National Bank of Malawi

Basel II Pillar III (Market Disclosure) Report For 2015

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1. Introduction

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.

2. Scope of the Report

This report serves to provide detailed information on the application of Basel II, capital management, risk exposures, risk assessment process and hence the capital adequacy of the Bank in compliance with Basel II Pillar III requirements.

3. 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. The shareholding structure as at 31st December, 2015 was as follows:

- Press Corporation Limited 51.5%
- Old Mutual Group 24.9%
- Members of the public 21.8%
- Employees 1.8%

The Bank is engaged in the business of retail, wholesale and investment Banking and stock broking. The subsidiary and associate companies of the Bank are shown below:

Subsidiary of the Bank	Percentage of control	Business Activity
NBM Capital Markets Limited	100%	Investment & Fund Management
NBM Securities Limited	100%	Dormant
National Bank of Malawi Nominees Limited	100%	Holding investment and assets as a Nominee
NBM Bureau de Change	100%	Dormant
Stockbrokers Malawi Limited	75%	Stock broking
NBM Pension Administration	100%	Pensions Administration

Limited		
Indebank Ltd	97.05%	Commercial Banking
Associate Company of the Bank	**Percentage of shareholding**	
United General Insurance Limited	26%	Short term insurance

4. Basel II

The Bank was fully compliant to Basel II in the period under review. All banks are on the basic approaches for the reporting on capital adequacy requirements and will be accepted to graduate into other advanced measurement approaches after a satisfactory assessment of their risk management processes by Reserve Bank of Malawi. Therefore the Group is computing the individual risks under each category using the following approaches:

i. Operational Risk – Basic Indicator Approach (BIA)
ii. Credit Risk – Standardized Approach (SA)
iii. 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 escalated to set the foundation for the Bank to finally graduate to Advanced Measurement Approaches. To achieve the set plans, the Bank has the following; a Basel II implementation gap analysis and an action plan (road map); a steering committee at Senior Management level and a project team for implementation and has to train Basel II to the Group's Directors, management and staff.

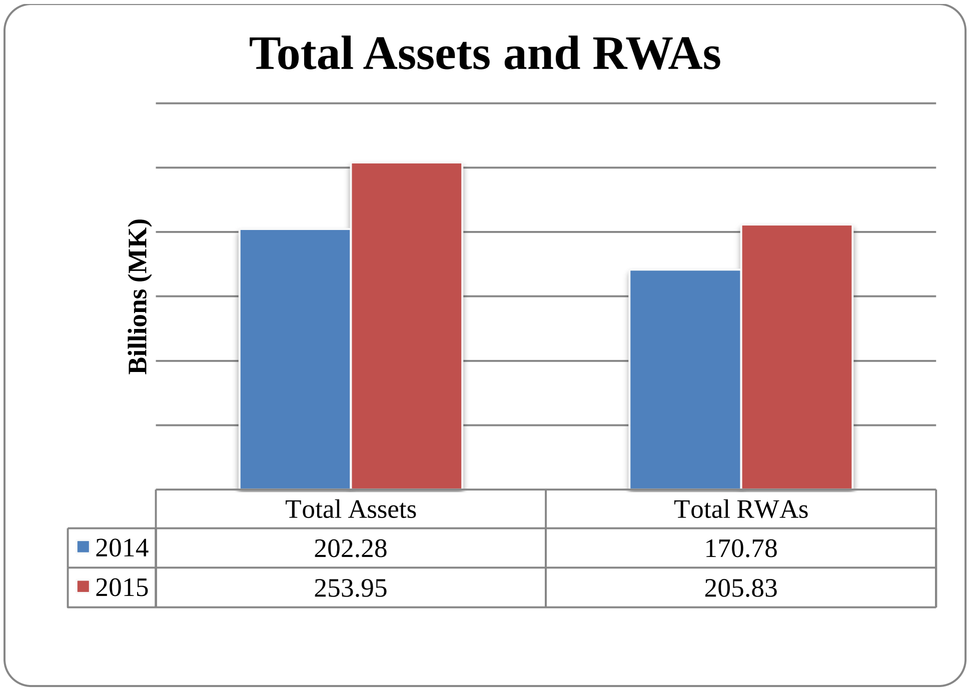
The Bank is assessing the Basel II approaches and their impact on its capital position to arrive at an appropriately calibrated total level of risk-weighted assets, qualifying capital and leverage ratio, and factor them into its strategic business plans.

