GOVERNMENT NOTICE NO. 19

FINANCIAL SERVICES ACT

(CAP 44: 05)

FINANCIAL SERVICES (CAPITAL ADEQUACY FOR BANKS) 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 Banks) Directive, 2018.

Interpretation

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

"bank" has the meaning ascribed to that term in the Banking Act; Cap. 44:01

"banking business" has the meaning ascribed to that term in the Banking Act; Cap. 44:01

"bank holding company" means a body corporate that owns or controls at least two financial institutions one of which is a bank, whether

the financial institution is a subsidiary or significant minority investment or interest of the body corporate;

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

"capital deficiency" means failure to meet the capital requirements prescribed in this Directive;

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

"contingent claims" or "off balance sheet items" means—

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

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

(*c*) self-liquidating letters of credit, such as documentary credits; and

(*d*) formal commitments, such as stand-by facilities and credit lines;

"core or Tier 1 capital" means the sum of the following—

(*a*) share capital, paid-up;

(*b*) share premium;

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

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

(*e*) other eligible core or Tier 1 capital elements which have been prescribed or approved by the Registrar;

less: investment in unconsolidated financial institutions as set out in paragraph 5 (6) of this Directive;

"general provisions" means loan loss reserves held against future, unidentified losses and are thus freely available to meet losses which subsequently materialise;

"impaired capital" means a capital deficiency to the extent of potential insolvency or endangering the funds of depositors and other creditors;

"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;

"significant minority investments or interest" means any ownership interest of less than fifty percent (50) of the voting rights or capital held by the holding company in the relevant entity;

"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 or tier 2 capital;

"supplementary capital (tier 2)" means the sum of the following—

(*a*) revaluation reserves;

(*b*) subordinated debt; and

(*c*) general provisions.

PART II—OBJECTIVES

Objectives

3. The objectives of this Directive are to—

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

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

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

(*d*) promote self-discipline in the management of banks.

PART III—CAPITAL REQUIREMENTS

Board responsibilities

4. The board of directors shall—

(*a*) ensure that a bank 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 bank'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 bank.

Capital adequacy requirements

5.—(1) A bank shall maintain a minimum core capital of Malawi Kwacha equivalent of five million United States Dollars (USD5,000,000.00) or such higher amount as the Registrar may determine.

(2) A leasing company or a discount house shall maintain a minimum core capital of Malawi Kwacha equivalent of one million five hundred thousand United States Dollars (USD1,500,000.00) or such higher amount as the Registrar may determine.

(3) For purposes of capital computation in subparagraphs (1) and (2), the applicable exchange rate shall be the Reserve Bank of Malawi ruling middle exchange rate on the commencement date of the Directive or an exchange rate as the Registrar may prescribe in writing to a bank.

(4) The minimum core capital in subparagraphs (1) and (2) shall after conversion as prescribed in subparagraph (3), remain the same until reviewed by the Registrar.

(5) A bank shall maintain a minimum core capital ratio of ten percent (10%) of the capital requirement basis.

(6) A bank shall maintain a minimum total capital of fifteen percent (15 %) of the capital requirement basis.

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

(8) Where a bank is required to make deductions from tier 2 capital but it does not have sufficient tier 2 capital to make that deduction, the bank shall deduct the shortfall from tier 1 capital.

(9) The amount of supplementary capital (tier 2) shall not exceed hundred percent (100%) of the bank's core (tier 1) capital.

(10) The aggregate amount of subordinated debt that may be eligible and recognized by the Registrar as supplementary or tier 2 capital shall be limited to fifty (50) percent of core capital, provided that such subordinated debt shall—

(*a*) be discounted by cumulative factor of twenty (20) percent per year during the last five years to maturity;

(*b*) be unsecured, uninsured and not be a deposit;

(*c*) have an original maturity of not less than five years;

(*d*) be subordinated to claims of all depositors and general creditors of the bank;

(*e*) not be redeemable at the option of the holder prior to maturity, except with prior approval of the Registrar; and

(*f*) not require payment of principal or interest unless the bank is solvent and shall remain solvent immediately thereafter.

(11) For a bank to have met the capital requirements of this paragraph, it must be in compliance with all the requirements of the Financial Services (Financial Asset Classification of Banks) Directive.

(12) The Registrar shall require a bank to hold capital against credit, market and operational risks, the basis of which shall be prescribed in respective guidelines.

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

(14) The Registrar shall prescribe higher capital requirements for domestic systemically important banks.

(15) The criteria for determining systemically important banks shall be prescribed by the Registrar through a Directive.

6. A bank or a bank holding company shall comply with the capital requirements set out in paragraph 5 on an individual and consolidated basis. Compliance on a solo and consolidated basis

7.—(1) A bank shall not invest in or hold publicly traded equity shares of another bank. Restrictions

(2) The amount of shares held by the public in a bank shall not exceed ten (10) percent of the bank's paid up capital at all times.

(3) A bank shall not own or hold shares in any non-financial institution the aggregate value of which exceeds ten percent (10%) of the bank's core capital.

8. A bank shall maintain adequate records, including daily balance sheets and periodic statements of income and expense to enable proper computation of capital adequacy. Record keeping

9.—(1) A bank shall on a monthly basis submit to the Registrar a Capital Adequacy Schedule in the format prescribed in the Financial Services (Submission of Information by Banks) Directive . Submission of Capital Adequacy Schedule

(2) The Registrar shall require adjustments to capital calculations with respect to increased provisions or interest accrual if a bank is found not to be in compliance with this Directive or other capital adequacy guidelines.

PART I—ENFORCEMENT

10.—(1) Where the capital ratios of a bank fall below the ones prescribed in this Directive, shareholders shall inject additional capital in the amount prescribed by the Registrar within the prescribed timeframe. Administrative penalties

(2) A bank that fails to comply with the capital requirements prescribed in this Directive shall be subjected to directions, administrative penalties and enforcement action as provided for under the Prompt Corrective Action Directive, the Banking Act and the Act. Cap. 44:01

11.—(1) Notwithstanding paragraph 10 above, the Registrar shall impose the following monetary penalties for violation of this Directive— Monetary penalties

(*a*) for banks, up to fifty million Kwacha (K50, 000,000); and

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

(2) With respect to banks, the Registrar shall—

(*a*) debit the penalty in subparagraph (1) (*a*) from the main account of the bank maintained at the Reserve Bank; and

(*b*) notify the bank in writing prior to debiting the account.

(3) With respect to natural persons or where the bank does not maintain an account with the Reserve Bank of Malawi, the natural person or the bank shall pay the penalty through a bank certified cheque or electronic transfer payable to the Reserve Bank of Malawi within ten (10) working days after being notified by the Registrar.

Revocation of G. N. 38/2014

12. The Directive on Financial Services (Capital Adequacy for Banks), 2014 is hereby revoked.

Made this 3rd day of April, 2018.

D. KABAMBE, PhD
Registrar of Financial Institutions

(FILE NO. FIN/PFSPD/03/04)