FINANCIAL SECTOR ASSESSMENT PROGRAM

MALAWI

TECHNICAL NOTE

LEGAL FRAMEWORK FOR ACCEPTANCE, REGISTRATION AND REALIZATION OF COLLATERAL

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I. TYPES OF COLLATERAL

1. A well-functioning legal framework for secured lending needs to provide for the creation, recognition and enforcement of security interests. This includes making it possible for all types of assets to be collateralized, effective notice and registration rules to be adapted to all types of property, and clear rules of priority on competing claims or interests in the same assets.

2. Creditors are very risk averse – real estate is the most popular security in Malawi. Lenders accept movable / immovable assets as collateral. Personal guarantees and corporate guarantees, depending upon the strength of the group, are also prevalent. Creditors finance a number of hire-purchase transactions for motor vehicles, where the vehicle is the collateral. Floating charges (debentures) are also taken over corporate property, but they are extremely rare since the only effective remedy in case of default is liquidation, at which stage not much remains to be recovered.

3. In Malawi, 65 percent of all land is customary land, with only user rights for individuals and no formal land titles. The land policy proposed by the government seeks to formally recognize assignment of rights in customary land, but has run into opposition from the Chiefs. There are three types of lands in Malawi – customary land, private land and public land. Customary land is under the control of Chiefs who allocate them to individuals for use. The user rights are similar to those obtaining over freehold land, though there are no title deeds in the name of the individual. Informal assignment of rights by individuals who have bestowed customary land by the Chiefs prevails. Such ‘sub-lease’ is however not registered, and is thus not legally recognized. The proposed land policy seeks to recognize and legitimize these transactions. Private land constitutes leaseholds and freeholds, while public land is government owned land.

II. PROCEDURE AND COSTS FOR A SECURED TRANSACTION

4. Freehold land can be mortgaged or transferred without much difficulty; creating a charge over leasehold land is beset with procedural hurdles and delay. Dealing with freehold land does not involve taking prior approval of the government. One can transfer freehold land or create a charge over it – only a notice of such intention is to be given to the government. When the land involved is on lease, prior permission of the government is required – in case one intends to create a charge over the land, the Commissioner of Lands needs to give the go-ahead; in case one intends to transfer it, prior approval of the Minister of Lands is required. Requests for transfer of leasehold land from all over Malawi are processed in the capital city Lilongwe. Additionally, if the land involved belongs to the Malawi Housing Corporation, their consent is required for a transaction (this is relatively easy to get).

5. The Minister of Lands typically approves twenty-thirty applications in a day, depending upon his schedule; Malawi should either remove this requirement or

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1 Written by Rahul Agrawal, World Bank.
delegate these powers to subordinate officials. Applications can pile-up and if he is traveling abroad, the Secretary in the Office of the President and the Cabinet signs the applications on his behalf. One can get the approval in one week if one is lucky; typically it takes a month, or sometimes even three-four months for the approval to come through. To eliminate these difficulties, Malawi should either do away with the requirement of government consent, or at least delegate the Minister’s and Commissioner of Land’s powers to a number of subordinate officials.

6. **Land transactions involve a lot of back and forth between different offices and are fairly expensive.** One needs to pay city tax, ground rent tax and get Malawi Revenue Authority’s tax clearance certificate before one can transfer land. The application for government consent costs 1000 Kwacha, while the application to Malawi Housing Corporation costs 2000 Kwacha. A 3 percent stamp duty on transactions involving sale is payable at the Registrar General’s office, which comes under the Ministry of Justice. For a mortgage, the stamp duty is about 0.6 percent. Once the fees is paid and the clearances from different departments obtained, one needs to visit the land registry, pay a fee of 2000 Kwacha, and register the land transfer documents. Malawi should take steps to simplify and consolidate these processes – for instance, the application for government consent, the stamp duty, and the document registration fee can all be paid at a single location.

7. **Legal fees under the Legal Practitioners (Scale and Minimum Charges) Rules are excessive.** Lawyers are bound to levy a 1 percent scaled charge on the value of the transaction for drafting mortgage / lease / transfer documents and 2 percent charge in case they negotiate the transaction. These charges are applicable to all types of security transactions, even where the underlying asset is not land. Anecdotal evidence suggests that debentures involving 250 million Kwacha are fairly common, while land sales reaching 50 million Kwacha are not unheard of. In addition, banks also levy this 1 percent charge, even though they have in-house counsel and are not supposed to take this fee. Lack of awareness among debtors results in their having to bear such charges. Considering that the documentation is fairly standard for these transactions, such charges are excessive and need to be rationalized.

