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REPORT IN RESPONSE

TO

TASK ORDER NO. 22 "USAID/MALAWI BUY-IN"

TO ASSESS INDEFUND'S

LOCAL (MALAWI) CAPITAL MARKETS

RAISING CAPABILITIES

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INDEFUND'S (MALAWI) LOCAL CAPITAL RAISING CAPABILITIES"

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INTRODUCTORY COMMENTS

1. The Terms of Reference assumed that Indefund is an institution which lends to the SME sector and will continue to do so exclusively. The TOR focused on the fact that past funding by donor grants and soft loans is going to change and that the local market might offer an alternative and sustainable funding source for Indefund to replace those donor funds. The focus was on (i) confirming that this was the case, (ii) determining to what extent and (iii) identifying what hurtles would have to be overcome.

2. The focus has been to respond to these questions and to enlarge the discussion a little by pointing out additional sources of replacement funding in addition to the local capital market.

3. In the process, however, it became clear that as a result of this shift to market based funding, Indefund's SME clients will be faced with almost a doubling of their lending costs. Recognizing this perhaps unanticipated consequence, I have presented some ideas outside the terms of reference for consideration by Indefund's management, Board and shareholders. Hopefully, these ideas will be helpful in building a consensus on how best Indefund can continue to perform its positive role vis a vis SME's if it must fund itself in the market rather than with donor funds.

EXECUTIVE SUMMARY

A. Conclusions on Terms of Reference

1. Indefund should be able to replace donor funding over time from the local financial market either by borrowing from deposit taking institutions or other institutional investors. Such investors will, for at least an interim period, almost certainly require additional security from Indefund in the form of a guaranty of one or more of its shareholders or GOM or otherwise in lieu of other collateral.

2. Indefund could also replace donor funding by becoming a deposit taking institution but the demands this would put on Indefund's executive talent and the administrative costs that this would entail argue against this solution.

3. If Indefund is to obtain funding from local sources, it must be prepared to pay the market rate for such funding (which is substantially higher than its present donor-based cost of funding). This has important implications for Indefund as well as its SME clients.

4. To the extent that Indefund must rely on market based borrowings to fund its SME loan portfolio in place of donor grants and soft loans, it must raise its risk-adjusted lending rates substantially to reflect the risks and administrative costs of serving the SME segment and its higher cost of funding. The impact could be substantial. For example, if Indefund were to attempt to fully fund itself with borrowed market based funds and recover its fully loaded costs from its clients, the on-lending rate to the SME's would be 11% over its cost of funds. That is, in the current market the lending rate to the SME's would have to be raised to 33-36% p.a., almost double the average rate of 18.5% that has until recently been charged by Indefund. It is not certain how such market based rates would be greeted by Indefund's shareholders, its traditional donors or GOM; nor how such rates would affect SME loan demand and the profit-making potential of Indefund and its clients.

5. It should be recognized that government policy is fairly firmly committed to free market policies and there is almost universal opposition to any suggestion that the government interfere with the workings of the market by credit allocation or otherwise. The World Bank and IMF have strongly supported this

approach. Paradoxically, both the government and the World Bank have noted the crucial role that SME's play in addressing the under-employment problem in Malawi as well as other development objectives.

6. The shift to market based funding need not necessarily result in an immediate dramatic increase in lending rates to Indefund's SME borrowers. The report notes a few expedients that might be employed to provide "transition" or "cushioning" of the effect of diminished donor support and recourse to market based funding.

B. Ideas for Consideration Beyond the Terms of Reference

1. Focus on the high level of rates required for market-based lending raises questions as to whether lending is appropriate financing for start-up SME's with the earnings potential to support such high rates. In developed economies (and more recently in some developing economies) the notion of risk capital or venture capital has emerged as an highly successful, and more appropriate, method for financing such enterprises.

2. Should Indefund be considering restructuring a part of its SME <u>lending</u> business into a venture capital <u>investment</u> business? It could be argued that the high cost Indefund incurs to service its SME clients are the very same costs that a venture capitalist incurs in nurturing an enterprise in which it invests. By contrast, the venture capitalist has greater upside because he participates as an investor in the actual growth of the company.

3. To the extent that Indefund makes equity investments rather than loans, it would need to raise equity capital rather than market-based borrowings to fund this activity. The report makes some comments on how this might be undertaken.

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A. Responses Within Terms of Reference

1. Identify potential funding sources for Indefund's on-lending requirements other than donor financing, and assess the need for local capital issue in light of all potential funding sources.

Local Sources of Financing

Indefund could raise funds domestically by (i) becoming a deposit taking institution, (ii) borrowing from institutional investors without becoming a depository institution or (iii) floating a bond issue under the new Capital Markets Development Act. Because Indefund's business is now structured to lend to SME's rather than invest in SME's, borrowing is the most appropriate way for it to finance itself. Because its loans are typically for 5 year maturity with a 3 year average life, its funding needs are comparable.

Indefund as a Deposit Taker

Indefund is not presently a deposit taking institution. However, under the Malawi Banking Law (see Annex B), Indefund could seek to qualify as a deposit taking institution. As a banking institution, however, it would have to have minimum capital of Kw 2 million rather than the minimum Kw 250,000 required as a financial institution; it would also be subject to compliance with strict reporting requirements and other regulation relating to such matters as loan loss reserves. The approval process calls for application for approval of the Minister through the Reserve Bank.

Conversations with other institutions which have recently qualified as deposit taking institutions suggest that obtaining approval in the current free market environment should not be very difficult for Indefund. If Indefund were to qualify as a deposit taking institution under Reserve Bank criteria, it would then be permitted to accept deposits from institutional investors, other financial institutions, corporations as well as individuals.

It is interesting to note that, under current legislation, becoming a deposit taking institution would be the only way that Indefund could utilize funding from the New Building Society. This situation, unlike that facing other institutional investors, grows out of the legislation applicable to the New Building Society. The New Building Society is strictly regulated as to how it may use its funds. That is, it must use them for real estate related projects (e.g. housing loans) or it must deposit them at approved depository institutions. Inasmuch as Indefund is in the business of making commercial, not real estate loans, Indefund can only look to the New Building Society as a source of funds if it (Indefund) were to become an approved depository.

As a deposit taker, Indefund could seek deposits to cover its portfolio of medium term SME loans. The three leasing companies (LFC, CBM Financial, and Mercantile) have qualified to become deposit taking institutions and are already receiving deposits to support lending of this tenor. These institutions are currently paying rates in excess of the Reserve Bank discount rate of 20% for such deposits. If Indefund were a deposit taking institution, it would have to match this competition and possibly pay an even higher rate for its funds. This would suggest that potential funding from deposits would cost Indefund a minimum of 20.5% in the current market. Moreover, this does not take into account the additional costs that Indefund would have to incur to administer deposits, which apart from the diversion of management time is likely to be costly as a "start up" undertaking.

The interest rate spread that Indefund has historically required to achieve profitability has been about 11% over its cost of funds; this compares with a commercial bank spread of about 5.5%. As already noted, if Indefund were to become a deposit taking institution, the additional costs for this activity would also have to be passed on to its SME borrowers.

Taking on an entirely new "start up" function implies "start up" costs that cannot initially be allocated over a large deposit base. These include additional personnel, additional regulatory reporting and compliance, additional computer capability and possibly even additional premises. Moreover, the recent emergence of other new depository institutions limits the deposit taking potential that is available to Indefund over which it could hope to allocate increased costs.

