



Standard Bank Limited PLC
(Malawi)

**Risk and Capital
Management Report
December 2020**

Standard Bank Limited PLC (Malawi) Risk and Capital Management Report



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1 Overview

Introduction

Effective risk management is fundamental to the business activities of Standard Bank plc (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.

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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 units and corporate functions 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, the existing capital buffers are enough to accommodate the risk.

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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 2020. 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.

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2 Corporate structure

The bank is a publicly 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 1.18%; and other public Investors 9.56%.

Standard Bank Bureau de Change Limited and Standard Bank Nominees Limited are 100% owned subsidiaries of the bank whose line of business are retail foreign exchange trading and to make investments on behalf of the clients respectively. 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: <https://www.standardbank.co.mw>

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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.

Table 1: Qualifying regulatory capital – 31st December 2020

Capital Component	Amount	
	MK'mn	
Total		
Issued primary capital	92,759	
Ordinary share capital	234	
Share premium	8,492	
Retained earnings	83,863	
General reserves	170	
Less: Regulatory deductions	3,772	
Deferred tax assets	3,707	
Investments in subsidiaries/associates	65	
Tier I	88,987	
Tier II		
Issued secondary capital and reserves	9,529	
Reserve: Statutory credit risk	-	
Revaluation reserves less 50% investments in subsidiaries/associates	9,529	
Total eligible capital	98,516	
Total regulatory capital demand	61,687	
Total risk weighted assets	411,246	
Credit risk weighted assets	314,983	
Operational risk weighted assets	91,386	
Market risk weighted assets	4,877	
Tier I capital ratio (%)	21.64%	
Total capital adequacy ratio (%)	23.96%	
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 Act, the Financial Services Act, and regulations relating to banks; these are consistent with the Basel II guidelines issued by the Bank for International Settlements as adopted by RBM.

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Table 2: Risk exposure amounts and risk weighted assets – 31st December 2020

	Exposure amounts	Loss provisions	Credit risk mitigation	Risk weighted assets
	MK'mn	MK'mn	MK'mn	MK'mn
Credit risk	711,211	7,351	3,001	314,984
Sovereign or central bank	174,581	393	-	-
Public sector entities	22	-	-	19
Exposure to banks	59,341	17	-	29,663
Corporate	73,270	903	-	72,367
Retail other	92,153	5,459	149	72,689
Retail mortgages	6,048	305	-	2,043
Other assets	81,520	-	-	51,264
Off balance sheet exposures	224,276	274	2,852	86,939
Market risk	4,877	-	-	4,877
Interest rate risk	497	-	-	497
Equity position risk	-	-	-	-
Foreign exchange risk	4,380	-	-	4,380
Commodities risk	-	-	-	-
Operational risk	91,386	-	-	91,386
Total risk weighted assets/capital requirement	807,474	7,351	3,001	411,246

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

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Table 3: Summary of capital ratios (%) – 31st December 2020

