



## Prudential Standard CPS 510

### Governance

#### Objectives and key requirements of this Prudential Standard

This Prudential Standard sets out minimum foundations for good governance of a regulated institution in the deposit-taking, general insurance and life insurance industries. Its objective is to ensure that a regulated institution is managed soundly and prudently by a competent Board (or equivalent), which can make reasonable and impartial business judgements in the best interests of the institution and which duly considers the impact of its decisions on depositors and/or policyholders.

The ultimate responsibility for the sound and prudent management of an APRA-regulated institution rests with its Board of directors (or equivalent).

It is essential that a regulated institution has a sound governance framework and conducts its affairs with a high degree of integrity. A culture that promotes good governance benefits all stakeholders of a regulated institution and helps to maintain public confidence in the institution.

The governance of a regulated institution builds on these foundations in ways that take account of the institution's size, complexity and risk profile.

The key requirements of this Prudential Standard for locally incorporated regulated institutions are that:

- specific requirements with respect to Board size and composition are met;
- the chairperson of the Board of directors must be an independent director;
- the Board must have a policy on Board renewal and procedures for assessing Board performance;
- a Board Remuneration Committee must be established and the institution must have a Remuneration Policy that aligns remuneration and risk management; and
- a Board Audit Committee must be established.

A number of the requirements in this Prudential Standard apply to foreign authorised deposit-taking institutions, Category C insurers and eligible foreign life insurance companies.

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## Authority

1. This Prudential Standard is made under:
  - (a) section 11AF of the *Banking Act 1959* (Banking Act) in relation to **authorised deposit-taking institutions (ADIs)** and **non-operating holding companies** authorised under the Banking Act (authorised banking NOHCs);
  - (b) section 32 of the *Insurance Act 1973* (Insurance Act) in relation to **general insurers** and **non-operating holding companies** authorised under the Insurance Act (authorised insurance NOHCs); and
  - (c) section 230A of the *Life Insurance Act 1995* (Life Insurance Act) in relation to **life companies**, including **friendly societies**, and **non-operating holding companies** registered under the Life Insurance Act (registered life NOHCs).

## Application

2. This Prudential Standard applies to:
  - (a) all ADIs, including **foreign ADIs**, and authorised banking NOHCs;
  - (b) all general insurers, including **Category C insurers**, and authorised insurance NOHCs; and
  - (c) all life companies, including friendly societies and **eligible foreign life insurance companies** (EFLICs), and registered life NOHCs.

These institutions are collectively referred to as ‘regulated institutions’ in this Prudential Standard.

3. All regulated institutions have to comply with this Prudential Standard in its entirety, unless otherwise expressly indicated. The obligations imposed by this Prudential Standard on, or in relation to, a foreign ADI, a Category C insurer or an EFLIC apply only in relation to the **Australian business** of that institution.
4. This Prudential Standard commences on 1 January 2013.

## Interpretation

5. Terms that are defined in *Prudential Standard APS 001 Definitions* (APS 001), *Prudential Standard GPS 001 Definitions* (GPS 001) or *Prudential Standard LPS 001 Definitions* (LPS 001) appear in bold the first time they are used in this Prudential Standard.
6. For the purposes of this Prudential Standard, the term ‘auditor’ is used to refer to the following positions except where otherwise specified:
  - (a) ‘Appointed auditor’ has the meaning given in APS 001, in relation to an ADI (including a foreign ADI) or authorised banking NOHC;

- (b) 'Appointed Auditor' has the meaning given in GPS 001, in relation to a general insurer (including a Category C insurer);
  - (c) 'Auditor' has the meaning given in *Prudential Standard LPS 310 Audit and Related Matters* (LPS 310), in relation to a life company (including an EFLIC); and
  - (d) 'responsible auditor' has the meaning given in GPS 001, in relation to an authorised insurance NOHC and in relation to a registered life NOHC, is an auditor who is required to prepare a report under the Life Insurance Act, prudential standards made under the Life Insurance Act or reporting standards made under the *Financial Sector (Collection of Data) Act 2001* (Collection of Data Act).
7. This Prudential Standard sets out the minimum requirements that a regulated institution must meet in the interests of promoting strong and effective governance.

#### **A. Governance arrangements – locally incorporated regulated institutions**

##### **The Board and senior management**

- 8. The **Board** of directors (the Board) of a locally-incorporated regulated institution is ultimately responsible for the sound and prudent management of that institution.
- 9. The Board must have a formal charter that sets out the roles and responsibilities of the Board.
- 10. The Board, in fulfilling its functions, may delegate authority to management to act on behalf of the Board with respect to certain matters, as decided by the Board. This delegation of authority must be clearly set out and documented. The Board must have mechanisms in place for monitoring the exercise of delegated authority. The Board cannot abrogate its responsibility for functions delegated to management.
- 11. The Board must ensure that **directors** and **senior management** of the regulated institution, collectively, have the full range of skills needed for the effective and prudent operation of the institution, and that each director has skills that allow them to make an effective contribution to Board deliberations and processes. This includes the requirement for directors, collectively, to have the necessary skills, knowledge and experience to understand the risks of the institution, including its legal and prudential obligations, and to ensure that the institution is managed in an appropriate way taking into account these risks. This does not preclude the Board from supplementing its skills and knowledge by engaging external consultants and experts.
- 12. Senior management of a locally incorporated regulated institution, with responsibilities relating to the business in Australia, must be ordinarily resident in Australia.

