National Bank of Malawi plc

June 2021

# MARKET DISCLOSURE

# Table of **Contents**

# 1. OVERVIEW

## 1.1. Introduction

The Bank undertakes to provide to the market adequate information covering financial performance, financial position, capital adequacy and solvency position, business activities, policies and procedures, risk management systems, strategies and practices covering all material risks to which the Bank is exposed, nature and extent of risk exposure corporate governance arrangements, and an overview of other key aspects. This is in compliance with its own Market Disclosure Policy, the Companies Act, Reserve Bank of Malawi (RBM) Directive on Disclosure of Information by Banking Institutions, the Guidelines on Market Disclosures under Basel II (2013), International Financial Reporting Standards (IFRS) and Malawi Stock Exchange (MSE) Listing Rules which require financial institutions or companies to disclose some information to the public.

The Market Disclosure Report is mandated by the Reserve Bank of Malawi Guidelines on Market Disclosures under Basel II Pillar III. The Disclosures under Basel II complement 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 plc hereby presents this report Market Disclosure report at 30th June 2021 in line with Guidelines on Market Disclosures under Basel II Pillar III issued by the Reserve Bank of Malawi.

## 1.2. Review of Current Reporting Period

**Financial Performance**

The Bank registered a good financial performance in the period ending 30th June 2021. The Bank recorded Profit Before Tax (PBT) of K20.45bn which was 31% above budget and 54% above profit attained on 30th June 2020. The Return on Equity (ROE) was at 32.60% from 25.43% as of 30th June 2020. The ROE performance ratio for the year was above the Bank's Risk Appetite of 18.89%. Cost to Income ratio was at 47.84% as compared to 53.00% as of 30th June 2020. The table below tracks the indicators and analyses the performance of the bank in the past twelve months.

| Cost to Income Ratio | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 |
|---|---|---|---|---|---|
| Profit before Tax | 13,264,809 | 23,383,089 | 32,683,983 | 10,052,069 | 20,450,933 |
| Total Assets | 484,445,409 | 507,441,305 | 599,836,703 | 582,649,753 | 610,014,510 |
| Total Operating Costs | 19,017,122 | 29,299,440 | 41,722,628 | 10,996,871 | 22,612,143 |
| *Ratios* | | | | | |
| Return on Equity Before Tax (%) | 25.43% | 29.30% | 29.00% | 33.45% | 32.60% |
| Return on Total Assets (%) | 3.80% | 4.25% | 4.20% | 4.76% | 4.63% |
| 364 TB Yield + 5% | 18.50% | 18.75% | 17.50% | 17.11% | 18.89% |
| Cost to Income Ratio | 53.00% | 52.00% | 54.00% | 49.27% | 47.84% |
| Leverage Ratio | 14.70% | 12.10% | 11.70% | 12.70% | 12.40% |

## 1.3. The Current and Emerging Risks

The Bank identifies and assesses both external and internal risks, determines the appropriate response, and monitors the effectiveness of the implemented response. The table below outlines the emerging and potential risks to the Bank's strategic ambitions and reflects its response to these risks. The COVID-19 dramatically changed the risk landscape, and the Bank will continue to drive the execution of the strategic objectives, taking into account the impact of the situation as it unfolds and prudently manage risk appetite.

**a. Economic and Business Environment Risk**

| Risk Issue | Status |
|---|---|
| The country is now experiencing the 'third wave' of the Covid-19 pandemic. Although the economy is open for business, economic activity and business is subdued. | As of 30th June 2021, the restructured facilities due to Covid amounted to K20.74bn from a pick of K33.00bn at its highest in the past twelve months. Government has relaxed the COVID Restrictions notwithstanding the third wave. The Bank has seen a remarkable improvement on the restructured facilities, but it remains cautious on the third wave which is still affecting the hotel industry. |
| The economy which is heavily reliant of imports has suffered from huge forex shortage that has put pressure on the Kwacha which is now unstable and continues to depreciate. This has resulted in increased prices impacting businesses. | The Bank is managing the forex position by rationing and prioritizing essential services on the demand side at the same time positioning itself for supply. |
| The new strategic choices resulting from the Covid-19 pandemic. | The Bank is dealing with the new issues from the changes in the new strategy; -<br><br>i. Rapid reskilling and upskilling of staff to deal with an ever-changing environment.<br>ii. Embrace digitization and innovation.<br>iii. Cultural changes to adapt to the new environment. |
| Acquisition risk- new risks arising from acquisition of Akiba Commercial Bank. | The Bank has just completed the acquisition of 51% stake in Abika raising the following risks:<br><br>- The Bank made a loss of K1.5bn as of 30th June 2021.<br>- Other risk facing Akiba is use of outdated core banking system.<br>- Capital risk arising from further write downs that have affected the capital levels as the bank is cleaning up its book.<br>- Huge losses from non-performing entity impacting on the bank.<br><br>The Bank has put a strategy to turn-around Akiba into a performing entity and also to respond to regulatory compliance risk. |

**Economic Outlook**

The economy is officially projected to grow by 3.8% in 2021. In the absence of long-term safety nets, the impending closure of the tobacco selling season and the supply and demand imbalances being experienced on foreign exchange, continued pressure on the exchange rate is expected. This coupled with the impact of the third wave of COVID-19, may dampen the growth prospects. In spite of the above, the Bank remains optimistic and expects to continue with its strong performance in the second half of the year.

