The role of non-bank financial intermediation in Lesotho: Challenges and possible remedies

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Abstract

Financial intermediation is the role that is traditionally dominated by the banking sector, with little or no space for the non-banks financial institutions. However, this is not the case in developing countries, either due to topology or relative development of the financial system. The purpose of this study is to evaluate the role and impact of the non-bank financial intermediaries in discharging their roles in Lesotho. These institutions have penetrated the country into the rural mountainous areas, and they offer healthy financial system by invoking competition with the banking sector, while also attending to the gap that is left unattended by the former. As a result, Lesotho ranks high on financial inclusion given that majority of services are offered by the informal and auxiliary establishments in the financial sector. However, the authorities have to consolidate on prudential supervision in order to minimise risk that may result from the aggressive offering from the NBFIs in all its various formations.

Keywords: *Financial Intermediation, Financial Intermediaries, Financial Stability, Microfinance, Savings Investment*

JEL Classification: G21, G22, G23, G24, O16.

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1. INTRODUCTION

Financial intermediation is the process in which funds are channelled from the surplus savers to deficit spenders through market created mechanisms, such as, financial institutions. It is a result of deliberate policy actions that create and mobilise resources to meet every day needs and demands (Sinha, 2001). This is effected through financial intermediaries, which economic theory defines as, financial institution that consolidates deposits and uses the funds to transform them into loans (Siklos, Pierre, 2001). Financial intermediaries bring together the economic agents who want to lend their surplus funds (invest) to those with a shortage of funds to benefit business cycle and facilitate economic development.

It must, however, be underscored that for financial intermediation to be effective, information asymmetry and costliness have to be factored in. As a result, traditional theories of financial intermediation are based on transaction costs and asymmetric information. Franklin Allen (1996) claimed that they are designed to account for institutions which take deposits or issue insurance policies and channel funds to firms. Financial intermediation theory builds on the notion that intermediaries serve to reduce transaction costs and informational asymmetries.

The role of financial institutions in financial intermediation seems to be eroding with developments in information technology, deregulation, deepening of financial markets, etc., which have relegated it since information is now readily available. Traditionally, this role was played effectively and efficiently by the banking sector, whereas the non-bank financial institutions (NBFIs) became relevant in informal settings and rural areas.

The main objective of the study is to evaluate the role and impact of NBFIs in discharging their roles in financial intermediation in Lesotho. Specific objectives are;

i) To determine the role and effectiveness of non-bank financial intermediation in Lesotho;
ii) To determine the challenges faced by the sector, growth and sustenance; and
iii) To identify and or suggest remedies.

The study is confined to the experience of Lesotho with a view to proffer advice on policy issues regarding the role of the sector in lubricating economic activity. The study investigates the NBFIs in their various formations, including the pension funds or contractual savings (assets of

pension funds and life insurance companies) with respect to their impact on national savings or other financial development.

The rest of the paper is organised as follows: after this introduction, section two provides theoretical definition of the non-bank financial intermediaries, including coverage of their operations as well as, the legal provisions in Lesotho. Section three briefly discusses theoretical literature, borrowing from some empirical research. Section four chats diagnostic approach to be employed, while section five presents the results. Section six concludes the paper, while section seven offers some policy recommendations for consideration.

2. NON-BANKS FINANCIAL INTERMEDIARIES – THE DEFINITION

The previous section recognises the banking sector as traditional player in financial intermediation. However, that has since changed with the Non-bank financial intermediaries (NBFIs) claiming a bigger role of key players in economic development in both developing countries and emerging markets. Therefore, this section interrogates definition and categories of the NBFIs, with aid from the existing legislative provisions in order to establish a standard and or common understanding of the sector.

The Monetary and Financial Statistics Manual 2000 of the International Monetary Fund (IMF) defines the non-banks financial companies, or NBFCs, as the financial institutions that provide certain types of banking services, though they do not hold a banking license. These institutions are not allowed to take deposits from the public, which keeps them outside the scope of traditional oversight required under banking regulations. The NBFIs are broadly classified into five groups of institutions, namely:

i) Development Financial Intermediaries - These are mutual investment schemes which pool the small savings of individual investors and enable a bigger investment fund. Therefore, small investors can benefit from being part of a larger investment trust.
ii) Saving Institutions – these are largely member based saving mobilising schemes whose aim is to share the collections on agreed periodicity.

iii) Employees Provident and Pension Funds – these are contributory schemes that distribute savings on retirement to smoothen members' spending and consumption after retirements.
iv) Insurance Companies – this category hedges against any unforeseen risks. Insurance companies spread the risk of default amongst members and over a longer time horizon.
v) Other Financial Intermediaries – this comprises all other players not described above, such as, Credit unions, which are informal types of banks which provide facilities for lending and depositing within a particular community. Financial advisors provide information on all the intricacies of the financial markets and spending time looking for best investment.

These institutions play a vital role in facilitating saving access to the usually non-banked populace, as well as, extending credit. Their services range from leasing, factoring, and venture capital, to various types of contractual savings and institutional investors (pension funds, insurance companies, and mutual funds). The structure of the subsector differs depending on the level of financial development of a country.

