Standard Bank Limited PLC (Malawi)

Risk and Capital Management Report December 2018

Standard Bank Moving Forward™

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1 Overview

Introduction

Effective risk management is fundamental to the business activities of Standard Bank Limited (Malawi) (SBM or the bank). While the bank remains committed to increasing shareholder value by developing and growing the business within the Board-determined risk appetite, the bank is mindful of achieving this objective in line with the interests of all stakeholders.

Effective risk management should provide complete, timely, accurate and relevant information to enhance senior management decision making ability to:

- calculate risk adjusted performance measures;
- manage volatility in earnings;
- minimise financial distress; and
- help appraise new business initiatives on a comparable basis.

Governance standards have been established as key components of good governance and business practice in the bank. The standards form an integral part of the control infrastructure and represents a high-level description of the expectations and requirements of the Board in respect to risk appetite, risk reporting and key areas of control activity within the bank.

Identification of material risks is a process overseen by the Chief Risk Officer, Head of Compliance and the Legal Counsel, with involvement from the business units and enabling functions.

Based on the above mentioned criteria, the following primary risk types are considered by the bank to be material:-

Credit risk (including counterparty credit risk)

Credit risk regulatory capital is determined by The Standardised Approach (TSA) as per the Reserve Bank of Malawi (RBM) regulations.

For both regulatory and internal credit risk capital measurement, the calculation of the capital requirement is affected by the level of stage 3 provisions for credit losses (relating to non-performing loans) that the bank has taken. Stage 3 provisions are taken in accordance with regulations and also take into account expected recoveries and the timing of such recoveries.

Market risk

Market risk regulatory capital is determined by TSA as per the RBM regulations. Additionally, market risk is measured and stress-tested within the bank using a number of established risk metrics and techniques, including Value at Risk (VaR).

Interest Rate Risk in the Banking Book (IRRBB)

The bank manages its exposure to changes in interest rates on its banking book assets and liabilities (loans and deposits) by ensuring that an interest rate shock for both the local currency and foreign currency books – as prescribed by the Asset and Liability Committee (ALCO) – does not result in adverse annualised net interest income change.

Liquidity risk

An extensive set of liquidity risk metrics are in place. Due to the robustness of the measurement and monitoring approaches, the level of unencumbered liquid assets, and the necessarily timeous management action required, the bank does not hold capital for liquidity risk.

Operational risk

The bank uses the Basic Indicator Approach (BIA) to calculate operational risk regulatory capital as per the RBM regulations. For internal measurement purposes, since operational risk regulatory capital is less risk sensitive, regulatory capital is further adjusted giving consideration to historical loss experience, the level of management oversight, the status of implementation/use of the operational risk management framework and operational risk events.

Legal risk

The bank has an in-house Legal Function whose main role is to provide legal advisory services to all business/enabling units within the bank on all transactions/activities that are carried out in the bank and implementing and maintaining a comprehensive legal risk management system. Furthermore, the in-house Legal Function ensures that all legal risks pertaining to new products and services developed and/or implemented by the various units within the bank are identified and adequately mitigated and/or managed. Supported by historical data on legal exposures and litigation outcomes, the bank considers its legal risk management risks adequate; therefore the existing capital buffers are enough to accommodate the risk.

Compliance risk

The bank has adopted the Compliance Risk Management Framework based on compliance risk management plans in which all statutory and regulatory requirements that impact on the bank's business; the existing control mechanisms that exists to ensure that the bank complies with the requirements; the responsible department and personnel responsible for ensuring that the bank complies with each specific statutory or regulatory requirement and the compliance targets and deadlines are identified and documented. Although the Board has the ultimate responsibility for the management of compliance risks, this approach ensures that officers at each and every level of the bank are aware of their responsibilities in managing compliance risks and take responsibility and accountability of all compliance risks that fall within their functional areas. The bank has adopted zero tolerance for statutory and regulatory breaches and proactively manages compliance, therefore no capital is held for compliance risk. The history of fines and penalties for the bank lends support to this statement.

Business risk

The bank's management have a clear understanding of the value drivers that impact on profitability. The bank does not specifically provide capital for business risk because it is contained within the capital buffer determined by the bank's comprehensive stress testing. It is also minimal as loss history is negligible.

The risk management processes have continued to prove effective throughout the 2018. The various management risk committees have remained closely involved in important risk management initiatives, which have focused particularly on preserving appropriate levels of liquidity and capital, and effectively managing the risk portfolios. Responsibility and accountability for risk management resides at all levels within the bank.

