MFSA

MALTA FINANCIAL SERVICES AUTHORITY

BANKING SUPERVISION UNIT

BANKING RULES

EXTENSION OF THE APPLICABILITY OF THE "ARM'S LENGTH"PRINCIPLE BY CREDIT INSTITUTIONS AUTHORISED UNDER THE BANKING ACT 1994

Ref: BR/11/2018.01

EXTENSION OF THE APPLICABILITY OF THE "ARM'S LENGTH" PRINCIPLE BY CREDIT INSTITUTIONS AUTHORISED UNDER THE BANKING ACT 1994.

INTRODUCTION

1. In terms of article 4 of the Banking Act 1994 ('the Act') the competent authority ('the Authority'), as appointed in terms of article 3(1) of the Malta Financial Services Authority Act, may make Banking Rules as may be required for the carrying into effect of any of the provisions of the Act.

2. This Rule extending the applicability of the "arm's length" principle ('the principle') is being made pursuant to the proviso to article 15(1) (a), (b) and (c) of the Act – Prohibited Transactions which states that:

   Provided that the competent authority may by Banking Rule extend the restrictions listed in paragraphs (a), (b) and (c) or any of them to other officers, employees or shareholders of credit institutions or to other categories of persons in such manner and to such extent as may be specified.

3. Paragraph (b) of article 15(1) of the Act determines the applicability of the principle both in relation to the granting of credit facilities and to the extension of other banking services by credit institutions.

4. Furthermore the same paragraph (b) of article 15(1) of the Act also provides for the measures that are to be taken by the Authority to ensure compliance by credit institutions with this provision and for sanctioning credit institutions in cases of non-compliance.

SCOPE AND APPLICATION

5. The provisions of this Rule shall apply to all credit institutions that are licensed under the Act.

6. The provisions of this Rule shall also apply in cases where credit institutions are supervised on a consolidated basis.

EXTENSION OF THE APPLICATION OF THE PRINCIPLE

7. In order to prevent abuses arising in transactions with related parties and to control or where appropriate mitigate conflicts of interest, credit institutions shall enter into any transactions with related parties on an arm's length basis, shall adopt adequate procedures for such transactions, establish adequate monitoring

systems, take appropriate steps to control or mitigate the risks and write off exposures to related parties in accordance with standard police and processes.

8. In granting credit facilities and in extending banking services, credit institutions shall have procedures to ensure that 'related parties' are not granted nor have outstanding credit facilities or other banking services under terms more favorable (e.g. in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than those applied to other persons.

9. Credit institutions shall apply the principle to the following additional related parties over and above those currently included in paragraph (b) of article 15(1) of the Act:

- qualifying and significant shareholders, auditors, or their respective close family members, whether jointly or severally, and to any commercial partnership in which such persons may have control;

- officers and employees of the credit institution, including members of the Board of Directors, their direct and related interests, and their close family members; and

- corresponding persons in affiliated companies.

The Authority may exercise discretion in applying this definition on a case-by-case basis.

10. The provisions of paragraph 9 above shall not apply in respect of credit facilities and banking services granted by credit institutions to their officers and employees under preferential terms as laid down in their conditions of employment.

11. Credit institutions shall ensure that there are specific procedures in place to prevent persons, benefiting from credit facilities and/or banking services, from being part of the preparation and the assessment leading to the decision of granting such facilities and/or services.

12. Credit institutions shall ensure that transactions with related parties and the write-off of related-party exposures exceeding specified amounts, or otherwise posing special risks, are subject to prior approval by the bank's Board. Members of the Board of Directors with conflicts of interest are to be excluded from the approval process of granting and managing related party transactions.

13. Exposures to related parties shall be treated as exposures to the same 'group of connected customers' as defined in article 4 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 ('the CRR'). The limit on the aggregate exposures to related parties shall be set in line with the

provisions of article 395 CRR. The Authority may on a case-by-case basis deduct exposures to related parties from capital when assessing capital adequacy.

14. Credit institutions shall ensure that adequate policies and processes are in place with regards to identifying individual exposures and transactions with related parties, as well as the total amount of exposures, and the monitoring and reporting on them through an independent credit review or audit process. Any exceptions to policies, processes and the limits shall be reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. Senior management shall monitor related party transactions on an ongoing basis, and the Board shall be bound to provide oversight of these transactions.

15. Credit institutions shall regularly report to the Authority information on aggregated exposures to related parties via the Financial Reporting (FINREP) framework.

ADMINISTRATIVE PENALTIES

16. Where a person fails to comply with the provisions of any Banking Rule, the Authority may impose on such person an administrative penalty in terms of article 35A of the Act.