Opportunity Bank

MALAWI

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS – MAY 2016

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1.0 Introduction

Opportunity International Bank of Malawi (OIBM) is on the threshold of a new era, when the strengths of the bank will be capitalised on to address current performance challenges.

Consistently loss making since starting operations in March 2003 (12 years) as a commercial bank licenced by the Reserve Bank of Malawi (in May 2002), the past few years have been particularly challenging for OIBM, culminating in an operational loss of K2.8billion for 2015. This is against the back drop of other commercial banks operating in the same environment in the country doing well, even in the face of the many economic challenges facing the country and recording consistent profits year after year.

Although Opportunity bank has done well on its transormational agenda and with 600,000 customers commands the highest number of customers, this has not translated into any financial gains thereby putting the sustainability of the bank at risk. In fact, the Central Bank has over the years consistently and with increasingly growing concern, noted and pointed out to both Board and management the vulnerability of customers' deposits given the continuing loss making position of the institution but acknowledged the high level of support received from the shareholders. At a recent meeting of management and the Central Bank, the regulators again emphasised their considered view that the business model of the bank is wrong as it completely ignores the aspect of profitability while focusing entirely on the transformation agenda. The regulators further emphasised that because the bank was licensed as a commercial bank and thus is involved in deposit taking, then by virtue of this deposit taking aspect to the bank's business, it is required to be profitable so as to ensure depositors funds are safeguarded at all times.

There are currently 12 commercial banks licensed by the Reserve Bank of Malawi .The banks have footprints in major cities and are spread across the country. Opportunity Bank Malawi was granted a full commercial banking license by the Reserve Bank of Malawi on March 21, 2002. The first branch was opened on 23rd May 2003 in Lilongwe. Currently, the bank has 36 branches, 11 sales offices, 9 mobile vans and 26 ATMs. OIBM has further complemented its footprint by adding 245 banking agents across the country. The bank is the largest microfinance institution in Malawi, known for serving the traditionally financially underserved. OIBM is the people's bank, and is recognized by name anywhere in Malawi.

2.0 Capital Management

Capital Management is at the center of the bank's risk management framework in order to ensure the sustainability of the bank and productivity in line with expected return on capital. The bank has a risk appetite statement which guides the level of risk that management is allowed to undertake in line with its various business strategies.

The Internal capital adequacy process is a review of the capital that the bank needs to maintain in line with the risks undertaken under the framework of its Risk Appetite statement.

The Bank's regulatory capital is analysed in two parts:

- Tier I capital which includes ordinary share capital, share premium, retained earnings, and other regulatory reserve after taking out any investment in a subsidiary; and
- Tier II capital which includes share revaluation reserve, investment revaluation reserve, property revaluation reserve and loan loss reserve.

The assessment process has reviewed the current capital adequacy position of the bank as at 31st December 2015 and also the projected capital adequacy position of 2016 in line with the annual forecast for 2016. The review further conducted a capital adequacy assessment under stressed conditions in order to ascertain the bank's resilience on the same.

The capital adequacy assessment process adopted by the bank is aimed at assessing the capital adequacy needs in line with regulatory requirements (regulatory capital) at a minimum. However the bank is aiming at achieving a 2% margin over the required minimum ratios to act as a buffer in case of any unforeseeable circumstances that can erode its capital.

The assessment shows that as on 31st December, 2015, the bank will be adversely impacted by the worst case scenario as follows:

- An assumed sudden migration of loans into NPLs results in the Tier I ratio falling, albeit within regulatory limits.

- A major shock to FX income arising from 50% depreciation would improve the Tier 1 ratio in all the 2015 quarters above the minimum regulatory threshold of 10%.
- The bank can manage liquidity risk exceeding 5 days after a major shock of 15% deposit run using a simple liquidity test which assumes a run on all banks and fire-sale of assets.
- The combined impact of the various factors indicates a stable Tier 1 ratio of 18.6%. This is so because the bank is gaining from adverse changes in the foreign currency exchange rate.

The Board and shareholders continuously assess whether OBM has the ability to continue as a going concern and our current assessment is that OBM has the ability to continue to operate as a going concern for the foreseeable future for the following reasons:

1. The bank has established a strategic plan that will ensure that the bank will achieve a breakeven point in June/July, 2016 on month to month basis and a full year breakeven in 2017 and be profitable from 2018. The new strategy will transform the bank into a profitable and transformational bank.
2. Shareholders of the bank have again committed to inject enough capital whenever required as per their comfort letter to the Banks's external auditors dated March, 2016.
3. Opportunity Bank has all the ingredients to have a successful, sustainable and profitable future. The bank has an established customer base, a healthy market share and a good reputation in the market. These are important factors in our assessment that Opportunity Bank Malawi already has the foundational attributes to be a healthy going concern after various restructuring decisions are implemented.

The Internal Capital Adequacy Assessment was reviewed, challenged and approved by the board of Directors on 31 May, 2015.

3.0 OBM Products

Opportunity Bank is a registered commercial bank providing financial services particularly deposit and credit services. The following highlights lending and deposit products:

Lending products:

- Group and Individual loans to micro businesses and smallholder farmers
- Small-Medium Enterprise
- Consumer loans (housing, school proprietor, and payroll).

Deposit products:

Ordinary savings, Fixed deposit, Premium Investment Account, School fee savings, Youth savings, Business savings, Group Savings- Foreign currency denominated accounts (FCDA), Foreign exchange drafts, Insurance products (as agent of Nico Life Insurance Company Limited and Old Mutual Life Assurance Company Limited): Life insurance, non-life insurance, weather-index crop insurance.

4.0 New Strategic Plan

The bank developed a new strategy in September, 2015

During the strategic planning process of September 2015, the team performed a current reality check of the bank which affirmed the true identity of the bank as for all intents and purposes being a fully-fledged commercial bank, though it has since its inception been behaving and operating largely as a microfinance institution. The current performance of the bank can thus mainly be attributed to this hybrid existence and behavior of the bank. However, the potential to reshape the bank is limitless given the bank's strong brand name and the huge number of clients currently served by the bank.

To ensure that the bank builds on its current strengths therefore, while fully exploiting all the viable opportunities that exist in the market; an inclusive and comprehensive planning process thus resulted in a vision and turnaround strategy for a transformed OIBM. This new vision is of an organization characterized by a business culture that leverages emerging technology, rewards innovation, and invents new business approaches that will lead the bank towards sustainability and continued relevance. The planning process thus sought to derive a turnaround strategy to mitigate against the risk associated with the bank's current mandate and thus its continued sustainability.

The main objectives of the strategic planning process were to derive radical and business unusual strategies which are calculated to address the challenges of continuous poor bank performance and poor internal and regulatory audit results that have trailed the bank for most of its 12 years of operational existence. To do this, the plan identifies four broad thematic areas nameley:

- **SUSTAINED IMPROVED PROFITABILITY**
- **WORLD CLASS CUSTOMER SERVICE.**
- **ROBUST AND OPTIMIMAL INTERNAL PROCESSES, AND**
- **BEST PRACTICE AND STANDARDS PEOPLE MANAGEMENT**

Within these four thematic areas, the plan further isolates the following key areas as critical to improving, sustaining and accelerating profitable growth of the bank within the available resources and time frame of the plan:

- **Sustained improved profitability**
  - Improve cost to income ratio from 101% to 60% by 2020
  - Return on Asset (ROA) of 6%
  - Break even within 9 months on month to month basis and breaking even within second full year – 2017
  - Cost reduction and cost management by exiting non performing businesses and products
  - Improve earning assets ratio from current 59% to 70%,
  - To reduce non-performing loans and impairments to below 5% at 30days and below 10% at 1 day.
  - Move from current 2% banking industry market share to 10% market share by 2020

- **WORLD CLASS CUSTOMER SERVICE.**
  - To focus on customer acquisition, segmentation - right customers, right products at the right segment, and retention
  - Focus building enduring rewarding relationship (ERR) with our SME customer by investing on Relatiosnhip management model
  - To adopt an omni-channel distribution strategy across the country
  - To focus on product development, marketing and position
  - To improve activity ratio, lintroduce loyalty program and customer experience
  - Invest in agent banking and other automated delivery channels– decongesting banking halls

- **ROBUST AND OPTIMAL INTERNAL PROCESSES**
  - To establish a good Corporate Governance culture
  - To improve audit processes and outcomes
  - To develop & implement a robust Risk & Compliance Framework
  - To develop an automated, seamless integrated system (core-banking)
  - Invest in scalable and robust IT systems and infrastrure
  - 100% compliance to internal and regulatory requirements,

- **BEST PRACTICE AND STANDARDS PEOPLE MANAGEMENT**
    - To have lean and streamlined organisational structure, right people with the right qualifications in the right roles
    - To improve skills and competencies
    - To achieve optimal staff utilisation
    - To build high performing value driven team, and execution culture
    - Competitive remuneration and talent management
    - Management leadership training, Board training and succession planning
    - Increase staff producytivity by training employees to be multiskilled

Through these identified priorities within the areas as outlined above, the plan thus seeks to maintain a balance among people (staff), processes, customers and governance (board and shareholders). Together, these strategies are envisaged to propel the bank forward from its current financial challenges to a new rebirth, re-invigorated existence and sustained prosperity in the medium-long term while making it possible for the bank to continue attaining transformational impact on the lives of the many economically active but marginalised Malawians

STRATEGIC GOALS, OBJECTIVES AND STRATEGIES

The OIBM turnaround strategy 2015-2020 aims at transforming the bank to ensure its continued growth and prosperity and seeks to formulate and implement appropriately integrated strategic, organisational and operational responses to internal and external conditions. In addition to being financially-focused, undertaking swift Human Resource due diligence during the bank's turnaround strategic plan implementation is critical to the attainment of results in investment benefits.

