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ROYAL MONETARY AUTHORITY OF BHUTAN

RMA/FISD/03/2009-2010 8115

April 27, 2010

The Chief Executive Officer
Royal Securities Exchange of Bhutan Ltd.
Thimphu, Bhutan

Sir,

Subject: Revision to PR 2002

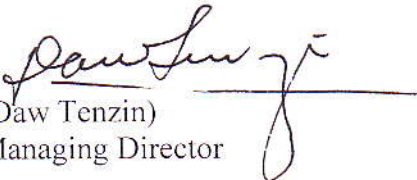
We would like to inform you of the recent changes in the Prudential Regulations 2002 pertaining to definition of related party, information on significant owner of listed companies, compliance requirement for RSEBL, compliance requirement for brokerage firms, regulations on share ownership of financial institutions and regulations on investment of the financial institutions.

The PR 2002 has been updated to ensure consistency with the Regulations for Establishment of Banks, Regulations for Establishment of Insurance Companies in Bhutan and to keep in line with the international best practices.

A detailed abstract of the changes is attached herewith for your kind reference. A copy of the amended PR 2002 is available on the RMA's website at www.rma.org.bt.

Thanking you.

Sincerely,


(Daw Tenzin)
Managing Director

ROYAL MONETARY AUTHORITY OF BHUTAN

FINANCIAL REGULATION AND SUPERVISION DEPARTMENT

PRUDENTIAL REGULATIONS 2002

In exercise of the powers conferred by Part II, 6(c) and Part VIII of the Royal Monetary Authority of Bhutan Act, 1982 and Article 26, Part V of the Financial Institutions Act of Bhutan 1992, the Royal Monetary Authority of Bhutan (RMA) hereby issues these regulations to the financial institutions in Bhutan. These regulations shall come into force from 1 June 2002 and supersede the existing Prudential Regulations 1999. These regulations shall be amended in part or as a whole when the RMA feels the need to affect such changes.

SECTION – 1

REGULATIONS FOR DIRECTORS AND CHIEF EXECUTIVES OF THE FINANCIAL INSTITUTIONS

APPOINTMENT OF DIRECTORS AND CHIEF EXECUTIVES

- 1.3.3 The composition of Board of Directors should be such that every two of the five directors must have more than five years experience in banking, finance, insurance and other related business of the financial institutions.¹
- 1.3.4 As a matter of desirable practice not more than one member of a family (spouse, children and/or economically dependent persons) or a close relative (up to second generation) or an associate (partner, employee, director, etc.) should be on the Board of the financial institution. The definition of a family or close relative provided by the RMA shall be binding.²

SECTION - 2

REGULATIONS ON RELATED PARTY TRANSACTIONS

2.2 DEFINITION OF RELATED PARTY

For the purpose of these regulations, a party is considered to be related if he/she has the ability to control, or exercise significant influence over the financial institution in making financial and operating decisions, and includes the following:-

- (a) significant owner;³
- (b) a member of the Board of Directors
- (c) officers and employees of the institution;
- (d) spouse and children of persons specified in (a) (b) and (c);

¹ Amended on March 29, 2010

² Amended on July 20, 2009

³ Amended on March 29, 2010

Significant owner means a person who either acting alone or in concert with other person represents 10% or more of the capital of the financial institution or can exercise control over the management of the financial institution

- (e) any individual for whom a director, **significant owner**, officer or employee is a guarantor;
- (f) any firm or company in which a significant owner, director and officer or employee has an interest as owner, partner, or has a direct or indirect equity interest equal to or exceeding 10 percent of the paid-up equity capital;
- (g) another financial institution with cross-shareholding in, or a high degree of influence over the financial institution;
- (h) the parent company, subsidiary ,fellow subsidiaries and affiliates of the financial institution.

