

**DRAFT FOR INFORMAL CONSULTATION – MARCH 2020**

**Prudential Standard FC04**

**Governance and risk management for financial conglomerates**

***Objectives and key requirements of Prudential Standard FC04***

*This Standard is made in terms of sections 105 and 164 of the Financial Sector Regulation, 2017 (Act No. 9 of 2017) and requires the holding company of a financial conglomerate to act within the principles of corporate governance and risk management for a designated financial conglomerate outlined in this Standard.*

*It is the responsibility of the board of directors (board) of the holding company of a financial conglomerate to ensure that the financial conglomerate meets the requirements for governance and risk management on a continuous basis.*

*This Standard highlights the Prudential Authority's requirements in terms of the governance and risk management as well as minimum requirements with regard to board composition, organisational structure, identification of material risks, risk aggregation, risk concentration, intragroup transactions and exposures, information flow, use of group policies and functions, fitness and proprietary requirements for key persons, oversight of outsourcing arrangements, stress and scenario testing, control of off-balance sheet transactions, and remuneration.*

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## **1. Commencement**

1.1 This Standard commences on 1 January 2022 (proposed).

Version number	Commencement date
1	1 January 2022

## **2. Legislative Authority**

2.1 This Standard is made under section 164 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act).

## **3. Application**

3.1 This Standard applies to all holding companies of financial conglomerates as designated by the Prudential Authority in terms of section 160(1) of the Financial Sector Regulation Act 9 of 2017 (FSR Act).

3.2 Where a responsibility is placed on the holding company in terms of this Standard, it must be discharged by the board of directors (the board) of the holding company and in respect of all the entities within the financial conglomerate.

3.3 A reference to the 'wider group' shall be read as a reference to the companies that are within the group, but which have not been included as members of the group designated as a financial conglomerate.

3.4 This Standard applies in addition to the financial sector laws which may be specific to institution type. Therefore, this Standard may not cover all areas of corporate governance as such areas are sufficiently dealt with in financial sector laws. Therefore, this Standard applies in addition to other financial sector laws and good corporate governance prescripts for boards. The requirements of this Standard do not derogate from the existing corporate governance requirements

of financial sector laws that apply to regulated entities whether at solo-entity or group level.

- 3.5 Unless otherwise indicated, any reference to the terms 'board', 'senior management' and 'control functions' shall be read to be a reference to the board, senior management and control functions of the holding company.
- 3.6 Key persons heading up control functions are responsible for those functions from a financial conglomerate perspective.

#### **4. Definitions and interpretation**

- 4.1 The terms used in this Standard, unless indicated otherwise, are defined in the FSR Act and Prudential Standards made thereunder, and have the same meaning in this Standard.
- 4.2 The term 'appropriate' should be read as proportionate to the size, nature and complexity of the financial conglomerate.
- 4.3 The term 'material' should be read in terms of the significance of the impact on the financial conglomerate.
- 4.4 ICAAP means the Internal Capital Adequacy Assessment Process and is a requirement under Pillar 2 of the Basel II framework for banks.
- 4.5 ORSA means the Own Risk and Solvency Assessment and is a requirement under Prudential Standard GOI 3 – Own Risk and Solvency Assessment for Insurers.
- 4.6 A 'substantial shareholder' means any person with a shareholding of which the total nominal value together with the total nominal value of shares already held by such person and by the associate or associates of such person or the voting rights in respect of the issued shares of such holding company of the financial conglomerate that are exercisable by such person together with the voting rights attached to the shares of holding company of the financial conglomerate that are already held and exercisable by such person and by the associate or associates of such person, amount to more than five (5) per cent of the total nominal value or the total voting rights in respect of all the issued shares of the holding company of the financial conglomerate, as the case may be.
- 4.7 A 'significant provider of equity or other sources of capital' means any person directly or indirectly providing equity or other sources of capital to the holding company of the financial conglomerate, which in aggregate is equal to or exceeds five (5) per cent of the aggregate amount of total qualifying capital and reserve funds of the holding company of the financial conglomerate;
- 4.8 A 'material provider of funding' means any person directly or indirectly providing funding to the holding company of the financial conglomerate, which in aggregate is equal to or exceeds five (5) per cent of the aggregate amount of total liabilities of the holding company of the financial conglomerate.
- 4.9 The 'Objectives and key requirements of Prudential Standard FC04' that are italicised in the preamble at the start of this Standard must not be used in the interpretation of any paragraph of this Standard.