**Strategic Performance of the 2018 – 2022 Strategy**

Strategy level of implementation stood at 73 percent as compared to implementation target of at least 80 percent as of 30th June 2021. Most of the planned activities and projects implementation experienced delays due to Covid-19 but management has developed work arounds for most projects and initiatives. The half year has had small movement in the deliverables.

# 2. CAPITAL MANAGEMENT

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

## 2.1. Approach to Capital Management

The Bank deploys a capital management strategy aimed at ensuring capital adequacy by considering the resources necessary to cover unexpected losses arising from discretionary risks, being those which it chooses to accept (such as credit risk and market risk), and from non-discretionary and inherent risks, being those which arise by virtue of its operations (such as operational risk and business risk). The Bank's capital management and allocation policy is underpinned in the Capital Management Policy. The Board and Senior Management examine the risk profile of the Bank from both regulatory and economic capital viewpoints to ensure that the Bank's level of capital achieves the following:

- Remain sufficient to support its risk profile and outstanding commitments;
- Is adequate to implement its growth plans embedded in the Strategic plan
- Exceeds the formal minimum regulatory capital required
- Is capable of withstanding severe economic shocks; and
- Remains consistent with the bank's strategic and operational goals, and shareholder expectations.

## 2.2. Regulatory capital

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.

The table below shows the capital position of the Bank as at **30th June 2021** compared to a similar period last year.

| Capital adequacy | June-2021 K'm | June-2020 K'm | Change (%) |
|---|---|---|---|
| Core Capital | 80,640 | 69,940 | 15.30% |
| Total Capital | 100,540 | 89,882 | 11.86% |
| Credit Risk Weighted Assets | 279,643 | 264,793 | 5.61% |
| Operational Risk Weighted Assets | 118,620 | 106,871 | 10.10% |
| Market Risk Weighted Assets | 9,938 | 9,687 | 2.59% |
| Total Risk Weighted Assets | 408,202 | 381,353 | 7.04% |
| Risk Based capital ratio I (Basel II approach) | 19.76% | 18.34% | 7.74% |
| Risk Based capital ratio II (Basel II approach) | 24.63% | 23.57% | 3.35% |

Total Risk Weighted Assets (RWA) increased by 7.04% from K381.353bn to K408.202bn. This change was largely attributed to an increase in the operational risk and credit risk and market risk components which increased by 10.10%, 5.61% and 2.59% respectively.

The Bank remained adequately capitalised of period 30th June 2021. The Bank's capital ratios were all above the prescribed minimum requirements for Reserve Bank of Malawi of 11.5% and 15% for tier I and tier II ratios respectively. The ratios were above the 2021 set risk appetite for the Bank for capital ratios of the range of 13.5% to 15% for tier I and 15% to 20 % for tier II. The Tier I and Tier II ratios stood at 19.76% and 24.63%.

While capital remains solid, the year 2021 presents an emerging challenge as crystallization of Covid 19 credit losses is expected to occur more especially to customers affected by the same. As such, the extra buffer will be used to absorb any anticipated losses that may arise.

# 3. BACKGROUND

### 3.1. Shareholding structure

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

The shareholding structure as at 30th June, 2021 was as follows:

| | |
|---|---|
| **Press Corporation Limited** | 51.5% |
| **Old Mutual Group** | 24.6% |
| **Members of the public** | 23.5% |
| **Employees (ESOS)** | 0.4% |
| **Total** | 100% |

### 3.2. Subsidiaries, Associates and Service Centres

National Bank of Malawi provides retail, corporate and investment banking as well as stock broking, insurance, and pension administration services in Malawi. It has a network of 33 Service Centres in Malawi.

The subsidiaries and associate companies of the Bank are shown below:

| Subsidiaries | Percentage of control | Nature of operations |
|---|---|---|
| **NBM Capital Markets Limited** | 100% | Investments and fund management |
| **NBM Securities Limited** | 100% | Dormant |
| **NBM Nominees Limited** | 100% | Holding of investments as nominee |
| **Stockbrokers Malawi Limited** | 75% | Registered stockbroker |
| **NBM Bureau de Change Limited** | 100% | Dormant |
| **NBM Pension Administration Limited** | 100% | Pension administration |
| **Akiba Commercial Bank** | 51.00% | Banking |
| **NBM Development Bank Limited** | 100% | SME and long-term financing |

### 3.2.1 Performance of Subsidiaries and Associates

#### Akiba Commercial Bank

On 4th of January 2021 NBM paid for the acquisition of the 51% stake in Akiba Commercial Bank. Subsequent review showed that Akiba Commercial Bank lost value due covid-19 and the negotiated issue-price NBM was awarded more shareholding from the initial payment made. The above milestone will pave way for negotiation of a further stake to get to the desired 75%.

Akiba Commercial Bank registered a loss after tax of K1.5b as at 30th June 2021 from a loss of K1.3b as at 30th June 2020 representing an increase of 11%. Total assets increased by 1% from K55.1b as at 30th June 2020 to K61.3b as at 30th June 2021. The bank has put in a capital plan that shows its strategic direction to ensure that it complies with the capital requirements.

