National Bank of Malawi plc

BASEL II PILLAR III (MARKET DISCLOSURE) REPORT

for the year ending

31st December 2018

Contents

1. OVERVIEW

1.1. Report Scope

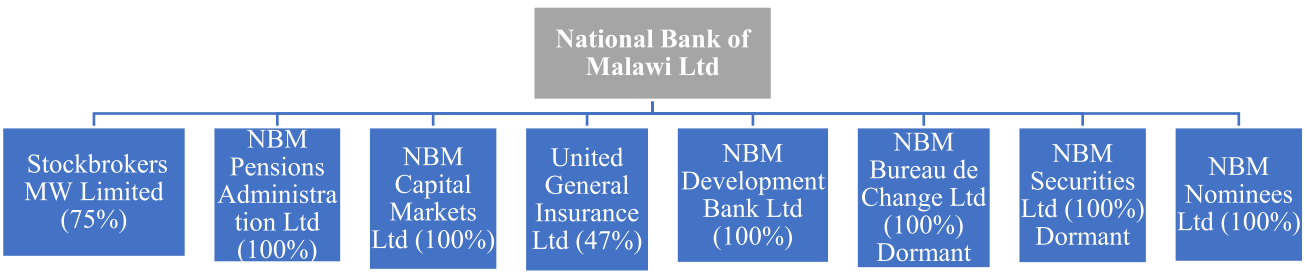
The Market Disclosure report for National Bank of Malawi (NBM) group is issued to show how the Bank manages enterprise risk in compliance with Pillar III Market Risk Disclosures guidelines. It discloses the scope of application of Basel II, capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of National Bank of Malawi plc (NBM).

The report's qualitative and quantitative risk disclosures provide a comprehensive view on the risk profile of NBM Group. The report also includes information that is contained within the audited consolidated financial statements as reported in the Group's Financial Report 2018.

1.2. NBM Group Structure

National Bank of Malawi PLC was established on 1st July 1971 through an amalgamation of the interests of 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 group provides retail, corporate, long-term/development finance and investment banking as well as stock broking, insurance and pension administration services in Malawi through 8 subsidiaries and a network of 32 Service Centres in Malawi.

The subsidiary and associate companies of the Bank are shown below



1.3. Enterprise Risk Group Structure and Oversight

The Group'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 following are the main governance structure for enterprise risk management:

1.3.1. The Board

The Board has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board develops the risk appetite, risk tolerance limits appropriate to the Group's strategy, and requires that management maintain 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.

1.3.1.1. The Board Risk Committee

The Board Risk Committee has responsibility for the risk management in the Group 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 Group may be exposed to in its course of business. It is also responsible for reviewing management performance in implementing the Group's strategic plan and ensures that the Group's activities are consistent with the policies agreed by the Group's Board and Directives of the RBM and other regulatory requirements.

1.3.1.2. The Board Audit Committee

The Board Audit Committee is responsible for conducting an independent check to ensure compliance with the Group'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 Group. The Board Audit Committees are assisted in these functions by an Internal Audit Division which undertakes both regular and ad-hoc reviews of risk management controls and procedures whose results are reported directly to Board Audit Committee.

1.3.1.3. The Board Credit Committee

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

1.3.1.4. The Appointments, Remuneration and Governance Committee

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

1.3.2. Enterprise Risk Management at Senior Management Level

At management level, the Enterprise Risk Committee (ERCO) provides a holistic oversight of the risks affecting the Group 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 Committee and IT Policy Committee (ITPC) are all responsible for developing and monitoring the Group's risk management policies in their specified areas.

The Group's Enterprise risk management policies are established to identify and analyse the risks faced by the Group, 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 Group strives to maintain a disciplined and constructive control environment, in which all employees understand their roles and obligations.

