

2022 Zambia Banking Industry Survey Report

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Foreword

Welcome to the seventh edition of the Zambia Banking Industry Survey.

This is the first survey we have conducted since the government lifted most of the remaining COVID-19 restrictions in September 2022. Despite the disruption caused by the pandemic plus a fragile global economy, Zambia's banking sector reported strong performance in 2022. Industry-wide profitability increased by 10.7% to K5.7bn last year, while total assets grew by 25.1% to K196bn.

Three main themes have emerged in our 2022 survey:

- An increased level of convergence over the issues of most significance – the highest since our inaugural survey.
- A gradual shift from operational to strategic matters.
- The future of banking and its offshoots dominate the top five issues.

We would like to thank the Governor of the Bank of Zambia, Dr Denny Kalyalya, and his team for their continued support of this publication. Their information and input provide the basis of our report and its delivery to stakeholders.

We would also like to acknowledge our guest contributor Betty Wilkinson, chief executive of Financial Sector Deepening Zambia, and the staff at PwC Zambia who have contributed to the preparation of this publication.



Martin Bamukunde
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1. Introduction

Zambia's economy bounced back with relative vigour in 2022, recording gross domestic product (GDP) growth of 4.7% for the year as the impact of the pandemic receded and optimism grew over an imminent deal with the International Monetary Fund (IMF). This growth was notably higher than global and regional GDP growth rates, which were 3.1% and 3.7% respectively. It was also higher than the 3.6% GDP growth the country recorded in 2021.

The long-awaited approval of a 38-month Extended Credit Facility by the IMF in August 2022 provided much-needed support to government plans to stabilise the economy through debt restructuring. In June this year, the government reached an agreement with creditors to reorganise US\$6.3bn of that debt – the equivalent of around 40% of Zambia's external debt. This latest development has paved the way for the release of the second tranche of IMF funding.

Inflation and interest rates remained relatively steady in 2022. After peaking at just under 25% in mid-2021, it fell during the first half of 2022 before levelling off at under 10% between May and December. Inflation is expected to average 10.3% in 2023 due to higher maize prices and tight global financial conditions. Although this is an improvement on high inflation in 2021, it remains above the Bank of Zambia's 6-8% target. Meanwhile, the monetary policy rate rose from 9% to 10% during 2022.

It is against this backdrop that banks recorded a sharp rise in profits in 2022. Industry-wide profitability increased by 10.7% from K5.1bn in 2021 to K5.7bn in 2022. Meanwhile, total assets grew by 25.1% to K196bn (2021: K156bn). **However, return on equity reduced from 30% to 26%.** This increase in profitability was due in part to banks' investment in government securities during the pandemic.

Despite the improved domestic backdrop, concerns over the Zambian economy remain. US dollar (USD) liquidity was tight in 2022 as demand for forex increased due to rising global interest rates and concerns over delays to Zambia's debt restructuring. Falling copper production has also affected the availability of USD on the domestic market. Furthermore, Kwacha volatility continues to be an issue for banks. After appreciating in the aftermath of the IMF deal last August, the Kwacha has weakened steadily since then due to protracted negotiations with external creditors.

Between the end of June and 22 August 2023, the Kwacha averaged K19.48/USD.

In light of this, we now present the findings of the *2022 Zambia Banking Industry Survey*.



2. Survey results

2.1 Methodology

To gather data for the survey, we sent questionnaires to all 17 commercial banks operating in Zambia and asked them about the issues currently affecting their business.

Two separate questionnaires were sent out to the banks. The first questionnaire was sent to the chief executive officer (CEO) or managing director (MD) of each bank. The questionnaire asked them to rank the most significant issues facing the sector and what their bank's strategic imperatives were going forward. The second questionnaire was sent to the chief financial officers (CFO) of the banks and asked a broader range of questions. The response rate was 88% from the CEOs/MDs and 70% from the CFOs.

In analysing the responses, PwC Zambia used a weighted average to identify the most significant issues at both a combined and disaggregated level.

The top five issues affecting banks in 2022 as reported by CEOs/MDs were (from most to least significant):

1. Cybersecurity
2. The state of the local economy
3. US dollar liquidity
4. Digital transformation
5. Increased competition from non-traditional players

2.2 Top five issues

Cybersecurity was identified as the most significant issue facing commercial banks in 2022 for the second year running. This is unsurprising given recent technological advancements. Furthermore, concerns over cybersecurity are growing, with 2022 seeing a higher average weighted score of 8.6 compared to 5.8 in 2021 and 4.1 in 2020. From our perspective, this ranking reflects the increased risk banks face from cybercrime as well as the importance banks place on their efforts to maximise technology in the provision of products and services.

The state of the local economy was the second most pressing issue for banks in 2022. Two things are worth noting here. First, the average weighted score given to the state of the economy by respondents increased from 5.5 in 2021 to 8.3 in 2022, indicating that this was more of an issue in 2022 than in 2021. Second, the state of Zambia's economy was identified as a big issue for banks despite an improvement in its outlook in 2022. Respondents said concerns over the delayed completion of the country's debt restructuring combined with fragile domestic economic fundamentals and a reduction in copper production following the slow resolution of challenges at Mopani and Konkola Copper Mines had added to concerns over the state of the local economy. (See Section 4 for more about the challenges at Mopani and Konkola).

It seems that cash is still king – and even more so if that cash is US dollars (USD). The importance of holding USD increased significantly among banks last year from a weighted score of 3.4 in 2021 to 5.9 in 2022. This increase meant that USD liquidity was the third most pressing issue facing banks in 2022 compared to fifth in 2021. Holding USD helps banks manage currency risk, which is important as fluctuations in exchange rates can impact profitability and stability. In 2022, USD supply tightened due to foreign investors exiting the securities market and lower foreign exchange earnings due to low productivity in the mining sector. As USD liquidity is highly dependent on the state of the local economy, it is unsurprising that this issue moved up the ranking in 2022.

Digital technology has had a huge impact on the banking sector as it has allowed new players to enter the market. The rise of fintechs, mobile money operators and digital payment platforms has increased competition for what was traditionally banks' business and prompted the development of new services and business models. These new technology-based players offer customer convenience, are more accessible than physical banks and support better financial inclusion. This has forced banks to combine operating physical branches with a focus on information technology (IT) and big data, along with highly specialised human capital. Consequently, banks and the financial markets have become more intertwined with intermediary activities.

Given this, it is unsurprising that the fourth biggest issue facing banks last year was digital transformation, with an average score of 4.9 (2021: 4.2). Despite the increase in the average weighted score, the ranking dropped from the third most pressing issue in 2021 to fourth in 2022 as issues such as USD liquidity took precedence. Digital transformation aligns with the top issue in 2022, cybersecurity, which is also linked to technological advancement.

Finally, increased competition from non-traditional players was the fifth most pressing issue for banks in 2022. This is the first time the issue has been cited among the top five, scoring 4.5 in 2022 compared to 2.2 in 2021, when it held tenth position.

Figure 1: Top five issues for banks 2020–2022

	2020		2021		2022
State of the local economy	8.6	Cybersecurity	5.8	Cybersecurity	8.6
Impact of COVID-19	8.2	State of the local economy	5.5	State of the local economy	8.3
High credit risk and NPLs	4.4	Digital transformation	4.2	USD liquidity	5.9
Cybersecurity	4.1	Impact of the proposed IMF programme on the banking sector	3.6	Digital transformation	4.9
Fee and service charge erosion	3.2	USD liquidity	3.4	Increased competition from non-traditional players	4.5

2.3 Top five issues: Six largest banks (by asset size as at 31 December 2022)

The top five issues cited as most pressing by the six largest banks (by asset size) in 2022 are the same as the banking sector overall except that the top two are reversed. In 2022, the six largest banks said the state of the local economy was the most pressing issue, with a score of 9.2, while cybersecurity was in second place, with a score of 8.5. This compares to the industry overall which ranked cybersecurity as the top issue and the state of the local economy second. USD liquidity, digital transformation and increased competition from non-traditional players were ranked third, fourth and fifth respectively in 2022.

This compares to 2021 when digital transformation was the highest-ranked issue (see Figure 2). In 2022, it was ranked fourth. Also, in 2021 high credit risk was the fifth most pressing issue but did not feature in the top five last year.

Figure 2: Top five issues – six largest banks

	2020		2021		2022
State of the local economy	9.0	Digital transformation	7.0	State of the local economy	9.2
Impact of COVID-19	7.8	Cybersecurity	7.0	Cybersecurity	8.5
High credit risk and NPLs	5.3	State of the local economy	5.5	USD liquidity	6.7
Cybersecurity	5.3	USD liquidity	4.3	Digital transformation	5.2
Fee and service charge erosion	3.5	High credit risk and NPLs	4.2	Increased competition from non-traditional players	4.0

2.4 Top five issues: Rest of the banks

Four of the top five issues for the rest of the banks are the same as those of the banking industry overall. Inequity in regulation and digital financial services is a new entrant into the top five with a score of 4.9, making it the joint fourth most pressing issue for the rest of the banks in 2022. This replaces digital transformation, which is the fourth biggest issue for the overall industry in 2022.

Among the rest of the banks, three of the top five issues remained the same in 2022 as they were in 2021, while two of the top five issues in 2021 dropped out. The two that dropped out were the impact of COVID-19 and the proposed IMF programme. Two new entrants replaced these issues. These were increased competition from non-traditional players, and inequity in regulation and digital finance services. The former shows how commercial banks are increasingly aware of the impact non-traditional players are having on the industry. The level of accessibility non-traditional players offer poses a serious threat to banks' market share despite integration between banks and various digital platforms.

Figure 3: Top five issues: Rest of the banks

2020		2021		2022	
Impact of COVID-19	8.4	State of the local economy	6.9	Cybersecurity	8.7
State of the local economy	8.3	Cybersecurity	6.4	State of the local economy	7.8
High credit risk and NPLs	3.8	Impact of COVID-19	4.8	USD liquidity	5.4
Liquidity risk	3.6	Impact of proposed IMF programme	4.5	Increased competition from non-traditional players	4.9
Cybersecurity	3.3	USD liquidity	3.5	Inequity of regulation and digital financial services	4.9

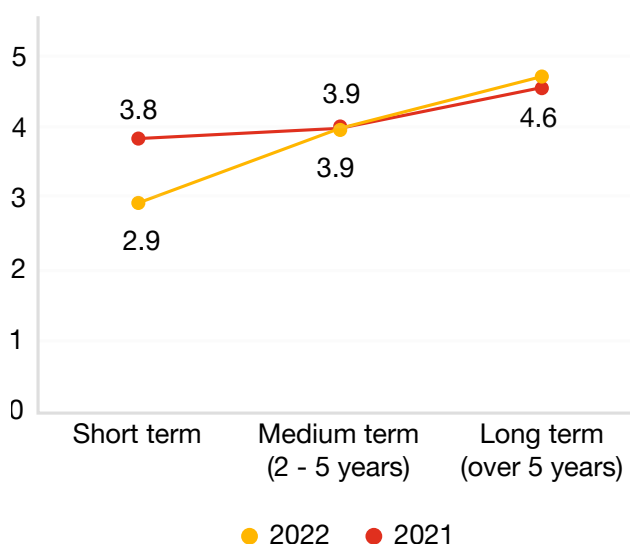
2.6 Outlook for the industry

Optimism within the banking sector was gauged using a five-point Likert scale, with a rating of one being the least optimistic and five being the most optimistic. The survey findings reveal a moderate level of optimism from all respondents.

The survey responses showed a significant increase in optimism about the industry's short-term prospects, with an average score of 3.8 (2021: 2.9). Optimism in the medium term remained unchanged with an average score of 3.9, while optimism in the long term dropped marginally to 4.5 (2021: 4.6).

The increased positive outlook among banks in the short term underscores the sector's anticipation that a successful conclusion to the debt restructuring process will stimulate investor confidence and trigger an influx of foreign direct investment.

Figure 4: Trend in optimism



Source: PwC analysis



2.7 Strategic priorities

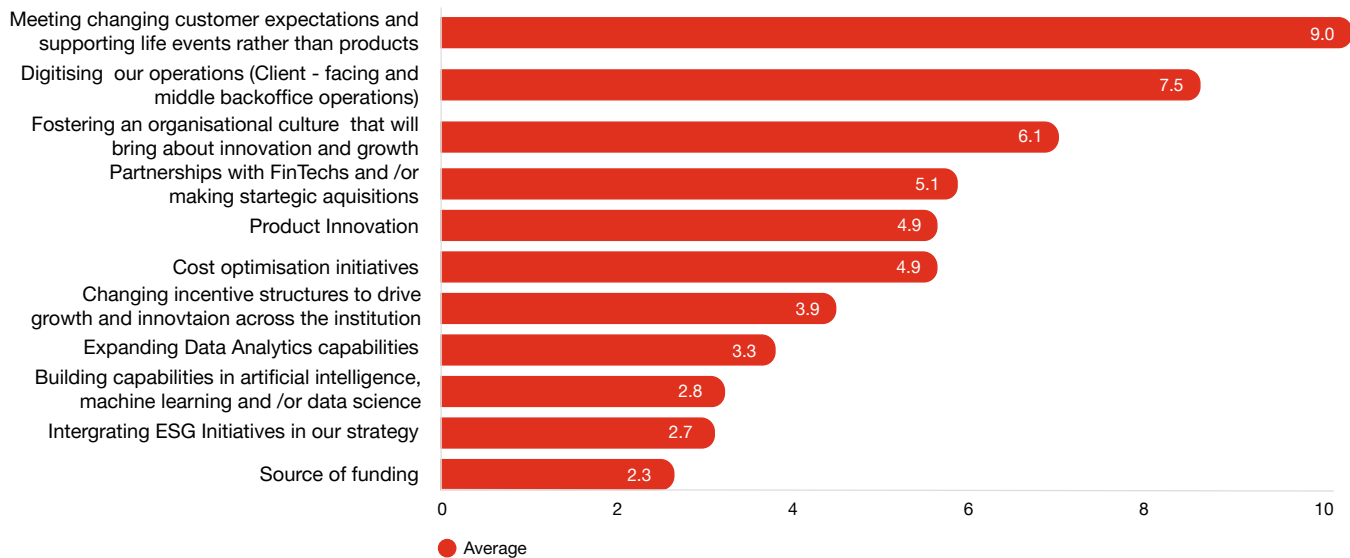
As part of the survey, we asked banks to assess which areas were strategically important for their business by ranking different areas on a scale of one to ten, with ten being the most important and one being the least important.

Meeting changing customer expectations ranked highest, with an average score of 9.0 (2021: second with a score of 8.6). Digitising operations was ranked second in 2022 with an average score of 7.5 (2021: first with a score of 9.4). With cybersecurity a growing concern for banks, it is unsurprising that meeting customer needs and digitising operations are a priority in today's people-led banking sector. Staying abreast of digital technological advancements is essential for banks as technology offers a channel through which they can meet customer expectations more effectively.

Fostering an organisational culture was ranked third, with an average score of 6.1 (2021: third with a score of 7.9). This reflects the internal efforts banks are making to prepare for the challenges and opportunities that lie in implementing improved operating structures. Meanwhile, partnerships with fintechs and strategic acquisitions was ranked the fourth most important area, with an average score of 5.1 (2021: fourth with a score of 7.0), illustrating how banks are responding to increased competition from non-traditional players.

Product innovation was the fifth most strategically important area for banks, with a score of 4.9. This underlines how banks are under pressure to launch products that appeal to a broad range of customers in order to capture market share.

Figure 5: Strategic priorities



3. Cybersecurity

Cybersecurity was ranked the most pressing issue for banks in 2022. The average rating for cybersecurity increased to 8.6 in 2022 from 5.8 in 2021 and 4.1 in 2020, possibly due to the growing number and severity of attacks both locally and globally.

A report published by Liquid C2, titled *The Evolving Cyber Security Landscape in Africa 2022*, highlights the increase in cyber-attacks last year. The report notes that in 2022, cyber-attacks increased by 76% in Kenya, South Africa and Zambia. Of particular note is the Log4 Shell vulnerability, which, according to PwC's *Cyber Threats 2022: A Year in Retrospect* report, is believed to have affected 93% of business cloud environments globally. The Log4 Shell vulnerability is a remote code execution vulnerability that enables malicious actors to create arbitrary Java code and take control of a target server. It affected Java logging frameworks on Amazon Web Services, Cloudflare, iCloud and Minecraft systems. Exploiting this vulnerability, various cyber threat actors targeted organisations while they were trying to identify affected instances in their systems. The report also highlighted ransomware attacks and credential-stealing malware as the other two prominent cyber threats in 2022. Prioritisation of system patching activities remains a key prevention mechanism.

