



Discussion Paper

Governance arrangements for RSE licensees

31 August 2015

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Preamble

In June 2015, the Government released for public consultation a package of reforms aimed at promoting good governance by registrable superannuation entity (RSE) licensee (RSE licensee) boards.

On 26 June 2015, APRA wrote to all RSE licensees to seek feedback on initial proposals to amend its superannuation prudential framework to support the Government's proposed legislative reforms.¹

This paper sets out APRA's response to the issues raised in submissions in relation to APRA's 26 June letter and outlines the proposed requirements set out in the draft prudential standards. These proposals reflect the Government's announcement on 19 August 2015 on the outcomes of its consultation on the draft legislation.²

The paper also provides some detail on the draft prudential practice guides (PPGs) which accompany this paper. APRA invites comment on the proposals reflected in the draft prudential standards and PPGs.

Subject to the passage of legislation and consideration of submissions received, APRA expects to release the final prudential standards and PPGs in December 2015 with the prudential standards expected to take effect on the date that they are registered on the Federal Register of Legislative Instruments.

This paper and the draft prudential standards and draft PPGs are available on APRA's website at www.apra.gov.au.

Written submissions on this paper should be forwarded by 23 October 2015, preferably by email, to:

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¹ APRA Letter to RSE licensees, 'Governance requirements for RSE licensees: proposed amendments', 26 June 2015.

² <http://jaf.ministers.treasury.gov.au/media-release/039-2015/>

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Glossary

| Term | Meaning |
|------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| the 26 June letter | APRA letter, 'Governance requirements for RSE licensees: proposed amendments', issued 26 June 2015 |
| the Bill | Superannuation Legislation Amendment (Governance) Bill 2015 |
| ceasing RSE licensee | an RSE licensee that intends to cease operating by the end of the transition period |
| complying RSE licensee | an RSE licensee that complies with the new governance requirements |
| CPS 510 | <i>Prudential Standard CPS 510 Governance</i> |
| new governance requirements | proposed Part 9 of the SIS Act (as amended) and SPS 510 |
| PPG | prudential practice guides |
| RSE | registrable superannuation entity as defined in s. 10 of the SIS Act |
| RSE licensee | a constitutional corporation, body corporate, or group of individual trustees, that holds an RSE licence granted under s. 29D of the SIS Act |
| RSE licensee's business operations | 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. |
| SIS Act | <i>Superannuation Industry (Supervision) Act 1993</i> |
| SPS 220 | <i>Prudential Standard SPS 220 Risk Management</i> |
| SPS 510 | <i>Prudential Standard SPS 510 Governance</i> |
| SPS 512 | <i>Prudential Standard SPS 512 Governance Transition</i> |
| SPG 510 | <i>Prudential Practice Guide SPG 510 Governance</i> |
| SPG 512 | <i>Prudential Practice Guide SPG 512 Governance Transition</i> |
| transition period | The three-year transition period starting on the day on which the Bill receives Royal Assent |
| transitioning RSE licensee | an RSE licensee that intends to comply with the new governance requirements |

Executive summary

In June 2015, the Government released for public consultation a package of reforms aimed at promoting good governance by registrable superannuation entity (RSE) licensee (RSE licensee) boards.³

The Government's reforms propose to require that all RSE licensee boards have a minimum of one-third independent directors, including an independent chairperson. The Government also proposes a three year transition period for the new reforms, commencing on the date that the legislation receives Royal Assent.

The Government has indicated that the aims of the reforms are two-fold: to broaden each board's pool of experience and to increase the accountability of decisions made by directors, particularly in relation to conflicts of interest.

The explanatory guide, which was released with the draft Bill, outlines the matters that the Government expects will be addressed by APRA in its prudential standards.

APRA wrote to all RSE licensees on 26 June 2015 to seek feedback on initial proposals to amend its superannuation prudential framework to support the Government's proposed legislative reforms.⁴

Since the release of the draft Bill, the Government has announced changes to its original proposals which have implications for APRA's proposed prudential standards. These include:

- including more detail on the definition of independence in the legislation, rather than APRA's prudential standards; and

³ Throughout this paper, references to the board should be read to include both boards of trustee corporations as well as groups of individual trustees. In addition, references to a director should be read to include directors of trustee corporations as well as individuals in a group of individual trustees.