The theme of the strategy itself is "moving from current organisational challenge to new rules, re-invigorated processes and sustainable existence". To achieve this feat, the turnaround strategy is thus aligned to the revised Strategy Foundations, Vision, Mission, Values and strategic recovery pillars of PROFITABILITY, INCOME IMPROVEMENT, COST REDUCTION, REGULATORY COMPLIANCE, IMPROVEMENT OF RISK PROFILE, EXECUTION, EFFICIENT DONOR MANAGEMENT AND IMPROVED ORGANISATIONAL PERFORMANCE. The revised, updated and re-generated Vision, Mission and Values statements are further interpreted as placing OIBM in a state of financial viability and longevity, while being the leading authority and example on reforming and altering both itself as an organisation and the lives of its customers, staff and identified stakeholders. The Mission asserts that OIBM will succeed for itself and for its stakeholders by being solution driven, with optimal processes, technological support, a staff base that is equipped, engaged and satisfied enough within themselves to be able to satisfy their stakeholders.

The revised OIBM Vision presents **" A profitable, sustainable and transformational bank."** The mission is **"to provide customized financial solutions to the economically active people in Malawi, and identified stakeholders, through optimized processes, technology and productive staff**. The fundamental values or ideals at the heart of OIBM are **COMMITMENT, HUMILITY, RESPECT, INTEGRITY, STEWARDSHIP and TRANSFORMATION,** and articulate ideals that the OIBM aspires to hold itself accountable to and for. They additionally offer guidance about how the organization will behave in carrying out its vision and mission.

The Plan itself charts the bank's course through 2015 to 2020; and is a roadmap that lays out specific priorities, which, in turn, will help guide the choices and directions that the bank intends to follow. The financial key turnaround grand strategy is driven by regrouping through cost reduction and improved profitability to reverse the current losses threatening the bank's very existence. The following strategies will be focused on within the plan period:

- GROWING REVENUE
- ORGANISATIONAL STRUCTURE RE-ALLIGNMENT & STAFF OPTIMISATION
- CUSTOMER AQUISITION, RETENTION AND SATISFACTION
- RIGHT SEGMENTATION, RIGHT CUSTOMER, RIGHT PRODUCTS
- REDUCTION OF PAR BELOW 5%
- NEW PRODUCT DEVELOPMENT & VALUE ADDED PROPOSITIONS TO CURRENT PRODUCTS
- COMPLIANCE & ACCEPTABLE AUDIT RATINGS, GOOD GOVERNANCE AND RISK FRAMEWORK & RBM AUDIT PASS
- BALANCE SHEET GROWTH AND EFFICIENCY
- LEAN, CHEAPER, EFFICIENT AND OMNI-DISTRIBUTION CHANNELS
- COST REDUCTION

The above strategies represent the set of strategic initiatives that will enable the execution of the OIBM turnaround strategy . The aim of the strategies is to create a unique strategic turned around position for the bank . This strategic position is defined and challenged by constant re-evaluation of what strategies will be deployed and how they will be executed . The objective of the strategies is to redefine the business and develop the restructuring plan’s strategic moves for a successful turnaround.

5.0 Economic Conditions

MALAWI GDP

Notwithstanding the downward adjustment of the country's performance in 2015 to 3 percent, Malawi's medium term prospects are positive with the economy projected to grow by 5.4 percent in 2016. This is on the assumption of normal harvesting season and achievement of short term stabilization of the macroeconomic environment. However, given recently released second round crop estimates put 2016 crop production at 12 percent lower than 2015 output; it is likely that the projected GDP growth of 5.4 percent will be missed.

INFLATION

Head line inflation in March decelerated to 22.1 percent from 23.40 percent in February 2016, representing a downward movement of 1.3 percentage points. The decrease in inflation in March 2016 was on account of decrease in food inflation at the back of early harvesting of maize.

INTEREST RATES

The policy rate, commercial banks' lending and savings rates remained unchanged in February 2016 at 27%, 37% and 8% (on average), respectively.

TREASURY BILLS

All type Treasury bill yield moved up by 1.13 percentage points and closed March 2016 at 28.06 percent from 26.93 percent in February 2016.

Government's appetite to borrow has been observed to be high in recent months – resulting in upward shift of Treasury bill yield across all the three tenors (91, 182 and 364 days).

Although Government's getting back on track with IMF program is anticipated to ease budgetary funding requirements, pressure on the budgetary funding still persists from the recent reported shortfall in revenue collections by MRA. Further, the recently reported 12 percent drop in projected agricultural output has budget implications if Government were to import more maize to supplement local supply using own resources.

Central bank has in recent months embarked on a tight monetary policy stance which has resulted in liquidity levels dropping in the market as excess liquidity has been removed through Open Market operations.

Given the above observations, outlook for short – medium term is for Treasury bill trend to continue moving upwards. Treasury will however not be able to take advantage of the current high yields through new Treasury bill investments as tobacco selling season is the highest cash requirement period for the bank. Therefore, to ensure the bank has adequate liquidity for the business, any excess cash will be put on short term investments on the interbank.

EXCHANGE RATE

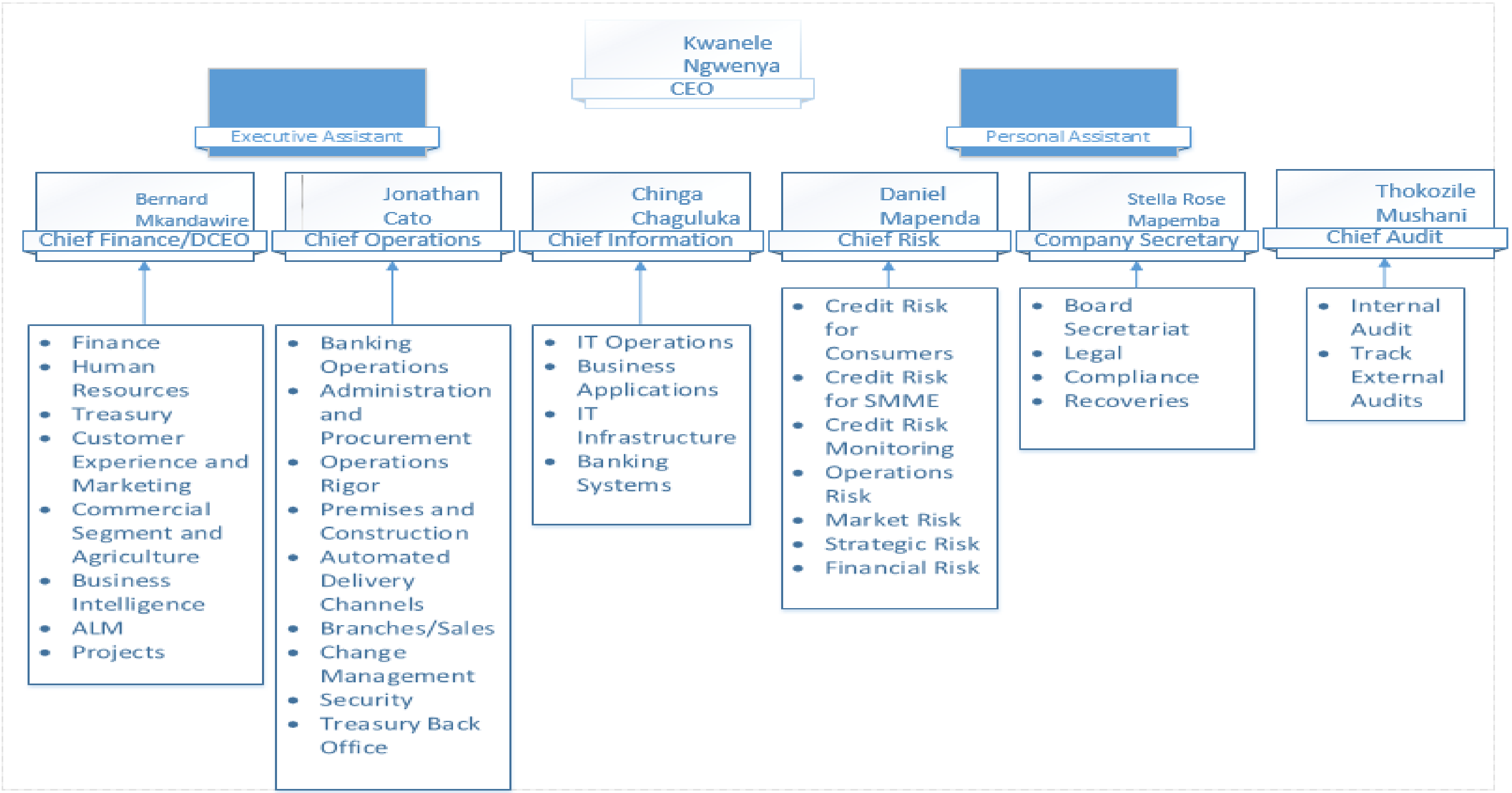
Kwacha appreciated against all its major trading currencies (USD, GBP, EUR and ZAR). The Kwacha gained K56.28 in the month and closed March 2016 at K689.9919 from K746.2756, representing a 7.5 percent appreciation.

