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NATIONAL BANK OF ETHIOPIA

## LICENSING AND SUPERVISION OF BANKING BUSINESS EXPOSURE TO RELATED PARTY DIRECTIVE NO. SBB/88/2024

**Whereas**, related party transactions are often exposed to conflict of interest and can potentially be unfair or fraudulent, threatening the soundness of a bank's business;

**Whereas**, there is a need to prevent abuses arising from transactions with related parties and address the risk of conflict of interest;

**Whereas**, any practice of extending credit to financially unstable related parties will have the potential to increase non-performing loans and jeopardize a bank's financial soundness;

**Whereas**, it is important to ensure that a bank's transactions with related parties are adequately monitored and conducted at arm's-length;

**Now, therefore**, in accordance with sub-article 22 (1) and sub-article 66 (2) of the Banking Business Proclamation No. 592/2008 (as Amended by Proclamation No.1159/2019), the National Bank of Ethiopia has issued this Directive.

### 1. Short Title

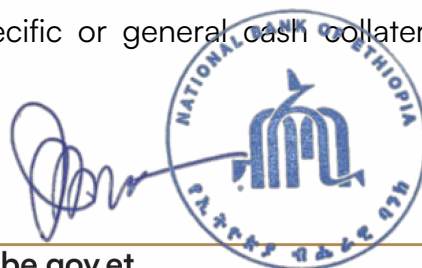
This Directive may be cited as "Exposure to Related Party Directive No. SBB/88/2024."

### 2. Definitions

2.1 "**Bank**" means a private or state-owned entity, licensed by the National Bank to undertake banking business.

2.2 "**Beneficial Owner**" means any natural person who ultimately owns or **controls** a customer or an account, the person on whose behalf a transaction is conducted, or the person who ultimately exercises effective control over a legal person or arrangement.

2.3 "**Cash Collateral**" means credit balances on accounts in the books of the lending bank over which customers have given the lending bank a formal letter of cession and which the bank at its discretion has transferred from the customer's account(s) to a specific or general cash collateral account(s) or blocked.





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NATIONAL BANK OF ETHIOPIA

2.4 “**Cash-substitutes**” shall mean:

2.4.1 a security issued by the Federal Government of Ethiopia;

2.4.2 an unconditional obligation or guarantee issued in writing by a foreign bank or foreign insurance company with an "A" or above rating by Standard and Poor's Corporation, Moody's Investor Services, or any other international rating company acceptable to the National Bank in their latest rating; and

2.4.3 other liquid and readily marketable securities approved in writing by the National Bank, and which are held in the vault of the lending bank.

2.5 “**Exposure**” means either on-balance sheet items such as loan or advance and/or off-balance sheet items like commitment to advance loans, regardless of collateral.

2.6 “**First Degree of Consanguinity or Affinity**” means spouse, children and parents.

2.7 “**Influential Shareholder**” means a person who holds directly or indirectly two percent (2%) or more of the total subscribed capital of a bank.

2.8 “**Loans or Advances**” means any financial assets of a bank arising from a direct or indirect advance, such as unplanned overdrafts, participation in loan syndication or the purchase of loans from another lender, to a person that is obliged to repay the funds, either on a specified date or dates or on demand, usually with interest or through interest-free finance.

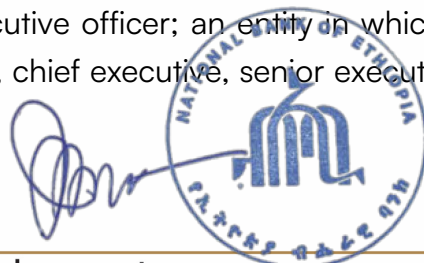
2.9 “**Off-balance Sheet Item**” means commitment to advance loans, revocable or irrevocable documentary letters of credit, standby letters of credit, leaseback agreements, and guarantees or sureties issued on behalf of a borrower.

2.10 “**Related Party**” means:

2.10.1 the bank’s majorly owned subsidiaries, and any party that the bank exerts control over or that exerts control over the bank;

2.10.2 the bank’s influential shareholders up to the ultimate beneficial owner and board members, chief executive officer, senior executive officer;

2.10.3 an influential shareholder, director, chief executive, senior executive officer of a bank and/or the spouse or relative in the first degree of consanguinity or affinity of such shareholder, director, chief executive officer or senior executive officer; an entity in which such influential shareholder, director, chief executive, senior executive officer and/or