Operations of the subsector in Lesotho are governed by the Financial Institutions Act 2012 and insurance Act 1976 as amended in 2014. These are mainly categorised into four groups:

i) Collective Investment Schemes,
ii) Insurance Companies,
iii) Insurance Brokers
iv) Others

The fourth category includes Microfinance institutions, credit bureau and other cooperative societies whose operations are limited to members. The legal provisions governing this sector are;

- Financial Institution Act 2012 - Regulations of 2014.
- Credit Bureau under the Credit Reporting Act 2011 and Credit Reporting Regulations 2013.
- Financial Leasing Under the Financial Institutions (Financial Leasing) Regulations of 2013.

- Money Lenders Amendment Act of 1993

3. LITERATURE REVIEW

3.1 Financial Intermediaries in Macroeconomic Management

Increased availability of financial instruments and institutions greatly reduces transaction and information costs in the economy which in turn influences savings rate, investment decisions and undertaking of technological innovations. The effectiveness of financial intermediation is registered in information asymmetry and reduction in transaction costs. This claim is further supported by Cetorelli et al (2012) who postulated that effectiveness of intermediation is when funding can be successfully matched with demand. This, therefore, places information asymmetry and transaction costs at the centre of financial intermediation for the surplus savings to benefit the deficit spenders.

Financial intermediaries eliminate transaction costs that arise from information asymmetry between borrowers and lenders. It facilitates efficient functioning of markets to ensure delivery of credit to lubricate macroeconomic activities. Therefore, financial intermediation transforms risk characteristics by efficiently allocating resources in the market.

Diamond and Dybvig (1983) recognised that without intermediation all investors would be locked into illiquid long-term investments that yield high payoffs only to those who consume at a later period. This means financial intermediation enhances risk sharing and facilitate welfare creation as it aids continuous consumption at different time intervals based on the need for liquid assets (Friedman, 1954). Financial intermediaries eliminate duplication through provision of information to potential market players at lower cost. They are able to hold long-term, high risk, large-denomination claims issued by borrowers and finance them by issuing short-term, low risk, small-denomination deposit claims.

This enables market players to evaluate prospective borrowers and investment projects to provide information accordingly. As a result, financial intermediaries are able to communicate information to investors about potential borrowers at a lower cost than can individual borrowers,

Leland and Pyle (1977). Thus, both investors and savers are able to make informed decisions at a lower cost than would have been the case if intermediation was not available. This is one way through which markets, and hence, economy benefit directly through financial intermediation.

Financial intermediaries reduce transaction costs by pooling diverse investment avenues to facilitate diversification of portfolios, and ensure positive returns to investors. Allen and Santomero (1998) opined that new markets for financial futures and options are mainly markets for intermediaries rather than individuals or firms. They purported an inverse relationship between intermediation vis-a-vis transaction costs and information asymmetry. They observed a rise in intermediation albeit falling transaction costs. This was further affirmed by Gary and Andrew (2002).

One of the glaring benefits of financial intermediation is the ability to ensure higher returns in order to induce firms to undertake projects with lower probabilities of success but higher payoffs when successfully implemented (Scholtens and Wensveen, 2003). As a result, it reduces the cost of channelling funds between relatively uninformed depositors to uses that are information-intensive and difficult to evaluate. It also facilitates collection of information, project evaluation, while monitoring borrowers' performance and risk sharing in order to moderate friction in the credit markets. As a consequence, a well-functioning and efficient financial system has beneficial impacts on economic growth.

Is the banking sector sufficiently equipped to provide financial intermediation for all economic sectors?

These arguments, therefore, warrant that financial intermediation facilitates economic growth and development. The challenge, however, is to establish whether the banking sector could provide all the financial services needed for growth. Carmichael and Pomerleano (2002) contend that no single financial intermediary can provide all financial services. They argued that such institutions would be extremely inefficient and would, in some areas, face conflicting incentives. The main limitation is that provision of payment services and liquidity constrains the ability of the banking sector to provide other services. They further claimed that the advanced risk-pooling services of insurance companies encounter the debt promises made by banks. This analogy,

therefore, necessitates the role and influence of NBFIs to complement the banking services, and to some extent, offer some competition in order to benefit the end-users.

This argument calls for a closer look at the role of NBFIs in financial intermediation. The study looks at the variety of formations of NBFIs and their specific areas of interest in financial development.

3.2 The Roles of Non-Bank Financial Intermediation

The above discussions point to a growing importance of NBFI in deposit and loan penetration in the disadvantaged settings, such as the rural areas and the unbanked urbanites. The most important function of the non-bank financial intermediaries is to extend financial services to the disadvantaged through transfer of funds from the savers to the investors. For that reason, NBFIs have gained importance due to their ability to meet diverse financial requirements of business enterprises which the banking sector is restrained from servicing (Gupta et al., 2013). They provide medium and long term financing for projects that would otherwise not be covered in the mainstream financial sector due to accompanying higher credit or market risk.