#### United General Insurance Company

United General Insurance reported a profit after tax of K275.7m as at 30th June 2021 from a loss of K276.1m as at 30th June 2020 representing an improvement of 200%. Total assets increased by 11% from K8,890m as at 30th June 2020 to K9,840m as at 30th June 2021. Solvency ratio is at 17.0% which is below the regulatory minimum of 20%. Management is working on regularizing the situation.

#### NBM Capital Markets

NBM Capital reported a profit after tax of K235.3m as at 30th June 2021 from K176.9m as 30th June 2020 representing an increase of 33%. Total assets increased by 77% from K19,840m as at 30th June 2020 to K35,057m as at 30th June 2021.

#### NBM Pensions Administration Limited

NBM PAL reported a profit after tax of K37.5m as at 30th June 2021 from K101.9m as at 30th June 2020 representing a decrease of 63%. Total assets decreased by 1% from K695m as at 30th June 2020 to K686m as at 30th June 2021. The decline was attributed to accumulated pensions contribution arrears and related administration on two accounts Auction Holding and Total Land Care.

#### Stockbrokers Malawi Ltd

Stockbrokers Limited reported profit after tax of K72.1m as at 30th June 2021 from K85.8m as at 30th June 2020 representing a decrease of 16%. Total assets increased by 11% from K9,962m as at 30th June 2020 to K11,082m as at 30th June 2021.

#### NBM Development Bank

NBM Development Bank registered a loss after tax of K7.1m as at 30th June 2021 from a loss of K203.3m as at 30th June 2020 representing a decrease of loss by 97%. Total assets decreased by 1% from K2,737m as at 30th June 2020 to K2,711m as at 30th June 2021.

# 4. RISK GOVERNANCE

In line with the corporate governance structure adopted by National Bank of Malawi plc, 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. 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.

## 4.1. Risk Management Oversight

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

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

The mandate of the Board subcommittees is as follows:

i. **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.

ii. **The Board Audit Committee** is the overall responsibility for the Bank's system of internal controls and for reviewing its effectiveness. The Committee also exercises the full powers and authority of the Board in accounting and financial reporting matters as guided by its terms of reference. Results of pre-arranged and surprise risk-based audits provide the Directors with information which assists them to assess the effectiveness of internal controls and management of risks in each business unit. The Board Audit Committee is 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.

iii. **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.

iv. **The Board 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.

v. **The Board Related Party Committee** is responsible for considering credit applications from Companies and Individuals related to the Bank to ensure that all transactions are conducted at arm's length.

vi. **The Board IT Projects Oversight Committee** is responsible for reviewing and approving the Bank`s IT strategy and policy documents from time-to-time to ensure that management has an effective strategic planning process for IT issues in place and that the IT strategy is aligned with the business strategy. The Committee further reviews the annual IT and operational strategies, including the financial, tactical and strategic benefits of proposed major IT and operational related initiatives.

At a management level, the Bank has the Enterprise Risk Committee (ERCO) 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. Capital Management report is discussed at both ERCO and Asset and Liability Committee (ALCO). Other management committee include Credit Committee and IT Policy Committee which are all responsible for developing and monitoring the Bank's risk management policies in their specified areas.

### 4.2. Approach to setting Risk Appetite

Risk appetite across all risk types for the Bank is determined by the risk appetite statement and is apportioned to the various business units. Each business unit sub allocates its apportionment to various risk types in accordance with its business strategy. In developing the Risk Appetite Statement, the Bank's strategy and the desired balance between risk and return is taken into consideration.

### 4.3. 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. It reflects the tolerance and willingness to accept risk. 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.

### 4.4. Monitoring Risk Appetite

The overall responsibility for the establishment and oversight of the Bank's risk appetite rests with the Board. Senior Management maintains an appropriate system of internal controls to ensure that these risks are managed within the agreed parameters.

The Board Risk Committee reviews the bank's risk profile in relation to the approved risk appetite on a quarterly basis.

### 4.5. Bank's Performance against Risk Appetite

During the review period, the Bank was generally within the approved risk appetite limits. Notable exception was that the Bank's Non-Performing Loan ratio which was at 11.15% against the risk appetite range of 3%-5%. This has been exacerbated by the COVID-19 which has slowed down business. However the Bank's Non-Performing Loan ratio against risk appetite improved as compared to ratio of 12.76% in June 2020.

## 5. STRESS TESTING

The Bank has a comprehensive Stress and Scenario Testing Framework which is used to assess the Bank's vulnerability to shocks of the different financial parameters. The aim of the stress test is to prepare the Bank for the worst case scenario in the financial system as it provides the Bank with a forward-looking assessment of risks and facilitates development of mitigation or contingency plans.

### 5.1. Approach to Stress Testing

The Bank conducts stress tests on a quarterly basis and the results of the stress tests are submitted to the ALCO, ERCO and BRC to ensure that appropriate strategies are formulated to address the needs revealed by the stress testing.

