BANK OF UGANDA

BANK SUPERVISION FUNCTION

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1.0.0 GOVERNOR'S REVIEW

Bank of Uganda's enhanced capacity for supervision and strict prudential regulation of financial institutions have restored public confidence in banks and non-bank financial institutions and led to a significant improvement in the safety and soundness of the financial sector during 2002. Increased confidence in the sector is reflected in the growth of banks' private sector shilling deposits and lending to the private sector. Total private sector deposits increased by 22 per cent from Sh.1,483 billion in December 2001 to Sh.1,822 billion in December 2002, while total banks' assets rose by 20.5 per cent from Sh.2,038 billion to Sh.2,456 billion. This compares with an increase of 11.9 per cent in total deposits in December 2001 compared to December 2000, and an increase in total assets of 10.5 per cent in December 2001 compared to December 2000. Furthermore, the non-performing assets (NPAs) to total assets ratio fell from 6.5 per cent in 2001 to 3.0 percent 2002 compared to a fall in the NPAs ratio from 60.6 per cent in 1999 to 9.8 percent in 2000. The core capital of banks and non-bank financial institutions increased more than threefold from Shs.56.7 billion in December 1998 to Shs.195.8 billion in December2002. All banks were in full compliance with the new statutory minimum capital requirement of Shs.4.0 billion by December 31, 2002. The banking industry also recorded a return on assets ratio of 1.48 per cent and all banks were generally liquid with an overall liquid assets/deposit ratio of 86.1 per cent.

The difficulties faced by financial institutions in liquidating collateral in the case of non-performing loans and advances are gradually being resolved with the recent strengthening of the Commercial Division of the High Court. Banks have been able to enforce recovery of bad debts with minimum difficulties. A credit reference bureau has been set up and awaits an enabling law to provide information on bad borrowers to lenders. Once this is implemented, the risk of bad borrowers will be minimized and the credit culture would improve even further.

The liberalization of the financial sector has increased the diversity of services and their reliability and efficiency. Most banks have also ventured into superior IT systems that have facilitated the linkage between the branches and head office so that account holders can deposit or withdraw from any point of service. These developments are concrete evidence of the ever-growing sophistication of Uganda's financial sector arising from the determination of the financial services providers to meet the varied tastes of the consumers. In addition, banks have also ventured into new products with the aim of improving Customer Service. The products that have been introduced in the recent past include ATMs, on-line banking and a series of instruments to attract savings. However, the increased sophistication of the financial sector in terms of financial innovation and application of superior IT systems have also complicated the risk profiles of financial institutions. It is, therefore, necessary for management of financial institutions to design and implement comprehensive risk focused management systems in order to mitigate the inherent risks resulting form the financial innovation and application of superior IT systems. There is also enormous potential for expansion in merchant and commercial banks, discount houses, insurance services, leasing, mortgage financing building societies and micro financing service.

In order to be able to competently execute its regulatory responsibilities in view of the ever-increasing complexity of the risk profile in financial institutions, Bank of Uganda finalized plans to embark on implementation of Risk-Based Supervision Approach to on-site examination. Risk-Based Supervision involves the application of a methodology that places strong emphasis on understanding and assessing the adequacy of the financial institution's risk management systems which are in place to identify, measure, control and monitor risk in an appropriate and timely manner. Using this approach, Bank of Uganda intends to design a risk matrix for each financial institution, which will be used to identify significant activities, the type and level of inherent risks and the adequacy of risk management over these activities

Following the liberalization of the Uganda's economy, the financial sector became openly exposed to globalization effects. Bank of Uganda therefore realized the necessity to protect Uganda's financial sector form the worldwide criminal acts of money laundering. As consultations are ongoing on the draft anti-money laundering legislation, Bank of Uganda has formulated Anti-Money Laundering Guidelines as a stopgap measure. The Anti-Money Laundering Guidelines provides a sense of direction to the financial institutions in Uganda regarding the prevention, detection and control of possible money laundering activities. Among other things, the Guidelines prescribe methods of identifying suspicious activities and the requirement to report such activities to Bank of Uganda for further investigations.

At long last, the resolution of Uganda Commercial Bank Ltd (UCBL) was completed on February 21, 2002 with the sale of the majority shares (80%) to Standard Bank Investment Corporation (Stanbic) of South Africa through its subsidiary Stanbic Bank (U) Ltd. The Government of Uganda retained the 20% shareholding. Later in the year, the two banks (Stanbic (U) Ltd and UCBL) merged and the shareholding of the Government of Uganda was reduced to 10% in the bigger bank.

On August 31, 2002, Bank of Uganda seized TransAfrica Bank Ltd because the bank was conducting its business in a manner that was detrimental to the interests of its depositors. Selected financially sound institutions were invited to offer bids for possible merger, acquisition, or purchase and assumption, of TransAfrica Bank business.

Upon evaluation of the bids offered, Orient Bank Limited emerged the best bidder and Orient Bank Limited was accordingly offered the opportunity to merge with TransAfrica Bank effective November 07, 2002. Orient Bank has since assumed all the assets and liabilities of TransAfrica Bank. Other resolution assignments being executed by Bank of Uganda refer to the banks that were closed in 1998/99 namely, Co-operative Bank Ltd, Greenland Bank Ltd and International Credit Bank Ltd. Bank of Uganda has continued to execute the resolution process of these banks in a manner that minimizes liquidation costs.

On strengthening the legal and regulatory framework, the Financial Institutions Bill 2002, which awaits approval by Parliament, is a crucial development for the financial sector. The new bill updates Uganda's financial institution legislation to international best practices as set out in the Basle Core Principles for Effective Supervision. The Bill seeks to maintain a regulatory and supervisory environment that encourages innovation, efficiency and competition in financial services. Also the Micro Deposit Taking Bill 2002 was passed by Parliament in December 2002.

Bank of Uganda continues strictly to pursue a policy of not bailing out insolvent financial institutions. Intervention in any weak financial institution will be conducted in a timely manner in order to prevent contagion. Furthermore, plans are underway to review and reform the Deposit Protection Fund in order to turn it into a more robust institution capable of taking over from the Bank of Uganda the resolution of problem financial institutions.

Finally, let me take this opportunity to call upon all stakeholders in the financial sector to remain vigilant in order to foster the soundness of the financial sector on a sustainable basis.

E Tumusiime-Mutebile
Governor

2.0.0 ACCOMPLISHMENTS FOR THE YEAR 2002

2.1.0 COMMERCIAL BANKING DEPARTMENT

2.1.1 Overview

During 2002, Commercial Banking Department continued to pursue its mission of fostering a sound and stable financial sector that is efficient and competitive. The department set out to accomplish this mission as stipulated in the annual workplan, through its three (3) divisions of On-site, Off-site and Financial Markets Intelligence Regulation and Resolution.

The On-site Division conducted on-site examinations of all the commercial banks at least once during the year, while the Off-site Division carried out surveillance on the financial condition of all banks to ensure compliance with the laws and regulations in force. The Financial Markets Intelligence Regulation and Resolution Division was able to conduct follow-up examinations to enforce prompt corrective actions and to review and design new regulations in line with the provisions of the Financial Institutions Bill 2002 (FIB 2002). It also continued with the liquidation of financial institutions that were closed prior to December 2001.

2.1.2 Developments

New initiatives to strengthen the supervisory capacity of the department were implemented during 2002. These included finalizing the following:

a) Implementation of Risk-Based Supervision Approach;

b) Automation of Submission of Statutory Returns;

c) Anti-Money Laundering Guidelines;

d) Enforcement of Capital Compliance Plans in banks;

e) The ongoing Capacity Building Programmes.

a) Risk-Based Supervision (RBS)

During the period under review, Bank of Uganda concluded preparations for launching of the Risk-Based Supervision approach to on-site examination of financial institutions.

The rationale for adopting the Risk-Based Supervision approach to on-site examination is summarized as follows:

- Changes in the environment in which financial institutions operate are having a significant impact on the way they conduct their business. Technological advances and product innovation result in changing risk profiles of financial institutions and require improvements in management systems and the way in which these institutions are supervised;

- The changes in economic environments have rendered the traditional supervisory process of focusing on quantitative appraisal of assets at a single point in time ineffective in evaluating safety and soundness;

- There is urgent need to evaluate effectively safety and soundness of each financial institution, including the assessment of its risk management systems, financial condition and compliance with applicable laws and regulations, while focusing on the institution's highest risk;

- There is an emerging trend worldwide towards adopting the risk-based approach to supervision, a method which places strong emphasis on understanding and evaluating each institution's internal risk management process and control infrastructures.

A brief comparison between the traditional and risk-based approaches to supervision is outlined below:

Traditional Approach	**Risk-Based Approach**
• Transaction-based testing	• Process-oriented
• Point-in-time assessments	• Continuous assessments
• Standard procedures	• Risk-profile driven procedures
• Historical performance	• Forward looking indicators
• Focuses on risk avoidance	• Focuses on risk mitigation

The basic framework for risk-based supervision includes:

- Understanding the financial institution;
- Assessing the financial institution's risks;
- Developing the supervisory plan;
- Executing the supervisory plan
- Determining and communicating the results.

The Risk-Based Supervision Approach is anchored in evaluating the soundness of the financial institution's risk management system comprising such key elements as:

- Active board and senior management oversight;
- Adequate policies, procedures and limits;
- Adequate risk monitoring and management information system;
- Comprehensive internal control systems.

Risk-Based Supervision is in line with the Basle Core Principles for Effective Banking Supervision which require supervisors to satisfy themselves that financial institutions have in place a comprehensive risk management process to identify, measure, monitor and control all the inherent risks in financial institution's business and where appropriate to hold capital against these risks.

The objectives of Risk-Based Supervision Approach:

The goal of risk-based supervision is not to attempt to severely limit risk-taking by financial institutions but rather to ensure that institutions understand and mitigate the types and levels of risks they assume. The assessment of risk incorporates both a current and prospective view of the institution's risk profile. The particular objectives for this new approach are:

- To promote a more safe and sound financial system by assessing how well institutions manage risk;
- To focus on qualifying problems by identifying system flaws and poor management practices that cause both current and potential problems;
- To enable examiners to identify problems and its root causes and carry out a proper evaluation of the institution's risk management;
- To develop a common framework and common terminology for practicing and communicating assessment of risks in the financial system.

Benefits of Risk-Based Supervision Approach:

- Provides consistent definitions of risk, a structure for assessing these risks and a more integrated use of risk assessment in the supervisory process;
- Focuses greater resources to areas of higher risks within individual institution;
- Uses a common framework and terminology developed specifically to assess risks and evaluate management practices, policies and procedures in the context of managing risks;
- Incorporates an assessment of management ability to deal with risks beyond the control of management such as systemic risks in the economic environment in which the institution operates.

Risk Management Guidelines

To facilitate the implementation of the Risk-Based Supervision Approach, Bank of Uganda designed Risk-Management Guidelines, which were circulated to all financial institutions. These Guidelines are in line with internationally accepted risk management principles and best practices. The Risk Management Guidelines outline the minimum risk management framework, which each financial institution is expected to institute as a measure to mitigate all the inherent risks in financial institution business. However, each financial institution is expected to institute a comprehensive Risk Management Programme that can enable management to identify, measure, monitor and control the levels and types of risks in a focused and timely manner. Most of the common risks in financial institution business e.g. Credit, Liquidity, Market, Interest Rate, Foreign Exchange, Operational, Legal, and Reputational Risks are adequately covered by the guidelines.

The basic elements of a sound Risk Management System should include the following as the minimum:

- An active Board and Senior Management Oversight
- Adequate Operational Policies, Procedures and Limits
- Adequate Risk Monitoring and Management Information System (MIS)
- Adequate Internal Controls
- Risk Management Committee (ALCO) or Risk Manager

Every financial institution shall therefore be required to submit to Bank of Uganda a copy of its comprehensive Risk Management Programme including the mandate and membership of its Risk Management Committee. Bank of Uganda shall review the adequacy of the Risk Management Programme of each financial institution through off-site analysis and on-site examinations. Bank of Uganda shall conduct Risk Assessment Visits (RAV) as and when deemed necessary. Updates of the Risk Management Programme by financial institutions shall likewise be submitted to Bank of Uganda for review before implementation.

b) Automation of Submission of Statutory Returns

During 2002, Bank of Uganda in collaboration with commercial banks launched an automated system by which statutory returns are electronically submitted. This eliminates the human element in the transmission of data from source (commercial banks) to the regulator (Bank of Uganda). The system requires that data from commercial banks is verified for accuracy before it is submitted on-line to Bank of Uganda and that while the data is in transit, only authorized parties can have access to it. The automated submission of data involves four important activities:

i) Exchange of test keys between each commercial bank and Bank of Uganda so that only authentic senders and recipients have access to secure information and ability to retrieve it.

ii) Encryption (encoding) of electronic returns data by a commercial bank ensures that any third party eavesdropper who comes across the submitted data will not be able to access it.

iii) Submission of the encrypted returns data from the commercial bank to Bank of Uganda by electronic mail provides a means of delivering secure electronic data without manual transfer of documents and diskettes, thus promoting timeliness.

iv) Decryption (decoding) of received encrypted returns by Bank of Uganda ensures that the secure data received can be retrieved as and when required.

