



Prudential Practice Guide

Draft SPG 510 - Governance

August 2015

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About this guide

Prudential Practice Guides (PPGs) provide guidance on APRA's view of sound practice in particular areas. PPGs frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.

Prudential Standard SPS 510 Governance (SPS 510) sets out APRA's requirements in relation to the governance of a registrable superannuation entity (RSE) licensee's (RSE licensee's) business operations. This PPG aims to assist an RSE licensee in complying with those requirements and, more generally, to outline prudent practices in relation to certain governance matters.

For the purposes of this guide, and consistent with the application of SPS 510, 'RSE licensee' has the meaning given in the *Superannuation Industry (Supervision) Act 1993*.

Subject to the requirements of SPS 510, an RSE licensee has the flexibility to structure its governance framework in the way most suited to achieving its business objectives. Not all practices outlined in this PPG will be relevant for every RSE licensee and some aspects may vary depending upon the size, business mix and complexity of the RSE licensee's business operations.

Principles

1. A number of principles underpin a sound and effective governance framework for an RSE licensee. These include:
 - (a) responsibility – the board of directors (the Board) is ultimately responsible and accountable for the decisions and actions taken by an RSE licensee¹;
 - (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 a Board while also ensuring ongoing effective oversight and understanding of the business of the RSE licensee by the Board;
 - (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 RSE licensee’s business operations²;
 - (g) transparency – demonstrated by a Board that is open and honest in its dealings on behalf of the RSE licensee; and

¹ For the purposes of this prudential practice guide (PPG), a reference to ‘a director’ is a reference to a director of an RSE licensee which has a Board of directors or, in the case of a group of individual trustees, an individual trustee and ‘group of individual trustees’ has the meaning given in section 10(1) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

² For the purposes of this PPG, an ‘RSE licensee’s business operations’ includes all activities as an RSE licensee (including the activities of each RSE of which it is the licensee), and all other activities of the RSE licensee to the extent that they are relevant to, or may impact on, its activities as an RSE licensee.

- (h) oversight – demonstrated by a Board that is able to satisfy itself that the management and operation of the RSE licensee’s business operations conforms to its strategy, direction and policies.

Governance framework

2. An effective governance framework includes the oversight of systems, structures, policies, processes and people that underpin responsibility arrangements within the RSE licensee’s business operations. It supports an RSE licensee to make objective business decisions in the best interests of beneficiaries.
3. APRA expects that a Board would establish a process to ensure that governance risks are properly and regularly evaluated and managed by the Board. Governance risks include, but are not limited to, risks associated with:
 - (a) accountability and transparency of decision-making processes;
 - (b) delegation of roles and responsibilities;
 - (c) remuneration arrangements;
 - (d) fitness and propriety; and
 - (e) the management of conflicts of interest.³
4. APRA’s view is that a prudent Board would determine a target size for the Board and its committees and reflect in the Board’s renewal policy an outline of how the Board intends to achieve and maintain this target size.
5. APRA’s view is that board size influences a Board’s capacity to operate effectively. APRA considers it would be prudent practice to periodically review the total number of directors on the Board and assess whether the size of the Board supports the effective functioning and decision-making of the Board. Whilst the size of the Board is ultimately a matter for the RSE licensee to set in light of

³ Refer to *Prudential Standard SPS 220 Risk Management* for guidance relating to governance risk and *Prudential Practice Guide SPG 520 Fit and Proper* and *Prudential Practice Guide SPG 521 Conflicts of Interest* (SPG 521) for further guidance relating to assessments of fitness and propriety and the management of conflicts.

the size, business mix and complexity of their business operations, APRA's view is that it is difficult to envisage circumstances in which an RSE licensee would need a Board of more than 12 directors.

6. APRA's view is that, when determining the overall composition of the Board, an RSE licensee would ordinarily take into account the RSE licensee's business and strategic plans and the skills and capabilities of directors required to effectively oversee the implementation of that strategy.
7. APRA expects that an RSE licensee would establish policies and procedures relating to voting rights which support effective decision-making by the Board. This would be expected to include procedures which ensure that the views of all directors are adequately reflected in all decisions made by the Board.
8. It would be prudent practice for the Board to consider using relevant board committees to provide appropriate oversight of key governance matters. Such committees may include a dedicated nomination committee or another appropriate board committee, such as the board risk committee.
9. The responsibilities of a dedicated nomination committee might include:
 - (a) overseeing the nomination, appointment, reappointment and removal processes for directors of the Board⁴;
 - (b) recommending candidates for appointment or reappointment to the Board; and
 - (c) overseeing remuneration and performance assessment policies and processes.
10. APRA expects the Board would determine an appropriate number of independent directors for each board committee, particularly those committees charged with the responsibility for the oversight of the composition of the Board.