There are now at least eight deposit taking institutions in Malawi (Annex C), four of which have only commenced taking deposits in the last year. Whereas previously there had been a highly concentrated market with virtually no competition, signs of competition and increased efficiency are already beginning to appear. With so many new depository institutions, Indefund stands to benefit more as a borrower from these deposit taking institutions than to risk raising its fixed overheads by taking on this new activity.

In view of these developments, and the apparent willingness of institutional investors to consider Indefund's borrowing needs, which will be discussed below, it does not seem necessary for Indefund to resolve its funding problem by becoming a deposit taking institution at this time. To do so would only duplicate costs already being incurred by other institutions and would only aggravate the problem of costs that Indefund must pass on to SME borrowers. Indefund should instead concentrate its energies on developing borrower relationships with existing institutional lenders as more fully discussed below. Only if it finds that these institutional lenders are not willing or able to supply its funding needs should Indefund embark on the course of becoming a bank and taking deposits.

Indefund as a Borrower from Institutional Investors

Internally, within Malawi, there are institutional investors which are in principle potential providers of funds to Indefund.

For example, from the point of view of liquidity and tenor the two major insurance companies as well as a few pension funds could be potential sources of funding. In addition, the New Building Society and the Post Office Savings Bank could also provide funds, but, as noted elsewhere, this would require legislative or administrative changes.

The National Insurance Company (NICO) indicated that it had growing liquidity, absent the recent short term money crunch. In the past, it was almost compelled to invest heavily in real estate because of the shortage of long term investment alternatives. NICO, as a life insurer, prefers to lend for maturities as long as 20 years but a 3-5 year maturity would be more acceptable than short term instruments or deposits. The General Manager of NICO indicated that although NICO had previously made such loans on a fixed rate basis, it would probably in the future insist on a floating rate i.e. 1.5% or more spread over the commercial bank base rate (which translates to 22.5% or more in the current market.)

Similarly, the Old Mutual Insurance Company normally seeks 7 to 15 year maturities and quotes an indicative floating rate of at least 3% over the commercial bank base rate (See Annex D). In the current market, this would translate into a 24% lending rate for the tenors that Indefund requires. Old Mutual, however, emphasizes that it will require satisfactory security which might involve guarantees from one or more shareholders of Indefund. (It should be noted that Old Mutual declined to participate in Indebank's 1989 financing because of inadequate security and now only lends to Indebank with the guarantee of its shareholders.) Indefund, which is considerably less profitable than Indebank, could not expect less stringent terms.

These insurance company lenders should be the first source of funding for Indefund to approach because they are natural lenders for the maturities that Indefund requires. Malawi banks are less likely candidates because of their short-term deposits and their skepticism regarding SME lending, but even they can be approached if Indefund continues to maintain its profitability record.

Indefund as Borrower in Local Capital Market

Although the new Capital Markets Development Act has been enacted in Malawi, no securities have yet been issued under this Act, though the Leasing Finance Company (LFC) has had some useful preliminary discussions with the Reserve Bank on the concept of launching a "transferable deposit" or bond issue. In view of this, it is not realistic to suggest that Indefund, an institution that is largely unknown as a borrower to the banks and other financial institutions in Malawi, undertake to be the first issuer in the capital markets.

Indefund's first step should be to raise funds as a borrower from the financial institutions in Malawi and after doing so successfully, consider utilizing the capital market as a way to improve on the terms it receives from these institutional lenders. Indefund's success in obtaining loans from local financial institutions will turn on its current financial position, cash flow and profitability as well as the availability of a guarantee from one or more of its shareholders. The increase in Indefund's loan delinquencies since the political difficulties in the Spring are a disquieting factor. Indefund must make an effort to demonstrate the seasonality of these loan delinquencies in past years so that the recent increase in loan delinquencies does not generate an exaggerated sense of concern.

Current Cost of Funding for Indefund

The current and assumed borrowing costs of Indefund according to its management are as follows:

> 7% on FMO loan (of which 3.25% is retained by Indefund for Client Services costs). This makes the effective cost of these funds 3.75%.
>
> Zero on KFW loans
>
> Three (3%) percent on US AID Loans, repayment commencing in 1993.
>
> Three percent on World Bank loans (assumed)
>
> All other loans 11% per annum

Replacing any of this funding with market-based funding will increase Indefund's costs substantially. The larger the share of market-based financing the more dramatic the increase in funding costs.

Indefund's Loan Spread and the Consequent SME Lending Rates

Commercial banks in Malawi are able to operate profitably with a loan spread of only 5.5%, but such institutions, while bearing the cost of a deposit taking function, largely do not service the SME sector which is regarded as both costly and risky. Indefund's success with this segment has been achieved by closely monitoring its clients and providing extensive advisory services to them. These additional services account for the larger loan spread (11%) required by Indefund to lend to the SME sector profitably. (It should be noted that Indefund does not take deposits and that its existing loan spread does not include costs associated with this function. The commercial bank loan spread does include such costs so that the effective differential is actually wider than it appears).

This larger spread (or at least the portion that exceeds the 5.5% bench mark of commercial banks) is often referred to by the management of Indefund as "developmental". But this may simply be the economic cost of serving the SME sector through a <u>lending</u> institution. In fact, the two major commercial banks explicitly try to avoid lending to the SME segment and claim they have adopted this policy because the costs of administration (including potential loan losses) are such a burden. In fact, the Commercial

Bank conceded that failure to adequately monitor and provide the advice that Indefund does as a part of its basic business can result in substantial loan losses, which was regrettably their experience on loans to small tobacco farmers last year.

Conversations with Indefund's management, a member of Indefund's Board of Directors, as well as government officials suggest that there is a widely held belief than an important part of Indefund's role is to provide "cheap" financing to the SME segment. The prospect of doubling the lending rate to SME's seems to be at odds with this objective.

At the same time, discussions with the management of Indefund as well as AID officials suggest a need for Indefund to provide financing to SME's on a "sustainable" basis --- a basis that is not heavily dependent on donor funding. "Cheap" or "subsidized financing", however, is not "sustainable" financing unless donors commit to permanently provide "subsidized" or "no cost" funding.

It is important, therefore, that the Board of Directors and shareholders resolve this apparent inconsistency in approach and reach consensus on which of these notions is to be given greater weight: (i) cheap, below market funding for SME's or (ii) sustainable funding. At present, the management of Indefund seems to be receiving conflicting signals that may be confusing.

Summary

Discussions with all the major players in the Malawian financial markets (See Annex D) suggest that Indefund can obtain a portion of its funding requirements in the local financial market either by borrowing from institutional investors, and failing that, seeking approval to become a deposit taking institution. Institutional lenders will, however, for at least an interim period, almost certainly require additional security from Indefund in the form of a guaranty of one or more of its shareholders or GOM in lieu of other collateral.

If Indefund is to obtain such funding from local sources, it must be prepared to pay the market rate for such funding (which is substantially higher than its present donor-based cost of funding). When this market based funding is coupled with Indefund's high costs to deliver its services, the combination results in a substantially higher lending rate to SME borrowers i.e. approximately 34-35%. This has important implications for Indefund as well as its SME clients.

International Sources

Even if donor funding is cut back, a few international funding sources may still remain. For example, IDA, the soft loan affiliate of the World Bank, granted a $120mm equivalent credit to the Government of Malawi (GOM) for the Entrepreneurship Development and Drought Recovery Program (EDDRP) in June 1992. This credit can presumably be accessed through GOM by institutions like Indefund, which finance the SME sector. Although the World Bank report (P-5461-Mai) specifically refers to Indefund as a potential beneficiary of this credit, it notes that the GOM is committed to "move towards a more market-oriented rate policy that reflects the risks and operating costs of lending to this sector."