Successful implementation of this system will yield the following benefits to the financial sector:

i) Data security will be enhanced, as only authentic participants in the system will have access, thus eliminating the leakage of confidential information.

ii) Reporting efficiency will be enhanced, as data will be submitted in a timely manner.

iii) Installation of the automated submission of returns system will provide a training ground and a smooth transfer to a bigger system when the East and Southern Africa Bank Supervision Application system is launched in the near future.

The electronic system will undergo a parallel run with the manual system for a period of two months in early 2003. Thereafter, the manual system will be discontinued and the electronic system will become the medium through which commercial banks will submit key statutory returns to Bank of Uganda.

c) Anti-Money Laundering Initiatives

During 2002, there was growing concern in Uganda about the lack of visible progress with the promulgation of an anti-money laundering law, despite indications that all the ingredients of possible money laundering schemes were present in Uganda. The banking sector in particular expressed its concern that, in view of the widespread money laundering tendencies worldwide, there might already be some entities misusing the country's banking /financial system on a much larger scale than previously thought. Furthermore, several foreign regulators have indicated that the lack of anti-money laundering measures in Uganda might impede the opening of branches and subsidiaries by Uganda financial institutions, in certain foreign countries.

The need for legislation on money laundering as well as the establishment of a central reporting agency has therefore been agreed upon. As the regulator and supervisor of the Ugandan financial sector, and in pursuit of its corporate mission of fostering a sound, stable and competitive financial sector, Bank of Uganda has taken all possible steps to promote consultations with the stakeholders in order to ensure the speedy establishment and implementation of anti-money laundering measures in due course. As an interim measure, Anti-Money Laundering Guidelines were issued to all financial institutions supervised by Bank of Uganda in December 2002. The Guidelines are aimed at countering the misuse of the country's financial sector for purposes of money laundering.

By the anti-money laundering measures stipulated in these Guidelines, banks and other financial institutions are required to comply with a set of broad minimum requirements including the 'Know Your Customer" principle(s). While some banks have already put in place most of the basic measures, much still needs to be done in terms of training staff and the establishment of an anti-money laundering culture.

Drafting of the country's anti-Money Laundering Law is at an advanced stage. The draft Bill will include proposals to establish a Financial Intelligence Authority to co-ordinate policy and efforts to counter money-laundering activities, and the Money Laundering Board, which will oversee the national strategy pertaining to anti-money laundering initiatives. The anti-money laundering law will apply to a list of accountable institutions, businesses and professions which will be required to implement specific internal administrative systems in order to keep detailed records of their customers. The accountable institutions, businesses and professions will be required to report certain transactions that are above a specified amount, as well as transactions that are suspicious. Furthermore, the accountable institutions, businesses and professions will be required to train their employees to recognize and deal with suspicious transactions.

d) Enforcing Capital Compliance Plans in Commercial Banks

On November 19, 1999, Bank of Uganda issued a Statutory Instrument No 48 entitled Financial Institutions (Revision of Minimum Capital Requirements) Instrument 1999. Under this instrument, the statutory unimpaired minimum capital for commercial banks was raised to Sh. 4.0 billion. However, the banks that were already in existence were given a transition period up to December 31, 2002 to build up their capital reserves to reach Sh. 4.0 billion. In the course of 2002, Bank of Uganda intensified surveillance over some banks that had not built up their capital reserves to the required level. To facilitate monitoring of compliance measures, such banks were compelled to submit to Bank of Uganda capital compliance plans, which spelt out the steps that were being undertaken to comply with the new capital adequacy requirements by December 31, 2002. By the close of 2002, all banks were able to comply with the new capital adequacy requirements, and had raised their unimpaired minimum capital to Sh. 4.0 billion.

e) Capacity Building Programmes

Staff in Commercial Banking Department continued to undertake in-house, local and foreign training opportunities on Central Banking, Risk-Based Supervision and financial sector regulation related topics as a means of equipping them for the launching of Risk-Based Supervision Approach. The training programmes that were accomplished in 2002 are outlined below:

- Nineteen officers participated in a course offered by the Barents Group on Risk-Based Supervision in Kampala
- Twelve officers attended a course on the New Capital Accord in Kampala
- Four officers took part in Joint Commercial Bank Examinations in Kenya and Tanzania
- Two officers attended a MEFMI workshop on Risk Management and Internal Controls in Financial Institutions in Kampala
- Two officers attended a MEFMI course on Best Practices and Practical tools for Macro-Prudential Supervision in Maseru, Lesotho
- Two officers took part in a Risk-Based Supervision course in India
- Two officers took part in an off-site analysis course in Abidjan, Cote d'Ivoire
- Three officers attended a workshop on Harmonizing Bank Supervision in Pretoria, South Africa
- One officer attended a course on Risk Management in Cambridge, United Kingdom
- One officer attended an ESAF course on Bank Supervision in Pretoria, South Africa
- One officer attended a course on Derivatives in Nairobi, Kenya
- One officer attended a course in Syndicated Lending in Accra, Ghana

- One officer attended the East African Central Banking Course in Arusha, Tanzania
- One officer attended a training programme on Capital Flows in Paris, France
- One officer attended a course on Assessment of Bank Fragility in Washington DC
- One officer attended a training programme on Banking and Finance in Small States in Malta.

2.2.0 NON-BANKING FINANCIAL INSTITUTIONS DEPARTMENT

2.2.1 Overview

The number of credit institutions supervised by the Non Banking Financial Institutions Department (NBFI) rose from six to seven in 2002. Post Bank (Uganda) Ltd was granted a restricted credit institution's business licence, which prohibited lending business until the institution has acquired sufficient financial and human resource capacity. The department has also been mandated to supervise Micro Deposit-taking Institutions (MDI), Discount, Finance and Acceptance Houses when the MDI Bill 2002 and the Financial Institutions Bill (FIB), 2002 are enacted.

2.2.2 On-site Inspection

- During the period under review, full scope on-site examination of all the seven credit institutions was carried out. Five credit institutions reported satisfactory performance, one reported Fair performance while two registered marginal performance.

- Memoranda of Understanding (MoU) were signed with three credit institutions during the period under review. While the credit institutions under MoUs registered progress in complying with some of the stipulated conditions, a number of conditions, which raise some serious supervisory concerns, are still outstanding. The department is following up on the progress of compliance with the MoUs through regular monitoring reports, on-site visits and discussions with management of the concerned institutions. Prompt corrective actions will be instituted against credit institutions that fail to comply with all the stipulated conditions of the MoUs upon expiry.

2.2.3 Off-site Analysis

The off-site analysis section receives and analyzes data, which is submitted weekly, monthly, quarterly, and annually by all credit institutions. The overall performance of the seven credit institutions during the year under review was rated fair.

Developments in NBFI

- Interstate Finance Company Limited (IFC) which was seized by Bank of Uganda on 7th August 2001 under sections 31, 32 and 33 of the Financial Institutions Statute, 1993 is now under liquidation. Former depositors of IFC were paid by Bank of Uganda up to Shs.3.0 million as provided for under the Deposit Insurance Fund.

- The MDI Bill 2002 was passed by Parliament

- In preparation for the regulation and supervision of MDIs, the NBFI department held consultative workshop with microfinance institutions (MFIs) practitioners and donors to discuss the draft regulations of MDIs. The Bank of Uganda draft prudential guidelines and regulations are in the respect of Capital Adequacy Requirements, Asset Quality, Liquidity Requirements, Licensing and Reporting Requirements.

2.2.4 Capacity Building

Staff in the NBFI department participated in various workshops, seminars, attachments and courses as follows:

- GTZ sponsored 2 officers for the annual Microfinance training programme at Naropa University, Boulder, Colorado, USA.
- One officer attended a workshop conducted by MEFMI on Risk Management and Internal Controls in Financial Institutions in Kampala.
- All staff attended the in house training session on the risk based supervision and the new examination report format.
- One officer attended a training programme in micro finance and micro finance institutions in India.
- One officer attended a savings workshop on institutional readiness, principles, products and sequencing for Micro Finance Institutions, Kampala.
- One officer participated in two workshops on the regulation and supervision of micro finance institutions in Kenya and South Africa.
- One officer attended a specialized course in credit risk management at the Federal Reserve Bank, Washington DC.
- Five officers attended a local seminar on the new Basle Capital Accord and Interest Risk in the Banking Book organized by the Financial Stability Institute in conjunction with ESAF, in Kampala.
- Two officers attended a symposium on Modalities for Financing SMEs, and a workshop on Treasury Management in Kampala.

3.0.0 A REVIEW OF PERFORMANCE OF SUPERVISED FINANCIAL INSTITUTIONS

3.1.0 Commercial Banks

3.1.1 On-site Inspections

In its resolve to foster a sound and stable banking system, where depositors' funds are safe, the Bank of Uganda conducted on-site examinations of 13 commercial banks during 2002. On site inspections are carried out in response to any early warning signals that may have been flagged by the regular off-site surveillance and follow up examinations. The on-site examinations provide Bank of Uganda with the most up to date information on the performance of the banking sector, thus making it possible to take prompt corrective actions.

According to the on-site examination findings, six banks were rated satisfactory; five were rated fair while two were rated unsatisfactory. The corresponding ratings in 2001 indicated that seven banks were rated satisfactory, six were rated fair, one was rated marginal and two were rated unsatisfactory. The programme of conducting a full-scope on-site examination of each bank at least once a year will continue to be pursued in order to ensure soundness of the financial sector and safety of depositors' funds.

3.1.2 Off-site Surveillance

During the year under review, the financial condition of the banking sector continued to post satisfactory performance under the CAMEL rating system. The key performance parameters of capital adequacy, asset quality, earnings and liquidity improved during the 2002. Three banks were upgraded from fair rating in 2001 to satisfactory rating in the year ended December 31, 2002, and one bank was upgraded from unsatisfactory rating to fair rating. On the other hand, one bank was downgraded from satisfactory composite rating recorded in 2001 to marginal composite rating during 2002. The performance ratings for all commercial banks in Uganda in 2001 and 2002 are depicted in Table 3.0.

Table: 3.0 Performance Rating of Commercial Banks as at year-end

Performance Category	2001					2002				
	Capital Adequacy	Asset Quality	Earnings	Liquidity	Overall	Capital Adequacy	Asset Quality	Earnings	Liquidity	Overall
	No. of Banks	No. of Banks	No. of Banks	No. of Banks	No. of Banks	No. of Banks	No. of Banks	No. of Banks	No. of Banks	No. of Banks
Strong	0	0	0	0	0	0	0	0	0	0
Satisfactory	14	10	6	16	8	15	11	7	14	10
Fair	1	4	4	1	7	0	3	5	1	4
Marginal	0	1	3	0	0	0	0	1	0	1
Unsatisfactory	2	2	4	0	2	0	1	2	0	0
Total	17	17	17	17	17	15	15	15	15	15

Table 3.1: Composite ratings of Commercial Banks' Deposits and Assets.

	2001			**2002**		
Total Deposits (Shs m)	**1,483,285**			**1,816,431**		
Total Adjusted Assets*(Shs m) 1/	**1,979,011.3**			**2,406,299.8**		
Composite Rating	No. of Banks	% of Total Deposits	% of Total Assets	No. of Banks	% of Total Deposits	% of Total Assets
Strong	0	0	0	0	0	0
Satisfactory	8	63.01	64.50	10	95.80	95.15
Fair	7	35.88	34.53	4	2.87	3.43
Marginal	0	0	0	1	1.33	1.42
Unsatisfactory	2	1.11	0.97	0	0	0
Total	**17**	**100.00**	**100.00**	15	**100.00**	**100.00**

Note:

*Total adjusted assets refer to total assets net of provisions and depreciation.