2 Corporate structure

The bank is a publically listed universal bank licensed in Malawi. It is majority owned (60.18%) by Standard Bank Group Limited. Other shareholders are: NICO Holdings Ltd 20%; Old Mutual Life Assurance Co 5.38%; Press Trust 2.32%; Fund Magetsi Pension 1.38%; National Investment Trust Limited 1.19%; and other public Investors 9.55%.

Standard Bank Bureau de Change Limited is a 100% owned subsidiary of the bank whose line of business is retail foreign exchange trading. The bank has a 9.1% investment in the National Switch Company.

2.1 Media and location

This document should be read in conjunction with the published Annual Report for the bank which is available on the bank's website: http://www.standardbank.co.mw

3 Regulatory capital structure and capital adequacy

The internal capital adequacy assessment process (ICAAP) ensures that the bank maintains sufficient capital levels for the purposes of regulatory compliance and adherence to the Board's risk appetite. Regulatory capital adequacy is measured by a Tier I and Tier II Capital Adequacy Ratio (CAR).

Tier 1 (primary capital) represents permanent forms of capital such as share capital, share premium and retained earnings less fifty percent of investment in subsidiary and deferred tax asset.

Tier II (secondary capital) includes revaluation reserves, general debt provisions and less fifty percent of investment in subsidiary.

IFRS 9 implementation impacted regulatory capital requirements. The increase in impairment provisions together with the increase in the deferred tax asset reduced Tier 1 capital. The IFRS 9 impact was adjusted against retained earnings at the beginning of the year.

Table 1: Qualifying regulatory capital – 31st December 2018

Capital Component	Amount MK'mn
Tier I	
Issued primary capital	67,799
Ordinary share capital	234
Share premium	8,492
Retained earnings	59,222
General reserves	(149)
Less: Regulatory deductions	3,051
Deferred tax assets	2,986
Investments in subsidiaries/associates	65
Total	64,748
Tier II	
Issued secondary capital and reserves	7,469
Reserve: Statutory credit risk	-
Revaluation reserves less 50% investments in subsidiaries/associates	7,469
Total eligible capital	72,217
Total capital demand	58,228
Total risk weighted assets	332,731
Credit risk weighted assets	246,723
Operational risk weighted assets	82,097
Market risk weighted assets	3,911
Tier I capital ratio (%)	19.46%
Total capital adequacy ratio (%)	21.70%
Minimum regulatory requirements	
Tier I capital ratio (%)	10.00%
Total capital adequacy ratio (%)	15.00%

During the period under review, the bank complied with all externally-imposed capital requirements to which its banking activities are subject. These include, but are not limited to, the relevant requirements of the Banking and Financial Services Act (BFSA) and regulations relating to banks; these are consistent with the Basel II guidelines issued by the Bank for International Settlements as adopted by RBM.

Table 2: Risk exposure amounts and risk weighted assets – 31st December 2018

	Exposure amounts MK'mn	Loss provisions MK'mn	Credit risk mitigation MK'mn	Risk weighted assets MK'mn
Credit risk	**539,224**	**7,757**	**1,191**	**246,723**
Sovereign or central bank	123,690	283	-	-
Public sector entities	18	-	-	-
Exposure to banks	33,467	-	-	16,542
Corporate	68,299	438	-	67,861
Retail other	51,097	6,701	176	38,951
Retail mortgages	1,849	153	-	621
Other assets	84,650	-	-	51,644
Off balance sheet exposures	176,153	182	1,015	71,104
Market risk	3,911	-	-	3,911
Interest rate risk	1,343	-	-	1,343
Equity position risk	-	-	-	-
Foreign exchange risk	2,568	-	-	2,568
Commodities risk	-	-	-	-
Operational risk	82,097	-	-	82,097
Total risk weighted assets/capital requirement	**625,232**	**7,757**	**1,191**	**332,731**

Note: Accrued interest on exposure amounts in the table above has been included in other assets in line with Reserve Bank of Malawi guidelines.

