



# Discussion Paper

## **Governance for APRA-regulated institutions**

18 May 2005

## Preamble

In November 2003, APRA released a discussion paper setting out details on the second round of proposed reforms for the general insurance industry.<sup>1</sup> A key part of those proposed reforms was concerned with governance arrangements for general insurers. APRA highlighted its intention to develop similar governance arrangements for all APRA-regulated industries. The proposals in this paper meet this intention and replace the draft prudential standard on board composition for ADIs released in 2001. After extensive public and industry consultation over the last year, APRA is publishing draft prudential standards covering governance arrangements for ADIs, general insurers, life companies and authorised NOHCs. Other matters canvassed as part of the second round of general insurance reforms, including *GPS 220 Risk Management*, *GPS 230 Reinsurance Management* and *GPS 310 Audit and Actuarial Reporting and Valuation* were the subject of a separate media release on 3 May entitled *APRA releases proposed general insurance risk and financial management reforms*.

In response to the initial draft governance proposals, 78 submissions were received from industry participants and other interested parties. This discussion paper provides background on the draft prudential standards and responds to the key points raised in submissions and in subsequent discussions.

The revised governance proposals are set out in the draft prudential standards which are located on the APRA web site at <http://www.apra.gov.au/policy>.

The governance prudential standards are intended to ensure that APRA-regulated institutions are managed prudently, that board members have access to appropriate independent expertise and that the composition of the boards of APRA-regulated institutions reflects the need for both appropriate independent oversight and industry experience.

Subject to consultation on this discussion paper, it is expected that the final prudential standards will be released in January 2006 and be effective from the end of an institution's then current financial year.

APRA invites written submissions on the draft prudential standards. These must be submitted not later than 12 August 2005 to:

Mr Greg Brunner  
General Manager  
Policy Research and Statistics  
Australian Prudential Regulation Authority  
GPO Box 9836  
Sydney NSW 2001  
Email: [governance@apra.gov.au](mailto:governance@apra.gov.au)

<sup>1</sup> *Prudential Supervision of General Insurance - Stage 2 Reforms*. Discussion paper. Australian Prudential Regulation Authority. November 2003. This paper can be found on the APRA web site at [www.apra.gov.au](http://www.apra.gov.au).

# Contents

<b>Glossary</b>	<b>4</b>
<b>Chapter 1</b>	
<b>Governance for APRA-regulated institutions</b>	<b>5</b>
1.1 Background	5
1.2 Transition period and related matters	6
<b>Chapter 2</b>	
<b>Responses to matters raised in submissions</b>	<b>7</b>
2.1 Independence of directors	7
2.2 Chairperson of the board	8
2.3 Board composition	9
2.4 Board member resignations	9
2.5 Board Audit Committee	10
2.6 Board Risk Committee	10
2.7 Board and senior management performance	11
2.8 Length of service of directors	11
2.9 Independence of external auditors and actuaries	12
2.10 Internal audit	12
<b>Chapter 3</b>	
<b>Other matters</b>	<b>14</b>
3.1 Australian operations of foreign entities	14
3.2 Information to be available to APRA	14

## Glossary

ADI	Authorised deposit-taking institution under the <i>Banking Act 1959</i>
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
ASX Corporate Governance Principles	ASX Corporate Governance Council <i>Principles of Good Corporate Governance and Best Practice Recommendations</i>
BAC	Board Audit Committee
Banking Act	<i>Banking Act 1959</i>
Board	Board of directors
BRC	Board Risk Committee
CEO	Chief executive officer
CLERP 9	Corporate Law Economic Reform Program No.9
Corporations Act	<i>Corporations Act 2001</i>
GGN	General insurance guidance note
GPS	General insurance prudential standard
Insurance Act	<i>Insurance Act 1973</i>
Insurer or general insurer	General insurer authorised under the <i>Insurance Act 1973</i>
Life Insurance Act	<i>Life Insurance Act 1995</i>
Life insurance company or life company	Life insurance company authorised under the <i>Life Insurance Act 1995</i>
NOHC	Non-operating holding company (authorised under either the <i>Banking Act 1959</i> or <i>Insurance Act 1973</i> )
Standards or prudential standards	References to the prudential standards

# Chapter 1

## Governance for APRA-regulated institutions

### 1.1 Background

APRA has previously indicated its intention to introduce governance requirements for APRA-regulated institutions as part of both the ADI standards-making process<sup>2</sup> and the second round of general insurance reforms.<sup>3</sup> For general insurers, APRA proposed a number of new governance provisions and amendments to existing provisions based on the Australian Stock Exchange (ASX) Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* (ASX Corporate Governance Principles). APRA also indicated in that discussion paper that it would seek to introduce similar requirements for other APRA-regulated industries.