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- the spouse or relative in the first degree of consanguinity or affinity owns 10% or more interest as shareholder or serves as a director, chief executive officer or senior executive officer;
- 2.10.4 state-owned banks and State/Federal Government-Owned Enterprises shall also be considered related parties;
- 2.10.5 parties that can exert significant influence as may be determined by the National Bank; and
- 2.10.6 any other relationships, as may be determined by the National Bank.
- 2.11 **“National Bank”** means the National Bank of Ethiopia.
- 2.12 **“Senior Executive Officer”** means any officer of a bank who is managing two or more work units and is accountable to the chief executive officer or is directly reporting to the board of directors and includes positions at a level of deputy to chief executive Officer.
- 2.13 **“Total Capital”** shall include the paid-up capital, legal reserve and any other unencumbered reserve held by a bank and accepted by the National Bank.
- 2.14 **“Transaction”** means on-balance sheet and off-balance sheet credit exposures; dealings such as service contracts, investments, asset purchases and sales, construction contracts and lease agreements; derivative transactions; borrowings; and write-offs and shall incorporate not only dealings entered with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

### **3. Scope of Application**

This Directive shall apply to commercial banks licensed by the National Bank.

### **4. Limits on Exposure to Related Parties**

- 4.1 The aggregate sum of all exposures directly or indirectly held by a bank to any one related party at any one time shall not exceed fifteen percent (15%) of the total capital of the bank
- 4.2 The aggregate sum of all exposures directly or indirectly held by a bank to all related **parties** at any one time shall not exceed thirty five percent (35%) of the total capital of the bank.
- 4.3 **Notwithstanding** the limits stated under sub article 4.1 and 4.2, a bank shall immediately communicate to the National Bank any breach of limit and shall



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promptly comply with the prescribed prudential limit.

4.4 The National Bank, when deemed appropriate, may require a bank to collateralize related party transactions with cash or cash substitute.

4.5 The National Bank may, on grounds it may deem sufficient, prohibit a bank from exposure to any related party.

## 5. Arm's Length Principle

A bank shall not conduct any transaction, as defined under sub-article 2.14 of this Directive, with a related party on preferential terms, as compared to with an unrelated party in the normal course of business, with respect to credit assessment, conditions, tenor, interest rates, fees, amortization, schedules, requirement for collateral, and repayment periods.

## 6. Exposure Value

6.1 For the **purposes** of this Directive, a bank shall calculate the exposure value based on the book value of the exposure.

6.2 Off-balance sheet items shall be converted into credit exposure equivalents using credit **conversion** factors (CCFs) set out in the National Bank's Capital Adequacy Directive.

6.3 A bank when computing the exposure value and determining compliance to the **prudential** limit required in this Directive, may consider, and deduct cash collateral and cash substitutes.

## 7. Approval Process

7.1 Transactions with related parties, and the write-off of related-party exposures exceeding Birr fifteen (15) million or otherwise posing special risks shall be subject to prior **approval** by the concerned bank's board. Board members with conflict of interest shall not be involved in the approval process and in managing related party transactions.

7.2 Prior to board approval, the Audit Committee shall provide its reasoned opinion on the bank's interest in entering in the transaction, as well as the suitability and substantial correctness of its underlying terms. The board may approve the



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NATIONAL BANK OF ETHIOPIA

transaction notwithstanding a negative opinion of the Audit Committee, provided the approval is fully disclosed to the National Bank, and the Audit Committee's opinion is submitted to it along with the disclosure report.

## **8. Internal Controls**

8.1 A bank shall put in place internal control function to ensure compliance with prudential limits, adherence to the bank's decision-making process, and the sound and prudent management of conflicts of interest intrinsic in related party transactions.

8.2 A bank's risk management function shall measure the risks inherent in related party transactions; oversee internal limits assigned to business lines; control the consistency of the operations of each business line with the risk appetite defined by the internal policies.

8.3 A bank's compliance function shall verify the reliability of the procedures and systems adopted in conducting related party transactions and ensure compliance with bank's own policies and regulatory requirements.

8.4 The internal audit function shall review material related party transactions and promptly report any anomalies to the board audit committee, and periodically report to the board. The internal audit function shall, if necessary, suggest the reviews of internal policies and control structures and recommend measures deemed suitable to strengthen the oversight and to prevent risks.

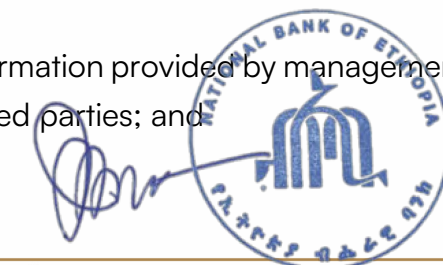
## **9. Role of External Auditors**

9.1 External auditors shall have access to sufficient and appropriate audit evidence regarding the identification and disclosure by the management of the bank regarding related parties and the effect of related party transactions that are material to the financial statements.

