National Bank of Malawi

Basel II Pillar III (Market Disclosure) Report

For 2016

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1. OVERVIEW

1.1. Report Scope

This report is in compliance with Pillar III Disclosures under Basel II which complements the minimum capital requirements and the supervisory review process. It discloses the scope of application of Basel II, capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of National Bank of Malawi. Disclosures consist of both quantitative and qualitative information and are provided at the consolidated level. National Bank of Malawi hereby submits this report in line with Guidelines on Market Disclosures under Basel II Pillar III issued by the Reserve Bank of Malawi.

1.2. Risk Governance

In line with the corporate governance structure adopted by National Bank of Malawi, the Board has the ultimate responsibility of ensuring that risks are adequately identified, measured, monitored and managed.

The Board is committed to good corporate governance which it achieves by following principles of openness, integrity and accountability as set out in the Malawi Corporate Governance Code, The Cadbury Report and the King Reports. The Board monitors compliance with policies and achievement of objectives by holding management accountable for its activities through quarterly Board meetings at which performance is reported.

1.3. Risk Management Oversight

The Bank's approach to risk management is based on a well-established governance process and relies both on individual responsibility and collective oversight, supported by comprehensive reporting. This approach balances stringent corporate oversight with independent risk management structures within the business units. Below is the governance structure of the bank;

The Board has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board develops the risk appetite and risk tolerance limits appropriate to the Bank's strategy and requires that management maintains an appropriate system of internal controls to ensure that these risks are managed within the agreed parameters. The Board delegates risk related responsibilities to five Board committees namely; the Risk Committee, the Credit Committee, the Audit Committee, the Appointments, Remuneration and Governance Committee, and the Related Parties Committee. The Board Committees comprise of a non-executive membership only and they report regularly to the Board on their activities.

The Board Risk Committee has responsibility for the risk management in the Bank as delegated by the Board. Its main responsibility is to have the overall oversight in the credit, market, liquidity and operational risks management as well as any other risks that the Bank may be exposed to in its course of business. It is also responsible for reviewing management performance in implementing the Bank's strategic plan and ensures that the Bank's activities are consistent with the policies agreed by the Bank's Board and Directives of the RBM and other regulatory requirements.

The Board Audit Committee is responsible for conducting an independent check to ensure compliance with the Bank's risk management policies, procedures and controls, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank.

The Board Credit Committee is responsible for oversight of the Bank's overall credit risk management issues. The committee is responsible for reviewing and approving the Bank's credit policies including provisioning, large loan exposures, counter-party lending and dealing lines.

The Appointments, Remuneration and Governance Committee is responsible for nominations and vetting of director appointments, good governance practices, ensuring that the Bank has a robust succession plan, that the Bank's human resources are best utilized, and that members of staff are remunerated commensurately with their responsibilities and effectiveness.

The Related Party Committee is responsible for overseeing the implementation of the transactions with related parties by all entities falling under the control of the Bank's Board.

The Enterprise Risk Committee (ERCO) is at management level which provides a holistic oversight of the risks affecting the Bank and the control measures that should be put in place to mitigate the risks and thereby reduce the potential losses.

The Bank ensures that capital is sufficient to cater for set risk appetite limits. The Bank's Risk Division in liaison with Finance Division generates the reports on capital. Capital oversight is provided by the Asset Liability Committee (ALCO) and Enterprise Risk Committee where capital results and capital risk respectively are discussed. The capital risk report is eventually discussed by the Board Risk Committee.

In addition, the other management Committees such as the ALCO, Credit Management Committee and IT Policy Committee, are all responsible for developing and monitoring the Bank's risk management policies in their specified areas.

2. BACKGROUND

National Bank of Malawi was established on 1st July 1971 through an amalgamation of the interests of the Standard Chartered Bank and Barclays Bank DCO. The Bank was listed on the Malawi Stock Exchange on 21st August 2000 with a total of 450,000,000 issued ordinary shares of K1 each.

1. Shareholding structure

The authorized share capital of the Bank is K500m (2015: K500m) divided into 500,000,000 Ordinary Shares of K1 each. The issued capital is K467m (2015: K467m) divided into 466,931,738 (2015: 466,931,738) fully paid Ordinary Shares of K1 each.

The shareholding structure as at 31st December, 2016 was as follows:

Press Corporation Limited	51.5%	51.5%
Old Mutual Group	25.1%	25.1%
Members of the public	23%	21.6%

Employees (ESOS)	0.4%	1.8%
	100%	100%

2. Subsidiaries, associates and Service Centres

National Bank of Malawi provides retail, corporate and investment banking as well as stock broking, insurance and pension administration services in Malawi. It has a network of 31 Service Centres in Malawi.

