foreign currency liabilities.

7. **The mission also assisted to fill-in the new metadata and institutional coverage report forms (FSM and FSIC) accompanying the publication of FSIs.** The contents of new Tables 2 and 3 of the metadata were broadly discussed and agreed with the CBL staff and are consistent with the requirements of the *2019 FSIs Guide*. The publication of the metadata would provide additional information on the structure of banking sector and the accounting and regulatory frameworks underpinning the production of the FSIs compared to the methodology of the *2019 FSIs Guide*.

8. **A timeframe for reporting FSIs to STA was also discussed and agreed on with the authorities.** The authorities started reporting FSIs data for DTs in IMF's FSI reporting template using the bridge tables developed during the mission and finalized the contents of metadata and FSIC report forms in June 2023 for review by STA, which were disseminated in the IMF's FSIs website in July 2023. Newly compiled FSIs on the size of OFCs and ICs can be reported by end-September 2023 for dissemination.

9. **To support progress in the compilation of FSIs in line with the *2019 FSIs Guide* and the dissemination of the data, the mission has prepared a detailed action plan.** The priority recommendations are summarized in Table 1. Further details on the other recommendations and the related actions/milestones can be found in Detailed Technical Assessment and Recommendations and Detailed Action Plan.

TABLE 1. Priority Recommendations

Target Date	Priority Recommendations	Responsible Institutions
June 2023 (Completed)	Report to STA for review the FSI sectoral financial statements (FSI-SRs) for DTs, including income and expense statement, balance sheet, and memorandum series form 2009 Q1 onwards, the new FSI institutional coverage (FSIC), and the new FSI metadata (FSM).	**CBL**
July 2023 (Completed)	Start regular reporting to STA, FSI-SRs (on a quarterly basis) for DTs, FSIC (annually) and FSM through the Integrated Collection System (ICS) for disseminating on the IMF's FSIs website with data from 2009 Q1 onwards.	**CBL**

Section I. Detailed Technical Assessment and Recommendations

A. ACTION PLAN

10. **The Action Plan below includes steps to accomplish milestones as well as the target completion dates.** Actions are prioritized as high (H), medium (M) and priority recommendations (PR) identified.

Priority	Action/Milestone	Target Completion Date
Improved data and metadata accessibility		
PR	Report to STA for review the FSI sectoral financial statements (FSI-SRs) for DTs, including income and expense statement, balance sheet, and memorandum series form 2009 onwards, the new FSI institutional coverage (FSIC), and the new FSI metadata (FSM).	June 2023 (Completed)
A new data set has been compiled and disseminated internally and/or to the public		
PR	Start regular reporting to STA for DTs, FSI-SRs (on a quarterly basis), FSIC (annually) and FSM (metadata) through the Integrated Collection System (ICS) for disseminating on the IMF's FSIs website with data from 2009 Q1 onwards.	July 2023 (Completed)
A new data set has been compiled and disseminated internally and/or to the public.		
H	Start using the revised bridge tables developed by the mission to compile the FSIs for DTs which are consistent with the *2019 FSIs Guide.*	May 2023 (Completed)
M	Align the definition of large exposure to the *2019 FSI Guide* from loans to top 20 borrowers to sum of all credit exposures to a single or group of connected borrowers which are 10 per cent or more of Tier 1 capital. If not, document in the metadata the deviation from the *2019 FSIs Guide* until the definition is revised.	June 2024
H	Realign the definition of customer deposits to cover deposits from residents and nonresidents, except those placed by (resident and nonresident) financial corporations, central governments, and central bank.	May 2023 (Completed)
H	Compile new FSIs on provision to NPLs, credit to private sector, and loans concentration by economic activity.	May 2023 (Completed)
H	Compile the spread between reference lending and deposit rate.	May 2023 (Completed)

H	Realign the calculation of return on assets to the definition of the *2019 FSIs Guide* by taking the net profit before tax instead of after tax.	May 2023 (Completed)
H	Liquid assets: include tradable short-term debt securities that can easily be converted into cash.	May 2023 (Completed)
M	Short-term liabilities: include deposit liabilities of 3 months or less. If not, document in the metadata the deviation from the *2019 FSI Guide*.	June 2024
H	Realign the calculation of net open position in foreign currency, foreign currency denominated loans and foreign currency liabilities to the *2019 FSIs Guide* by including the positions in rand.	May 2023 (Completed)
H	Re-map management fees from personnel costs to other expenses in the income and expense statement.	May 2023 (Completed)
M	'Provision on bad debts' in the income and expense statement include both provision for loan losses and provision other losses. Document this lack of breakdown in metadata.	May 2023 (Completed)
M	Compile five additional FSIs for ICs of which one relates to the size of the OFC subsector (ICs), effective from March 2020 data, for dissemination in the FSIs website.	September 2023 (Completed)

B. BACKGROUND

11. **This was the second FSIs TA mission for Lesotho after the first one in April 2014.** Prior to the mission, the CBL has been compiling and reporting to STA quarterly FSIs since 2009 Q1 data onwards but they were based on the methodology of the *2006 FSIs Guide*. The CBL also benefited from several TA Missions on Monetary and Financial Statistics (MFS) to enhance sectorization of financial statements, which are also adopted for the compilation of the FSIs. The FSIs for DTs currently play a significant role in the CBL's surveillance of the financial system.

