



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Financing Facilities with Connected Parties

Applicable to:
Prescribed Development Financial Institutions

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PART A OVERVIEW

1 Introduction

Policy objective

- 1.1 The Financing Facilities with Connected Parties (the policy document) sets out the parameters for development financial institutions (DFIs) to extend financing facilities including investment to connected parties which are of good credit standing in the ordinary course of the DFIs' business while performing its mandate. DFIs are to ensure that connected parties, by virtue of their position that could potentially exert influence over a DFI, do not inappropriately benefit from such transactions to the detriment of the DFI.

Scope of policy

- 1.2 This policy document sets out the broad parameters and conditions relating to the conduct of such transactions as mentioned in paragraph 1.1 above with connected parties to ensure an appropriate level of prudence. It also outlines the roles and responsibilities expected of the management and the board of directors.

2 Applicability

- 2.1 This policy document is applicable to DFIs prescribed under the Development Financial Institutions Act 2002 (DFIA).

3 Legal Provisions

- 3.1 This policy document is issued pursuant to sections 28(3), 28(3A), 28(4), 28(5), 41, 116(1) and 126 of DFIA.

4 Effective Date

- 4.1 This policy document comes into effect on 13 July 2016.

5 Interpretation

- 5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the DFIA, as the case may be, unless otherwise defined in this policy document.

- 5.2 For the purpose of this policy document:-

“**S**” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action.

“**G**” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

“**Connected Party**” refers to any of the following:

- (a) **Director** of a DFI, whether as an executive director or otherwise, and whether or not receiving compensation, and his close relatives.
- (b) **Controlling shareholder** of a DFI and his close relatives.
A person shall be deemed to be a controlling shareholder if he fulfils any of the following criteria, whether individually or with other persons acting in concert with him:
 - (i) controls more than 50% of the voting rights;
 - (ii) holds more than 50% of the issued share capital whether directly or indirectly (excluding preference shares);
 - (iii) controls the composition of the board of directors;
 - (iv) has the power to appoint and/or remove all or a majority of the board of directors;
 - (v) controls the controlling shareholder of the DFI; or
 - (vi) is a person in accordance with whose directions or instructions, a director of the DFI or its holding company are accustomed to act.
- (c) **Influential shareholder** of a DFI and his close relatives.
A person shall be deemed to be an influential shareholder if he fulfils any of the following criteria, whether individually or with other persons acting in concert with him:
 - (i) holds 20% or more interest in shares of a DFI, but is not a controlling shareholder; or
 - (ii) has the power to appoint at least one person to the board of directors.
- (d) **Senior management** of a DFI which includes the Chief Executive Officer and senior officers and their close relatives.
- (e) **Officer** who is responsible for or has the authority to appraise and/or approve financing facilities or review the status of existing financing facilities, either as a member of a committee (e.g. Credit/Financing or Investment Committee) or individually, and his close relatives.
- (f) **Firms, partnerships, companies or any legal entities** which control, or are controlled by, any person (including close relatives in the case of individuals) listed in (a) – (e) above. For this purpose, ‘control’ shall be determined with reference to the criteria set out in paragraph (b) above.
- (g) **Firms, partnerships, companies or any legal entities** in which any person (including their close relatives in the case of individuals) listed in (a) – (e) above is interested as a director, partner, senior management, agent or guarantor, and their subsidiaries or entities controlled by them.

- (h) **Subsidiary** of, or an entity controlled by, a DFI, and its connected parties.
- (i) Any person for whom the person listed (including their close relatives in the case of individuals) in (a) – (e) above is a guarantor.

For the purpose of this policy document, the term “**officer**” shall exclude those that are not described in paragraphs 5.2(d) and 5.2(e) above.

5.3 For connected parties who are individuals, **close relative** means those family members who may be expected to influence or be influenced by that individual, as well as dependents¹ of the individual. This includes the individual’s:

- (a) spouse and dependents of the spouse;
- (b) child (including step children and adopted children) and spouse of the child;
- (c) parent; and
- (d) brother or sister and their spouses.

5.4 **Total Capital** is defined under paragraph 8 of the ‘Capital Framework for Development Financial Institutions’.

6 Related Legal Instrument and Policy Documents

6.1 This policy document must be read together with other relevant legal instruments, policy documents, guidelines, codes or circulars issued by the Bank, in particular ‘Capital Framework for Development Financial Institutions’.

¹ This refers to any person who is financially dependent on the individual or his spouse for his livelihood, e.g. a person who receives financial assistance on a regular basis from the individual/spouse.

PART B POLICY REQUIREMENTS**7 Specification for Purposes of Section 28(3A) of DFIA**

- S** 7.1 For the purposes of section 28(3A) of DFIA, a DFI shall not grant any financing facility to any corporation in the shares of which any of the DFI's members, directors or officers has any interest which, in aggregate, is in excess of 50%.

