

Fit and Proper Assessment – Best Practice

Final Report



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**EMERGING MARKETS COMMITTEE
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1. Introduction

Based on the *Report on Consultation and Exchange of Information under Fit and Proper Assessments* prepared by the International Organization of Securities Commissions' (IOSCO) Emerging Markets Committee (EMC) Working Group on Enforcement and the Exchange of Information (WG4), the decision was made to prepare a guide to Best Practices as a continuation of the WG4 mandate. The guide's main aim is to reduce the risk that responsible persons of the regulated institutions are not fit and proper for their roles.

The EMC believes that the maintenance of *fit and proper* standards is essential to ensuring that business activities in financial sector are conducted with high standards of market practice and integrity.

The Best Practices are intended to support the members of IOSCO in ensuring that financial institutions are subject to adequate regulations and supervision and that competent authorities take necessary legal or regulatory measures in this matter.

The *fit and proper* assessment is both an initial test undertaken during consideration of an application for licensing or authorization, and also a continuing and cumulative test which takes into account the ongoing conduct of business and the history of compliance with all applicable laws, regulation and codes.

The Best Practices are a framework of minimum voluntary standards for sound supervisory practices and are considered universally applicable. National authorities are free to adopt supplementary measures that they deem necessary to achieve effective supervision in their jurisdiction.

The Best Practices may be read in conjunction with relevant international agreements and national regulations.

1.1 Objectives:

Best Practices are designed to ensure that intermediaries providing financial services are soundly and prudently managed, directed and that none of the key persons may be a source of weakness to those entities. Best Practices may also promote arrangements to facilitate consultation between Financial Regulators on the exchange of information on individuals and regulated institutions, on a case-by-case basis, when requested by other supervisors, to achieve the objective set out above.

1.2 The purpose of the Best Practices is to:

- (a) support the development of a common understanding of what fit and proper assessments involve,
- (b) outline the principles involved in applying fit and proper tests,

(c) indicate good practices in the design and implementation of an effective fit and proper assessment approach.

1.3 Glossary:

“Applicant” means any person subject to fit and proper assessment test,

“Financial Regulator” means an appropriate financial authority,

“Fit & Proper Person” means one who is financially sound, competent, reputable and reliable,

“Key Person” means any person responsible for managing or overseeing, either alone or together with another responsible person, the activities of a licensed provider relating to the rendering of financial services

“Person” means a natural person or an organization with legal rights and duties,

“Proposing Entity” means any entity applying for a license or approval for the Key Person,

“Regulated Activities” means any activities regulated by law,

“Regulated Institution” means any corporation or entity registered under the appropriate law or whose activities require an approval or license granted by the Financial Regulator.

2. Who needs to comply with these Best Practices

The Fit and Proper Best Practices may apply to the regulated institution as a whole and the individuals involved in its management and control, as well as to those who exercise significant power or discharge significant responsibilities in relation to the activities carried on by the business.

A fit and proper assessment should be applied, but not limited, to the following list of Key Persons/Applicants:

- (a) a company, unit trust or limited partnership applying for a license or licensed as an investment fund;
- (b) each director, general partner or trustee, as the case may be, of an investment fund;
- (c) each promoter of an investment fund;
- (d) a person seeking to be approved as a custodian of an investment fund;
- (e) a person seeking to be approved as an auditor of an investment fund;
- (f) a company, firm or other entity applying for a license or licensed as an investment fund administrator;
- (g) each shareholder, beneficial owner and director of an investment fund administrator;
- (h) a company applying for a license or licensed as a clearing agency;
- (i) each shareholder and director of a clearing agency;
- (j) a company, firm or other entity applying for a license or licensed as a securities facility;
- (k) a company applying for a license or licensed as a securities dealer;
- (l) each shareholder, beneficial owner and director of a securities dealer;
- (m) an individual or company applying for a license or licensed as an investment advisor;
- (n) each shareholder, beneficial owner and director of a corporate investment advisor;
- (o) an individual applying for or license as a securities dealer's representative or an investment advisor's representative;
- (p) an insurer;
- (q) an insurance manager;
- (r) an insurance agent;
- (s) an insurance broker;
- (t) a principal insurance representative;

(u) any other key person as determined by the Financial Regulator.