The subsidiary companies of the Bank are shown below:

Subsidiaries of National Bank of Malawi	Percentage of control	Nature of operations
NBM Capital Markets Limited	100% (2015: 100%)	Investments and fund management
NBM Securities Limited	100% (2015:100%)	Dormant
NBM Nominees Limited	100% (2015:100%)	Holding of investments as nominee
Stockbrokers Malawi Limited	75% (2015:75%)	Registered stockbroker
NBM Bureau de Change Limited	100% (2015:100%)	Dormant
NBM Pension Administration Limited	100% (2015: 100%)	Pension administration
Indebank Limited	100% (2015: 97.05%)	Commercial banking(up to 30 April2016)

3. Performance and Financial Position

The Bank registered a decline in profit before tax of 5.3% (K19.6 billion against K20.67 billion (2015).A summary of the Bank's financial performance between 2015 and 2016 was as follows:-

- Total assets increased by 23.88% from K253.87 billion to K314.49 billion. This has been attributed to an increase in the following: fixed assets, loans and advances to customers, other assets and interest bearing securities.

- Total capital increased by 26.93% from K53.20 billion to K67.53 billion due to an increase in retained earnings and revaluation reserves.

- Total risk weighted assets increased by 23.55% from K205.84 billion to K254.30 billion. This increase was a result of a 34.53% increase in the credit risk component.

- The capital adequacy ratio increased significantly from 15.16% to 18.57%.

- Net profit before tax increased significantly by 27.8% from K19.63 billion to K25.08 billion. This was mostly due to an increase in income from lending activities which grew by 45.8%.

- Operating expenses increased by 46.6% from K21.11 billion to K30.95 billion

- Impairment charges decreased by 44.36% from K2.85 billion to K1.58 billion. A total of K1.35 billion was recovered on impaired loans in 2015 compared to K925 million recovered in 2016.

3. CAPITAL MANAGEMENT

The Bank’s capital management strategy is designed to ensure that regulatory capital requirements are met at all times, and that the Bank and its principal subsidiaries are capitalised in line with the group’s risk appetite and target ratios, both of which are approved by the board.

1. Approach to Capital Management

The Bank’s Capital Management Policy (CMP) provides the processes for defining, measuring, raising and investing all types of capital in the Bank. The policy aims at optimizing the Bank’s capital usage and to fulfil the requirements of the business and maintain an efficient capital structure with limited excesses. Capital adequacy is actively managed and forms a key component of the Bank’s budget and forecasting process. The capital plan is tested under a range of stress scenarios as part of the Bank’s annual internal capital adequacy assessment process (ICAAP) and recovery plan.

3.1.1. Governance

The Board of Directors is responsible for the ultimate oversight of capital management, including the annual review and approval of the Bank’s Capital Plan and ICAAP.

The Board discharges its roles through the Board Risk Committee which is responsible for the governance of capital management, which includes: approval of capital management policies, regular review of the Bank’s capital position and management processes, approval of ICAAP, as well as ongoing review of internal controls over capital adequacy, and approval of the Bank’s risk appetite/tolerance; and the Bank’s optimal capital mix.

At Senior Management level, the Bank has also the Asset and Liability Committee (ALCO) which has the primary management oversight responsibility for capital management and regularly reports in detail on compliance with established limits and guidelines. ALCO oversees the risks associated with capital management whose principal governance documents are the Capital Management Policy, Liquidity and Funding Management Policy and the Market Risk Framework.

3.1.2. Regulatory update

The Reserve Bank of Malawi introduced Basel II on 1 January 2014 to all Malawian Banks. The intention was to align bank’s business risk as reflected in both the banking book and the trading book to its required minimum capitalisation. This was as a result of notable shortfalls in granularity in Basel I hence the need to ensure that banks are adequately capitalised.

The Bank was fully compliant to Basel II as at 1 January 2014.The Bank is computing the individual risks under each category using the following approaches:

- Operational Risk – Basic Indicator Approach (BIA)
- Credit Risk – Standardized Approach (SA)
- Market Risk – Standardized Approach (SA)

The Bank is fully committed to develop its operational risk measurement tools through enhancement of Loss Data Collection which will be vital in graduating to Advanced Measurement Approaches by 2018.

The Bank continues to assess the Basel II approaches and their impact on its capital position to arrive at an appropriately calibrated total level of risk-weighted assets, qualifying capital and leverage ratio, and factor them into its strategic business plans. In the year under review, the Group capital ratios were all above the prescribed minimum requirements under Basel II for the Reserve Bank of Malawi of 10% and 15% for tier I and tier II ratios, respectively. Further, the ratios are above the 2016 set risk appetite for the Group for capital ratios of the range of 10% to 15% for tier I and 15% to 17.5 % for tier II.

3.1.3. Regulatory capital

The Bank manages its capital levels to support business growth, maintain depositor and creditor confidence, create value for shareholders and ensure regulatory compliance. The main regulatory requirements to be complied with are those specified in the Financial Services Act 26 of 2010, The Reserve Bank of Malawi Directive on Capital Adequacy and related regulations, which are aligned with Basel II.