5. The Bank's 2015 Performance and Financial Position

The Bank registered a decline in profit before tax of 5.3% (K19.6 billion against K20.67 billion (2014).A summary of the Bank's financial performance between 2014 and 2015 was as follows:-

i. Total assets increased by 25.54% from K202.28 billion to K253.95billion. This has been attributed to an increase in the following: fixed assets, loans and advances to customers, other assets and interest bearing securities.

ii. Total risk weighted assets increased by 20.5% from K170.78 billion to K205.83 billion. This increase was a result of a 29.0% increase in the credit risk component and 4.3 % increase in the operational risk component.



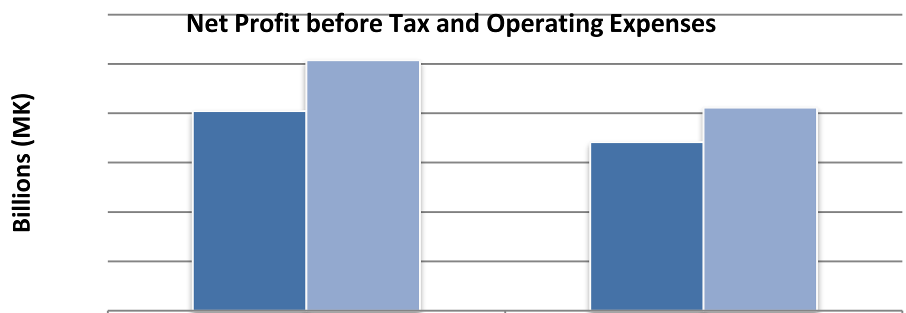
iii. Total capital increased by 21.91% from K43.70 billion to K53.28 billion due to an increase in retained earnings and revaluation reserves.

iv. The capital adequacy ratio decreased marginally from 15.96% to 15.16%.

v. Net profit before tax decreased by 2.9% from K20.22 billion to K19.63 billion. This was mostly due to an increase of 20.0% in operating expenses. Operating expenses increased by 20.0% from K17.59 billion to K21.11 billion.

vi. Impairment charges increased by 41.4% from K2.01 billion to K2.85 billion. A total of K1.34 billion was recovered on impaired loans in 2014 compared to K1.35 billion in 2015.

The graph below illustrates the movement in Net profit before tax and Operating expenses between 2014 and 2015;



	Net Profit	Operating Expenses
2014	202.28	170.78
2015	253.95	205.83

6. Governance and Structure

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.

The Board discharges its duty through policies and frameworks as well as specialized committees namely; Board Risk Committee (BRC),Board Audit Committee (BAC), Appointments, Remuneration and Governance Committee and Credit Committee.

7. Approach to Risk Management

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.

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 Risk and Audit Committees are assisted in these functions by the Risk Division and Internal Audit which undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Board Risk Committee.

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.

At management level, there is the Enterprise Risk Committee (ERCO) which provides the 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. In addition, the other management Committees such as the Asset and Liability Committee (ALCO), Credit and IT Policy, are all responsible for developing and monitoring the Bank's risk management policies in their specified areas.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor and adhere to those policies and controls.

Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank strives to maintain a disciplined and constructive control environment, in which all employees understand their roles and obligations.

8. Risk Appetite

National Bank of Malawi measures and expresses risk appetite qualitatively and in terms of quantitative risk metrics. The quantitative metrics include earnings at risk (EaR) (or earnings volatility) and, related to this, the chance of experiencing a loss, the chance of regulatory insolvency and economic capital adequacy. These comprise the Bank's core risk appetite metrics. In addition, a large variety of risk appetite metrics with targets, triggers, mandates and guidelines are in place for all the financial risks.

