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Prudential Standard GOI 1

Framework for Governance and Operational Standards for Insurers

Objectives and Key Requirements of this Prudential Standard

This Standard sets out the high-level framework for assessing the governance and operational soundness of South African insurers from a regulatory perspective. The principles set out in this Standard are supported by detailed Standards and Attachments that address particular aspects of the framework (collectively the Governance and Operational Standards for Insurers).

It is the responsibility of the board of directors of an insurer to ensure that the insurer meets the governance and operational requirements on a continuous basis.

The cornerstones of the framework are good governance and effective risk management. The Governance and Operational Standards highlight the Prudential Authority's expectations in terms of good governance, and set down minimum requirements for governance, from board structures through to the allocation of roles and responsibilities within an insurer. Since insurers absorb risk from the economy, it is essential they manage those risks professionally and prudently. The Governance and Operational Standards also establish the Prudential Authority's minimum requirements for an insurer's approach to risk management and control.

Other areas addressed in the Governance and Operational Standards include fitness and propriety, management of outsourcing, business continuity, and transfers of business. The Standards also address certain miscellaneous regulatory requirements provided for in the Insurance Act, 2017.

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1. Application

- 1.1. This Standard and the full set of Governance and Operational Standards apply to all insurers licensed under the Insurance Act, 2017 (the Act), other than microinsurers, Lloyd's and branches of foreign reinsurers.¹ The application of these Standards to insurance groups that have been designated as such by the Prudential Authority under section 10 of the Act is addressed in a separate standard, GOG (Governance and Operational Standard for Insurance Groups).
- 1.2. Unless otherwise indicated, all references to "insurer" in this Standard can be read as a reference to life insurers, non-life insurers and reinsurers.

2. Roles and Responsibilities

- 2.1. An insurer's board of directors is ultimately responsible for ensuring that the insurer complies with the principles and requirements of this Standard and all related Governance and Operational Standards.
- 2.2. Where required to do so by a particular Standard, an insurer's control functions must regularly review and report to the board of directors on the insurer's compliance with the particular Standard.
- 2.3. If requested to do so, an insurer's auditor must provide assurance to the insurer and the Prudential Authority, that the insurer complies with the requirements of this Standard and all related Governance and Operational Standards or a part thereof.

3. Commencement and Transition Provisions

- 3.1. This Standard commences on 1 July 2018.

Version Number	Commencement Date
1	1 July 2018
<u>2</u>	<u>1 December 2020 – as amended by Joint Standard 1 of 2020 – Fitness, propriety and other matters relating to significant owners</u>

4. Principles underlying Governance and Operational Requirements for Insurers

- 4.1. Insurers perform an essential function in the South African financial system, economy and broader community. By absorbing risks, they enable individuals and businesses to mitigate the impact of the many adverse events to which they are exposed.
- 4.2. Risk pooling is not without its dangers. Well-managed insurers enhance individual and systemic stability by acting as a cushion against adverse events. But risk pooling also concentrates risk. Poorly managed insurers may not survive adverse events, thereby re-exposing the public to the risks they believed had been transferred.
- 4.3. It is therefore essential that insurers manage their businesses professionally and

¹ Governance and Operational Standards for microinsurers, Lloyds and branches of foreign reinsurers are addressed separately.

prudently.

- 4.4. The Financial Soundness Standards for Insurers provide the first pillar of regulatory assurance around the capacity of insurers to meet their financial promises. The Governance and Operational Standards provide a second pillar of regulatory assurance, aimed at ensuring insurers maintain a minimum standard of sound governance and prudent business management.
- 4.5. The Governance and Operational Standards focus on the following main areas for insurers:
- a) governance;
 - b) risk management and internal controls;
 - c) fitness and propriety of key persons² responsible for critical functions and activities within an insurer's business, **and significant owners**³;
 - d) oversight of outsourcing arrangements;
 - e) controls around transfers of business from one insurer to another and other significant transactions; and
 - f) miscellaneous regulatory requirements provided for in the Act.