Regulatory capital adequacy is measured through the following two risk-based ratios:

- **Tier 1 (core capital) ratio**: the sum of share capital, paid-up, share premium, retained profits (prior years), 60% of after tax profit (current year-to-date) and in case of a loss, 100% and Other eligible core capital (Tier 1) capital elements as prescribed by the Registrar, less: investment in unconsolidated financial institutions.

- **Tier II (supplementary capital) ratio**: the sum of revaluation reserves, subordinated debt; and the general provisions, which have received prior approval of the Registrar.

Below is the Bank's capital position for 2016 as compared to 2015;

	2016	**2015**
	K'm	**K'm**
Tier 1 capital		
Share capital	467	467
Share Premium	613	613
Retained earnings	43,612	33,707
50% Investment in unconsolidated investments	(3,641)	(3,591)
Tier 1 Capital	**41,051**	**31,196**
Asset Revaluation reserve & General Loss Reserve	9,356	13,195
50% Investment in unconsolidated investments	(3,641)	(3,591)
Tier II Capital	**46,766**	**40,800**

- Tier I capital increased by 32% thus from K31.2 billion to 41.1 billion.
- Tier II capital increased by 15% thus from K40.8 billion to K46.8 billion.

3.1.4. Risk weighted capital

Risk Weighted Assets are a measure of the amount of bank assets, adjusted for risk.

	2016 K'm	2015 K'm
Tier I capital	41,051	31,196
Tier II capital	46,766	40,717
Credit Risk	212,706	158,109
Operational Risk	38,549	42,582
Market Risk	3,048	5,145
Total Risk Weighted Assets	**254,303**	**205,837**
Minimum internal Capital Requirement (10%)	25,430	20,584
Maximum Internal Capital (15%)	38,145	30,876
Total Capital Demand	**63,576**	**51,459**
Total excess capital (10%)	**15,621**	**10,612**
Excess Capital	**2,906**	**320**
Capital Buffer	**12,715**	**10,292**
Capital adequacy ratios		
Tier I ratio	**16.14%**	**15.16%**
Tier II ratio	**18.39%**	**19.78%**

3.1.5. Capital adequacy ratios

The following were the Bank's capital ratios as at 31 December 2016;

Capital Adequacy Ratios	RBM Limits	Risk Appetite	Actual	
Capital adequacy	2016	2016	2015	2016
Risk Based Capital Ratio I	≥10%	10%-15%	15.16%	16.14%
Risk Based Capital Ratio II	≥15%	15%-17.5%	19.82%	18.39%
Leverage Ratio	≥2.5%	≥5%	10.20%	10.76%

The ratios show that the Bank has excess capital for both Tier I and Tier II ratios as at 31 December, 2016. Tier I ratio increased from 15.16% as at 31st December, 2015 to 16.14% as at 31st December, 2016. Tier II ratio decreased from 19.82% to 18.39% in the same period mainly due to an increase in RWA. The Bank's capital ratios were all above the prescribed minimum requirements for Reserve Bank of Malawi and the internal Risk Appetite for capital ratios.

4. RISK APPETITE

Risk appetite is the amount and type of risk that the Bank is able and willing to accept in pursuit of its business objectives. The risk appetite must not exceed the Bank's risk capacity (i.e. the maximum amount of risk that the Bank can take). The risk appetite therefore reflects the tolerance and willingness to accept risk. The subsequent implementation of the risk appetite into the Bank's risk limit sets some bonds to our business strategy and our ability to exploit business opportunities.

The Bank's risk appetite includes qualitative statements as well as quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures. Qualitatively, the Bank expresses risk appetite in terms of policies, processes, procedures, statements and controls meant to limit risks that may or may not be quantified.

1. Governance

The Board of Directors shall have the overall responsibility for the establishment and oversight of the Bank's risk appetite. The Board has developed risk appetite and risk tolerance limits appropriate to the Bank's strategy and require that Senior Management maintains an appropriate system of internal controls to ensure that these risks are managed within the agreed parameters.

The primary management level governance committee overseeing risk appetite the Enterprise Risk Committee chaired by the Chief Executive Officer. The principal governance documents are the Risk Management Framework and Risk Appetite Statement.

2. Risk Appetite Statement

The Chief Risk Officer is responsible for recommending the Bank's Risk Appetite Statement, to the Enterprise Risk Committee which is then approved by the Board Risk Committee (BRC) on behalf of the Board. In developing the Risk Appetite Statement, the Bank considers the group's strategy and the desired balance between risk and return. The BRC reviews the group's current risk profile on a quarterly basis and risk profile, both stressed and unstressed on annual basis.