⁴ APRA Letter to RSE licensees, 'Governance requirements for RSE licensees: proposed amendments', 26 June 2015.

- an intention to commence the requirements, subject to transitional arrangements, on the legislation receiving Royal Assent, rather than 1 July 2016.

APRA's draft prudential standards and prudential practice guides (PPGs) are consistent with these revised proposals.

Submissions

APRA received 17 written submissions from a wide range of stakeholders including RSE licensees, consultants, industry bodies and professional bodies in response to the 26 June letter. In addition to considering written submissions, APRA has met with a number of RSE licensees and other stakeholders to discuss the proposals.

Submissions were unanimously supportive of APRA's objectives and the broad direction of the proposed prudential standards and guidance, including the range of topics that the prudential standards will cover.

The submissions, however, raised a number of issues about the detail of the proposals. Some of the issues raised have since been addressed by the proposed changes in the legislation. Other issues raised in submissions are discussed in this paper.

Next steps

APRA is seeking comments on the draft prudential standards and related PPGs that accompany this paper.

Subject to the passage of the Bill and consideration of feedback received in response to this consultation package, APRA intends to finalise the prudential standards and PPGs before the end of 2015.

Chapter 1 – Introduction

A culture that promotes good governance benefits all stakeholders of an RSE licensee and helps to maintain public confidence in the entity. It is therefore essential that an RSE licensee has a sound governance framework and conducts its affairs with a high degree of integrity. Effective governance arrangements also assist RSE licensees and their individual directors to satisfy their legal obligations in a manner that meets the reasonable expectations of beneficiaries.

In June 2015, the Government released, for public consultation, a package of reforms aimed at promoting good governance by RSE licensee boards. The Government proposes to require that RSE licensees meet strengthened obligations relative to current board composition requirements contained in Part 9 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

The reforms propose that all RSE licensee boards have a minimum of one-third independent directors, including an independent chairperson. The Government has indicated that the aims of the reforms are two-fold: to broaden each board's pool of experience and to increase the accountability of decisions made by directors, particularly in relation to conflicts of interest.

The proposed amendments to APRA's superannuation prudential framework outlined in this paper reflect the Government's reforms. They also seek to harmonise, where appropriate, the governance obligations applying to RSE licensees with those applying to other APRA-regulated industries.

1.1 Summary of proposed legislative reforms

At present, Part 9 of the SIS Act requires certain RSE licensees to maintain board structures with equal numbers of employer representatives and member representatives. The boards of such RSE licensees can also appoint an independent director if such an appointment is permitted under an RSE's

governing rules and is requested by the employer or member representatives on the board.

The Bill proposes to amend the SIS Act to improve governance in superannuation by ensuring that there is an appropriate proportion of independent directors on the boards of all APRA-regulated superannuation funds. This is proposed to be achieved by replacing the existing equal representation requirements in Part 9 with new board composition requirements focused on the appointment of independent directors.

The Government has also proposed amendments to the *Corporations Regulations 2001* and the *Superannuation Industry (Supervision) Regulations 1994* to support the changes to the SIS Act.

1.1.1 Independence

The Bill proposes to require all RSE licensee boards to have a minimum of one-third independent directors, with the chairperson of the board drawn from these independent directors. These requirements must be met by the end of a three-year transition period.

1.1.2 Commencement and transition

Subject to the passage of legislation, the Bill proposes that the new governance regime will apply from Royal Assent. This means that new RSE licensees established after the date of Royal Assent will have to meet the new governance arrangements from the time they are established. The Government has announced, however, that existing RSE licensees will have three years to transition to the new arrangements from the time the legislation receives Royal Assent. The Bill provides for APRA's prudential standards to set out how RSE licensees will be required to transition to the new requirements of Part 9.

From the date of Royal Assent, standard-employer sponsored RSE licensees that comply with transition requirements set out in APRA's prudential standards will be required to comply with neither the former equal representation rules

nor the new governance arrangements. Irrespective of this, APRA expects that RSE licensee boards continue to operate in a manner that enables them to discharge their fiduciary obligations throughout the transition period; this may involve boards deciding to maintain for an appropriate period any governance models that existed prior to the reforms taking effect.

