

Rwanda

## Regulation on Transactions with Bank Related Parties and Management of Credit Concentration Risk

Regulation 13-REG of 2017

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## Rwanda

# Regulation on Transactions with Bank Related Parties and Management of Credit Concentration Risk

## Regulation 13-REG of 2017

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**Assented to on 23 November 2017**

**Commenced on 4 December 2017**

*[This is the version of this document from 4 December 2017.]*

Pursuant to Law n°48/2017 of 23/09/2017 governing the Central Bank of Rwanda, especially in Articles 6, 8, 9, 10 and 15;

Pursuant to Law n° 47/2017 of 23/09/2017 governing the organization of banking, especially in Articles 31, 37 and 117;

Having reviewed the regulation n° 04/2008 on insider lending of banks;

Having reviewed the regulation n° 05/2008 on credit concentration and large exposure;

The Central Bank of Rwanda hereafter referred to as “The Central Bank”, decrees:

## Chapter One General provisions

### Article one – Purpose

This regulation governs transactions of banks with their related parties for sound practices and prudential rules relating to management of concentration risk.

### Article 2 – Definitions

In this regulation, the following terms and expressions shall mean:

- 1° **"Bank"**: a financial institution regulated and supervised under the law governing the organization of banking;
- 2° **"Bank related party"** any natural person or legal entity is considered as a bank-related party in the following circumstances:
  - a. a person who is a member of the Board of Directors or member of the senior management of the bank;
  - b. a person who has a direct or indirect significant holding in the bank;
  - c. a person who is a member of the Board of Directors or the management of an entity covered by "g" or "h";
  - d. any spouse, family member on direct line or collateral line up to the second degree of any of the persons mentioned under "a", "b", or "c";
  - e. any entity in which any of the persons mentioned under "a", "b", "c", or "d" is a member of the Board of Directors or the management;

- f. any entity in which any of the persons mentioned under "a", "b", "c", or "d" above holds directly or indirectly, alone or with others, at least ten (10%) percent of the shares or voting rights or on which these persons can exert influence;
  - g. any entity that the bank, alone or with others, controls or on which it exerts influence directly or indirectly;
  - h. an entity controlled or on which influence is exerted directly or indirectly by an entity that controls the bank.
- 3° **"Interconnected parties"**: two (2) or more natural persons or legal entities are regarded as interconnected if:
- a. one controls the other or the entire group, directly or indirectly;
  - b. they are so interrelated that, if one of them is experiencing financial problems, the other or all of the others encounter repayment difficulties;
- 4° **"Control"**: power by which natural persons or legal entities exercise control over a bank on account of:
- a. holding more than fifty percent (50%) in the equity capital or voting rights;
  - b. having the right to appoint or remove majority of the members of the Board of Directors of a bank who are at the same time shareholders of that bank;
  - c. having the power to exert influence over a bank on the basis of a contract entered into with that bank, or to a clause in the bylaws of said bank;
- 5° **"Counterparty"**: a party to whom a bank has an on- or off- balance sheet credit exposure or a potential credit exposure.
- 6° **"Counterparty credit risk"**: the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows, usually referred to in order to measure the exposure to securities and derivatives transactions.
- 7° **"Credit"**: any asset or off-balance sheet item which contains credit risk, such as loans, overdrafts, advances, finance leases, acceptances, bills discounted, guarantees and other assets or contingencies connected with credit risk;
- 8° **"Credit risk"**: the risk of financial loss, despite realization of the main or secondary collateral, because of a debtor's inability to satisfy his obligations to a bank.
- 9° **"Credit risk mitigation"**: the use of appropriate strategies to reduce adverse effects of the credit risk exposure, including collateralization, guarantees and derivatives.
- 10° **"Credit exposure"**: the total amount of credit extended to a borrower by the bank, including credit lines, letters of credit, advances, debt securities and similar forms of credits or credit commitments granted by a bank to a client;
- 11° **"Large exposure"**: exposures to a counterparty or group of connected counterparties, which represent at least ten percent (10%) or more of the bank's core capital.
- 12° **"Senior managers"**: the management personnel which are the high-level key executives of the bank. These are:
- a) The Chief Executive Officer (CEO)/Managing Director (MD);
  - b) Senior Executives reporting to the Board or to Board Committees; and
  - c) Senior executives reporting to the Chief Executive Officer (CEO)/Managing Director (MD)