### 5.2. Results of Recent Stress Testing

| Economic Indicator | 202106 | 202109F | 202112F | 202212F | TrendF | 202109M | 202112M | 202212M | TrendM |
|---|---|---|---|---|---|---|---|---|---|
| rGDP | 3.0% | 3.0% | 3.0% | 3.5% | | 3.0% | 1.5% | -1.0% | |
| CPI | 9.1% | 9.1% | 9.1% | 8.1% | | 9.1% | 15.0% | 14.0% | |
| CCPI | 11.2% | 11.2% | 11.2% | 10.1% | | 11.2% | 17.0% | 16.0% | |
| TBRate | 13.0% | 13.0% | 13.0% | 13.0% | | 13.0% | 17.0% | 16.0% | |
| IBR | 12.0% | 12.0% | 12.0% | 12.0% | | 12.0% | 15.0% | 16.0% | |
| LoB | 1.2% | 1.2% | 1.2% | 1.2% | | 1.2% | 4.0% | 2.0% | |
| MSE | 5.0% | 5.0% | 5.0% | 5.0% | | 5.0% | 5.0% | 5.0% | |
| | | | | | | | | | |
| **Performance Measure** | **202106** | **202109F** | **202112F** | **202212F** | **TrendF** | **202109M** | **202112M** | **202212M** | **TrendM** |
| Total Revenue | 48,795,190 | 70,453,357 | 94,483,756 | 97,223,786 | | 70,453,357 | 98,582,706 | 103,914,443 | |
| Net Interest Income | 28,043,335 | 39,226,458 | 52,612,770 | 54,782,683 | | 39,226,458 | 56,945,451 | 61,391,682 | |
| Non-interest income | 20,751,855 | 31,226,898 | 41,870,986 | 42,441,103 | | 31,226,898 | 41,637,255 | 42,522,761 | |
| Operating Costs | 23,091,055 | 34,745,943 | 46,558,066 | 47,182,077 | | 34,745,943 | 46,090,737 | 46,927,406 | |
| Income (net) | 25,704,135 | 35,707,414 | 47,925,690 | 50,041,709 | | 35,707,414 | 52,491,969 | 56,987,037 | |
| Impairment Charge | 3,211,525 | 1,266,384 | 2,955,708 | 1,948,111 | | 1,266,384 | 8,290,202 | 6,784,273 | |
| Profit Before Tax (PBT) | 22,492,610 | 34,441,030 | 44,969,982 | 48,093,598 | | 34,441,030 | 44,201,767 | 50,202,764 | |
| Tax | 6,972,709 | 10,676,719 | 13,940,695 | 14,909,016 | | 10,676,719 | 13,702,548 | 15,562,857 | |
| Profit After Tax (PAT) | 15,519,901 | 23,764,310 | 31,029,287 | 33,184,582 | | 23,764,310 | 30,499,219 | 34,639,907 | |
| Retained Earnings | 4,655,970 | 7,129,293 | 9,308,786 | 9,955,375 | | 7,129,293 | 9,149,766 | 10,391,972 | |
| Dividend Paid | 10,863,930 | 16,635,017 | 21,720,501 | 23,229,208 | | 16,635,017 | 21,349,453 | 24,247,935 | |
| | | | | | | | | | |
| Cost-to-Income Ratio (%) | 47.3% | 49.3% | 49.3% | 48.5% | | 49.3% | 46.8% | 45.2% | |
| | | | | | | | | | |
| Net Loans & Advances | 202,077,647 | 203,320,011 | 204,448,912 | 209,646,989 | | 203,320,011 | 200,706,500 | 207,745,531 | |
| Gross Loans & Advances | 210,008,927 | 211,957,173 | 213,710,752 | 218,552,465 | | 211,957,173 | 215,302,835 | 221,487,168 | |
| Average Loans & Advances | 202,474,903 | 203,119,611 | 204,266,645 | 207,047,950 | | 203,119,611 | 201,095,704 | 204,226,015 | |
| Deposit From Customers | 389,442,512 | 391,836,785 | 394,012,394 | 404,030,090 | | 391,836,785 | 386,800,046 | 400,365,614 | |
| Total Assets (net of impairments) | 622,015,715 | 626,906,957 | 630,628,792 | 646,744,501 | | 626,906,957 | 588,484,949 | 616,869,881 | |
| Average Assets | 605,806,320 | 626,657,882 | 630,129,064 | 638,686,647 | | 626,657,882 | 593,357,779 | 602,677,415 | |
| Total RWAs | 408,201,708 | 410,084,175 | 411,788,698 | 419,586,800 | | 410,084,175 | 396,195,934 | 416,191,346 | |
| RWA Credit Risk | 279,643,312 | 280,926,718 | 282,085,415 | 287,381,815 | | 280,926,718 | 276,829,541 | 284,705,897 | |
| RWA Operational Risk | 118,620,281 | 119,164,681 | 119,656,182 | 121,902,832 | | 119,164,681 | 117,426,724 | 120,767,749 | |
| RWA Market Risk | 9,938,116 | 9,992,775 | 10,047,101 | 10,302,153 | | 9,992,775 | 1,939,669 | 10,717,700 | |
| RWA Other | | | | | | | | | |
| Impairment Stock | 7,931,280 | 8,637,162 | 9,261,841 | 8,905,476 | | 8,637,162 | 14,596,335 | 13,741,638 | |
| | | | | | | | | | |
| Interest Rate L&A | 18.0% | 16.7% | 16.7% | 16.8% | | 16.7% | 18.1% | 18.6% | |
| | | | | | | | | | |
| | | | | | | | | | |
| PD (PIT) | 21.5% | 22.0% | 22.5% | 19.1% | | 22.0% | 26.7% | 24.1% | |
| LGD | 27.1% | 27.3% | 27.5% | 27.9% | | 27.3% | 34.7% | 32.6% | |
| NPL Ratio | 11.3% | 11.9% | 12.4% | 8.7% | | 11.9% | 12.9% | 10.3% | |
| RWA Credit Risk Density | 133.2% | 132.5% | 132.0% | 131.5% | | 132.5% | 128.6% | 128.5% | |
| Total RWA Density | 65.6% | 65.4% | 65.3% | 64.9% | | 65.4% | 67.3% | 67.5% | |
| Loan loss rate | 159 | 62 | 145 | 94 | | 62 | 412 | 332 | |
| | | | | | | | | | |
| Interest Rate Margin (%) | 9.3% | 8.3% | 8.3% | 8.6% | | 8.3% | 9.6% | 10.2% | |
| | | | | | | | | | |
| Free Cash Flow Generated | 15,438,327 | 23,703,322 | 30,974,311 | 32,404,772 | | 23,703,322 | 24,667,081 | 32,640,366 | |
| Tier 1 Capital (%) | 19.8% | 20.9% | 19.6% | 21.5% | | 20.9% | 20.6% | 22.0% | |
| Tier 2 Capital (%) | 4.9% | 6.5% | 6.4% | 6.3% | | 6.5% | 6.7% | 6.4% | |
| Total Capital (%) | 24.6% | 27.3% | 26.0% | 27.8% | | 27.3% | 27.3% | 28.4% | |
| | | | | | | | | | |
| RoRWA % | 3.8% | 5.8% | 7.5% | 7.9% | | 5.8% | 7.7% | 8.3% | |
| RoE % | 58.7% | 89.8% | 117.3% | 125.4% | | 89.8% | 115.3% | 130.9% | |
| RoRC % | 30.4% | 46.4% | 60.3% | 63.3% | | 46.4% | 61.6% | 66.6% | |
| RoA % | 2.6% | 3.8% | 4.9% | 5.2% | | 3.8% | 5.1% | 5.7% | |