13. Board members and senior management of a locally incorporated regulated institution must be available to meet with APRA on request.
14. The Board must provide the auditor and the **Appointed Actuary** of the regulated institution, as relevant, with the opportunity to raise matters directly with the Board.

### **Independence**

15. For the purposes of this Prudential Standard, an ‘independent director’ is a non-executive director who is free from any business or other association — including those arising out of a substantial shareholding, involvement in past management or as a supplier, customer or adviser — that could materially interfere with the exercise of their independent judgement. The circumstances that will not meet this test of independence include, but are not limited to, those set out in Attachment A.
16. If the Board of a locally incorporated regulated institution is in doubt about a director’s independence for the purposes of this Prudential Standard, the institution may refer the matter to APRA for guidance.

### **Definition of non-executive director**

17. For the purposes of this Prudential Standard, a reference to a ‘non-executive director’ is interpreted as meaning reference to a director who is not a member of the regulated institution’s management. Non-executive directors may include Board members or senior managers of the parent company of the locally incorporated regulated institution or of the parent company’s subsidiaries, but not executives of the regulated institution or its subsidiaries.

### **Board composition**

18. The Board of a locally incorporated regulated institution must have a minimum of five directors at all times.
19. The Board must have a majority of independent directors at all times. For a locally incorporated regulated institution that is a **subsidiary**<sup>1</sup> of another APRA-regulated institution or overseas equivalent<sup>2</sup>, exceptions may apply as set out at paragraphs 29 to 31. For a locally incorporated regulated institution that is a subsidiary of a parent company that is not prudentially regulated, exceptions may apply as set out at paragraph 32.
20. The chairperson of the Board must be an independent director of the regulated institution.
21. A majority of directors present and eligible to vote at all Board meetings must be non-executive directors.

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<sup>1</sup> ‘Subsidiary’ means a subsidiary within the meaning of the *Corporations Act 2001* (Corporations Act).

<sup>2</sup> An ‘overseas equivalent’ is an entity which is not authorised in Australia but is authorised and subject to prudential regulation in a foreign country.

22. The chairperson of the Board cannot have been the Chief Executive Officer (CEO) of the regulated institution at any time during the previous three years. If the position of the CEO is unexpectedly vacated, the chairperson may serve as an interim CEO. After a period of 90 days, approval must be sought from APRA to allow this arrangement to continue.
23. The chairperson must be available to meet with APRA on request.
24. For a locally owned and incorporated regulated institution, a majority of directors must be ordinarily resident in Australia.
25. For a foreign-owned, locally incorporated regulated institution, at least two of the directors must be ordinarily resident in Australia, at least one of whom must also be independent.

### **Board representation**

26. Board representation must be consistent with a locally incorporated regulated institution's shareholding. Where a shareholding constitutes not more than 15 per cent of the institution's voting shares, there should not be more than one Board member who is an associate of the shareholder where the Board has up to six directors, and not more than two Board members who are associates of the shareholder where the Board has seven or more directors. A director is taken to be an associate of a shareholder for the purposes of this Prudential Standard if the director is an associate of the shareholder, or the shareholder is an associate of the director, according to the definition of associate in clause 4 of Schedule 1 of the *Financial Sector (Shareholdings) Act 1998* (Financial Sector (Shareholdings) Act). That definition is to be applied for the purposes of this Prudential Standard as if subparagraph (1)(l) of that definition were omitted.
27. Where an individual shareholding is greater than 15 per cent, as approved under the Financial Sector (Shareholdings) Act, the Board representation of that shareholding may be greater than allowed in paragraph 26, although it must still be broadly proportionate to the shareholding concerned.<sup>3</sup>
28. For an ADI that operates as a special service provider, the ADI may apply to APRA for approval for alternative Board composition arrangements that meet the objectives of this Prudential Standard. APRA may approve alternative arrangements for the ADI if satisfied that those arrangements will, in APRA's opinion, achieve the objectives of this Prudential Standard.

### **Regulated institutions that are subsidiaries of other APRA-regulated institutions or overseas equivalents**

29. For a locally incorporated regulated institution that is a subsidiary of another APRA-regulated institution or an overseas equivalent, the Board of the regulated institution must have a majority of non-executive directors, but these non-executive directors need not all be independent.

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<sup>3</sup> Note that, where the proportionate shareholding does not equate to a whole number, it may be rounded to the nearest whole number.

30. A regulated institution to which paragraph 29 applies will be required to have, at a minimum, two independent directors, in addition to an independent chairperson, where the Board has up to seven members. Where the Board has more than seven members, the regulated institution will be required to have at least three independent directors, in addition to an independent chairperson.
31. For the purposes of meeting the requirements in paragraph 30, the independent directors on the Board of the parent company or its other subsidiaries may also sit as independent directors on the Board of the regulated institution.

### **Subsidiaries of a parent that is not prudentially regulated**

32. For a locally incorporated regulated institution that is a subsidiary of another entity not covered by the arrangements in paragraphs 29 to 31 of this Prudential Standard, the Board must have a majority of independent directors. However, independent directors on the Board of the parent company or its other subsidiaries may also sit as independent directors on the Board of the regulated institution.

