

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS



SUPERVISORY STANDARD ON FIT AND PROPER REQUIREMENTS AND ASSESSMENT FOR INSURERS

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1. Introduction

1. To safeguard the interests of present and future policyholders, beneficiaries and insurance claimants, it is crucial that insurers are soundly and prudently managed. Furthermore, it is essential that individuals in key positions do not pose a risk to the interests of the insurer and stakeholders such as present and future policyholders, beneficiaries and insurance claimants.

2. Research into the experience of insurers has demonstrated that a significant underlying cause of financial difficulties resulting in insurer bankruptcies or “near misses” can be problems with senior management or shareholders leading to issues such as “incompetence or operating outside their area of expertise, lack of integrity or conflicting objectives, or weakness in the face of inappropriate group decisions”.¹

3. Therefore, it is necessary to set standards on fitness and propriety for significant owners and key functionaries, and for the assessment of the compliance with these standards, or fit and proper testing, by supervisors.

4. Performance of fit and proper tests by supervisors also contributes to the prevention of criminals from taking control over an insurer and thus plays a role in addressing financial crime such as money laundering.²

5. This standard should be read in conjunction with the following IAIS Insurance core principles:

- Principle 5: Supervisory cooperation and information sharing
- Principle 7: Suitability of persons
- Principle 8: Changes in control and portfolio transfers
- Principle 27: Fraud

2. Objectives

6. The objectives of this standard are:

- to address the risk of mismanagement of and inadequate or inappropriate control or influence over insurers;
- to ensure that supervisors of insurers exercise their responsibilities to assess whether insurers are soundly and prudently managed and directed (fit and proper testing);
- to facilitate consultation between supervisors and the exchange of information on individuals and insurers to achieve the above.

3. General statements

General standard to apply fit and proper requirements

7. In order to promote the sound and prudent operation of the insurer, the standards on fitness and propriety or other qualifications of this paper should be applied to significant owners and key functionaries of the insurer as defined in the next section of this paper. The main responsibility for assessment of the fitness and propriety of key functionaries lies with the insurer itself.

¹ Conference of Insurance Supervisory Services of the Member States of the European Union, *Prudential Supervision of Insurance Undertakings*.

² Financial Action Task Force, *The Forty Recommendations*, recommendation 23.

General standard to perform a fit and proper test

8. Supervisors should perform adequate tests to assess whether these significant owners and key functionaries meet the applicable requirements.

Unitary and two tier board systems

9. Supervisors should be aware that, in respect of the functions and responsibilities of directors, there are differences in legislative and regulatory frameworks from jurisdiction to jurisdiction. In some jurisdictions, there is a two tier board system consisting of a supervisory board, which has a main function of supervising the management board. Thus, the supervisory board has no executive functions. In other jurisdictions, with a unitary board system, the board has a broader responsibility. In this regard, fitness, propriety or other qualification tests should be applied to directors in the light of their role and responsibilities, taking into account the structure of the boards.

4. Scope of the standard

Minimal application to significant owners and key functionaries, definitions

10. The fit and proper requirements set out in this paper and the assessment thereof by the competent supervisor apply at a minimum to significant owners and key functionaries, such as board members, directors and senior management. A significant owner is defined³ as a person (legal or natural) that directly or indirectly, alone or with an associate, exercises control³ over the insurer.

Application to additional functionaries

11. Jurisdictions may impose these requirements and apply these tests also to other functionaries, including appointed actuaries, compliance officers, underwriters, financial controllers, treasurers, etc.

Look through principle for corporate institutions

12. Corporate institutions are sometimes significant owners of insurers. In these cases, the test and evaluation of fit and proper principles should be applied to these institutions as well as to the significant owners and key functionaries of the institution in question.

5. Fit and proper requirements

General requirements

Distinction between necessary qualities

13. In order to meet fit and proper requirements, a significant owner or a key functionary should have and demonstrate the necessary qualities that will allow him/her to perform the duties and carry out the responsibilities of his/her position with the insurer.

14. With respect to a significant owner, these qualities relate at a minimum to:

- the integrity demonstrated in personal behaviour and business conduct;

³ IAIS, *Insurance core principles and methodology*, core principle no. 7, definition of "control".

