

Fit and Proper Principles paper

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Objective

1. To ensure that supervisors of entities within a financial conglomerate are able to exercise their responsibilities to assess whether those entities are soundly and prudently managed and directed and whether key shareholders (as defined below) are not a source of weakness to those entities.
2. To promote arrangements to facilitate consultation between supervisors and the exchange of information on individuals and regulated entities, on a case-by-case basis, when requested by other supervisors, to achieve the objective set out above.

Background

3. The probity and competence of the top management of banks, securities firms and insurance enterprises are critical to the achievement of the objectives of supervision. The primary responsibility for ensuring that regulated entities are prudently and soundly managed and directed rests with the regulated entities themselves. Supervisors' expectations are that the entities will take the measures necessary to ensure that managers, directors and shareholders whose holdings are above specified thresholds or who exercise a material influence on their operations ("key shareholders") meet the fitness, propriety or other qualification tests of their supervisors.
4. An effective and comprehensive supervisory regime should include controls designed to encourage the continued satisfaction of the fitness, propriety or other qualification tests of supervisors and to allow supervisory intervention where necessary. The application of such tests for managers, directors and key shareholders is a common regulatory mechanism for supervisors to ensure that the institutions for which they have supervisory responsibility are operated in a sound and prudent manner. Supervisors generally have at their disposal various sanctions to ensure remedial measures are taken in respect of managers, directors and key shareholders who do not meet the relevant fitness and propriety or other qualification standards.
5. Solo supervisors are subject to statutory and other requirements in applying fitness, propriety or other qualification tests to the entities under their jurisdiction. It is not

intended that such statutory and other requirements (as well as their procedures for the application of those tests) will be superseded by the elements of this principle. In exercising their statutory responsibilities, supervisors should consult, as applicable, the supervisors of other regulated entities in the financial conglomerate in question.

6. The organisational and managerial structure of financial conglomerates adds elements of complexity for supervisors seeking to ensure the fitness, propriety or other qualifications of the top management of regulated entities as the management and direction of such entities can be influenced by individuals who may not be managers or directors of the regulated entities themselves or of any regulated entity in the group.

Principal elements of fit and proper criteria

7. Fitness tests usually seek to assess the competence of managers and directors and their capacity to fulfil the responsibilities of their positions while propriety tests seek to assess their integrity and suitability. To determine competence, formal qualifications, previous experience and track record are some of the elements focused on by supervisors. To assess integrity and suitability, elements considered include: criminal records, financial position, civil actions against individuals to pursue personal debts, refusal of admission to, or expulsion from, professional bodies, sanctions applied by regulators of other similar industries, and previous questionable business practices.

8. Factors relative to the assessment of the fitness, propriety or other qualifications of key shareholders include business repute and financial position, and whether such ownership would adversely affect the regulated entity.

9. It is recognised that in addition to the factors identified in the previous paragraphs, the assessment of fitness, propriety and other qualifications is a judgmental matter and that supervisors may have additional information at their disposal that they can consider on a case-by-case basis.

Issues arising from the emergence of financial conglomerates

10. Managers and directors in unregulated entities, usually those upstream from the regulated entities, in a financial conglomerate can exercise a material influence over many aspects of the regulated entities' business and can also play a key role in controlling risks in the various entities in the whole group.

11. This element raises issues of supervisory jurisdiction as supervisors' reach may not extend beyond their geographical boundaries, i.e. to other regulated entities in the group

which are overseen by supervisors in other jurisdictions, and to unregulated entities in the group. Furthermore, measures taken to apply fitness, propriety or other qualification tests to unregulated entities in the group may create the false impression that supervision generally extends to those unregulated entities.

12. This also raises the issue of sharing of information among supervisors with respect to individuals and has implications with respect to the usual requirements of professional secrecy on supervisors. Most countries have legislation in place protecting the privacy of individuals and accordingly it is recognised that there may be limitations to a free exchange of information between supervisors.

Guiding Principles

- 1. In order to assist in ensuring that the regulated entities within financial conglomerates are operated prudently and soundly, fitness and propriety or other qualification tests should be applied to managers and directors of other entities in a conglomerate if they exercise a material or controlling influence on the operations of regulated entities.**
- 2. Shareholders whose holdings are above specified thresholds and/or who exert a material influence on regulated entities within that conglomerate should meet the fitness, propriety or other qualification tests of supervisors.**
- 3. Fitness, propriety or other qualification tests should be applied at the authorisation stage and thereafter, on the occurrence of specified events.**
- 4. Supervisors' expectations are that the entities will take the measures necessary to ensure that fitness, propriety or other qualification tests are met on a continuous basis.**

13. The application of fitness, propriety or other qualification tests to managers, directors and key shareholders may vary depending on the degree of their influence and on their responsibilities in the affairs of regulated entities. It is recognised that an individual considered fit for a particular position within an institution may not be considered fit for another position with different responsibilities or for a similar position within another institution, and conversely, an individual considered unfit for a particular position in a particular institution may be considered fit in different circumstances.

14. There are significant differences in legislative and regulatory frameworks across countries as regards the functions of the board of directors and senior management. In some countries, there is a two tier board system consisting of a supervisory board which has the main, if not exclusive, function of supervising the executive body (the management board) to ensure that the latter fulfils its tasks. This means that the board has no executive functions. In other countries, with a unitary board system, the board has a broader competence in that it lays down the general framework for the management of the institution. In this regard, fitness, propriety or other qualification tests should be applied to directors in light of their role and responsibilities.

5. Where a manager or director deemed to exercise a material influence on the operations of a regulated entity is or has been a manager or director of another regulated entity within the conglomerate, the supervisor should endeavour to consult the supervisor of the other regulated entity as part of the assessment procedure.

6. Where a manager or director deemed to exercise a material influence on the operations of a regulated entity is or has been a manager or director of an unregulated entity within the conglomerate, the supervisor should endeavour to consult with the supervisors of other regulated entities that have dealings with the unregulated entity as part of the assessment procedure.

7. Supervisors should communicate with the supervisors of other regulated entities within the conglomerate when managers, directors or key shareholders are deemed not to meet their fitness, propriety or other qualification tests.

15. Such communications should take into account whether such disclosures could interfere with supervisory action.

16. Generally, channels to permit the exchange of information within sectors, e.g. banking, securities and insurance, have been established. Where there is no direct channel to a regulator in another jurisdiction, it may be possible to route information to the relevant domestic supervisor for onward transmission.

17. It may be that in some instances arrangements to exchange information between supervisors should be formalised in agreements, e.g. memoranda of understanding to establish a framework for the efficient transfer of such information.

Notification

18. Mechanisms should be in place to ensure that supervisors are advised, at the authorisation stage, of managers, directors and shareholders who can exert a material influence, directly or indirectly, on the operations of regulated entities, and thereafter, are notified of changes in such managers, directors and shareholders, on the occurrence of specified events.