Accordingly the Bank established an enhanced suite of base case (through-the-cycle) risk appetite metrics and incorporated these within the three-year business plans since then, at both Bank and business cluster levels. Stressed risk appetite limits for the point-in-time risk appetite metrics, and linked to the Bank's stress- and scenario-testing programme, have been introduced.

Earnings volatility is the level of potential deviation from expected financial performance that the Bank is prepared to sustain at relevant points on its risk profile. It is established with reference to the strategic objectives and business plans of the Bank, including the achievement of financial targets, payment of dividends, funding of capital growth and maintenance of target capital ratios.

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 quantifiable. Policies, processes and procedures relating to governance, effective risk management, adequate capital and internal control has board and senior management oversight and is governed by the three lines of defence. A key component of the Enterprise Risk Management Framework (ERMF) is a comprehensive set of board-approved risk policies and procedures, which are updated annually. The coordination and maintenance of this formal process rests with the Chief Risk Officer.

The Bank's risk appetite is defined across five broad categories as set out in the board approved Risk Appetite Framework, namely:

i. Core risk appetite metrics. These are expanded upon in the table below.
ii. Specific risk-type limit setting (which clarify across the Bank's businesses the mandate levels that are of an appropriate scale relative to the risk and reward of the underlying activities so as to minimize concentrations and other risks that could lead to unexpected losses of a disproportionate scale).
iii. Stakeholder targets (such as performance targets, regulatory capital targets and target economic capital adequacy, capital allocations to business units, dividend policy, target credit impairment ratios, de-risking the balance sheet of non-core assets, etc).
iv. Policies, procedures and controls.
v. Zero-tolerance statements.

Below is the risk appetite statement for 2015

Quantitative Indicators	**Risk Appetite 2015**
1. Capital adequacy	
Risk Based capital ratio I (Basel II approach) :	10% to 15 %
Risk Based capital ratio II (Basel II approach) :	15% to 20%
Leverage Ratio	≥5%

2. Credit Risk	
Total loans and advances to total deposits	65% to 82%
Non Performing loans to total loans and advances	3% to 5%
Credit RWA: Loans and Advances	65% to 70%
Credit Property exposure: Loans and Advances	<50%
3. Concentration Risk	
Total large exposures to Core capital	≤400%
Top 10 depositors to total deposits	≤25%
Top 10 borrowers to total capital employed	≤25%
Total exposure to Related Parties	≤25%
4. Market Risk	
Overnight Open Exposure Limits	US$/MWK- Nil
5. Liquidity Risk	
Liquidity Ratio 1	30% to 40%
Liquidity Ratio II	20% to 30%
5.1. Liquidity gaps MWK (000)	
Up to 1 Month	(50,000,000) to (55,000,000)
1 - 3 Months	(40,000,000) to (50,000,0000
3 - 6 Months	(36,000,000) to (43,000,000)
6 - 12 Months	(27,000,000) to (30,000,000)
1 - 3 Years	(17,000,000) to (21,000,000)
3 - 6 Years	9,000,000 to 15,000,000
Over 6 Years	5,000,000 and Above
6. Equity Investment Risk Profile	
Exposure : Core Capital	≤25%
7. Operational Risk	
Total Operational Risk Loss : Core Capital	<0.1%
Internal Fraud Loss : Core Capital	<0.03%
External Fraud Loss : Core Capital	<0.07%
8. Performance	
Return on Equity before tax	>TB Yield 365 + 5%
Annual cost to income ratio	≤50%
Dividend payout ratio	≤50%
Fixed assets to Total assets	0.12
9.0 Tolerance Risks	
Amount for breaches, fines or headlines	Zero

9. Capital Management

National Bank's Capital Management provides the processes for defining, measuring, raising and investing all types of capital. In the Bank, Capital Management is an on-going process and the Bank assesses its capital requirements relative to its overall risks taking in determining its capital requirements. The Bank's approach to capital quantification has been within the minimum requirements of the Reserve Bank of Malawi as well as best risk management practice recommended by Basel II. The Bank ensures sufficiency of capital not only to cover material risks but to enable it to be resilient in stress times. In this line therefore, the Bank does not only set aside regulatory capital but has been guided by economic capital needs that cover all its risks and undertakings.