- soundness of judgement;
 - financial soundness.
15. With respect to a key functionary, these qualities relate at a minimum to:
- the integrity demonstrated in personal behaviour and business conduct;
 - soundness of judgement;
 - a sufficient degree of knowledge, experience and professional qualifications.

Interests to be safeguarded

16. In general, the interests the supervisor or supervisory legislation is designated to protect, including the interests of the insurer and of its policyholders, beneficiaries and insurance claimants, should not in any way be threatened by the significant owner or key functionary occupying his/her position with the insurer.

Independence and conflicts of interests

17. Notwithstanding his/her accountability to others, according to the national legislation for sound and prudent management and control over the insurer, the insurer should have sufficient safeguards in place to prevent undue influence over the key functionaries with respect to the performance of their duties and responsibilities. The insurer must have adequate policies and procedures to control conflicts of interest for key functionaries.

Continuous compliance; control measures by the insurer

18. Supervisors should require that significant owners and key functionaries meet the applicable fit and proper requirements on a continuous basis. Insurers should also be required to report any significant information gained about key functionaries subsequent to the initial application. Supervisors should require insurers to take the measures necessary to ensure that these requirements are met by setting high standards of ethics and integrity, promoting adequate corporate governance and maintaining a sufficient degree of knowledge, experience and decision making ability.

Temporary replacement of a key functionary

19. There can be circumstances where a key functionary is unable to carry out his/her role and a replacement needs to be appointed at short notice. It may be appropriate, for example for policyholder protection, for the supervisor to permit the post to be filled temporarily until the successor has been approved by the supervisor. In such circumstances a supervisor might require additional steps to be taken by the insurer to protect policyholders, beneficiaries and insurance claimants.

Requirements on integrity

Integrity

20. The conduct and actions of the individual who is subject to the fit and proper requirements should be such that his/her integrity is beyond reasonable doubt. Indicators of an individual's integrity include criminal, financial, supervisory and other aspects.

Indicators of a criminal nature

21. Criminal indicators relate to criminal conduct. As a matter of principle, the individual should not have a record or evidence of previous conduct and activities where he/she has been convicted for a criminal offence under any legislation designed to protect members of the public from financial loss, for example, due to dishonesty, or misappropriation of assets, embezzlement and other fraud.

Indicators of a financial nature

22. Financial indicators provide information on possible financial misconduct, improper conduct of financial accounting or negligence or bad judgement in decision making. Indicators could be financial difficulties leading to legal proceedings, discrepancy between financial commitments and income and funds, bankruptcy in private or financial difficulties or bankruptcy procedures or insolvency of an institution to which the individual is or was a significant owner or key functionary.

Indicators of a supervisory nature

23. Supervisory indicators provide information collected by supervisors in the performance of their supervisory duties. These supervisors could also be authorities with supervisory responsibility in sectors other than insurance. Indicators could be the withholding of information from public authorities, submission of incorrect financial or other statements, prior refusal of regulatory approval, other corrective actions or interventions by a public authority.

Indicators of any other nature

24. Other indicators may provide information relevant to the fitness and propriety of the individual. Examples include disputes with previous employers concerning correct fulfilment of position or compliance with a code of conduct which has led to the imposition of a penalty under employment law, and disciplinary measures imposed by trade or professional associations, for example on actuaries, accountants or lawyers.

Requirements on soundness of judgement

Soundness of judgement

25. In respect of soundness of judgement, the individual should show an adequate degree of balance, rationality and maturity, demonstrated in conduct and decision making, especially with respect to previous business practices. Soundness of judgement may be deducted from the lack of adverse information from e.g. the questionnaire mentioned in paragraphs 33 and 34.

Incriminating track record

26. In addition, the individual should not have a record or evidence of previous business conduct and activities where he/she has engaged in any business practices, for example, of a deceitful, oppressive or otherwise improper nature, or which otherwise raises concerns about the individual's methods of conducting business.

Requirements on knowledge and experience of key functionaries

Knowledge and experience

27. The knowledge and experience of the individual subject to the fit and proper requirements should be sufficient for a sound and prudent management and decision making of the insurer and should be maintained at an adequate level.

Complementary knowledge and experience of other functionaries

28. For the assessment of the required level of knowledge and expertise, the qualifications and experience of other functionaries within the insurer could be taken into account as a complementary factor. Nevertheless, the knowledge and experience of the individual should be at an adequate minimum level.

