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Dear General Manager

Submissions on Governance Review - Discussion Paper

These submissions are made in response to the 'Governance Review - Discussion Paper' (**Discussion Paper**) released by the Australian Prudential Regulation Authority (APRA) on 6 March 2025. The Discussion Paper contains eight proposals to strengthen core prudential standards and guidance on governance for banks, insurers and RSE licensees. These submissions set out the areas where we consider the proposals are unnecessary or inappropriate or otherwise require clarification to ease the regulatory burden on entities and avoid potential confusion.

1 Proposal 1 - Skills and capabilities

Require regulated entities to:

- a. identify and document the skills and capabilities necessary for the board overall, and for each individual director
- b. evaluate existing skills and capabilities of boards and individual directors
- c. take active steps to address gaps through professional development, succession planning and appointments.

(a) Focus on individual director skills and capabilities

We have concerns about the requirement in paragraph a. of Proposal 1 to identify and document the skills and capabilities "necessary for each individual director".

Boards function as collective decision-making bodies in which all directors are responsible for decisions of the board and director duties' apply equally to all directors (in their role as directors). Identifying skills and capabilities "necessary for each individual director" risks making individual directors responsible for matters relating to their particular skills and capabilities, a trend that would ultimately make boards dysfunctional. Our concern here is reflected in APRA's statement that boards should identify attributes that "include specific expectations for the chair, chairs of board committees *and other individual directors*".

The focus on individual director skills and capabilities goes further than necessary to address the problem of inadequate skills and capabilities at the Board level. As APRA Chair John

Lonsdale noted in a speech earlier this year,¹ gaps in directors' skills and capabilities often reflect a failure to think seriously about the mix of skills required by a board and how to remedy skill gaps when they are identified. These shortcomings can be sufficiently addressed through appropriate focus on the collective skills and capabilities of boards.

(b) Minimum skills for directors and collective board skills and capabilities

We have no issue with a requirement for minimum skills for directors, nor with boards identifying the skills and capabilities they require collectively. However, we would urge APRA to minimise any change to the existing requirements of CPS 510 and SPS 510 which address this issue adequately, and also to recognise existing obligations under other applicable laws and regulations.

- (i) CPS 510 *Governance (CPS 510)* and SPS 510 *Governance (SPS 510)* already require boards to collectively have the necessary skills, knowledge and experience to manage regulated entities appropriately, and for each director to have skills to allow them to make an effective contribution.² CPS 510 and SPS 510 also require collective board performance and individual director performance to be assessed at least annually.³
- (ii) Regulated entities that are listed on ASX already comply with similar principles under the ASX Corporate governance Principles and Recommendations (4th edition) (**ASX Corporate Governance Principles**),⁴ with a number of unlisted entities also implementing a skills matrix for directors as a matter of accepted good governance practice.
- (iii) As noted in the Discussion Paper, all directors are subject to directors' duties under the *Corporations Act 2001* (Cth) and general law, including duties to act with reasonable care and diligence, in good faith and for a proper purpose. Further, directors of superannuation trustees are subject to a higher set of duties under the *Superannuation Industry (Supervision) Act 1993* (Cth) which are owed directly to fund members. The effective discharge of these duties necessarily requires a minimum level of skills, knowledge and capabilities.

In our view, introducing requirements that are largely duplicative of existing regulatory frameworks is unlikely to result in improved governance outcomes and risks creating greater uncertainty and confusion.

2 Proposal 2 - Fitness and propriety

Require regulated entities to meet higher minimum requirements to ensure fitness and propriety of their responsible persons.

Require SFIs, and non-SFIs under heightened supervision, to engage proactively with APRA on potential appointments.

(a) Specific 'fit and proper' criteria and verification requirements

¹ APRA Chair John Lonsdale, 'Building a strong governance framework for turbulent times', (Speech, AFR Banking Summit, 18 March 2025) <<https://www.apra.gov.au/news-and-publications/apra-chair-john-lonsdale%E2%80%99s-speech-to-afr-banking-summit-0>> (**AFR Banking Summit Speech**).

² See paragraph 19 of CPS 510 and paragraph 10 of SPS 510.

³ See paragraph 44 of CPS 510 and paragraph 21 of SPS 510.

⁴ See Principle 2, and Recommendations 2.2 and 2.6 of the ASX Corporate Governance Principles.

APRA's proposal to introduce a more detailed list of matters that must be considered as part of a fit and proper assessment (and requiring verification of certain matters) is likely to be helpful in bringing a degree of standardisation of approach across regulated entities.