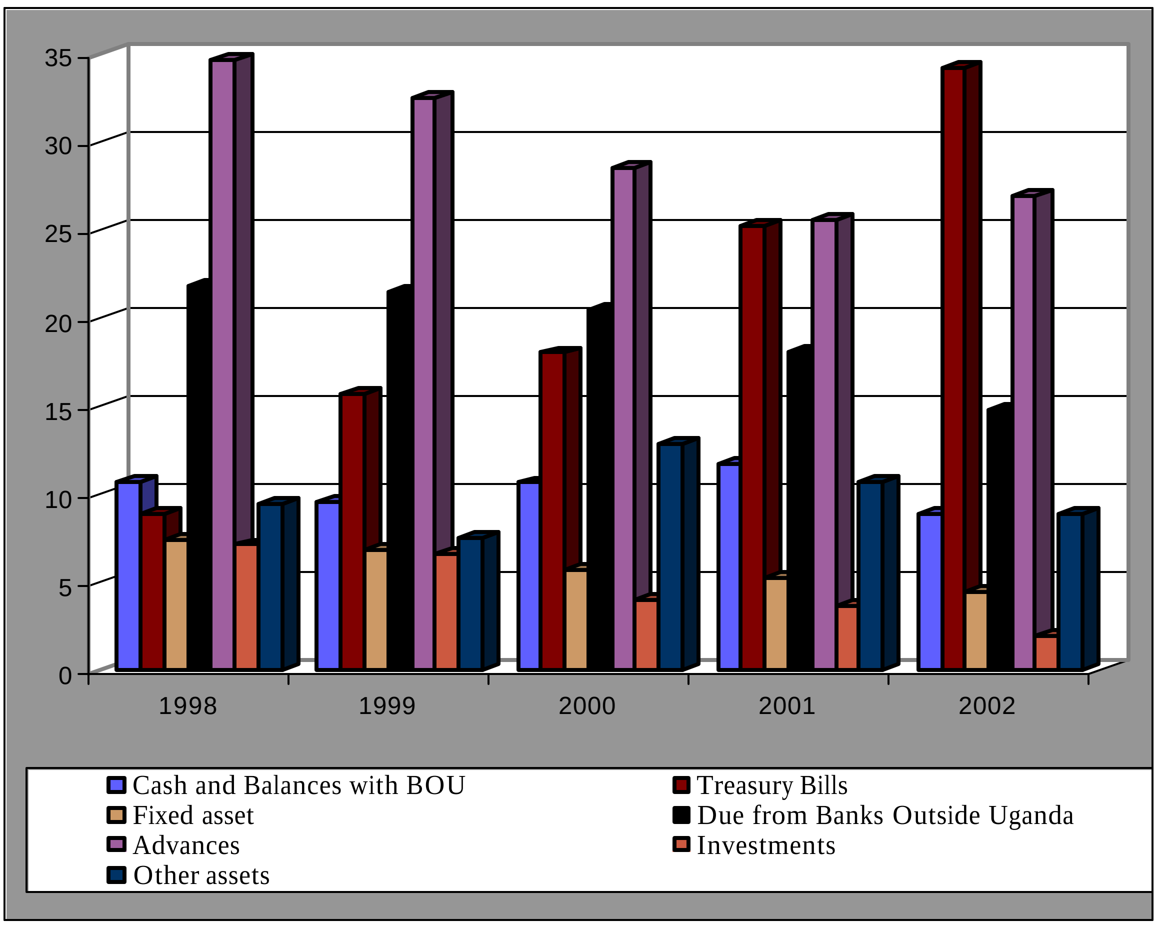
Table 3.1 above, illustrates that during the year 2002, 10 banks posted satisfactory composite ratings and held 95.80% of the total deposit liabilities and 95.15% of the total adjusted assets. 4 banks with a fair rating held only 2.87% of total deposits and 3.43% of total adjusted assets. This is an improvement over the year 2001, when eight banks with satisfactory composite ratings held only 63.01% of deposits and 64.50% of assets. This is an indication that most of depositors' funds are held in strong banks.

3.1.3 Balance Sheet Structure

The banking sector's total assets recorded a growth of Shs.419 bn or 20.5 per cent from Shs.2,038 bn as at the end of the year 2001 to Shs.2,456 bn as at the end of the year 2002. This compares with an increase of 10.5 per cent in December 2001 compared to

December 2000. Loans, overdrafts and discounts amounted to Shs.661 bn or 26.9% of total assets showing an increase of Shs.140 bn or 26.9% from the respective figures of Shs.521bn or 25.6% of total assets recorded at the end of the year 2001 (Figure 3.1). This compares with a decrease of 0.7 per cent in total advances in December 2001 compared to December 2000. Investments in treasury bills increased by Shs.325 bn or 63.2% from Shs.514 bn recorded at the end of 2001 to Shs.839 bn and constituted 34.2% of total assets at the end of the year 2002. Balances due from banks outside Uganda totaled Shs.362 bn or 14.7% of total assets as at the end of the period under review. While commercial banks continue to place more funds in less risky investment like treasury bills compared to lending to private sector, the growth in loans and advances of Sh. 26.6% cited above is an indication that banks are fostering financial intermediation.

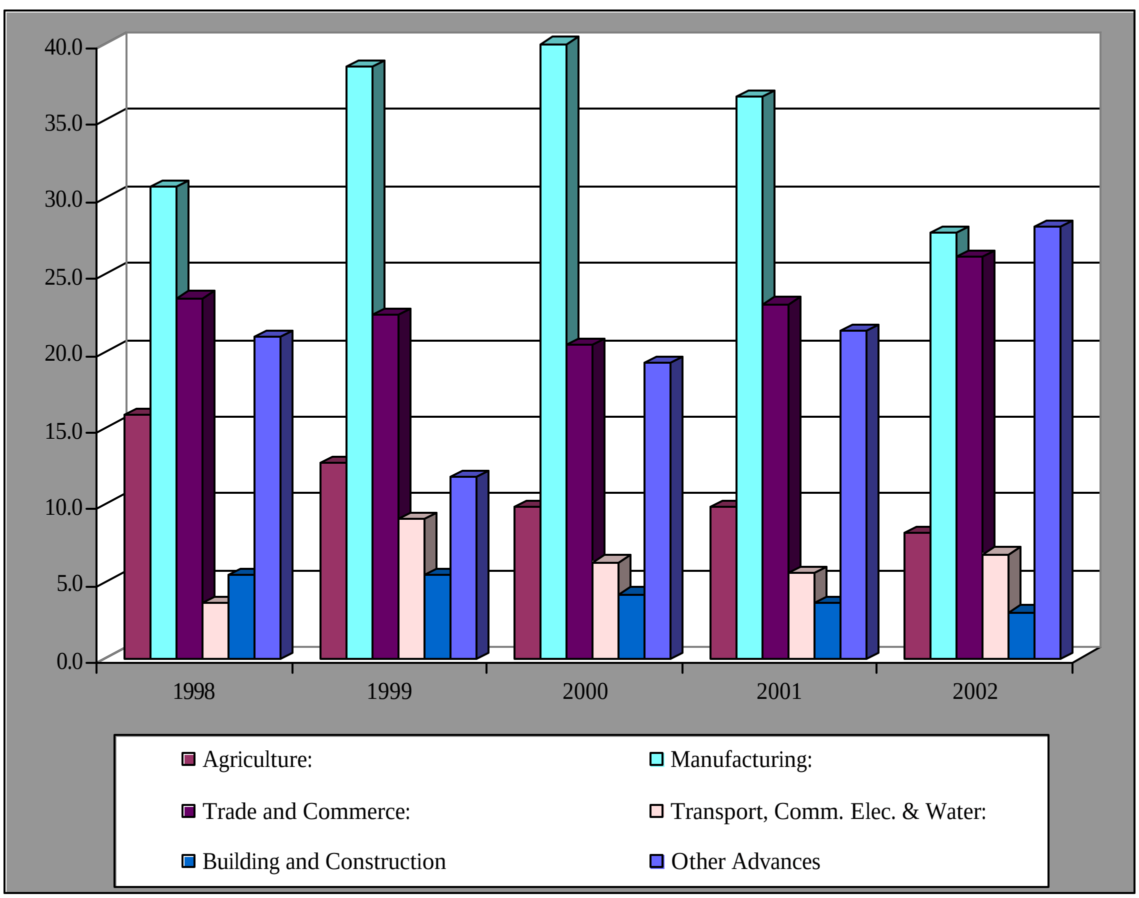
Fig 3.1 Structure of Commercial Banks' Assets (In percentage of total)



3.1.4 The sectoral distribution of loans and advances.

The banking sector recorded an expansion in total credit amounting to Shs.140 billion from Shs.521 bn as at the end of December 2001, to Shs.661bn as at the end of the year 2002. Figure 3.2 depicts the sectoral stock of credit outstanding, as a percentage of total credit portfolio. During the year under review, 27.7% of the outstanding total credit i.e. Shs.183 bn was accounted for by the manufacturing sector. Trade and commerce ranked second in outstanding credit, taking a share of Shs.173bn or 26.2% of total credit portfolio. The share of credit to agriculture and transport sectors to total credit portfolio was 8.17% and 6.81% respectively during the year ended 2002. While the category "Other advances" was insignificant, it comprised of credit outstanding to various sectors including mining, government, real estate and personal loans.

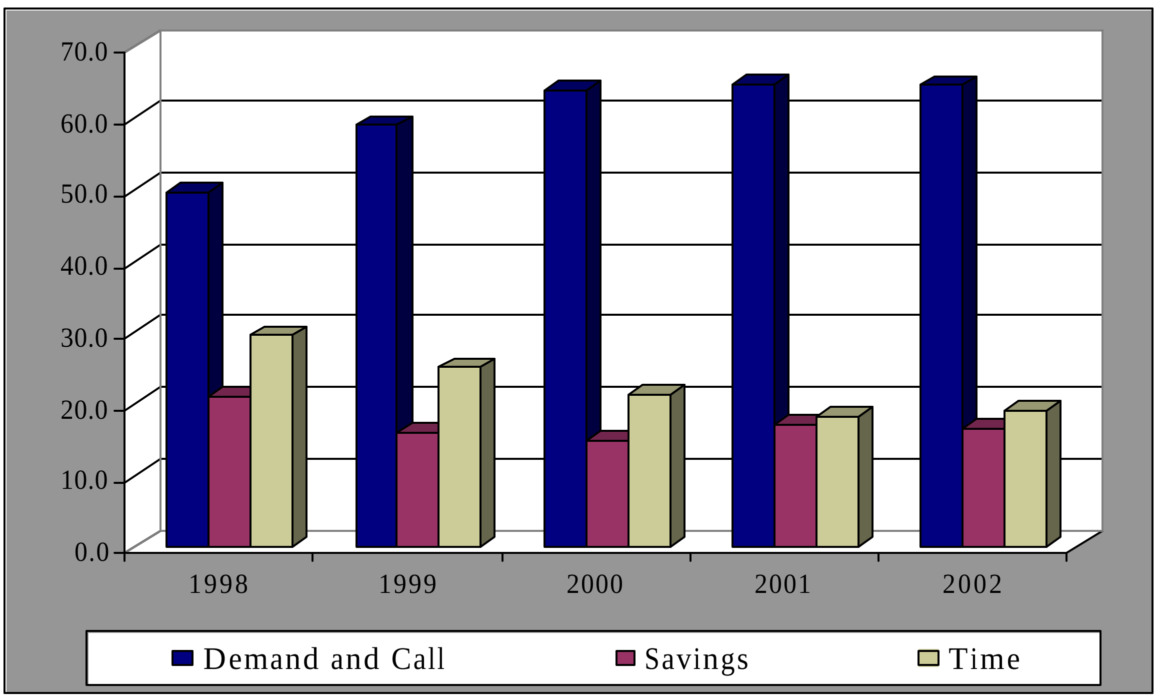
Figure 3.2: Sectoral distribution of Commercial Banks' Credit
(In percentage of total)



3.1.5 Deposits

The banking sector's total deposit base grew by Shs.339 bn or 22.9% from Shs.1,483 bn as at 31.12.2001 to Shs.1,822 bn as at 31.12.2002. This compares with an increase of 11.9 percent in total deposits in December 2001 compared to December 2000. As at end-December 2002, demand and call deposits represented 64.5% of the total deposits while time and savings deposits accounted for 18.9% and 16.6% of total deposits respectively. The growth in deposits was mainly reflected in demand and call deposits, which increased by Shs.215 bn or 22.4% from Shs.960 bn in 2001 to Shs.1,175 bn as at the end of 2002. Figure 3.3 shows the structure of deposits.

