

FINANCIAL SUPERVISORY COMMISSION



Cook Islands

PRUDENTIAL STATEMENT

No. 06-2006

BANK LICENSEES – FIT AND PROPER PERSONS

This Prudential Statement is intended to provide guidance on the information and criteria used by the Financial Supervisory Commission (FSC) in order to be satisfied that significant shareholders and officers¹ of a bank are fit and proper persons for implementation of Sections 8, 17 and 28 of the Banking Act 2003 (the Act).

The character, competence and financial integrity of significant shareholders and officers of banking institutions have proven to have a strong influence on the operating condition and performance of banking institutions. As such, fit and proper significant shareholders and officers are necessary to provide protection for depositors and engender public confidence in the banking and financial system.

It is the responsibility of the Board of Directors of a bank to ensure that every person who is an officer of the bank is at all times a fit and proper person. In addition, it is the responsibility of every person who is or proposes to become a significant shareholder to satisfy the FSC of being a fit and proper person.

1. Duties and Responsibilities of the Board of Directors

To effectively discharge its responsibilities, the bank's Board of Directors should:

- formulate and adopt a fit and proper person policy, taking into account the criteria outlined in this Prudential Statement;
- apply the policy to significant shareholders and officers on an on-going basis;

¹ According to Section 2 of the Act an "officer" is defined as "*director, manager or company secretary*" and a "manager" is defined as "*(a) an individual who occupies the position of chief executive (however described) of the licensee or (b) any other individual who under the immediate authority of the chief executive or a director exercises management functions for the licensee*" and a "director" is defined as "*an individual who exercises management and policy making functions at the highest level of a company, and includes an individual who is a member of the board of directors, committee, council or other governing body of a company.*"

- implement appropriate procedures to provide for, at a minimum, an annual review of each significant shareholder and officer, in order to confirm that they continue to meet the fit and proper criteria outlined in this Prudential Statement;
- ensure appropriate current documentation is maintained by the bank to evidence the implementation of the policy, including at a minimum, the annual completion of a written signed statement by each significant shareholder and officer of the bank confirming either no change or detailing any change relevant to their previous Affidavits;
- ensure that the chief executive officer applies the fit and proper person policy to other employees of the bank on an on-going basis and periodically, but not less than on an annual basis, require the chief executive officer to report to the Board on the results thereof.

2. Responsibility of Persons Subject to Fit and Proper Person Criteria

It is the responsibility of significant shareholders and officers to provide evidence to the satisfaction of the FSC that they are fit and proper persons. They must accordingly complete and submit to the FSC a Personal Affidavit (FSC Form BKL-2) and other information as may be requested by the FSC to make a fully informed decision regarding their capacity to meet the fit and proper person criteria. They are further obligated to notify the FSC of any events or circumstances that occur subsequent to the FSC's initial assessment of fit and proper person that might change the assessment or at least have a material bearing on it. The FSC shall investigate the information on a priority basis and decide on the person's fit and proper person status.

The bank's Board of Directors, in case an individual fails to observe the above notification responsibility, nevertheless, should remain vigilant about information that might throw light on an individual's fit and proper person status and take action as appropriate. It remains the board's responsibility, however, to monitor and assure that significant shareholders and officers of the bank meet the fit and proper criteria outlined in this Prudential Statement.

3. Role of the External Auditors

If during the course of an audit of the books, records or accounts of a bank, the external auditor becomes aware of information, events or circumstances that suggest a significant shareholder or officer of the bank does not meet the fit and proper person criteria outlined in this Prudential Statement, the external auditor shall immediately notify the bank's Board of Directors in writing of the information, events or circumstances concerned. The Board shall, within 30 days after such notification by the external auditor, take a decision in the matter and initiate whatever action is necessary. The Board's proceedings shall be properly documented in the minutes of the appropriate Board meeting. The bank's Board of Directors shall, within 30 days thereafter, advise the FSC in writing of the matter and its decision.

4. Fit and Proper Person Criteria

Before it issues a bank licence and on a continuing basis, the FSC is required to be satisfied that the significant shareholders and officers of a bank are fit and proper persons in terms of the Act. It is emphasized that the FSC's prime concerns are the protection of depositors and the reputation of the Cook Islands banks and banking system. More generally, because the reputation of a bank is such a critical factor in the maintenance of confidence in the institution, there is no room for compromise or giving the benefit of the doubt. The following is a list, not to be considered exhaustive, of circumstances that MAY lead the FSC not to be satisfied that a person is fit and proper or at least raise questions that require further enquiry –