The Bank remains resilient to impact of Credit Risks and Liquidity Risks. The stress test to see impact of increase in Non-Performing The Bank remains resilient to impact of Credit Risks and Liquidity Risks. The stress test to see impact of increase in Non-Performing Loans, default of Top 5 borrowers and impact of Sector shock on Tier 1 Capital showed that the Bank was within the regulatory limit of 10% when applied with ratios ranging from 19.8% to 16% from default of the first to the fifth borrower.

However, the exception was that the liquidity shock's results indicated that the Bank was able to survive for 2 days only which was below the recommended survival period of 5 days. Another exception was that the Bank did not meet the minimum Tier 1 ratio when extreme combined macro-economic shocks were applied. The ratio fell from 19.8% to 6.7% which is below the regulatory limit.

### 5.3. Mitigation Strategy for Exceptions on Capital

In order to mitigate the impact of capital risk, the Bank did an Internal Capital Adequacy Assessment Process (ICAAP) for the year to 31st December 2021. Overall, the Bank is projected to be adequately capitalized by the end of December 2021. The Bank's projected capital position as at 31st December 2021 shows that Tier I Ratio will be at 17.30% being above the regulatory minimum of 11.5% for Tier I and also above the internal trigger limit of 13.50%. The 'Stressed' Tier I shows that it will be at 12.20%. Tier II is projected to be at 22.53% as at 31st December 2021. The 'Stressed' Tier II shows that it will be at 15.90%. The Bank is well capitalized as at 31st December 2020 and we project the same for the 12months to 31st December, 2021. The Bank has deliberately set the internal limit trigger for capital at 13.50%. The Bank's projected Capital Ratios for 2021 is well above set limit.

## 6. CREDIT RISK

Credit Risk means the likelihood that a debtor or financial instrument issuer is unwilling or unable to pay interest and/or repay the principal according to the terms specified in a credit agreement resulting in economic loss to the Bank. The risk arises from direct lending, trade finance and leasing business, but also from off-balance sheet activities such as guarantees, letters of credits and from holding of debt securities.

### 6.1. Approach to Managing Credit Risk

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

Additionally, there is a management Credit Committee which is comprised of some members of senior management. The 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 bank's risk grades in order to categorize 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 bank's overall credit risk management issues.

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.

### 6.2. 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 Standardized 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 follows IFRS 9 Expected Credit Loss (ECL) Model for all financial instruments that are subject to impairment accounting. It recognises a loss allowance for expected credit losses on a financial asset measured at amortised cost or at fair value through other comprehensive income, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements of the Standard apply. Expected credit losses shall be an estimate of losses that the Bank expect to result from a credit event, such as a payment default. 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). In adopting IFRS 9 the Bank re-aligned all definitions of default and cure given by IFRS 9 to those of Basel II.