Gupta et al., 2013 established that NBFIs facilitate long term investment and financing, which the banking sector is not able to provide. They widen the range of products available for individuals and institutions with resources to invest. They do not only provide demand side of funds, but alternative sector of financing besides bank financing, meeting the lowest denomination as per preferences of their respective clients. This is further confirmed by Vittas, (1999), adding that the NBFIs complement commercial banks activities and provide the necessary competition to be more efficient and responsive to customers' needs. The paper further argued that the NBFIs provide a stimulus to development of capital markets through generation of large amounts of long-term financial resources which also creates new sources of supply and demand for marketable securities. Furthermore, it is alleged that there is correlation between the size of contractual savings and the development of equity markets. Pension funds and other institutional investors that mobilise large long-term financial resources are mentioned as examples that act as countervailing forces to the dominant position of commercial banks.

The presumption is further affirmed by Snurazani (2013) who reported that saving mobilisation through compulsory pension funds scheme may have positive impact on economic growth through increasing national savings. Conceptually, high savings rates typically go hand in hand with high and persistent investment rates which is widely acknowledged as one of the key engines for driving sustained economic growth. The findings further implied that institutional investors (both at the aggregated and disaggregated levels) have significant causal impact on economic growth.

According to the Malaysian experience, the NBFIs contributed to improvement in the per capita real GDP through increased investment (Snurazani, 2013). The development of NBFIs promoted economic growth through providing long term financing to the productive investment activities where the financing activities of the conventional banking system were limited. They also promoted development of small and medium-sized industries which were previously disadvantaged to meet their financial needs from entering into the stock market and also from the commercial banking system.

On insurance industry, Vittas (1997) asserts that income and wealth, macrofinancial stability, and the regulatory framework are the main determinants of insurance business as they are of contractual savings. The study points out that the main line of insurance business is compulsory motor insurance, which is often subjected to regulation and low premiums. The study however, confirms that development of life insurance is affected by existence of credible social security systems, and or the offer of well-funded company pensions based on defined benefit plans. The study also notes that weak and unreliable security of social pensions benefits life insurance business, as workers would seek alternative means for security to meet their old age needs.

It can therefore, be concluded that NBFIs play the following functions:

- Provision of funds to small businesses for which it is difficult to sell stocks and bonds because of high transaction costs;
- Benefits the small savers by pooling their funds and diversifying their investments;
- Reduction of risk through portfolio diversification;
- Employment of efficient and professional managers.

As a result, NBFIs play an important role in promoting savings in any economy. They provide stores of value for savings through a wide range of financial assets, and enable savings mobilisation through expert advice from the financial advisors.

3.3 The Importance of NBFIs in monetary policy operations

As stipulated by Baker (2016), activities of the NBFIs increase effectiveness of monetary policy. This is in contrast to the apparent stringent regulatory conditions and requirements in banks' operations, which do not make it easy for some segments of society to access financial services. As a result, the NBFIs have increased the transmission of monetary policy to the real economy.

Ndele (1991) investigated the effects of NBFI's on the conduct of monetary policy in Kenya. The findings revealed that NBFIs offered healthy competition to the commercial banks in mobilising saving and also in provision of both medium-term and long-term credit. This revelation enhances predictability of anticipated responses to monetary policy actions, which enables Central Banks to effectively select and employ appropriate policy instruments.

Green et al., (2012) observed that the effects of a rise in the official interest rates, lead to higher incomes in Kenya. They noted that interest rate liberalisation increases supply of bank deposits and reduce the demand for bank loans, thus reducing credit rationing. This is because higher interest rates attract funds from other sectors of the economy, including the informal sector, and as a result, increases availability of credit, and thus, investable funds available for economic growth.

Do NBFIs respond to macroprudential regulation?

Moe (2014) asserts that reforming the non-bank financial sector has been high on the policy agenda for some time. This was on realisation of the mismatch between the long-term credit extension and short-term funding, following the 2001 financial crisis. The study observed that a sharp growth in shadow banking activities coupled with a shift from unsecured to secured credit created pressure on high quality liquid assets and central bank liquidity facilities. Accordingly,

central banks broadened their liquidity support to non-deposit-taking institutions and intervene directly in a broad range of asset markets related to shadow banking activities.

This also compliments supervision role as evidenced in Ghana (World Bank report, 2002). Some empirical evidence suggests presence of a positive relationship between minimum capital adequacy requirement and profitability. This revelation indicates that asking NBFIs to keep higher minimum capital adequacy ratio is likely to result in improving their profitability. This implies that capital regulation is an effective tool in enhancing the stability and profitability of the financial services sector. In addition, the paper found a positive relationship between regulatory pressure in terms of restrictions on deposits and NBFI profitability. This is because clients treat their deposits in NBFIs as part of their wealth.

However, Mayes (2014) advises that prudential regulation should be employed at all times for better alignment of incentives to ensure good governance and compliance. Otherwise, the consequences of failure to execute prudential regulations are a complete collapse of the sector, with dire consequences.

4. ANALYTICAL APPROACH

4.1 Market Performance

This paper investigates the role of NBFIs in Lesotho, the scope and significance in the economy. It looks at the share of the NBFIs in financial intermediation, with emphasis on their reach and coverage. The study explores the relevant legislation supporting development and operations of the NBFIs.

The theory suggests that the Non-bank financial institutions play a vital role mobilising savings for the society that is often excluded from the banking stream. Some of the establishments are often owned and managed by the cooperative members, which makes information asymmetry and uncertainty irrelevant.