The Bank managed and monitored capital from several perspectives, including; regulatory capital, economic capital and subsidiary capital. Senior management to a large extent relied on a Bank's ICAAP and the capital planning process to itemize capital requirements by major risk type in arriving at a capital requirement by specific risk type.

Under Basel II, Capital is risk weighted according to the exposures in Credit Risk, Market Risk and Operational Risk. The main component of Risk Weighted Assets (RWAs) in the Bank is Credit Risk Weighted Assets which is seconded by Operational Risk Weighted Assets and then Market Risk Weighted Assets. Depending on type of exposure, collateral, assets are risk weighted from 0% to 100% for Capital Adequacy computations.

Below are the Capital figures for the Bank as at 31st December 2015;

9.1. Capital

The table below summarizes the regulatory capital position (capital supply) for the Bank over the past two years.

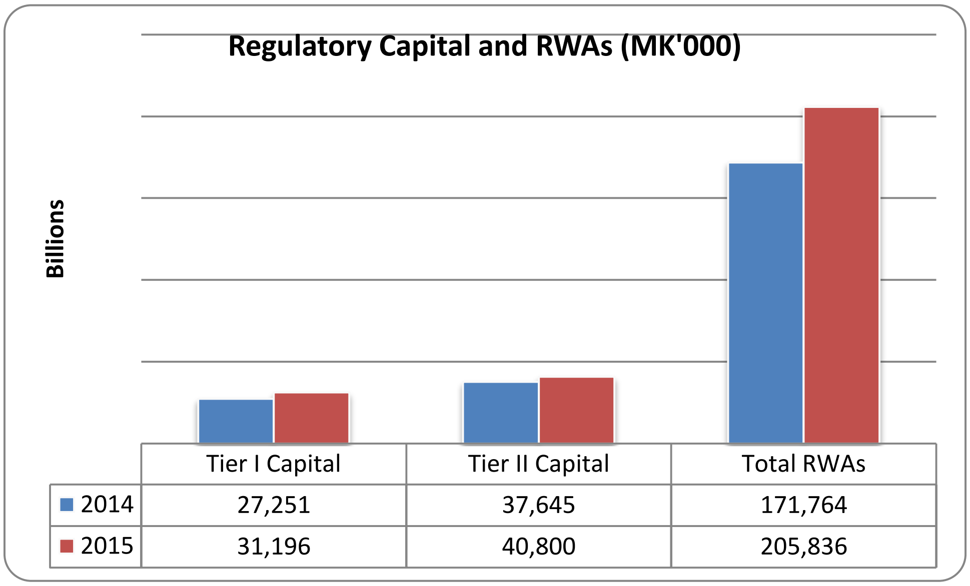
	2015 K'm	**2014 K'm**
Tier I capital		
Share capital	467	467
Share Premium	613	613
Retained earnings	33,707	26,542

Less :Investment in Unconsolidated Investments	(3591)	(371)
	31,196	**27,251**
Tier II capital		
Revaluation reserve	13,195	9,115
Loan loss reserve	(3,591)	
Available for sale assets reserve		
Total regulatory capital Tier II	**40,800**	**37,645**

9.2. Risk Weighted Capital

The table below summarizes the capital of the Bank over the past 2 years;

	2015	2014
	K'm	**K'm**
Credit Risk	158,109	125,738
Operational Risk	42,582	40,830
Market Risk	5,145	7,398
Total Risk Weighted Assets	**205,836**	**171,764**
Regulatory Minimum Capital Requirement (10% of Total Risk Weighted Assets)	**20,584**	**17,176**
Capital Excess/Shortfall (Capital Supply -Capital Demand)	**10,612**	**10,075**



9.3. Capital Adequacy Ratio

Quantitative Indicators	RBM	NBM Risk appetite	Actual Trend	
Capital adequacy	**2015**	**2015**	**2014**	**2015**
Risk Based Capital Ratio I (Basel II approach)	≥10%	10%-15%	15.90%	15.16%
Risk Based Capital Ratio II (Basel II approach)	≥15%	15%-17.5%	21.90%	19.82%
Leverage Ratio	≥2.5%	≥5%	11.01%	10.20%