Submissions on APRA's governance proposals were received from a broad cross-section of APRA-regulated institutions and industry bodies, representing general insurers, ADIs, life companies and other parties. Generally, the views expressed in submissions were that while governance is an important factor for successful corporations, governance was the responsibility of the Australian Securities and Investments Commission (ASIC), and the ASX for listed companies. Concern was also expressed that the introduction of governance prudential standards by APRA would inevitably lead to a myriad of governance requirements for APRA-regulated institutions which would differ from other regulators, making it more difficult for APRA-regulated institutions to operate effectively. Submissions also questioned why APRA-regulated institutions should be subject to more onerous governance arrangements than other public companies.

In light of the responses received, it is appropriate to reiterate why APRA intends to require APRA-regulated institutions to put in place minimum governance standards, and why the proposed standards are at the firmer end of the governance spectrum that companies incorporated in Australia are expected to meet.

APRA's duty as the prudential regulator is to look after the interests of beneficiaries (depositors, policyholders and superannuation fund members) and ensure that their interests are not compromised by the actions of the board and management of APRA-regulated institutions. This duty has an appreciably different focus from that of the ASX which is responsible for ensuring the operation of a transparent, accessible and accountable market, or the *Corporations Act 2001* (Corporations Act) requirements which require boards to act in the interests of the corporation.

APRA-regulated institutions require a higher minimum benchmark of financial strength and risk management than is required for other companies. If institutions are to meet this benchmark APRA needs to be confident that governance arrangements are robust. An 'if not, why not' approach, as advocated by the ASX Corporate Governance Principles, with shareholders as the main arbiter, will not always achieve APRA's purpose. Furthermore, the majority of APRA-regulated institutions are not listed on the ASX and hence are not subject to the ASX Corporate Governance Principles.

In addition, for those APRA-regulated institutions that operate as branches of foreign-owned and incorporated institutions, APRA's duty as the prudential regulator to protect the interests of Australian beneficiaries still applies for general insurers and life companies. For branches of foreign-owned and incorporated ADIs, APRA also needs to ensure that their affairs are conducted in a sound manner. Neither the ASX Corporate Governance Principles, nor the majority of the Corporations Act provisions, apply in such cases. Hence, APRA needs to ensure an acceptable minimum level of governance is applied to the local operations of these institutions.

In its proposals to date, APRA has sought to achieve its objectives by proposing standards of governance for APRA-regulated institutions that are generally considered good practice. Some submissions expressed the view that the governance proposals were too prescriptive and may hinder the effective and efficient functioning of boards. APRA agrees that

<sup>2</sup> *Draft Prudential Standard Board Composition*. August 2001.

<sup>3</sup> *Prudential Supervision of General Insurance - Stage 2 Reforms*. Discussion paper. Australian Prudential Regulation Authority. November 2003.

a prescriptive model by itself will not result in good governance – appropriate behaviour is also essential. However, APRA remains of the view that certain minimum governance requirements are necessary in order to ensure that the decision-making frameworks of APRA-regulated institutions are sound and protect beneficiaries' interests appropriately.

Respondents suggested that a better method may be for APRA to set out high-level principles that individual APRA-regulated institutions need to meet, without the burden of overly prescriptive requirements. To make such an approach work nonetheless, it is still necessary to establish minimum requirements that APRA-regulated institutions must adhere to, including requirements for independence and board composition. APRA needs to be able to enforce its expectations about governance matters, and its governance requirements need to be well-defined and not open to misinterpretation. For matters not specifically dealt with in the draft prudential standards, APRA supports the ASX Corporate Governance Principles, including the 'if not, why not' approach to disclosure, as a basis for good practice.

