RESERVE BANK OF MALAWI

GUIDELINES FOR REGULATION AND SUPERVISION

OF

NON-INTEREST (ISLAMIC) BANKING PRODUCTS IN MALAWI

AUGUST 2017

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GUIDELINES ON NON-INTEREST BANKING PRODUCTS FOR BANKS

1.0 REGULATORY BASIS AND RATIONALE

Section 25 (f) of the Banking Act, 2010 requires every bank to seek prior written approval from the Registrar before it introduces a new product to the public. The primary rationale for requiring prior Registrar's approval is to ensure that bank customers and the general public are not subjected or exposed to undue risks that threaten the safety of their funds or which could result in them losing out if they accessed the product or service.

The Registrar of Financial Institutions recognizes that non-interest banking products would widen the choice of banking products to the general public including some segment of the population who due to their religious beliefs are unable to access conventional banking products and services because of the interest element embedded in most of the products on offer. On the part of banks, non-interest banking would provide additional revenue streams and hence contribute to shareholder's return. However, considering the unique nature of non-interest banking products, it is imperative that adequate safe guards are put in place to ensure that delivery is consistent with sound banking practices. This is aimed at discharging the regulatory and supervision obligation: to ensure safety and soundness of both banks themselves as well as the system; protect depositors, creditors and other investors; avert criminal activities and overall compliance with the applicable laws and regulations which merit credibility of the system and the country.

These Guidelines are thus meant to provide the minimum requirements that banks must follow when offering non-interest banking products and services. It is expected that issuance of the Guidelines will ensure consistency in terms of risk management practices across banks.

The Guidelines are issued pursuant to *Section 96 of the Financial Services Act 2010* and shall apply in addition to all other prudential regulatory requirements for conventional banks currently in force or as may be amended from time to time.

2.0 PART I-PRELIMINARY PROVISIONS

2.1 Citation

These Guidelines may be cited as the Banking (Guidelines for Regulation and Supervision of Non - Interest Banking Products) 2017.

2.2 Application

These Guidelines shall apply to all licensed banks offering noninterest banking products in Malawi.

2.3 Interpretation

"Investment account holders" means persons who have effected placements of funds with a bank engaged in non-interest banking on the basis of either sharing of the profits to be realized by the bank, or profit-and-loss sharing where risks generated from funding the project are borne by both parties;

"Non-interest banking business" means such banking business the objectives of which are in accordance to the principles of Sshariah law;

"Non-interest banking window" means a division, department or unit of a conventional bank that conducts noninterest banking business;

"Registrar" means the Registrar of Financial Institutions appointed under *section 8 of the Financial Services Act 2010.*

"Shariah" refers to the corpus of Islamic law which embodies all aspects of the Islamic faith, including beliefs and practices.

2.4 Objectives

The objectives of these Guidelines are to:

(i) Provide regulatory guidance to banks offering non-interest banking products and services;

(ii) Provide for the governance and risk management framework for non-interest banking.

2.5 Regulatory and Supervisory Approach

2.5.1 A bank offering non-interest banking products shall be subjected to the same prudential requirements applicable to conventional banks.

Banks approved to offer non-interest banking products will be waived from the requirements of *Section 22 (a) and (b) of the Banking Act 2010* with respect to assets acquired or owned to discharge non-interest banking offering.

2.5.2 The rationale for such an approach in 2.5.1 is premised on the fact that banks with non-interest banking windows generally face similar risks to those of conventional banks. However, the guidelines recognize the existence of specific risks identifiable with non-interest banking as prescribed under paragraph 3.1 of the Guidelines.

2.5.3 A bank shall only offer non-interest banking products through a non-interest banking window.

2.6 Approval Requirements for Non - Interest Banking Windows

2.6.1 An existing licensed conventional bank which intends to conduct non-interest banking business shall seek the Registrar's approval prior to offering non-interest banking products.

2.6.2 The Registrar shall take into account the following when assessing an application from a bank wishing to offer non-interest banking through a window:

a. Capital adequacy;
b. Profitability;
c. Track record of the bank's compliance with prudential requirements;
d. Governance structure;
e. Evidence of availability of personnel with requisite knowledge and expertise in non-interest banking products;
f. Adequacy of risk management system necessary to manage non-interest banking products;
g. Any other factor(s) that the Registrar may determine from time to time.

2.6.3 The applicant shall submit the following in support of the application:

a. A synopsis of a business case for non-interest banking;
b. Mode of offering non-interest banking business;
c. List of product(s) to be offered through the window;
d. Governance structure;
e. Policies and procedures/operational manual for the non-interest banking window;
f. Board resolution approving the introduction of the non-interest banking window; and
g. Any other documentation that may be prescribed by the Registrar from time to time.

2.6.4 The Head of the non-interest banking window shall be considered as a senior management official and be subjected to approval by the Registrar in line with the *Financial Services (Fit and Proper Requirements for Shareholders, Directors and Senior Management Officials of Banks) 2014*.

3.0 PART II-GOVERNANCE AND INTERNAL AUDIT

3.1 Governance Requirements

3.1.1 The Board shall be responsible for oversight and management of all non-interest banking products being offered by the bank

3.1.2 A bank engaged in non-interest banking shall establish a governance policy framework for the management of its non-interest banking products in line with Shariah principles.

