GOVERNMENT NOTICE NO.54

FINANCIAL SERVICES ACT

(CAP. 44:05)

FINANCIAL SERVICES (CAPITAL ADEQUACY FOR DEVELOPMENT FINANCE INSTITUTIONS) DIRECTIVE, 2018

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IN EXERCISE of the powers conferred by section 34 (2) (*c*) of the Financial Services Act, I, DR. DALITSO KABAMBE, Registrar of Financial Institutions, make the following Directive—

PART I—PRELIMINARY

Citation

1. This Directive may be cited as Financial Services (Capital Adequacy for Development Finance Institutions) Directive, 2018.

Interpretation

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

"Board" means the Board of directors of an institution;

"capital adequacy" means the maintaining of sufficient capital in line with the regulatory requirements prescribed in this Directive;

"capital requirement basis" means the total risk converted assets and risk converted contingent claims upon which core capital and supplementary capital is measured, to determine the capital requirement calculation for capital adequacy of a development finance institution.;

"core capital (tier 1)" means the sum of the following—

(*a*) paid-up share capital;

(*b*) share premium;

(*c*) retained profits (prior years);

(*d*) 60% of after tax profit (current year-to-date) and in case of a loss, 100%; and

(*d*) less, investment in unconsolidated financial institutions;

"general reserve" means a mandatory non-distributable reserve created by transfer of a specified proportion of annual profits of the development finance institution;

"institution" means the development finance institution;

"revaluation reserve" means the increase in book value of a fixed asset or other tangible asset based on a professional appraisal as to the market value of the asset;

"specific provisions" means loan loss reserves held against presently identified losses or potential losses and are thus not available to meet losses that subsequently materialize;

"subordinated debt" means a debt with original fixed term maturity of not less than 5 years and satisfying the Basel Committee's conditions for supplementary capital (tier 2); and

"supplementary capital" means the sum of the following—

(*a*) revaluation reserves;

(*b*) subordinated debt;

(*c*) general provisions; and

(*d*) any other capital instrument not qualifying as core capital (tier 1).

Objectives

PART II—OBJECTIVES

3. The objectives of this Directive are to—

(*a*) ensure that institutions have an adequate cushion of capital to absorb losses;

(*b*) protect the interests of creditors and the general public;

(*c*) ensure that institutions maintain internationally recognized prudent capital requirements; and

(*d*) enhance credibility and self-discipline in the management of institutions.

PART III—CAPITAL REQUIREMENTS

Board responsibilities

4. The Board shall—

(*a*) ensure that an institution is well capitalized and meets the regulatory requirements prescribed in this Directive at all times;

(*b*) adopt a capital plan that outlines, among other things, the institution's dividend policy, bonus and incentives policy, sources of capital augmentation, capital allocation and expansion strategy; and

(*c*) develop a comprehensive internal capital adequacy assessment process commensurate with the risk profile of the institution.

Capital adequacy requirements

5.—(1) An institution shall maintain a paid-up capital of Malawi Kwacha equivalent to USD50,000,000 or a higher amount as the Registrar may determine.

(2) An institution shall maintain a minimum core capital ratio of 15% of the capital requirement basis.

(3) Deductions in unconsolidated financial institutions shall be 50% from core capital (tier 1) and 50% from supplementary capital (tier 2).

(4) Where an institution is required to make deductions from supplementary capital (tier 2) but it does not have sufficient capital to make that deduction, the institution shall deduct the shortfall from core capital (tier 1).

(5) Long term debt to equity ratio for an institution shall not exceed 10 to 1.

(6) For an institution to have met the capital requirements of this paragraph, it must be in compliance with all the requirements of the Financial Services (Credit Risk Management for Development Finance Institutions) Directive, 2018.

(7) The Registrar may raise capital requirements for a specific institution where the supervisory review process reveals existing risks in the institution warranting the increase.

Mandatory reserve

6. An Institution shall have a policy on general reserve which requires transfer of at most 25 % of the institution's annual profits.

Equity ownership

7.—(1) Equity ownership in an entity that is not a financial subsidiary of the institution shall not exceed 35% of that entity's equity.

(2) The sum of all equity investments shall not exceed 50% of the institution's total capital.

Record keeping

8. An institution shall maintain adequate records, including daily balance sheets and periodic statements of income and expense for proper assessment of capital adequacy.

Submission of Capital Adequacy Schedule

9.—(1) An institution shall on a monthly basis submit to the Registrar a Capital Adequacy Schedule in the format prescribed by the Registrar.

(2) The Registrar shall require adjustments to capital calculations with

respect to increased provisions or interest suspension and reversals if an institution is found not to be in compliance with this Directive or the Financial Services (Credit Risk Management for Development Finance Institutions) Directive, 2018.

PART IV--- ENFORCEMENT

10. Where the capital ratios of an institution fall below the ones prescribed in this Directive, shareholders shall inject additional capital in the amount prescribed by the Registrar within the prescribed timeframe.

11. (1) Not withstanding paragraph 10 above, the Registrar shall impose the following monetary penalties for violation of this Directive-

(*a*) for development finance institutions, up to K50,000,000; and

(*b*) for natural persons who are members of the Board of directors, or senior management up to K10,000,000.

Made this ..... day of June, 2018.

D. KABAMBE, PhD

(FILE NO. FIN/PFSPD/03/04) *Registrar of Financial Institutions*