Indefund management has been projecting a drawdown under an earlier IDA credit in the amount of KW 1.35mm at the end of 1992 and additional amounts in each year until 1996. The effective interest rate on this money has been assumed to be 3% p.a. It is doubtful, however, in view of the GOM policy quoted above, that Indefund can expect such soft terms under the EDDRP credit.

Another source of long term financing for Indefund in the medium term might be the UN Pension Fund. But in order for Indefund to qualify for such financing, the government of Malawi must provide a mechanism for companies like Indefund to list their securities, either domestically or on a regional exchange. This is more fully discussed in Annex A to this report.

2. Identify appropriate mechanisms for local capital issue or issues.

Indefund could offer a three to five year bond issue under the Capital Markets Development Act. Such an issue would involve the production of a prospectus of the type that Indefund management has already been drafting and would require approval by the Reserve Bank of Malawi. A three to five year maturity is appropriate to try to match the tenor of Indefund's lending business. Such an issue might have warrants attached as a way of attempting to obtain a lower interest rate for Indefund. These warrants might be convertible into Indefund shares upon payment of a premium. Such a bond issue might require the guarantee of one or more of Indefund's shareholders to generate sufficient investor interest.

While a bond issue and warrants would be permissible under the Capital Markets Development Act which strongly encourages development of the Capital Markets, the actual procedures for implementation of such an issue are largely theoretical, except for the need for Reserve Bank of Malawi approval. This grows out of the unusual situation in Malawi where the Capital Markets Development Act has been issued prior to the development of a capital market. Typically, such legislation is enacted after market practice has been established as a way of regulating and finetuning existing market practice. In the case of Malawi, no capital market had emerged prior to the enactment of the Act and no issues have yet been made under the Capital Markets Act. Consequently, discussions with the Reserve Bank are the means by which this practice will be established and clarified.

A bond issue by Indefund would face an additional market driven problem. Such a bond issue, even with a guarantee and\or warrants attached, will probably also have to offer the holder the right to sell it back to the issuer at any time. The reason for the need for such a provision would be to coax short term depositors at the banks to purchase these three or five year instruments. Without such a provision, particularly because there is no established secondary market for securities in Malawi, it is doubtful that short term depositors would purchase three to five year securities. This approach has been utilized in other developing countries and has already been favorably explored by the Leasing Finance Company with the Reserve Bank of Malawi.

Of course, Indefund would find it difficult to offer such a "buy back" provision at the present time. First, its liquidity situation would not permit it. Secondly, such a provision would on its face undermine the objective of obtaining funds that essentially match the tenor of its lending portfolio.

In order to offer such a "buy back" provision, Indefund should seek from one or more of its shareholders a matching commitment to buy back and hold the securities to maturity in the event that a purchaser exercises his right to sell back to the issuer. This is discussed in more detail in Section 4 below.

The exact terms of such an issue is something that is finalized after discussion with potential investors, when the issuer is much closer to an actual offering. For reasons that are discussed more fully in paragraph 4 below and elsewhere, Indefund should not consider the capital market as a viable, immediate option but only as a medium to long term objective. In this connection, it should adopt a long term strategy now with entry into the capital market as a possible target in a two to three year timeframe. As part of this strategy, it should begin borrowing from local financial institutions in a systematic way, familiarizing those institutions with Indefund and building their confidence. By so doing, Indefund will not only be establishing the basic building block for accessing the capital market but will be providing the track record that will demonstrate its ability to service the debt instruments referred to above.

3. Assess Indefund's institutional and financial capability to design and manage the issue.

While Indefund is quite adequately managing its SME lending business, undertaking a bond issue under the new Capital Markets Development Act would tax its current capabilities. It should be noted that Indefund has put together a preliminary prospectus describing its current business. However, the launching of the first such issue in the capital market will require, among other things, educating potential investors through seminars and investment forums. Such responsibilities are currently beyond the experience of Indefund staff. In fact, with the current absence in the market of brokers and investment bankers, it will require exceptionally innovative, capital market talent and experience to launch such an issue in Malawi today.

In view of our recommendation that Indefund consider the capital markets funding a more distant objective, it is not necessary at the present time for Indefund to bolster its management or staffing for this purpose. Current management and staffing should be able to provide the information that lending institutions require for loan consideration.

4. Identify potential institutional, legal and procedural constraints which Indefund may face in implementing the issue or issues.

The key constraints facing Indefund as regards a capital issue are not legal and procedural or institutional but rather market related. First and foremost is the question of which investors are likely to purchase an Indefund issue of the type described above.

There are two types of investors: institutional and individual. The main institutional investors who make direct loans of three and five year duration are the insurance companies; these very same investors, therefore, would presumably be purchasers of securities of such duration. Typically, however, such investors must "know" the borrower and usually such investors develop this familiarity by making direct loans to the borrower or by investing in a private placement of the borrower's securities. In making such direct loans or private placements, the institutional investor can impose tailor-made covenants and require collateral of the borrower to obtain greater security. As the institutional investor gains greater experience and confidence in the borrower, it will typically reduce the covenant and collateral requirements. In fact, a borrower which has established its creditworthiness with institutional investors through such a proven track record might offer its securities publicly as a way of forcing the institutional investors to further alleviate their requirements; a borrower can only do this, however, if it is confident that other, usually individual, investors will purchase the securities it plans to offer in the market.

Let's look at the individual investors in Malawi and their potential interest in an Indefund bond issue. First, it is important to remember that no bond issue has yet been made under the Capital Markets Development Act. This means individual investors are not yet accustomed to purchase such securities in Malawi. The marketing task, therefore, that must be undertaken by the first issuer is enormous. Even in a developed market where issues come frequently, a new borrower must conduct a "road show" to provide information on itself and its securities. This "road show" is a costly feature of most initial public offerings, as would be the case for Indefund.

But in Malawi the task and costs would be even greater because there are still no brokers or investment bankers to take on part of this marketing responsibility. A successful marketing effort might, therefore, not only tax Indefund's organizational resources but it may also prove unacceptably costly and timeconsuming to Indefund. Nevertheless the need to familiarize the individual investor in Malawi with securities, their safety, and their suitability as an alternative to bank deposits must be undertaken and the costs will disproportionately have to be borne by the "pioneer" issuers. In other countries, e.g. Ghana and Indonesia, large scale advertising and investor education forums have been viewed as necessary pre-requisites to initial issues and donors have been persuaded to contribute some portion of these costs.

Individual investors pose an additional constraint in Malawi: they currently make only short term deposits and are not accustomed to tying up their funds for three to five years, the tenor that Indefund requires. Thus, even if the capital market were already flourishing in Malawi and individual investors were accustomed to investing in securities, the further challenge remains to persuade the individual investor to tie up his funds for the longer period. This is a formidable task but one that has been overcome in other markets with investment banking ingenuity.

The Leasing Finance Company has gone furthest in exploring the flexibility of the Capital Markets Act and has already discussed with the Reserve Bank the possible issuance of "transferable deposit" instruments (i.e. bonds) under it. These securities are analogous to the instruments that Indefund will want to issue at some time in the future, if its borrowing program is successful.