1.4. Risk Universe

NBM Group's risk universe is defined, actively managed and monitored in terms of the Enterprise Risk Management Framework with its subsidiary policies. A summary table of the key risk types impacting the group is provided below;

No	Risk Type	Risk Issue	Risk Rating
1.	**Political risk**	Political risk is the risk that an investment's returns could suffer as a result of political changes or instability in a country. Political risk is rated moderate. The rating is heightened as the General Election approaches as the political environment is envisaged to be very competitive. The Bank's business may be affected if a new Party win the elections as they may usher in new economic policies. The Bank will remain neutral in its dealings with the Government.	Medium
2.	**Strategic Risk**	Strategic risk is the risk that failed business decisions, or lack thereof, may pose to a company. Strategic risk is rated high. There have been calls for interest capping which will have negative effect on the Bank's operations and profitability. Further the Reserve Bank of Malawi issued a Directive on Supervision of Domestically Systemically Important Banks (SIB'S) which will require SIB's to set aside additional capital of between 1.00% and 3.5%. To mitigate the risk, the bank is increased it lending to its customer and the later by implementing the Advanced Measurement Approach for Operational Risk and Internal Ratings Based Approach for Credit Risk.	High
3.	**Credit Risk**	Credit Risk is 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.	Low

		Credit risk is rated low. The ratio of NPLs was at 4.07% as at 31 December, 2018 which was within the Risk Appetite of within 3% to 5%.	
4.	**Market Risk**	Market risk is the risk of losses in on and off-balance sheet positions arising from adverse movements in market prices. In accordance to the Basel II risk categories market risk shall comprise of interest rate risk, foreign exchange rate risk and price risk. Market risk is rated low. The Bank operated within the set limits and liquidity ratios were above the regulatory and internal limits.	Low
5.	**IT Risk**	IT Risk is the potential that a given threat will exploit vulnerabilities of an asset or group of assets and thereby cause harm to the organization. IT risk was rated high due to increased cyber security exposures and some unresolved system issues.	High
6.	**Operational Risk**	Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems and from external events. Operational risk is rated high due to system failures arising from network outages, rising general ledger differences and some unresolved internal audit issues.	High
7.	**Compliance Risk**	Compliance Risk is the risk of legal or regulatory sanctions, material financial loss or damage to reputation that the Bank may suffer as a result of failure to comply with laws, regulations, rules, self-regulatory organization standards and codes of conduct applicable to its activities. Compliance risk was rated moderate. The Bank adhered to all laws and Directives issued by the Reserve Bank of Malawi (RBM).	Medium
8.	**Project implementation Risk**	Project risk is an uncertain event or condition that, if it occurs, has a positive or negative effect on a project's objectives such as scope, schedule, cost or quality. Project risk was rated high. This was largely due to project time overruns which resulted to some	High

		projects being delayed.	

2. Risk appetite

2.1. Definition

Risk appetite is the amount and type of risk that the NBM Group is able and willing to accept in pursuit of its business objectives. The risk appetite must not exceed the Group's risk capacity (i.e. the maximum amount of risk that the Group can take). The risk appetite therefore reflects the tolerance and willingness to accept risk and our ability to exploit business opportunities.

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

2.2. Oversight

The Board has 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.

2.3. Performance against Risk Appetite

The risk appetite metrics is cascaded down to all business units to ensure monitoring and compliance. While prudent and appropriately conservative, the risk appetite is enabling the businesses to operate within a set risk range, as well as promoting competitive but sustainable growth and returns. Overall, the Bank performance was within the set risk appetite metrics except for a few as detailed below;

Quantitative Indicators	Risk Appetite 2018	Position Dec 2018	Comments
1. Capital adequacy			
Risk Based capital ratio I (Basel II approach)	10% to 15 %	14.12%	Within Risk Appetite

