



19 March 2015

To: All RSE licensees

Managing conflicts of interest in superannuation

Background

APRA introduced new prudential standards for the superannuation industry in 2013, including *Prudential Standard SPS 521 Conflicts of Interest* (SPS 521) which took effect on 1 July 2013.

In 2014, APRA undertook a thematic review to assess how the superannuation industry was implementing SPS 521 requirements relating to managing conflicts of interest. The review covered a cross-section of 37 RSE licensees from all segments of the superannuation industry (industry, retail, corporate and public sector) and sought to identify areas of better practice and potential areas for improvement.

The prudential standard requires that the Board of an RSE licensee take ultimate responsibility for having a conflicts management framework that is appropriate to the size, business mix and complexity of an RSE's business operations. Key requirements of the standard are that an RSE licensee develop, implement and review a conflicts management policy that is approved by the Board; identify all relevant duties and interests; and develop registers of relevant duties and interests. The supporting Prudential Practice Guide, *SPS 521 Conflicts of Interest*, provides guidance on APRA's view of sound practice, including the importance of a strong conflicts management culture, the role of the conflicts management framework, issues to consider in developing the conflicts management policy and registers of relevant duties and interests, and the avoidance and management of conflicts.

APRA has provided specific feedback to the funds covered by the review. The purpose of this letter is to highlight to the industry more generally the key findings of the thematic review. RSE licensees should review this letter carefully and consider whether improvements to their current conflicts management arrangements may be appropriate.

General observations

The review highlighted that there is a wide range of practice in relation to conflicts management across the superannuation industry. APRA identified some positive developments and examples of good practice in the management of conflicts by RSE licensees. Overall, however, the review indicates that implementation of the requirements is still in its early stages and further steps need to be taken by many RSE licensees to improve conflicts management practices to meet the requirements of the prudential standard.

The review found a strong correlation between sound risk culture and effective implementation of the new conflict management requirements. Those RSE licensees with a stronger risk culture tended to implement a more robust conflicts management framework that was effectively embedded in their business operations. In these cases, the conflicts

management framework was also well integrated into the overall risk management framework rather than adopted as a stand-alone process.

On the other hand, those RSE licensees with a less robust risk culture and risk management framework tended to adopt a more minimalist approach to implementing the prudential requirements, designed simply to comply with, rather than meet the spirit and intent of, the requirements. This approach adopts an overly narrow view on what may be relevant conflicts and a reactive approach to dealing with conflicts, rather than a process which ensures there is regular and appropriate prior consideration of conflicts. Such a compliance driven approach tended to result in immature conflicts management frameworks and practices.

While some RSE licensees demonstrated comprehensive and effective approaches to implementing conflicts management frameworks, the review also identified areas of inadequacy in the conflicts management frameworks of a number of RSE licensees. The key areas for further development in the implementation of SPS 521 are described below.

1. Identification of conflicts

For some RSE licensees, the policies underlying the conflicts management framework were narrowly focused on conflicts arising for responsible persons, without giving due consideration to conflicts that might arise in relation to the RSE licensee as an entity. This narrow approach to conflict identification tended to also be characterised by a lack of consideration of how these conflicts might be perceived by external stakeholders, most importantly, current and potential beneficiaries. In some cases, the conflict identification process relied solely on self-identification by directors or responsible persons, with no independent review undertaken by, for example, the risk function to ensure that the disclosure was complete and adequate to be relied on by the RSE licensee.

Of particular concern was where it was evident that multiple directorships of RSE licensees were either not identified as, or were considered to not give rise to, an actual or potential conflict. APRA has previously indicated that the board of an RSE licensee is expected to assess the extent to which multiple directorships involve, or could be perceived to involve, conflicts and be able to demonstrate how the best interests of beneficiaries remain at the forefront of decisions being made by directors holding multiple positions. Further, where abstention is deemed an appropriate response to such a conflict, boards must also be able to demonstrate that board effectiveness is unimpeded and that critical decisions can be made. APRA notes that similar considerations may arise where a director of an RSE licensee may hold other roles within the superannuation (or broader financial services) industry, such as directorships of, or senior roles with, a service provider to, or other entities in, the industry.

For consideration:

- *Is the approach to identification of conflicts broadly applied across the entity, adequately capturing possible conflicts as an RSE licensee as well as those of directors, responsible officers and staff?*
- *Is the definition of a conflict of interest (including registers of relevant duties and relevant interests) sufficiently broad to capture all actual, potential and perceived conflicts of interest?*
- *Are external stakeholders' perceptions of conflicts of interest considered within your entity and used to inform your identification of conflicts?*
- *Are directors of your entity complying with their obligation to give priority to duties to and interests of the beneficiaries of your RSE over the duties to and interests of other persons?*

- *What conflicts are considered to be untenable and to be avoided rather than managed?*

2. Sound governance structures

Some RSE licensees have implemented robust governance arrangements as part of their conflicts management framework. At the same time, whilst many RSE licensee boards demonstrated sound governance processes for dealing with conflicts, there were some examples where APRA noted a lack of evidence of conflicts having been considered or declared at board or committee meetings. This led to uncertainty as to how, or whether, such conflicts were being managed.

