GOVERNMENT NOTICE NO. 38

FINANCIAL SERVICES ACT, 2010

(NO. 26 OF 2010)

FINANCIAL SERVICES (CAPITAL ADEQUACY REQUIREMENTS FOR DEPOSIT TAKING MICROFINANCE INSTITUTIONS) DIRECTIVE, 2014

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Form: Computation of Capital Adequacy

IN EXERCISE of the powers conferred by section 34 (2) (*c*) of the Financial Services Act, 2010, I, CHARLES S. R. CHUKA, Registrar of Financial Institutions, issue the following Directive—

PART I— PRELIMINARY

Citation

1. This Directive may be cited as the Financial Services (Capital Adequacy Requirements for Deposit Taking Microfinance Institutions) Directive, 2014.

Interpretation

2. In this Directive, unless the context otherwise requires—

"capital adequacy" refers to the maintenance of minimum on-going capital requirements as required by the Act or specified in this Directive;

"contingent claims" (also known as "off-balance sheet items") include—

(*a*) direct credit substitutes, such as guarantees, acceptances and endorsements;

(*b*) transaction-related items such as performance bonds; and

(*c*) formal commitments, such as standby facilities, credit lines, and unused facilities;

"core capital" consists of—

(*a*) issued and fully-paid shares;

(*b*) share premium;

(*c*) retained earnings;

(*d*) fifty per cent (50%) of current year to-date after tax profit or one hundred per cent (100%) of loss;

(*e*) capital grants; or

(*f*) any other distributable reserves, less investments in unconsolidated financial subsidiaries;

"institution" means a deposit taking microfinance institution;

"Registrar" means the Registrar of Financial Institutions appointed under the Act;

"supplementary capital" consists of—

(*a*) revaluation reserves on the assets of an institution that arise periodically from the independent valuation of those assets;

(*b*) fifty per cent (50%) of current year to-date; or

(*c*) any other form of capital as may be determined and approved by the Registrar from time to time;

"total assets" means the amount reported under monthly statements of assets and liabilities submitted by an institution to the Registrar pursuant to the Financial Services (Financial Reporting Requirements for Microfinance Institutions) Directive, 2014; and G.N. of 2014

"total capital" means the sum of core capital and supplementary capital.

PART II—OBJECTIVES

3. The objectives of this Directive are to— Objectives

(*a*) ensure that an institution has adequate cushion of capital to absorb losses; and

(*b*) protect the interests of depositors, creditors and the public in general by ensuring that deposit taking microfinance institutions are well capitalised.

PART II—MINIMUM CAPITAL REQUIREMENTS

4. An applicant for a licence to operate a deposit-taking microfinance institution shall have at least a minimum paid up capital of two hundred and fifty million Kwacha (K250.0 million). Minimum paid up capital

Minimum capital adequacy ratios

5. Unless higher minimum ratios have been set by the Registrar for an individual deposit taking microfinance institution, the institution shall maintain the following capital ratios at all times—

(*a*) a core capital to total risk-adjusted assets plus risk-adjusted off-balance-sheet items of not less than ten per cent (10%); and

(*b*) a total capital to total risk-adjusted assets plus risk-adjusted off-balance sheet items of not less than fifteen per cent (15%) .

Criteria for higher minimum capital ratios

6. The Registrar may require an institution to maintain higher minimum capital ratios if the Registrar determines that such higher ratios are necessary due to—

(*a*) high levels of losses (expected or realized);

(*b*) significant exposure to credit risk, concentration risk, market risk, interest rate risk, liquidity risk, operational risk, reputational risk, legal risk, or any other risks;

(*c*) poor quality of loan portfolio and other assets;

(*d*) rapid growth without proper risk management systems or adequate capitalization in place or both;

(*e*) a significant likelihood that the deposit taking microfinance institution may be adversely affected by the activities or condition of its holding company, associates or subsidiaries; or

(*f*) for any other reason necessitating higher capital ratio as assessed by the Registrar.

Risk weighting of assets

7.—(1) A risk-based approach to capital adequacy measurement shall be applied to both on-balance sheet and off-balance sheet items.