2.3 RESTRICTIONS ON LENDING TO **SIGNIFICANT OWNERS,DIRECTORS, OFFICERS AND EMPLOYEES**

2.3.1 A financial institution shall not extend credit to:-

- (a) any of its significant owner beyond a maximum limit of 10 Percent of the institution's capital fund.
- (b) any of its directors beyond a maximum limit of 10 percent of the institution's capital fund, and
- (c) any of its officers or employees exceeding 5 percent of the institution's capital fund.

2.3.2 For the purpose of deriving the limits specified in Section 2.3.1 above, the following loans shall be aggregated:-

- (a) loans and advances granted to the **significant owner**, director and officer or employee personally;
- (b) loans and advances granted to the spouse, children and to any other direct dependents of the **significant owner**, director and officer or employee;
- (c) loans and advances to a firm or company of which the **significant owner**, director and officer or employee is owner, partner, or in which he/she has an equity interest exceeding 10 percent of the equity capital. Such loans and advances shall be aggregated in proportion to the **significant owner's**, director's, officer's or employee's equity in the firm or company. Where the **significant owner**, director and officer or employee owns 50 percent or

more of the firm or company's equity stock, the total loan exposure to that firm/company shall be aggregated.

- (d) loans and advances guaranteed by the **significant owner**, director and officer or employee.

2.3.3 Sanction of loans and advances to a **significant owner** or director beyond 5 percent of the institution's capital fund and to an officer or employee beyond 1 percent of its capital fund, must have the prior approval of the Board. In other words, if an institution's exposure to a **significant owner** or director is 5 percent of its capital fund, any further loan or advance to him/her must have the prior approval of the Board. Similarly, if the institution's exposure to an officer or employee is 1 percent of its capital fund, any further loan or advance to him/her must have the prior approval of the Board.

2.3.4 Where a default occurs in respect of any loan granted to a **significant owner**, director and officer or employee, he/she shall not be eligible for any further loan until the loan account has been regularized.

2.3.5 A report of all outstanding loans and advances granted to **significant owner** directors and officers or employees must be submitted to the Board at each meeting thereof.

2.4 GRANTING OF FAVORED TERMS PROHIBITED

2.4.1 All loans to related persons (i) shall be on the same terms and conditions, including interest rates, fees, margins and security, as those applicable at the time of origination to similar loans to any other person who is not a related person of the financial institution; (ii) shall not involve more than the normal risk of repayment or any other unfavorable features, and (iii) the financial institution shall apply credit underwriting procedures that are no less stringent than those applied for comparable transactions with persons who are not related person.⁴

2.5 RESTRICTIONS ON LENDING TO LEGAL ENTITIES RELATED TO THE FINANCIAL INSTITUTIONS AS SPECIFIED UNDER ARTICLE 48 OF FI ACT 1992 AND SECTION 2.2 OF PR 2002.

2.5.1 A financial institution shall confirm to the following limits and requirements with regard to lending to the following related parties:

- a) holding **or parent**⁵ company
- b) subsidiary of the holding **or parent company**

⁴ Amended on July 20, 2009

⁵ Amended on March 29, 2010

c) companies in which the holding **or parent** company has a direct or indirect equity interest equal to or exceeding 10 percent

d) Financial institutions' subsidiaries and its affiliates

SECTION - 3

REGULATIONS ON THE CODE OF ETHICS FOR DIRECTORS AND EMPLOYEES OF THE FINANCIAL INSTITUTIONS

3.2 PRINCIPLES OF ETHICAL CONDUCT

3.2.5 Confidentiality

- (a) The confidentiality of relations and dealings between a financial institution and its customers is paramount in maintaining the financial institution's reputation. Thus, staff and Directors must take every precaution to protect the confidentiality of customer information and transactions. In accordance with Article 23 of the FIA, no staff or Director shall divulge information regarding any customer, or any correspondence, accounts or dealings of the financial institution or its customers, to any person other than administrative or judicial authorities.
- (b) Business and financial information about any customer may be used or made available to third parties only with the prior written consent of the customer, or in accordance with arrangements for the proper interchange of information between financial institutions and **Credit Information Bureau**⁶ about credit risks, or when disclosure is required by law.