### **Joint ventures**

33. For the purposes of this Prudential Standard, a locally incorporated regulated institution that operates as a joint venture can be considered as part of the group of each parent entity. Independent directors of a parent may sit as independent directors on the Board of the joint venture entity. However, the general concessions available to subsidiaries in paragraphs 29 to 31 are not available to joint ventures.

### **Regulated institutions that are part of a corporate group**

34. Where a locally incorporated regulated institution is part of a **corporate group**, and the regulated institution utilises group policies or functions, the Board of the regulated institution must approve the use of group policies and functions and must ensure that these policies and functions give appropriate regard to the regulated institution's business and its specific requirements.

### **Board performance assessment**

35. The Board of a locally incorporated regulated institution must have procedures for assessing, at least annually, the Board's performance relative to its objectives. It must also have in place a procedure for assessing, at least annually, the performance of individual directors.

### **Board renewal**

36. The Board of a locally incorporated regulated institution must have in place a formal policy on Board renewal. This policy must provide details of how the Board intends to renew itself in order to ensure it remains open to new ideas and independent thinking, while retaining adequate expertise. The policy must give consideration to whether directors have served on the Board for a period that

could, or could reasonably be perceived to, materially interfere with their ability to act in the best interests of the regulated institution.

**B. Governance arrangements – foreign ADIs, Category C insurers and EFLICs**

37. As in the case of locally incorporated regulated institutions, the ultimate responsibility for the safety and soundness of a foreign ADI or a Category C insurer resides with its Board. Foreign ADIs and Category C insurers must nominate a senior officer (whether a director or senior executive) outside Australia with delegated authority from the Board (**senior officer outside Australia**) who will be responsible for overseeing the Australian branch operation.
38. For a foreign ADI or Category C insurer, there must also be a senior manager<sup>4</sup> in Australia responsible for the local operation who is ordinarily resident in Australia. The senior management must be available to meet with APRA on request.
39. A Category C insurer that appoints a **corporate agent** as its **agent in Australia** must additionally ensure that:
  - (a) the Board of the corporate agent has a minimum of three directors at all times; and
  - (b) a majority of the directors of the Board of the corporate agent are ordinarily resident in Australia.<sup>5</sup>
40. The ultimate responsibility for the safety and soundness of an EFLIC resides with its Board. An EFLIC must establish a **Compliance Committee**<sup>6</sup> to assist the Board in meeting its responsibilities under the Life Insurance Act. The requirements for the composition of the Compliance Committee are detailed in Attachment B. The senior management of an EFLIC must be available to meet with APRA on request.
41. The senior officer outside Australia or Compliance Committee of an EFLIC, as relevant, must provide the external auditor of the regulated institution with the opportunity to raise matters directly with the senior officer outside Australia or the Compliance Committee, as relevant.

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<sup>4</sup> For foreign ADIs, 'senior manager' has the same meaning as in *Prudential Standard CPS 520 Fit and Proper* (CPS 520). For Category C insurers, 'senior manager' has the same meaning as in the Insurance Act read with CPS 520. Note that the person who performs this role may be the same as the agent in Australia (where the agent is an individual) or a director or senior manager of the agent in Australia (where the agent is a corporate agent) as required under section 118 of the Insurance Act.

<sup>5</sup> Note that, by virtue of paragraph 118(6)(a) of the Insurance Act, an individual agent in Australia must be resident in Australia.

<sup>6</sup> Compliance Committee has the same meaning as in subsection 16ZF(1) of the Life Insurance Act.



## C. Remuneration

### Remuneration policy

42. A regulated institution must establish and maintain a documented 'Remuneration Policy'. The Remuneration Policy must outline the remuneration objectives and the structure of the remuneration arrangements, including but not limited to the performance-based remuneration components, of the regulated institution.
43. The Remuneration Policy must be approved by the Board, the senior officer outside Australia or the Compliance Committee, as relevant.
44. For the purposes of this Prudential Standard, remuneration arrangements include measures of performance, the mix of forms of remuneration (such as fixed and variable components, and cash and equity-related benefits) and the timing of eligibility to receive payments. All forms of remuneration are captured by this Prudential Standard.
45. In addition to any other objectives, the Remuneration Policy's performance-based components of remuneration must be designed to encourage behaviour that supports:
  - (a) the regulated institution's long-term financial soundness; and
  - (b) the **risk management framework** of the regulated institution.
46. The performance-based components of remuneration must be designed to align remuneration with prudent risk-taking and must incorporate adjustments to reflect:
  - (a) the outcomes of business activities;
  - (b) the risks related to the business activities taking account, where relevant, of the cost of the associated capital; and
  - (c) the time necessary for the outcomes of those business activities to be reliably measured.
47. The Remuneration Policy must provide for the Board, the senior officer outside Australia or the Compliance Committee, as relevant, to adjust performance-based components of remuneration downwards, to zero if appropriate, in relation to persons or classes of persons, if such adjustments are necessary to:
  - (a) protect the financial soundness of the regulated institution; or
  - (b) respond to significant unexpected or unintended consequences that were not foreseen by the Board Remuneration Committee, the senior officer outside Australia or the Compliance Committee, as relevant.
48. The Remuneration Policy must set out who is covered by the Policy. The Remuneration Policy must cover, as a minimum:

- (a) each responsible person, as that term is defined in *Prudential Standard CPS 520 Fit and Proper* (CPS 520), excluding:
  - (i) non-executive directors;
  - (ii) auditors described in paragraphs 6(a) to (d) inclusive;
  - (iii) for foreign ADIs, the senior officer outside Australia;
  - (iv) for general insurers, external Appointed Actuaries and the **Reviewing Actuary**;
  - (v) for Category C insurers, the senior officer outside Australia, and non-executive directors of the Category C insurer's agent in Australia where the agent in Australia is a corporate agent;
  - (vi) for life companies, external Appointed Actuaries; and
  - (vii) in the case of an EFLIC, members of the Compliance Committee;
- (b) persons whose primary role is risk management, compliance, internal audit, financial control or actuarial control (collectively 'risk and financial control personnel'); and
- (c) all other persons for whom a significant portion of total remuneration is based on performance and whose activities, individually or collectively, may affect the financial soundness of the regulated institution.

A person will be included within one of the above categories if that person is: employed directly by the regulated institution; retained directly by the regulated institution under contract; employed by, or a contractor of, a body corporate (including a service company) that is a **related body corporate** of the regulated institution<sup>7</sup>; or, subject to paragraph 49, an entity that is not a related body corporate of the regulated institution.

49. The Remuneration Policy must cover a service contract between a regulated institution and a body that is not a related body corporate of the regulated institution, if:
- (a) the primary role of the body is to provide risk management, compliance, internal audit, financial control or actuarial control services to the regulated institution; or
  - (b) the services provided by the body, either individually or collectively with like services provided by other bodies, may affect the financial soundness of the regulated institution and, under the services contract with the regulated institution, a significant portion of the total payment to the body is based on performance.

However, the Remuneration Policy need not cover a service contract with such a body if:

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<sup>7</sup> Related body corporate has the meaning given in section 50 of the Corporations Act.

- (i) the regulated institution's risk management framework explicitly addresses the structure of payments to bodies of the relevant kind and the risk that payment incentives can give rise to inappropriate behaviour; and
  - (ii) oversight of this risk has been delegated to a Board Committee, the senior officer outside Australia or the Compliance Committee, as relevant.
50. APRA may determine that an individual or class of individuals must be covered by the regulated institution's Remuneration Policy. APRA will notify the regulated institution of such a determination in writing.
51. The Remuneration Policy must prohibit persons covered by paragraph 48(a), who receive equity or equity-linked deferred remuneration, from hedging their economic exposures to the resultant equity price risk before the equity-linked remuneration is fully vested and able to be sold for cash by the recipient. The Remuneration Policy must specify the actions to be taken where a person is found to have breached this requirement.
52. The Remuneration Policy must ensure that the structure of the remuneration of risk and financial control personnel, including performance-based components if any, does not compromise the independence of these personnel in carrying out their functions.
53. Nothing in this Prudential Standard prevents a regulated institution from adopting and applying a group Remuneration Policy that is also used by a related body corporate provided that the policy has been approved by the Board, the senior officer outside Australia or the Compliance Committee, as relevant, in accordance with paragraph 43 and meets the requirements of this Prudential Standard.<sup>8</sup>
54. The Remuneration Policy must form part of a regulated institution's risk management framework.<sup>9</sup>
55. The Remuneration Policy must be provided to APRA on request.

### **Board Remuneration Committee**

56. A locally incorporated regulated institution must, unless otherwise approved in writing by APRA, have a Board Remuneration Committee that complies with the requirements of this Prudential Standard.
57. The Board Remuneration Committee must have at least three members. All members of the Committee must be non-executive directors of the regulated institution. A majority of the members of the Committee must be independent. The chairperson of the Committee must be an independent director of the regulated institution.

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<sup>8</sup> For the avoidance of doubt, paragraph 34 of this Prudential Standard applies to foreign ADIs, Category C insurers and EFLICs for the purpose of group Remuneration Policies

<sup>9</sup> Refer to APS 310, *Prudential Standard GPS 220 Risk Management (GPS 220)* and *Prudential Standard LPS 220 Risk Management (LPS 220)*, as may be applicable.

58. The Board Remuneration Committee must have a written charter and terms of reference that outline the Committee's roles, responsibilities and terms of operation. The Remuneration Committee must be provided with the powers necessary to enable it to perform its functions.
59. The responsibilities of the Board Remuneration Committee must include:
  - (a) conducting regular reviews of, and making recommendations to the Board on, the Remuneration Policy. This must include an assessment of the Remuneration Policy's effectiveness and compliance with the requirements of this Prudential Standard;
  - (b) making annual recommendations to the Board on the remuneration of the CEO, direct reports of the CEO, other persons whose activities may, in the Board Remuneration Committee's opinion, affect the financial soundness of the regulated institution and any other person specified by APRA; and
  - (c) making annual recommendations to the Board on the remuneration of the categories of persons covered by the Remuneration Policy (other than those persons for whom such recommendations are already required under paragraph 59(b)).
60. The Board Remuneration Committee, the senior officer outside Australia or the Compliance Committee, as relevant, must:
  - (a) have free and unfettered access to risk and financial control personnel and other parties (internal and external) in carrying out its duties; and
  - (b) if choosing to engage third-party experts, have power to do so in a manner that ensures that the engagement, including any advice received, is independent.
61. Where a locally incorporated regulated institution is part of a corporate group, the Board of the regulated institution may use a group Board Remuneration Committee in order to meet the requirements of paragraph 56 and 57 of this Prudential Standard, provided that the other requirements set out in this Prudential Standard are met, all members of the Board Remuneration Committee are non-executive directors of the head of the group and the Board of the regulated institution has unfettered access to the group Board Remuneration Committee.
62. Members of the Board Remuneration Committee must be available to meet with APRA on request.
63. For foreign ADIs and Category C insurers, the senior officer outside Australia, and for EFLICs, the Compliance Committee, must:
  - (a) conduct regular reviews of, and make decisions in relation to, the Remuneration Policy. This must include an assessment of the Remuneration Policy's effectiveness and compliance with the requirements of this Prudential Standard;