The Government has indicated that RSE licensees that notify APRA that they will cease operating before the end of the transition period will not be required to comply with the new requirements of Part 9 of the SIS Act where they meet the transition requirements set out in APRA's prudential standards.

1.1.3 APRA's power to determine independence

The draft Bill proposes that APRA be given the power to determine whether an individual director is, or is not, considered independent.

This proposal aligns with equivalent existing APRA powers in respect of both the superannuation industry and other APRA-regulated industries. These powers include the power to disqualify individuals where APRA is satisfied that they are not a fit and proper person to be a trustee of an RSE licensee.⁵

APRA employs these types of powers only where the circumstances are sufficiently serious to warrant their use, for example, where there is the risk of significant negative impacts on the interests of beneficiaries. They are nonetheless a crucial component of the regulatory framework.

APRA reiterates its position in the 26 June letter that it expects to use these proposed powers rarely. APRA's view is that a legislative definition of independence will provide industry with sufficient information to undertake robust assessments of a director's independence. APRA will look to provide supporting guidance to assist RSE licensees as they undertake such assessments.

⁵ Refer to section 126A(3) of the SIS Act.

Draft *Prudential Standard SPS 510 Governance* (SPS 510) also encourages RSE licensees, where they may be in doubt about a director's independence, to refer the matter to APRA for guidance.

1.2 Proposed amendments to APRA's prudential standards

On 26 June 2015, APRA wrote to all RSE licensees regarding initial proposals to amend the superannuation prudential standards to support the Government's proposed legislative reforms.⁶

APRA received 17 submissions in response to the 26 June letter. This paper outlines the key issues raised in these submissions that have not been addressed by proposed changes in the legislation. The paper outlines APRA's proposed response to these issues, including any consequential amendments to its superannuation prudential framework.

Accompanying this discussion paper are:

- revised draft SPS 510 and revised draft *Prudential Practice Guide SPG 510 Governance* (SPG 510) to support the proposed amendments to Part 9 of the SIS Act. These revised drafts introduce the concept of a formal governance framework (including detailed requirements relating to the nomination, appointment and removal of directors) and enhance requirements relating to key board committees in light of the proposed changes to board composition (refer to Chapter 2); and
- new draft *Prudential Standard SPS 512 Governance Transition* (SPS 512) and new draft *Prudential Practice Guide SPG 512 Governance Transition* (SPG 512) which aim to support RSE licensees implementing the new governance requirements (refer to Chapter 3).

⁶ APRA Letter to RSE licensees, '*Governance requirements for RSE licensees: proposed amendments*', 26 June 2015.

Attachment A to this paper summarises the proposed amendments to existing SPS 510 and SPG 510.

1.3 Consequential amendments to APRA's reporting standards

APRA currently collects information relating to RSE licensee boards under *Reporting Standard SRS 001.0 Profile and Structure (Baseline)* (in relation to board structure) and *Reporting Standard SRS 600.0 Profile and Structure (RSE)* (in relation to the representation of individual directors and board committees). These reporting requirements will be updated in due course to support the final legislative and prudential requirements.

1.4 Next steps and timetable

The Government has indicated that it intends to finalise the amendments to the SIS Act and related regulations as soon as possible.

APRA will release the final prudential standards and PPGs once the legislation has passed. At this stage, APRA intends to release the final package before the end of 2015, with amended SPS 510 and new SPS 512 to take effect once registered on the Federal Register of Legislative Instruments, to allow sufficient time between the release of final SPS 510 and SPS 512 and the proposed completion of the preliminary assessment under SPS 512 in July 2016.

Final SPG 510 and SPG 512 will be released at the same time as the final standards.

If the legislative amendments proceed on a different timetable, or change in a way which affects APRA's prudential standards and guidance, APRA will adjust the timetable and undertake further consultation as required.

Chapter 2 – Proposed amendments to existing governance requirements (SPS 510 and SPG 510)

SPS 510 establishes minimum requirements for how RSE licensees govern themselves to ensure that they conduct their affairs with a high degree of integrity. A framework that promotes good governance benefits beneficiaries of an RSE and helps to maintain public confidence in the RSE licensee's operations.

SPS 510 was introduced in 2012 as part of APRA's new prudential standards for the superannuation industry. The proposed changes to SPS 510 outlined in this chapter represent the first amendments to SPS 510 since its introduction.

