



RESERVE BANK OF MALAWI

DIRECTIVE

NO.DO2-06/LA EX

LARGE EXPOSURES

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LARGE EXPOSURES

PART 1: SHORT TITLE, AUTHORISATION, APPLICATION AND INTERPRETATION

Part 1. PRELIMINARY

Sec 1 Short Title: LARGE EXPOSURES

Sec 2 Authorization

This directive is issued by the Reserve Bank of Malawi pursuant to its authority set forth in Sections 26 and 27 of the Banking Act (1989), for the purpose of implementing the provisions of Sections 28(a) and 30 of the Banking Act.

Sec 3 Application

This directive applies to all banks and other financial institutions licensed under the Banking Act (“licensed institutions”), on both a solo and consolidated basis.

Sec 4 **Interpretation:** In this Directive unless the context otherwise requires:

4.1 ‘**Banking Act**’ means the Banking Act, 1989, of Malaŵi.

4.2 ‘**Board of Directors**’ means the highest body of authority in a licensed institution responsible for strategically guiding the licensed institution, effectively monitoring management, and properly accounting to shareholders.

4.3 ‘**Capital Base**’ means for purposes of calculating limits on a licensed institution’s exposures, its capital base shall be calculated as follows, provided however, that an adequate allowance for loan and lease loss has been established pursuant to the Reserve Bank’s *Directive on Asset Classification*:

4.3.1. The sum of:

- Share capital, paid-up;
- Share premium;
- Retained profits (prior years);
- Sixty percent (60%) of after-tax profit (current year-to-date);

4.3.2 Less:

- Investment in unconsolidated companies.

4.4 ‘**Credit**’ means any asset or off-balance-sheet item that contains credit risk, including loans and participations, overdrafts, advances and all of the following “credit facilities” listed in Section 2 of the Banking Act: financing by means of factoring, leasing, hire purchase, accepting of trade and other bills, discounting of such bills and notes, the opening or confirming of documentary credit, the issue of other letters of standby, credit, guarantee or

surety, the undertaking to pay on account of another person, and other similar undertakings.

4.5 ‘**Eligible Guarantee**’ means for purposes of calculating the amount of a licensed institution’s exposure which is subject to the limitations of this directive, a guarantee is considered eligible if it meets all of the following requirements.

4.5.1. The guarantee must be issued by either of the following:

- The Government of Malaŵi;
- The government of a member country of the Organization of Economic Cooperation and Development (“OECD”);
- The government of a country with a current consensus country risk classification of 1 or 2 as published by the OECD; *or*
- An international bank with an external credit assessment of AAA to AA- issued by an external credit assessment institution acceptable to the Reserve Bank.

4.5.2. The guarantee must:

- Represent a direct claim on the guarantor;
- Be denominated in the same currency as the exposure or a strong convertible currency.
- Clearly and incontrovertibly define the extent of the guarantee’s cover of a specific exposure;
- Be irrevocable and non-cancelable by the guarantor, except for non-payment of the credit protection contract;
- Have no clause in the contract that would allow the guarantor unilaterally to cancel the guarantee, increase the effective cost of the guarantee, or delay payment under the guarantee for any reason including the need to be funded in the budget;
- Have as the only condition for its enforcement the obligor’s failure to meet his/her/its obligation to the licensed institution; *and*
- Be executed so that neither the guarantor nor any other person is in a position to challenge the legal rights of the licensed institution in calling the guarantee.

4.6 ‘**Executive Officer**’ means an officer at the most senior level of the management of a licensed institution (whether or not he/she is a director) who effectively manages that licensed institution.

4.7 ‘**Exposure**’ means the amount of a licensed institution’s exposure to a person or group of inter-related persons is calculated as follows:

4.7.1. The sum of the following:

- Credits;
- Equity securities;
- Debt securities;
- Securitized assets and other transactions with recourse; and

- Contingent liabilities, such as commitments to extend credit.

4.8 ‘Group of Inter-Related Persons’ means two or more persons holding exposures from a licensed institution, whether on a joint or separate basis, which are mutually associated and meet at least one of the following criteria:

- 4.8.1 The persons are a “group of related debtors” as that term is defined in Section 2 of the Banking Act: one person holds a controlling interest in the other(s) or the persons are under common ownership or control;
- 4.8.2 The persons have common management and/or common directors;
- 4.8.3 Cross guarantees exist; or
- 4.8.4. A direct financial interdependency exists between the persons which cannot be substituted in the short term.

4.9 ‘Large Exposure’ means an exposure, direct or indirect, of the licensed institution to any person or group of inter-related persons which equals or exceeds ten percent (10%) of the capital base of the licensed institution.

4.10 ‘Licensed Institution’ means a bank or other financial institution holding a valid license, issued by the Reserve Bank, authorizing it to engage in deposit-taking business in Malaŵi.