- (b) make annual decisions on the remuneration of the Head of the Australian branch operation, direct reports to that person, other persons whose activities may in the opinion of the senior officer outside Australia or of the Compliance Committee, as relevant, affect the financial soundness of the institution, and any other person specified by APRA; and
- (c) make annual decisions on the remuneration of the categories of persons covered by the Remuneration Policy (other than those persons for whom such recommendations are already required under paragraph 63(b)).

#### **D. Audit arrangements**

##### **Board Audit Committee**

- 64. A regulated institution (excluding foreign ADIs and Category C insurers but including EFLICs) must have a Board Audit Committee, which assists the Board by providing an objective non-executive review of the effectiveness of the regulated institution's financial reporting and risk management framework unless, with respect to risk management, there is another Board Committee which carries out this function.
- 65. The Board Audit Committee must have sufficient powers to enable it to obtain all information necessary for the performance of its functions.
- 66. The Board Audit Committee must have at least three members. All members of the Committee must be non-executive directors of the regulated institution. A majority of the members of the Committee must be independent.
- 67. The chairperson of the Board Audit Committee must be an independent director of the regulated institution.
- 68. The chairperson of the Board may sit on the Board Audit Committee, but may not chair the Committee.
- 69. The Board Audit Committee must have a charter that includes a reference to the fact that the Committee is responsible for the oversight of:
  - (a) all APRA statutory reporting requirements;
  - (b) other financial reporting requirements;
  - (c) professional accounting requirements;
  - (d) internal and external audit; and
  - (e) the appointment of the regulated institution's auditor.
- 70. The Board Audit Committee must review the engagement of the auditor at least annually, including making an assessment of whether the auditor meets the Audit Independence tests set out in *APES 110 Code of Ethics for Professional*

*Accountants*,<sup>10</sup> as well as the additional auditor independence requirements set out in this Prudential Standard.

71. For a foreign ADI or a Category C insurer, the assessment referred to in paragraph 70 is the responsibility of the senior officer outside Australia, and for an EFLIC, it is the responsibility of the Compliance Committee.
72. The Board Audit Committee must regularly review the internal and external audit plans, ensuring that they cover all material risks and financial reporting requirements of the regulated institution. It must also regularly review the findings of audits, and ensure that issues are being managed and rectified in an appropriate and timely manner.
73. The Board Audit Committee must ensure the adequacy and independence of both the internal and external audit functions.
74. The members of the Board Audit Committee must, at all times, have free and unfettered access to senior management, the internal auditor, the heads of all risk management functions, the auditor and the Appointed Actuary, as applicable, and vice versa.
75. The Board Audit Committee must establish and maintain policies and procedures for employees of the regulated institution to submit, confidentially, information about accounting, internal control, compliance, audit, and other matters about which the employee has concerns. The Committee should also have a process for ensuring employees are aware of these policies and for dealing with matters raised by employees under these policies.
76. Members of the Board Audit Committee must be available to meet with APRA on request.
77. The Board Audit Committee must invite the auditor and the Appointed Actuary, as applicable, to meetings of the Committee.
78. The internal auditor must have a reporting line and unfettered access to the Board Audit Committee.
79. For a foreign ADI, a Category C insurer and an EFLIC, the auditor of the local operation must have direct access to the Head Office audit function.

### **Internal audit**

80. A regulated institution must have an independent and adequately resourced internal audit function. If a regulated institution does not believe it is necessary to have a dedicated internal audit function, it must apply to APRA to seek an exemption from this requirement, setting out reasons why it believes it should be exempt. APRA may approve alternative arrangements in writing for a regulated institution where APRA is satisfied that they will achieve the same objectives.

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<sup>10</sup> *APES 110 Code of Ethics for Professional Accountants* was issued by the Accounting Professional and Ethical Standards Board in December 2010.

81. The objectives of the internal audit function must include evaluation of the adequacy and effectiveness of the financial and risk management framework of the regulated institution.<sup>11</sup> To fulfil its functions, the internal auditor must, at all times, have unfettered access to all the regulated institution's business lines and support functions.