(2) An institution shall weight on-balance sheet assets, for purposes of computing capital adequacy ratios stipulated in paragraph 5, as follows—

(*a*) zero per cent (0%) weight for the following—

(i) cash in local currency;

(ii) balances with the Reserve Bank of Malawi;

(iii) treasury bills, bonds and promissory notes issued by the Reserve Bank of Malawi or the Government of Malawi;

(iv) loans fully secured by cash;

(v) loans guaranteed by the Government of Malawi, as long as such guarantees are approved in accordance with the Public Finance Management Act; and

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(vi) advances guaranteed by the central governments of any member country of the Organisation for Economic Co-operation and Development (OECD);

(*b*) twenty per cent (20%) weight for the following—

(i) cash in foreign currency;

(ii) deposits and balances in licensed local banks and other licensed financial institutions;

(iii) deposits and balances in licensed foreign banks and other licensed financial institutions;

(iv) securities issued by the central government of any foreign country; and

(v) claims guaranteed by any multilateral development bank; and

(*c*) one hundred per cent (100%) weight for the following—

(i) deposits and balances in banks and financial institutions that are under statutory management;

(ii) fixed assets less depreciation;

(iii) all loans and advances less net of provisions;

(iv) other investments; and

(v) all other assets and investments that have not been covered under subparagraph (*a*) and (*b*).

(3) An institution shall weight off-balance sheet assets, for the purpose of computing the capital adequacy ratios stipulated in paragraph 5, as follows—

(*a*) zero per cent (0%) weight for the following—

(i) assets that are fully secured by cash or cash equivalents;

(ii) assets that are guaranteed by the Government of Malawi; as long as such guarantees are approved in accordance with the Public Finance Management Act; and Cap. 37:02

(iii) assets that are guaranteed by the central governments of any member country of the OECD; and

(*e*) one hundred per cent (100%) weight for all other assets not covered under subparagraph (*a*).

PART IV—MISCELLANEOUS

Reporting requirements

8.—(1) An institution shall prepare and submit a monthly capital adequacy report to the Registrar demonstrating its compliance with the capital adequacy requirements set out in this Directive.

(2) The capital adequacy report shall be in format prescribed in the Schedule to this Directive.

Powers of the Registrar

9.—(1) The Registrar may call for adjustments to the capital of an institution if it is determined based upon returns or on-site inspection findings that the institution is not complying with the provisions of this Directive.

(2) The Registrar may use the powers under the Act to verify the accuracy of all returns and order an institution to amend any returns as the Registrar deems fit.

PART V—ENFORCEMENT

Enforcement

10—(1) Where capital ratios of an institution fall below the ratios stipulated in paragraph 5, the institution shall immediately—

(*a*) inform the Registrar;

(*b*) cease to—

(i) grant credit and make further investment;

(ii) pay dividends to shareholders; or

(iii) introduce new products; and

(*c*) submit, for approval, a board-approved recapitalization plan with specific time frames to the Registrar.

(2) If the plan submitted pursuant to subparagraph (1) is not approved by the Registrar, or the deposit taking microfinance institution fails to implement the plan within the stipulated period, the Registrar shall take any action provided for under the Act or the Microfinance Act.

Act No. 21 of 2010

SCHEDULE

CAPITAL ADEQUACY REPORT

(1) LEVERAGE CAPITAL RATIO:	
Share Capital (Paid Up)	
Share Premium	
General Reserve	
Retained earnings-Prior years	
Net income (loss)-Current period (ties to line 13. Sch. 02)	
Less: Investment in unconsolidated subsidiaries	
Total equity	
Total Assets- Book amount (line 23, schedule 01-Assets)	
Add: Provisions for loan losses (general only)	
Less: Revaluation reserves (fixed assets)	
Total assets (adjusted)	
Leverage ratio	
(2) RISK-BASED CAPITAL RATIOS:	
Share Capital (Paid Up)	
Share premium	
General Reserve	
Retained earnings-Prior years	
Net income (loss)-Current period (60%)	
Less: Investment in unconsolidated subsidiaries	
Core Capital	
Add: Revaluation reserves (fixed assets)	
Provisions for loan losses (general only)	
Total Capital	

RISK BASED ASSETS	*Amount (K'000)*	*Risk Weight*	*Risk Weighted Assets*
Currency & coin (domestic and foreign)			
Balances with Reserve Bank of Malawi			
Balances with other banks (excl. resid. maturity > 1 yr)			
Cheques in the course of collection			
Malawi Government securities			
Malawi Government treasury bills			
Reserve Bank of Malawi day bills			
Other securities			
Loans to or guaranteed by Malawi Government			
Loans secured by cash deposits			
Loans guaranteed by OECD incorporated banks			
All other loans			
Fixed assets			
All other assets			
Contingent Claims			
Claims to or guaranteed by Government			
Claims with cash collateral			
Direct credit substitutes (guarantees, acceptances, etc.)			
Transaction related contingency (perf. bonds, standbys)			
Documentary credits etc (trade related & self liquidating)			
Other commitments with maturity of over 1 year			
Similar commitments of up to 1 year or which can be conditionally cancelled			
TOTAL RISK-BASED ASSETS			
Risk-Based Capital Ratio			
TOTAL Risk-Based Ratio			

Made this 21st day of July, 2014.

C. S. R. CHUKA
Registrar of Financial Institutions

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