



FINANCIAL SERVICES  
COMMISSION

## **GUIDELINE NO. 4**

### **GUIDELINE ON RELATED PARTY TRANSACTIONS**

**(This guideline is issued pursuant to section 53 of the Financial Services Commission Act, and comes into effect on March 1, 2013)**

#### **1.0 INTRODUCTION**

- 1.1 Related party transactions are a complex issue for regulatory agencies to supervise. These transactions can be troublesome because unlike normal transactions in the market place where two independent parties negotiate terms and prices to their satisfaction before a transaction is consummated; related party transactions do not involve independent parties. As a result, there is a potential for related party transactions to be at other than fair market value and not in the best interest of the insurance company due to the nature of the relationship.
- 1.2 This is not merely a theoretical concern. World-wide, financial institution supervisors have often seen financial institutions, including insurance companies, raise funds from the public and then rather than wisely invest the funds, move them to a parent or associated company. From there, the funds can be channelled into various enterprises, which may not generate sufficient cash flow to repay the obligations of the financial institution. The Caribbean region is not immune from such situations.
- 1.3 At the same time it must be recognized that insurance companies are increasingly becoming members of groups of companies with common ownership through processes of mergers, acquisitions, and otherwise. In this context, it makes economic sense for these insurance companies to transact business with associated companies of the group. From an economic perspective, an insurance company that requires deposit services would prefer to obtain those services from an affiliated company rather than that company's competitor. In addition, where trustee arrangements are required, insurance companies may prefer to use an affiliated company where available other than a competing bank to offer those trustee services but this may bring the question of segregation of funds and decisions into question.

- 1.4 The key to the related party issue is to ensure that the related party transactions undertaken by the insurance company are at fair market value, in the normal course of the insurance company's business and in the best interests of the insurance company at all times.
- 1.5 The Commission's approach to the supervision of insurance is becoming increasingly risk-based. This means that the Commission, to the extent possible, identifies, assesses, prioritizes, and minimizes the likelihood of events or circumstances occurring with might prevent the Commission from achieving its objectives. Further to this the Commission assesses the risks posed by an insurer by gaining an understanding of a licensed insurer's operations, the risks it faces and how it deals with these risks. The consideration of the governance and the decision-making and control processes of an insurer is a key component of this assessment process. This approach to supervision is in contrast to a transaction-oriented review.
- 1.6 The objective of this guideline is to require local insurance companies to establish a process whereby related party transactions are subject to review to ensure that they are at fair market value, in the normal course of business and in the best interests of the insurance company.

## **2.0 DEFINITIONS**

- 2.1 For purposes of this guideline related parties are defined as any party able to exercise control over the institution or over which the institution itself can exert control and include:
  - 2.1.1 A significant shareholder of the insurance company, defined by a person or entity owning more than 10% of the company's voting shares.
  - 2.1.2 A director of the insurance company;
  - 2.1.3 An officer of the insurance company;
  - 2.1.4 An affiliated entity or subsidiary of the insurance company;
  - 2.1.5 A significant shareholder of an affiliated entity;
  - 2.1.6 Directors and officers of an affiliated entity; and,
  - 2.1.7 The spouses and other relatives of a related party who reside in the same residence as the related party.
- 2.2 Where an insurance company believes that specific classes of exposure or relationships, while falling within the above definition, should not properly fall to be treated or reported as 'related', they may seek approval from the Commission on a case by case basis for a particular counterparty or class of counterparties to be treated as non-related.

### **3.0 TO WHOM DOES THIS GUIDELINE APPLY**

- 3.1 This guidance applies to all insurers and intermediaries licensed to write insurance policies under the FSC Act, the Insurance Act Cap310 and the Exempt Insurance Act CAP308B.

### **4.0 TYPES OF RELATED PARTY TRANSACTIONS**

- 4.1 The following are examples of related party transactions that are not appropriate and can jeopardize the financial health of an insurance company:
  - 4.1.1 Excessive dividend payments to owners relative to the income of the insurance company;
  - 4.1.2 Investments, loans or deposits to a related party at less than market rates of return and with no formal loan agreement documentation;
  - 4.1.3 The extension of credit to a related party with no serious attempts to collect the outstanding receivables;
  - 4.1.4 Sales of assets or services to a related party where the sales price is less than fair market value;
  - 4.1.5 Asset or service purchases from a related party where the price of the asset or service is in excess of fair market value;
  - 4.1.6 Management agreements with the parent company or other related party where the management fees are greater than what a third party manager would charge for the same service;
  - 4.1.7 Joint ventures with an affiliated company or other related party that are structured such that the insurance company pays a high proportion of the costs, but receives a low proportion of the benefits;
  - 4.1.8 Rental agreements with a related party where the rent paid by the insurance company is greater than fair market value;
  - 4.1.9 Rental agreements with a related party where the rent received by the insurance company is less than fair market value; and,
  - 4.1.10 Loan guarantees on behalf of an affiliated company or other related party with no guarantee fee being charged.

### **5.0 ACTIONS REQUIRED BY INSURANCE COMPANIES**

#### General Requirements

- 5.1 Limits applying to related party exposures must be at least as strict as those applying to non-related counterparties. Institutions need to put in place arrangements for identifying

all related parties and establish specific policies and procedures requiring exposures to such persons to be conducted on an arm's length basis. They must also ensure that these exposures are carefully monitored to prevent abuse and that appropriate steps are taken to control and mitigate risks arising from such exposures and that provisioning and write-off policies are fully consistent with those applying to the generality of exposures.

#### Identifying Related Parties

- 5.2 Insurance Companies need to put in place policies and procedures whereby all material related exposures, all such exposures posing special risks, and all proposals for material write-offs of related party exposures are identified and recorded. In addition, the related party transaction should be subject to express prior approval by the Board.
- 5.3 Insurance companies should seek to establish an audit committee. The audit committee is often charged with reviewing all related party transactions and performing the following duties:
- Preparing a list of all related parties to the insurance company and updating the list on an annual basis;
  - Reviewing all related party transactions;
  - Providing written approval for all related party transactions that are at fair market value, in the normal course of the company's business and in the best interests of the company; and,
  - Retaining all records and information that was used in approving or rejecting each related party transaction that has been reviewed.

#### Conflict of Interest Procedures

- 5.4 Insurance companies should put written procedures in place to ensure that any Board member or company officer, who faces a conflict of interest in relation to the particular exposure arising from a related party, must be excluded from the approval process.

## 6.0 COMPLIANCE

- 6.1 Related party transactions pose a significant challenge for all supervisory agencies including the FSC. Nevertheless, it is recognized that related party transactions are a fact of life during the course of business. The Insurance Guideline outlines a process that allows insurance companies the flexibility to undertake related party transactions provided that certain policies and procedures are put in place and that such transactions are at fair market value, in the normal course of the company's business and in the best interests of the company.

6.2 The Commission will monitor closely the insurance company's material exposure to related parties. During the course of an on-site inspection, it is the intent of the Commission to review documentation associated with the approval of related party transactions and to assess the company's procedures for monitoring and managing related party transactions. We do not believe that transitional arrangements will be required on an industry-wide basis as the expected impact from the guideline on the operations of the company should be minimal.