Risk Based capital ratio II (Basel II approach)	15% to 20%	19.06%	Within Risk Appetite
Leverage Ratio	≥5%	11.16%	Within Risk Appetite
2. Credit Risk			
Total loans and advances to total deposits	76.25% to 86.25%	70.63%	Below Risk Appetite.
Non-Performing loans to total loans and advances	3% to 5%	4.07%	Within Risk Appetite
Real Estate Finance: Loans and Advances	<50%	17.69%	Within Risk Appetite
Unsecured Credit Facilities: Loans and Advances	<20%	16.28%	Within Risk Appetite
3. Concentration Risk			
Total large exposures to Core capital	≤400%	256.87%	Within Risk Appetite
Top 10 depositors to total deposits	≤25%	11.51%	Within Risk Appetite
Top 10 borrowers to total capital employed	≤35%	52.86%	*Above Risk appetite.
Total exposure to Related Parties	≤25%	20.72%	Within Risk Appetite
Total exposure to a Counterparty	≤25%	26.34%	Above Risk Appetite
Foreign Currency Lending Ratio	≤85% - June 2018	72.57%	Within Risk Appetite
4. Equity Investment Risk Profile			
Exposure : Core Capital	≤25%	15.72%	Within Risk Appetite
5. Operational Risk			
Total Operational Risk Loss : Core Capital	<0.1%	0.63%	Above Risk Appetite
Internal Fraud Loss : Core Capital	<0.03%	0.03%	Within Risk Appetite
External Fraud Loss : Core Capital	<0.07%	0.02%	Within Risk Appetite
Total loss on Electronic Transactions :Total income	0.05%	0%	Within Risk Appetite
6. Performance			
Return on Equity before tax	≥20%	26.89%	Within Risk Appetite
Annual cost to income ratio	≤51%	60.00%	Above Risk Appetite
Fixed assets to Total assets	≤12%	6.78%	Within Risk Appetite
7. Market Risk			
Overnight Open Forex Exposure Limits	Near square position	US$65,951	Within Risk appetite.
8. Liquidity Risk			
Liquidity Ratio	35% to 45%	56.84%	Within Risk Appetite

*the largest borrowers were above the limit, but were from a diversified portfolio, the Bank is currently reducing the exposures.

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 and strategic associates are well capitalized in line with the group's risk appetite and target ratios approved by the Board.

3.1. Approach to Capital Management and Governance

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).

3.2. 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, Reserve Bank of Malawi (RBM) Directive on Capital Adequacy and related regulations, which are aligned with Basel II. Regulatory capital adequacy is measured through Tier 1 and Tier II ratios.

Below is the Bank's capital position for 2018 as compared to 2017;

	2018 K'm	2017 K'm
Tier 1 capital		
Ordinary share capital	467	467
Share premium	613	613
Retained earnings	61 369	51 740
Unconsolidated investment	(3 763)	(3 459)

Total regulatory (tier 1) capital	58 686	49 361
Supplementary capital		
Loan loss reserve	-	1 160
Revaluation reserve	21 156	18 158
Deferred tax	(7 599)	(6 332)
Unconsolidated investment	(3 763)	(3 459)
Total regulatory (tier 2) capital	68 480	58 888
Risk-weighted assets		
Retail bank, corporate bank and treasury	339 067	263 452
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets	20%	22%
Total tier 1 capital expressed as a percentage of risk-weighted assets	17%	19%

4. Credit risk

4.1. Management of Credit Risk

Credit risk arises when customers or counterparties are not able to fulfill their contractual obligations. The Group has a 'three lines of defense' risk management and internal controls structure in mitigating risk exposures namely: Business Units, Risk Division and Internal Audit. The first line is made up of the Business Units who assess, evaluate, measure and control risk exposures through the day-to- day activities of the business within the framework set by the second line of defense. The second line is made up of Risk Division and is responsible for providing an independent oversight of the first line of defense. The third line is Internal Audit which provides the assurance and independent checks. In addition to these three lines, External Audit provide an independent confirmation of the Bank's financial reporting.

4.2. The Nature and Extent of Credit Risk

The Group's exposure as at 31 December 2018 stood at K173.3 billion with an NPL ratio of 4.07% while in 2017, the Bank closed the year with a loan book worth K143.5 billion and an NPL ratio of 7.76%. NPL ratio is expected to decline from the previous reporting period due to enhanced monitoring of loans and strict recovery approach.

4.3. Extent of Utilization of Granted Limits

The Bank closed 2018 with unutilized overdrafts of K48.4 billion against limits of K59.4 billion representing 81.52% of the total limits compared to the unutilized limits of K57.1 billion against limits of K110.4 billion in December 2017 representing 51.74% of the total limits.

