# Pillar 3 Disclosures

## For The Period Ended 30th June 2017

# Zenith Bank Plc

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www.zenithbank.com

**CONTENT OF THE PILLAR 3 DISCLOSURE REPORT**

# 1. EXECUTIVE SUMMARY

## 1.1. Introduction

The Basel II framework was put in place following successive rounds of proposals and broad consultation with all interested parties between 1999 and 2003. This framework introduced comprehensive disclosure requirements for banks operating under the new legislative framework. The disclosure requirements fall under Pillar 3 of the CRD which requires Banks to publish certain information relating to their risk management and capital adequacy.

The main objective of the Basel II framework is to further strengthen the soundness and stability of the international banking system via better risk management, by bringing regulatory capital requirements in line with International best practices. The framework was subsequently updated with implementation beginning in 2007. The Basel II framework stipulates a minimum level of capital that banks must maintain to ensure that they can meet obligations, cover unexpected losses; and promote stakeholders confidence.

## 1.2. Pillar 3 Regulatory Framework

The Basel II Framework is structured around three pillars:

The framework laid down the new supervisory regulations governing banks and banking groups, which have been comprehensively revised following the changes that have been introduced in international regulations. The framework also takes into account developments in the risk management, methodologies adopted by banks and the new policies and criteria underpinning supervisory activity. The new supervisory framework is founded on three "pillars".

**The first pillar** introduces capital requirements to support the risks that characterise banking and financial activity (credit risk, counterparty risk, market risk and operational risk). To this end, the regulations provide for alternative methods for calculating capital requirements featuring different levels of complexity in the approaches taken to measuring risk and in organisational and control requirements.

**The second pillar** requires banks to adopt a strategy and control process for assessing current and prospective capital adequacy, embedded in its business activities and operational complexities. It charges supervisory authorities with the task of ascertaining the reliability and consistency of results and of adopting, where necessary, appropriate corrective measures.

**The third pillar** introduces disclosure requirements concerning capital adequacy, risk exposure and the general features of the related risk management and control systems. The disclosure requirements compliment the two other pillars of the CRD, the minimum capital requirement (Pillar 1) and the supervisory review process (Pillar 2) which Zenith Bank has captured within its Internal Capital Adequacy Assessment Process (ICAAP) report.

The approach provides for the precise measurement of a broader range of risks and ensures that capital requirements are linked more closely to the actual risk exposure of each intermediary. Moreover, it provides incentives for Zenith Bank to improve their management practices and risk measurement techniques, including possible reductions in the amount of capital they are required to hold. The system also ensures a more level competitive playing field, with the expanded harmonisation of activities and techniques, and enhances the role of market discipline with the introduction of specific disclosure requirements.

In terms of the Pillar 1 requirements, the bank has adopted the Standardized Approach for Credit and Market Risks measurements while using the Basic Indicator Approach for Operational Risk. The aim of the disclosures is to encourage market discipline and allow market participants and stakeholders to assess key pieces of information on risk exposures and the risk assessment process.

### 1.3. Disclosure Policy

The bank regards information as confidential if there are obligations to customers or other counterparty relationships binding the bank. In the event that any of such information is omitted, we shall disclose such and explain the grounds why it has not been disclosed. The CBN Pillar III disclosure requirements allow banks to omit one or more of the disclosures listed if the information provided by such disclosures is not regarded as material. The requirements similarly allow banks to omit items of information from being disclosed; if the information is regarded as proprietary or confidential. The Bank Board of Directors will review any of such omissions as part of the overall approval process. However, Zenith Bank regards information as proprietary if sharing that information with the public would undermine its competitive position. Proprietary information may include information on products or systems, strategies which if shared with competitors, would have the potential of negatively impacting on our competitive edge. The Board will review and approve the Bank's Pillar 3 disclosures unless circumstances necessitate additional disclosures. Disclosures are prepared in conjunction with the preparation of the annual statements of accounts.

### 1.4. Scope of Application

Zenith Bank Plc disclosures have been prepared in accordance with best practices and in compliance with the CBN guidance notes on Pillar 3, which covers the qualitative and quantitative disclosure requirements therein. The disclosures should be read in conjunction with the bank's Directors' Report and Financial Statements for the corresponding financial year.

### 1.5. Frequency/Location

The Pillar 3 Disclosures Report will be made on bi-annual basis and will be published on the bank's website at www.zenithbank.com together with or shortly after the Directors' Report and Financial Statements.

## 2 BUSINESS STRUCTURE & ACTIVITIES OF THE BANK

### 2.1 Organisational Overview

Zenith Bank Plc was incorporated in Nigeria under the Companies and Allied Matters Act as a private limited liability company on 30 May 1990. It was granted a banking license in June 1990, to carry on the business of commercial banking and commenced business on 16 June 1990. The Bank was converted into a Public Limited Liability Company on 20 May 2004. The Bank's shares were listed on the 21 October 2004 on the floor of the Nigerian Stock Exchange. Our principal activity is the provision of banking and other financial services to corporate and individual customers.
Our business and affairs are conducted through the local branch networks and subsidiary banks in other countries. As at 30 June 2017, we had five subsidiary companies namely, Zenith Bank (Ghana) Limited, Zenith Pension Custodian Limited, Zenith Bank (UK) Limited, Zenith Bank (Sierra Leone) Limited, and Zenith Bank (The Gambia) Limited. In line with regulatory directives on the scope of banking operations in Nigeria, the Bank has concluded the divestment from its non-core banking operations (excluding Zenith Pension Custodian Limited). The Bank also has two representative offices in South Africa and China. We have Three Hundred and sixty nine (369) branches with over Two Hundred and Five (205) off-site locations in our network, strategically located in various commercial centers of the country. All the branches are linked by a technologically advanced system, thereby aiding banking transactions across the country.

In line with its long-term plan of building Zenith Bank into an international financial institution, we have taken concrete steps towards establishing presence in major West African countries. We would expand into the other African Regions as well as the European and Asian continents when the opportunity arises, while consolidating our position as a leading financial services provider in Nigeria.
Having consolidated our position in the banking industry and owing to the opportunities provided by the concept of universal banking which was introduced into the banking industry in Nigeria in 2001, we broadened our business to include the entire spectrum of the financial services sector. This led to the establishment of subsidiaries to play in key financial services sector, such as Insurance, Registrars, Pension custodian, Capital Markets. Though the Bank has divested from these non- banking subsidiaries (except for Zenith Pension Custodian Ltd), it still leverages on the relationships built from the divested subsidiaries.

### 2.2 Zenith Bank's Business Strategy

The overall vision of our Bank is "to build the Zenith brand into a reputable international financial institution recognized for innovation and superior performance while creating premium value for all stakeholders".
As a result of our decision to comply with CBN Banking Activities Regulation we divested from subsidiaries which carry out non-banking activities, our principal strategy is aimed at promoting the growth and profitability of banking activities. We are pursuing organic growth in the short to medium term. Our growth and marketing plans will seek to optimize strengths, maximize available opportunities and minimize identified threats while taking steps to mitigate the effects of observed weaknesses.

The strategic objectives of our Bank include:

- Improving capacity to meet customers' changing and increasing banking needs as well as sustain high quality growth despite the volatile business environment; and to be amongst and remain one of the top tier banks in Africa in terms of profitability, balance sheet size, risk assets quality, financial stability and operational efficiency; and
- Focus on deploying more electronic banking products. The use of Electronic channels to meet

our customers' needs would be aggressively pursued. In addition, the Bank will look to strengthen its corporate solutions tools such as sales collections, school fees collections, salary payment solutions as well as micro credits to employees of large corporate who are customers of the Bank.

In order to achieve these objectives, the Bank will implement the following key strategies:

- Continuous investment in branch network expansion, thus bringing quality banking services to its existing and potential customer base;
- Continuous investment and deployment of state-of-the-art technology using Information and Communication Technology (ICT) platforms;
- Building offsite Automated Teller Machine (ATM) galleries at strategic locations;
- Leverage on its understanding of specific trade and correspondent banking requirements to drive business relationships with banks and financial institutions in the West African sub-region to encourage them to use its foreign subsidiaries for businesses they are currently transacting with other banks;
- Target companies that currently have trade partners in Nigeria and other locations across the globe and process their trade transactions through the Zenith Bank network. This approach is aimed at encouraging cross border marketing and the routing of a portion of their international trade transactions through the Bank; and
- Focus on international trade and export trade transactions for the lending businesses.

Other strategies that the Bank intends to implement to achieve its growth, includes:

- Continue to seek, employ and retain the best personnel available;
- Continuous investment in training and re-training of its personnel;
- Maintain and reinforce its core customer service delivery charter;
- Sustain strong profitability and ensure adequate Return on Equity (ROE);
- Sustain strong balance sheet size with adequate Liquidity and Capital base;
- Sustain its brand and premium customer services, that guarantee excellent customer service experience;
- Focus on cautious and synergistic global expansion;
- Remain customer service focused;
- Retain emphasis on the use of technology as a competitive tool; and
- Maintain strong risk management, adequate controls and good corporate governance practices.

## 2.3 Corporate Structure

Zenith Bank's current and future business strategy is implemented through an efficient organisational structure. The Bank's organisational structure is presented in Appendix 1.

## 2.4 Zenith Bank's Legal Entities

Zenith Bank Plc has controlling interest in several banking and non-banking subsidiaries in Nigeria, Africa and Europe. Aside from Zenith Bank Pensions Custodian Limited, which was incorporated in Nigeria, the remaining legal entities are incorporated in their respective countries. The figure below shows the Bank's legal entities.

## Zenith Bank Plc Legal Entities

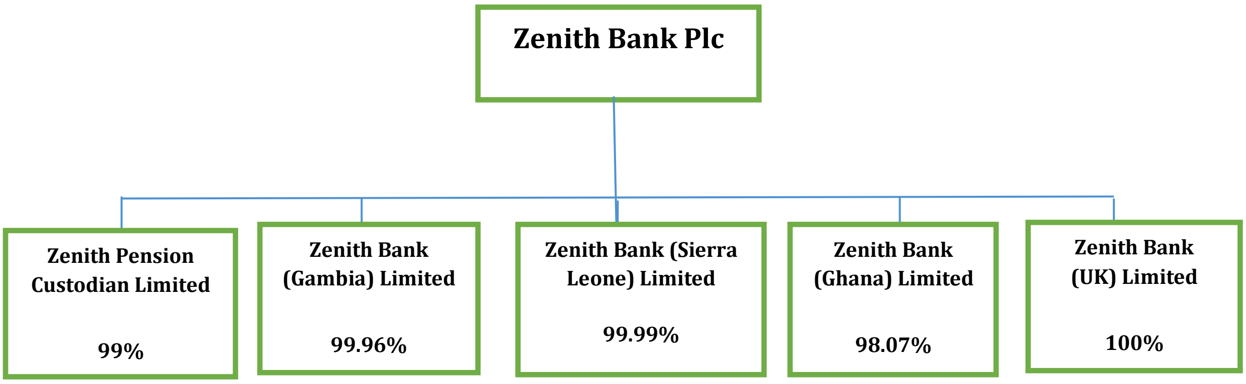



Figure 1: Zenith Bank Plc Legal Entities

Our material legal entities based on strategic importance are Zenith Bank UK and Zenith Bank Ghana. Zenith Bank Ghana controls a significant proportion of the Ghanaian market; the entity is the fifth largest commercial bank in Ghana; while Zenith Bank UK Limited is the main hub for the Bank's trade finance activities.

Both entities are at the frontier of our expansion strategy in the African market. In terms of financial performance, all five subsidiaries contribute 10.3% to the Bank's operating income. Amongst the Bank's various subsidiaries, Zenith Bank UK and Zenith Bank Ghana contribute the largest share to the Group's operating income (2.5% and 5.7% respectively) and assets (5.70% and 3.4% respectively).