**III. REGISTRATION SYSTEM**

8. **Malawi has a dual system of registration – title registration and deeds registration.** Deeds registration is chronological and archaic, without any guarantee as to the underlying title. Searching the deeds registry is time consuming. There is one centralized deeds registry in Malawi. The title-registration system, which has already covered the important urban centers of Blantyre, Zomba and Lilongwe, is more reliable and trustworthy. Creditors can rely upon the ownership details as recorded in the title-registry and advance moneys on that basis. Chances of fraud are lesser. Malawi is trying to move towards title-registration for the whole country, but shortage of funds has impeded progress.

9. **The land registry continues to suffer from resource and infrastructural constraints; the World Bank supported BESTAP Project supports computerization**
of land registries. The registries are short staffed and have limited space. The Commissioner of Land is also acting as the Chief Land Registrar, since the post remains unfilled from the time the previous Chief Land Registrar passed away. Heavy workload impedes an efficient discharge of either function, with the result that registration of documents is not immediate. The filing and recording system continues to be manual, with records prone to decay and damage. Malawi should computerize the land registry – it is noteworthy that the World Bank supported BESTAP Project has recognized this deficiency and proposes to computerize the land registry.

10. The Companies Registry is a multi-purpose registry, entrusted with the incorporation of companies, registration of business names, trusts and political parties, and registration of charges, debenture, movables, Bills of Sale, stop orders etc. As of July 15, 2007, the Companies Register had 8,412 companies and 101,380 business names. The Companies Registry is also tasked with the filing of annual returns from companies, and ensuring they are not delinquent in that regard. However, even though about 3000 companies do not comply with this requirement, there is rarely any follow-up in this regard. Shortage of staff and inexperience with procedures results in very little enforcement action being undertaken.

11. The Companies Registry also suffers from infrastructural constraints; realizing this deficiency, efforts to computerize the Registry are underway. The filing system is manual, with records maintained haphazardly and prone to decay. Search process is inefficient, as either staff may not be available to retrieve the records or the record itself may be misplaced. Efforts to digitize the records are underway; however, the process has given rise to complaints that the files take for digitization get misplaced and are unavailable for prolonged periods of time. The computer infrastructure also suffers from serious shortcomings – internet is slow and expensive, hardware is outdated, after-sales hardware and software support is lacking. The World Bank supported BESTAP Project aims to computerize the company registry and smoothen its functioning – it is recommended that the Project look at capacity building and training issues, not just of the Companies Registrar and her immediate support staff, but also of technical personnel to keep the hardware maintained and running in good form.

IV. Credit Reference Bureau

12. In absence of an enabling legal environment, Malawi has one informal credit bureau. The credit bureau is run without any support from banks or financial institutions. Concern over violating customer privacy makes lenders not share repayment and default information with the credit bureau. In absence of a specific law, creditors are hesitant to obtain customer authorization at the time they process loan applications and share loan and repayment details with the credit bureau. In absence of specific Reserve Bank of Malawi support to the credit bureau, lenders are unwilling to access referencing services from the credit bureau. The credit bureau is thus unable to fulfill its function of assisting lenders price credit appropriately.

13. Realizing the importance of a credit bureau, Malawi has proposed a Credit Referencing Bureau Bill to regulate the establishment and functioning of a credit
bureau. The Bill provides for the establishment of a credit bureau, and the rights and responsibilities of various parties. The provisions permit individuals to access the credit information and dispute its correctness. They oblige the credit bureau to maintain integrity of the information. The Bill is expected to fill the current vacuum in the legal framework and provide a fillip to credit bureaus in Malawi.

14. **The proposed Credit Reference Bureau Bill suffers from a major lacuna in as much as it restricts the credit bureau to the collection of only negative information.** The credit bureau will not be in a position to document timely payment of dues by responsible borrowers, and its role will be reduced to being a ‘blacklisting’ entity. Additionally, while the provisions do attempt to prevent misuse of customer information by credit bureau employees and enable individuals to get their credit information corrected, they do not envisage a situation where a third party hacks into the credit bureau accounts and steals individual’s credit information to trade in it or otherwise violate individual privacy. Malawi must rectify such deficiencies in order to provide a stable and well-functioning legal framework for credit bureaus in the country.