### **Auditor independence<sup>12</sup>**

82. The Corporations Act contains a number of requirements in relation to auditor independence. The auditor independence requirements in this Prudential Standard are substantially consistent with those requirements, and are intended to help ensure the independence of an auditor engaged to perform work of a prudential nature in relation to the Banking Act, Insurance Act, Life Insurance Act (collectively, the 'Prudential Acts'), prudential standards and reporting standards.<sup>13</sup>
83. The Board, senior officer outside Australia or the Compliance Committee, as relevant, must, to the extent practical, undertake steps to satisfy itself that the auditor, who undertakes work for the regulated institution in relation to the Prudential Acts, prudential standards or reporting standards, is independent of the regulated institution,<sup>14</sup> and that there is no conflict of interest situation that could compromise, or be seen to compromise, the independence of the auditor.
84. As part of the process of ascertaining the independence of the auditor, a regulated institution must obtain a declaration from the auditor to the effect that:
- (a) the auditor is independent, both in appearance and in fact;
  - (b) the auditor has no conflict of interest situation; and
  - (c) there is nothing to the auditor's knowledge (either in relation to the individual auditor or any audit firm or audit company of which the auditor is a member or director) that could compromise that independence.
85. For the purposes of this Prudential Standard, a conflict of interest situation exists in relation to a regulated institution at a particular time, if because of circumstances that exist at that time:
- (a) the auditor is not capable of exercising objective and impartial judgement in relation to the conduct of the work that is undertaken for the regulated institution in relation to the Prudential Acts, prudential standards or reporting standards; or

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<sup>11</sup> For general insurers, also refer to GPS 220 for the requirement for a review of a general insurer's risk management framework. Such a review carried out by a role or function within the general insurer other than internal audit does not relieve the internal audit function from carrying out a review of the risk management framework, though the internal audit function may rely on such other review in carrying out its own review. For life companies, refer to LPS 220.

<sup>12</sup> Refer also to APS 310, *Prudential Standard GPS 310 Audit and Related Matters* (GPS 310) and LPS 310.

<sup>13</sup> 'Reporting Standards' are those standards made under the Collection of Data Act.

<sup>14</sup> Independent of the APRA-regulated entity means that the auditor has been assessed as independent in terms of paragraph 70 of this Prudential Standard.

- (b) a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that the auditor is not capable of exercising objective and impartial judgement in relation to undertaking the work for the regulated institution for the purposes of the Prudential Acts, prudential standards or reporting standards.<sup>15</sup>
86. A person, who was a member of an audit firm or a director of an audit company, and who served in a professional capacity in the audit of a regulated institution in relation to the Prudential Acts, prudential standards or reporting standards, cannot be appointed to the role of director or senior manager of that regulated institution until at least two years have passed since they served in that professional capacity.
87. A person, who was an employee of an audit company, other than a director of that company, and who acted as the lead auditor<sup>16</sup> or review auditor<sup>17</sup> in the audit of a regulated institution in relation to the Prudential Acts, prudential standards or reporting standards, cannot be appointed to the role of director or senior manager of that regulated institution until at least two years have passed since they acted as the lead auditor or review auditor.
88. A person cannot be appointed as a director or senior manager of a regulated institution if:
- (a) the person was, or is, a director of the audit company or a member of the audit firm that was, or is, responsible for the audit of the regulated institution in relation to the Prudential Acts, prudential standards or reporting standards; and
- (b) there is already another person employed as a director or senior manager of the regulated institution who was a director of the audit company or a member of the audit firm, at a time when the audit company or audit firm undertook an audit of the regulated institution at any time during the previous two years.
89. An individual who plays a significant role<sup>18</sup> in the audit of a regulated institution in relation to the Prudential Acts, prudential standards or reporting

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<sup>15</sup> This definition is based on that used in section 324CD of the Corporations Act to describe the circumstances under which a conflict of interest situation is considered to exist, and is intended to be interpreted in a similar manner. Without limiting the situations that may cause a conflict to arise for the purposes of this Prudential Standard, it is expected that any circumstances of the type that would lead to a breach of the Corporations Act requirements for audit independence, whether or not these provisions actually apply in relation to the audit of the regulated institution, will also result in a breach of the provisions of this Prudential Standard.

<sup>16</sup> Lead auditor means the registered company auditor who is primarily responsible to the audit firm or the audit company for the conduct of audit work conducted in relation to the Prudential Acts, Prudential Standards or Reporting Standards.

<sup>17</sup> Review auditor means the registered company auditor (if any) who is primarily responsible to the individual auditor, audit firm or audit company for reviewing audit work conducted in relation to the Prudential Acts, Prudential Standards or Reporting Standards.

<sup>18</sup> For the purpose of this paragraph 'an individual who plays a significant role' means an individual auditor who acts as the auditor in respect of any of the requirements of the Prudential Acts, Prudential Standards or Reporting Standards, or the lead or review auditor where such audit work is performed by an audit company or audit firm.



standards, for five successive years, or for more than five years out of seven successive years, cannot continue to play a significant role in the audit until at least a further two years have passed, except with an exemption in writing from APRA. APRA may grant an exemption from this requirement if the individual provides specialist services that are otherwise not readily available or there are no other registered company auditors available to provide satisfactory services for the regulated institution.