Zenith Bank (UK) Limited

Zenith Bank UK was incorporated on 17 February 2006 and commenced operations on 30 March 2007. The bank provides a range of commercial, wholesale, investment, retail banking, and treasury/wealth management financial services. The subsidiary acts as the contact point for correspondent banking relationships with Nigerian and other West African banks, by providing facilities for letter of credit confirmation and treasury products.

Zenith Bank (Ghana) Limited

Zenith Bank Ghana was incorporated on April 15, 2005 and commenced operations on September 16, 2005. The bank provides corporate and retail banking services with several payment services functions.

Zenith Bank (Gambia) Limited

Zenith Bank Gambia was incorporated on 24 October 2008 and granted an operating license by the Central Bank of Gambia on 30 December 2009. The bank commenced banking operations on 18 January 2010. They provide several corporate and retail banking services in Gambia.

Zenith Bank (Sierra Leone) Limited

Zenith Bank Sierra Leone was incorporated on 17 September 2007 and granted an operating license by the Bank of Sierra Leone on 10 September 2008. It commenced banking operations on 18 January 2010. The bank provides corporate and retail banking services in Sierra Leone.

Zenith Pension Custodian Limited

Zenith Pension Custodian Limited was incorporated on 1 March 2005. The name was changed from "Zenith Pensions Limited" to Zenith Pensions Custodian Limited" on September 20, 2005. It

was licensed by the National Pension Commission (PENCOM), as a custodian of pension funds and assets on 7 December 2005. Zenith Pension provides pension fund custodial services to licensed Pension Fund Administrators (PFA's) and Closed Pension Funds Administrators (CPFA's) under the Pension (Reform) Act, 2004.
The bank's business is built on a core principle of working in customers' best interest. The Zenith brand has become synonymous with the deployment of state-of-the-art technologies in banking. The bank defines service standards for exceptional service delivery to its ever expanding clientele.

## 2.5 Zenith Bank's Core Business Lines (CBL)

Zenith Bank Plc's service offerings covers most aspects of banking and caters to banking needs of public and private sector clients. The Bank's service offerings largely constitute its core business lines; these include – Corporate Banking, Institutional and Investment Banking, Retail Banking and Public Sector Banking. These business lines were determined based on several quantitative and qualitative factors. Quantitative factors include each business lines contribution to total bank revenue, pre-tax operating profit and contribution to total assets.
Other non-core business lines (i.e. support services) with strategic importance to the Group are Operations and IT Division, Trade Services and Foreign Exchange services and Treasury services. These business lines act as support services for the bank's key business lines.

***Corporate Banking***

The Bank's Corporate Banking Business line, offers a wide range of services to multinationals, large-local conglomerates and corporate clients with an annual turnover in excess of One Billion Naira and above. The Group is focused on providing superior banking services and customised banking products to the top tier end of the market. Within this Business Group, industry specific desks or sub-units exist to facilitate efficient and effective management of the relationships with the unit's corporate customers. The sub-units include Transport & Aviation, Conglomerate, Breweries & Beverages, Manufacturing Companies, Oil & Gas, Power, Infrastructure and Construction.

***Retail Banking***

The Bank's retail banking business Group focuses on small and medium enterprises (SMEs), consumer businesses and commercial businesses with annual turnover of less than One Billion Naira. Consumer business consists of personal, current and savings account customers and all unincorporated entities (e.g. societies, clubs, churches, mosques, etc.). The Bank extends loans and advances in the forms of overdrafts, import finance lines, term loans and leases (for customers involved in sales and distribution of Fast Moving Consumer Goods and key distributors). The primary focus of our retail banking business is 'deposit liability creation' using customer loans as a leverage where necessary.

***Institutional & Investment Banking (IIBU)***

Zenith Bank's institutional and investment banking business line manages the Group's business relationship with other banks, financial institutions, multilateral agencies, securities houses, insurance companies, asset management companies and other non-bank finance companies, private equity and venture funds. The IIBU also assists individuals, corporations and governments in raising capital by underwriting and/or acting as the client's agent in the issuance of securities as well as assisting companies in mergers and acquisitions.

The unit through its Treasury sub unit provides ancillary services such as market making, derivatives trading, fixed income instruments, foreign exchange and manages the group's correspondent banking relationships. The Treasury sub-group's activities are carried out through the following five (5) units: the Liability and Deposit Management Unit, Bonds Trading unit, foreign currency trading unit and the Treasury Naira, Fixed Income Trading Unit and the recent Treasury Sales Unit.

***Public Sector Banking***

Zenith Bank's public sector business line provides services to all tiers of government (federal, state and local government), ministries, departments and agencies, non-profit organisation, embassies and foreign missions. Services offered to our public sector clients includes revenue collection schemes, cash management, deposit and investment, electronic payroll systems, offshore remittances and foreign exchange and project finance.

## 2.6 Operational Interconnectedness

### 2.6.1 External Interconnectedness

We currently have over 150 approved vendors to provide various services for the Bank' operations. Services provided by the vendors are detailed in a Service Level Agreement (SLA), which are reviewed at irregular intervals. The SLA's reside with the relevant departments within the Bank. We work with several vendors for each of its key services. This process ensures default from one vendor will not negatively affect our operations. Key services provided by various vendors include the following:

- Information Technology, Administrative & Support Services
- Enterprise Storage and Server Management
- Electronic Fund Transfer Services
- Messaging Security & Collaboration Services
- Cash Movement Services
- Electronic Payment Services (ePAY, Pay Connect, Remitta & Zmobile)  Debt Collection Services (arising out of facilities granted to customers)
- Power Related Services
- Communication Services
- Card Production Services
- Hardware Equipment/Servicing

Other vendors provide services for POS & software development services, counting/sorting machine servicing, electronic fund transfer services, image capture services, education portal service and mail delivery and courier services.

### 2.6.2 Intra-group Interconnectedness

The Bank provides various value-adding services to its international subsidiaries. We currently have a Liaison office that handles all administrative services for the various subsidiaries (e.g. organizing meetings, trainings, etc.). Services provided to subsidiaries by the Bank include the following:

- Technology support services: IT system hosting, maintenance support, etc. (this service is provided to all entities excluding Zenith Bank UK)
- Credit approval Process: Credits are approved for the various entities, including Zenith Bank UK.
- Staff secondment: we provide key staff to various entities (excluding Zenith Bank UK) within their various divisions (e.g. IT, Financial Control, Internal Control, etc.)
- Card services: we produce all debit cards for our subsidiaries, and provide card management support services
- Financial Control: There is support provided to our subsidiaries

We also provide oversight functions to our subsidiaries – several board members from Zenith Bank Plc, sit on the board of our subsidiaries and parental supervisory activities are stronger.

## 3. Risk Management

### 3.1 Enterprise Risk Management

The bank adopts an integrated approach to risk management by bringing all risks together under a limited number of oversight functions. The bank addresses the challenge of risks comprehensively through the Enterprise Risk Management (ERM) Framework by applying practices that are supported by a governance structure consisting of board level and executive management committees.
As part of its risk management policy, the bank segregates duties between market facing business units and risk management functions while management is governed by well-defined policies which are clearly communicated across the Group.

Risk related issues are taken into consideration in all business decisions and the Group continually strives to maintain a conservative balance between risk and revenue consideration. Risk culture and education is always on the ascendancy across the group.

### 3.2 Risk Management Philosophy/Strategy

In the course of conducting our business operations, we are exposed to a variety of risks including Market, Credit, Liquidity, Operational and other risks that are material and require comprehensive controls and ongoing oversight. These risks are monitored by our core business management as well as our independent risk control groups.

- The group considers sound risk management practice to be the foundation of a long lasting financial institution.
- The group continues to adopt a holistic and integrated approach to risk management and therefore, brings all risks together under one or a limited number of oversight functions.
- Risk management is a shared responsibility. Therefore the Group aims to build a shared perspective on risks that is grounded in consensus. Decisions are mainly driven by a collective action at defined committee meetings.
- There is clear segregation of duties between market facing business units and risk management functions.
- Risk Management is governed by well-defined policies which are clearly communicated across the Group.
- Risk related issues are taken into consideration in all business decisions. The Group shall continually strive to maintain a conservative balance between risk and revenue consideration.

### 3.3 Risk Appetite

Zenith Bank Plc has a relatively modest risk appetite as the bank is well aware of the various risks associated with the business of banking globally and particularly those risks to which the bank is exposed. Typically, these risks relate to the very nature of banking activities – sourcing of funds, the creation of assets, meeting operational needs and counterparty obligation.
The bank's risk appetite is reviewed by the Board of Directors annually, at a level that minimizes erosion of earnings or capital due to avoidable losses or from frauds and operational inefficiencies. This reflects the conservative nature of Zenith Group as far as risk taking is concerned.

The risk appetite describes the quantum of risk that it would assume in pursuit of its business objectives at any point in time. For the Group, it is the core instrument used in aligning its overall corporate strategy, its capital allocation and risks.

The bank sets tolerance limits for identified key risk indicators ("KRIs"), which serve as proxies for the risk appetite for each risk area and business/support unit. Tolerance levels for KRIs are jointly defined and agreed upon by the business/support units and are subject to annual reviews.

### 3.4 Risk Management Policies and Procedures

Zenith Bank manages its risks in a structured, systematic and transparent manner through a global risk policy which embeds comprehensive risk management processes into the organizational structure and risk measurement and monitoring activities. This structure ensures that the bank's overall risk exposures are within the thresholds set by the Board.

The key features of the Bank's risk management policy are:

- The Board of Directors provides overall risk management direction and oversight.
- The Bank's risk appetite is approved by the Board of Directors.
- Risk management is embedded in the Group as an intrinsic process and is a core competence of all its employees.
- The Bank manages its credit, market, operational and liquidity risks in a coordinated manner within the organisation.
- The Bank's risk management functions are independent of the business divisions.
- The Bank's internal audit function reports to the Board Audit Committee and provides independent validation of the business units' compliance with risk policies and procedures and the adequacy and effectiveness of the risk management framework on an enterprise-wide basis.

Risk management strategy and policies are the responsibility of the Managing Director working in conjunction with the Chief Risk Officer. They are subject to regular review (at least annually) and are authorized by the Board.

Zenith Bank will continually modify and enhance its risk management policies and systems to reflect changes in markets, products and international best practices. Training, individual responsibility and accountability, together with a disciplined and cautious culture of control, is an integral part of the bank's management of risk.

### 3.5 Risk Management Approach

The bank addresses the challenge of risks comprehensively through an enterprise-wide risk management framework and a risk governance policy by applying leading practices that are supported by a robust governance structure consisting of board level and executive management committees. The Board drives the risk governance and compliance process through its committees. The audit committee provides oversight on the systems of internal control, financial reporting and compliance. The Board credit committee reviews the credit policies and approves all loans above the defined limits for Executive Management.

The Board Risk Committee sets the risk philosophy, policies and strategies as well as provides guidance on the various risk elements and their management. The Board Risk Control Functions are supported by various management committees and sub committees

(Global Credit committee, Management Risk committee and Assets and Liabilities Committee, ALCO) that help it develop and implement various risk strategies. The Global Credit committee is responsible for credit evaluation, approval and documentation activities. It ensures that the credit policies and procedures are aligned with the Group's business objectives and strategies. The Management Risk committee and ALCO drives the management of the financial risks (Market, Liquidity and Credit Risk), operational risks as well as strategic and reputational risks.

In addition, the bank manages its risks in a structured, systematic and transparent manner through a global risk policy which embeds comprehensive risk management processes into the organizational structure and risk measurement and monitoring activities. This structure ensures that the Group's overall risk exposures are within the thresholds set by the Board.