Some RSE licensees also appeared not to have in place adequate training for directors and other responsible persons and staff on the impact of the new conflicts management requirements.

For consideration:

- *Are governance arrangements covering conflicts management well embedded in your entity?*
- *Is consideration of conflicts of interest issues a standing agenda item at board and committee meetings, with directors and committee members required to make relevant declarations in relation to conflicts at each meeting?*
- *Are conflicts management committees or similar mechanisms used to deal with complex or particularly conflicted matters, for example, where a relationship with a related party results in inherent structural conflicts?*
- *Are directors able to access independent advice, if necessary, about their circumstances so as to ensure all relevant actions or declarations in relation to actual and potential conflicts are made?*

3. Policies and procedures and roles and responsibilities

Some RSE licensees adopted conflicts management frameworks which clearly articulated how duties of responsible persons should be disclosed, how registers should be maintained and how conflicts assessments and reviews should be undertaken. These frameworks resulted in actual, potential and perceived conflicts being identified and managed throughout the entity, not just at board level.

In a number of cases, procedural guidance that underpinned an RSE licensee's conflicts management framework lacked sufficient clarity; for example, what comprised a relevant duty or interest within that RSE licensee's business operations, how materiality thresholds were to be applied and how appropriate checks and controls from identification through to management and review of conflicts were to operate. This lack of clarity resulted in inconsistent treatment of duties and interests and some misreporting and poor management of conflicts. There were also instances where policies were not followed, resulting in inadequate or out-of-date disclosures. APRA also noted cases where there was a lack of clear responsibilities regarding the maintenance and review of the registers of relevant duties and interests resulting in the registers being static and becoming outdated.

Finally, it was apparent that the principles embodied in some policies and procedures did not appropriately reflect the conflicts management culture and corporate values espoused by the RSE licensee, which affected how well the conflicts management framework was embedded into the RSE licensee's business operations.

For consideration:

- *Are registers of relevant interests and duties reviewed regularly to ascertain their accuracy and relevance?*
- *Do conflicts management arrangements clearly articulate how duties and responsibilities of responsible persons should be disclosed?*
- *Are there clear and complete policies to address gifts, entertainment and remuneration, as well as the consideration of indirect interests (for example, where interests are held by family members)?*
- *Are there clear links between the conflicts management framework and the fit and proper assessments required under Prudential Standard SPS 520 Fit and Proper?*
- *Are employment, remuneration and incentive arrangements of responsible persons transparent, disclosed and appropriately managed?*
- *Are conflict management processes well supported by the provision of quality training for all directors and RSE licensee staff?*

4. Robust related party dealings

Robust management of related party arrangements is a critical element of a sound conflicts management framework. There was a lack of consistency across industry in relation to RSE licensees identifying and managing conflicts when dealing with intra-group service and product providers and related parties. The inconsistencies arose, in part, due to inadequacies in the conflicts management framework for these RSE licensees. Critically, where RSE licensee level conflicts were not adequately addressed within the framework, differing and inconsistent practices were applied to the identification and management of related party conflicts.

Where the framework was more mature and captured RSE licensee level conflicts, the identification and management of related party conflicts was often limited to an RSE licensee's assessment of actual conflicts and did not adequately capture perceived or potential conflicts. An RSE licensee's inability to fully recognise all relevant conflicts involving related parties was seen to be driven by inadequate definitions within the conflicts management framework and the RSE licensee's application and interpretation of those definitions.

Conflicts management frameworks were also found to be lacking in their consideration of the new Section 58A and Section 58B of the SIS Act which essentially frees up RSE licensees from previous 'tied' arrangements.

For consideration:

- *Are the definitions of conflicts of interest and duty used by your entity sufficiently broad to capture all relevant related party dealings?*
- *Are related parties appropriately identified and dealings with such parties rigorously monitored?*
- *Are there agreed protocols for selection, comparison and assessment of material service providers, including assessments undertaken on an arms' length basis, with appropriate benchmarking of key aspects such as product features and rates?*
- *In conglomerate group structures, is there appropriate input and influence over shared services provided by the group? Are these services sufficiently captured by your conflicts management framework?*

Next steps

Whilst the thematic review indicated that there are some examples of sound conflicts management practices across the superannuation industry, APRA's view is that there is significant room for improvement.

APRA's responsible supervisors will follow up with RSE licensees to ensure that any specific issues arising from the review are addressed in a timely manner. Responsible supervisors will also continue to focus on conflicts management issues as part of future supervision activities.

Please contact your responsible supervisor if you wish to discuss any of the matters highlighted in this letter in further detail.

A handwritten signature in cursive script that reads "Helen Rowell".

Helen Rowell
APRA Member