

STANDARD BANK LIMITED

RISK AND CAPITAL MANAGEMENT REPORT 31 DECEMBER 2014

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31ST DECEMBER 2014

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1. Introduction

Standard Bank Limited (“SBM”) is subject to the Basel II regulatory framework for calculating minimum capital requirements published by the Reserve Bank of Malawi (“RBM”). The framework came into effect on 1 January 2014.

The supervisory objective of Basel II is to further strengthen the soundness and stability of the banking system while maintaining sufficient consistency that capital adequacy regulation will enhance competitive equality among active banks, establish minimum levels of capital, and promote the adoption of stronger risk management practices by the banking industry.

The framework constitutes a more comprehensive approach to addressing risks and is based on the concept and rationale of the three pillars approach: minimum capital requirements, supervisory review and market discipline. SBM is subject to regulation and supervision by RBM.

2. General information

SBM is a company domiciled in Malawi. The bank is primarily involved in investment, corporate and retail banking.

SBM’s ultimate parent company is Standard Bank Group (SBG) Limited, which owns the majority shareholding of 60.18%. Other shareholders include: NICO Holdings Ltd (20%); Old Mutual Life Assurance Co. (4.81%); Press Trust (2.30%); Stanbic Bank Pension Fund (2.05%); and Public Investors (10.66%).

Standard Bank Bureau de Change Limited is a 100% owned subsidiary of SBM whose line of business is retail foreign exchange trading.

3. Media and location

This document should be read in conjunction with the published Annual Report for SBM which is available on the Bank’s website: <http://www.standardbank.co.mw>

4. SBM strategy

The Board is responsible for establishing the overall strategic direction of the bank. Strategy setting culminates in asset growth targets, profitability targets, balance sheet composition changes, pricing directives, and dividend proposals. All of these decisions have the potential to significantly impact the bank’s risk appetite and capital adequacy.

Asset growth targets and balance sheet composition changes typically increase risk taking and, therefore, the bank’s regulatory capital requirements (capital demand) while profitability targets and pricing directives typically result in changes to capital resources (capital supply). The total impact of these initiatives has to be understood and measured to ensure that the bank’s risk profile and capital adequacy position are maintained in line with the strategic direction set by the Board.

The bank’s strategy currently centres around:

a) Customer

- Deliver a competitive value proposition
- Deliver the firm
- Attract and retain profitable customers

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4. SBM strategy(continued)

b) People

- Develop skills for the future bank
- Develop a competitive reward and recognition proposition
- Leadership culture modeled on the bank's core values
- Entrepreneurial corporate culture: innovative thinking and high performance culture
- Be the employer of choice to the employee of choice

c) Execution

- Deliver excellent customer service through the digital revolution i.e. digital banking channels and paperless banking
- Improve management information system (MIS) capability

d) Financials

- Diversifying revenue sources by becoming the transactional bank of choice
- Protecting the dominant foreign exchange market share and defending liability market share
- Growing the local currency asset book
- Streamlining costs

Dividends are an integral part of the capital management process and are paid out in line with prudent and conservative practices after consideration of the following factors:

- Capital adequacy requirements in terms of RBM.
- Current financial position of SBM.
- Future anticipated business growth and expansion plans for SBM. The anticipated capital requirements of SBM calculated over at least the next two years are taken into account.
- The current and expected level of Tier 2 capital of SBM.
- All dividends will only be declared in line with prudent and conservative business practices.
- The impact of dividend withholding taxes is considered. However, as a general statement of principle, the fact that a dividend gives rise to withholding taxes is not considered on its own a valid reason not to declare dividends.
- The bank ensures that the declaration of dividends complies with all statutory requirements (for instance, memorandum and articles of association, banking legislation, tax legislation) and any other requirements from RBM.

5. Risk management framework

Overall responsibility for risk management within SBM rests with the Board which delegates certain functions and responsibilities relating to risk and capital management to the Board Risk Committee (BRC), the Board Credit Committee (BCC) and the Board Audit Committee (BAC). A diagrammatical overview of these committee structures are given in Section 5.1.

5. Risk management framework(continued)

Day-to-day risk management responsibility is delegated to the Executive Management Committee (Exco) and its sub-committees which consist of Asset and Liability Committee (ALCO), Risk Management Committee (RMC), Credit Risk Management Committee (CRMC), Personal and Business Banking Credit Committee (PBB CC), Corporate and Investment Banking Credit Committee (CIB CC), and the New Products Committee (NPC). The line management functions (the first line of defense) within the bank are responsible for managing the risks that arise from the respective operations.

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 SBM. 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 of risk appetite, risk reporting, and key areas of control activity within SBM and its business units.

SBM has approved policies and procedures in place which have been derived from the following standards:

- Risk appetite policy,
- Stress-testing policy,
- Capital management framework,
- Credit risk standard,
- Liquidity risk standard,
- Market risk standard,
- Legal risk and compliance standard, and
- Operational risk standard.

Identification of material risks is a process overseen by the Chief Risk Officer and Head of Compliance/Legal Counsel, with involvement from the business/enabling units. In addition, the approach to quantifying the capital requirements for each of the risks is discussed and noted at a review meeting, as well as at the respective risk committees e.g. ALCO. BRC and BAC is also responsible for the analysis of capital requirements and the effective utilisation of capital. In the determination of what risks are considered material to the bank, cognizance is taken of:

- regular risk and control self assessments performed by management which identify risks that could threaten the achievement of business objectives;
- history of losses as well as potential future losses;
- those risks to which significant amounts of regulatory capital is allocated; and
- the definition of materiality thresholds which are advised by the regulations.

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

- Credit risk, including country and concentration risk;
- Market risk, including interest rate risk in the banking book;
- Operational risk;
- Legal and compliance risk;
- Liquidity risk; and

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5. Risk management framework(continued)

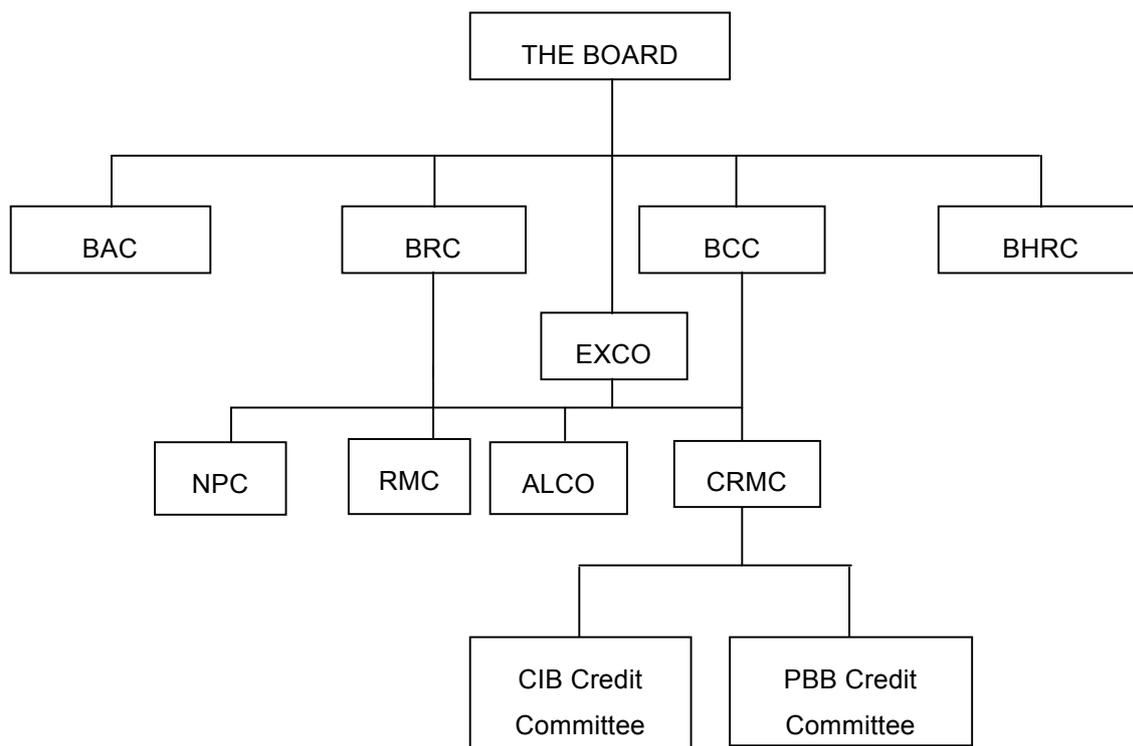
- Business risk – including strategic risk and reputational risk.

