Prudential Practice Guide

Draft SPG 512 – Governance Transition

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 512 Governance Transition (SPS 512) establishes requirements for the purposes of [proposed section 24 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)], which requires all RSE licensees to comply with [Part 9 of the SIS Act (as amended)] within [three years of Royal Assent to the amendments to Part 9]. These obligations include, inter alia, obligations for the Board of a registrable superannuation entity (RSE) licensee (RSE licensee) to have at least one-third independent directors, including an independent chairperson.

This PPG aims to assist an RSE licensee in complying with those requirements and, more generally, to outline prudent practices in relation to how an RSE licensee either implements the new governance requirements or ceases to operate by the end of the transition period.

For the purposes of this guide, and consistent with the application of SPS 512, 'RSE licensee' has the meaning given in section 10 of the SIS Act.

Subject to the requirements of SPS 512, an RSE licensee has the flexibility to structure its arrangements for implementing the new requirements in [Part 9 of the SIS Act (as amended)] and *Prudential Standard SPS 510 Governance* 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.

Introduction

1. This prudential practice guide (PPG) provides guidance to an RSE licensee as it implements the new governance requirements introduced by [Part 9 of the SIS Act (as amended)] and *Prudential Standard SPS 510 Governance* (SPS 510) by the end of the transition period.[1] For the purposes of this PPG, the new requirements in [Part 9 of the SIS Act (as amended)] and SPS 510 are referred to as 'the new governance requirements'.

2. This PPG also provides guidance to a ceasing RSE licensee in developing a comprehensive exit plan to ensure it ceases operating in an orderly manner by the end of the transition period.[2]

3. New RSE licensees established after the date of Royal Assent will have to meet the new governance arrangements from the time they are established. This PPG is not relevant to new RSE licensees.

Key milestones

4. SPS 512 requires an RSE licensee to undertake certain actions by the end of the transition period. The key requirements are summarised in the table below.

Date	Governance transition requirement
[Date of registration]	New governance requirements commence in SPS 510 and SPS 512
1 July 2016	RSE licensees to complete preliminary assessment
1 January 2017	Transition plan or exit plan to be submitted to APRA
[Royal Assent + 3 years date]	All RSE licensee boards must comply with the new governance requirements or have exited the industry

5. The legislation requires compliance with the new governance requirements by the end of the transition period. APRA expects each RSE licensee Board to comply with the new governance requirements at the earliest reasonable opportunity, as seeking early compliance is likely to be in the best interests of beneficiaries.

6. Notwithstanding that RSE licensees have until the end of the transition period to comply with the new requirements, APRA expects an RSE licensee to demonstrate that appointments made to the Board during the transition period are consistent with achieving compliance by the end of the transition period.

Ongoing effectiveness

7. It is expected that the new governance requirements will require some boards to appoint independent directors for the first time. Other boards may have to appoint additional independent directors to meet the new governance requirements. Any changes to the composition of the Board are therefore likely to require an RSE licensee to make consequential amendments to board documentation, public disclosures and existing policies, processes and systems relating to board operations.

8. APRA expects that a prudent RSE licensee would be mindful of the additional complexity that is likely to arise during the transition period when maintaining the overall skills and fitness of the Board. A transitioning RSE licensee would be expected to seek to ensure that the Board has the appropriate expertise

1 The board independence requirements are outlined in [proposed sections 86 and 87 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)] and a reference to 'transition period' in this PPG is a reference to a transition period as defined in [proposed section 23 of the SIS Act].

2 For the purposes of this PPG, 'transitioning RSE licensee' and 'ceasing RSE licensee' have the meaning given in *Prudential Standard SPS 512 Governance Transition* (SPS 512).

to carry out its functions at all times during the transition period.

Risk management during transition

9. *Prudential Standard SPS 220 Risk Management* (SPS 220) requires an RSE licensee to maintain a risk management framework in respect of its business operations.[3]

10. SPS 512 requires an RSE licensee to update its risk management framework to reflect the risks associated with transitioning to the new governance requirements or, where it has notified APRA that it intends to cease to operate, risks associated with exiting the industry. Such updates may include, but are not limited to, the identification of key operational risks associated with the transition or exit and how these risks will be managed, as appropriate.

