



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem

July 2013

**RELATED PARTY LENDING**

**FREQUENTLY ASKED QUESTIONS**

## Contents

1	Introduction .....	2
2	General Information .....	3
3	Scope, Legal Basis and Application .....	6
4	Lending .....	9
5	Related Parties and Connected Persons of Related Parties .....	18
6	Oversight by Credit Institutions .....	23
7	Exemptions .....	25
8	Prior Central Bank Approval .....	29
9	Reporting .....	32

## 1 Introduction

The Code of Practice on Lending to Related Parties (‘the RPL Code’) sets out obligations which apply to credit institutions to seek to prevent abuse arising from exposures to related parties. This document (‘the RPL External FAQs’) is drawn up for guidance purposes only. It addresses commonly asked questions which have been raised in relation to the RPL Code and is informed by the Central Bank’s practice and experience in applying the RPL Code. This guidance may be updated by the Central Bank from time to time.

The RPL External FAQs have no legal status. They are issued solely for guidance purposes to assist credit institutions and Banking Supervision Division staff.

Risk, Governance and Accounting Policy Division

July 2013

## 2 General Information

### 2.1 When was the Related Party Lending Code introduced?

The Related Party Lending Code (RPL Code) was originally published by the Central Bank on 20 October 2010 following a public consultation process. It became effective on 1 January 2011. A revised RPL Code (revised RPL Code<sup>1</sup>) was issued on 27 June 2013 which became effective on 1 July 2013.

### 2.2 What prompted the RPL Code?

The release of the RPL Code was prompted by events in the Irish banking sector, specifically the lending to directors, and to persons and entities connected to directors, within a domestic credit institution. The RPL Code was introduced to seek to prevent abuse arising from exposures to related parties and to address possible conflicts of interest in this area.

### 2.3 How does the RPL Code differ from previous requirements?

The RPL Code replaced previous non-statutory requirements which were contained in Section 8.4 of the Central Bank's 'Licensing and Supervision Requirements and Standards for Credit Institutions' ('the Standards') which were published in the Central Bank's Quarterly Bulletin, Winter 1995. The main differences from previous requirements are:

- A breach of the Standards was not sanctionable under the Administrative Sanctions Procedure. A breach of the RPL Code is sanctionable.
- Related parties under the RPL Code include a director, senior manager or significant shareholder of the credit institution or an entity in which the credit institution has a significant shareholding, as well as a connected person of any of the aforementioned persons. Thus the RPL Code broadened the definition of a related party to include senior manager and to include 'connected persons' of a related party.

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<sup>1</sup><http://www.centralbank.ie/regulation/industry-sectors/credit-institutions/Documents/Amended%20Code%20of%20Practice%20on%20Lending%20to%20Related%20Parties%20June%202013.pdf>

- It widened the definition of loan to include quasi-loans (see FAQ 4.3 below) and off-balance sheet commitments.
- It reduced the maximum amount that can be loaned to an individual related party i.e. the maximum amount that a credit institution could lend to an individual related party was previously 2.0% of own funds. This was reduced to 0.5% per cent in Section 6(i) I of the RPL Code. All other limits contained in Section 6(i) of the RPL Code represent half of the limits that previously existed in the Standards.
- It introduced a new requirement for prior Central Bank approval (Section 6(d)) for loans over €1 million.
- It is more prescriptive and more onerous regarding the role of the Board in its approval and monitoring of lending to related parties.

The reports which credit institutions must submit to the Central Bank on a quarterly basis are more detailed – for detail on reporting requirements please refer to Section 9 of this FAQ document.

The revised RPL Code contains changes relating to:

- **Debt for Equity Swaps** – in order to encourage credit institutions to address the extent of loans in arrears, lending to a related party who becomes a related party only by virtue of a credit institution acquiring a significant shareholding as part of a restructuring of a non-performing loan or to provide additional collateral for a performing loan will be exempted from Requirements 6(d) and 6(i) of the revised RPL Code subject to certain conditions as set out in the revised RPL Code (see FAQ 4.13);
- **Definition of Connected Persons and Clients** – has been amended to clarify that this definition includes a civil partner (see FAQ 5.9);
- **De Minimis Limit** – a de minimis amount of €25,000 is introduced, below which Requirement 6(b) of the Code (prior approval of the credit institution's Board or subcommittee of the Board) would not apply for certain types of lending, in summary for personal lending to a 'natural' connected person of a director or senior manager (see FAQ 7.1).

## **2.4 Is the external auditor covered by the Code?**

No. Auditors are not considered to be connected persons to the Regulated Financial Service Provider. The auditor's own independence rules prohibit the auditor from holding any significant financial stake (including loans) with any entity which they audit.

## **2.5 Does the RPL Code supersede the Central Bank's Conditions imposed on credit institutions regarding lending to directors?**

No. In 2009, as one part of the Central Bank's response to the discovery of the removal and reduction at year-end of directors' loans at a domestic credit institution, a decision was made to impose conditions on banks and directions on building societies requiring them to improve the transparency of loans made by them to their directors and to persons connected with directors. The conditions/directions imposed on credit institutions in August 2009 relate to the public disclosure in the institution's annual financial statements of lending to directors and to connected persons and to the maintenance of registers of such lending. For further detail regarding public disclosures required by credit institutions refer to FAQ 9.17. These are separate from the requirements in the RPL Code which relate to private, prudential reporting to the Central Bank on a quarterly basis by credit institutions of lending to related parties. For detail on prudential reporting requirements please refer to Section 9 of this FAQ document.

### 3 Scope, Legal Basis and Application

#### 3.1 To which institutions does the RPL Code apply?

The RPL Code applies to all credit institutions (banks and building societies) operating in Ireland licensed and authorised by the Central Bank. The RPL Code does not apply to credit institutions incorporated in other EEA Member States operating in Ireland on a branch or cross-border ('passporting' of services) basis.

The RPL code is not applicable to Credit Unions.

#### 3.2 What are the requirements of the RPL Code?

The RPL Code introduced statutory requirements in relation to lending by banks and building societies to related parties. In summary it requires that such lending is:

- extended on an arm's length basis;
- is limited to a percentage of the institution's own funds; and
- is subject to appropriate and effective management oversight and limits.

The RPL Code requires, inter alia:

- Loans to related parties shall not be granted on more favourable terms than comparable loans to non-related parties (Section 6(a)).
- Loans to related parties or any variation of the terms require prior Board approval or approval by a Subcommittee of the Board established specifically to deal with related party lending. That Subcommittee is required to report directly to the Board (Section 6(b)).
- Actions in respect of the management of such loans (for example, grace periods, interest roll-ups, loan write-offs) require prior Board approval or approval by a Subcommittee of the Board established specifically to deal with related party lending where that Subcommittee reports directly to the Board (Section 6(c)).
- Approval is required from the Central Bank prior to extending loans to a related party which exceed €1million (Section 6(d)).
- The Board of the credit institution is obliged to put policies and procedures in place over related party lending, ensure adherence thereto, monitor and report on such loans (Sections 6 (e), (f), (g), and (h)).