The key features of the bank's risk management policy are:

- **(a)** The Board of Directors provides overall risk management direction and oversight.
- **(b)** The bank's risk appetite is approved by the Board of Directors.
- **(c)** Risk management is embedded in the Group as an intrinsic process and is part of the core competence expected from all employees.
- **(d)** It sets out steps for managing its credit, market, operational and liquidity risks in a coordinated manner within the organization.
- **(e)** The bank's risk management function is independent of the business divisions.
- **(f)** The bank's internal control and audit function is independent and the Group reports to the Board Audit Committee and provides independent validation of the business units' compliance with risk policies and procedures and the adequacy and effectiveness of the risk management framework on an enterprise-wide basis.

The Group continually modifies and enhances its risk management policies and systems to reflect changes in markets, products and international best practices. Training, individual responsibility and accountability, together with a disciplined and cautious culture of control, is an integral part of the Group's management of risk.

### 3.6 Methodology for Risk Assessments

The risk management strategy is to develop an integrated approach to risk assessments, measurement, monitoring and control that captures all risks in all aspects of the bank's activities.

All activities in the bank have been profiled and the key risk drivers and threats in them identified. Mitigation and control techniques are then determined in tackling each of these threats. These techniques are implemented as risk policies and procedures that drive the strategic direction and risk appetite as specified by the board. Techniques employed in meeting these objectives culminate in the following roles for the risk control functions of the bank:

### 3.7 Credit Risk

Credit risk is the risk of a financial loss if an obligor does not fully honour its contractual commitments to the bank. Obligors may be borrowers, issuers, counterparties or guarantors. Credit risk is the most significant risk facing the Bank in the normal course of business. The Bank is exposed to credit risk not only through its direct lending activities and transactions but also through commitments to extend credit, letters of guarantee, letters of credit, securities purchased under reverse repurchase agreements, deposits with financial institutions, brokerage activities, and transactions carrying a settlement risk for the Bank such as irrevocable fund transfers to third parties via electronic payment systems.

The bank has robust credit standards, policies and procedures to monitor and control all types of risks envisaged in the normal course of business including concentration risks. This is done by instituting controls in selection, underwriting, administration and management of all credits. Some of these include:

**(g)** Credit is only extended to suitable and well identified customers and never where there is any doubt as to the ethical standards and record of the intending borrower.

**(h)** Exposures to any industry or customer will be determined by the regulatory guidelines, clearly defined internal policies, debt service capability and balance sheet management guidelines.

**(i)** Credit is not extended to customers where the source of repayment is unknown or speculative, and also where the destination of funds is unknown. There must be clear and verifiable purpose for the use of the funds.

**(j)** Credit is not given to a customer where the ability of the customer to meet obligations is based on the most optimistic forecast of events. Risk considerations will always have priority over business and profit considerations

**(k)** The primary source of repayment for all credits must be from an identifiable cash flow from the counterparty's normal business operations or other financial arrangements. The realization of security remains a fall back option.

**(l)** A pricing model that reflects variations in the risk profile of various credits to ensure that higher risks are compensated by higher returns is adopted.

**(m)** All insiders' related credits are limited to regulatory and strict internal limits.

### 3.7.1 Credit Metrics and Measurement Tools

Zenith Bank and its subsidiaries have devoted resources and harnessed data from different sources in order to develop models to improve the determination of economic and financial threats due to credit risk. Before a sound and prudent credit decision can be taken, the credit risk associated with the borrower or counterparty must be accurately assessed. This is the first step in processing credit applications. As a result some key factors are considered in credit risk assessment and measurement:

**(a)** Adherence to the strict credit selection criteria which includes defined target market, credit history, the capacity and character of customers.

**(b)** Credit rating of obligor

**(c)** The likelihood of failure to pay over the period stipulated in the contract.

**(d)** The size of the facility in case default occurs.

**(e)** Estimated Rate of Recovery which is a measure of the portion of the debt that can be regained through freezing of assets and collateral should default occur.

### 3.7.2 Credit Rating Tools

The principal objective of the credit risk rating system is to produce a reliable assessment of the credit risk to which the Group is exposed. As such, all loans and indirect credits such as guarantees and bonds as well as treasury investments undergo a formal credit analysis process that would ensure the proper appraisal of the facility.

### 3.7.3 Credit Risk Management

Zenith Bank's dynamic and proactive approach in managing credit risk is a key element in achieving its strategic objective of maintaining and further enhancing its asset quality and credit portfolio risk profile. The conservative, prudent and well- established credit standards, policies and procedures, risk methodologies and framework, solid structure and infrastructure, risk monitoring and control activities enable the bank to deal with the emerging risks and challenges with a high level of confidence and determination.

Our rigorous credit processes are supplemented by sectoral portfolio reviews focused on countries, regions or specific industries as well as multiple stress testing scenarios. These are intended to identify any inherent risks in the portfolios resulting from changes in market conditions and are supplemented by independent reviews from the bank's Internal Audit.

Additionally, the bank continues to upgrade and fine-tune its credit management processes in line with the developments in the financial services industry environment and technology.

## 3.8 Market risk

Market risk is the risk of potential losses in both on and off balance-sheet positions arising from movements in market prices. Market risks can arise from adverse changes in interest rates, foreign exchange rates, equity prices, commodity prices and other relevant factors such as Market Volatilities.

The objective of market risk management activities is to continually identify, manage and control market risk exposure within acceptable parameters, while optimizing the return on risks taken.

### 3.8.1 Management of Market Risk

The Bank has an independent Market Risk Management unit which assesses, monitors, manages and reports on market risk taking activities across the Group. The bank has continued to enhance its Market Risk Management Framework. The operations of the unit is guided by the mission of "inculcating enduring market risk management values and culture, with a view to reducing the risk of losses associated with market risk-taking activities, and optimizing risk-reward trade-off."

The bank's market risk objectives, policies and processes are aimed at instituting a model that objectively identifies, measures and manages market risks in the Group and ensure that:

- **(a)** The individuals who take or manage risk clearly understand it.
- **(b)** The Group's risk exposure is within established limits.
- **(c)** Risk taking decisions are in line with business strategy and objectives set by the Board of Directors.
- **(d)** The expected payoffs compensate for the risks taken.

**(e)** Sufficient capital, as a buffer, is available to minimise the impact of the risk.

The bank proactively manages its market risk exposures in both the trading and non-trading books within the acceptable levels.

### 3.8.2 Foreign Exchange Risk

Fluctuations in the prevailing foreign currency exchange rates can affect the Groups financial position and cash flows - 'On' and 'Off' Balance Sheet. The bank manages part of the foreign exchange risks through basic derivatives products and hedges (such as forward and swap). It is also managed by ensuring that all risk taken by the Group are within approved limits. In addition to adherence to regulatory limits, Zenith bank established various internal limits (such as the banks non-VAR models, overall overnight and Intra-day positions), Dealer limits, as well as individual currency limits, etc which are monitored on a regular basis. These limits are set with the aim of minimizing the Group's exposures to exchange rate volatilities and keep same within acceptable level.

### 3.8.3 Interest Rate Risk

The bank is exposed to a considerable level of interest rate risk-especially on the banking book (i.e. the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates

These changes could have a negative impact on the net interest income, if not properly managed. The bank however, has a significant portion of its liabilities in non-rate sensitive liabilities. This helps it in minimising the impact of the exposure to interest rate risks. The bank also enjoys some form of flexibility in adjusting both lending and deposits rates to reflect current realities.

## 3.9 Liquidity Risk

Liquidity risk is the potential loss arising from the bank’s inability to meet its obligations as at and when due or to fund increases in assets without incurring unacceptable cost or losses. Liquidity risk is not viewed in isolation, because financial risks are not mutually exclusive and liquidity risk is often triggered by consequences of other bank risks such as credit, market and operational risks.

### 3.9.1 Liquidity Risk Management Process

The bank has a sound and robust liquidity risk management framework that ensures that sufficient liquidity, including a cushion of unencumbered and high quality liquid assets are maintained at all times, to enable the Group withstand a range of stress events, including those that might involve loss or impairment of funding sources.

The bank’s liquidity risk exposure is monitored and managed by the Treasury Group while the Asset and Liability Management Committee (ALCO) has a very tight oversight function on the activities of the Group on a regular basis. The committee meets on a weekly basis and ensures that the bank maintains adequate liquid assets and marketable securities sufficient to manage any liquidity stress situation. The liquidity ratio of the bank remains one of the best among its’ peers and is far above the regulatory limits.

### 3.10 Operational Risk

Operational Risk is the risk of loss resulting from inadequate and /or failed internal processes, people and systems or from external events, including legal risk and any other risks that is deemed fit on an ongoing basis but exclude reputation & strategic risk. Operational risk exists in all products and business activities.

The bank has a broad Operational Risk management framework which defines the set of activities designed to proactively identify, assess and manage all operational risk by aligning the people, technology and processes with best risk management practices towards enhancing stake holder's value and sustaining industry leadership.

Operational risk objectives include the following:

**(a)** To provide clear and consistent direction in all operations of the bank

**(b)** To provide a standardized framework and appropriate guidelines for creating and managing all operational risk exposures

**(c)** To enable the group identify and analyze events (both internal and external) that impact its business.

The Operational Risk units constantly carry-out reviews to identify and assess the operational risk inherent in all material products, activities, processes and systems. It also ensures that all business units within the Bank monitor their operational risk using set standards and indicators. Significant issues and exceptions are reported to Risk Management and are also picked up by the independent risk function for discussion at the risk management committee.

Disaster recovery procedures, business continuity planning, self-compliance assurance and internal audit also form an integral part of our operational risk management process.

### 3.11 Strategic Risk

Strategic risk refers to possible loss(es) that might arise from the pursuit of an unsuccessful business plan. Strategic risk examines the impact of design and implementation of business models and decisions, on earnings and capital as well as our responsiveness to industry changes.

This responsibility is taken quite seriously by the Board and Executive Management of the bank and deliberate steps are taken to ensure that the right models are employed and appropriately communicated to all decision makers in the bank. The processes, execution, and constant reviews of actions ensures that strategic objectives are achieved. This has essentially driven the Group's sound banking culture and performance record to date.

### 3.12 Reputational Risk

Reputation risk is defined as the risk of indirect losses arising from a decline in the bank's reputation amongst one or multiple bank stakeholders. The risk can expose the bank to litigation, financial loss or damage to its reputation. The Reputation risk management philosophy of the Bank involves anticipating, acknowledging and responding to changing values and behaviours on the part of a range of stakeholders. Accordingly, the following are the roles and responsibilities:

(a) Board and senior management overseeing the proper set-up and effective functioning of the reputational risk management framework

(b) Enterprise Risk Management Policy/Strategy (ERSP) is responsible for supporting the Board and senior management in overseeing the implementation of reputational risk management framework.

(c) Corporate Communications is responsible for managing both the internal and external communications that may impact the reputation of the Bank

The process of reputation risk management within the Bank encompasses the following steps:

(a) Identification: Recognizing potential reputational risk as a primary and consequential risk

(b) Assessment: Qualitative assessment of reputational risk based on the potential events that have been identified as reputational risk.

(c) Monitoring: Frequent monitoring of the reputational risk drivers

(d) Mitigation and Control: Preventive measures and controls for management of reputational risk and regular tracking of mitigation actions

(e) Independent review: The reputational risk measures and mitigation techniques shall be subject to regular independent review by the Internal Auditors and/or Statutory Auditors.

(f) Reporting: Regular, action-oriented reports for management on reputational risk.

### 3.13 Legal Risk

Legal risk is defined as the risk of loss due to defective contractual arrangements; legal liability (both criminal and civil) incurred during operations by the inability of the organization to enforce its rights, or by failure to address identified concerns to the appropriate authorities where changes in the law are proposed. The bank manages this risk by monitoring new legislation, creation of awareness of legislation amongst employees, identification of significant legal risks as well as assessing the potential impact of these.

Legal risks management in the bank is also being enhanced by appropriate product risk review and management of contractual obligations via well documented Service Level Agreements and other contractual documents.

