



Prudential Practice Guide

LPG 510 – Governance

May 2006

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About this guide

Prudential Standard LPS 510 Governance (LPS 510) sets out APRA's requirements in relation to the governance of life companies. This prudential practice guide aims to assist life companies in complying with those requirements and, more generally, to outline prudent practices in relation to certain governance matters.

Subject to the requirements of LPS 510, life companies have the flexibility to configure their governance framework in the way most suited to achieving their business objectives.

Not all the practices outlined in this prudential practice guide will be relevant for every life company and some aspects may vary depending upon the size, complexity and risk profile of the life company.

Principles

1. A number of principles underpin a sound and effective governance framework for a life company. These include:
 - (a) responsibility – the board of directors (the Board) is ultimately responsible and accountable for the decisions and actions taken by a life company;
 - (b) independence – demonstrated by a Board that discharges its review and oversight role effectively and independent of the interests of dominant shareholders, management, and competing or conflicting business interests;
 - (c) renewal – a policy of renewal provides for fresh insight and general reinvigoration of the Board while also ensuring ongoing understanding of the business of the life company;
 - (d) expertise – demonstrated by a Board with the necessary expertise to fulfil its role and functions and access to independent expertise not readily available amongst the current directors;
 - (e) diligence – demonstrated by a Board that discharges its duties and responsibilities carefully and conscientiously;
 - (f) prudence – demonstrated by a Board with a clear focus on the prudent management of the life company;
 - (g) transparency – demonstrated by a Board that is open and honest in its dealings on behalf of the life company; and
 - (h) oversight – demonstrated by a Board that is able to satisfy itself that the management and operation of the life company conforms with its strategy, direction and policies.

Independence

2. A person who is a member of a mutual society that is a life company is not by that fact alone to be considered not independent for the purposes

of meeting the independence requirements in LPS 510. A person is only precluded from being considered an independent director if they do not meet the criteria for independence referred to in LPS 510.

Residency

3. As a guide, a person might be considered 'ordinarily resident', as referred to in LPS 510, if they are likely to be in Australia for a majority of days in any 12-month period.

The Board and senior management

4. As stated in LPS 510, the Board has ultimate responsibility for the sound and prudent management of a life company. A well-functioning Board will review and approve business strategies and significant policies of the life company. It will also satisfy itself that an effective system of risk management and internal control is established and maintained, and that senior management monitors the effectiveness of the risk management framework.
5. Senior management has responsibility for day-to-day management of the life company. This includes the implementation and monitoring of structures, processes, information and oversight arrangements used in managing the life company.

Conflicts of interest

6. The *Corporations Act 2001* (Corporations Act) contains requirements for dealing with conflicts of interest. Specifically, subject to certain exceptions, subsection 195(1) of the Corporations Act requires a director of a public company with a material personal interest in a matter that is being considered at a directors' meeting not:
 - (a) be present while the matter is being considered at the meeting; or
 - (b) vote on the matter.

7. The Corporations Act allows exceptions to this rule. Subsection 195(2) permits directors who do not have a material personal interest in a matter to pass a resolution that the director with a material personal interest should not be disqualified from voting or being present when the matter is considered. APRA expects that such resolutions would be limited to exceptional circumstances and to be minuted, together with reasons.
8. Section 195 of the Corporations Act does not apply to the directors of proprietary companies or Eligible Foreign Life Insurance Companies (EFLICs). However, APRA expects that directors of all life companies will absent themselves from discussions and voting on matters where they have a conflict of interest as if subsection 195(1) and the exceptions to it under the Corporations Act applied.
11. While some duties of directors may be delegated to board committees, as appropriate, the Board retains ultimate responsibility for ensuring that those duties are performed.
12. In establishing committees, a well-functioning Board will have regard to the risk profile of the life company and the complexity of its business, as well as the experience and expertise of the directors.
13. Where board committees are established, it would be prudent practice for these committees to have clearly defined charters that set out their role and objectives, responsibilities, authorities and tenure, and that the charters of these committees be regularly reviewed. It would also be prudent practice that board committees report regularly to the Board.

Life companies that are part of a corporate group

9. Where a life company is part of a corporate group¹, APRA expects that the Board of the life company will consider the potential impact of the operations of other entities in the group on the life company. If the life company is at the head of the group, APRA would expect the Board to have considered the impact of the operations of member entities of the group on all APRA-regulated institutions within the group.

Board committees

10. A well-functioning Board of a life company will typically consider whether there may be merit in establishing board committees for the purpose of overseeing critical functions. While the Life Insurance Act requires the establishment of an Audit Committee, the Board may find the establishment of other committees beneficial for certain functions and for strengthening the overall governance arrangements of the regulated institution.
14. It is noted that the minimum requirements with respect to the composition of Audit Committees for life companies are set out in the Life Insurance Act. APRA notes the requirements with respect to Audit Committees set out in the Life Insurance Act are the minimum requirements that a life company must comply with on the extent of membership of executives on the Audit Committee. However, we would nevertheless expect that the Audit Committee of a life company not to include any person involved in the management of the life company. This requirement is imposed by APRA through prudential standards on authorised deposit-taking institutions and general insurers.
15. APRA also expects that, in addition to the requirements in LPS 510, the Audit Committee will, from time to time, meet separately with the internal auditor and external auditor without other parties being present.

¹ A 'corporate group' comprises more than one company that are related bodies corporate within the meaning of section 50 of the Corporations Act.

Internal audit

16. While LPS 510 requires the internal audit function to have a reporting line and unfettered access to the Audit Committee, this does not preclude the internal auditor from having a reporting line to management, provided that this does not undermine the independence of the internal audit function, either in appearance or in fact.

Board performance assessment

17. LPS 510 requires the Board to assess its performance and that of individual directors relative to its objectives. In undertaking this assessment, a well-functioning Board will typically consider and document the objectives that it sets for the Board collectively and for individual directors.
18. Objectives for the Board could include:
 - (a) establishing the overall strategy for the life company and ensuring reporting against this strategy;
 - (b) approving the risk management strategy of the life company including determining the level of risk it is willing to accept;
 - (c) assessing operating and financial conditions against forecasts;
 - (d) assessing senior management performance against agreed criteria, which would include, for relevant senior management, the effectiveness of risk controls; and
 - (e) making key decisions in a timely manner.
19. Objectives for individual directors could include:
 - (a) whether a director demonstrates the required expertise for their role;
 - (b) attendance and participation at Board meetings; and
 - (c) contribution to Board deliberations and the overall direction of the life company.



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