The proposed amendments to SPS 510 are aligned, to the extent appropriate, with equivalent provisions applying to authorised deposit-taking institutions (ADIs) and insurers under *Prudential Standard CPS 510 Governance* (CPS 510).

SPG 510 aims to assist compliance with the requirements of SPS 510 and, more generally, to outline prudent practices in relation to governance matters.

APRA's 26 June letter indicated that APRA would review and extend the existing guidance in SPG 510 to ensure that it aligns with the new requirements in the SIS Act and in draft SPS 510 and continues to support sound governance by RSE licensees. This chapter also outlines the proposed amendments to SPG 510.

Further, the proposed amendments outlined in this chapter and the proposed approach in draft SPS 512 are aligned with the principles reflected in the letter issued to ADIs and insurers on 28 August 2015, which outlines APRA's plans regarding clarification of APRA's requirements relating to boards and senior management.⁷

⁷ <http://www.apra.gov.au/Pages/default.aspx>

2.1 Proposed changes to structure of the definition of independence

The Government has indicated that it intends to amend the draft Bill prior to its introduction into Parliament to provide more detail on the definition of independence in the legislation.⁸

As a result, APRA's prudential standards do not include requirements relating to the definition of independence, other than by reference to the legislation.

2.1.1 Independence in conglomerate groups

The draft Bill includes in the definition of 'independent' a person who is not or who has not in the last three years been an executive officer or director of a body that has a material relationship with the licensee.

APRA's 26 June letter proposed, on the basis of the provisions in the draft Bill, that SPS 510 would include a provision (similar to that in CPS 510) to permit a group independent director that met both the proposed legislative definition and the requirements of SPS 510 to be considered independent on the RSE licensee's board.

Proposed approach

Whilst the legislation will be amended to provide more detail on the definition of 'independent' in the law, rather than in APRA's prudential standards, the definition of independent has not yet been finalised.

As a result, draft SPS 510 released with this paper is silent on the issue of independent directors in conglomerate groups. APRA will ensure that the

⁸ <http://jaf.ministers.treasury.gov.au/media-release/039-2015/>

final version of SPS 510 reflects the final legislation.

2.2 Governance framework

Proposed approach

To improve the clarity of the requirements applying to RSE licensee boards in SPS 510, APRA proposes to require RSE licensees to put in place a formal governance framework, defined as:

how the Board oversees and exercises its authority in relation to its business operations and which encompasses the totality of systems, structures, policies, processes and people within an RSE licensee's business operations.

APRA intends that this framework operate in a similar manner to framework requirements set out in *Prudential Standard SPS 220 Risk Management (SPS 220)*, *Prudential Standard SPS 530 Investment Governance* and *Prudential Standard SPS 250 Insurance in Superannuation*.

The proposed governance framework will therefore require RSE licensees to have in place policies and procedures to support effective governance practices. APRA's view, however, is that the governance framework requirement reflects the approach that the majority of RSE licensees have put in place since SPS 510 commenced. The majority of the components of the governance framework, therefore, reflect provisions that are currently in SPS 510. The key new components are:

- a formal policy regarding board size and composition; and
- nomination, appointment and removal processes (discussed in further detail below).

In APRA's view, the size of an RSE licensee board is determined after considered analysis of the most appropriate size for effective governance of the RSE licensee's business operations. APRA therefore proposes to include additional guidance about board size in draft SPG 510 to support boards when undertaking such analysis, particularly where the size of the board has the potential to inhibit

effective governance of the RSE licensee's business operations.

2.3 Nomination, appointment and removal of directors

The draft Bill states that RSE licensees must comply with requirements in the prudential standards relating to the appointment and removal of independent directors.

SPS 510 currently requires RSE licensees to have in place a formal policy on board renewal. In the 26 June letter, APRA indicated that it intended to require that the renewal policy address specific matters relating to the nomination, appointment and removal of directors. In APRA's view, these are crucial to effective governance.