5. Governance

- 5.1. Good governance is the foundation of prudent business management by an insurer. Strong governance arrangements provide effective oversight of the way in which an insurer operates its business and manages its risks. The governance requirements in this standard build on and complement the requirements in the Companies Act, 2008.
- 5.2. Strong governance arrangements include, but are not limited to:
- a) clear assignment of roles and responsibilities, including documentation, monitoring and accountability for delegations;
 - b) clarity around decision making, including ensuring that decision makers have the necessary powers and information to support their responsibilities, and appropriate accountability for the decisions they make;
 - c) incentive arrangements that support sound and prudent decision making;
 - d) well-documented policies and procedures that establish how the business should operate;
 - e) clear and reliable mechanisms for escalating breaches of internal policies and procedures to senior management and the board of directors, and breaches of the Governance and Operational Standards to the Prudential Authority; and
 - f) clear protocols to ensure all regulatory matters are properly prioritised and communicated consistently and accurately to the Prudential Authority.
- 5.3. To be effective, strong governance arrangements need to be supported by the insurer's corporate culture, which reflects the commonly held beliefs and values of the individuals who carry out the business of the insurer. Effective culture is closely aligned with the objectives and values of the insurer, as defined and implemented by the insurer's board of directors. An effective culture is one in which individuals feel comfortable, and are protected, when raising difficult issues, challenging the status

² The concept of key person is defined in section 1 of the Act. In essence, a key person is someone who participates in or influences decision making that affects the business of the insurer, or who has the capacity to affect significantly the financial standing of the insurer.

³ Significant owners are also defined in section 1 of the Financial Sector Regulation Act, 2017. In essence, significant owners are persons who, individually or collectively, have the ability to control or influence materially the business or strategy of the insurer.

quo, and calling out breaches of the insurer's governance framework.

- 5.4. Good governance starts with the board of directors and senior management. GOI 2 (Governance of Insurers) establishes minimum requirements for the structure and operation of an insurer's board of directors and how roles and responsibilities should be allocated between the board and senior management. Governance of the risk management system is addressed in GOI 3 (Risk Management and Internal Controls).

6. Risk Management and Internal Controls

- 6.1. Insurers are exposed to a multiplicity of risks, both financial and non-financial. Effective risk management is critical to an insurer being able to honour its promises to its policyholders.
- 6.2. The Prudential Authority's approach to regulating risk management by insurers (see GOI 3 (Risk Management and Internal Controls for Insurers)) has four main components:
 - a) An insurer's board of directors is required to establish an enterprise-wide risk strategy for the insurer. The risk strategy sets out the types of risks that the insurer is willing to retain in implementing its business plan / business objectives, and the way in which it will manage those risks. While insurance risks are central to an insurer's risk retention, other financial and non-financial risks can be just as important to the prudent management of the insurer. A key component of the risk strategy is the insurer's board-approved risk appetite statement, which sets out the overall level of risk the insurer is prepared to accept and the articulation down of that overall limit into granular risk limits on different material risk categories, activities, and business units, where appropriate.
 - b) An insurer is required to implement a risk management system that enables it to identify, assess, monitor, report on, and mitigate the material risks to which it is exposed.
 - c) An insurer is required to implement an effective system of internal controls to ensure that the strategies, policies, and processes approved by the board of directors are in fact in place, observed, and effective in assisting the board of directors and senior management in fulfilling their respective responsibilities for oversight and management of the insurer.
 - d) To provide appropriate governance over the risk management system and system of internal controls, an insurer is required to establish a risk governance structure including at least the following control functions: a risk management function, a compliance function, an internal audit function, and an actuarial function.

7. Fitness and Propriety

- 7.1. Prudent business management is heavily dependent on the suitability of individuals who make the critical business decisions for the insurer. Persons who are responsible for the management and oversight of an insurer need to have appropriate skills, experience and knowledge. These skills and qualities strengthen the protection afforded to policyholders and other stakeholders.
- 7.2. The concept of fitness and propriety takes a broad view of suitability. Competence, including formal qualifications, skills and practical experience, is critical. But so too is integrity; without integrity, business decisions may fail to reflect the desired culture of the insurer and fail to meet the minimum standards set by the Prudential Authority.