Table 3: Summary of capital ratios (%) – 31st December 2018

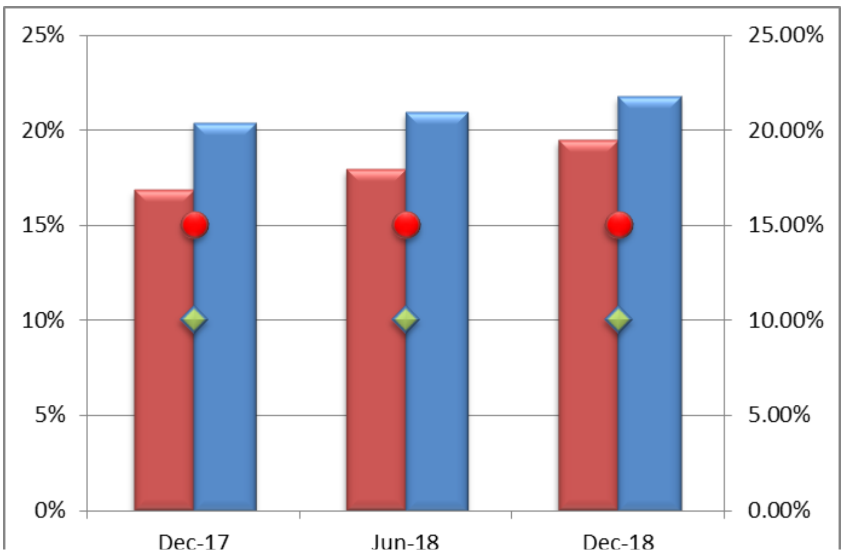
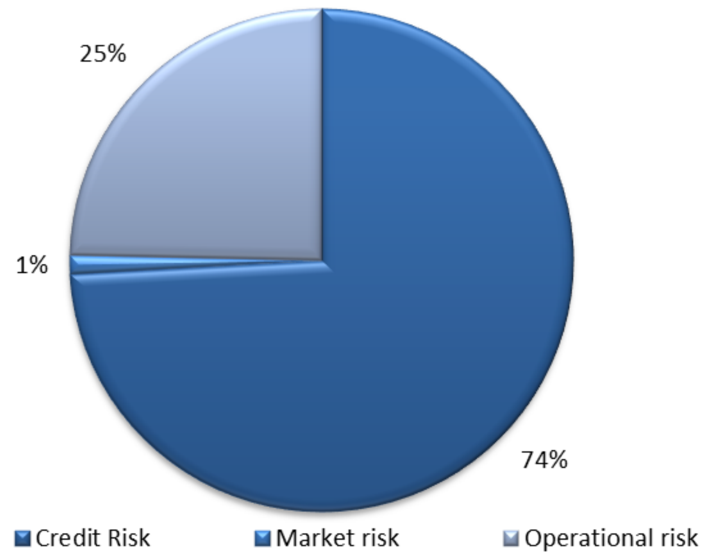


Figure 1: Risk weighted assets composition – 31st December 2018



4 Credit risk

Credit risk is the bank's most material risk, and is managed in accordance with the bank's comprehensive risk management control framework. The Credit Standard sets out the principles under which the bank is prepared to assume credit risk. Responsibility for credit risk resides with the bank's business units, supported by the bank's Risk Function and with oversight, as with other risks, by the bank's risk committees and ultimately the Board.

The principal executive management committee responsible for overseeing credit risk is the Credit Risk Management Committee (CRMC). The credit committees for both Personal and Business Banking (PBB) and Corporate and Investment Banking (CIB) report directly to CRMC and indirectly to the Board Credit Committee (BCC).

CRMC is responsible for making decisions on credit risk. It was approved by the Board as the designated committee for approving key aspects of the credit rating systems for PBB and CIB as required by the BFSA, and other regulations relating to banks. The CRMC recommends the approval of all counterparty large exposures and insider lending transactions to the extent required by RBM regulations. All such approvals are approved by the bank's Board.

The BCC is the principal board committee responsible for the oversight of credit risk, with CRMC having oversight responsibility for reviewing credit impairment adequacy.

Impairment policy

Expected credit losses (ECL) is recognised on debt financial assets classified as at either amortised cost or fair value through other comprehensive income (OCI), financial guarantee contracts that are not designated at fair value through profit or loss as well as loan commitments that are neither measured at fair value through profit or loss nor are used to provide a loan at a below market interest rate.

The measurement basis of the ECL of a financial asset includes assessing whether there has been a significant increase in credit risk (SICR) at the reporting date which includes forward-looking information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. The measurement basis of the ECL, which is set out in the table that follows, is measured as the unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes, the time value of money and forward-looking information.

Stage 1	A 12-month ECL is calculated for financial assets which are neither credit-impaired on origination nor for which there has been a SICR.
Stage 2	A lifetime ECL allowance is calculated for financial assets that are assessed to have displayed a SICR since origination and are not considered low credit risk.
Stage 3 (credit impaired assets)	A lifetime ECL is calculated for financial assets that are assessed to be credit impaired. The following criteria are used in determining whether the financial asset is impaired: • default • significant financial difficulty of borrower and/or modification • probability of bankruptcy or financial reorganisation • disappearance of an active market due to financial difficulties.