Appreciation was on account of speculation of increased forex supply in the market due to impending opening of the tobacco marketing season. Looking ahead, Kwacha expected to be on an appreciation trend from April to around July 2016 due to increased forex supply in the market from seasonal inflow of forex in the economy through tobacco earnings.

GROSS OFFICIAL RESERVES

As at 31st March 2016, Gross official reserves rebounded to USD624.82million (equivalent of 2.99months of import cover) from USD554.57million and equivalent of 2.65 months of import cover in February 2016.

6.0 Organisation Structure and Management



7.0 Historical Financial Performance

The tables below depict the financial performance of the bank over the past five years with a depiction of the movements in the balance sheet and Income statements over the period:

7.1.1 Balance Sheet Summary

In thousands of Malawi Kwacha	2015	2014	2013
Assets			
Cash and cash equivalents	10,862,273	8,032,983	3,170,164
Loans and advances	5,007,447	6,385,971	7,723,645
Other Receivables	310,432	816,678	616,727
Other Assets	6,394,822	6,601,964	4,931,384
Total assets	**22,574,974**	**21,837,596**	**16,441,920**
Liabilities			
Customer deposits	14,693,864	12,101,794	9,525,976
Other liabilities	3,626,781	6,165,161	1,446,143
Total liabilities	**18,320,645**	**18,266,955**	**10,972,119**
Equity	**4,254,329**	**3,570,640**	**5,469,801**
Total Equity and Liabilities	**22,574,974**	**21,837,595**	**16,441,920**

7.1.2 Income Statement Summary

In thousands of Malawi Kwacha	**2015**	**2014**	**2013**
Net interest income	2,915,877	3,185,659	2,044,531
Fees and commissions	972,888	816,777	670,137
Other income	1,006,656	1,287,212	1,556,747
Operating income	**4,895,421**	**5,289,648**	**4,271,415**
Expenditure			
Salaries and benefits	2,294,962	1,575,876	1,262,113
Operating expenses	4,130,201	3,234,427	2,382,442
Other expenses (depreciation and amortization)	748,514	633,548	357,792
Total expenditures	**7,173,677**	**5,443,851**	**4,002,347**
Operating profit before loan provision	(2,278,256)	(154,203)	269,068
Increase in specific loan provision	927,277	1,609,422	209,922
Net income before income tax	**(3,205,533)**	**(1,763,625)**	**59,146**
Taxation	**(423,317)**	**660,071**	**184,779**
Net income for the year	**(2,782,216)**	**(2,423,696)**	**(125,633)**
Other comprehensive income	**12,239**	**9,564**	**1,196,369**
Total comprehensive income for the year	**(2,769,977)**	**(2,414,132)**	**1,070,736**

The bank's financial statements depict the following trends over the past three years:

- Steady growth of the asset base which has grown by 37% over the period.
- 35% decline of the loan book. This is due to asset quality challenges within the agriculture book which resulted in a higher provision level. The bank is also transforming its approach to the agriculture sector which forms the significant portion of the book.
- Steady growth of deposits which have grown by 54% over the period.
- A strong shareholder commitment which has seen more capital invested in the bank over the period. Equity has declined, though, by 22% mostly owing to the bank's loss making position.
- The bank has made losses throughout the three year period.
- The loss of K2.782bn for 2015 was mainly because of the following reasons:

    - Declining loan book resulting in depressed interest income.

    - Inflation impacting the operating cost base.

    - Lower than anticipated other income (commission income) due to lower volumes of transactions and lower loan loss recoveries during the year.

8.0 SWOT Analysis

Strengths

- OIBM has young and dedicated staff Good ICT systems and operating procedures for serving clients
- Strong support from OIBM shareholders, Opportunity International
- Established partnership with lenders and donors
- Christian values-this facilitates transformation of clients and staff lives
- Diversified product range which also takes care of the previously unbanked population.
- Growing deposit book and this provides cheap funding
- Strong brand name (Banki Yanga) with highest number of customers
- Wide distribution network-providing accessibility to the bank’s target customers
- Well-developed process manuals, policies and risk management tools
- Very innovative- first to enter markets like cell phone and agent banking

Weaknesses

- Costly and in-efficient processes
- Organizational structure is not properly aligned to the business (Bureaucracy)
- Weak performance and consequence management system
- Weak skill set
- Lack of in-depth market research when introducing new products
- Inadequate systems and infrastructure to run the business properly. The ambience of banking halls is not strong.
- Failure to retain good talent
- Failure to revitalize products in the decline stage of the product life cycle.
- Poor Documentation, filing and auditing systems
- Quality Management system is weak

Opportunities

- High growth opportunities to recruit Small and Medium Enterprises
- Growing demand for financial services
- Government agenda to promote cashless transactions
- Promotion of commodity exchange by Government which will provide structured market(s) for Agriculture Business
- Existence of qualified institutions that can train staff to required levels of performance e.g. Bankers Association of Malawi, Malawi Institute of Management)
- Active and growing middle income level of the population
- Growing population that can provide opportunities for the bank's growth, like the growing youth population

Threats

- High insecurity with high crime rate manifesting in increased armed bank robberies, physical and violent household breakings
- Volatile economy (high inflation, weak currency, high interest rates). The economy is season-driven
- Existing players with strong financial muscle scaling down to bottom of the pyramid market
- Poaching of talented Staff by competitors
- The coming of Non- Financial players into Banking Sector. For example Telecommunication Networks
- Inclusion of MFI's to become licensed deposit taking institutions

9.0 Capital Adequacy

9.1.1 Capital Assessment Process

Capital Management is at the centre of the bank's risk management frameworks in order to ensure the sustainability of the bank and productivity in line with expected return on capital. The bank has a risk appetite statement which guides the level of risk that management is allowed to undertake in line with its various business strategies.

The internal capital adequacy assessment process considers the capital needs the bank needs to maintain in line with the risks undertaken under the framework of its risk appetite statement.

9.1.2 Opportunity Bank's Risk Appetite Statement

Risk Area	Area	Risk Appetite	Dec 2012 Position	Dec 2013 Position	Dec 2014 Position	Dec 2015 Position
Liquidity	Realizable liquid assets / Total voluntary savings deposits	>35%	49%	37%	68%	69%
	Deposits to total liabilities	Between 35% and 70%	78%	76%	67%	79%
Credit	Portfolio At Risk at 30 days	below 5% by value	14%	8%	15%	10%
	Annualized Loan Loss Reserve Write off / Rolling Average Gross Loan Portfolio	<1%	7.27%	5%	16%	16%
Capital	Return on Equity	Between 1% and 10%	0.10%	1.20%	-50.00%	-65.00%
	Gearing Ratio	Between 3 and 5	296.20%	2.50%	2.50%	4.00%
	Capital Adequacy	10% for Core capital	24.70%	18%	10%	12.95%
		15% for Total Capital	34.80%	29%	20%	21.62%
Operational	Annual staff Retention Rate	>90%	89.30%	98%	99%	98%

The capital adequacy assessment process adopted by the bank is aimed at assessing the capital adequacy needs in line with regulatory requirements (regulatory capital) at a minimum. However the bank is targeting to achieve a 5% margin over the regulatory minimum capital ratios to act as a buffer in case of any unforeseeable circumstances that can erode its capital base.

