

**THE PAYMENT SYSTEM IN  
MALAWI**



# Table of Contents

<b>OVERVIEW OF THE NATIONAL PAYMENT SYSTEM IN MALAWI .....</b>	<b>59</b>
<b>1. INSTITUTIONAL ASPECTS .....</b>	<b>59</b>
<b>1.1 General legal aspects .....</b>	<b>59</b>
<b>1.2 Role of financial intermediaries that provide payment services .....</b>	<b>60</b>
<i>1.2.1 Commercial banks .....</i>	<i>60</i>
<i>1.2.2 Savings bank .....</i>	<i>60</i>
<i>1.2.3 Development finance houses and leasing companies .....</i>	<i>61</i>
<i>1.2.4 Foreign exchange bureaux .....</i>	<i>61</i>
<i>1.2.5 Other financial institutions .....</i>	<i>61</i>
<b>1.3 The role of the central bank .....</b>	<b>61</b>
<b>1.4 Roles of other private sector and public sector bodies .....</b>	<b>62</b>
<i>1.4.1 National Payments Council .....</i>	<i>63</i>
<i>1.4.2 Bankers Association of Malawi .....</i>	<i>63</i>
<b>2. SUMMARY INFORMATION ON PAYMENT MEDIA USED BY NON-BANKS .....</b>	<b>63</b>
<b>2.1 Cash payments .....</b>	<b>63</b>
<b>2.2 Non-cash payments .....</b>	<b>64</b>
<i>2.2.1 Credit transfers .....</i>	<i>64</i>
<i>2.2.2 Cheques .....</i>	<i>64</i>
<i>2.2.3 Direct debits .....</i>	<i>64</i>
<i>2.2.4 Payment cards .....</i>	<i>64</i>
<b>3. PRESENT INTERBANK EXCHANGE AND SETTLEMENT SERVICES .....</b>	<b>65</b>
<b>3.1 General overview .....</b>	<b>65</b>
<b>3.2 Structure, operation and administration .....</b>	<b>65</b>
<i>3.2.1 Major legislation, regulation and policies .....</i>	<i>65</i>
<i>3.2.2 Participants in the system .....</i>	<i>66</i>
<i>3.2.3 Types of transactions handled .....</i>	<i>66</i>
<i>3.2.4 Operations of the transfer system .....</i>	<i>66</i>
<i>3.2.5 Transaction processing environment .....</i>	<i>66</i>
<i>3.2.6 Settlement procedures .....</i>	<i>67</i>
<i>3.2.7 Pricing policies .....</i>	<i>67</i>
<i>3.2.8 Credit and liquidity risks .....</i>	<i>67</i>

<b>4.</b>	<b>SPECIAL USE OF INTERBANK TRANSFER SYSTEMS FOR INTERNATIONAL AND DOMESTIC FINANCIAL TRANSACTIONS .....</b>	<b>67</b>
4.1	Exchange and settlement systems for international transactions .....	67
4.2	Exchange and settlement systems for securities transactions .....	67
<b>5.</b>	<b>THE ROLE OF THE CENTRAL BANK IN INTERBANK SETTLEMENT SYSTEMS .....</b>	<b>68</b>
5.1	General responsibilities .....	68
5.1.1	<i>Statutory responsibilities .....</i>	<i>68</i>
5.1.2	<i>Establishment of clearing rules .....</i>	<i>68</i>
5.2	Provision of settlement and credit facilities .....	68
5.3	Monetary policy and the payment system .....	69
5.4	Risk reduction measures .....	69
<b>6.</b>	<b>RECENT DEVELOPMENTS IN THE PAYMENT SYSTEM .....</b>	<b>70</b>
6.1	Description of the new system .....	70
6.1.1	<i>NPC plan of action for modernisation of the payments systems in Malawi ....</i>	<i>70</i>
6.2	Other developments .....	70
6.2.1	<i>Automation of clearing house system .....</i>	<i>70</i>
6.2.2	<i>MICR cheque processing standards .....</i>	<i>70</i>
6.2.3	<i>Establishment of data bank .....</i>	<i>70</i>
6.2.4	<i>Review of Clearing House rules .....</i>	<i>70</i>
<b>7.</b>	<b>INFRASTRUCTURE .....</b>	<b>71</b>
7.1	Telecommunications infrastructure .....	71
7.2	Availability of electricity .....	71
7.3	Road infrastructure .....	71
7.4	Economic reforms .....	71
<b>Tables</b>	<b>.....</b>	<b>72</b>
<b>Selected references</b>	<b>.....</b>	<b>73</b>

## **OVERVIEW OF THE NATIONAL PAYMENT SYSTEM IN MALAWI**

The development of the payment system in Malawi has been influenced to a great extent by the structural reforms that have been implemented in the financial sector since the early 1980s. These reforms were initiated by the Malawi Government as part of the overall structural adjustment programmes the country has implemented since 1981 with the help of the International Monetary Fund and the World Bank. They are aimed at making the whole financial system more responsive and efficient so that it can adequately support the development requirements of the country by providing the required financial resources.

