National Bank of Malawi plc

BASEL II PILLAR III

(Market Disclosure)

Report For 2017

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1. OVERVIEW

1.1. 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 (NBM).

The report's qualitative and quantitative risk disclosures provide a comprehensive view on the risk profile of NBM Group. The quantitative information generally reflects NBM Group for the reporting date 31 December, 2017. In the limited instances where a consolidated view has not been presented, a separate Bank risk disclosure or applicable qualitative commentary is provided where appropriate.

However, it also includes information that is contained within the audited consolidated financial statements as reported in the Group's Financial Report 2017. NBM Group 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 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. The NBM's Group's Risk governance structure and the overall process adopted to identify, measure, monitor and control these risks is as described below;

1.3.1. Board Oversight

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.

1.3.2. Management Oversight

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. 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 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.

2.1. Shareholding structure

The authorised share capital of the Bank is K500m (2016: K500m) divided into 500,000,000 Ordinary Shares of K1 each. The issued capital is K467m (2016: K467m) divided into 466,931,738 (2016: 466,931,738) fully paid Ordinary Shares of K1 each. The shareholding structure as at 31st December, 2017 was as follows:

	2017
Press Corporation Limited	51.5%
Old Mutual Group	25.1%
Members of the public	23.0%
Employees (ESOS)	0.4%
	100%

2.2. Subsidiaries, associates and Service Centres

NBM Group 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% (2016: 100%)	Investments and fund management
NBM Securities Limited	100% (2016:100%)	Dormant
NBM Nominees Limited	100% (2016:100%)	Holding of investments as nominee
Stockbrokers Malawi Limited	75% (2016:75%)	Registered stockbroker
NBM Bureau de Change Limited	100% (2016:100%)	Dormant
NBM Pension Administration Limited	100% (2016: 100%)	Pension administration
Indebank Limited (NBM SME Development Bank)	100% (2016: 100%)	Dormant

2.3. Performance and Financial Position

The NBM Group registered an increase in profit before tax of 9.11% (K27.55 billion against K25.25 billion (2016).A summary of the Bank’s financial performance between 2016 and 2017 was as follows:-

- Total assets increased by 19.05% from K329.50 billion to K392.27 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 19.23% from K68.95 billion to K82.21 billion due to an increase in retained earnings and revaluation reserves.

- Total risk weighted assets slightly increased by 3.60% from K254.30 billion to K263.45 billion.

- The capital adequacy ratio decreased significantly from 18.57% to 16.23%.

- Operating expenses remained at K33.36 billion.

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 well capitalised in line with the group's risk appetite and target ratios, both of which are approved by the board.

3.1. 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.

3.2. 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 oversight responsibility for capital management and reports in detail 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.

3.3. Regulatory update

The Bank fully implemented and complied with Basel II on 1 January 2014.The Bank computes 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.

3.4. 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 2017 as compared to 2016;

	2017	**2016**
	K'm	**K'm**
Tier 1 capital		
Share capital	467	467
Share Premium	613	613
Retained earnings	51,740	43,612
50% Investment in unconsolidated investments	(3,459)	(3,369)
Tier 1 Capital	**49,361**	**41,323**
Loan Loss Reserve	1,160	708
Asset Revaluation reserve	18,158	15,459
50% Investment in unconsolidated investments	(3,459)	(3,369)
Tier II Capital	**58,888**	**47,310**

- Tier I capital increased by 19.45% thus from K41.3 billion to K49.3 billion.
- Tier II capital increased by 24.47% thus from K47.3 billion to K58.9 billion.

3.5. Risk weighted capital

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

	Capital Supply/Demand Projections	Capital Supply/Demand (actual)
	2018	**2017**
	K'm	K'm
Tier I capital (a)	59,468	49,361
Tier II capital	72,904	58,888
Credit Risk	275,761	217,203
Operational Risk	43,824	39,840
Market Risk	7,050	6,409
Other Risk	-	-
Total Risk Weighted Assets	**326,634**	**263,452**
Minimum Capital at 10% (b)	32,663	26,345
Maximum Capital at 15% (c)	48,995	39,518
Capital Buffer (c-b)	**16,332**	**13,173**
Excess Capital at a max of 15% (a-c)	**10,473**	**9,843**
Capital adequacy ratios		
Tier I ratio	18.21%	18.74%
Tier II ratio	22.32%	22.35%
Limits		
Tier I ratio	**10% - 15%**	**10% - 15%**
Tier II ratio	**15% – 20%**	**15% – 20%**