As already noted, the Malawian deposit market is heavily weighted toward short term deposits that are usually rolled over continually. The typical Malawian depositor seems to want to have the ability to withdraw on short notice; this is particularly important in Malawi because bank deposits are not protected by government insurance.

Nevertheless institutions like LFC and Indefund cannot operate with 30 day funds but require longer term funding (3 to 5 year maturities) to conduct their business. The challenge will be to design a capital markets instrument that will bridge the availability of short term deposit funds with the institutions' need for medium-term (e.g.3- 5 year) funds.

LFC's idea is that short term depositors might be persuaded to invest in five year paper if they felt they could sell this paper at any time. The absence of a functioning secondary market does not presently give investors this confidence. Therefore, in order to provide the desired sense of liquidity in the absence of a secondary market, LFC proposes to offer the purchasers of its bonds a right to sell them back (i.e. "put" them) to LFC at any time. LFC will offer investors this right because it will in turn obtain standby commitments from its shareholders to repurchase and hold the bonds until maturity, should any investor avail himself of this "put" privilege. In this way, LFC hopes to overcome a major obstacle in the start-up phase of the Malawian capital market. By so doing, LFC will probably be able to obtain somewhat cheaper funding than it can through taking deposits or borrowing directly from insurance companies and pension funds.

Incidentally, a public issue would also eliminate some of the lending limit constraints that sometimes reduce the availability of funds to LFC when it is borrowing directly from institutions.

These proposed approaches for filling the gaps in the Capital Markets Development Act are creative but untried. UDC, a shareholder of LFC has pioneered this approach successfully in other African countries like Botswana. Indefund need not pioneer these innovations but will be able to benefit from any progress that LFC achieves, after it completes the direct borrowing program recommended here.

The key institutional market constraints then for Indefund is that it is unknown to both institutional investors who could make loans to it directly as well as to individual investors. Moreover, the absence of a functioning capital market and secondary market imposes formidable costs of entry on the "pioneer" issuers, costs which it would be difficult for Indefund to bear.

A more subtle but real constraint also applies in the case of Indefund at the present time. To date, Indefund has almost entirely been funded by donor funds. Consequently, its profitability record is based on a cost of funds that is unusually low as well as a loan portfolio which is also below market. Any prospectus would have to disclose that borrowings obtained as a result of the issue would be at substantially higher rates than past borrowings and will necessitate a commensurate increase in Indefund's lending rates. The prospectus would have to disclose that there is no certainty that Indefund will be able to maintain its profitability under these new conditions. Such a caveat might be disheartening to potential investors. It is precisely in such circumstances that issuers, who are already known in the market, resort to borrowing from more flexible and sophisticated institutional investors until such uncertainties are resolved.

In summary, the absence of established practice in the capital market in Malawi, the unfamiliarity of institutional investors in Malawi with Indefund, the need for individual investors to become acquainted with securities generally, the need for the first issuer to provide special liquidity provisions in the absence of a secondary market, the "entry" marketing costs to be borne by the pioneer issuers all constitute constraints that would face Indefund if it were to attempt to implement an issue at the present time.

Consequently, Indefund should consider the capital market as a viable medium to long term objective. In this connection, it should adopt a long term strategy now with entry into the capital market as a possible target in a two to three year timeframe. As part of this strategy, it should begin borrowing from local financial institutions in a systematic way, familiarizing those institutions with Indefund and building their confidence. By so doing, Indefund will be establishing the basic building blocks for accessing the capital markets in the future.

5. Assess the overall climate for a capital issue by Indefund, particularly given the shallowness of the market in Malawi and investors' lack of experience with Indefund. Propose an amount for each issue.

If Indefund were to access the public market, it would undoubtedly need to issue bonds of the type being considered by LFC but, unlike LFC, Indefund would not already be known in the market as a borrower in good standing. It is recommended, therefore, that Indefund approach this option in stages and as a first step introduce itself to financial institutions as a modest borrower and establish a repayment record, and thus establish confidence in its creditworthiness. Moreover, this gradual shift to market-based funding will cushion the necessary increases in on-lending rates to its clients.

At this stage, Indefund should set its sights low and should not seek more than Kw 2-3mm in its first borrowing effort.

After establishing a track record, Indefund could consider the issuance of bonds similar to those being considered by LFC. Hopefully, by then, LFC will have pioneered such an issue, making it easier for Indefund to follow.

6. Submit an action plan outlining the steps necessary to plan, initiate, promote and manage the capital issue.

As already indicated a capital issue should not be viewed as a short term objective for Indefund for a variety of reasons. First, its current profitability has been achieved to a large extent because of grants and soft funding. Shifting to more market based financing will require substantial upward adjustment in the lending rates to its clients and it is by no means clear what effect this will have on future prospects for its business. Secondly, in recent months Indefund has experienced increased delinquency rates after the political problems in the spring. Both these uncertainties should be better understood before trying to access the capital market.

Third, Indefund is virtually unknown to the investing public, even the institutional investors.

Fourth, not a single issue has been launched under the Capital Markets Development Act and the problems of the market's start-up should not be added to Indefund's challenges.

In view of the foregoing, Indefund should be looking at its action plan as having several steps:

1. It must arrive at a consensus among its management and shareholders as to whether it wishes to continue **exclusively** as a lending institution to the SME segment if it can no longer use largely subsidized funds.

2. In any event, it should begin the process of raising its lending rates and gradually shifting to market based funding.

3. Such market based funding could be sought initially from institutional lenders in no more than K2-3mm amounts.

4. Indefund could also consider becoming a deposit taking institution, but it is doubtful that this is the most desirable course, as discussed elsewhere.

5. In order to cushion the shift to market based lending and funding, Indefund should explore the possibility of obtaining interim financing from the Post Office Savings Bank (POSB), which is presently taking tax free deposits at a 16% interest rate. These tax free deposits are being made by corporate clients and actually constitute a hidden subsidy which heretofore has produced cheap funding to the Treasury. If GOM policy is to maintain an interim "developmental" subsidy to the SME segment, it may do so by allowing the POSB deposits to be made available to Indefund to replace any reduction in donor funding. Thus, the GOM's left hand can help its right hand, particularly during this unusually tight money situation.

It should be understood, however, that at best this is an interim solution because GOM policy is to do away with governmental subsidies. But in this transitional period it could be justified, particularly as current high interest rates may otherwise crowd out the SME sector entirely.

B. Ideas Beyond the Scope of the Terms of Reference

1. Other stop-gap approaches to cushion the increase in funding costs should be explored. One such approach is to request that donor institutions enter into currency swaps with multinational companies with operations in Malawi. Transactions can be designed so that the foreign currency of the donors can in effect generate expanded local currency for Indefund at cheaper cost. In this way, diminishing donor funds can be made to last longer. Indefund may want to engage consultants to pursue this

possibility. (Eccles Associates has specialized experience in arranging currency swaps and could be of assistance here.)

2. Another approach to make a diminishing amount of donor funds go further would be to repackage what is requested from donors. Instead of seeking donor funding for the entire Indefund portfolio, Indefund might rather ask donor support only to pay the excess portion of the loan spread that might be attributable to the "development" role that Indefund plays in making SME loans i.e. the difference between 11% and the typical 5.5% spread of other financial institutions. Thus, to the extent that Indefund funds itself from market sources, Indefund would seek donor funding to fund the 5.5% excess (i.e. "developmental" spread that it incurs in servicing the SME segment). To the extent that Indefund is successful in replacing donor funds with market based funding, and requests donor funding only for the excess developmental "spread i.e. 5.5%, it will pro tanto reduce its need for donor funds by almost 95% to maintain its current portfolio. In fact, Indefund may even be able to expand its portfolio if market based funds are adequate and if donor funds are available for this purpose.