4.11 ‘Person’ means any of the following: an individual; sole proprietorship; partnership; joint venture; association; trust; estate; business trust; corporation, not-for-profit corporation; sovereign government, agency, instrumentality, or political subdivision thereof; any similar entity or organization.

4.12 ‘Reserve Bank’ means the Reserve Bank of Malaŵi established under the Reserve Bank of Malaŵi Act, 1989.

PART II: STATEMENT OF POLICY

Sec. 1: Objectives

- 1.1 To help ensure banks follow the sound practice of credit diversification;
- 1.2 To help ensure credit is not concentrated in a small number of borrowers resulting in denial of credit to smaller entities with viable credit needs;
- 1.3 To help ensure that losses incurred by any single borrower or group of related debtors are not large enough to impair the soundness of a bank;
- 1.4 To ensure that no borrower or related group of borrowers becomes large enough to receive favouritism with regard to: credit standards, interest rates, repayment terms or additional advances to protect existing exposures.

Sec. 2: Rationale

- 1.1 Banks engage in credit risk; when such credit risk is concentrated in a single borrower or group of related borrowers, the risk of default by such large borrowers impairs the viability of the bank;
- 1.2 The risks of large credit concentrations are reduced when credit facilities to such borrowers are syndicated or other-wise shared by two or more banks, and such shared risk is encouraged through credit concentration limits;
- 1.3 Banking failures and/or crises in many countries have been attributed, in large part, to excessive credit concentrations where such borrowers have failed to properly service their credit obligations; credit concentration limits prevent such excessive risks from developing;
- 1.4 Credit concentration limits have become a widely recognized part of effective bank supervision for developing countries, provided such limits are not arbitrary and reflect the nature of the financial sector.

PART III REQUIREMENTS

Sec 1: Policies and Procedures

The board of directors of each licensed institution shall adopt, and ensure that senior management implements, a written policy covering Large Exposures. This policy may be a part of the licensed institution's overall written credit policy. Processes should be established within the licensed institution to allow the board of directors to monitor compliance with the policy. The board of directors shall review the policy on at least an annual basis. The policy, at a minimum, shall:

- 1.1 Address concentrations of risk arising from individual Large Exposures and total Large Exposures, including those to groups of inter-related persons; and
- 1.2 Impose strict and binding limits on Large Exposures, including those to groups of inter-related persons, which do not exceed the limitations contained in this directive.

Sec 2 Groups of Inter-Related Persons

If two or more persons are deemed to be a group of inter-related persons, then the exposures of all persons in that group shall be combined for purposes of applying the limitations on Large Exposures of the Banking Act and this directive.

Sec 3 Approval by the Board of Directors

Large Exposures must be approved in advance by the licensed institution's board of directors, or by a duly authorized sub-committee thereof.

Sec 4 Recordkeeping

Each licensed institution shall maintain adequate records to identify:

- 1.1 All Large Exposures, including those to groups of inter-related persons; and

- 1.2. Other concentrations within the portfolio, including sectoral and geographic.

PART IV LIMITATIONS

- 1 Except as provided in Part 4 of this directive, a Large Exposure shall not exceed 25% of a licensed institution's capital base.
2. The aggregate of a licensed institution's Large Exposures shall not exceed 800% of its capital base.

PART V REQUESTS TO THE RESERVE BANK

- 1 With the prior written permission of the Reserve Bank for good cause shown, a licensed institution may hold a Large Exposure which exceeds the limitation of Section 3.1 of this directive; provided however, that the Large Exposure shall be reduced to an amount equal to, or less than, 25% of the licensed institution's capital base within 12 months.
- 2 Requests for the prior written permission of the Reserve Bank pursuant to this part shall be made in the form prescribed in the annex to this directive. The Reserve Bank may request additional or supplementary information if, in the opinion of the Reserve Bank, the basic information submitted is incomplete or insufficient. Failure to provide the Reserve Bank with all required information in a timely manner will result in the Reserve Bank returning the request without consideration.
- 3 Within 30 days from the date that the Reserve Bank receives all information required and sufficient for making a decision, the Reserve Bank shall render a decision on the request and shall notify the licensed institution of its decision in writing.
- 4 The decision of the Reserve Bank whether to grant permission to a licensed institution to hold a Large Exposure exceeding 25% of its capital base shall be based upon the following criteria:
 - 4.1 The licensed institution is currently maintaining an adequate capital base and a capital ratio of 6% for core capital and 10% for total capital.
 - 4.2. Including the proposed Large Exposure, the licensed institution's aggregate Large Exposures will not exceed the limitation on aggregate Large Exposures of this directive.
 - 4.3. The licensed institution is in full compliance with the Reserve Bank's *Directive on Asset Classification*.
 - 4.4. There are no remedial measures outstanding or pending against the licensed institution, nor is the licensed institution otherwise subject to supervisory concern.