90. For a general insurer (including a Category C insurer) or a life company (including an EFLIC), for the purposes of maintaining their independence and objectivity, the auditor and Appointed Actuary cannot both be employed by the same body corporate or related bodies corporate, or by the same firm or **related firms**.<sup>19</sup>

## **E. Other matters**

### **Persons not to be constrained from providing information to APRA<sup>20</sup>**

91. No prospective, current, or former officer, employee or contractor (including professional service provider) of a regulated institution may be constrained or impeded, whether by confidentiality clauses or other means, from disclosing information to APRA, from discussing issues with APRA of relevance to the management and prudential supervision of the regulated institution, or from providing documents under their control to APRA, that may be relevant in the context of the management or prudential supervision of the regulated institution. Such persons are not to be constrained or impeded from providing information to, as applicable, auditors, the Appointed Actuary, the Reviewing Actuary and others, who have statutory responsibilities in relation to the regulated institution.
92. A regulated institution must ensure that its internal policy and contractual arrangements do not explicitly or implicitly restrict or discourage auditors or other parties from communicating with APRA.

### **Adjustments and exclusions**

93. APRA may, by notice in writing to a regulated institution, adjust or exclude a specific prudential requirement in this Prudential Standard in relation to that regulated institution.<sup>21</sup>

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<sup>19</sup> For the purposes of this Prudential Standard, related firms means either two or more firms, or a firm and a body corporate, that have common ownership or management, or where one has a substantial shareholding in the other. Refer to CPS 520 for a similar restriction on the Appointed Auditor and Appointed Actuary being from the same entity. Refer also to GPS 310 and *Prudential Standard GPS 320 Actuarial and Related Matters*.

<sup>20</sup> Also refer to the provisions for the protection of whistleblowers in Part VIA, Division 1 of the Banking Act, Part IIIA, Division 4 of the Insurance Act, Part 7, Division 5 of the Life Insurance Act, and the whistleblowing provisions in CPS 520.

<sup>21</sup> Refer to subsection 11AF(2) of the Banking Act, subsection 32(3D) of the Insurance Act and subsection 230A(4) of the Life Insurance Act.

**Determinations made under previous prudential standards**

94. An exercise of APRA's discretion (such as an approval, waiver or direction) under a previous version of this Prudential Standard continues to have effect as though exercised pursuant to a corresponding power (if any) exercisable by APRA under this Prudential Standard.

For the purposes of this paragraph, 'a previous version of this Prudential Standard' includes:

- (a) *Prudential Standard APS 510 Governance* made on 26 November 2009;
- (b) *Prudential Standard GPS 510 Governance* made on 26 November 2009;
- (c) *Prudential Standard LPS 510 Governance* made on 2 March 2010; and
- (d) *Prudential Standard CPS 510 Governance* made on 9 September 2011.

## Attachment A<sup>22</sup>

A director is **not** independent if the director:

1. is a substantial shareholder<sup>23</sup> of the regulated institution or an officer of, or otherwise associated directly with, a substantial shareholder of the regulated institution;
2. is employed, or has previously been employed in an executive capacity by the regulated institution or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the Board;
3. has within the last three years been a principal of a material professional adviser or a material consultant to the regulated institution or another group member, or an employee materially associated with the service provided;
4. is a material supplier or customer of the regulated institution or another group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer; or
5. has a material contractual relationship with the regulated institution or another group member other than as a director.

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<sup>22</sup> The circumstances outlined in this Attachment are adapted from the guidance on 'Relationships affecting independent status' to be considered by a Board when determining the independent status of a director set out in Box 2.1 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (2<sup>nd</sup> Edition 2007).

<sup>23</sup> For the purpose of this Attachment, a 'substantial shareholder' is a person with a substantial holding as defined in section 9 of the Corporations Act.

## **Attachment B**

### **Compliance Committee for eligible foreign life insurance companies**

#### **Purpose of the Compliance Committee**

1. The purpose of the Compliance Committee (referred to in this Attachment as 'the Committee') is to:
  - (a) ensure the eligible foreign life insurance company (EFLIC) complies with the requirements in, or imposed under, the Life Insurance Act; and
  - (b) assist the Board in meeting its responsibilities under the Life Insurance Act.
2. As required by subsections 16ZF(1) and (4) of the Life Insurance Act, the Board must delegate sufficient powers of management to the members of the Committee to enable Committee members to ensure that the EFLIC complies with the requirements in, or imposed under, the Life Insurance Act. The Board must do so irrespective of anything to the contrary in the EFLIC's constitution.

#### **Continuing responsibility of the Board**

3. Establishment of the Committee does not free the Board from ultimate responsibility for ensuring the Australian branch of the EFLIC complies with the requirements in, or imposed under, the Life Insurance Act.
4. In recognition of this, the Board must:
  - (a) have the power to appoint and remove, at its discretion, members of the Committee, as long as certain composition and residency requirements pertaining to the Committee continue to be met (refer to paragraphs 5 to 8 of this Attachment);
  - (b) ensure that the delegation of relevant managerial powers (of the kind referred to in paragraph 16ZF(1)(a) and (b) of the Life Insurance Act) is not irrevocable, and that the Board retains the powers delegated; and
  - (c) establish adequate procedures for monitoring and supervising the operation of the Committee, as well as assessing its performance.