11. For transitioning RSE licensees, risks that may arise during the transition period include, but are not limited to:

    (a) the Board not having the requisite skills to perform its role effectively, as required by SPS 510;

    (b) delays in the selection and appointment of directors;

    (c) delays in amending the constitution of the RSE licensee, enacting legislation (in the instance of public sector RSEs) or amending any other governing rules or documentation;

    (d) inexperience of new directors affecting their ability to effectively contribute to the successful functioning of the Board; and

    (e) a poorly planned and executed transition process.

12. For ceasing RSE licensees, the risks include, but are not limited to:

    (a) lack of resources to put into effect the actions articulated in the exit plan;

    (b) difficulties in identifying a successor fund; and

    (c) circumstances that prevent the wind-up of the RSE(s) as originally planned.

Preliminary assessment

13. Where an RSE licensee notifies APRA that it complies with the new governance requirements on the commencement of SPS 512, APRA expects that the RSE licensee's preliminary assessment would describe the basis for that view and the process by which the assessment of independence for each independent director was undertaken. APRA also expects that the preliminary assessment for such entities would outline the changes required to the RSE licensee's governance framework and risk management framework to ensure that it maintains compliance with the new requirements at all times.

14. For transitioning RSE licensees, APRA expects that the preliminary assessment would identify the key actions that the RSE licensee expects that it will need to undertake in order to comply with the new governance requirements by the end of the transition period. These actions will then form part of the RSE licensee's transition plan.

15. Some of these key actions may include:

    (a) seeking legal advice on whether the RSE licensee's constitution, enacting legislation or any other governing rules or documentation require amendment to provide the RSE licensee the necessary capacity to appoint and remove directors, and making such changes where required;

    (b) engaging with external parties such as sponsoring organisations, employer sponsors and shareholders to discuss, and agree on, the proposed actions required to achieve compliance with the new governance requirements; and

    (c) identifying policies, procedures and processes in the RSE licensee's governance framework which need to be updated.

3 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.

These may include, at a minimum, the board appointment and removal processes, board committee appointment and removal processes, conflicts management framework, fit and proper assessment processes and risk management strategy.[4]

16. The new governance requirements do not preclude an existing director from being reclassified as an independent director where they meet the new governance requirements, regardless of their previous status or role on the Board. APRA expects an RSE licensee would provide details of the basis for the reclassification of any director in the preliminary assessment.

17. Where the Board of a ceasing RSE licensee has made an in-principle decision to cease operating, notifying APRA of the expected date for the RSE licensee to cease operating will be sufficient for the purposes of the preliminary assessment.

18. Where an RSE licensee has yet to make a final decision to cease operating but is likely to do so, APRA expects that the preliminary assessment would include details of when the decision is expected to be made and an overview of the actions that may be required in the event that a decision to continue to operate is taken.

Transition plan (transitioning RSE licensee)

19. Successful implementation of the new governance requirements requires careful planning and management. Depending on the level of complexity identified in the preliminary assessment, an RSE licensee may consider seeking specialist advice to assist with the development and implementation of their transition plan.

20. The power to appoint and remove directors, including the chairperson, does not always reside with the Board. For example, the shareholders of the RSE licensee or other sponsoring organisations may hold this power.

21. In such circumstances, APRA expects that the RSE licensee would engage with these external organisations early in the transition period to agree how existing arrangements will be amended to ensure compliance with the new governance requirements. This would not only include consideration of the power to appoint, re-appoint and remove directors from the Board, but also whether the Board is to have the right to veto such decisions.

22. It is likely that these external parties will have to revise their policies and procedures to support the RSE licensee complying with the new governance requirements by the end of the transition period.

23. As part of the transition plan, APRA expects an RSE licensee would ensure that individual board terms are appropriately staggered, so that there is a continuity of appropriate knowledge, skills and experience on the Board. This reduces the risk that multiple concurrent new appointments will adversely affect the effectiveness of the Board's operation.