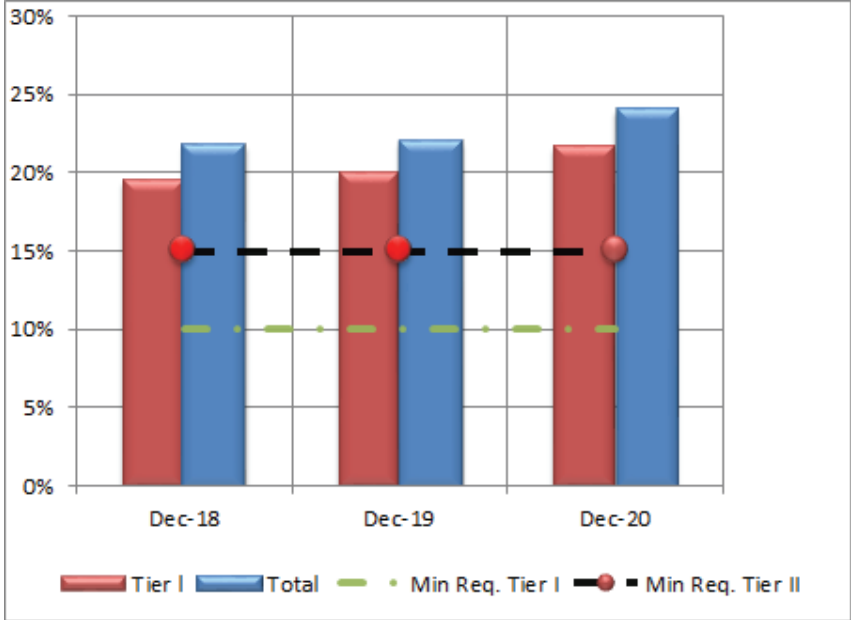
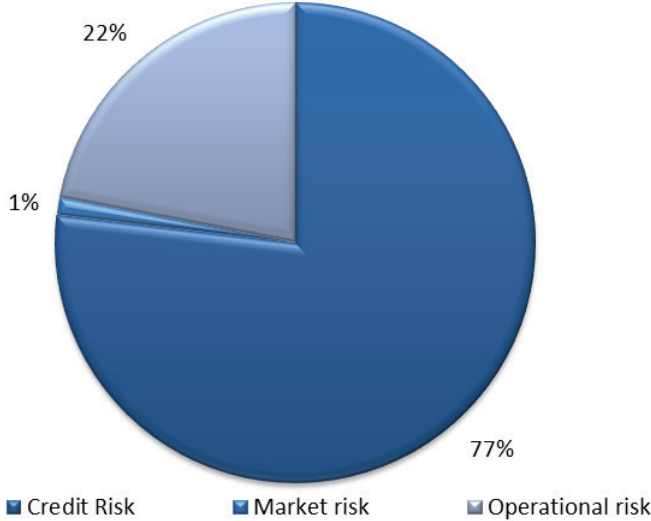


Figure 1: Risk weighted assets composition – 31st December 2020



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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.

Governance

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 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 Banking Act and the Financial Services Act, 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 loss (ECL) is recognised on debt financial assets classified as 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.

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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: <ul style="list-style-type: none"> • 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: <ul style="list-style-type: none"> • 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
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	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.

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Table 4: Total credit exposures as per IFRS 7 – 31st December 2020

	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	Stage 2	Stage 1	Stage 2	Stage 1	Stage 2	Stage 3	Purchased /originated credit impaired MKm						
		MKm	MKm	MKm	MKm	MKm	MKm	MKm	MKm						
Loans and advances at amortised cost															
PBB	98,686	-	-	72,558	-	17,499	6,374	2,255	-	2,255	45	152	2,058	98%	2%
Mortgage loans	6,073	-	-	5,604	-	-	342	127	-	127	35	4	88	73%	2%
Vehicle and asset finance	11,740	-	-	11,643	-	-	-	97	-	97	1	-	96	99%	1%
Card debtors	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other loans and advances	80,873	-	-	55,311	-	17,499	6,032	2,031	-	2,031	9	148	1,874	100%	3%
CIB	156,120	77,275	-	76,128	2,477	-	240	-	-	-	-	-	-	-	-
Corporate	73,611	17,755	-	53,139	2,477	-	240	-	-	-	-	-	-	-	-
Sovereign	22,989	-	-	22,989	-	-	-	-	-	-	-	-	-	-	-
Bank	59,520	59,520	-	-	-	-	-	-	-	-	-	-	-	-	-
Other service	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross carrying amount	254,806	77,275	-	148,686	2,477	17,499	6,614	2,255	-	2,255	45	152	2,058	98%	1%
Less: Interest in suspense	152														
Less: Total expected credit losses for loans and advances	6,704														
Net carrying amount of loans and advances measured at amortised cost	247,950														
Financial investments measured at amortised cost															
Corporate	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sovereign	136,800	-	-	136,800	-	-	-	-	-	-	-	-	-	-	-
Bank	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross carrying amount	136,800														
Less: total expected credit loss for financial investments	372														
Net carrying amount of financial investments measured at amortised cost	136,428														
Financial investments at fair value through OCI															
Corporate	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sovereign	5,904	-	-	5,904	-	-	-	-	-	-	-	-	-	-	-
Bank	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross carrying amount	5,904														
Add: Fair value reserve relating to fair value adjustments (before the ECL balance)	170														
Total financial investment at fair value through OCI	6,074														
Off-balance sheet exposures															
Letters of credit and banker's acceptances	18,056														
Guarantees	125,465														
Irrevocable unutilised facilities	14,936														
Total exposure to off-balance sheet credit risk	158,457														
Expected credit losses for off-balance sheet exposures	274														
Net carrying amount of off-balance sheet exposures	158,183														
Total exposure to credit risk on financial assets subject to an expected credit loss	547,934														
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	29,353														
Derivative assets	602														
Trading assets	3,030														
Pledged assets	12,928														
Other financial assets	2,371														
Total exposure to credit risk	596,919														