#### **5. Roles and responsibilities**

- 5.1 The board is responsible for ensuring that the financial conglomerate complies with the principles and requirements of this Standard

- 5.2 Where a financial conglomerate's control functions are required to perform certain functions in terms of a particular Standard, the board must ensure that the control functions regularly review and report to the board on the financial conglomerate's compliance with the Standard.
- 5.3 If requested to do so, a financial conglomerate's board and/or auditor must provide assurance to the PA that the financial conglomerate complies with the requirements of this Standard and all related standards pertaining to financial conglomerates.

## **6. Principles underlying governance and risk management for financial conglomerates**

- 6.1 The emergence of financial conglomerates is a key feature of the evolution of financial systems and the increased functional integration between the business of banking, insurance and securities services. The participation in multiple financial sectors may introduce risks into the financial system that may not be adequately addressed in existing regulatory and supervisory frameworks.
- 6.2 Prudential regulation of providers of financial products and securities services is subject to three levels of regulation and supervision, namely solo-entity, group and financial conglomerate regulation and supervision. Financial conglomerate regulation and supervision endeavours to capture the activities at the level of the ultimate holding company and where solo-entity and group supervision does not adequately capture the risks at financial conglomerate level.
- 6.3 It is essential that the board of the financial conglomerate ensures that entities within the financial conglomerate are prudently managed.
- 6.4 The Governance and Risk Management Standard is drafted on the basis of the following principles:
- a. the sound composition of, and governance by, the board;
  - b. the adoption of a transparent organisational structure;
  - c. the development of an appropriate combined assurance framework, including an enterprise-wide risk management framework for the financial conglomerate;
  - d. the identification and management of material risks;
  - e. the development of an appropriate information flow framework and internal control environments;
  - f. the conducting of appropriate stress- and scenario-testing exercises;
  - g. the prudent aggregation of risks and risk data reporting;
  - h. the identification and management of risk concentration and intragroup transactions and exposures;
  - i. the adoption of appropriate controls around off-balance sheet transactions;
  - j. the prudent use of group policies and functions;
  - k. the prudent oversight of outsourcing arrangements;
  - l. the development and implementation of fitness and proprietary requirements for key persons; and
  - m. the development of appropriate reward and remuneration policies.

## **7. Board composition and governance framework**

- 7.1 Sound governance is the cornerstone of prudent business management by a financial conglomerate. Strong governance arrangements empower the financial conglomerate with the ability to effectively detect, monitor and manage risks and material activities emanating from the financial conglomerate. The governance requirements in this Standard complement the requirements of the Companies Act, 2008 (Act No. 71 of 2008).
- 7.2 The board is ultimately responsible for developing and maintaining a corporate governance framework that provides for the prudent management and oversight of the financial conglomerate.
- 7.3 The board must ensure that the composition of both the board and the boards/oversight committees of the members of the financial conglomerate is appropriate given the nature, size and complexity of the financial conglomerate and is in accordance with each company's Memorandum of Incorporation/founding documents.
- 7.4 Sound governance arrangements for a financial conglomerate include, but are not limited to:
- a. incentive arrangements that support sound and prudent decision making at the holding company level;
  - b. clear protocols to ensure all regulatory matters are properly prioritised and communicated consistently and accurately to the Prudential Authority;
  - c. policies that enable material risks stemming from the financial conglomerate to be identified and appropriately managed;
  - d. documented policies and procedures on how the entities within the financial conglomerate shall interface with one another;
  - e. an appropriate risk management culture that is widely understood in the financial conglomerate and supports the conduct of business with integrity; and
  - f. documented and well understood policies on conflicts of interest and disclosure requirements.
- 7.5 The board must ensure that directors, senior management and key persons of the financial conglomerate individually and collectively have the appropriate educational qualifications, experience or expertise, relevant skills and knowledge required for effective prudent management of the financial conglomerate. In ensuring the suitability of board members, senior management and key persons, the board must:
- a. ensure that there are processes and procedures in place in the financial conglomerate to assess the requirements in 7.5; and
  - b. ensure that there are processes in place to effectively manage instances where the persons identified in 7.5 cease to be suitable.