SBM manages its capital base to achieve a prudent balance between maintaining capital ratios to support business growth and depositor confidence, and providing competitive returns to shareholders. The capital management process ensures that SBM maintains sufficient capital levels for legal and regulatory compliance purposes. SBM ensures that its actions do not compromise sound governance and appropriate business practices and it eliminates any negative effect on payment capacity, liquidity or profitability.

The amount of capital required for the bank is determined by taking into consideration all its material risks, and how these risks are governed, managed, controlled and mitigated. Advanced risk measurement techniques within the bank for the material risk types inform the quantification of the capital required where appropriate.

5.1 Risk governance and control

Figure 1: SBM risk management and compliance structure



The Board

The Board takes ultimate responsibility for the management of risk and is required to ensure that an effective risk management framework exists and is maintained throughout the bank. The Board appoints members to four separate board sub-committees to assist in discharging its duties in relation to the management of risk.

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5.1 Risk governance and control(continued)

The Board(continued)

The sub-committees are chaired by a non-executive director to maintain, as best practice requires, the independence and objectivity of the function. The Chief Risk Officer, Heads of Credit, Internal Audit and Compliance also have direct access to the chairpersons of the relevant sub-committees.

The Board Audit Committee (BAC)

The role of the committee is to provide an independent evaluation of the adequacy and efficiency of the bank's internal control systems, accounting practices, information systems and auditing processes. Communication between the Board, executive management, internal audit, and external audit is encouraged. The committee liaises with the external and internal auditors on accounting procedures and on the adequacy of controls and information systems and reviews the financial statements.

The committee meets at least four times a year. During the year ended 31 December 2014, the committee held four meetings. As at 31 December 2014, the committee comprised three non-executive directors.

Board Risk Committee (BRC)

The committee reviews risk policies and strategies, and assesses the integrity of the risk control systems. It ensures that risks are effectively identified, managed and monitored in order to contribute to a climate of discipline and control, which will reduce the opportunity of risk (including fraud) in all areas of operation. The BRC also reviews and approves risk appetite, reviews stress testing results and considers the adequacy of mitigating actions if required.

The committee meets four times a year. During the year ended 31 December 2014, the committee held four meetings. As at 31 December 2014, the committee comprised three non-executive directors.

Board Credit Committee (BCC)

The Board Credit Committee is tasked with the overall review of the bank's lending policies. At each meeting, the committee directs, monitors, reviews and considers all issues that may materially impact on the present and future quality of the bank's credit risk management. It ensures that there are effective procedures to identify irregular credit facilities, minimize credit losses and maximize recoveries.

This committee meets quarterly. During the year ended 31 December 2014, the committee held four meetings. As at 31 December 2014, the committee comprised three non-executive directors.

Board Human Resources Committee (BHRC)

The committee considers all human resources issues including recruitment policy, industrial relations, succession planning, safety and health, and remuneration terms and packages for management and staff.

The committee meets four times a year. During the year ended 31 December 2014, the committee, held four meetings. As at 31 December 2014, the committee comprised three non-executive directors.

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5.1 Risk governance and control(continued)

Management Committees

Executive Management Committee (Exco)

The Chief Executive (CE) has the authority to manage the bank within the constraints laid down by the Board. Therefore, Exco is constituted to assist the CE to manage the bank. Exco meets at least monthly.

Risk Management Committee (RMC)

The Risk Management and Compliance teams provide the day to day oversight on compliance and management of risk and promotes the risk/compliance culture across the bank. The RMC is responsible to create and maintain the operational risk, financial crime, IT security, compliance and legal risk management practices across the bank – to ensure that respective controls are in place. The compliance and risk management teams maintain objectivity by being independent of operations and in addition they have reporting lines into the CE and the relevant board committees.

Credit Risk Management Committee (CRMC)

The Board recognizes the expertise of appointed credit functions and expert committees of SBG and SBM. Accordingly, certain oversight functions and management participations are authorised as if the SBG employees participating are direct employees of SBM in line with the management agreements signed by the bank and the relevant SBG entities.

The CRMC is a senior management credit risk monitoring function. The role of the CRMC is to ensure compliance with the Board's directives which are based on the bank's credit standard. CRMC effectively enhances the credit discipline within the bank and is responsible for controlling, *inter alia*, delegated authorities, concentration risk, distressed debt, regulatory issues that pertain to credit, credit audits, policy and governance.

The committee meets once per month and is chaired by the Chief Risk Officer.

PBB Credit Committee and CIB Credit Committee

The CIB and PBB Credit Committees are senior management credit decision-making committees with defined delegated authority as determined by CRMC from time to time.

The purpose of the Credit Committees is to:

- Exercise responsibility for the independent assessment, approval, review and monitoring of all credit risk assets relating to the bank's business in PBB space as well as in CIB space;
- Ensure that the credit portfolios in PBB space as well as in CIB space are maintained within the risk appetite set by BCC; and

5.1 Risk governance and control(continued)

PBB Credit Committee and CIB Credit Committee(continued)

- Ensure that the origination and management of the assets in the two portfolios is done in terms of the SBG Credit Standard and any other guidance given to it by the Group's Credit Governance Committees from time to time.

For purposes of complying with its duties and responsibilities, the two Credit Committees have the right to delegate responsibilities to sub-committees and/or individuals within clearly defined mandates and delegated authorities.

Asset and Liability Management Committee (ALCO)

ALCO meets on a monthly basis to monitor and control all trading book risk, banking book liquidity risk, and interest rate risk in accordance with the bank's risk appetite; review limit, guideline or trigger breaches and agree remedial actions in order to align exposures with agreed appetite; approve Market Risk, Liquidity Risk and Banking Book Interest Rate Risk policies, together with key procedure documents; set market risk limits and monitors compliance thereto, but does not take decisions on trading or banking book positioning; designate certain positions which should be held as endowment hedges; approve the bank's Liquidity Contingency Plan; review regulatory capital adequacy; review and note the impact of internal and external factors on the net interest margin for the banks within the scope of ALCO; ensure that effective capital management governance is in place; ensure that SBM is adequately capitalised given risks assumed (including stressed), minimum regulatory capital requirements and business plans; and ensure that capital requirements are structured in a way that optimises current and future returns to shareholders. ALCO members consist of senior management and the committee is chaired by the CE.

New Products Committee (NPC)

The NPC is a senior management committee chaired by the Head of Operations. The Committee meets as and when required to facilitate the introduction of new or amended products, services, businesses, legal entities, systems or processes in a coordinated and effective manner that is consistent with the bank's overall strategic, business, and risk management focus. The committee exercises proper oversight and ensures action has been taken to ensure that any significant risks that could arise from the introduction or amendment of businesses, products or services, systems and processes are properly identified and appropriately addressed by the relevant parties prior to implementation.