## 4. Capital Management

The strategy for assessing and managing the impact of our business plans on present and future regulatory capital forms an integral part of the bank's strategic plan. Specifically, the Group considers how the present and future capital requirements will be managed and met against projected capital requirements. This is based on the bank's assessment and against the supervisory/regulatory capital requirements taking account of the bank business strategy and value creation to all its stakeholders.

The bank prides itself in maintaining very healthy capital adequacy ratio in all its areas of operations. Capital levels are determined either based on internal assessments or regulatory requirements. The Group maintained impressive capital levels above the regulatory minimum prescribed in all its operating jurisdictions.

The Capital Adequacy of the bank is reviewed regularly to meet our internal guidance limits, regulatory requirements and standard of international best practices in order to adopt and implement the decisions necessary to maintain the capital at a level that ensures the realisation of the business plan with a certain safety margin.

The bank undertakes a regular monitoring of capital adequacy and the application of regulatory capital by deploying internal systems based on the guidelines provided by the Central Bank of Nigeria (CBN) and the regulatory authorities of the subsidiaries for supervisory purposes.

It has consistently met and surpassed the minimum capital adequacy requirements applicable in all areas of operations. Most of the bank's capital is Tier 1 (Core Capital) which consists of essentially share capital, and reserves created by appropriations of retained earnings.

Banking subsidiaries in the Group, not incorporated in Nigeria, are directly regulated and supervised by their local banking supervisor and are required to meet the capital requirement directive of the local regulatory jurisdiction. Parental support and guidance are given at the Group level where the risk level in the Group in relation to capital level and adequacy is closely monitored. The Group supports and meets all capital requests from these regulatory jurisdictions and determines the adequacy based on its expansion strategies and internal capital assessments.

The bank's capital plan is linked to its business expansion strategy which anticipates the need for growth and expansion in its branch network and IT infrastructure. The capital plan sufficiently meets regulatory requirements as well as providing adequate cover for the Group's risk profile. The bank capital adequacy remains strong and the capacity to generate and retain reserves continues to grow.

The bank will only seek additional capital where it finds compelling business need for it and with the expectation that the returns would adequately match the efforts and risks undertaken.

The following sources of funds are available to the bank to meet its capital growth requirements:

**(a)** Profit from Operations: The bank has consistently reported good profit which can easily be retained to support the capital base.

(b) Issue of Shares: The bank can successfully access the capital market (Local and/or International) to raise desired funds for its operations and needs.

(c) Bank Loans (long term/short term).

(d) Global Depository Receipts (GDR) and Eurobond

In 2014 financial year, Zenith Bank commenced capital computations in accordance with Basel II standard under the guidelines issued by the Central Bank of Nigeria. The guidelines require capital adequacy computations based on the Standardized Measurement Approach for Credit Risk and Market Risk while Basic Indicator Measurement Approach was advised for Operational Risk. The capital requirement for the Bank has been set at 15% and an addition of 1% as a Systemically Important Bank (SIB) in accordance with the guidelines.

### 4.1 Capital Structure

The bank's capital structure is made up of equity capital, share premium, statutory reserves and retained profit. These constitutes the bank's core funding source and has witnessed a continued year on year growth due to the banks dividend policy which always ensures a significant portion of profit retention. Secondary funding is derived primarily from customer deposits, term borrowings from multilateral financial institutions and the Central Bank of Nigeria (on-lending funds) and Eurobonds.

**Regulatory Capital Structure as at 30th June 2017**

| Capital Structure | Amount(NairaMn) |
|---|---|
| **Eligible Total Tier 1 Capital** | **565,277** |
| **Eligible Total Tier 2 Capital** | **-** |
| **Total Regulatory Capital** | **565,277** |

## 4.2 Overall Capital Requirement

Zenith Bank's total capital requirement as at 30th June 2017 is set out below:

| Risks | Capital (N Mn) | RWA (N Mn) |
|---|---|---|
| Credit risk | 321,417 | 2,142,778 |
| Market risk | 2,590 | 32,371 |
| Operational risk | 43,226 | 540,331 |
| **Pillar 1 Capital Requirement**( See Annexure 1)** | **367,233** | **2,715,480** |
| Credit Concentration Risk | 11,012 | 73,413.33 |
| IRRBB | 5,180 | 34,533.33 |
| IT Risk | 2,143.52 | 14,290.13 |
| Liquidity risk | | |
| Strategic risk | | |
| Reputational risk | | |
| **Pillar 2 Capital Requirement** | **18,335.52** | **122,236.80** |
| **Economic Capital (Pillar 1 + Pillar 2)** | **385,568.52** | **2,837,716.80** |
| **Tier 1 Capital** | 573,711 | |
| **Tier 2 Capital** | - | |
| **Total Available Capital (Tier 1 + Tier 2)** | 573,711 | |
| **Regulatory Capital Adequacy ratio** | **21.00%** | |
| **Economic Capital Adequacy ratio** | **20.00%** | |
| CBN Guidelines | 15.00% | |

### Highlights

- Credit Risk Capital computation as per Standardised Approach comprises about 83.36% of the total capital requirement
- The Maturity Method (under Standardized Approach as per CBN guidelines) has been adopted for Market Risk Capital Computation. The capital requirement for market risk as of 30th June 2017 is ₦ 2590M which is less than 1% of the total capital requirement.
- The bank performed Net Interest Income (NII) analyses (IRRBB) to measure the impact of changes in interest rate on NII. The impact of 200Basis Point Shift in Interest Rates as a result of Repricing Risk amounted to ₦ 5.18Bn. Consequently, we made a capital allocation of ₦ 5.18Bn under Pillar 2 Risks.
- The capital requirement for operational risk as of 30th June 2017 is ₦43,226M, which is about 11.40% of the total capital requirement.
- Based on the controls set by the bank in managing its loan portfolio, capital requirement to serve as a buffer for the concentration risk over and above the requirement in Pillar 1 for credit risk, will be assumed as 1% of the exposure to south west multiplied by the HHI index of 0.6634 which amounts to N11.01B.
- The bank also takes into cognizance the significance of IT to its banking activities which comes with some attendant risk elements inform of system down time, rollback plans on different systems implementation. A buffer of ₦ 2.14Bn was allocated which is about 1% of the bank's gross earnings.
- Stress testing has been carried out for Credit Risk, Market Risk, Interest Rate Risk in Banking Book, and Liquidity Risk. The stress scenarios have been selected taking into consideration the nature and complexity of Bank's operations.
- Detailed risk control measures have been described for some additional risks arising from some aspects of our business and we have tried to estimate and quantify capital needs as much as possible.

The Bank has a regulatory capital adequacy ratio of 21.00% with a margin of 6.00% over regulatory requirement for domestically systemically banks. It can be seen that the Bank's capital is adequate to meet both anticipated regulatory requirements and its own capital assessment. Looking forward and taking account of future projected business, there is headroom above the Bank's own internal assessment of capital requirements.

We will also focus more attention on how to improve our systems to enable us move into more advanced approaches( in the key risk areas-Credit, Market and Operational Risk) in order to take advantage of lower capital requirements.

## 5. RISKGOVERNANCE

### 5.1. Overview

Zenith Bank Plc risk management focuses on the major areas of credit risk, liquidity risk, market risk (including interest rate risk and foreign exchange risk) and operational risk. The management of these risks ultimately rests with the Board of Directors as the ultimate governing authority of the bank.

### 5.2. Board Sub-committee

The Bank's Board has seven sub-committees reporting to it:

| Composition & Responsibilities of Board Committees | | | |
|---|---|---|---|
| **Committee** | **Members** | **Responsibilities** | **Frequency of Meetings** |
| **Board Audit and Compliance Committee (BACC)** | • 3 Representatives of Shareholders<br>• 3 Non-Executive Directors | • Meet to discuss and determine the terms of engagement of independent auditors, the scope of audit and procedures to be used.<br>• Approves internal audit and compliance arrangements including monitoring of the operation of the internal control framework, including the Internal Capital Adequacy Assessment process (ICAAP). | Quarterly |
| **Board Risk Committee (BRC)** | • Chief Executive Officer<br>• 3 Non-Executive Directors<br>• 1 Executive Director | • ensure that sound policies, procedures and practices are in place for the risk-wide management of the Bank's material risks and to report the results of the Committee's activities to the Board of Directors<br>• Approves the Bank's credit risk management framework, other risk management policies and arrangements and internal control policies relating to the management of credit and related risks. | Quarterly |
| **Board Credit Committee (BCC)** | • Chief Executive Officer<br>• 4 Non-Executive Directors<br>• 4 Executive Directors | • To establish and periodically review the Bank's credit policy and portfolio in order to align organizational strategies, goals and performance<br>• To evaluate on an annual basis the components of total credit facilities as well as market competitive data and other factors as deemed appropriate. | Quarterly |
| **Board Finance and General Purpose Committee** | • 3 Non-Executive Directors<br>• 3 Executive Directors | • Review of all matters relating to staff welfare and large scale procurement by the bank including review of contract awards of large expenditure.<br>• Determines the remuneration, appointment and contractual arrangements of individual | Quarterly |

| Composition & Responsibilities of Board Committees | | | |
|---|---|---|---|
| **Committee** | **Members** | **Responsibilities** | **Frequency of Meetings** |
| | | executive directors, non-executive directors and senior staff, having regard to a general policy framework for executive remuneration established by the Board. | |
| **Board Governance, Nominations and Remuneration Committee (BGN&RC)** | • Chief Executive Officer<br>• 5 Non-Executive Directors<br>• 1 Executive Director | • Determine a fair, reasonable and competitive compensation practice for executive and Non-executive officers and other key employees of the Bank which are consistent with the Bank's objective.<br>• Review and continuous assessment of the size and composition of the Board and Board Committees, and recommend the appropriate Board structure requirements in line with needs of the Group and diversity required | Quarterly |
| **Executive Committee (EXCO)** | • Chief Executive Officer<br>• All Executive Directors | • Formulates the strategy of the Bank, in compliance with the Zenith Group's strategy.<br>• Ensures the Bank is managed in accordance with the agreed strategy; and is managed in a sound, prudent and ethical manner.<br>• provide leadership to the Management team and ensure efficient deployment and management of the Bank's resources | Twice Weekly |

To support the work of these committees the management of Zenith Bank Plc has established the following Management Committees:

- **Asset and Liability Committee (ALCO)**: This committee manages a variety of risks arising from the Bank's business including market and liquidity risk management, loan to deposit ratio analysis, cost of funds analysis, establishing guidelines for pricing on deposit and credit facilities, exchange rate risks analysis, balance sheet structuring, regulatory considerations and monitoring of the status of implemented assets and liability strategies.
- **Management Committee (Manco)**: This committee is saddled with the responsibility of Identifying, analyzing, and making recommendations on risks arising from day-to-day activities as well as ensuring that risk limits as contained in the Board and Regulatory policies are complied with.
- **Risk Management Committee (RMC):** this committee is responsible for regular analysis and consideration of risks other than credit approval in the Bank. Makes contributions to the Board Risk Management Committee and also ensures that the Board Risk Committee's decisions and policies are implemented.
- **Management Global Credit Committee (MGCC)**: This committee ensures that the Bank complies with the Credit Policy Guide as established by the Board. The Committee also makes contributions to the Board Credit Committee. They are empowered to approve credit facilities to individual obligors not exceeding in aggregate a sum as pre-determined by the Board from time to time.
- **IT Steering Committee:** this committee is responsible for amongst others, development of corporate information technology (IT) strategies and plans that ensure cost effective

application and management of resources throughout the organization.

### 5.3. Oversight of Strategy, Policies and Procedures

The Board of directors of Zenith Bank Plc has ultimate responsibility for the level of risk taken by the Bank. Accordingly, it approves the overall business strategies and significant policies of the Bank, including those related to managing and taking risks, and also ensures that senior management is fully capable of managing the activities that the Bank conducts. The Board of Directors are responsible for understanding the nature of the risks significant to the Bank and ensuring that management is taking the steps necessary to identify, measure, monitor, and control these risks, the level of technical knowledge required of directors may vary depending on roles and responsibilities attached to members.