⁴ For the purposes of this PPG, 'appointment' encompasses both the appointment of new directors and reappointment of existing or past directors to the Board or board committees.

The Board and senior management

11. As stated in SPS 510, the Board has ultimate responsibility for the sound and prudent management of an RSE licensee's business operations. A well-functioning Board will review and approve business strategies and significant policies of the RSE licensee. 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.
12. Senior management has responsibility for day-to-day management of an RSE licensee's business operations. This includes the implementation and monitoring of systems, structures, policies, processes, information and oversight arrangements used in managing the RSE licensee.

Independence

13. [Part 9 of the SIS Act (as amended)] and SPS 510 set out requirements relating to governance arrangements for RSE licensees, including requirements relating to the minimum number of independent directors on RSE licensee boards. Specifically, SPS 510 requires RSE licensee to have in place a process to ensure that the circumstances affecting the independence of independent directors are regularly reviewed and assessed.
14. As the factors that influence independence can change over time and may be affected by factors external to the RSE licensee or the group within which it operates, APRA expects an RSE licensee would identify key factors or scenarios which may, if they occur, affect a director's independence. APRA expects that the Board would give consideration to these factors and scenarios and review them in light of the circumstances of all independent directors on a regular basis.
15. Where an RSE licensee's assessment of a director's independence raises concerns which may affect the RSE licensee's ability to manage conflicts of interest and duty and its compliance with the SIS Act, this process would also be expected to trigger a

reassessment of the relevant director's relevant interests and duties.⁵

16. APRA's view is that membership of an RSE within the RSE licensee's business operations does not preclude a director from being considered to be independent.

Residency

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

RSE licensees that are part of a corporate group

18. Where an RSE licensee is part of a corporate group, APRA expects that the Board would consider the potential impact on the RSE licensee of the operations, including but not limited to, the policies and procedures of other entities in the group. If the RSE licensee is the head of the group, APRA expects the Board would consider the impact of the operations of member entities of the group on all RSE licensees within the group.

Board renewal

19. APRA expects a Board renewal policy would document the maximum tenure period for each director, including the circumstances where the RSE licensee may deviate from the terms of its tenure policy.
20. APRA expects that an RSE licensee would develop and implement a considered approach for assessing each director on the cessation of their term and, at the end of the RSE licensee's maximum tenure period, to determine whether it is appropriate for the individual to be reappointed. This includes having regard to periods of time served on the Board of a predecessor RSE licensee where a merger has taken place. APRA expects that any circumstances under which a person is

reappointed at the end of a reasonable total period of tenure would be exceptional.

21. APRA expects the Board renewal policy would include factors the Board would consider when determining the number of independent directors to be appointed to the Board. In addition to how the RSE licensee will ensure compliance with minimum independence requirements on an ongoing basis, this would reflect whether the Board considers it appropriate to appoint a higher proportion of independent directors.
22. Factors that the Board might consider when setting the proportion of independent directors include consideration of the Board's size and structure, the RSE licensee's business operations and its strategic plan. It would be prudent practice for the Board to also consider requirements to disclose the reason the board does not have a majority of independent directors.⁶

Board nomination, appointment and removal

23. Achieving overall Board composition which is appropriate for an RSE licensee's business operations and which meets the requirements of [Part 9 of the SIS Act (as amended)] provides the foundation for sound governance. The nomination, appointment and removal processes of the Board are crucial to achieving appropriate Board composition.
24. APRA's view is that the Board would be expected to have in place robust processes to support the nomination of appropriate candidates for appointment to the Board. This would include processes to support open and effective communication and consultation with organisations with a right to nominate directors for appointment to the Board. APRA considers that it would be appropriate for the Board to have processes in place to respond to the situation where a sponsoring organisation nominates or appoints a director that the Board considers unsuitable for appointment.

⁵ Refer to *Prudential Standard SPS 521 Conflicts of Interest*.

⁶ Refer to the [*Corporations Regulations 2001*].