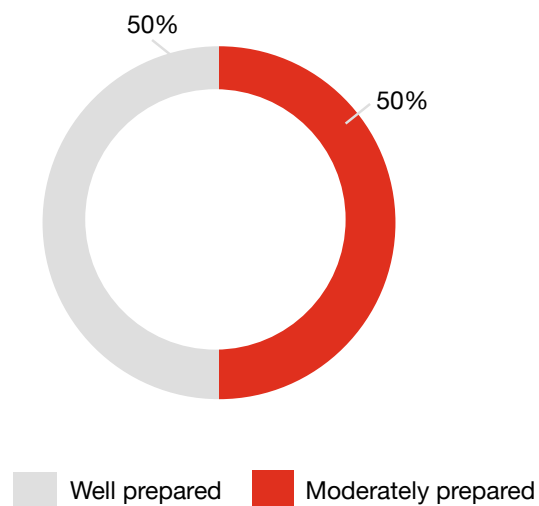
The Bank of Zambia issued the *Cyber and Information Risk Management Guidelines* on 31 May 2023. These guidelines are premised on the National Institute of Science and Technology framework and provide the minimum requirements for the management of cyber and information risk by regulated entities. The guidelines outline steps that banks should take to identify key information assets, protect those identified assets and detect any vulnerabilities in the company's network. The guidelines further define how banks can respond to and recover from a cyberattack. These guidelines have been issued on an implement or explain basis to account for differences in the nature, size and complexities of the various organisations they are aimed at.

The results of our survey indicate that 50% of the respondent banks are inadequately prepared to implement the Bank of Zambia's cybersecurity guidelines (See Figure 6). This is a worrying statistic. The guidelines suggest that each entity should conduct an annual cyber security maturity assessment to help identify immediate weaknesses and the overall information security position. The first assessment is, however, only due in 2024.

Some of the benefits that could be realised from the implementation of these guidelines are:

- **Enhanced protection against cyber-threats.** The guidelines provide a basic framework to mitigate the risks associated with cyberattacks and help safeguard customers' financial data, reducing the likelihood of fraudulent activities and potential financial loss.
- **Improved customer trust.** When customers feel secure in their banking transactions, they are more likely to engage in online banking services and actively use digital payment solutions, contributing to the growth of the industry.
- **Enhanced incident response capability.** The guidelines emphasise the importance of having robust incident response plans and procedures in place. By actively preparing for potential cyber incidents, banks can respond more effectively, minimising the impact on their operations and customers, and improving their resilience.

Figure 6: Banks preparedness for the Bank of Zambia's *Cyber and Information Risk Management Guidelines*

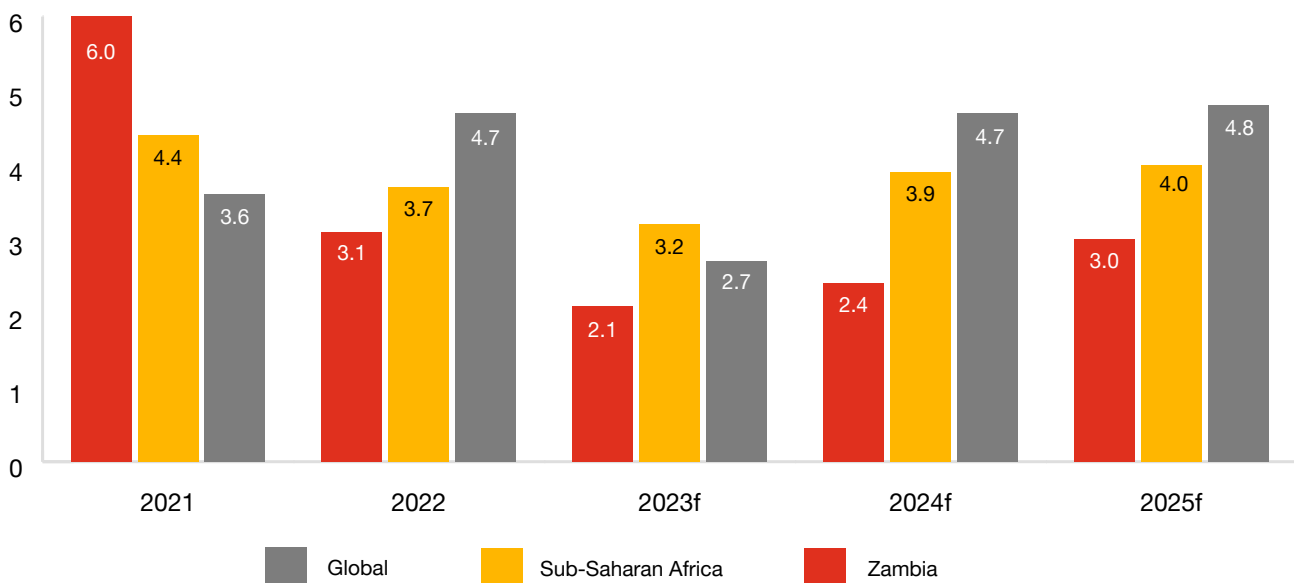


Source: PwC Analysis

4. State of the local economy

In 2022, the state of the local economy continued to be a significant issue for the banking sector. Respondents ranked it the second most pressing issue for the second year running with a score of 8.3 (2021: 5.5). Zambia’s economy grew significantly less than the global GDP average in 2021 (see Figure 7). However, in 2022 Zambia outperformed both the sub-Saharan and global economies in terms of GDP growth. In mid-2023, Zambia’s GDP growth was downgraded from 4.2% to 2.7%. This is expected to be higher than global growth in 2023, which is projected to be 2.1%, but lower than the regional average (3.2%).

Figure 7: GDP growth - global, sub-Saharan Africa and Zambia.



Source: World Bank and Ministry of Finance and National Planning

Global economic growth increased by 3.1% in 2022. In 2023, it is expected to slow down to 2.1% due to moves by international central banks to contain inflation through monetary policy tightening and the continued impact of the Russia-Ukraine conflict. Global growth is expected to recover marginally in 2024 to 2.4%. Tightening global financial conditions are likely to weigh negatively on growth across emerging markets and developing economies. Monetary policy rate hikes and financial instability caused significant unrealised losses for global central banks in 2022, indicating renewed focus on financial regulation reform. Despite that, spillovers from global banking stress have so far been limited.¹

Growth in sub-Saharan Africa is expected to slow to 3.2% in 2023 from 3.7% in 2022. The region has not yet fully recovered from the pandemic due largely to the rising cost of living, which has curbed private consumption. In addition, tight global financial conditions continue to weigh on investment growth, while limited access to external borrowing is expected to delay recovery, especially for heavily indebted countries.



¹ <https://www.reuters.com/markets/global-central-banks-post-losses-reserves-2022-no-quick-recovery-seen-survey-2023-06-27/>

Imported inflation and the depreciation of domestic currencies caused regional inflation to remain in double-digits in 2022, averaging 12.6%. This is slightly below Africa's average of 14.2%. Adverse weather events also contributed to the rise in food prices in several countries. Inflation rose in all countries except Angola, which benefited from an appreciation in its currency following higher oil exports, and Zambia, which embarked on an IMF support programme to stabilise the economy.²

The Zambian economy grew by 4.7% in 2022, which is higher than the 3.6% growth it recorded in 2021. The financial and insurance services sector contributed 1.2% of that growth, up from 0.3% in 2021. Growth was also driven by the transport and storage, information and communication technology, and education sectors. The agriculture, mining and construction sectors remained subdued.³

In July 2023, the Ministry of Finance and National Planning's 2023-2025 Medium Term Budget Plan downgraded Zambia's GDP growth to 2.7% from the earlier expectation of 4.2%.⁴ This is due to restrained growth in the mining, energy and education sectors. Policy measures are being undertaken in line with the IMF programme and the recently achieved US\$6.3bn debt restructuring deal under the G-20 Common Framework in June 2023 to support continued macroeconomic stability. Ongoing fiscal consolidation and structural reform measures are expected to provide continuous improvement in investor confidence in the domestic economy.

2 <https://www.afdb.org/en/documents/southern-africa-economic-outlook-2023>

3 <https://www.mofnp.gov.zm/?wpdm-pro=2022-annual-economic-report>

4 https://www.boz.zm/MPC_Presentation_August_2023.pdf

Private business conditions

In assessing private business conditions, we reviewed the Bank of Zambia's *Quarterly Survey of Business Opinion and Expectations*. The survey assesses the perspectives of the business community on macroeconomic conditions in the review period and expectations for the quarter and year ahead. This assessment forms part of the monetary policy decisions undertaken by the central bank.

Overall, the 2022 survey revealed sluggish growth in three out of the four quarters, with growth only noted in the second quarter of the year when economic growth was driven by agricultural marketing and the peak tourism season. For the quarters where economic performance slowed, the survey showed this was due to slower economic activity, with firms experiencing declines in output, domestic sales, new orders, capacity utilisation and investment due to high borrowing costs, subdued demand, a weaker Kwacha, high input costs and raw material shortages.

The slowed economic activity noted in 2022 has continued into 2023, with further deterioration in private sector business activity across most economic sectors noted during the first quarter. Most firms attributed the decline to weak demand, exchange rate depreciation and high input costs. In some industries, raw material shortages constrained activity, causing reduced output, new orders, domestic sales, capacity utilisation, volume of sales, profitability and labour demand.⁵ However, as noted in the Stanbic PMI, business conditions have exhibited an improvement in Q2 onwards.

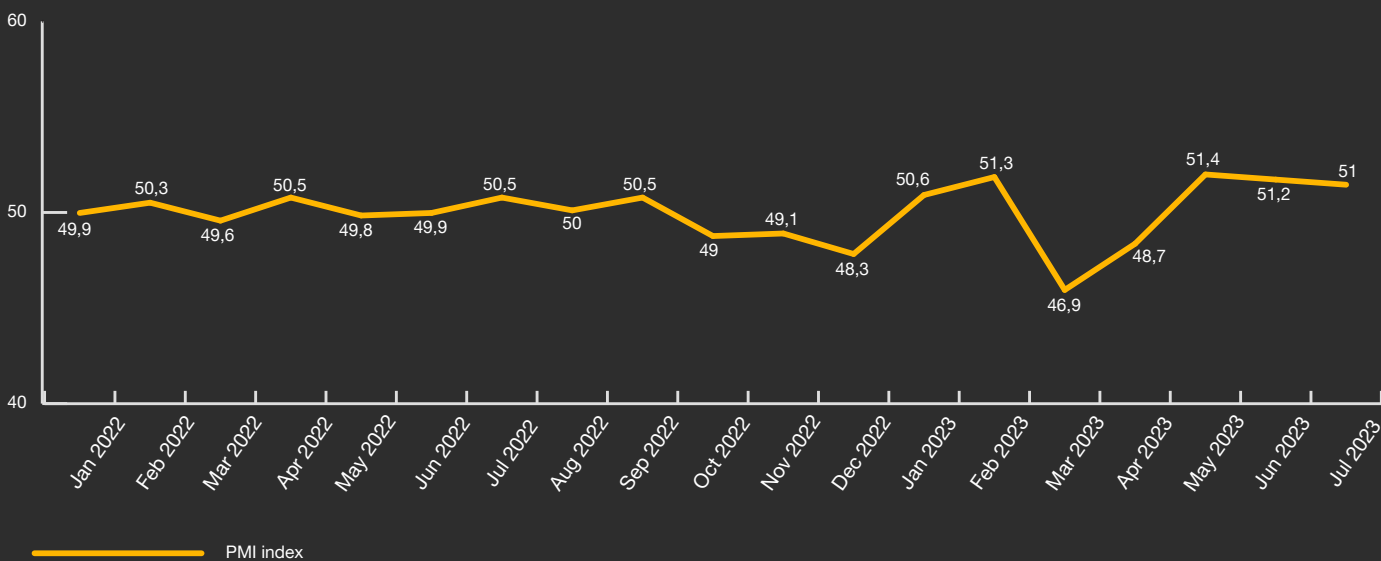
5 https://www.boz.zm/QSBOEs_Report_2023_Q1.pdf

Purchasers Managers Index

The Stanbic Purchasers Managers Index (PMI) is a monthly survey that gives insight into the prevailing business environment in the country. Readings range from zero to 100, over 50 signifying favourable business conditions and below 50 unfavourable conditions.

In 2022, the Stanbic PMI was more volatile, starting and ending the year below the 50-mark. In actual terms, the PMI fell below the 50-mark-threshold in seven of the 12 months in 2022. In 2023, there has been an improvement in the PMI, with five of the seven months to date recording above 50. The better performance noted in 2023 compared to 2022 was due to a general improvement in business conditions and has been supported by an increase in output and new orders. Another significant factor has been the easing of inflationary pressures, which together led to the index signalling the first consistent improvement in business conditions in three months.⁶

Figure 8: Zambia's Purchasers Managers Index



Source Stanbic Bank Zambia PMI

⁶ <https://www.pmi.spglobal.com/Public/Home/PressRelease/1bcb6b3a0aea4fdeb02a56647a025681>

Inflation

The Monetary Policy Committee (MPC) set the Monetary Policy Rate (MPR) at 9% throughout 2022 to support economic growth. The decision took into account slow growth and financial sector vulnerabilities, and presented a good opportunity for companies to strengthen capital positions and build buffers and countercyclical capital.⁷ Inflation remained in single digits in the second half of 2022, ending the year at 9.9%. This is in line with the central bank's target to close the year with single digit inflation.⁸ Overall, non-food inflation remained in the target 6-8% band during 2022, while food inflation was above target.⁹

In 2023, the MPC has made several monetary policy decisions designed to protect against inflationary pressures. These include:

- In February, the monetary policy rate was increased from 9% to 9.25% after inflation was projected to remain above the target range despite the central bank's initial projection in November 2022 that it would return to the 6-8% range by 2023. In the same month, the statutory reserve ratio on local and foreign currency deposits was raised from 9% to 11.5%. This aimed to manage increased exchange rate volatility, which had intensified in December 2022 and persisted into 2023.¹⁰
- In May, the Bank of Zambia raised the monetary policy rate by 25 basis points to 9.5%. The increase aimed to mitigate ongoing inflationary pressures and manage vulnerabilities in the financial sector.¹¹
- In August, the monetary policy rate was again increased, this time by 50 basis points to 10%.
- Inflation is projected to average 10.2% in 2023, according to the MPC's August meeting. Higher maize grain prices as well as tight global financial conditions are the main drivers of rising inflation.¹²

7 https://www.boz.zm/Zambanker_December_2022.pdf

8 https://www.boz.zm/Bank_of_Zambia_2022_Annual_Report.pdf

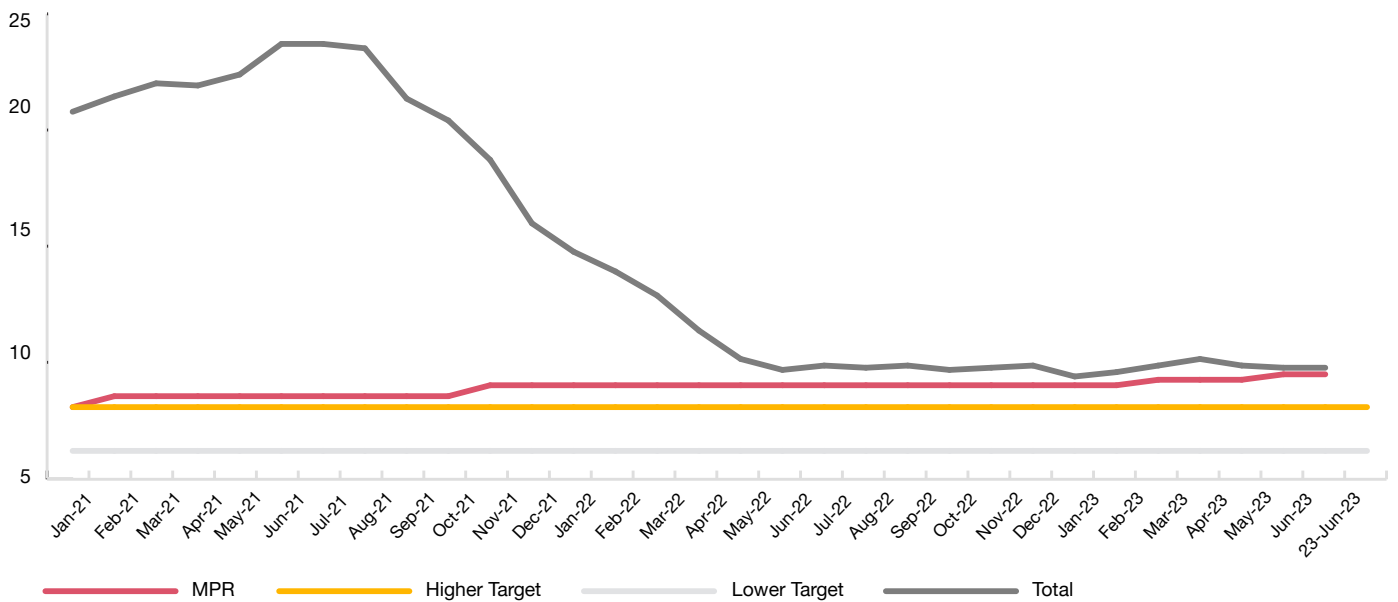
9 https://www.boz.zm/Bank_of_Zambia_2022_Annual_Report.pdf