- Limits are imposed on a credit institution's lending to related parties, both on an individual level and on an aggregated basis (Section 6(i)).
- Detailed reporting requirements to the Central Bank are imposed, including the reporting of deviations from the RPL Code (Section 7).
- Specific exemptions (Section 8 of revised RPL Code (June 2013)).

Section 6(j) contains an anti-avoidance provision which aims to prevent firms from engaging in practices, entering arrangements, structuring or restructuring loans or executing documents in such a manner as to avoid the requirements of the RPL Code.

### **3.3 What is the legal basis for imposition of the RPL Code?**

The RPL Code is imposed pursuant to Section 117 of the Central Bank Act 1989 on banks incorporated in the State licensed under Section 9 of the Central Bank Act 1971 and on building societies authorised under the Building Societies Act 1989. It also applies to designated credit institutions registered under the Asset Covered Securities Act 2001.

Separately, the reporting requirements described in Section 7 of the RPL Code are imposed pursuant to Section 117(3) (a) of the Central Bank Act 1989.

### **3.4 What happens if a credit institution does not comply with the RPL Code?**

A contravention of the RPL Code may be liable to the Central Bank using any of its regulatory powers, including, but not limited to, one or both of the following:

- The imposition of an administrative sanction under Part IIIC of the Central Bank Act, 1942.
- The prosecution of an offence.

### **3.5 Where one credit institution licensed or authorised by the Central Bank is merged with, or acquired by, another credit institution that is licensed or authorised by the Central Bank, what are the implications for application of the RPL Code?**

It depends on the terms of the merger/acquisition. If the two credit institutions continue to be licensed or authorised then both institutions will continue to be subject to the RPL Code and they both must continue to submit quarterly RPL returns to the Central Bank (see FAQ 9.1). Intra-group lending within a banking group to undertakings that are covered by consolidated supervision is exempt from the limits in



Requirement 6(i) (see FAQ 7.2). It should be noted that each credit institution will have to reassess who are its Related Parties following the merger/acquisition.

If one of the credit institutions hands back its licence or authorisation then the RPL Code will no longer apply to that entity. The remaining credit institution will continue to be subject to the RPL Code and will have to reassess who are its Related Parties following the merger/acquisition.

## 4 Lending

### 4.1 What lending is captured by the RPL Code?

The RPL Code captures loans, quasi-loans and any credit transaction which results in an exposure or potential exposure, including guarantees. Refer to FAQs below for definitions of each of the components identified by the RPL Code.

### 4.2 Does it only apply to lending within Ireland?

No. It applies to lending inside or outside the State.

### 4.3 What is a quasi-loan?

The concept of a 'quasi-loan' is taken from Section 25 of the Companies Act, 1990. An example of a quasi-loan is where a loan is granted to one individual but repayment is undertaken by another.

Quasi-loans are defined within the Companies Act, 1990 as:

- (a) a quasi-loan is a transaction under which one party ("the creditor") agrees to pay, or pays otherwise than in pursuance of an agreement, a sum for another ("the borrower") or agrees to reimburse, or reimburses otherwise than in pursuance of an agreement, expenditure incurred by another party for another ("the borrower") -
  - (i) on terms that the borrower (or a person on his behalf) will reimburse the creditor; or
  - (ii) in circumstances giving rise to a liability on the borrower to reimburse the creditor;
- (b) any reference to the person to whom a quasi-loan is made is a reference to the borrower; and
- (c) the liabilities of a borrower under a quasi-loan include the liabilities of any person who has agreed to reimburse the creditor on behalf of the borrower.

### 4.4 What is a credit transaction?

A credit transaction is defined in Section 25(3) of the Companies Act 1990 as:

'a credit transaction is a transaction under which one party ("the creditor") –

- (a) supplies any goods or sells any land under a hire-purchase agreement or conditional sale agreement;
- (b) leases or licenses the use of land or hires goods in return for periodical payments;
- (c) otherwise disposes of land or supplies goods or services on the understanding that payment (whether in a lump-sum or instalments or by way of periodical payments or otherwise) is to be deferred.'

#### 4.5 How is exposure defined?

Exposure has the same meaning as set out in the Capital Requirements Directive 2006/48/EC ('CRD'). It includes on and off-balance sheet items.

The definition for an exposure under CRD is very wide. A definition is provided in Article 106(1) and Article 78 of the CRD. Article 79 provides a list of categories to which exposure classes are required to be assigned.

#### 4.6 Should credit institutions report the exposures approved, exposures drawn down or exposures outstanding at the reporting date?

Details of all of these categories of exposures are required to be reported at the reporting date. The 'RPL Return Notes on Compilation' (see FAQ 9.1) contains the following definitions regarding exposures:

- Exposure Approved – Gross amount of lending approved as at the reporting date (includes drawn and undrawn amounts). For inter-group credit lines this field should be populated with an amount equivalent to the limit approved.
- Exposure Drawn Down - Gross amount of lending approved that was drawn down or advanced as at the reporting date. For reporting credit lines, this field should be populated with an amount equivalent to the maximum exposure drawn down (at close of business day) during the quarter under review.
- Exposure Outstanding - Carrying amount (see FAQ 4.9) of on balance sheet commitments (balance outstanding on the drawn down amount less individual impairment provisions) **plus** the value of any off-balance sheet commitments e.g. guarantees or committed facilities as at the reporting date (for guarantees or committed facilities, this should be an amount equivalent to the full exposure value).

**4.7 Should credit card limits and overdraft limits (even though it is possible for the credit institution to withdraw them without notice) be included in the Exposure Approved limit?**

Yes.

**4.8 Is the exposure drawn down value calculated based on the highest balance of the loans drawn down plus month end balance for credit cards and overdrafts?**

The exposure drawn down is the gross amount of lending approved that was drawn down or advanced as at the reporting date. For reporting credit lines (e.g. credit cards, overdrafts) the exposure drawn down should be an amount equivalent to the maximum exposure during the quarter under review.

**4.9 How is ‘carrying amount’ defined? Is it net of provisions?**

Carrying amount is as defined in accounting standards. As outlined in the ‘RPL Return Notes on Compilation’ (and in FAQ 4.6) carrying amount of on balance sheet commitments is stated net of individual impairment provisions.

