



South African Reserve Bank
Prudential Authority



Statement* of the need for, expected impact and intended operation of a regulatory instrument:

Joint Standard on fit and proper person requirements for significant owners of financial institutions

23 July 2019

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1 Introduction

1.1 In terms of section 98 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSRA), a financial sector regulator must not make a regulatory instrument¹ unless it has published the following documents:

- (i) a draft of the regulatory instrument;
- (ii) a statement explaining the need for and the intended operation of the regulatory instrument;
- (iii) a statement of the expected impact of the regulatory instrument; and
- (iv) a notice inviting submissions in relation to the regulatory instrument, stating where, how and by when submissions are to be made.

1.2 In fulfilment of the above-mentioned requirements, the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA) (collectively referred to as the Authorities) have prepared a statement of the need for, intended operation and expected impact of the draft Joint Standard on fit and proper person requirements for significant owners (Statement).

1.3 The Statement takes into account industry feedback received in response to the impact questionnaire that was published with the previous version of the draft Joint Standard on 16 November 2018.

2 Statement of the need — context and definition of policy problem

2.1 One of the key elements of the governance framework of financial institutions is the role of significant owners. This is in light of their ability to control and materially influence the business and strategy of a financial institution. Significant owners have a responsibility in ensuring that a financial institution is prudently run, profitable and that it delivers fair outcomes to financial customers and the stability of the financial system at large.

2.2 The financial sector reform that saw the implementation of the Twin Peaks model of financial sector regulation recognises the importance of significant owners of financial institutions and requires significant owners to be fit and

¹ For the purpose of this Statement, this refers to a Joint Standard

proper — have necessary integrity, competence and financial resources to support the business.

- 2.3 On one hand, failure of a financial institution, and more particularly a systemically-important one, can trigger a systemic crisis which can cause disruption to the smooth functioning of the entire financial system. This could also impact on the wider economy as was demonstrated during the global financial crisis. On the other hand, failure by a financial institution to treat its customers fairly can also lead to poor consumer outcomes.
- 2.4 In order to avoid disruptions to the financial system from poor management of a financial institution as well as poor treatment of customers, it is of paramount importance that significant owners and those running financial institutions are fit and proper. This will enable them to exercise sufficient oversight, in respect of both prudential and market conduct risks over the financial institutions of which they are significant owners.
- 2.5 Fit and proper significant owners should also be in a position to inject more capital into the financial institution, more so in the event of a run or liquidity crisis.
- 2.6 The requirement for approval by the PA of a person ceasing to be a significant owner set out in FSRA is aimed at ensuring that there is an orderly disinvestment by significant owner(s) from a financial institution(s). This is even more important particularly in the event of a financial institution of which a person is a significant owner facing liquidity and other financial challenges, where a disorderly exit by a significant owner(s) can even exacerbate the safety and soundness of such an entity.
- 2.7 In light of the important role and influence of significant owners on the business and strategy of financial institutions, significant owners must have the necessary qualities, competencies, experience and financial standing to execute their responsibilities and exercise their influence on a financial institution in the most effective manner. This includes making decisions that are in the best interest of the financial institution and its customers. Market participants and the public at

large also need to be confident that significant owners of financial institutions are fit and proper.

2.8 The Authorities have a mandate to ensure that financial institutions are safe and sound and that they treat their customers fairly. The proposed Joint Standard will assist the Authorities in achieving their regulatory objectives.

2.9 Section 159(1) of the FSRA requires financial sector regulators to make standards that must be complied with by significant owners of financial institutions with respect to 'fit and proper person' requirements.

2.10 In addition, the financial sector regulators are required, in terms of section 159(1)(b) of the FSRA to make joint standards specifying what constitutes an increase or a decrease in the extent of the ability of a person, alone or together with a related or inter-related person, to control or influence materially the business or strategy of a financial institution. This requirement furthermore provides for a trigger point for the Authorities to assess the ability of a person seeking to increase their extent of influence to meet applicable fit and proper requirements.

2.11 Fit and propriety requirements of significant owners in the Joint Standard will apply to significant owners of all financial institutions unless specifically exempted. In addition, the Joint Standard must be read with the requirements of the FSRA related to approval or notification, as the case may be, in respect of a person becoming or ceasing to be a significant owner of an eligible financial institution or manager of a collective investment scheme.

2.12 The Joint Standard specifies what constitutes an increase and decrease in the extent of the ability of a person, alone or together with a related or interrelated person to control or influence materially the business or strategy of a financial institution.