7.6 The chairperson of the board and of sub-committees of the board must be independent non-executive directors provided that-

- a. The board must make adequate provision for cases when the chairperson may become non-independent for some reason for a period of time or is conflicted on a specified matter, such as for example, the appointment of a lead independent director
- b. In exceptional cases, and at the sole direction of the Prudential Authority, the Prudential Authority may approve in writing and subject to such conditions as may be specified in writing by the Prudential Authority, the appointment of a non-independent non-executive director to serve as the chairperson of the board for such a period of time as may be specified in writing by the PA, and after due consideration of factors such as-
  - i. the adequacy of mechanisms in place to strengthen the independence of the board,
  - ii. adequate provision for an additional channel of communication for board members when the chairperson may be conflicted,
  - iii. the appointment of a lead independent director, and
  - iv. such other factors regarded as material by the Prudential Authority.
- c. Where appointed, the functions of the lead independent director are to, among other things:
  - i. provide leadership and advice to the board of directors in respect of matters where the chairperson has a conflict of interest or perceived conflict of interest, including the identification of circumstances where the chairperson may have a conflict of interest or perceived conflict of interest that may impact on the chairperson's independent decision making;
  - ii. preside at meetings of the board of directors or sub-committees of the board, as the case may be, from which the chairperson is absent or in respect of which the chairperson has a conflict of interest or perceived conflict of interest;
  - iii. perform the functions of the chairperson that cannot be performed by the latter because of a conflict of interest or perceived conflict of interest;
  - iv. provide a sounding board for the chairperson to discuss confidential issues related to governance, board performance, the performance of individual directors, and concerns raised by directors, shareholders or employees; and
  - v. perform the annual assessment/appraisal of the chairperson's performance based on direct and confidential feedback from all directors.

7.7 The chairperson of the board of directors must:

- a. provide leadership to the board of directors in respect of the proper and effective functioning of the board as a collective;
- b. ensure that adequate time is allocated for discussion of board matters, especially discussions of a strategic nature; and
- c. promote a culture of openness and debate among directors, senior management and heads of control functions.

- 7.8 In this Standard, 'non-executive director' is a reference to a director who is not a member of the financial conglomerate's management and not an executive of any of the entities within the financial conglomerate.
- 7.9 For purposes of this Standard a director cannot be classified as a non-executive if in relation to the financial conglomerate, has at any time during the preceding twelve months-
- a. been an executive director;
  - b. been the chief executive officer;
  - c. been the designated external auditor directly or indirectly responsible for performing the statutory audit, or a key member of the external audit team directly or indirectly responsible for performing the statutory audit; or
  - d. been the curator.
- 7.10 In exceptional cases, based on the sole discretion of the PA, and after due consideration of factors such as proportionality, the systemic importance or interconnectedness of the financial conglomerate within the domestic financial system, or such other factors regarded as material in relation to the person or institution under consideration, the PA may approve the appointment of any of the aforementioned persons to serve as a non-executive director of the financial conglomerate, after such a period shorter than twelve months as may be specified in writing by the PA.
- 7.11 The majority of non-executive directors on the board must be independent. Independence generally means the capacity to exercise objective judgement, free from conflicts or biases. In terms of this Standard, an independent director shall be one that is not:
- a. involved in the day-to-day management of the financial conglomerate's business or has not been so involved at any time during the previous three financial years;
  - b. a prescribed officer or full-time employee of the financial conglomerate or another related or inter-related company, or has not been such an officer or employee at any time during the previous three financial years;
  - c. a material supplier or customer of the company, 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;
  - d. is a substantial shareholder of the holding company of the financial conglomerate or an executive officer of or otherwise associated directly with a substantial shareholder of the holding company of the financial conglomerate;