25. The Board's process for nominating and appointing directors would be expected to ensure that terms of tenure are staggered to support continuity and the appropriate transfer of knowledge and skills to new directors

26. When considering potential candidates and appointing new directors, APRA's view is that an RSE licensee would assess:

- (a) the current and past associations of candidates;
- (b) the appropriateness of other directorships held by the candidate director, especially directorships of other RSE licensees⁷;
- (c) the skills and capabilities of nominated candidates against the role and responsibilities of the vacancy and the Board as a whole, including consideration of committee vacancies; and
- (d) the fitness and propriety of nominated candidates.

27. When considering potential candidates for appointment as an independent director, in APRA's view an RSE licensee would assess:

- (a) in the case of an existing director being reappointed to the Board as an independent director, the length of the director's tenure on the RSE licensee's Board;
- (b) the independence of nominated candidates under [proposed section 87 of the SIS Act], including consideration of the circumstances and any other factors which may affect the capacity of each candidate to exercise independent judgement in the performance of the role; and
- (c) assess the ability of potential independent directors to actively contribute to the independent functioning of the Board.

⁷ Refer to SPG 521.

Board committees

28. SPS 510 sets out the minimum requirements for independence for the Board Remuneration Committee and Board Audit Committee.

29. A well-functioning Board will typically consider whether there may be merit in establishing board committees for the purpose of overseeing critical functions. Whilst SPS 510 only requires the establishment of a Board Remuneration Committee and a Board Audit Committee, the Board may find the establishment of other committees beneficial for certain functions and for strengthening the overall governance arrangements of the RSE licensee.

30. While some functions and responsibilities of directors may be delegated to board committees where appropriate, the Board retains ultimate responsibility for ensuring that those duties are performed.

31. In establishing committees, a well-functioning Board will have regard to the risk profile of the RSE licensee and the complexity of its business, as well as the experience and expertise of the directors.

32. 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 for the charters of these committees to be regularly reviewed. It would also be prudent practice that board committees report regularly to the Board.

33. When considering board committee membership, APRA expects an RSE licensee would take into account the requirement in SPS 510 to have one third independent directors on the Board Remuneration Committee and the Board Audit Committee and ensuring appropriately skilled committee members, whilst not overburdening individual independent directors.

Board Audit Committee

34. APRA expects that, in addition to the requirements in SPS 510, the Board Audit

Committee would, from time to time, meet separately with the internal auditor and RSE auditor without other parties being present.

Board Risk Committee

35. SPS 510 does not require an RSE licensee to establish a dedicated Board Risk Committee. However, APRA expects that the Board would have considered the necessity of such a committee and the suitability of arrangements for dealing with risk issues at the Board level. Typically, APRA expects larger and more complex RSE licensees would have a separate Board Risk Committee.
36. A Board Risk Committee would be responsible for reviewing the risk management framework of the RSE licensee, for determining policies that ensure the risk management framework is adhered to and for monitoring adherence to those policies.
37. It would be prudent practice for the Board Risk Committee to allow those responsible for risk management functions to meet with it, without other parties being present.

Internal audit

38. While SPS 510 requires the internal audit function to have a reporting line and unfettered access to the Board 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

39. SPS 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 would typically consider and document the objectives that it sets for the Board collectively and for individual directors.
40. Objectives for the Board could include:

- (a) establishing the overall strategy for the RSE licensee and ensuring reporting against this strategy;
 - (b) assessing operating and financial conditions against forecasts;
 - (c) assessing senior management performance against agreed criteria, which would include, for relevant senior management, the effectiveness of risk controls; and
 - (d) making key decisions in a timely manner.
41. Objectives for individual directors may include:
 - (a) demonstrating the required expertise for their role;
 - (b) attendance and participation at Board meetings; and
 - (c) contributing to Board deliberations and the overall direction of the RSE licensee.
 42. APRA expects the Board to consider whether its annual Board assessment would be best undertaken by a party who is free from connection to the RSE licensee or its associates. At a minimum, APRA expects the Board assessment would be undertaken by an external party at least every three years.
 43. APRA expects that a Board would have in place a documented policy on Board performance assessments which includes:
 - (a) the timeframe within which assessments will be conducted;
 - (b) how sufficient objectivity in performance assessments will be achieved;
 - (c) how the Board will manage the outcomes of performance assessments and recommended courses of action in the event of performance that is below expectations; and
 - (d) a reasonable timeframe for action after performance assessments have been conducted.



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