



26 June 2015

To All RSE licensees

Governance requirements for RSE licensees: proposed amendments

Background

The Government has recently released for consultation proposed changes to the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) which set out minimum independence requirements for boards of registrable superannuation entity (RSE) licensees (RSE licensees).¹ The Government has indicated that the legislative changes are expected to take effect on 1 July 2016.

These changes will require RSE licensees to put in place, by the end of a three year transition period, boards with at least one-third independent directors and an independent chair. The exposure draft Bill includes the following proposed provisions relating to independence:

A person is independent from an RSE licensee if the person:

- (a) *does not have, and is not directly associated with a person who has, a substantial holding (within the meaning of the Corporations Act 2001) in the RSE licensee, or in another entity that is a member of the same group as the RSE licensee; and*
- (b) *does not have a material relationship with, and is not employed by an entity that has a material relationship with:*
 - (i) *if the RSE licensee is a body corporate - the RSE licensee; or*
 - (ii) *if the RSE licensee is a group of individual trustees - any of the trustees; and*
- (c) *has not at any time in the last 3 years been an executive officer or director of a body corporate that has, or has at any time in the last 3 years, had a material relationship with:*
 - (i) *if the RSE licensee is a body corporate - the RSE licensee; or*
 - (ii) *if the RSE licensee is a group of individual trustees - any of the trustees.*

APRA can determine prudential standards under s. 34C of the SIS Act in relation to prudential matters (as defined in s. 34C(4)).

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. These include further detail to supplement the independence provisions in the draft Bill and

¹ Note that a reference to a 'board' is to be read as a reference to the board of directors or group of individual directors of an RSE licensee.

transition requirements for the implementation of the independence requirements during the transition period.

To support the proposed legislative amendments, APRA proposes to:

- amend *Prudential Standard SPS 510 Governance* (SPS 510) to, at a minimum, supplement the definition of independent director as outlined below; and
- introduce a new *Prudential Standard SPS 512 Governance Transition* (SPS 512) to support RSE licensees in transitioning to the new legislative framework.

Later in 2015, APRA will release drafts of amended SPS 510 and new SPS 512 for consultation, with a view to releasing the final prudential standards before the end of 2015. APRA proposes that the amendments to SPS 510 and new SPS 512 will take effect on 1 July 2016, in line with the expected commencement date of the legislative amendments.

Proposed prudential requirements

1. *Definition of independence*

APRA intends to amend SPS 510 to supplement the proposed definition of independence in the SIS Act by substantially aligning SPS 510 with the requirements applying to the banking and insurance industries in *Prudential Standard CPS 510 Governance* (CPS 510).

APRA therefore proposes to amend SPS 510 to reflect the independent director requirements as outlined below.

(a) *Definition of 'material relationship'*

The proposed SIS Act definition of independence states that a person who has a material relationship with the RSE licensee, including through an employer that has such a relationship, cannot be an independent director on that RSE licensee's board. This extends to individuals who are currently or have been within the last three years an executive officer or director of a body corporate that has (or has at any time in the last three years) had a material relationship with the RSE licensee.

APRA intends to supplement the legislative definition by setting out in SPS 510 some of the circumstances which APRA considers will constitute a material relationship. In line with the requirements of CPS 510, APRA proposes to include material professional advisors, consultants or suppliers as examples of material relationships. Further, as outlined in the explanatory guide to the draft legislation, material relationships are likely to include relationships between the RSE licensee and standard employer sponsors, parent companies and bodies with the right to nominate potential directors.

(b) *Independence in conglomerate groups*

As indicated above, the third limb of the proposed legislative definition prohibits directors who have been an executive officer or director of a body that has had a material relationship with the RSE licensee in the past three years from being an independent director. APRA's view is that this limb of the proposed definition will result in some independent directors on entities within a conglomerate group being prevented from also serving as an independent director on the RSE licensee board. This will particularly be the case where a group independent director is director of an entity that has a material

relationship with the RSE licensee; in that situation, that director could not be considered independent for the purposes of the RSE licensee board.

Where, however, a group independent director meets both the proposed legislative definition and the requirements of SPS 510, APRA's view is that this director may be able to be considered independent on the board of the RSE licensee. This reflects the existing requirements of CPS 510 which state:

... independent directors on the Board of the parent company or its other subsidiaries may also sit as independent directors on the Board of the institution.

Note that regardless of whether a group independent director can be considered independent for the purposes of the RSE licensee board, the existing requirements relating to conflicts of interest (in both the SIS Act and in *Prudential Standard SPS 521 Conflicts of Interest*) must continue to be complied with.

(c) Independence on board committees

SPS 510 currently contains requirements relating to the membership of board committees which are designed to promote independent decision-making by such committees in the absence of overarching independence requirements for RSE licensees.

As RSE licensees will have at least one-third independent directors and an independent chair by the end of the transition period, APRA proposes to amend the committee composition requirements so that they more closely align with those contained in CPS 510.

Specifically, APRA proposes to amend SPS 510 to:

- require that a majority of both the Board Audit Committee and Board Remuneration Committee be independent directors;
- require the chair of the Board Audit Committee and Board Remuneration Committee to be independent;
- permit the chair of the board to also be the chair of the Board Remuneration Committee; and
- remove the existing provision which allows the chair of the board to also chair the Board Audit Committee where the chair is the only independent director on the board.