9.2 External auditors shall have the duty to find reasonable evidence that the financial statements taken are free from material misstatement, whether caused by fraud or error, including those stemming from related party transactions.

9.3 External Auditors shall obtain a written declaration from management concerning:

9.3.1 the completeness of information provided by management itself regarding the identification of related parties; and





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9.3.2 the adequacy of related party disclosures in the financial statements.

9.4 External Auditors shall consider whether any arm's-length assertions made by management about related party transactions are appropriate and shall have the duty to find sufficient appropriate evidence to support any such assertions.

## **10. Policies and Procedures for Identifying and Monitoring Related Party Transactions**

10.1 A bank shall have policies and procedures to:

10.2 maintain an updated related party database at all time;

10.3 timely identify individual exposures to and transactions with related parties, as well as the total amount of exposures;

10.4 prevent persons benefiting from related-party transactions (and/or persons related to such a person) or who otherwise have conflict of interest from being part of the process of granting and managing related party transactions;

10.5 monitor and report exposure resulting from related party transactions through an independent credit review or audit process; and

10.6 such procedures may include declarations by directors, chief executive officer, senior executive officers and influential shareholders.

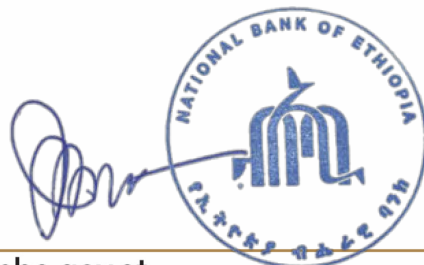
10.7 Exceptions to policies, processes and limits are reported to the board risk management and compliance committee and the board, for timely action.

10.8 The chief risk officer/risk management and compliance function shall monitor related party transactions on an on-going basis and provide regular reports, as per internal reporting requirements, to the board risk management and compliance committee.

## **11. Reporting Requirements on Related Party Transactions**

11.1 A bank shall report to the National Bank its aggregate exposures to related parties on monthly basis.

11.2 A bank shall also report to the National Bank all related party exposures on monthly basis. The report shall be submitted in accordance with Annex 1 attached herewith, which shall be part of this Directive.





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## **12. Threshold for Treatment of Shareholders as Related Party**

With regards to shareholders, only those shareholders of a bank with holdings of two percent (2%) or more of a bank's subscribed capital shall be treated as related party and shall be subject to the provisions of this Directive.

## **13. Responsibility for Identifying Related Parties**

13.1 Every bank shall be responsible for the identification of related parties.

13.2 Every bank shall put in place an effective information technology system to map all related parties at each stage of the relationship.

## **14. Exemptions**

The National Bank may provide exemptions to the prudential limits specified in this Directive when deemed necessary under special considerations.

## **15. Transition Period**

A bank which is not in compliance with the requirements of this Directive, due to the revisions made thereof, shall submit an action plan within ninety (90) days after this Directive enters into force, to bring down its excess exposures according to this Directive within a maximum three (3) years from the effective date of this Directive.

## **16. Repeal**

Credit Exposures to Single and Related Counterparties Directives No. SBB/53/2012 is hereby repealed and replaced by this Directive.

## **17. Effective Date**

This Directive shall enter into force as of the 12<sup>th</sup> day of June 2024.

  
Mamo Esmelealem Mihretu  
Governor





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**ANNEX 1**

**Monthly Returns on Related Party Transactions**

**List of Related Party Exposures**

(In millions of Birr)

Name of Bank: \_\_\_\_\_

Reporting Month: \_\_\_\_\_

Total Capital \_\_\_\_\_

Counterparty/ Name	Nature of Counterparty (e.g. influential shareholder, director, subsidiary ....)	Type of Exposure	Sector of Exposure	Approved Limit/Facility	Exposure Amount/ Outstanding Balance (on- balance sheet) A	Off-balance sheet exposure amount (e.g. guarantee) B	Maturity Date	Exposure amount (A+B) as Percent of Total Capital	Status (classificat ion)	Collateral	
										Type	Estimated /Face value
<b>TOTAL</b>				<b>XXX</b>	<b>XXX</b>	<b>XXX</b>					

Note: \*Classification shall be reported in line with relevant Asset Classification and Provisioning Directive of the National Bank.

Prepared by: \_\_\_\_\_

(name and signature)

Telephone: \_\_\_\_\_

Approved by: \_\_\_\_\_

(name and signature)

Telephone: \_\_\_\_\_

