



**BANK OF PAPUA NEW GUINEA**

**PRUDENTIAL STANDARD**

**6/2005**

**TRANSACTION WITH RELATED PARTIES**

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1. Effective Date

**PART I: PRELIMINARY**

- 1: **Short Title** – Transactions with Related Parties.
- 2: **Authorization** – The Bank of Papua New Guinea (Bank) is authorized to issue prudential standards under Section 27 of the Banks and Financial Institutions Act 2000 (Act) in relation to prudential matters to be complied with by all Authorized Institutions.
- 3: **Application** – All banking institutions licensed by the Bank to conduct banking business in Papua New Guinea (PNG).
- 4: **Definitions** – Terms used within this standard are as defined in the Act, as defined below, or as reasonably implied by contextual usage:
  - 1) **“bank”** - means all banks and other licenced financial institutions authorized under the Act to carry on banking business.
  - 2) **“capital base”** – means Total Capital as defined in Prudential Standard 1/2003 Capital Adequacy.
  - 3) **“related party”** – means any person who is a director, officer and/or shareholder controller of the bank that is in a policy-making position, together with his/her financially-dependent children or other relatives, his/her business associates, the holding company of which the bank is a subsidiary, or other company that is affiliated with the bank or holding company through common ownership, control or management.
  - 4) **“transaction”** – means any transaction with a related party, other than a loan or credit exposure to a related party; for purposes of this standard, transactions include the following transactions between a bank and a related party of the bank:
    - (a) purchases, leases or sales of assets whether financial or non-financial, tangible or intangible, or movable or immovable property;
    - (b) 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;
    - (c) borrowings from a related party in the form of notes, subordinated debentures, securities sold under an agreement to repurchase, assumptions or incurrence of a liability, or any similar forms of indebtedness;
    - (d) investments in the shares of a related party; or
    - (e) 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.

**PART II: STATEMENT OF POLICY**

- 1: **Purpose** – This standard is intended to ensure that all transactions between a bank and a related party of the bank (a) are on substantially the same terms and conditions (“arm’s length” basis) as the same or similar transactions between a bank and an unrelated 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 a bank, and (d) are not used as a means of evading capital or other regulatory requirements.

- 2: **Scope** – This standard applies to all banking institutions licensed and operating in PNG.
- 3: **Responsibility** – It is the responsibility of the board of directors of each bank to (a) establish an appropriate policy in respect of transactions with related parties, (b) require management to adopt corresponding procedures to implement the policy, and (c) monitor and ensure compliance to the policy and this prudential standard.

### PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

- 1: **Minimum Requirements** – The following minimum requirements shall apply to all transactions with a related party:
  - (a) **Conformance to policy** - All transactions between a bank and a related party shall conform to a written policy that has been approved and adopted by a majority of the entire board of directors and that is adequate to ensure compliance with this standard and with prudent banking practices;
  - (b) **Non-preferential terms** - All transactions between a bank and a related party shall be at arm's length, i.e. on substantially the same terms and conditions in respect of charges, fees, interest rate, liability, maturity, price, repayments, risk, security, etc. as the same or similar transactions between a bank and an unrelated party;
  - (c) **Prior Board approval** - Any single transaction between a bank and a related party, or group of transactions so closely-related or sufficiently similar that they should be treated as a single transaction, that exceeds the lesser of K100,000 or 5% of a bank's capital base must be approved in advance by a majority of the entire board of directors; for purposes of this standard, the amount of a transaction, or group of closely-related transactions, is the aggregate amount to be paid (or received) for services received (or given), or the book value at the time of the transaction of an asset to be sold or purchased or a liability to be assumed or incurred.
- 2: **Prohibited Transactions** – No bank shall: 1) purchase a low quality asset from a related party, and no bank shall incur a liability for or to a related party in respect of a low quality asset; for purposes of this standard, a low quality asset is any asset that is, or should be, classified as Special Mention or a lower grade according to Prudential Standard 2/2003 Asset Classification; or 2) sell or otherwise transfer an asset to a related party at a price or value that is below the current fair market value of that asset; or 3) purchase or otherwise receive an asset from a related party at a price or value that is above the current fair market value of that asset.
- 3: **Reporting Requirements**. Each bank shall submit to the Bank such returns as the Bank may require and in the form and frequency as the Bank may prescribe.

### PART IV: CORRECTIVE MEASURES

- 1: **Remedial measures and sanctions** - If a bank breaches any provision of this prudential standard in a flagrant manner which results, or threatens to result, in an unsafe or unsound condition, or fails to comply with the instructions and reporting requirements, or if there is risk that the existing capital base will be impaired and result in a condition that threatens the interests of depositors or the general public, the Bank may pursue appropriate corrective actions and sanctions by imposing or varying conditions on the bank's licence as provided in Section 14 of the Act.

Such conditions imposed on a bank's licence under Section 14 may include, but are not limited to, the following –

- a) Require the bank to take certain steps or to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way, including a prohibition from engaging in any further foreign exchange activities for a specified period of time;
- b) Impose limitations on the acceptance of deposits, the borrowing of money, the granting of credit or the making of investments;
- c) Prohibit the bank from soliciting deposits, either generally or from persons who are not already depositors;
- d) Prohibit the bank from entering into any other transaction or class of transactions;
- e) Suspend access to the credit facilities of the Bank; or
- f) Suspend or require the removal of any directors, managers or chief executives.

**PART V: EFFECTIVE DATE**

- 1: **Effective date** – The effective date of this prudential standard shall \_\_\_\_\_  
2005.

**Questions relating to this prudential standard should be addressed to The Manager, Financial System Supervision Department, Bank of PNG, Tel: 322-7200.**

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**L Wilson Kamit, CBE**  
**GOVERNOR**