The financial system in Malawi, like in many developing countries, is relatively small, underdeveloped and dominated by a few financial institutions who offer a limited range of services. The economy is predominantly rural-based with only about 15% of the population living in cities and towns. Cash is the dominant mode of payment, but the authorities are now trying to promote the use of cashless instruments such as cheques. The importance of cash in payments processes is reflected in the share of (M1) in the aggregate money supply which averaged 53% between 1992 and 1996. Few people maintain bank accounts. Automated Teller Machines (ATM) facilities are offered on a small scale by one commercial bank (Commercial Bank of Malawi).

A number of factors have a limiting effect on the process of modernisation in Malawi. Some of these factors are:

- lack of commitment by the individual commercial banks to the modernisation programme due to high cost implications;
- low level of computerisation in the banking sector;
- legal and technological shortfalls; and
- differences in corporate strategies among banks.

Despite these problems, the Reserve Bank of Malawi has provided very strong leadership and is a major driving force in the change process. In addition, there is a National Payments Council (NPC) which provides a forum through which the central bank and the commercial banks adequately discuss issues on the modernisation programme and agree on common strategies. Further, the banking sector is relatively small and it has often been very easy for the central bank to bring all parties together and agree on certain issues. There is also global and regional pressure to modernise the payment system to be in line with international standards in order for Malawi to continue transacting with the rest of the world.

### **1. INSTITUTIONAL ASPECTS**

#### **1.1 General legal aspects**

There is no specific legislation that currently governs the payment systems in Malawi, but the following legislation is relevant to the payment and clearing system in the country:

- Reserve Bank of Malawi Act 1989;
- Banking Act 1989;
- Bills of Exchange Act 1967;
- Bank Supervision Act 1989;
- Building Societies Act 1964;
- Capital Markets Development Act 1990.

The new Reserve Bank of Malawi Act and the Banking Act were amended in 1989. These changes were aimed at instituting necessary reforms in the financial system. The Reserve Bank of Malawi Act provides the legal basis for the existence of the central bank and its functions. It also provides the basis for the establishment of the Clearing House and confers upon the Reserve Bank of Malawi certain powers and duties connected with Banking, Currency and Coinage functions. The Banking Act provides for the regulation of the business of banking in Malawi conducted by commercial banks and other financial institutions and also provides a mandate to the Reserve Bank for the supervision of banking business. In addition to these, the Capital Market Development Act was also enacted in 1990.

This legislation is primarily aimed at laying adequate foundations for the development of a sound banking system and financial markets in Malawi as well as ensuring adequate supervisory provisions. Secondly, they were aimed at protecting the savings of the public and safeguarding the smooth functioning of the commercial banks through laid down rules and regulations for their operations. In particular, the Capital Markets Development Act laid a foundation upon which the Malawi Stock Exchange was established.

The Bills of Exchange Act primarily focuses on a few paper-based instruments such as cheques, promissory notes and bills of exchange. The Act sets out the rights and uses of different types of payment instruments. Apart from the above legislation, there is also no specific legal provision governing other “traditional” payment media or electronic payment systems. Relations between financial institutions, consumers and retailers are governed by private contracts.

## **1.2 Role of financial intermediaries that provide payment services**

The financial system in Malawi, like in many developing countries is relatively small, underdeveloped and dominated by a few financial institutions that offer a limited range of services. For this reason, the banking sector is also relatively small. It comprises four commercial banks, three leasing companies, one building society, one savings bank and several finance houses with the central bank at the apex. These institutions provide financial services in the economy. There are also a number of foreign exchange dealers that offer foreign exchange services. These are governed by the Exchange Control (Forex Bureaux and Foreign Exchange Fixing Sessions) Regulation of 1994.

### ***1.2.1 Commercial banks***

There are no branches of foreign banks in Malawi and the four commercial banks are therefore all locally incorporated. The two largest banks, namely National Bank of Malawi Limited and Commercial Bank of Malawi Limited, have a wide network of branches including mobile and static agencies throughout the country. The other two banks, First Merchant Bank Limited and Finance Bank Malawi Limited, have established a small number of branches in the major cities. These banks offer a wide range of services to their customers which include payment facilities, loans, foreign exchange transactions, etc. The banks also facilitate payments for the acquisition of Government Treasury bills and Local Registered Stocks by their clients. These banks offer both corporate and retail banking services. Presently, the four commercial banks have a total number of 32 branches and 20 static agencies throughout the country.

Competition among the banks is very low with all of them offering almost similar limited products and the two big banks dominating the market.

### ***1.2.2 Savings bank***

The Malawi Savings Bank was licensed under the Banking Act 1989. Malawi Savings Bank is still using the Malawi Post Office network for most of its operations. It is therefore the only institution with a very wide network of branches penetrating all the rural areas of the country.