The key components of the impairment methodology are described as follows:

Significant increase in credit risk	At each reporting date the group assesses whether the credit risk of its exposures has increased significantly since initial recognition by considering the change in the risk of default occurring over the expected life of the financial asset. Credit risk of exposures which are overdue for more than 30 days are also considered to have increased significantly.
Low credit risk	Exposures are generally considered to have a low credit risk where there is a low risk of default, the exposure has a strong capacity to meet its contractual cash flow obligations and adverse changes in economic and business conditions may not necessarily reduce the exposure's ability to fulfil its contractual obligations.
Default	The group's definition of default has been aligned to its internal credit risk management definitions and approaches. A financial asset is considered to be in default when there is objective evidence of impairment. The following criteria are used in determining whether there is objective evidence of impairment for financial assets or groups of financial assets: • significant financial difficulty of borrower and/or modification (i.e. known cash flow difficulties experienced by the borrower) • a breach of contract, such as default or delinquency in interest and/or principal payments • disappearance of active market due to financial difficulties • it becomes probable that the borrower will enter bankruptcy or other financial reorganisation • where the group, for economic or legal reasons relating to the borrower's financial difficulty, grants the borrower a concession that the group would not otherwise consider. • Exposures which are overdue for more than 90 days are also considered to be in default.

Forward-looking information	Forward-looking information is incorporated into the group's impairment methodology calculations and in the group's assessment of SICR. The group includes all forward looking information which is reasonable and available without undue cost or effort. The information will typically include expected macro-economic conditions and factors that are expected to impact portfolios or individual counterparty exposures.
Write-off	Financial assets are written off when there is no reasonable expectation of recovery. Financial assets which are written off may still be subject to enforcement activities.

ECLs are recognised within the statement of financial position as follows:

Financial assets measured at amortised cost (including loan commitments)	Recognised as a deduction from the gross carrying amount of the asset (group of assets). Where the impairment allowance exceeds the gross carrying amount of the asset (group of assets), the excess is recognised as a provision within other liabilities.
Off-balance sheet exposures (excluding loan commitments)	Recognised as a provision within other liabilities.
Financial assets measured at fair value through OCI	Recognised in the fair value reserve within equity. The carrying value of the financial asset is recognised in the statement of financial position at fair value.

Table 4: Total credit exposures as per IFRS 7 – 31st December 2018

	Gross Carrying amount MKm	SB 1 - 12		SB 13 - 20		SB 21- 25		Default		Total gross carrying amount of default exposures MKm	Securities and expected recoveries on default exposures MKm	Interest in suspense on default exposures MKm	Balance sheet expected credit loss on default exposures MKm	Gross default coverage %	Non-performing exposures %
		Stage 1 MKm	Stage 2 MKm	Stage 1 MKm	Stage 2 MKm	Stage 1 MKm	Stage 2 MKm	Stage 3 MKm	Purchased /originated credit impaired MKm						
Loans and advances at amortised cost															
PBB	**53,215**	**-**	**-**	**26,511**	**9,995**	**8,554**	**-**	**8,155**	**-**	**8,155**	**1,917**	**1,494**	**4,744**	**76%**	**15%**
Mortgage loans	1,870	-	-	1,131	261	416	-	62	-	62	57	-7	12	8%	3%
Vehicle and asset finance	6,256	-	-	3,509	1,653	687	-	407	-	407	165	-	242	59%	7%
Card debtors	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other loans and advances	45,089	-	-	21,871	8,081	7,451	-	7,686	-	7,686	1,695	1,501	4,490	78%	17%
Personal unsecured lending	19,663	-	-	13,031	3,126	3,135	-	371	-	371	481	10	-120	-30%	2%
Business lending and other	25,426	-	-	8,840	4,955	4,316	-	7,315	-	7,315	1,214	1,491	4,610	83%	29%
CIB	**145,372**	**30,502**	**-**	**114,739**	**131**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Corporate	68,856	950	-	67,775	131	-	-	-	-	-	-	-	-	-	-
Sovereign	46,964	-	-	46,964	-	-	-	-	-	-	-	-	-	-	-
Bank	29,552	29,552	-	-	-	-	-	-	-	-	-	-	-	-	-
Other service	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross carrying amount	**198,587**	**30,502**	**-**	**141,250**	**10,126**	**8,554**	**-**	**88,155**	**-**	**8,155**	**1,917**	**1,494**	**4,744**	**76%**	**4%**
Less: Interest in suspense	1,494														
Less: Total expected credit losses for loans and advances	7,455														
Net carrying amount of loans and advances measured at amortised cost	**189,638**														
Financial investments measured at amortised cost															
Corporate	-	-	-	-	-	-	-	-							
Sovereign	68,368			68,368											
Bank	-	-	-	-	-	-	-	-							
Other instruments	-	-	-	-	-	-	-	-							
Gross carrying amount	**68,368**	**-**	**-**	**68,368**	**-**	**-**	**-**	**-**							
Less: total expected credit loss for financial investments	119														
Net carrying amount of financial investments measured at amortised cost	**68,249**														
Financial investments at fair value through OCI	-	-	-	-	-	-	-	-							
Corporate	-	-	-	-	-	-	-	-							
Sovereign	17,097	-	-	17,097	-	-	-	-							
Bank	-	-	-	-	-	-	-	-							
Other instruments	-	-	-	-	-	-	-	-							
Gross carrying amount	**17,097**	**-**	**-**	**17,097**	**-**	**-**	**-**	**-**							
Add: Fair value reserve relating to fair value adjustments (before the ECL balance)	-														
Total financial investment at fair value through OCI	**17,097**														
Off-balance sheet exposures															
Letters of credit and banker's acceptances	15,850														
Guarantees	92,266														
Irrevocable unutilised facilities	-														
Total exposure to off-balance sheet credit risk	**108,116**														
Expected credit losses for off-balance sheet exposures	182														
Net carrying amount of off-balance sheet exposures	**107,934**														
Total exposure to credit risk on financial assets subject to an expected credit loss	**382,919**														
Add the following other banking activities exposures:															
Other loans and advances at fair value through profit or loss	-														
Cash and balances with the central bank	29,260														
Derivative assets	369														
Other financial investments	130														
Trading assets	11,993														
Pledged assets	-														
Other financial assets	4,454														
Total exposure to credit risk	**429,125**														