The NBFIs, both in the formal and informal category provide credit to lubricate economy, though the amounts are relatively less than that obtainable from the banking sector and often limited to members who have to borrow for growth and sustenance of the organisations. The default rate is almost eliminated for members realise returns through collectively participating in generating and managing the returns.

4.2 The Structure of the NBFIs in Lesotho

The NBFIs are largely categorised into two main groupings, namely: depository and contractual intermediaries as already indicated. They play a variety of role to lubricate the economy and respond to policy initiatives. For instance, the Contractual Intermediaries can influence the interest of the financial sector following pronouncement of policy rate by the Monetary Policy Committee. Depository Intermediaries can also moderate both the lending rates and deposits rate as they attempt to lure more members to join them.

These arguments are usually clarified by construction of the flow of funds accounts, which are used to analyse the “use and source of funds” in order to explicitly determine the significance and importance of the NBFIs in the economy through funds mobilisation. The flow of funds accounts list the sources of all funds received and the uses to which they are put within the economy. All changes in assets are recorded as uses and all changes in liabilities are recorded as sources.

5. RESULTS PRESENTATON: MARKET PERFORMANCE

5.1 Sectoral Performance Analysis

This part of analysis largely benefited from the report of the financial inclusion environment, "Making Access Possible (MAP) Lesotho initiative" that was conducted by FinMark Trust[2] in 2014. The report provided an in-depth analysis on the financial structure, financial products and market coverage.

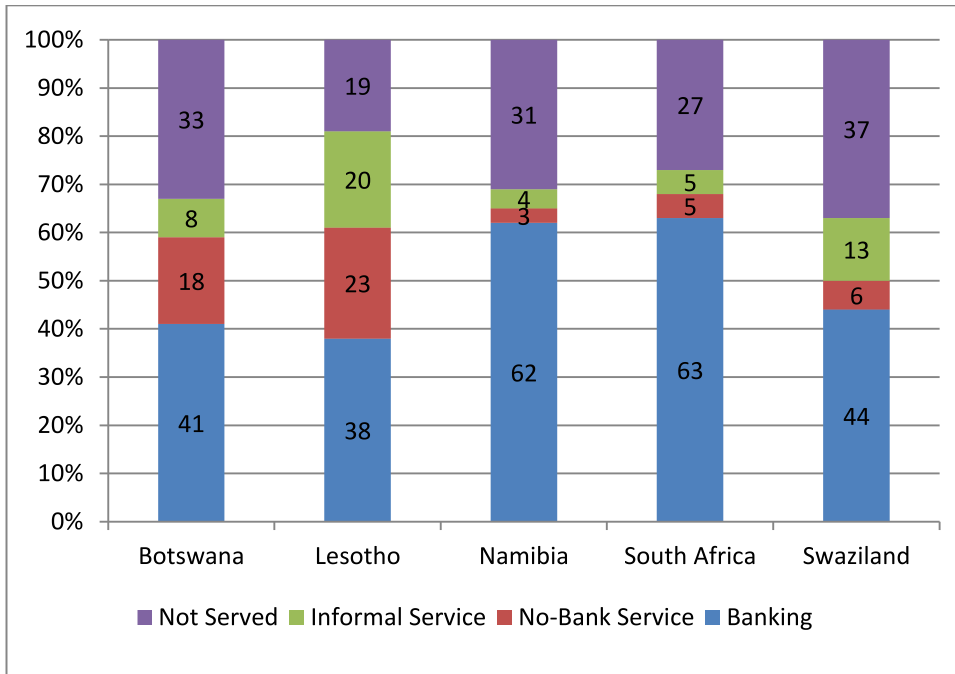
As described in the previous sections, NBFIs provide a variety of financial services to different segments of society. This is particularly true in Lesotho, with high financial inclusion, largely due to coverage and operation of the informal sector as depicted in figure 1. The FinMark report showed that 20 per cent of those receiving financial services largely benefited from the informal sector. The report further discovered that 62.4 per cent of the adult population used informal financial mechanisms, such as informal savings, insurance and credit extension.

According to the results of the 2011 FinScope survey, 81 per cent of Basotho adults were financially included. This means that Lesotho had the highest level of financial inclusion of any of the African countries where FinScope surveys were conducted. This high level of inclusion was driven by very high usage of insurance, primarily funeral insurance (formal as well as informal), which covered 62 per cent of adults, with a further 23 per cent having another form of formal financial service.

As a result, Lesotho had the lowest financial exclusion at 19.1 per cent of adult Basotho at the end of 2016. This figure compares with 27 per cent for South Africa, 31 per cent Namibia, and 33 per cent for Botswana. Other African countries registered exclusion figure of more than 75 per cent. However, the report shows that Lesotho ranks the lowest amongst SACU member state on access to the banking services at 38 per cent.

[2] FinMark Trust (www.finmark.org.za) is an independent non-profit trust whose purpose is 'Making financial markets work for the poor by promoting financial inclusion and regional financial integration'. The trust was established in March 2002 with funding from the UK's Department for International Development (DFID).