4.4. Implementation of IFRS 9

IFRS 9 replaces IAS 39 and sets out the updated requirements for the recognition and measurement of financial instruments. These requirements specifically deal with the classification and measurement of financial instruments, measurement of impairment losses based on an Expected Credit Loss model (ECL), and closer alignment between hedge accounting and risk management practices. Recognition and Measurement are in three phases as follows:

Phase 1 – Classification and measurement of financial assets and financial liabilities;
Phase 2 – Impairment methodology; and
Phase 3 – Hedge accounting.

Effective 1 January 2018, the Bank adopted IFRS 9. As permitted by IFRS 9, the requirements were applied retrospectively without restating comparatives. Differences between previously reported carrying amounts and new carrying amounts of financial instruments as of 31 December 2017 and 1 January 2018 amounting to K3.4 billion have been recognised in the opening retained earnings net of deferred tax. The key changes arising from adoption of IFRS 9 are that the Bank's credit losses are now based on expected losses rather than on incurred loss model, and the change in the classification and measurement of the Bank's financial assets and liabilities. There were no significant changes arising from the adoption of the Hedge accounting requirements of IFRS 9 because the Bank does not apply hedge accounting for its financial assets and liabilities.

4.5. 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 & COMPANY	
	2018	2017
Concentration by sector	**K'm**	**K'm**
Agriculture	27 957	22 663
Finance and insurance	4 850	1 951
Manufacturing	28 581	28 283
Other	23 555	5 046
Transport and communication	5 005	3 822
Real estate	1 662	1 048
Personal	27 813	20 966
Wholesale and retail	47 198	53 796
	166 621	137 575

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.

4.6. Loans and advances to customers at amortized cost categorized by Stages

	2018	2017
Stage	K'm	K'm
Stage 1	161 601	132 418
Stage 2	5 871	6 085
Stage 3	5 701	5 033
Total Gross Carrying Amount	**173 173**	**143 536**
Loss Allowance	(6 552)	(6 974)
Carrying amount	**166 621**	**136 562**

4.7. Maximum exposure to credit risk Disregarding 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 IFRS 9 Financial Instruments 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	
	2018 K'm	2017 K'm	2018 K'm	2017 K'm
Balances with the Reserve Bank of Malawi	10 833	16 139	10 833	16 139
Government of Malawi treasury bills, treasury notes and Reserve Bank of Malawi bonds	96 403	29 478	82 315	29 478
Government of Malawi Promissory notes	1 441	48	1 441	48
Placements with other banks	22 899	32 052	22 899	32 052
Loans and advances to customers	166 621	137 575	166 621	137 575
Other money market deposits	40 314	104 195	26 426	78 450
Other assets *(2017 Restated)*	2 782	1 305	2 151	526
Total recognised financial instruments	341 293	320 792	312 686	294 68
Guarantees and performance bonds	7 079	9 025	7 079	9 025
Letters of credit	28 720	26 216	28 720	26 216
Total unrecognised financial instruments	35 799	35 241	35 799	35 241
Total credit exposure	377 092	356 033	348 485	329 509

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.

4.8. Credit quality of loans and advances

The credit quality of loans and advances is managed by the Group using internal credit ratings as per the analysis below;

	GROUP	
	2018	**2017**
	K'm	**K'm**
Individually impaired:		
Grade 9: Impaired	6 462	8 041
Grade 8: Impaired	741	3 372
Past due but not impaired:		
Grade 7: Watch list	7 305	14 573
Neither past due nor impaired:		
Grade 1 - 3 Low risk	25 356	12 651
Grade 4 - 6 Fair risk	133 309	104 899
Impairment provision	(6 552)	(5 961)
Total carrying amount	166 621	137 575

Below is an analysis of the expected credit losses per risk grade:

	GROUP & COMPANY	
	Gross amount	**Provision**
31 December 2018	**K'm**	**K'm**
Risk Grade		
Grade 9: Impaired	6 462	2 327
Grade 8: Impaired	741	159
Grade 7: Watch list	7 305	755
Grade 4 – 6 Fair risk	133 309	2 635
Grade 1 - 3 Low risk	25 356	447
Total Gross carrying amount	173 173	6 323

The impairment provision of K6323m excludes an off balance sheet assets provision amounting to K229m.

4.9. 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 9 in the bank's internal credit risk grading system.

4.10. 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.