- 4.5 The licensed institution's existing credit risk management system and management information system are adequate, and the bank has adequate financial, managerial, and organizational resources to handle the increased concentration risk.
- 4.6 The licensed institution has a history of properly reporting and managing Large Exposures, and of complying with the limitations contained in this directive.
- 4.7 The proposed Large Exposure will be 100% secured by one or more of the following collateral: (1) cash; (2) gold; (3) eligible guarantee; (4) assets eligible to meet the Reserve Bank's *Liquidity Reserve Requirement*; or (5) debt securities issued by the Government of Malaŵi, the government of a member country of the OECD, or the government of a country with a current consensus country risk classification of 1 or 2 as published by the OECD or any security like Debentures and mortgage that has been properly perfected.
- 4.8 The obligor of the proposed Large Exposure has made full disclosure of any group of inter-related persons with which the obligor is involved. The licensed institution has properly included the obligor in such group of inter-related persons for purposes of calculating compliance with the limitations of this directive.
- 4.9 The credit is granted in respect of exports from Malawi.
- 4.10. With the exception of exceeding the limitation on Large Exposures of Section 3.1 of this directive, the exposure meets all of the licensed institution's credit-granting standards as stipulated in the licensed institution's written request.
- 4.11. The board of directors, or a duly authorized sub-committee thereof, has approved the subject Large Exposure for good cause shown subject to receiving the written permission of the Reserve Bank.
- 4.12. The Large Exposure will be reduced to a level which complies with the limitation of Section 3.1 of this directive within 12 months, in accordance with a specific plan of reduction presented by the licensed institution in its request.

PART VI REPORTING

Each licensed institution shall submit a report to the Reserve Bank, as of each quarter-end in the format prescribed by the Reserve Bank, showing all Large Exposures and evidencing compliance with this directive.

PART VII REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

Sec. 1: Remedial Measures

- 1) When the Reserve Bank determines that a bank is not in compliance with this directive, it may impose remedial measures as specified under Section 31 of the Banking Act, 1989.
- 2) When the Reserve Bank determines that a bank's non-compliance with this directive has resulted in such undue risk that its capital is impaired or solvency is otherwise threatened, it may petition the High Court to sanction procedures as called for under Section 32 of the Banking Act, 1989.

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 fails to comply with 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 Reserve Bank credit facilities;
- 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 the acquisition of fixed assets.

PART VIII EFFECTIVE DATE & SUPERSEDEENCE

Sec 1: Effective Date

The Effective Date of this Directive shall be 13th March 2006.

Sec 2: Supersedence

This Directive shall supersede and replace Credit Concentration Directive for Banks of 1993.

Questions relating to this Directive should be addressed to the Bank Supervision Department of the Reserve Bank of Malawi

Victor Mbewe
GOVERNOR

Part 7. ANNEX

Prescribed form for a licensed institution to request the prior written permission of the Reserve Bank for a Large Exposure to exceed the limitation of Section 3.1 of this directive.

ANNEX
DIRECTIVE ON LARGE EXPOSURES

Prescribed form for a licensed institution to request the prior written permission of the Reserve Bank for a Large Exposure to exceed the limitation of Section 3.1 of this directive.

The written request to the Reserve Bank must be signed by the executive officer of the licensed institution and be submitted in official duplicate. Information should be presented in the order requested and be accompanied by appropriated referenced required supporting documentation.

1. Date request submitted.
2. Name of licensed institution.
3. Amount of total capital (core capital and supplemental capital).
4. Amount of capital base (core capital).
5. Obligor, including group of inter-related persons.
6. Details of the proposed Large Exposure. If the Large Exposure will be comprised of more than one individual exposure, provide details on each separate exposure as well as on the total Large Exposure.
 - Amount;
 - Obligor / Group of inter-related persons;
 - Type of exposure;
 - Terms and conditions, including the repayment or liquidation schedule or terms of amortization.
7. The proposed Large Exposure as a percentage of the capital base and of total capital.
8. The licensed institution's aggregate Large Exposures, including the proposed Large Exposure, presented as an amount and as percentages of the capital base and total capital.
9. The specific purpose of the proposed Large Exposure.
10. Description of collateral, including:
 - the amount, and method and source of the determination of value,
 - the percentage of the exposure covered by the collateral, and
 - the method by which the licensed institution's interest in the collateral will be perfected.
11. Reason for the request for Reserve Bank permission to exceed the limitation on Large Exposures.

12. A copy of the analysis performed by the licensed institution showing that the proposed Large Exposure meets the licensed institution's credit-granting standards. The analysis should include the obligor's current audited financial statements.
13. A specific plan, including methods and time frames, to reduce the proposed Large Exposure to a level that does not exceed the limitation of the directive within 12 months. The plan may include amortization of the proposed exposure and a reasonable estimate of growth in the licensed institution's capital base.
14. Evidence of appropriate approval by the licensed institution, including approval by the board of directors or a duly authorized sub-committee thereof, made subject to receiving the written permission of the Reserve Bank.
15. Official resolution of the board of directors authorizing the executive officer to submit the subject request to the Reserve Bank.