Figure 3.3: Structure of Commercial Banks' Deposits (In percentage of the total)

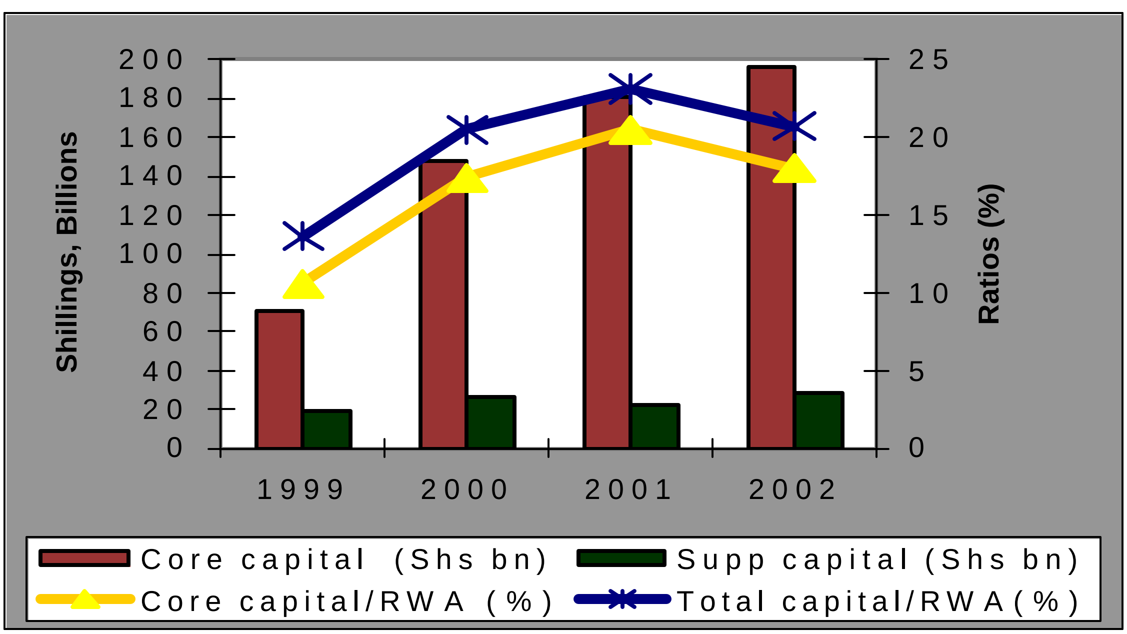


3.1.6 Capital Adequacy

As at the end of December 2002, the total capital held by the banking sector amounted to Shs.225 bn, reflecting an increase of Shs.22 bn or 10.8% from Shs.203 bn as at end of December 2001. Core capital amounted to Shs.195.8 bn while supplementary capital stood at Shs.29.2 bn. The sector's paid up capital was Shs.85.7 bn up from Shs.83.5 bn at the end of 2001. The improvement is mainly attributed to additional capitalisation of some banks due to the new minimum unimpaired capital adequacy requirement of Shs.4 bn, which came into force on December 31, 2002 and an increase in retained earnings during the year ended 2002.

Capital adequacy in a banking institution is measured in relation to the relative risk weights assigned to the different category of assets held both on and off the balance sheet. All the 15 commercial banks were solvent and complied with all the regulatory and statutory capital adequacy requirements. The Average Core Capital to Risk Weighted Assets (RWA) ratio declined slightly from 20.5% as at December 31, 2001, to 18.0% as at December 31, 2002. The decline in the average core capital to risk weighted assets ratio was mainly as a result of a more than proportionate increase in risk weighted assets of Shs.208.56 bn or 23.7% compared to an increase of Shs.15.54 bn or 8.62% in core capital. The Capital Adequacy Indicators for 1999 to 2002 are depicted in Figure 3.4. Supplementary capital, which includes revaluation reserves, unencumbered general provisions and subordinated debt recorded an increase of Shs.6.85 bn or 30.6% from Shs.22.39 bn as at 31 December 2001 to Shs.29.24 bn as at 31 December 2002.

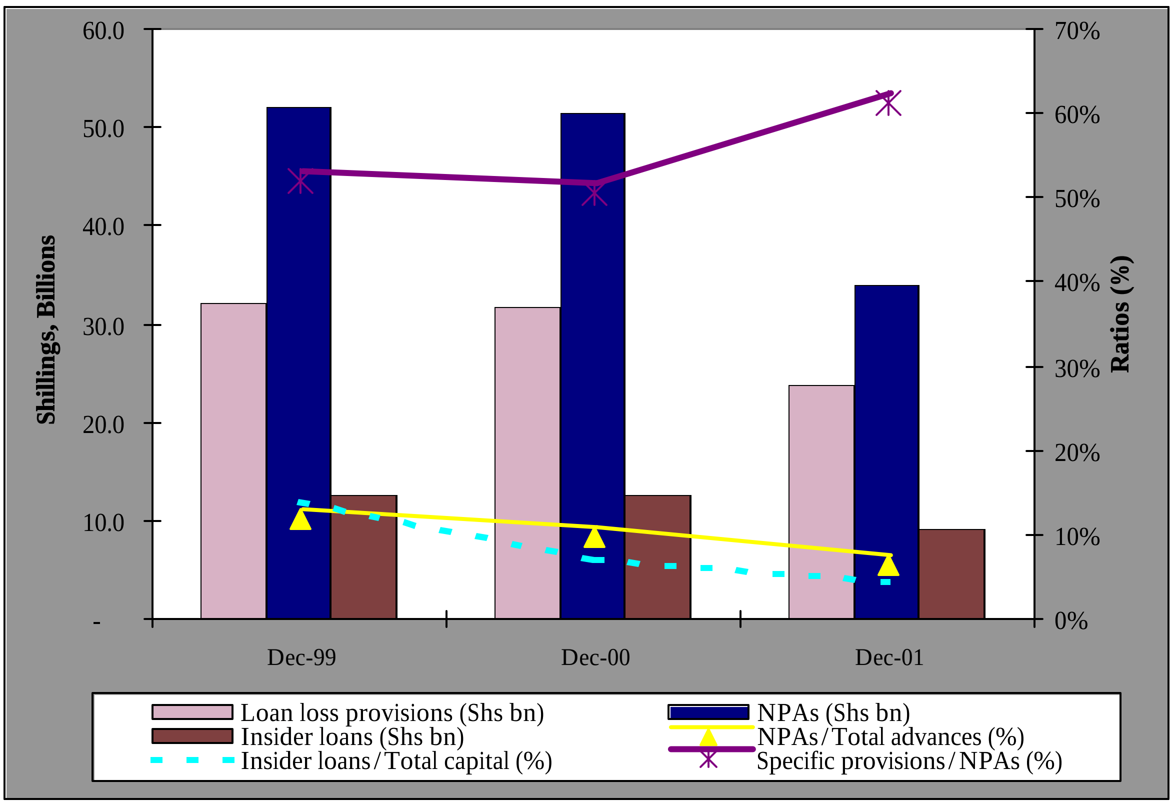
Figure 3.4: Capital Adequacy Indicators



3.1.7 Asset quality

Credit risk is inherent in lending, which is the major banking business. It arises when a borrower defaults on the loan repayment agreement. A financial institution whose borrowers default on their repayments may face cash flow problems, which eventually affect its liquidity position. Ultimately, this negatively impacts on profitability and capital through extra specific provisions for bad debts. Despite innovations in the financial services sector, credit risk is still the major cause of many bank failures.

Figure 3.5: Asset Quality Indicators

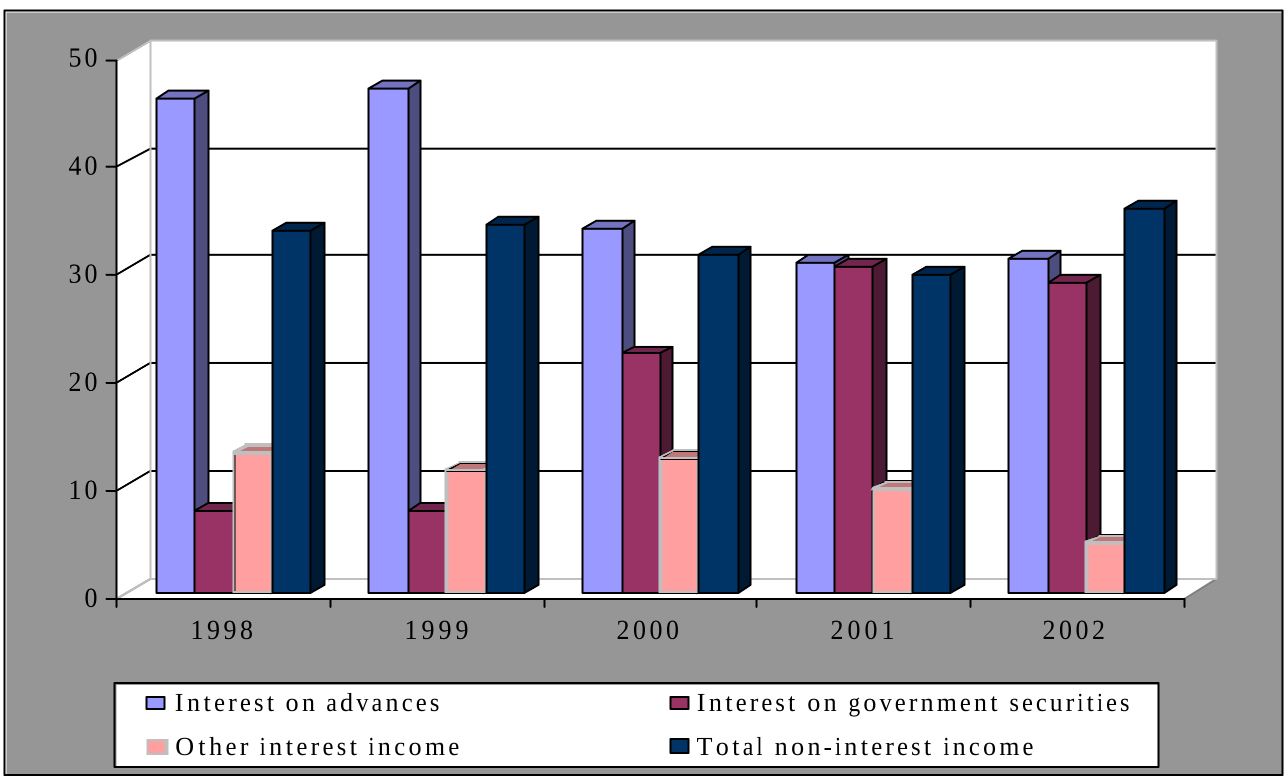


During the year 2002, banks registered an improvement in the asset quality. The average ratio of non-performing advances to total advances declined considerably from 6.5% in the year 2001 to 3.0% at the end of the year 2002 (Figure 3.5). In addition to enhancing recovery efforts of the delinquent facilities, banks made considerable progress in improving their credit risk management processes during the year. The banking sector's ratio of insider loans to core capital marginally increased from 5.1% for the year ended 31 December 2001 to 5.2%, but remained within the prudent benchmark of 25% of core capital as per requirements of the Financial Institutions Statute (FIS) 1993.

3.1.8 Earnings

The continued viability of a bank depends on its ability to earn an adequate return on its assets and capital. Good earnings performance enables a bank to fund its expansion, remain competitive in the market and replenish and/or increase its capital base.

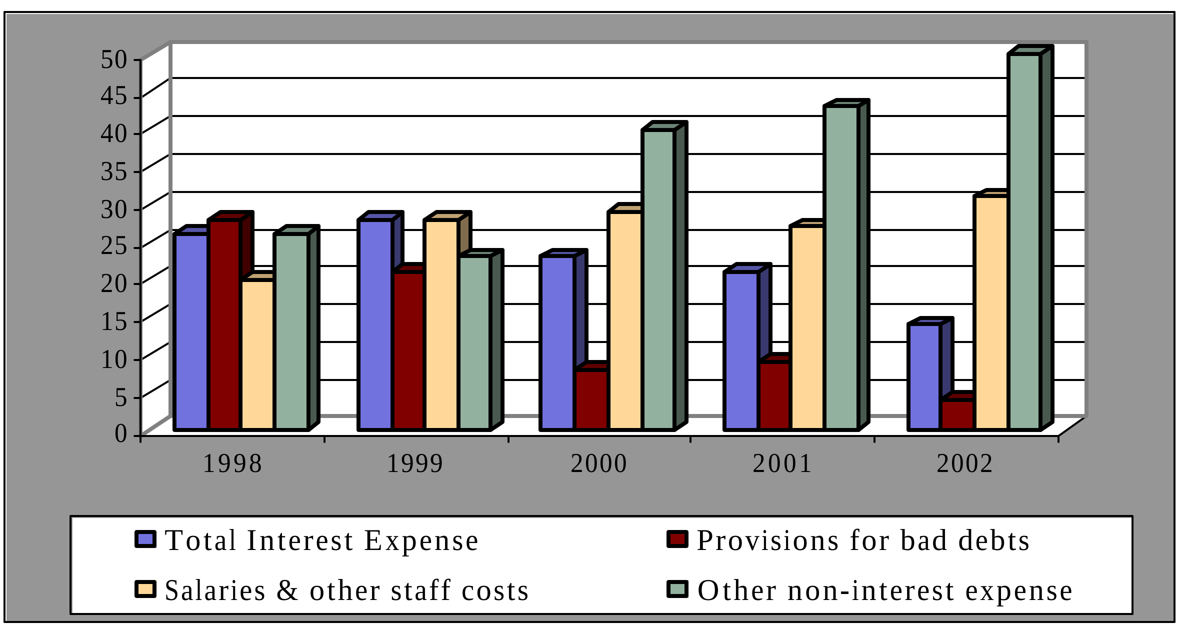
Figure 3.6: Commercial Banks' sources of income (In percentage of the total)



As at the end of the period under review, the banking sector recorded a return on assets (ROA) of 2.72% down from 4.13% registered as at the end of the previous year. The decline in ROA was as a result of a decrease of Shs.16.4 bn or 20% in net profits and an increase in total adjusted assets of Shs.427.3 bn or 21.6%. The major source of earnings for the sector was interest income, accounting for 64% of total income. Total interest income decreased by Shs.37 bn from Shs.205 bn in 2001 to Shs.168 bn as at the end of the period under review. Non-interest income on the other hand rose by Shs. 7 bn over the period from Shs.86 bn in 2001 to Shs.93 bn in 2002, and represented 36% of total income, from 34%, 31% and 30% in 1999, 2000 and 2001 respectively.

