



RESERVE BANK OF MALAWI

# **DIRECTIVE**

NO. DO2-93/MCR

## **MINIMUM CAPITAL RATIOS FOR BANKS**

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# **DIRECTIVE NO. DO2-93/MCR**

## **MINIMUM CAPITAL RATIOS FOR BANKS**

### **PART I: PRELIMINARY**

**Sec. 1:**     **Short Title** - Capital Adequacy Requirements

**Sec. 2:**     **Authorization** - Section 15 (2) of the Banking Act of 1989

**Sec. 3:**     **Application** - Banks in Malawi

**Sec. 4:**     **Interpretation** - In this directive, unless the context otherwise requires-

- 1)     "bank" is as defined in Section 2 of the Banking Act of 1989;
- 2)     "banking business" is as defined in Section 2 of the Banking Act of 1989;
- 3)     "capital adequacy" means the maintaining of sufficient capital as called for in Section 15 of the Banking Act of 1989 and is specified in the requirements of this directive;
- 4)     "capital deficiency" is defined as a failure to meet all the capital requirements of this directive by a bank;
- 5)     "capital requirement basis" means the total upon which core and supplementary capital is measured to determine the capital requirement calculation for capital adequacy, consisting of risk converted assets and risk converted contingent claims;
- 6)     "contingent claims" also known as "off balance sheet items" are meant to include: direct credit substitutes, such as guarantees, acceptances, and endorsements; transaction related items, such as performance bonds; self-liquidating letters of credit, such as documentary credits; and formal commitments, such as standby facilities and credit lines;
- 7)     "core capital (tier 1)" consists of paid-up shares and disclosed reserves, with the latter being defined as statutory reserves, retained profits from prior years, share premiums,

and 60% of after-tax profits in the current year-to-date, less any unconsolidated investment in financial companies;

- 8) "general provisions" means loan loss reserves held against future, presently unidentified losses and are thus freely available to meet losses which subsequently materialize;
- 9) "impaired capital" means a capital deficiency to the extent of potential insolvency or endangering the funds of depositors and/or other creditors;
- 10) "prudential guidelines" means the directive issued by the Reserve Bank with regard to: non-performing assets, income recognition of such non-performing assets, and classification & provisioning of such non-performing assets;
- 11) "Reserve Bank" means the Reserve Bank of Malawi established under the Reserve Bank of Malawi Act of 1989;
- 12) "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 such asset;
- 13) "specific provisions" means loan loss reserves held against presently identified losses or potential losses and thus not available to meet losses which subsequently materialize;
- 14) "supplementary capital (tier 2)" consists of revaluation reserves and general provisions, when such general provisions have received prior approval of the Reserve Bank;
- 15) "total assets" means the amount reported under that heading in form B1 submitted by banks to the Reserve Bank;
- 16) "total capital" means the sum of core capital and supplementary capital.

## **PART II: STATEMENT OF POLICY**

### **Sec. 1: Objectives**

- 1) To help ensure banks have an adequate cushion of capital to absorb losses;

- 2) To protect the interests of depositors, creditors, and the public interest in general;
- 3) To ensure banks maintain capital standards recognized internationally as being prudent;
- 4) To promote self-discipline in the management of banks.

**Sec. 2: Rationale**

- 1) Banks need to maintain a specified level of capital to promote public confidence and help ensure the safety of depositors' funds.
- 2) As the supervisory authority, it is the responsibility of the Reserve Bank to prescribe minimum capital ratios for banks; this responsibility is mandated in Section 15 (2) of the Banking Act of 1989.
- 3) As banks expand their business internationally, it is of importance to demonstrate that banks in Malawi maintain a level of capital commensurate with international standards.
- 4) Sufficient capital adequacy enables banks to have the needed cushion to absorb adverse events either within their control or due to external factors to prevent insolvency or an unsound position.

**Sec. 3: Applicability of capital adequacy requirement**

- 1) For all banks licensed under the Banking Act of 1989 at the time of this directive, the capital adequacy requirements come into effect as of 30 June, 1993, unless an extension of such applicable date is authorized by the Reserve Bank upon request of a bank.
- 2) For all applicants for a licence to conduct business as a bank under the Banking Act of 1989, the capital adequacy requirements become applicable upon being licensed.