**4.10 Is Credit Risk Mitigation allowed in calculating the Net Exposure Outstanding?**

No. Credit Risk Mitigation (CRM) is not applied in calculating Exposure Outstanding. Net Exposure Outstanding relates to (gross) Exposure Outstanding less Exemptions and Exclusions granted under Requirement 6(i) of the RPL Code – see Section 7 of this FAQ document for further details regarding exemptions.

**4.11 If CRM is not allowed in calculating ‘Net Exposure Outstanding’, is this not inconsistent with the ‘Own Funds’ figure on which the limits in Section 6(i) are based as it reflects the credit exposure after taking account of CRM?**

It is the view of the Central Bank that CRM should not be taken into account in reporting the net exposure outstanding in order to supervise and monitor related party lending on a gross basis rather than on a net basis. However, in certain instances

where a legal right of off-set applies, such as repos, the exposure can be reported after taking account of netting.

#### **4.12 Can equity investments be excluded from the RPL Code?**

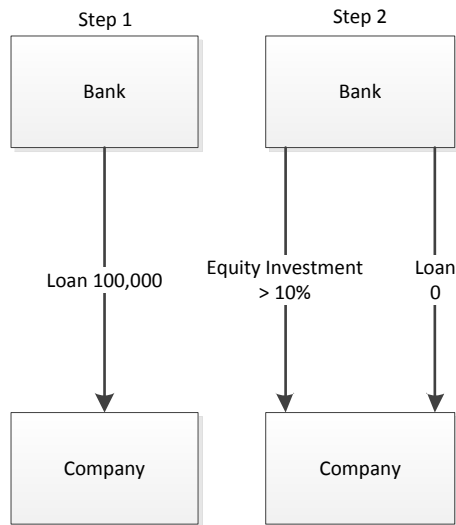
Yes. The RPL Code does not apply to equity investments – i.e. the RPL Code does not apply where a bank invests in shares of a company (often in start-up ventures) in anticipation of receiving income from dividends and capital gains if the shares rise in value. However credit institutions are asked to note the anti-avoidance provisions of the RPL Code (Section 6(j)) and are advised that they should prudently satisfy themselves that they are not engaging in a practice that is designed to circumvent the RPL Code i.e. if a bank decides to finance a company by means of an equity investment instead of by provision of lending to the company so as to circumvent the RPL Code, then the anti-avoidance provisions would apply.

Note, an exposure to a counterparty in which the credit institution holds an equity investment representing a 'significant shareholding' is normally captured by the RPL Code as a related party but the equity investment itself is outside the scope of the Code – see also further elaboration below in FAQ 4.13 regarding debt restructurings/Debt for Equity swaps and the taking of an equity stake by a credit institution in a 'performing' entity for the purpose of securing further lending to that entity.

#### **4.13 In the current difficult financial environment circumstances exist where an entity becomes a related party of a credit institution by virtue of a debt restructuring/debt for equity transaction or as a result of a credit institution acquiring an equity stake in a performing entity for the purposes of securing further lending to that entity. In such circumstances the credit institution can have other exposures in the form of lending to that related party. Can this exposure (in addition to the equity investment itself as per FAQ 4.12) also be excluded from the Code?**

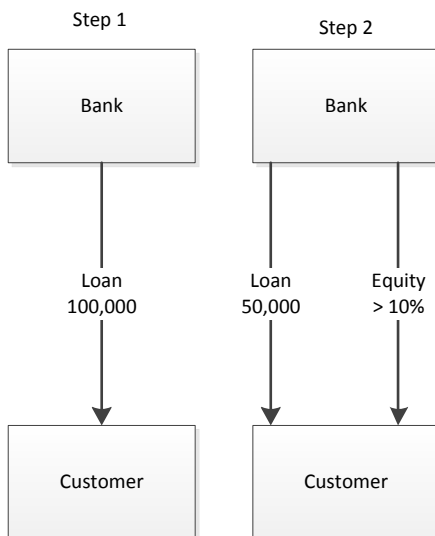
It depends on the individual circumstances of the transaction. Take an example where Bank A advanced a loan of €100,000 to Company X. Company X experiences financial difficulties and wishes to have a debt restructuring. Bank A and Company X engage in discussions and agree a Debt for Equity swap.

### Scenario A – The entire non-performing loan is converted to equity



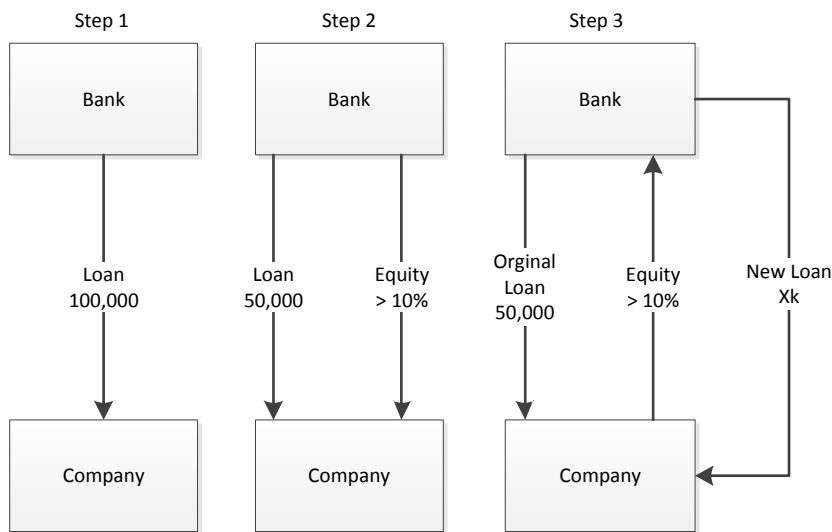
All of the €100,000 loan is converted to equity which results in Bank A becoming a significant shareholder in Company X. Company X meets the definition of a 'related party' of Bank A but, as outlined in FAQ 4.12, the RPL Code does not apply to equity investments.

### Scenario B – Replacement of part of the existing non-performing loan with an equity stake



€50,000 of the loan is converted to equity which results in Bank A becoming a significant shareholder in Company X and the remaining pre-existing loan of €50,000 remains as a loan. Company X meets the definition of a 'related party' of Bank A but, as outlined in FAQ 4.12, the RPL Code does not apply to equity investments. In the absence of any other relationship which would qualify as a Related Party relationship, the pre-existing loan of €50,000 is exempted from the revised RPL Code on the basis that when the loan was originally extended the borrower was not a Related Party and that the relationship has only arisen as a direct result of the credit institution seeking to maximise its return on the loan that otherwise may not have been collectable.