10 <https://www.boz.zm/CBCircularNo.02of2023-AdjustmenttotheKwachaandForeignCurrencyStatutoryReserveRatio.pdf>

11 https://www.boz.zm/MPC_Statement_Q2_2023.pdf

12 https://www.boz.zm/MPC_Presentation_August_2023.pdf

Figure 9: Actual inflation and the target band



Source: Bank of Zambia

Interest rates

Overall, benchmark interest rates remained roughly the same in 2022 with the following notable mentions:

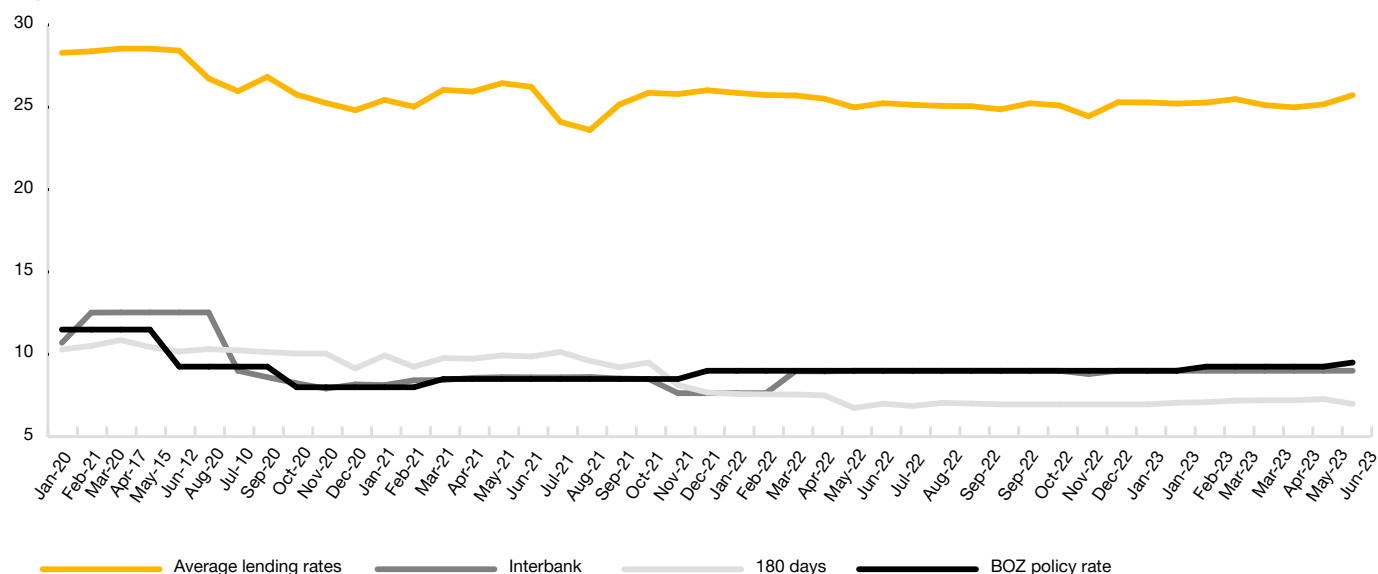
In the third and fourth quarters of 2022, credit conditions for households, SMEs and large corporations remained favourable due to ample liquidity in the money market. Increased demand for household loans was driven by personal obligations, economic activity picking up and the IMF approval of an extended credit facility. Lending rates remained mostly unchanged in 2022.

In the first quarter of 2023, credit conditions for households, SMEs and large corporations again remained favourable due to sufficient liquidity in the money market. Banks introduced favourable lending conditions to encourage borrowing as firms sought additional financing to support operations. The Bank of Zambia increased the monetary policy rate from 9% to 9.5% in its continued effort to curb inflation.¹³



Monetary policy in 2023 has centred on steady increases in the policy rate to curb inflation, rising from 9% to 9.25% in February, 9.25% to 9.5% in May 2023, and from 9.5% to 10% as of August 2023.

Figure 10: Interest rates



Source: Bank of Zambia

Debt restructuring

After many years of contracting unsustainable levels of debt, in 2020 Zambia made a request through the G20 common framework for sustainable debt treatment. Thereafter, the Official Creditor Committee was formed by countries with eligible claims against Zambia.

Negotiations with creditors continued throughout 2022 and there was ongoing expectation of an imminent agreement up to the first quarter of 2023.¹⁴ The Official Creditor Committee finally reached an agreement to restructure US\$6.3bn of Zambia’s debt on 22 June 2023.¹⁵

Official bilateral creditor countries have agreed to provide the much-needed debt relief to Zambia under the following terms¹⁶:

- A significant maturity extension of existing debt of more than 12 years, with final maturity in 2043.
- Interest rates to be cut to concessional rates for the next 14 years and to not exceed 2.5% thereafter under the baseline scenario.
- Principal repayments commence in 2026 for 0.5% of the debt stock per annum for the period 2026 to 2035.

Official creditors have agreed with the government that local currency denominated debt of US\$6.8bn will be excluded from any treatment.¹⁷ The success of the current debt deal serves as a structure for government’s engagement with private creditors, including bondholders, as the government is committed to an agreement on comparable terms. Conversations are ongoing and it is hoped that government will reach an agreement with private lenders imminently.¹⁸

Zambia’s performance under the IMF programme has been positive so far. Debt restructuring was one of the conditions for Zambia’s eligibility for the US\$188m second tranche of financing. The completion of the first extended credit facility review of the fund-allocated programme allowed for an immediate disbursement of the US\$188m. This brings Zambia’s total disbursements under the arrangement to US\$374m.¹⁹

14 <https://www.uneca.org/sites/default/files/MGD/INFFSept2022/Zambia%20Debt%20-%20Maryann%20Lumba%20Nkunika-Lwandamina%20En.pdf>

15 https://www.parliament.gov.zm/sites/default/files/images/publication_docs/Ministerial%20Statements%20-%20Debt%20Restructuring.pdf

16 https://www.parliament.gov.zm/sites/default/files/images/publication_docs/Ministerial%20Statements%20-%20Debt%20Restructuring.pdf

17 Ministry of Finance and National Planning <https://www.mofnp.gov.zm/?p=7486>

18 Ministry of Finance and National Planning <https://www.mofnp.gov.zm/?p=7444>

19 <https://www.imf.org/en/News/Articles/2023/07/13/pr23262-imf-executive-board-concludes-article-iv-consultation-with-zambia-and-review-under-ecff#:~:text=The%20IMF%20Executive%20Board%20completed,under%20the%20program%20remains%20strong.>

Impact of delayed completion of debt restructuring on banks

According to respondents, the delayed completion of the debt restructuring process has negatively impacted the banking sector because it has:

- Challenges in building up USD assets: Dollar-denominated asset holders were not particularly satisfied as there was stagnation in asset growth
- Elevated country risk premium. Zambia’s heightened risk profile has had an impact on the cost of capital and foreign direct investment, leading to constraints in lending to the public and private sectors. Zambia’s credit rating for foreign currency debt will be under consideration in line with negotiations with private creditors.
- Led to muted foreign direct investment activity, which has resulted in slower economic growth as investors look to engage with countries with stable fiscal positions and sustainable borrowing.
- IFRS9 and generalised acceptance for impairment provisions against government securities.
- Increased volatility in the foreign exchange market.

Actions to stimulate the economy

According to respondents, in addition to the successful conclusion of the debt restructuring process, the following measures targeted at increasing production will help stimulate the economy and provide a strong foundation for sustained economic growth:

Economic diversification. This means diversified contribution of different economic sectors to economic growth as well as differentiated production within core sectors. The more diversified the export earnings, the less volatile they are and the more sustainable their growth.

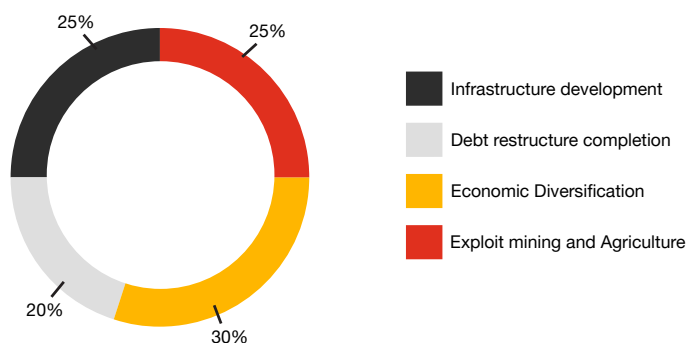
Investment in infrastructure. This enhances capacity, especially in low-productivity sectors, and encourages more competitive local and export production.

Resolution of mining issues. It is essential that the two mines in dispute be brought back into full operation. At the time of writing, the government and Vedanta Resources had just reached an agreement to get the mine back up and running. However, a conclusion of the situation with Mopani is yet to be reached.

Konkola Copper Mines: Provisional liquidator ZCCM-IH (20% interest) took hold of Konkola Copper Mines after Vedanta Resources (80% interest) deconsolidated Konkola and regarded it as a discontinued operation on May 21 2019. Government re-engaged Vedanta Resources and identified ten critical issues to resolve before any repossession could occur. Negotiations came to a close on September 5 2023 when the government announced that it is handing Konkola back to Vedanta Resources on the proviso that Vedanta reinvests US\$1.2bn into the mine as it prepares to resume operations.²⁰

Mopani Copper Mines: The mine is currently under provisional management as the government searches for a new investor. In March 2021, Carlisa Investments, a subsidiary of Glencore, signed a US\$1.5bn deal with ZCCM-IH to transfer 90% of its interest in Mopani Copper Mines while continuing to retain offtake rights in respect to Mopani’s production.²¹ The final stages of the bidding process was completed in July 2023.²² Negotiations are ongoing.

Figure 11: Actions to stimulate the economy



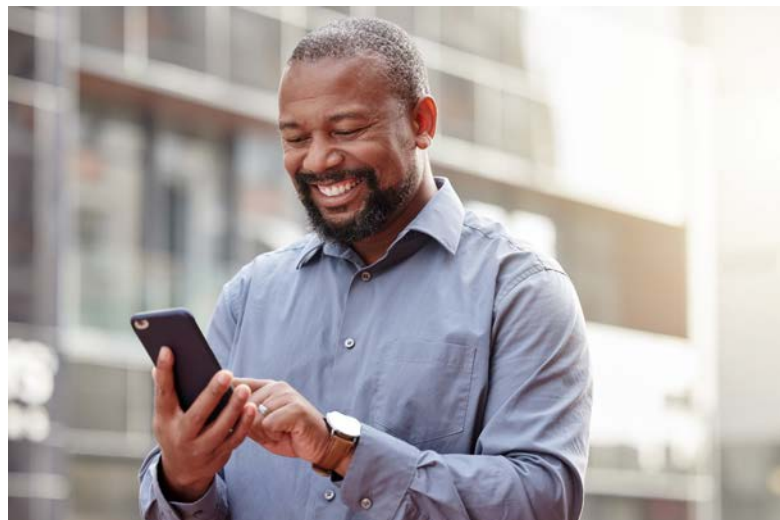
Source : PwC Analysis

Note: Participants provided more than one response

20 <https://www.reuters.com/markets/commodities/zambia-agrees-hand-disputed-copper-assets-back-indias-vedanta-2023-09-05/>

21 <https://www.glencore.com/rest/api/v1/documents/ce4fec31fc81d6049d076b15db35d45d/GLEN-2021-annual-report-.pdf> pg 188

22 Ministry of Mines and Mineral Development <https://www.mmmmd.gov.zm/?p=2587>



5. USD liquidity

Respondents identified USD liquidity as the third most significant issue in 2022, with a score of 5.9. In 2021 it ranked fifth with a score of 3.9. This brings the imbalance in the economy post COVID-19 sharply into focus, with demand for foreign exchange far outstripping supply.

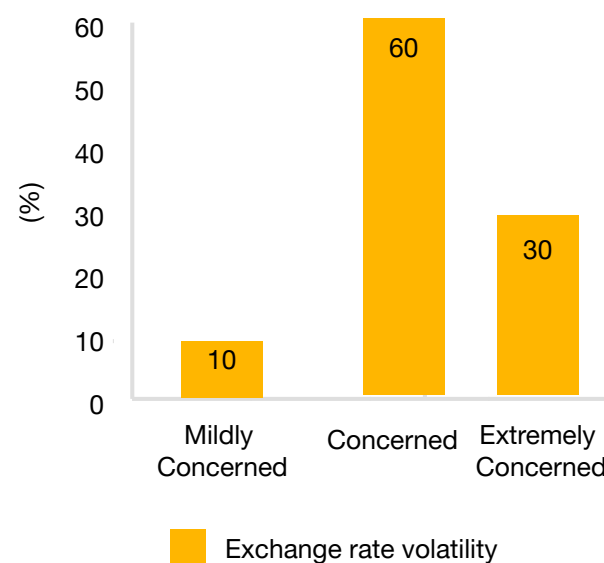
The mining sector accounted for 77% of foreign exchange earnings in 2021, with copper contributing 90% of the sector's exports.²³ Between January and June 2023, Zambia's copper production decreased by 11.9% from 365,042 metric tonnes in the same period in 2022 to 321,779 metric tonnes this year. In June 2023, production decreased by 23% compared to that in June 2022.²⁴ Low production was due to the ongoing impasses at Mopani and, until recently, Konkola, which has negatively affected market supply and impacted the Treasury's foreign exchange earnings. In the second quarter of 2023, mining tax receipts paid to the central bank decreased by 49%, from US\$494.3m in the second quarter of 2022 to US\$242.4m.²⁵

At the same time, USD demand has continued to rise. The rise in global interest rates combined with uncertainty regarding the treatment of non-resident holders of government securities has led to offshore investors divesting from government securities. In addition, exchange rate volatility has attracted market speculators aiming to preserve value in the USD. Import-driven demand also remained strong on account of agricultural inputs and trade.

Exchange rate volatility

Our survey noted that 90% of respondents were concerned about the impact of exchange rate volatility on banking operations (See Figure 13).