Internal Audit

Internal Audit's mission is to provide independent and objective assurance and advisory services designed to add value and improve SBM's operations. It plays an important role in the combined assurance model and assists the SBM to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and the internal control environment.

5.1 Risk governance and control(continued)

Internal Audit(continued)

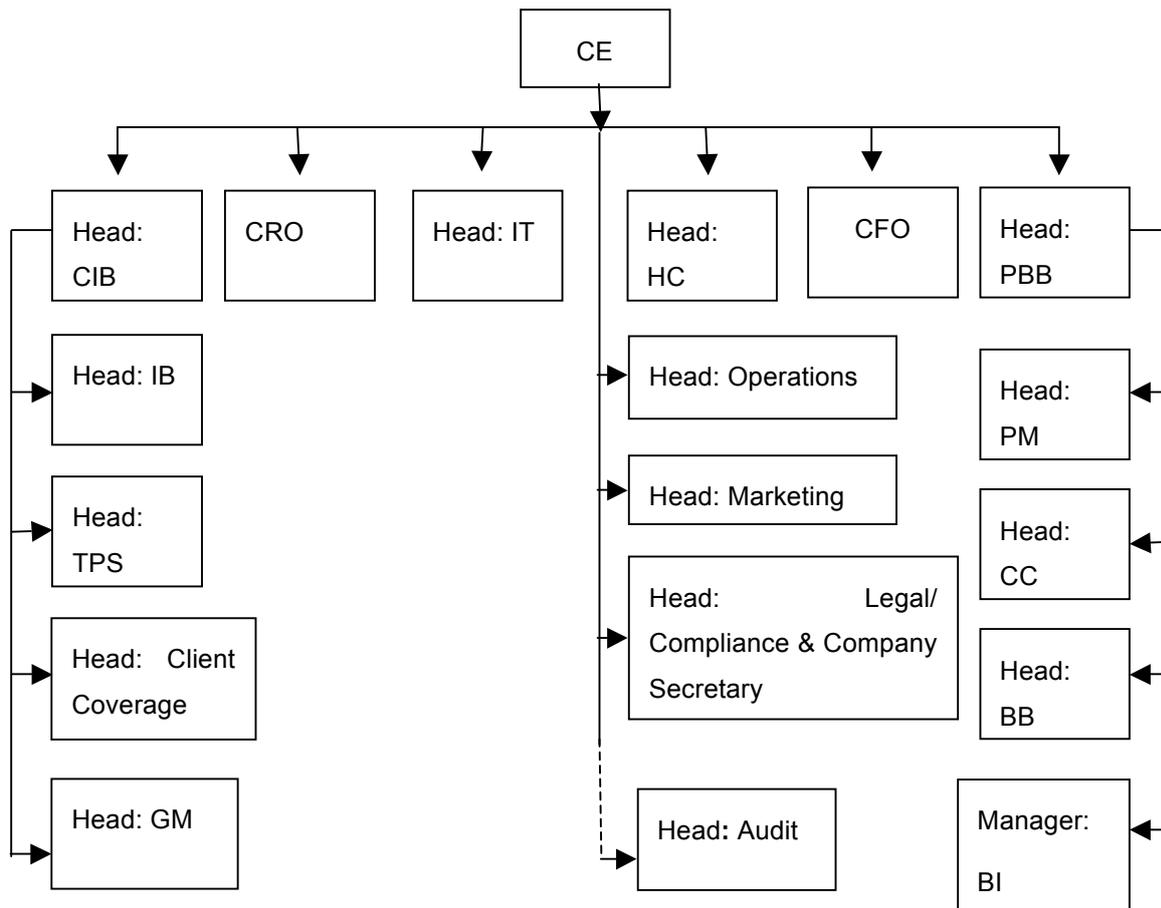
This entails that Internal Audit should understand the business environment, strategy and operating models in order to determine what controls should be in place to manage the risk profile within acceptable norms and where the bank takes on risk, it should be informed and managed. Internal Audit is directly accountable to BAC.

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5.1 Risk governance and control(continued)

Figure 2: Management structure



Management of risk

The risk management framework, minimum standards and policies adopted by SBM are consistent with applicable RBM's regulatory requirements. The approval of risk limits and tolerances by SBM risk governance structures follows the bank's risk governance processes.

Credit risk (including concentration risk)

Credit risk appetite is a major component of the total risk appetite, with the corresponding earnings at risk measured in terms of anticipated (expected) and statistical (unexpected) credit losses. The Board is ultimately responsible for setting SBM's credit risk appetite. In practice, the risk appetite setting framework involves the dual responsibility between the bank's Credit and Business functions. The process then feeds into the budgeting process which ultimately results in the Board approving the said budgets.

5.1 Risk governance and control(continued)

Credit risk (including concentration risk)(continued)

In order to monitor, control and manage the bank's credit risk appetite, the credit function delegates the responsibility for maintaining a supporting framework of suitable limits and triggers to the business unit credit functions. This includes, but is not restricted to, the following:

- Portfolio loss limits and triggers set in terms of economic capital, expected loss, or suitably calibrated measure of unexpected loss; and
- Concentration risk limits and triggers covering individual countries, industrial sectors and obligors.

Credit portfolio limits and triggers are applied at the following levels:

- Corporate and Investment Banking; and
- Personal and Business Banking.

Limits represent hard upper bounds on risk appetite, whereas triggers are softer and serve to alert management and other relevant parties to potentially excessive levels of risk.

Market risk

Market risk appetite is set by ALCO and managed by the Chief Risk Officer. Limits are set based on the business plan (budget), regulatory limits, volatility of the various spot rates and liquidity. The bank has a daily VAR limit and a PV01 limit. In addition, there is a product mandate. Any limit and product mandate breaches are escalated with a clear action plan to correct the breach.

- The VAR limit is a one day 95% confidence interval limit, calculated on a daily basis for trading books and supported by currency limits.
- The PV01 limit sets the extent of price risk (1 basis point interest rate movement) the bank is willing to take on its banking and trading fixed interest portfolios.
- Underpinning all of the aforementioned level 1 limits are a series of level 2 limits (agreed by Market risk) and level 3 limits.
- The market risk management framework applied in SBM is consistent with the group's market risk management framework.

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 ALCO) does not result in adverse annualised net interest income change.

5.1 Risk governance and control(continued)

Operational risk

The operational risk framework follows primarily a qualitative approach, being focused on ensuring that underlying risks are identified and owned and that the residual risk is maintained within an acceptable level in the opinion of the relevant management, overseen by an independent operational risk function within risk management.

Independent assurance on the management of operational risk is provided by Internal Audit.

The framework is based around Risk Identification and Control Process (RICP) and Incident Management (IM). Escalation criteria are in place to ensure that management action can be applied in the event that the identified risks or risk indicators show a level of residual risk exposure beyond that deemed acceptable and when an individual event breaches a set materiality threshold. In addition, loss tolerance thresholds are set by senior management for individual and aggregate losses.

Operational risk appetite is subsequently managed by the operational risk manager. In addition, the bank purchases insurance cover that limits the amount the bank can suffer as a consequence of any individual insurable loss to US\$250,000 per incident.

Liquidity risk

Liquidity limits within SBM are governed by the Liquidity Risk standard and other relevant policies. Further liquidity limits and/or guidelines may be set by ALCO in terms of policies set to take account of particular local market conditions and/or regulatory requirements.