### Scenario C – Additional loan transactions subsequent to restructuring of the non-performing loan



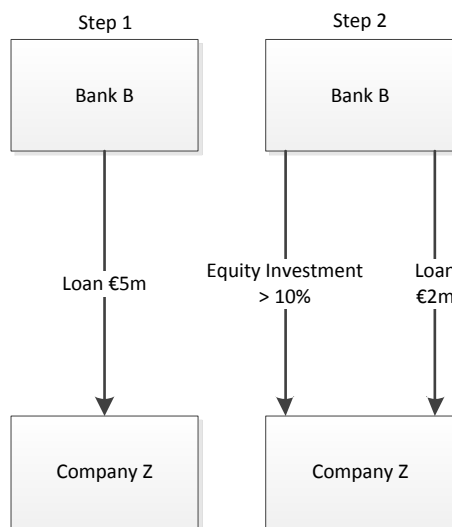
€50,000 of the original loan of €100,000 is converted to equity which results in Bank A becoming a significant shareholder in Company X, the remaining loan of €50,000 remains as a loan and Company X requires an additional loan of €20,000. Company X meets the definition of a 'related party' of Bank A but, as outlined in FAQ 4.12, the RPL Code does not apply to equity investments. In the absence of any other relationship which would qualify as a Related Party relationship, the pre-existing loan of €50,000 is not subject to the RPL Code (Scenario B above). The additional loan transaction may also be excluded from Requirements 6(d) and 6(i) of the revised RPL Code subject to certain conditions, on the basis that the relationship is as a result of a measure to recover a loan balance and not as a result of a strategic intention on the part of the credit institution to invest in that business specifically. The conditions (as set out in Paragraph 8.1 of the revised RPL Code), to be met at the time of providing the additional loan, are as follows:

- (i) The initial acquisition of the shares or voting rights in the company must have been as a result of a scheme of arrangement or debt restructuring agreement entered into between the credit institution and the borrower due to the company being unable to repay its original debt;
- (ii) The additional loan must be issued on an arm's length basis;
- (iii) The credit institution and the borrower must not be related parties under any part of the Related Party definition other than the credit institution being a significant shareholder as a direct result of the debt restructuring arrangement;
- (iv) The Board of the credit institution is responsible for prudently satisfying itself that the credit institution is not engaging in a practice that is designed to

circumvent the Code. If the Board has any doubt as to whether the Code applies to an exposure then it shall apply the Code;

- (v) In all cases it will be incumbent on the credit institution to maintain a register of these loans recording compliance with (i)-(iv) above and the credit institution must be able to demonstrate that these loans are subject to regular monitoring and review by the credit institution's Board.

### Scenario D – Taking an equity stake in a performing entity to secure further lending to that entity



Bank B has an exposure of €5 million to Company Z whose loans are 'performing'. Company Z requires additional loan facilities of €2 million. Bank B takes a significant shareholding in Company Z in order to secure its lending. Similar to the scenarios discussed above, the relationship is as a result of a measure to secure a loan balance and not as a result of a strategic intention on the part of the credit institution to invest in that business specifically. Such transactions may be excluded from Requirements 6(d) and 6(i) of the revised RPL Code subject to the following conditions (as set out in Paragraph 8.2 of the revised RPL Code) being met at the time of providing the additional loan:

- (i) The initial acquisition of the shares or voting rights in the company must have been as a result of the collateral requirements set out in the loan agreement between the credit institution and the borrower;
- (ii) The additional loan must be issued on an arm's length basis;
- (iii) The credit institution and the borrower must not be related parties under any part of the Related Party definition other than the credit institution being a significant shareholder as a direct result of the collateral requirements in the underlying loan agreement;
- (iv) All other loans already in place between the credit institution and the borrower must be performing at the time the additional loan is issued;



- (v) The Board of the credit institution is responsible for prudently satisfying itself that the credit institution is not engaging in a practice that is designed to circumvent the Code. If the Board has any doubt as to whether the Code applies to an exposure then it shall apply the Code;
- (vi) In all cases it will be incumbent on the credit institution to maintain a register of these loans recording compliance with (i)-(v) above and the credit institution must be able to demonstrate that these loans are subject to regular monitoring and review by the credit institution's Board.

The anti-avoidance measures currently included within the RPL Code will continue to apply to any credit institution which structures an arrangement with the express intention to avoid the requirements of the RPL Code.

#### **4.14 Are Nostros<sup>2</sup> included in Related Party Lending?**

Yes. There is no basis in the RPL Code for excluding Nostros as they can constitute a credit risk. Where the Nostro is inter-group it can come within the exemption in Section 6(i) III & IV.

#### **4.15 Are securitisations included?**

Yes, in accordance with FAQ 5.13, in the absence of persuasive evidence to the contrary, one party is deemed by the Central Bank to control another if one party consolidates the results of another for the purposes of financial reporting under IFRS or local GAAP; or under accounting standards one party is considered to control another, regardless of whether consolidated financial statements are presented.

#### **4.16 Are all derivatives captured by the Code?**

Derivatives are explicitly identified as exposures for the purposes of calculating own funds requirements in relation to credit risk within Section 3, Subsection 1 of the CRD and therefore are included within the scope of exposures for the purpose of the RPL Code.

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<sup>2</sup> A Nostro Account is an account denominated in a foreign currency established through a local bank at a bank in the respective country of the currency desired.

Derivatives entered into with related parties for the purposes of treasury management or risk mitigation (such as hedging) are excluded from the requirements of Section 6(d) of the RPL Code where those derivatives have:

- been entered into with related parties for the purposes of treasury management or risk mitigation (such as hedging); and
- the credit institution is able to demonstrate that there is sufficient eligible collateral in place at all times to cover the entities' exposure to that derivative.

To avail of this exclusion Credit Institutions will be required to provide sufficient appropriate evidence as to the purpose for which the derivatives have been entered into and to demonstrate that there are sufficient risk management processes to control those risks to which the credit institution may be exposed as a result of carrying out the treasury management or risk mitigation practices.

#### **4.17 Are Repos captured by the RPL Code?**

Yes. Repo Transactions involve an exchange of cash for a financial asset which constitutes direct lending. In response to issues raised regarding the practical application of the requirements of the RPL Code, where the counterparty is captured under exposure category 6(i) III & IV of the Code an exemption is available under Section 6(i) of the RPL Code and in the case of the requirements in Sections 6(b) & 6(c) a Subcommittee of the Board can be appointed to provide an approval service rather than gaining approval directly from the Board of the credit institution.

#### **4.18 Are exposures created as a result of general debtor inter-company balances (e.g. overhead recharges and accruals) captured by the RPL Code?**

On the basis that there is no exchange of cash and the exposure is created by the transfer or provision of goods and services, such exposures may be excluded from the scope of the RPL Code.