### 6.3. Expected Credit Loss Model and Provisioning Categories

The adoption of IFRS 9 has necessitated implementation of its classification standards which maps the credit book into three stages to reflect the general pattern of the deterioration of a financial instrument that ultimately defaults as follows: -

**Stage 1:** This is where a 12-month expected credit losses is recognized in profit or loss and a loss allowance shall be established as soon as a financial instrument has been originated or purchased. For financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk at the reporting date, the loss allowance for 12month expected credit losses is maintained but updated for changes in amount. For financial assets, interest revenue is calculated on the gross carrying amount of the asset (i.e. without reduction for expected credit losses);

**Stage 2:** If the credit risk increases significantly and the resulting credit quality is not considered to be low credit risk, full lifetime expected losses are recognized. Lifetime expected credit losses are only recognized if the credit risk increases significantly from when the entity originates or purchases the financial instruments but that do not have objective evidence of a credit loss event. Expected credit losses may be individually and/or collectively assessed. For a financial asset, interest revenue is still calculated on the gross carrying amount of the asset (same as for Stage 1).

**Stage 3:** If the credit risk of a financial asset increases to the point that it is considered credit impaired (that have objective evidence of impairment at the reporting date), lifetime expected credit losses continue to be recognised. For financial assets in this stage, lifetime expected credit losses will generally be individually assessed. However, interest revenue shall be calculated on the amortized cost net carrying amount (i.e. reduced for expected credit losses).

### 6.4. Credit Risk Monitoring

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.

### 6.5. Credit Risk Mitigation

As a fundamental credit principle, the bank 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.

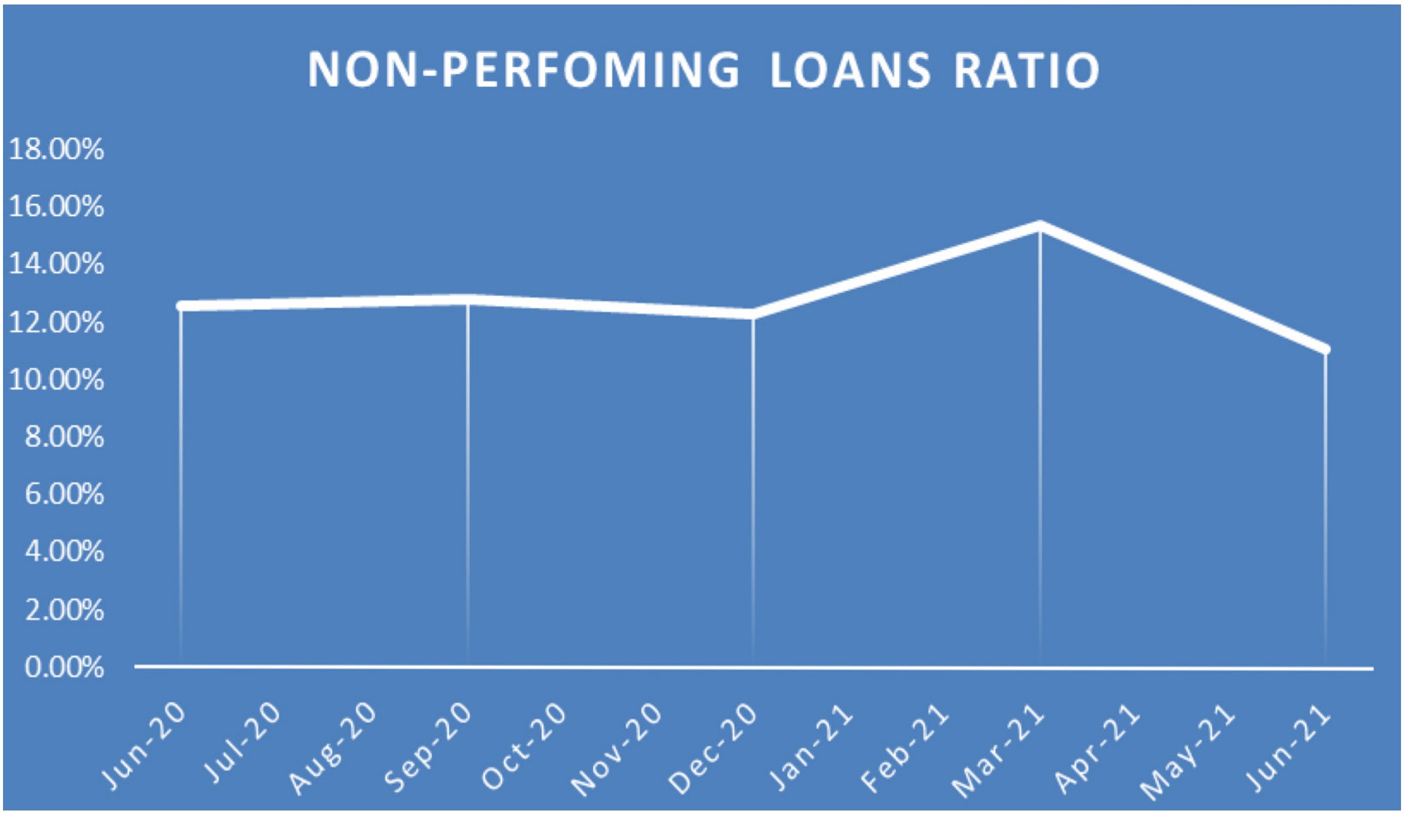
## 6.6. Credit Risk Exposures

Overall credit risk was rated moderate.

| Indicators | June-2021 K'm | June-2020 K'm | Change (%) |
|---|---|---|---|
| Loans and Advances | 198,94 | 203,677 | -2.33% |
| Non-Performing loans | 23,761 | 27,628 | -14% |

Loans and advances decreased by 2.33% from K203.677bn as at 30th June 2020 to K198.94bn as at 30th June 2021. This decrease was attributed to the repayment by one of the large borrowers (Lilongwe Water Board) among others.

