



**FINANCIAL SUPERVISORY COMMISSION
OF THE
COOK ISLANDS**

Banking Prudential Statement

BPS14

Related Lending, Activities and Entities

Objective and key requirements of this Prudential Statement

This Prudential Statement requires a bank to adopt policies and procedures to appropriately manage risks associated with financial transactions with directors, officers and other parties which are related through ownership, employment or control of the bank.

The ultimate responsibility for the management of the above risk rests with the Board of Directors.

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Authority

1. This Prudential Statement is issued by the Financial Supervisory Commission (FSC) in accordance with section 65, of the Banking Act 2011 (the Act).

Application

2. This Prudential Statement is applicable to all financial institutions incorporated in the Cook Islands and licensed under the Banking Act 2011

Definitions

3. This Prudential Statement has used the following terms, which unless otherwise indicated, have the meanings specified below:
 - 3.1. **Bank** – an entity licensed under the Banking Act 2011.
 - 3.2. **Eligible Capital** – as defined in Prudential Statement BPS02 on Capital Adequacy.
 - 3.3. **Equity Investment** – purchase of shares of a public or private company.
 - 3.4. **Officer** - Chief Executive Officer, Senior Executives, Managers, Company Secretary and others who are generally known to be representatives of the bank.
 - 3.5. **Related Activities** – refers to non-credit financial transactions with a related party.
 - 3.6. **Related Borrower** – where the borrower is a related party.
 - 3.7. **Related Lending** - all forms of direct and indirect credit (on and off-balance sheet, loans, investments and claims) exposures of a bank to individuals or to parties which are connected to that bank through ownership or control. In the context of direct exposure, it includes a bank's exposure where a director, officer or shareholder of the bank is liable jointly or severally or as a guarantor. It also includes a bank's exposure to any company where it has an equity interest. In the context of indirect exposure, it 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 bank has an interest or is a director, partner, manager, member, shareholder, agent or otherwise.
 - 3.8. **Related Party** – has the same meaning as licensee-related party defined in section 43(5) of the Banking Act 2011.

Board and Senior Management Responsibilities

4. The Board is ultimately responsible for the sound and prudent management of the risks associated with related lending, related activities and direct ownership interests of the bank.
5. The Board must ensure that the bank has in place a risk management framework that incorporates the management of risk associated with related lending, related activities and direct ownership interests of the bank. The Board must approve all aspects of the framework.
6. Senior management must implement a related lending and activities policy which should be approved by the Board. The policy must include appropriate processes to identify related lending and activities, and the additional required steps and conditions under which related party activities, both credit and non-credit, are handled. This includes the annual requirement for a conflict of interest statement from all significant parties within the bank.
7. The related lending and activities policy must address the credit and non-credit approval process for related parties, which will include elevated approval authorisations for all aspects of these activities. Such approvals must include the same level of scrutiny and documentation that is required for non-related parties. The affected party must not take part in any discussion or voting regarding the related party transaction, and bank documentation must record such abstentions.
8. The Board must ensure that terms and conditions provided to related parties are on the same commercial terms as those provided to unrelated parties. The Board and management must establish a process that will ensure and demonstrate that interest rates, terms and conditions are not preferential.

Related Lending

9. A bank must not be used as a funding vehicle or “front” for the operations of related parties or any of its associates. It must not give a general guarantee of the repayment of any liability of a related borrower and should ensure that a related borrower does not up-grade the status of its liabilities, seek to give an impression that the bank’s financial resources stand generally behind, or could be called upon to stand behind, its operations.
10. A bank’s financial dealings with any related borrower must be based on normal bank principles, i.e. a bank would be expected to subject the financial position of a related borrower to as close a scrutiny as it would in the case of an unrelated borrower or customer, and all transactions must be on commercial terms and conditions.
11. Any explicit financial commitment by a bank to a related party or to an associate should be limited as to amount, i.e. it should not be open-ended, and the commitment should be approved by the manager of the bank.
12. A bank must be able to provide the FSC data in respect to any financial exposure to its related borrowers.

13. A bank may apply a discounted rate of lending for employees, however a bank must have appropriate policies and procedures in place for employee related lending. It should include elevated approval authorisations for all aspects of these activities and must include the same level of scrutiny and documentation that is required for non-related parties.

Related Activities

14. Related activities include the purchase of services and supplies, rentals of equipment, real estate and bank promises, or any other transaction of a financial nature. Such activities require a higher level of transparency. Any proposed significant related activities must be approved by a majority of the members of the 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 bank, and not the director or officer.
15. It is the duty of every director and officer who has an interest in any proposal for related activities 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 and officer who has made a declaration should not take part in any way in any evaluation, deliberations or decisions relating to that application.

Direct Ownership Interests

16. The Board must adopt a risk appetite statement for direct ownership interests. It must include acceptable and unacceptable bank ownership interests. When such ownership interests include related parties and entities as discussed in this Prudential Statement, additional due diligence and risk mitigants should be applied.

Dealings with Related Entities

17. For the purposes of this Prudential Statement, a related entity are entities where the bank has the following equity investment:
 - 17.1. the value of shares in the entity is more than ten percent (10%) of the bank's eligible capital; or
 - 17.2. the shares exceed ten percent (10%) of the total voting stock of the entity.
18. Where appropriate, the FSC may deem that other entities (and their subsidiaries) are a 'related entity' of a bank.
19. The Board must establish, and monitor compliance with, policies governing all dealings with related entities. The policies, including any material changes, must be provided to the FSC if requested.
20. A bank's policies on related entity dealings must, at a minimum, include:

- 20.1. a requirement that the bank address risks arising from dealings with related entities as strictly as it would address its risk exposures to unrelated entities;
 - 20.2. prudent limits on exposures to related entities at both an individual and aggregate level;
 - 20.3. procedures for resolving any conflict of interest arising from such dealings; and
 - 20.4. requirements relating to the transparency of individual and third-party dealings associated with related entities.
21. Terms or conditions imposed by a bank in relation to its dealings with related entities that are inconsistent with the benchmark for unrelated entities must be approved by the Board with justifications fully and clearly documented in a register. The bank must make this register available for inspection by the FSC, if so requested.

Prior Approval Requirements

22. A bank must request and receive prior approval from the FSC before:
- 22.1. entering into a credit exposure with a related party if, as a result, the bank's total credit exposure to all related parties will equal to or is more than ten percent (10%) but less than twenty five percent (25%) of the bank's eligible capital;
 - 22.2. establishing or acquiring a subsidiary;
 - 22.3. committing to any proposal to acquire (whether directly or indirectly) shares in an entity, if:
 - 22.3.1. the value of shares is more than five percent (5%) of the bank's eligible capital; or
 - 22.3.2. the shares exceed five percent (5%) of the total voting stock of the entity.
 - 22.4. taking an equity interest in an entity arising from the work-out of a problem exposure.

Notification Requirements

23. A bank should report any equity investments that are not subject to the prior approval requirements set out in paragraph 22, in writing, to the FSC within 30 calendar days of undertaking the investment.

Issuance Details

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By Commissioner	
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