## 5 Related Parties and Connected Persons of Related Parties

### 5.1 Who is a related party under the RPL Code?

A related party is defined as:

- (i) a director (refer to FAQ 5.2 and FAQ 5.3),
- (ii) a senior manager (refer to FAQ 5.4), or
- (iii) a significant shareholder of the credit institution (refer to FAQ 5.6, FAQ 5.7 and FAQ 5.8), or
- (iv) an entity in which the credit institution has a significant shareholding, as well as
- (v) a connected person of any of the aforementioned persons (refer FAQ 5.9).

### 5.2 Are directors of the entity's parent connected persons of the entity?

Yes. If bank A is owned by bank B, a director of bank B is presumed to be a connected person of bank A, unless bank A can show that the director of bank B and the Credit Institution (bank A) do not constitute a single risk because one of them directly or indirectly does not have control over the other.

### 5.3 If the Bank has a common director with another entity, is this entity a related party?

Not necessarily. For example, Bank A as part of its normal lending business extends a loan to Company X which is not a related party of Bank A. A director of Company X is appointed as a non-executive director to the board of directors of Bank A. Company X does not become a related party of Bank A by virtue of this common director, but credit institutions should check whether there are circumstances which might bring Company X within the RPL Code e.g. whether they constitute a single risk (part (b) of 'connected persons' definition) or there is a relationship of control (part (c) of 'connected persons' definition).

### 5.4 Who is regarded as a senior manager?

A senior manager is a person who is a member of management of the institution or a person who reports directly to the board of directors or the chief executive (howsoever described) of the credit institution.

**5.5 Does the definition of Related Party relate to: ‘a director, senior manager etc. of the credit institution or an entity in which the credit institution has a significant shareholding’ rather than ‘a director, senior manager etc. of the credit institution of an entity in which the credit institution has a significant shareholding’?**

The definition of Related Party relates to: ‘Directors, senior managers etc. of the credit institution or an entity in which the credit institution has a significant shareholding NOT directors, senior manager etc. of an entity in which the credit institution has a significant shareholding.

**5.6 How is significant shareholder defined?**

A significant shareholder is a person who holds, either by themselves or in aggregate with their connected persons, 10% or more of the shares or voting rights in the credit institution or business.

**5.7 Does significant shareholding capture indirect as well as direct shareholdings?**

Yes. The significant shareholding definition applies to both direct shareholdings held by the credit institution itself and to indirect shareholdings held by the credit institution via another entity.

**5.8 Are Governments included as significant shareholders in those credit institutions where the Government has a stake of 10% or more?**

No. Governments are specifically excluded from the definition of significant shareholder in the definitions section (Section 5) of the RPL Code. Thus those credit institutions in which the government is a significant shareholder are not required to apply the RPL Code to lending to other entities in which the government is a significant shareholder.

**5.9 Who is a connected person under the RPL Code?**

A connected person is:

- (a) A spouse, domestic partner, civil partner (within the Civil Partnership and Certain Rights and Obligations of Cohabitants Act, 2010) or child (whether natural or adopted) of a person;
- (b) Two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or
- (c) Two or more natural or legal persons between whom there is no relationship of control as set out in point (b) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties.

### 5.10 Does the reference to ‘child’ include stepchildren?

The definition of ‘child’ includes stepchildren. Part (a) of the definition of a connected person makes explicit reference to both adopted and natural children.

### 5.11 Can ‘domestic partner’ be elaborated upon?

The concept of a domestic partner is included in the definition of close family members under International Accounting Standard 24 ‘Related Party Disclosures’ (IAS 24). The Central Bank would expect firms to use the same meaning for ‘domestic partner’ as they would for the purposes of applying IAS 24. Note when defining a civil partner consideration should be given to Company Law (section 26 of the Companies Act, 1990) which makes reference to a ‘civil partner’ as being within the meaning of the Civil Partnership and Certain Rights and Obligations of Cohabitants Act, 2010.

### 5.12 The limit of 0.5% of own funds in Section 6(i) I of the RPL Code includes ‘exposures to any business in which the director or senior manager has a significant shareholding’. This category appears to be outside the definition of related party as it is not caught by parts (b) or (c) of the connected person definition i.e. where the director/senior manager’s shareholding in the investee business is not one which grants ‘control’ and where the director/senior manager and the investee do not constitute a ‘single risk’.

While this observation is correct the Central Bank still requires exposures to any business in which the director or senior manager has a significant shareholding to be

captured for the purposes of applying the limits set out under Section 6 (i) I of the RPL Code.

### 5.13 How is control defined for the purposes of the RPL Code?

The definition of control in the RPL Code is wider than >50% of shares or voting rights. The definition of control was that contained in Article 4(9) of the CRD (Directive 2006/48/EC) which is taken from the accounting definition in the Seventh Company Law Directive (Article 1 of Directive 83/349/EEC on consolidated accounts). Control means the relationship between a parent undertaking and a subsidiary or a similar relationship between any natural/legal person and an undertaking.

It should be noted that the definition of ‘connected persons and clients’ extends beyond control of a subsidiary by a parent to incorporate persons/entities who are interconnected by some form of material economic dependency e.g. where there is a main common source of funding in the form of credit support, potential funding or direct, indirect or reciprocal financial assistance. The interpretation of control is also elaborated on within the [“CEBS Guidelines on the implementation of the revised large exposures regime 11 December 2009”<sup>3</sup>](#) and this should be referred to by credit institutions when making an assessment under the RPL Code.

In the absence of persuasive evidence to the contrary, at a minimum, one party will be deemed by the Central Bank to control another if:

- a) It is captured as a connected person for the purposes of Large Exposures reporting under CRD; or
- b) One party consolidates the results of another for the purposes of financial reporting under IFRS or local GAAP; or
- c) under accounting standards one party is considered to control another, regardless of whether consolidated financial statements are presented; or
- d) there is clear evidence of control pursuant to the definition of control in the Companies Acts and/or other relevant EU Directives (for example, Group Accounts Regulations (S.I. No 201 of 1992)).

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<sup>3</sup> [http://www.eba.europa.eu/documents/10180/37070/Guidelines-on-Large-exposures\\_connected-clients-and-schemes.pdf](http://www.eba.europa.eu/documents/10180/37070/Guidelines-on-Large-exposures_connected-clients-and-schemes.pdf)

### **5.14 Can a credit institution engage in any lending on ‘favourable’ terms to its related parties?**

Section 6(a) of the RPL Code prohibits lending to related parties on favourable terms. An exemption is permitted for beneficial terms that are part of a remuneration package available to staff of the credit institution generally (e.g. staff loans at favourable rates) provided such terms have been approved by the Board of the credit institution.