In addition to promoting a sound decision-making framework, APRA also seeks to ensure that the individuals involved in decision-making and review processes at senior levels are appropriate. With this objective in mind, APRA will be issuing revised proposals in relation to fit and proper requirements for APRA-regulated institutions in coming months.

Chapter 2 of this paper sets out APRA's responses to some key issues raised during the initial consultation on its governance proposals. Chapter 3 provides a brief overview of additional governance matters.

## 1.2 Transition period and related matters

As stated in the preamble, it is anticipated that the prudential standards, once finalised, will commence in January 2006. APRA-regulated institutions will be required to be fully compliant with all applicable requirements in the governance prudential standard by their first balance date that falls after the commencement of the prudential standard. Until that time, all existing governance prudential requirements will continue to apply. Formal transition arrangements will be included in the final governance prudential standards or set out in a separate transitional prudential standard.

The proposed governance prudential standards will replace existing governance requirements as follows:

- *GPS 220 Risk Management* (paragraphs 15-18, 20, and 23) and *GGN 220.1 Governance* (paragraphs 1, 2, 6-15) for general insurers;
- the preserved prudential statement on ownership and control of banks (PS B1) for banks;
- the preserved subsection 237(2) of the former Financial Institutions Code for building societies and credit unions; and
- the preserved Financial Institutions Scheme prudential standard dealing with the composition of the board of special service providers.

For life companies and friendly societies, the governance requirements in the proposed governance prudential standard will be in addition to any existing governance requirements, including those in the *Life Insurance Act 1995* (Life Act).

## Chapter 2

### Responses to matters raised in submissions

#### 2.1 Independence of directors

##### Original proposal

The boards of locally-incorporated APRA-regulated institutions<sup>4</sup> are to be comprised of a majority of independent, non-executive directors. APRA will define the terms 'independence' and 'non-executive'. The board must have a minimum of five directors.

Exceptions to the independence requirements were proposed for APRA-regulated institutions that are subsidiary members of certain corporate groups.

In addition, comments were sought on whether independent directors of the parent company should be able to sit as independent directors on the boards of subsidiaries.

##### Policy objective

Board independence is intended to reduce the potential for boards to be controlled by individuals whose interests could align with management or dominant shareholders, or who may have competing or conflicting business interests which could affect their ability to discharge their role and functions adequately and appropriately. It aims to promote board decision-making that has appropriate regard to the interests of all stakeholders in the APRA-regulated institution.

##### Comments received

The majority of submissions either opposed or had serious reservations about the proposal and its impact.

Many submissions expressed concern that APRA was imposing governance requirements that were seen as the responsibility of ASIC and the ASX. Many of these submissions also indicated that prescribing a 'one-size-fits-all approach' to board structures was less than ideal. There was support expressed for the ASX approach whereby entities that do not meet ASX Corporate Governance Principles must explain why they do not meet those requirements, rather than mandating rules that must be adhered to.

A commonly held view was that the proposal valued independence over industry experience and expertise, with the ultimate outcome that boards would be dominated by directors with little relevant experience. It was argued that this would lead to less independence as greater reliance would be placed on existing executive directors who have a sound knowledge of the business and the industry more generally.

In addition, it was argued that the need to have a majority of independent directors would result in industry having to find a significant number of new directors. This would come at the expense of knowledge and experience as the existing pool of directors available and suitable to serve on boards is limited. It was pointed out that APRA-regulated institutions, especially smaller ones, could face significant additional costs if forced to find additional independent directors to serve on their boards.

There was general support for the requirement that boards have a majority of non-executive directors but, as discussed above, there was little support for the requirement that a majority of these directors also be independent.

In general, APRA's definition of independence was considered overly restrictive. Specific concerns were expressed about the failure to cater for joint ventures. Of the submissions providing comment on this matter, the view was that a joint venture company should be considered as part of the 'group' of each shareholder company, and independent directors of a shareholder company should still be considered independent for the purposes of sitting on the board of the joint venture company.

