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27 August 2026

General Manager
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Policy and Advice Division
Australian Prudential Regulation Authority

By email: PolicyDevelopment@apra.gov.au

Dear Sir/Madam

APRA's GOVERNANCE REVIEW CONSULTATION

Thank you for the opportunity to provide feedback on APRA's latest draft Prudential Standard CPS 510 Governance (**Consultation Draft**).

We support APRA's objective of strengthening governance in APRA-regulated entities. We also acknowledge APRA's principles-based approach, which is intended to preserve flexibility for firms to meet the required standards in ways that are proportionate to their risks and business models.

The breadth of guidance that APRA can include in CPG 510 to accompany CPS 510 will be central to realising this flexibility. We encourage APRA, in this respect, to include in CPG 510:

- **(Specific scenarios raised during consultation)** commentary on how it considers the new requirements apply by reference to specific implementation challenges and scenarios that have been raised during consultation; and
- **(Exemption Guidance)** guidance on when APRA would consider a request for adjustment or exclusion from a specific CPS 510 requirement, as contemplated by paragraph 9 of the Consultation Draft. This should include the matters APRA would expect a firm to address, and examples of the topics most likely to give rise to adjustment or exclusion requests.

We submit below for APRA's consideration:

- a specific scenario for CPG commentary on how firms ought to consider independence for directors serving or proposed to concurrently serve as an independent director on the boards of both an APRA-regulated parent and subsidiary (**Related Entity Independent Directors**); and
- a topic for exemption guidance relating to director tenure in context of transferred life insurance

business.

Assessing independence of Related Entity Independent Directors

CPS 510 currently assumes that a director assessed as independent at the parent level is independent on a regulated subsidiary board. This is proposed to be removed in the revised CPS 510.

We consider that this amendment is unnecessary. Differences are clear in entity roles and customer interests across different types of APRA regulated entities. This makes potential conflicts apparent and more easily managed. The current presumption in CPS 510 enables firms to efficiently manage Board composition and leverage the benefit of common directors whilst still ensuring that potential conflicts are appropriately managed.

If the final CPS 510 does in fact remove this presumption, APRA's accompanying guidance in CPG 510 should state that, other than for conflicts specifically listed in CPS 510.32, neither the law nor APRA automatically presumes that a Related Entity Independent Director has actual or potential conflicts, and each case will turn on its own facts.

If this isn't said, firms could become unnecessarily conservative in making independence assessments. This could result in perverse policy outcomes, given that a common benefit of having some Related Entity Independent Directors is to facilitate effective information flows, oversight and knowledge sharing across a regulated group, which strengthens overall governance outcomes.

In addition to clarifying the point above, firms would be assisted by further commentary and examples in CPG 510 that:

- the existence of actual or potential conflicts *of itself* does not render a Related Entity Independent Director as incapable of being assessed as independent for CPS 510 purposes;
- firms should comprehensively identify actual or potential conflicts, consider circumstances that mitigate the extent of conflict, and then critically analyse specific arrangements that are proposed to be implemented to manage any residual conflicts, including ongoing assurance on the effectiveness of these arrangements; and
- it is open for firms to assess a Related Entity Independent Director as independent if conflicts can be effectively managed.

For example, in the case of a life insurer parent of a related private health insurer subsidiary, a potential conflict might arise for a Related Entity Independent Director where the subsidiary board considers whether profits should be retained or paid as dividend to the life insurer parent.

Circumstances that mitigate the extent of this potential conflict include that:

- the subsidiary's capital levels to support policyholder obligations are subject to prudential standards and managed under its ICAAP;
- dividends above certain levels require APRA approval; and
- the subsidiary's own dividend policy may have explicit pre-conditions (e.g. surplus cash, minimum capital ratio) that need to be met before a dividend can be proposed.

The firm could also, if necessary, put in place additional measures including, if necessary, recusal of the relevant director from voting on resolutions to pay a dividend.

12-year non-executive director tenure limit in circumstances of life insurance business transfers

We support APRA's objective of promoting board renewal and ensuring boards maintain an appropriate mix of skills, experience and perspectives.

We also acknowledge APRA's objective to promote consistency where possible across regulated industries, and that 12-year tenure limits already exist in APRA guidance for superannuation trustees and private health insurers.

Whilst a 12-year tenure limit may be an appropriate default rule, we submit that:

- there can be circumstances where exceptions are justified and would not compromise fundamental policy objectives if granted.
- APRA's guidance in CPG 510 should:
    - acknowledge that whilst the reforms are generally intended to operate consistently across industry segments, APRA may (as contemplated in paragraph 9 of the Consultation Draft) adjust or exclude a specific requirement in the standard in relation to an entity;
    - identify topics raised during consultation, such as 12-year tenure limits, where circumstances may warrant APRA considering an adjustment or exemption; and
    - outline, by illustration and example, matters that a firm should cover in any application to APRA for modification to or exemption from a particular requirement in CPS 510.

The application of 12-year tenure limits in context of retail term life insurance business transfers would be a good illustrative example. This is because:

- A fundamental difference between retail term life insurance businesses and other financial product businesses is the nature of the long-term guaranteed renewable contract between insurer and insured. Discharge of policyholder obligations requires continuity and proper administration of specific and historical policy terms over the course of decades and multiple generations of product series.
- memory and tenure at all levels within a life insurance firm (including its Board) assist and in some cases are uniquely beneficial to proper discharge of long-standing policyholder promises.
- retail term life businesses have consolidated over time via Court approved schemes, and in the case of material transfers, it is common for a transferee insurer board to include one or more non-executive directors from a transferor board; and
- where a transferee board composition is sufficiently diverse, retention of a transferee director for the benefit referenced above, even where this director has a combined tenure across the two insurer entities exceeding 12 years, will be unlikely to diminish the overall diversity and experience profile of the board.

Of course, it would be incumbent on a firm to make this case to APRA in an exemption application and in doing so make submission on matters that APRA specify including, for example, the duration of any exemption, planned succession, overall board composition, and other circumstances that either mitigate (or potentially increase) the risk that an exemption would be inconsistent with underlying policy objectives.

Explicit guidance in CPG 510 on illustrative topics and circumstances in which firms may seek exemption

or adjustment from APRA, will assist to preserve and promote flexibility in implementation.

Should you wish to discuss any aspect of our response, please do not hesitate to contact [redacted]

Yours sincerely,

[redacted]

[redacted]
AIA Australia