### **5.15 Clarification is required on whether the general prohibition on the provision of loans on favourable terms to related parties under Requirement 6(a) of the RPL Code can be applied only to Directors, Senior Management and to the connected persons of Directors and Senior Management and not to any inter-group lending on the basis that inter-group lending is a unique market and has no comparison so it is difficult to ascertain what terms are favourable in an inter-group context**

There is no provision within the RPL Code to exempt inter-group lending from Section 6(a) of the Code.

### **5.16 If it comes to light that a connected person of a member of senior management, (unbeknownst to the senior manager) has taken out a loan, is that senior manager liable to sanctions referred to in the RPL Code?**

Section 6(f) of the RPL Code states that policies and processes shall be in place, and adhered to, in order to identify individual loans to a related party. Section 7(b) of the RPL Code describes the actions to be taken by the credit institution where it considers that there may be an error in its conduct by reference to the requirements of the Code.

## 6 Oversight by Credit Institutions

### 6.1 Section 6(b) requires that Board members with conflicts of interest shall be excluded from the RPL loan approval process. Can the Central Bank provide guidance on a definition of conflicts of interest?

The onus is on the person to satisfy themselves that they are not conflicted. There are requirements regarding conflicts of interest contained in the Central Bank's Corporate Governance Code for Credit Institutions and Insurance Undertakings (Paragraphs 7.10 to 7.12 inclusive regarding appointment of directors and their abstention from decision-making where a reasonably perceived potential conflict of interest exists; Paragraphs 15.4 and 15.5 regarding documenting 'conflicts of interest' policy and consideration of a change of board membership if on-going conflicts of interest arise). This assessment should be documented by the credit institution and be available for the Central Bank to inspect.

### 6.2 If a loan is taken out by a related party prior to 1 January 2011, does it need to be retrospectively approved by a sub-committee of the Board?

Yes. The transitional provisions of the RPL code, as outlined in Section 4 of the RPL Code, requires that steps be taken in respect of any loan taken out prior to 1 January 2011 that is not consistent with the requirements of the RPL Code to bring that loan in line with the RPL Code. This includes retrospective approval by a sub-committee of the Board if required.

### 6.3 Section 6(f) of the RPL Code requires that loans to related parties are monitored and reported on through 'an independent credit review process'. Will an Internal Audit review satisfy this requirement?

An independent credit review process can be conducted by internal audit, among others.



**6.4 For various commercial reasons, loans to inter-group companies are provided on a daily basis by credit institutions. The pricing of these loans will normally be set out in a liquidity matrix approved in advance by senior management. It will not be practical to convene a Board sub-committee of the credit institution to approve these loans daily. Can such inter-group lending be provided in accordance with pre-approved limits determined by the Board on a quarterly basis?**

Yes. The Board can set pre-approved limits for inter-group lending for the purposes of Section 6(b) of the Code. The Central Bank will permit the Board to set pre-approved inter-group lending limits on a quarterly basis subject to these limits being in compliance with Section 6(i) of the Code.

**6.5 As per FAQ 6.4, compliance with Section 6(b) of the RPL Code may be achieved by the Board setting pre-approved limits for inter-group lending on a quarterly basis. On a practical basis, decisions on inter-group loans are required to be made on a daily basis. Will the Central Bank permit the Board to set pre-approved processes relating to the measures referred to in Section 6(c) of the RPL Code in relation to these inter-group loans as a practical means of complying with Section 6(c)?**

No. It is not permissible to set pre-approved processes regarding the management of a loan as required by Section 6(c) of the RPL Code.

## 7 Exemptions

### 7.1 Is it possible to exempt RPL loans which fall below a small threshold from the RPL Code?

When the RPL Code was developed in 2010 the Central Bank did not deem it appropriate to incorporate de minimis amounts at that time. This led to practical difficulties in the implementation of the RPL Code as all exposures arising as a result of lending by credit institutions to Related Parties - including clearly immaterial transactions - were captured by the RPL Code. In order to reduce the significant administrative burden on credit institutions and on Banking Supervisors, and subject to the anti-avoidance provision in Requirement 6(j), a de minimis amount was introduced in the revised RPL Code in respect of lending to Natural Connected Persons (as set out in Paragraph 8.3 of the revised RPL Code) as follows:

- a) A credit institution is exempted from complying with Requirement 6(b) of the revised RPL Code in the case of incurring an exposure to a Connected Person as defined in category (a) of the definition of Connected Persons and Clients where such exposure relates to a personal credit card, personal overdraft or unsecured personal loan and the credit institution has incurred a total exposure of not greater than €25,000 with respect to that natural connected person;
- b) In all cases where a credit institution is availing of this exemption regarding lending to natural connected persons it will be incumbent on the credit institution to monitor such loans to ensure that the limit imposed in Paragraph 8.3(a) of the revised RPL Code is not exceeded and to maintain a register of these loans recording how it has complied with this requirement;
- c) The credit institution must be able to demonstrate that these loans are subject to regular monitoring and review by the credit institution's Board.

### 7.2 Is it possible to have a blanket exemption for all inter-group related parties as otherwise any new inter-group facility will need approval?

Applications were assessed by the Central Bank on a case-by-case basis. Credit institutions were advised that the application for an exemption should specify:

- the entity to which the exemption relates;
- the details of the primary activities of the entity;
- whether the entity to which the loan is being extended is regulated; and

- the extent of the exposure to the relevant entity.

This process is administratively burdensome for credit institutions and for Banking Supervisors for certain routine type exemptions. The RPL Code was modified in June 2013 to clarify that certain loan facilities are exempted from the limits in Requirement 6(i) III & IV provided the loans are made to a parent undertaking, to other subsidiaries of the parent undertaking or to the credit institution's own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the credit institution is itself subject.

An exemption could be potentially available in circumstances other than those which apply when an entity is supervised on a consolidated basis. Credit institutions may still apply to the Central Bank in writing for an exemption from the limits in Requirement 6(i) III and IV for intra-group lending to an undertaking that is not covered by the supervision on a consolidated basis to which the credit institution is itself subject. Such applications will be assessed by the Central Bank on a case-by-case basis (see FAQ 7.5).

### **7.3 Clarification is required on whether the exemption as contained in the footnote relating to Section 6(i) Exposure Category III applies to an Irish subsidiary, supervised by the Central Bank, whose accounts are consolidated into an EU parent?**

Yes. It also applies to supervision on a consolidated basis within the EEA or with the equivalent standards in force in a third country.

### **7.4 Clarification is required on which limits in Section 6(i) apply to lending to a credit institution's own subsidiaries. Is such lending captured as Exposure Categories III & IV or is it captured as Exposure Categories V and VI?**

Lending to a credit institution's own subsidiaries should be captured as an exposure to the credit institution's significant shareholder within Categories III and IV of Section 6(i) – while the text within Category III does not refer specifically to an exposure to a credit institution's own subsidiaries, the footnote at the bottom of the table in Requirement 6(i) relating to Exemptions from Categories III and IV specifically mentions a credit institution's own subsidiaries (in so far as those undertakings are covered by the supervision on a consolidated basis to which the credit institution itself is subject).