The ratios show that the Bank has excess capital for both Tier I and Tier II ratios despite a decrease from the December, 2015 figures. Tier I ratio decreased from 15.90% as at 31st December, 2014 to 15.16% as at 31st December, 2015. Tier II ratio decreased from 21.90% to 19.82% in the same period. The Bank capital ratios were all above the 10% and 15% for tier I and tier II ratios respectively as the prescribed minimum requirements for Reserve Bank of Malawi. Further the ratios are above the 2015 set risk appetite for capital ratios of the range of 10% to 15% for tier I and 15% to 17.5 % for tier II.

10. Credit Risk

Credit risk is the likelihood of financial loss to the Group if customers or counterparties to financial instruments fail to meet their contractual obligations, and arises principally from the Group’s loans and advances to customers. Credit risk measurement therefore in National Bank consists of appraising the track record of customers as appropriate for prediction of the likely future behaviour of the existing accounts for ongoing credit risk management. Ultimately, the Bank assesses whether individual business areas provide sufficient contribution to the targeted risk-return profile in order to determine the capital allocation that yields the optimum return, achieved by channeling risk capital away from low-return to high-return business areas, in a manner commensurate with the risks shouldered.

10.1. Credit Risk Management

The Board has the responsibility for approving and periodically reviewing the credit risk strategy and significant credit risk policies or departures there from of the Group as well as sanctioning facilities beyond management's delegated limits. The Board of Directors has delegated 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 is also responsible for establishing the authorisation structure for the approval and renewal of credit facilities.

The Committee oversees development, maintenance and review of the Group's risk gradings 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:

i. 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;
ii. Overseeing the granting and administration of credit i.e. assessment, approval, sanctioning, security perfection, monitoring, review, classification etc.;
iii. 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;
iv. Monitoring compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types; and
v. 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.

10.2. 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.

10.3. 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.

10.4. 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;

Gross maximum exposure	GROUP		COMPANY	
	2015	2014	2015	2014
	K'm	K'm	K'm	K'm
Balances with the Reserve Bank of Malawi	18 161	20 457	16 183	20 457
Government of Malawi treasury bills and Reserve Bank of Malawi bonds	29 409	23 523	27 040	23 523
Government of Malawi Promissory notes	2 285	6 552	2 285	6 552
Placements with other banks	24 129	26 516	18 878	26 516
Loans and advances to customers	113 975	79 322	109 610	79 322
Other money market deposits	40 023	8 412	23 437	-
Other assets	5 985	7 543	5 021	7 458
Total recognized financial instruments	**233 967**	**172 325**	**202 454**	**163 828**
Guarantees and performance bonds	2 058	1 138	1 583	1 138
Letters of credit	18 577	17 391	18 564	17 391
Total unrecognized financial instruments	20 635	18 529	20 147	18 529
Total credit exposure	**254 602**	**190 854**	**222 601**	**182 357**

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. The total on balance sheet exposure of MK248.2bn was risk weighted to MK 158.1bn for capital computation.