Using this knowledge and information, the board provides clear guidance regarding the level of exposures acceptable to the Bank and has the responsibility to ensure that senior management implements the procedures and controls necessary to comply with adopted policies. Senior management is responsible for implementing strategies in a manner that limits risks associated with each strategy and that ensures compliance with laws and regulations on both a long-term and day- to-day basis. Accordingly, Management is being fully involved in the activities of the Bank and possesses sufficient knowledge of all major business lines to ensure that appropriate policies, procedures, controls, and risk monitoring systems are in place and that accountability and lines of authority are clearly delineated.

### 5.4. Assurance

The assurance function is provided by the Internal Audit, External Audit and The Board of Directors. In Zenith Bank Plc, the Board and Executive Management rely on Internal Control & Audit Department for objective assurance and insight on the effectiveness and efficiency of governance processes to help the organization achieve its strategic, operational, financial, and compliance objectives.

#### 5.4.1. Internal Audit

The Bank's internal audit programme seeks the promotion of accuracy and efficiency in Bank's accounting, administrative procedures and risk management controls. The Head of Internal Audit reports to the Chairman of the Audit Committee and prepares an annual audit programme which is presented to the Committee for review and approval.

#### 5.4.2. External Audit

External audit is undertaken by the Bank's appointed auditors (KPMG) to review and ascertain the validity of the financial statements and its' content and to provide feedback to the Audit Committee and the Board on the operation of the internal and financial controls of the Bank which are reviewed as part of the annual audit.

#### 5.4.3. Compliance

The Head of Compliance is responsible for compliance oversight. The compliance function exists to monitor and maintain the quality of the bank's business activities and to ensure that business activities are always compliant with regulatory requirements. The Head of Compliance Group reports directly to the Executive Compliance Officer and ensures that all staff are aware of their regulatory and legal responsibilities.

Zenith Bank Plc operates a strict and comprehensive anti-money laundering policy with all members of staff receiving regular training as applicable in the industry. This involves training on customer on-boarding activities like: Customer due Diligence, Account Opening, Customer Acceptance including Customer Classification modules, and always in accordance with the Independent and Corrupt Practices and Other Related Offences Act,

2000. The bank maintains an Anti-Money Laundry policy and supporting procedures.

### 5.4.4. The Board of Directors

The board provides independent assurance to all the stakeholders that the institution is run in a professional manner and in line with Global best practice. It also provides comfort that all applicable regulatory/supervisory guidelines are being adhered to in the running of the bank's affairs.

## 6. RISK ASSESSMENT AND CAPITAL ADEQUACY

Risk assessment and Capital Adequacy for Zenith Bank Plc has been done by considering the Pillar – I and Pillar – II risks as per CBN and Basel II guidelines.

| Type | Risk Type | Methodology | Capital Allocated | Justification |
|---|---|---|---|---|
| **Pillar 1 Risks** | Credit Risk | Standardized Approach | Yes | As per regulatory requirement |
| | Market Risk | Standardized Approach | Yes | As per regulatory requirement |
| | Operational Risk | Basic Indicator Approach | Yes | As per regulatory requirement |
| **Pillar 2 Risks** | Concentration Risk | Herfindahl Hirschmann Index (HHI) | Yes | Concentrations along Geographical lines |
| | Interest Rate Risk in Banking Book (IRRBB) | NII / EVE Approach | Yes | Impact within acceptable threshold- But Capital is allocated in recognition of the implication of the Risk to the Bank. |
| | Liquidity Risk | Liquidity Gap Approach | No | Adequate liquidity buffers available |
| | Strategic Risk | Qualitative Assessment | No | Minimal risk level. Available Controls are sufficient to mitigate Risk. |
| | Reputational Risk | Qualitative Assessment | No | Minimal risk level. Available Controls are sufficient to mitigate Risk. |
| | Regulatory/ Compliance Risk | Qualitative Assessment | No | Minimal risk level. Available Controls are sufficient to mitigate Risk. |
| | Physical Security | Qualitative Assessment | No | Minimal risk level. Available Controls are sufficient to mitigate Risk. |
| | Technology Risk | Qualitative Assessment | Yes | Adequate Controls are in place. But Capital is allocated in recognition of the implication of the Risk to the Bank. |
| | Legal Risk | Qualitative Assessment | No | Minimal risk level. Available Controls are sufficient to mitigate Risk. |
| | Political Risk | Qualitative Assessment | No | Minimal risk level. Available Controls are sufficient to mitigate Risk. |

### 6.1. Pillar 1 Risks

#### 6.1.1. Credit Risk

Credit risk is the risk arising from the uncertainty of an obligor’s ability to perform its contractual obligations. Credit risk is one of the core risks assumed in pursuit of Zenith Bank’s business objectives. The principal activity of the Bank is granting credit facilities. Zenith Bank Plc is exposed to credit risk through direct lending, issuance of guarantees and investment activities. It is the most significant risk type in terms of regulatory capital requirements. Credit decisions in Zenith Bank Plc are based on an in-depth review of the obligor’s creditworthiness and track record. The credit portfolio is managed at aggregate level to optimize the exposures given the risk levels being carried.

##### 6.1.1.1. Credit Risk Acceptance Criteria:

Zenith Bank Plc pursues a set of sound principles which specify the terms and conditions for extending facilities to an obligor in its target market. It defines items such as:

- Product eligibility
- Tenor and volume limits
- Pricing
- Collateral security and support required for the financing
- Required documentation

Credit is extended to the bank's target market as per the above criteria for Risk acceptance.

**6.1.1.2. Classification of Credit exposures as per CBN and Basel-II guidelines:**

CBN in its published note titled 'CBN Guidance Notes on Credit Risk Capital Requirement – Dec 2013' clearly highlights the following types of credit exposures and classifies them into the following Asset classes;

- Central Governments and Central Bank
- Non Central Government Public Sector Enterprises
- State Government and Local Authorities.
- Multilateral Development Banks (MDB s)
- Supervised Institutions
- Corporate and Other Persons
- Regulatory Retail Portfolio
- Mortgages on Residential Property
- Mortgages on Commercial Real Estate
- Past Due Exposures
- High Risk Exposures
- Other Assets

**Credit Exposure by Segment as at 30th June 2017 (as per CBN Guidelines)**

| No. | Segment | Exposure (Naira Mn) | % of Total |
|---|---|---|---|
| 1 | Sovereigns | 1,628,125 | 34.63% |
| 2 | Public Sector Entities (PSEs) | 116,853 | 2.49% |
| 3 | State & Local Governments | 243,163 | 5.17% |
| 4 | Supervised Institutions (DMBs, Discount Houses, etc.) | 321,309 | 6.83% |
| 5 | Corporate and Other Persons | 1,639,706 | 34.88% |
| 6 | Regulatory Retail Portfolio | 16,705 | 0.36% |
| 7 | Secured by Residential Mortgages | 8,040 | 0.17% |
| 8 | Secured by Commercial Mortgages | 20,581 | 0.44% |
| 9 | Past Due Exposures | 46,119 | 0.98% |
| 10 | Other Balance Sheet Exposures | 252,906 | 5.38% |

| No. | Segment | Exposure (Naira Mn) | % of Total |
|---|---|---|---|
| 11 | Off Balance Sheet Exposures | 408,022 | 8.68% |
| | TOTAL | 4,701,529 | 100 |

The segment analysis above indicates that exposures to Corporate and Other Persons account for the largest proportion (34.88%) of the Credit Portfolio as at30th June 2017.

#### 6.1.1.3. Classification as per Prudential Guidelines:

The foremost method of identification of Credit Risk adopted by the Bank is the reporting of the Credit Portfolio by the asset Quality. As at 30th June 2017, the table below gives the detailed segregation of the Credit Portfolio on basis of the Asset Quality.

**Credit Portfolio by Asset Quality**

| Credit Quality | Amount(NairaMn) | Asa %of Total CreditPortfolio |
|---|---|---|
| Neither Past due nor impaired | 2,004,993 | 93.09% |
| Past due but not impaired | 74,098 | 3.44% |
| Individually impaired | 55,697 | 2.59% |
| Collectively impaired | 18,920 | 0.88% |
| **Total** | **2,153,708** | **100.00** |

#### 6.1.1.4. Capital Computation for Credit Risk

Zenith Bank Plc. has used Standardised Approach (SA) for assessment of Credit Risk Capital Charge as per the CBN's Basel-II guidelines. The classifications of the Bank's total exposures into various Asset Classes have been done as per the CBN's Basel-II guidelines. As exposure in most of the Asset classes is to obligors who are not rated by ECAIs (External Credit Assessment Institutions), risk weight applicable to an unrated obligor type is applied to the exposure. However, Credit Ratings for some of the obligors classified under 'Supervised Institutions' are available, in which cases, risk weight applicable to the credit rating of the obligor has been applied on the exposure to compute risk weighted assets.

The Bank is developing capacity to move to more advanced approaches for the assessment of Credit Risk.

#### 6.1.1.5. Credit Portfolio Dissection using Exposure and RWA

Risk Weights (RW) have been assigned as per CBN Guidelines for Credit Risk ("CBN Guidance Notes on Credit Risk Capital Requirement - December 2013").

## Credit Exposure & RWA as at 30th June 2017

| Asset Class | Exposure Amount (Naira Mn) | CRM | Net Exposure (Naira Mn) | RWA (Naira Mn) |
|---|---|---|---|---|
| Sovereigns | 1,628,125 | - | 1,628,125 | - |
| Public Sector Entities (PSEs) | 116,853 | 99,199 | 17,654 | 17,654 |
| State & Local Governments | 243,163 | 181,213 | 61,950 | 58,145 |
| Supervised Institutions | 321,309 | - | 321,309 | 121,945 |
| Corporates and Other Persons | 1,639,706 | 246,572 | 1,393,134 | 1,393,134 |
| Regulatory Retail Portfolio | 16,705 | 173 | 16,532 | 12,399 |
| Secured by Residential Mortgages | 8,040 | 552 | 7,488 | 5,616 |
| Secured by Commercial Mortgages | 20,581 | 1,560 | 19,021 | 19,021 |
| Past Due Exposures | 46,119 | 14,862 | 31,257 | 37,106 |
| Other Balance Sheet Exposures | 252,906 | - | 252,906 | 180,572 |
| Off Balance Sheet Exposures | 408,022 | 78,465 | 329,557 | 297,185 |

The table above shows the total credit exposures along with risk weighted assets (RWA) classified according to the asset category as per CBN. The past due exposures are included in the respective categories of the asset classes. The exposures have been converted into risk weighted assets (RWA) as per guidelines of CBN under Standardised Approach and it is observed that the "Corporate and Other Persons" category has a major share in RWA.