##### APRA prudential approach

APRA's intention is to ensure that boards perform their review and oversight roles effectively and that the interests of other stakeholders – notably depositors/policyholders – are not secondary to the interests of dominant shareholders, current or past management or competing or conflicting business interests. Better practice governance arrangements require a majority of independent directors in institutions with dispersed shareholdings and APRA continues to propose that

<sup>4</sup> The November 2003 proposals related specifically to general insurers. In this paper the term APRA-regulated institutions is used to refer to general insurers, life companies and ADIs. This reflects the broad range of respondents and the intention to apply the proposals to ADIs and life companies as well as general insurers.

the boards of locally-incorporated APRA-regulated institutions be required to have a majority of independent, non-executive directors.

Exceptions will be allowed under certain circumstances. Specifically, where an APRA-regulated institution is a subsidiary of another APRA-regulated institution, an authorised NOHC or their overseas equivalent, APRA proposes to require the board of the subsidiary to have a majority of non-executive directors. These directors can include board members or senior management of the parent company, but not executives of the subsidiary itself or any of its subsidiaries. These non-executive directors need not all be independent, although it will be necessary for the boards of subsidiaries to have a minimum number of independent directors and an independent chair, as set out in the prudential standard. These independent directors can include independent directors of the parent company. This is intended to reflect the rights and responsibilities of parent companies in corporate groups and the prudential regulations applied to such companies.

APRA will also allow some exceptions for subsidiaries that have a parent that is not prudentially regulated. In such cases, the independent directors of the parent will be able to sit as independent directors on the board of the subsidiary. These subsidiaries will still be required to have a majority of independent, non-executive directors.

Irrespective of the composition of the board, it is incumbent upon the directors on the board of an APRA-regulated institution to act in the best interests of that institution. The board of the APRA-regulated institution will also need to have regard to the impact of the other entities in the group on the APRA-regulated institution itself. Where the APRA-regulated institution is at the head of the group it will need to have regard to the operations of member entities of the group on other APRA-regulated institutions within the group. Further, an APRA-regulated institution will not be able to engage in activities that support other group members to the detriment of any APRA-regulated institution in the group, even if an entity's constitution expressly authorises the board or individual directors to act in the interests of another

group member. APRA intends to monitor behaviour in this regard, particularly when the exceptions have been used.

APRA also concurs that the board collectively needs to have significant industry expertise as well as a broad range of other skills and, hence, that independence requirements need to be balanced with expertise requirements. These will also be covered by the fit and proper proposals.

APRA proposes to align its definition of independence with that of the ASX. Departures from the ASX definition would need to be agreed with and accepted by APRA. At the same time, APRA will apply a slightly different definition of 'non-executive'. This definition is set out in the prudential standard and is intended to deal more specifically with situations where the APRA-regulated institution is a subsidiary.

## **2.2 Chairperson of the board**

### **Original proposal**

The chairperson of the board must be an independent non-executive, and must not formerly have been the Chief executive officer (CEO) of the APRA-regulated institution.

### **Policy objective**

APRA's objective in proposing that a former CEO would not be able to assume the role of chairperson of the board is to promote and ensure that the chairperson takes an objective view of the APRA-regulated institution, including matters resulting from past and present management decisions. This includes ensuring that an immediate past CEO cannot unduly influence the continuing management of the APRA-regulated institution. The intention is to allow the new management of the APRA-regulated institution time to establish an appropriate approach of its own while continuing to protect the interests of all stakeholders.

### **Comments received**

A wide range of views were expressed on this proposal, with varying degrees of support. Some submissions made the point that proposals pertaining to the chairperson were ASIC's responsibility.

A number of submissions voiced strong opposition to the proposal that a previous CEO should not assume the position of chairperson on that company's board. It was argued that this is a decision for shareholders to make. There were arguments made that a former CEO was a logical choice for chairing the board in some situations, given their intimate knowledge and experience of the institution. Comments were also made that it would be more appropriate, if such an approach was adopted, to put in place a time limit before a former CEO could assume the position of chairperson.

A number of submissions argued that while it was appropriate to mandate that the chairperson must be a non-executive they did not support the need for the chairperson to be independent.

#### **APRA prudential approach**

APRA remains of the view that the chairperson should be independent. However, it agrees that its objective would not be compromised if a former CEO were to become the chairperson, but only after a period of time has elapsed from the time the person held the position of CEO. The proposal is that the period should be three years. This is in line with the ASX Corporate Governance Principles where a person can be considered independent provided they have not had certain relationships during the previous three years.