Table 5: Geographical distribution of loans and advances to customers – 31st December 2018

	Amount in MK'mn	Percentage Concentration
North and central	60,164	49%
South	61,907	51%
	122,071	100%

Table 6: Distribution of exposures to customers by industry – 31st December 2018

	Amount in MK'mn	Percentage
Agriculture, forestry, fishing and hunting	49,801	40.8%
Construction	1,291	1.1%
Electricity, gas, water and energy	650	0.5%
Financial services	757	0.6%
Individuals and households	28,274	23.2%
Manufacturing	6,526	5.3%
Mining and quarrying	1	0.0%
Transport, storage and communication	12,170	10.0%
Wholesale and retail trade	15,894	13.0%
Community, social and personal services	1,567	1.3%
Real estate	4,757	3.9%
Restaurant and others	383	0.3%
	122,071	**100.0%**

The table below sets out an analysis of credit risk by maturity as at 31 December 2018. Residual maturity of credit exposures is based on contractual dates.

Table 7: Residual contractual maturity of credit exposures – 31st December 2018

	Up to 1 month MK'mn	<1-3months MK'mn	>3-12months MK'mn	Over 1 Year MK'mn	Undated MK'mn	Total MK'mn
Sovereign or central bank	**19,884**	**34,740**	**23,071**	**45,995**	**-**	**123,690**
Public sector entities	**18**	**-**	**-**	**-**	**-**	**18**
Exposure to banks	**33,467**	**-**	**-**	**-**	**-**	**33,467**
Corporate	**11,154**	**28,967**	**10,894**	**17,284**	**-**	**68,299**
Retail other	**3,697**	**1,853**	**6,939**	**38,609**	**-**	**51,098**
Retail mortgages	**1**	**6**	**5**	**1,837**	**-**	**1,849**
Other assets	**84,650**	**-**	**-**	**-**	**-**	**84,650**
Off balance sheet exposures	**34,882**	**44,615**	**26,087**	**70,569**	**-**	**176,153**
Total credit risk exposures	**187,753**	**110,181**	**66,996**	**174,294**	**-**	**539,224**

Note: Accrued interest on exposure amounts in the table above has been included in other assets in line with Reserve Bank of Malawi guidelines.