## Credit Portfolio Summary Result

| Sl. No. | PART A: RISK-WEIGHTED AMOUNTS (ON-BALANCE SHEET EXPOSURES (Naira Mn.) | Exposure Amounts | RWA | Capital |
|---|---|---|---|---|
| 1 | Exposures to Sovereigns | 1,628,125 | - | - |
| 2 | Exposures to Public Sector Entities (PSEs) | 116,853 | 17,654 | 2,648 |
| 3 | Exposures to State & Local Governments | 243,163 | 58,145 | 8,722 |
| 4 | Exposures to Supervised Institutions | 321,309 | 121,945 | 18,292 |
| 5 | Exposures to Corporate and Other Persons | 1,639,706 | 1,393,134 | 208,970 |

| Sl. No. | PART A: RISK-WEIGHTED AMOUNTS (ON-BALANCE SHEET EXPOSURES (Naira Mn.) | Exposure Amounts | RWA | Capital |
|---|---|---|---|---|
| 6 | Exposures included in Regulatory Retail Portfolio | 16,705 | 12,399 | 1,860 |
| 7 | Exposures Secured by Residential Mortgages | 8,040 | 5,616 | 842 |
| 8 | Exposures Secured by Commercial Mortgages | 20,581 | 19,021 | 2,853 |
| 9 | Past Due Exposures | 46,119 | 37,106 | 5,566 |
| 10 | Other Balance Sheet Exposures | 252,906 | 180,572 | 27,086 |
| 11 | Off-balance sheet exposures | 408,022 | 297,185 | 44,578 |
| | **TOTAL** | **4,701,529** | **2,142,777** | **321,417** |

### 6.1.1.6. Credit Risk – Monitoring

Zenith Bank Credit exposures are continuously monitored through a system of triggers and early-warning signals aimed at detecting symptoms which could result in deterioration of credit quality. The triggers and early-warning systems are supplemented by facility utilization and collateral valuation monitoring together with a review of upcoming credit facility expiration and market intelligence to facilitate timely corrective action by management. The results of the monitoring process are duly discussed at a quarterly review session.

Zenith Bank Plc monitors credit risk on an ongoing basis through weekly, monthly and quarterly reporting to ensure senior management awareness of shifts in credit quality and portfolio performance along with changing external factors such as economic and business cycles.
The capabilities of the credit review team are continuously being improved in order to enhance monitoring activity and assure good quality Risk Asset Portfolio across the bank.
A specialized and focused loan recovery and workout team handles the management and recovery of problem credit facilities complemented by external agents.

### 6.1.1.7. Credit Risk – Control and Mitigants

Controls are essential in maintaining the quality of credit portfolio overtime. Dimensions of control exercised by Zenith Bank Plc include:

- Adherence to Credit Policy and Procedures
- Adherence to Credit Approval Processes
- Timely and accurate recording of borrower information in the Bank's transaction processing systems.
- Recording and updating of facility limits and related details promptly and accurately into our database subsequent to credit approvals
- Monitoring the Loan to Value vis-a-vis changing valuation of the Collateral, wherever relevant and asking for increase in the required margin where necessary
- Monitor the repayment of loan installments to identifying any overdue amounts under loans
- Maintenance and revision of watch-list criteria for non-performing loan accounts as well

as early indicators of non-repayment behavior. Zenith Bank identifies the assets which could potentially turn out to be NPLs and puts such assets in the Watch list. The Bank monitors broad spectrum of watch list indicators for example, account turnover, end use of funds, drawing power based on current assets in addition to other qualitative factors like rating migration, changes to company management and industry trends to track slippages in account quality and generate problem loan reports. The selected problem loans are then moved to watch list category and appropriate remedial actions are undertaken.

- Termination and cancellation of credit facility contingent on inferior repayment performance observed.

#### 6.1.1.8. Collateral Management

Zenith Bank Plc maintains a detailed collateral management policy and administration in line with best practice and CBN guidelines on eligible collateral. The Policy covers but not limited to the following:

- Acceptable collateral types
- Loan to Value Ratios
- Down Payment
- Collateral identification, verification, appraisal process, re-valuation
- Documentation, Lien registration, Insurance requirements
- On-going processes for margin maintenance, continuation of insurance etc

**Coverage on Collateral**

| Collateral Types | Coverage |
|---|---|
| **Cash, Treasury Bills, Other near cash Items** | **Minimum of 120% of the facility amount** |
| **Shares** | **Minimum of 200% of the facility amount** |
| **Other tangible collaterals** | **Minimum of 200% of Forced Sales Value {FSV} of the facility amount or as determined by EXCO from time to time and on a case by case basis.** |

### 6.1.2. Market Risk

Market risk is the risk of potential losses in both on and off balance-sheet positions arising from movements in market prices. Market risks can arise from adverse changes in interest rates, foreign exchange rates, equity prices, commodity prices and other relevant factors such as Market Volatilities.

The objective of market risk management activities is to continually identify, manage and control market risk exposure within acceptable parameters, while optimizing the return on risks taken.

Zenith Bank Plc proactively manages its Market risk exposures in both the trading and non-trading books within the acceptable levels.

The bank's Market Risks exposures are broadly categorized into:

- **Trading Market Risks** - These are risks that arise primarily through trading activities and Market Making activities. These include position taking in foreign exchange and fixed income securities (Bonds and Treasury Bills).
- **Non Trading Market Risks** -These are risks that arise from assets and liabilities that are usually on our books for a longer period of time, but where the intrinsic value is a function of the movement of financial market parameter.

**Market Risk – Measurement**

Zenith Bank Plc adopts mainly Non-VAR approach for quantitative measurement and control of market risks in both trading and non-trading books. The Non -VAR measurements includes: Duration; Factor Sensitivities (Pv01), Stress Testing, Aggregate Foreign Currency Trading Position etc. The measured risks are therefore monitored against the pre-set limits on a daily basis. All exceptions are investigated and reported in line with internal policies and guidelines.

Limits are sets to reflect the risk appetite that is approved by the Board of Directors. These limits are reviewed, at least, annually or at a more frequent interval. Some of the limits include; Foreign Currency Trading Position (FCTP- for foreign exchange); Aggregate Control Limits (for Fixed income Securities); Management Action Trigger (MAT); Duration; Factor Sensitivities (Pv01); Permitted Instrument and Tenor Limits; Holding Period and Off Market Rate Tolerance limit.

Zenith Bank Plc generally does not offer very complex derivative products. However, as market dynamics change, it is expected that more sophisticated products will be introduced into the market. The bank at all times ensures that adequate capacity (both systems and training/knowledge base) are in place to handle these products as at when they are introduced. The overall size of the trading book is maintained at a very manageable size. The Bank computes the Capital charge for market risk using Maturity method under standardized approach as per CBN guidelines.

The details of the trading positions, capital charge and the risk weighted assets for market risk portfolio are shown in the table below.

**Position in the Trading Portfolio as at30th June 2017**

| Instrument Type (Trading Book) | Value (N Mn) |
|---|---|
| FGN bonds | 3,138 |
| T-bills | 441,841 |

**Market Risk Exposure: Risk Weighted Assets by Risk Type**

| Risk type | Position (in N Mn) | Capital (in N Mn) | RWA (12.5x Capital) |
|---|---|---|---|
| Interest Rate (FGN Bond & T-Bills) | 444,979 | 2,532 | 31,650 |
| Foreign Exchange Risk (Net Open Position) | 725 | 58 | 725 |
| Total | | | 32,375 |

The above table shows the market risk exposures along with the capital charge computed under the Standardized Approach. The capital charge for market risk is fairly low in comparison with the other risk types due to the size of the trading portfolio.

### 6.1.2.1. Market Risk – Monitoring and Reporting

The Bank classifies the exposures into the trading book as per Basel II guidelines and monitors on a daily basis for adherence to the conditions laid down for their inclusion in the trading book. The Bank monitors the risk identification process with a view to update it to handle new products and new types of risks in line with the market conditions.

The reliability of source of data, accuracy of data and frequency of updating the data is monitored for the data which is used for performing the valuations and computing risk measures. Limits are also monitored on a daily basis which allows the Bank to identify the concentration levels of exposures and risk to a number of dimensions such as asset classes, risk factors etc.

The reporting of market risk is done in a concise, accurate, comprehensive and timely manner. The reporting covers the current position, risk exposures through time and exceptions from policy prescription.

Daily market risk reports are generated by the market risk teams on the profile of the market risk and reported to the risk taking units/departments and Senior Management.

### 6.1.2.2. Market Risk – Control and Mitigants

Zenith Bank's market risk exposures are monitored daily against approved risk limits. Market risk unit advises functions / divisions responsible to carry out suitable corrective actions in case of identified breaches as part of risk monitoring process. The risk control involves carrying out corrective steps for deviations found as a result of risk monitoring process relating to trading book definitions, effectiveness of risk identification process, adequacy of data for risk measurement and stress testing.

Interest rate risk in the Trading Book is shown as part of trading portfolio risk report of the Bank which is prepared by individuals who are independent of the risk-taking unit. Interest rate risk is controlled using various market risk limits including the Volume Limits, Total Position Limits, and Stop Loss Limit, etc.

Foreign exchange positions are monitored daily by Market Risk Management team. The net open positions (NOP) are compared to the approved market risk limits and are promptly addressed as per the market risk policy. Foreign exchange risk is controlled by means of market risk limits that are applied on the trading portfolios, e.g. MAT

### 6.1.3. Operational Risk

Operational Risk is the risk of loss resulting from inadequate and /or failed internal processes, people and systems or from external events, including legal risk and any other risks that is deemed fit on an ongoing basis but exclude reputation & strategic risk. Operational risk exists in all products and business activities.

Zenith Bank Plc has a broad Operational Risk management framework which defines the set of activities designed to proactively identify, **assess** and manage all operational risk by aligning the people, technology and processes with best risk management practices towards enhancing stake holder's value and sustaining industry leadership.

#### 6.1.3.1. Operational Risk – Identification

To identify operational risks, Zenith Bank Plc has established the Risk and Control Self-Assessment (RCSA) Process. This process is in place since early 2013 in order to assess different types of operational risks, given the adequacy & effectiveness of the existing internal controls in place to manage those risks. The RCSA process is managed by the Operational Risk Management team and all business units are required to conduct self-assessments of risks and developing mitigation plans for those risks that are assessed as being significantly above the acceptable level. Furthermore, Key Risk Indicators are also identified as part of the RCSA exercise for regular tracking of key risks.

The Bank has instituted an internal loss event data collection exercise to identify operational risk events and evaluate the causes and impact thereof.

#### 6.1.3.2. Operational Risk – Measurement

The Bank’s RCSA process also aids in measuring operational risk events in terms of probability of occurrence and financial impact or severity of the event. This initiative is instituted to help achieve compliance by all business units on an annual basis. Accordingly, these results are currently not used as measures to allocate capital for operational risk exposures.

The Bank currently allocates capital for operational risks by following the Basic Indicator Approach (BIA), as prescribed by the Basel Committee and the Central Bank of Nigeria (CBN). According to this approach, the Bank’s gross income is treated as a proxy for the institution's overall operational risk exposure and operational risk capital requirement is computed as 15% of the average gross income from the preceding three years. Gross income is defined as net interest income plus net non-interest income, in line with CBN guidelines for regulatory capital measurement as part of Basel II implementation.

The computation of operational risk capital requirement as of 30th June 2017 is based on the previous three (3) years gross income data as defined by the guideline.

<u>**Operational Risk Capital Computation**</u>

| GROSS INCOME (Naira Mn.) | 2014 Year 1 | 2015 Year 2 | 2016 Year 3 |
|---|---|---|---|
| Gross income for the Three financial years under consideration | 264.190 | 278,012 | 322,327 |
| Aggregate gross income (year 1 to 3) | **864,529** | | |
| Beta factor | 15% | | |
| gross income X beta factor | 129,679 | | |
| Number of year with positive annual gross income | 3 | | |
| **Operational risk capital charge** | **43,226** | | |

### 6.1.3.3. Operational Risk – Monitoring

Operational risk issues are monitored on a regular basis by the respective business units through periodic reviews of operations. The Internal control and audit Group conducts regular audits of the Bank's operations and these reports also provide senior management with information about the effectiveness of internal controls in managing operational risks. The Bank has recently implemented processes to identify and track key risk indicators in order to establish a periodic mechanism for monitoring trends of different types of operational risk.

The Bank has a Loss Data Collection process in place whereby operational loss incidents are reported on a periodic basis to the Operational Risk Management team. This process is followed across all business activities and operational losses reported are classified under the Basel recommended business lines and loss event types. Near misses, which are operational risk incidents that have not resulted in any financial losses, are also captured and reported. This process is subject to review by the Internal Audit.