All individuals with the responsibility for the management and control of the business and key persons within the business, must prove and assure the Financial Regulator that they comply with fit and proper test.

3. Fit and proper standards

The Financial Regulator exercises judgment and discretion in assessing fitness and propriety and takes into account all relevant matters including:

1. Competence and capability;
2. Honesty, integrity, fairness, ethical behavior, and
3. Financial soundness;

to ensure that the applicant is not likely to have significant implications for the sound and prudent management of a regulated institution.

The above matters must be considered in respect of the person (if an individual), the corporation and any of its officers (if a corporation) or the institution, its directors, chief executive, managers and executive officers (if an authorized financial institution), for the functions and duties to be undertaken by any of these persons that are involved in any regulated activities.

3.1 Competence and capability

The applicant must show that they are competent to undertake the relevant class of regulated activities including, where appropriate, detailed knowledge of the structure, purpose and risks of the products associated with the activity.

To demonstrate competence, the person involved in carrying out the financial business must act in a knowledgeable, professional and efficient manner, complying with the prevailing regulations. The nature and extent of the competence required will depend upon the services being offered or to be offered.

In determining a person's competence and capability, the Financial Regulator shall have regard to matters including, but not limited to:

- (a) the person has satisfactory past performance or expertise in the nature of the business being conducted;
- (b) the person has an appropriate range of skills and experience to understand, operate and manage the regulated activities/financial affairs;
- (c) the person has the technical knowledge and ability to perform prescribed duties for which they are engaged, especially recognized professional qualifications and membership of relevant professional institutions.

3.2 Honesty, integrity, fairness, ethical behavior

Key persons who are honest, diligent and independent-minded,, who act ethically and with integrity and fairness are essential to the good reputation and trustworthiness of the financial services industry in general and of individual entities in particular.

In determining the honesty, integrity and reputation of the applicant/key person, the Financial Regulator may consider among other things, whether the applicant/key person has been convicted, on indictment, of dishonesty, fraud, money laundering, theft or financial crime within the last 10 years. This may be regarded by the Financial Regulator as an indication that a person is not fit and proper and will, in principle, bar a person from holding a position as the Regulated Person. Where a person has a conviction dating beyond ten years, such information may be notified to the Financial Regulator. Older convictions or indictments will be reviewed by the Financial Regulator in order to adjudicate on the application.

The Financial Regulator may treat each candidate's application on a case-by-case basis taking into account the seriousness of, and circumstances surrounding, the offence, the explanation offered by the convicted person, the relevance of the offence to the proposed role, the passage of time since the offence was committed and evidence of the individual's rehabilitation

3.3 Financial soundness or solvency

In assessing the financial soundness of the key person the Financial Regulator will assess whether the regulated person can maintain solvency and prudent financial control. It includes meeting liabilities as they become due and ensuring adequate control over financial risks on a continuing basis. It also involves taking proper care of customers. Financial soundness is an important element in determining the fitness and probity of applicants.

In determining the financial soundness of the key person (both natural and corporate), the Financial Regulator will consider matters such as, but not limited to:

- (a) whether there are any indicators that the person will not be able to meet its debts as they fall due;
- (b) whether relevant solvency requirements are met;
- (c) whether the person has been subject to any judgment debt or award that remains outstanding or has not been satisfied within a reasonable period;
- (d) whether the person has made arrangements with creditors, filed for bankruptcy or been adjudged bankrupt or had assets sequestered;
- (e) whether the person has been able to provide the Financial Regulator with a satisfactory credit reference.

4. Operation of the test

Fitness, propriety or other qualification tests may be applied at the authorization stage and thereafter, on the occurrence of specified events. The fitness and probity regime primarily fulfills a gatekeeper role ensuring that applicants to the key position have required level of competence and integrity. A properly applied test does not necessarily mean a reduced burden, although it may result in a more effective selection of the Key Person.