This ICAAP has therefore used the Basel capital calculation standards as a key determinant of the bank's capital adequacy position in line with its financial positions as of December 2014. The ICAAP will be revised every year to reflect the actual financial position and take into account other new risks faced in a particular year that may affect the capital position. Due to the instability of the macroeconomic environment which may impact the performance of the bank in the short to medium term, the bank has adopted that it reviews its capital adequacy position every 6 months and plan for the next 12 months of operation. The capital assessment process has also considered the capital adequacy under stressed conditions. The assessment has been done in liaison with senior management of the bank and the board of directors.

The process therefore considered the capital required for each of the risk weighted assets under Operational, Credit and market risks. The ICAAP also considered the capital adequacy for the bank for the next 12 months based on its financial projections over the same period.

The Bank's regulatory capital is analysed in two parts:

- Tier I capital, which includes ordinary share capital, share premium, retained earnings, and other regulatory reserve after taking out any investment in a subsidiary; and
- Tier II capital, which includes share revaluation reserve, investment revaluation reserve, property revaluation reserve and loan loss reserve.

As of December 2015 the calculation of both the above ratios is given below:-

		2015	2014	2013	2012
Share Capital Class A		932,450	932,450	932,450	932,450
Share Capital Class A		2,962,366	1,254,393	850,077	607,837
Share Premium		4,737,532	2,987,563	1,813,222	1,208,147
Retained loss		(6,085,209)	(3,388,376)	(1,047,631)	(879,244)
General Reserve		96,265	121,724	144,751	101,997
Less: Investments in unconsolidated subsidiary companies		-7,500	0	0	0
Total Tier 1 Capital		**2,635,904**	**1,907,754**	**2,692,869**	**1,971,187**
General and Revaluation Reserves		1,603,425	1,658,610	1,708,971	522,859
Convertible debt					
Total Tier 11 Capital		**1,603,425**	**1,658,610**	**1,708,971**	**522,859**
Total Regulatory Capital		**4,239,329**	**3,566,364**	**4,401,840**	**2,494,046**
Risk Weighted Assets		**18,175,785**	**18,103,404**	**14,477,320**	**7,985,627**
Total Regulatory capital as a % of total risk weighted assets		**23.32%**	**19.70%**	**30.41%**	**31.23%**
Total Tier 1 capital as a % of total risk weighted assets		**14.50%**	**10.54%**	**18.60%**	**24.68%**

NB: The capital ratios for 2015, 2014 and 2013 are based on Basel 2 regulatory framework while 2012 capital ratios based on Basel 1 regulatory framework.

The bank has been maintaining capital above minimum regulatory capital at end of each year.

10.0 Risk Management

The board of directors of the Bank has ultimate responsibility for the level of risk taken by the Bank and accordingly they have approved the overall business strategies and significant policies of the Bank, including those related to managing and taking risk. The bank's Asset and Liability Committee ("ALCO") is responsible for implementing strategies in a manner that limits risks associated with each strategy and that ensures compliance with rule and regulation, both on a long term and day to day basis. At its board meeting in February 2016, the board's assessment of the overall risks for the Bank for 2015 was as follows:

Risk Area	Level of Risk	Management Comments	Q1	Q2	Q3	Q4	Jan'16
Capital and funding	High	Capital adequacy ratio is at 13.61% as of January 2016. Whilst this is above the regulatory cap of 10% we have achieved this through capital injections as the Bank has been making losses all along. At the pace that the Bank is going there will be need for further capital injection after 31 March 2016 Despite the initiatives that are being pursued by management to turn around the business there is need for additional funding to achieve the following: 1. The rationalization of the business. There is need to close down loss making branches and remain with winners 2. Capital investment on the systems as we roll out new products that will enable the Bank to compete favorably with the other banks in the industry. Some of this investment will enable the Bank to comply with the regulatory requirements – AML/ALM/Credit Scoring	↔	↔	↔	↔	↔

Risk Area	Level of Risk	Management Comments	Q 1	Q 2	Q3	Q4	Jan'16
Economic Environment	Medium to high	The economic environment remains challenging with high inflation rate at 24.9% as at the end of December 2015 and high borrowing interest rates. The situation is being exacerbated by the poor rains that will result in low crop yields and the weakening Kwacha as Dollar liquidity tightens up. In response to the above we continue to be selective in the quality of customers that we lend to and at the same time the loans officers are providing close monitoring on our borrowing customers.	↓	↑	↔	↑	↑

Risk Area	Level of Risk	Management Comments	Q 1	Q 2	Q3	Q4	Jan'16
Credit	High	The bank closed the year 2015 on 31st December 2015 with 30 day PAR at 10% but this ratio worsened to 15% as at 31 January 2016. This is a direct consequence of the exposure of Umodzi Sugarcane Growers Association and Green Leaf Association totaling MWK 363 million that has been categorised substandard. We are working with these two customers with a view to restructure the debts. We are still confident that the debt can be recovered in full but over a period of 2 to 3 years. The target is however to reduce the PAR 30 days to 5% by 30th June 2016. We intend to achieve this through the following: 1. The restructuring of the Umodzi and Green Leaf debts and properly securing these with hard security 2. The recovery team has been enlarged to 25 people after the training provided by external consultant. Additional people have been allocated from the credit admin team and loans officers from the sales team. 3. New collections strategies are being implemented after the training. 4. Implementation of new credit granting process 5. We are engaging a third party to train our collection team on the techniques for approaching defaulters as the legal process is failing on the majority of cases	↔	↓	↓	↔	↔

Risk Area	Level of Risk	Management Comments	Q 1	Q 2	Q3	Q4	Jan'16

Risk Area	Level of Risk	Management Comments	Q 1	Q 2	Q3	Q4	Jan'16
Operational	High	The risk rating is high due to: 1. Poor management of dormant and suspense accounts. 2. Lapse in controls over management of Loan security savings accounts. 3. Unauthorized overdraft. 4. Inappropriate handling of customers' files 5. Incomplete BCP – No Redundant line to link the branches directly to the disaster recovery site in the case of of the Head Office being completely destroyed 6. Unavailability of the exception reports to facilitate close monitoring at the branch level 7. The incidences of frauds that are being reported. 8. Inappropriate people manning the branches – It appears that people were prematurely promoted to branch manager/supervisory positions Whilst exceptions reports are now being produced there is need for an overall branch rationalisation which issue is being delayed because of budgetary constraints.	↔	↑	↓	↓	↔

Risk Area	Level of Risk	Management Comments	Q 1	Q 2	Q3	Q4	Jan'16
People	High	The Bank is overstaffed against the level of business being underwritten. The bank is ranking at the bottom in terms of key performance areas of deposits, loans, profit, and customer service and yet is the third largest in terms of number of staff engaged for the operations. **Initiatives being pursued** 1. Branch and countrywide staff rationalised. More staff has been redeployed from back office to front office to help in business generation. 2. Branch and Departmental structures have been reviewed so that these fall in line with the agreed business model	↑	↔	↔	↔	↔
Financial reporting	Medium	Financial reports continue to be manually produced against the directive from RBM **Action** The RBM have given the Bank a grace period of up to June 2016 to work on automating the AML/ALM and credit scoring systems. It is important that the Board authorises the implementation of at least one system to show commitment in the eyes of the Regulators. We are likely to be penalised come the deadline date.	↔	↔	↔	↔	↔

Risk Area	Level of Risk	Management Comments	Q 1	Q 2	Q3	Q4	Jan'16
Regulatory	High	The bank is yet to automate AML/ALM and Credit scoring models and RBM has given a grace period up to June 2016. The AML system will enable the Bank to detect the suspicious transactions whilst the credit scoring system will enable assess loan applicants uniformly to avoid bias in line with the Basel II requirements. The ALM system will assist the Bank in managing the balance sheet better and also the automation of the RBM reports. As there is no traction on resolving this issue the Bank is risking being penalised by the Regulators. The Board will have to authorise management to start implementing at least one system	↔	↔	↔	↔	↔
Governance	Medium	The bank has now in place all governance committees and meetings are being held as per approved ToRs.	↔	↔	↓	↔	↔
Liquidity - Market risk	Medium	The Bank is liquid and LRR has been in line within the requirement of RBM. >7.5% effective 1 August 2015. There is no deposit concentration and the bulk of our resources are on the stable savings accounts. It is however noted that liquidity Gap analysis is compiled manually and it is therefore not possible to simulate different liquidity stressed scenarios. We are therefore rating liquidity medium until we implement the ALM system	↔	↔	↔	↔	↔