The Malawi Post Office Savings Bank was licensed under the Banking Act 1989, but currently a new Malawi Savings Bank Act is being drafted. The aim of this is to transform its operations and make it more competitive in the market. Currently, Malawi Savings Bank does not take part in Clearing House operations.

### ***1.2.3 Development finance houses and leasing companies***

There are also a number of development and leasing institutions that provide various services in the financial sector. Amongst these are INDE Fund Limited, Leasing and Finance Company, CBM Financial Services Limited, National Finance Company Limited, NICO Finance Company Limited, and Malawi Rural Finance Company Limited. These institutions provide financial support to various development activities such as manufacturing, tourism, construction, transport, education, agriculture and general trading. In particular, the Malawi Rural Finance Company provides loans to small and medium enterprises and mainly in the agriculture and transport sectors.

### ***1.2.4 Foreign exchange bureaux***

There are several authorised Foreign Exchange Bureaux operating in Malawi. These are allowed to conduct buying and selling of foreign currency notes and travellers' cheques. The Foreign Exchange Bureaux business was established under the Exchange Control (Forex Bureaux and Foreign Exchange Fixing Sessions) Regulation of 1994.

### ***1.2.5 Other financial institutions***

In addition to the institutions mentioned above, there are also a number of small financial institutions that provide credit facilities and advice to small businesses. Some of these institutions are Malawi Union of Savings Credit Cooperatives Limited (MUSCO), Development of Malawian Traders Trust (DEMATT), Small Enterprise Development Organisation of Malawi (SEDOM), Women World Banking (WWB), National Association of Business Women (NBW) and, National Association of Small and Medium Enterprises (NASME).

MUSCO is basically a savings institution which concentrates on encouraging people to form savings groups. The accumulated savings benefit members of the very same groups in terms of loans. DEMATT is mainly a business advisory body aimed primarily at assisting small businessmen in business planning and implementation.

Non-bank institutions are also represented in the payment media market although on a very small scale. Some of these are:

- companies issuing entertainment cards or luncheon vouchers such as hotels and tour operators;
- commercial companies issuing in-house cards or vouchers such as petrol companies like Oilcom which issue pre-funded vouchers for fuel procurement.

## **1.3 The roles of the central bank**

The Reserve Bank of Malawi (RBM) is the country's central bank. It was established in July 1965, a year after the country's independence from its former colonial ruler, Britain. The Bank was established under the Reserve Bank of Malawi 1964 Act of Parliament. This Act was amended in 1989. The Bank's principal responsibilities and duties as stipulated in the Act are as follows:

- to issue legal tender currency in Malawi;
- to act as banker and adviser to the Government;

- to maintain external reserves so as to safeguard the international value of the Malawi currency;
- to implement measures designed to influence the money supply and the availability of credit, interest rates and exchange rates with the view to promoting economic growth, employment, stability in prices and a sustainable balance of payments position;
- to promote a sound financial structure in Malawi, including payment systems, clearing systems and adequate financial services;
- to promote a money and capital market in Malawi;
- to act as lender of last resort to the banking system;
- to supervise banks and other financial institutions;
- to collect economic data from the financial and other sectors for research and policy purposes; and
- to promote development in Malawi.

In the pursuance of the above functions, the Reserve Bank of Malawi is expected to act with due regard to the interest of the national economy and to the economic policies of the Government.

Distribution of notes and coins is done by the Reserve Bank of Malawi through its head office in Lilongwe as well as its branch in Blantyre in the Central and Southern Regions respectively. In the Northern Region where the central bank does not have its own branch, it maintains a sub-chest agreement with National Bank of Malawi whereby the central bank uses National Bank, Mzuzu Branch as its distribution centre.

As lender of last resort, the Reserve Bank of Malawi grants credit to commercial banks and other financial institutions in the case of severe liquidity problems. As banker to government, the RBM maintains Government accounts and accepts deposits. It also issues Government Treasury bills and Local Registered Stocks on behalf of the Government. The Reserve Bank of Malawi is not involved in retail activities.

The RBM provides the settlement mechanism among banks. Settlement and clearing services are provided at both its head office in Lilongwe and its branch in Blantyre. Malawi uses a netting out settlement system which is basically manual since clearing house operations have not yet been automated. The Bank also plays a leading role in setting standards for the financial system and assumes general responsibility for the smooth operation of payment systems. In this regard, the Reserve Bank issues Monetary Directives from time to time to regulate the financial market.

The Reserve Bank of Malawi is interested in the efficiency, reliability and integrity of the payments system which is vital for monetary policy operations. It is also a supervisory authority over commercial banks and other financial institutions including insurance companies.

In addition to maintaining government accounts, it also maintains accounts for commercial banks and some statutory bodies, foreign central banks, private commercial banks and international organisations like the IMF and the International Bank for Reconstruction and Development (IBRD).

