



RESERVE BANK OF MALAWI

**DIRECTIVE**

NO.DO4-06/TRP

**TRANSACTIONS WITH RELATED PERSONS**

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**PART I: SHORT TITLE, AUTHORIZATION, APPLICATION, AND INTERPRETATION**

**Sec. 1:** **Short Title** – Transactions with Related Persons

**Sec. 2:** **Authorization** - This directive is issued by the Reserve Bank of Malaŵi pursuant to its authority set forth in Sections 26 and 27 of the Banking Act (1989), for the purpose of implementing the provisions of Sections 28(a) and 29 of the Banking Act.

**Sec. 3:** **Application** - This directive applies to all banks and other financial institutions licensed under the Banking Act (licensed institutions), on both a solo and consolidated basis.

**Sec. 4:** **Interpretations** - In this directive, unless the context otherwise requires-

- 1) **‘Arm’s-Length’** means literally: at a distance; transacting business with an insider or related person on the same terms as available to members of the general public, rather than on familiar, friendly, or preferential terms.
- 2) **‘Banking Act’** means the Banking Act, 1989, of Malaŵi.
- 3) **‘Board of Directors’** means the highest body of authority in a licensed institution responsible for strategically guiding the licensed institution, effectively monitoring management, and properly accounting to shareholders.
- 4) **‘Capital Base’** means for purposes of calculating limits on a licensed institution’s exposures, its capital base shall be calculated as follows, provided however, that an adequate allowance for loan and lease loss has been established pursuant to the Reserve Bank’s *Directive on Asset Classification*:  

The sum of:

  - Share capital, paid-up
  - Share premium;
  - Retained profits (prior years);
  - Sixty percent (60%) of after-tax profit (current year-to-date);

Less:

  - Investment in unconsolidated companies.
- 5) **‘Credit’** means any asset or off-balance-sheet item that contains credit risk, including loans and participations, overdrafts, advances

and all of the following “credit facilities” listed in Section 2 of the Banking Act: financing by means of factoring, leasing, hire purchase, accepting of trade and other bills, discounting of such bills and notes, the opening or confirming of documentary credit, the issue of other letters of standby, credit, guarantee or surety, the undertaking to pay on account of another person, and other similar undertakings.

- 6) **‘Director’** means any person, by whatever name called, who performs or is empowered to perform, substantially the same functions for the licensed institution as those performed by the director of a company.
  
- 7) **‘Eligible Guarantee’** means for purposes of calculating the amount of a licensed institution’s exposure pursuant which is subject to the limitations of this directive, a guarantee is considered eligible if it meets all of the following requirements:
  - a). The guarantee must either be issued by:
    - The Government of Malawi;
    - The government of a member country of the Organization of Economic Cooperation and Development (“OECD”);
    - The government of a country with a current consensus country risk classification of 1 or 2 as published by the OECD; *or*
    - An international bank with an external credit assessment of AAA to AA- issued by an external credit assessment institution acceptable to the Reserve Bank.
  
  - b). The guarantee must:
    - Represent a direct claim on the guarantor;
    - Be denominated in the same domestic currency as the exposure or strong convertible currency;
    - Clearly and incontrovertibly define the extent of the guarantee’s cover of a specific exposure;
    - Be irrevocable and non-cancelable by the guarantor, except for non-payment of the credit protection contract;
    - Have 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;
    - Have as the only condition for its enforcement the obligor’s failure to meet his/her/its obligation to the licensed institution; *and*

- Be executed so that neither the guarantor nor any other person is in a position to challenge the legal rights of the licensed institution in calling the guarantee.
- 8) **‘Executive Officer’** means an officer at the most senior level of the management of a licensed institution (whether or not he/she is a director) who effectively manages that licensed institution.
- 9) **‘Exposure’** means the amount of a licensed institution’s exposure to a person or group of inter-related persons is calculated as follows:
- The sum of the following:
- Credits;
  - Equity securities;
  - Debt securities;
  - Securitized assets and other transactions with recourse; and
  - Contingent liabilities, such as commitments to extend credit.
- 10) **‘Group of Inter-Related Persons’** means two or more persons holding exposures from a licensed institution, whether on a joint or separate basis, which are mutually associated and meet at least one of the following criteria:
- a) The persons are a “group of related debtors” as that term is defined in Section 2 of the Banking Act: one person holds a controlling interest in the other(s) or the persons are under common ownership or control;
  - b) The persons have common management and/or common directors;
  - c) Cross guarantees exist; or
  - d) A direct financial interdependency exists between the persons which cannot be substituted in the short term.
- 11) **‘Insider’** Includes all of the following:
- a) Principal shareholders;
  - b) Members of the board of directors and/or audit committee;
  - c) Executive officer; and
  - d) Senior management officials.
- 12) **‘Licensed Institution’** means a bank or other financial institution holding a valid license, issued by the Reserve Bank, authorizing it to engage in deposit-taking business in Malaŵi.
- 13) **‘Person’** means any of the following: an individual; sole