In summary:

- On at least a monthly basis, SBM must ensure that for each material currency, on a net cumulative basis (i.e. any cumulative surplus or shortfall is carried forward to the next maturity time band), the Bank's aggregate expected cash inflows less its aggregate expected cash outflows in each of the prescribed time band (i.e. overnight, 1 month, 2 months, 3 months, 6 months, and 12 months) should not exceed the stated percentage of total funding related liabilities to the public.
- Additionally, SBM is required to hold a minimum stock of liquid assets in excess of the regulatory requirements. The aggregate value of unencumbered marketable assets, at the closing market prices on the preceding day less a forced-sale discount, must at all times exceed 14.5% of total funding related liabilities to the public.
- Additional liquid assets are required if the bank's liabilities are considered to be concentrated.
- Marketable assets such as securities are regarded as liquid once consideration has been taken of certain discounts to reflect forced-sale conditions.
- Sight to 3 months depositor concentration limits in respect of single and top-10 depositor exposure are enforced, in addition loans to deposit ratio limits, and interbank reliance limit are set. The bank also monitors the adequacy of long-term funding in line with business strategy.

SBM has developed a liquidity dashboard, and monitors it on an ongoing basis to identify early warning signs of a liquidity crisis and a plan to the likely management response to those conditions.

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5.1 Risk governance and control(continued)

Liquidity risk(continued)

Stress tests are used to quantify the impact of identifiable scenarios. SBM is required to show that it is able to meet its basic mismatch limits, even taking account of the stress tests. SBM also needs to be compliant with RBM guidelines.

Legal risk

Management has adopted a structured approach to management of legal risk by formulating a bank-wide Legal Risk Management Plan. The legal risk management plan documents all the identified sources of legal risks, the control measures that have been put in place to manage or mitigate and identifies the responsible personnel for ensuring that the legal risks identified are properly managed or mitigated.

Compliance risk

Management recognises that the business of banking is a highly regulated business. It thus arranges the affairs of the bank in a prudent manner to ensure that there is low risk adversely impacting the bank and its reputation flowing from regulatory exposures, and mitigate the consequences that may arise there from. In this respect, the bank has put in place a Compliance Risk Management Framework which principally embeds the management of compliance risk within the bank's business processes and procedures at each and every level of the business so that compliance with regulatory and statutory requirements becomes a way of doing business in the bank.

Business risk

SBM mitigates business risk in the following manner:

- Business risk is governed by EXCO which is ultimately responsible for managing the costs and revenues;
- New product committee meetings (when required) are held at which the risks and mitigating controls for new/amended products and services are tabled and discussed;
- By proactively managing stakeholders to ensure favourable outcomes from external factors beyond the bank's control;
- By consistently monitoring the profitability of product lines and customer segments;
- By maintaining tight control over the cost base, including the management of its cost-to-income ratio;
- Being alert and responsive to changes in market forces;
- As part of the budget and revised estimate process there is a strong focus on achieving headline earnings growth whilst containing cost growth. In addition, contingency plans are built into the budget that allow for costs to be significantly reduced in the event that expected revenue generation does not materialise;
- SBM continually aims to increase the ratio of variable costs to fixed costs allowing more strategic flexibility to proactively reduce costs during downturn economic conditions; and

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5.1 Risk governance and control(continued)

Business risk(continued)

- Pension obligation risk is managed by proactively adopting defined contribution schemes for the bank.

Reputational risk is managed on a proactive and reactive basis to manage the likelihood of occurrence of events and is most directly connected to the risk identification and assessment processes. The bank, therefore, has processes which ensure that potential areas of reputational risk are identified relative to the transactions or services which it facilitates on behalf of customers.

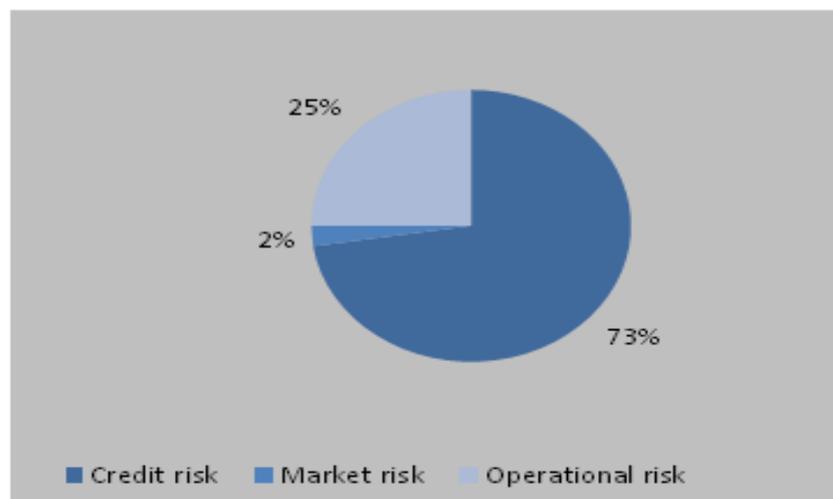
6. Regulatory capital

The risk weighted assets are calculated and disclosed in accordance with the measurement approaches adopted by the bank (see results in Table 1 below) – Basic Indicator Approach for operational risk and Standardised Approaches for both credit and market risk.

Table 1: Risk weighted assets

	Dec-14 MKm
Credit risk	130 131
Market risk	4 224
Operational risk	44 855
Risk weighted assets	179 210

Figure 3: Composition of risk weighted assets



6. Regulatory capital(continued)

SBM assesses its capital adequacy against the capital requirement to absorb unexpected losses that may arise from the risks inherent in the business. Regulatory capital requirements are determined on the basis of prescribed regulatory approaches that apply to each of the main risk types. In addition, SBM has adopted an Internal Capital Adequacy Assessment Process (“ICAAP”) which reflects management’s internal assessment of risk. The ICAAP requires capital to be held for risks as assessed by management instead of a prescribed regulatory formula, and as such is widely encompassing. SBM’s governance process includes a robust assessment of capital forecasts and stress-testing, allowing for capital raising and usage reductions to be expedited timeously, ensuring that minimum capital ratios are maintained.

During the period under review SBM complied with all externally imposed capital requirements to which its banking activities are subject.

The requirement to maintain adequate financial resources is assessed by SBM in relation to its activities and the risks to which they give rise. The capital adequacy ratio, which reflects the capital strength of an entity compared to the minimum regulatory requirement, is calculated by dividing the capital held by that entity by the sum of its risk-weighted assets.

Capital is split into two tiers:

- Tier I (primary capital) represents permanent forms of capital such as share capital, share premium and retained earnings less investment in subsidiary and deferred tax asset
- Tier II (secondary capital) includes revaluation reserves and general debt provisions.

Total risk-weighted assets are determined by multiplying the capital requirements for market risk and operational risk by the reciprocal of the minimum capital ratio and adding the resulting figures to the sum of risk-weighted assets for credit risk. Included in the overall credit risk-weighted assets is both the on- and off-balance sheet exposures risk weighted according to the relative credit risk of the counterparty.

The use of non-equity forms of regulatory capital plays an important role in the SBM’s capital management process. Within SBM, capital does not have any restrictions or impediments.