4.11. Write-off policy

IFRS 9 provides more detailed guidance on the point at which a loan and advance should be written off. In terms of IFRS 9 a loan and advance is written off when the group has no reasonable expectations of recovering the asset partially or in its entirety. This assessment is judgemental and includes both qualitative and quantitative information, including trends based on historical recoveries.

4.12. 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 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	
	2018	2017
	K'm	K'm
Against individually impaired		
Motor vehicles	462	133
Commercial property	2 501	1 594
Residential property	1 010	474
Equities	1	-
Cash	25	-
	3 999	2 201
Against the rest of the loan book		
Motor vehicles	21 695	15 203
Commercial property	11 241	12 673
Residential property	71 803	50 978
Cash	7 300	8 150

Equities	22 419	1 514
Treasury bills	18	25
Mortgages	9 440	9 207
Debentures	24 825	24 330
Bank guarantee	168	1 036
Total	168 909	123 116
Grand Total	172 908	125 317

5. Liquidity Risk and Funding

5.1. Approach and Management of Liquidity Risk

The primary role of a bank in terms of financial intermediation is to transform short-term deposits into longer-term loans. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have 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. The daily management of liquidity is entrusted to the Treasury and Investment Banking Division (TIBD) at Head Office. The TIBD receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The TIBD maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole. The liquidity requirements of business units are funded through deposits from customers. Any short-term fluctuations are funded through treasury activities such as inter-bank facilities, repurchase agreements and others.

5.2. Regulatory Liquidity Limits

The RBM requires all banks to maintain a minimum liquidity ratio of 25%. The Bank's Liquidity ratio decreased from 64.74% in December 2017 to 56.84% in December 2018. The decline was due to 32.87% decrease in balances with RBM from K16.13billion to K10.83, this decrease was mainly due to change in the computation of Liquidity ratios as stipulated in the revised Prudential Liquidity Directive 2018 where all funds held for Liquidity Reserve Requirement purposes are not included in the computation of Liquidity Ratio.

5.3. Measurement of liquidity risk

The key measure used by the Group for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose, net liquid assets are considered as including cash and cash equivalents and investment securities for which there is an active and liquid market less any deposits from banks, other borrowings and commitments maturing within the next month. A similar, but not identical, calculation is used to measure the Group's compliance with the liquidity limit established by the Reserve Bank of Malawi. Details of the reported Group ratio of net liquid assets to deposits from customers at the year-end date and during the reporting period were as follows:

	2018	2017
At 31 December	57%	65%
Average of the period	58%	60%
Maximum for the period	64%	67%
Minimum for the period	52%	55%

5.4. Liquidity Maturity Profiles

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
2018						
Financial assets						
Cash and funds with Reserve Bank of Malawi	25 023	-	-	-	25 023	25 023
Government of Malawi treasury Reserve Bank of Malawi bonds	-	33 590	52 323	10 490	96 403	96 403
Government of Malawi Promissory notes	1 441	-	-	-	1 441	1 441
Equity investments	-	3 891	-	-	3 891	3 891
Placements with other banks	22 899	-	-	-	22 899	22 899
Loans and advances to customers	16 958	14 209	62 350	73 104	166 621	166 621
Other money markets deposits	40 314	-	-	-	40 314	40 314
Other assets	2 782	-	-	-	2 782	2 782

Total financial assets	109 417	51 690	114 673	83 594	359 374	359 374
Financial liabilities						
Loans	-	-	3 301	16 127	19 428	19 428
Customer deposits	257 682	35 287	1 556	-	294 525	294 525
Amounts due to other banks	1 414	-	-	-	1 414	1 414
Provisions	-	-	1 933	-	1 933	1 933
Other liabilities	1 526	-	-	-	1 526	1 526
Total financial liabilities	260 622	35 287	6 790	16 127	318 826	318 826
Contractual liquidity mismatch	**(151 205)**	**16 403**	**107 883**	**67 467**	**40 548**	**40 548**
Cumulative mismatch	**(151 205)**	**(134 802)**	**(26 919)**	**40 548**	**-**	**-**

The contractual liquidity mismatch shows the mismatch before any adjustments are made for product and customer behavioural assumptions. The Group's Asset and Liability Committee manages this mismatch by setting guidelines and limits for anticipated liquidity gaps and monitors these gaps daily. The committee reviews the product and customer behavioural assumptions when there is indication that there is a shift in one or more variables.