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	54,573,968			54,573,968	0%				
3	Exposures to Parastatals or Statutory Corporations	1,455,730	-	-	1,455,730	100%	1,455,730			
4	Exposures to Central Government Departments e.g. Immigration and MRA	31	-	-	31	0%	-			
5	Exposures to Local Assemblies	5,511	-	-	5,511	100%	5,511			
6	Exposures to banks assigned a Credit Risk Assessment Rating of AAA to AA-.	18,878,136			18,878,136	20%	3,775,627			
7	Claims to local corporates	32,033,427	-	2,064,392	29,969,035	100%	29,969,035			
8	Exposures in foreign currency	39,682,928	-	-	39,682,928	100%	39,682,928			
9	Past Due Exposures	1,630,875	447,962	-	1,182,913	100%	1,182,913			
10	Retail exposures (excluding overdrafts) that fully comply with the RBM Credit Risk Guidelines) not exceeding MK30 Million	6,016,146.10	-	785,805.00	5,230,341	75%	3,922,756			
11	Overdrafts and Retail exposures above MK30 Million	2,302,656.00	-	-	2,302,656	100%	2,302,656			
12	Past Due Exposures	379,748.00	207,264.00	-	172,484	100%	172,484			
13	Claims fully secured by residential mortgage (whether owner occupied or not)	1,148,494	-	-	1,148,494	35%	401,973			
14	Past Due Exposures	86,555	25,006	-	61,549	100%	61,549.00			
15	Claims fully secured by mortgage on commercial real estate.	21,929,271	-	-	21,929,271	100%	21,929,271			
16	Past Due Exposures	512,907	42,578	-	470,329	100%	470,329			
17	Cash, gold, coins,bullion, foreign notes & coins, statutory reserves with the Reserve Bank of Malawi	27,450,873	-	-	27,450,873	0%	-			
18	Cheques in course of collection	119,177	-	-	119,177	20%	23,835			
19	Other assets	37,707,179	-	-	37,707,179	100%	37,707,179			
20	Exposures pertaining to venture (start up) capital or private equity, or project finance as per Guidance Note	1,825,678	-	22,450	1,803,228	150%	2,704,842			
21	Past Due Exposures	514,006	189,404	-	324,602	150%	486,903			
22	**Total on Balance Sheet RWA Amount**	**248,253,296**	**912,214**	**2,872,647**	**244,468,435**		**146,255,521**			

23	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		
24	Transaction Related Contingency (Performance Bonds, Stand by L/Cs etc)	13,607,657	-	13,607,657	**50%**	**6,803,829**	**100%**	6,803,829		
25	Undrawn commitments	6,811,826	-	6,811,826	**50%**	**3,405,913**	**100%**	3,405,913		
26	Documentary Credits (Trade related & Self liquidating)	8,219,851	-	8,219,851	**20%**	**1,643,970**	**100%**	1,643,970		
27	**Total off balance sheet Exposures Amounts**								**11,853,711**	
28	**GRAND TOTAL: ALL EXPOSURES**									**158,109,232**

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 K'm	**Offset K'm**	**Net exposure to credit risk K'm**
2014			
Balances with the Reserve Bank of Malawi	20 457	-	20 457
Government of Malawi treasury bills and Reserve Bank of Malawi bonds	23 523	-	23 523
Government of Malawi promissory notes	6 552	-	6 552
Placements with other banks	26 516	-	26 516
Loans and advances to customers	79 322	-	79 322
Other money market deposits	8 412	-	8 412
Other assets	7 543	-	7 543
	172 325	-	172 325
2015			
Balances with the Reserve Bank of Malawi	18 161	-	18 161
Government of Malawi treasury bills 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	-	113 975
Other money market deposits	40 023	-	40 023
Other assets	5 985	-	5 985
	233 967	-	**233 967**

COMPANY

	Carrying Amount K'm	Offset K'm	Net exposure to credit risk K'm
2014			
Balances with the Reserve Bank of Malawi	20 457	-	20 457
Government of Malawi treasury bills and Reserve Bank of Malawi bonds	23 523	-	23 523
Government of Malawi promissory notes	6 552	-	6 552
Placements with other banks	26 516	-	26 516
Loans and advances to customers	79 322	-	79 322
Other assets	7 458	-	7 458
	163 828	-	**163 828**
2015			
Balances with the Reserve Bank of Malawi	16 183	-	16 183
Government of Malawi treasury bills and Reserve Bank of Malawi bonds	27 040	-	27 040
Government of Malawi promissory notes	2 285	-	2 285
Placements with other banks	18 878	-	18 878
Loans and advances to customers	109 610	-	109 610
Other money market deposits	23 437	-	23 437
Other assets	5 021	-	5 021
	202 454	-	**202 454**

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	
	2015	2014	2015	2014
Individually: Impaired	K'm	K'm	K'm	K'm
Grade 8: Impaired	1,910.00	971.00	755.00	971.00
Grade 9: Impaired	1,999.00	3,738.00	1,999.00	3,738.00

Gross Amount	**3,909.00**	**4,709.00**	**2,754.00**	**4,709.00**
Allowance for Impairment	**(1,711.00)**	**(1,831.00)**	**(1,192.00)**	**(1,831.00)**
Carrying Amount	**2,198.00**	**2,878.00**	**1,562.00**	**2,878.00**
Grade 7: Watch list	**5,041.00**	**3,055.00**	**4,422.00**	**3,055.00**
Grade1-3 Low Risk	**21,380.00**	**14,947.00**	**18,002.00**	**14,947.00**
Grade 4-6 Fair Risk	**87,067.00**	**60,273.00**	**86,816.00**	**60,273.00**
Total Carrying Amount	**115,686.00**	**81,153.00**	**110,802.00**	**81,153.00**

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.