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7. Capital resources

Table 2: Eligible capital and risk ratios – 31 December, 2014

	MKm
Tier I	
Issued primary capital	32 818
Ordinary share capital	234
Share premium	8 492
Retained earnings	24 070
General reserves	22
Less: regulatory deductions	1 387
Deferred tax assets	1 272
Investment in subsidiaries	115
	31 431
Tier II	
Issued secondary capital and reserves	4 863
General allowance for credit impairments	652
Revaluation reserves	4 211
	4 863
Total eligible capital	36 294
Total capital requirement	
Total risk-weighted assets	179 210
Tier 1 (%)	17.54%
Capital adequacy ratio (%)	20.25%
Minimum regulatory limits	
Tier 1 (%)	10.00%
Capital adequacy ratio (%)	15.00%

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7. Capital resources (continued)

Capital requirement

Figure 4: Eligible capital and risk ratios – Basel II

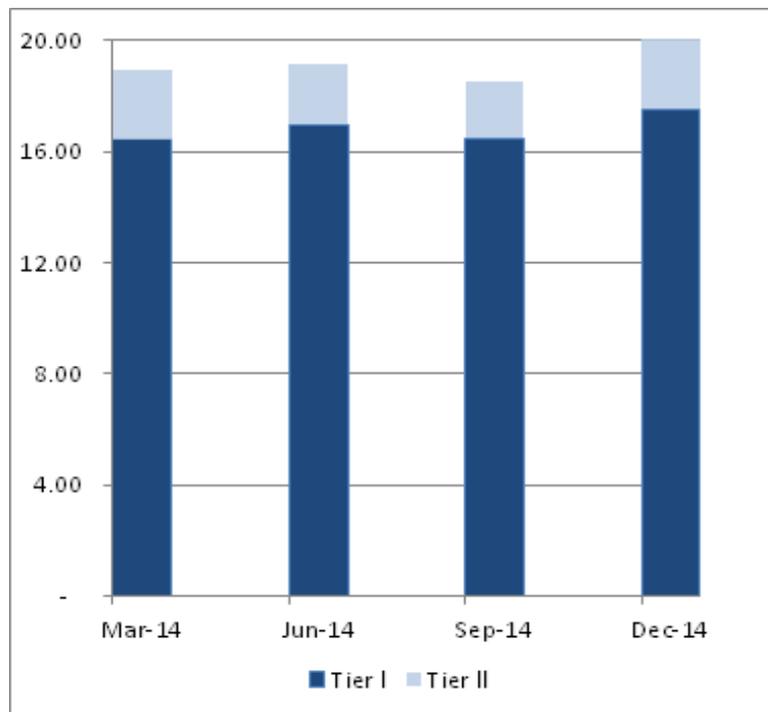


Table 3: Risk exposure amounts and risk weighted assets

	2014			
	Exposure amounts MKm	Specific provisions MKm	Credit risk mitigation MKm	Risk weighted assets MKm
Credit risk	241,262	2,680	7,269	130,131
Corporate	27,408	652	4	26,751
Sovereign	19,695			
Exposure to banks	55,482			27,478
Public sector entities	4			4
Retail mortgages	955	146		301
Retail other	29,241	1,882	100	26,556
Other assets	51,039			19,490
Off balance sheet exposures	57,438		7,165	29,551
Market risk	4,224			4,224
Interest rate risk	1,612			1,612
Equity position risk				
Foreign exchange risk	2,612			2,612
Commodities risk				
Operational Risk	44,855			44,855
Total risk-weighted assets/capital requirement	290,341		7,269	179,210

8. Credit risk

Credit risk is the risk of loss arising from failure of counterparties to meet their financial or contractual obligations when due. It comprises of:

- Counterparty risk;
- Settlement risk;
- Country risk; and
- Concentration risk.

Counterparty risk is the risk of loss to SBM as a result of failure by the counterparty to meet its financial and/or contractual obligations to SBM. 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.

Settlement risk is the risk of loss to SBM from a transaction settlement, where value is exchanged, failing such that the counter value is not received in whole or part.

Country risk is the uncertainty that obligors may not be able to fulfil their obligations to SBM, where the host country is outside their jurisdiction, because of political or economic conditions in the host country.

Concentration risk refers to any single exposure or group of exposures large enough to cause credit losses which materially affect SBM 's capital adequacy and ability to maintain its core operations.

Impairment policy

The bank writes off a loan/security balance (and any related allowances for impairment losses) when Credit department determines that the loans/securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardised loans, charge off decisions generally are based on a product specific past due status.

Impaired loans and securities

Impaired loans and securities are loans and securities for which the bank determines that it is probable that it will not be able to collect all principal and interest due according to the contractual terms of the loan/securities agreements.

Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the bank 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 bank.

8. Credit risk(continued)

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category regardless of satisfactory performance after restructuring.

Allowances for impairment

The bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for banks of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Valuation of collateral

The bank uses the following minimum requirements to valuation of collateral:

- All items proposed as collateral are valued using agreed valuation methodologies and/or evaluators with appropriate expertise, prior to accepting such items as collateral.
- The assessors/evaluators of collateral must be independent of the business originators and providers of the collateral.
- All collateral is marked to market and revalued at a frequency appropriate to that collateral, taking into account the value and nature of the collateral, the ease and cost of valuation, and the volatility of the collateral's value. The valuation methodology to be used and the maximum time interval that will apply to the revaluation of individual collateral is determined by the business and documented in the Credit Procedure Manual.
- If the repossession of the collateral is effected, a revaluation of the collateral is done, and a write-down taken if there is a shortfall in the collateral.
- Valuations of generic collateral for product classes (e.g. home loans, non-specialised vehicle and asset finance) are updated in accordance with product rules.
- To the extent that collateral valuation methodology relies on expert judgment, quantification of collateral reliance is exclusively owned by the Credit function, and where it is necessary for external valuation to be undertaken, the acceptance of valuations by experts thus appointed is at the discretion of the relevant DA. In order to qualify as a LGD mitigant and hence provide regulatory capital relief, collateral valuations must be undertaken in accordance with such approved valuation methodologies as are in use from time to time. It follows that collateral values may not be influenced by business or pricing imperatives under any circumstances.

Monitoring

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 the collateral;

8. Credit risk(continued)

Monitoring(continued)

- annual reviews of the performance of the collateral is performed to ensure that the collateral types are still acceptable and the terms for acceptance are still appropriate (excluding home loans and vehicle and asset finance);
- updates to reflect changes in market and economic conditions are performed at pre-determined intervals;
- updates to reflect new legislation and updates to existing legislations are performed on regular basis;
- collateral is realised as per the delegated authority after all efforts have been made to rehabilitate the customer; and
- 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 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. All prior encumbrances must be duly cancelled.
- 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, such as warehouse agents, must be able to identify assets which provide collateral. Any such parties are vetted, approved, and monitored by the business.
- Insurance must be in place at all times, covering all appropriate risks. The bank must be designated as the first loss payee under the insurance policy, with advance notice of cancellation required. Insurance is confirmed on renewal.

Types of guarantees and indemnities involved in banks credit risk mitigation techniques

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

Explicit: must be a documented obligation assumed by the protection provider, explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible.

8. Credit risk(continued)

Types of guarantees and indemnities involved in banks credit risk mitigation techniques(continued)

Direct: the obligation must represent a direct claim on the protection provider. The bank must be in the position to exercise its rights and receive payments directly.

Irrevocable: there are no determinants that the protection provider is able to amend. Specifically, there must be no clause that gives the protection provider the ability to unilaterally cancel the guarantee.

Unconditional: such commitments must include the obligation of the protection provider to pay immediately when conditions as set in the commitment regarding the third party obligation are met. Such commitments should not include any clause outside the direct control of the Bank that could result in non-payment by the protection provider.

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.

Prior to acceptance, an assessment of the ability and willingness of the protection provider to honour the guarantee and indemnity is undertaken, including consideration of any correlation between the protection provider, the borrower and past performance under guarantees and indemnities previously provided.