5. STRESS TESTING

The Bank has a comprehensive Stress and Scenario Testing Framework which is used, inter alia, to stress the base case projections and so assess the adequacy of the Bank's capital buffers and target ratios. The Bank conducts stress tests on a quarterly basis by applying various scenarios on its market risk exposures to ensure that the bank is capable of withstanding any stressed conditions. Results of the stress tests are submitted to the ALCO, ERCO and BRC to ensure that appropriate strategies are formulated to address the market risk needs revealed by the stress testing.

The Bank's stress and scenario testing recognizes and estimates the potential volatility of its capital requirements and the base-case (expected) three-year business plan projections, including the key assumptions and sensitivities contained therein, which themselves are subject to fluctuation, and ultimately the adequacy of the Bank's capital buffers and target capital ratios.

The Stress Testing results showed satisfactory results and the scenarios showed that the minimum requirement would be met.

6. CREDIT RISK

1. Definition

The Bank defines Credit Risk as the likelihood that a debtor or financial instrument issuer is unwilling or unable to pay interest or repay the principal according to the terms specified in a credit agreement resulting in economic loss to the Bank.

2. Approach to Managing Credit Risk

The group's credit risk arises mainly from wholesale and retail loans and advances. The Board of Directors has the responsibility for approving and periodically reviewing the credit risk strategy and significant credit risk policies or departures there from of the Bank as well as sanctioning facilities beyond Management's delegated limits. The Board of Directors delegates this responsibility to its Board Credit Committee.

Additionally, there is a Management Credit Committee which is comprised of some members of senior management. The Management Credit Committee has the responsibility of implementing the credit risk strategy approved by the Board and for formulating and developing policies and procedures for identifying, measuring, monitoring and controlling credit risk in existing as well as new products, activities and procedures in order to ascertain quality of the Bank's credit portfolio.

The Committee oversees development, maintenance and review of the Group's risk grades in order to categorise exposures according to the degree of risk of potential financial loss and focus management on the attendant risk. The risk grading system helps in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Risk grades are subject to regular reviews.

The committee reviews credit concentrations vis-à-vis the Bank's capital in the form of single borrowers or counter parties, group of connected counter parties, sectors and products to ensure aggregate credit commitments to arrest widespread losses that can arise out of close linkages and correlated factors.

A separate Credit Management Division reporting to the Chief Executive and the Board Credit Committee is responsible for oversight of the Group's overall credit risk management issues including:

- Formulating credit policies and procedures as a general guide to lending in order to maintain credit risk exposure within acceptable parameters and in compliance with the Bank's risk strategy, legal, regulatory and statutory requirements;
- Overseeing the granting and administration of credit i.e. assessment, approval, sanctioning, security perfection, monitoring, review, classification etc.;

- Managing exposures to ensure aggregate credit commitments be they in form of single borrowers or counter parties, a group of connected counter parties, are maintained within acceptable concentration vis-à-vis the Bank's capital;
- Monitoring compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types; and
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

Each Business Unit (BU) is required to implement the Bank's credit policies and procedures, within delegated credit approval authorities. Each business unit has a Head or Manager who is accountable for all credit related matters and reports as appropriate to Credit Management Division or the Credit Committee through Credit Management Division. Regular audits of business units and Credit processes are undertaken by the Internal Audit Division.

3. Credit Risk Measurement

The Bank measures the credit risk capital requirements by applying appropriate risk weights to both on-balance sheet and off-balance sheet exposures in line with Basel II and the Guidelines on Standardised Approach to Credit Risk issued by the Reserve Bank of Malawi (RBM). The capital adequacy and return on capital levels for the individual risk categories of the Bank's portfolio are regularly monitored against the overall risk-bearing capacity of the Bank, in order to ensure that the Bank is, at all times, maintaining adequate capital to provide for its growth and to support a reasonable measure of unexpected losses.

Basel II under credit risk does provide three approaches in calculating required capital. These are; the Standardized Approach and the Internal Ratings Based (IRB) approaches. The IRB approach is further divided into two, the Foundation IRB approach and the Advanced IBR approach. The approaches are more aligned or biased towards the robustness of the internal risk management systems of the banks. RBM has prescribed that all banks be on the Standardized Approach on the initial adoption of Basel II. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

The Bank's Credit Division in collaboration with the Business Units regularly analyses default trends, these enable identification of the underlying root causes and subsequently channels recommendations to Senior Management allowing the fine-tuning of the appropriate credit scoring parameters. Similarly, risk grades of major corporate customers are used to set tolerance limits to enhance the management of excesses.

4. Credit Risk Mitigation

As a fundamental credit principle, the Group generally does not grant credit facilities solely on the basis of the collateral provided. All credit facilities are granted based on the credit standing, source of repayment and debt servicing ability of the borrower. Collateral is taken whenever possible to mitigate the credit risk assumed. The value of the collateral is monitored periodically, with the frequency of valuation depending on the type, liquidity and volatility of the collateral value. On the whole, the main credit risk mitigation techniques applied by the Bank include security/collateral, netting and guarantees, all of which contribute to a reduction in the Bank's credit risk exposures.