6. Market risks

6.1. Management of Market Risk

The Group separates its exposure to market risk between trading and non-trading portfolios. Basel II's market risk standardized approach has pre-specified and standardized methods for all the four types of risks covered: Interest rate risk, equity risk, exchange rate risk and commodity risk. The accord specifically states that eligible capital can only be calculated after the bank has calculated minimum capital requirement for credit risk and also operational risks then only can it be established how much Tier I and Tier II capital is available to support market risk. The Group's trading portfolios mainly are held by the TIBD, and include positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

Overall authority for market risk is vested in ALCO. TIBD is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to day review of their implementation.

6.2. Interest rate risk in the banking book

The principal risk to which non-trading portfolio are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. 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 TIBD in its day-today monitoring activities. The table below summarizes the exposure to interest rate risks. Included in the table are the Group's assets and liabilities at carrying amounts, categorized by earlier of contractual re-pricing or maturity dates. The Group does not bear an interest rate risk on off balance sheet items. A summary of the Group's maturity profile gap position on non-trading portfolio is as follows:

GROUP

	Less than 1 month K'm	1 - 3 months K'm	3 - 12 months K'm	Over 1 year K'm	Non interest sensitive K'm	Total K'm
2018						
Financial assets						
Cash and funds with Reserve Bank of Malawi	-	-	-	-	25 023	25 023
Government of Malawi T'bills and Reserve Bank of Malawi bonds	-	33 590	52 323	10 490	-	96 403
Promissory notes	1 441	-	-	-	-	1 441
Equity investments	-	-	-	-	3 891	3 891
Placements with other banks	22 899	-	-	-	-	22 899
Loans and advances to customers	16 958	14 209	62 350	73 104	-	166 621
Other money market deposits	40 314	-	-	-	-	40 314
Other assets	-	-	-	-	2 782	2 782
Total financial assets	81 612	47 799	114 673	83 594	31 696	359 374
Financial liabilities						
Loans	-	-	3 301	16 127	-	19 428
Customer deposits	239 091	35 287	1 556	-	18 591	294 525
Amounts due to other banks	1 414	-	-	-	-	1 414
Provisions	-	-	-	-	1 933	1 933
Other liabilities	-	-	-	-	1 526	1 526
Total financial liabilities	240 505	35 287	4 857	16 127	22 050	318 826
Interest sensitivity gap	**(158 893)**	**12 512**	**109 816**	**67 467**	**9 646**	**40 548**
Cumulative gap	**(158 893)**	**(146 381)**	**(36 565)**	**30 902**	**40 548**	**-**

	Less than 1 month K'm	1 - 3 months K'm	3 - 12 months K'm	Over 1 year K'm	Non interest sensitive K'm	Total K'm
2018						
Impact on profit of an increase in interest rates:						
+1%	(1 589)	125	1 098	675	-	309
+2%	(3 178)	250	2 196	1 350	-	618
+3%	(4 767)	375	3 294	2 025	-	927
Impact on profit of a decrease in interest rates:						
-1%	1 589	(125)	(1 098)	(675)	-	(309)
-2%	3 178	(250)	(2 196)	(1 350)	-	(618)
-3%	4 767	(375)	(3 294)	(2 025)	-	(927)

6.3. Foreign currency Risk in the banking book

Foreign currency risk is the risk of the group's assets losing value as a result of movements in exchange rates that adversely impact the Malawi Kwacha value. The Bank closed the year with a short position on the US Dollar amounting to (K6.77 billion). However the Bank was adequately cushioned from foreign currency exposure as the over net position of the Malawi Kwacha amounted to K40.5 billion which covers this short position.