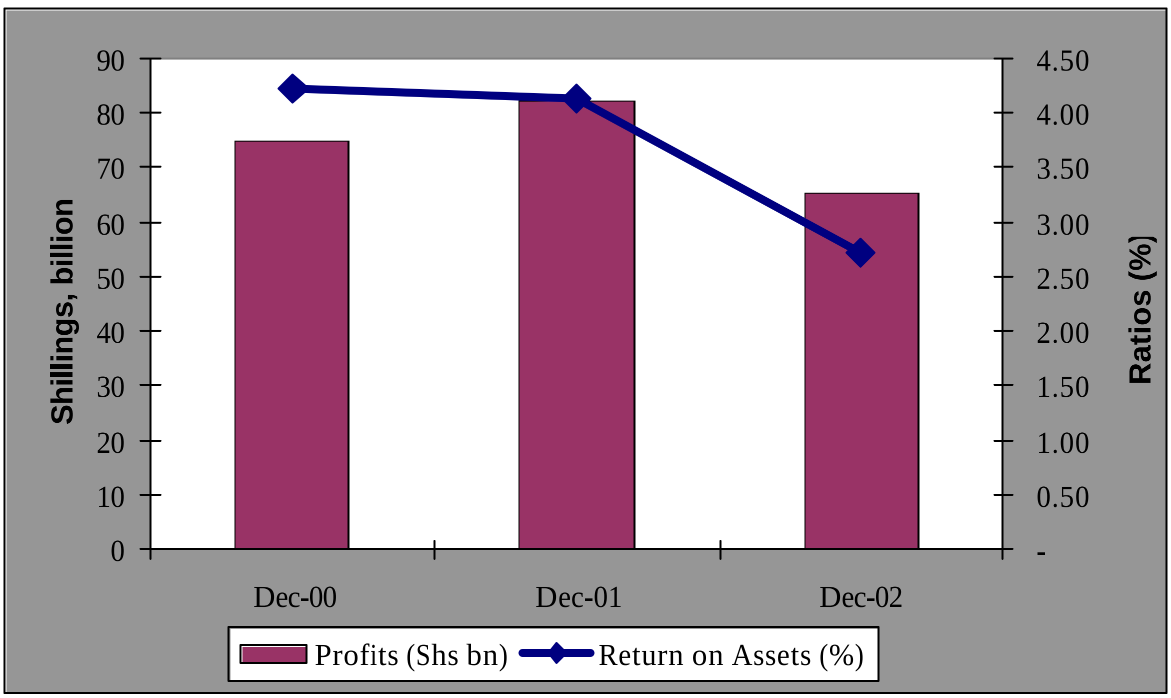
The share of earnings from Government securities declined from 30.2% in 2001 to 28.7% during the year under review largely on account of a decline in interest rates on treasury bills. The proportion of income earned from Advances and discounts slightly increased from to 30.6% to 31.0% in the same period. Other interest income declined from 9.6% to 4.6% of total income. Figure 3.6 depicts income earned from the various sources in relation to total income.

Figure 3.7: Commercial Banks' categories of expenditure (In percentage of total)



The banking sector's total interest expense recorded a decline of Shs.17 bn or 37.8% from Shs.45 bn in 2001 to Shs.28 bn in 2002. Total non-interest expense (including tax and provisions for bad debts) increased by Shs.3 bn or 1.8%, from Shs.165 bn to Shs.168 bn during the same period. The major expenditure items were salaries, staff costs and other non-interest expenses, which increased by Shs.18 bn or 12.2% from Shs.147 bn as at end December 2001, to Shs.165 bn as at December 2002. Interest expenses on time deposits reported at Shs.24 bn in the previous year, declined by Shs.7 bn or 29.2% during the year under review. Figure 3.7 shows the relative shares of the various expenditure items to total expenses, while figure 3.8 gives the trend of the return on assets and profits during the years 2000, 2001 and 2002.

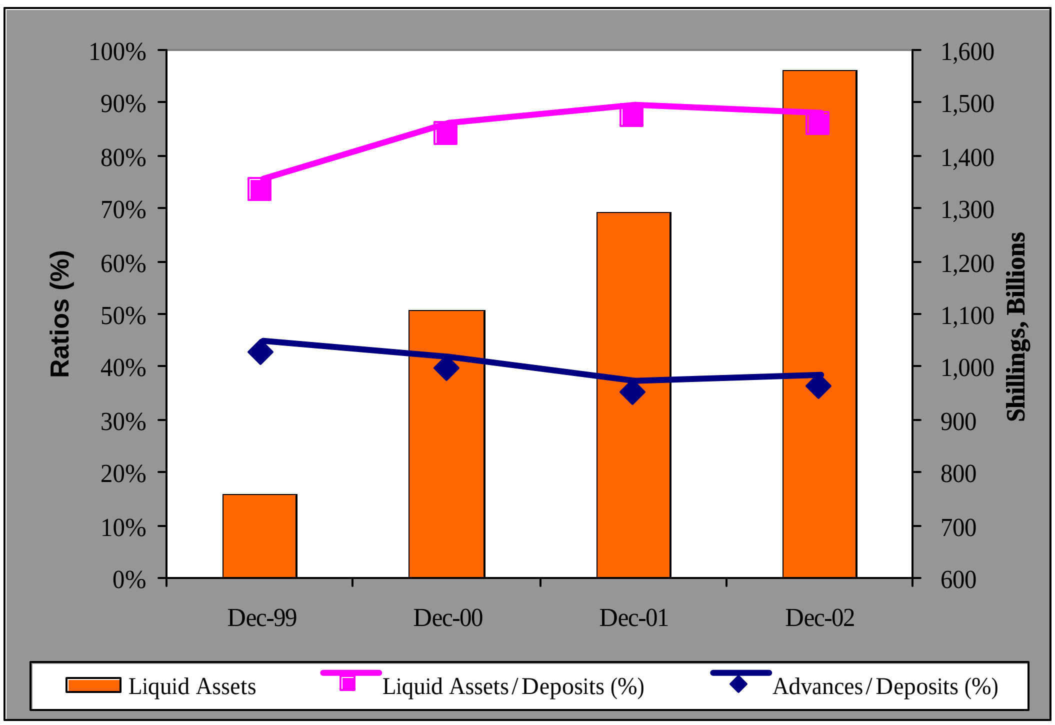
Figure 3.8: Return on Assets and Earnings



3.1.9 Liquidity

As at the end of 2002, the banking sector recorded an overall satisfactory liquidity position. Liquid assets increased by Shs.272 bn or 21.1% from Shs.1,292 bn as at end of 2001 to Shs.1,564 bn during the year under review. This compares with an increase of 16.8 percent of liquid assets in December 2001 compared to December 2000. The ratio of liquid assets to deposits decreased slightly from 87.59% in 2001 to 86.08% in 2002. The lending ratio slightly increased from 34.46% as at end of 2001 to 35.09% at the end of 2002. All banks maintained adequate credit-clearing balances with Bank of Uganda. Figure 3.9 depicts that liquid assets recorded a steady increase over the period.

Figure 3.9 Liquidity Indicators



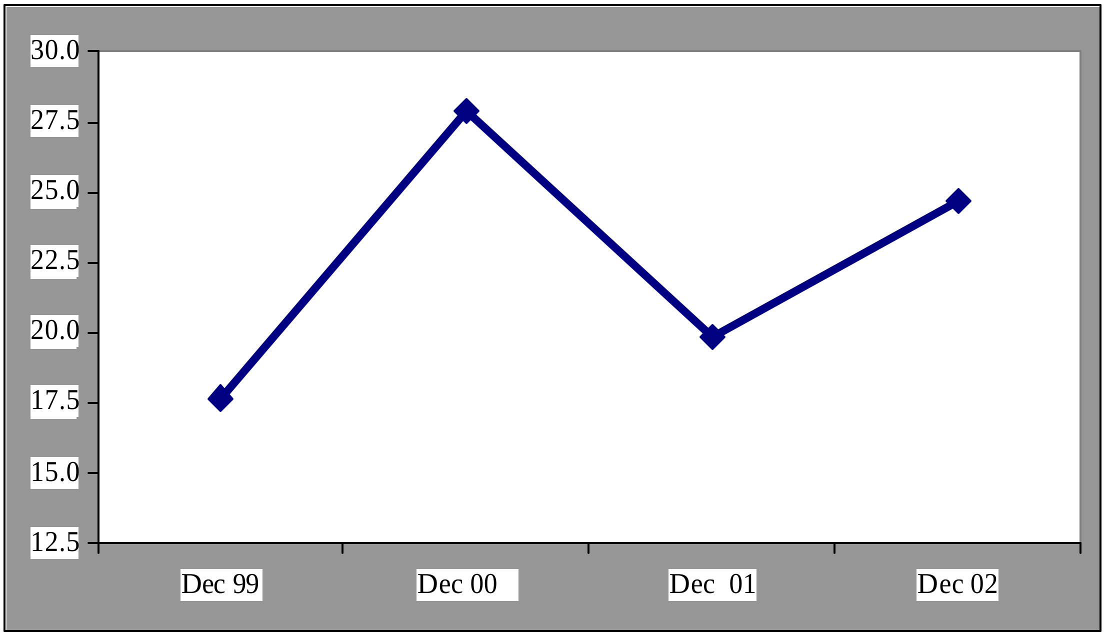
3.2.0 Performance of Credit Institutions

Total assets (net of administered loans) of the seven operating credit institutions increased by 63.2% from Shs.60.0 bn in 2001, to Shs 97.9 bn at the end of the period under review. The financial condition of the credit institutions, based on the consolidated statements of assets and liabilities as at 31st December 2002 remained fair. Out of the seven institutions, four were rated satisfactory, two were rated marginal, and only one was rated fair. This is an improvement compared to December 2001 when 4 institutions were rated fair, and two were rated satisfactory. It is important to note however, that compared to 2001, the rating for two institutions deteriorated from fair to marginal, while two improved from fair to satisfactory. The rating for two more institutions remained satisfactory. Furthermore, six credit institutions remained profitable, while one made an operating loss of Shs.250.72 m in the financial year ended December 2002. This was mainly attributed to high operating costs.

3.2.1 Capital Adequacy

The Paid-up capital of the credit institutions increased by 30.2% from Shs.7,435 m as at the end 2001, to Shs 9681.5 m as at the end 2002. All the credit Institutions maintained core capital to risk weighted assets ratios above the minimum requirement of 8%. The core capital to risk weighted assets ratio (RWA) improved from 19.9% in 2001, to 24.70% in 2002. These developments are depicted in figure 3.10.

