

CENTRAL BANK OF SOLOMON ISLANDS
Financial Market Supervision Department

Prudential Guideline No. 12
On Related Party Transaction

Applicability

1. The Prudential Guideline is applicable to Financial Institutions licensed and deemed licensed by the Central Bank of Solomon Islands (CBSI).

Purpose of Prudential Guideline

2. The requirements in this guideline are specified pursuant to section 12 of the Financial Institution Act 1998 (FIA) as amended.
3. This Prudential Guideline aims to ensure that all transactions between a Financial Institution (FI) and a related party of the FI (a) are on substantially the same terms and conditions as the same or similar transactions between the FI and a non-related party; (b) do not result in capital or income being transferred to a related party in a manner that gives unwarranted preference to a related party; (c) do not adversely affect the solvency, liquidity, or profitability of the FI; and (d) are not used as a means of evading capital or other regulatory requirements.
4. This Prudential Guideline sets out the requirements to be applied to all related party transactions entered into by an FI to ensure that such transactions are conducted on arm's length basis and in accordance with good governance and with appropriate disclosures.
5. This Prudential Guideline also requires FIs to give due consideration to the risks associated with the corporate group of which they are a member and to ensure they are not exposed to excessive risk as a result of their associations and dealings with related entities.
6. The key requirements of this Prudential Guideline are that a FI must:
 - a. develop and adopt policies and procedures to manage risks associated with transactions between the FIs and related party(s).
 - b. meet minimum requirements with respect to transactions with related parties and certain related matters.

Definitions

7. As used in this Prudential Guideline the following terms, unless otherwise clearly indicated by the context, have the meanings specified below.
8. **"Related Party"** – means any person, together with that person's financially-dependent children and other relatives or business associates, who participates in policy-making functions of the FI or has the authority to lend or invest assets of or

cause the FI to incur liabilities in the normal course of its operations. The term "related party" includes, but is not limited, to:

- a. "Large Shareholders" - which includes anybody corporate or person who owns or controls, either directly or indirectly, 10% (ten percent) or more of the FI's voting shares of stock or the voting shares of stock of any holding company of which the FI is a subsidiary;
 - b. "Directors" – which include each member of the board of directors of the FI;
 - c. "Officers" – which include permanent staff and contracted Management and staff of the FI;
 - d. "Subsidiary" – includes any legal entity over which the FI, either directly or indirectly, holds more than 50% (fifty percent) of the voting shares of the legal entity.
 - e. "Affiliate" – includes any legal entity over which the FI, either directly or indirectly:
 - i. holds or has the power to vote at least 20% (twenty percent) but not more than 50% (fifty percent) of the outstanding voting shares of the legal entity or
 - ii. has the power or ability to exert influence over the policies of the legal entity.
 - f. In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form.
9. **"Transaction"** – means a transfer of benefits, resources, obligations, or the provision of products and services, between an FI and a related party, regardless of whether or not a price is charged. For the purpose of this guideline, transactions include the following:
- a. Related Party lending:
 - i. all forms of direct and indirect loan or credit exposure agreements (on and off-balance sheet, loans, investments and claims).
 - ii. borrowings in the form of notes, securities, assumptions or incurrence of a liability, or any similar forms of indebtedness;
 - iii. in the context of direct exposure, it includes a FI's exposure where a Director, Officer or shareholder of the FI is liable jointly or severally or as a guarantor. It also includes a FI's exposure to any company where it has an equity interest.
 - iv. in the context of indirect exposure, Related Party lending includes exposures to any immediate family member of any Director, Officer or shareholder and to any company, partnership, association or group of individuals whether incorporated or not, wherein any Director, Officer or shareholder of the FI has an interest or is a Director, partner, manager, member, shareholder, agent or otherwise.
 - b. Related Party non-lending transaction:

- i. purchases, leases or sales of assets, whether financial or non-financial, tangible or intangible, or movable or immovable property;
 - ii. agreements or contracts for the provision or receipt of services, with or without fees, such as accounting, advisory, appraisal, consulting, credit administration and collateral control, data processing, insurance, legal, loan guarantees or agreements of protection, loan processing, safekeeping, staff secondments, technical assistance, training, and other similar financial, operational or professional services;
 - iii. investments in the shares of a Related Party; or
 - iv. any other transaction which, on the basis of its structure, terms or conditions, can reasonably be construed as being, or intended to be, a transfer of value to a Related Party.
10. **“Equity Investment”** – purchase of shares of a public or private company.
11. **“Senior Management”** – means country heads, general managers, chief executive officers, senior managers, senior executives or individuals holding similar positions whose conduct have significant impact on the sound and prudent management of the FI’s day-to-day administration and or operations and can make a policy decision.
12. **“Total Capital”** – means Capital as defined in Prudential Guideline No.5 on Large Exposures.