Note: The numbers in the table above include accrued interest. In accordance with International Financial Reporting Standards (IFRS)

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Table 5: Geographical distribution of loans and advances to customers – 31st December 2020

	Amount in MK'mn	Percentage Concentration
North and central	88,393	51%
South	83,904	49%
	172,297	100%

Table 6: Distribution of exposures to customers by industry – 31st December 2020

	Amount in MK'mn	Percentage
Agriculture, forestry, fishing and hunting	52,321	30.4%
Construction	3,833	2.2%
Electricity, gas, water and energy	6,598	3.8%
Financial services	199	0.1%
Individuals and households	68,743	39.9%
Manufacturing	9,405	5.5%
Mining and quarrying	-	0.0%
Transport, storage and communication	11,396	6.6%
Wholesale and retail trade	13,344	7.7%
Community, social and personal services	1,690	1.0%
Real estate	4,327	2.5%
Restaurant and others	441	0.3%
	172,297	100.0%

The table below sets out an analysis of credit risk by maturity as at 31st December 2020. Residual maturity of credit exposures is based on contractual dates.

Table 7: Residual contractual maturity of credit exposures – 31st December 2020

	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	43,806	10,986	37,436	82,353	-	174,581
Public sector entities	22	-	-	-	-	22
Exposure to banks	59,341	-	-	-	-	59,341
Corporate	32,266	18,663	10,394	11,947	-	73,270
Retail other	2,551	2,567	12,663	74,372	-	92,153
Retail mortgages	4	1	12	6,031	-	6,048
Other assets	81,520	-	-	-	-	81,520
Off balance sheet exposures	129,619	23,251	42,441	28,965	-	224,276
Total credit risk exposures	349,129	55,468	102,946	203,668	-	711 211

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

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Table 8: Classification of Loans and advances to customers by Sector – 31st December 2020

	Stage 1 MK'mn	Stage 2 MK'mn	Stage 3 MK'mn	Total MK'mn
Sector				
Agriculture, fishing, forestry and hunting	49,588	2,526	-	52,114
Mining and quarrying	-	-	-	-
Manufacturing	8,109	841	1	8,951
Electricity, gas, water and energy	3,310	143	-	3,453
Construction	2,576	929	95	3,600
Wholesale and retail trade	13,480	723	306	14,509
Restaurant and hotels	411	18	1	430
Transport, storage and communication	10,569	711	38	11,318
Financial services	185	50	17	252
Community, social and personal services	67,603	3,143	1,795	72,541
Real estate	4,323	-	2	4,325
Total	160,154	9,084	2,255	171,493

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

Table 9: Distribution of non-performing loans, provisions and interest in suspense – 31st December 2020

	Non-performing loans MK'mn	Loss provisions MK'mn	Interest in suspense MK'mn
Sector			
Agriculture, fishing, forestry and hunting	-	-	-
Mining and quarrying	-	-	-
Manufacturing	1	1	-
Electricity, gas, water and energy	-	-	-
Construction and Engineering	95	88	6
Wholesale and retail trade	306	292	9
Restaurant and hotels	1	-	-
Transport, storage and communication	38	37	1
Financial services	17	17	-
Community, social and personal services	1,795	1,621	136
Real estate	2	2	-
Total	2,255	2,058	152