#### **1.4 The role of other private sector and public sector bodies**

Several entities play various roles in the modernisation of the payment system in Malawi.

#### ***1.4.1 National Payments Council***

The promotion of the national payments system in Malawi is done by the National Payments Council (NPC), a body which was established in 1993 under the IMF assisted modernisation programme of the financial sector. A consultancy study on the status of Malawi's national payments system was carried out in that year. The results of this study revealed that much progress could be made in the payments system if there was a specific body to initiate developments in the area. The original members of NPC included the Reserve Bank of Malawi, National Bank of Malawi, Commercial Bank of Malawi and the Government, represented by the Accountant General of the Ministry of Finance. Today membership has expanded to include the two new commercial banks, namely First Merchant Bank and Finance Bank of Malawi Limited. It also includes other financial institutions such as Finance Company of Malawi (FINCOM), New Building Society, Malawi Savings Bank, INDE Financial Services Limited and the Malawi Posts and Telecoms Corporations Department.

The NPC comprises the Governor of the Reserve Bank of Malawi and the Chief Executives of the member institutions. Below this council, there is a steering committee which deliberates issues before they are referred to the council and below this steering committee, there are several task teams which are usually set up by the steering committee to work on specific projects. Committees of this nature are usually disbanded once the purpose for which they were established has been accomplished.

#### ***1.4.2 Bankers Association of Malawi***

Under the auspices and influence of NPC, in 1995, the commercial banks formed their own association known as the Bankers Association of Malawi. The main objective of this Association is to promote and protect matters of common interest among its members. The Bankers Association of Malawi works hand in hand with the NPC on all issues relating to payments and the modernisation programme.

## **2. SUMMARY INFORMATION ON PAYMENT MEDIA USED BY NON-BANKS**

### **2.1 Cash payments**

Cash has remained the most widely used payment medium in the consumer sector in Malawi. Approximately 75% of all business transactions are conducted through cash payments. In 1996 the currency in circulation in Malawi averaged MKW 1,398 billion, an increase of approximately 77% over the 1992 levels.

The unit of currency used in Malawi is the Malawi Kwacha (MKW) and comprises notes (Kwacha) and coins (Tambala). One hundred tambala equal one Malawi Kwacha. The banknotes are issued in six denominations of MKW 200, 100, 50, 20, 10, and 5 while the coins are in seven denominations of 1, 2, 5, 10, 20, 50 Tambala and MKW 1. Cash withdrawals are mainly made through the counters in banks. The proportion of notes in relation to the value of total cash in circulation amounted to approximately 96.5% at the end of 1996.

Although it is difficult to estimate the actual value or number of payments made using cash, the relatively underdeveloped banking system has meant that cash takes precedence in most business transactions. As indicated above, the use of ATM services for obtaining cash are offered on a very small scale by one commercial bank.

## **2.2 Non-cash payments**

### **2.2.1 Credit transfers**

Some payments are made through credit transfers using telegraphic transfers and mail transfers in Malawi. Under credit transfers, the order is given by the customer making the payment to his bank usually in paper form and handed in at his bank branch or sent by post. Credit transfer instructions are also normally used for payments of recurring nature such as rent. However, credit transfers constitute a small proportion of all payments in the country.

Telegraphic transfers are also another form of credit transfers which enables a payment to be made to a holder of a bank account at one branch from an account holder at a different branch of the same bank. Telegraphic transfers are used for both intrabank and interbank transactions validated through use of tested telex messages. Mail transfers are usually used for inter-branch payments.

For cross border transactions, banks are currently being encouraged to use S.W.I.F.T. facilities as opposed to telegraphic transfers in transferring funds because of their efficiency, relatively high security and low cost.

### **2.2.2 Cheques**

Cheques are issued under the Bills of Exchange Act and they are the most frequently used cashless payment instruments. However, the use of cheques has not been popular due to a number of factors. Two of these factors are the long delays in cheque clearing periods and the large number of cheques issued on insufficiently funded accounts. The authorities through the NPC and the Bankers Association of Malawi are examining various ways through which usage of cheques could be promoted. One way through which this can be done is by encouraging banks to issue cheque guarantee cards. It is expected that by supplying creditworthy customers with cheque guarantee cards, financial institutions will promote the acceptability of cheques to creditors. These cards will serve as a guarantee that any cheque drawn will be honoured up to a specific amount whether or not the drawer's bank account has sufficient cover.

In general terms, the volume of cheques has been increasing slowly each year. Unlike other cashless payment instruments, the cheque can be used for several successive payments, by means of endorsement. This practice is, however, relatively limited.

In addition to cheques issued by individual financial institutions, the Post Office also issues a special category of pre-funded instruments, known as the postal and money orders. These are payment orders sent by post which the recipient can cash at a post office or at a financial institution at which he is a customer. There is generally extensive use of the postal and money orders in Malawi because the Post Office has a very wide network extending to all rural areas. The Post Office also provides the only available network through which people are able to send cash to rural areas.