### **7.5 Is there an exemption to the limits in paragraph 6(i) available for entities where a credit institution has a significant shareholding but does not consolidate the entity (such as associates and/or joint ventures)?**

An exemption to the limits set out in Section 6(i) III & IV may potentially be available to a significant shareholder, other than credit institutions, including exposures to businesses in which the significant shareholder has a significant shareholding. Section 5 of the RPL Code defines who is a significant shareholder (and in FAQ 5.6). Any person seeking such an exemption must apply to the Central Bank.

An exemption could be potentially available in circumstances other than those which apply when an entity is supervised on a consolidated basis. Applications for these exemptions require additional consideration and are granted on an exceptional, case-by-case basis based on the facts and circumstances of each case. Factors that would be taken into consideration include, but are not limited to, the following:

- The risk to retail depositors and customers of the credit institution (e.g. the credit institution may be funded largely by equity and inter-group funding rather than by Irish retail deposits);
- The extent to which the credit risk is ultimately borne by another entity within the banking group (e.g. if the parent pre-funds lending by a credit institution to a 'sister' company and there are guarantees in place from the parent and the sister company regarding repayment of the loan by the sister company);
- The consequences of not affording an exemption, specifically on the business model of the credit institution.

### **7.6 Can a credit institution incur exposure to EACH of its significant shareholders and affiliates of up to 5% of own funds?**

Yes, the 5% limit applies to exposures to each significant shareholder and any person under 6(i) Exposure Category III. However, a credit institution will not be permitted to incur such exposures in excess of an aggregate of 15% of own funds.

**7.7 Article 113 of the Large Exposures Directive (Directive 2009/111/EC) provides exemptions from large exposure reporting for lending to group entities. Can a credit institution avail of the exemption under Article 113 for the purposes of the RPL Code?**

No. The exemption under Article 113 of EU Directive 2009/111/EC does not apply to the RPL Code.

**7.8 Notwithstanding the exemptions available under Requirements 6(i) III & IV of the RPL Code in respect of limits applying to intra-group lending, is it also necessary to separately apply for an exemption in respect of the Large Exposure requirements?**

Yes. The exemption available from the Large Exposures limits does not automatically entitle the credit institution to an exemption from the limits in 6(i) of the RPL Code and vice versa – if a credit institution wants to avail of exemptions under both the Large Exposures requirements and the RPL Code it must make separate applications in respect of both.

## 8 Prior Central Bank Approval

### 8.1 Does the threshold of €1 million apply to the aggregate of all loans to a related party or does it apply to each individual loan to a related party?

Prior approval from the Central Bank is required once the credit institution expects that the aggregate of all loans to any one related party will exceed €1 million.

### 8.2 Where loans are provided to connected persons of a related party, does the requirement to obtain prior Central Bank approval for loans in excess of €1 million apply to loans to each connected person or does the €1 million threshold apply in aggregate per related party including his 'connected persons'?

Prior approval from the Central Bank is required if the credit institution expects that the aggregate of all lending to any one related party including lending to that party's connected persons will exceed €1 million.

For example, where a director has a loan of €750,000, his son has a mortgage of €150,000 and a daughter is now applying for a mortgage of €200,000, prior Central Bank approval is required because the loans to the director and his connected persons would exceed €1 million in aggregate.

### 8.3 Will all the loans that make up the €1 million figure require approval or is it just the final loan that takes the total exposure over €1 million that requires approval? Will information on all loans be required?

Only the final loan will require approval. Additional information on the total exposure may be requested if deemed necessary by the Bank Supervisors.

### 8.4 Is Central Bank approval required for any related party loans in excess of €1 million provided prior to 1 January 2011? Alternatively is such approval only required where there is a variation to the loan facility or it is up for renewal post 1 January 2011?

Retrospective approval by the Central Bank is not required in respect of loans in excess of €1 million provided prior to 1 January 2011; however, any material variation or renewal subsequent to 1 January 2011 on the applicable loan requires Central Bank approval – see FAQ 8.5.

**8.5 Can the Central Bank provide clarification as to what constitutes a “material variation” of a loan and what considerations should be taken into account when determining if a variation of a loan would be considered a “material variation” by the Central Bank?**

It is not possible to provide an exhaustive list of what constitutes a “material variation”. As a guide a material variation would include any changes to the terms of the loan including, without limitation, terms:

- as to credit assessment;
- duration;
- interest rates;
- amortisation schedules; or
- collateral requirements.

**8.6 Will loans exceeding €1 million require prior Central Bank approval where the credit institution has received an exemption under Section 6(i) III and IV of the RPL Code?**

No.

**8.7 In those situations where a credit institution is granted an exemption for inter-group lending under Section 6(i), do any other exemptions from the RPL Code apply?**

Exemptions are potentially available from the limits in Categories III & IV in Section 6(i). If such an exemption is granted, the requirement in Section 6(d) to apply for prior Central Bank approval for lending exceeding €1 million does not apply.

All other requirements of the RPL Code apply.

**8.8 Credit institutions have obligations under the Code of Conduct for Business Lending to Small and Medium Enterprises including the requirement for credit applicants to be informed of how long the application process will take. Can the Central Bank give a time commitment in relation to the processing of applications for approval for related party loans in excess of €1 million?**

The Central Bank will perform the processing of loans as expeditiously as possible. However a time frame cannot be provided for this. Speed of response will be a function of the quality and adequacy of information provided in the application for the Central Bank's prior approval.

**8.9 What is the process in getting Central Bank approval i.e. how will this operate?**

Approval should be sought in writing and should be addressed to the Senior Examiner. A 'Questionnaire for Approval of Loans exceeding €1 million' is available on the Related Party Lending section of the Central Bank's [website](#)<sup>4</sup>.

**8.10 How are the impacts of foreign exchange (FX) rate fluctuations on loans values captured in relation to the RPL Code requirements for approval of loans exceeding €1 million?**

It is the responsibility of the credit institution to ensure that it is in compliance with the RPL Code and thus approval should be sought from the Central Bank if there is a chance that the loan will exceed €1 million at any time throughout its existence.

A bank may have a loan pending for USD\$ 1.1 million which at any time could translate to more than or less than €1 million. At the credit approval stage it may translate to say €950,000 but at the drawdown date it could be in excess of €1 million. In this case, there is no date which is specified at which the bank is required to translate the loan to Euro for consideration as to whether the €1 million threshold has been breached.