proprietorship; partnership; joint venture; association; trust; estate; business trust; corporation, not-for-profit corporation; sovereign government, agency, instrumentality, or political subdivision thereof; any similar entity or organization.

- 14) **‘Principal Shareholder’** means a person who holds (directly or indirectly): (1) Ten percent (10%) or more of either the equity or the voting rights of the licensed institution; or (2) Such other interest in the licensed institution that enables the person to exercise significant influence over its management or activity.
- 15) **‘Related Person’** Includes all of the following:
- a) Any person who is related to an insider (principal shareholder, member of the board of directors or audit committee, executive officer or senior management official) of a licensed institution by marriage or consanguinity to the second degree;
  - b) Any juridical person in which an insider has a business interest, including as a partner, director, manager or guarantor;
  - c) individual person for whom an insider is a guarantor;
  - d) Subsidiary of the licensed institution or of an insider;
  - e) Company or undertaking in which at least a 10% interest is held by the licensed institution or by an insider;
  - f) Parent company of the licensed institution or of an insider;
  - g) Company that is under common control with the licensed institution or of an insider;
  - h) Company that holds at least a 10% interest of another company in which the licensed institution or an insider holds at least a 10% interest;
  - i) Company that has common management and/or common directors with the licensed institution, an insider, or another related person of the licensed institution; and
  - j) Political campaign committee that is controlled by an insider or related person or that the funds or services of which will benefit an insider or related person.
- 16) **‘Reserve Bank’** means the Reserve Bank of Malaŵi established under the Reserve Bank of Malaŵi Act, 1989.
- 17) **‘Senior Management Official’** means any person who is an officer of a licensed institution, including the chief “executive officer,” vice-president(s), chief accountant, chief lending officer, chief treasury officer (or their equivalents), and any other person who, alone or together with one or more others, has the authority to

enter into commitments for the account of the licensed institution.

- 18) **‘Subsidiary’** means a juridical person in which another person, or group of persons acting in concert, holds the equivalent of fifty percent (50%) or more of any class of shares with voting rights; or a shareholding that permits such other person or group of persons to exercise effective control over the management or policies of the juridical person.

## **PART II: STATEMENT OF POLICY**

### **Sec. 1: Objectives**

- 1) To ensure that all transactions between a licensed institution and its insiders and related persons are done on an arm’s-length basis;
- 2) To ensure that licensed institutions do not enter into a transaction with or for the benefit of an insider or related person if such transaction would be entered into on less favorable terms and conditions, or not at all, with or for the benefit of persons who are not so related to the licensed institution;

### **Sec. 2: Rationale**

Transactions made to related parties often lead to non-performing assets that adversely affect the financial performance and condition of a bank or financial institution and should therefore be avoided or effectively monitored.

## **PART III: REQUIREMENTS FOR ARM’S-LENGTH TRANSACTIONS**

### **Sec. 1: Requirements for Arm’s-Length Transactions for Banks**

All transactions between a licensed institution and its insiders and related persons shall be on an arm’s-length basis. Licensed institutions shall not enter into a transaction with or for the benefit of an insider or related person if such transaction would be entered into on less favorable terms and conditions, or not at all, with or for the benefit of persons who are not so related to the licensed institution.

### **Sec. 2: Policies and Procedures**

The board of directors shall adopt, and ensure that senior management officials implement, a written policy covering all transactions, including deposit-taking and credit-granting, between a licensed institution and its insiders and related persons. Processes should be established within each licensed institution to allow the board of directors to monitor compliance with the policy. The board of directors shall review the policy on at least an annual basis. The policy, at a minimum, shall:

- a) Prohibit the licensed institution from providing favorable treatment to insiders and related persons and require that all such transactions be on an arm's-length basis. Prohibited favorable treatments include, but are not limited to:
- Altering credit-granting standards, collateral requirements, collection efforts or any other policies of the licensed institution;
  - Providing preferential rates, terms, and/or conditions on deposits or credits;
  - Providing products or services that are not available to the general public;
  - Covering trading losses; and
  - Waiving fees.
- c) Impose strict and binding limits on exposures to insiders and related persons which do not exceed the limitations of this directive.
- d) Prohibit insiders and related persons who have an interest in a credit or other transaction with the licensed institution from being involved in the administration, assessment, or decision-making process involved with the transaction.
- e) Require that transactions with insiders and related persons, including all deviations from the board-approved policy, be reported to the board of directors on a regular basis.
- f) Comply with the Banking Act and this directive.