Table 8: Aging of loans and advances past due but not specifically impaired – 31st December 2018

	Total MK'mn	Less than 30 days MK'mn	31 to 60 days MK'mn	61 to 90 days MK'mn	91 to 180 days MK'mn	More than 180 days MK'mn
Personal and Business Banking	**9,995**	**5,596**	**3,883**	**516**		
Mortgage loans	261	183	58	20	-	-
Instalment sales and finance leases	1,653	1,451	161	41	-	-
Card debtors	-	-	-	-	-	-
Other loans and advances	**8,081**	**3,962**	**3,664**	**455**	**-**	**-**
Personal unsecured lending	3,126	2,805	202	119	-	-
Business lending and other	4,955	1,157	3,462	336	-	-
Corporate and Investment Banking	**-**					
Corporate loans	-	-	-	-	-	-
Commercial property finance	-	-	-	-	-	-

Table 9: Overdue and nonaccrual loans, leases and other assets by sector – 31st December 2018

	Stage 1 MK'mn	Stage 2 MK'mn	Stage 3 MK'mn	Total MK'mn
Sector				
Agriculture, fishing, forestry and hunting	47,749	363	1,443	49,555
Mining and quarrying	1	-	-	1
Manufacturing	1,992	2,472	2,058	6,522
Electricity, gas, water and energy	650	-	-	650
Construction	676	562	53	1,291
Wholesale and retail trade	9,840	2,111	3,896	15,847
Restaurant and hotels	382	1	-	383
Transport, storage and communication	11,837	51	-	11,888
Financial services	757	-	-	757
Community, social and personal services	24,474	4,435	705	29,614
Real estate	4,756	-	-	4,756
Other sectors	-	-	-	-
Total	**103,114**	**9,995**	**8,155**	**121,264**

Note: The amounts in the table above do not include accrued interest in line with Reserve Bank of Malawi guidelines.

Table 10: Distribution of non-performing loans, provisions and interest in suspense – 31st December 2018

	Non-performing loans MK'mn	Loss provisions MK'mn	Interest in suspense MK'mn
Sector			
Agriculture, fishing, forestry and hunting	1,443	422	41
Mining and quarrying	-	-	-
Manufacturing	2,058	1,398	657
Electricity, gas, water and energy	-	-	3
Construction	53	16	2
Wholesale and retail trade	3,896	2,351	749
Restaurant and hotels	-	-	-
Transport, storage and communication	-	-	-
Financial services	-	-	-
Community, social and personal services	705	557	42
Real estate	-	-	-
Other sectors	-	-	-
Total	**8,155**	**4,744**	**1,494**

Table 11: Reconciliation of changes for impaired loans and advances and charge-offs during the period

	MK'mn
Impaired loans and advances to customers as at 01 January 2018	13,821
Classified as impaired during the year	4,257
Transferred to not impaired during the year	(242)
Amount written-off	(9,681)
Impaired loans and advances to customers as at 31 December 2018	**8,155**

Table 12: Reconciliation of changes in loss provisions for impairment – 31st December 2018

	MK'mn
Loans & advances customers provisions (stage 1 & 2)	
Opening balance as at 01 January 2018	1,435
IFRS 9 transition adjustment	2,641
Provisions for the year	3,105
Subsequent changes in ECL	(4,155)
Change in ECL due de-recognition	(417)
Other movements	(31)
	2,578
Loans & advances customers provisions (stage 3)	
Opening balance as at 01 January 2018	7,337
IFRS 9 transition adjustment	-
Provisions for the year	7,008
Write-offs	(9,681)
	4,744
Financial investments provisions (stage 1 & 2)	
Opening balance as at 01 January 2018	-
IFRS 9 transition adjustment	110
Provisions for the year	9
	119
Loans & advances banks provisions (stage 1 & 2)	
Opening balance as at 01 January 2018	-
IFRS 9 transition adjustment	389
Provisions for the year	(256)
	133
Off balance sheet provisions (stage 1 & 2)	
Opening balance as at 01 January 2018	-
IFRS 9 transition adjustment	241
Provisions for the year	(59)
	182
Loss provisions as at 31st December 2018	7,757

Table 13: Off balance sheet items – 31st December 2018

	MK'mn
Guarantees	92,266
Letters of credit	15,850
Foreign exchange and interest rated contracts	51,336
Unutilised commitments	16,701
Total	176,153

Valuation of collateral

The bank uses the following minimum requirements to value collateral:

- All items proposed as collateral are valued using agreed valuation methodologies and/or evaluators with appropriate expertise, prior to accepting items as collateral.
- The assessors/evaluators of collateral must be independent of the business originators and providers of collateral.
- All collateral is marked to market and revalued at a frequency appropriate to that collateral, taking into account the value and nature of collateral, the ease and cost of valuation and the volatility of the collateral's value.