Proposed approach

Submissions did not raise concerns about the proposed expansion of the board renewal policy to address matters indicated in APRA's 26 June letter. APRA, therefore, proposes to amend SPS 510 to require the board to establish and implement policies and processes relating to the nomination, appointment and removal of directors which include, inter alia:

- the length of director terms and maximum number of terms;
- the management of vacancies on the board;
- how the board will assess the suitability of nominated candidates, including the assessment of independence;
- the factors that will determine when an existing director will be reappointed;
- how the Board will resolve disputes about nominations, appointments or removal of directors;
- when and how a director will be removed from the board; and
- the board's policy on voting rights and related voting procedures.

Draft SPG 510 expands on existing guidance relating to board renewal, and provides guidance related to the nomination, appointment and removal of directors. This includes proposed guidance on:

- determining the appropriate number of independent directors on the board and ensuring that this number is maintained on an ongoing basis;
- appropriate nomination, appointment and removal processes;
- the management of nomination and appointment processes where organisations external to the board have a right to nominate or appoint directors;
- the management of tenure to ensure an appropriate transfer of knowledge between directors;
- factors to be considered when reviewing potential candidates and appointing new directors to the board; and
- consideration of disclosure requirements, including the RSE licensee's reasoning for maintaining a proportion other than a majority of independent directors.⁹

Draft SPG 510 also sets out a number of further considerations that are intended to support RSE licensees seeking to appoint new directors. These include assessing the independence of candidates for independent director positions, assessing candidates against the fit and proper policies of the RSE licensee and assessing the ability of candidates to actively contribute to the functioning of the board.

2.4 Composition of board committees

At present, SPS 510 sets requirements relating to the membership of the Board Remuneration Committee and Board Audit Committee designed to promote independent decision-making by these two key board committees.

In the 26 June letter, APRA proposed that the Board Audit Committee and the Board Remuneration Committee would be required to have a majority of independent directors and an

⁹ Refer also to the Government's proposal to require RSE licensees that do not have a majority of independent directors be required to report on an 'if not, why not basis' (<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Reforms-to-Superannuation-Governance>).

independent chair. This approach was proposed to align SPS 510 with the equivalent requirements in CPS 510.

Submissions received

Submissions highlighted significant concerns with this proposed approach. In particular, submissions argued that given that the proposed legislative changes require only one third independent directors on the Board, it would be logistically difficult for an RSE licensee to maintain a majority of independent directors on board committees and still maintain appropriate skills and experience on these committees.

Proposed approach

In light of the feedback received, APRA now proposes to amend SPS 510 to:

- require at least one third of the members of both the Board Audit Committee and Board Remuneration Committee to be independent directors;
- require the chair of both the Board Audit Committee and Board Remuneration Committee to be an independent director; and
- prohibit the chairperson of the Board from acting as the chair of the Board Audit Committee.

As indicated in its 26 June letter, APRA proposed to amend SPS 510 to remove the existing provision which allows the chairperson of the board to also chair the Board Audit Committee where the chairperson is the only independent director on the board. Whilst submissions raised some concerns with the additional expense that will be incurred in paying independent directors to chair the Board Audit Committee, APRA believes that its original proposal, which aligns with CPS 510, promotes better governance. Accordingly, this proposal remains unchanged and is reflected in draft SPS 510.

APRA also proposes to expand SPG 510 to clarify APRA's expectations in relation to board committees in light of both the draft legislation and proposed changes to SPS 510. 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. Draft SPG 510 also suggests that RSE licensees consider how the operations of all of its key board committees might be enhanced through the inclusion of additional independent directors.

2.5 Ongoing assessment of independence

The Bill proposes that RSE licensees must have at least one-third independent directors on an ongoing basis from the end of the transition period.

To support this requirement, and because a person's independence can be affected by the passage of time or changes in their individual circumstances, APRA proposed in the 26 June letter to require each RSE licensee board to undertake regular assessments of the independence of each director.

Proposed approach

Submissions did not raise concerns with this preliminary proposal. As a result, the existing requirement to assess board performance at least annually in draft SPS 510 has been updated to make reference to regularly assessing independence.

2.6 Proposed commencement

APRA proposes that amended SPS 510 take effect on the date of registration of SPS 510 on the Federal Register of Legislative Instruments.

Whilst SPS 510 will take effect on this date, the combination of the provisions in draft SPS 510 and draft SPS 512 (as discussed in chapter 3) are such that RSE licensees do not have to fully comply with the new requirements in SPS 510 until the end of the transition period.

