

12 May 2016

Mr Pat Brennan  
General Manager, Policy Development  
Policy and Advice Division  
Australian Prudential Regulation Authority

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Dear Mr Brennan

### **Clarifications to the non-capital Level 3 prudential standards**

Governance Institute of Australia (Governance Institute) is the only independent professional association with a sole focus on whole-of-organisation governance. Our education, support and networking opportunities for directors, company secretaries, governance professionals and risk managers are second to none.

Our members have primary responsibility to develop and implement governance frameworks in public listed, unlisted and private companies, as well as in the not-for-profit (NFP) and public sectors. They frequently are those with the primary responsibility for dealing and communicating with regulators such as the Australian Securities and Investments Commission (ASIC), and in listed companies have primary responsibility to deal with the Australian Securities Exchange (ASX) and interpret and implement the Listing Rules. Our members are frequently the nexus between boards and shareholders.

Our submission responds to:

- drafting clarifications regarding the requirements for a Head of a group in the cross-industry prudential standards, and
- edits to address feedback provided in submissions to APRA's consultation on *Improving APRA's board engagement* in October 2014, to improve the clarity of the requirements applying to a board.

We have not provided comment on:

- the edits implemented as a result of *Prudential Standard 3PS 110 Capital Adequacy* (3PS 110) not being finalised at this time
- an amendment in *Prudential Standard CPS 220 Risk Management* (CPS 220) to the timeline for submitting a risk management declaration to APRA in response to feedback from industry that the existing wording created some confusion.

### **Requirements applying to the board**

Governance Institute commends APRA for clarifying in the prudential standards the requirements applying to the board. The blurring between board and management responsibilities that was the source of concern in earlier versions of the prudential standards is no longer present. The oversight role of the board, which differs from the implementation and day-to-day management role of the senior management team, has now been clarified.

## **Requirements for a Head of a group in the cross-industry prudential standards**

Governance Institute is of the view that the revisions intended to clarify the requirements for a Head of a group in the cross-industry prudential standards have not aided understanding, but create considerable confusion as to the application of the requirements.

It is unclear from the current drafting as to when the requirements apply at the group level and when they apply at the individual level. It is also unclear when group policies can be relied on across the group.

The potential for confusion is exacerbated by the considerable amount of cross-referencing that is required to seek to understand how the paragraphs apply, whether they conflict and whether they can be read as applying at the group or individual levels.

For example, the application of requirements in relation to the remuneration policy and framework is unclear as to its application at the group and individual level. In *Prudential Standard CPS 510: Governance*, CPS 510.3 states that 'All APRA-regulated institutions have to comply with this Prudential Standard in its entirety, unless otherwise expressly indicated'. CPS 510.4 states that:

Where an APRA-regulated institution is the 'Head of a group', it must comply with a requirement of this Prudential Standard:

- (a) in its capacity as an APRA-regulated institution;
- (b) subject to paragraph 43, by ensuring that a requirement is applied appropriately throughout the group, including in relation to institutions that are not APRA-regulated; and
- (c) on a group basis.

In applying the requirements of this Prudential Standard on a group basis, references in paragraphs 51 to 64, 66 to 72, 74 to 100 and 102 to 112 to an 'APRA-regulated institution' should be read as 'Head of a group' and references to 'institution' should be read as 'group'.

We have given some examples below, but these are just for illustration.

For example, when seeking to apply these application provisions to CPS 510.56, it is unclear as to whether the intention is that the policy must provide for the Head of the group to adjust performance-based components of remuneration downwards to zero if appropriate, or if all of the subsidiaries must also undertake this, or just the subsidiaries, not Head of the group. Based on the combined effect of CPS 510.3 and CPS 510.4 it appears that it would be both the board of Head of group and the board of the subsidiary, but we doubt this is the intention.

Furthermore, CPS 510.62, which from CPS 510.3 applies to the subsidiary, and CPS 510.4, which applies to the Head of group, suggests that the board of a group could adopt a group remuneration policy that has been developed by a subsidiary. A Head of group would not adopt such a policy. The subsidiary would adopt the group policy.

The provisions about board remuneration committees (CPS 510.69 ff ) create similar confusion.

From a compliance perspective, the current drafting suggests duplication of effort in many instances throughout the group, when Governance Institute understands that APRA is seeking to provide group entities with the capacity to adopt and implement group policies across the group. The current drafting does not clearly support this intention.

Moreover, given that it is unclear how the requirements apply in the current drafting, it will be difficult for entities to be confident that they are complying with the requirements.

**Governance Institute recommends** that the lack of clarity could be addressed by inserting words similar to the following in CPS 510.3: Application (assuming each is relevant):

Paragraphs [a, b and c]<sup>1</sup> apply to all entities  
 Paragraphs [x, y and z] apply to the Head of group, not subsidiaries.  
 Paragraphs [l, m and n] apply to the subsidiaries, not Head of group (eg, 510.62)  
 Paragraphs [d, e and f] apply to foreign entities.

Governance Institute notes that the prudential standards are already long and detailed, and recommends that more words not be added to various paragraphs to seek to address the current confusion.

### **Independence**

Governance Institute is on the public record as expressing disquiet that the factors relevant to assessing the independence of a director as expressed in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (Principles and Recommendations) have been adopted as prescriptive requirements in the APRA prudential standards.

Notwithstanding this, for the purposes of compliance, the requirements in the APRA prudential standards should match in content the factors relevant to assessing independence as expressed in the Principles and Recommendations, given that any differences may cause challenges for APRA-regulated entities that are also listed entities.

We note that Attachment A in *Prudential Standard CPS 510: Governance* lists factors relevant to the independence of a director from the 2<sup>nd</sup> edition of the Principles and Recommendations. The 3<sup>rd</sup> edition of the Principles and Recommendations was published in March 2014. The factors relevant to assessing independence in the 3<sup>rd</sup> edition differ from those set out in the 2<sup>nd</sup> edition. These could either be restated in their entirety or APRA could incorporate the factors by reference, so that if they change, the standard remains up to date.

Yours sincerely



Steven Burrell  
 Chief Executive

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<sup>1</sup> Numbering to be inserted as relevant to requirements — these are examples only.