Table 10: 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 2020	4,666
Classified as impaired during the year	1,960
Transferred to not impaired during the year	(1,279)
Amount written-off	(3,092)
Impaired loans and advances to customers as at 31st December 2020	2,255

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Table 11: Reconciliation of changes in loss provisions for impairment – 31st December 2020

	MK'mn
Loans & advances customers expected credit losses (stage 1 & 2)	
Opening balance as at 01 January 2020	3,171
Total transfers between stages	(128)
ECL on new exposure raised	2,009
Subsequent changes in ECL	59
Change in ECL due de-recognition	(484)
Other movements	15
	4,642
Loans & advances customers expected credit losses (stage 3)	
Opening balance as at 01 January 2020	3,307
Total transfers between stages	128
ECL on new exposure raised	1,716
Subsequent changes in ECL	-
Change in ECL due de-recognition	-
Other movements	(3,093)
Write-offs	-
	2,058
Financial investments expected credit losses (stage 1 & 2)	
Opening balance as at 01 January 2020	185
Total transfers between stages	369
ECL on new exposure raised	-
Subsequent changes in ECL	-
Change in ECL due de-recognition	(185)
Other movements	3
	372
Loans & advances banks expected credit losses (stage 1 & 2)	
Opening balance as at 01 January 2020	0
Total transfers between stages	-
ECL on new exposure raised	-
Subsequent changes in ECL	4
Change in ECL due de-recognition	(0)
Other movements	-
	4
Off balance sheet expected credit losses (stage 1 & 2)	
Opening balance as at 01 January 2020	180
Total transfers between stages	133
ECL on new exposure raised	(1)
Subsequent changes in ECL	(38)
Change in ECL due de-recognition	-
Net impairments raised/(released)	-
Other movements	-
	274
Loss provisions as at 31st December 2020	7,350

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Table 12: Off balance sheet items – 31st December 2020

	MK'mn
Guarantees	125,465
Letters of credit	18,056
Foreign exchange and interest rated contracts	32,689
Unutilised commitments	48,066
Total	224,276

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 updates 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.

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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 possesses 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 related 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.

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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.

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Table 13: Trading portfolio values – 31st December 2020

Normal VaR	USD			
	High	Mean	Low	Actual
Foreign exchange trading	100,310	88,085	66,646	99,754
Money market trading	29,918	29,450	28,762	29,933
Money market banking	1,909	1,275	770	1,992
Bank-wide	126,649	112,730	92,687	125,015

Stress VaR	USD			
	High	Mean	Low	Actual
Foreign exchange trading	510,267	441,076	333,303	510,267
Money market trading	669,577	656,901	643,511	643,511
Money market banking	21,089	19,942	18,588	18,588
Bank-wide	1,129,653	1,049,122	913,730	1,129,653

Table 14: Trading securities and derivative assets – 31st December 2020

	Nominal value MK'mn	Carry value MK'mn	Mark to market MK'mn	Fair value gain/(loss) MK'mn
Trading securities & derivative assets	3,260	3,132	3,632	500
Total	3,260	3,132	3,632	500

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6 Operational risk

Operational risk is 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 categorized as follows:

- Process risk; the risk of loss suffered as a result of failed or inadequate processes. This includes the design and operation of the control framework.
- 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. This is generally limited to events that impact the operating capability of the group (i.e. it does not include events that impact the areas of market risk, credit risk, or country risk etc.). It also includes risks arising from suppliers, outsourcing, and external system failures.

Operational risk arises in all parts of SBM; all senior management are thus responsible for consistently implementing and maintaining policies, processes and systems for managing operational risk in all material products, services, activities, processes and systems. The ultimate responsibility for establishing, approving and periodically reviewing the operational risk framework however 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 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 function. Importantly, the operational risk function performs incident recording, management and analysis, and the risk self-assessment process, the key risk indicators and scenario analysis. Independent assurance on the management of operational risk is further provided by Internal Audit.