8 Financing Facilities with Connected Parties

- S** 8.1 A DFI shall exercise due care in entering into transactions with connected parties to ensure that the transactions are on an arm's length basis. In this regard, the following principles shall be observed:
- a) the creditworthiness of the connected party shall not be less than what is normally required of other persons;
 - b) the terms and conditions of financing facilities with connected parties shall not be more favourable than those entered into with other counterparties with similar circumstances and creditworthiness, in respect of tenure, interest/profit rate, amortisation schedules and requirement for collateral;
 - c) the financing facilities transactions shall be in the interest of the DFI; and
 - d) the financing facilities transactions is approved by the board of directors with not less than three quarters of all the board members present, and such approval is duly recorded in the minutes of the meeting.
- S** 8.2 Where the board of directors delegates its authority for the approval of financing facilities with connected parties that are not of a material nature to other officers, the following shall apply:
- a) the board of directors shall limit the delegation to transactions that meet parameters set by the board. These parameters shall address, amongst other things, threshold limits, the nature of transactions and the connected parties involved in relation to which delegation is permitted;
 - b) the board of directors shall unanimously approve the delegation and establishment of parameters, with no less than three quarters of the board members present;
 - c) except as allowed under paragraphs 8.4 and 8.5 below, the board of directors shall delegate authority to a properly constituted committee which includes at least 2 non-executive directors who are independent of the transaction and whose composition has been approved by the board. There must be a clear separation between this committee and the credit review committee (if such a committee is formed) pursuant to paragraph 9.4; and
 - d) the board of directors shall ensure that all decisions made under the delegated authority are properly recorded in the minutes of the committee meetings and reviewed by the board on a regular basis.
- S** 8.3 For the purpose of paragraph 8.2, the management of DFIs is required to update the board of directors on any non-material connected party transactions on a periodic basis.

- S** 8.4 For low valued personal consumption financing facilities as determined by the board of directors², a DFI shall delegate approving authority to at least two responsible officers of the DFIs who are also independent of the transactions. The board shall approve any delegation to individual officers in accordance with paragraphs 8.2(a), (b) and (d) of the policy document. In addition, the board or a credit committee that is properly constituted in accordance with paragraph 8.2(c) of the policy document shall individually ratify all such delegated credit decisions.
- S** 8.5 Where derivative transactions such as interest rate swaps, currency swaps, currency forwards and options which are entered into with group entities for risk management purposes, a DFI shall be allowed to delegate approving authority to responsible officers. DFIs must nevertheless ensure that:
- a) the creditworthiness of the relevant group entity is not less than what is normally required for similar transactions with third parties; and
 - b) the transactions (including applicable terms and conditions) are consistent with the DFI's internal risk management policies and procedures.
- S** 8.6 The administration and management of credit risk for exposures resulting from transactions with connected parties (including debt collections, credit reviews, provisioning, write-offs, follow-up actions, legal actions and concentrations of exposures to connected parties) shall similarly adhere to approved policies and procedures applied to other counterparties.
- S** 8.7 A DFI shall ensure that a connected party abstains from participating directly or indirectly in the deliberation and decision-making process involving financing facilities and management of the exposures (e.g. credit reviews, investment reviews etc.) in which he has an interest.
- S** 8.8 The DFI's subsidiaries and other entities controlled by the DFI shall also observe the principles and requirements of this policy document when dealing with financing facilities and exposures with connected parties.

9 Controls Over Transactions with Connected Parties

Oversight by Board of Directors

- S** 9.1 The board of directors shall be ultimately responsible for ensuring that risks associated with exposures to connected parties are effectively managed. Board members are also expected to play a significant role in ensuring the effective implementation of policies and procedures designed to control and manage risk exposures and to promote sound business practices.
- S** 9.2 The board of directors shall be responsible for establishing a clear written policy on financing facilities and management of exposures with connected parties. The policy shall be periodically reviewed and any changes to the policy shall be approved by the board.

² Examples include motor vehicle, mortgage, credit card and personal financing facilities which are below a limit to be set by the board.

- S** 9.3 The board of directors shall ensure that a proper mechanism is in place to implement policies and procedures relating to the control and management of risk exposures and risk of malpractices associated with connected party transactions.
- S** 9.4 Financing facilities and exposures with connected parties shall be regularly reviewed, and monitored by the board of directors. The board, may delegate this function to a credit review committee, subject to the following requirements:
- a) The committee is chaired by a member of the board (either executive or non-executive) who does not have a material financing facilities with the DFI, and must not be empowered to approve financing or investments. The board shall determine the composition of the committee and the committee shall report directly to the board; and
 - b) The committee shall comprise persons experienced in credit and risk management, preferably drawn from those having specialised skills in managing various elements of the credit investment activities. Such persons shall be able to evaluate and make recommendations to the board on risk management issues, the level of risk exposure and appropriate risk mitigants in relation to transactions with connected parties.
- S** 9.5 To facilitate the board of directors in carrying out its functions, management of the DFI or the credit review committee referred to in paragraph 9.4 shall submit regular reports to the board on:
- a) financing facilities with connected parties;
 - b) the status and aggregate exposures to each connected party; and
 - c) material concentrations.