Total non-performing loans decreased by 14% from K27.628bn to K23.761bn which led to a decrease in NPL ratio from 12.6% to 11.15% within the same year period. This was attributed to the repayment by one of the large borrowers that was not performing. Below graph gives highlight in the movement of non-performing loans within the period.




IFRS 9 Credit risk provisioning decreased from K10.0bn as at 30th June 2020 to K7.28bn as at 30th June 2021 mainly attributed to the incorporation of more security for facilities and the repayment by one of the large borrowers that was not performing.

### 6.7. Restructured Facilities by Sector

Out of the 13 Sectors, Restaurants, and hotels (60. %), Agriculture, forestry, fishing and hunting (34.7%) were the most affected; The table below gives a summary of restructured facilities by Sector;

| Sector | Corporate (MK) | Retail (MK) | Total (MK) | Total (%) |
|---|---|---|---|---|
| Restaurants and hotels | 12,534,200,670 | 44,057,230 | 12,578,257,900 | 60.2% |
| Agriculture, forestry, fishing and hunting | 7,255,106,205 | - | 7,255,106,205 | 34.7% |
| Wholesale and retail trade | 947,468,820 | - | 947,468,820 | 4.5% |
| Manufacturing | - | 102,482,436 | 102,482,436 | 0.5% |
| Mining and quarying | - | - | | 0.0% |
| Electricity, gas, water and energy | - | - | | 0.0% |
| Construction | - | - | | 0.0% |
| Transport, storage and communications | - | - | | 0.0% |
| Financial services | - | - | | 0.0% |
| Real estate | - | - | | 0.0% |
| Other sectors | - | - | | 0.0% |
| **TOTAL** | **20,736,775,696** | **146,539,666** | **20,883,315,362** | **100.0%** |

### 6.8. IFRS 9 Provision

IFRS 9 Credit risk provisioning improved from K9.76bn as at 31st March 2021 to K7.28bn as at 30th June 2021 mainly attributed to the incorporation of more security for facilities and the repayment of one of the large borrowers which not performing and the write-off of some loans.

| Classification of Loans, Leases And Other Assets by Sector in their IFRS 9 Stages | | | | |
|---|---|---|---|---|
| | Stage 1 | Statge 2 | Stage 3 | Total |
| Agriculture, forestry, fishing and hunting | 37,601,874 | 25,993 | 274,241 | 37,902,108 |
| Mining and quarying | 517,094 | 63 | 515 | 517,672 |
| Manufacturing | 13,708,690 | 1,777,017 | 8,228,736 | 23,714,443 |
| Electricity, gas, water and energy | 14,646,088 | 2,414 | 10,647 | 14,659,149 |
| Construction | 3,117,089 | 156,698 | 358,043 | 3,631,830 |
| Wholesale and retail trade | 25,931,866 | 1,012,286 | 8,869,937 | 35,814,089 |
| Restaurants and hotels | 7,897,332 | 9,440,196 | 1,155,189 | 18,492,717 |
| Transport, storage and communications | 7,324,721 | 552,838 | 829,124 | 8,706,683 |
| Financial services | 3,323,203 | 205,395 | 2,176,538 | 5,705,136 |
| Community, social and personal services | 5,958,360 | 398,146 | 290,160 | 6,646,666 |
| Real estate | 6,556,378 | 2,254 | 723 | 6,559,355 |
| Other sectors | 44,277,710 | 1,813,508 | 1,567,862 | 47,659,080 |
| Less: Loss Provisions | 3,995,541 | 615,861 | 2,672,614 | 7,284,016 |
| **TOTAL** | **166,864,864** | **14,770,947** | **21,089,101** | **202,724,912** |

Distribution of Non-Performing Loans and their related IFRS 9 Credit risk provision.

| Distribution of Non Performing Loans and Loss Provisions by Sector | | |
|---|---|---|
| **Sector** | **Non Performing Loans** | **Provisions** |
| Agriculture, forestry, fishing and hunting | 274,241 | 16,831 |
| Mining and quarying | 515 | 133 |
| Manufacturing | 8,228,736 | 105,136 |
| Electricity, gas, water and energy | 10,647 | 1,576 |
| Construction | 358,043 | 57,863 |
| Wholesale and retail trade | 8,869,937 | 1,279,075 |
| Restaurants and hotels | 1,155,189 | 223,669 |
| Transport, storage and communications | 829,124 | 117,806 |
| Financial services | 2,176,538 | 7,860 |
| Community, social and personal services | 290,160 | 124,125 |
| Real estate | 723 | 181 |
| Other sectors | 1,567,862 | 738,359 |
| **TOTAL** | **23,761,715** | **2,672,614** |