Figure 1: Percentage Distribution of Financial Service in SACU Member States



Source: FinScope 2011

According to figure 1 above, the NBFIs play important role to facilitate flow of funds to lubricate the economy in Lesotho. This is confirmed by more than 40 per cent of financial services that are sourced from the sector (Non-bank services plus informal service). The next section will analyse the products offered by the sector in order to determine the significance of the NBFIs relative to the banking sector.

Like many other developing countries, commercial banks mainly operate in urban areas. This means people in rural areas do not get full financial services enjoyed by their urban counterparts. Consequently, the NBFIs provide services that the commercial banks do not offer, especially the informal arrangements. This service is not exclusive to the rural areas, but includes those marginalised, either due to their financial status or historical background and preferences. To aid analysis, the study presents results by product ranges as follows;

a) Savings

Saving is one segment of financial service that is mainly popular with the banking sector and available in urban areas to those with regular incomes. As a result, significant number of Basotho do not get this service, and those who do, are subjected to negative return due to the monopolistic nature of the sector. This is confirmed by the FinMark report which observed that the total informal deposit loan book stood at M400 millions in 2012/13. This constituted about **15 per cent** of total household financial savings in banks.

MFIs and Collective Saving Schemes

The savings mobilised through the banking sector are complemented by those mobilised through the Microfinance institutions and collective saving schemes to financial needs. These institutions are authorised to receive deposits from their members. It must be noted that Lesotho has developed a culture of collective institutions such as burial societies and savings clubs, which comprise NGOs, Savings and Credit Cooperatives, Village Savings and Loan Associations, Rural Savings and Credit Groups. These institutions do not only provide financial services, but also social and emotional support to build resilience to day-to-day economic challenges to their members.

Pension and Provident Funds

Pension fund is relatively underdeveloped compared to what obtains in other countries in the region. The formal initiative was established in 2008 largely targeting public servants. This was estimated to cover about 35,000 members, and its assets were estimated at M2.5 billons in 2013. FinMark survey revealed that about 35 per cent of employees in the formal sector were covered in pension funds. This figure excludes those whose policies are held with South African based NBFIs, which has, to some extent, affected potential development of pension and provident funds market in Lesotho.

The NBFIs continue to be relevant for the general populace, as per the extend of service coverage compared with the banking sector, and the number of users of their services. Table 1 shows that operations of NBFIs reached roughly 400 thousand clients, with the informal groups

serving more than 300 thousand of the total. The informal groups largely comprises collective savings schemes based in communities to mobilise collective savings.

Table 1: Holding of Savings by Provider

Types of Institution	Approximate no. of customers
Banking Sector	368,000
Pension Fund	45,000
Savings and Credit Cooperatives*	41,000
Informal Groups	304,500
Others	3,234

*This represents one such establishment
Source: CBL Various Reports and own calculations

Development of Stock Market

The introduction of the Lesotho Unit Trust[3] in 2001 was an attempt by Government to facilitate participation of Basotho in acquiring shares from Government parastatals during privatisation. African Alliance entered the foray in 2008, with the aim of providing access to the CMA wholesale money markets, regional listed equities and bond markets.

Lesotho has recently established Maseru Securities Market to mobilise capital necessary for development of the private sector. This is to curb the outflow of capital, and perhaps attract some from CMA in order to affect policy initiatives, and to grow the value of shares held with local assets management establishments.

b) Credit

Credit is the other segment of financial service that lubricates economy for development. This is one function that is widely provided by a variety of players, it being formal or informal. The banking sector has not fully provided this service to the productive sector of the economy. FimMark (2014) estimated that only 16.6 per cent of adults got credit from the formal sector, with a meagre 3.8 per cent served by the commercial banks in 2013. It has largely benefited

[3] This had assets in excess of M1.7 billion in 2013.

consumption for clients with regular income in the form of monthly salaries that are used as collateral. As a result, business aspirants have largely depended on own means of mobilising resources to meet their financial needs. This is seen in development of different types of financial groupings to facilitate resourcing the productive sector.

The trend is, however, improving perhaps supported by the on-going reforms such as the amended Land Act of 2010 which provides for land as collateral, as well as, married persons equality, which enables married women access to credit without spousal consent.

Credit Cooperatives

Government has supported formation of Savings and Credit Cooperatives, Rural Savings and Credit Groups to address the gap that was left by the formal financial institutions since liquidation of both Agricultural and Lesotho Development Banks. This is in addition to cooperatives that are initiated by private individuals. There are other forms of such, where members contributed agreed minimum deposit to finance one another rotationally[4]