Related Party Transactions Guideline Requirements

Roles and Responsibilities

13. The Board of Directors (Board) or proxy board¹ of each FI is ultimately responsible to:
- a. ensure sound and prudent management of the risks associated with related party transactions.
 - b. ensure risk management framework is in place that incorporates the management of related party transaction risk. The board or its proxy board must approve all aspects of the framework.
 - c. ensure that Senior management implements a related party transaction policy, approved by the board or its proxy board. The policy must include appropriate processes to identify related party transaction and activities; and the additional required steps and conditions under which related party transactions, both lending and non-lending, are handled. This includes the annual requirement for a conflict of interest statement from all significant parties² within the FI.
 - d. ensure the Related Party transaction policy must address the credit and non-credit approval process for Related Party(s), which will include elevated approval authorizations for all aspects of these transactions. Such approvals

¹ Refers to the delegated senior management body/executive responsible for related party transaction policy for a branch of a foreign incorporated financial institution operating Solomon Islands.

² Significant parties include at a minimum senior management, all directors, and large shareholders.

must include the same level of scrutiny and documentation that is required for non-related party. The affected Related Party must not take part in any discussion or voting of the Related Party Transaction and FI documentation must memorialize such abstentions.

- e. ensure that terms and conditions provided to Related Party are the same as those provided to non-related party. The board or its proxy board and management must establish a process that will ensure and demonstrate that Related Party interest rates, terms and conditions are not preferential.
- f. monitor and ensure compliance to the policy and this Prudential Guideline.
- g. review applicable policy periodically.
- h. provide to CBSI if requested, the policy, including any material changes thereto.

General Minimum Requirement

The following minimum requirements shall apply to all transactions with a Related Party:

- 14. All Transactions between an FI and a Related Party shall conform to a written policy that has been approved and adopted by Board of Directors or its proxy board and that is adequate to ensure compliance with this guideline and with prudent practices;
- 15. All transactions between an FI and a Related Party must not be prejudicial to the interests of the FI and its depositors; and not adversely affect the financial condition of the FI.
- 16. All transactions between an FI and a Related Party shall be at arm's length, that is, on substantially the same terms and conditions in respect of charges, fees, interest rate, liability, maturity, price, repayments, risk, security, etcetera as the same or similar transactions between an FI and a non-related party. It is the responsibility of an FI's Board of Directors or its proxy board to ensure that substantially the same terms and conditions are applied to all related party transactions. FI should therefore establish policy guidelines and review procedures to minimise the potential for self-dealing.
- 17. All related party transactions must be properly documented by the FI.
- 18. A FI must satisfy CBSI that it has adequate systems and controls to identify, review, monitor and manage risks arising from transacting with Related Parties. CBSI may require a FI to establish additional internal controls and a more robust reporting mechanism and to maintain a higher prudential capital requirement if CBSI is not satisfied with the adequacy of the FI's systems and controls.

19. It is the duty of every Director and Officer who has an interest in any proposal for Related Party transaction to declare his or her relationship or interest in that proposal. The declaration should be recorded and should form part of the documents relating to the proposal. A Director or Officer who has made a declaration must not take part in any way in any evaluation, deliberations or decisions relating to that application.

Related Party lending transactions

20. A FI must not be used as a funding means for the operations of Related Party borrowers. It must not give a general guarantee of the repayment of any liability of a Related Party borrower and should ensure that a Related Party borrower does not up-grade the status of its liabilities, seek to give an impression that the FI's financial resources stand generally behind, or could be called upon to stand behind, its operations.
21. A FI's financial dealings with any Related Party borrower must be based on normal FI principles, which is FIs would be expected to subject the financial position of a Related Party borrower to as close a scrutiny as it would in the case of a non-related party; and all Transactions must be on commercial terms and conditions.
22. Any explicit financial commitment by a FI to a Related Party borrower should be limited as to amount and not be open-ended.
23. A FI must be able to provide CBSI the data in respect to any financial exposure to its Related Party borrowers and its associates.

Related Party non-lending transactions

24. Related Party non-lending Transactions require a higher level of transparency. Any proposed significant Related Party non-lending transactions must be approved by a majority of the members of the Board or its proxy board, with any interested Director abstaining. Where available and appropriate, such proposals should reflect due diligence with other vendors or service providers to ensure and demonstrate that the actions taken are in the best interest of the FI and not the Related Party.

Direct ownership interests

25. The Board or its proxy board must adopt a risk appetite statement for direct ownership interests. It must include acceptable and unacceptable FI ownership interests. When such ownership interests include related parties and entities as discussed in this Prudential Guideline, additional due diligence and restrictions apply.