- e. has within the last three years been a principal of a material professional adviser or a material consultant to the holding company of the financial conglomerate, 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;
- f. is a significant provider of equity or other sources of capital, or a material provider of funding, to the holding company of the financial conglomerate;
- g. is the recipient of a form of remuneration other than
  - a) directors' fees; or
  - b) directors' remuneration,such as by means of a share-based incentive scheme, which is contingent on the performance of the holding company of the financial conglomerate;
- h. is or has within the last three years been a significant or ongoing professional adviser to or an internal auditor of the holding company of the financial conglomerate, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that person is compromised by that relationship;
- i. is a member of the immediate family of an individual who falls within any of the aforementioned categories of persons;
- j. has been an executive director, the Chief Executive Officer (CEO) or an executive officer of the holding company of the financial conglomerate at any time during the preceding three (3) years;
- k. has served as an independent non-executive director of the holding company of the financial conglomerate for a period of nine (9) years, provided that should the holding company of the financial conglomerate decide to reappoint a person who already served as an independent non-executive director of the holding company of the financial conglomerate for a period of nine (9) years or longer, to remain a member of the board after the aforementioned period of nine (9) years, that person shall for purposes of this Standard be regarded as a non-executive director of the holding company of the financial conglomerate concerned, but not as an independent non-executive director of the holding company of the financial conglomerate;
- l. has been the designated external auditor directly or indirectly responsible for performing the statutory audit for holding company of the financial conglomerate, or a key member of the audit team directly or indirectly responsible for performing the statutory audit for the holding company of the financial conglomerate, at any time during the preceding three financial years;
- m. 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;



- n. has been the curator of the holding company of the financial conglomerate at any time during the preceding three years; or-
- o. related to any person who falls within any of the above criteria.

7.12 In line with the Companies Act, the board must ensure that its holding company and boards of subsidiaries of the financial conglomerates consist of appropriate board committees including but not limited to audit committee, social and ethics committee and remuneration committee.

7.13 Furthermore, the members of the board must be able to exercise their independence and must be free from undue influence in decision making.

7.14 The board must be capable of describing and understanding the purpose, structure, strategy, material operations and material risks of the financial conglomerate, including unregulated entities that are part of the financial conglomerate. In addition, the Board must have a good understanding, and consider any aspects, of the wider group that may adversely affect the financial conglomerate as a whole or any of its legal entities.

7.15 To be effective, sound governance requirements must be supported by an enterprise-wide corporate culture that reflects the organisational values and norms. An organisational culture that supports disclosure, whistle-blowing and open communication enables the board to maintain strong governance of the financial conglomerate.

7.16 Conflict of interest within the financial conglomerate could arise:

- a. at the level of the board, senior management and key persons in control functions of the holding company and of its legal entities; and
- b. among the legal entities or between the wider group and those of any legal entity within the financial conglomerate.

7.17 Where conflicts of interest involving key persons or legal entities cannot be avoided or resolved, the relevant key person or legal entities must inform the relevant board of the conflict, and take measures prescribed by the board to mitigate its adverse impact.

## **8. Organisational structure**

8.1 Financial conglomerates typically participate in diverse economic sectors for a range of reasons. The organisational structure of a financial conglomerate will thus typically involve extensive and complex interconnections between prudentially regulated entities and/or between prudentially regulated and non-prudentially regulated entities. For this reason, the Prudential Authority requires the holding company to clearly document the legal and management structures of, and inter-relationships within, the financial conglomerate to enable an understanding of its structure to assist in the identification and management of risks.

- 8.2 The board must ensure that the financial conglomerate has a transparent organisational and management structure which is consistent with the overall strategy and risk profile of the financial conglomerate.
- 8.3 The requirements of this paragraph 8 must be read with section 165(2)(c) of the FSR Act.

## **9. Material acquisitions and disposals**

- 9.1 Section 166(1)(a) of the FSR Act requires the holding company of the financial conglomerate to obtain the approval of the Prudential Authority prior to making an acquisition or disposal of a material asset.
- 9.2 Section 166(1)(b) of the FSR Act requires the Prudential Authority to prescribe what constitutes 'material' for the purposes of establishing transactions involving the acquisition or disposal of an asset that require the approval of the Prudential Authority.
- 9.3 In terms of the above-mentioned sections of the FSR Act, the following are prescribed as a material acquisition or disposal:
- a. Any acquisition or disposal of an entity regulated by a financial sector regulator or organ of state.
  - b. Any entity with assets in excess of 5% of the total assets of the financial conglomerate
  - c. Any entity with a net income after tax in excess of 5% of the total net income after tax of the financial conglomerate, at acquisition or disposal or within the projected business plan period; or
  - d. Any entity that will result in an intra-group exposure within the financial conglomerate in excess of 10% of the total amount of intra-group exposures of all the entities within the financial conglomerate.
  - e. Consideration must also be given to sequential acquisitions and disposals that on aggregation become material to the financial conglomerate.

