



RESERVE BANK OF MALAWI

DIRECTIVE

NO. LRR1-07 FMO

LIQUIDITY RESERVE REQUIREMENT

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PART I: SHORT TITLE, AUTHORIZATION, APPLICATION AND DEFINITIONS

Section

- 1: **Short Title** - Liquidity Reserve Requirement
- 2: **Authorization** - Section 38 of the Banking Act of 1989, Cap 44:01, and Section 30, 36 and 48 of the Reserve Bank of Malawi Act, 1989, Cap 44:02.
- 3: **Applications** - All depository institutions operating in Malawi and coming under the scope of the Banking Act 1989, and which accept demand, savings or time deposits or any substantial equivalent thereof. For the time being these institutions are banks and discount houses.
- 4: **Definitions** - The following terms shall be defined as specified below, unless the context in which such term is used requires otherwise:-
 - (1) **"depository institution"** - any financial institution licensed under the Banking Act of 1989 which accepts demand, savings, or time deposits, or any variation thereof from the public.
 - (2) **"eligible assets"** - eligible assets shall be balances on deposit with the Reserve Bank, vault cash and any other assets as the Reserve Bank may define from time to time.
 - (3) **"required reserves"** - means eligible assets held by a depository institution for the purpose of satisfying the Liquidity Reserve Requirement stipulated by this Directive.
 - (4) **"collateralised deposit"** – means a deposit against which the depositor receives collateral in any form.

PART II STATEMENT OF POLICY

Objectives - The objective of this directive is to strengthen the liquidity reserve requirement (LRR) as an instrument of monetary policy while at the same time ensuring flexibility in liquidity management.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

Section

- 1: **Minimum Liquidity Reserve Requirements** - Each depository institution shall maintain minimum cash balances in relation to the preceding week's total local currency deposit liabilities, including government deposits. In the case of discount houses, the LRR shall be

applied to non-collateralised deposits from the corporate sector. The LRR ratio shall be 15.5 percent.

- 2: **Limit on non-collateralised deposits** – Non-collateralised deposits with discount houses to be considered as part of LRR shall not exceed 7.5 percent of the LRR.
- 3: **Reserve Maintenance Period** - The minimum LRR specified in Section 1 above shall be maintained as a simple one week (Monday - Sunday) average. In other words a depository institution can have eligible assets whose total (as specified in section 4(2) above) can be less than the LRR on some days of the week provided that the simple average of the daily balances for the seven days meets the LRR. Monitoring of compliance shall be effective from the first business day of the week.
- 4: **Deadline for Meeting Liquidity Reserve Requirement** - All depository institutions shall ensure that the LRR has been observed by close of business on the last working day of the week.
- 5: **Penalty for Noncompliance** - Failure to maintain the weekly average minimum Reserve Requirement as specified in the preceding section will constitute a violation of the LRR Directive. The penalty charge shall be 0.25 percent of the amount of violation multiplied by 7. Notwithstanding the imposition of this penalty, the Reserve Bank may take additional measures as outlined in Part IV of this Directive.
- 6: **Settlement of Penalty Charges** - Penalty charges in respect of LRR violations shall fall due on the first day of the week immediately following the week for which the LRR was not complied with. Late settlement of penalty charges will be by direct debit of the concerned depository institution's operating account with the Reserve Bank.
- 7: **Use of Funds Maintained for Liquidity Reserve Requirement** - All deposits with the Reserve Bank may be used for domestic cheque clearing. However, should a depository institution anticipate that the usage of funds for clearing purposes will result into a violation of the LRR by the end of the week; the depository institution will be expected, to provide additional funds from the interbank market.
- 8: **Interest on Required Liquidity Reserves** - Funds maintained on deposit with the Reserve Bank for the purpose of satisfying the Liquidity Reserve Requirement may or may not earn interest, regardless of whether the amount so carried exceeds the required reserve amount.

- 9: **Basis for Computing Required Liquidity Reserve Amount** - The basis for computing the required reserve amount shall be the simple average of daily deposit liabilities specified in Section 1 above. Such averages are to be computed using totals as of close of business for each working day of the week (sample attached as appendix 1). In addition, each depository institution is to show the structural breakdown of the deposit liabilities.
- 10: **Submission of Data for Computation of LRR** - Each depository institution shall submit to the Reserve Bank its daily deposit liabilities (as stipulated in Section 9 above) during the previous week's business days. The position attained on the last business day shall be maintained for holidays and remaining days of the week. The data must be submitted by 11.30 am on the first business day of the week in which the new LRR is to apply. Failure to send the returns to the Reserve Bank within the time limit specified shall call for a penalty charge at the rate of K50,000.00 per day.
- 11: **Exceptions to Liquidity Reserve Requirement** - The Reserve Bank, in its sole discretion, may exempt a given depository institution from observing the required cash reserve after such institution has shown good cause necessitating the exception. The Reserve Bank shall determine the duration for the exemption.

PART IV: ADDITIONAL REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

Section

- 1: **Remedial Measures** - If the Reserve Bank determines that a depository institution is not in compliance with this directive:-
- (1) Remedial measures may be imposed in accordance with Section 39 of the Banking Act, 1989;
 - (2) If such noncompliance has resulted or threatens to result in an unsafe or unsound operating condition, then remedial measures as provided under Section 32 of the Banking Act, 1989 may also be pursued.
- 2: **Administrative Sanctions** - In addition to the remedial measures available for use as provided in Section 1 above, the Reserve Bank may impose any or all of the following administrative sanctions upon a depository institution or its board of directors and managing executive officers for noncompliance with this directive:-
- (1) Prohibition from declaring and/or paying dividends;

- (2) Prohibition from establishing new branches or facilities;
- (3) Prohibition from engaging in new services or activities or expanding existing services or activities;
- (4) Suspension of access to Reserve Bank credit facilities;
- (5) Suspension of lending, investment, and credit extension operations;
- (6) Prohibition from acquiring additional fixed assets;
- (7) Prohibition from accepting further deposit liabilities;
- (8) Prohibition from declaring and/or paying bonuses, salary incentives, severance packages, management fees, or other discretionary compensation schemes to directors or managing executive officers.

PART V: EFFECTIVE DATE AND SUPERSEDEDENCE

Section

- 1: **Effective Date** - The effective date of this directive shall be February 1, 2007.
- 2: **Supersedence** - This directive shall amend and replace Directive No. LRR1-06 FMO.

Victor Mbewe
GOVERNOR

February 2007