**Sec. 3: Disclosure**

A director or senior management official of a licensed institution who is a party to, or has an interest in, any credit or other transaction with the licensed institution, including those proposed, shall:

- a) Disclose in writing to the board of directors at the earliest opportunity the nature and extent of his/her interest.
- b) Leave any meeting at which the credit or other transaction is discussed.
- c) Refrain from voting on any matter related to the credit or other transaction, provided that such interest, if so disclosed, shall not disqualify a director from constituting a quorum.

**Sec. 4: Approval by the Board of Directors**

- a) All transactions, including credits, between a licensed institution and its insiders and related persons must be approved unanimously and in advance by the board of directors, provided however, that any director who has an interest in the transaction shall abstain from the board's consideration and decision process.
- b) The official minutes of the board of directors shall document approval of the credit or other transaction, the terms and conditions of the credit or other transaction, and the determination by the board of directors that the credit or other transaction was made on an arm's-length basis.
- c) The board of directors shall ensure that credits and other transactions with insiders and related persons are monitored in a manner independent of the insider or related person.
- d) All credits granted by a licensed institution to a senior management official or employee that exceed two-years remuneration of such senior management official or employee must be approved unanimously and in advance by the board of directors.

**Sec. 5: Recordkeeping**

- a) Each licensed institution shall maintain records on disclosures made by directors or senior management officials who are a party to, or have an interest in, any credit or other transaction with the licensed institution, including those proposed.
- b) Each licensed institution shall have procedures in place to identify Insiders and Related Persons, including groups of inter-related persons. The licensed institution's records shall be updated on at least an annual basis.
- c) Records shall be maintained of all credits and other transactions with Insiders and Related Persons.

**PART IV. LIMITATIONS**

- 1) If two or more persons are deemed to be a "group of inter-related persons," then the exposures of all persons in that group shall be combined for purposes of applying the limitations on exposures to insiders and related persons.
- 2) A licensed institution's exposure to any insider or related person,

including a group of inter-related persons, shall not exceed 25% of the licensed institution's capital base, except where prior approval has been granted by the Reserve Bank of Malawi as per the Directive on Large Exposures

- 3) A licensed institution's aggregate exposure to all insiders and related persons, including groups of inter-related persons, shall not exceed the amount of its capital base.
- 4) Any exposure to an insider or related person that exceeds these limitations or that was otherwise made in violation of the requirements of this directive shall be deducted from the licensed institution's capital base for purposes of determining capital adequacy.

## **PART V. REPORTING**

Each licensed institution shall submit to the Reserve Bank a report, as of each quarter-end in the format prescribed by the Reserve Bank, showing all exposures to insiders and related persons and evidencing compliance with this directive.

## **PART VI: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

### **Sec. 1: Remedial Measures**

- 1) When the Reserve Bank determines that a bank is not in compliance with this directive, it may impose remedial measures as specified under Section 31 of the Banking Act, 1989.
- 2) When the Reserve Bank determines that a bank's non-compliance with this directive has resulted in such undue risk that its capital is impaired or solvency is otherwise threatened, it may petition the High Court to sanction procedures as called for under Section 32 of the Banking Act, 1989.

### **Sec. 2: Administrative Sanctions**

In addition to the remedial measures available to it as given above in Part IV Section 1, the Reserve Bank may impose any or all of the following administrative sanctions with regards to a bank that fails to comply with this directive:

- 1) Prohibition from declaring and/or paying dividends;
- 2) Suspension of the establishment of new branches and/or expansion into new banking or financial activities;

- 3) Suspension of access to Reserve Bank credit facilities;
- 4) Suspension of lending operations;
- 5) Suspension of the opening of letters of credit;
- 6) Suspension of the acceptance of new deposits;
- 7) Suspension of the acquisition of fixed assets.

#### **PART VII: EFFECTIVE DATE**

The Effective Date of this Directive shall be 13<sup>th</sup> March 2006.

**Questions relating to this directive should be addressed to the Bank Supervision Department of the Reserve Bank.**

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**Victor Mbewe**  
**GOVERNOR**