12. **FSIs are indicators of the current health of a country's financial sector, and of its corporate and household counterparts.** In this regard, the *2019 FSIs Guide* recommends compiling and disseminating 17 core and 12 additional FSIs for DTs, and 23 additional FSIs for other sectors. The IMF's FSIs website disseminates FSIs data and metadata for 147 countries. The site acts as a hub where users have a point of easy access to FSIs that broadly comply with internationally accepted methodological standards, promoting cross-country comparability.

C. OVERVIEW OF THE FINANCIAL SYSTEM IN LESOTHO

13. **The CBL performs the traditional central banking functions.** In addition, the CBL acts as a supervisory authority mainly for the banks, ICs, pension funds, microfinance institutions, and collective investment schemes. In addition, the CBL supervises large Savings and Credit Cooperatives (SACCOs) of which total assets exceed the threshold of 5 million Loti.

14. In Lesotho, DTs account for approximately 47 percent of the total financial system assets (Table 1):

- **The banking sector comprises four banks, of which one is domestic controlled and three are foreign-owned banks.** The three foreign-owned banks operating in Lesotho hold around 41 percent of the total assets of the banking sector and are subject to the same banking laws and regulations as the domestically controlled bank. These banks do not have any resident or nonresident subsidiaries or nonresident branches.

- **There are 68 SACCOs which are all domestically controlled and domestically incorporated.** They do not have any branches or subsidiaries**.** Their combined assets represent less than one percent of the DTs subsector. They are normally supervised by the Ministry of Small Business Development, Cooperatives and Marketing. Since November 2022, one of the largest SACCOs, namely Boliba Multi-purpose Cooperative, has fallen under the supervision of the CBL while other SACCOs which are of smaller size are still under the supervision of the Ministry of Small Business Development, Cooperatives and Marketing. The prudential requirements for large SACCOs currently are different from banks, and they do not report data to CBL yet. They only have to maintain cash reserve and liquid asset requirements of one percent and 10 percent, respectively, on their deposits and savings. Therefore, banks are the only DTs which are included in the coverage of FSI.

15. The OFCs subsector holds approximately 53 percent of total assets of the financial system. The bulk of the OFCs sector are concentrated in two groups: insurance corporations (ICs) and pension funds (PFs). Together they constitute around 44 percent of the total financial system.

- **The insurance sub-sector consists of six life and four non-life ICs.** Together the ICs account for around 22 percent of the total financial system assets.

- **The PF sub-sector accounts for 21.8 percent of the total assets of the financial system.** The main institution of the PF sub-sector is the Government Pension Fund, which covers mainly civil servants and accounts for more than 80 percent of the sub-sector.[1]

- **The remaining of the OFCs subsector comprises 132 nonbank deposit taking microfinance institutions, one money market fund, and three non-money market funds.** Together, they account for around 10 percent of the total financial system assets.

TABLE 2: The Financial Sector

Financial Corporations	Number of Institutions	Total Assets (Million, Loti)	Share in Total Assets (in percent)
Deposit Takers	**72**	**20, 014**	**47%**
Commercial banks	**4**	19,843	46.2%
o/w domestic controlled	**1**	2,094	4.9%

[1] The *Pension Fund Bill* was promulgated in 2019, giving the CBL just recently supervisory authority over the subsector. So far, the CBL has registered and received data from only six private PFs.

o/w foreign controlled	3	17,748	41.3%
Savings and credit cooperatives	68	171	<1 %
Other Financial Corporations	145	**22,929**	**53%**
Insurance	**10**	*9,405*	*21.9%*
o/w life insurance	6	*8,622*	*20.1%*
o/w nonlife insurance	4	*783*	*1.8%*
Pension funds	7	*9,374*	*21.8%*
Money market funds	1	*774*	*1.8%*
Non-Money Market Funds	3	*2,210*	*5.1%*
Non-DT microfinance institutions	132	*1,166*	*2.7%*
Total	217	**42,943**	**100%**

Sources: CBL and IMF staff.

D. INSTITUTIONAL COVERAGE AND CONSOLIDATION BASIS

16. **The FSIs are currently compiled using DL consolidation basis for DTs and ARBA for OFCs.** DL currently covers resident DTs along with their resident branches in the same sector. DL provides adequate coverage of the DTs for reporting FSIs since none of DTs operating in Lesotho have cross-border or cross-sector activities. As mentioned earlier, the institutional coverage for DTs comprises three foreign-controlled banks and one domestically controlled bank in operation, which are all domestically incorporated. SACCOs are excluded because they do not have the same capital and prudential requirements. For ICs, the FSIs are compiled using ARBA. ARBA consists of simple aggregation of the income and expense statements, balance sheets, and memorandum series of ICs. No intragroup adjustments are done since the insurance laws and regulations require ICs to conduct life and nonlife activities in separate units.

17. **Currently there are no DTs in receivership/liquidation in Lesotho.** The *2019 FSIs Guide* recommends including DTs in distress if they hold significant positions and to compile FSIs both including and excluding these DTs. However, if they are excluded from the compilation of the FSIs, this should also be stated in the FSIC.