- 7.3. Prudent business management requires that an insurer establish mechanisms to ensure that the key persons who are responsible for the key functions and activities of the insurer are fit and proper for their roles.
- 7.4. Prudent business management of an insurer also depends on the suitability of its owners. Where an insurer has one or more significant owners, the risks arising from unsuitability are accentuated. When applied to the significant owners of an insurer, the concept of fitness and propriety includes integrity and financial resources. The latter arises from the potential need, under certain circumstances, for significant owners to support the insurer's business with additional financial resources.
- 7.5. The Prudential Authority requires insurers to have, and to implement, a board-approved policy and related procedures for testing the fitness and propriety of its ~~significant owners and~~ key persons. GOI 4 (Fitness and Propriety of Key Persons and ~~Significant Owners~~ of Insurers) sets out the minimum requirements for an insurer's fit and proper policy and procedures.
- 7.6. While responsibility for maintaining the fitness and propriety of ~~significant owners and~~ key persons resides primarily with the board of directors of an insurer, under Chapter 3 of the Act, the insurer must seek the Prudential Authority's approval for individuals or firms before they become significant owners, directors, or auditors.⁴

8. Outsourcing

- 8.1. Outsourcing of some activities is a growing part of any modern business. In many instances, specialised external providers can offer a level of service that businesses cannot replicate internally. Outsourcing can be both cost effective and quality enhancing.
- 8.2. Insurers are licensed to provide critical financial services, partly on the basis of the Prudential Authority's assessment of their specialised capacity to deliver these services effectively and prudently. While outsourcing of certain general functions may improve the efficiency of an insurer, outsourcing of its core functions runs contrary to the essence of prudential licensing and therefore requires close consideration by the insurer and the Prudential Authority.
- 8.3. The basic principle of outsourcing by an insurer, as set out in GOI 5 (Outsourcing by Insurers), is that the insurer retains responsibility for all regulatory obligations, regardless of whether or not an activity or function is outsourced. Therefore, the outsource arrangement must provide the Prudential Authority with the same visibility over regulated activities as it has with the insurer. It also means the insurer must have appropriate oversight of the person who provides the outsourced activities or functions, so as to ensure that the insurer's regulatory compliance is not impaired.
- 8.4. GOI 5 (Outsourcing by Insurers) sets down three general sets of standards for outsourcing by insurers, namely:
- a) circumstances in which an insurer may not outsource a function or activity, such as where the outsourcing may impair the insurer's operational soundness or ability to monitor its compliance with its legal and regulatory obligations;
 - b) circumstances in which an insurer must notify the Prudential Authority before entering into an outsource arrangement for a material activity; and

⁴ See sections 17(3) and 14(1)(a) of the Act respectively for approval of significant owners and key persons respectively.

- c) matters that must be considered in any outsource arrangement, including avoiding conflicts of interest, the fitness and propriety of the person who performs the outsourced activity, and contractual considerations.

9. Transfers of Business and other Significant Transactions

- 9.1. The licensing of an insurer is an intensive process that requires the Prudential Authority to understand and assess the insurer's financial and operational soundness. The licence is based on continuous updating of that understanding and assessment through the supervisory process. Any major changes to an insurer's business, resources, or ownership are grounds for reconsidering the validity of the insurer's licence. Of particular concern are situations in which an insurer proposes to transfer all, or a part, of its balance sheet to another insurer, and other significant transactions, such as a fundamental transaction or compromise as contemplated in the Companies Act, or a change to the insurer's corporate form (such as conversion from a co-operative to a company, or changing the type of person from that which the insurer was on the date it was licensed as an insurer).
- 9.2. The basic principle underlying the Prudential Authority's approach to transfers of business and other significant transactions, as set out in section 50 of the Act, is that an insurer must not enter into such a transaction without the prior approval of the Prudential Authority. The purpose of requiring approval is so that the Prudential Authority can assess whether or not the proposed transfer could impair the insurer's (or the acquirer's) financial soundness, or impact negatively on the interests of policyholders.
- 9.3. GOI 6 (Transfers of Business and Other Significant Transactions by Insurers) sets out the information that must be provided by an insurer in order to have the Prudential Authority consider its request, and the process that the review will follow. The Standard also sets out the actions that the Prudential Authority may take.

10. Miscellaneous Regulatory Requirements

- 10.1. The Act provides for the Prudential Authority to prescribe certain matters with respect to the operation of insurers. These are set out in GOI 7 (Miscellaneous Regulatory Requirements for Insurers), which addresses the following matters:
 - a) Excluded business - section 5(8)(a) of the Act enables the Prudential Authority to prescribe that certain types, kinds or categories of insurance business are exempted from the application of the Act.
 - b) Registration of shares in the name of nominees - section 18 of the Act provides that the Prudential Authority may prescribe circumstances under which an insurer that is a profit company registered under the Companies Act, 2008, need not require prior approval from the Authority in order to allot, issue, or register a transfer of any of its shares, to a person other than the intended holder of a beneficial interest.
 - c) Provision of rider benefits - section 25(3) of the Act provides that an insurer that is licensed to conduct a specific class or sub-class of insurance business may provide the rider benefits as may be prescribed by the Prudential Authority in respect of that class or sub-class of insurance business.
 - d) Capital and securities – section 38(2) of the Act enables the Prudential Authority to prescribe the circumstances in which its approval under subsection 38(1) of the Act is not required for an insurer or controlling company that is a profit company, or an insurer that is a co-operative whose constitution provides for membership shares to be issued to members, to adjust its share capital by issuing additional shares, cancelling shares, or other transactions, the net effect