### 6.1.3.4. Operational Risk – Reporting

The Bank's Operational Risk Management Department collects and aggregates data about internal losses, and results of RCSAs for reporting to senior management and Board of Directors, as appropriate. The line management of the respective business units also makes periodic reports on areas of significant operational risk arising from their business processes to the senior management. The Operational Risk Management Department presents a periodic operational risk dashboard analyzing the loss events, results of the risk and control self-assessment, and progress of risk mitigation initiatives such as business continuity planning. These reports are reviewed by the Chief Risk Officer, Risk Management Committee& Board Risk Management Committee.

### 6.1.3.5. Operational Risk - Control and Mitigants

The overall objective for managing Operational Risk given the scope of our operation as well as the geographical spread is anchored on three critical considerations as follows:

- To ensure that effective and efficient processes and service standards are entrenched as part of doing business;

- To create a corporate culture that views ORM as a good business practice and not just as a compliance or regulatory issue.
- To leverage on the existing internal control framework in order to minimise the frequency and financial impact of operational risks in our products and processes;

For timely Operational Risk Identification, Assessment, treatment and Monitoring, the Bank has acquired SAP-GRC solution and is being implemented to assist in data collation/analysis, escalation and reporting of key Operational Risk events

There was no significant financial loss resulting from operational risk incidence during the period across the group. However, the terrorists activities in the North-East part of Nigeria which has impacted on business operations in those locations in the last few years is abetting and businesses are gradually retuning to normalcy in this region.

## 6.2. Pillar 2 Risks

### 6.2.1 Interest Rate Risk in Banking Book (IRRBB)

IRRBB is the risk to interest income arising from a mismatch between the maturity and re-pricing dates of assets and liabilities, both on and off balance sheet, which arises in the normal course of business activities. The interest rate measurement is capable of assessing the effect of interest rate changes on both earnings as well as the capital of the Bank. Zenith Bank Plc performs NII sensitivity analysis and Economic value of equity (EVE) analysis as measures of IRRBB. The result as at 30th June 2017 shows a figure less than the outlier threshold of 20% as recommended by Basel II. However, conservatively we have allocated the sum of N5.18 Billion to cover these risks in recognition of its contribution to the total risk structure profile of the Bank.

**Interest Rate Sensitive Gap Analysis**

| Amount in NGN Bn. | IRRBB - EVE Approach | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Particulars \ Time-Bucket** | **Upto 1 Month** | **1 - 3 Mnth** | **3 - 6 Mnth** | **6 - 12 Mnth** | **1 - 2 Yrs** | **2 - 3 Yrs** | **3 – 5 Yrs** | **> 5 Yrs** |
| Rate Sensitive Assets (RSA) | 840.79 | 264.09 | 390.68 | 366.28 | 0.00 | 281.37 | 917.01 | 578.32 |
| Rate Sensitive Liabilities (RSL) | 1,423.17 | 162.74 | 28.39 | 5.49 | - | 816.24 | 704.03 | 239.49 |
| **Rate Sensitive Gap (RSG)** | (582.38) | 101.35 | 362.29 | 360.79 | 0.00 | (534.87) | 212.98 | 338.84 |
| Weighted Net RSG (200 bps) | 0.47 | (0.32) | (2.61) | (5.12) | - | 24.07 | (14.74) | (60.79) |
| **Sum of Weighted Net RSG (200 bps)** | **(59.05)** | | | | | | | |
| Tier 1 & 2 Capital (TQC) | 570.28 | | | | | | | |
| Negative Gap as % of TQC | **(10.35)** | | | | | | | |

### 6.2.2 Liquidity Risk

Liquidity risk is the potential loss arising from the bank's inability to meet its obligations as they fall due or to fund increases in assets without incurring unacceptable cost or losses. Liquidity risk is not viewed in isolation, because financial risks are not mutually exclusive and liquidity risk is often triggered by consequences of other bank risks such as credit, market and operational risks.

### 6.2.3 Liquidity Risk Management Process

Zenith Bank Plc has a sound and robust liquidity risk management framework that ensures that sufficient liquidity, including a cushion of unencumbered and high quality liquid assets are maintained at all times, to enable the bank withstand a range of stress events, including those that might involve loss or impairment of funding sources.

The Bank's liquidity risk exposure is monitored and managed by the Treasury Group, under strict oversight and guidance by Asset and Liability Management Committee (ALCO) of the Bank.

This process includes:

a. Projecting cash flows and considering the level of liquid assets necessary in relation thereto;
b. Monitoring balance sheet liquidity ratios against internal and regulatory requirements;
c. Maintaining a diverse range of funding sources with adequate back-up facilities;
d. Managing the concentration and profile of debt maturities;
e. Monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix;
f. Maintaining up to date liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises while minimizing any adverse long-term implications for the business.
g. Regular conduct of stress testing, coupled with testing of contingency funding plans from time to time.

The Maximum Cumulative Outflow has remained positive all through the short tenor maturity buckets. Assessments are carried out on Contractual and Behavioral bases. These reveal very sound and robust liquidity position of the Bank.

Zenith Bank Plc maintains adequate liquid assets and marketable securities sufficient to manage any liquidity stress situation. The liquidity ratio remains one of the best among the peer banks and is above the regulatory limits.

### 6.2.4 Reputational Risk

Reputation risk is defined as the risk of indirect losses arising from a decline in the bank's reputation amongst one or multiple bank stakeholders. The risk can expose the bank to litigation, financial loss or damage to its reputation. The Reputation risk management philosophy of the Bank involves anticipating, acknowledging and responding to changing values and behaviors on the part of a range of stakeholders. Accordingly, the following are the roles and responsibilities within the Bank for reputation risk management:

- Board and senior management overseeing the proper set-up and effective functioning of the Reputational risk management framework
- Enterprise Risk Management Policy/Strategy (ERSP)is responsible for supporting the Board and senior management in overseeing the implementation of reputational risk within the Bank
- Corporate Communications is responsible for managing both the internal and external communications that may impact the reputation of the Bank.

The process of reputation risk management within the bank encompasses the following steps:

- Identification: Recognizing potential reputational risk as a primary and consequential risk
- Assessment: Qualitative assessment of reputational risk based on the potential events that have been identified.
- Monitoring: Frequent monitoring of the reputational risk drivers
- Mitigation and Control: Preventive measures and controls for management of reputational risk and regular tracking of mitigation actions
- Independent review: The reputational risk measures and mitigation techniques shall be subject to regular independent review (Internal Auditors and or Statutory Auditors)
- Reporting: Regular, action-oriented reports for management on reputational risk.

In identifying reputational risk factors, the bank makes use of the output of the operational risk identification process, which involves a backward-looking (historical event-based) and forward- looking (risk drivers based potential future issues identification) analysis.

**Reputation Risk Impact Score**

| Score | Rating |
|---|---|
| 1 | Insignificant |
| 2 | Minor |
| 3 | Moderate |
| 4 | High |
| 5 | Significant |

**Reputation Risk Likelihood Score**

| Score | Rating |
|---|---|
| 1 | Rare |
| 2 | Unlikely |
| 3 | Possible |
| 4 | Likely |
| 5 | Almost certain |

The reputation risk grid helps the bank to align risk event with management and escalation activities. An event or risk is assigned a risk score and a risk rating by locating it on the Reputation Risk Grid that has impact and likelihood scenarios in a matrix.

Zenith Bank Plc also strives to maintain quality customer services and procedures, and business operations that enable compliance with regulatory rules and legislation in order to minimize the risk of a drop in the reputation of the bank.

Zenith Bank Plc did not record any issue with major reputational effect in the financial year.

### 6.2.5 Strategic risk

Strategic risk is possible source of loss that might arise from the pursuit of an unsuccessful business plan. Strategic risk examines the impact of design and implementation of business models and decisions, on earnings and capital as well as the responsiveness to industry changes.

This responsibility is taken quite seriously by the Board and Executive Management of Zenith Bank Plc and deliberate steps are taken to ensure that the right models are employed and appropriately communicated to all decision makers in the bank. The execution, processes and constant reviews ensures that strategic objectives are achieved. This has essentially driven the Bank's sound banking culture and performance record to date.

### 6.2.6 Concentration risk

Concentration risk can be defined as any single (direct and/or indirect) exposure or group of exposures with the potential to produce losses large enough to threaten the bank's health or its ability to maintain its core business.
Concentration risk arises from:
1. Large (possibly connected) individual exposures - the definition of connected for these purposes needs to be sufficiently broad to capture exposures which are connected through, for example, common ownership/management/ guarantors.
2. Significant exposures to groups of counterparts whose likelihood of default is driven by common underlying factors, for example:

- economic sector,
- geographical location,
- currency
- Credit risk mitigation measures (including, for example, risks associated with large indirect credit exposures to a single collateral issuer).

In order to monitor concentration risk in the credit portfolio, risk appetite limits are set for individual or related groups of obligors, sector/industry and for products. These limits are reviewed annually and reported to the Global Credit Committee and the Board for approval.
The Bank carries out analyses of the credit portfolio, including estimates of trends, and the results of these analyses is used in setting and verifying the adequacy of procedures and limits, thresholds or similar concepts for credit risk management.
The following sets some of the expression of limits and thresholds

| Concentration Risk | Limits |
|---|---|
| Single Obligor | Largest exposure to a single or connected customer must not exceed 20% of Share Holder's Funds |
| Large Exposure | Large Exposure shall not exceed the CBN required maximum of 10% of Shareholders Fund. Internal guidance is set at 5% of Total Loan Portfolio for the purpose of monitoring. |
| Top 20 Borrowers | Exposure to top 20 borrowers will not exceed 40% of Gross Lending Portfolio |
| Aggregate Large exposures | Total Exposures of clients with exposures exceeding 10% of capital base not to exceed 800% of Bank's Share Holders Fund. |
| Foreign Currency Exposure | Foreign Currency portion of the loan book must not exceed 35% of Total Loan Portfolio (in ordinary course of business). |
| Sector Concentration | Sector growth shall not exceed 20% of Total Loan Portfolio as stipulated in the CBN prudential guidance |
| Collateral coverage | The bank will require 100% insurance bond coverage as support for weak collateral (where there is uncertainty in the recoverability of the collateral.)Where the value of the collateral drops after revaluation, a margin call will be required to ensure proper coverage of exposure. |

If issues of concern are identified in the monitoring activity, the Bank's management will consider those issues and provide appropriate responses. Management responses include but are not limited to:

- Requesting for a more detailed review of the risk environment (the intrinsic risk) in the particular sector,
- Applying additional stress tests and scenario analyses,
- Reviewing with greater intensity the economic performance of existing borrowers,
- Reviewing approval levels for new business, or
- Regularly reviewing risk mitigation techniques, their value and their legal enforceability.