## **10. Risk management system**

- 10.1 The holding company must ensure that the financial conglomerate's group-wide risk management system (may consist of integrated risk management system) encompasses the levels of the holding company and legal entities within the financial conglomerate and covers, at the minimum, the:
- a. diversity and geographical reach of the activities of the financial conglomerate;
  - b. nature and degree of risks of individual legal entities and business lines;
  - c. aggregation of risks from the legal entities within the financial conglomerate that arises at the level of the holding company, including cross-border risks;

- d. interconnectedness of the legal entities within the financial conglomerate; and
- e. level of sophistication and functionality of information and reporting systems in addressing key group-wide risks.

10.2 The group-wide financial conglomerate's risk management system should:

- a. be integrated with its organisational structure, decision-making processes, business operations and risk culture;
- b. be integrated within its legal entities; and
- c. measure the risk exposure of the financial conglomerate against the risk appetite limits on an ongoing basis in order to identify potential concerns as early as possible.

10.3 The holding company must reflect, in the documentation of the financial conglomerate's group-wide risk management framework and system, the material differences in risk management that may apply to different legal entities within the financial conglomerate due to the nature, scale and complexity of the risks and their associated risks with the business conducted.

10.4 The holding company of the financial conglomerate must at least on an annual basis or when there is a significant change in the risk profile of the financial conglomerate, conduct an appropriate capital assessment to ensure that sufficient capital is held by the financial conglomerate. An ICAAP or an ORSA for the financial conglomerate needs to materially align with the ICAAP or ORSA currently required for a banking or insurance group. Subject to the approval of the Prudential Authority, a banking or insurance group ICAAP or ORSA may not be required if it is not materially different from the ICAAP or ORSA of the financial conglomerate. The relevant ICAAP or ORSA must be submitted to the Prudential Authority within 14 days after board approval.

## **11. Identification of material risks**

11.1 The Board and senior management of the financial conglomerate must ensure the implementation of governance arrangements that enable the identification of risks and appropriate assessment within the financial conglomerate. Sound material risk identification arrangements include, but are not limited to:

- a. monitoring adherence of the financial conglomerate with its overall strategy;
- b. monitoring adherence to the risk appetite of the financial conglomerate and, where necessary, constraining business activities that breach the risk appetite of the financial conglomerate; and
- c. being satisfied that the senior management of the financial conglomerate has a firm-wide understanding of its risk factors.

11.2 Where an institution within the financial conglomerate engages in business activities that may pose a material risk to either the financial conglomerate or the wider group, the board must ensure that such business activities are undertaken in a way that complies with the governance arrangements of the financial conglomerate.

11.3 The Board should ensure that the risk management framework satisfies the requirements in this Standard, and should therefore ensure that it is reviewed at least annually in order to maintain its efficiency

## **12. Risk aggregation**

12.1 Owing to the participation of financial conglomerates in more than one financial sector, risk management at the holding company level will need to take into account the material risks unique to each sector.

12.2 For the purpose of having a holistic view of material risks to a financial conglomerate, the board must ensure that the financial conglomerate prudently aggregates the risks to which it is exposed. The board should ensure that the financial conglomerate has adequate resources and systems (including information technology (IT) resources and systems) for the purpose of aggregating risks.

## **13. Risk concentration, intragroup transactions and exposures**

13.1 The holding company of the financial conglomerate must have in place effective systems and processes to manage and report group-wide risk concentrations, intragroup transactions and exposures

## **14. Information**

14.1 The operations within the financial conglomerate may inhibit the flow of information within the financial conglomerate.

14.2 The board must develop and implement a framework for governing information flows within the financial conglomerate. A sound information flow framework would enable the board to identify the linkages within the financial conglomerate from a governance and risk management perspective.

14.3 The Prudential Authority may in order to fulfil its supervisory duties in respect of the financial conglomerate request additional information from the holding company of the financial conglomerate in respect of members of the group of companies.