5. Credit Risk Exposure

1) Maximum exposure to credit risk without taking into account any collateral or other credit enhancements

The table below shows the maximum exposure to credit risk by class of financial instrument. Financial instruments include those instruments defined and recognised under IAS 39 Financial Instruments: Recognition and Measurement as well as other financial instruments not recognised.

The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements;

	GROUP		**COMPANY**	
	2016	2015	2016	2015
Gross maximum exposure	K'm	K'm	K'm	K'm
Balances with the Reserve Bank of Malawi	15,786	18,161	15,779	16,183
Government of Malawi treasury bills,treasury notes and RBM bonds	25,843	29,409	23,834	27,040
Government of Malawi Promissory notes	1,100	2,285	1,100	2,285
Placements with other banks	21,683	24,129	21,683	18,878
Loans and advances to customers	133,287	113,975	133,287	109,610
Other money market deposits	59,077	40,023	46,882	23,437
Other assets	10,545	5,985	9,975	5,021
Total recognised financial instruments	267,321	233,967	252,540	202,454
Guarantees and performance bonds	2,251	2,058	2,251	1,583
Letters of credit	15,603	18,577	15,603	18,564
Total unrecognised financial instruments	17,854	20,635	17,854	20,147
Total credit exposure	**285,175**	**254,602**	**270,394**	**222,601**

In respect of certain financial assets, the bank has legally enforceable rights to offset them with financial liabilities. However, in normal circumstances, there would be no intention of settling net, or of realising the financial assets and settling the financial liabilities simultaneously.

Consequently, the financial assets are not offset against the respective financial liabilities for financial reporting purposes.

However, the exposure to credit risk relating to the respective financial assets is mitigated as below;

The Table below details the Loans and Advances as risk weighted under the Standardized Approach to Basel II.

The Bank is on Standardized Approach for Credit Risk measurement under Basel II.

Line no.	PART A: RISK-WEIGHTED AMOUNTS (ON-BALANCE SHEET EXPOSURES) Nature of Item	Exposure Amounts	Specific Provisions for Past Due Exposures	Credit Risk Mitigation (CRM)	Exposure Amounts after CRM	Risk-weights (%)	Risk-weighted Amounts	
1	**Portfolio I: Exposures to Sovereign or Central Banks**							
2	Exposures to the Malawi Government or RBM	71,104,094			71,104,094	**0%**	0	
3	**Sub-total**	**71,104,094**	**0**	**0**	**71,104,094**		**0**	
4	**Portfolio II: Exposures to Public Sector Entities (PSEs)**							
5	Exposures to Parastatals or Statutory Corporations	2,080,860	-	-	2,080,860	**100%**	2,080,860	
6	Exposures to Central Government Departments e.g. Immigration and MRA	7,968	-	-	7,968	**0%**	0	
7	Exposures to Local Assemblies	2,187	-	-	2,187	**100%**	2,187	
8	**Sub-total**	**2,091,015**	**0**	**0**	**2,091,015**		**2,083,047**	
9	**Portfolio IV: Exposures to other Banks**							
10	Exposures to banks assigned a Credit Risk Assessment Rating of AAA to AA-.	2,220,196			2,220,196	**20%**	444039	
11	Exposures to banks assigned a Credit Assessment Rating of A+ to A-.	16,749,930			16,749,930	**50%**	8374965	
12	Exposures to banks assigned a Credit Asssessment Rating of BBB+ to BBB- or unrated banks.	294,852			294,852	**50%**	147426	
13	Exposures to banks assigned a Credit Assessment Rating of BB+ to B-.	2,417,952			2,417,952	**100%**	2417952	
14	**Sub-total**	**21,682,930**	**0**	**0**	**21,682,930**		**11384382**	
15	**Portfolio VI: Exposures on Corporates**							
16	Claims to local corporates	38,852,898	-		38,852,898	**100%**	38,852,898	
17	Exposures in foreign currency	35,601,827	-	-	35,601,827	**100%**	35,601,827	
18	Past Due Exposures	1,459,518	470,711	-	988,807	**100%**	988,807	
19	**Sub-total**	**75,914,243**	**470,711**	**0**	**75,443,532**		**75,443,532**	
20	**Portfolio VII: Exposures included in the Retail Portfolio**							
21	Retail exposures (excluding overdrafts) that fully comply with the RBM Credit Risk Guidelines) not exceeding MK30 Million	6,763,299.00			6,763,299	**75%**	5,072,474	
22	Overdrafts and Retail exposures above MK30 Million	4,531,592.00			4,531,592	**100%**	4,531,592	
23	Exposures in foreign currency				0	**100%**	0	
24	Past Due Exposures	382,172.00			210,327	**100%**	210,327	
25	**Sub-total**	**11,677,063**	**171,845**	**0**	**11,505,218**		**9,814,393**	
26	**Portfolio VIII: Residential Mortgages**							