- of which is to alter its share capital.
- e) Material acquisitions or disposals – section 50(2) of the Act requires the Prudential Authority to prescribe what constitutes ‘material’ for the purposes of establishing those transactions that require the Authority’s approval.
- f) Classes and sub-classes of insurance business – Schedule 2, Table 1 of the Act requires the Prudential Authority to prescribe the maximum amount payable to a beneficiary of a funeral policy.

11. Regulatory Intervention

- 11.1. The Governance and Operational Standards establish the minimum standards required by the Prudential Authority in terms of operating an insurance business. As with the Financial Soundness Standards, the Prudential Authority expects insurers to aspire to higher standards in some, if not all, of the areas addressed. In particular, where the complexity and scale of the insurance business is greater, so too should be the standards of governance and operations.
- 11.2. While ultimate responsibility for the sound and prudent management of an insurer’s business rests squarely with an insurer’s board of directors, the Prudential Authority has the power and responsibility to intervene if an insurer does not meet the minimum requirements established by these standards.
- 11.3. The Act establishes trigger points for regulatory intervention. In practice, while failure to meet the minimum governance and operational requirements signals the need for intervention, prudential regulatory monitoring and supervision is typically more nuanced and graduated than is implied by discrete points of intervention.

12. Structure of the Governance and Operational Standards for Insurers

- 12.1. The Governance and Operational Standards for insurers consist of Standards, Attachments that set out supporting detail such as definitions and technical material, and Guidance Notes. Guidance Notes provide guidance on how certain aspects of a standard may be applied. As suggested by their name, Guidance Notes are intended to be helpful rather than definitive. It is not a breach of the prudential standards for an insurer to interpret / apply the matters covered in a Guidance Note differently to the way suggested by the Prudential Authority. The Prudential Authority nevertheless expects an insurer to be able to justify its alternative interpretation and may call on it to do so.
- 12.2. The Governance and Operational Standards for insurers are organised as follows:

GOI 1	Framework for Governance and Operational Standards for Insurers
GOI 2	Governance of Insurers
GOI GN 2.1	Corporate Culture
GOI 3	Risk Management and Internal Controls for Insurers
GOI 3.1	Own Risk and Solvency Assessment (ORSA) for Insurers
GOI 3.2	Business Continuity Management
GOI 3.3	Reinsurance and Other Forms of Risk Transfer by Insurers
GOI 4	Fitness and Propriety of Significant Owners and Key Persons of Insurers
GOI 5	Outsourcing by Insurers
GOI 6	Transfers of Business and Other Significant Transactions by Insurers
GOI 7	Miscellaneous Regulatory Requirements for Insurers

Attachment 1: Definitions used in the Governance and Operational Standards for Insurers

The following terms used in the Governance and Operational Standards for Insurers are defined in the Act:

- auditor
- board of directors
- cell captive insurer
- Companies Act
- company
- control function
- controlling company
- director (only board of)
- eligible own funds
- foreign reinsurer
- head of a control function
- insurance business
- insurance group
- insurance obligations
- insurance policy
- insurer
- inter-related
- key person
- life insurance business
- life insurance policy
- Lloyd's
- microinsurance business
- microinsurer
- non-life insurance business
- non-life insurance policy
- operational risk
- outsourcing
- person
- policyholder
- premium
- prescribed
- Prudential Authority
- Prudential Standard
- regulatory authority
- reinsurance business
- reinsurer
- related
- rider benefit
- securities
- senior manager / senior management
- significant owner

The following terms used in the Governance and Operational Standards for Insurers are defined in the Financial Sector Regulation Act, 2017:

- financial institution
- Financial Sector Conduct Authority
- financial sector regulator

The following table sets out definitions of additional terms used throughout the Governance Standards for Insurers:

Term	Definition
binder fee	Fees related to a binder agreement referred to in section 49A of the Long-term Insurance Act, 1998 and section 48A of the Short-term Insurance Act, 1998.
board	Board of directors, as defined in the Act.
board charter	A document describing the internal governance practices and procedures of the board of directors, setting out (among other things) its roles and responsibilities, the processes it will carry out to fulfil its roles and responsibilities, and its processes for nominating, selecting and removing board members.
board member	Director, as defined in the Act.
chairperson	Chairperson of the board of directors or any board subcommittee including the audit committee.
commission	Commission paid by the insurer to a person or agent for rendering “services as intermediary” as defined in the Regulations made under the Long-term Insurance Act, 1998 and the Short-term Insurance Act, 1998.
committee	Audit committee, risk committee or remuneration committee.
co-operative	As defined in section 1 of the Co-operatives Act, 2005.
critical business operations	The functions, resources and infrastructure that may, if disrupted, have a material impact on an insurer’s business functions, reputation, profitability, or policyholders.
culture	The commonly held beliefs and values of the individuals who carry out the business of the insurer.
Financial Soundness Standards	Collective term for the suite of Prudential Standards prescribed by the Prudential Authority in respect of the financial soundness of insurers.
fundamental transaction or compromise	A transaction contemplated in Part A of Chapter 5 or section 155 of the Companies Act.
funds withheld clause	A provision in a reinsurance arrangement under which some or all of the premium due to the reinsurer is not paid but withheld by the insurer to reduce the potential credit risk, or to retain control over investments.
global insurance program	Insurance programs with a coverage territory encompassing at least four jurisdictions, including the country in which the insured is domiciled, that is arranged for a multinational business.

Term	Definition
Governance and Operational Standards for Insurers	Collective term for the suite of Prudential Standards prescribed by the Prudential Authority in respect of the governance and operational requirements of insurers.
independent director	<p>A non-executive director who is not:</p> <ul style="list-style-type: none"> a) a prescribed officer, or employee, of the insurer or a related or inter-related party of the insurer, and has not been such an officer or employee at any time during the previous three financial years; b) a material supplier or customer of the insurer, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; c) a significant provider of financial capital or ongoing funding to the insurer; d) holding directly or indirectly a material equity position in the insurer or a related or interrelated party of the insurer; e) the recipient of remuneration, such as through a share-based incentive scheme, that is contingent on the performance of the insurer; f) a significant or ongoing professional adviser to, or internal auditor or auditor of, the insurer; g) in any business or other relationship (contractual or statutory), which could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner; or h) a member of the immediate family of an individual who falls within any of the above criteria. <p>For the purposes of applying the governance requirement in GOI 2 (Governance), any director who is regarded as independent at the holding company level, is also considered to be independent with respect to any subsidiary within the group.</p>
lead independent director	An independent director of the board of directors whose functions are as prescribed in section 6.5 of GOI 2 (Governance of Insurers).
market spirals	A situation whereby claims made by a reinsurer under a retrocession arrangement, result in the same reinsurer receiving additional claims under reinsurance policies that they have written.

Term	Definition
non-executive director	A director who is not involved in the day-to-day management of the insurer and has not been so involved at any time during the last 12 months.
prescribed officer	As defined in section 1 of the Companies Act.
profit company	As defined in section 1 of the Companies Act.
reinsurance arrangement	The terms and conditions of the reinsurance contract combined with those of any related contract. A related contract means a contract that alters the commercial effect of a reinsurance contract between parties and is entered into between the parties to the reinsurance contract, or between those parties and a related or inter-related person of either of those parties. An arrangement may involve one contract, or a combination of two or more individual contracts and/or side letters.
reinsurance recoverables	Amounts that may be recovered from reinsurance arrangements.
remuneration	As defined in section 30(6) of the Companies Act.
risk appetite statement	A statement covering the overall level of risk the insurer is prepared to accept in pursuit of its strategic objectives and business plan, and related matters set out in section 5.6 of GOI 3 (Risk Management and Internal Controls for Insurers).
risk mitigation instrument	An instrument or arrangement used by an insurer to transfer part or all of their risks to another party, including derivatives and reinsurance arrangements.
Standard	Prudential Standard.

Attachment 2: Abbreviations

Abbreviation	Definition
BCM	Business Continuity Management
ORSA	Own Risk and Solvency Assessment