However, any mandatory requirement to obtain character or regulatory references to evaluate performance in other roles (including the financial and reputational performance of previous organisations) will need to be carefully managed to comply with applicable privacy laws, as well as the legal and commercial sensitivities relevant to previous organisations (such as the need to preserve legal professional privilege in relation to regulatory matters, protect confidentiality and avoid compromising any ongoing internal investigations).

We are supportive of APRA's proposal to explore aligning role definitions with the Financial Accountability Regime (FAR) and relying on reports received under FAR rather than requiring two sets of reports.

(b) Level of APRA involvement in responsible person selection

Proposal 2 requires SFIs and non-SFIs under heightened supervision, to engage proactively with APRA on potential appointments. Where APRA is not satisfied with a proposed or incumbent responsible person, this will inform the intensity of APRA supervision and may cause APRA to use its other supervisory or enforcement powers to address outstanding risk to the regulated entity.

Even if the proposal were to be limited to entities under heightened supervision, we would still be concerned if expanded involvement by APRA in responsible person selection could be used in a way that was effectively equivalent to a statutory right of approval or veto over appointments for the following reasons:

- (i) As noted in the Discussion Paper, legislative change would be required to enable APRA to have a formal power of approval or veto in relation to responsible persons. We understand that legislative change is out of the scope of review and is not being proposed.⁵
- (ii) As Australia's prudential and financial safety regulator, APRA's primary role is to promote financial system stability through the setting of prudential standards and monitoring compliance. If APRA were to influence responsible manager appointments in a manner that was tantamount to a statutory right of approval or veto, it would be overstepping its mandate and inappropriately stepping into the shoes of boards and shareholders.
- (iii) The selection of board members and responsible managers requires consideration of a range of criteria and attributes including skills and experience that extend beyond an assessment as to whether the person is fit and proper or otherwise prudentially acceptable. APRA would not be well placed to assess those other criteria and attributes, which must be taken into account in a balanced way in the selection process.
- (iv) A requirement for detailed consultation with APRA on responsible person selection may affect the ability of regulated entities to comply with rules requiring board vacancies to be filled within 90 days.⁶

⁵ See pages 12-13 of the Discussion Paper. See also remarks by APRA Chair, John Lonsdale, in the AFR Banking Summit Speech (see note 1 above) stating that "Unlike some peer regulators overseas, we don't propose introducing a requirement for APRA to approve appointments, however we do intend to step up our oversight of succession planning nominations."

⁶ See for example, section 89(3)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cth).

3 Proposal 3 - Conflicts management

Extend current RSE licensee conflict management requirements to banks and insurers so they are also required to:

- a. proactively identify actual and potential conflicts of interest and duty
- b. avoid or prudently manage conflicts
- c. take remedial action when conflicts are not disclosed or managed properly.

Require regulated entities to consider perceived conflicts, in addition to actual and potential conflicts.

There is a real question as to whether Proposal 3 is necessary in light of the following ‘guardrails’ already in place:

- (a) CPS 220 *Risk Management (CPS 220)* already requires regulated entities to maintain policies and procedures for identifying, monitoring and managing potential and actual conflicts of interest⁷ - we expect that almost all regulated entities will already have a conflicts management policy that addresses “perceived” conflicts of interest;
- (b) directors of banks and insurers are already required to disclose material personal interests and report related party transactions;⁸
- (c) under FAR, accountable persons are required to take reasonable steps to protect the prudential reputation of regulated entities;⁹
- (d) all regulated banks and insurers are Australian financial services licensees and are statutorily required to have in place adequate conflict of interest management arrangements in the provision of financial services;¹⁰
- (e) requiring public disclosure of registers of duties and interests by banks and insurers is likely to create privacy issues - it may also deter individuals from seeking directorships in the financial services sector and reduce the pool of available qualified directors.

4 Proposal 4 - Independence

Strengthen independence on regulated entity boards by:

- a. requiring that at least two of their independent directors (including the chair) are not members of any other board within the entity’s group
- b. making minor amendments to the independence criteria, including extending the prohibition on directors who are substantial shareholders in a regulated entity or group from being considered independent, to include material holdings of any type of security
- c. extending the current requirement for bank and insurer boards to have a majority of independent directors to include boards of entities with a parent that is regulated by APRA or an overseas equivalent.

⁷ See paragraph 35(e) of CPS 220.

⁸ See section 191 and Chapter 2E of the *Corporations Act 2001 (Cth) (Corporations Act)*.

⁹ Section 21(1)(c) of the *Financial Accountability Regime Act 2023 (Cth)*.

¹⁰ See section 912A(1)(aa) of the *Corporations Act* and ASIC Regulatory Guide 181: *Licensing: Managing conflicts of interest (RG 181)*.