E. ACCOUNTING AND REGULATORY FRAMEWORKS UNDERLYING THE FSI DATA

18. **Commercial banks have already adopted the IFRS9 since 2018.** Prior to implementation of the IFRS9, commercial banks used IAS39 for valuation of financial instruments. In accordance with IFRS9, financial instruments may be valued at amortized cost, fair value through other comprehensive income (FVOCI), and fair value through profit and loss (FVTPL). In addition, banks have already adopted expected credit loss model, alongside supervisory method to calculate loan loss provisioning requirements. Realized and unrealized gains/losses from the revaluation of financial instruments denominated in foreign currencies are valued at FVTPL. For insurance corporations, the realized and unrealized gains/losses on investments in financial instruments are valued at FVTPL.

19. The regulatory framework for compiling the capital adequacy ratios of banks follows mainly Basel I Capital Accord. The components of regulatory capital and risk-weighted assets (RWAs) are defined in the CBL's Financial Institutions Regulations 2016 on capital adequacy.

- Tier 1 capital comprises ordinary shares, ordinary share premium, undisclosed reserves, perpetual non-cumulative preference shares and preference share premium, statutory reserve, capital reserves- excluding asset revaluation, general reserves- excluding reserves for losses on assets, audited retained earnings after application of supervisory deductions for current year losses (whether audited or not), and goodwill.
- Tier 2 capital consists of fixed assets revaluation reserves, securities revaluation reserves, undisclosed reserves, general provisions for losses on specific assets that are not eligible for inclusion in capital (up to 1.25% of weighted-risk assets), perpetual cumulative and long-term preference shares, perpetual debt instruments, mandatory convertible debt instruments, subordinate term debt, and limited life preference shares.
- Total regulatory capital is the sum of Tier 1 capital and Tier 2 capital after application of all deductions such as investment in unconsolidated financial subsidiaries, intangible assets, deficiencies in provisions for losses, and other deductions that may be determined by the central bank.
- RWAs are calculated using mostly the Basel I's standardized approach for credit and market risk. Off-balance sheet credit exposures are converted into their credit equivalent amounts by multiplying their nominal amounts with their respective credit conversion factor, ranging from 0–100 percent, before risk weights are applied (Table 3). Market risk comprises foreign exchange risk, commodities risk, interest rate risk, and equity risk with respective risk weights.

20. The Basel I regulatory framework is applied uniformly to all commercial banks and is currently not applicable to SACCOs. The minimum total capital adequacy ratio is currently at 8.0 percent. A higher minimum may be required for an individual bank based on several criteria, for example, whether or not the bank is less than 3 years old.

TABLE 3: Summary of Risk-Weighted Coefficients for Credit Exposures

Types of claims	Risk Weights (in percent)
▪ **Cash, balances due from the CBL; claims on or securities issued or guaranteed by Lesotho government; claims on local government, statutory boards and other public sector entities (guaranteed by Lesotho Government); claims on OECD and approved regional countries; and fully secured claims.**	0
▪ **Balances due from banks and other financial institutions licensed in Lesotho, OECD countries, approved regional countries, as well as in other countries with 1 year or less residual maturity; other claims and loans guaranteed by banks and other financial institutions licensed in Lesotho and OECD countries; Claims on or loans guaranteed by multilateral institutions or collateralized by securities issued by such institutions; Claims on or loans guaranteed by OECD and**	20

	approved regional countries' public sector entities; and Cash items in the process of collection.	
▪	**Real estate housing loans fully secured by mortgage on residential properties which are owner-occupied or rented.**	50
▪	**Commercial, personal, other loans and advances; balances due from banks and financial institutions licensed in other countries with residual maturity of over 1 year; claims on and obligations guaranteed by other foreign central banks and other foreign central governments; fixed assets; investments; other assets.**	100

21. **The national definitions of NPLs are broadly consistent with the *2019 FSIs Guide*.** NPLs and minimum provisions requirements are defined in the CBL's Financial Institutions (Banks) (Asset Classification) Regulation, 2016. NPLs are defined as the loans for which any portion of principal or interest is due and unpaid for 90 days or more, and the interest charges for 90 days or more have gone unpaid or have not been covered by deposits refinanced or rolled over into a new loan. NPLs comprise past due loans that are classified as substandard, doubtful, and loss while performing loans comprise loans that are classified as pass and special mention (Table 4). Provisions on performing loans are reclassified to general and other provisions in Table 5.1 DT of FSI-SRs from other liabilities. Further, when loans are classified as NPLs, they are placed on non-accrual status.

TABLE 4: Loans Classification and Minimum Provisioning Requirements

Category	Number of days past due	Minimum provisions (in percent)
Pass	0–29	0
Special mention	30–89	10
Substandard	90–179	20
Doubtful	180–359	50
Loss	more than 360	100

F. SOURCE DATA

22. **Source data from DTs and ICs are broadly adequate to compile the FSIs for Lesotho.** The source data to compile FSIs for DTs and ICs cover income and expense statements, the balance sheets, and memorandum series that are collected from the regulated entities on a monthly/quarterly basis. These are described in their respective charts of accounts. In addition, source data cover other supervisory series for DTs relating to capital adequacy, asset quality, earnings and profitability, liquidity, and net open positions in foreign exchange.