### 6.9. Off Balance Sheet Exposures (Guarantees and Financial Instruments)

The table below shows the Off-Balance Sheet Exposures as of 30th June 2021. Documentary credit and undrawn commitments comprise the 87% of the exposure.

| RISK-WEIGHTED AMOUNTS (OFF-BALANCE SHEET EXPOSURES) | Exposure Amounts | Credit Conversion Factors (CCF) | Risk- Weighted Amounts |
|---|---|---|---|
| Claims to or Guaranteed by Government | - | - | - |
| Claims with Cash Collateral | | - | - |
| Credit substitutes (Guarantees, Letters of credit, Assets pledged as collateral security) | - | 1.000 | - |
| Transaction Related Contingency (Performance Bonds, Stand by L/Cs etc) | 7,159,024 | 0.500 | 3,579,512 |
| Undrawn commitments | 22,926,891 | 0.500 | 11,463,446 |
| Documentary Credits (Trade related & Self liquidating) | 28,127,608 | 0.200 | 5,625,522 |
| Other Commitments with maturity of over 1 year | - | 0.500 | - |
| Similar Commitments of up to 1 year or which can be | 416,253 | - | - |
| **TOTAL** | **58,629,776** | | **20,668,479** |

# 7. LIQUIDITY RISK

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

### 7.1. Approach to Managing Liquidity Risk

The Bank's approach to managing liquidity is to ensure 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 Bank 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 then 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.

The TIBD monitors compliance of all operating units of the Bank with local regulatory limits on a daily basis.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of both the Bank and operating units. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

### 7.2. Regulatory Liquidity Limits

The Bank experienced overall decline in liquidity ratios during period ending 30 June 2020 as compared to similar period last year. Despite that the Bank was within both the regulatory limit and internal limit.

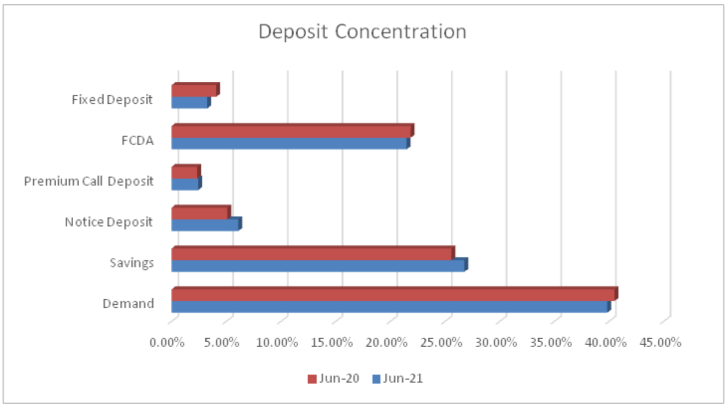
The Table below shows that the Liquidity ratios were within regulatory limit and risk appetite.

| | June-2021 | June-2020 |
|---|---|---|
| Liquidity Ratio I | 48.25% | 42.00% |
| RBM Limit | 25.00% | 25.00% |
| NBM Limit | 45.00% | 45.00% |

### 7.3. Deposit Concentration

In normal times, the deposit concentration may not pose a problem and instead prove to be profitable, but in unforeseen circumstances, sudden withdrawal of funds by the category of deposits can pose a serious challenge and, therefore expose the Bank to un-quantified risk.

The total deposits increased by 26.45% from K308.710bn as at 30th June 2020 to K390.357bn as of 30th June 2021. The deposits were largely made up of Demand Deposits (39.84%), Savings Deposits (26.78%), Foreign Currency Denominated Deposits (21.49%) and as depicted in the graph below;




The total Top 10 Deposits were at K31.2bn representing 10% of the total deposits. The ratio was within the 25% threshold limit.

# 8. MARKET RISK

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

## 8.1. Approach to Managing Market Risk

The Bank 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 Bank's trading portfolios mainly are held by the Treasury and Investment Banking Division, 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. The total capital set aside for market risk under the Standardized Approach was as follows;

| Capital Charge | June 2021(K'm) | June 2020 (K'm) |
|---|---|---|
| Interest Rate Risk | - | - |
| Foreign Exchange Risk | 225.2 | 179.0 |
| Equity Risk | 768.5 | 789.8 |
| Total | 993.8 | 968.8 |

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.

# 9. OPERATIONAL RISK

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology, and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Bank's operations and are faced by all business entities.

The Bank has an Operational Risk Management Framework that guides the management of operational risk.

## 9.1. Approach to Managing 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 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 | June 2021(K'm) | June 2020 (K'm) |
|---|---|---|
| Operational Risk | 118,620 | 106,871 |

## 10. CONCLUSION

The Bank continues to closely monitor its core risks and ensure that they are properly mitigated. Supported by the sustained growth in retained earnings, exposures across risk types are generally assigned comfortable capital levels. The economy is officially projected to grow by 3.8% in 2021. In the absence of long-term safety nets, the closure of the tobacco selling season and the supply and demand imbalances being experienced on foreign exchange, continued pressure on the exchange rate is expected. This coupled with the impact of the third wave of COVID-19, may dampen the growth prospects.

In spite of the above, the Bank remains optimistic and expects to continue with its strong performance in the second half of the year.