

INSTRUCTION CPO/B-2000/6
TRANSACTIONS WITH RELATED PERSONS,
RELATED BANKS AND FINANCIAL INSTITUTIONS, AND AFFILIATES

I. AUTHORITY

This instruction is issued by the Central Payments Office of East Timor (hereinafter, “CPO”) pursuant to Sections 22, 25, 27, and 29 of *Regulation No. 2000/8 on Bank Licensing and Supervision* (hereinafter, the “Regulation”). This instruction applies to all transactions with related persons, related banks and financial institutions, and affiliates.

II. DEFINITIONS

A. **Affiliates** of a bank means the following, pursuant to Section 49(b) of the Regulation:

1. A subsidiary of the bank;
2. A company of which the bank is a subsidiary; or
3. A company that is under common control with the bank.

B. **Credit Exposure** to a person or a group of inter-related persons, as those terms are defined herein, means the sum of a bank’s:

1. credits, as defined in Section 49(g) of the Regulation, including participations;
2. equity interests, as defined in Section 49(k) of the Regulation;
3. debt securities, as defined in Section 49(i) of the Regulation;
4. credit substitutes such as guarantees, acceptances, letters of credit and bills, finance lease receivables;
5. securitized assets and other transactions with recourse; and
6. contingent liabilities, such as commitments to extend credit.

less an amount by which any of the above-listed items are fully and irrevocably secured by:

7. collateral in the form of cash deposits placed with the bank who extended the credit; or
8. a guarantee of the government of East Timor or of a government of an Organization of Economic Cooperation and Development country, provided that the guarantee:
 - (a) has as its only condition for the enforcement of the right resulting from the guarantee the counterparty's failure to meet his obligation toward the bank;

- (b) is explicit in all its prerequisites; and
- (c) can be executed so that neither the guarantor nor any other person is in a position to challenge the legal rights of the bank resulting from the guarantee.

C. **Group of Inter-Related Persons** means two or more persons (as the term “person” is defined herein), whether individuals or juridical persons, holding exposures from the same bank and any of its subsidiaries, whether on a joint or separate basis, but who are mutually associated in that:

1. one of them holds, directly or indirectly, power of control over the other; or
2. their cumulated exposures represent to the bank a single risk in so much as they are so interconnected with the likelihood that if one of them experiences financial problems the other or all of them are likely to encounter repayment difficulties. Such interconnections include, but are not limited to:
 - partnerships,
 - common ownership or control,
 - common directors,
 - cross guarantees, and
 - direct commercial interdependency which cannot be substituted in the short-term.

D. **Person** is defined in Section 49(q) of the Regulation.

E. **Regulatory Capital** is defined in the CPO’s *Instruction B-2000/2 on Regulatory Capital*.

F. **Related banks and financial institutions** of a bank, include the following, without limitation, pursuant to Section 29.5 of the Regulation:

1. Any private or governmental person or institution, or any number of such persons or institutions acting in concert, that has a direct or indirect significant interest in the bank; and
2. Any juridical person or undertaking in which the bank holds a significant interest.

G. **Related persons** of a bank include the following, without limitation, pursuant to Section 29.2 of the Regulation:

1. Any administrator of the bank, as defined in Section 49(a) of the Regulation;
2. Any principal shareholder of the bank as defined in Section 49(r) of the Regulation;
3. Any person who is related to such administrator or principal shareholder by marriage, consanguinity to the second degree, or business interest; and

4. Any legal person that has a significant interest in a juridical person in which the bank has a significant interest.

H. **Tier One Capital** is defined in the CPO's *Instruction B-2000/2 on Regulatory Capital*.

III. REQUIREMENTS

- A. All transactions with related persons, related banks and financial institutions, and affiliates of a bank must be made on an arm's-length basis. Banks shall not enter into a transaction with or for the benefit of a related person, related bank or financial institution, or affiliate if such transaction would be entered into on less favorable terms and conditions, or not at all, with or for the benefit of persons who are not so related to the bank (non-related persons).
- B. The Board of Governors of each bank shall adopt, and ensure that senior management implements, a written policy covering all transactions, including extensions of credit and deposits, with related persons, related banks and financial institutions, and affiliates. Processes should be established within the bank to allow the Board of Governors to monitor compliance with the policy. The Board of Governors shall review the policy on at least an annual basis. The policy, at a minimum, shall:
 1. prohibit the bank from providing preferential treatment to related persons, related banks and financial institutions, and affiliates (such as accepting deposits or lending on highly favorable terms, covering trading losses, waiving commissions, etc.);
 2. impose strict and binding limits on credits to related persons, related banks and financial institutions, and affiliates, which do not exceed the limitations contained in this instruction;
 3. require that credits to related persons, related banks and financial institutions, and affiliates are fully collateralized;
 4. prohibit the altering of the bank's credit-granting criteria, credit collection efforts, or any of the bank's other credit administration policies and procedures, to accommodate related persons, related banks and financial institutions, and affiliates; and
 5. conform to the requirements of Sections 22 (Disclosure of Conflicts of Interest and Fiduciary Obligations), 25 (Prohibited Anti-Competitive Transactions and Practices), and 29 (Transactions with Related Persons) of the Regulation, and to this instruction.
- C. All transactions with related persons, related bank and financial institutions, and affiliates of a bank must be approved in advance by the Board of Governors, excluding board members with conflicts of interest. The approval of the Board of Governors shall be registered in the minutes, shall include evidence of the terms and conditions of the transaction, and shall document the Board of Governors' determination that the transaction is in the best interest of the bank and

was made on an arm's length basis (that is, on the same terms and conditions as those available for comparable transactions with non-related persons).

- D. Banks shall maintain records necessary to identify all related persons, related banks and financial institutions, and affiliates of the bank, and all transactions entered into with said persons. Banks shall have procedures in place to properly identify groups of inter-related persons.

IV. LIMITATIONS

- A. The bank's Credit Exposure to any related person, related bank or financial institution, affiliate, or group of inter-related persons shall not exceed 5 % (five percent) of the bank's Regulatory Capital.
- B. The maximum aggregate Credit Exposure that a bank shall be permitted to extend to or for the benefit of all related persons, related banks and financial institutions, affiliates, and groups of inter-related persons shall not exceed 40% of the bank's Tier One Capital.

V. REPORTING

Each bank shall submit to the CPO a report as of each month-end in the format prescribed by the CPO showing all Credit Exposures to related persons, related banks and financial institutions, and affiliates, as well as compliance with the limitations contained in Section IV above.

26 December 2000

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**REPORT ON CREDIT EXPOSURES TO RELATED PERSONS
RELATED BANKS AND FINANCIAL INSTITUTIONS AND AFFILIATES**

Name of Bank:
CPO Identification Number:
Report for Month Ended:

Calculation of Limitations

Amount of Tier One Capital as of Current Month End:

Amount of Regulatory Capital as of Current Month End:

40% Tier one capital:

5% of Regulatory Capital:

List all Credit Exposures to Related Persons, Related Banks and Financial Institutions, and Affiliates:

	Identification of Counter-party (include groups of inter-related persons)	Credit Exposure
1.		
2.		
3.		
4.		
5.		
6.		
7.		
8.		
9.		
10.		
etc.		
	Sum of all Credit Exposures to Related Persons, Related Banks and Financial Institutions, and Affiliates	