23. **The FSIs for DTs and ICs are calculated using the following prudential reports that are reported to CBL within 20 days for monthly data and within 30 days for quarterly data after the end of the period:**

- DTs: MFS. Balance sheet (Monthly) from MFS (New serialized MBS) (2013Q3 onwards)

- DTs: SD 001. Monthly Banking Statistics (Monthly) (Prior to 2013Q3)
- DTs: MFS. Balance sheet from MFS (Monthly, old, serialized MBS) (Prior to 2013Q3)
- DTs: SD 001AA1001. Loans and advances (Monthly)
- DTs: SD 002. Income Statement (Quarterly)
- DTs: SD 011. Capital adequacy (Quarterly)
- DTs: SD LS-SD011CK3001. Total qualifying capital (Quarterly)
- DTs: SD 012. Exposure to Top 20 Borrowers (Quarterly)
- ICs: FG 20. Income statement - General Insurance (Quarterly)
- ICs: FG 10. Balance sheet - General insurance (Quarterly)
- ICs: FL 20. Income statement - Life Insurance (Quarterly)
- ICs: FL 1. Balance sheet- Life insurance (Quarterly)

G. COMPILATION FRAMEWORK

24. The mission worked with the CBL staff to update bridge tables to compile the core and additional FSIs for DTs for transmission to STA. In addition, the mission also developed new bridge tables to compile the additional FSIs for ICs. This process involved mapping source data to tables 5.1 DT and 5.3 ICs of the FSI-SRs and deriving the FSIs from the underlying data in FSD sheet. The bridge tables show where each item in the income and expense statement, balance sheet, and memorandum series are classified, serving as a useful reference for compilers. The compilation spreadsheets, including the bridge tables for DTs and ICs, were provided to the CBL staff. The use of the bridge tables will facilitate the compilation of the FSIs for DTs and ICs. Currently, the CBL staff aggregates the data manually from the call reports to compile FSIs. Eventually, the CBL would benefit from automating the calculation of the FSIs from the calls reports to reduce manual interventions.

25. The mission expanded the list of FSIs reported to STA. The list of new FSIs compiled comprise 14 core and ten additional FSIs for DTs, and five additional FSIs for ICs, of which one relates to the size of the OFC subsector (ICs). All FSIs are to be compiled and reported to STA on a quarterly basis.

26. There are certain differences between the existing FSIs compiled by the CBL and those developed during the mission. The FSIs compiled by the mission are based on the recommended compilation methodologies of the *2019 FSIs Guide.* Though the authorities did compile FSIs for financial sector stability analysis, the definitions were aligned with the *2006 FSIs Guide.* The differences between the existing FSIs compiled by CBL with the FSIs compiled during the missions are explained in Appendix III.

Deposit Takers

Sectoral financial statements

27. The mission updated the bridge tables to compile FSIs for DTs. Compared to the current framework, a few accounts were reclassified in the income and expense statement and sectoral balance sheet (see Table 4). The bridge tables developed during the mission include these reclassifications.

28. The components of revenue and expenses in the call report are fully aligned with Annex 2 of the old FS2 template. As a result, this facilitated their mapping to the income and expenses to generate consistent sets of profitability indicators.

29. Consistent with the approach adopted by *2019 FSIs Guide,* extraordinary profits/losses were reclassified to other income/expenses, respectively. This is because the *2019 FSIs Guide* follows IAS1 which does include a separate line item for extraordinary profits/losses. Prior to the *2019 FSIs Guide*, extraordinary profits/losses were adjusted in operating profits/losses before deduction of income tax. As a result of this reclassification, the past profitability indicators need to be restated.

TABLE 5: Reclassification of main accounts in Table 5.1 DTs

	Income and Expense Statement
1.	Management Fees reclassified to other expenses from personal expenses
2.	Extraordinary profit/losses reclassified to other income/expenses.
Balance Sheet	
3.	Accumulated depreciation is to be deducted from the nonfinancial assets instead of recording in other liabilities
4.	Re-mapped the definition of customer deposits to be aligned with the *2019 FSIs Guide*.
5.	Deposit liabilities from CBL, Central Government, and OFCs have been reclassified to other currency and deposits from customer deposits
6.	Specific provisions have been reclassified from other liabilities and deducted from gross loans.
7.	General provision and provision for other losses have been reclassified in General and other provisions from other liabilities.

30. The mission revised the composition of customer deposits as from 2009 Q1 onwards to be in line with the *2019 FSIs Guide*. These are used to compile the FSI on customer deposits to non-interbank loans. The concept of customer deposits is specific to the *2019 FSIs Guide*. Customer deposits refer to the portion of stable deposits from certain institutional sectors. In addition to deposits of financial corporations (banks and OFCs), the *2019 FSIs Guide* narrows the composition of customer deposits to also exclude resident and nonresident deposits from central banks and central governments.[2] Therefore, the mission reclassified transferable deposit and other deposits from resident and nonresident central banks, central government, and OFCs from customer deposits to other deposits and currency. Non-interbank loans consist of loans to the resident and nonresident sectors other than other depository corporations.