Risk Area	Level of Risk	Management Comments	Q1	Q2	Q3	Q4	Jan'16
Reputation	High	The image of the Bank continues being adversely impacted by the losses that are being incurred as well the fraud cases one of which was leaked to the media and has prompted the Regulators to call on us. You will see under Capital that how management is proposing to address the profitability of the Bank. The processes are being tightened to limit the incidence of fraud cases.	↔	↔	↓	↓	↓
Strategic	Medium	Business Strategic plan now in place. We are in the implementation stage with every department focusing on their area of control.	↔	↔	↔	↔	↔
Market Risk - Interest rate	Medium	The bulk of our resources are on savings accounts and the interest spread is over 12%. The rating is low but as there are no systems in place to enable us to carry out stress tests we will keep the rating as medium	↔	↔	↔	↔	↔
Market Risk - Foreign Exchange	Medium	This risk is low because the Bank maintains a low open foreign exchange exposure position. However due to the absence of an ALM system we cannot stress test different exchange rate movements and hence we maintain the rating as medium.	↔	↔	↔	↔	↔

To ensure that risk management is properly divulged to and understood by all business lines, the bank has established the following risk management frameworks:

10.1.1 Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks, and investment debt securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk.

Credit Risk Management is based on detailed analysis of the creditworthiness of customers applying for loans, customer's timeliness in loan repayment and evaluation of collateral. Credit analysis consists of qualitative and quantitative segments and it includes reviewing customer's character, management competence, invested capital, customer's solvency and profitability, achieved and future cash flows and general business conditions.

As best practice, the Bank ensures that it is keeping adequate level of loan loss provisions. This is done by conducting individual facility assessments and by conducting collective assessments of credits of similar risk grades as guided by bank's loan loss provision policy. The individual assessment is a rigorous process that looks at each non-performing facility. This helps ascertain the future cash flows that are further discounted to determine the estimated recoverable amount. The amount of provision under this method is the amount that remains unsecured when the estimated recoverable amount is applied. On the other hand, credit exposures that are current and those that are past due but not yet impaired go through a collective assessment in determining the estimated provision for loss. In collective assessment, a credit portfolio's loss rate is calculated over a period of the past 12 months. Using historical losses, the necessary probability of loss is computed to estimate the portfolio's provision for loss.

The bank mitigates credit risk by proactively managing it. Lending and other facilities are granted only if the level of risk is acceptable. This is achieved by thoroughly evaluating customers' credit worthiness before facilities are granted. Even after the facilities are granted, the bank continues to monitor customers' performance so that timely corrective action can be taken should circumstances demand. Various committees and structures are in place for sanctioning large facilities and monitoring customers' performances.

The Bank places its cash holdings with reputable banks only that are licensed in their jurisdiction and these are sanctioned by board approved counterparty limits.

10.1.2 Management of credit risk

Opportunity Bank's portfolio is divided across a large number of industry sectors to create a large and balanced risk diversification. Risks arising from changes in credit quality and the recoverability of loans and other amounts due from counterparties are inherent to most of the bank's activities. During the year to December 2015, the bank registered operational loss of MK2.3 billion out of which MK927 million is credit losses. We conducted a rigorous review of the credit book in the year just ending, and have put up adequate systems to minimise this risk going forward. Among others, the bank introduced two committees of early alert and substandard accounts to constantly review the loan book and come up with timely solutions.

The following table shows the movement of loan book in the year as well non-performing loans from January 2015 to December 2015:

Indicator (K'000)	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Loan Book	7 218 664	7 814 851	7 882 095	7 819 979	7 225 632	6 260 665	5 929 627	5 563 678	5 275 775	4 971 719	4 452 458	5 212 395
Non-Performing Loans	856 310	915 961	986 566	852 648	918 771	715 977	715 358	692 461	678 473	649 512	204 743	289 698

The 2015 performance is an improvement compared to the prior year 2014. We envisage significant improvements in the years 2016 through 2017.

The bank's credit risk exposure is restricted in part by obtaining collateral where necessary. The amount and nature of the collateral required depends partly on the assessment of the credit risk of the loan to the counterparty. The bank follows guidelines for the purpose of accepting and valuing different types of collateral. The major types of collateral are:

- Residential mortgage collateral;
- Bill of sale movable property mainly for business loans;
- Cash

The bank has various levels of credit committees, the highest level being the opportunity network risk committee which approves loans above $250,000. Loans applications between $50,000 and $250,000 approved by the board credit committee. Composition Credit committee head office and branch level is ratified the Board Credit Committee which looks at the credit knowledge, experience and management responsibilities of the incumbents.

Processes are in place to detect the early warning signs of customers in financial difficulty. These ranges from portfolio analysis meetings that take place weekly, setting watch list customers and organizing meetings where signs of distress are discussed with the aim of finding solutions. This review includes client accounts that are still up to date but are showing early signs of distress in according to bank's policy.

The Board Credit Committee is responsible for oversight of the credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure: this includes a structure for approvals and renewals of credit facilities. Authorisation limits are provided to credit officers and credit committees.
- Reviewing and assessing credit risk. The Credit Department assesses all credit exposures and prepares a watch list which includes all those clients whose repayments are in arrears or have exceeded their limits.
- Reviewing compliance by the risk department so that exposure limits remain within the acceptable range.
- Providing advice, guidance and specialist skills to business units to promote best practices throughout the Bank in the management of credit risk.
- Compliance with the bank credit standards is supported by a programme of periodic reviews undertaken by Internal Audit.

10.1.3 Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk as of December 2014 was as follows:

In thousands of Malawi Kwacha	2015	2014	2013	2012	2011
Cash and cash equivalents	10 881 960	4 417 144	3 170 164	3 329 794	4 612 169
Loans and advances to customers	5 007 039	6 713 288	7 600 950	3 751 425	3 226 527
Staff loans and advances	290 462	371 670	122 695	54 741	88 218
Other receivables	158 229	758 252	616 727	326 951	290 171

In thousands of Malawi Kwacha	2015	2014	2013	2012	2011
TOTAL	**16 339 705**	**12 260 354**	**11 510 536**	**7 462 911**	**8 217 085**

The customer's loans and advances of the Bank and its exposure to credit risk comprise:

Year	2015	2014	2013	2012	2011
Standard (fully performing)	4 684 836	5 651 745	7 093 948	3 732 431	3 396 411
Past due but not impaired	341 776	653 157	482 439	68 536	145 553
Impaired	289 698	408 386	406 693	259 921	551 388
Gross Loan Portfolio	**5 318 325**	**6 713 288**	**7 716 182**	**4 060 888**	**3 993 637**

Past due but not impaired loans and advances comprise:

Year	2015	2014	2013	2012	2011
30 – 60 days late	64 241	161 903	140,844	32,846	48,932
60 – 90 days late	277 535	491 253	74,697	35,690	96,621
Total Past Due but not impaired	**341 776**	**653 157**	**215,542**	**68,536**	**145,553**

The Bank follows the guidelines of Reserve Bank of Malawi on asset classification. When a loan is not serviced for more than 30 days from the date it is due, it is classified as special mention (past due), and when it is not serviced for more than 90 days, it is classified as impaired.

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, charges over moveable assets and guarantees. Estimates of fair value of collateral are based on the value assessed at the time of borrowing and generally not updated except when an individual loan becomes impaired.
individual loan becomes impaired.

10.1.4 Liquidity risk

Liquidity is vital to the ongoing viability of any banking organization. Liquidity risk arises where the operations of the Bank cannot be funded due to mismatches in the cash flows of assets and liabilities within the statement of financial position. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame. Thus in accordance with the overall Pillar 2 rule, The Bank, through its Assets and Liabilities Committee (ALCO), considers its exposure to liquidity risk through such potential maturity mismatches, and assesses its response were such risks to materialize. For instance, where short term liabilities approach the level of liquid or easily liquidated balance sheet assets, this can point to a higher level of liquidity risk and so the bank might consider altering certain maturity profiles where necessary, with a view to minimizing the impact of such mismatches on liquidity. Further, when assessing liquidity risk, the bank's ALCO also considers the amount of assets the bank holds in highly liquid, marketable forms that are available to the bank, should unexpected cash out-flows lead to a liquidity problem for the bank.