These requirements will also apply to the boards of APRA-regulated institutions that are subsidiaries.

## **2.3 Board composition**

### **Original proposal**

It was proposed that a director not be able to serve on the board of more than one APRA-regulated institution within the same industry sector at the same time, excluding APRA-regulated institutions that are part of the same group. Joint venture companies were deemed to form part of the group of each parent entity for this purpose.

### **Policy objective**

This proposal sought to promote independence on the boards of APRA-regulated institutions and minimise the potential for conflicts of interest arising from people sitting on the boards of institutions that compete against each other in the same market.

### **Comments received**

There was no argument with the need to carefully and diligently manage conflicts of interest. Submissions generally expressed the view that a director serving on two or more boards of APRA-regulated institutions operating in the same industry does not automatically face a conflict of interest. It was stated that there is a broad spectrum of business within each industry that APRA regulates and many smaller entities would lose the benefit of industry expertise and experience should this proposal be effected.

The key argument was the fact that such a requirement would further limit the pool of experienced directors available to serve on the boards of APRA-regulated institutions, and the ultimate outcome would be to reduce the overall quality and effectiveness of boards. It was stated that existing Corporations Act requirements to manage conflicts of interest are sufficient for this purpose.

### **APRA prudential approach**

APRA sees merit in allowing institutions to manage conflicts of interest on a case by case basis. APRA will monitor cross-directorships but will generally allow institutions autonomy in managing potential conflicts of interest. Any concerns APRA has in this regard will be handled as part of its ongoing supervisory processes.

## **2.4 Board member resignations**

### **Original proposal**

APRA-regulated institutions would be required to provide APRA with details of the resignation and removal of directors, in writing, within 14 days of the resignation or removal, including advice setting out reasons for the director's resignation or removal. It was intended to extend this requirement to other responsible persons.<sup>5</sup>

<sup>5</sup> Responsible persons include directors, senior managers, auditors and actuaries. For further details on the definition of 'responsible persons' and 'senior manager' refer to the draft fit and proper prudential standards on the APRA web site at <http://www.apra.gov.au/policy/>.

### **Policy objective**

The resignation and removal of directors and senior management can sometimes be a warning signal that there are problems within an APRA-regulated institution, or that an individual is not fit and proper for the role they previously occupied. When this is the case, APRA as the prudential regulator needs to be aware. The intention of this proposal was to foster communication of these issues.

### **Comments received**

There was general opposition to this proposal, which centred on two themes. The first was that this information is already provided to ASIC, so providing the information to APRA would involve a duplication of effort. Secondly, concerns were expressed about forcing APRA-regulated institutions to notify APRA of matters that may be of a confidential nature.

### **APRA prudential approach**

Further details of these proposals were set out in the draft fit and proper prudential standards released in March 2004. This matter will be dealt with as part of the consultation on those prudential standards. APRA remains firmly of the view that it is important, from a prudential perspective, to be notified of senior resignations or removals. The proposal requiring that specific reasons be provided to APRA will be replaced with one that allows APRA to investigate matters further if it feels it to be necessary. APRA also intends to require APRA-regulated institutions to avoid creating any barriers to communication between former directors, other responsible persons and APRA (also refer 3.2 of this discussion paper).

## **2.5 Board Audit Committee**

### **Original proposal**

All APRA-regulated institutions would be required to have a Board Audit Committee (BAC). The BAC is to be comprised of at least three members, all of whom must be non-executive directors, with a majority of these being independent. The chairperson of the board is not to sit on the BAC. The BAC must have a charter that sets out its roles and responsibilities.

### **Policy objective**

The intention of this proposal was to ensure that APRA-regulated institutions have appropriate arrangements covering independent oversight of the institution, including ensuring that the operation and management of the institution is in accordance with the policies and procedures of the board, and all other relevant requirements are being met.

### **Comments received**

The proposal to require institutions to have a BAC comprised of non-executive directors, with a majority being independent, was widely accepted. However, the proposal that the chairperson of the board could not sit on the BAC was opposed by the majority of submissions. It was argued that there was no apparent benefit from imposing such a requirement, especially given the chairperson will be required to be independent, and that this could remove an important source of information for the chairperson. It was suggested that it would be more appropriate to allow the chairperson of the board to sit on the BAC but prevent them from chairing the committee.