3. As has been elsewhere suggested in this report, the dramatic increase in interest rates to SME borrowers could conceivably be viewed by some as being inconsistent with Indefund's basic raison-d'etre to provide affordable financing to SME's. In any event, lending rates in excess of 34%-35% would require that borrowers have rates of return in excess of this amount to make such borrowings reasonable.

4. It should be noted that in other economies, when companies have such high rates of return, investors are often willing to provi long term equity financing rather than borrowings in ord to share in the company's growth as owners rather than "cappi " their return as lenders by the interest rate on a loan. Providing long term capital to SME's, which does not require current debt service, means that the investee company can grow even faster but the provider of the long term equity must be willing not to look for his return in less than a 5-7 year time frame.

5. There are many questions that need to be examined in the context of Malawi to determine whether or not venture capital could in fact be adapted to local circumstances. The absence of an active stock market appears to be the most serious obstacle as this would not afford an easy "exit" for the venture capitalist. The venture capitalist might gain as an owner but be unable to convert that gain into cash, in the absence of an active stock market.

6. A number of donor agencies have been supportive of venture capital in developing country contexts, e.g. Commonwealth Development Corporation and FMO. It would be interesting to examine the experience that is developing in the countries where it is being tried.

7. If the introduction of venture capital is to be considered, technical assistance of the following types would be extremely useful:

a. An informational workshop or seminar could be held to inform government officials as well as members of the private sector (including Press Corporation), about venture capital and how it is being used to foster growth and development of SME's both in developed and developing countries. Entrepreneurs should be included in this workshop or seminar as well as those government officials who can be helpful in moving forward the capital markets and Investment Promotion program, as there are important linkages to be developed.

b. Such a seminar or workshop should be linked to the new Investment Promotion Act and probably should permit a review, among other things, of whether Indefund's present policy of not financing Malawian-controlled SME's that have any foreign or Asian joint venture partners is any longer consistent with these investment objectives or most likely to achieve the desired results for indigenous SME's and entrepreneurs.

c. "Hands-on" technical assistance should be provided to Indefund management to show how the advisory services they have developed for SME lending can be adapted and used in managing a venture capital business; to examine where venture capital has succeeded and what problems have cropped up, to explore how issues of running cost are dealt with in a venture capital context. A short-term consultancy and/or study tour might accomplish this transfer of "know-how" most effectively.

ANNEX A

The UN Pension Fund has a substantial portfolio in both local and foreign currency and operates under a UN Resolution that urges a special effort to increase investment in developing country capital markets. The UN Pension Fund actively seeks such investment opportunities but restricts its investments to securities listed on a securities exchange. This is an important and under-utilized potential source of funding for a developing country enterprise like Indefund.

However, Indefund could only access this source of funding if it could issue bonds under Malawi's Capital Markets Development Act and have these bonds listed on a securities exchange. Unfortunately, the new Capital Markets Development Act has yet to be utilized by any issuer and in any event does not contemplate the establishment of an exchange or describe any alternative listing procedures.

As the capital market takes shape in Malawi, it should be borne in mind that the absence of an exchange and listing procedures may in effect eliminate financing from the UN Pension Fund, a potentially significant funding source for institutions like Indefund.

Incidentally, the UN Pension Fund can invest in equities as well as debt instruments but its interest in any securities in Malawi as elsewhere would, of course, be conditioned on the potential to receive a market rate of return on its investments.

Other sources of external financing could also be explored such as the African Development Bank, Edesa, PTA, APDF, IFC's Africa Enterprise Fund, Recycled soft loan funds being repaid to the GOM. These possibilities could be pursued in a second consultancy, if Indefund wishes.

BANKING ACT ANNEX B

(Published 1st December, 1989)

Act

No. 19 of 1989

I assent

H. KAMUZU BANDA

LIFE PRESIDENT

17th November, 1989

ARRANGEMENT OF SECTIONS

21

An Act to provide for the regulation of the business of banking in Malaŵi conducted by commercial banks and financial institutions, to provide for Reserve Bank supervision over banking business and to provide for matters incidental thereto or connected therewith

ENACTED by the Parliament of Malaŵi as follows—

PART I—PRELIMINARY

Short title and commencement

1. This Act may be cited as the Banking Act, 1989, and shall come into operation on such date as the Minister may appoint by notice published in the *Gazette*; and the Minister may, upon the recommendation of the Reserve Bank, appoint different dates—

(*a*) for the coming into operation of different parts, divisions or sections of this Act; or

(*b*) for the coming into operation of this Act in respect of different classes of banking business.

Interpretation

2.—(1) In this Act, unless the context otherwise requires—

"bank" means a person who conducts banking business in Malaŵi, including the acceptance of funds withdrawable by cheque or transferable by other means;

"banking business" means the business of receiving funds from the public by accepting demand, time and savings deposits or by borrowing from the public or other banks, and of employing such funds, in whole or in part, by granting loans, advances and credit facilities and by investing or by any other means at the risk of the person conducting such business;

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"Reserve Bank" means the Reserve Bank of Malaŵi established under the Reserve Bank of Malaŵi Act, 1989; Act No. 8 of 1989

"reserves", in relation to a bank or financial institution, means all funds which have been built up out of earnings, premiums on shares, profits from the realization of assets and increase of the value of assets upon revaluation of such assets, and which have been set aside as a general or special reserve and are available for meeting the liabilities of the bank or financial institution;

"savings deposit" means deposit of money, the withdrawal of which is subject to certain regulations and for which a predetermined interest will be paid in accordance with regulations applicable in respect of a category of savings deposits;

"unsecured", in relation to loans, advances or credit facilities, means loans, advances or credit facilities made without collateral, guarantee or other personal security, or if made against a collateral, guarantee or other personal security, such part of the loan, advance or credit facility which at any time exceeds the market value of the collateral or the amount recoverable from the guarantor or surety, as the case may be.

(2) For the purpose of this Act, a person shall be deemed to be accepting deposits of money if he accepts from the general public deposits of money as a regular feature of his business, or if he solicits such deposits, irrespective of the terms and conditions under which such deposits are accepted or solicited and whether or not certificates or other instruments are issued in respect of any such deposit:

Provided that—

(*a*) the acceptance of money against the issue of debentures, bonds, certificates, notes or other instruments, offered to the public and repayable in not less than twelve months; and

(*b*) the acceptance of insurance premiums by an insurer,

shall not be deemed to constitute acceptance of deposits of money for the purposes of this Act.

INDEFUND does not appear to be a bank w/in meaning of banking Act of 1989

PART II—LICENSING OF BANKS AND FINANCIAL INSTITUTIONS

Licensed?

3.—(1) No person shall conduct banking business in Malaŵi or otherwise indicate to the public that he is conducting or is about to conduct banking business, unless he has been licensed under this Act as a bank or financial institution. Only licensed companies may carry on banking business

(2) No person other than a company shall be licensed under this Act, except by special permission granted by the Minister on the recommendation of the Reserve Bank.

Register of banks and financial institutions; publication of the register

4.—(1) The Reserve Bank shall keep a register of banks and financial institutions and such register shall consist of a separate part for each class of banking business.

(2) The Reserve Bank shall publish in the *Gazette*—

(*a*) the entry of a bank or financial institution, or the cancellation of any entry, in the register;

(*b*) a copy of the register as at 31st December of the preceding year.