Memorandum and Supervisory Series

31. Large exposures are compiled using a national definition. The *2019 FSIs Guide* adopts the 2014 Basel framework to calculate large exposures. Therefore, the *2019 FSIs Guide* defines large exposures as the sum of all credit exposures to a single or group of connected borrowers which are 10 percent or more of Tier 1 capital. The CBL currently includes the loans to the top 20 borrowers when reporting large exposures. This deviation in the FSIs needs to be explained in the metadata. To ensure consistency with the *2019 FSIs Guide*, the mission recommended to change the definition of large exposures from loans to top 20 borrowers to the sum of all credit exposures to a single or group counterparts, which are 10 percent or more of Tier 1 capital.

[2] Excludes deposits from state and local governments.

32. The mission updated the components of liquid assets. Prior to the mission, the CBL continued to compile the core measure of liquid assets although this was phased out in the *2019 FSIs Guide* to calculate the liquidity indicators. Liquid assets consist of cash and transferable deposits only. All debt securities were excluded from liquid assets. The *2019 FSIs Guide* recommends that all securities which are actively traded can also be included in the liquid assets. The mission re-mapped the CBL securities in liquid assets in the bridge table, given they are actively traded.

33. The definition of short-term liabilities is not in line with the *2019 FSIs Guide*. The CBL compiles short-term liabilities as deposit liabilities maturing within one year. Also, the mission noted that government deposits as well as nonresident deposits are excluded from short-term liabilities and recommended that they may be included if they are of short-term maturity of 3 months or less. The mission documented the deviation in the metadata for now.

34. Foreign currency loans, foreign currency liabilities, and net open position in foreign exchange do not include positions in rand but only those positions in other foreign currencies. Lesotho is a member of the Common Monetary Area (CMA), and the South African rand (ZAR) co-circulates with the Lesotho Loti. The exchange rate is fixed at 1:1 and although ZAR is legal tender in the country, it is not issued by the CBL. According to the *2019 FSIs Guide*, domestic currency is the one which is legal tender in the economy and is issued by the monetary authority for that economy or a common currency area to which the economy belongs. Any currencies that do not meet this definition are foreign currencies to that economy. Under this definition, rand is a foreign currency to Lesotho as it is issued by a monetary authority of another economy which is South Africa. The mission assisted the FSI compilers in integrating positions in rand in these FSIs. This approach was also recommended by the 2014 FSI mission.

35. The mission assisted the CBL compilers to calculate the FSI on spread on reference lending and deposit rates for reporting to STA. The reference lending rates were recalculated using weighted averages by dividing interest income (loan) by non-interbank gross loans, while deposit rates were calculated using interest expense divided by customer deposits, consistent with the second approach recommended by the *2019 FSIs Guide*.

36. Finally, the mission also compiled two newly introduced core and one additional FSIs for DTs for reporting to STA. Source data for compiling these three FSIs are readily available from the call reports and are consistent with the *2019 FSIs Guide*.

- **Provisions to NPLs:** the coverage ratio, which is a new core FSI for DTs introduced in *2019 FSIs Guide,* is calculated by taking specific provisions divided by total NPLs.
- **Loan concentration by economic activity:** This new core FSI, which replaces the previous core FSI on sectoral distribution of loans, measures credit concentration risk in the three top subsectors forming part of nonfinancial corporations. Lending by economic activity is based on the UN International Standard Industrial Classification of All Economic Activities, Rev 4 (ISIC Rev.4), which provides a widely accepted structure for the classification of economic activities. Source data for classification of economic subsectors are broadly consistent with ISIC Rev 4.
- **Credit growth to the private sector:** This new additional FSI for DTs measures the yearly growth rate of credit to the private nonfinancial corporations and households and non-profit institutions serving households (NPISH). This new FSI intends to capture emerging systemic risks and can serve as a forward-looking indicator of potential asset quality problems and vulnerabilities in the DT sector. The credit to private sector currently consists of loans extended by DTs to the private nonfinancial

corporations, households, and NPISHs only since nonfinancial corporations currently do not issue any form of debt securities.

Recommendations:

- *Align the definition of large exposure to the 2019 FSIs guide from loans to top 20 borrowers to sum of all credit exposures to single or group of connected borrowers which are 10 per cent or more of Tier 1 capital by June 2024. If not document in the metadata the deviation from the 2019 FSIs Guide until revision in the definition.*
- *Short-term liabilities: include deposit liabilities of 3 month or less. If not, document in the metadata the deviation from the 2019 FSIs Guide.*

Insurance Corporations

37. The mission compiled five additional FSIs for ICs, of which one relates to the size of the OFC subsector (ICs), for reporting to STA on a quarterly basis. The ICs cover six LICs and four NLICs. There are no composite ICs in Lesotho, since the insurance laws and regulations require the ICs to produce separate sets of financial statements for their life and non-life operations. For the purpose of constructing the bridge tables, the income and expense statements and sectoral balance sheets of LICs and NLICs were mapped separately and then aggregated to fill-in Table 5.3 ICs of the FSIs-SRs. Further improvements in collection of disaggregated data on components of revenue and expenses would improve their current classifications although this does not affect the compilation of the FSIs for ICs. The five additional FSIs for ICs are:

- **OFCs (ICs) total assets to GDP:** This additional FSI provides a metric to gauge the volume of the OFCs (ICs) within the overall economy. GDP figures are derived from IMF's World Economic Outlook (WEO) database to ensure comparability across the countries.
- **Shareholder equity to total invested assets (LICs, NLICs, ICs):** This additional FSI may be used as a proxy to measure capital adequacy and leverage for ICs since there are presently no agreed international standards to measure capital adequacy for ICs. This FSI is calculated by taking capital and reserves as numerator while the denominator is the sum of ICs' holdings of currency and deposits, loans, debt securities, equity and investment fund shares, other financial assets, financial derivatives, and nonfinancial assets held for investment purposes.
- **Combined ratio (NLICs):** This FSI should be calculated for NLICs only. This ratio measures the profitability of a given year's insurance underwriting, calculated as the sum of net incurred losses and underwriting expenses divided by net earned premium. For nonlife insurers operating in a healthy market, this ratio should be less than 100 percent, indicating profitable underwriting. If more than 100 percent, this is a sign of mispricing and an incentive to invest in riskier assets to try to make insurers profitable overall.
- **Return on equity (ROE) (LICs, NLICs): The ROE should be separately calculated for life and nonlife insurance corporations due to their different capital structure.** It is calculated by using annualized net profit after tax divided by average capital and reserves of ICs. The ratio needs to be interpreted in combination with FSIs on capital adequacy (equity to invested assets) because a high ROE may indicate high profitability but also low capitalization while a low ratio could be caused by an elevated level of capitalization.

- **Return on assets (LICs):** This new additional FSI is intended to measure the efficiency of LICs and is calculated by taking annualized net profit profits/losses before tax divided by average total assets. Annualized net profits and total assets are calculate using the same framework as for DTs.

Recommendation:

- *The CBL to start compiling five additional FSIs for ICs of which one relates to the size of the OFC sub-sector (ICs), effective from March 2020 data for dissemination in the FSIs website by September 2023.*

H. DATA AND METADATA REPORTING

38. Following the successful mapping of source data to the new FSI-SRs, as recommended by the mission, the CBL started reporting FSIs for DTs to STA for dissemination in June 2023. To facilitate compilation and dissemination of the FSIs, the CBL should align the definitions of FSIs that are currently produced with that of the *2019 FSIs Guide.*

39. The mission assisted the FSI compilers in updating the contents of the new Tables 2 and 3 of the metadata for Lesotho, which the CBL started reporting to STA in July 2023. The publication of the metadata provides additional information on the structure of the banking sector and the national accounting and regulatory frameworks underpinning the production of the FSIs for banks compared to the methodology of the *2019 FSIs Guide.*

I. RESOURCES, TRAINING, AND TECHNICAL COOPERATION

40. The mission also encouraged the CBL staff to attend IMF's regional and headquarters (HQ) training courses on financial sector statistics. CBL staff who compile the FSIs for DTs and ICs would benefit from participation in training courses that STA is delivering at IMF HQ (each course once every two years) and regional centers. Details can be found on the webpage of the IMF's Institute for Capacity Development.

Appendices

APPENDIX A. CBL OFFICIALS MET DURING THE MISSION

No.	Name	Title	Division
1.	Ms. Puseletso Tau	Director	Banking Supervision and Financial Stability Department
2.	Mr. Nkhahle Seeiso	Head	Financial Stability Division
3.	Mr. Refiloe Tsephe	Section Head	Macroprudential Policy, Research and Analysis
4.	Mr. Ntsane Moliko	Section Head	Section Head Macro-Regulatory Environment and Resolution Planning
5.	Ms. Moleboheng Hloele	Analyst	Financial Stability Division
6.	Ms. Makhala Tsunyane	Analyst	Banking Supervision Division
7.	Mr. Libe Lerotholi	Examiner	Banking Supervision Division
8.	Mr. Fumane Jonathan	Analyst Occupational Pensions	Pension and Securities Supervision Division
9.	Mr. Mokoroane Lejapoli	Analyst	Pension and Securities Supervision Division
10.	Ms. Bolebali Taasoana	Analyst	Non-Banks Supervision Division
11.	M. Moeketsi Phasumane	Examiner	Insurance Supervision Division
12.	Mr. Maphuthi Phakoe	Analyst	Insurance Supervision Division
13.	Ms. Moliehi Marake	Actuarial Analyst	Insurance Supervision Division
14.	Ms. Bonang Molatseli	Examiner	Insurance Supervision Division
15.	Ms. Kamohelo Dooda	Economist	Government Financial statistics Section
16.	Mr. Molemo Rasupu	Senior Economist	Statistics Division (Monetary and Financial Statistics Section)