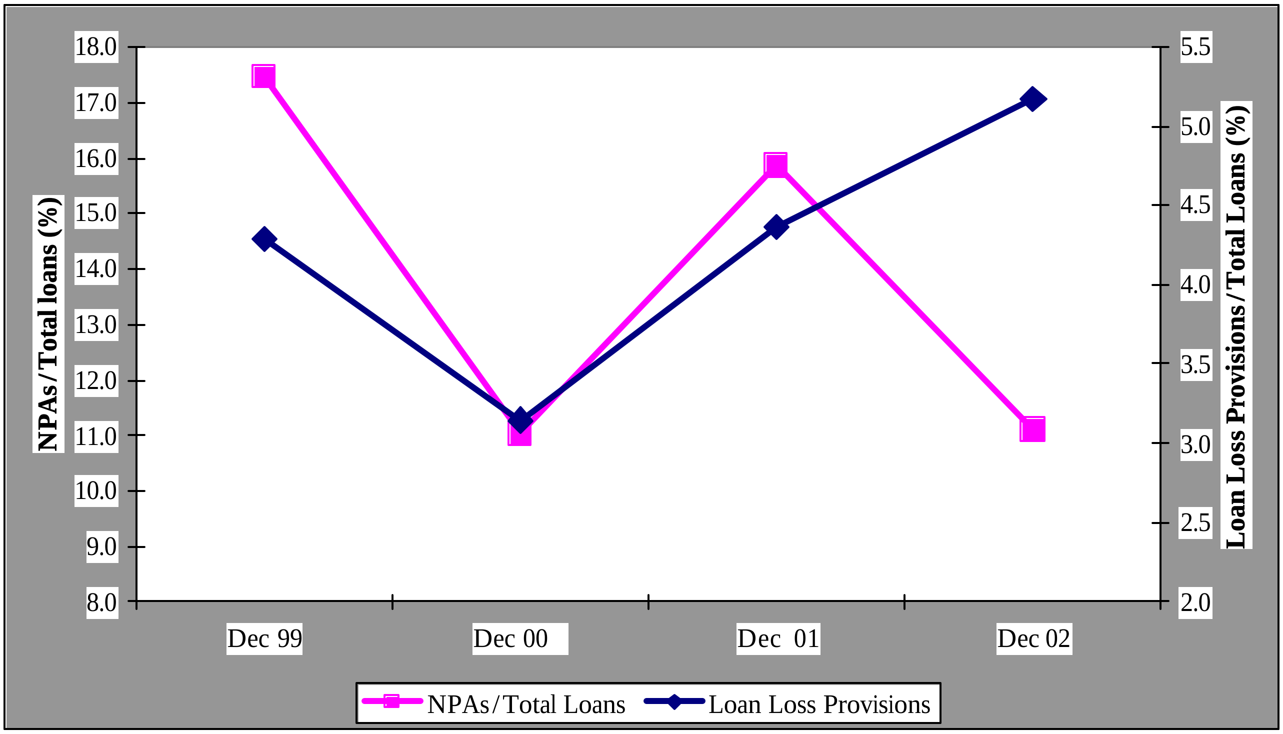
Figure 3.10: Ratio of Core Capital to Risk Weighted Assets (%)



3.2.2 Asset Quality

The performance of the credit portfolio remained fair. The credit institutions total credit portfolio (excluding administered loans) increased by 31.1% from Shs.31,978.9 m in 2001, to Shs.41,925.3 m as at the end of the year under review. Housing Finance Company of Uganda Ltd manages an administered loan portfolio for mortgage business i.e. purchase of residential houses, construction, or completion of existing structures. The administered loans decreased marginally by 1.1%, from Shs.27,927.41m to Shs 27,616.99 m, between 2001 and 2002. As at the end of the period under review, Mortgage loans represented 86% of total loans compared to 73% in 2001, and 75% in 2000. The ratio of non-performing advances to total advances (NPA) in the credit institutions' sub-sector declined from 15.8% in 2001 to 11.1% in 2002. The decline is partly due to write-offs of bad loans, and improved loan recovery efforts. The specific provisions as a percentage of NPA rose from 25.9% to 29.7% at end of the period under review.

Figure 3.11: Asset Quality Indicators

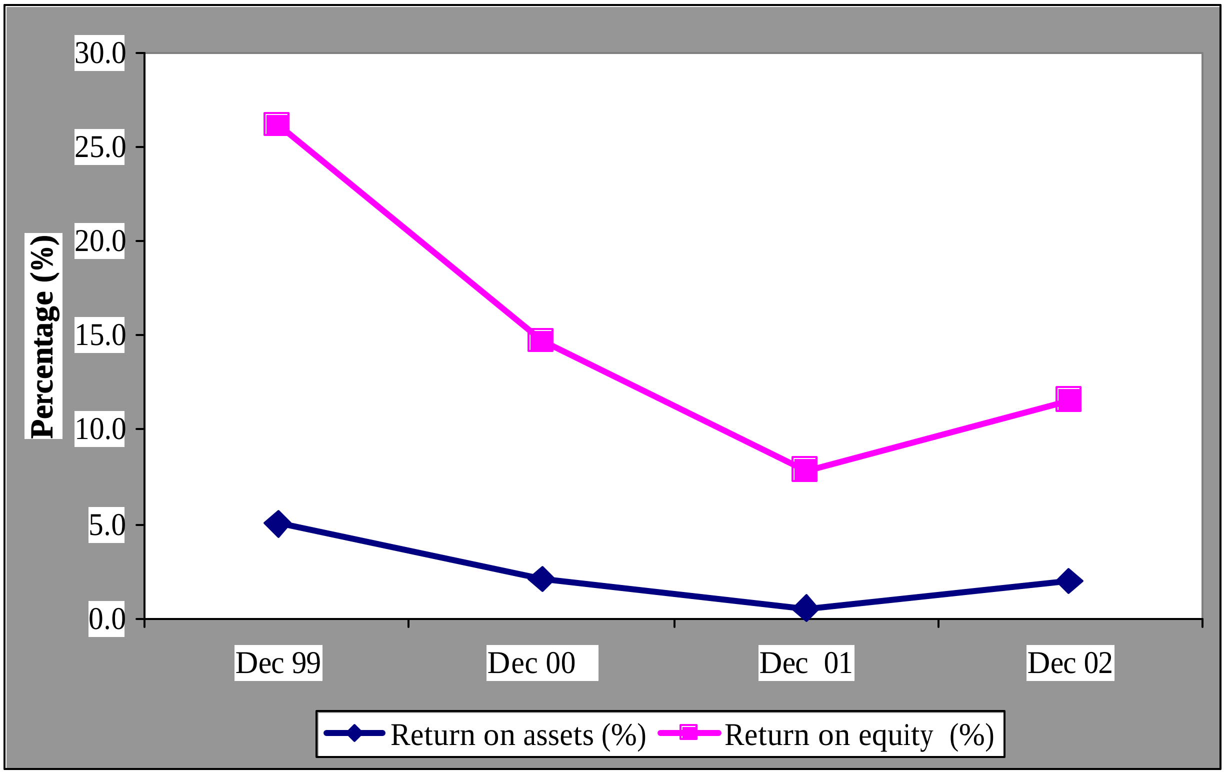


Lending to the building and construction sector continues to take up the bulk of the loans of credit institutions, although the share in total loans declined from 85.8% in 2001, to 78.8% during 2002. The manufacturing sector and the Trade and commerce sectors gained 6.9 and 0.8 percentage points. (Table 2 in appendix 3)

3.2.3 Earnings

Compared to 2001, the overall credit institutions' profitability improved significantly by Shs 1,426.2m from Shs.511.45 m in 2001 to Shs 1937.6 m in 2002. This was attributed to declining losses registered in one credit institution, and improved earnings in others. Interest income from the intermediation function constituted the main source of earnings for the credit institutions. Interest income increased by 20.8% from Shs 7,873.03 m in the year 2001, to Shs 9,507.15m in 2002. Interest expenses increased by 37.72% from Shs 1,622.89 m in 2001, to Shs 2,235.11m by the end of the year under review. Return on assets ratio rose marginally from 1.0% to 1.5% between 2001 and 2002, while Return on Equity rose by 7.9% and 11.6% for the years 2001 and 2002 respectively.

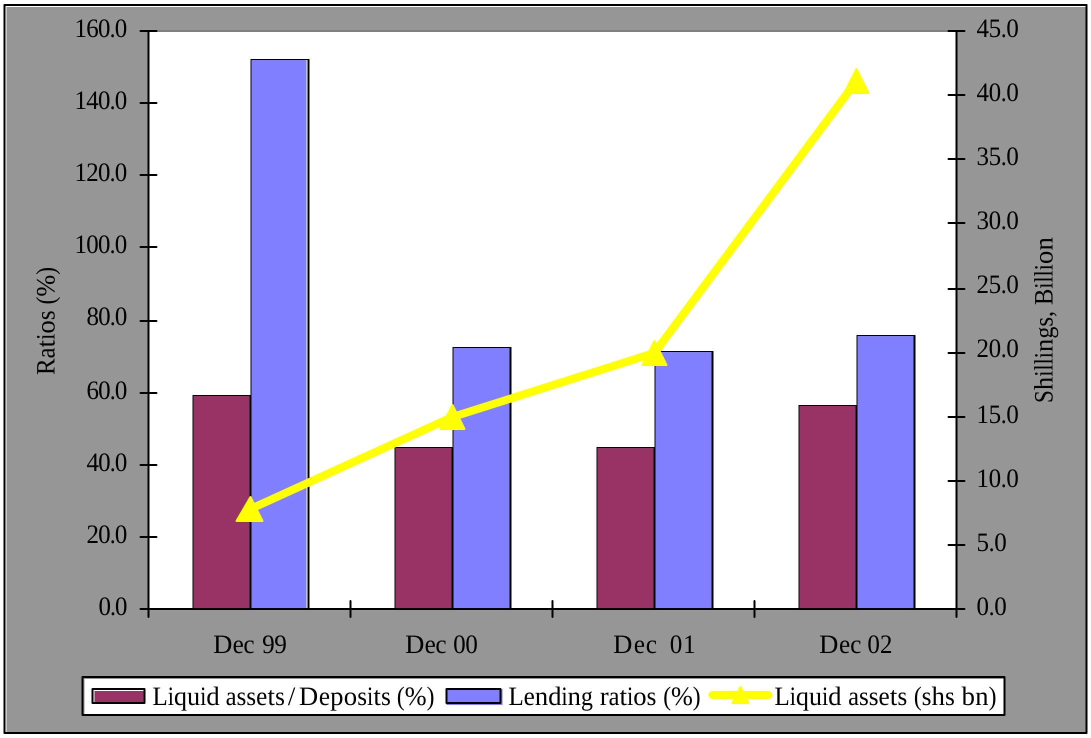
Figure 3.12: Return on Assets and Equity (%)



3.2.4 Liquidity

All the credit institutions complied with the statutory liquidity requirements during the period under review. The overall liquid assets to deposits ratio rose significantly by 11.58 percentage points, from 44.66% at the end of 2001, to 56.22% at the end of 2002. This was mainly as a result of including the data for Post Bank (U) Ltd (PBU). Furthermore, as figure 3.13 shows, the lending ratio declined from 71.7% to 75.8% over the same period. This ratio excludes data for PBU because it has not yet embarked on lending. Liquidity indicators are depicted in figure 3.13.

Figure 3.13: Liquidity Indicators



4.0.0 DEVELOPMENTS IN THE FINANCIAL SECTOR IN UGANDA

4.1.0 Closed Financial Institutions Update

Liquidation of Co-op, ICB and Greenland Banks

The liquidation of the banks that were closed in 1998/99, (Co-operative Bank Ltd, Greenland Bank Ltd and International Credit Bank Ltd) has progressed with notable success being recorded in the recoveries of bad debts through foreclosure of collateral securities. Bank of Uganda's own has continued to execute the liquidation process in order to minimize the costs of the exercise. However, whenever it has been found necessary, legal experts, valuers and auctioneers have been employed to execute special assignments. Provisional summary of the closed banks' total recoveries and liquidation expenses as at November 30, 2002 is outlined in table 4.0.

Table 4.0: Provisional summary of the status of closed banks (shillings, million)

Bank	Total Loans & Overdrafts as at closure	Total fixed & other realizable assets at closure	Total recoveries as at Nov. 30, 2002	Assets realized so far (Sale of assets, cash at closure and rent)	Expenses as at Nov. 30, 2002
Greenland	40,941.6	12,971.6	14,520.3	3,261.5	6,152.5
Co-operative	56,755.4	28,767.5	15,018.2	15,026.5	5,656.7
ICB Ltd	13,103.0	4,357.0	3.969.7	2,049.0	1,769.5
Total	110.800.0	46,096.1	33,508.2	20,337.0	12,578.7

4.2.0 Foreign Exchange Risk Management

During the year, Bank of Uganda reviewed and amended the "Prudential Guidelines on Dealer Banks' Foreign Exchange Business". The purpose of the amendment was to align the foreign exchange guidelines with the internationally accepted method of calculating foreign exchange risk exposure known as the "shorthand method".

Banks in Uganda have been using the Net Aggregate Position method for calculating their foreign exchange exposures. The apparent feature of this approach is that long and short positions are netted off against each other, independently from the currency in which they are denominated. This technique therefore, does not show the per currency exposure and indeed ignores the cross-currency risks inherent in multiple foreign currency portfolios.

Under the "shorthand method", all net long and net short foreign currency positions have to be added up and the greater of the absolute value of both sums is then taken as the overall open position. Additionally, the amendment includes other off-balance sheet items such as guarantees and similar commitments denominated in foreign currencies, which are certain to be called upon and are likely to be irrevocable, for purposes of calculating foreign exchange position limits.

4.3.0 National Payment System

During the year 2002, a number of significant payment system developments took place. These were in the areas of electronic clearing, payment system oversight, payment technology, standards and the legal and regulatory framework.