15. **While the deficiencies in the proposed Bill are rectified, Reserve Bank of Malawi should issue directives to facilitate the functioning of credit bureaus.** Considering the current political situation in Malawi, there is no certainty about the passage of legislative instruments. A via-media can be found through Reserve Bank of Malawi directives, which could mandate banks to obtain customer consent for sharing information as part of loan applications, share such information with credit bureaus, and affirmatively seek such information from credit bureaus for new loan applicants. The Reserve Bank could make this conditional upon credit bureaus submitting to its supervision, so as to watch for consumer interest.

V. **Realization of Collateral**

16. **The enforcement of security is time-consuming and expensive.** Foreclosure requires giving a 120 day notice to the debtor (under the Registered Lands Act), during which the debtor can either pay the outstanding loan or the property will be sold. During the 120 days, creditors usually get the property valued through agents and apply for the Minister of Lands to consent to the reserve price (this consent is relatively easy to get). The 120 days is excessive, since anecdotal evidence suggests that within 30 days the debtor’s ability to repay the outstanding loan becomes evident. After 120 days, a Trust Auctioneer or Estate Agent holds a public auction, and charges a commission of 5 percent of the sale price. Transfer of the land to the new owner takes a long time due to procedural hurdles, on an average two to three months. Malawi should shorten the 120 day requirement, perhaps to a more reasonable 60 days, and ensure that the new owner can get the title to land within a few days of paying the full purchase price.

17. **For enforcing bills of sale (such as in hire purchase financing), creditors usually apply to the Court to get an ex-parte seizure order and apply to the Sheriff to seize the property.** The Sheriff charges a 35,000 Kwacha fee for seizing the vehicle. While documentation for such transactions is standard and permits the creditors to periodically inspect the collateral, banks rarely undertake such inspections. The collateral
thus does not fetch a very good price in public auction, and most likely has to be sold through private tenders. Recovery usually is less than the outstanding amount, and a separate suit has to be filed for the balance. In such cases, the balance is usually written off. Debentures entitle creditors to appoint receivers with one-week notice, who then sell the assets and recover for the creditors.

VI. Judicial Framework

18. Following the British tradition, the judiciary in Malawi is held in high esteem. Judges are widely regarded as competent and impartial in their decision-making. However, their understanding of commercial issues is not up to the mark. They routinely grant injunctions in favor of debtors whenever a secured creditor attempts to enforce collateral, such as during the foreclosure process. They allow litigants to drive the process and permit liberal adjournments. Judges also took a long time, once hearing of a case was concluded, to deliver the final judgment. The consequent delays of between six-months to three years frustrate the realization of collateral by secured creditors, during which time the interest on unpaid loan mounts. Secured creditors eventually have to write-off the sum.

19. Malawi is trying to address these deficiencies through the constitution of a specialized Commercial Court. The government recently established a Commercial Court for dealing with matters of a commercial nature, with its own set of Rules and procedures. The Commercial Court, which started functioning on May 14, 2007, will play a more active role in dispute resolution, through mandatory mediation, pre-trial conferences and settlement of issues. An in-house bailiff / sheriff for prompt execution of judgments is also envisaged. The Rules provide that judgments will have to be delivered within sixty days of conclusion of the hearing. It is hoped that the number of adjournments will be less and the case will be finally decided within six months.

20. The Commercial Court will require a lot of capacity building and infrastructural support to emerge successful; some support is being provided under the BESTAP Project. It is anticipated that nearly 80 percent of all cases filed in Malawi could be of a commercial nature – an exercise is proposed to be undertaken wherein case auditors will review pleadings in currently pending cases in the High Court and identify them for transfer to the Commercial Court. However, under Order 22 Rule 5 of the Commercial Court Rules, this exercise is to be finished within six months from the constitution of the Court. Though 6 Judges have been sanctioned (4 in Blantyre and 2 in Lilongwe), so far only 2 Judges have been appointed. The strength of 6 Judges may also prove to be inadequate, and might need to be augmented. The Court is functioning out of rented premises and does not possess adequate information technology infrastructure. The registration and case filing system is manual. Judges also require initial capacity building and thereafter continuous training to keep them up to date with commercial developments and further their understanding of law, economy and finance.
VII. **Insolvency and Corporate Rehabilitation**