Monitoring of collateral

The bank uses the following minimum requirements on monitoring of collateral;

- Controls are put in place to monitor the collateral and ensure appropriate action is taken whenever there are developments that may impact negatively on the value of collateral.
- Annual reviews of the performance of the collateral are carried out to ensure that collateral types are still relevant and terms for acceptance are still appropriate.
- Updates to changes in market and economic conditions are performed at pre-determined intervals.
- Updates to reflect new legislation and updated to existing legislations are performed on a regular basis.
- Collateral is realised as per the delegated authority after all efforts have been made to rehabilitate the customer.
- Collateral management unit maintains a systematically-driven, shared diary to ensure that collateral credit events are timeously actioned.

Financial collateral

Where the collateral is not denominated in the same currency as the exposure, an adequate margin for currency fluctuations is set appropriate to the potential currency volatility. The maturity of any collateral is set equal to or greater than the repayment period of the underlying exposure, unless documentation and operational procedures are such that adequate rights and controls are in place to ensure the value of collateral remains in place throughout the tenure of the approved facility.

Physical collateral

The bank ensures that physical collateral possess the following qualities:

- Must be capable of identification and must be documented.
- The location of any such assets must be known or, for movable assets such as vehicles, traceable within a reasonable period.
- Rights of access must be preserved.
- Any third-party used to control assets must be able to identify assets which provide collateral.

- Insurance must be in place at all times, covering all appropriate risks.

Types of guarantees and indemnities involved in banks credit risk mitigation

The bank ensures that guarantees and indemnities should have the following qualities:

- Explicit: – must be a documented obligation, explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible.
- Direct: – the obligation must represent a direct claim on the protection provider.
- Irrevocable: – there are no determinants that the protection provider is able to amend.
- Unconditional: – obligation of the protection provider to pay immediately when conditions as set in the commitment regarding the third-party obligation are met.
- Complete: – such commitments must cover the full principal of the guaranteed credit facility plus interest, fees and all other costs and must include all types of payments the underlying obligor is expected to make under the documentation governing the transaction.

Counterparty credit risk

Counterparty risk is the risk of loss to the bank as a result of failure by the counterparty to meet its financial and/or contractual obligations to the bank. It has three components:

- Primary credit risk which is the exposure at default (EAD) arising from lending and relating banking product activities, including the underwriting of such products;
- Pre-settlement credit risk which is the EAD arising from unsettled derivative transactions, arising from the default of the counterparty to the transaction and measured as the cost of replacing the transaction at the current market rates; and
- Issuer risk which is the EAD arising from traded credit and equity products, and including the underwriting of such products.

5 Market risk

The bank defines market risk as the risk of a change in market value, actual or effective earnings or future cash flows of a portfolio of financial instruments, including commodities, caused by adverse moves in market variables such as equity, bond and commodity prices, currency exchange rates and interest rates, credit spreads, recovery rates, correlations and implied volatilities in all of these variables.

The market risk management framework applied in the bank is according to the Market Risk Standard and Policy approved by the Board.

The market risk management unit is independent of trading operations and accountable to ALCO to monitor market risk exposures due to trading and banking activities.

The market risk portfolios that the bank manages consist of:-

Trading book market risk

These risks arise in trading activities where the bank acts as a principal for clients in the market. The bank's policy is that all trading activities are contained in the bank's trading operations. Asset classes included in this category are instruments with tenors not exceeding one year for money market trading and those exceeding one year for the fixed income trading whose intent is purely for trading.

Foreign exchange risk

The bank's primary exposures to foreign currency risk arise as a result of the currency price translation effect on the bank's net open positions held. The bank is mandated to trade twelve currencies.

Interest rate risk

These risks arise from the structural interest rate risk caused by mark-to-market (MTM) in line with IFRS 9 treatment around revaluation of assets and liabilities on the banking book. The bank constantly remarks the banking book positions to reflect current market prices. Intent in this categorization is holding to maturity though paper can be sold in exceptional circumstances such as liquidity stress and a bearish interest rate environment.