(i) Implementation of Electronic Clearing System (ECS)

Following a successful pilot testing phase of just over six months, the electronic clearing system was implemented on May 02, 2002. Effective that date, all clearing banks deliver cheque clearing data to the clearing house in electronic form. The electronic clearing system, after verifying the authenticity of the data, computes and derives the net obligations of each bank in a much shorter period than was the case in manual clearing.

ii) Electronic Fund Transfer (EFT) Clearing

The Electronic Fund Transfer Clearing System (EFTCS), which went live in May 2002, supports both debit and credit clearing. During the year, a Project Plan to implement electronic fund transfer clearing (i.e. the clearing of credit transfers and direct debits) was prepared, reviewed and adopted by the banks. Since November 2002, clearing banks have been upgrading their electronic clearing systems so as to accommodate EFT transactions. EFT Pilot testing is scheduled for March 2003, while the implementation of EFT clearing is expected later in the same year.

iii) Development of an EFT Standard

In order to embark on the introduction of EFT clearing, an EFT standard had to be developed. During the year, an EFT standard was adopted.

iv) Real Time Gross Settlement System (RTGS)

As part of a co-coordinated approach to developing and modernizing the country's payment system, Bank of Uganda embarked on the process of procuring, installing and implementing a Real Time Gross Settlement System. The RTGS (also referred to as a Large Value Transfer System) is an inter-bank credit transfer system in which large or time-sensitive payments are transferred and settled immediately (real-time) and on individual basis (i.e. gross). During the year, a concept paper spelling out the strategic objectives, benefits, critical success factors and an implementation schedule of the proposed RTGS System was prepared and is currently under review.

v) Electronic Submission of Payment System Oversight Data

During 2002, the National Payment System Secretariat (NPSS) worked closely with Commercial Banking and Management Information Systems (MIS) departments initiated the development of a system that would enable commercial banks to securely and electronically submit payment system oversight data to NPSS. The MIS is currently developing such a system to facilitate a secure and electronic submission of oversight data.

vi) Extension of Electronic Clearing to Upcountry Areas

The implementation of electronic clearing in May 2002 started within the Kampala area, and it is scheduled to be extended to the rest of the country in the first half of 2003. In September 2002, an implementation plan to extend electronic clearing to the rest of the country was prepared, reviewed and subsequently adopted. It is expected that once ECS upcountry clearing is implemented, the whole country will have a three-day uniform clearing cycle for cheques, a situation that should stimulate the usage of non-cash instruments. The process to implement ECS upcountry clearing is currently underway.

vii) Procurement of MICR Software

During the year, Bank of Uganda procured software to automate cheque data capture using the MICR (Magnetic Ink Character Recognition) machines. Cheque data from outward cheques (i.e. cheques being sent by a collecting bank to the paying bank) are automatically read by the MICR machines, imported into a computer system and electronic files generated for onward transmission to the electronic clearing house. Similarly, incoming cheques (i.e. cheques from other banks) are read by the MICR machines, imported into a computer system where automated reconciliation is carried out between the electronic data from the clearing house and that read by the MICR machines.

viii) ATM Growth and Need for a Switch

There was a significant increase in the number of ATMs during the year 2002. From 25 at the end of 2001, the number increased by over 100% to 50 by the end of 2002. Moreover, the ATM functionality has also been expanding. Customers can now load airtime on their mobile phones (cell phones) from some ATM points. The increasing number of ATMs, coupled with the expansion of the ATM functionality and the need to promote the use of payment cards (debit, credit and e-purse cards) has made the establishment and operation of a switching system a strategic imperative.

During the year, we held discussions with several vendors who expressed interest in setting up a switching system in the country. The switch would enable customers to withdraw cash from any ATM of a bank that is connected to the switch. Debit cards would also largely replace cash in purchases from places where Point of Sale (POS) terminals exist.

ix) Development of an Adequate Legal Framework

A legal consultant to review the adequacy of the existing payment system-related legal framework was recruited in 2002. He reviewed and proposed amendments to a number of existing laws including the Bills of Exchange, Bank of Uganda Statute, Uganda Evidence Act, Uganda Penal Code, Companies Act, Financial Institutions Statute, Telecommunications Act and the Uganda Contracts Act.

The Consultant also proposed new draft laws in the areas of payment system regulation, Internet and Electronic Commerce and cross border payments. The new draft laws and proposed amendments to existing laws will soon be submitted to Government for enactment.

4.4.0 Deposit Protection Fund

- ***Policy Proposal***

During the year under review, further steps were taken to advance investor protection through the formulation of a comprehensive proposal for reforming the existing Deposit Protection Fund in Uganda. A lengthy consultative process, conducted through a committee under the chairmanship of the Bank of Uganda and involving various interested parties, preceded the formulation of the proposal. The main objective of the development of the proposal is the protection of small unsophisticated depositors, in order to promote public confidence in the banking system and, thereby, promote its stability and encourage saving by the public. An effective DPF would also provide a formal, structured and consistent administrative process for the handling of bank/financial institution failures. The Bank of Uganda embarked on the drafting of a law to give the Deposit Protection Fund autonomy.

- ***Financial Condition***

According to the audited financial statements of the Deposit Protection Fund as at 30th June 2002, the total assets base of the Fund is still low, although there has been some improvement. Total assets increased by Shs. 3.97 billion from Shs.10.29 billion in 2001 to Shs. 14.26 billion as at December 2002. The Fund paid off the borrowing from the Bank of Uganda amounting to Shs. 37.85 billion, leaving net assets of the Fund at Shs. 14.12 billion as at 30th June 2002. Contributions received from member banks and credit institutions increased by Shs. 553.11 million from Shs. 2,167.1 million as at the end of June 2001 to Shs. 2,720.2 million as at 30th June 2002.

The Fund continues to hold investments in treasury bills and earned interest income amounting to Shs. 1,278.6 million during the period under review. As at 30th June 2002, payments to depositors during the year amounted to Shs. 151.5 million.

4.5.0 Regulatory and Legal Framework Developments

As indicated in the previous annual report, a particularly important function of the Bank of Uganda is to ensure that the legal framework for the regulation and supervision of financial institutions in Uganda remains relevant and current. The Bank of Uganda can fulfill this responsibility only if it ensures that the legal framework governing the operations of the financial institutions remains in line with international regulatory and market developments. Therefore the Bank of Uganda has to review the banking and financial institutions legislation on an on-going basis. This section provides a brief overview of the developments in the regulation of the financial institutions in Uganda during 2002.

Amendments to the Financial Institutions Statute 1993

The proposed amendments introduced by the Financial Institutions Bill, 2002 were described in some detail in the 2000 and 2001 Annual Reports. These amendments were tabled in Parliament during 2002. Following the prescribed approval process, these amendments were promulgated as the Financial Institutions Bill, N0.6/2002 in the Uganda Gazette No. 30 Volume XCV of 24th May 2002. However, debate on the bill had not yet commenced by the time of compiling this report.

Amendments to the Regulations Relating to Financial Institutions Statute 1993

In its 2001 Annual Report, the Supervision Function reported comprehensively on the most important proposed amendments to the implementing regulations for the Financial Institutions Bill, No. 6/2002. The review of these regulations continued in the period under review but could not be concluded because the FIB 2002 has not yet been enacted into law by Parliament.

5.0.0 Regional Cooperation Initiatives

a) Monetary Affairs Committee

Uganda has continued to actively participate in the implementation of the Monetary Affairs Committee (MAC) programmes, which aim at harmonizing the monetary and financial policies of the three East African countries. The Monetary Affairs Committee is constituted by the Governors of the three Central Banks of Kenya, Tanzania and Uganda and coordinated by the East African Community Secretariat based at Arusha, Tanzania. At the annual MAC meeting, which took place on May 02, 2002 at Arusha, Tanzania the Governors, resolved to expedite the implementation of the following issues:

- Maintain Prudent Monetary Policy
- Foster the establishment of a Single Currency Vision
- Conduct a Review of the Current Monetary Policy Frameworks in East Africa
- Enforce Disclosure Requirements by Financial Institutions
- Institute Best Practices in Recovery of Non-Performing Loans
- Evaluate the likely impact of the new Basle Capital Accord on LDCs
- Harmonize the East African Central Banks Information Technology
- Harmonize the East African Payment Systems

These are ongoing issues whose implementations are reviewed every year at the annual MAC meetings to establish the level of compliance. Each central bank has therefore set up lead departments/functions to spearhead implementation of the issues.

b) Bank Supervision Application Systems

In an effort to harmonize Banking Supervision processes and facilitate Information Systems in the Eastern, Central and Southern Africa Region, a project to develop a Supervision Application IT System was initiated through Cooperation of SADC and ESAF. The Central Bank of Mozambique, “Banco de Mozambique” volunteered to develop and implement the system with the help of the South African Reserve Bank. M/s T-systems, a software developer, was contracted to develop the solution and implement it at Bank of Mozambique initially, and thereafter in other Central Banks in the Region.

In early 2002, representatives from ESAF Central Banks met in Pretoria South Africa, and signed off the Project Definition Report. In addition, a Steering Committee was formed to oversee the project development. A Project Management Committee was also set up to carry out project development, implementation, and monitoring of the risk aspects. It was decided that representatives from Bank Supervision Departments across the region should attend workshops in the Reserve Bank of South Africa to complete the business specification of the project. Three workshops were held between February and May 2002 in which the solution specifications were finalized.

A number of IT specialists from the central banks in the region were chosen to be part of the solution developing team. These IT developers were full time based in South Africa and worked with T-systems in developing the solution. They received training in the various applications that were to be used in developing the solutions. Bank Supervisors in the region held several workshops during 2002 to review the development of the solution as it progresses. It is anticipated that after these reviews, the final solution will be installed in Banco de Mozambique in the earlier part of 2003.

The Steering Committee has been holding monthly meetings to review the progress of the project. In addition heads of Supervision in the region have been meeting quarterly and were informed of the project progress in these meetings. Finally, members of the project committee team made a tour of all the Central Banks in the region to assess the degree of preparedness for the oncoming Bank Supervision Applications system and to advise on what these banks should do in the interim period. This tour was called a 'Road Show' and took place in September – October 2002. It is expected that by the end of 2003, a substantial number of Central Bank in the region will have the application installed in their countries.

c) COMESA:

Bank of Uganda participated in COMESA initiatives for harmonization of banking regulation and supervision. The 13th Meeting of the COMESA Council of Ministers sat in May 2002, and recommended a second meeting of Bank Supervisors in COMESA Region to be held in Lusaka, Zambia from 3 – 5 Feb 2003. Of main concern is the harmonization of minimum standards for Bank Regulation and Supervision in the COMESA region.

COMESA attaches great importance to adoption of internationally recognized standards on Corporate Governance, Macro Economic stability, Regulation and Supervision of the financial sector. The meeting underscored the importance of Financial Sector Adjustment Programme in helping countries enhance their resilience to crisis and border contagion. Proceedings of the meeting were consolidated into a draft report that was circulated to the members. The issues discussed include:

a) Financial Sector Assessment Programme (FSAP)
b) Designing Regulatory Policy and Institutional Mechanisms for Micro Finance Institutions.
c) Harmonization of Bank Supervision and Regulation in the COMESA Region.
d) Consolidated Supervision for Banking Groups
e) Framework for the Implementation of Banking and Financial Standards in Africa under NEPAD.

ii) Designing Regulatory Policy and institutional mechanism for Micro Finance.

The meeting appreciated the necessity for a framework for regulating Micro finance Institutions that mobilized deposits from the public. It was agreed that micro finance institutions that mobilized deposits from the public should be fully regulated and monitored by a regulatory agency. The meeting noted the broad approaches to regulation of micro finance and the suitability of each approach based on a country's unique circumstances. It was recommended that:

- COMESA should produce a model legislation based on good practices for the regulation of MFIs.

- All COMESA states should enact legislation for the regulation of Micro Finance Institutions based on good practices.

In this regard, Uganda has already instituted a law, the MDI Bill 2002, which adopted the "Tiered Approach" providing room for flexibility to micro finance activities. The Bill incorporated the necessity to regulate different intermediaries in a different manner. The MDI Bill 2002 was passed by Parliament in December 2002 and awaits the assent of the President to become law.

iii) Framework for harmonisation of Bank Supervision and Regulation in the COMESA

The status of implementation of the 25 Core Principles for Effective Banking Supervision among the COMESA member countries was reviewed. Most member countries had put in place key supervisory systems in areas of licensing, capital adequacy, loan classification and provisioning for bad debts. The meeting discussed the major areas of harmonization, which included licensing standards, capital adequacy, accounting and disclosure standards, on- site and off- site supervision, consolidated supervision, resolution of troubled and insolvent banks, money-laundering etc. An Action Plan for harmonization of bank supervision and regulation was presented and adopted commencing 2003. Member states were to report their progress to the COMESA Secretariat.

iv) Consolidated Supervision

The COMESA members observed that deregulation and internationalization of financial markets had necessitated the need for the various supervisors to establish a coordinated approach to supervision so that a prudential assessment could be made from a group-wide perspective. To facilitate a harmonized consolidated and cross-border supervisory regime, compliance with the Basle Core Principles was stressed.

v) Framework for the implementation of Banking and Financial Standards in Africa under NEPAD

The members discussed the broad objectives of NEPAD and the case for adopting banking and financial standards. It was observed that the centerpiece for adopting financial standards under NEPAD was the proposed African Peer Review (APR) mechanism. Following the FSAP assessment, countries would draw time bound action plans to deal with the identified weaknesses in their compliance with financial standards and codes. COMESA indicated that it had already put in place through its macro – economic convergence criteria some form of peer review that is closely monitored by the Committee of Central Bank Governors and the Ministers of Finance. The meeting made several recommendations for the COMESA members among which was that the African Development Bank should organize the self assessment and peer review process for banking and financial standards and codes in COMESA. COMESA Secretariat is to establish the African Peer Review (APR) mechanism for its member states.