Figure 12: Exchange rate volatility



Source: PwC analysis

The Kwacha appreciated 6.6% in the third quarter of 2022 to average K16.02 to the USD for the quarter. The strengthening was attributed to optimism following the approval of an IMF Extended Credit Facility in August 2022 and anticipation of subsequent approval for debt restructuring.²⁶ In the final quarter of 2022, the Kwacha depreciated 4.3% to average 16.71% in that quarter. This was driven by the procurement of seasonal agricultural inputs, medicines and petroleum products.²⁷



23 <https://zambiaeti.org/wp-content/uploads/2023/05/2021-ZEITI-Report.pdf>

24 PwC estimates using Zambia Chamber of Mines Data

25 https://www.boz.zm/MPC_Presentation_August_2023.pdf

26 https://www.boz.zm/MPC_Statement_November_2022.pdf

27 https://www.boz.zm/MPC_Statement_February_2023.pdf

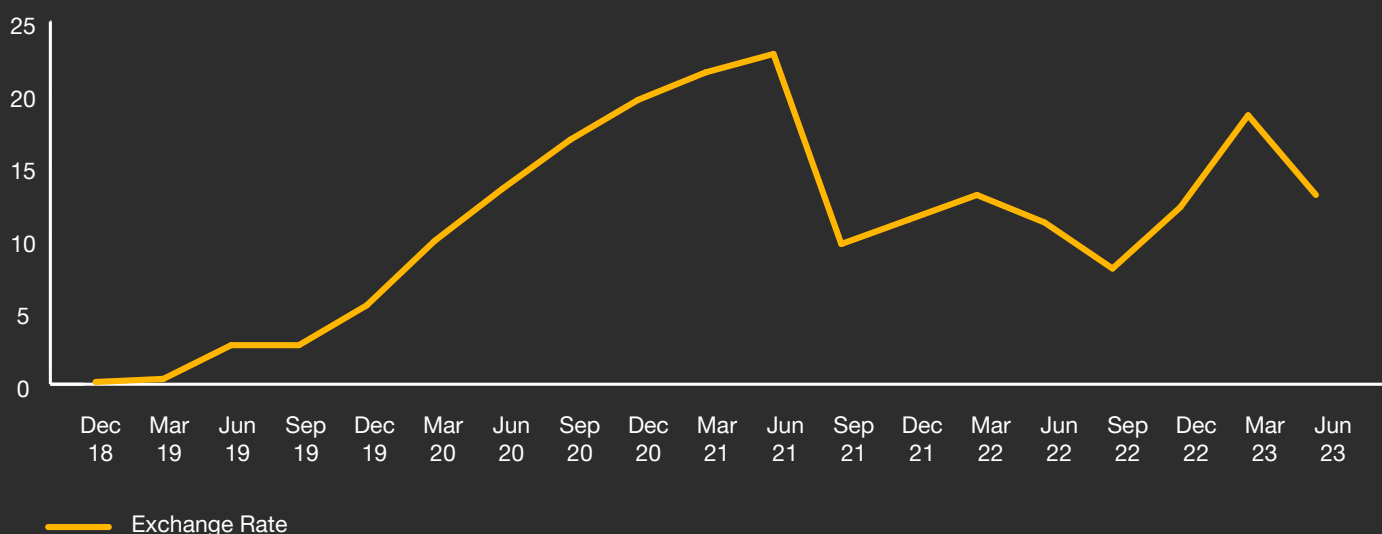
To counter the Kwacha's downward trend, the Bank of Zambia raised the statutory reserve ratio from 9% to 11.5% on February 1, 2023. The move aimed to minimise exchange rate volatility by reducing the impact of the Kwacha's fall on inflation and macroeconomic stability.

The Kwacha depreciated by 16.8% during the first quarter of 2023 to average K19.52 to the USD. Excess dollar demand, adverse market sentiments associated with Zambia's protracted debt restructuring and tightening global financial conditions all contributed to the Kwacha weakening.²⁸

In the second quarter of 2023, the Kwacha appreciated by 4.8% before falling 11% to K19.48 /USD between the end of June and August 22 2023. The Kwacha was buoyed in the second quarter by positive market sentiment after government reached an external debt restructuring agreement with Zambia's official creditors. However, since then the foreign exchange market has been hampered by low supply and increased demand.

The central bank has continued to support the foreign exchange market by offloading foreign currency onto the market to ease volatility. In 2023, the Bank of Zambia released a collective US\$871m onto the market – US\$377m in the first quarter and US\$494m in the second quarter - to moderate the exchange rate.²⁹

Figure 13: Exchange rate



Source: Bank of Zambia

Since Zambia negotiated new terms for US\$6.3bn of its debt with sovereign creditors under the IMF G20 framework, the IMF has released a second US\$188m tranche of funding. This will support foreign exchange supply and should have a positive impact on Kwacha stability going forwards.³⁰

Zambia's gross international reserves rose to US\$2.7bn at the end of June 2023 from US\$2.9bn at the end of March. The decline was led by the Bank of Zambia's support to the market, coupled with government use of foreign exchange and external debt servicing.³¹

28 https://www.boz.zm/MPC_Statement_Q2_2023.pdf

29 https://www.boz.zm/MPC_Presentation_August_2023.pdf

30 <https://www.bloomberg.com/news/articles/2023-07-13/imf-approves-189-million-zambia-payment-after-debt-breakthrough>

31 https://www.boz.zm/MPC_Presentation_August_2023.pdf

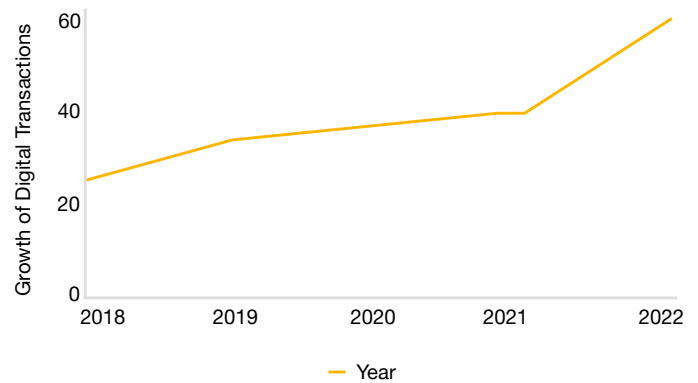
6. Digital transformation

As part of a wider global trend of digital transformation in banking, Zambian banks have implemented many initiatives to embrace this transformation. Growth in this area can be attributed to several factors, including support from the Zambian government with respect to policy development. The government has taken steps to ensure widespread access to digital technology, including the development of a national information and communications technology (ICT) policy and broadband plan, establishing community ICT centres for training and access, digitising government services, and support for mobile money and financial inclusion.

According to the Zambia Information, Communications and Technology Authority's (ZICTA) 2022 National Survey on Access and Usage of ICTs, there has been a significant uptake in the use of digital financial services. The ZICTA survey found that 73.1% of respondents made use of digital financial services in 2022 compared to 48.9% in 2018.

Among the respondents to our survey, 60% of banks reported a significant adoption of electronic and digital channels for customer transactions. The banks said over 80% of customer transactions, including deposits, payments and withdrawals, were now conducted using electronic or digital channels. This represents a significant rise on previous years, with only 40% of banks reporting high use of electronic and digital channels in 2021 and 34% in 2019 (See Figure 15). These findings show a clear trend towards customers choosing to adopt electronic options, underscoring the ongoing shift towards digital banking and financial practices in Zambia.

Figure 14: Growth of electronic/digital banking transactions.



Source: PwC Analysis

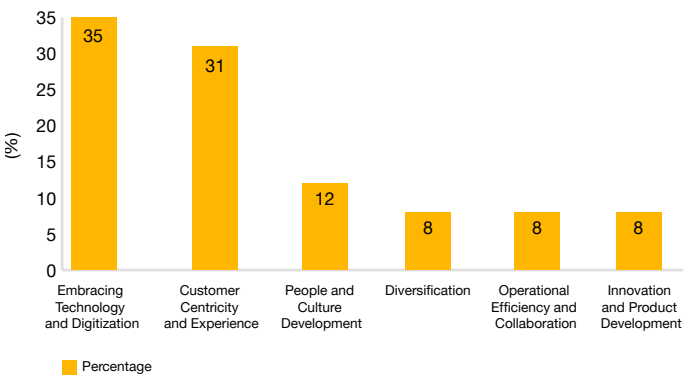
Bank of the future

The survey results show that most banks in Zambia recognise the importance of investing in technology and digital transformation if they are to become the 'bank of the future'. According to our survey results, 35% of banks identified technology and digital transformation as top priorities, while 31% said customer centricity and experience was a priority (See Figure 16).

The survey findings show that banks in Zambia are focusing heavily on the adoption of technology by investing in automation, digital platforms and emerging technologies such as artificial intelligence (AI) and robotic process automation. These technologies are seen as instrumental in driving transformation, particularly with regards to enhancing customer experience, improving operational efficiency and fostering product innovation.

By prioritising technology and digital transformation, banks in Zambia acknowledge the potential technology offers to revolutionise their services, operations and offerings. Strategic investment in this area will enable them to meet the evolving needs and expectations of customers and stay ahead of the competition in an increasingly digitising industry.

Figure 15: Bank of the future ratings



Source: PwC Analysis

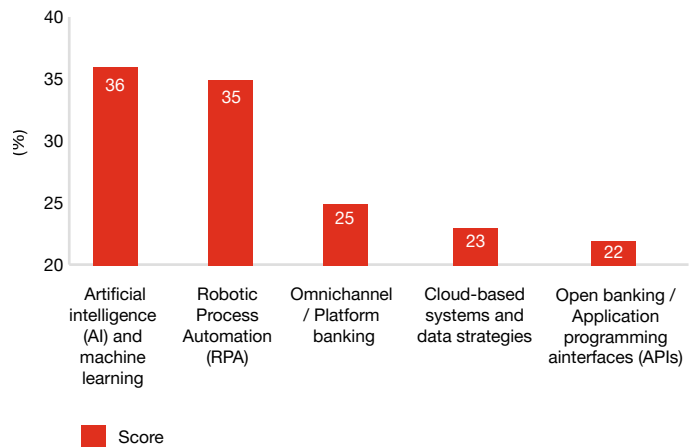
Artificial intelligence – developments as drivers of future banks' success

When asked which technological developments were important for the success of banks in the future, 36% of respondents identified AI and machine learning as the driving force behind the bank of the future's success. Surprisingly, robotic process automation follows closely behind, with 35% of respondents identifying this as an important technological development for banks of the future, surpassing omnichannel and platform banking, cloud-based systems, data strategies and open banking APIs (See Figure 17).

The survey further revealed that AI's impact is currently limited, but certain banks have made significant strides in integrating AI solutions into their customer service operations. Notably, these advancements have primarily been observed in social media platforms, suspicious transaction monitoring and lending processes. Consequently, these banks are likely to experience improved customer service efficiency and an expansion of self-service options for their customers. This level of automation empowers customers to manage their finances conveniently and efficiently. With further advancements and a change in mindset, AI has the potential to transform the operations of Zambian banks in the future.

Cloud-based systems and data strategies are also important for banks in Zambia and can contribute to their success. By leveraging cloud infrastructure, banks can enhance operational efficiency, security and scalability while reducing costs. However, it is important to note that the Data Protection Act of 2021 supports the need for data localisation, a move that could potentially hinder the growth of cloud computing and the use of cloud-based systems.

Figure 16: Technological developments important for banks' success



Source: PwC Analysis

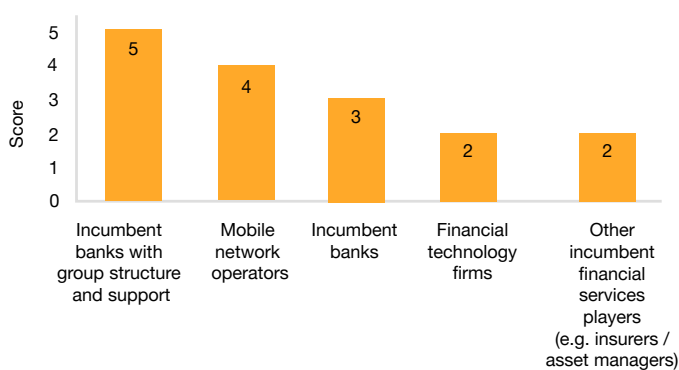
7. Increased competition from non-traditional players

Increased competition from non-traditional players was identified as the fifth most pressing issue faced by banks in 2022 with a score of 4.5 (2021: 2.2), up from tenth place in the previous year.

The banking sector in Zambia is experiencing a shift driven by the growth of non-traditional players, which are challenging the long-standing dominance of traditional banks. These non-traditional players, which include fintechs, mobile money operators and digital payment platforms, are using technology to redefine how financial services are accessed, delivered and experienced. As Zambia navigates this transformative phase, it is crucial to analyse the key factors driving this shift, its impact on traditional banks and the outlook for the future.

Historically, Zambia’s banking sector was characterised by physical branch networks, established reputations and adherence to conventional banking practices. However, this landscape is evolving rapidly due to the influx of non-traditional players. The regulatory framework that once ensured the stability and integrity of traditional banks now needs to be re-evaluated to accommodate the innovative disruptions introduced by these new entrants.

Figure 17: Competitive threats

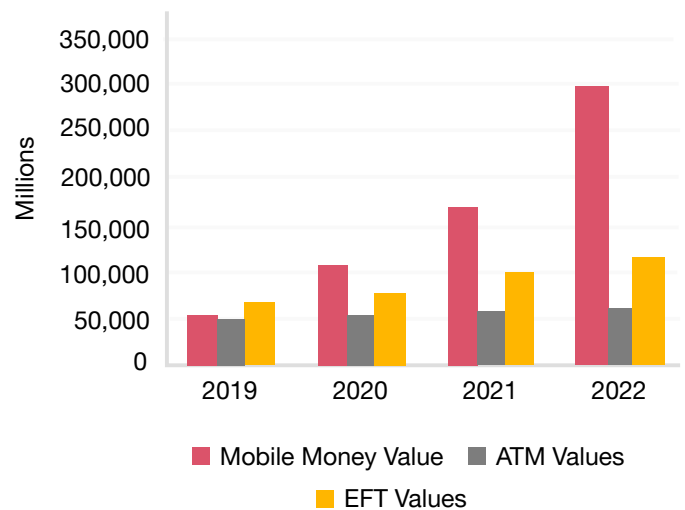


Source: PwC analysis

Both international banks and local banks have the view that incumbent banks with group structure and support are their greatest threat. This suggests that collaborative efforts and shared resources within a group structure could potentially insulate banks from certain competitive pressures. Interestingly, both international and local banks held the view that mobile network operators were their second most significant threat. This is underscored by the increasing volume of mobile money transactions.

The pressure posed by non-traditional players increasing their market share and revenue streams should prompt banks to adapt their strategies, diversify their service offerings and bolster their digital capabilities. As the financial industry evolves, these insights can serve as a useful compass, guiding banks and financial institutions in their strategic decisions.

Figure 18: Exponential growth of mobile money transactions in Zambia.



Source: Bank of Zambia website.

8. Making it or breaking it: Zambian banks at the crossroads

By Betty Wilkinson, Financial Inclusion Consultant

Globally and in Africa, how do leading organisations reflect as banks evolve in this Fourth Industrial Revolution, when technology and global information flows are changing both the way we live and expectations of what types of goods and services are right for us? For banks and their existing or potential clients, the key findings from cloud-services systems integrator Hitachi Solutions are:

- Smart, savvy fintech competitors have entered the market, disrupting traditional customer relationships.
- Global digitisation has changed customer expectations to include 24/7 self-service, lightning-fast response, and personalised experience across service channels and payment platforms.
- With sophisticated cybercrime on the rise, maintaining security and privacy is critical to customer trust.
- Stringent and complex regulatory compliance must be maintained to ensure a good reputation and avoid security breaches, fines and litigation.
- Spending cuts and shrinking budgets hinder the ability to properly maintain IT infrastructures, leaving them vulnerable and potentially impairing customer service.
- Faced with rising consumer expectations and a disruptive economy, many banks have dropped the ball with customer experience and now find themselves at an inflection point.³²

What are the circumstances in the Zambian banking system and its economy that mean banks must respond to these client issues in ways that people will agree with, understand and use?

Zambia is known by some as ‘the land of the last minute’ because the population is often a late adapter to change, and is tolerant of problems and (for the informal group) waiting. Banks are not trusted by their clients and banks in turn view most actual or potential clients as difficult, insisting on immediate help and not trustworthy. If the trust issue is not resolved, banks in Zambia will fail and be replaced by mobile financial services, which are fast-growing and less complex to address and use.

It is important to remember that Zambia is a citadel economy with two levels. There is a (relatively small) formal economy of people on payrolls or with investments who use banks and engage in more formal services of every kind. They use English at work, have stable residences, and participate in a range of both consumption and investment spend. They, and their families, have stronger financial education levels and ready access to TV, cell phones, radio and social media.

Then there are those Zambians who live in the informal economy, whether in compounds or at some distance from cities and towns. In this group, incomes are irregular, assets ebb and flow, and cell phones are simple and do not access the internet even when they can get signal. Furthermore, financial education is limited, economic engagement intermittent, borrowing informally among friends and family is common, savings are irregular and investments are uneven. The fact that many in this second group are youths is also important since they have stronger expectations of service delivery and are much more likely to expect more and better services of any kind, including in banking.