Applications for licences

5.—(1) An application for a licence to conduct banking business shall be made to the Minister through the Reserve Bank in the prescribed form and shall be accompanied with such documents as may be prescribed by the Reserve Bank.

(2) For the purpose of considering an application for a licence, the Reserve Bank may require an applicant to submit such additional information and documents as it may deem necessary.

Criteria for licensing

6.—(1) In considering an application for a licence the Reserve Bank shall conduct an investigation to ascertain—

(*a*) the validity and accuracy of the documents and information submitted therewith;

(*b*) the financial condition and history of the applicant;

(*c*) the reputation of the executive officers of the applicant and their competence and expertise to conduct the proposed business;

(*d*) the capacity of the applicant—

(i) to maintain an adequate capital base at all times;

(ii) to comply with the provisions of this Act and of any other Act relevant to its business;

(*e*) the adequacy of the capital base, and earning prospects resulting from the intended operation;

(*f*) the nature and scope of the proposed operation;

(*g*) the needs and convenience of the community or sector to be served;

(*h*) the structure of its organization;

(*i*) the interests of depositors and creditors of the applicant;

(*j*) the interest of the national economy and the public interest; and

(*k*) other matters that may be deemed essential by the Reserve Bank.

(2) After having considered an application as required under subsection (1), the Reserve Bank shall forward the application to the Minister with its recommendations.

7.—(1) The Minister, upon the recommendation of the Reserve Bank may, subject to such conditions as he may deem necessary to impose, grant a licence to a bank or a financial institution to conduct banking business or may refuse to grant a licence.

Issue of licences

(2) The decision to grant or refuse a licence shall be communicated to the applicant in writing by the Reserve Bank within ninety days after receipt of the application or, where further information has been required, after receipt of the last of such further information.

8.—(1) A licence shall not be granted unless—

Minimum capital and other requirements for a licence

(*a*) in the case of a bank—

(i) the bank will effectively be managed by at least two persons as executive officers; and

(ii) its paid up capital is at least two million Kwacha (K2,000,000);

(*b*) in the case of a financial institution, its paid up capital is at least two hundred and fifty thousand Kwacha (K250,000).

(2) The Minister may, on the recommendation of the Reserve Bank, grant exemption from the minimum requirements specified in subsection (1) where such exemption is required in the public interest or in the interest of the national economy or in the special circumstances of the case.

9.—(1) A licence granted under this Act shall indicate—

Contents of a licence

(*a*) the name of the licensee;

(*b*) the class or classes of banking business that the licensee is authorized to conduct;

(*c*) the place or places at which the licensee is authorized to conduct such business.

(2) A bank or financial institution shall not engage in any business other than the business designated in its licence.

10.—(1) The Minister, upon the recommendation of the Reserve Bank, may revoke a licence, if the licensee—

Revocation of a licence

(*a*) supplied false information in its application;

(*b*) fails to commence its business within a period of twelve months following the granting of the licence;

(*c*) ceases to conduct business for which the licence has been granted;

(*d*) fails to comply with any condition of the licence;

(*e*) fails to comply with any provision of this Act and of any other Act relevant to its business.

(2) The Minister may at any time revoke a licence upon the request of a licensee and if the Reserve Bank so recommends.

(2) The Minister may from time to time, upon the recommendation of the Reserve Bank and by order published in the *Gazette*, amend the Schedule by adding thereto or deleting therefrom the name of any bank or financial institution.

Division II—Obligations of Banks and Financial Institutions

Capital funds and minimum capital ratios

15.—(1) Every bank and financial institution licensed under this Act shall maintain an adequate capital base for the conduct of its business.

(2) The Reserve Bank shall prescribe minimum capital ratios which shall relate the capital base of a bank or financial institution to its assets and other risk bearing commitments.

(3) Every bank and financial institution shall ensure that its provisions for bad and doubtful debts are adequate at all times.

Directives related to accounting policies of banks and financial institutions

16. For the purpose of ensuring that banks and financial institutions comply with the requirements of section 15, the Reserve Bank may issue directives as to—

(*a*) valuation of assets;
(*b*) depreciation of assets;
(*c*) provision for bad and doubtful debts;
(*d*) provision for contingent losses and litigation;
(*e*) provision for tax payable;
(*f*) amortization of goodwill;
(*g*) such other items as may be prescribed.

Restrictions of cash dividends

17.—(1) Subject to subsection (2), no bank or financial institution shall pay any cash dividend on its shares where its capital requirements under section 15 have not been met.

(2) Where the Reserve Bank deems it appropriate, it may, upon request by a bank or financial institution, grant such bank or financial institution dispensation from the requirement of subsection (1).

Periodical returns

Does Independent submit reports?

18.—(1) Every bank and financial institution shall periodically submit to the Reserve Bank statements of assets and liabilities, including such information as the Reserve Bank may, from time to time, determine.

(2) The format of the statements required under subsection (1) and the periods within which they must be submitted shall be determined by the Reserve Bank, and may vary for different classes of banks and financial institutions.

(3) The Reserve Bank may require a bank or financial institution to submit a report of its auditor regarding the statements referred to in subsection (1).

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(2) Inspectors appointed by the Reserve Bank for the purpose of subsection (1) may at any time investigate the business or any part of the business of a bank or financial institution.

(3) Any bank or financial institution being examined shall co-operate with an inspector duly authorized by the Reserve Bank, shall produce such records, minutes, books, accounts and documents, and supply all such information, as may be reasonably requested within such time as the inspector may specify.

(4) Any major findings of the inspection shall be communicated to the bank or financial institution concerned by the Reserve Bank.

Division III—Structural Matters and Limitations

Prohibited transactions

23. A company licensed under this Act to conduct any class of banking business shall not—

(*a*) purchase shares in its own business or make loans or advances against such shares as collateral;

(*b*) hold shares in a company by which it is controlled.

Restricted transactions

24. Except with the prior approval of the Reserve Bank, a company licensed under this Act to conduct a banking business shall not—

(*a*) engage on its own account in wholesale or retail trade, including import and export trade, except in so far as may be necessary in the course of the satisfaction of debts due to it;

(*b*) purchase, acquire or hold immovable property other than for the purpose of conducting its business or providing housing or amenities for its staff:

Provided that such company may secure a debt on any immovable property and in default of repayment, may acquire such property for resale as soon as possible thereafter.

Actions requiring prior approval

25. A bank or financial institution shall obtain prior written approval of the Reserve Bank for the following matters—

(*a*) appointment of executive officers;

(*b*) change in the articles of association;

(*c*) reduction of its capital base by repayment of capital or distribution of reserves;

(*d*) opening and closing of branches and static or mobile agencies;

(*e*) opening of establishments abroad;

(*f*) take-over of assets or liabilities of other banks or financial institutions:

(*g*) participation in any other company to an extent in excess of ten per cent of the paid up capital of such company;

(*h*) financial restructuring;

(*i*) liquidation;

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(2) For the purpose of this section "shareholder" if an individual, "director", "officer", or "employee" includes—

(*a*) the close relations of such person;

(*b*) any firm or company in which such person is interested as a partner, director, manager or guarantor;

(*c*) any company in which such person has a material interest;

(*d*) any individual for whom such person is a guarantor.

(3) Any loans, advance or credit facility granted by a bank or financial institution to any of its officers or employees in excess of two years remuneration of such officer or employee shall require unanimous approval of the board of directors of the bank or financial institution concerned.