3.6. Capital adequacy ratios

The following were the Bank's capital ratios as at 31 December 2017;

Capital Adequacy Ratios	RBM Limits	Actual	
Capital adequacy	2017	2017	2016
Risk Based Capital Ratio I	≥10%	18.74%	16.14%
Risk Based Capital Ratio II	≥15%	22.35%	18.39%
Leverage Ratio	≥2.5%	10.92%	10.76%

The ratios show that the Bank has excess capital for both Tier I and Tier II ratios as at 31 December, 2017. Tier I ratio increased from 16.14% to 18.74%. Tier II ratio increased from 18.39% to 22.35% in the same period. 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.

4.1. 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.

4.2. 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

6.1. 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.

6.2. 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 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.

6.3. 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.

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.

6.4. 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.

6.5. 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	
	2017	**2016**	**2017**	**2016**
	K'm	**K'm**	**K'm**	**K'm**
Balances with the Reserve Bank of Malawi	16 139	15 786	16 139	15 779
Government of Malawi treasury bills, treasury notes and				
Reserve Bank of Malawi bonds	29 478	25 843	29 478	23 834
Government of Malawi Promissory notes	48	1 100	48	1 100
Placements with other banks	32 052	21 683	32 052	21 683
Loans and advances to customers	137 575	133 287	137 575	133 287
Other money market deposits	104 195	59 077	78 450	46 882
Other assets	7 673	10 545	6 819	9 975
Total recognised financial instruments	327 160	267 321	300 561	252 540
Guarantees and performance bonds	9 025	2 251	9 025	2 251
Letters of credit	26 216	15 603	26 216	15 603
Total unrecognised financial instruments	35 241	17 854	35 241	17 854
Total credit exposure	362 401	285 175	335 802	270 394

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;

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

GROUP	Carrying Amount K'm	Offset K'm	Net exposure to credit risk K'm
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
2017			
Balances with the Reserve Bank of Malawi	16 139	-	16 139
Government of Malawi treasury bills, treasury notes and Reserve Bank of Malawi bonds	29 478	-	29 478
Government of Malawi promissory notes	48	-	48
Placements with other banks	32 052	-	32 052
Loans and advances to customers	137 575	8 150	129 425
Other money market deposits	104 195	-	104 195
Other assets	7 673	-	7 673
	327 160	8 150	319 010

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 AND COMPANY	
	2017	**2016**
	K'm	**K'm**
Individually impaired:		
Grade 9: Impaired	8 041	1 416
Allowance for impairment	(5 961)	(1 091)
Carrying amount	2 080	325
Past due but not impaired:		
Grade 7: Watch list	17 945	25 028
Neither past due nor impaired:		
Grade 1 - 3 Low risk	12 651	8 402
Grade 4 - 6 Fair risk	104 899	99 532
Total carrying amount	**137 575**	**133 287**

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.

8) Credit Concentration by Sector

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 AND COMPANY	
	2017	2016
	K'm	K'm
Concentration by sector		
Agriculture	22 663	28 210
Finance and insurance	1 951	1 007
Manufacturing	28 283	30 654
Other	5 046	4 033
Transport and communication	3 822	9 128
Real estate	1 048	738
Personal	20 966	18 907
Wholesale and retail	53 796	40 610
	137 575	133 287

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.

7. LIQUIDITY RISK

7.1. Definition

The Group defines Liquidity Risk as the potential for loss to the Group 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).

7.2. Approach to Managing Liquidity Risk

The Group's approach to managing liquidity is to ensure that it has sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The Group has a Liquidity and Funds Management Policy that provides guidance in the management of liquidity. While the Board has overall oversight over the management of liquidity, the daily management of liquidity is entrusted to the Treasury and Investment Banking Division (TIBD) at Head Office. The TIBD is responsible for monitoring compliance of all operating units of the Group with local regulatory limits on a daily basis.

All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of both the Group and operating units. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

ALCO's responsibilities include the following:

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

Regular audits of business units and liquidity processes are undertaken by the Internal Audit Division and the findings are submitted to the Board Audit Committee.