Microfinance Institutions

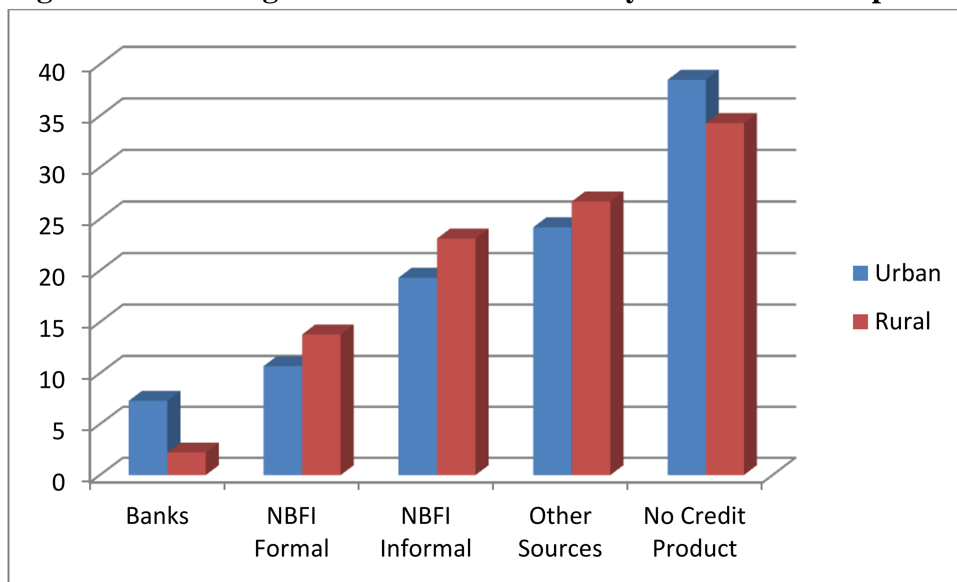
Credit extension in the non-banked and the informal sector largely benefits from Credit-only Microfinance Institutions. As at end of December 2015, CBL had registered seven (7) Credit-only MFIs and non-deposit taking MFIs, with total assets of M550.0 million. The sector primarily served people with regular income, offering personal loans of up to M250,000.00.

Money Lenders

As already indicated, there is significant number of Money Lenders in Lesotho. At the end of 2015, Central Bank renewed eighty six (86) licenses and issued forty one (41) new applications. This sector plays a very important role in financial inclusion, since they serve the unbanked individuals, as well as, the Small, Medium, and Micro Enterprises (SMMEs).

[4] This rotational collection and distribution of contribution is called “mochaellano” in local language.

Figure 2: Percentage Distribution of Credit by Source and Recipient



Source: FinScope 2011

c) Money Transfer

Money Transfer institutions provide a formal and critical conduit through which payments are made and remittances are transferred for households and business purposes in a safe manner. There are five players in the sector, categorised by;

a) Two traditional over-the-counter companies;
b) The Employment Bureau of Africa (TEBA); and
c) The innovative approach operated by the mobile operators.

TEBA services, whose membership has been decreasing in recent times, was mainly a channel for payment of deferred payments for migrant mineworkers. This used to form part of bank deposits with Lesotho Bank, and later Standard Lesotho Bank until government dissolved the arrangement.

As depicted in Table 2, mobile money continues to grow exponential, serving about half a million customers. This enables customers to pay for services and transfer funds. The service has

further seen enhancement with introduction of cross border transfers in collaboration with some retail outlets both in Lesotho and South Africa.

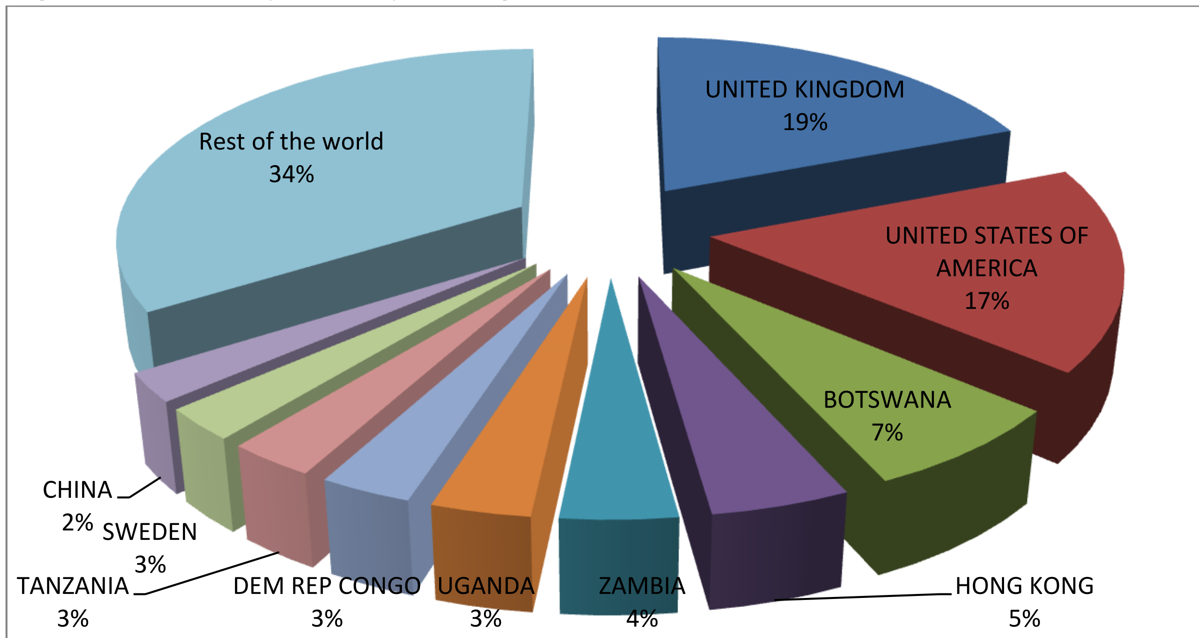
Table 2: Money Transfer by volumes

Types of Institution	Approximate no. of customers
TEBA	22,000*
Mobile Money	500,000

*This continues to play important role for migrant mineworkers who receive their deferred pay funds through the facility.
Source: CBL Reports

Foreign money transfers in and out of the country continue to grow, signifying the importance of remittances channels in the country. Inflows by country of origin, excluding South Africa, were dominated by the United Kingdom with 19 per cent, United States of America with 17 per cent and Botswana with 7 per cent, while outflows were dominated by Asian and other African countries, as per figure 3 below as at December 2015.