### **2.2.3 Direct debits**

The direct debit facility exists to a small degree in Malawi. Like the standing order, its purpose is simply the execution of regular payments and the signing of agreements between suppliers and consumers such as payment for electricity, water and telephone bills or subscriptions. The direct debit is made out by the creditor (payee) and presented to his bank for collection from the debtor's (payor's) bank.

### **2.2.4 Payment cards**

*Credit cards and travel and entertainment cards.* Credit card facilities are not yet available in Malawi. However, hotels and tour operators accept credit cards issued by international

organisations such as American Express, Diners Club, Eurocard and VISA. These cards are usually used by foreign tourists. The Reserve Bank and the NPC are encouraging commercial banks to consider introducing these facilities. However, the success of this will depend on the introduction of an electronic payment infrastructure.

**Pre-paid vouchers.** Pre-paid vouchers issued by petrol companies and large retail outlets are also available in Malawi. These vouchers are used manually and are only controlled by their issuers.

**ATM and POS networks.** ATM services are currently offered by Commercial Bank on a stand-alone basis at a few branches. However, the other commercial banks will also be introducing these services in the near future. Point Of Sale (POS) card payments are yet to be introduced and the commercial banks in Malawi are planning to install these facilities at large retail outlets for its customers.

### **3. PRESENT INTERBANK EXCHANGE AND SETTLEMENT SERVICES**

#### **3.1 General overview**

Interbank exchange and settlement services are offered by the Reserve Bank of Malawi through the clearing house. Malawi has a net settlement system. However, plans are under way to introduce Real Time Gross Settlement (RTGS) in the long term. There is no specific law relating to payment, clearing and settlement services, but these functions are currently carried out under the Reserve Bank of Malawi Act. Clearing House operations are conducted by the Reserve Bank at both its Lilongwe and Blantyre offices.

Clearing is done twice a day at 11.30 and 13.30 from Monday to Friday. The 11.30 clearing is mainly for exchange of items by banks and actual settlement is done at 13.30. During peak periods like month end, an extra clearing period is usually arranged at 15.00.

Malawi has not yet automated its clearing house operations and therefore the clearing system involves the physical exchange of paper-based payment instruments such as cheques, clearance vouchers and mail transfers. Interbank financial market transactions are also processed by the Reserve Bank through the accounts of the commercial banks maintained by the Reserve Bank. Interbank transfers are normally effected either by issue of a letter to the Reserve Bank from the bank requesting the transfer of funds from its account authorising the Reserve Bank to debit the account and credit the account of the borrowing bank specified in the instruction. Membership of the Clearing House is only extended to deposit taking institutions licensed under the Banking Act and the Reserve Bank of Malawi Act.

#### **3.2 Structure, operation and administration**

##### **3.2.1 Major legislation, regulation and policies**

There is only one exchange and settlement system in Malawi. As indicated above, there is no specific legislation regulating the payments and clearing system in Malawi. The rules and regulations governing the Clearing House operations are agreed between the Reserve Bank and the participating institutions. The Reserve Bank plays the role of inspector of the Clearing House in order to safeguard the smooth functioning of the system.

### **3.2.2 Participants in the system**

Currently, there are five members in the Clearing House in Malawi. These are:

- Reserve Bank of Malawi (Member and Inspector of the Clearing House);
- National Bank of Malawi (Member);
- Commercial Bank of Malawi (Member);
- First Merchant Bank Ltd. (Member);
- Finance Bank Malawi Ltd. (Member).

However, other financial institutions participate indirectly through the four clearing banks. Each bank is held responsible for the transactions of the indirect participants which it represents at the Clearing House.

### **3.2.3 Types of transactions handled**

Since Clearing House operations are done manually, all types of paper-based payment instruments can be processed. At present, only cheques, clearing vouchers and mail transfers are handled.

### **3.2.4 Operations of the transfer system**

As indicated above, clearing rules provide for two clearing times each business day at 11.30 and 13.30. The morning session is mainly for exchange of items among members while the afternoon session is for the actual settlement of financial obligations among the participating banks. At month ends, extra clearing time is normally provided at 15.00. This extra period is provided to avoid the banks having to hold a huge amount of uncleared effects.

Punctuality in the Clearing House is emphasised. Members reporting late for clearing may be fined. Once the transfer documents are exchanged during the morning session, each member separately classifies the items into either claims against his bank and in favour of another bank or against another bank and in favour of his bank. During the afternoon session, each member then calls and records the total amount received from and delivered to the other banks. The inspector of clearing then tallies all the figures and the settlement figure is arrived at by netting out the total value of items received and that of the total items delivered. Each member is required to certify his settlement figure by signing a clearing house certificate.

The actual settlement takes place in the form of passing settlement entries into the accounts of the member banks held by the Reserve Bank of Malawi. Once the settlement figures have been certified and the necessary book entries passed, the transactions cannot be revoked. Finality is thus provided at that stage.