8) Loans and advances to customers

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of individually impaired assets by risk grade.

COMPANY

	Gross	Impairment	Net
31 Dec 2015			
Grade 8: Individual Impaired	971	-	971
Grade 9: Individual Impaired	3738	-1831	1907
Total	4709	-1831	2878
31 Dec 2014			
Grade 8: Individual Impaired	1910	-	1910
Grade 9: Individual Impaired	1999	-1711	288
Total	3909	-1711	2198

GROUP

	Gross	Impairment	Net
31 Dec 2015			
Grade 8: Individual Impaired	971	-	971
Grade 9: Individual Impaired	3738	-1831	1907
Total	4709	-1831	2878
31 Dec 2014			
Grade 8: Individual Impaired	755	-	755
Grade 9: Individual Impaired	1999	-1192	807
Total	2754	-1192	1562

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.

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

	GROUP		COMPANY	
	2015	**2014**	**2015**	**2014**
	K'm	**K'm**	**K'm**	**K'm**
Against individually Impaired				
Motor vehicles	361	368	361	368
Commercial Property	452	1586	452	1568
Residential Property	392	701	392	701
Cash	1	-	1	-
	1206	**2655**	**1206**	**2655**
Against the rest of the loan book				
Motor vehicles	12065	13426	11485	13426
Commercial Properties	9693	8951	9693	8951
Residential properties	30920	25107	28577	25107
Cash	2937	2467	2849	2467
Equities	5488	4196	5488	4196
Treasury Bills	27	25	25	25
Mortgages	4325	3841	4325	3841
Bank Guarantees	1109	142	1036	142
Total	**66564**	**58155**	**63478**	**58155**
Grand Total	**67770**	**60810**	**64684**	**60810**

9) Collateral repossessed

It is the Group's policy to dispose of repossessed collateral in an orderly fashion. The proceeds are used to reduce or repay the outstanding loan balance.

The Group monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the year-end date is shown below:

Loans and Advances to customers

	GROUP		COMPANY	
	2015	**2014**	**2015**	**2014**
Concentration by sector	K'm	K'm	K'm	K'm
Agriculture	22893	16433	22167	16433
Finance and Insurance	797	201	797	2942
Manufacturing	30576	20270	29986	20270
Other	10643	12111	10037	12111
Real Estate	-	-	4997	-
Personal	13602	11238	12494	11238
Wholesale and Retail	27452	18769	26561	18769
	113975	**79322**	**109610**	**79322**

The risk that counterparties to trading instruments might default on their obligations is monitored on an on-going basis. In monitoring credit risk exposure, consideration is given to trading instruments with a positive fair value and the volatility of the fair value of trading instruments.

To manage the level of credit risk, the Group deals with counterparties of sound credit standing, enters into master netting agreements wherever possible, and when appropriate, obtains collateral. Master netting agreements provide for the net settlement of contracts with the same counterparty in the event of default.

11. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The definition includes legal risk but excludes strategic and reputational risk. Legal risk includes but not limited to, exposures to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements. Operational risks arise from all of the Bank's operations and are faced by all our business entities.

11.1. Operational Risk Management

The Bank has on overall Operational Risk Framework which governs the management of operational risk. 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
- Requirements for appropriate segregation of duties, including the independent authorization of transactions
- 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.

11.2. Operational Risk Measurement

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 2015 (K'm)**	**December 2014 (K'm)**
Operational Risk	42,582	40,830

12. Compliance

Compliance Risk is the risk of non-compliance with any statutory requirements of central or local government, including regulations imposed by the Reserve Bank of Malawi and other regulatory bodies.