Policy on Financing Facilities with Connected Parties

- S** 9.6 A DFI shall ensure that established internal policies and procedures regarding financing facilities and management of exposures with connected parties specifically address all material aspects and at a minimum, cover the following areas:
- a) the types of financing facilities and exposures that are subject to the policies and procedures. These shall follow the categories as defined in this policy document but DFIs may include any other types of financing facilities;
 - b) a connected party shall be clearly defined in line with the Interpretation provided in the policy document. Where appropriate, the board of directors may include other parties it considers as having the ability to exert significant influence over the DFI;
 - c) conditions, including interest/profit rates, and other terms and conditions that must be complied with for financing facilities with connected parties which are consistent with the principles outlined in paragraph 8.1;
 - d) all financing facility with connected parties must be approved by the board of directors or a committee properly constituted by the board in accordance with paragraph 8.2(c). The write-off of connected party exposures exceeding an amount as determined by the board shall also be subject to the board's approval;

- e) financing limits, applicable both for exposures at the individual/entity level and for aggregated exposures to connected parties within the same group or that are otherwise affiliated. The limits shall be appropriate to avoid excessive exposures to connected parties that will increase risks to the DFI beyond prudent levels. Such limits may be lower than that permitted under paragraph 10.1 of this policy document;
- f) procedures for the processing and monitoring of financing facilities and exposures with connected parties, including, but not limited to:
 - i) procedures for the effective management and review of financing facilities and exposures;
 - ii) clear controls prohibiting a person with an interest in the financing facilities and/or exposure from participating in the deliberation, decision making or management of the transaction and/or exposure;
 - iii) appropriate mechanisms to identify individual and aggregate exposures to connected parties to ensure compliance with approved limits; and
 - iv) procedures for regular reporting to the management and board on financing facilities and exposure levels with connected parties as well as the status of such exposures.
- g) internal controls and other procedures to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

Monitoring of Connected Lending

- S** 9.7 A DFI shall institute appropriate processes that will facilitate its timely identification of parties which are connected to it. Such processes shall include declarations by directors, senior management and controlling shareholders of their affiliations and close relatives. The list of connected parties shall be updated regularly.
- S** 9.8 A DFI shall ensure the presence of a robust system to identify, measure and monitor exposures to a connected party and compliance with established policies and procedures, as well as to identify exceptions.
- S** 9.9 A DFI shall establish a system of independent, on-going assessment of financing facilities with a connected party to ensure their compliance with established limits. The results of such reviews shall be communicated directly to the board and senior management.
- S** 9.10 The internal audit function shall conduct regular reviews into financing facilities with connected parties to ensure compliance with established policies and procedures. The resulting audit reports shall be submitted directly both to the board of directors and the Audit Committee.
- S** 9.11 Any exceptions shall be reported promptly to the appropriate level of management as established in the policies and procedures. Material exceptions shall be immediately reported directly to the board of directors or Audit Committee and concurrently to the Bank.

10 Limits on Exposures with Connected Parties

- S** 10.1 Total outstanding exposures to all connected parties (including exposures through subsidiaries or other entities that are under the DFI's control), except those exempted under paragraph 11.2 below, shall not exceed 100% of the total capital or 25% of total outstanding exposures, whichever is lower.
- S** 10.2 For purposes of this policy document, exposures shall include both outstanding and unutilised financing arising from financing facilities with connected parties.
- S** 10.3 For off-balance sheet transactions, the on-balance sheet equivalent (financing equivalent) value of the exposure shall be determined by applying a credit conversion factor (CCF) to the nominal principal amount of the off-balance sheet exposures. The applicable CCF shall be based on the nature of the off-balance sheet exposures as listed in the 'Capital Framework for Development Financial Institutions' issued on 22 February 2008.

