GOVERNMENT NOTICE NO. 10

FINANCIAL SERVICES ACT

(CAP. 44: 05)

FINANCIAL SERVICES (TRANSACTIONS OF BANKS WITH RELATED PARTIES) DIRECTIVE, 2018

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SCHEDULE-Policy on transactions with insiders and related parties

IN EXERCISE of the powers conferred by section 34 (2) (z) of the Financial Services Act, I, Dr. DALITSO KABAMBE, Registrar of Financial Institutions, make the following Directive—

PART I – PRELIMINARY

Citation

1. This Directive may be cited as the Financial Services (Transactions of Banks with Related Parties) Directive, 2018.

Interpretation

2. In this Directive unless the context otherwise requires—

"arms length basis" means where a transaction between related parties is conducted upon terms no more favourable than those which would be offered under prevailing conditions to persons other than related parties;

"bank" has the meaning ascribed to that term in the Banking Act; Cap.44:01

"banking business" has the meaning ascribed to that term in the Banking Act; Cap.44:01

"banking group" means a group of two or more companies at least one of which is a bank domiciled in Malawi where the holding company is a bank or a non-financial company domiciled in Malawi;

"board" means the highest body of authority in a financial institution responsible for strategically guiding the institution, effectively monitoring management and properly accounting to shareholders;

"core or Tier 1 capital" has the meaning ascribed to that term in the Financial Services (Capital Adequacy for Banks) Directive 2012; G.N. 31/2012

"credit facility" has the meaning ascribed to that term in the Banking Act. Cap.44:01

"eligible guarantee" means a guarantee that is issued by —

(*a*) the Government of Malawi in compliance with section 63 of the Public Finance Management Act; Cap.37:02

(*b*) any sovereign country with a sovereign rating approved by the Registrar;

(*c*) an international bank with an external credit assessment of AAA to AA- issued by an external credit assessment institution acceptable to the Registrar;

(*d*) a multilateral development bank or institution; or

(*e*) a third party entity that—

(i) represents a direct claim on the guarantor;

(ii) is denominated in the same domestic currency as the exposure or strong convertible currency;

(iii) clearly and incontrovertibly defines the extent of the guarantee's cover of a specific exposure;

(iv) is irrevocable and non-cancelable by the guarantor, except for non-payment of the credit protection contract;

(v) has no clause in the contract that would allow the guarantor to unilaterally cancel the guarantee, increase the effective cost of the guarantee, or delay payment under the guarantee for any reason including the need to be funded in the budget;

(vi) has, as the only condition for its enforcement the obligor's

failure to meet an obligation to the bank; and

(vii) is executed so that neither the guarantor nor any other person is in a position to challenge the legal rights of the bank in calling the guarantee;

"exposure to an insider or related party" means the amount of the insider's or related party's obligation to a bank calculated as the sum of the following—

(*a*) credit facilities;

(*b*) equity securities;

(*c*) debt securities;

(*d*) securitized assets and other transactions with recourse; and

(*e*) contingent liabilities, such as commitments to extend credit;

"group of related parties" means two or more persons holding exposures from a bank, whether on a joint or separate basis, which are mutually associated and meet any of the following criteria—

(*a*) the parties are a "group of related debtors" as defined in the Banking Act; Cap.44:01

(*b*) the persons have common management or common directors;

(*c*) cross guarantees exist; or

(*d*) a direct or indirect financial interdependency exists between the persons which cannot be substituted in the short term.

"insider" has the meaning ascribed to that term in the Banking Act; Cap.44:01

"related party" has the meaning ascribed to that term in the Banking Act; Cap.44:01

"senior management official" means—

(*a*) an executive officer;

(*b*) head of department or function;

(*c*) an official who reports either directly to the board of directors, to a committee of the board of directors or to an executive officer;

(*d*) a branch manager of a bank that the Registrar declares as a senior management official; and

"subsidiary" has the meaning ascribed to that term in the Companies Act. Act No. 15 of 2013

PART II – OBJECTIVES

Objectives

3. The objectives of this Directive are to—

(*a*) promote sound practices with regard to the granting of credit to related parties;

(*b*) ensure that transactions between a bank and its insiders and related parties are done on an arm's-length basis; and

(*c*) promote public confidence in banks by ensuring that no undue favouritism is extended to insiders or related parties of banks.

PART III – REGULATORY REQUIREMENTS

Restrictions on insider lending and related parties

4.—(1) A credit facility to an insider or to a related party shall be on arm's length basis.

(2) A bank's exposure to an insider or to a related party shall not exceed ten percent (*10%*) of its core capital.