GROUP

	MK K'm	USD K'm	GBP K'm	EURO K'm	ZAR K'm	OTHER K'm	TOTAL K'm
2018							
Financial assets							
Cash and funds with Reserve Bank of Malawi	24 093	801	12	23	94	-	25 023
Government of Malawi T'bills and Reserve Bank of Malawi Bonds	96 403	-	-	-	-	-	96 403
Promissory notes	1 441	-	-	-	-	-	1 441
Equity investments	3 891	-	-	-	-	-	3 891
Placements with other banks	-	13 827	3 351	4 775	918	28	22 899
Loans and advances to customers	106 545	60 076	-	-	-	-	166 621
Other money market deposits	40 314	-	-	-	-	-	40 314
Other assets	2 782	-	-	-	-	-	2 782
Total financial assets	275 469	74 704	3 363	4 798	1 012	28	359 374
Financial liabilities							
Loans	209	19 219	-	-	-	-	19 428
Customer deposits	224 465	61 919	3 245	4 706	190	-	294 525
Liabilities to other banks	373	342	-	-	699	-	1 414
Provisions	1 933	-	-	-	-	-	1 933
Other liabilities	1 526	-	-	-	-	-	1 526
Total financial liabilities	228 506	81 480	3 245	4 706	889	-	318 826
Net balance open position	46 963	(6 776)	118	92	123	28	40 548
Impact of a 10% strengthening of the Malawi Kwacha against other currencies on profit							
	-	678	(12)	(9)	(12)	(2)	643
Impact of a 10% weakening of the Malawi Kwacha against other currencies on profit							
	-	(678)	12	9	12	2	(643)

6.4. Capital Charge for Market

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

Capital Charge	2018	2017
	(K'm)	(K'm)
Foreign Exchange Risk	93	16
Equity Risk	622	639
Total	**715**	**655**

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.

7. Operational risk

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.

7.1. 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. 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.

8. Stress and scenario testing

8.1. Stress and Scenario 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.

8.2. Stress frequency and scenarios

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.

8.3. Stress Testing Results for the Year 2018

Overall the Bank had a solid capital base during the year which was to sustain itself in a number of worst scenarios. Furthermore, overall the Bank improved in responding to a combination of macro-economic shocks during the year. On liquidity risk shocks the Bank remained constant as it was able to survive for 3 days. The Bank continues to monitor the structure of the Assets and Liabilities to ensure minimal mismatch so as to improve the liquidity base and the number of days in which the Bank would be liquid in the event of a run on deposits.

Notwithstanding, the bank was exposed to the impact of default of top five borrowers and increase in non-performing loans by sector which resulted in the ratios of regulatory requirement falling below the prescribed minimum. In order to manage capital risk, the Bank has embarked on implementation to Internal Rating approach for credit risk and Advanced Measurement Approach for operational risk. Implementation of these approaches is expected to result in improvement in capital ratios and improvement in the quantum of credit extended to or customers.

9. Conclusion

The NBM Group considers that sound enterprise risk management can contribute to living our values through enhanced accountability, strong risk and performance management, transparency and effective leadership.

Our approach to risk and compliance management goes beyond simply meeting legislative requirements. Our practical and enabling risk culture ensures that spirit and intent are borne in mind, while valuing the integrity and importance of appropriate governance. Risk management is ingrained in the NBM Group culture. Proactive and well-established risk management practices ensure that appropriate levels of capital and resources are allocated.

Overall the NBM Group achieved its capital management objective of ensuring that adequate capital resources are available for business growth, investment opportunities as well as for coping with adverse situations while delivering returns to shareholders and maintaining a strong capital position consistent with the expectations of various stakeholders such as regulators, investors and customers amongst others.

The Group also complied with various regulatory limits and reporting requirements in place with regards to market and liquidity risks. This was achieved through the Group's approach of supplementing regulatory limits with a set of internal limits and targets fixed by ALCO and cascaded, where applicable, to the Treasury and Investment Banking Division for further delegation to different trading units and individual dealers.

Operational risk management has also been to standards within the Group. Mitigation of operational risk relied on fitting policies, processes and systems throughout the Business Units that lead to maximum risk mitigation through clear segregation of duties, dual control, regular verification and reconciliation of transactions. Moreover, a measure of risk transfer is ensured through insurance, where appropriate. In addition, as aforementioned, root cause analysis enables the identification of areas for improvement and appropriate mitigating strategies.