14.4 Without limiting the information referred to in paragraph 14.3, the following information may be requested from the holding company:

- a. Copies of correspondence between a regulated entity or holding company and a foreign supervisory authority that relates to matters that may or are likely to have a material impact on the supervisory duties of the Prudential Authority;

- b. copies of all correspondence between a subsidiary of a regulated entity or holding company or between a representative office and a foreign supervisory authority that relates to matters that may or are likely to have a material impact on the supervisory duties of the Prudential Authority;
- c. any material information which may or is likely to negatively affect the suitability of a major shareholder;
- d. copies of any other information or documentation at the disposal of such a bank, insurer, controlling company or subsidiary that relates to matters that may or are likely to have a material impact on the supervisory duties of the Prudential Authority;
- e. details of major shareholders of any entity within the financial conglomerate or of the holding company;
- f. the financial conglomerate's group structure based on the business line structure and the legal structure;
- g. the main business activities conducted by any of the entities in the financial conglomerate, including relevant matters relating to services and products, markets, geographic regions and sectors;
- h. the composition of the board of any of the significant entities that form part of the financial conglomerate, and further information as may be required to perform the Prudential Authority's supervisory responsibilities, such as the roles and responsibilities of the respective boards and information relating to any of the board subcommittees;
- i. the management structure of significant entities that form part of the financial conglomerate, and the respective main responsibilities of such senior management;
- j. the business model or strategy adopted by any entity within the financial conglomerate and whether or not the financial activities conducted within the financial conglomerate cut across legal entities or are conducted autonomously within individual financial entities;
- k. the control structure adopted by entities that form part of the financial conglomerate, including matters relating to accounting policies, internal audit, the compliance function, outsourcing, external audit and the interaction between internal and external audit, and whether or not the respective adopted control functions are globally controlled or locally controlled with individual financial entities;
- l. the strategy adopted by the entities that form part of the financial conglomerate in respect of risk, including their appetite for risk, the principal risks they are willing to assume, any specific or board approved limits relating to risk positions, the manner in which risks are monitored and controlled, and the frequency with which risk information has to be reported to the respective boards and senior management of the relevant entities included in the reporting group of entities;

- m. the strategy adopted by entities that form part of the financial conglomerate in respect of their responsibility to manage or hold any excess capital and reserve funds in the group, the monitoring of capital in relation to the risks incurred by various entities in the group, and the allocation of capital among the various entities included within the group;
- n. the strategy adopted by entities that form part of the financial conglomerate in respect of funding and liquidity management, including the extent to which liquidity management is centralised or managed on a business or legal entity basis;
- o. the strategy adopted by entities that form part of the financial conglomerate in respect of intragroup transactions and transactions with related persons or entities, including whether or not limits are imposed in respect of intragroup transactions and transactions with related persons or entities, and to ensure that intragroup transactions with related persons or entities are conducted on an arm's-length basis;
- p. the strategy adopted by entities that form part of the financial conglomerate in respect of concentration risk, including whether or not limits are imposed in respect of concentration risk;
- q. investments or interests held within a financial conglomerate in regulated entities, unregulated entities, regulated joint ventures, unregulated joint ventures, regulated associates and unregulated associates, specified special-purpose institutions, companies acquired during a specified period and/or any other entity specified in writing by the Prudential Authority;
- r. in respect of each investment or interest specified in (q) above, the nature of the business conducted by the relevant entity, that is, the main activity or business such as banking, insurance, securities trading, portfolio management property holding or development, the country in which an entity is incorporated, whether the entity conducts business as the principal or agent or as both principal and agent, the relevant regulatory authority or supervisor of the rules that apply to the relevant entity, and the latest date in respect of which audited financial statements are available;
- s. in respect of a regulated entity, the minimum capital requirement or solvency amount determined in accordance with the rules or regulations of the relevant authority or supervisor responsible for the supervision of the relevant entity, the amount of qualifying capital and reserve funds determined in accordance with the rules and regulations of the relevant authority or supervisor responsible for the supervision of the relevant entity, and any surplus or shortfall amount, that is, the difference between the entity's qualifying capital and reserve funds and the required amount of capital and reserve funds;
- t. the aggregate amount of any direct or indirect exposures granted by other entities within the group to another entity or the aggregate amount of any direct or indirect exposures granted by a relevant entity to other entities within the group; and

- u. the relevant approaches or methods implemented by an eligible financial institution for the measurement of its exposure to relevant risks.