Areas of knowledge and expertise

29. Collectively knowledge and expertise of key functionaries within the insurer should at a minimum relate as appropriate to:

- professional management of an organisation;
- rules and regulations applicable to the insurer;
- insurance products and markets;
- financial and actuarial aspects such as financing, investments and financial markets, actuarial principles and reinsurance;
- administrative organisation, internal control, information technology and risk management;
- financial accounting and reporting;
- outsourcing arrangements.

Duration of past experience

30. The board, as well as the management as a whole, should at an adequate level consist of individuals with several years' experience in the management of an insurer.

6. Assessment of fitness and propriety by the supervisor

Timing

31. The assessment (fit and proper testing) of significant owners and key functionaries of an insurer by the supervisor should at a minimum take place as part of the licensing procedure before the insurer is granted access to the insurance industry and - if the insurer is already licensed - before a significant owner acquires its stake in the insurer or a key functionary may exercise his/her duties and responsibilities with the insurer.

Fact finding

Obligation to collect sufficient information

32. The supervisor should collect sufficient and appropriate information to assess if the individual meets the fit and proper requirements. The paragraphs below outline a possible approach, but in practice supervisors may use other methods of collecting such information. The information to be collected and the assessment of it by the supervisor may differ depending on the position of the person being assessed in relation to the interests to be safeguarded.

Information required from the individual

33. For the purpose of collecting information for the assessment, the supervisor should require the submission of:

- a questionnaire to be filled in and signed by the individual;
- a résumé indicating the professional qualifications as well as previous and current positions of the individual;
- any other information necessary to assist in the assessment.

Contents of the questionnaire

34. The questionnaire mentioned in the previous paragraph should contain questions regarding:
- financial problems or bankruptcy in his/her private capacity;
 - financial problems or bankruptcy of an institution in which the individual is/was a significant owner or key functionary;
 - civil liability as a consequence of unpaid debts;
 - suspension, dismissal or disqualification from a position from acting as a director or in management of any company or organisation;
 - preventative or corrective measures imposed on institutions in which the individual is/was a significant owner or key functionary;
 - convictions in criminal cases in his/her private capacity;
 - convictions in criminal cases of an institution in which the individual is/was a significant owner or key functionary;
 - outcome of previous assessments of fitness and propriety, or sanctions or disciplinary actions taken by another supervisor;
 - for members of professional organizations, any disciplinary action taken against the individual;
 - pending proceedings in his/her capacity as the subject in civil or criminal cases;
 - any other fact or circumstance that the individual should reasonably consider relevant for the assessment.

Consequence of incorrect completion of the questionnaire

35. Any false or misleading reply to the questionnaire or deliberate withholding of crucial information should be considered a strong indication that the individual lacks integrity. The individual should be made aware of this consequence.

Information concerning corporate institutions

36. If the significant owner that is to be assessed is a corporate institution, the supervisors should also review:
- its financial soundness and strengths (including its capital structure);
 - the nature and scope of its business;
 - its significant owners and key functionaries;
 - the group structure (if applicable) and organisation chart.

Checking of criminal and police records

37. The supervisor should make appropriate use of information available from the appropriate law enforcement authorities and/or the financial intelligence unit. It should be noted that the facts established in the course of these investigations and proceedings are at least as relevant as the outcome in terms of acquittal or conviction, because prosecutors may be charged with a different level of proof.

Other records and databases

38. The supervisor should also check available records and databases for example on institutions registered by the chamber of commerce, on bankruptcies and press publications.

Interview

39. If necessary, an interview could be conducted with the individual.

Consultation with other supervisors

40. In cases where or key functionalities are known to other supervisors (in the same or another jurisdiction), the supervisor should communicate with those supervisors as part of the assessment procedure.

Corporate institutions in another jurisdiction

41. If a significant owner that is to be assessed is a corporate institution regulated in another jurisdiction, the supervisor should seek confirmation from the relevant regulators that the institution is in good standing in that other jurisdiction.

Analysis and decision making

42. On the basis of the information collected, the supervisor should assess if the individual meets the requirements of fitness and propriety. Where this information gives rise to doubts about the individual's fitness and propriety, the supervisor should do further research until it is in a position to make a decision. The assessment should be conducted in a timely manner.