The management of compliance risk has become a distinct discipline within the Group's overall risk management framework. Ultimate responsibility for this risk lies with the Board of Directors. A combination of key activities are undertaken to manage the risk such as identifying the regulatory universe and developing compliance management plans, training staff and other stakeholders on relevant regulatory requirements, and monitoring compliance. The Group has a dedicated Compliance Officer who consults the country's Financial Intelligence Unit on money laundering and anti-terrorist financing matters.

Money laundering control and occupational health and safety (including aspects of environment risk management) are managed within the compliance function and there are increasingly onerous legislative requirements being imposed in both are as. The Group has adopted anti-money laundering policies including Know Your Customer policies, and procedures, and adheres to the country's anti-money laundering legislation and Reserve Bank of Malawi regulations and directives.

12.1. Statutory requirements

In accordance with the Section 38 of Banking Act, 2009, the Reserve Bank of Malawi has established the following requirements as at the year-end date:

1) Liquidity reserve requirement

The Bank is required to maintain a liquidity reserve with the Reserve Bank of Malawi equivalent to no less than 15.5% of total customer deposits. At the end of the year the liquidity reserve was equivalent to 54.39% (2014: 61.31%) of total customer deposits.

2) Capital adequacy requirement as per Section 10(1) of the Banking Act, 2009

The Bank's available capital is required to be a minimum of 10% of its risk bearing assets and contingent liabilities. At the end of the year the Bank's available capital was 18% (2014: 21.9%) of its risk bearing assets and contingent liabilities.

3) Prudential aspects of bank liquidity

As a complement to the Section 38 of the Banking Act, 2009,the Reserve Bank of Malawi had issued the following guidelines on the management of liquidity as at the year-end date:

- Liquidity Ratio I - Net liquidity (total liquid asset less suspense accounts in foreign currency) divided by total deposits must be at least 30%; and
- Liquidity Ratio II - Net liquidity (total liquid assets less suspense accounts in foreign currency and cheques in the course of collection) divided by total deposits must be at least 20%.

4) Liquidity ratios

At the end of the year, the Bank's liquidity ratio I was 54.5% (2014: 61.50%) and liquidity ratio II was 54.39% (2014: 61.3%).

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.

A best-practice framework and process are adhered to in order to confirm the robustness of the bank's capital adequacy and to assist in proactively de-risking the bank in appropriate segments in view of the global financial crisis.

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.

13. Market Risk

Market risk is the risk of loss arising from adverse movements in interest rate, exchange rate and prices associated with positions which are able to be fair-valued on the balance sheet on a frequent basis in both the banking and trading books of the Bank.

The Bank's exposure to market risk is in the following areas;

- Interest rate risk
- Foreign Exchange Risk
- Commodity risk

13.1. Market Risk Management and Monitoring

The Bank has a Market Risk Framework that is used to govern the management of Market Risk. The Board is responsible for approving broad business strategies and policies that govern or influence market risks however the overall authority for market risk is vested in the Asset Liability Committee (ALCO).

Risk Division in coordination with Treasury and Investment Banking Division are responsible for the development of market risk policies and for the day-to day review of their implementation. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO, ERCO and BRC.

13.2. Market Risk Measurement

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 2015 (K'm)	December 2014 (K'm)
Interest Rate Risk	0	0

Foreign Exchange Risk	831	3,494
Equity Risk	4,314	3,904
Total	**5,145**	**7,398**

13.3. Market Risk Limits

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.

13.4. Interest Rate Risk in Bank's Books (IRRBB)

IRRBB is the risk of loss in earnings or in the economic value on banking book items as a consequence of movements in interest rates.

The Bank has an IRRBB Policy which is used in the management of interest rate risk. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands.

The ALCO is the monitoring body for compliance with these limits and is assisted by Treasury and Investment Banking Division in its day-today monitoring activities.

13.5. 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.

A best-practice framework and process are adhered to in order to confirm the robustness of the bank's capital adequacy and to assist in proactively de-risking the bank in appropriate segments in view of the global financial crisis.

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.