2.13 The regulation of direct and indirect significant owners, specifically in respect of licensing, acquisitions, disposals and transfers, is not new to the South African regulatory landscape — particularly in respect of banks, insurers, market infrastructures, managers of collective investment schemes, and controlling

companies of banks and insurers. However, the South African regulatory landscape has not consistently defined what constitutes significant ownership of financial institutions or established consistent requirements for the fitness and propriety of significant owners.

2.14 As stated above, while the regulation of significant owners is not new to the South African regulatory landscape, the FSRA introduces the following changes:

- going forward reference will be made to significant owners of financial institutions as opposed to “persons controlling financial institutions”;
- the criteria for qualifying as a significant owner is extended to, among other things, include persons who have the ability to dispose of or control the disposal of at least 15 per cent of the financial institution’s securities, voting or other similar rights; and
- requirements for regulatory approval or notification if a person no longer qualifies as a significant owner.

2.15 Significant owners of financial institutions are in a position to influence critical decisions and affairs of a financial institution. They must therefore be persons with integrity, good reputation and of a sound financial position in order to minimise risks that could threaten the:

- safety and soundness of the financial institution;
- efficiency and integrity of financial markets;
- ability of the financial institution to meet its obligations to its financial customers; and
- delivery of fair outcomes to financial customers.

2.16 In order for the Authorities to meet the obligations placed on them by virtue of section 159(1) of the FSRA, and to establish a consistent framework for fit and proper person requirements for significant owners across the different financial institutions, a draft Joint Standard is being proposed.

2.17 The Standards required in terms of section 159 of the FSRA, which have been developed jointly by the PA and FSCA, draw together a number of prescripts contained in various financial sector laws and establish a clear and consistent

fitness and propriety framework for significant owners across all persons and financial institutions to whom the standard applies.

3 Objectives of the proposed Joint Standard

The draft Joint Standard is intended to address the following:

- fit and proper person requirements for significant owners of financial institutions;
- parameters of what constitutes ‘an increase or a decrease in the extent of the ability of the person, alone or together with a related or inter-related person, to control or influence materially the business or strategy of the financial institution’; and
- amend Prudential Standard GOI 4: *Fitness and Propriety of Significant Owners and Key Persons of Insurers (GOI 4)* made by the Prudential Authority under the Insurance Act, 2017 by deleting the term ‘significant owner’ wherever it appears as well as repealing sections of the Prudential Standard.

4 Approach taken by the Authorities on the Joint Standard

- 4.1 In conceptualising the fit and proper person requirements of the draft Joint Standard, care was taken to include only those requirements that are regarded as essential minimum requirements that must be met by significant owners.
- 4.2 The draft Joint Standard provides for the proportional application of the requirements by allowing financial institutions and the financial sector regulators to take into account the nature and scope of the significant owner’s business, and the structure of any group of companies of which the significant owner is part of, when assessing fitness and propriety.
- 4.3 The draft Joint Standard proposes that any increase or decrease in excess of 5 per cent in the interest (securities, voting and other similar rights) that affects the significant ownership of a person, constitutes an “increase or a decrease in the extent of the ability of the person, alone or together with a related or inter-related person, to control or influence materially the business or strategy of the financial institution” for purposes of sections 157(1) and 158(4) of the FSRA.

- 4.4 In developing the draft Joint Standard the existing domestic regulatory landscape was considered, specifically existing requirements provided for in GOI 4 made in terms of section 63 of the Insurance Act, 2017 (Act No 18 of 2017) and Notice 910 of 2010: Determination for Fit and Proper Requirements and Conditions for Managers of Collective Investment Schemes made under the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002) (CISCA).
- 4.5 The making of the draft Joint Standard under section 159 of the FSRA requires the amendment of GOI 4 to be in line with the Joint Standard. The requirements relating to significant owners under GOI 4 will be repealed.
- 4.6 The draft Joint Standard applies to significant owners of all financial institutions, unless otherwise exempted. Given the size and complexity of some of the institutions (e.g. financial services providers other than a CIS) as well the practicality to comply with the Joint Standard in view of the nature and structure of ownership which is member-based (e.g. pension funds, cooperative banks), the Authorities propose to exempt significant owners of financial institutions in table 1. The rationale for the exemption of significant owners of each of the financial institutions in table 1 from the requirements of the Joint Standard is set out in column 2 of the table.

Table 1: Financial institutions whose significant owners will be exempted from the requirements of the Joint Standard

Type of financial institution	Rationale for not including these institutions in the scope of the statement and draft Joint Standard
Pension Funds and Friendly Societies	These financial institutions are member-based institutions. They do not have significant owners within the meaning of the FSRA.
Co-operative Financial Institutions (CFIs), Co-operative Banks and Insurers that are co-operatives	These financial institutions are member-based institutions. These financial institutions must be co-operatives registered under the Co-operatives Act. They do not have significant owners within the meaning of the FSRA.
Financial service providers ²	These financial institutions vary significantly in nature, scope, size, complexity and the type of services provided. Further work on appropriate fit and proper person requirements best suited for these types of financial institutions will be undertaken. Once this work is completed significant owners of financial service providers, or specific types of financial service providers, might be included in the standard.