## **Chapter II**

### **Transactions with bank related parties**

#### **Article 3 – Prudential management of transactions of a bank with its related parties**

A bank must have and implement effective policies and procedures to identify, evaluate and manage risks that would arise from transactions of a bank with its related parties. The policies and procedures on bank's transactions with its related party must:

- (1) guarantee that the transactions are not undertaken on more favorable terms than it would be if the transaction was done with a person who is not a bank related party;
- (2) provide for frequent identification of individual exposures to related parties, as well as the total amount of such exposures;
- (3) ensure efficient monitoring of the transactions on an ongoing basis and ensure they are subject to an independent credit review process;
- (4) ensure that appropriate actions are taken to control or mitigate the risks of such transactions;
- (5) guarantee that transactions with related parties are written off in accordance with regulations as well as standard policies and procedures;
- (6) ensure prior approval of the Board of Directors for transactions with members of the Board and the Senior management;
- (7) ensure timely actions by the board of directors once exceptions to policies, processes, thresholds and limits detected.

Board members with conflicts of interest shall be excluded from the approval process of granting and managing related party transactions.

A bank must have sound administrative and accounting procedures and adequate internal control mechanisms for the purpose of identifying, recording and monitoring all exposures to related parties and subsequent changes to them, in order to ensure adequate management and compliance, at a consolidated level, with the limits to transactions with related parties.

Loans to related parties shall not be secured by the bank's own shares.

#### **Article 4 – Limit of exposures to related parties**

Total exposure to a bank related party shall not, in any case, exceed 5% of the core capital of the bank.

Aggregate exposures to bank related parties or to groups of connected bank related parties shall not, in any case, exceed 25% of the bank's core capital.

#### **Article 5 – Collaterals**

Aggregate loans or commitments to bank related parties must be fully secured by collaterals acceptable by the Central Bank.

#### **Article 6 – Loans to employees**

The policies and processes on bank's transactions with its related parties shall not provide for beneficial terms that are part of an overall remuneration package such as favorable interest rates for employees' loans.

Exposures to employees of the bank shall not exceed 15% of its core capital.

## **Chapter III**

### **Management of concentration risk**

#### **Article 7 – Prudential management of concentration risk**

A bank must have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentration risk on a timely basis. Those policies must be approved by the Board of Directors which shall also oversee their implementation.

A bank must actively manage the exposures causing risk concentration and large exposures to single counterparties or groups of connected counterparties.

The bank's risk management policies and processes shall:

- (1) establish thresholds for concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength; and
- (2) require all material concentrations to be regularly reviewed and reported to the Board of Directors of the bank.

The established policies and thresholds must be clearly understandable and regularly communicated to bank employees.

#### **Article 8 – Large exposure limits**

The total of the exposure values of a bank to a single counterparty or to a group of connected counterparties shall never exceed 25% of the bank's core capital.

The board and senior management shall monitor implementation of established large exposures limits and thresholds on concentrations risk.

#### **Article 9 – Guidelines for measuring the exposures**

A bank must consider the exposure values to a counterparty as defined under the risk-based capital framework, therefore the total exposure to a counterparty or to a group of interconnected counterparties shall be equal to the sum of:

- (1) On- and off-balance sheet exposures included in the banking book, as in the risk weighted assets (RWA) measure for credit risk;
- (2) On- and off-balance sheet exposures included in the trading book, as in the RWA measure for market risk;
- (3) Exposure from positions that give rise to counterparty credit risk.

Positions in financial instruments such as bonds and equities shall be considered by the large exposure limit, but positions in a particular commodity or currency must not be considered.

The exposure value shall be the accounting value of the exposure net of specific provisions and value adjustments.

For the purpose of the large exposures, off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCFs) set out in the risk weighted assets (RWA) measure for credit risk, with a floor/ limits of 10%.

## Article 10 – Exempted exposures

Without prejudice to other regulatory requirements, the following exposures shall be exempted from being considered in concentration and large exposures limit calculation:

- (1) exposures to the Government of Rwanda denominated and funded in Rwandan Francs;
- (2) exposures to strategic development projects financed by a development bank with collaterals issued by the Government of Rwanda;
- (3) exposures to the Government of Rwanda denominated in a currency other than the Rwandan Francs which are risk weighted at 0%;
- (4) exposures that are deducted from capital;
- (5) Intra-day interbank exposures.