4.1 Recruitment/selection

- (a) Proposing the appointment of the key person,
- (b) Financial Regulator expects that the recruitment process of each entity would normally cover the following:
 - (i) Consideration of the duties and responsibilities of the post to be filled;
 - (ii) A selection/appointment process that matches the selected person to the requirements of the post;
 - (iii) Verification of qualifications, experience, references and membership of professional bodies;
 - (iv) Some probity checks, and
 - (v) In relation to directors of larger institutions, how the institution determined that the individual would be a strategic and effective fit with the other members of the Board and that they had suitable relevant experience.

4.2 Submission of necessary documents and forms¹

All applicants must provide all the required documents and forms as listed in Appendix A. Where applicants have been approved by financial services regulators in third countries, the proposing entity may contact the relevant department in the Financial Regulator to ascertain whether these approvals will have equal status as national approvals.

4.3 Verification of information by Proposing Entity

The Proposing Entity should verify the information necessary in its opinion to establish that the Applicant has the experience necessary and is capable of fulfilling the designated role and that there are no issues arising from the material that would cause the entity to reconsider its proposal to appoint the person. The Proposing Entity should then carry out checks on the information to ensure its accuracy.

By signing the declaration² the Proposing Entity confirms that it is prepared to proceed with the appointment, which confirms the Proposing Entity has verified to the best of its ability the information in the completed forms and is seeking approval of the proposed appointment.

¹ See Appendix A for the list of documents that may be submitted to the Financial Regulator for use in fit and proper assessments.

² To be specified by the Financial Regulator, see Appendix B

4.4 Determination by the Financial Regulator

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 Institution. It is recognized 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.

4.5 Appointment

In principle, no appointments may be made until the Financial Regulator has been assured that the proposed person is suitable and valuable for the entity. The fit and proper process can be time-consuming, particularly where checks with third parties, such as foreign regulators are involved. The Financial Regulator will endeavor to reach a decision as soon as possible.

Interim appointment may be made without a full fit and proper assessment for a period of up to 90 days including any prior period of interim appointment. Prior to making such an appointment, reasonable steps must be taken, as specified in the Best Practices, to assess the fitness and propriety of the person. The regulated company must complete a full fit and proper assessment prior to appointing the person to the key person position on a permanent basis.

5. Continuing requirements of F&P standards

5.1 Fitness

The Key Person will be expected to remain competent for the positions they hold. Failure to maintain appropriate qualifications or memberships, where they are relevant, would raise doubts about the person's continuing fitness and would have to be reviewed by the Proposing Entity and by the Financial Regulator.

The Person's character, competence and experience relative to the duties involved, including if the person:

1. has sufficient skills, knowledge, competence, diligence and soundness of judgment to undertake and fulfill the particular duties and responsibilities of the position in question; and
2. has demonstrated the appropriate competence and integrity in fulfilling professional responsibilities previously during his/her career.

5.2 Probity

Probity is an issue not just at the moment of appointment, but on an ongoing basis. Industry professionals are expected to be in full compliance with their contract of employment. This would include adherence to the entity's internal code of ethical behavior.

Where there has been wrongdoing, the Regulated Institution may make all reasonable efforts to establish grounds for taking disciplinary action and where appropriate take the action. In any case, where such matters come to light, they may be reported immediately to the Financial Regulator.