24. APRA recognises that changes may be required to the governing rules, constitution, enacting legislation or other documentation prior to the appointment of the new directors. As a result, APRA expects a transitioning RSE licensee would allow sufficient time to make these necessary changes as part of its planning.

25. Transitioning RSE licensees are likely to encounter certain barriers and challenges to achieving orderly compliance with the new governance requirements. Anticipating these barriers and challenges will help an RSE licensee avoid or manage these challenges to reduce the risk of them becoming major impediments to successful implementation.

26. In identifying possible impediments to meeting the new governance requirements, APRA expects an RSE licensee would consider, at a minimum:

4 Refer to SPS 510 for requirements relating to the governance framework, *Prudential Standard SPS 521 Conflicts of Interest* for requirements relating to conflicts management, *Prudential Standard SPS 520 Fit and Proper* for requirements relating to the assessment of fitness and propriety and SPS 220 for requirements relating to risk management.

(a) who currently has the authority to appoint and remove directors to the Board, and the process for doing so;

(b) where applicable, whether sponsoring organisations and employer sponsors that have a right to appoint directors support the RSE licensee moving to compliance and are aware and accepting of the proposed changes;

(c) the terms and contracts of the appointed directors; and

(d) the resources and time likely to be required to complete the actions required to comply with the new governance requirements by the end of the transition period.

27. Where impediments to complying with the new governance requirements are identified, APRA expects an RSE licensee's transition plan would include details of how it intends to address or resolve these impediments. Whilst such details may not be fully developed in the early stages of development of the transition plan, APRA expects an RSE licensee would resolve these impediments as quickly as practicable, and have processes and timeframes for identifying solutions to any additional issues that may arise during the transition period.

Board committees

28. APRA does not expect RSE licensees to appoint independent directors to board committees until the RSE licensee has complied with the requirement in [proposed section 86 of the SIS Act] to have a minimum of one-third independent directors on the Board.

Exit plan (ceasing RSE licensees)

29. APRA expects that the process to wind-up an RSE licensee's business operations would ordinarily take no longer than 18 months to complete. Where an RSE licensee's exit plan indicates a timeframe longer than 18 months, APRA expects the plan would provide a detailed explanation of why the additional timeframe is deemed necessary.

30. Where an RSE licensee is well progressed towards the winding-up of the RSE licensee's business operations and has, at least, provided written notice to APRA in accordance with r.11.07A(6) of the *Superannuation Industry (Supervision) Regulations 1994* of its decision to wind-up its RSE(s), APRA expects an RSE licensee would provide the details required in the exit plan as soon as possible but in any case no later than 1 January 2017.

31. For successor fund transfers, APRA expects an exit plan to:

(a) identify the RSE to which member benefits will be transferred (the successor entity);

(b) set out the process for capturing and transmitting to the successor entity all data about each member; and

(c) set out the process to ensure the retention of sufficient assets to meet costs incurred in the wind up of the RSE.

Monitoring the transition or exit plan

32. APRA's view is that a prudent Board would consider whether it would be appropriate to establish a Board Transition Committee or appoint a person with responsibility for overseeing all activities essential to a successful execution of the transition or exit plan.

33. If a Board Transition Committee is established or a person is appointed to oversee transition, APRA expects that Committee or person would report directly to the Board.

34. A prudent Board would ensure that there were no conflicts of interest arising in relation to the Board Transition Committee or appointed person.

Review of the transition and exit plans

35. SPS 512 requires an RSE licensee to regularly review the RSE licensee's progress against stated milestones within the transition or exit plan. Where material changes are subsequently made to either the transition or

exit plan, SPS 512 requires an RSE licensee to notify APRA of the changes along with an explanation for the changes.

36. APRA expects that a prudent RSE licensee would conduct such a review at least every three months.

37. An RSE licensee would generally be expected to investigate the reasons for any divergence from stated milestones in the plan, identify any risks arising from the divergence and put in place measures to address these risks.

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