Chapter 3 – Proposed governance transition requirements (SPS 512 and SPG 512)

The Government has recognised that transitioning to the new board composition requirements in Part 9 of the SIS Act will take time. As such, the Bill proposes a three-year transition period starting on the day on which the Bill receives Royal Assent (transition period).

The Government has clarified that neither the current equal representation rules in Part 9 of the SIS Act nor the new independence requirements in Part 9 (as amended) will apply during the transition period where an RSE licensee complies with relevant transitional requirements in APRA's prudential standards.

This transition period is expected to provide RSE licensees with sufficient time to make any necessary changes to their governance frameworks and board composition to meet the new requirements.

New RSE licensees established after the date of Royal Assent will have to comply with the new Part 9 requirements from that date.

If an RSE licensee notifies APRA that it will cease operating before the end of the transition period, it does not have to comply with the new requirements in Part 9.

3.1 Key requirements

Draft SPS 512 proposes to require RSE licensees to undertake a preliminary assessment and, as indicated in the 26 June letter, prepare a board-approved transition plan.

APRA's primary goal in setting transition requirements is to support the orderly transition of RSE licensees to the new governance regime and to facilitate effective governance by RSE licensee boards throughout the transition period.

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, or at the very least assist, the RSE licensee achieving compliance by the end of the transition period.

An RSE licensee that notifies APRA that it will cease operating and have its RSE licence cancelled before the end of the transition period will be required under draft SPS 512 to provide APRA with an exit plan for either winding-up or transferring the RSE(s) within its business operations.

This requirement seeks to ensure that those RSE licensees that elect to cease operating as an RSE licensee before the end of the transition period appropriately manage the wind up of their business operations.

3.2 Key milestones

Draft SPS 512 outlines several actions proposed to be required of an RSE licensee transitioning to the new governance requirements. These are summarised 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 or exit plan (as applicable) to be submitted to APRA |
| Royal Assent + 3 years | All RSE licensee boards must comply with the new governance requirements or have exited the industry |

3.3 Preliminary assessment

APRA indicated in its 26 June letter that RSE licensees would be required, under draft SPS 512, to prepare a board-approved transition plan no later than 1 July 2016, with the plan to be submitted to APRA by this date. The purpose of this plan is to formally document how the RSE licensee intends to move towards compliance with the new governance requirements.

Submissions received

Submissions indicated that the proposed timeframe for submitting the transition plan was insufficient in light of the complexities that would accompany compliance with the new composition requirements.

Submissions argued that a number of complex tasks will need to be undertaken before the board will be able to confirm how and when it will achieve compliance. These tasks include seeking advice and considering any restructuring of the board and its committees.

Proposed approach

In light of the feedback received, APRA now proposes a two-stage process to provide RSE licensees sufficient time to consider their transitional arrangements.

Draft SPS 512 proposes that all RSE licensees be required to undertake a preliminary assessment of the extent to which their governance arrangements comply with the new governance requirements and to notify APRA whether it complies with the new requirements (complying RSE licensees), intends to comply with the requirements (transitioning RSE licensees) or intends to cease operating by the end of the transition period (ceasing RSE licensees). APRA proposes that the preliminary assessment be completed no later than 1 July 2016.

In undertaking the preliminary assessment, an RSE licensee will need to identify (at a high level) the key changes required to its governance and risk management frameworks to comply with the new governance requirements together with a broad

indication of the dates by which they are proposed to be completed. Further detail on the actions required to implement these changes, and the proposed timeframes will then need to be included in the transition plan.

For transitioning RSE licensees, APRA proposes that the preliminary assessment must also consider whether the existing directors are independent and the number of directors (including independent directors) that the RSE licensee intends to have on its board at the end of the transition period.

Draft SPG 512 expands on the types of actions that a transitioning RSE licensee may need to undertake in order to comply with the new governance requirements by the end of the transition period, including some examples of the types of impediments that an RSE licensee may face. Similar, but appropriately modified, guidance is also provided for ceasing RSE licensees.

Whilst draft SPS 512 requires that the preliminary assessment be undertaken by all RSE licensees, APRA recognises that some RSE licensees will already comply with the proposed requirements. In such circumstances, the preliminary assessment will be required to only describe the process by which the assessment of independence for each independent director was undertaken.