Methodology adopted to grant credit limit to counterparty

Pre-credit committee

Before the credit process is invoked and in accordance with the relevant mandate, all material lending proposals (and certain trading proposals) are to be placed before the CIB Global or Regional Pre-Credit Committee (PCC), a Business Forum whose voting membership includes senior members of CIB Credit. Certain Global Markets activities subject to carve-out, and intra-group exposures, are however not subject to PCC screening, being subject to their own processes.

Application origination

Following approval to proceed from PCC, a credit officer, in conjunction with the business, engages with the client to gather and interrogate the credit information necessary to conduct a risk assessment at the appropriate depth and scope.

This information is then used to formulate an application for facilities for submission to the person or Committee within whose delegated authority level the proposed facilities fall.

Pricing of facilities and the associated ROE/RAROC is quantified by the Business sponsor in every case. The responsibility for pricing decisions rests jointly with Credit and Business, to assure the appropriate risk/return balance. pricing and capital.

8. Credit risk(continued)

Methodology adopted to grant credit limit to counterparty(continued)

Application origination (continued)

However, inputs into the calculations with respect to PDs, LGDs (including all collateral values) and EADs are exclusively owned by the Credit Risk function.

The decision with respect to the values assigned to each of these credit risk inputs is ultimately affirmed by the DA approving the facility.

Application approval validity period

For new and increased facilities (with the exception of uncommitted trading lines, contingent Trade Finance facilities and interbank money market/placement lines), the approval of a sanctioned facility not accepted and invoked within 3 months of sanction (or such longer period as applied for and explicitly approved in the original application), will lapse, and requires referral to the sanctioning authority for fresh approval, with the exception of expiring approvals by DA Levels 1 to 3, which may be reaffirmed at DA4 level for a further period.

After acceptance and drawdown, all approved facilities are subject to annual review, (on the understanding that if information comes to light that has a material bearing on the risk inherent in the exposure, the counterparty limit/exposure will be re-assessed immediately, notwithstanding the presence of a sanctioned review date that lies in the future). Hence each application or review should, in the normal course, be assigned a review date no longer than 12 months from the date of the credit sanction. Note that this annual review requirement remains independent of the existence of term exposures that may have been committed for periods longer than a year.

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8. Credit risk(continued)

Table 4: Loans and advances performance – 31 December 2014

Sub-Classification of Performing and Non-Performing Loans and Advances	Performing loans				Non-performing loans					Total non-performing loans	Non-performing loans %			
	Neither past due nor specifically impaired				Specifically impaired loans									
	Normal monitoring	Close monitoring	Early arrears	Non-performing	Sub-standard	Doubtful	Loss	Total	Securities and expected recoveries on specifically impaired loans			Net after securities and expected recoveries on specifically impaired loans	Balance sheet impairment for non-performing specifically impaired loans	Gross specific impairment coverage
Gross Loans and Advances														
Personal and Business Banking														
Mortgage Loans	1,526	-	319	-	75	81	17	173	27	146	146	84%	173	11%
Instalment Sales and Finance Leases	4,500	-	1,034	-	-	427	243	670	191	479	479	71%	670	15%
Card Debtors	-	-	-	-	-	-	-	-	-	-	-	0%	-	0%
Other Loans and Advances	24,843	-	1,471	-	145	328	1,880	2,353	951	1,402	1,402	60%	2,353	9%
Personal Unsecured Lending	9,545	-	1,471	-	3	12	219	234	-	234	234	100%	234	2%
Personal overdrafts	1,151	-	599	-	0	-	48	48	-	48	48	100%	48	4%
Personal term loans	8,394	-	871	-	3	12	171	186	-	186	186	100%	186	2%
Revolving credit plan	-	-	-	-	-	-	-	-	-	-	-	0%	-	0%
Business lending and other	15,298	-	-	-	142	316	1,661	2,119	951	1,168	1,168	55%	2,119	14%
Corporate and Investment Banking														
Corporate Loans	27,949	-	-	-	-	-	653	653	-	653	653	100%	653	2%
Commercial Property Finance	-	-	-	-	-	-	-	-	-	-	-	0%	-	0%

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8. Credit risk(continued)

Table 5: Ageing of loans and advances past due but not specifically impaired

	Total	Less than 31 days	31 to 60 days	61 to 90 days	91 to 180 days	More than 180 days
Personal and Business Banking	2,824					
Mortgage Loans	319	165	149	5	-	-
Instalment Sales and Finance Leases	1,034	900	128	6	-	-
Card Debtors	-	-	-	-	-	-
Other Loans and Advances	1,471	365	1,020	86	-	-
Personal Unsecured Lending	1,471	365	1,020	86	-	-
Business lending and other	-	-	-	-	-	-
Corporate and Investment Banking	-					
Corporate Loans	-	-	-	-	-	-
Commercial Property Finance	-	-	-	-	-	-

Table 6: Risk exposure and risk weighted assets by class

	Exposure amounts MKm	2014 Credit risk mitigation MKm	Risk weighted assets MKm
Credit risk			
Corporate	27,408	657	26,751
Sovereign	19,695		
Public sector entities	4		4
Exposure to Banks	55,482		27,478
Retail mortgages	955	146	301
Retail other	29,241	1,981	26,556
Other assets	51,039		19,490
Off balance sheet exposures	57,438	7,165	29,551
	241,262	9,949	130,131
Market risk	4,224		4,224
Interest rate risk	1,612		1,612
Equity position risk			
Foreign exchange risk	2,612		2,612
Commodities risk			
Operational Risk	44,855		44,855
Total risk-weighted assets/capital requirement	290,341	9,949	179,210

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8. Credit risk(continued)

Table 7: Exposures by economic sector

	2014	
	MKm	Percentage Concentration
Agriculture, forestry, fishing and hunting	12,541	21%
Construction	765	1%
Electricity, gas, water and energy	1,515	3%
Finance,real estate and other business services	487	1%
Individuals	17,957	31%
Manufacturing	6,723	11%
Mining and quarrying	1,976	3%
Transport, storage and communications	8,519	14%
Wholesale and retail trade	3,023	5%
Community, social and personal services	5,312	9%
	58,818	100%

Table 8: Geographic distribution of gross loans and advances

	December	
	MKm	Concentration
North and Central	23,629	40%
South	35,189	60%
	58,818	100%

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8. Credit risk(continued)

Table 9: Distribution of non-performing loans, provisions and interest in suspense

Sector	2014		
	Non performing Loans MKm	Specific Provisions MKm	Interest in suspense MKm
1. Agriculture, forestry, fishing and hunting	1,314	928	328
2. Mining and quarrying	29	4	6
3. Manufacturing	97	55	66
4. Electricity, gas, water and energy	5	0	2
5. Construction	55	45	28
6. Wholesale and retail trade	799	469	230
7. Restaurants and hotels			
8. Transport, storage and communications	946	732	64
9. Financial services	9	5	1
10. Community, social and personal services	593	442	149
11. Real estate			
12. Other sectors			
Total	3,847	2,680	874

Table 10: Reconciliation of changes in the provision account

	2014 MKm
Specific provisions	
Opening balance	2,920
Provisions during the year	2,966
Write offs	(1,453)
Recoveries	(1,753)
	2,680
General Provisions	
Opening balance	671
Provisions during the year	(20)
	651
Total	3,331

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8. Credit risk(continued)

Table 11: Off balance sheet items – 31 December 2014

	2014 MKm
Gurantees	6,218
Letters of Credit	16,848
Foreign exchange and interest related contracts	19,281
Unused commitments	15,091
Total	57,438

9. Operational Risk

Operational risk is the risk of loss suffered as a result of inadequacy of or a failure in internal processes, people and systems or from external events. SBM is currently treating operational risk under the basic indicator approach (BIA) by calculating the capital requirement based on annualised gross income. SBM is planning to move to the standardized approach (TSA) whereby the capital requirement for operational risk is mapped from income from Basel II-established business lines.

