



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

28 September 2007

Mr Keith Chapman
General Manager
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Australian Prudential Regulation Authority
GPO Box 9836
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By email: governance@apra.gov.au

Dear Mr Chapman

Discussion paper
Governance for APRA-regulated institutions

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the discussion paper released by the Australian Prudential Regulatory Authority (APRA) in September 2007 on governance for APRA-regulated institutions, in which it proposes amendments to the prudential standards to align with the revisions included in the 2nd edition of the ASX Governance Council's *Corporate Governance Principles and Recommendations* (the Principles).

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. As such, CSA considers itself fully qualified to comment on the issues covered by the paper. In Australia, CSA has over 8,500 members and affiliates representing the majority of public companies listed on the Australian Securities Exchange (ASX) and many unlisted companies. These include the major authorised deposit-taking institutions (ADIs), as well as general insurers, life insurers and authorised non-operating holding companies (NOHCs), superannuation trustees and fund managers.

Members of CSA have a thorough working knowledge of applied governance, including board composition and renewal, and director and auditor independence, and are frequently charged with the responsibility of advising boards on these matters.

Independence

The 2nd edition of the Principles moved away from providing a definition of independence to identifying relationships which may affect independent status. While the discussion paper recognises this shift, APRA has determined to retain its independence test. CSA is concerned that APRA's independence test is not aligned with the Principles, which state that:

When determining the independent status of a director, the board should consider whether the director:

1. is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company

2. is employed, or has previously been employed in an executive capacity by the company 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 company or another group member, or an employee materially associated with the service provided
4. is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
5. has a material contractual relationship with the company or another group member other than as a director.

CSA notes that in the APRA standards the wording is 'The circumstances which will not satisfy this principle include, but are not limited to, those set out in Attachment A.' CSA is concerned that, while the Principles clearly envisage that the board should take into account the relevant factors in coming to a conclusion, under the APRA standards, the board has no such discretion.

CSA notes that the *Response to Submissions on Review of Corporate Governance Principles and Recommendations* from the ASX Corporate Governance Council (p 13) states that 'Council has always considered that the determination of a director's independence is a matter for the board'. CSA agrees with the ASX Corporate Governance Council that the test of independence should be a board decision. On this basis, CSA notes and is concerned that the mandatory aspect of the APRA standards is not consistent with the Principles and its 'if not, why not' approach.

Moreover, CSA is also concerned that other wording in the APRA standard in relation to director independence refers to 'materially' interfering with the exercise of independent judgment, which means that the board is not given the opportunity to determine the issue of materiality. The Principles make it clear that the board has the opportunity to consider the issue of materiality, and that disclosure of its reasoning for the purpose of determining independence is what is sought.

Moreover, conflicts of interests are covered as part of the duties and responsibilities of directors under the Corporations Act 2001. Including materiality as interfering with the exercise of independent judgment has the effect of supplementing the law through prudential regulation.

CSA recommends that, if APRA genuinely wishes to align its governance standards with the Principles, the approach of the Principles should be adopted consistently, so that the board makes an appropriate determination after taking into account all relevant circumstances.

Board renewal

The Principles moved away from any reference to tenure to concentrate on board renewal, with an emphasis on the board evaluation as the tool to foster discussion and determination as to how best to achieve the mix of an appropriate set of skills and experience on a board to meet the current needs of the company it serves. However, the APRA discussion paper proposes that the governance standards will retain a reference to the tenure of a director, moving it from the definition of independence to a required consideration in an APRA-regulated company's formal policy on board renewal.

APRA's proposed inclusion of tenure as a required consideration in a board renewal policy does not align with the approach taken in the revised Principles, which relegates the reference to tenure to the commentary on the Recommendations, and only states that directors should be conscious of the length of tenure of directors in succession planning. CSA would be very concerned if the retention of tenure requirements fostered a move to setting arbitrary limits on

tenure, which CSA does not accept as being best practice. Highlighting tenure in board policies in such a way could lead to an undesirable 'tick-the-box' approach, rather than one focused on principles and outcomes suitable to individual company and individual director circumstances, which should be encouraged.

The impact on smaller companies

CSA notes that the impact on smaller companies of prescriptive APRA governance standards is of particular concern. Prescribing governance standards, rather than providing for an 'if not, why not' approach as formulated in the Principles, creates a very onerous compliance burden for smaller companies. CSA believes that this could be a significant factor in leading many smaller companies to merge or seek acquisition. For example, if directors of smaller credit unions resign because they do not meet the prescriptive APRA test of independence, those companies can find that, given their limited resources, they cannot source other directors to meet both the independence test prescribed by APRA and the 'fit and proper' requirements set in place by APRA. As a result, mergers may follow.

CSA support of the Australian Institute of Company Directors (AICD) submission

CSA concurs with the concerns expressed by the AICD in its submission on the discussion paper on the assessment of independence and the retention of tenure as a test in board renewal. CSA agrees that, while the discussion paper comments on alignment with the Principles, the amendments proposed in the discussion paper do not align with the Principles, but steer the standards in a prescriptive direction.

CSA in particular supports the statement in the AICD submission that:

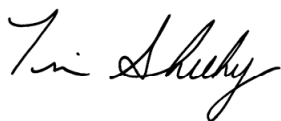
The Federal Treasurer and independent inquiries have recommended that APRA avoid prescriptive regulation and support alignment with the ASX Council's Principles, including the 'if not, why not' options that characterise its approach (Banks Task Force on Overregulation, Treasurer's Statement of Expectations, HIH Royal Commission).

Conclusion

CSA supports a principles-based approach to governance and the alignment of the APRA standards with the Principles.

CSA hopes that its comments on the amendments proposed in the discussion paper assist in supporting such an approach, rather than a prescriptive one.

Yours sincerely



Tim Sheehy
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