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Ensuring 'proper fitness' of significant owners of insurers in 2021

By Christine Rodrigues

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The Financial Sector Conduct Authority (FSCA) and the Prudential Authority (PA) published Joint Standard 1 of 2020 on 1 June 2020, which sets out the requirements for fitness, proprietary and other matters related to 'significant owners', as defined and introduced by the Financial Sector Regulation Act (FSRA) 2017.

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This came into effect on 1 December 2020 and is important, because a person who qualifies as a significant owner - a person who has the ability to control or influence the business or strategy of a financial institution materially - must pass both the financial as well as the fit, proper and integrity litmus tests.

Parallels can be drawn between South African insurance regulation and the European Insurance Occupational Pensions Authority (EIOPA) paper: *Results of the Peer Review on Propriety of Administrative, Management or Supervisory Body Members and Qualifying Shareholders*, which states:

> *"Behaviour steers businesses. Character influences governance. Conduct dictates the integrity of the financial health and reporting of businesses. Behaviour, character and conduct often contribute to the likelihood of failure and unfair treatment of consumers. This is particularly true for the insurance business whose survival and sustainability rely heavily, throughout its lifecycle, on the use of professional judgement and assumptions from interpreting current trends to predicting future developments."*

The Paper published by EIOPA is interesting because it provides a clear indication that the European Economic Area (EEA) is harmonising legislation to ensure that it is applicable to all member states. So, for example, where a qualifying shareholder is deemed not to be fit and proper in member state A, and attempts to then apply to become a qualifying shareholder in member state B, it will also be considered not to be fit and proper in that state.

Similar assessment

The assessment of whether a person is proper or suitable for acquiring a qualifying shareholding in terms of the EIOPA

Guidelines on System of Governance (European Guidelines), is similar to that of South Africa. The European Guidelines have five bases for fit and proper assessment: criminal offences and administrative sanctions for non-compliance with provisions governing financial activities; pending investigations for criminal offences or administrative sanctions; bankruptcy or insolvency of an insurer where the candidate was previously a director; personal bankruptcy or inclusion on a list of unreliable debtors; and matters of transparency or honesty, rejection of an application, exclusion or limitation to conduct operations which requires authorisation or dismissal from employment.

Of interest is the consideration of 'pending investigations for criminal offences or administrative sanctions'. Usually application processes only require applicants to disclose if they have been convicted of criminal offences and do not require information about pending sanctions or actions.

The EIOPA Paper recommends that regulators should always require qualifying shareholders and insurers to inform them of all pending legal proceedings at the time of application or at the start of such proceedings. This therefore impacts not only new applicants but also existing qualifying shareholders.

It suggests that a minimum set of information should be required from the candidate or the insurer. Based on the relevant information available, the regulator should then assess the materiality of the facts and their impact on the reputation of the candidate and the insurer.

Need for ongoing assessment

South Africa's fit and proper standard requires that the insurer ensures that the significant owner remains fit and proper at all times. The EIPOA Paper states, that the SII Directive requires regulators to assess on an on-going basis, the proprietary assessment of qualifying shareholders in the following categories: the initial assessment at the time of appointment; ad-hoc assessments or triggered assessments when the regulator comes across new information in relation to a qualifying shareholder (this is often initiated by insurers who bring the new information to the attention of the regulator) and; ongoing assessments by both insurers and regulators.

It is therefore important that insurers develop policies for the ongoing proprietary assessment of significant owners. Factors that should be considered include: financial stability; whether pending or new proceedings or legal action impact proprietary; if the qualifying shareholder is a controller in other entities (not necessarily regulated) whether, under such control, the shareholder has been subject to legal action or investigation which might put its integrity into question; and the governance structure of the qualifying shareholder and whether there are substantial or a series of changes in the governance structure.

The more stringent regulation of significant owners is either likely to force consolidation. Alternatively, we could see shareholders reducing their shareholding to below the prescribed limit.

The bottom line is that, insurers need to ensure that they assess the proprietary of their significant owners on an ongoing basis. Being passive and merely accepting that their shareholder is fit and proper is no longer acceptable in terms of our

regulation.

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