² Other than financial service providers that are eligible financial institutions or managers of collective investment schemes.

Credit rating agencies	Further work is required in order to determine to what extent it is practical and feasible to place fit and proper requirements on significant owners of credit ratings agencies.
Branches of foreign reinsurers and Lloyd's or Lloyd's Underwriters referred to in the Insurance Act, 2017 (Act No. 18 of 2017), and branches of foreign institutions referred to in the Banks Act, 1990 (Act No. 94 of 1990)	Branches are not legal entities separate from the foreign reinsurers or institutions, but are operating entities of the foreign reinsurers or institutions located in the Republic of South Africa.

5 Consultation

5.1 On 16 November 2018 the Authorities released the *'draft Joint Standard on Fit and Proper Person Requirements for Significant Owners'* for public comment, together with a questionnaire to solicit for industry input on the expected impact of the draft Joint Standard.

5.2 The following key concerns were raised in respect of the draft Joint Standard:

- the practicality and reasonableness of the fact that the requirements in the Standard, which relates to significant owners, apply directly to the financial institution and not the significant owner;
- requirement for annual assessment or reviews of fitness and propriety of significant owners;
- requirement for compliance assurance by external auditors;
- definition of "significant owner"; and
- application of the draft Joint Standard to credit ratings agencies and significant owners of credit ratings agencies.

5.3 The Authorities have carefully considered the comments received and consequently made material revisions to the draft Joint Standard as discussed below:

Direct application of requirements on financial institutions

5.4 The Authorities recognise that the direct application of the requirements of the draft Joint Standard on financial institutions as opposed to applying the requirements to their significant owners creates practical challenges.

5.5 The Authorities also recognise the limitations surrounding the controlling body's ability to influence or exert power in relation to its ownership.

5.6 For this reason the draft Joint Standard has been amended to place most of the requirements directly on the significant owner, and not on the financial institution. The only requirements that are proposed to be placed directly on the financial institution are specific reporting requirements.³

Annual assessment or reviews of fitness and propriety of significant owner

5.7 Various concerns were raised regarding the requirement that a financial institution must annually review the fitness and propriety of significant owners, which were cited as onerous.

5.8 These concerns around financial institutions having to review the fitness and propriety of significant owners on an annual basis are now irrelevant given that the requirements of the draft Joint Standard no longer apply directly to the financial institutions.

Assurance by external auditors

5.9 Questions were asked regarding what providing "assurance" in the context of the draft Joint Standard means.

5.10 The draft Joint Standard has been amended to require, upon request from an Authority, confirmation by an independent party (as determined by the Authority) on any matters related to compliance of the significant owner or financial institution with the Joint Standard, in the manner and form determined by the Authority.

5.11 Further detailed responses to the submissions received during the initial consultation process are contained in the comments matrix published together with this Statement and the draft Standard.

Definition of "significant owner"

5.12 Another key concern raised was that the definition of a "significant owner" is extremely broad and that it is unclear who will be captured in the definition. This

³ See sections 4.2 and 4.3 of the draft Joint Standard.

issue was specifically raised in the context of applying the look-through principle in the investment funds environment, including issues relating to beneficial ownership.

5.13 It was argued that the consequence of the definition as mentioned above, and the fact that the draft Joint Standard places various requirements on the financial institution itself, results in various significant practical challenges that have the potential of severely disrupting the industry.

5.14 The Authorities acknowledge and agree, to some extent, with the concerns raised. This is also one of the reasons why the draft Joint Standard has been repositioned to predominantly place the requirements on the significant owner and not on the financial institution itself. The Authorities believe that this repositioning will alleviate a lot of the practical issues that have been raised.

5.15 Furthermore, the Authorities are of the view that the rest of the concerns predominantly relate to the definition of a significant owner as defined in the FSRA. Apart from defining a significant owner, the FSRA also places certain requirements on significant owners, including requirements relating to approvals and notification. It must be noted that concerns relating to the aforementioned requirements contained in the FSRA cannot be addressed through the draft Joint Standard which is subordinate legislation.

5.16 Further comments on this this issue and the extent to which the revised draft Joint Standard has addressed the concerns raised are welcomed.

Application of the draft Joint Standard to credit ratings agencies and significant owners of credit ratings agencies

5.17 Concerns were raised by various credit rating agencies regarding the fact the draft Joint Standard is proposed to apply to credit rating agencies and significant owners of credit rating agencies. It was argued that this would not be in line with international standards and also creates practical issues as many credit rating agencies are merely branches of foreign listed companies.