If banks want to be successful, they need to address the issues listed above in the context of social norms and the citadel economy, and the rapid increase in digitisation and client expectations. Faster, better, stronger and more trustworthy and responsive should be banks’ core values.

What characteristics are important for the bank of the future? Many players from Goldman Sachs to IBM are writing about this globally, and they all seem to agree on several areas, all of which are relevant for Zambia. These are five of the most relevant areas in Zambia:

- Responsive, balanced, and humanised bank ICT and people.
- Better financial education options.
- Evolution in bank structures and broadline services.
- Improved data collection, analysis and use.
- Addressing challenges in privacy, cybercrime and complaints.

³² Twelve Banking Customer Experience Trends to Watch in 2023 (hitachi-solutions.com)

Responsive, balanced, and humanised ICT and people, both in strategies and in branches and offices.

This starts at the top, with the leadership working both in ICT and the profitability and organisational culture, and trickles down to areas like Interactive Voice Response (IVR) to provide easy training on cell phones in local languages. (This is already in use for smallholder farmers addressing crop diseases.)

The social difference is stark between a well-dressed banker speaking fluent English and using technical terms, and the client who may or may not be comfortable in English, dressed informally and might not trust bankers to help them. Bankers engage with middle and higher-income households frequently and know these clients will understand and work with them, even if the issue is complex technically. For those who live informally, or are older or disabled, getting into a branch, standing in a queue and being told to go somewhere else is hard and takes time. Seeing that their banker is already frustrated because they know the problem will be more complex due to misunderstandings, and possibly technology, means they may just give up. They will also talk to others and perpetuate this negative view.

Offices need to look open and friendly. Where there is a front face to people, it needs to be staffed by individuals who can use multiple languages and hold multiple views, and who talk to all customers as if they are important clients, regardless of appearance or attitude. The more comfortable and confident a customer feels when interacting with people and with digital channels and remote services, the better their overall financial services customer experience will be. Continuing to support customers until problems are solved is also critical. The most recent phrase on TV is, 'How can we help you?' Bankers (in person, virtual and through digital systems) must say it, mean it and act on it.

Ultimately, banks need to show that they care about their customers and their well-being and offer an integrated human/ICT/mobile service flow. This can mean anything from delivering text alerts to help consumers stay on top of payments, to helping them pay lower fees. Ultimately, doing the right thing is all about demonstrating to customers that you are putting their interests first.

Rebuilding poor levels of trust starts with integrated people and IT systems that clients can count on to make their banking experience work and be reliable. Customers need to know that bankers understand their needs, can meet those needs in ways they understand, are pleasant even (or especially) when the client is not and resolve the issue promptly.

Bank IT systems need to be working all the time, be easy to use, be clear about what they can and cannot do, and ensure fees are transparent. Banks' digital systems should have areas where explanations are given on how to use them, starting with signing in, so clients can find both verbal explanations in languages for call-ins (especially for people without internet) and videos. Orientation for the lowest level of cell phone is important; communicating at the level that is understood by everyone will work.

AI is emerging as an important area for the business community at large, and increasingly for the population. But this brings its own challenges. Chatbots, which are a form of client interface that learn to route and solve bank enquiries from clients, are patient and can learn iteratively from a client, but may not always be able to explain what a set of options means for a customer. AI has recently been found to be sexist, to misinterpret information, and to provide information which may or may not be fully responsive and relevant. In countries where AI is common, clients will often divert to a live agent, which costs more, for issues that can usually be solved through good AI. When engaging in banking business with AI, it is critical that social norms and values are incorporated into the systems, and early-stage diligence in monitoring will be essential. This may also mean that legislation and regulations will need to be made simpler, such as using the Canadian Simple Language rules, which have been successfully used in financial legislation in South Africa. Humanising AI is vital.

Better options to improve client knowledge and understanding about finances and financial services

The Finscope 2020 Survey shows that financial education levels are low in Zambia. Insurance data shows that some clients have such services and do not even realise they have them. Customers can only interact effectively with banks (and other financial services providers) if they have access to financial education that is targeted to them. Such education should enable actual and potential clients to ask the right questions and make the right choices about services, provide clarity on how they can use what is on offer, and what to do about problems.

In Zambia, organisations like Financial Sector Deepening Zambia have experimented with a wide range of financial education options. These include radio stories (Bank of Zambia sponsored), printed materials, videos, IVR, local village elder talks with their people, and long-term work developing the national financial education curriculum with the Ministry of Education (grades 8-12 rolling out now; grades 1-7 in final development.) In countries like South Africa, banks are finding other ways to reach clients, such as producing cartoons and TV dramas.

The Bank of Zambia and the Ministry of Finance and Economic Planning have developed a new Financial Education Strategy to 2030. The strategy includes a wide range of tools and encourages private and public entities to empower Zambians to become financially educated at higher levels. It will be useful for banks to assess the challenges actual and potential customers have and offer methods of learning that enable them to engage more effectively in banking services. The access to the mobile money trust funds for industry associations and others to enable financial education is an area for exploration, and matching grants will be very attractive to potential financing partners.

Need for evolution in bank structures and broadline services

McKinsey shows that African banks face high cost-to-income ratios, lower market penetration than other continents, and challenges from nonbanks and digitisation³³. Furthermore, interest rates and exchange rates are volatile. Market diversification and engagement with clients is low and declining, which the Finscope 2020 Survey showed to be true for Zambia. Additional factors that affect bank profitability include economic outlook, customer demand for better and faster services and digital engagement, and high capital needs when moving from physical branches to digital services, with higher talent needs from staff.

In business and in banking, new methods of client engagement and service mean smaller, cross-functional teams that do not operate in silos, along with digitising various standard administrative functions such as HR and payroll. In addition, mapping the range of client value chains and offering more services to meet the various needs of these chains is important. Banks tend to be structured under historical systems which have more staff and less streamlining, more standard services and less partnered ones. With the exception of a few clients who have strong personal banker relationships, clients may have a wider range of financial services and needs which banks do not recognise and therefore cannot serve.

The shift towards agile ways of working is likely to require significant cultural change across banks away from an authoritative and hierarchical structure towards one of empowered teams. Better use of data analysis and human information can develop and deliver client product innovation and problem solving. Teams need to be supported so they are more accountable for their spending, and move from siloed engagement to strong collaboration, adopting an action-oriented mindset of testing and quickly iterating. This could have added benefits, including reducing duplication, increasing employee satisfaction, boosting productivity and, ultimately, improving overall customer experience.

A key area for mutual agreement and understanding between banks and customers is fees. Banks often change fees and structures of services without sufficient discussion with clients. Banks charge at least US\$30 for clients with domestic forex accounts to make foreign currency payments between accounts within Zambia. Some bankers even tell clients to withdraw the money in cash and walk next door to deposit it free in a creditors account. There is a quick fix: the Bank of Zambia can survey fees quarterly and compare publicly. It can also authorise lower fees on domestic transfers of forex between accounts.



33 African Banking: The Productivity Opportunity, McKinsey

Improved data collection, analysis and use

A significant amount of data is collected by banks, not only through KYC and regulatory requirements, but also through client interactions. However, this data is not analysed or used in ways that can tell banks more about who their clients are, what they need and what issues they face. Data entry is done by hand, which results in errors. Data is stored locally or in hard copy, which is expensive and less accessible.

For example, if your client is female, it is likely she is married with children, and the husband may be working as well. Do your bank's services meet their various family needs? How many of your clients have specific need profiles that allow your bank to predict and meet their needs better? Is there other data that clients may provide you that can help them too? It may be useful to add a few extra items such as family composition, the financial services they use outside the bank, and other interests. In addition, a regular assessment of data availability, analysis, and learning is very important in assessing product and service demand, profitability, client satisfaction, and attracting new customers for a specific service. More can be done in this area.

Every year customers go to their mobile phone operator and file separately for a SIM card, mobile money account and regular account. This takes a long time and is tedious; even more so if you have more than one account. To do this, customers need a wide range of documents and data, which is easy for middle class customers to gather, but a nightmare for anyone in compounds or outside cities. Making records easily available and aligning requirements for mobile money with those for bank accounts makes sense. Discussion with regulators across financial industries can help with account opening, data validation for KYC, and risk assessment and management.

Data storage trends show that globally banks are increasingly storing data in the cloud to improve security and access as well as costs. Banks in Zambia are moving in this direction and it will be interesting to see how they manage this along with backup requirements.

Addressing challenges in privacy, cybercrime and complaints

Client privacy is an interesting topic in Zambia. Some customers are fierce about it and others are willing to trade some degree of privacy for better service delivery. The law and recent court decisions imply high restrictions. This is an area which banks do not assess or develop, and papers signed on accounts are complex and in small print. It would be much better to have a simple language summary of a minimum privacy requirement, then ask via surveys if clients are willing to share with you any other information. Discussions with the Bank of Zambia and client groups might address this and make it easier.

One of the most significant challenges in the banking industry, and now by extension in mobile money services, is cybercrime, as the PwC Banking Survey shows. Losses due to cybercrime are rising, clients are complaining and business has become challenging in terms of protection systems and legal redress. Ironically, because mobile money is tracked daily by the Bank of Zambia, mobile wallets are more amenable to a regulatory response and tracking than the banks, with their lack of deposit insurance. However, client trust levels are dropping fast and this means a return to cash use, which is highly undesirable, costly and less safe over time. Clients also believe that most thefts have an element of insider involvement, further reducing trust in banks.

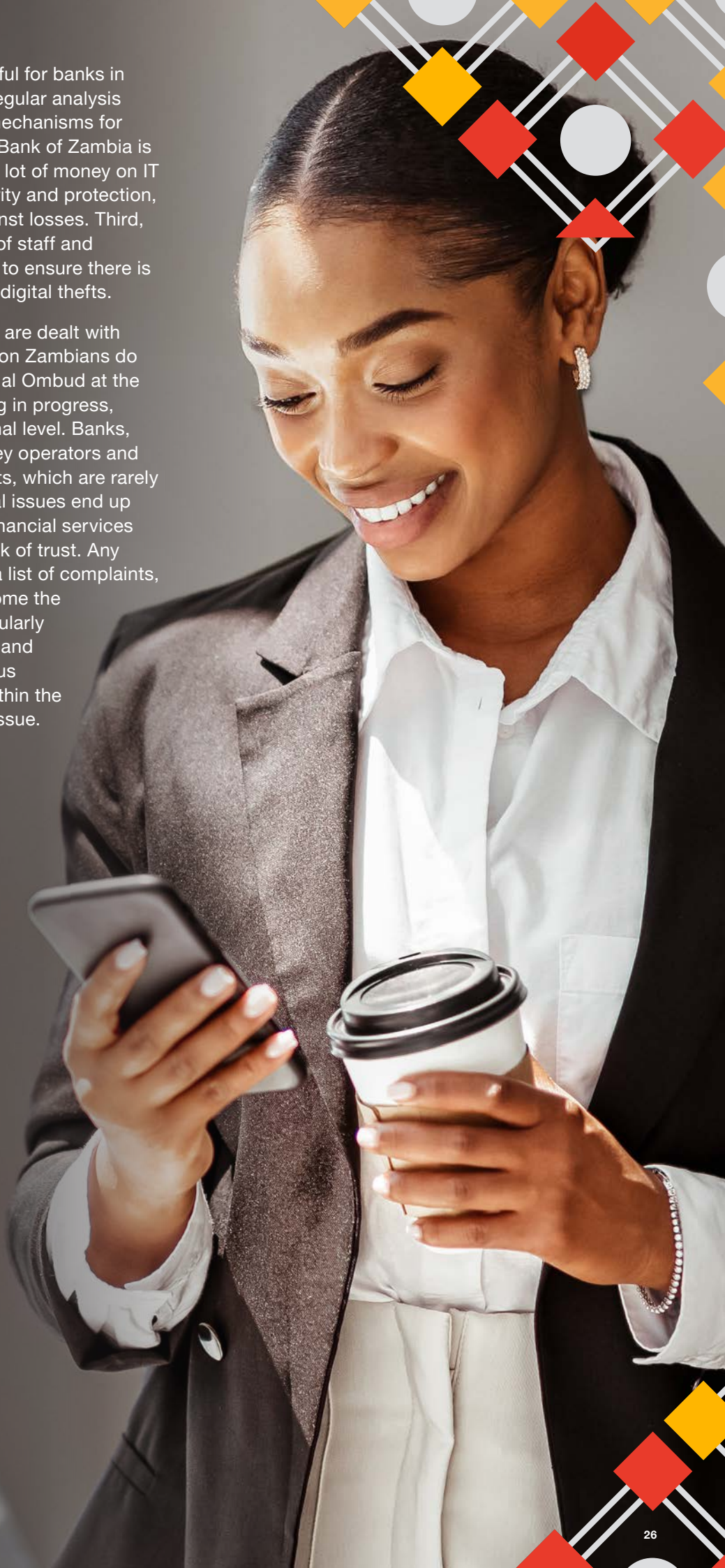
There are many examples of cybercrime for example, money is sent on a mobile transfer, then it disappears. The bank takes a statement then says go to the cell operator. The cell operator takes another statement then says go to the police. The police take a third statement and advise you to come back periodically to check and nothing ever happens. Requiring one entity to handle and process such complaints and requiring the payer agency to process and refund ex ante if not assessed and tracked would help. Customers who see these crimes being addressed are likely to move accounts and talk about experiences.

The story is similar for bank accounts and transfers. I waited over a year for a bank reimbursement for a lost telegraphic transfer (which should take five to six days to find), and the bank charged US\$586 for their error. The Bank of Zambia is close to finalising the Financial Ombud and we hope to see that in operation by the end of this year at the latest. A bank that steps up to accept and address complaints promptly and transparently will find its business expands rapidly and substantially.



These three suggestions may be useful for banks in relation to cybercrime. First, a very regular analysis of cybercrime trends and updating mechanisms for prevention with other banks and the Bank of Zambia is critical. Second, be ready to spend a lot of money on IT system upgrades, especially in security and protection, including considering insurance against losses. Third, do careful and regular assessments of staff and anyone who has access to your data to ensure there is significant protection against insider digital thefts.

Finally, the way customer complaints are dealt with is, after lack of money, the main reason Zambians do not open bank accounts. The Financial Ombud at the Bank of Zambia, which has been long in progress, is desperately needed at the functional level. Banks, other financial services, mobile money operators and the police pass around the complaints, which are rarely addressed. Radio call-ins on financial issues end up being a series of complaints about financial services gone wrong, with the subsequent lack of trust. Any bank that agrees to accept, publish a list of complaints, and address them promptly will become the number one bank very rapidly, particularly if they publish who takes complaints and is responsible to resolve them. Serious discussion and action are needed within the banking community to address this issue.



9. Taxation, the tax environment and banks

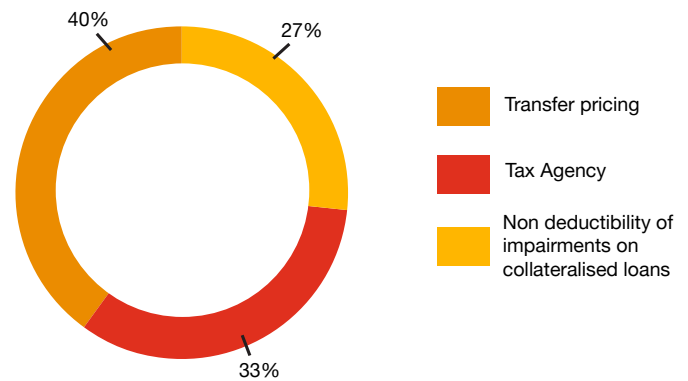
9.1 Survey results

Taxation, both in the form of taxes borne by banks and taxes collected by banks on behalf of the government, has a huge bearing on a bank's business. This is because taxes borne by banks are very significant, and taxes collected by banks require additional resources and capacity to ensure effective collection. It is therefore critical that banks have a strategy in place to manage their tax obligations. If not, risk can creep into the bank's ecosystem, which could result in financial loss and reputational damage.

With this in mind, we asked the banks who responded to our survey a series of questions about contemporary tax compliance and related matters and their impact. We have summarised the responses below.