Prudential limits as to size of loans, participations and immovable property

30.—(1) Without prejudice to the generality of the powers of the Reserve Bank to issue directives under section 26, no bank or financial institution shall without prior permission of the Reserve Bank—

(*a*) grant or permit to be outstanding any loan, advance or credit facility in excess of 25 per cent of its capital base to any debtor or group of related debtors:

Provided that this limit shall not apply to any credit facility granted in respect of exports from Malaŵi;

(*b*) have investments in land, buildings and other immovable property in aggregate in excess of the sum of its capital and reserves;

(*c*) own, to an aggregate value exceeding 25 per cent of the sum of its capital and reserve, shares in the capital of any company, firm or enterprise.

(2) The Minister may, upon the recommendation of the Reserve Bank, by order published in the *Gazette*, and having due regard to the nature of business customarily carried on by certain financial institutions, exempt any financial institution or any class of financial institutions from all or any of the requirements of section 30.

PART IV—REMEDIAL MEASURES

Remedial measures directed by the Reserve Bank

31.—(1) If it is found upon inspection under section 22 that a bank or financial institution is conducting its business in an unlawful or unsound manner, or that its solvency or liquidity are endangered, the Reserve Bank, in addition to any other course of action open to it under this Act or any other written law, may—

(*a*) require such bank or financial institution to take such measures as the Reserve Bank deems necessary to rectify the situation;

(*b*) with the approval of the Minister, add conditions to the licence granted to the bank or financial institution;

control the bank or financial institution in liquidation, including powers to—

(*a*) temporarily continue its operations;

(*b*) stop or limit the payment of its obligations;

(*c*) employ any necessary officers and employees;

(*d*) execute any instrument in the name of the bank or financial institution; and

(*e*) initiate, defend and conduct in the name of the bank or financial institution any action or proceedings to which it may be a party.

(4) Prior to taking any measure under subsection (1), the Reserve Bank shall consult with the Minister.

PART V—WINDING-UP

Companies Act applicable in case of winding-up

33. Subject to the provisions of this Part, the provisions of the Companies Act relating to the winding-up of companies (Part XII of that Act) shall be applicable to licensed banks and financial institutions which are companies, within the meaning of that Act:

Cap. 46:03

Provided that the provisions of the Companies Act, specially applicable to a creditor's voluntary winding-up (sections 253, 254, 255, 256, 257, 258, 264 and 265 of that Act) shall not apply to banks and financial institutions.

Reserve Bank powers prior to winding-up

34. Before any winding-up of a bank or financial institution, whether voluntary or by a court, may be commenced, 14 days' prior notice in writing shall be given to the Reserve Bank, which may—

(*a*) take such action as is provided for under section 32;

(*b*) in the case of a voluntary winding-up, permit the winding-up to proceed on such terms and conditions as the Reserve Bank may determine; or

(*c*) in the case of a winding-up by the court, permit the petition to proceed, in which case the Reserve Bank shall be entitled to appear before the court at the hearing of the petition and make representations.

Entries in bank books and evidence of depositor claim
Cap. 46:03
Cap. 11:01

35. For the purposes of any winding-up and notwithstanding anything to the contrary contained in sections 204 to 305, inclusive, of the Companies Act or in the Bankruptcy Act, any entry in the books, accounts or records of a bank or financial institution relating to deposits shall be *prima facie* evidence of the claims of the depositors.

Preference of certain claims
Cap. 46:03
Cap. 11:01

36. Notwithstanding the provisions of sections 260 and 287 (10) of the Companies Act and section 35 of the Bankruptcy Act, in the winding-up of a bank or financial institution unable to pay its debts, any balance of the free residue after making provision

(3) The Reserve Bank may grant full or partial dispensation from a directive under subsection (1) to one or more institutions in special cases or under special circumstances.

(4) Directives under subsection (1) shall be published in the *Gazette*.

(5) The Reserve Bank may require any bank or financial institution to furnish such information as the Reserve Bank may deem necessary to satisfy itself that the directives, referred to in subsection (1), have been complied with.

Interest-free penalty

39.—(1) If a bank or financial institution has not complied with a general directive issued under section 38, the Reserve Bank may order such bank or financial institution to maintain an interest-free penalty-deposit with it, the size of which shall be commensurate with the amount of non-compliance.

(2) For the purposes of subsection (1), "amount of non-compliance", in relation to a prescribed amount, means any excess over a set maximum or any shortfall under a set minimum as the case by be.

PART VII—ABANDONED PROPERTY

Abandoned property to be delivered

40.—(1) The following items held by a bank shall be presumed to have been abandoned—

(*a*) any deposit, including interest, in respect of which the depositor has not for seven years after the last deposit transaction in his account increased or decreased the amount of the deposit or presented the passbook or other record for the crediting of interest, or corresponded with the bank concerning such deposit; and

(*b*) other property deposited with the bank including the contents of any safe deposit box upon which the lease or rental period has expired and in respect of which the owner thereof has not for seven years following such expiry, corresponded with such bank or in any other manner indicated an interest therein.

(2) Any bank bolding items presumed to have been abandoned under subsection (1) shall report such holdings to the Reserve Bank and thereafter—

(*a*) in the case of any money deposits, pay such deposits into the Bankruptcy Estates Account at the prescribed bank or with the Accountant General as if they were unclaimed or undistributed funds under the Bankruptcy Act, and section 134 of that Act shall apply accordingly; Cap. 11:01

(*b*) in the case of any other property, deliver such property to the Reserve Bank, together with the name and last-known address of the owner thereof.

Use of the word "bank"

43.—(1) Save with the consent of the Reserve Bank, which may impose such conditions as it thinks fit, no person, other than a bank or financial institution, shall use in the description or title under which such person is conducting its business in Malaŵi the word "banker", "banking", "saving", "deposit", "credit", or literal translation of such words or any combination of letters in which such words appear.

(2) A person who contravenes subsection (1) commits an offence and shall be liable to a fine of one thousand Kwacha.

Advertisement of financial services

44. No person, other than a bank or financial institution, shall advertise that he performs financial services in Malaŵi normally rendered by banks and financial institutions.

Persons disqualified as directors

45.—(1) Without prejudice to any provision of the memorandum of association, constitution, articles of association or other rules for the conduct of the business concerned, which is not inconsistent with the provisions of this section, no person shall be appointed or remain a director of a company registered in a class of banking business—

(*a*) if he has, under an enactment in force in Malaŵi or elsewhere—

(i) been adjudged or otherwise declared insolvent or bankrupt and has not been by law discharged from insolvency or bankruptcy; and

(ii) made an assignment to or arrangement or composition with his creditors which has not been rescinded or set aside;

(*b*) if he is convicted of an offence involving dishonesty or fraud.

(2) No person who was a director or executive officer of a bank or a financial institution which was wound up shall act or continue to act as a director or executive officer of a bank or financial institution without the approval of the Reserve Bank.

(3) Any person acting in contravention of this section shall be guilty of an offence and shall be liable to a fine of five thousand Kwacha and to imprisonment for one year.

Offences and penalty for contravening certain provisions

46. A bank or financial institution which contravenes any provision of sections 3, 18, 19, 20, 21, 22, 23, 24, 25 or 41 or any of the directives issued by the Reserve Bank pursuant to sections 8, 11, 15, 16, 17, 18, 26, 27, 28, 29, 30, 31, 38 or 41 of this Act, shall be guilty of an offence and liable to a fine of five thousand Kwacha and ten thousand Kwacha for any subsequent offence of the same nature.