7.3. Regulatory Liquidity Limits

	2017	**2016**
Liquidity Ratio I	64.74%	53.57%
RBM Limit	30.00%	30.00%
NBM Limit	40.00%	40.00%

	2017	**2016**
Liquidity Ratio II	64.66%	53.22%

RBM Limit	20.00%	20.00%
NBM Limit	30.00%	30.00%

7.4. Maturity profiles for Assets and Liabilities

The table below analyses assets and liabilities into relevant maturity profiles based on the remaining period to the contractual maturity date.

GROUP

	Less than 1 month K'm	**1 - 3 months K'm**	**3 - 12 months K'm**	**Over 1 year K'm**	**Total K'm**	**Carrying amount K'm**
2017						
Financial assets						
Cash and funds with Reserve Bank of Malawi	27 098	-	-	-	27 098	27 098
Government of Malawi treasury Bills, treasury notes and Reserve Bank of Malawi bonds	-	11 021	15 698	2 759	29 478	29 478
Government of Malawi promissory notes	48	-	-	-	48	48
Equity investments	-	3 698	-	-	3 698	3 698
Placements with other banks	32 052			-	32 052	32 052
Loans and advances to customers	10 338	10 103	59 912	57 222	137 575	137 575
Other money markets deposits	104 195	-	-	-	104 195	104 195
Other assets	7 673	-	-	-	7 673	7 673
Total financial assets	181 404	24 822	75 610	59 981	341 817	341 817
Financial liabilities						
Loans	-	-	61	14 124	14 185	14 185
Customer deposits	237 210	39 697	1 585	-	278 492	278 492
Amounts due to other banks	1 714	-	-	-	1 714	1 714
Provisions	-	-	3 127	-	3 127	3 127
Other liabilities	9 601	-	-	-	9 601	9 601
Total financial liabilities	248 525	39 697	4 773	209	307 119	307 119
Contractual liquidity mismatch	**(67 121)**	**(14 875)**	**79 837**	**45 857**	**34 698**	**34 698**
Cumulative mismatch	**(67 121)**	**(81 996)**	**(11 159)**	**34 698**	**-**	**-**

8. MARKET RISK

8.1. Definition

The Bank defines Market risk as 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 Group.

8.2. Approach to Managing Market Risk

The objective of market risk management is to manage and control risk exposures within acceptable parameters, while optimising the return on risk. The Group has a Market Risk Framework that guides the overall management of market risk.

The Group adopted 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. NBM Group fixed instruments are measured under credit risk. The Group does not trade in any commodities therefore is not exposed to commodity risk.

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

Capital Charge	December 2017 (K'm)	December 2016 (K'm)
Foreign Exchange Risk	16	1
Equity Risk	6,392	3,046
Total	**6,408**	**3,047**

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.

8.3. 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

9.1. 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.

9.2. 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.

9.3. 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 2017 (K'm)	December 2016 (K'm)
Operational Risk	39,840	38,549

10.CAPITAL MANAGEMENT OUTLOOK FOR 2018

The Group 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, 2017 and the forward looking position for the year ending 31st December, 2018. 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 2018 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 2018 ICAAP was developed taking into consideration the Bank's capital requirements from a group perspective. This entails analyzing the capital requirements of National Bank of Malawi as a Company, its subsidiaries namely: - NBM Capital Markets Limited, NBM Pensions Administration Limited, NBM SME Development Bank, Stockbrokers Malawi Limited and including its Associate United General Insurance. In coming up with the capital plan consideration has been taken to comply with the regulatory minimum Capital Adequacy Ratios (CAR) as well as set limits capital limits in the risk appetite. Further, all the risk exposures faced by the Bank under Basel II pillar II have also been assessed in this ICAAP, supported by stress tests.

Overall, the Bank is projected to be adequately capitalized by the end of December 2018. The Capital Adequacy Ratio is projected to be 18.21% as at 31st December 2018 which is slightly below 18.74% recorded in December, 2017. 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. The Bank is projected to have a capital buffer of K16.33 billion as at end 31st December 2018 as compared to K13.17 billion recorded in

2017. The range of 5% is provided as a capital buffer to cater for countercyclical exogenous factors that can derail the Bank's business as well as provide a cushion for risks arising from stress test results, high concentration risk, impairment charges for IFRS9 and any unexpected losses that may occur as well as ensure augmentation for capital for business growth and accommodate future expansion plans.

Excess capital is projected to be K10.47 billion by end of period 2018 as compared to K9.84 billion recorded in 2017. This is sufficient capital to support the business operations of the Bank and cushion any shocks arising from stress testing and concentration risk. An initial dividend amount of K8.5 billion has been set aside for 2018.