Having assessed an issue, the bank's management may conclude that it is appropriate to take mitigating action. For example, one or more of the following might be considered appropriate:

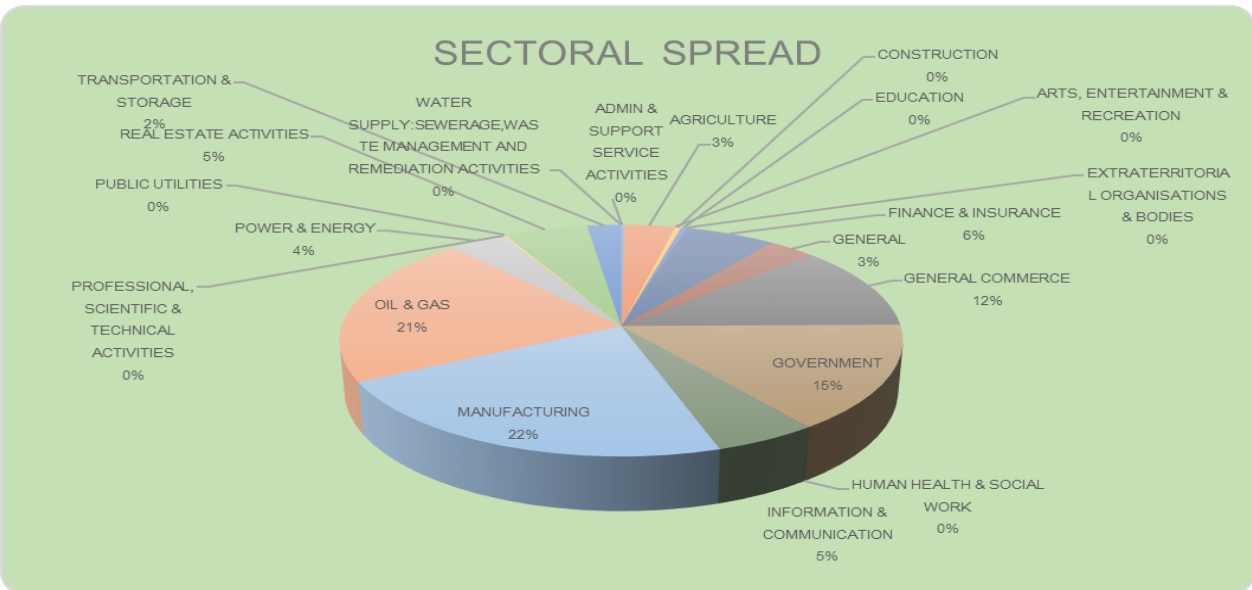
- Reducing limits or thresholds on risk concentrations,
- Adjusting new business acquisition to address undue concentrations,
- Transferring credit risk to other parties, buying protection from other parties (examples include collateral, guarantees, sub-participation or syndication) or selling down.
- Allocating additional internal capital

The bank is moderately diversified amongst the active sectors of the economy, with moderate concentrations in Oil& Gas, Manufacturing and Government sectors. The bank applies Herfindahl Hirschmann Index (HHI) which is an indicator used to determine concentration risk in the sector distribution. The HHI is derived from the summation of the sectors' squared relative shares of the credit portfolio. The formula of the index may be drawn as follows:

**HHI = $(\%S_1)^2 + (\%S_2)^2 + (\%S_3)^2 + ... + (\%S_i)^2 + ... + (\%S_n)^2$,**

Where **%S** = percentage share per sector of the loan portfolio. The HHI for sector distribution as at 30th June 2017 was **0.1436**, which clearly shows that the portfolio is well diversified.

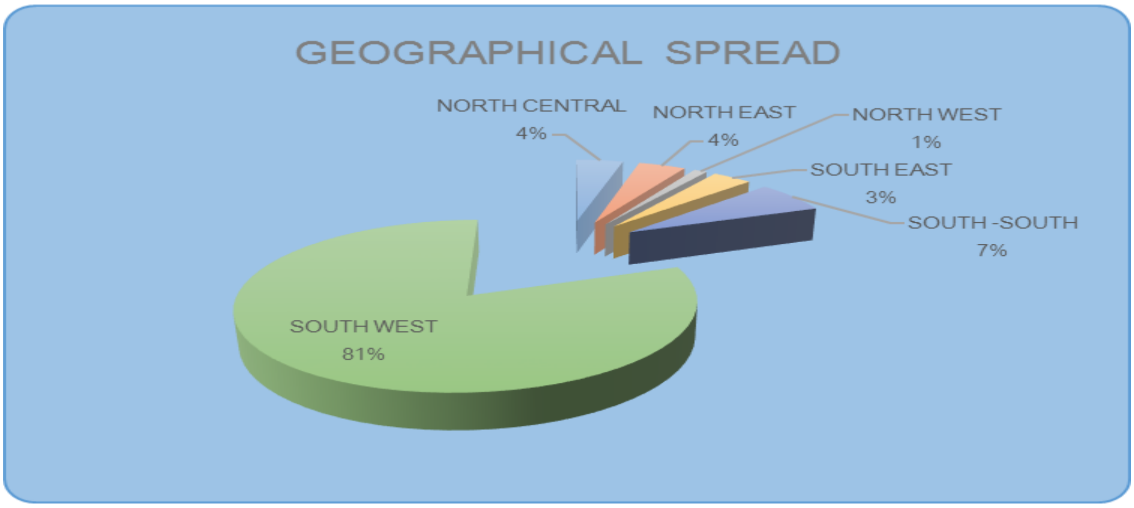
**Classification as per sector/Industry**




In the geographical segment however, the Bank is significantly concentrated with a share of 81% in the South West region most of which is situated in Lagos. This is expected as Lagos is the commercial nerve centre of the country and most of the companies registered offices are in Lagos. All critical loans are also

deliberately managed in Head Office where the control and expertise is abundant and assured. The bank has made a provision of **N11.012Billion** to cover this risk.
The Bank also actively monitors this risk while ensuring the deepening of the real economy through lending to the real sector and lending for infrastructural development. The Bank proactively waits for new opportunities to spring up in other regions due to Government initiatives by having a branch network that spans the whole of Nigeria. The Bank has presence in all the geographical regions as can be seen below:

**Distribution of Credit Exposure by Geographical Region**




### 6.3 Stress Testing

Stress Testing refers to the creation of hypothetical scenarios, with respect to the performance/ standards of the Bank's portfolio, which might cause a sharp fall in asset quality. Stress testing is an important risk management tool used by the Bank as part of internal risk management. It alerts the Bank management on the adverse unexpected outcomes related to various risks and provides an indication of the amount of capital required to absorb loses should large shocks occur. It provides an indication on the level of capital necessary to endure deteriorating economic and market conditions.

The Board and the Senior Management of the Bank are involved to ensure that stress testing is appropriately used in risk governance and capital planning. The ultimate responsibility of stress testing programme lies with the Board while the Senior Management is responsible for implementation, management and oversight functions of stress testing.

The Bank ensures that the stress testing methodologies include all relevant risk factors that can affect the corporate, treasury and retail portfolio as a whole or specific sub-segment(s) of the portfolio. The risk factors will be determined by an analysis of the composition and nature of the respective portfolio as well as external environmental factors. A comprehensive list of risk factors will be prepared by combining product-specific, environment-related and regulator-defined risk factors. The Bank will, at the minimum, consider the following direct risk factors:

- Default rates or Non-Performing Loans (or Assets) rates
- Recovery rates for defaulted loans
- Utilization rates or drawdown rates
- Time taken for recovery or closing the open positions in the market
- Expenses involved in recovery process or closing the positions

- Collateral values, other acceptable securities valuation
- Credit grades or any other credit quality indicator
- Banking Book/Trading Book volume (# of positions)
- Interest rates
- Equity prices and stock index
- Exchange rates
- Inflation rate

In addition, zenith bank identifies and select a set of risk factors based on macroeconomic indicators and external environmental factors that will impact the portfolio indirectly by influencing the above-mentioned direct risk factors. The Bank also build statistical or expert judgment based models that would link these risk factors to the above direct risk factors.

Stress tests have been conducted for the following types of risks:

**Pillar – I**

- Credit Risk
- Market Risk
- Operational Risk

**Pillar – II**

- Liquidity Risk
- Interest Rate Risk
- Credit Concentration Risk

### 6.3.1 Integrated Stress Testing

There are four phases in the Bank's stress test methodology:

(1) Choice of scenario;

(2) Translation of scenario;

(3) Stress test calculations; and

(4) Evaluation of results

The Bank evaluates the main scenarios and their relevance on an ongoing basis. The most relevant scenarios in terms of the current economic situation and related risks are analysed at least once a year. New scenarios may be added when necessary. The scenarios are an essential part of the bank's capital planning process.

### 6.3.2 Fixed Income Instruments – FGN Bond & T-Bills

**Stress Scenario on Fixed Income Exposure:**

Since Market Risk Capital Charges are computed based on '***Residual Maturity Bucke***t' under the ***Maturity Approach***, the Stress Scenario assumes **double(100bp) the change in yield** in Maturity Approach to calculate the Stressed Market Risk Capital.

**Foreign Exchange Exposure**

Under the Standardized Approach, Market Risk Capital is computed based on 'Net Open Position (NOP)' and 8% risk weight on the highest of the Net Long & Net Short position.

### 6.3.3 Stress Testing -Interest Rate Sensitivities (IRBB)

Interest rate sensitivities were carried out using Net Interest Income (NII) and Economic Value of Equity approaches. We assess the impact of parallel shift (of 200bp and 500bp) in interest rate on Net Interest Income and Economic Value of Equity (EVE).

### 6.3.4 Stress Testing - Operational Risk

The bank currently compute Operational Risk Capital Charge based on '***Basic indicator Approach***. With this approach, Operational Risk stress test is empirically difficult to achieve. However, we have made an assumption in stressing the operational risk capital charge position.

The Stress Scenario assumes certain percentages increases in the Net Gross incomes over a period of three (3) years to calculate the stressed Operational Risk Capital. The results show that the Bank is sufficiently capitalized to withstand all the scenarios in use. In an extreme scenario, the Bank would remain capitalized, but gradual management interventions would be required.

## 6.4 Key Developments in H1, 2017

The bank strived to be efficient in its use of capital through active management of the balance sheet with respect to different asset, liability and risk categories. The Bank's goal is to enhance returns to shareholders while maintaining a prudent risk and return relationship.

This section describes the main findings in relation to areas of improvement in the field of administrative organization and internal control identified by internal reviews of the business units, audits conducted by the internal audit department and/ or the external auditor and audits by the regulator. The bank dedicated particular attention to these items of improvement in 2017.

**Risk Management**

The Board is committed to improving risk management and increase risk transparency. The bank is presently reporting on Basel II guidelines as stipulated by the regulator (CBN), using the standardized approaches for Credit and Market risk and Basic Indicator approach for Operational Risk capital computations; whilst building capacity to move to the more advanced approaches. The bank recently reported on its Recovery and Resolution Plan; however, work on the Recovery and Resolution Plan Framework is being finalized.

The bank is also working on improving on some areas such as Internal Liquidity Assessment Adequacy Process (ILAAP), Recovery and Resolution Plans.

**General Internal Control Environment**

The overall attitude, awareness and actions of directors and management regarding the internal control system and its importance to the bank is appreciable. The Management style, corporate culture, values, philosophy and operating style, the organisational structure, and human resources, policies and procedures are well aligned and fitted for our size and purpose.

**Business Continuity Management**

The bank has developed a comprehensive bank-wide business continuity plan, which covers the continuity of all key aspects of bank's operations. The plan outlines the processes, procedures and people necessary to recover and continue critical business processes in the event of a service interruption or major disaster. These plans are all tested at least once every year. ISO certifications have also been pursued and obtained in this regard.

**Compliance function**

Legislation and regulation in the financial sector continued to be subjected to rapid changes and increasing complexity in 2017. Compliance, Risk and Internal Audit departments have been strengthened accordingly. There has been significant investment in systems in order to ensure the ethical business operations and controlled conduct of our business.

**Information Technology**

Since the business activities of the bank depend on IT through payment system (self and agency) or administration systems, a significant proportion of the operational risk concerns IT risk. IT risks can therefore indirectly pose a threat to the bank's financial position and result. To reduce this risk, a large number of control measures have been implemented in the following areas: organization and policy, security management, incident and problem management, testing, change and configuration management and continuity. Consequently, the Bank embarked on a re-certification in three areas: IT security, IT services management and business continuity. We have been recertified for version 3.1 of the Payment Card Industry Data Security Standards (PCIDSS), among others. We are also implementing other IT Standards including the Control Objectives for IT Related Technology (COBIT) Framework.

## 7. NOTICE

The disclosures herein are based on the bank's financial figures as at 30th June 2017 and should be considered in line with the Directors' Report and Financial Statements for the corresponding financial year, where more detailed information is available. The disclosures are subject to periodic review, update and internal audit. The information contained in this Pillar 3 disclosure has not been audited by the bank's external auditors.

For further information on any aspect of this report please contact the bank at www.zenithbank.com.