For up-country cheques, the maximum clearing period is five days. Currently each bank uses its own courier system to transport its country cheques to the clearing centres of Lilongwe and Blantyre.

### **3.2.5 Transaction processing environment**

At present, the clearing process is purely manual involving the physical exchange of items among clearing house members.

### **3.2.6 Settlement procedures**

The Reserve Bank of Malawi is the only settlement agent. Finality of Clearing House operations is at the end of the day when the net financial obligation of each individual bank is entered in their respective accounts. Since this is not an online process, the banks are unable to obtain their treasury positions until the next business day when end-of-day processing by the Reserve Bank is completed. Notification of each bank's position is done by telephone every morning of each business day.

### **3.2.7 Pricing policies**

Since there are no sophisticated clearing and settlement facilities in the Malawi Clearing House, the small costs arising from the clearing house operations are borne by the Reserve Bank. Processing of end-of-day operations is done by the bank's computer system using the bank's own personnel. Telephone bills arising from confirmation of bankers' positions are also borne by the bank. There are no transaction fees.

### **3.2.8 Credit and liquidity risks**

All banks are required to maintain adequate balances in their main accounts held at the central bank at the end of each business day. The idea of this is to reduce any credit risks. However, when a bank's clearing account is overdrawn after settlement, it is expected to borrow funds from the interbank market. If it fails to secure funds from the interbank market, the bank can resort to the discount window facility at the central bank. Borrowing from the central bank is usually on the basis of collateral whose value must always be equal or higher than the value of the loan.

## **4. SPECIAL USE OF INTERBANK TRANSFER SYSTEMS FOR INTERNATIONAL AND DOMESTIC FINANCIAL TRANSACTIONS**

### **4.1 Exchange and settlement systems for international transactions**

International payments are effected through traditional correspondent banking channels maintained with all major trading partners. All existing exchange controls have been liberalised except on capital transfers.

Payment instructions are either received or sent through tested telex or S.W.I.F.T. messages to and from foreign banks. However, the Reserve Bank of Malawi is encouraging commercial banks to use S.W.I.F.T. because of high security and low cost considerations. Documentary letters of credit are also used, particularly for big contracts.

The major commercial banks also maintain international correspondent business. In the context of international payments made face-to-face, the most commonly used payment instruments are traveller's cheques and to a small degree banknotes and bank drafts.

### **4.2 Exchange and settlement systems for securities transactions**

The only securities instruments traded in Malawi are Malawi Government Treasury Bills and Local Registered Stocks. These instruments are issued by the Reserve Bank of Malawi as an agent of the Malawi Government.

## **5. THE ROLE OF THE CENTRAL BANK IN INTERBANK SYSTEMS**

### **5.1 General responsibilities**

#### ***5.1.1 Statutory responsibilities***

As mentioned above, there is no specific legislation for the clearing and settlement system in Malawi, but by virtue of its responsibilities as described in the Reserve Bank of Malawi Act, the Bank plays an active role in both clearing and settlement functions and the development and modernisation programmes of the payment system in Malawi.

In clearing and settlement functions, the Reserve Bank plays the role of inspector of the clearing house and provides office accommodation for this purpose and also supervises and confirms all settlements among banks.

It also maintains the settlement accounts of commercial banks through which interbank settlement obligations are met. It also accepts deposits from commercial banks and may make current account advances and short-term loans to them in its role as lender of last resort through these settlement accounts.

The Reserve Bank also processes interbank loans by debiting and crediting the main accounts of the concerned parties on instruction from the account holders.

The Reserve Bank is also responsible for the supervision of the commercial banks. In Malawi, the supervisory authority of the Reserve Bank also extends to all other financial institutions including the insurance industry. In these supervisory duties, which are carried out within the general framework of oversight, the Bank's major concerns are to ensure that the banks are financially sound, well managed and not posing a threat to depositors' interests.

#### ***5.1.2 Establishment of clearing rules***

Through the initiative of the Reserve Bank, Clearing House rules were established. However, any amendment of these rules now requires the involvement of the Bankers Association of Malawi and the National Payments Council. The Reserve Bank also regularly issues Monetary Directives for monetary policy purposes.

### **5.2 Provision of settlement and credit facilities**

The role of the Reserve Bank in the settlement process of interbank payments has already been covered above. It is the aim of the Reserve Bank of Malawi that payments are settled in a coherent way without any risk.

The Reserve Bank provides an overdraft facility to banks taking part in clearing and settlement functions. The conditions for usage of these credit facilities are determined by monetary policy considerations.

As regards all clearing operations, the Reserve Bank requires that each financial institution must ensure that its credit balance is sufficiently large to allow its transfer orders to be processed. If necessary, banks may borrow from and lend to one another to acquire funds to initiate irrevocable transactions during the day.