These amendments seek to ensure the maintenance of an appropriate level of independence on board committees.

APRA recognises that some RSE licensees may experience difficulty in complying with the requirement for an independent majority on these board committees and seeks feedback about any practical implementation challenges arising from this proposal.

(d) Director appointment and removal processes

The draft legislation includes a provision which makes clear 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, which includes a process for appointing and removing all directors. This process must, at a minimum, outline the factors that will determine when an existing director will be reappointed.

APRA intends to expand these requirements to set out other aspects to be addressed as part of the RSE licensee's appointment and removal processes. This is expected to include provisions relating to the process by which candidate directors are nominated for board positions and the framework used to assess the suitability of those candidates for appointment. APRA also expects to support these provisions with guidance.

(e) Regular assessment of independence

The Government proposes to require RSE licensees to 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 proposes to require each RSE licensee board to undertake regular assessments of the independence of each director.

(f) Capacity for APRA to determine a director independent or not independent

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

APRA anticipates that it will only use this power rarely. One situation where this power might be used is where a director appears to meet the independence requirements of the SIS Act and SPS 510 but APRA forms the view on the basis of relevant information that there are circumstances in relation to the director that may limit their ability to act in a sufficiently independent manner.

(g) Updates to guidance

Prudential Practice Guide SPG 510 Governance (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 intends to review and, in some cases, extend the existing guidance in SPG 510 to ensure that it aligns with the new requirements in SPS 510 and the SIS Act and continues to support sound governance by RSE licensees. This revised guidance will particularly address APRA's view of good practice in areas such as:

- the size of RSE licensee boards;
- renewal and appointment processes;
- setting director tenure limits;
- the management of conflicts of interest, particularly where multiple directorships are held; and
- the role of board committees, in particular nomination and risk committees.

APRA seeks submissions on other matters on which industry sees benefit in APRA providing additional guidance.

2. *Transition requirements*

As noted above, the proposed amendments to the SIS Act are expected to commence on 1 July 2016.

All new RSE licensees which are licenced on or after 1 July 2016 will be required to meet the independence requirements upon commencement of their business operations. All existing RSE licensees, however, will be granted transition relief for three years, and so will have until the end of the transition period to fully meet the revised requirements.

The transition period is expected to provide RSE licensees with sufficient time to make any necessary changes to the composition of their board to meet the independence requirements. The draft legislation specifically requires compliance with transition requirements in APRA's prudential standards to support RSE licensees meeting the independence requirements by the end of the transition period. APRA proposes to set out these transition requirements in the new SPS 512.

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

APRA's proposed transition requirements are outlined below.

(a) *Ongoing board effectiveness*

The Government has announced that RSE licensees must meet the new requirements by the end of a three-year transition period. Whilst it has been made clear that RSE licensees will be permitted to breach both the existing equal representation requirements and the new independence obligations during the transition period, APRA's view is that each RSE licensee must nevertheless ensure that their board remains effective and functional whilst its membership is adjusted.

To this end, draft SPS 512 will make clear that each RSE licensee must ensure ongoing compliance with governance requirements in SPS 510 at all times throughout the transition period. This includes ensuring that the board, at all times, has the range of skills needed for the effective operation of the RSE licensee. Risks associated with transitioning to the new independence requirements will be required, under draft SPS 512, to be adequately assessed, monitored and reviewed by the board to support the effective functioning of the board during the transition period.

(b) *Minimum requirements for transition plans*

APRA proposes to require RSE licensees to formulate and implement a transition plan to support the effective functioning of the board during the transition period and the orderly and timely adoption of changes required to meet the new requirements.

Draft SPS 512 will, therefore, require a transition plan to be prepared and approved by the board no later than 1 July 2016, in line with the commencement of the legislation, with the plan to be submitted to APRA. The purpose of the transition plan is to require formal documentation of how the RSE licensee intends to address the factors to be considered by RSE licensees in order to comply with the new requirements.

Matters that are proposed to be included in transition plans include, at the highest level, an assessment of the status of each current director on the RSE licensee board, what

changes are needed to board membership to meet the new requirements and the steps that the board will take to achieve full compliance with the legislative obligations by the end of the transition period.

A non-exhaustive list of the matters that may be required to be considered within a transition plan include:

- a list of current directors and whether they can be considered independent under the new definition;
- when the term of each current director expires;
- the board's target for the number of directors on the board, and thus the target number of independent directors; and
- the board's plans for each director throughout, and at the end of, the transition period, including whether any directors will be replaced and if so, when this is likely to occur).

APRA also proposes that the transition plan include a requirement for an RSE licensee to set key milestones throughout the transition period to facilitate timely transition to the new requirements. This may include consideration of internal and external expert resources required to ensure a smooth transition.

An important component of the transition plan will be the identification of any impediment to compliance with the independence requirements. APRA proposes that each RSE licensee be required to identify impediments to meeting the requirements early in the transition period to ensure that any such impediments are appropriately managed to achieve full compliance by the end of the transition period.

(c) Guidance to support transition

APRA intends to support the transition requirements with further guidance on better governance practices, in areas such as those outlined above.

Next steps

APRA invites comments on the proposals in this letter. Written submissions on this paper should be forwarded by Friday 31 July 2015, preferably by email, to:

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