There were also concerns that if the original proposal stood it would mean that a small institution would not be able to operate with a board of five directors, with the requisite minimum three independent directors (including the chairperson). Rather a minimum of six directors would be required if the chairperson was prevented from sitting on the BAC.

### **APRA prudential approach**

APRA continues to propose that BACs have a majority of independent directors. However, the chairperson of the board will be allowed to sit on the BAC but will not be able to chair the committee. Additional BAC criteria will apply as set out in the draft prudential standard.

## **2.6 Board Risk Committee**

### **Original proposal**

All APRA-regulated institutions would be required to have a Board Risk Committee (BRC) with responsibility for developing, setting and monitoring adherence

to risk management strategies. The BRC may be combined with the BAC under certain circumstances. APRA-regulated institutions that are part of a corporate group may be able to use group committees under certain circumstances, subject to APRA approval.

### **Policy objective**

The objective is that APRA-regulated institutions have arrangements in place to ensure there is adequate independent oversight of the management of risk within an APRA-regulated institution.

### **Comments received**

Overall, comments received in response to the proposal to require APRA-regulated institutions to have a BRC were supportive.

### **APRA prudential approach**

For general insurers and ADIs, the draft prudential standards incorporate the original proposals in relation to BRCs. For life companies the provisions in the Life Act apply. This means that life companies cannot utilise Group Board Committees. Also, in view of the functions of the audit committee required under the Life Act, it is appropriate for the audit committee of a life company to have carriage of risk issues.

## **2.7 Board and senior management performance**

### **Original proposal**

APRA-regulated institutions will be required to put in place procedures for assessing the performance of the board and senior management, relative to their respective objectives.

### **Policy objective**

The objective is to ensure there are procedures in place requiring assessment of the board, directors and senior management, against their respective objectives.

### **Comments received**

There was general support for the proposal to require that APRA-regulated institutions have in place procedures for assessing the performance of the

board including individual directors, as well as senior management. However, it was felt that APRA should not stipulate specific requirements in this regard.

### **APRA prudential approach**

APRA will require APRA-regulated institutions to put in place procedures for the assessment of the board, individual directors, and senior management against their respective objectives. The actual detail of the assessment procedures will be at the discretion of individual institutions. The adequacy of these arrangements will be reviewed as part of APRA's supervisory processes.

## **2.8 Length of service of directors**

### **Original proposal**

APRA proposed that a director must be elected for a fixed period of time, preferably not more than three years, but could nominate for re-election. It was also proposed that boards set a maximum term for the tenure of directors. Additionally, an independent director who had served for ten years on the board would not be able to be classified as independent.

### **Policy objective**

The objective is to ensure that the board of an APRA-regulated institution provides an independent perspective and is open to new ideas and current thinking, while retaining adequate expertise.

### **Comments received**

There was opposition to any attempt by APRA to prescribe a maximum tenure for the purposes of classifying a person as an independent director. The general argument was that there is no evidence to support a link between the length of tenure of a director and their level of independence. It was felt that the proposal valued independence over experience and would restrict the pool of directors available to serve on the boards of APRA-regulated institutions, which would be detrimental for the financial services industry generally.

Submissions also questioned how the proposals would be applied to APRA-regulated institutions that do not hold an annual general meeting.

A number of submissions raised the fact that APRA-regulated institutions may need to amend their constitutions in order to meet such a proposal.

### APRA prudential approach

APRA believes that ongoing renewal of boards is an important element in ensuring that they operate effectively. However, it will pursue this in a more flexible manner, to better allow for the circumstances of individual boards. Each board must put in place a policy dealing with board renewal that sets out how the board intends to ensure that it remains open to new ideas and independent thinking while retaining adequate expertise. The adequacy of these policies will be reviewed as part of APRA's supervisory processes.

## 2.9 Independence of external auditors and actuaries

### Original proposal

In order to strengthen the independence of auditors and actuaries, APRA proposed a number of measures including periodic tendering of audit engagements; rotation of audit partners; limitations on services provided by auditors; peer review of auditors' and actuaries' work; increased scrutiny of audit and actuarial firms; and separation of audit and actuarial firms.