10.1.5 Management of liquidity risk

The Bank's approach to managing liquidity is through on an going assessment and quantification of the bank's liquidity risks, the bank's proposed actions to mitigate such risks, and how much current and future liquidity is required; so as to ensure as far as possible that it will always have sufficient liquidity to meet its liabilities when due, both under stressed and normal conditions, without causing damage to the Bank's reputation.

The ongoing assessment and quantification of liquidity risks is thus achieved through the following integrated processes that aim at ensuring that the bank maintains sufficient liquid funds in order to ensure that appropriate cover is available for future imbalances between payment inflows and outflows:

a. Daily liquidity position monitoring by the Treasury department which monitors the level of mismatches in the maturity positions of assets and liabilities through GAP reporting and analysis and taking appropriate action to minimize those mismatches. This is monitored using a gap report.
b. Weekly liquidity position monitoring by the Internal Liquidity Committee of the bank's internal liquidity Ratio – defined as Net liquid assets (including undrawn credit line facilities) less unstable deposit base, then divided by the stable (sticky) deposit base should be 20%
c. Monthly and quarterly liquidity position monitoring and management, through monthly GAP analysis and balance sheet review, and quarterly liquidity stress testing, done under normal and severe market conditions, by the bank's ALCO Committee; (see liquidity stress test results as at 31st December 2015 attached)

   Key in assessing the adequacy of liquidity for the bank however, both through regular GAP analysis and stress testing as alluded to above, is the behavioral assumptions affecting liquidity such as inter alia, the stickiness of normal savings and demand deposits. According to the bank's current assessments, it is assumed that under normal circumstances customer demand deposits will remain stable or increase in value and un-recognised loan/ overdraft commitments are not expected to be immediately drawn down in their entirety.

d. Quarterly review of the bank's liquidity position by the Board Asset Liability Committees –ALCO (management committees which meet once every quarter, or more often if necessary) through review of GAP reports, stress tests reports and internal liquidity ratio reports.
e. Regular review and approval by the Board Asset Liability Committees (ALCO) of all liquidity policies and procedures that are used by the bank to identify, quantify and manage liquidity risk.

10.2 Asset and Liability Management Committee (ALCO)

Reporting to the Board, the Asset and Liability Committee (ALCO) of the bank is comprised of senior management across the bank's major functions, who are responsible for collectively managing the bank's balance sheet.
The primary objective of the ALCO is to manage financial risk emanating from the bank's operations that include liquidity, market and credit risk. The ALCO seeks to manage risks in order to minimize the volatility of net interest income and protect the long term economic value of the Bank. The committee also monitors the capital adequacy of the Bank.
Key functions of the ALCO include setting pricing guidelines for assets and liabilities, setting limits and managing liquidity and interest rate risk, ensuring funding diversification, and ensuring that contingency funding plans are in place to avert funding crises.

The ALCO is also responsible for developing any future dynamic strategies for the bank that balance both profitability and risk.

The ALCO is also responsible for monitoring compliance to regulatory reporting requirements on liquidity and Foreign exchange exposure limits. Under liquidity reporting requirements, the following liquidity ratios are key: Liquidity Reserve Requirement (LRR) and Liquidity Ratios 1 and 2

10.2.1 Liquidity requirement Reserve Requirement (LRR)

Each depository institution is required to maintain minimum cash balances in relation to the preceding two week's total currency deposit liabilities, including government deposits as well as foreign currency deposit liabilities. As at year end, the Liquidity Reserve Requirement (LRR) including cash and cash equivalents in the cash vaults was at 13.32% against minimum requirement of 7.5%.

10.2.2 Net Liquidity

As a complement to the Banking Act, 2010, the Reserve Bank of Malawi has set the following liquidity guidelines through the following two liquidity ratios – Liquidity ratio 1 and Liquidity Ratio 2:

Liquidity ratio 1

Defined as the Net Liquidity (total liquid assets less suspense accounts in foreign currency) divided by total deposits must be at least 30%.

Liquidity ratio 2

Defined as the Net Liquidity (total liquid assets less suspense accounts in foreign currency and cheques in the course of collection) divided by total deposits must be at least 20%.

At the end of the year 2015 the Bank's Liquidity Ratio 1 and 2 were at 62.89% and 63.25% respectively.

10.2.3 Market Risk

Market risk is the risk that changes in market prices, such as interest rates and foreign exchange rates, will affect the Bank's income or the value of its holding of financial instruments. The objective of the Bank's market risk management policy is to ensure the bank is able to accurately assess and actively manage and control all material market risk exposures to be within acceptable parameters while optimizing the return on risk.

For the purpose of measuring market risk, the bank utilizes the Standard Supervisory method for calculating capital requirements.

10.2.4 Interest Rate Risk

Interest rate risk is generally referred to as the exposure of the Bank's net interest margin to adverse movements in interest rates as a result of assets and liabilities re-pricing at different times and using different bases. The risk therefore has a direct impact on the Bank's net interest margin.

A bank is exposed to interest rate risk through its Trading and banking books. For OIBM, the source of its market risk is from the banking book as the bank does not maintain a trading book. Accordingly, the measurement of interest rate risks is performed on positions in the banking book. Banking book is defined as portfolios which do not qualify for trading book treatment from regulatory perspective. Banking books consist of client assets/liabilities, investment books, money market banking books etc.

The responsibility of assessing and monitoring interest rate risks resides with ALCO, which reviews calculations on economic risk as prepared monthly by the bank's Treasury department and captured in an Interest Rate Sensitivity analysis reports on the bank's rate sensitive assets and liabilities as available in the banking book. Therefore, ALCO takes appropriate action to reduce the effect of the risk. The analysis assumes a 1500 basis point interest rate shift as an extreme scenario in interest rate developments.

Below is the interest rate sensitivity analysis for the bank as at 31st December 2015:

		Fixed rate			
	Floating rate	0-6 months	6-12 months	Over 12 months	Total
As at 31 December 2015					
Total rate sensitive assets	**1,847,802**	**8,225,783**	**4,619,983**	**1,008,801**	**15,702,369**
Total rate sensitive liabilities	**-**	**(16,633,936)**	**(546,181)**	**(273,993)**	**(17,454,110)**
Asset Liability Gap	**1,847,802**	**(8,408,153)**	**4,073,802**	**734,808**	**(1,751,741)**
Cumulative Gap					
Impact of increase in interest rate					
5%	92,390	(420,408)	203,690	36,740	(87,588)
10%	184,780	(840,815)	407,380	73,480	(175,175)
15%	277,170	(1,261,223)	611,070	110,221	(262,762)
Impact of decrease in interest rate					
-5%	(92,390)	420,408	(203,690)	(36,740)	87,588
-10%	(184,780)	840,815	(407,380)	(73,480)	175,175

10.3 Foreign exchange risk

Foreign exchange risk means the risk of financial loss to the Bank arising from adverse movements in foreign exchange rates. This involves the risks of the Bank incurring financial loss on settlement of foreign exchange positions taken in trading and banking books. These movements may thus impact negatively on the Bank's future cash flows.

The Bank's foreign exchange positions generally arise from the following two activities:

- Trading in foreign currencies through spot and forward transactions on the interbank market as a market maker or position taker, as well as through customer driven foreign exchange transactions;
- Holding foreign currency positions in the banking book (e.g. in the form loans, deposits or cross border investments)

Since excessive foreign exchange risk can pose a significant threat to the bank's earnings and capital adequacy, the Bank thus manages this risk by:

- Setting and adhering to appropriate internal open foreign exchange exposure limits as crafted by the Board ALCO.
- Adhering to the open foreign exchange exposure limits as set by the Reserve Bank of Malawi.
- Quarterly stress testing by ALCO of the bank's open foreign currency position to evaluate adequacy of capital to support the risk.
- Quarterly review of the bank's open foreign currency exposure position by the Board Asset Liability Committees to ensure adherence to set limits.
- Periodic reviewing the policies, procedures and currency limits regularly in line with changes in the economic environment.
- Provision of appropriate training to staff in Treasury department to ensure they are equipped with the necessary knowledge and expertise to undertake foreign exchange transactions.

The daily responsibility of monitoring of foreign exchange risk resides with the Treasury Department, which ensures strict adherence to internal as well as RBM open currency exposure limits as alluded to above.