Appendix 1: Tables for Commercial Banks

Table 1: COMMERCIAL BANKS' ASSETS AND LIABILITIES

(Shillings, billions)

ASSETS	1998	1999	2000	2001	2002
Cash and Balances with BOU	137	129	196	238	218
Treasury Bills	113	212	332	514	839
Fixed assets	95	92	106	106	110
Due from Banks Outside Uganda	279	290	377	368	362
Loans & advances to customers	443	439	525	521	661
Other securities	91	89	73	74	48
Other assets	121	101	236	217	218
Total assets	**1,279**	**1,352**	**1,845**	**2,038**	**2,456**
LIABILITIES					
Due to Deposit Money Banks	247	9	77	65	77
Deposits	691	1,040	1,325	1,483	1,822
Capital (excl. year-to-date profits)[2]	88	72	106	167	201
Provisions	86	53	63	58	50
Other liabilities	166	152	196	199	241
Year to date profit[2]	1	26	78	66	65
Total Liabilities & Capital	**1,279**	**1,352**	**1,845**	**2,038**	**2,456**

Note:

1. As at December for each year. Figures for closed banks are excluded from the data for subsequent periods.
2. Does not take into consideration the end of reporting periods for individual banks and therefore, does not take reflect the calendar year profits owing to differences in reporting periods between Financial Institutions. From December 2002, all commercial banks financial year-ends coincide with the calendar year end.

Source: Monthly returns of Commercial banks

Table 2: COMMERCIAL BANKS' COMPARATIVE INCOME STATEMENT[1]

(Shillings, billions)

PROFIT & LOSS	1998	1999	2000	2001	2002
Income					
Interest on advances	60	74	84	89	81
Interest on government securities	10	12	55	88	75
Other interest income	17	18	31	28	12
Total interest income	87	104	170	205	168
Total non-interest income	44	54	78	86	93
Total Income	**131**	**158**	**248**	**291**	**261**
Expenses					
Total Interest Expense	34	34	40	45	28
Provisions for bad debts	37	25	14	18	3
Salaries & other staff costs	27	33	50	57	64
Other non-interest expense	35	28	69	90	101
Total Expenses	**133**	**120**	**173**	**210**	**196**
Net Income[2]	**(8)**	**38**	**75**	**82**	**65**

Note:

1. As at December for each year. Figures for closed banks are excluded from the data for subsequent periods.
2. The loss in 1998 occurred as a result of large losses in Co-op Bank Ltd (Shs 10.1bn), Gold Trust Bank Ltd (Shs 2.7bn) Greenland Bank Ltd (Shs 7.9bn) and others.

Source: Commercial banks' quarterly income statements.

Table 3: SECTORAL DISTRIBUTION OF COMMERCIAL BANKS' CREDIT[1]

(Shillings, billion)

Sector	1998	1999	2000	2001	2002
Government	3	2	3	2	3
Agriculture	70	56	52	51	54
Mining and Quarrying	1	2	2	4	3
Manufacturing	136	169	210	190	183
Trade and Commerce	104	98	107	120	173
Transport, Comm. Elec. & Water:	16	40	33	29	45
Building and Construction	24	24	22	19	20
Other Services[2]	89	48	96	105	180
Total	**443**	**439**	**525**	**521**	**661**

Note:
1. As at December for each year. Figures for closed banks are excluded from the data for subsequent periods.
2. Includes bills of exchange, real estate, and lending to NBFIs.

Source: Monthly statements of Commercial banks.

Table 4: STRUCTURE OF COMMERCIAL BANKS DEPOSITS[1]

(Shillings, billions)

Type of Deposits	1998	1999	2000	2001	2002
Demand and Call	342	612	847	960	1,175
Savings	145	167	197	253	302
Time	204	260	281	270	345
Total	**691**	**1,039**	**1,325**	**1,483**	**1,822**

Note:
1. As at December for each year. Figures for closed banks are excluded from the data for subsequent periods.

Source: Monthly returns of commercial banks.

Table 5: KEY FINANCIAL INDICATORS

INDICATOR	1998	1999	2000	2001	2002
CAPITAL ADEQUACY					
Core Capital/RWAs (%)	7.7	10.6	17.4	20.5	18.0
Owner's funds – Equity (Shs bn)	88	72	166	194	214
EARNINGS RATIOS					
ROA (%)	-0.18	1.02	4.21	4.13	2.72
ROE (%)	-13.10	24.50	45.10	50.85	
LIQUIDITY					
Liquid assets/Total deposits (%)	40.98	73.62	84.15	87.59	86.08
Total Advances/Total deposits (%)	64.01	41.46	38.98	35.33	36.39
Liquid assets (Shs bn)	392	783	1,106	1,292	1,564
ASSET QUALITY					
Loans and Advances (Shs bn)	443	439	525	521	661
Non Performing Advances -NPA (Shs bn)	251	266	52	34	20
Provisions for NPA (Shs bn)	69	56	32	24	16
Specific Provisions (Shs bn)	66	28	26	21	10
NPA/Total Advances (%)	56.7	60.6	9.8	6.5	3.0
Specific Provisions/NPA (%)	26.4	10.5	50.5	61.2	53.2

Note:

ROA - Return on Assets
ROE - Return on Equity
NPA - Non Performing Assets (primarily loans and advances)
RWA - Risk Weighted Assets

Source: Monthly returns of Commercial banks.

Appendix 2: REGISTERED COMMERCIAL BANKS AS AT 31 DECEMBER 2002

	Name of Institution	Ownership	No. of Branches	No. of Agencies	Other
1	dfcu Bank	Foreign	4		
2	Nile Bank Ltd.	Foreign	3		
3	Allied Bank International	Foreign	3		
4	Centenary Rural Dev. Bank	Local	18		
5	National Bank of Commerce	Foreign	2		
6	Orient Bank Ltd.	Local	6		
7	Barclays Bank (U) Ltd.	Foreign	2	3	
8	Bank of Baroda (U) Ltd.	Foreign	6		
9	Stanbic Bank	Foreign	68		
10	Standard Chartered Bank	Foreign	6		
11	Tropical Bank	Foreign	3		
12	Crane Bank	Local	2		
13	Cairo Bank	Foreign	1		
14	Diamond Trust Bank	Foreign	1		
15	Citibank	Foreign	1		
	Total		126	3	

Note:

1. During the year 2002,the purchase of UCBL by Stanbic Bank was completed.

2. During the same year, Orient Bank merged its operations with TransAfrica Bank Ltd.

Appendix 3: Tables for credit institutions

Table 1: STATEMENT OF ASSETS AND LIABILITIES FOR CREDIT INSTITUTIONS
(Shillings, millions)

	Dec-99	Dec-00	Dec-01	Dec –02
LIABILITIES				
Total Liabilities to Depositors	13,242.8	33,486.8	44,631.7 7	73,240.66
Balances due to Commercial Banks/Associated Cos	100.0	-	-	
Administered Funds 2/	39,083.2	28,469.2	27,918.4	27,616.99
Other Liabilities	1,410.6	1,597.8	1,385.9	3,591.32
Provisions	1,629.1	1,859.6	3,341.9	4372.2
Capital	4,633.6	9,369.1	9,847.9	14,744.89
Profit/(loss) for the current year	1,643.9	1,612.4	845.5	1,937.61
Total liabilities and capital	61,743.2	76,394.8	87,971.3	125,503.67
ASSETS				
Cash	273.2	804.0	1,454.2	2,665.5
Balance with Commercial banks & Associated Cos in Uganda	5,281.7	9,924.5	13,535.0	21,413.7
Balance with Commercial Banks Outside Uganda	968.8	1,406.6	1,217.2	1,332.5
Investments:	1,675.7	3,069.6	4,352.3	16,724.28
Bank of Uganda Schemes	-	-	-	-
Loans and Advances	49,032.2	53,131.1	59,906.3	69,542.28
O/w Administered Loans	29,018.4	28,876.8	27,927.4	27,616.99
Premises & other fixed assets	3,440.4	4,872.5	5,438.7	8,811.96
Other assets	1,071.3	3,186.5	2,067.5	5013.5
Total Assets	61,743.2	76,394.8	87,971.3	125,503.7

Note:
1. Data includes Post Bank (U) Limited from December 2002.
2. Contra entry for Administered Mortgage loams managed by Housing Finance Company of Uganda under the agreement with Government of Uganda.

Source: Monthly returns of Credit Institutions.

Table 2: SECTORAL DISTRIBUTION OF LOANS AND ADVANCES OF CREDIT INSTITUTIONS (In percentage of the total)

Sector	**Dec - 99**	**Dec - 00**	**Dec - 01**	**Dec - 02**
Agriculture	0.2	0.0	0.1	0.3
Mining & quarrying	0.0	0.0	0.0	0.0
Manufacturing	0.9	0.9	0.6	0.6
Trade and commerce	5.8	9.1	9.9	9.9
Transport and communication	0.1	0.4	2.3	2.3
Electricity and water	0.0	0.0	0.0	0.0
Building and construction	92.4	88.5	85.8	78.8
Other services	0.6	1.1	1.3	0.8
Total	100.0	100.0	100.0	100.0

Source: Monthly returns of Credit Institutions.

Table 3: LIQUID ASSETS OF CREDIT INSTITUTIONS (Shillings, millions)

Liquid Asset	Dec-99	Dec-00	Dec-01	Dec-02
Cash in vaults	273.21	804.01	1,454.25	2,665.49
Treasury bills holdings	1,266.74	2,823.41	3,724.79	9,046.69
Balances at Commercial banks in Uganda	5,281.71	9,784.88	13,535.02	20,669.10
Balances at Commercial banks abroad 1/	968.79	1,406.59	1,217.24	1,332.5
Total	7,790.45	14,818.88	19,931.29	33,713.78

Note:
1. Call or demand deposits.

Source: Monthly returns of Credit Institutions

Table 4: Structure of deposits of credit institutions
(Shillings, millions)

Type of deposit	Dec-99	Dec-00	Dec-01	Dec-02
Savings Deposits	8,383.7	15,455.7	21,211.3	43,005.18
Time Deposits	4,769.8	4,557.1	6,808.3	9,699.0
Other Deposits (Agency funds) 1/	-	13,415.2	6,499.7	19,914.31
Accrued Interest	89.4	58.8	112.4	622.17
Total Liabilities to Depositors	13,242.8	33,486.8	44,631.7	73,240.66

Note:
1. “Agency funds" represent amount collected so far from the beneficiaries of the government pool house sale scheme and interest charged thereon, by the Housing Finance Company Ltd.

Source: Monthly statements from the Credit Institutions.

Table 5: KEY FINANCIAL INDICATORS.

Indicator	Dec 99	Dec 00	Dec 01	Dec 02
CAPITAL ADEQUACY				
Core Capital/RWAs (%)	17.68	27.89	19.87	24.70
Owner's funds (Equity)	6,277.5	10,981.52	10,693.36	16,682.50
EARNINGS RATIOS				
ROA (%)	2.7	2.1	1.0	1.5
ROE (%)	26.2	14.7	7.9	11.6
LIQUIDITY				
Liquid assets/Total deposits (%)	59.23	44.67	44.66	56.22
Total advances/Total deposits (%)	85.9	72.43	71.65	75.8
Liquid assets (Shs millions)	7,790.45	14,818.48	19,931.29	33,713.78
ASSET QUALITY				
Loans and Advances (Shs millions)	20,013.79	24,254.32	31,978.9	41,925.3
Non Performing Advances-NPA (Shs millions)	3,495.60	2,676.30	5,067.44	4,650.17
Provisions for NPA (Shs millions)	858.00	762.89	1,395.39	2,168.02
NPA/Total Advances (%)	17.47	11.03	15.85	11.09
Provisions/NPA (%)	24.55	28.51	27.54	46.6

Source: Quarterly returns of Credit Institutions

APPENDIX 4: REGISTERED CREDIT INSTITUTIONS AS AT 31/12/2001

	Name of Credit Institution	Ownership	Number of Branches
1	Housing Finance Company (U) Ltd.	Local	2
2	Commercial Micro Finance Ltd.	Local	6
3	Mercantile Finance Co. Ltd.	Local	0
4	Capital Finance Corporation Ltd.	Local	1
5	Stanhope Finance Co. Ltd.	Local	0
6	Imperial Investments Finance Co. Ltd.	Local	0
7	Post Bank (U) Ltd[1]	Local	10
8	Interstate Finance Company Ltd	Local (In Liquidation)	1
	TOTAL		20

Note:

1. Post Bank (U) Ltd has 11 agencies.

APPENDIX 5: CIRCULARS TO FINANCIAL INSTITUTIONS ISSUED DURING 2002.