Figure 19: Banks' tax issues



Transfer pricing

A third, or 40%, of survey respondents said compliance with transfer pricing regulations was a concern. This was also an issue for banks in the previous survey (2021: 28%). It is expected that transfer pricing is a concern given the operating models that banking groups adopt, which include the centralisation of shared financial services, the pooling of treasury functions, specialised skills and delivery platforms. The sector is therefore exposed to scrutiny of the pricing of both local and cross-border group transactions and the tax applicable thereto.

In addition, the evolution of the international tax landscape plus local nuances in the enforcement of transfer pricing requirements by the Zambia Revenue Authority (ZRA) place banks in the spotlight in this area. This is discussed in more detail later in the report.

Tax agency

This refers to the administrative responsibility relating to the appointment of banks as agents of ZRA. In their role as tax agents, banks are required to provide ZRA with a list of their vendors and suppliers before payment is made to the vendors and suppliers. The ZRA determines if there are any garnishments against the suppliers on the list. If so, banks are required to make payment to ZRA in lieu of full payment being made to suppliers. In our survey, 33% of banks identified the administrative responsibility of banks having to act as agents of ZRA as a significant area of impact.

The survey responses show that banks have actively engaged in their administrative responsibility as agents of ZRA. Survey respondents said a proposal for automating ZRA has been made, showing a desire for a streamlined process that will enhance efficiency and reduce administrative burdens. This forward-looking approach aligns with the industry's commitment to embrace technology.

Non-deductibility of impairments on collateralised loans

The tax treatment of provisions for bad or doubtful debts for institutions registered under the Banking and Financial Services Act is different from that of other entities in that uncollateralised bad debt within the limited Bank of Zambia allowable provisioning levels is allowable for tax purposes.

As in the 2021 survey, the non-deductibility of impairments on collateralised loans was identified as a major challenge in 2022, with 27% of banks saying this continued to be a major issue. The prevalence of this matter is indicative of its implications for financial institutions' financial reporting and tax obligations. The variance in responses may indicate potential differences in loan portfolios, collateral structures or accounting practices between banks. We have not undertaken further analysis of this in this report as this has been covered in previous PwC publications.

Tax amnesty

ZRA ran a tax amnesty programme for the waiver of penalties and interest that ran from October 1 2022 to March 31 2023, with a further extension to June 30 2023. ZRA issued guidelines on eligibility and procedures (the guide) to be followed by taxpayers who wished to participate and apply for amnesty.

The amnesty programme aimed to:

- Provide relief to businesses who faced challenges due to the COVID-19 pandemic.
- Enhance voluntary compliance to widen the tax base.
- Boost revenue collection.

With the above in mind, when asked whether the amnesty programme was helpful, 90% of respondents said it was helpful.

Respondents also stated that after the amnesty, they would look at enhancing the following:

- Tax compliance risk management systems and controls.
- Tax accounting and reporting processes and strategies.
- Tax cost optimisation strategies.
- The banks preparedness for tax audits including undertaking of tax health-checks and preparation of defence strategies especially taking into account ZRA's plan of strict enforcement of penalties for noncompliance after the amnesty.

Taking the above into account, the survey respondents identified various actions that must be taken in respect of the areas affected. These are listed below.

Banks' responses to the identified issues

The respondents provided the following actions as necessary to enhance compliance with taxes:

- Engagement with government and tax authorities.
- Investment in enhanced training across impacted functions within the respective organisations.
- Outsourcing key complex tax matters to subject matter experts.
- Investment in structures and processes within the organisation.
- Proposed automation of revenue house functions.
- Compliance with regulations.
- Discussion with peers and peer groups (i.e. the Bankers Association of Zambia) on best practices as well as discussions on the above impact areas.

9.2 Other tax matters of interest to banks

9.2.1 Transfer pricing considerations for financial institutions

As highlighted in the survey, compliance to transfer pricing regulations was a major risk faced by banks in 2022. As part of the ZRA's ongoing initiatives to enhance tax compliance, we have noted an increase in the frequency of transfer pricing audits. With this in mind, we would like to share some thoughts on this topical issue from the perspective of ZRA audits with respect to banks.

In an era of heightened globalisation and intricate financial interdependencies, Financial Transaction Transfer Pricing stands as a critical consideration for Zambian banks. By establishing and implementing sound transfer pricing practices, banks can contribute to the country's economic growth, tax revenue generation and overall financial stability. A proactive approach to understanding and addressing transfer pricing risks and challenges is paramount for a thriving and resilient financial sector in Zambia.

Zambia's transfer pricing regulations were initially introduced in 2000 under Section 97A of the Zambia Income Tax Act, which introduced the 'arm's length' principle as the acceptable standard for related party transactions. The Income Tax (Transfer Pricing) Regulations 2000 provided further definitions regarding the extent of application of the transfer pricing provisions contained in the Act.

In 2018, the *Income Tax (Transfer Pricing) (Amendment) Regulations, Statutory Instrument No. 24 of 2018*, introduced a requirement to prepare and maintain transfer pricing documentation in line with the guidance provided by the Organisation for Economic Cooperation and Development (OECD).

This transfer pricing legislation applies to both cross-border transactions and to transactions between Zambian residents (i.e. domestic transactions). This is to ensure losses are not effectively shifted between taxpayers or between sources by applying non-arm's length pricing. In addition, the transfer pricing legislation applies to companies as well as partnerships and individuals.

For financial institutions such as banks, financial transactions are of particular interest to the revenue authority. There is a wide array of financial instruments available for organisations, particularly financial institutions. These instruments have varying features and attributes which affect their pricing. It is therefore important when analysing financial transactions between related parties to document carefully the features and attributes of the financial product or service being provided to related parties.

Some of the features and attributes are listed below.



Key factors influencing financial transaction transfer pricing:

- Nature of services. The nature of financial services rendered, such as interbank lending, foreign exchange transactions and other banking services, plays a pivotal role in determining transfer pricing methodologies.
- Market conditions. The prevailing market conditions and economic factors in both the domestic and international markets significantly impact the pricing of financial transactions. Interest rates, foreign exchange rates and liquidity considerations must be carefully evaluated.
- Risk assessment. The allocation of risks associated with financial transactions is crucial. Determining who bears the credit, interest rate and market risks can impact the allocation of profits between related entities.
- Functional and risk profile. Understanding the roles and responsibilities of each entity involved in the financial transaction is essential. This includes evaluating their contributions, capabilities and functions in the transaction.
- Comparability analysis. Conducting a thorough analysis of comparable transactions in the market helps to establish an appropriate arm's length range for pricing.

As a general point, financial transactions can be a means by which multinational enterprises maximise interest deductions. Generally, interest is tax deductible, while payments such as dividends to shareholders are not. An artificially high interest expense or low interest income therefore has the potential to impact the amount of tax payable in Zambia. For this reason, financial transactions may be subject to considerable scrutiny from ZRA in order to minimise base erosion and profit shifting.

In determining the arm's length nature of financial transactions, the OECD guidelines recommend that taxpayers and tax administrations consider not only whether the interest rate provided in a loan agreement is an arm's length rate, but also whether the related party loan should be viewed as a loan or a quasi-equity instrument.

To decide whether a loan can be regarded as a loan or equity, the transaction needs to first be accurately delineated. In line with the treatment of all related party transactions, the accurate delineation of a financial transaction may involve an identification of the economically relevant characteristics of the transaction. These include:

- The functions performed.
- Assets used and risks assumed by the respective parties to the transaction.
- The characteristics of the financial instruments.
- The economic circumstances of the parties and of the market.
- The business strategies pursued by the parties.

We have noted considerable scrutiny of financial transactions by ZRA. Banks and insurance companies are particularly susceptible to ZRA audits following the increases to the minimum statutory capital requirements for both local and foreign owned financial institutions. Based on our experience, the ZRA scrutinises the terms and conditions of hybrid financial instruments such as tier II loans. We note that ZRA is questioning not just the interest charged on those loans, but also whether the transaction involves debt or equity in the first place as opposed to a pure loan (i.e. recharacterisation of transaction from loan to equity). The consequence of the above recharacterisation means that all interest deductions that an entity has allowed in the past would be disallowed for tax purposes.

Based on the foregoing, it is therefore important that banks and financial institutions review their financial instruments and loan transactions with related parties e.g. tier II loans. A review of the transactions would ensure the speedy conclusion of audits as well as provide taxpayers with the option to self-disclose where it is determined that the transaction was not conducted in line with the arm's length principles.

9.2.2 Compliance through cooperation

Revenue authorities the world over are increasingly taking a more collaborative and customer-centric approach to compliance, which is nurturing a more trust-based relationship between the taxpayer and the tax authority. This results in less intrusion (including limited audits, fast track tax clearances etc) in the taxpayers' affairs that demonstrate credibility by the tax authority. This is appealing to taxpayers for these reasons. Generally, getting to this programme requires the taxpayer to meet various minimum requirements.

ZRA appears to have also taken this posture as articulated in the ZRA 2022 -2024 Corporate Strategic Plan. We provide an extract of its four-pillar strategy below.

Strategic pillars	Key result areas	Strategic objectives
Tax Compliance	Enhanced revenue collection	<ul style="list-style-type: none"> • Optimise revenue collection • Enhance compliance
Customer Focus & Collaboration	Satisfied and knowledgeable taxpayers	<ul style="list-style-type: none"> • Improve public perception • Improve customer experience
Process Efficiency	Simplified, efficient, and reliable business systems	<ul style="list-style-type: none"> • Develop and stabilise ICT systems • Improve business processes • Improve data integrity
Right People	Committed, competent and high performing workforce	<ul style="list-style-type: none"> • Increase human capital and staff motivation. • Improve infrastructure and facilities

The first two pillars provide an outline of this collaborative/customer-centric approach.

In addition, ZRA has indicated on various public platforms that it wishes to adopt a “cooperative compliance” approach for its large taxpayers. This would ultimately result in great benefits for both ZRA and the respective taxpayers. ZRA is yet to provide further detail on how it expects to implement this.

With this in mind, we have made reference to the OECD framework on cooperative compliance in order to demonstrate how cooperative compliance works, the accreditation process, and the benefits to both the revenue authority and the taxpayers.

Considering the above, it is generally accepted that there is a need for increased collaboration between ZRA and relevant stakeholders to improve the tax ecosystem.



Cooperative compliance

Cooperative compliance - known internationally as 'enhanced relationship' or 'horizontal monitoring' - is the development of a relationship between the taxpayer and the revenue authority of a given state. This bilateral relationship is based on trust and cooperation and ensures the highest level of voluntary tax compliance and certainty.³⁴

To create a functional and mutually beneficial relationship, ZRA would need to evaluate the companies' internal controls and assess historical compliance with set tax laws and regulations. This may be achieved through accreditation audits by the tax authority to establish adequacy and effectiveness of internal controls. In turn, the audits would allow the tax authority to maintain or adjust their systems and/or legislation as the engagement provides them with insights on the ever-changing business environment and provides first hand insight into challenges that may be faced by taxpayers and adjust accordingly.

In essence, according to the OECD³⁵ the expected benefits of cooperative compliance to the respective parties are as follows:

Benefits to tax authority	Benefits to taxpayers
The tax authority's staff are more commercially aware, professional and helpful.	Improved compliance. By appropriately considering and working to reduce significant tax risks, boards of large businesses can increase the standard of their corporate governance and their awareness of the implications of major transactions. The standard of corporate governance has a direct bearing on whether a company has a high, moderate or low tax risk level. Businesses will be able to manage their tax risks better.
Brings a more pragmatic approach to tax administration.	Improved compliance through an enhanced relationship due to increased transparency, understanding and trust founded on an improving tax control framework.
Access to guidance and advice.	Lower compliance costs. Revenue bodies focus most of their large company compliance resources on high risks, particularly where taxpayers are not transparent, open and compliant. Large businesses that have good corporate governance practices and enhanced relationships with the revenue body will generally experience fewer audit interventions, since the audit and enforcement focus will be biased towards those not committed to high compliance standards.
Commercial understanding of the various parts/functions of the tax authority.	This contributes to greater certainty and the potential to reduce compliance costs. The cost of compliance is expected to be lower for those large businesses in an enhanced relationship as the intensity of engaging with such business is in most cases less when compared to higher risk taxpayers.
A better coordinated infrastructure within the tax authority.	Quicker tax audits, greater focus on improving internal processes and (future) compliance, faster filing and settling of returns and fewer post filing audit adjustments thanks to the tax control framework and joint tax risk assessment can also reduce administrative costs and the compliance burden.
Less complexity.	Greater use of the work of others by the revenue body (for example internal and/or external auditors) could reduce the costs for the taxpayer.
General improvement in levels of openness and transparency on tax.	Corporate social responsibility. Cooperative compliance models will also help to boost community confidence in the fairness of tax systems, demonstrating that revenue bodies are addressing non-compliance in an effective way.
	Highlighting problems. The opportunity to highlight problems with the tax code or its administration. The increased ability to identify and bring to the relevant law-making body's attention, areas where the law is not operating satisfactorily or is producing unacceptably high compliance costs.

Cooperative compliance would require significant consideration and practical developments arising from implementing an enhanced tax control framework.

34 <https://www.revenue.ie/en/companies-and-charities/cooperative-compliance>

35 Cooperative Compliance: A Framework – From Enhanced Relationship to Cooperative Compliance © OECD 2013

From a tax authority perspective, this would require:

- Stakeholder engagement and sensitisation.
- Set up rules, regulations and guidelines for the accreditation.
- Allocate (or reallocate) the tax authorities' financial and human resources.

From a taxpayer perspective, this would require:

- Moving from an incident-driven approach to a systematic process.
- Shift from documenting what should happen to evidencing what actually happens.
- Real time risk identification and exception reporting.
- Automating controls.
- Insight into tax-related opportunities.
- Tax being part of the complete business control framework – everyone has a role, not just tax.
- Implementing a monitoring function to provide assurance to multiple stakeholders.

If the approach to cooperative compliance adopted by ZRA is based on similar principles outlined in the OECD approach, it would be beneficial for banks to consider getting on board as this would further improve banks' tax control environments and, all things being equal, significantly reduce tax compliance costs.

9.2.3 Total tax contribution by the financial services industry

Based on figures published in ZRA's 2022 Annual report³⁶, tax revenue amounted to 17.8% of GDP. Furthermore, the report indicated that in 2022 the financial services sector contributed K6.7bn (2021: K4.6bn), which represented 6.3% of total tax collections. The report placed financial and insurance activities as part of the sectors contributing to 80% of the gross tax revenue collected in the year. As a further note, ZRA shared information on the contribution made by all the key sectors in their quarter updates during 2023. The financial and insurance sector ranked fifth at 5.4% of the gross tax revenue compared to 7.1% in 2022.

This sort of reporting demonstrates the scrutiny with which stakeholders like the government now place on corporate players such as banks in terms of their tax contributions. This takes even more critical importance as the total tax contribution of the sector can be taken as a proxy for its contribution to the economic transformation agenda of the government of the day, and, by extension, the given sector's contribution to funding society.

Enter Total Tax Contribution (TTC) reporting.

In our view, it is important for the banking sector to take control of the narrative and actively demonstrate its total tax contribution in a way that is fair and consistent. This can be done by way of preparing its own TTC report. The Kenya banking sector has successfully done so with the Kenya Bankers Association TTC report, which is now in its sixth year.

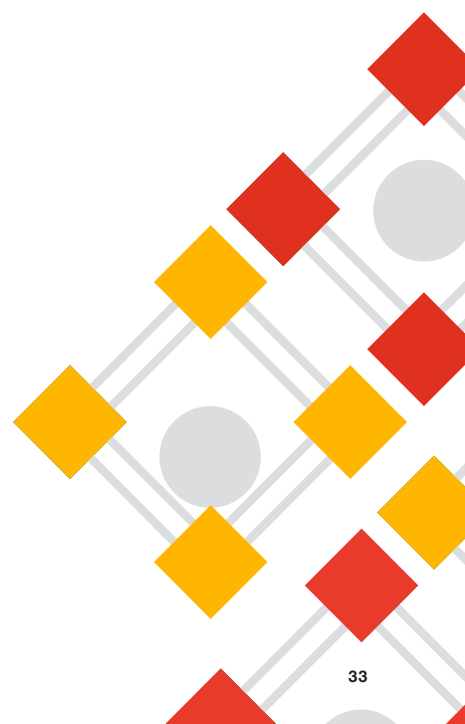
The TTC framework is built around two essential criteria:

- The definition of tax.
- The distinction between taxes that are the company's cost (taxes borne) and taxes that the company collects on behalf of the government (taxes collected).
- Taxes borne are the bank's own contribution in taxes that impact their results, e.g. corporation tax, irrecoverable value added tax (VAT), VAT on imported services, withholding taxes and other taxes borne.