3.4 Transition plan and exit plan requirements

3.4.1 Transition plan (for transitioning RSE licensees)

The purpose of the transition plan for transitioning RSE licensees is to document, in detail, the steps that the RSE licensee intends to take so that they comply with the requirements by the end of the transition period.

To achieve these goals, draft SPS 512 proposes that the transition plan include, inter alia:

- an outline of the key changes required to the RSE licensee's governance and risk management frameworks to ensure compliance by the end of the transition

period, including clear key milestones for monitoring progress;

- whether each existing director is independent under the new definition of independent in Part 9 of the SIS Act and whether they will be reappointed or not (and when this is expected to take place);
- the expected date for compliance with the new requirements of Part 9; and
- identification of any impediments to meeting the new governance requirements.

APRA anticipates that assessments and analysis completed by the RSE licensee for the purposes of completing its preliminary assessment would serve as the foundation for the transition plan.

Draft SPS 512 also requires that the transition plan set out processes and procedures to regularly review the RSE licensee's progress against stated milestones. APRA also proposes that an RSE licensee regularly review the ongoing appropriateness and adequacy of the transition plan.

Submissions on the 26 June letter sought further information about how and when a current director might be reclassified as an independent director under the proposed definition of independence, even though they might have held a different position on the board prior to 1 July 2016.

APRA's view is that a current director is not precluded from being reclassified as an independent director, as long as they meet the definition of independence at the time the reclassification assessment is undertaken.

3.4.2 Exit plan (for ceasing RSE licensees)

A ceasing RSE licensee must cease operating by the end of the transition period. This means that the RSE licensee must have its licence cancelled by APRA under section 29G of the SIS Act by the end of the transition period.

The purpose of the exit plan is to formally document how the RSE licensee will manage the wind-up of its business operations, including the

management of any risks associated with this winding-up.

Draft SPS 512 requires the RSE licensee's exit plan to state the processes and expected timeframes to ensure:

- members of RSEs within the RSE licensee's business operations are informed about the RSE licensee's intention to cease operating in a timely manner;
- members benefits are appropriately transferred out of the RSE licensee's business operations without undue delays or detriment; and
- relevant governing rules and legislation are followed.

Draft SPS 512 proposes to require that the exit plan, similar to the transition plan requirements, sets out processes and procedures to regularly review the RSE licensee's progress against stated milestones, and that the exit plan is reviewed regularly.

Draft SPG 512 provides guidance for RSE licensees on managing the wind-up process for those undertaking the wind-up by member consent or successor fund transfer.

3.5 Risk management frameworks

SPS 220 requires an RSE licensee to maintain a risk management framework for its business operations. Both transitioning and ceasing RSE licensees will be expected to identify and manage any risks arising as a result of moving to the new legislative requirements or exiting the industry. Draft SPG 512 provides guidance on the types of risks that APRA expects be reflected in an RSE licensee's risk management framework.

3.6 Notifying APRA

To allow APRA sufficient oversight of an RSE licensee's progress in satisfying the transitional requirements, draft SPS 512 proposes to require that RSE licensees notify APRA within 10 business days of:

- the RSE licensee becoming aware that it will not satisfy the requirements of SPS 510 by the end of the transition period; or
- for a ceasing RSE licensee, becoming aware that it will not cease operating by the end of the transition period.

3.7 Commencement date

APRA proposes that new SPS 512 take effect on the date of registration of SPS 512 on the Federal Register of Legislative Instruments. The proposed first date for compliance with the requirements of SPS 512 is 1 July 2016, when the preliminary assessment must be completed.

Chapter 4 – Cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. The Government will be preparing a Regulation Impact Statement on the proposals outlined in the draft Bill, and will include cost-benefit information arising from the reforms introduced by the Bill. On this basis, APRA has assessed that compliance costs, relating to the proposals set out in this paper are not significant. Notwithstanding this, if a respondent considers that compliance costs will increase as a result of the proposals in this paper, over and above those costs relating to proposals in the draft Bill, APRA requests that they provide an assessment of the impact on compliance costs. Compliance costs are defined as direct costs to businesses of performing activities associated with complying with Government regulation.