#### **Composition and residency status of Committee members**

5. The Committee must comprise at least five members appointed by the Board. Those members must include:
  - (a) at least one director of the Board of the EFLIC;
  - (b) the Principal Executive Officer (PEO) appointed by the EFLIC for its Australian branch under either subsections 20(2) or 246(4) of the Life Insurance Act; and

- (c) at least two independent members.
- 6. A member cannot satisfy more than one of the composition requirements contained in subparagraphs 5(a), 5(b) and 5(c) of this Attachment (i.e. the director, PEO and independent members must all be separate individuals).
- 7. At least two of the Committee members must be ordinarily resident in Australia, one being the PEO and the other an independent member.
- 8. It should be noted that the definition of director contained in the Life Insurance Act, in relation to an EFLIC, is taken to refer to both members of the Committee and the directors of the EFLIC (except for certain provisions, notably sections 230B and 245 of the Life Insurance Act, where only Committee members are being referred to).

### **Application for a modified Committee composition**

- 9. APRA may, on application from an EFLIC, determine a modified Committee for the EFLIC where it can be demonstrated that it is appropriate to do so.
- 10. In making this determination, APRA will take into account the following factors:
  - (a) the quantum of liabilities written by the EFLIC;
  - (b) the cost effectiveness or otherwise of establishing a Committee;
  - (c) any restrictions on the lines of business written by the EFLIC;
  - (d) whether these restrictions limit the number of policyholders of the EFLIC (for example, by targeting specific policyholder characteristics, such as age, nationality or geographical location); and
  - (e) whether the EFLIC has written any material amount of long tail business.
- 11. The composition of any modified Committee would be determined in writing on a case-by-case basis by APRA, but the possible modifications could take one or more of the following forms:
  - (a) a Committee with fewer than five members;
  - (b) replacing the director of the Board of the EFLIC as required by subparagraph 5(a) of this Attachment with the PEO; or
  - (c) a Committee with fewer than two independent members.

### **Appointment and removal of Committee members**

- 12. The power to appoint and remove members of the Committee resides with the Board.
- 13. The Board must have appointed all members and formally constituted the Committee within seven days of receiving notification of registration.

14. Each member of the Committee must be fit and proper for the role in accordance with the requirements for fitness and propriety as set out in CPS 520.
15. The Board must ensure that the Committee as a whole possesses the necessary skills and expertise to ensure that the EFLIC complies with the requirements in, or imposed under, the Life Insurance Act, and to discharge the duties and responsibilities of the Committee provided for in this Prudential Standard.
16. The Committee must have a policy for dealing with conflicts of interest.
17. Notwithstanding the Board's power to appoint and remove members, APRA may, under section 230B of the Life Insurance Act, direct an EFLIC to remove a member of the Committee.
18. While membership of the Committee is the responsibility of the Board, the powers to appoint and remove members of the Committee must not be used in a manner that impedes, discourages or otherwise hinders the Committee from discharging its duties and responsibilities. Examples that would be cause for concern by APRA would be an excessive turnover of members, or the removal of members at inappropriate times (for example at critical reporting periods). If requested to do so by APRA, an EFLIC must, within a time stipulated by APRA in writing (which must not be unreasonable), provide a written report to APRA responding to any queries APRA has regarding the removal of members.

### **Processes of the Committee**

19. At least three members of the Committee are required to be present at a meeting of the Committee to form a quorum. The PEO, and at least one independent member who is ordinarily resident in Australia, must be amongst the three members present.
20. The chairperson of the Committee must be a non-executive member.
21. Resolutions can be passed only by a majority with the chairperson having a casting vote.
22. The Committee must meet as often as required to discharge its duties and responsibilities, although APRA would expect the Committee to meet on at least a quarterly basis. Members, and individuals who may be needed to address the Committee, must be given reasonable notice of pending meetings.
23. The Committee must ensure that the Appointed Actuary is given reasonable notice of any meeting of the Committee at which matters are to be considered that relate to the functions and duties of the actuary, including matters:
  - (a) that relate to, or may affect:
    - (i) the solvency of the company; or
    - (ii) the adequacy of the capital of the company; or
  - (b) that relate to advice given by the Appointed Actuary to the directors; or

- (c) that concern a matter in relation to which the Appointed Actuary will be required to give advice.
24. Written minutes of Committee meetings must be taken and copies kept and made available to APRA on request. Any papers or submissions put to the Committee must likewise be kept and made available to APRA on request.

### **Duties and responsibilities of the Committee**

25. The Committee must, with the powers delegated to it by the Board, ensure that the EFLIC complies with:
- (a) the Life Insurance Act;
  - (b) the *Life Insurance Regulations 1995*;
  - (c) the prudential standards determined under section 230A of the Life Insurance Act;
  - (d) the Prudential Rules made under section 252 of the Life Insurance Act;
  - (e) any conditions placed upon the EFLIC under section 22 of the Life Insurance Act at the time of, or after, its registration;
  - (f) directions given under the Life Insurance Act; and
  - (g) the Collection of Data Act.
26. The Committee members must report to APRA, within 14 **business days** of becoming aware:
- (a) that the EFLIC has failed to comply with a requirement referred to in paragraph 25 of this Attachment; or
  - (b) the Committee believes there is a material risk of the EFLIC being unable to meet its obligations at some future time.
27. The report must:
- (a) be in the form of a written report explaining the causes of the failure or the material risk to the solvency of the EFLIC identified by the Committee; and
  - (b) outline a plan and timeframe for rectifying the failure or mitigating the risk of insolvency.
28. APRA would expect the Committee to provide a copy of the report to the Board.