Among other things, the treasury department is responsible for:-

- Setting the daily foreign exchange risk management strategy and tolerance levels.
- Ensuring that effective risk management systems and internal controls are in place.
- Monitoring significant foreign exchange exposure and taking appropriate corrective action where applicable.
- Ensuring that foreign exchange operations are supported by adequate management information systems which complement the risk management strategy
- Reviewing the policies, procedures and currency limits regularly in line with changes in the economic environment.

The ALCO regularly monitors the foreign exchange risk management strategies as carried out by the treasury department, and reviews/checks compliance on the set limits through review of foreign exchange exposure reports. As of December 2015, the foreign exchange exposure position of the bank was as below:

Reporting Bank:					**Contact Person:**			**Phone:**	
								Fax:	
Ccy	Positions in foreign currencies			Exchange rates		Positions in local currency			In %
	Balance	Off bal.	Overall	Cross	Local	Balance	Off bal.	Overall	of
	sheet	sheet	net	rates	ccy	sheet,	sheet,	net	capital
	net	net	positions		rates	net	net	positions	
1	2	3	4	5	6	7	8	9	10
USD	355,515	-	355,515	1.0000	466.0977	165,704,678	-	165,704,678	6.83%
GBP	49,388	-	49,388	1.5562	724.1213	35,762,780	-	35,762,780	1.47%
EUR	1,798	-	1,798	1.2156	547.6875	984,994	-	984,994	0.04%
ZAR	403,871	-	403,871	11.5653	40.0236	16,164,380	-	16,164,380	0.67%
OTHER	-	-	-	-	-	-	-	-	0.00%
				Net foreign currency positions		218,616,832	-	218,616,832	9.01%
Qualifying capital									
Paid-up Capital			2,789,524,284		Total overall long position			218,616,832	9.01%
Share Premium			2,088,753,283						
General Reserve			-		Total overall short position			-	0.00%
Retained Earnings (prior years)			- 1,024,958,283						
60 % current profits (year-to-date)			- 1,425,600,284		Gross aggregate position (sum of 14 & 15)			218,616,832	9.01%
Less: Investments in unconsolidated subsid.			-						
Total			2,427,719,000		Net aggregate position (difference of 14 & 15)			218,616,832	9.01%
Overall currency limit (35 %)			849,701,650		**Shorthand position (larger of 14 or 15)**			218,616,832	9.01%

10.4 Operational risk

This is the risk of losses arising from the operations of the Bank. Losses can occur due to system malfunctioning or failure to follow procedures. Operational risk manifests itself in losses, customer complaints and claims.

To reduce operational risk, management continuously reviews the controls and procedures in place. Branch and head office departments employ risk officers in addition to internal auditing performed by the internal audit and Risk and Standard departments, which, periodically, determine whether the controls in place are commensurate with the risk involved. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Bank. Disaster recovery arrangements are also in place so that business can continue should major disruptions occur.

The objective of the Bank is to manage operational risks so as to balance the avoidance of financial losses and damages to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to departmental and branch section heads. This is supported by the development a standard control template for each business function in line with the Opportunity Network Operations team w for the management of operational risks in the following areas:-

- Requirements for appropriate segregation of duties, including the independent authorisation of transactions
- Requirements for the reconciliation and monitoring of transactions
- Compliance with regulatory and other legal requirements
- Documentation of controls and procedures
- Requirements for the periodic assessment of operational risks faced through the identification of Key Risk Indicators, and the adequacy of controls and procedures to address the risks identified through Risk Self-Assessment Templates (SATs)
- Requirements for the reporting of Operational Loss Data and proposed remedial action
- Development of contingency plans
- Training and professional development

- Ethical and business standards.
- The Dormant Account Policy has been developed to secure the funds in dormant accounts.
- The Teller Difference Policy is in place which guides the consequences on differences.
- Introduction of Biometrics(in progress) as means of identifying the customers

11.0 Stress Testing

In order to ensure capital adequacy in various unforeseeable circumstances, Opportunity Bank Malawi conducts periodic stress testing exercises in order to review the bank's resilience in case of adverse economic conditions. This is done in consultation with all functions in the bank in order to determine the effect that stressed scenarios may have on various functions of the bank and the action that can be taken to normalize the operations of the bank. The stress scenarios have also been done in view of the bank's concentration risk in low income market segments which are highly vulnerable to economic downturns as highlighted under the Pillar II risk analysis.

- For purposes of this ICAAP, the bank conducted the following stress tests on its financials for 2015 for credit risk, foreign exchange risk, liquidity risk and interest rate risk.

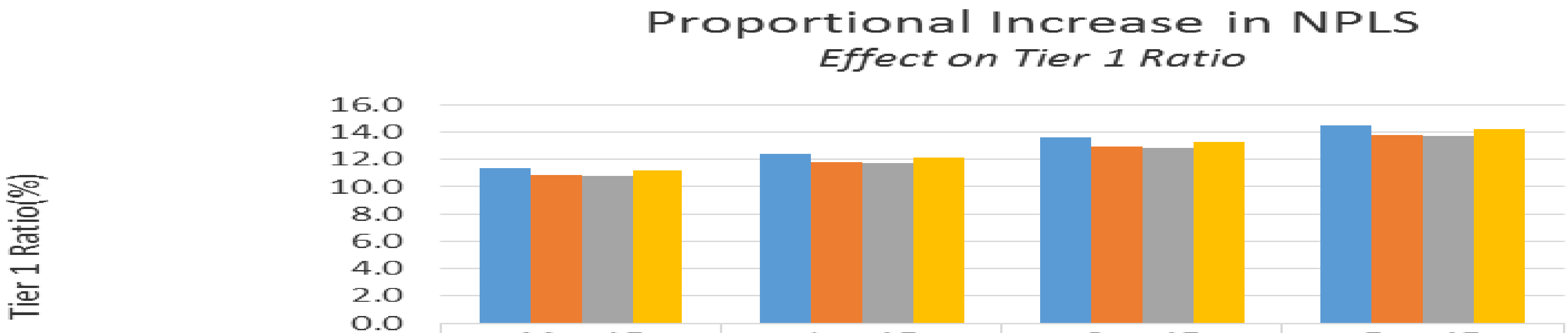
- We also performed scenario stress testing to assess the impact of combination of various shocks on the business.

Stress Testing Results

Stress tests were conducted on the quarterly actual results for 2015 to assess the ability of the bank to absorb different levels of shocks and the resultant impact on the capital position of the bank.

CREDIT RISK ASSUMPTIONS			
Assumed provisioning rates (%)	Mild	Moderate	Major
Pass loans	1	2	10
Special mention loans	10	15	20
Substandard loans	20	25	30
Doubtful loans	50	60	70
Loss loans	100	100	100
Assumed haircut on collateral	20	20	35
Assumed increase in NPL (%)	20	30	40

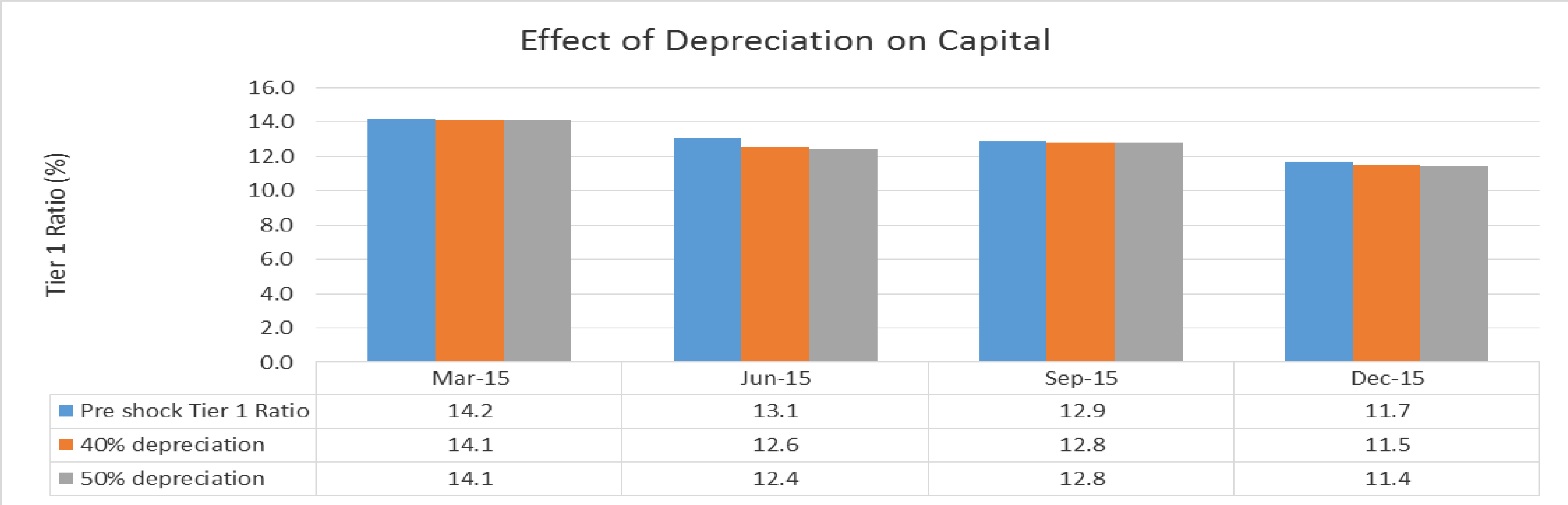
0



	Mar-15	Jun-15	Sep-15	Dec-15
Preshock Tier 1 Ratio	11.4	12.4	13.6	14.5
25% Increase	10.9	11.8	12.9	13.8
30% Increase	10.8	11.7	12.8	13.7
10% Increase	11.2	12.1	13.3	14.2