Operational risk exists in the natural course of business activity. The bank's approach to managing operational risk is to adopt fit-for-purpose operational risk practices that assist business line management to understand their inherent risk and to reduce their risk profile, in line with the group's risk tolerance, while maximising their operational performance and efficiency.

9.1 Operational risk management framework

The framework adopted by the bank sets out a structured and consistent approach for the management of operational risk across the Group. The risk management approach involves identifying, assessing, managing, mitigating, monitoring and measuring the risks associated with operations, enabling a comprehensive view, analysis and reporting of the bank's operational risk profile.

The operational risk governance standard defines the minimum requirements for operational risk management and is supported by specific policies and procedures to ensure that operational risk is managed in an appropriate manner, and integrated across the bank.

The operational risk management function is independent from business line management and is part of the second line of defence. Its role is to monitor, manage and report on risks to ensure operational risk exposure remains within tolerance. This function is also responsible for developing and implementing the operational risk management framework, and for promoting sound and relevant risk management practices across the Group. Business line management, as the first line of defence, is ultimately responsible for owning and managing risks resulting from their activities.

9. Operational Risk(continued)

9.1 Operational risk management framework(continued)

The day-to-day management of operational risk is embedded within the business areas in order for the risks to be managed where they arise.

The primary oversight body for operational risk is the Risk Management Committee (RMC) which reports to EXCO and ultimately the Board. RMC is chaired by the Chief Risk Officer and includes representation from specialist/enabling functions and business units.

9.2 Managing operational risk

Operational risk management forms part of the day-to-day responsibilities of management and staff at all levels. The operational risk management framework includes qualitative and quantitative methodologies and tools to assist management to identify, assess, monitor, control and mitigate operational risks.

These methodologies and tools include:

- An incident database of operational risk events, including near-misses. This enables action to be taken in response to an incident, and lessons to be learnt from it.
- A risk and control self-assessment process to analyse business processes and identify and assess operational risks associated with the processes. Risk and control self-assessments are designed to be forward-looking. This enables the development of a risk profile and allows for an understanding of the residual risk.
- Key risk indicators are used across the bank to monitor the relevant risks and controls highlighted in the risk and control self-assessment process. The main purpose is to assist management by providing an early-warning indicator of potential risk exposures and/or a potential breakdown of controls.

Operational risk reports are produced on both a regular and an event-driven basis. The reports include a profile of the key risks to business units, achievement of their business objectives, relevant control issues and operational risk incidents and trends for root causes of those incidents. Specific reports are prepared on a regular basis for the relevant business unit committees and for RMC, EXCO and the Board.

Specialist functions are responsible for oversight of specific components of operational risk including legal, financial crime, physical security, information security and business continuity management.

9.3 Business continuity management and resilience

Business continuity management is defined as a holistic management process that identifies potential impacts that threaten the bank. It provides a framework for building resilience and the capability for an effective response that safeguards the interests of key stakeholders, reputation, brand and value-creating activities.

The bank has business resiliency and continuity plans in place to ensure its ability to operate on an ongoing basis and limit losses in the event of severe business disruptions.

9. Operational Risk(continued)

9.3 Business continuity management and resilience(continued)

Crisis management is based on a streamlined command and control process for managing the business through a crisis to full recovery. These processes may also be deployed to manage non-operational crises, including business crises, at the discretion of senior management.

Business continuity management is an integral component of the bank's risk management framework. The bank's business continuity strategy is structured to ensure strong central monitoring and reporting and decentralised execution, and is supported by an entrenched governance process. The bank continues to ensure that business continuity is managed in an effective manner through a framework of policies, procedures and tools to identify, assess, monitor, control and report such risks.

Contingency and recovery plans for core services, key systems and priority business activities have been developed and are revisited as part of existing management processes to ensure that continuity strategies and plans remain relevant.

10. Market Risk

Market risk is defined as the risk of a decrease in the actual or effective market value or earnings of a portfolio of financial instruments 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 the above.

The Market Risk standards and methodology have been adopted by SBM to ensure the measurement, reporting and monitoring of market risk associated with operations across SBM follow a common governance framework. The objective of market risk management is to manage and control market risk exposures within acceptable parameters while optimising the return on risk.

The bank uses a number of techniques to measure and control market risk including daily Value at Risk ("VaR"), stress testing, annual net interest income at risk, and economic value of equity. Other market risk measures specific to individual business units include permissible instruments, concentration of exposures, gap limits, maximum tenor and stop loss triggers. In general, only approved products that can be independently priced and properly processed are permitted to be traded. Stop loss triggers are designed to contain losses for individual business units by enforcing management intervention at predetermined loss levels measured against the individual 'high-water mark' year-to-date profit and loss. Market risk positions are primarily taken as a result of the execution of customers' orders, however the SBM also assumes proprietary risk positions which are insignificant in the context of SBM's overall risk portfolio. Trading risk management is primarily the responsibility of traders, overseen by trading management on the desk. SBM provides its traders with appropriate technology and assures itself that risks are measured, monitored and controlled by independent processes and that risk limits are overseen by the Market Risk and ALCO.

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10. Market Risk(continued)

Market risk appetite is approved by ALCO and managed by the Chief Risk Officer. Limits are set top-down and are commensurate with budgeted and projected revenues, estimated business mix, portfolio diversification and available capital allocated to each business area. High level limit breaches are reported to ALCO.

10.1 Value at Risk (VaR) and stressed VaR

The scope of SBM VAR model permission includes the foreign exchange, risk, credit trading and interest rate risk trading businesses.

SBM generally uses the historical VaR approach to derive quantitative measures, specifically for market risk under normal conditions. Normal VaR is based on a holding period of one day and a confidence interval of 95%. Daily losses exceeding the 95% VaR are likely to occur, on average, 13 times in every 250 days. Where the bank has received internal model approval, a VaR and a Stressed VaR with a confidence level of 99% and holding period of 10 days are used to determine market risk regulatory capital. Normal VaR is based off the previous twelve month's time series, while Stressed VaR is based off a twelve month's time series that captures a market stressed period. All VaR limits require prior approval from ALCO.

Management are aware of the limitations of the use of historic VaR as it is based on historical correlations and volatilities in market prices and assumes that future prices will follow the observed historical distribution. SBM back-tests its VaR models to verify the predictive ability of the VaR calculations and ensures the appropriateness of the models. Back-testing compares the daily hypothetical profit and losses under the one-day buy and hold assumption to the prior day's VaR.

The VaR and PV01 limits shown in the tables overleaf are set by ALCO and reviewed on an annual basis.

Table 12: Trading portfolio limits – 31 December 2014

	Basic limit		Headroom		Basic + Headroom	
	Normal	Stress	Normal	Stress	Normal	Stress
Foreign Exchange	116,000	4,164,000	29,000		145,000	4,164,000
Interest Rate Trading	590,000	3,090,000			590,000	3,090,000
Money Markets trading	794,000	4,191,000			794,000	4,191,000
Fixed Income trading						
Bankwide	1,496,000	11,445,000	29,000		610,000	5,200,000

*Trading limits are based in US dollars. **Limits are expressed as VaR

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10. Market Risk(continued)

Table 13: PV01 Limits – 31 December 2014

	Limit US\$	
Money Market trading	MM	2,529,000
Interest Rates trading	FI	561,000

Table 14: Financial instruments – 31 December 2014

	2014			
	Nominal value MKm	Carry value MKm	Mark to market MKm	Fair value gain/(loss) MKm
Available for sale financial instruments	21,082	20,180	20,160	(20)
Trading securities	12,702	11,958	11,931	(27)
Total	33,784	32,138	32,091	(47)

10.2 Valuation

SBM valuation policy and financial asset classification is governed by IFRS (in particular IAS 39) and changes in asset classification is subject to IFRS restrictions. Valuations are the responsibility of the risk owners and they are accountable for the timely revaluation of assets and liabilities according to the methodologies and procedures applying to their particular business area.