27	Claims fully secured by residential mortgage (whether owner occupied or not)	6,093,402		-	6,093,402	**35%**	2,132,691	
28	Past Due Exposures	109,546	14,793	-	94,753	**100%**	94,753	
29	**Sub-total**	**6,202,948**	**14,793**	**0**	**6,188,155**		**2,227,444**	
30	**Portfolio IX: Commercial Real Estate (lending to finance commercial real estate)**							
31	Claims fully secured by mortgage on commercial real estate.	29,953,418	-	-	29,953,418	**100%**	29,953,418	
32	Past Due Exposures	114,747	-	-	114,747	**100%**	114,747	
33	**Sub-total**	**30,068,165**	**0**	**0**	**30,068,165**		**30,068,165**	
34	**Portfolio X: Other Assets**							
35	Cash, gold, coins,bullion, foreign notes & coins, statutory reserves with the Reserve Bank of Malawi	29,608,481	0	0	29,608,481	**0%**	0	
36	Cheques in course of collection	41,462	0	0	41,462	**20%**	8,292	
37	Other assets	48,965,155	0	0	48,965,155	**100%**	48,965,155	
38	**Sub-total**	**78,615,098**	**0**	**0**	**78,615,098**		**48,973,448**	
39	**Portfolio XI: Exposures to Higher Risk Categories**							
40	Exposures pertaining to venture (start up) capital or private equity, or project finance as per Guidance Note	8,844,107	-		8,844,107	**150%**	13,266,161	
41	Past Due Exposures	2,665,984	-		2,665,984	**150%**	3,998,976	
42	**Sub-total**	**11,510,091**	**0**	**0**	**11,510,091**		**17,265,137**	
43	**TOTAL ON-BALANCE SHEET RISK-WEIGHTED AMOUNT**	308,865,648	657,349	0	308,208,299		**197,259,547**	
44	**PART B: RISK-WEIGHTED AMOUNTS (OFF-BALANCE SHEET EXPOSURES)**	**Exposure Amounts**	**CRM**	**Exposure amount after CRM**	**Credit Conversion Factors (CCF)**	**Credit Equivalent Amounts**	**Risk-weights of Credit Equivalent Amounts**	**Risk- weighted Amounts**
45	Transaction Related Contingency (Performance Bonds, Stand by L/Cs etc)	15,949,206	0	15,949,206	**50%**	**7,974,603**	**100%**	7,974,603
46	Undrawn commitments	13,681,701	0	13,681,701	**50%**	**6,840,851**	**100%**	6,840,851
47	Documentary Credits (Trade related & Self-liquidating)	3,156,435	0	3,156,435	**20%**	**631,287**	**100%**	631,287
48	**Sub-total**	**32,787,342**	**0**	**32,787,342**		**15,446,741**		
49	**TOTAL OFF-BALANCE SHEET RISK-WEIGHTED AMOUNT**							**15,446,740.50**
50	**GRAND TOTAL: ALL EXPOSURES**							**212,706,287.89**

2) **Net exposure to credit risk without taking into account any collateral or other credit enhancements (Continued)**

In respect of certain financial assets, the bank has legally enforceable rights to offset them with financial liabilities. However, in normal circumstances, there would be no intention of settling net, or of realising the financial assets and settling the financial liabilities simultaneously. Consequently, the financial assets are not offset against the respective financial liabilities for financial reporting purposes. However, the exposure to credit risk relating to the respective financial assets is mitigated as follows:

GROUP	**Carrying Amount**	**Offset**	**Net exposure to credit risk**
	K'm	**K'm**	**K'm**
2015			
Government of Malawi treasury bills, **treasury notes** and Reserve Bank of Malawi bonds	29 409	-	29 409
Government of Malawi promissory notes	2 285	-	2 285
Placements with other banks	24 129	-	24 129
Loans and advances to customers	113 975	2 937	111 038
Other money market deposits	40 023	-	40 023
Other assets	5 985	-	5 985
	215 806	2 937	212 869
2016			
Balances with the Reserve Bank of Malawi	15 786	-	15 786
Government of Malawi treasury bills, **treasury notes** and Reserve Bank of Malawi bonds	25 843	-	25 843
Government of Malawi promissory notes	1 100	-	1 100
Placements with other banks	21 683	-	21 683
Loans and advances to customers	133 287	3 314	129 973
Other money market deposits	59 077	-	59 077
Other assets	10 545	-	10 545
	267 321	3 314	264 007

The Group's credit risk is primarily attributed to overdraft and other loan facilities extended to its customers. The amounts presented in the statement of financial position are net of provisions for doubtful debts. The specific provision represents allowances for estimated irrecoverable amounts when there is objective evidence that the asset is impaired.