All commercial banks in Malawi are by law subjected to liquidity reserve requirements and therefore hold balances in the Liquidity Reserve Requirement accounts with the Reserve Bank of Malawi. Currently, the Liquidity Reserve Requirement is calculated at 35% of the total deposit base

of a bank for the preceding month. The Reserve Bank imposes heavy penalties for non-compliance with the liquidity reserve requirement.

In a further effort to tighten money market conditions, the reserve requirement base was, in February 1996, redefined to include government deposits with the commercial banks.

As mentioned above, the Reserve Bank also provides all other facilities relating to clearing to all banks and assumes the role of the Inspector of the Clearing House. The bank also ensures that all commercial banks' overdrawn accounts are cleared before the end of each business day. Currently, the Reserve Bank is not charging the commercial banks for the clearing services.

### **5.3 Monetary policy and the payment system**

The principal objective of the Reserve Bank of Malawi's monetary policy is price stability which is mainly guided by targeted growth and exchange rates. Malawi liberalised its economy and the exchange rate of the Malawi Kwacha is therefore determined by economic forces. Previously, the Malawi Kwacha was linked to a basket of seven currencies comprising the US dollar, pound sterling, Deutsche Mark, rand, yen, french franc and dutch guilder, from 17th January 1984 to 1994. On 7th February 1994, the Malawi Kwacha was floated. The first fixing session was on 18th February 1994 on which US\$ 1.00 settled on MKW 6.51.

With regard to interest rates, the Reserve Bank of Malawi announces and provides its official discount rate, thereby giving clear indications on the desired movement of short-term interest rates. In order to achieve desired interest rates, the Reserve Bank is guided by the economic growth targets that are set at the beginning of each financial year. Control of inflation is one major concern of monetary policy in Malawi. This aims at ensuring that the level of inflation is consistent with growth objectives.

To change the bank rate the Reserve Bank is guided by the average of six auctions of the 91-day Treasury bills rate. However, the bank rate is only adjusted if there is a continuous change in the trend of the Treasury bills rate either downwards or upwards. This helps to ensure that changes in bank rate are really determined by market forces.

In monitoring money supply in order to bring the overall market position to the desired levels of surplus or deficit, the Reserve Bank uses Open Market Operations in order to mop up excess liquidity or increase money supply in the economy.

Although exchange controls have been liberalised, Malawi still maintains exchange control on capital flows. Accordingly, residents of Malawi have to seek exchange control approval for any external direct or portfolio investments. Similarly, all foreign capital inflows for direct or portfolio investments have to be registered with the Reserve Bank of Malawi.

### **5.4 Risk reduction measures**

The Reserve Bank of Malawi through the NPC has managed to reduce the clearing period for cheques. This move was aimed at reducing the liquidity risk in the payment system usually associated with delays in cheque clearing. In order to avoid the systemic and credit risk that the banks may be exposed to in the Clearing House, all members of the clearing system are requested to maintain adequate credit balances in their clearing accounts with the Reserve Bank.

The banks have also agreed to establish a fraud investigation unit to be responsible for investigating all fraud cases in the banking industry and also prosecute the cases in court. This unit will be established on a cost sharing basis among all members in the financial system.

## **6. RECENT DEVELOPMENTS IN THE PAYMENT SYSTEM**

### **6.1 General overview**

#### ***6.1.1 NPC plan of action for modernisation of the payments system in Malawi***

Malawi has embarked on a comprehensive programme to re-examine its payment system infrastructure. Under this, the NPC has drawn a comprehensive payments system modernisation plan of action. Some legislation will be reviewed under this plan of action.

There are also plans to develop new legislation for areas which are not currently covered. One legislation to be reviewed is the Bills of Exchange Act. There are also plans to review the Building Societies Act. The new legislation under consideration is the Payment System, Settlement and Clearing Act, Money Laundering Act and Securities Act. Drafting of the Money Laundering Act and the Securities Act has already been completed and awaiting parliamentary debate.

Under this modernisation programme there are also plans to introduce more cashless payment instruments such as smart cards, debit/credit cards, POS and others. In order to promote the use of cheques and restore the public's confidence in cheques as acceptable means of payment, the banks have agreed to introduce cheque guarantee cards.

### **6.2 Other developments**

#### ***6.2.1 Automation of clearing house system***

Malawi has a long-term strategy to eventually automate its Clearing House operations. Already plans are under way to link the commercial banks and the central bank. Some consultants have already been approached to carry out a feasibility study on this project.

#### ***6.2.2 MICR cheque processing standards***

Banks in Malawi have agreed to introduce modern cheque processing standards by using MICR technology. This move is in line with the current payments system modernisation plan of action.

#### ***6.2.3 Establishment of data bank***

In order to share information on issues of mutual interest, banks have also agreed to establish a data bank. Through this data bank, banks will share such information as list of bad customers as well as fraud cases. It is hoped that through this banks will be able to avoid certain risks.