Responsibility of executive officers for correct statements

47.—(1) Any executive officer of a bank or financial institution who—

(*a*) fails to take all reasonable steps to secure compliance by the bank or financial institution with this Act or any directive issued by the Reserve Bank under this Act; or

52. Neither the Reserve Bank nor any of its directors, managers, officers or employees, nor any other person appointed as adviser under section 31 (1) (*d*) shall be subject to any action or to claims by any person or to liability to any person in respect of anything done in good faith in pursuance, or in execution, of any power conferred upon the Reserve Bank under this Act or under the Reserve Bank of Malaŵi Act, 1989. No action or claims to lie against the Reserve Bank and its directors and officers

Act No. 8 of 1989

53. The cost of supervision of banks and financial institutions related to the implementation of this Act or regulations made under this Act may be recovered by the Reserve Bank from such banks and financial institutions in accordance with Reserve Bank directives issued under this Act and approved by the Minister or in accordance with regulations made under this Act. Cost of Reserve Bank supervision may be recovered from banks and financial institutions

54. The Reserve Bank shall every year present a report to the Minister on the administration and implementation of this Act. Annual report on banking and supervision

55.—(1) A person who contravenes any provision of this Act shall be guilty of an offence. General offence and penalty

(2) A person who is guilty of an offence under this Act for which no other penalty is specified shall be liable to a fine of two thousand Kwacha and to imprisonment for one year.

56. The Minister may, upon the recommendation of the Reserve Bank, make regulations for the better carrying out of the objectives of the Act and for its better administration. Regulatory powers of the Minister

57. Any matter required to be prescribed under this Act may be prescribed by directives issued by the Reserve Bank under this Act or by regulations made by the Minister under section 56. Mode of prescribing matters to be prescribed under this Act

58. The Minister may, on the recommendation of the Reserve Bank and by Order published in the *Gazette*, declare that this Act shall not apply to the banking business of any financial institution or class of financial institutions. Non-application of this Act to certain classes of banking business

59. The Banking Act is hereby repealed. Repeal of Cap. 44:01

SCHEDULE

s. 14 (1)

BANKS AND FINANCIAL INSTITUTIONS SUBJECT TO PRUDENTIAL SUPERVISION

Commercial Bank of Malaŵi Limited

Leasing and Finance Company of Malaŵi Limited

Mercantile Credit Limited

National Bank of Malaŵi

ANNEX C

MALAWI DEPOSIT TAKING INSTITUTIONS

1. National Bank of Malawi
2. Commercial Bank of Malawi
3. INDEBANK
4. Leasing and Finance Company of Malawi
5. CBM Leasing Company
6. Mercantile Leasing Company
7. FINCOM (Financial Corporation of Malawi)
8. Post Office Savings Bank (POSB)

MAJOR NON-BANK FINANCIAL INSTITUTIONS

1. Insurance Companies
   - A. Old Mutual Insurance Company
   - B. National Insurance Company
2. New Building Society
3. Pension Funds
   - A. Indebank Pension Funds
   - B. Other Pension Funds (Largely Managed by Insurance companies)

ANNEX D

Old Mutual Building
Glyn Jones Road
P O Box 393
Blantyre

Telegrams Mutual
Tel 620 677
Telex 44690
Fax 622 649

P O Box 30158
Lilongwe 3 Tel. 730 588/730 542
P O Box 318
Mzuzu Tel 332 804

Our Ref WKB/ecm

Your Ref

OLD MUTUAL

30 July 1992

The President
Eccles Associates
One Cyrus Field Road
IRVINGTON
New York 10533

Dear Sir

APPROACH FOR OLD MUTUAL FINANCIAL ASSISTANCE

I refer to your enquiry regarding Old Mutual Lending Policy and the parameters within which investment loans are negotiated. I confirm as follows:

1. TRUST FUNDS

   The funds available for investments are trust funds belonging to Old Mutual's policy holders and as such Old Mutual must establish complete security of the funds before Old Mutual's Board can approve a recommendation to make funds available to an organisation.

2. GOING CONCERNS

   The policy is to provide financial assistance to or through going-concerns which have a proven track record. In this respect Old Mutual does not lend or invest in ventures nor in high risk projects.

3. LOAN OFFER

   If negotiations have been finalised satisfactorily, Old Mutual makes a written offer spelling out in more detail the terms and conditions under which a loan is to be given and the Borrower is required to indicate acceptance or otherwise by a given date.

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9. LOAN REPAYMENT

The repayment term of loan capital is negotiable between 7 to 15 years. A moratorium period when interest only is paid can be negotiated if required.

10. COMMITMENT FEE

A commitment fee is payable to Old Mutual by the Borrower before the loan or part thereof can be disbursed.

11. CANCELLATION FEE

If in terms of the Loan Agreement loan funds remain undrawn or cannot be disbursed then the Borrower is required to pay Old Mutual a cancellation fee on the amount of the loan which remains undrawn.

12. DEFAULT

Payment of interest, capital or any amounts due to Old Mutual are to be made on due dates. The Borrower shall be considered to have defaulted if payment is not made on due dates.

12.1 If payment has been delayed for a period of up to 14 days after the due date then the Borrower shall pay interest on the outstanding amount at the rate being charged in terms of Clause 8 above calculated from the due date to the date when Old Mutual is paid.

12.2 In the event that the Borrower has delayed payment for a period of 15 days or more then the loan plus all unpaid moneys shall become immediately payable.

12.3 If Old Mutual accepts a request by the Borrower not to call up the loan, then all outstanding amounts will immediately attract interest generally of 2 percentage points per annum over and above the rate payable in terms of Clause 8 above, and adjusted terms will be negotiated. Such interest shall be calculated from the due date to the date when Old Mutual is paid.

13. OTHER PROVISIONS

13.1 There could be a requirement to include controls on Management and possibly Board of Directors.

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13.2 If funds are required for construction, Old Mutual would require to approve the appointment of Architect, Contractor and other professionals involved.

13.3 The Borrower may be required to obtain Reserve Bank of Malawi's approval to borrow local funds.

13.4 Audited accounts for the last 5 years, management accounts, and other pertinent financial reports and cashflow projections may be required to establish a clear understanding of the borrowing organisation, its management and activities and its future loan servicing ability.

13.5 All legal costs of and incidental to the preparation and execution of the loan-related documents are to be borne by the Borrower even if the loan is discontinued for any reason. The Borrower must pay these costs before the first drawdown is effected.

13.6 For the duration of the loan the Borrower is required to take out comprehensive insurance on the property or properties offered as security with Old Mutual's associated insurers.

I should be grateful to know whether you would want to arrange a date when we can discuss this matter further.

Yours faithfully

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J E SMITHYMAN
MANAGER OLD MUTUAL MALAWI

ANNEX E

List of Interviewees (Partial)

W. K. Banda
Manager Malawi Investments
Old Mutual

Peter K. Pohland
Deputy Resident Representative
World Bank Mission
in Malawi

Jan Claassen
Managing Director
CBM Financial Services Ltd.

John A. Barker
Chairman & General Manager
B.A.T. (Malawi) Ltd.

Dr. G. O. Sibweza
Chief Executive
Finance Corporation of Malawi

D. R. Wodowson
General Manager
The New Building Society

D. R. Donaldson
Deputy Chief Executive
National Bank of Malawi

Chadwick Mphande
General Manager
INDEBANK

A. J. Varela (Mrs.)
Controller of Projects Monitoring
INDEBANK