- i. with respect to officers, it is not apparent that the person concerned has sufficient competency in terms of relevant experience and skills for the FSC to be satisfied that the person will be able to discharge satisfactorily the duties and responsibilities of the proposed position;
- ii. the person has been, or is being, removed or suspended or is otherwise the subject of an enforcement or administrative action by the FSC, FIU or by a regulatory or supervisory authority in another jurisdiction;
- iii. the person has previously contravened any provision of the Act or any rule, regulation or prudential statement issued by the FSC, FIU or any other applicable regulatory or supervisory authority, or any other relevant law or regulation;
- iv. the person has been or is a significant shareholder or officer of a bank, other financial institution, or business enterprise which has been or is being wound up or liquidated by order of a bank supervisory authority or Court;
- v. the person has been censured, disciplined, prosecuted, warned as to conduct or made subject to a Court Order by any governmental department, agency, commission or organ, by any professional association, or by any regulatory or supervisory body within the past fifteen (15) years;
- vi. the person has been the subject of a judgement or award that is outstanding and unpaid for more than one (1) year after the judgment or award was made final;
- vii. the person has previously been judged by a Court to be civilly liable for fraud, malfeasance, or any other misconduct;
- viii. the person has previously been adjudged bankrupt or has made any compromise with creditors or otherwise failed to satisfy creditors in full as debts became due. (Note this applies even though the person may have since been discharged from bankruptcy);

- ix. the person has not settled all undisputed obligations for taxes due for payment to the taxation authorities in the Cook Islands or in any other jurisdiction;
- x. the person is or becomes an appointed or elected member of the Cook Islands Parliament;
- xi. in the case of significant shareholders, the source of their capital contribution may give rise to questions either about their other past or current activities or whether they are really the beneficial owner or are merely acting as nominees, trustees or agents for some other undisclosed party.

The Commission's view of the criteria goes well beyond the mere consideration of whether or not the person concerned has an unsatisfactory record or reputation and it does so in at least two respects.

- (i) The Commission does not look only for evidence that the person at least meets a minimum standard but rather it looks for evidence that the person meets a high standard. This is because, in the context of the provision of financial services, the person concerned will almost invariably occupy a position of trust in respect of money, other assets or financial interests of customers and this must imply higher standards of conduct than in many walks of life. With regard to institutions which become subject to regulation under new legislation and thereby applicants for authorization, the Commission will look for much more positive evidence in favour of the applicant than the simple fact that it has operated in the particular field of financial services concerned for some years without giving cause for complaint.
- (ii) The Commission believes that the concept embraces not only honesty but solvency, competence and responsible behaviour. It believes that an objective standard exists which it is required by its statutory functions to apply and that it is competent to apply such a standard. It is irrelevant than an applicant or authorised institution may hold a subjective view of its own fitness and propriety and, while the view of customers or counter-parties may be relevant to the Commission's consideration of these criteria, it is not a substitute for the Commission's judgement. One reason for holding this view is that the Commission also believes that the concept of "fit and proper" extends to conduct not only in dealings with the public but in the ordering of the institution's internal affairs.

In considering whether a person fulfils the "fit and proper" criteria the Commission has regard to a number of general considerations, whilst always taking account of the particular circumstances of the individual or institution concerned. With regard to institutions, the Commission is entitled to take account, inter alia, of their business records, their other business interests, their financial soundness and strength, the nature and scope of their business, the integrity of their dealings with customers and others, and the institution's record-keeping and other internal systems. With regard to an individual who is an officer of the institution, the Commission includes amongst the relevant considerations whether he has sufficient skills, knowledge, experience and application properly to undertake and fulfil his particular duties and

responsibilities. In addition, the Commission takes into account a person's reputation and character, including such matters (as previously described) as whether he has a criminal record. Convictions for dishonesty are especially relevant but the Commission also has regard to other types of offence since it is vital that a person responsible for managing an institution authorised by the Commission in discharging its statutory functions is of the highest integrity.

The Commission has regard to the performance of the person in the exercise of his duties. Thus incompetence or imprudence in the conduct of an institution's business or anything which has threatened (without necessarily having damaged) the interests of existing or future customers will reflect adversely on those responsible, whether the matters of concern have arisen through the way they have acted or their failure to act in an appropriate manner. The Commission takes a cumulative approach, so that it may determine that a person does not fulfil the criteria on the basis of several instances of such conduct which, taken individually, might not lead to that conclusion.

The standards demanded are more onerous for those with prime responsibility for an institution's affairs, though they will vary according to the scale and nature of the business concerned. In all cases, the Commission looks for a firmly based understanding of the institution's business, a clear conception of its future development and evidence of sound judgement regarding both commercial and administrative matters relevant to the business.

Finally, as there could be various "arrangements" or legal structures regarding the ownership, anything that would hinder or cloud identification by FSC of the beneficial/ultimate owners, as well as the determination of whether the fit and proper criteria are satisfied, will not be allowed.

This Prudential Statement is issued effective 26 January 2006 and hereby replaces Practice Note No. 4-2004 issued 10 May 2004.

FINANCIAL SUPERVISORY COMMISSION
26 January 2006