(3) The aggregate of a bank's exposures to insiders and related parties shall not exceed twenty five percent (25%) of the bank's core capital, unless the bank obtains written permission of the Registrar.

(4) A credit facility to an insider or to a related party shall be secured by collateral which is enforceable.

(5) Subparagraphs (1) and (4) shall not apply to a credit facility that a bank may grant to its employees as part of their terms and conditions of employment that equally apply to all officers and employees.

(6) A bank shall not grant any credit facility to an insider or to a related party while another credit facility to that person is non-performing.

(7) A bank shall not purchase a non-performing credit facility or other low quality asset from an insider or a related party.

(8) The Registrar shall consider placements of a bank to any of its affiliated entities in Malawi as insider transactions and they shall be subject to the provisions of this Directive.

(9) An exposure to an insider or related party that exceeds the limitations of this Directive or is made in violation of the requirements of this Directive shall be deducted from the bank's core capital for purposes of determining capital adequacy.

Board responsibilities

5. The board of directors of a bank shall—

(*a*) adopt and ensure implementation of a written policy on transactions with insiders and related parties that includes the provisions set out in the Schedule to this Directive;

(*b*) approve all transactions, including credit facilities, between a bank and its insiders and related parties, provided that a director who has an interest in the transaction shall not participate in the board's consideration and decision process; and

(*c*) ensure that a credit facility or a transaction with an insider or a related party is monitored independent of the insider or related party.

Disclosure

6.—(1) A director or senior management official of a bank who is a party

to or has an interest in an existing or prospective credit facility or other transaction with the bank shall—

(*a*) disclose in writing to the board of directors at the earliest opportunity the nature and extent of the interest;

(*b*) leave any meeting at which the credit facility or other transaction is discussed;

(*c*) refrain from voting on any matter related to the credit facility or other transaction, provided that such interest, if so disclosed, shall not disqualify a director from constituting a quorum.

(2) A bank shall disclose all its credit facilities to insiders and related parties in line with the requirements of the Financial Services (Disclosure of Information by Banks) Directive 2011.

G.N. 4/2011

Record keeping

7. A bank shall maintain adequate records with regard to all credit facilities to insiders and related parties.

PART IV-ENFORCEMENT

Cap.44:01

8.—(1) The Registrar shall impose the following monetary penalties for violations of this Directive—

(*a*) for banks, up to fifty million Kwacha (K50, 000,000); and

(*b*) for natural persons who are members of the board of directors, or senior management, up to ten million Kwacha (K10,000,000).

(2) With respect to banks, the Registrar shall—

(*a*) debit the penalty in subparagraph 1 (a) from the main account of the bank maintained at the Reserve Bank of Malawi; and

(*b*) notify the bank in writing prior to debiting the account.

(3) With respect to natural persons or where the bank does not maintain an account with the Reserve Bank of Malawi, the natural person or the bank shall pay the penalty through a bank certified cheque or electronic transfer payable to the Reserve Bank of Malawi within ten working days after being notified by the Registrar.

Administrative penalties

Cap. 44:01

9. In addition to the monetary penalty imposed in paragraph 8 (1), the Registrar may impose directions, administrative penalties and enforcement action as provided for under the Act and the Banking Act.

Renovation G.N. 40/2012

10. The Financial Services (Transactions with Related Parties of Banks) Directive, 2012 is revoked.

SCHEDULE (par. 5 (*a*)

POLICY ON TRANSACTIONS WITH INSIDERS AND RELATED PARTIES

1. This policy on transactions with insiders and related parties —

(*a*) requires a bank to handle all transactions with insiders and related parties on an arm's-length basis. The following preferential treatment is prohibited—

(*i*) altering credit-granting standards, collateral requirements, collection efforts or any other policies of a bank;

(*ii*) providing preferential rates, terms or conditions on deposits or credits;

(*iii*) providing products or services that are not available to the general public;

(*iv*) approving credit facilities without the board of directors approval;

(*v*) covering trading losses; and

(*vi*) waiving fees;

(*b*) imposes strict and binding limits on exposures to insiders and related parties which do not exceed the limitations of this Directive;

(*c*) prohibits insiders and related parties who have an interest in a credit facility or other transaction with the bank from being involved in the administration, assessment, or decision-making process relating to the transaction; and

(*d*) requires the management of a bank to report all transactions with insiders and related parties, and any deviations from the board-approved policy on insiders and related parties, to the board of directors on a regular basis.

Made this 24th day of January, 2018.

DR. D. KABAMBE
Registrar of Financial Institutions

(FILE REF. FIN/PFSPD/03/04