### Policy objective

The objective is to ensure that auditors and actuaries have the independence and objectivity necessary to discharge their duties and functions, without the possibility that conflicts of interest that could impair their ability to perform these critical functions.

### Comments received

There were a substantial number of comments generated by these proposals. Essentially, submissions were of the view that APRA should not impose additional requirements for auditors beyond those being proposed under the Corporate Law Economic Reform Program No.9 (CLERP 9).

There was broad, although not universal, support for the proposal to require peer review for actuaries provided this takes into account the current work of the Institute of Actuaries of Australia on this topic.

### APRA prudential approach

APRA now proposes to require all APRA-regulated institutions to ensure that their auditor complies with auditor independence provisions consistent with those in CLERP 9, irrespective of whether these provisions of the Corporations Act would otherwise apply to them.

For insurers, APRA proposes to mandate peer review for the Approved Actuary (general insurers) and Appointed Actuary (life insurers). The proposal dealing with the topic of peer review for actuaries of general insurers was covered in a media release on 3 May entitled *APRA releases proposed general insurance risk and financial management reforms*. A similar proposal for life companies will follow at a later date. In both cases this matter is expected to be dealt with as part of a dedicated audit and actuarial prudential standard.

The original proposal that the auditor and actuary (when externally appointed) of an insurer not come from the same or related firms will proceed. A provision to this effect has been included in the governance standards for general insurers and life companies.

## 2.10 Internal audit

### Original proposal

APRA proposed to clarify its proposals with respect to the internal audit function and provide additional guidance on the role of internal audit. APRA intended to require all locally-incorporated APRA-regulated institutions to have a comprehensive and independent internal audit function. An APRA-regulated institution would be able to pursue alternative arrangements, with APRA, in specific circumstances. It was also proposed that the internal audit function report directly to the BAC.

### **Policy objective**

The objective is to ensure that APRA-regulated institutions have appropriate and adequately resourced internal audit functions to help identify high risk issues early and with reporting lines that preserve the independence and the integrity of this function.

### **Comments received**

There was general support from submissions for the need for an internal audit function, but views were mixed as to what constitutes an appropriate reporting line. There was some support for a direct reporting line to the board or BAC. However, many respondents argued that internal audit was a function of management and should therefore report to management, but still have access to the board or BAC.

It was also requested that APRA clarify its position on internal audit requirements for branches and

whether APRA-regulated institutions that are part of a corporate group will be able to utilise the 'group' internal audit function where one exists.

### **APRA prudential approach**

APRA is of the view that internal audit provides a fundamental risk management 'check and balance' function for the board. APRA proposes to require all APRA-regulated institutions to have a dedicated internal audit function, unless appropriate alternative arrangements are agreed with APRA. The internal audit function must be adequately resourced. The internal auditor will be required to have a reporting line to the BAC and have unfettered access to the BAC at all times. While APRA accepts that, for administrative purposes, internal audit may have other reporting lines, these must not compromise the independence of the audit function.

Internal audit requirements for branches are also set out in the prudential standard.

## Chapter 3

### Other matters

#### 3.1 Australian operations of foreign entities

As well as the proposals applicable to the Australian operations of foreign institutions under the proposed governance prudential standards, APRA is considering separate governance proposals for branches of general insurers. These will be the subject of separate prudential standards to be developed during 2005.

#### 3.2 Information to be available to APRA

The proposed governance prudential standards include the need to ensure that officers, employees,

auditors and actuaries are not prevented from providing information to APRA, where a person reasonably believes the information is relevant to APRA in its role as the prudential regulator. A similar proposal for communications with auditors, actuaries and board members is also included. These are designed to ensure that APRA-regulated institutions do not attempt to prevent the provision of any relevant information to APRA, or other persons or entities with responsibility for independent review or oversight in relation to APRA-regulated institutions.



Telephone  
1300 13 10 60

Web site  
[www.apra.gov.au](http://www.apra.gov.au)

Mail  
GPO Box 9836  
in all capital cities  
(except Hobart and Darwin)