3.1.3 In addition to the requirements of the *Corporate Governance Guidelines for Banks, 2010 or any other relevant directive issued by the Registrar*; a bank engaged in non-interest banking business shall have a Shariah board/advisors comprising of at least three members.

3.1.4 The appointment of the members of the Shariah Board or advisors shall require prior written approval of the Registrar.

3.1.5 Members of the Shariah board or advisors shall not be salaried or otherwise employees of the bank.

3.1.6 In addition to meeting the requirements of the *Financial Services* (*Fit and Proper Requirements for Shareholders, Directors and Senior management officials of Banks) Directive 2014)* the Shariah Board or advisors shall at least comprise of:

a. A Shariah scholar who is either based in Malawi or abroad;
b. A person of highest integrity, honesty, professionalism and ethical behavior;
c. A person with proven track record, experience, skills and knowledge in the delivery of Shariah rulings and issuing scholary opinions on matter of Islamic law and finance.

3.1.7 Notwithstanding the establishment of the Shariah board or advisors in 3.1.3, the overall oversight responsibility over the affairs of the bank including non-interest banking products remains vested in the Board of the bank.

3.1.8 The Shariah board or advisors shall perform the following roles and responsibilities among others:

a. Reviewing and approving non-interest banking products;
b. Certifying that products/services are Shariah compliant;
c. Overseeing the development of innovative Shariah compliant products;
d. Overseeing and/or conducting non-interest banking training to staff;
e. Issuing a report to be incorporated in the annual report confirming that the board or advisors have conducted a Shariah review.

3.1.9 A bank shall report to the Registrar any removal or resignation of a member of the Shariah board within seven (7) days of the removal or resignation citing reasons for such removal or resignation.

3.2 Audit and Compliance Function

3.2.1 A bank engaged in non-interest banking shall have an internal audit structure which incorporates an independent assessment of control procedures for addressing the specific profile and risks of non-interest banking products.

4.0 PART III-PRUDENTIAL REQUIREMENTS

4.1 Liquidity Requirements

4.1.1 A bank engaged in non-interest banking shall comply with the Reserve Bank of Malawi *Liquidity Reserve Requirements Directive 2010*.

4.1.2 All deposits made by investment account holders shall be payable on demand or after expiry of a stated period regardless of whether the bank made losses or profits from investing such deposits.

4.2 Risk Management

4.2.1 A bank engaged in non-interest banking shall develop appropriate policies, systems and procedures to identify, measure, monitor and control risk exposures in line with the *Risk Management Guidelines for Banks, 2007.*

4.2.2 A bank engaged in non-interest banking business should also take into account Shariah compliance matters and manage this compliance risk as part of their overall risk management process.

4.3 Permissible Non-Interest Banking Products

4.3.1 A bank may offer the following non-interest banking products but not limited to:

(a) Murabaha
(b) Mudaraba
(c) Musaharaka
(d) Diminishing Musharaka
(e) Ijarah

(f) Istisna

4.3.2 In terms of regulatory treatment i.e. reporting, risk weighting and capital charge allocation, the products in 4.3.1 shall be mapped to conventional products as follows:

Non-Interest Banking Product or Service	**Conventional Banking Equivalent**	**Mapping for Regulatory Treatment**
Mudaraba/Qard (whether restricted or not i.e profit sharing or not)	Deposit	Treat as deposit for the determination of liquidity risk and lending ratio amount. Maturity should be mapped into appropriate category of deposits.
Musharaka and Murabaha on residential property	Residential Mortgage Loans	Treat as residential mortgages for regulatory risk weighting (35.0 percent)
Musharaka/Murabaha on commercial property	Commercial Mortgages/Real Estate Loans	Treat as commercial real estate (100 percent)
Ijarah or Murahaba on motor vehicles or equipment	Leases	Report as lease financing in call report (100 percent)
Murabaha on trade	Trade, other bills or acceptances etc	Treat as normal lending 100 percent risk weight
Istisna	Construction contract (whether short term or long term financing)	As any long term finance (100 percent)
Salam	Trade finance (local or foreign)	Normal loan secured by the asset (100 percent)
Murabaha on equity finance	Equity/Joint Venture etc	High risk category (150 percent)

5.0 PART IV- ACCOUNTING, REPORTING AND DISCLOSURE

5.1 Accounting Standards

5.1.1 A bank engaged in non-interest banking shall comply with the International Financial Reporting Standards (IFRS) or International Accounting Standards (IAS) in all respects of its business.

5.1.2 Paragraph 5.1.1 does not exclude a bank from preparing its accounts in line with the relevant provisions of the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) for its own use;

provided however that such accounts shall not be used for regulatory reporting and public disclosure.

5.1.3 The audited financial statements for a bank engaged in non-interest banking shall contain a statement on the nature, amount and status of non-interest banking products that are carried on its statement of financial position.

5.2 Reporting Requirements

5.2.1 A bank engaged in non-interest banking shall report its banking activities to the Registrar in the form and frequency as prescribed in the *Financial Services (Submission of information by banks) Directive, 2012.*

5.3 Transparency and Market Discipline

5.3.1 A bank engaged in non-interest banking shall establish an effective disclosure regime on all its non-interest banking products.

5.3.2 Non-interest banking products shall be offered to all customers.

6.0 PART V-AML/CFT COMPLIANCE

6.1 Compliance with Anti-money Laundering Requirements

6.1.1 A bank engaged in non-interest banking shall comply with Financial Crimes Act 2017 and all relevant, Regulations and Directives.