- An assumed sudden migration of loans into NPLs results in the Tier I ratio falling, albeit within regulatory limits.

DIRECT FX RISK: DEVALUATION/APPRECTION OF MWK



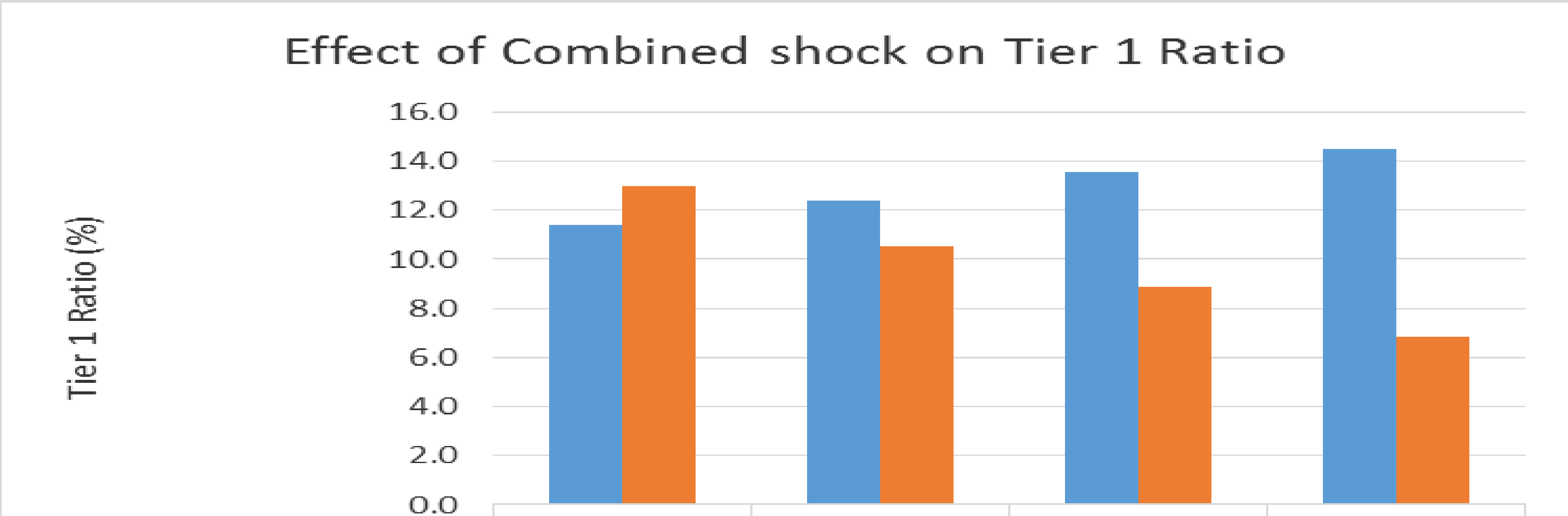
- A major shock to FX income arising from 50% depreciation would deteriorate the Tier 1 ratio in all the 2015 quarters, albeit above the minimum regulatory threshold of 10%.

Liquidity Risk: Withdrawal of deposits

- The bank can manage liquidity risk exceeding 5 days after a major shock of 15% deposit run using a simple liquidity test which assumes a run on all banks and fire-sale of assets.

COMBINATION OF SHOCKS

		Scenario 1	Scenario 2	Scenario 3
		Mild	Moderate	Major
Increase in provisioning				
	Pass loans	1	2	10
	Special mention loans	10	15	20
	Substandard loans	20	25	30
	Doubtful loans	50	60	70
	Loss loans	100	100	100
-				
Increase in NPLs (%)		10	25	30
Increase in interest rates		0	5	10
Exchange rate change (+ depreciation, - appreciation)		0	40	50



	Mar-15	Jun-15	Sep-15	Dec-15
Pre-shock Tier 1 Ratio	11.4	12.4	13.6	14.5
Post-shock Tier 1 Ratio	13.0	10.5	8.9	6.9

Revised capital forecast 2016

SUMMARY OF TIER 1 RATIO COMPUTATION - MWK		Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
		April,16	May,16	June,16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
Line no.	CONSTITUENTS OF CAPITAL	Amounts	Amounts	Amounts	Amounts	Amounts	Amounts	Amounts	Amounts	Amounts
1	TIER 1 CAPITAL									
2	Paid-up ordinary shares	3,894,816	3,894,816	3,894,816	3,894,816	3,894,816	3,894,816	3,894,816	3,894,816	3,894,816
3	Share premium	4,737,532	5,151,532	5,151,532	5,151,532	5,151,532	5,151,532	5,151,532	5,151,532	5,151,532
4	Retained profits/(accumulated losses)	(6,091,463)	(6,085,209)	(6,085,209)	(6,085,209)	(6,085,209)	(6,085,209)	(6,085,209)	(6,085,209)	(6,085,209)
5	Current year profits (60%) if loss (100%)	(799,411)	(868,609)	(1,129,113)	(1,158,072)	(1,131,911)	(1,135,433)	(1,127,609)	(1,121,491)	(1,102,078)
6	General reserves	97,256	97,256	97,256	97,256	97,256	97,256	97,256	97,256	97,256
7	**Sub-Total (sum of line items 2 to 6)**	**1,838,730**	**2,189,786**	**1,929,282**	**1,900,323**	**1,926,483**	**1,922,961**	**1,930,785**	**1,936,904**	**1,956,316**
8	Deduct: Goodwill	-	-	-	-	-	-	-	-	-
9	Deduct: Investments in unconsolidated banking & financial subsidiary companies	7,500.00	7,500.00	7,500.00	7,500.00	7,500.00	7,500.00	7,500.00	7,500.00	7,500.00
10	financial institutions and significant									
11	Deduct: Deferred Tax Assets	-	-	-	-	-	-	-	-	-
12	**NET-TOTAL TIER 1 CAPITAL (line item 7 less line items 8 to 11)**	**1,831,230**	**2,182,286**	**1,921,782**	**1,892,823**	**1,918,983**	**1,915,461**	**1,923,285**	**1,929,404**	**1,948,816**
26	**AGGREGATE RISK-WEIGHTED ASSETS (sum of line items 21, 23 and 25)**	**17,975,351**	**17,525,351**	**17,268,065**	**17,106,065**	**17,181,851**	**17,064,806**	**17,064,806**	**17,064,806**	**17,064,806**
28	**TIER 1 RISK-BASED CAPITAL RATIO (line item 12 divided by line item 26) (Minimum of 10%)**	**10.19%**	**12.45%**	**11.13%**	**11.07%**	**11.17%**	**11.22%**	**11.27%**	**11.31%**	**11.42%**
30	**CAPITAL RECEIVED/PLANNED TO BE RECEIVED**	-	414,000	-	-	-	-	-	-	-

The CAR ratios will be at 11% due to the savings that will accrue after the exercise.

The above capital projection to December 2016 includes a capital injection of USD600, 000 from OIUS and a full business rationalization that is expected to take place in June, 2016.

Although projected capital ratios are below the 2% cushion required by management, the ratio will be above the regulatory minimum ratio of 10% and it is expected that the ratio will be within the target set by management at above 12% in 2017.

12.0 Challenge of the ICAAP

Senior management and board reviewed, challenged and approved the ICAAP on 31st May, 2016.

The senior management and board continue to actively direct and monitor management's efforts to restore the health of the Bank.