Consistent with the Government's requirement, APRA will use the methodology behind the Regulatory Burden Measurement Framework to assess any increase in compliance costs identified by respondents. This framework is designed to capture the relevant costs in a structured way, including a separate assessment of upfront costs and ongoing costs. Further information is available at: <http://www.dpmc.gov.au/office-best-practice-regulation/publication/regulatory-burden-measurement-framework-guidance-note>

Respondents are requested to use this methodology to estimate any increase in compliance costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. When submitting their cost assessment to APRA, respondents are asked to include any assumptions made and, where relevant, any limitations inherent in their assessment. Feedback should address the additional costs incurred as a result of complying with APRA's requirements or expectations, not activities that institutions would undertake regardless of regulatory requirements in their ordinary course of business.

Attachment A - Summary of proposed amendments to existing SPS 510 and SPG 510

Note that paragraph references in this attachment refer to draft SPS 510 and draft SPG 510 (released with this discussion paper) unless otherwise indicated.

Proposed changes are highlighted in yellow in draft SPS 510 and draft SPG 510.

Prudential Standard SPS 510 Governance

- Proposed paragraphs 16 - 18 inclusive set out the new proposed requirements relating to the RSE licensee's 'governance framework'.
 - Requirement for the board to have a formal charter (current paragraph 9) moved to proposed paragraph 18(a) without amendment.
 - New section 'Board composition', which incorporates:
 - the requirement for the chairperson of the board to be a director of the RSE licensee in proposed paragraph 19 (replaces current paragraph 17 without amendment);
 - proposed paragraph 20, which requires that the majority of directors present and eligible to vote at all board meetings be non-executive directors;
 - the requirement for the majority of directors of an RSE licensee to be ordinarily resident in Australia in proposed paragraph 21 (replaces current paragraph 13 without amendment); and
 - proposed paragraph 22, which permits RSE licensees to refer to APRA for guidance when in doubt about a director's independence.
 - Proposed paragraph 23 (current paragraph 19) reflects a new requirement for the board to have in place a procedure to assess, at least annually, the independence of individual directors.
- Proposed paragraph 24 and proposed paragraph 25(f), relating to board renewal, replaces current paragraph 20.
 - New section 'Board nomination, appointment and removal', which includes proposed paragraph 25 to set out the processes and policies which must be established and implemented by the board for the nomination, appointment and removal of directors.
 - Proposed paragraph 42 (current paragraph 37) proposes that the chairperson of the board Remuneration Committee is required to be an independent director of the RSE licensee.
 - Proposed paragraph 43 (current paragraph 36) proposes to require at least one-third of the members of the Board Remuneration Committee to be independent.
 - Proposed paragraph 52 is new and proposes that the chairperson of the Board Audit Committee be an independent director of the RSE licensee.
 - Proposed paragraph 53 is new and proposes that at least one-third of the members of the Board Audit Committee must be independent.
 - Proposed paragraph 54 (current paragraph 46) has been amended to propose that the chairperson of the board may sit on the Board Audit Committee but may not chair the Committee.
 - Transitional arrangements which are no longer in effect have been removed (current paragraphs 68-70 inclusive).
 - Proposed paragraph 77 has been added to make clear that approval, waivers or discretions made under previous versions of SPS 510 continue to have effect.

Prudential Practice Guide SPG 510 Governance

- Proposed paragraph 1(c) has been amended to encompass 'effective oversight' of the board.
- New section 'Governance Framework', which incorporates new proposed paragraphs 2-10

inclusive, sets out APRA's expectations in relation to the RSE licensee's governance framework.

- Existing section 'Composition of the Board' (current paragraphs 5-12 inclusive) has been removed in light of the proposed repeal of the existing equal representation board requirements from the SIS Act.
- New section 'Independence', which incorporates new proposed paragraphs 13-16 inclusive, sets out guidance on matters related to independent directors.
- Guidance on directors which are part of a corporate group acting as a director of more than one regulated entity in a corporate group has been removed (current paragraph 14).
- Existing section 'Board renewal' has been moved to sit with amended guidance on renewal in proposed paragraphs 20-22 inclusive.
- New section 'Board nomination, appointment and removal', which incorporates new proposed paragraphs 23-27 inclusive, sets out guidance relating to nomination, appointment and approval processes.



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