5.18 The Authorities have changed its approach and significant owners of credit rating agencies will now be excluded from the application of the draft Joint

Standard until further work has been performed to determine to what extent it is practical and feasible to place fit and proper requirements on significant owners of credit ratings agencies.⁴

6. Statement of expected impact – Costs and benefits of the Joint Standard

Cost and resource implications

- 6.1 The repositioning of the draft Joint Standard as well as proposed amendments to the GOI 4, as discussed above requires significant owners to have administrative procedures for assessing and attesting their fitness and propriety in accordance with the requirements of the Joint Standard. Financial institutions are required to notify the Authorities within 30 days of becoming aware of significant ownership or any non-compliance with the Standard by a significant owner. This is expected to place an administrative burden on significant owners and financial institutions.
- 6.2 The draft Joint Standard may also adversely impact significant owners that are currently not adequately resourced to support the business of the financial institution in which they are a significant owner. While the draft Joint Standard may potentially result in increased ongoing compliance costs, the Authorities are of the view that these additional costs are justified given that the prudent and responsible management of financial institutions is dependent on the fitness and propriety of persons that influence critical business decisions of financial institutions. Fit and proper significant owners are essential and in the best interest of the financial entity, financial customers and the overall financial regulatory outcomes.

Expected benefits of the Joint Standard

- 6.3 The draft Joint Standard is expected to yield enhanced oversight and governance of financial institutions given that significant owners must demonstrate competence and ability to understand the business, risks inherent and high level management processes required to effectively run a financial institution.

⁴ Also see Table 1 in paragraph 4.6 above and the draft Exemption Notices.

6.4 Fitness and propriety of significant owners is linked to financial standing among other considerations. A significant owner must be able to demonstrate financial capacity to contribute to the safety and soundness of a financial institution and protection of the interests of depositors and other stakeholders. Safety and soundness of particularly systemically-important financial institutions will assist in reducing systemic risk and generally, public trust and confidence in the financial sector.

6.5 The Joint Standard applies to all financial institutions, unless otherwise exempted. This will ensure that the assessment and attesting of fit and propriety will be consistent across the financial institutions regulated by the PA and the FSCA.

7 Statement of intended operation — Implementation and evaluation

7.1 The Joint Communication issued by the PA and the FSCA on 11 March 2019 stated that Chapter 11 of FSRA came into effect on 1 January 2019 and taking into consideration the status of the draft Joint Standard, changes in significant ownership need to be notified to the Authorities and will be considered on a case-by-case basis in line with the relevant provisions of the FSRA until the Joint Standard comes into effect.

7.2 The draft Joint Standard is intended to become effective on 1 January 2020 or as soon as practically possible thereafter. However, it is recognised that transitional arrangements may be required to facilitate the effective implementation of the draft Joint Standard. The Authorities will advise the industry accordingly.

7.3 The draft Joint Standard applies to significant owners of financial institutions. However, significant owners of some identified financial institutions will specifically be exempted from the requirements of the draft Joint Standard in terms of draft Exemption Notices to be issued by the Authorities in conjunction with the Joint Standard.

7.4 The Banks Act, 1990 and the Financial Markets Act, 2012 (Act No. 19 of 2012) provide for the Minister of Finance to approve certain transactions relating to

significant owners. This is not inconsistent with the FSRA. The FSRA applies concurrently with the above-mentioned Acts. This means that from 1 October 2019, the PA or the FSCA, as the case may be, will approve significant owners in accordance with the FSRA and the relevant financial sector laws, and where Minister's approval is required under the financial sector laws, the application will be forwarded to National Treasury for the Minister's approval.

7.5 The Joint Standard is proposed to amend GOI 4: Fitness and Propriety of Significant Owners and Key Persons of Insurers made by the PA in terms of the Insurance Act by deleting the term 'significant owner' wherever it appears in GOI 4 and repealing section 7.

7.6 Following the implementation of the draft Joint Standard, the Authorities will assess and evaluate the effect of the draft Joint Standard on a continuous basis as part of the Authorities' supervisory responsibility to ensure that any unintended consequences of the Joint Standard on the industry are adequately addressed.

8 Conclusion

The draft Joint Standard and this Statement are prepared and published in terms of section 98 of the FSRA, taking into consideration all submissions received during the initial public consultation process. Subsequent to the consultation process, the Authorities will update the draft Joint Standard and this Statement accordingly. The draft Joint Standard and the accompanying documents will be submitted to Parliament for a period of at least 30 days while Parliament is in session before the Joint Standard is subsequently made.