Taxes collected are those that the bank administers on behalf of the government and collects from others, e.g. income tax deducted under pay as you earn (PAYE), withholding VAT, withholding tax collected, excise duty collected and other taxes collected.

As companies are under increasing public scrutiny to explain their tax strategies and taxes paid, a TTC study can demonstrate how companies/industries contribute to the integrated economy (both domestically and globally), while a public tax strategy or tax principles can help set out a narrative around business motivations.

³⁶ ZRA's 2022 Annual report <https://www.zra.org.zm/uploads/2023/05>



Purpose of the study

The role of the banking sector as a credit intermediary on the path to economic recovery cannot be overstated. A TTC framework offers an opportunity for the tax contribution of the banking sector to be quantified and analysed so that policymakers can assess whether the operating environment is supportive of the sector. At the same time, it offers an opportunity for the banking sector to report on value creation by illustrating the interconnection between financial and non-financial information.

As an example, the TTC report prepared by PwC Kenya for the Kenya Bankers' Association for 2022³⁷ showed that although the Kenyan banking sector only contributes 8.9% of the total tax collection by the Kenya Revenue Authority, it was the highest contributor of corporate income tax of all the sectors at 35.9%. This provides insights into the Kenyan government's over reliance on banks to pay corporate taxes compared to other sectors of the economy. The banking sector was also responsible for the collection of 25% of withholding tax on behalf of the Kenya Revenue Authority.

The purpose of the TTC study would therefore be to quantify the contribution made by Zambia's banking sector and the trends in TTC of the sector over time.

The study would also highlight that the contribution by banks is broader than corporate income tax, with employment taxes, withholding VAT, irrecoverable VAT, withholding tax and excise duty all adding to the total. It would also contain data to highlight the impact of legislative amendments on the industry.

The TTC framework is a straightforward concept and is not tax technical, and therefore would be relatively easy for stakeholders to understand.

Generally, the taxes collected have an administrative cost for the bank and will invariably have an impact on the bank's operations. The results of a TTC study would provide information which would not otherwise be available in the public domain since this is not information companies are required to disclose in their financial reports.

³⁷ <https://www.kba.co.ke/wp-content/uploads/2023/08/Total-Tax-Contribution-Report-2022.pdf>

Possible benefits of conducting a TTC study

Tax transparency for organisations poses potential risks in addition to associated costs attached to tax disclosures and contribution studies. These include the cost of collating the information and the risk that commercially sensitive information could be revealed or information misunderstood.

At the same time, there are notable benefits that banks can accrue from adopting tax transparency initiatives in line with sustainability reporting. We highlight below the possible benefits for consideration:

- Influence over tax policy and strategy. TTC reports allow the banking sector to quantify its contribution to public finances in the form of taxes and analyse the trends in contribution over time. Furthermore, such disclosures allow the government to assess the tax contribution of the sector which may inform future policy around taxation of the banking sector.
- Improved access to capital. Tax transparency in pursuit of financial sustainability will enable banks to access capital in the form of debt and equity. Generally, stakeholders have expressed increased interest in organisations that show commitment to positively impact society and the environment in a way that can be quantified.
- A great head start. Environmental, social and governance (ESG) reporting is quite new but a critical concept that every organisation should consider embedding in its overall corporate strategy. Setting the pace may prompt adoption across the broader economy given that the banking sector plays an important role in facilitating trade.

Overall, the greatest risk is for the banking sector to delay being plugged into the tax transparency discussion. A TTC report is one of the easiest ways to demonstrate commitment as a conversation starter. It is therefore important that banks consider partnering with experts to achieve the required compliance and rate highly on the ESG scorecard.

The banking industry has a role both in launching new ESG products, such as compliant savings products, and financing third parties that spur innovation, like environmental technology start-ups. To ensure success, banks should set ESG targets and track and report these back to stakeholders.

Furthermore, given the dynamics different entities operate in, there is no single right approach. Each company has its own environmental and social impacts, a different position on the ESG maturity curve and a different prioritisation of ESG issues. In this regard, financial institutions should develop governance frameworks to hold all the ESG parts together and help create transparency, which supports building trust.

10. Sustainability and banking – sustainable finance and sustainability ESG reporting

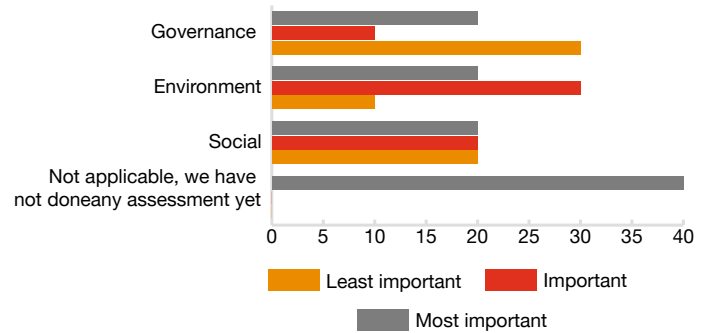
Companies have never been subject to as much public scrutiny as they are today. The term ‘business as usual’ is no longer a sufficient response for companies who need to demonstrate that they can add value, build trust and help solve problems in the context of global climate and social challenges. Companies must incorporate these climate and social risks - and opportunities - into their business strategy because they can have a big impact on their value.

Environmental, social and governance

ESG provides a framework for assessing a company’s impact and reliance on society and the environment as well as the effectiveness of its corporate governance. It also provides a way to measure business risks and opportunities in those areas. ESG pays particular attention to environmental performance and climate change, and to social issues - and the organisation’s governance of both. Each of the three ESG pillars are equally important.

We asked survey respondents to rate the three ESG pillars in order of importance, from most to least important. Interestingly, 40% of respondents said their banks had not undertaken an assessment of the three aspects of ESG and therefore could not rate their importance. One fifth, or 20%, of respondents rated all three ESG attributes as most important to their business. Meanwhile, 30% of respondents said the environment was important, while governance was rated as the least important aspect according to 30% of the respondents. Social issues were rated second most important after the environment in the important category, with 20% of respondents rating it as important. Social issues were also the second least important aspect of ESG for 20% of respondents.

Figure 20: Banks



We asked respondents to rank how they prioritise ESG risks, opportunities and measures. Most said ESG risks and opportunities were a critical factor in strategic decision-making. Taking ESG into account in business planning can help banks create a more sustainable, responsible and successful business.

- 1 ESG risks and opportunities are a critical factor in strategic decision-making.
- 2 We should prioritise ESG issues in the interests of customers, society and our reputation, even if doing so reduces profitability.
- 3 Climate-related risk is built into our credit and project risk process.
- 4 Investors will adversely perceive companies that are not taking sufficient action on ESG issues.
- 5 ESG performance measures and targets should be included in executive pay.
- 6 Enhancing disclosure, reporting and transparency around ESG topics.
- 7 ESG risks and opportunities are important over the medium to long-term, but it may be difficult to implement meaningful ESG initiatives in the short-term in my institution or territory due to social and/or geopolitical concerns (e.g. potential job losses, significant reliance on fossil fuels etc.).

Respondents said the next ESG-related priority is that ESG issues should be in the interests of customers, society and their reputation - even if doing so reduces profitability. Through ESG reporting, banks can demonstrate their commitment to sustainability and ethical practices, fostering open dialogue with stakeholders.

Climate-related risk being built into credit and project risk management was rated as the third priority. Although integrating climate risk measures into credit risk management would be a huge endeavour for most banks given that all phases of the credit lifecycle are expected to be affected by climate risk, doing so is a critical step towards effective risk management and a carbon-neutral future.

Investors will adversely perceive companies that are not taking sufficient action on ESG issues. This was rated as the fourth priority. According to the *PwC 2021 Global Investor ESG Survey*, almost half of investors surveyed, or 49%, expressed a willingness to divest from companies that were not taking sufficient action on ESG issues. Therefore, companies failing to act on ESG issues risk losing investors, according to the survey, which captured the views of 325 investors from around the world.

Respondents rated ESG performance measures and targets being included in executive pay as the fifth priority. The incorporation of ESG performance measures can send a critical message to executives, employees, investors and other stakeholders where boards are clearly aligned with strategy and future business performance.

The respondents rated enhancing disclosure, reporting and transparency around ESG as the sixth priority. Better accountability and transparency through ESG reporting enables businesses to share their sustainability efforts with customers, workers and investors. Enhancing disclosure, reporting and transparency also plays a role in risk management and mitigation. By disclosing ESG data, businesses can identify potential risks early on and implement corrective measures.

Finally, respondents said ESG risks and opportunities were important over the medium to long-term, but said it may be difficult to implement meaningful ESG initiatives in the short-term in their institution or territory due to social and/or geopolitical concerns (e.g. potential job losses, significant reliance on fossil fuels etc.)

Organisations can address ESG risks, opportunities and measures by making a commitment to tackling ESG matters. The newly released *PwC Africa Business Agenda: ESG Perspective 2023* discusses how African companies are focusing on and implementing ESG strategies. The following are the report's key findings:

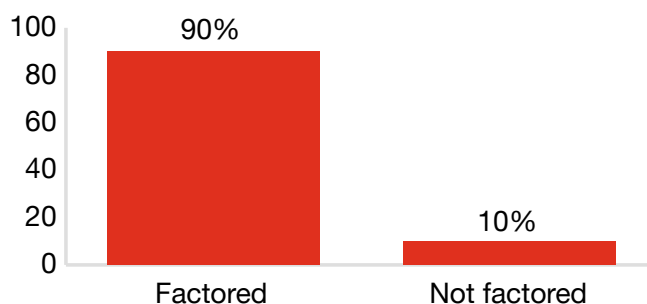
Governments cannot solve these challenges on their own.

- Collaboration and trust can help tackle societal and climate challenges.
- Climate risk action is urgent.
- A holistic, operational ESG approach drives value for business and society.
- Data provides insight informing emissions-reducing strategies.

ESG strategies will differ from company to company in the same way markets differ. While ESG is a relatively new aspect not just for Zambia but globally, there are some aspects that local banks can do to get ahead of this emerging concept.

The survey responses show that 90% of banks have factored the impact of ESG into their strategy and operations over the past year.

Figure 21: Factoring impact of ESG in the strategy

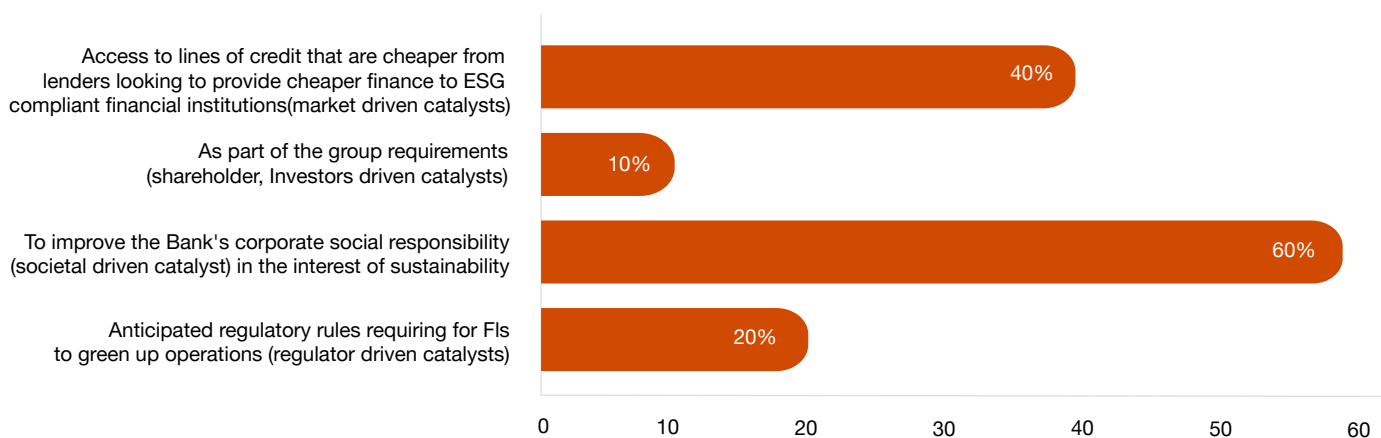


■ Factoring impact of ESG in the strategy

Respondents said the main driver for factoring ESG into their company strategy was to improve corporate social responsibility in the interest of the bank's sustainability. Having access to lines of cheaper credit from lenders who want to offer lower-cost finance to ESG-compliant financial institutions was the second biggest driver for banks factoring ESG into their strategy. Factoring ESG into a bank's strategy is also being driven by anticipated regulatory rules requiring financial institutions to 'green up' operations, as well as if ESG is part of the bank's group requirements. One respondent said although ESG was a consideration, it was not currently seen as a priority.



Figure 22: Main drivers for factoring ESG



Sustainability reporting

ESG affects every aspect of doing business. A successful ESG strategist will define a roadmap for incorporating sustainability into the bank's business model and adapt the organisation to meet these goals. This involves defining a clear set of KPIs for business units and tracking ESG data to measure success. Banks must also have a strategy for communicating these goals to their stakeholders, including a sophisticated and transparent reporting system. If leveraged correctly, ESG actions and associated data can become a competitive advantage in determining the right way to a successful transition.

There are various advantages for organisations moving from traditional financial reporting to adopting integrated and enhanced reporting in line with ESG. Firstly, sustainable reporting helps address stakeholder concerns about how a bank's operations and decisions are impacting the environment and society. This in turn will assist stakeholders to make more informed decisions on their interest in the organisation.

There are several ESG reporting standards/frameworks. These include:

Global Reporting Initiative

The Global Reporting Initiative standards enable any organisation – large or small, private or public – to understand and report on its impact on the economy, environment and people in a comparable and credible way, thereby increasing transparency around its contribution to sustainable development. The standards are highly relevant not just for companies but other stakeholders too, including investors, policymakers, capital markets and civil society.

Sustainability Accounting Standards Board

These standards enable organisations to provide industry-based disclosures about sustainability-related risks and opportunities that could reasonably be expected to affect the company's cash flows, access to finance or cost of capital over the short, medium or long-term.

Task Force on Climate-Related Financial Disclosures

The Task Force's recommendations on climate-related financial disclosures are widely adoptable and applicable to organisations across sectors and jurisdictions. They are designed to solicit decision-useful, forward-looking information that can be included in mainstream financial filings.

ISSB inaugural global sustainability disclosure standards

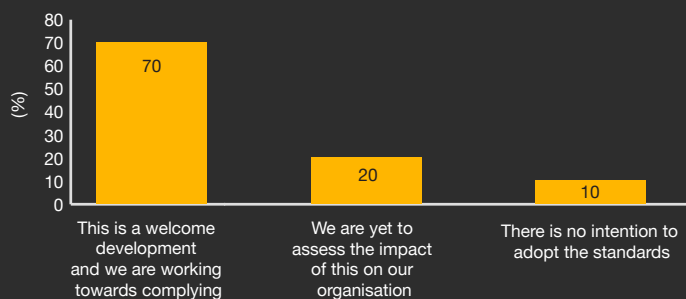
On 26 June 2023, the International Sustainability Standards Board (ISSB) issued its inaugural standards. These standards set the tone for the new era of sustainability-related disclosures in capital markets that use the International Financial Reporting Standards (IFRS) foundations framework of standards worldwide.

The IFRS board has issued two standards: IFRS S1 and IFRS S2. These stem from the feedback received from the G20, the Financial Stability Board and the International Organisation of Securities Commissions, as well as leaders in the business and investor community.

The standards are aimed at incorporating climate and related factors into companies' disclosures to inform investment decisions. This is a key milestone in sustainability reporting as it lays a foundation for those preparing financial statements for companies that use IFRS as their reporting framework.

The new standards are a welcome development for most of our survey respondents who are working towards complying with and preparing for the adoption of these standards, with 70% saying the standards were a welcome development.