APPENDIX B. FSI FOR LESOTHO

Financial Soundness Indicators for DTs and ICs, 2022 Q1–2022 Q4

	2022 Q1	2022 Q2	2022 Q3	2022 Q4
Core FSIs				
Regulatory capital to risk-weighted assets	27.0	23.9	23.4	24.0
Tier 1 capital to risk-weighted assets	29.0	25.7	25.1	25.6
Nonperforming loans net of provisions to capital	6.9	8.1	6.7	6.0
Tier 1 capital to assets	13.5	12.4	12.0	12.5
Nonperforming loans to total gross loans	4.4	4.6	4.4	4.3
Loan concentration by economic activity	62.1	64.1	69.0	66.2
Provisions to nonperforming loans	49.9	49.7	57.7	61.2
Return on assets	2.5	2.2	2.1	2.5
Return on equity	12.8	10.6	10.4	12.5
Interest margin to gross income	55.4	55.8	56.1	56.3
Noninterest expenses to gross income	70.2	72.2	72.2	69.2
Liquid assets to total assets	26.4	25.2	22.6	20.6
Liquid assets to short-term liabilities	38.5	36.9	33.2	30.3
Net open position in foreign exchange to capital	251.6	272.7	263.8	232.5
Additional FSIs				
Large exposures to capital	56.2	66.8	69.4	66.8
Gross asset position in financial derivatives to capital	2.8	0.6	0.1	1.8
Gross liability position in financial derivatives to capital	0.3	3.0	3.4	0.8
Trading income to total income	4.6	4.6	4.6	5.0
Personnel expenses to noninterest expenses	40.1	40.6	40.8	40.8
Spread between reference lending and deposit rates (bp)	1,191.5	1,113.5	1,105.8	1,130.7
Customer deposits to total (non-interbank) loans	161.4	153.8	157.9	153.9
Foreign-currency-denominated loans to total loans	0.0	0.0	0.0	0.0
Foreign-currency-denominated liabilities to total liabilities	25.2	24.9	23.9	38.3
Credit growth to private sector	7.3	7.8	5.0	5.1
Insurance Corporations				
OFCs' assets to gross domestic product: Insurance Corporations	21.8	21.3	21.4	22.5
Shareholder equity to total invested assets (Life insurance only)	15.5	13.3	14.8	13.8
Shareholder equity to total invested assets (Nonlife insurance only)	39.0	38.3	37.4	32.7
Shareholder equity to total invested assets (Life insurance nonlife insurance)	16.5	14.3	15.8	14.7
Combined ratio (Nonlife insurance only)	74.3	80.1	77.2	79.6

Return on assets (Life insurance only)	9.8	5.7	4.9	4.7
Return on equity (Life insurance)	72.4	42.6	35.1	32.9
Return on equity (Nonlife insurance)	-48.6	-27.1	-21.6	-13.5
Return on equity (Life insurance & nonlife insurance)	59.2	34.9	28.8	27.8

Source: CBL and IMF staff.

APPENDIX C. COMPARISON OF FSIS BEFORE AND AFTER THE TECHNICAL ASSISTANCE

Indicator	Recommendation
Regulatory capital to risk-weighted assets	Numerator: No change Denominator: No change
Tier 1 capital to risk-weighted assets	Numerator: No change Denominator: No change
Nonperforming loans net of provisions to capital	Numerator: No change Denominator: Total regulatory capital
Tier 1 capital to assets	Numerator: Tier 1 capital Denominator: Total assets (Accumulated depreciation is to be deducted from the nonfinancial assets)
Nonperforming loans to total gross loans	Numerator: No change Denominator: No change
Loan concentration by economic activity	New FSIs compiled during the mission Numerator: Loans to the top three economic sectors Denominator: Loans to nonfinancial corporations
Provisions to nonperforming loans	New FSIs compiled during the mission Numerator: Specific provisions Denominator: Nonperforming loans
Return on Assets (ROA)	Numerator: Annualized net income before tax Denominator: Average Total assets
Return on Equity (ROE)	Numerator: Annualized net income after tax Denominator: Average Capital and Reserves
Interest margin to gross income	Numerator: No change. Denominator: Extraordinary income is included
Noninterest expense to gross income	Numerator: Extraordinary expense is included Denominator: Extraordinary income is included
Liquid assets to total assets	Numerator: Comprise cash, demand deposits and tradable CBL securities. Denominator: Total assets
Liquid assets to short-term liabilities	Numerator: Comprise cash, demand deposits and tradable CBL securities. Denominator: liabilities with a maturity of three months or less (To be implemented)