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<sup>4</sup> <http://www.centralbank.ie/regulation/industry-sectors/credit-institutions/Pages/reporting.aspx>



## 9 Reporting

### 9.1 Section 7(a) of the RPL Code states that related party exposures shall be reported to the Central Bank in a format specified by the Central Bank. Has the Central Bank specified a format for RPL reporting?

The Central Bank issued a template for RPL reporting within its '[Related Party Lending Return Notes on Compilation](#)<sup>5</sup>'.

### 9.2 How frequently is the RPL return required?

The RPL return must be submitted to the Central Bank on a quarterly basis as part of the quarterly reports made by credit institutions. It must be submitted within 20 business days of the quarter-end via the Online Reporting System.

### 9.3 How does the RPL return interact with other Prudential Returns submitted to the Central Bank, for example, COREP and the Large Exposures Returns?

The RPL return is a 'standalone' report. There is no interaction between this report and other prudential reports to the Central Bank.

### 9.4 Which officer of the credit institution is responsible for making the RPL Returns to the Central Bank?

Sign-off is required on the RPL return by a Director of the credit institution.

### 9.5 Does the RPL return relating to year-end have to be reconciled to the annual financial statements? If so, 20 business days may be insufficient to allow for these reconciliations.

RPL returns are required to be submitted on a quarterly basis. There is no distinct annual return required. RPL quarterly reports (including the quarter coinciding with

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<sup>5</sup> <http://www.centralbank.ie/regulation/industry-sectors/credit-institutions/Documents/Related%20Party%20Lending%20Compilation%20Notes.pdf>

the credit institution's year-end) are required within 20 business days. This is in line with other reporting to the Central Bank, such as Large Exposures reporting.

**9.6 Does a credit institution have to make an RPL return if it has no lending to related parties?**

Yes. A return is required even if reporting a 'Nil' return.

**9.7 The reporting template does not cater for joint accounts.**

- **How should the disclosure be made that there is a third party with access to a related party account?**
- **Should a separate unique identifier be requested for joint parties (e.g. director + spouse/brother)?**
- **How should these connections be reported in column RP1.7 (nature of connection)?**

For joint accounts, the whole exposure amount should be reported as the related party – refer to page 9 of the Notes on Compilation for further details regarding reporting of joint accounts.

**9.8 A credit institution has loans to an individual who is a director of the parent company, but is not a director of the Irish regulated entity. Under column Principal RP 1.1, which type of principal should it be disclosed under?**

Directors of the parent company should be reported under the principal classification (RP 1.1) of Entity and connected classification (RP 1.2) of connected party of an entity.

**9.9 What definition of Own Funds is used in the calculation of the limits imposed in Section 6(i) of the RPL Code?**

Own funds has the meaning as set out in the CRD. The own funds figure represents a licensed credit institution's own funds at the individual level – this can be either solo or sub consolidated (amended solo). As set out on page 7 of the Notes on Compilation regarding Column RP 1.14, Tier 3 Own Funds must be excluded when calculating the limits in Section 6(i) of the RPL Code.

**9.10 Is there any requirement for credit institutions to submit an RPL report on a consolidated basis?**

No. The condition imposed under Section 117 of the Central Bank Act 1989 can only be applied to the licence holder.

**9.11 Does the RPL Code apply to (and similarly is the reporting requirement at) the 'Amended Solo' regulatory level?**

Yes.

**9.12 If the RPL return is prepared on a licensed bank basis, do all exposures with inter-group entities outside of the individual licences need to be shown on the return even though after the exemption provisions the exposure will be NIL?**

Yes (as outlined at the bottom of Page 6 of the Notes on Compilation).

**9.13 Does the RPL Code apply to loans made by credit institutions to other credit institutions within the same banking group and if so, which aspects?**

Lending to credit institutions within the same banking group is excluded from the scope of Requirements 6(i) III, IV, V & VI. All other requirements of the RPL Code apply to inter-credit institution lending. The RPL Code was revised in June 2013 to widen the grounds for exclusion of intra-group lending from 6(i) III, IV, V and VI (see FAQ 7.2).

**9.14 Can the exclusions that apply to lending to credit institutions be extended also to 'financial institutions' as defined by the CRD. This would provide an automatic exclusion of parent companies and sister companies which are either credit institutions or financial institutions from the application of the limits set in 6(i) III and IV.**

It was not the intention of the original RPL Code to automatically exclude intra-group lending to financial institutions but, under the revised RPL Code issued in June 2013, the limits in Requirements 6(i) III and IV do not apply in the case of loan facilities provided the loans are made to a parent undertaking, to other subsidiaries of the

parent undertaking or to the credit institution's own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the credit institution is itself subject.

Applications for an exemption may be made in respect of intra-group lending to other institutions which are not subject to consolidated supervision and where it is deemed appropriate, on application to the Central Bank, exemptions will be granted.

**9.15 Reporting of deviations from the RPL Code (Section 7(b)): Is this required within 5 days of reporting to the Board or 5 days after discovery of the deviation?**

The deviation should be reported within 5 days of the discovery of the deviation.

**9.16 Is it considered a breach when the 'drawn' exposure exceeds the % limit in Section 6(i) for the applicable category?**

A breach should be recognised in relation to limits when the net exposure outstanding exceeds the % limit for the applicable category. Refer to Notes on Compilation for the definition of net exposure outstanding (RP 1.13).

**9.17 Do credit institutions have to publicly disclose lending extended that is within the scope of the RPL Code?**

Credit institutions are not required by the RPL Code to publicly disclose lending extended that is within the scope of the RPL Code. However, credit institutions are required to make public disclosures by other requirements as set out below. It should be noted, however, that the definitions used within these requirements have a tendency to differ from those included in the RPL Code:

- Conditions were imposed on credit institutions by the Central Bank in August 2009 requiring public disclosure of lending to connected persons in their annual financial statements.
- The Companies Acts 1963 to 2012 include requirements for the company to make certain disclosures in respect of related party lending under sections relating to Directors' remuneration and transactions (including details of lending on 'favourable' terms to connected persons). The Building Societies Act 1989 requires building societies to make certain disclosures regarding transactions with Directors.

- Disclosures are required regarding related party transactions that are material and which have not been conducted under normal market conditions by Directive 2006/46/EC. This was implemented in Ireland by Statutory Instrument (S.I.) 450 of 2009 for Irish incorporated companies and by amendments to S.I. 294 of 1992 for credit institutions and amendments to S.I. 23 of 1996 for insurance undertakings.
- Accounting standards (International Accounting Standard (IAS) 24/ Financial Reporting Standard (FRS) 8) also contain disclosure requirements on Related Party Disclosures.

### **9.18 Will the Central Bank aggregate RPL lending and issue a public report on RPL lending?**

There is no proposal to publicly disclose data collected by the Central Bank on RPL.



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