⁶ Amended on March 29, 2010

SECTION - 4
REGULATIONS ON SHARES TRADING

4.4 INFORMATION ON SIGNIFICANT OWNER OF LISTED COMPANIES⁷

The depository under the Royal Securities Exchange of Bhutan shall inform and submit to the Financial Regulation and Supervision Department of Royal Monetary Authority of Bhutan, the list of all the significant owners of the listed companies on a monthly basis.

4.5 COMPLIANCE REQUIREMENTS FOR THE ROYAL SECURITIES EXCHANGE OF BHUTAN⁸

The Royal Securities Exchange of Bhutan shall comply with the following regulation:-

- (a) Securities Exchange Regulation 1993
- (b) Rules Governing the Official Listing of the Securities
- (c) Rules of the Exchange

4.6 COMPLIANCE REQUIREMENT FOR BROKERAGE FIRMS⁹

All Brokerage firms and their staff shall comply with the requirements of the Control of Brokers Regulations 1993.

⁷ Amended on March 29, 2010

⁸ Amended on March 29, 2010

⁹ Amended on March 29, 2010

SECTION - 6
REGULATIONS ON CAPITAL REQUIREMENT

6.2 MINIMUM CAPITAL REQUIREMENT¹⁰

(i) The minimum paid-up capital for different types of financial institutions shall be as follows:-

(a)	Bank	-	Nu.300 million.
(b)	Non-bank financial institution	-	Nu.200 million.
(c)	Non-bank finance company	-	Nu.100 million.

(ii) No license shall be issued to a financial institution until the paid-up portion of its subscribed capital amounts to the minimum prescribed level, indicated above.

(iii) All existing banks and non-bank financial institutions shall raise their paid-up capital to the minimum prescribed amount indicated in (i) (a) and (b) above latest by January 1, 2009.

(iv) ¹¹ Except for those financial institutions which are exempted by the RMA in consideration of the special circumstances relating to the nature of its business all financial institutions shall be a public limited company registered under Companies Act 2000 and listed with any stock exchange in Bhutan.

¹⁰ Amended on March 31, 2008

¹¹ Amended on March 29, 2010

SECTION-14¹²

REGULATIONS ON SHARE CAPITAL OWNERSHIP OF BANKS

14.1 Financial Institutions carrying on banking activities shall not, directly or indirectly, without prior written authorization from the RMA:

- (a) come under common ownership with, or become owned to more than twenty percent of its equity by:
 - i. enterprises; and
 - ii. non-bank financial institutions
- (b) permit the investment described under Section 14.1 (a) above to exceed the equivalent of 25 percent of its net worth.

14.2 Financial Institutions carrying on banking activities shall not be owned by another bank exceeding five percent of its paid-up capital.

14.3 No individual, together with his/her immediate family¹³ members and companies in which he/she has ownership of 10 percent or more, can hold more than 20 percent of the paid-up share capital of the bank.

14.4 The ownership of the Joint Venture Bank (foreign bank) in the proposed bank shall not exceed 51 percent of the paid up share capital of the bank at any point of time.

14.5 No holding/parent company can have ownership in two or more banks exceeding 5 percent of the paid-up capital of the respective bank(s).

14.6 It shall be mandatory for the banks to submit a report to RMA in the event a natural or legal person or an entity holds more than ten percent of the share capital issued.

¹² Amended on March 29, 2010

¹³ Immediate family means spouse of an individual, the individual's minor children and any of the individual's children (including adults) residing in the individual's home.

SECTION-15¹⁴

REGULATIONS ON INVESTMENTS IN EQUITY BY BANKS

15.1 Financial institutions carrying on banking activities shall not, directly or indirectly, without prior written authorization from the RMA:

(a) purchase shares, become partner in, or acquire an interest that in the aggregate amounts to more than 20 percent of the equity of the:

- i. projects or enterprise; and
- ii. non-bank financial institutions

(b) permit the investment described in Section 15.1 (a) above to exceed the equivalent of 25 percent of its net worth.