## **15. Use of group policies and functions**

- 15.1 The boards of the subsidiaries of the holding company of a financial conglomerate will ordinarily be responsible for the activities of its subsidiaries either in banking, insurance or the provision of securities services. As a result, the boards of each of these entities may develop policies that relate to the business lines of those respective entities. While these policies will be reflective of the requirements of specific business lines, it is critical that the policies of the entire financial conglomerate are aligned with the financial conglomerate's overall strategy and policies.
- 15.2 The board must ensure that policies utilised by entities within the financial conglomerate are aligned with group policies without prejudice to the governance of the individual entities in the group. Where a prejudice exists, the decision to align or deviate from group policies should be aligned with the overall strategy of the financial conglomerate and be approved by the board of the holding company.
- 15.3 The board must ensure that where functions are being utilised by entities within the financial conglomerate, the boards of the subsidiaries of the holding company of a financial conglomerate have approved the use of the functions and ensured that such functions give appropriate regard to the entities' business and specific requirements.
- 15.4 The board must ensure that the financial conglomerate has developed and implemented a full suite of risk management policies required by sectoral law and ensure that policies on large exposures and concentration risk form part of this suite.

## **16. Fit and propriety requirements of key persons**

- 16.1 Prudent management of the financial conglomerate is heavily reliant on the appointment of suitably qualified persons to governance and management roles in the financial conglomerate. It is critical that the board ensures that the persons appointed at each of the entities forming part of the financial conglomerate possess the requisite fitness and propriety requirements.
- 16.2 The holding company of the financial conglomerate must have a fit and proper policy, which must be applied group-wide. The policy requirements on fitness and propriety should be reflective of the organisational values to which the financial conglomerate subscribes, and which must be applied group-wide.
- 16.3 In addition, the fitness and propriety policy should include, but not be limited to:
  - a. requirements on competence with respect to formal qualifications, knowledge, skills and practical experience;
  - b. personal character qualities of honesty and integrity;

- c. good financial standing;
- d. a requirement that all key persons satisfy legislative requirements for fitness and propriety;
- e. succession planning for the replacement of key persons; and
- f. a requirement that the legislative requirements for key persons and the policy on fitness and propriety are well communicated and understood by all entities that form part of the financial conglomerate and the wider group.

## **17. Oversight of outsourcing arrangements**

- 17.1 The outsourcing of some activities is an integral part of many modern businesses. It is common cause that on account of the core business of financial conglomerates, entities that fall outside of the financial conglomerate would be better placed and resourced to provide services to the financial conglomerate for the furtherance of its objectives.
- 17.2 Furthermore, outsourcing may introduce risks to the financial conglomerate given that the financial conglomerate relies on the controls it would expect to be in place in the entity with which it has outsourcing arrangements.
- 17.3 Additionally, where a number of entities within the financial conglomerate have individually entered into outsourcing arrangements with a single service provider or connected service providers, a risk may arise within the service providers, and the financial conglomerate will need to provide for business continuity in the event of the risk materialising.
- 17.4 When considering whether to outsource a material function or activity, the holding company must ensure that an assessment of the risks of outsourcing is carried out, including the appropriateness of outsourcing the particular function or activity, taking into account the size, nature and complexity of the outsourced function or activity. The holding company must ensure that there are processes and criteria in place to review decisions to outsource a function in order to ensure that such outsourcing does not imply delegation of responsibility for that function or activity.

## **18. Stress and scenario testing**

- 18.1 The risks associated with specific business lines may differ markedly in respect of each other. This distinction is more apparent between prudentially regulated and non-prudentially regulated institutions. Therefore, stress tests carried out at a group-wide level and that are escalated for the consideration of the board of the holding company ideally present a holistic view of the risks that may affect specific sectors and any spill over effects that may affect other entities within the financial conglomerate and the wider group.
- 18.2 The holding company must periodically carry out group-wide stress tests and scenario analyses for its major sources of risk.



18.3 The Prudential Authority may request a financial conglomerate to conduct a stress and/or scenario test outside the periods stipulated in paragraph 18.2 in circumstances determined by the Prudential Authority.

## **19. Controls around off-balance sheet transactions**

19.1 It is essential for the board to fully appreciate the material risks that may emanate from special purpose entities that may impact the financial conglomerate. For this reason, it is important for special purpose entities to be captured in the risk management processes of the financial conglomerate and the wider group.

19.2 The board must ensure that material off-balance sheet activities, including those of special purpose entities, are part of the enterprise risk-wide management framework.