#### ***6.2.4 Review of Clearing House rules***

As mentioned above, the current Clearing House rules were drawn up by the Reserve Bank. It is realised by the central bank that the commercial banks through the Bankers Association of Malawi should be fully involved in the formulation of these rules and should actually take ownership of the rules. In this way the Association will be able to punish any member who contravenes the rules. It is very difficult at the moment to punish any member who contravenes the current rules because they are simply viewed as Reserve Bank rules imposed on the members. All these measures are aimed at creating an environment where cashless payment instruments will gain acceptability and reduce excessive use of cash, thereby establishing an efficient system on the transfer of value through the payment system.

## **7. INFRASTRUCTURE**

### **7.1 Telecommunications infrastructure**

The Malawi Posts and Telecoms Corporation (MPTC), formerly the Government Department of Posts and Telecommunications within the Ministry of Transport and Communications until 1995, is mainly responsible for the provision of the telecommunications infrastructure in Malawi. Private companies have not yet been licensed to provide telecommunication services.

The MPTC has a wide network of telecommunication facilities throughout the country. It is currently putting up new exchange centres in the urban areas in order to improve telecommunication facilities. The NPC has also formed a special subcommittee to constantly review the requirements of the banking industry together with MPTC.

### **7.2 Availability of electricity**

The Electricity Supply Commission of Malawi (ESCOM) is the sole supplier of electrical power in Malawi. It has a wide distribution network of electricity throughout the country. Most of the urban centres are adequately supplied with electricity. Currently, there is a project on Rural Electrification, funded by the World Bank, the African Development Bank and the Malawi Government, which is aimed at bringing electricity to most of the rural areas.

ESCOM is putting up more new hydroelectric power stations in order to boost its generating capacity.

### **7.3 Road infrastructure**

Malawi has a very good road network connecting the major cities and towns. Malawi also has a good road network in the rural areas which has been constructed under the Rural Integrated Development Programme. Since Malawi is mainly an agricultural economy, the improvement of roads in the rural areas has been given priority in order to facilitate the transportation of agricultural commodities to the markets.

The good road network between cities has helped to speed up the movement of cheques from one corner of the country to another and thereby speeding up the clearing of cheques. Recently, the cheque clearing period in Malawi has been reduced from as long as 21 days to a maximum period of 5 days.

### **7.4 Economic reforms**

Economic reforms started in the early 1980s through the World Bank and IMF sponsored Structural Adjustment Programmes. Both the Government and the central bank have played active roles in these economic reforms. The reforms have mainly aimed at rejuvenating the private sector in order to turn it into an engine of economic growth.

The impact of these reforms on the country's financial sector has been positive. Malawi has witnessed the establishment of new banks and several financial institutions in an industry which was dominated by a few institutions before. The birth of these new institutions has increased competition, which in turn has helped to improve efficiency in the country's payments system.

Table 1  
**Basic statistical data**

	1992	1993	1994	1995	1996
Population (millions) .....	9.4	9.7	10.0	10.34	10.70
GDP (US\$ millions) .....	1,857.71	2,069.86	1,286.80	1,422.70	2,201.70
GDP per capita (US\$) .....	182.85	226.71	128.31	142.21	205.5
Exchange rate (domestic vis-à-vis USD)					
<i>year end</i> .....	<i>4.3956</i>	<i>4.4656</i>	<i>15.2986</i>	<i>15.3048</i>	<i>15.3224</i>
<i>average</i> .....	<i>3.6013</i>	<i>4.4132</i>	<i>8.8476</i>	<i>15.2839</i>	<i>15.2771</i>

Table 2  
**Settlement media used by non-banks**  
(at year-end, not seasonally adjusted, in billions of Kwacha)

	1992	1993	1994	1995	1996
Notes and coin .....	65.93	92.75	40.83	64.53	79.85
Transferable deposits .....	123.53	181.00	65.60	118.45	184.15
Narrow money supply (M1) .....	153.71	206.05	92.43	135.48	170.44
Broad money supply (M3) .....	277.24	387.05	158.02	253.93	354.59

### **Selected references**

Reserve Bank of Malawi: Report and Accounts for year ended 31st December, 1996.

Reserve Bank of Malawi: Report and Accounts for year ended 31st December, 1995.

Reserve Bank of Malawi: Financial and Economic Review, Volume XXIX - Number 1, 1997.

Reserve Bank of Malawi: Financial and Economic Review, Volume XXVIII - Number 4, 1996.

Reserve Bank of Malawi: Financial and Economic Review, Volume XXVIII - Number 1, 1996.

National Statistical Office: Monthly Statistical Bulletin, January, 1997.

National Statistical Office: Monthly Statistical Bulletin, July, 1997.

Reserve Bank of Malawi: The Economy and its Financial System, A Guide to the Financial Services Industry.

Bank for International Settlements: Payment Systems in the Group of Ten Countries, Basle 1993.