## Article 11 – Allowable collaterals

Considering the large exposure limits, a bank may, at its discretion, grant an advance or credit facility exceeding 25% limit but not more than 50% of its Core Capital, if its maturity does not exceed 5 years and is adequately secured by the following collaterals or securities:

1. Rwanda Government or Central Bank securities;
2. Fixed deposits with the lending bank;
3. Guarantees issued by the World Bank or other similar multilateral lending organizations;
4. A financial guarantee issued by a foreign financial institution rated at least BBB- or its equivalent by a reputable credit rating agency;
5. A guarantee issued by a parent financial institution where the parent institution is rated at least BBB- or its equivalent by a reputable credit rating agency

## Article 12 – Limits in aggregate large exposures

A bank shall not have large exposures which, in aggregate, exceed 8 times its core capital.

## Article 13 – Reporting requirements

With respect of the reporting periods provided for in the regulation on reporting requirements from banks, a bank must submit electronically to the Central Bank the following information using formats provided in the electronic reporting system:

- a) Report on aggregate exposures to related parties;
- b) A list of all bank's related parties;
- c) A list of all interconnected parties;
- d) Filled template of:
  - 1° all exposures with values equal or above 10% of the bank's core capital;
  - 2° all other exposures without the effect of credit risk mitigation being taken into account equal to or above 10% of its core capital;
  - 3° all the exempted exposures with values equal to or above 10% of the bank's core capital;

- 4° the largest 20 exposures to single counterparties or groups of connected counterparties, irrespective of the values of these exposures relative to the bank's core capital.

Without prejudice to the provisions of paragraph One of this article, the Central Bank reserves the right to access above information from the bank database.

## **Chapter IV Sanctions**

### **Article 14 – Administrative sanctions**

Without prejudice to other administrative and pecuniary sanctions provided by other regulations, where a bank fails to meet any of the requirements of this regulation, the Central Bank may apply any of the following sanctions:

- a) issue a warning to the bank;
- b) prohibit all transactions with its related parties and connected parties except repayment to the bank of any outstanding credit accommodation or any transaction specifically permitted by the Central Bank to facilitate recapitalization;
- c) ordering the bank to inject additional capital funds;
- d) prohibit the bank to declare or pay any dividend;
- e) prohibit the bank from awarding any bonuses or increments in the salary, emoluments and other benefits of its directors, managers and officers;
- f) suspension or prohibition to the bank from establishing new branches;
- g) suspension of expansion into new banking or financial activities;
- h) suspension of access to new credit facilities of the Central Bank;
- i) suspension or prohibition of lending, investment, and credit extension operations;
- j) suspension of opening letters of credit or issuance of guarantees;
- k) suspension or prohibition from accepting further deposits or other lines of credit;
- l) prohibition from acquiring, through purchase or lease, additional fixed assets;
- m) deduct from the core capital the excess loan or sum amount granted to related parties;
- n) require a repayment by the offending insider lending, of any amount which exceeds the prescribed lending limits;
- o) any other measure deemed appropriate by the Central Bank in accordance with the provisions of the law concerning organization of banking and relevant regulations.

### **Article 15 – Pecuniary sanctions**

When the Central Bank determines that a bank is not in compliance with this Regulation, it may impose any or all of the pecuniary sanctions prescribed in the regulation on pecuniary sanctions applicable to banks.



## **Chapter V**

### **Transitional and final provisions**

#### **Article 16 – Transitional provisions**

A bank which is not in compliance with limits provided for in this regulation, shall submit to the Central Bank, 30 days after publication of this Regulation, a detailed compliance plan that shall be implemented during the next 12 months.

#### **Article 17 – Repealing provisions**

Regulation n° 04/2008 on insider lending of banks and regulation n° 05/2008 on credit concentration and large exposure and any other previous provisions contrary to this regulation are hereby repealed.

#### **Article 18 – Drafting and consideration of this Regulation**

This Regulation was prepared, considered and approved in English.

#### **Article 19 – Commencement**

This regulation comes into force on the date of its publication in the Official *Gazette* of the Republic of Rwanda.