21. **The legal framework for an effective corporate insolvency should generally aim to integrate with a country’s broader legal and commercial systems**; maximize the value of a firm’s assets by providing an option to reorganize; strike a careful balance between liquidation and reorganization; provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors; provide for timely, efficient and impartial resolution of insolvencies; prevent the premature dismemberment of the debtor’s assets by individual creditors; provide a transparent procedure that contains incentives for gathering and dispensing information; recognize existing creditor rights and respect the priority of claims with a predictable and established process; and establish a framework for cross-border insolvencies, with recognition of foreign proceedings.

22. **The insolvency / bankruptcy system in Malawi is outdated and in urgent need of reform.** Insolvency provisions are a part of the Companies Act, which is based on the 1948 UK Companies Law. Individual bankruptcy is based on the 1930’s Bankruptcy Act. Creditors find it unviable to pursue winding-up / bankruptcy proceedings. Consequently, there are hardly any winding-up cases reported in Malawi. Anecdotal evidence suggests bankruptcy to be a seasonal phenomenon - creditors approach courts with bankruptcy petitions against individuals seeking a political post, fear of bankruptcy and consequent inability to get elected makes the individuals pay their dues. Thereafter, creditors lose interest in the court process and petitions are not pursued further. The proposed review / redrafting of commercial laws under the BESTAP Project must include a review of the Company Law, particularly insolvency and rehabilitation provisions.

23. **Formal workouts and corporate restructuring provisions are out of date, cumbersome and ineffective; they are almost never resorted to.** Even though the size of the Malawi banking sector is relatively small with a small number of players, disagreement among creditors can derail realistic restructuring proposals. A lot is left to the good sense of the creditors, with the debtors having no recourse if lenders are influenced by the implications of provisioning requirements in the short term at the expense of long term viability of the restructuring. Every creditor reviews the facts and forms its own opinion – the same enterprise may thus be treated differently, depending upon the creditor’s approach.

24. **Creditors are usually eager to liquidate assets and maximize their recovery without giving the enterprise a viable chance at restructuring; chartered accountants are appointed to act as receivers / administrators for this sole purpose.** There is no mechanism under which the debtors could approach the Court and get a short term stay against creditors, while they try to restructure and turn their businesses around. There is also a dearth of experienced professionals in Malawi. More structured rules and procedures are required to enable formal workouts and restructuring in Malawi; simultaneous attention should also be paid to developing professional expertise in the area.
25. **Malawi also needs to evolve a scheme for informal restructuring of enterprises, which would work outside the court system.** The Reserve Bank of Malawi could evolve guidelines for restructuring of loans above a certain threshold and provide provisioning incentives for banks to utilize the same. Such guidelines would go beyond rescheduling of debts only, and may involve sacrifice on part of the creditors, conversion of debt into equity, bringing in of priority financing to sustain a business enterprise etc. Such guidelines would ensure common treatment by banks of similar fact situations, and be of immense utility particularly in case of large corporate groups undergoing financial distress.

**VIII. RECOMMENDATIONS**

26. Considering the above, Malawi should attempt to undertake the following reforms:

**Short-term**
- Shorten the 120 day period prescribed in the Registered Lands Act before sale of foreclosed property can take place
- Delegate the power of Minister of Lands / Chief Commissioner of Lands to grant consent to transfer / creation of a charge over leasehold property to subordinate officials
- Augment resources available to Commercial Courts; increase the number of Judges and support staff
- Enable the functioning of credit reference bureaus by Reserve Bank of Malawi directives

**Medium-term**
- Rationalize legal fees under the Legal Practitioners (Scale and Minimum Charges) Rules by capping it
- Introduce capacity-building and continuous training programs for Commercial Court Judges and support staff
- Introduce legislation facilitating the establishment and functioning of credit bureaus
- Introduce informal corporate debt restructuring guidelines through Reserve Bank of Malawi directives

**Long-term**
- Revise Company Law, and provide for comprehensive insolvency and corporate rehabilitation provisions