Figure 3: Inflows by Country of Origin



Source: CBL

d) Insurance

FinScope estimated that 62 per cent of the adult population had some form of insurance coverage as at end of 2011. Like the other segments of financial services, usage of insurance was recorded to be significantly higher in urban areas, where formal penetration was 48.1 per cent as compared to the 31.8 per cent in rural areas. Conversely, informal-only usage was much higher in the rural areas at 30 per cent compared with 11.4 per cent in urban areas. The seemingly, skewed preference of informal usage in rural areas was driven by funeral coverage (burial societies) also explained by the trend highlighted in the previous discussions where community mobilisation was geared towards emotional support in addition to attending to financial needs.

Analysis by product type also reveals that long-term (life) insurance dominated the segment in terms of premium payment. This comprised corporate and retail business, where corporate life business focused on employee benefits such as pension and provident funds, and funeral cover to the workforce. The retail business, which consists of fire accidents, health, property and transportation, were recorded at 50 per cent in 2011.

Table 3 below presents the market size from the supply side. As at end of December 2015, there were 42 service providers, six companies providing short-term insurance, six companies in the long-term, although dominated by one company with a market share of more than 70 per cent. This was served by 30 insurance brokers, in addition to financial advisors employed by some insurance companies.

Table 3: Insurance Market in Lesotho

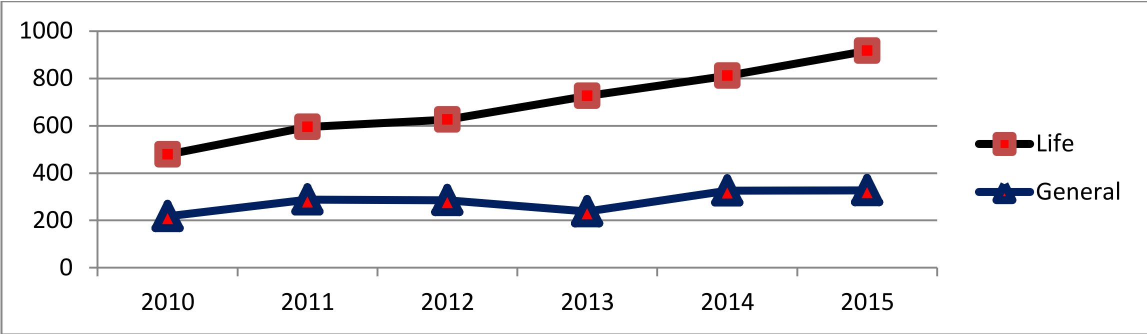
Insurer	Number
Short-term	6
Long-term	6
Insurance Brokers	30

Source: CBL

Figure 4 below presents growth of premium over a six year period from the year 2010. It can be observed that the long-term insurance has maintained an upward trajectory in line with the earlier claim that this is the profitable and lucrative insurance option. This compares with the short-term insurance coverage, which rose by a lower margin over the same period. Generally, insurance

business enjoyed positive growth as measured by the claim ratio ranging between 47 per cent and 60 per cent over a period 2009 to 2015, which is regarded as good client value by international standards. Short-term insurance penetration, as measured by ratio of gross premium to GDP stood at 1.5 per cent as at December 2016, compared with 4 per cent for the long-term.

Figure 4: Insurance Premium by Type



Source: CBL Reports

5.2 Financial Stability

Financial intermediation is often accompanied by some challenges, it being in the form of legal provisions or development in the sector, for all to realise the common purpose. This involves risks associated with financial transactions, predictability and uncertainty of the sector, and security of the investments. All these are catered for through a sound financial stability.

Thus, financial stability to ensure soundness is the necessary condition for intermediaries to function properly. This is a condition in which an economy's mechanisms for pricing, allocation, and managing financial risks (credit, liquidity, counterparty, market etc.) are functioning well to contribute to the performance of the economy (Schinasi, 2004). Financial stability is said to embrace the concept of a continuum since it encompasses a subset of all impediments that may impede smooth functioning of the economy such as savings and investments, lending and borrowing, liquidity creation and distribution, asset pricing and wealth accumulation and growth. Therefore, financial stability can be summarised as ability of the financial system to mediate

financing, through provision of payment mechanisms and redistribution of risks without giving in to disturbances in the economy.