26. The aggregate total for all investments with a single Related Party at any one time is limited to ten percent (10%) of the FI's total capital. For the purposes of this calculation, the investment portion of the ratio is the aggregate total of cash or the initial documented market value of non-cash assets used for the investment.
27. Where the aggregate total for all investments with a single Related Party at any one time is likely to exceed the ten percent (10%) of the FI's total capital, the Board of Directors or its proxy board of the FI is required to advise CBSI of the proposal and ways to manage the associated risks before committing the FI in such investment.

Dealings with related entities

28. For the purposes of this Prudential Guideline, all entities where the FI has an equity investment in that entity that is five percent (5%) or greater of its total capital, is considered a related entity.
29. Where appropriate, the CBSI may deem that other entities (and their subsidiaries) are a related entity of a FI.
30. The Board or its proxy board must establish, and monitor compliance with, policies governing all dealings with related entities. The policies, including any material changes thereto, must be provided to the CBSI.
31. A FI's policies on related-entity dealings must, at a minimum, include:
 - a. a requirement that the FI address risks arising from dealings with related entities as strictly as it would address its risk exposures to non-related entities;
 - b. prudent limits on exposures to related entities at both an individual and aggregate level;
 - c. procedures for resolving any conflict of interest arising from such dealings; and
 - d. requirements relating to the transparency of individual and third-party dealings associated with related entities.
32. Terms or conditions imposed by a FI in relation to its dealings with related entities that are inconsistent with the benchmark for non-related entities must be approved by the Board or its proxy board with justifications fully and clearly documented in a register. The FI must make this register available for inspection by the CBSI if so requested.
33. A FI must not have unlimited exposures to related entities either in aggregate or at an individual entity level (that is a general guarantee of the obligations of a related entity).

Prudential limits

34. A FI must ensure that its Related Party exposures comply with the following limits:
- a. exposure to any individual Related Party must not exceed 10% of total capital and
 - b. aggregate of all Related Party Transactions must not exceed 35% of total capital.

Prior approval requirements

35. A FI must request and receive prior approval from the CBSI before:
- a. entering into a Transaction with a Related Party that would result in any excess to the prudential limits specified in paragraph 34 of this Guideline;
 - b. establishing or acquiring a subsidiary;
 - c. committing to any proposal to acquire (whether directly or indirectly) more than five percent (5%) of equity interest in an entity or of the voting shares of an entity; and
 - d. taking an equity interest in an entity arising from the work-out of a problem exposure.

Policy Framework

36. A FI's Board or its proxy board policies on Related Party Transactions must, at a minimum, include:
- a. a requirement that the FI address risks arising from Transactions with Related Party as strictly as it would address its risk exposures to non-related entities;
 - b. prudent limits on exposures to related parties at both an individual and aggregate level.
 - c. procedures for resolving any conflict of interest arising from such Transactions;
 - d. requirements relating to the transparency of third-party Transactions associated with related parties.
 - e. FI should develop materiality criteria for each type and category of Related Party Transaction. In addition, internal reporting thresholds should be set for each type and category.
 - f. The materiality of an item is usually determined with reference to the nature or size of that Transaction. However, the nature of the relationship between the FI, the Related Party and the nature of the Transaction, should also be considered when determining materiality.

Exempted Transactions

37. Staff Benefits - any benefit or compensation programme provided to an employee by the FI: that is widely available to employees of the FI; or that is reasonable remuneration is exempted.

Pre-Existing Transactions

38. Within 30 calendar days of this guideline coming into effect, each FI must submit to the CBSI a list of all related party transactions in existence on 31st June 2018, together with a description of the nature of each transaction, its principal terms and conditions, remaining term to maturity, and amount outstanding.
39. A FI must report any equity investments that are not subject to the prior approval requirements set out in paragraph 35, in writing, to the CBSI within 30 calendar days of undertaking the investment.

Reporting Requirements to the CBSI

40. Each FI shall submit to the CBSI such returns as may be required and in the form and frequency as the CBSI may prescribe.

Enforcement and Corrective Measures

41. A FI, which fails to comply with the requirements contained in this Prudential Guideline or to submit certain reports to the CBSI, which are materially inaccurate, will be considered in breach of violation of this guideline and therefore, may be subject to a monetary penalty.
42. The CBSI may pursue any or all corrective measures as provided in section 16 of the Financial Institutions Act 1998 (as amended) to enforce the provisions of this Prudential Guideline including:
- g. Issuance of an order to cease and desist from the unsound and unsafe practices and
 - h. Action to replace or strengthen the management of the FI.

Effective Date

43. The effective date of this Prudential Guideline is July 1, 2018.

Issued this 16th day of April 2017.



Governor Denton Rarawa
Central Bank of Solomon Islands