The credit risks on balances with banks, treasury bills, bonds and local registered stocks are limited because the counterparties are institutions with low default risk. The book is spread over a relatively large number of counterparties and customers.

3) Credit quality of loans and advances

The credit quality of loans and advances is managed by the Group using internal credit ratings. The analysis below shows the credit quality of the loans and advances based on the Group's credit rating system;

	Group		Company	
	2016	**2015**	**2016**	**2015**
Individually: Impaired	K'm	K'm	K'm	K'm
Grade 9: Impaired	1,416	1,999	1,416	1,999
Gross Amount	**1,416**	1,999	**1,416**	**2,754**
Allowance for Impairment	(1,091)	(1,711)	(1,091)	(1,192)
Carrying Amount	**325**	**288**	**325**	**1,562**
Grade 7: Watch list	25,028	5,041	25,028	4,422
Grade1-3 Low Risk	8,402	21,380	8,402	18,002
Grade 4-6 Fair Risk	99,532	87,067	99,532	86,816
Total Carrying Amount	**133,287**	**113,776**	**133,287**	**110,802**

4) Impaired loans and advances

Impaired loans and advances are loans and advances for which the Group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan/advances agreement(s). These loans are graded 8 to 9 in the bank's internal credit risk grading system.

5) Past due but not impaired loans

These are loans and advances where contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Group.

6) Allowance for impairment

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individual significant exposures.

7) Write-off policy

The Group writes off a loan balance (and any related allowances for impairment losses) when it has determined that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

The Group holds collateral against loans and advances to customers in the form of mortgage interests over property, cash, equities, registered securities over assets, guarantees and other forms of collateral. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are only updated when performing the annual review except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

7. LIQUIDITY RISK

1. Definition

The Bank defines Liquidity Risk as the potential for loss to the Bank arising from either its inability to meet obligations as they fall due or to fund increases in assets without incurring unacceptable cost or losses (funding or market liquidity risk).

2. Approach to Managing Liquidity Risk

The Board of Directors shall have responsibility for the management of liquidity risk. Risk Division shall be monitoring the key risk indicators and reports will be submitted to the Board Risk Committee and Asset and Liability Committee (ALCO). Generally, the responsibilities of the Board shall include the following:

- Providing guidance on the level of tolerance for liquidity risk
- Establishing an appropriate structure and lines of authority for managing risk
- Continuously monitoring the Bank's performance and the overall liquidity risk profile
- Ensure the Bank takes the necessary steps to identify, measure, monitor and control liquidity risk; and
- Reviewing the adequacy of the Bank's contingency plans

ALCO's responsibilities shall include the following:

- Assessing current balance sheet position
- Projecting exogenous factors like the economic changes, performance of counterparties, competition, etc.
- Developing the assets and liability strategy
- Simulating strategies
- Determining the most appropriate strategies
- Setting targets
- Communicating targets to the appropriate managers and staff; and
- Monitoring and reviewing performance.

Regular audits of business units and liquidity processes shall be undertaken by the Internal Audit Department and the findings should be submitted to the Board Audit Committee.

3. Regulatory Liquidity Limits

	Dec-16	Dec-15
Liquidity Ratio I	53.57%	54.45%
RBM Limit	30.00%	30.00%
NBM Limit	40.00%	40.00%
	Dec-16	Dec-15
Liquidity Ratio II	53.55%	54.39%

RBM Limit	20.00%	
NBM Limit	30.00%	

8. MARKET RISK

1. Definition

The Bank defines Market Risk as is the risk of a change in the market value, actual earnings, or future cash flows of a portfolio of financial instruments, including commodities, caused by adverse movements in market variables such as equity, bond and commodity prices, currency exchange and interest rates and implied volatilities in all of these variables.

2. Approach to Managing Market Risk

The Management of Market Risk is conducted on a daily basis using the mark to market method by Treasury and Investment Banking and is verified by Risk Division. The valuation of securities shall be done as stipulated in the Trading Book Policy.

After the calculations the amounts ascertained will be checked against the limits in effect and if any limit has been exceeded the violation will be registered and reported to Treasury and Investment Banking Division and Senior Management.

The Bank uses the standardized approach to measure market risk. The standardized approach calculates market risk charges for Fixed Interest Instruments, Equities, Foreign Exchange and Commodities. These are then added up to come up with the total market risk charge.

The total capital set aside for market risk under the Standardized Approach was as follows;

Capital Charge	December 2016 (K'm)	December 2015 (K'm)
Interest Rate Risk	0	0
Foreign Exchange Risk	1	831
Equity Risk	3,046	4,314
Total	**3,047**	**5145**

The Bank has a comprehensive framework of limits that is used to control market risk exposures for different levels of reporting. The limits are reviewed at least annually or more frequently and adjusted when conditions of risk tolerances change. A summary of all breaches is reported to ALCO, ERCO and BRC.