15.2 No financial institutions carrying on banking activities shall be permitted to invest in another bank exceeding 5 percent of the paid-up capital of the other bank.

¹⁴ Amended on March 29, 2010

SECTION-16¹⁵

REGULATIONS ON SHARE CAPITAL OWNERSHIP OF NON-BANK FINANCIAL INSTITUTIONS

- 16.1** Non-bank financial institutions shall not, directly or indirectly, without prior written authorization from the RMA:
- (a) come under common ownership with, or become owned to more than 20 percent of its equity by:
 - i. enterprises; and
 - ii. other financial institutions which are not in the same line of business
 - (b) permit the investment described under Section 16.1 (a) above to exceed the equivalent of 25 percent of its net worth.
- 16.2** No non-bank financial institution shall be owned by another non-bank financial institution exceeding 5 percent of its paid-up capital.
- 16.3** No individual, together with his/her immediate family members and companies in which he/she has ownership of 10 percent or more, can have ownership of more than 20 percent of the paid-up share capital of the non-bank financial institution.
- 16.4** No company together with its subsidiaries can have ownership in non-bank financial institutions more than 25 percent of the paid-up capital of the non-bank financial institution.
- 16.5** No holding company can have ownership in two or more non-bank financial institutions exceeding 5 percent of the paid-up capital of the respective non-bank financial institutions.
- 16.6** It shall be mandatory for the non-bank financial institutions to submit a report to RMA in the event a natural or legal person or an entity holds more than ten percent of the share capital issued.

¹⁵ Amended on March 29, 2010

SECTION-17¹⁶

REGULATIONS ON INVESTMENTS IN EQUITY BY NON- BANK FINANCIAL INSTITUTIONS

17.1 Non-Bank Financial institutions shall not, directly or indirectly, without prior written authorization from the RMA:

(a) purchase shares, become partner in, or acquire an interest that in the aggregate amounts to more than 20 percent of the equity of the:

- i. projects or enterprise; and
- ii. other financial institutions which are not in the same line of business

(b) permit the investment described in Section 17.1 (a) above to exceed the equivalent of 25 percent of its net worth.

17.2 Non- Bank financial institutions shall not be permitted to invest in another non-bank financial institutions (with same line of business) more than 5 percent of the paid-up capital of the other non-bank financial institutions.

¹⁶ Amended on March 22, 2010

SECTION - 20

REGULATIONS ON ON-SITE EXAMINATIONS OF FINANCIAL INSTITUTIONS

- 20.1** In terms of Article 54 of the Financial Institutions Act of Bhutan 1992, the Examining Officers of the Royal Monetary Authority shall conduct on-site examinations of each financial institution as and when found necessary.
- 20.2** The financial institutions are required to make available to the Examining Officers of RMA all records and documents to enable them to ascertain the overall financial condition of the institution. Furthermore, the employees and officers of the financial institution are required to provide such information concerning any aspects of the financial institution's operations, which the Examining Officers may reasonably request to determine its safety and soundness.
- 20.3** A copy of the Examining Officers' on-site report of examination shall be submitted to the Board of Directors and Executive Management of the financial institution and shall be discussed by the Board of Directors at its meeting immediately succeeding receipt of the report.
- 20.4** Each member of the Board of Directors shall acknowledge receipt and perusal of the report of examination on the form provided at the time of the Board Meeting.
- 20.5** *Management of the financial institution is required to respond to the findings in the report within 14 working days of the meeting of the Board of Directors referenced in 20.3 above.*
- 20.6**¹⁷ Management of the financial institution shall report to the RMA the necessary actions/measures/remedies taken by the Board based on the findings of the on-site inspection report, within 6 months from the date of submission of the on-site inspection report.

¹⁷ Amended on March 29, 2010