11 Non-application of Specific Requirements in the Policy Document

- S** 11.1 The non-application of specific requirements in this policy document are as follows:
- a) Paragraphs 8.1(a) and 8.1(b) shall not apply to financing facilities extended under schemes of service for staff and executive directors; and
 - b) Financing facilities with subsidiaries are exempted from paragraph 8.1(b).
- S** 11.2 The limit under paragraph 10.1 shall not apply to exposures arising from the following transactions with connected parties:
- a) Financing facilities extended under schemes of service for staff and executive directors;
 - b) Financing facilities provided under special or compassionate circumstances, to senior management, or staff, subject to a maximum amount at any one time not exceeding 6 months remuneration of the senior management or staff concerned;
 - c) Financing facilities provided to finance the purchase of a house for own occupation by an individual connected party or his close relatives;
 - d) Financing facilities provided to finance the education of children of the connected party;
 - e) Transactions, partially or entirely secured by cash or bank deposits. The exemption shall be limited to the amount secured by the said security;
 - f) Transactions associated with debt-to-equity conversion schemes in which the DFI's holding does not exceed 33% of the restructured company's nominal paid-up capital. DFIs are, however, prohibited from entering into new/additional financing transactions with the company concerned;
 - g) Transactions with development institutions and corporations as listed in Appendix I; and
 - h) Short-term intra-group liquidity facilities with tenures not exceeding one year.

12 Records

- S** 12.1 A DFI shall maintain the necessary records which will identify connected parties, related interests and specify their exposures. These records shall be updated regularly.
- S** 12.2 Records regarding each transactions with a connected party shall cover, at a minimum, the following:
- a) name of borrower;
 - b) name of connected party;
 - c) relationship;
 - d) date approved and reviewed;
 - e) purpose of the financing facility;
 - f) type of exposure;
 - g) amount of approved facility;
 - h) outstanding amount or carrying value;
 - i) internal credit rating;
 - j) terms and conditions; and
 - k) security.
- S** 12.3 These records shall be available for inspection by the Bank and/or external auditors at any time.

13 Regulatory Reporting

- S** 13.1 A DFI shall be required to report on a semi-annual basis to the Bank, its exposures to connected parties in the format provided in **Appendix II**.
- S** 13.2 A DFI must immediately report to the Bank the following:-
- a) any significant non-compliance with policies and procedures in line with paragraph 9.11; and
 - b) any transactions with connected parties which do not comply with the limits specified by the Bank under this policy document.
- S** 13.3 The board of directors shall be responsible to ensure adequate procedures are in place and effectively implemented to secure the accuracy of reports submitted to the Bank.

14 Disclosure

- S** 14.1 A DFI shall disclose in its published financial statements on an annual basis, information, regarding exposures arising from transactions with connected parties. At a minimum, the information shall include:-
- a) the aggregate value of outstanding exposures with connected parties;
 - b) the percentage of outstanding exposures to connected parties as a proportion of total exposures; and
 - c) the percentage of outstanding financing exposures with connected parties which is non-performing or in default.

- G** 14.2 Exposures on connected party transactions should be disclosed semi-annually should the DFIs opt to publish its interim financial report on half-yearly basis.

15 Capital Adequacy Treatment

- S** 15.1 The amount of exposures to a connected party shall be deducted from the regulatory capital, or the DFI shall be required to collateralise the exposures, if the Bank is of the opinion that the transaction was undertaken in a manner that is inconsistent or not compliant with the principles and requirements set out in this policy document.

16 Other Connected Party Transactions

- G** 16.1 While the policy document addresses financing facilities and exposures with connected parties, the principles herein should be generally observed for all other forms of transactions with a connected party³, particularly in relation to the approval, control (including monitoring and oversight) and limits (where appropriate) of such transactions.

³ Examples of other connected party transactions include the procurement of goods and services, lease rentals, consulting or professional services with connected parties, the purchase or sale of real estate and other capitalized leases.

PART C APPENDICES**Appendix I****List of Exempted Institutions**

1. Cagamas Berhad
2. Credit Guarantee Corporation Berhad
3. Malaysian Industrial Development Finance Berhad
4. Sabah Development Bank Berhad
5. Sabah Credit Corporation
6. Permodalan Nasional Berhad
7. Permodalan Usahawan Nasional Berhad
8. Khazanah Nasional Berhad
9. Kumpulan Wang Simpanan Pekerja
10. Lembaga Tabung Haji

Appendix II

Name of Development Financial Institution:

Semi - Annual Reporting on Financing Facilities with Connected Parties

For position as at

(to be submitted to Jabatan Kewangan Pembangunan dan Enterpris, no later than 3 weeks after the reporting date)

	Total Outstanding Value (RM '000)	Total number of connected party accounts / counterparty	Total exposure (total outstanding + unutilised limit) (RM '000)	Total financing exposure which is non-performing or in default (RM '000)
Financing facility (except guarantee)				
Off-balance sheet exposures ¹				
Equities and PDS held				
TOTAL				
Total exposure to connected parties as % of total capital				
Total exposure to connected parties as % of total outstanding exposures				

¹ Off-balance sheet transactions that give rise to financing and/or counterparty risk. These transactions also include guarantees, underwriting obligations, etc.