(a) **Proposal 4a. Requirement for at least two independent directors (including the chair) to not be members of any other group board**

We understand that Proposal 4a. is intended to uplift intragroup conflict management practices by ensuring that some directors “don’t wear two hats” and are “solely responsible for the interests of regulated entities within a group”.¹¹

If this proposal proceeds, it needs to be clarified in two material respects:

- The Chair of a NOHC should not be prevented from sitting on the board of a subsidiary regulated bank or insurer; and
- The two independent directors on the board of a regulated bank or insurer should be restricted only from sitting on the board of the NOHC or another regulated entity in the group, and not restricted from sitting on the boards of unregulated entities in the group.

In our view, Proposal 4a. in its current form gives rise to a number of other concerns:

- (i) **‘One size fits all’ approach:** As APRA acknowledges in the Discussion Paper, the extent of conflicts between group entities varies across corporate groups. In relation to groups where interests are well-aligned or which have implemented mature and effective conflicts management practices, the introduction of Proposal 4a. creates additional regulatory burden with limited, if any, corresponding benefit. As with many of these proposals, some flexibility is required.

In relation to groups with a much higher potential for intragroup conflicts of interest, APRA is able to, and does, address this through its existing powers and practices, including requiring entities to restructure boards, take specific actions to address conflicts, and appoint additional independent directors.¹²

- (ii) **Availability of qualified directors:** Groups may have multiple regulated entities within their corporate structure. Requiring at least two independent directors (including the chair) on each regulated entity that do not also sit on other boards will require recruitment and vetting of additional qualified directors. As APRA is aware, the availability of suitable directors in the financial services sector can be challenging due to the complexity and volume of regulation, the need for specialised expertise, and the level of public and media scrutiny.
- (iii) **Operational challenges:** Requiring a separate chair and external director for a non-operating holding company as well as its wholly owned regulated subsidiaries could facilitate a divergence of strategy between various entities and create unnecessary dysfunction. It could also weaken existing governance structures which balance group-wide oversight with the need to identify and manage intragroup conflicts. In particular:
- inefficiencies could arise from directors who are directors of only a single entity within a corporate group being unfamiliar with the broader context of the group’s strategy, operations, performance and commercial drivers; and
 - section 187 of the Corporations Act allows directors of a wholly owned subsidiary to act in the best interests of its holding company if permitted by its constitution (provided the director acts in good faith and the subsidiary remains solvent). This

¹¹ Page 22 of the Discussion Paper (Problem statement in relation to Proposal 4) and remarks by APRA Chair, John Lonsdale, in the AFR Banking Summit Speech (see note 1 above).

¹² Page 22 of the Discussion Paper.

enables corporate groups to strike an appropriate balance between the legitimate interests of shareholders of regulated groups and the particular interests of regulated subsidiaries.

In addition, all directors, irrespective of independence, are required to act in the best interests of the entity of which they are directors and manage conflicts appropriately.

There are compelling governance reasons for the chair of a NOHC to also be the chair of the regulated subsidiaries, which could still have at least two independent directors to address APRA's concerns. That model is currently working well for bank NOHCs and their bank subsidiary boards.

We are concerned that this proposal focuses on management of crises (which are extremely rare under APRA's prudential supervision) and disregards the optimum board structure for oversight of the day-to-day business operations of the regulated entities within a corporate group.

(b) Proposal 4b. Amendments to the independence criteria

We have no concerns with the proposed revised definition of independent director, with one exception.

However, the proposal to extend the prohibition on directors who are substantial shareholders from being considered independent, to include material holdings in any type of security raises several issues:

- (i) It is worth reconsidering whether there is any justification to regard a director as "not independent" if the director is or is associated with a substantial shareholder such as an institutional investor that does not control the company and has no other connection to the company. It is certainly not a lack of independence from the regulated bank or insurer. The interests of such a shareholder are aligned with the interests of all shareholders, and the directors have a duty to act in those interests.
- (ii) We can see no justification for extending this concept to directors who have, or are associated with entities that have, a "material" holding of non-voting securities in the regulated entity. We cannot see how a holding of non-voting securities can affect "independence".
- (iii) This type of regulation is also inconsistent with the widely held view that directors should have "skin in the game". Directors may, as a matter of customary practice, acquire "skin in the game" over time, including through non-voting securities such as non-executive director rights or similar instruments.

(c) Proposal 4c. Subsidiaries to have a majority of independent directors

We have no concerns with Proposal 4c. to the extent it requires the boards of all regulated entities to have a majority of independent directors (including regulated entities which are subsidiaries of an APRA-regulated parent or overseas equivalent).