This is one major challenge in overseeing operations of the NBFIs in Lesotho as there is dual regulation of the sector which is coupled with out-dated legal provisions that needs to be resolved as a matter of urgency if the country is to enjoy the full potential of intermediation. The current legislations do not provide for operation of the subsector in the current environment, and poses some systemic risk that may emanate from operation of one of the subsectors. Clarity on the roles of Central Bank and that of government Ministries make it difficult to apply the Financial Institutions Act as amended in 2012, despite having clear and appropriate regulatory provisions.

5.3 The Challenges

This section enumerates challenges which range from the market size, the landscape and proximity to the big economy with well-developed financial superstructures, as well as, financial literacy. Of course it is worth noting that Government has taken responsibility to level the play field for this to be attractive in order to ensure financial inclusion.

(a) Credit-only and no deposit-taking MFIs play a critical role in financing developments in Lesotho. This is reflected by their total assets, as well as the profits margin. However, it becomes difficult to capture their financial activity in the flow of funds accounts as they are mostly owner financed, with the funding sourced from within CMA due to the arrangement on capital mobility. As a result, this leaves a discrepancy which is not easy to interpret. Likewise, supervision and regulation is another challenge that makes it difficult. The law mandates the Department of Cooperatives to oversee operations of this subsector, leaving the financial regulator handicapped, despite their core business being financial. Disbursements of credit to beneficiaries are often processed from companies' headquarters direct into beneficiaries' bank accounts. This distorts full representation in the Monetary and Financial Statistics coverage because it offers incomplete balance sheets due to the free capital movement within CMA. This was first observed when the

deferred pay funds, that used to be centralised with the former Lesotho Bank through TEBA, were transferred into personal accounts.

(b) Even though the insurance subsector may seem to be challenge free, there are some challenges that either derails it from fully developing in order to operate at full potential. The short-term insurance is mainly dominated by motor vehicle and property (housing) insurance coverage, which are conditional to accessing finances, thereby operating below capacity. However, the subsector has made footprints on long-term insurance. This has largely benefited from funeral schemes that include savings plans, in addition to life insurance, which gained dominance in recent times, as per insurance supervision reports. Nonetheless, this continues to face stiff competition from the relatively well established industry in South Africa.

(c) Provident and pension funds remain underdeveloped in Lesotho. This is despite government initiatives to facilitate development of the sector, with enactment of supporting legislation. Securities market has been operational for some time now, but there is little or no market acceptance. This may be due to the relative low level of financial market development in the country. Investors hold on to their securities until maturity, thereby, hampering secondary market operations. Moreover, majority of companies operating in Lesotho are subsidiaries of regional companies headquartered in South Africa. So it is easy for them to mobilise funding through the parent companies across the border.

6. CONCLUSIONS

The analysis validates that the NBFIs play an important role in financial intermediation to benefit economic development. Indeed, the NBFIs play roles that are otherwise, excluded or not fully offered by the banking sector. These include;

i) Broaden the spectrum of risks available to investors through, amongst others;
   - injecting liquidity

- putting in place mechanisms for information dissemination, and
- risk-pooling services.

ii) They encourage investment and savings, particularly for the unbanked rural communities and previously disadvantaged urbanites, and as a result, facilitate financial inclusion;

Therefore, NBFIs provide competition for banks in the provision of financial services, and further unbundle the services to provide components on a competitive basis for lower segments of the markets. They mobilise savings from the communities which were, otherwise not served by the banking sector and avail credit to the productive sector. As a result, they inject the necessary liquidity into the system. The credit-only institutions is the other segment that provides finances to the productive sector of the economy, thereby, lubricating economic activities, and in the process contribute to healthy financial fluidity. Consequently, they add to economic strength by enhancing resilience of the financial systems to economic shocks.

This is confirmed by Carmichael and Pmerleano (2002), who argue that a well-developed and properly regulated NBFI sector adds to a broad, balanced, efficient financial system that spreads risks and provides a sound base for economic growth and prosperity. By extension, this also opens up channels through which economic policy actions are transmitted. Their services are also tailor-made for specific sectoral needs, something that give them advantages arising from specialisation.

7. POLICY RECOMMENDATIONS

The study has reaffirmed the importance of the non-bank financial intermediaries in facilitating economic activities in Lesotho. This is despite operating under some legislative bottlenecks that suffocates their potential role for development of the local productive sector. It is, therefore, important to address those challenges through amendment of relevant legal provisions in order to level the play field.

The Financial Institutions Act of 2012, as the mother legal framework, should be amended to provide for financial innovations that are consistent with international developments. That will include, but not limited to:

- Transactions in mobile money, whether transfers to the third party or actual settlement of transactions, have grown exponentially since its introduction a few years back. This is one area that has to be addressed as a matter of urgency to improve on the current operational arrangement.
- The Real Estate Price Index is another initiative that could facilitate proper price and predictability of property pricing in Lesotho. This could benefit leasing and general access to financing by the deficit spenders, and thus fuel economic growth. It can also benefit the Land Administration Authority and Municipalities in terms of benchmarking.
- These advances should be supported with enactment and or amendment of the following legal provisions to fully hedge against any unforeseen risks, while also facilitating development of their respective markets, including secondary market which can spur operations of Maseru Securities Market:
  i) Insurance Act of 1976 as amended
  ii) Money Lenders Act
  iii) Money Transfer Regulations
  iv) Construction of the real estate price index.

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