Person is not proper whenever he/she:

- 1) has demonstrated a lack of willingness to comply with legal obligations, regulatory requirements or professional standards, or has been obstructive, misleading or untruthful in dealing with regulatory bodies or a court;
- 2) has breached a fiduciary obligation;
- 3) has perpetrated or participated in negligent, deceitful, or otherwise discreditable business or professional practices;
- 4) has been reprimanded, or disqualified, or removed by a professional or regulatory body in relation to matters relating to the person's honesty, integrity or business conduct;
- 5) has seriously or persistently failed to manage personal debts or financial affairs satisfactorily in circumstances where such failure caused loss to others;
- 6) has been substantially involved in the management of a business or company which has failed, where that failure has been occasioned in part by deficiencies in that management;
- 7) is of bad repute in any business or financial community or any market; or

- 8) was the subject of civil or criminal proceedings or enforcement action, in relation to the management of an entity, or commercial or professional activities, which were determined adversely to the person (including by the person consenting to an order or direction, or giving an undertaking, not to engage in unlawful or improper conduct) and which reflected adversely on the person's competence, diligence, judgment, honesty or integrity.

6. Whistleblowing

Whistleblowing is an important mechanism in prevention and detection of improper conduct, fraud and corruption. The organization should implement an appropriate policy in its organizational structure which shall raise awareness of the whistleblowing process which is available to raise concerns about improper conduct within the organization. The process includes reporting concerns over Key Person fitness and propriety to the CEO (or equivalent) or to Financial Regulator without the risk of reprisal and detrimental actions. The policy shall outline the mechanisms for the protection of employees who make such a disclosure and the strategies implemented to address issues such as reporting, responsibility and confidentiality.

7. Information sharing

Financial regulators, designated competent authorities and law enforcement agencies should be able to share information and feedback on results and identified vulnerabilities, so that consistent and meaningful inputs can be provided to the private sector. All parties shall consider the domestic legislation on data protection in order to prevent the data from disseminating in contravention of applicable laws and regulations.

It is also desirable that Financial Regulators exchange and obtain information that may be valuable to help in prudential supervision. To be productive, information exchanged between the financial regulators should be developed by means through which this information might be shared in a timely and effective manner.

Each Financial Regulator should have general statutory authority to share its own supervisory information with foreign supervisors, in response to requests, or when the supervisor itself believes it would be beneficial to do so. Financial Regulators should have the authority to share objective information about Key Persons on the same rules as they share information about firms and other entities.

To facilitate cooperation between Financial Regulators, the IOSCO Multilateral Memorandum of Understanding (MMoU) concerning Consultation, Cooperation and the Exchange of Information should be utilized.

8. Conclusions

Best Practices are designed and intended to be in place to ensure that supervisors are aware, at the authorization stage, of managers, directors and shareholders who can exert a material influence, directly or indirectly, on the operations of Regulated Institutions, and thereafter, are notified of changes regarding the positions of managers, directors and shareholders, on the occurrence of specified events.

Financial Regulators' expectations are that these entities will take the measures necessary to ensure that fitness, propriety or other qualification tests are met on a continuous basis.

APPENDIX A

Documents to be submitted on application

1. On application, or as otherwise requested, the following documents may be submitted to the Financial Regulator to facilitate the assessment of the fitness and propriety of persons:
 - a) Personal Questionnaire and Declaration form;
 - b) An updated, signed Curriculum Vitae;
 - c) A Certificate of Good Character or Conduct from the relevant authority of the relevant jurisdiction;
 - d) Criminal Record (if applicable); and
 - e) Any other document that the Financial Regulator deems necessary.

2. In the case of the corporations, the following documents may be submitted:
 - a) Corporate Questionnaire and Declaration form;
 - b) Copy of the company's Memorandum of Association and Articles of Association or Articles of Incorporation or Continuance and By-Laws or other instrument of incorporation and certificate of incorporation;
 - c) Copies of audited financial statements of the company concerned, for three consecutive years immediately preceding its application or for each year it has been in operation, if less than three years; and
 - d) Any other document that the Financial Regulator deems necessary.

APPENDIX B

The fit and proper assessments should be performed preferably with the use of a standardized and comprehensive checklist. The responsible unit and staff members should maintain clear audit trails and supporting documents on the assessment of every proposed relevant individual or entity, the results, the follow-up actions on any irregularities found, and the identity of the assessor and the approver. The assessment should be approved by an independent reviewer at a reasonable level of seniority.