Accounting and regulatory rules require held for trading positions to be recorded at fair value on the balance sheet. Fair value is the amount at which the instrument could be exchanged in a current transaction between knowledgeable and willing parties. The best evidence of fair value of financial instruments is quoted prices in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available and these prices represent actual and regularly occurring market transactions on an arms length basis.

Trading positions are marked to market on a daily basis and profits or losses on the revaluation of positions are recognised in the income statement. Traders can either mark a position directly to observable prices in an actively quoted market or indirectly through the use of an independently approved model, where the inputs to the model are observable. Independent price verification act as a control mechanism to ensure accuracy and validity of prices.

10. Market Risk(continued)

10.2 Valuation(continued)

For markets or instruments which exhibit low trading volumes or intermittent trading patterns, it can be difficult to establish if a price reflects a fully active market. If the market for financial investments is not active or has little transparency, the SBM establishes fair value using valuation techniques. The fair value may be less objective and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument. Pricing assumptions include risk premiums, liquidity discount rates, credit risk, volatilities and correlations however changes in these assumptions could affect the reported fair values of the financial instruments.

Financial instruments measured at fair value are classified according to a fair value hierarchy which reflects the spread of valuation methodologies used.

10.3 Independent price verification

Independent price verification is the process by which the prices and model inputs used for valuation purposes are verified against independently sourced data.

Market risk performs daily reviews of liquid price inputs and at least a monthly review of less liquid prices. Where material differences occur mark-to-market adjustments are made. For products where no independent price is obtainable, Market Risk tests the inputs to the model, use suitable approved proxies and/or fully provide for valuation uncertainty. This process is a key control over the marking of positions and operates to validate both the daily profit and loss and the fair value of trading book assets and liabilities.

10.4 Interest rate risk in the banking book (IRRBB)

IRRBB is the exposure of a bank's financial condition to adverse movements in interest rates. This arises mainly due to a maturity mismatch between the bank's assets and liabilities. Accepting this risk (maturity transformation) 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 the level of other sensitive income and operating expenses.

The most important sources of interest rate risk are:

- Re-pricing risk: The most common source of interest rate risk arises from timing differences in the maturity (for fixed rate) and re-pricing (for floating rate) of bank assets, liabilities and off-balance-sheet positions;
- Yield curve risk: Re-pricing mismatches can also expose the bank to changes in the slope and shape of the yield curve;
- Basis risk: Another important source of interest rate risk arises from imperfect correlations in the adjustment of rates earned and paid on different instruments with otherwise similar re-pricing characteristics; and
- Optionality risk: An additional source of interest rate risk arises from options embedded in many bank assets, liabilities, and off-balance sheet portfolios.

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10. Market Risk(continued)

10.4 Interest rate risk in the banking book (IRRBB) (continued)

These sources of risk can influence the bank from both an earnings perspective as well as an economic value perspective. To reflect the volatile interest rate environment, the relative change in interest rates are measured monthly by calculating a market calibrated shock using the historic volatility over a period of five years, with a 95% confidence interval, assuming a holding period of one month. This calculation is then used to determine the quantum of an upward and downward parallel interest rate shock. Rest of Africa ALCO reviews prescribed shocks on a bi-annual basis, but, should in-country developments warrant it, the discretionary adjustments may be made between the reviews.

The balance sheet is shocked on as is basis, no assumptions made with regard to loan repayments and non-maturity of assets for this purpose.

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 its local currency and foreign currency books (as prescribed by ALCO) limit the maximum adverse change in annualized net interest income to 10%. For interest rate sensitivities, the balance sheet is shocked on as is basis. Loans and deposits with no maturity dates but which are rate sensitive are bucketed in the overnight bucket given that the customer can repay the loan or withdraw the deposit at any time. For deposits with lazy rates, 90% of these deposits are assumed to be rate insensitive with the remainder bucketed in the overnight bucket.

The benchmark for the banking book interest rate sensitivity is the cumulative 12 month NII impact of a parallel rate shock. The limit imposed by ALCO is a maximum 10% adverse change in forecast annual NII when the balance sheet is subjected to a specific standardized rate shock. The respective rate shocks are 650bps downward shock and 550bps upward shock for local currency and 75 bps up and downward shock for foreign currency.

The cumulative 12 month NII impact on the various currencies, for SBM, for a selection of bps parallel shocks is as shown in the table below (as at 31 December 2014).

Table 15 : Interest rate risk in the banking book – foreign currency

Rate Change	Bps Change	NII USD'000	NII Change USD'000	Bps Change
-0.75%	-75	2,413	(147)	-6%
0.00%	0	2,560	-	0%
0.75%	75	3,644	1,085	42%

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10. Market Risk(continued)

Table 16 : Interest rate risk in the banking book – local currency

Rate Change	Bps Change	NII MK'mn	NII Change MK'mn	Bps Change
-6.50%	-650	13,939	(1,872)	-12%
-5.50%	-550	14,231	(1,580)	-10%
0.00%	0	15,811	-	0%
5.50%	550	16,686	875	6%
6.50%	650	16,845	1,034	7%

There was a breach on local currency book and this is attributed to the balance sheet structure whereby there are more rate sensitive assets than the liabilities. Management condoned the breach on the basis that interest rates are not expected to come off quite soon and that the market has limited instruments to hedge this risk.

10.5 Equity position risk

The bank did not hold any equity position as at 31 December 2014.

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11. List of abbreviations

ALCO	Asset and liability committee	IRRBB	Interest rate risk in the banking book
BAC	Board Audit Committee	IT	Information technology
BB	Business banking	KRI	Key risk indicators
BCC	Board Credit Committee	NPC	New products committee
BI	Business information	NPL	Non performing loan
BIA	Basic indicator approach	RMC	Risk Management Committee
BHRC	Board Human Resource Committe	PBB	Personal and business banking
BRC	Board risk committe	PM	Personal markets
CAR	Capital adequacy ratio	RBM	Reserve Bank of Malawi
CBD	Corporate banking division	RC	Regulatory capital
CC	Customer channels	RCSA	Risk and control self assessment
CE	Chief executive	RWA	Risk weighted assets
CFO	Chief financial officer	SBG	Standard Bank Group
CIB	Corporate and Investment Banking	SBM	Standard Bank Limited (Malawi)
CRMC	Credit Risk Management Committee	Tier 1	Primary capital
CRO	Chief Risk Officer	Tier 2	Secondary capital
EAD	Exposure at default	TPS	Transactional products and services
EXCO	Executive committee	TSA	The standardised approach
HC	Human capital	VaR	Value-at-risk
IAS	International Accounting Standards		
ICAAP	Internal Capital Adequacy Assessment Process		
IFRS	International Financial Reporting Standards		
IM	Incident management		

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Table 15 : Interest rate risk in the banking book – foreign currency

Table 16 : Interest rate risk in the banking book – local currency

FIGURES

Figure 1: SBM risk management and compliance structure

Figure 2: Management structure

Figure 3: Composition of risk weighted assets

Figure 4: Eligible capital and risk ratios – Basel II