Net open position in foreign exchange to capital	Numerator: To include rand positions as well as other foreign currencies Denominator: Total regulatory capital
Large exposures to capital	Numerator: Total exposures to single or group of connected counterparties which are equal to or above 10 per cent of Tier 1 capital. (To be implemented) Denominator: Tier 1 capital
Gross asset position in financial derivatives to capital	Numerator: No change Denominator: Total regulatory capital
Gross liability position in financial derivatives to capital	Numerator: No change Denominator: Total regulatory capital
Trading income to total income	Numerator: No change Denominator: Extraordinary income is included
Personnel expenses to noninterest expenses	Numerator: Management fees are excluded Denominator: Management fees are included
Spread between reference lending and deposit rates (basis points)	Numerator: Weighted average of lending rates of banks using interest income-loan divided by non-interbank gross loans Denominator: Weighted average of deposits rates of banks using interest expense divided by customer deposits
Customer deposits to total non-interbank loans	Numerator: Customer deposits include all deposits placed by residents or non-residents, except those placed by (resident or nonresident) financial corporations, central governments and central banks. Also include accrued interests. Denominator: No change
Foreign-currency-denominated loans to total loans	Numerator: Include rand positions as well as other foreign currencies Denominator: No change
Foreign-currency-denominated liabilities to total liabilities	Numerator: Include rand positions as well as other foreign currencies Denominator: No change
Credit growth to private sector	New FSI compiled during the mission. Credit to private sector include loans to private nonfinancial corporations and households and include securities issued by non-financial corporations held by banks.
OFCs' assets to gross domestic product: Insurance Corporations	New FSIs compiled during the mission. Numerator: OFCs' assets: Insurance Corporations Denominator: Gross domestic product
Shareholder equity to total invested assets (Life insurance only)	New FSI compiled during the mission. Numerator: Capital Denominator: Total invested assets
Shareholder equity to total invested assets (Nonlife insurance only)	New FSI compiled during the mission. Numerator: Capital Denominator: Total invested assets
Shareholder equity to total invested assets (Life insurance & nonlife insurance)	New FSI compiled during the mission Numerator: Capital Denominator: Total invested assets

Combined ratio (Nonlife insurance only)	New FSI compiled during the mission. Numerator: Net claims and underwriting expenses Denominator: Net premium earned
Return on assets (Life insurance only)	New FSI compiled during the mission. Numerator: Net income before taxes Denominator: Total assets
Return on equity (Life insurance only)	New FSI compiled during the mission. Numerator: Net income after taxes Denominator: Capital
Return on equity (Nonlife insurance)	New FSI compiled during the mission. Numerator: Net income after taxes Denominator: Capital
Return on equity (Life insurance & nonlife insurance)	New FSI compiled during the mission. Numerator: Net income after taxes Denominator: Capital

APPENDIX D. FSI METADATA FOR DT AND IC

Metadata should be disseminated together with FSI data to facilitate data interpretation. Metadata include information about FSIs and their compilation, such as data definitions, how data are consolidated, supervisory and accounting rules adopted by the reporting banks and ICs, institutional coverage, and data sources, which are useful to data users.

Method of consolidation

FSIs are compiled for DTs on DL and for ICs on ARBA

Institutional coverage

The coverage of the FSIs for (i) DTs comprising one domestically controlled, and three foreign controlled banks domestically incorporated, (ii) ICs covering six LIC and four NLICs.

Consolidation adjustments

Intra-group consolidation adjustments are not applicable for DTs since banks do not have deposit taking subsidiaries. No adjustments are done for ICs since insurance laws and regulations require ICs to conduct life and nonlife activities separately.

Residence of institutional units

The classifications of financial instruments and economic sectors are adequate consistent with the *2019 FSIs Guide*.

Accounting framework

Commercial banks are required to prepare their financial statements in IAS/IFRS. The accounting principles of accrual, time of recording and exchange rate as broadly consistent with IAS21/IFRS9.

Regulatory framework

The regulatory framework for compiling the capital adequacy ratios of banks follows mainly Basel I Capital Accord.

Tier 1 capital comprises ordinary shares, ordinary share premium, undisclosed reserves, perpetual non-cumulative preference shares and preference share premium, statutory reserve, capital reserves-excluding asset revaluation, general reserves- excluding reserves for losses on assets, audited retained earnings after application of supervisory deductions for current year losses (whether audited or not) and goodwill.

Tier 2 capital consists of fixed assets revaluation reserves, securities revaluation reserves, undisclosed reserves, general provisions for losses on specific assets that are not eligible for inclusion in capital (up to 1.25% of weighted-risk assets), perpetual cumulative and long-term preference shares, perpetual debt instruments, mandatory convertible debt instruments, subordinate term debt and limited life preference shares.

Total regulatory capital is sum of Tier 1 capital and Tier 2 capital after application of all deductions such as investment in unconsolidated financial subsidiaries, intangible assets and deficiencies in provisions for losses and other deductions that may be determined by the central bank.

Risk-Weighted Assets are calculated using mostly the Basel I's standardized approach for credit and market risk.

Nonperforming Loans (NPLs) are defined as the loans in which any portion of principal or interest is due and unpaid for 90 days or more.

Large exposures are defined as total loans to top 20 borrowers.

Credit to private sector include loans to private nonfinancial corporations, households and nonprofit institutions serving households (NPISHs) and debt securities issued by nonfinancial corporations and held by banks consistent with the *2019 FSIs Guide*.

Return on assets is calculated as the ratio of annualized net income before tax divided by average total assets.

Return on equity is calculated as the ratio of annualized net income after tax divided by average capital and reserves.

Reference deposit/lending rates are calculated using the average of interest rate on loans. Reference deposit rate is calculated by average of interest rates deposits.

Liquid assets consist of cash, transferable deposits and tradable CBL securities.

Short term liabilities comprise all debt liabilities with remaining time to maturity of not more than one year.

Source data

Source data for compiling FSIs include income and expense statement, balance sheet and other call reports that are needed to compile memorandum and supervisory series for DTs and ICS.