Table 14: Trading portfolio values – 31st December 2018

Normal VaR		USD		
	High	Mean	Low	Actual
Foreign exchange trading	33,016	12,800	1,101	19,080
Money market trading	29,462	15,802	6,428	16,051
Fixed income trading	-	-	-	-
Money market banking	-	-	-	-
Bank-wide	44,632	24,769	8,539	32,070

Stress VaR		USD		
	High	Mean	Low	Actual
Foreign exchange trading	725,821	275,049	16,196	248,060
Money market trading	842,101	575,089	293,149	490,453
Fixed income trading	-	-	-	-
Money market banking	-	-	-	-
Bank-wide	868,203	619,984	365,256	579,835

Table 15: Trading securities and derivative assets – 31st December 2018

	Nominal value MK'mn	Carry value MK'mn	Mark to market MK'mn	Fair value gain/(loss) MK'mn
Trading securities & derivative assets	13,624	12,884	12,362	(522)
Total	13,624	12,884	12,362	(522)

6 Operational risk

The bank defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes but is not limited to information risk, legal risk, compliance risk, and financial crime risk. Strategic, reputational, and business risks are excluded from the definition. The reputational effects of operational risk events are, however, considered for management information. Operational risk is thus categorised as follows:

- Process risk: – the risk of loss suffered as a result of failed or inadequate processes.
- People risk: – the risk of loss arising from issues related to the personnel within the bank.
- Systems risk: – the risk of loss suffered as a result of failed or inadequate systems, security breaches, inadequate systems investment, development, implementation, support and capacity.
- External event risk: – the risk of loss suffered as a result of external events.

Operational risk arises in all parts of the bank; all senior management are thus responsible for consistently implementing and maintaining policies, processes and systems for managing operational risk in all of material products, services, activities, processes and systems. The ultimate responsibility for establishing, approving and periodically reviewing the operational risk framework lies with the Board. The Board oversees senior management to ensure that the framework is implemented effectively at all decision levels.

Operational risk is managed to acceptable levels by continuously monitoring and enforcing compliance with relevant policies and control procedures. The bank also uses the new and amended business, products or services process in order to address the identification and assessment of risks associated with new and/or amended products or services. Other major frameworks that have been introduced are business continuity management framework, and information security management.

The practice of operational risk in the bank is overseen by an independent operational risk unit. Importantly, the operational risk function performs incident recording, management and analysis, the risk self-assessment process, and the key risk indicators process. Independent assurance on the management of operational risk is further provided by Internal Audit function.

7 Interest rate risk in the banking book (IRRBB)

IRRBB is the exposure of the bank's financial condition to adverse movements in interest rates. This arises mainly due to a maturity mismatch /different repricing characteristics between the bank's assets and liabilities. Accepting this risk is a normal part of banking and it can be an important source of profitability and shareholder value for the bank. However, excessive interest rate risk can pose a serious threat to a bank's earnings and capital base. Changes in interest rates affect the bank's earnings by changing its Net Interest Income (NII) and fair value banking book profit.

The most important sources of interest rate risk are re-pricing risk, yield curve risk, basis risk, optionality risk and endowment risk.

Table 16: Impact of parallel rate shock on NII (FCY) – 31st December 2018

Rate Change %	BPS Change	NII USD'000	NII Change USD'000	NII Change %
-1.00	-100	3,664	(709)	-16.22%
1.00	100	5,096	722	16.51%

Table 17: Impact of parallel rate shock on NII (LCY) – 31st December 2018

Rate Change %	BPS Change	NII MK'mn	NII Change MK'mn	NII Change %
-3.50	-350	20,835	(1.060)	-4.84%
5.00	500	22,992	1,097	5.01%

8 Conclusion

This disclosure document has been prepared in accordance with the requirements prescribed in the guidelines on market disclosures under the Basel II Framework and is intended to provide background information on the bank's approach to risk management as related to maintaining and preserving the capital position of the bank. It also provides detailed information about asset and capital calculations under Pillar 1.

In the event that a user of this disclosure document requires further explanation regarding the disclosures, application should be made in writing to the Chief Risk Officer at Kondwani.Mlilima@standardbank.co.mw or the Chief Finance Officer at Temwani.Simwaka@standardbank.co.mw .

9 List of abbreviations

ALCO	Asset and liability committee
BCC	Board Credit Committee
BFSA	Banking and Financial Services Act
BIA	Basic Indicator Approach
CAR	Capital adequacy ratio
CIB	Corporate and Investment Banking
CRMC	Credit Risk Management Committee
EAD	Exposure at default
ECL	Expected credit losses
IAS	International Accounting Standard
ICAAP	Internal Capital Adequacy Assessment Process
IRRBB	Interest rate risk in the banking book
MTM	Mark-to-market
NII	Net interest income
OCI	Other comprehensive income
PBB	Personal and Business Banking
RBM	Reserve Bank of Malawi
SICR	Significant increase in credit risk
TSA	The Standardised Approach
USD	United States dollar
VaR	Value-at-risk

10 List of figures and tables

Figure

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