Judgmental nature of the assessment

43. It is recognised that the assessment of fitness and propriety may be a judgmental matter and that supervisors may have additional information at their disposal that they can consider on a case-by-case basis. However, any negative decision of the supervisor on the basis of the standard may need to be justified and stand up to independent scrutiny. The supervisor should recognise that, while criminal convictions or past misconduct are significant factors in assessing fitness and propriety of a person, consideration should be given to the lapse of time since the misconduct or conviction, and its severity, as well as the person's subsequent conduct.

Outcome of the assessment linked to specific position

44. An individual considered suitable for a particular position within an institution may not be considered suitable for another position with different responsibilities or for a similar position within another institution, and, conversely, an individual considered unsuitable for a particular position in a particular institution may be considered suitable in different circumstances.

Accumulation of separate instances

45. With respect to the assessment, the supervisor could use a cumulative approach; that is, the supervisor may judge that an individual does not fulfil the criteria on the basis of several instances of such conduct which, if taken separately, might not have led to such a conclusion.

Reassessment

46. A supervisor could decide to reassess the fitness and propriety of an individual if his/her conduct or actions give cause for such a measure.

Impact of business conduct

47. In this respect it should be noted that the business conduct of the insurer could reflect on the performance of all relevant individuals:

- imprudence in the conduct of business, or actions which have threatened the interests of policyholders, will reflect adversely on the competence and soundness of judgement of those responsible;

- failure by an insurer to conduct its business with integrity and professional skills will reflect adversely on the fitness and propriety, competence and soundness of judgement of those responsible. This applies whether the matters of concern have arisen from the way the individuals responsible have acted, or from their failure to act in an appropriate manner.

Changing business conditions, policy and strategy

48. Also, a reassessment may be considered necessary:

- when an insurer changes its policy or strategy for example when it engages in new lines of business, enters new markets or changes its investment practices;
- to verify if the knowledge and experience are still at the required level in view of the size of the insurer or the evolution of its business.

7. Enforcement measures

Supervisory controls in general

49. An effective and comprehensive supervisory regime should include controls designed to encourage the continued satisfaction of the fitness, propriety or other qualification tests by supervisors.

Preventative and corrective measures

50. Supervisors should have at their disposal various measures of a preventative and of a corrective nature in respect of significant owners and key functionaries who do not meet the relevant fitness and propriety or other qualification standards. Such measures could be the authority to:

- prevent appointment of an individual in a position as key functionary by the insurer;
- suspend or dismiss an individual in a position as key functionary with the insurer, either directly or by ordering the insurer to take these measures;
- appoint individuals in a position as key functionary either directly or by ordering the insurer to take this measure to enforce the sound and proper management and control of the insurer;
- withdraw or impose conditions on the business licence, especially in the case of a major breach of fit and proper requirements, either in terms of the impact of the breach or the number of key functionaries involved.

Appeal process

51. An appropriate appeals process should be made available to individuals affected by corrective determinations made against them.

8. Final provisions

52. The cooperation mentioned in this document, whether national, supranational, or cross-sectoral, with law enforcement agencies and financial intelligence units, is subject to regulations on data protection and confidentiality, as far as permitted by international regulations and treaties.

53. It should be noted that, in accordance with the IAIS *Supervisory standard on the exchange of information*, an insurance supervisor should have statutory power or legal authority, at its sole discretion and be subject to appropriate safeguards, to share relevant:

- objective information on individuals holding positions of responsibility in insurers (to include owners, shareholders, directors, managers, employees or contractors);

- objective information on individuals or insurers involved, or suspected of being involved, in criminal activities;
- information on supervisory investigations and reviews, and on any restrictions imposed on the business activities of insurers.

that it has obtained in the course of its own activities.⁴

⁴ IAIS, *Supervisory standard on the exchange of information*, par. 6 and 10; *Insurance core principles and methodology*, core principle no. 5, essential criterion (c) and core principle no. 7, essential criterion (e).

Appendix A: References

References

1. Conference of Insurance Supervisory Services of the Member States of the European Union, *Prudential Supervision of Insurance Undertakings*, 2002.
2. Financial Action Task Force, *The Forty Recommendations*, 2003.
3. IAIS, *Insurance core principles and methodology*, 2003.
4. IAIS, *Supervisory standard on the exchange of information*, 2002.
5. Joint Forum on Financial Conglomerates, *Fit and Proper Principles paper*.