**PART III: CAPITAL REQUIREMENTS FOR BANKS**

**Sec. 1: Capital Requirements for Banks**

- 1) Banks shall maintain at all times a minimum core capital, as defined in this directive, equal to the requirements of Section 8 of the Banking Act. Such minimum core capital for

licensed banks may be raised from time to time by the Reserve Bank as circumstances warrant.

- 2) Each bank shall maintain core capital of 4% or more of the capital requirement basis for banks as reported to the Reserve Bank on a quarterly basis.
- 3) Each bank shall maintain total capital of 8% or more of the capital requirement basis for banks as reported to the Reserve Bank on a quarterly basis.
- 4) The Reserve Bank shall set a desired level of capital for banks at core capital of 6% or more of the capital requirement basis and total capital of 10% or more of the capital requirement, and shall monitor for soundness all banks which meet the requirements of this section but fail to meet the desired levels.
- 5) For banks to have met the capital requirements of this section, they must be in full compliance with the Reserve Bank's directive on prudential guidelines.

**Sec. 2: Computation of Capital Adequacy**

- 1) Banks shall at all times maintain adequate records, including daily balance sheets and periodic statements of income and expense to enable proper computation of their capital adequacy.
- 2) Each bank shall submit on a quarterly basis to the Reserve Bank a form titled "Capital Adequacy Computation" to be prepared as of the close of business at the end of the months of March, June, September, and December.
- 3) The Reserve Bank shall determine if a bank is in compliance with the capital adequacy requirements of this directive from the form described in subsection (2) above.
- 4) The Reserve Bank may use its powers to inspect under Section 22 of the Banking Act to verify the accuracy of this form and direct such bank to adjust or correct this form based on the findings of such inspection.
- 5) Each bank shall require its auditor, as appointed under Section 20 of the Banking Act, to verify to the Reserve Bank the accuracy of the form for capital adequacy computation as

of the financial year-end date and to so alert the Reserve Bank of any errors or adjustments to this form as of any other quarter end period during the financial year under review.

- 6) In determining the computation for capital adequacy requirements, the Reserve Bank shall determine if the bank is in compliance with its directive on prudential guidelines, and as such, it shall determine if the bank has made adequate provisions for bad debts, specific and/or general, and followed proper guidelines with regard to income recognition, specifically accrual of interest. The Reserve Bank may call for adjustments to capital calculations with respect to increased provisions and/or interest accrual if a bank is found not to be in compliance with its directive on prudential guidelines.

#### **PART IV: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

##### **Sec. 1: Remedial Measures**

- 1) When the Reserve Bank determines that a bank has not met the capital adequacy requirements of this directive and thus has a capital deficiency, it may impose remedial measures as specified under Section 31 of the Banking Act.
- 2) When the Reserve Bank determines that a bank's capital deficiency is severe enough to have resulted in impaired capital, it may petition the High Court to sanction procedures as called for under Section 32 of the Banking Act.

##### **Sec. 2: Administrative Sanctions**

In addition to the remedial measures available to it as given above in Part IV Section 1, the Reserve Bank may impose any or all of the following administrative sanctions with regards to a bank that has a capital deficiency by failing to meet the capital requirements of this directive:

- 1) Prohibition from declaring and/or paying dividends;
- 2) Suspension of the establishment of new branches and/or expansion into new banking or financial activities;
- 3) Suspension of access to credit facilities of the Reserve Bank;

- 4) Suspension of lending operations;
- 5) Suspension of the opening of letters of credit;
- 6) Suspension of the acceptance of new deposits;
- 7) Suspension of acquisition of fixed assets.

## **PART V: EFFECTIVE DATE**

### **Sec. 1: Effective Date**

The effective date of this Directive will be 30 June, 1993

*Questions relating to this directive should be addressed to the Bank Supervision Department of the Reserve Bank.*

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**Victor Mbewe**  
**GOVERNOR**