In 2020, the Bank incurred K217.5mn to fight the Corona virus pandemic to ensure safety of its members of staff and customers. These were treated as operational losses in line with the Group policy and caused the losses to significantly increase, however the loss to gross income ratio at 0.52% did not breach the 0.6% limit.

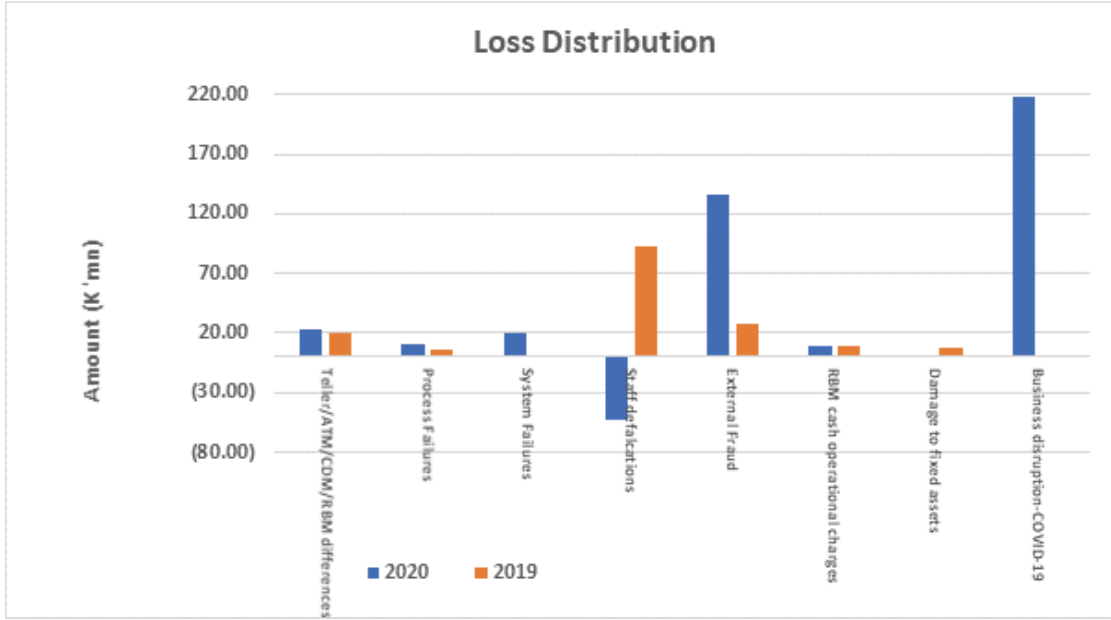
Again, external fraud losses increased in 2020 mainly through cheque fraud. Private prosecution is undertaken to ensure custodial sentences on the culprits where possible. Internal fraud losses of K240m were recovered in 2020 directly and through insurance.

The graph below shows the loss distribution in the year 2020:-

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Figure 2: Losses distribution – 31st December 2020



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7 Interest rate risk in the banking book (IRRBB)

IRRBB is the exposure of the bank's financial position to adverse movements in interest rates. This arises mainly due to a maturity mismatch /different repricing characteristic between the bank's assets and liabilities in the banking book. 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 of the 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 15: Impact of parallel rate shock on NII (FCY) – 31st December 2020

Rate Change	BPS Change	NII	NII Change	NII Change
%		USD'000	USD'000	%
-1.00	-100	1,692	86	5.32%
0.00	0	1,607	0	0.00%
1.00	100	1,358	(249)	-15.47%

Table 16: Impact of parallel rate shock on NII (LCY) – 31st December 2020

Rate Change	BPS Change	NII	NII Change	NII Change
%		MK'mn	MK'mn	%
-3.50	-350	35,779	(3,634)	-9.22%
0.00	0	39,413	0	0.00%
5.00	500	43,851	4,438	11.26%

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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.

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9 List of abbreviations

ALCO	Asset and liability committee
BCC	Board Credit Committee
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

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