Figure 23: Banks



Sustainable finance

Sustainable finance encompasses all actions taken by financial service providers with the intention of lessening harm to the environment and climate, fostering social participation and promoting sustainable corporate governance. The Paris Agreement and the EU Action Plan that resulted from it establish specific sustainability objectives for the financial industry, and, as such, they serve as a cornerstone of sustainable finance. Sustainable finance means that in the future capital will flow towards more sustainable investments, environmental risks will be taken into account and transparency will be encouraged. In this way, the financial services sector is meant to support the transformation of the overall economy and guide it towards sustainability.

How banks are transitioning to sustainable finance

To encourage climate financing and entrepreneurship in Zambia, some local banks are now gaining access to funds for businesses and climate-related projects. The funds are meant to be used as a directed lending line to provide finance for micro-SMEs and climate-related projects. The banks are considering lending in the area of climate change, and some are focusing primarily on the renewable energy sector, creating the appropriate procedures, capacities and sustainability plans to expand their climate book. There is therefore a general focus on banks to incorporate ESG into their risk management frameworks, which is driving the requirement for banks to be more aware of how the funding they offer is being utilised.

On the regulations side, the Zambia Securities and Exchange Commission issued the *(Green Bonds) Guidelines, Gazette Notice No. 26 of 2019* in January 2020 in accordance with the *Securities Act, No. 41 of 2016*. This was done to encourage integrity in the growth of the green bond market in Zambia. The green bond guidelines establish mandatory regulations for green bond labelling.

The green bond guidelines give investors the option to invest capital in projects or commercial ventures that are in line with their ESG goals. While meeting their ESG investment criteria and enhancing their reputation for sustainability, the investor also secures a predictable financial return typical of any bond investment.

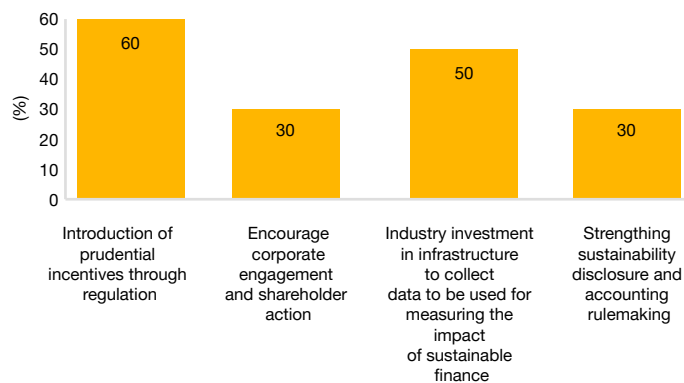
The sustainable development goals, the Paris Agreement, the African Union’s Agenda 2063, and sustainable banking frameworks in their countries of operation are all ways that banks in the region, including South Africa, are committing to ensuring that their strategy is consistent with their mission of promoting sustainable growth in Africa. Managing ESG risks, formalising ESG compliance and sustainability, and establishing a culture of responsible banking throughout the group are ways they are achieving this.

Several banks across the region now offer solutions and products that include green loans, green bonds, sustainability-linked loans, sustainability-linked bonds and the creation of frameworks for sustainable-finance fundraising. They have structured several pioneering, innovative and impactful solutions that have gained international recognition and the support of their clients as well as local and international investors. Their teams have acquired a variety of skills, including knowledge of the identification of ESG risks and opportunities, loan and debt capital markets, and treasury.

Measures to promote sustainable finance in Zambia

We asked the banks what measures they think should be put in place to promote sustainable finance in Zambia. They said the introduction of prudential incentives through regulation and industry investment in infrastructure to collect data for use in measuring the impact of sustainable finance were the most useful measures that could be introduced.

Figure 24: Banks



Through improved management of environmental and social performance, these two measures can:

- Lower financial sector risks.
- Lower costs associated with labelling and releasing green financial instruments.
- Create opportunities for investing in climate-friendly projects.
- Support regulatory and supervision oversight of the financial sector.

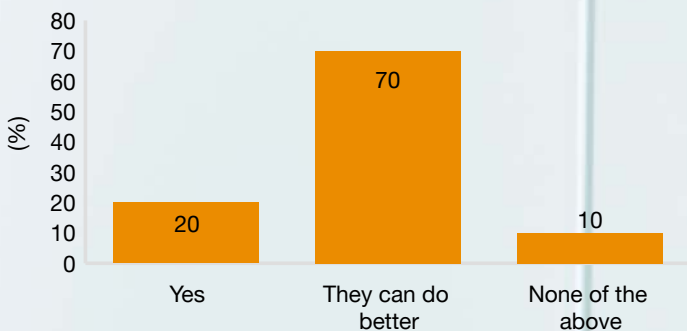
Leveraging internal and external resources to achieve long-term growth and transition will enable compliance and help banks establish a strategic position in a sustainable market environment, which should lead to business growth.

Actions being undertaken by the regulators

Feedback from the respondents indicates that the regulators can do better. This affirms that regulators have a crucial role to play in encouraging ESG investing by establishing a legal framework that ensures firms are held accountable for their impact on the environment and society, and that investors have access to the information they need to make educated investment decisions. Regulators can promote a more sustainable and responsible investing environment by supporting ESG investment, promoting transparency and accountability, and working with industry stakeholders and other organisations. Regulators, investors and businesses must work together if they are to confront the global challenges faced and create a sustainable future.



Figure 25: Do you think the regulators are doing enough to support sustainable finance in Zambia?



Opportunities offered by sustainable finance

Financial institutions have a great opportunity to reposition their business models in line with changing client expectations, economic risks and challenges, as well as more recent ESG and sustainability mandates and standards influenced by society.

At the same time, green finance means re-routing financial resources towards projects and investments that are environmentally sustainable. It is an excellent tool for easing the transition to a low-carbon economy and advancing world objectives.

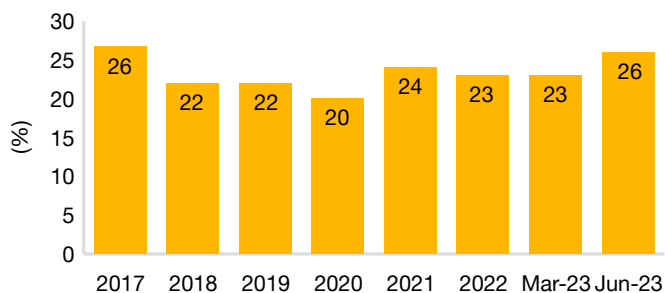
Financial institutions should be encouraged to incorporate the shift towards sustainable finance in their business model so that they meet ESG rules and stakeholders' expectations and show customers that they understand changing market dynamics. This shift will affect the company's culture, data systems, organisational processes and ways of working. This in turn will ensure less impact from regulations, high returns on investments from products and services that are sustainable, help companies attract cheaper finance and capture business from environmentally conscious customers.



11. Financial performance and analysis

11.1 Capital adequacy ratio

Figure 26: Capital Adequacy Ratio

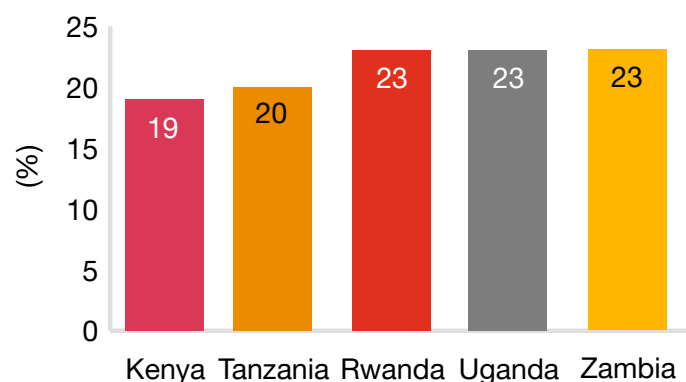


Source: PwC analysis

The capital adequacy ratio (CAR) decreased slightly from 24% in 2021 to 23% in 2022. At the end of the first half of 2023, the CAR maintained at 23%. This was mainly attributed to an increase in aggregate industry profit. The industry’s average CAR of 23% nevertheless exceeds the Bank of Zambia’s minimum requirement of 10%, showing that the sector overall remains well capitalised.

Regional analysis

Figure 27: Capital adequacy ratio for selected African Countries



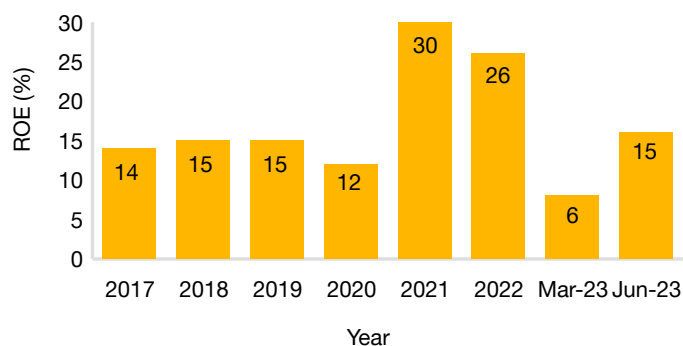
Source: PwC analysis

Note: Due to limitations of data, the CAR for the region has been computed as of 30 June 2022.

The CAR of the Zambian banking sector is the same as Rwanda and Uganda as at 31 December 2022. Zambia’s CAR was higher than the banking sector in Kenya (19%) and Tanzania (20%).

11.2 Return on equity

Figure 28: Return on Equity

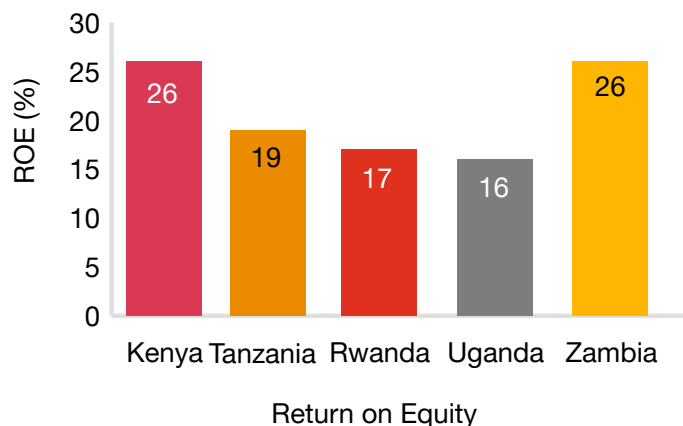


Source: PwC analysis

The return on equity (ROE) shrunk by 4% to 26% in 2022 from 30% in 2021. This was largely driven by increased shareholder equity of the sector in 2022. In 2023, the ROE decreased to 8% at the conclusion of the first quarter in March.

Regional comparison

Figure 29: ROE for selected African Countries

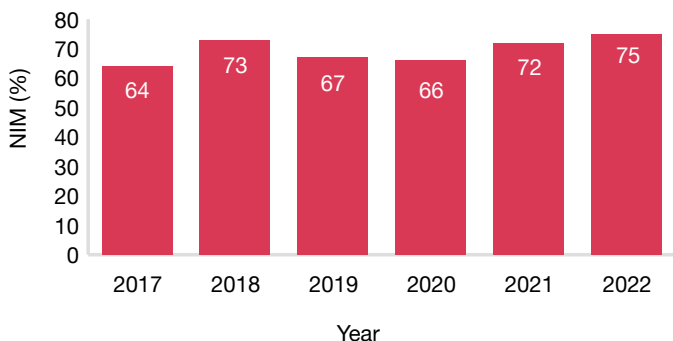


Source: PwC analysis

The Zambian banking industry ranks highest at 25.7% compared with the selected countries. This is attributed to a strong capital position through assumed retained earnings, satisfactory earnings performance and liquidity conditions. Notably improved asset quality is owed to bad loan restructuring and write-offs. Kenya came in a close second at 25.6%. Uganda, at 15.5%, ranked the lowest of the countries chosen for comparison, while Tanzania and Rwanda scored 18.5% and 16.5% respectively.

11.3 Net interest margin

Figure 30: Net Interest Margin

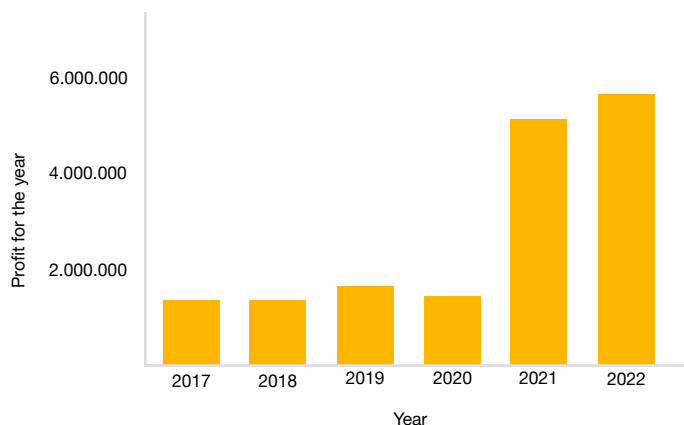


Source: PwC analysis

The industry' net interest margin (NIM) grew from 72% in 2021 to 75% in 2022. The reason for this growth was an increase in interest income due to more investment in government securities. The six biggest banks saw a NIM gain of 1% in 2022 compared to a 3% increase for the remainder of the industry.

11.4 Profitability

Figure 31: Year on Year Profit – Banks



Source: PwC analysis

As noted in the graph above, commercial banks have continued to increase their year-on-year profit as profits increased by 11% from K5.1bn to K5.7bn in 2021. However, compared to prior year, the growth in annual profits has slowed down, perhaps indicating both the maturity and competition in the sector.



11.5 Glossary for financial performance and analysis

i. Capital adequacy ratio (CAR)

$$\text{CAR} = \frac{(\text{Tier 1 capital} - \text{goodwill}) + \text{Tier 2 capital}}{\text{Risk weighted assets}}$$

ii. Return on Equity (RoE)

$$\text{RoE} = \frac{\text{Profit for the year}}{\text{Shareholders equity}}$$

iii. Net interest margin (NIM)

$$\text{NIM} = \frac{\text{Net interest income}}{\text{Interest income}}$$

iv. Non-performing loans ratio (NPLR)

$$\text{NPLR} = \frac{\text{NPLs}}{\text{Gross loans}}$$



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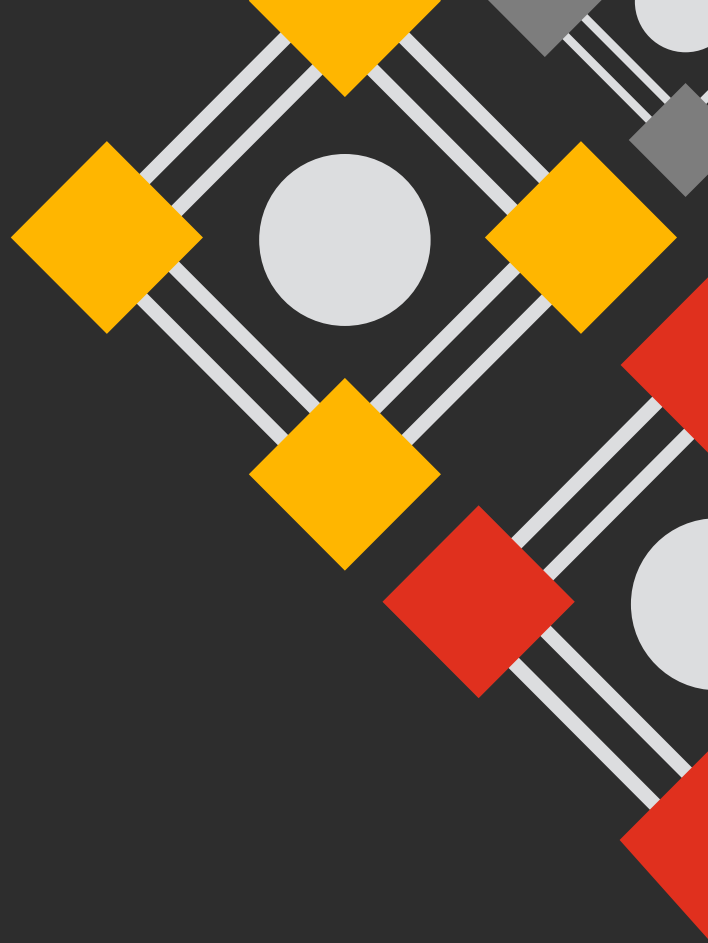


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