3. Governance

The Board shall has the overall responsibility for the management of market risks. The Bank's Risk Division which operates independently from the business areas has the main responsibility of monitoring and analyzing market risk arising from the positions assumed by the Bank versus the risk appetite determined by the ERCO/BRC and approved by the Board.

9. OPERATIONAL RISK

1. Definition

The Bank defines Operational Risk as the risk of loss resulting from inadequate or failed internal processes, people, systems and from external events. In accordance to Basel II risk categories, operational risk comprises of strategic risk, operational risk, compliance risk; and reputation risk.

2. Governance

The Board is responsible for approving broad business strategies and policies that govern or influence operational risks.

The ERCO is responsible for implementing the operational risk strategy approved by the Board and for formulating and developing policies and procedures for identifying, measuring, monitoring and controlling operational risk.

The Bank's objectives is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and avoid control procedures that restrict initiative and creativity.
The primary responsibility for the development and implementation of control to address operational risk is therefore assigned to senior management within each business unit. This responsibility shall be supported by the Risk Division. Bank standards shall be developed for the management of operational risk in the following areas:

- Handling of both external and internal frauds
- Employment practices and workplace safety
- Clients, products and business practices
- Prevent damage to physical assets
- Prevent business disruption and system failures
- Ensure efficient and secure execution, delivery and process management
- Requirement for the reconciliation and monitoring of transactions
- Compliance with regulatory and other legal requirements
- Documentation of controls and procedures
- Requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risk identified
- Requirements for the reporting of operational losses and proposed remedial action development of contingency plans
- Training and professional development
- Ethical and business standards
- Risk mitigation, including insurance where this is effective

The overall oversight of operational risk issues falls under the responsibility of the Operational Risk Function within Risk Division. A summary report, including any exceptions and remedial action taken, is submitted regularly to ERCO and BRC.

3. Regulatory Capital Approach

The Bank measures operational risk using the Basic Indicator Approach. In using this approach the Bank determines the gross income for 3 years and then multiplies it by a capital charge factor of 15% to determine the total operational risk capital charge

The total capital set aside for operational risk under the Basic Indicator Approach was as follows;

Capital Charge	December 2016 (K'm)	December 2015 (K'm)
Operational Risk	38,549	42,582

10.CAPITAL MANAGEMENT OUTLOOK FOR 2017

The Bank conducted carried an Internal Capital Adequacy Assessment Process (ICAAP) which is a documented risk based assessment of National Bank of Malawi's actual capital adequacy position as at 31st December, 2016 and the forward looking position for the year ending 31st December, 2017. The ICAAP reflects the level of capital required to be held against identified material risk that the Bank may become exposed to, in order to meet current capital needs for 2017 and the strategies employed for managing its risk profile. The ICAAP assessment takes into consideration the economic environment, as well as the regulatory requirements to provide an overall assessment of the Bank's capital adequacy.

The 2017 ICAAP details the Banks capital from a group perspective. This entails analyzing the capital requirements of National Bank of Malawi, its subsidiaries namely:- NBM Capital Markets, NBM Pensions Administration Limited, Stockbrokers Malawi Limited and its associate United General Insurance. The Bank ensures that it is adequately capitalized in terms of the minimum capital adequacy ratios (CAR) and ensures that it continuously complies with all banking legislation in Malawi. In addition to this the Bank will also take into consideration capital requirements for Basel II pillars I and II and other planned activities for 2017 that will create additional pressure on capital.

In terms of major activities for 2017, the Bank plans to continue exploring the possibility of expanding its footprint outside Malawi, replace IT equipment and refurbish a number of Service Centres such as Liwonde and Top Mandala. The cost of replacement of IT equipment and refurbishments has already been incorporated in the 2017 budget. The Bank also plans to establish a Development Bank which will require an initial capital outlay of K1.0 billion which has also been included in the budget.

All the risk exposures faced by the Bank under Basel II pillar II have also been assessed in this ICAAP, supported by stress tests. Capital Adequacy Ratio is projected to be 16.63% which is slightly above 16.14% recorded in December, 2016. This is above both the regulatory minimum of 10% as well as the internal set capital risk appetite of the range of 10% and 15% for the Bank. Based on a capital buffer of 5% between the lower and up range from 10% minimum Capital Adequacy ratio, the Bank would have a capital buffer of K17.22 billion as at end 31st December 2017 as compared to K12.72 billion recorded in 2016. Excess capital is projected to be K5.63 billion by end of period 2017 as compared to K2.91 billion recorded in 2016.

This is sufficient capital to support the business operations of the Bank and cushion any shocks arising from stress testing and concentration risk. Further, the excess capital will be able to be used partially for establishing fully the operations of the Development Bank in 2018.

The Bank will therefore be able to adequately meet its capital demands for 2017.