However, we assume that this proposal is limited to boards of regulated entities and will not apply to boards of unregulated subsidiaries in a corporate group. This should be clarified, because the alternative would be unworkable: we understand that APRA has clarified in various forums that Proposal 4c. is intended to apply to APRA-regulated subsidiaries only. We agree with APRA that a reasonable transition period should be allowed to allow for the recruitment of additional independent directors where required.

5 Proposal 5 - Board performance review

Require SFIs to commission a qualified independent third-party performance assessment at least every three years which covers the board, committees and individual directors.

This proposal accords with existing standard practice for listed Australian companies and is in line with the ASX Corporate Governance Principles and Recommendations. It also accords with existing APRA guidance for RSE licensees. There is also a suggestion that Boards of SFIs must be able to demonstrate to supervisors how they are acting upon the recommendations of external reviews. However, in implementing these recommendations, there should not be any obligation on regulated entities to implement all recommendations (and there should be flexibility to determine which recommendations are appropriate) arising from a third-party review for the following reasons:

- (a) Any requirement for a Board to implement all recommendations of a third party review would create dysfunction and could skew selection of the reviewing body to one that is anticipated to provide more favourable or palatable recommendations.
- (b) The circumstances underpinning a recommendation by an external body could change, such that it may not be appropriate to implement one or more recommendations.
- (c) Unlike independent external consultants, boards are subject to fiduciary duties to act in the best interests of the company, and will be able to exercise judgment having regard to the totality of the circumstances and information relevant to the company, including appropriate cost-benefit assessments.
- (d) It is difficult to see how financial system stability would be promoted if boards and companies were beholden to recommendations made by external third parties.

The Discussion Paper also contemplates submission of confidential and sensitive independent triennial board performance reports to APRA. This is a new requirement (although APRA may be receiving reports from some regulated entities). It has the potential to limit the candour applicable to board performance review participants. A more appropriate requirement may be for a regulated entity to have a policy requiring it to periodically engage an external review and to confirm to APRA that it has undertaken and considered the findings of that external review. Any requirement to provide the finding of the external review to APRA could be limited to entities under heightened supervision.

6 Proposal 6 - Role clarity

Define APRA's core expectations of the Board, the Chair and senior management.

Provide additional guidance on which APRA requirements may be delegated to board committees and senior management.

APRA notes that boards spend too much time on operational issues, but that is in no small part driven by the fact that many APRA prudential standards impose obligations on boards that are more appropriately undertaken by board committees or senior management.

This recommendation will be welcome if it results in changes to prudential standards to remove these types of obligations from boards and allows them to focus on strategic matters, succession issues and efficient monitoring of the entity's risk management and compliance obligations.

However:

- (a) delegation to Board committees is unlikely to reduce the operational workload of Boards given committees are delegates of the Board and not decision-makers unless expressly authorised as part of their terms of reference. The Board remains liable for decisions and actions of its committees in any event; and
- (b) boards should retain the discretion to determine which matters are referred to board committees or delegated to management, and which matters are to be considered by the board, rather than being forced to refer or delegate matters.

7 Proposal 7 - Board committees

Extend the current requirement for bank and insurer boards to have separate risk and audit committees, to apply to SFI RSE licensees as well. Repeal this requirement for non-SFI banks and insurers, allowing flexibility for smaller entities.

Mandate that only full board members can be voting members of APRA-required board committees.

This proposal is welcome, but should also include some flexibility for SFI RSE licensees depending on their board structures and board skills.

8 Proposal 8 Director tenure and board renewal

Impose a lifetime default tenure limit of 10 years for non-executive directors at a regulated entity.

Require regulated entities to establish a robust, forward-looking process for board renewal.

A default tenure limit of 10 years is concerning for a number of reasons:

- (a) As APRA acknowledges, no other regulator anywhere in the world imposes a hard limit on tenure of directors.¹³ Serving on a board for a substantial period does not automatically mean that a director has become too close to management to not be considered independent.
- (b) It seems a stretch to suggest, as APRA does, that the ability of directors to act in the best interests of the company or, for superannuation fund directors, to act in the best financial interests of fund members, is compromised after 10 years. Officers are subject to similar duties and APRA does not propose that they be restricted from continuing in their roles after 10 years. As APRA acknowledges, many long serving directors are highly experienced and make a strong contribution throughout their directorships. APRA has not presented any empirical evidence, and we are not aware of any empirical evidence, to suggest that tenure alone (rather than the impact of a dominant CEO or persistent conflicts of interest) is detrimental to the ability of a director to discharge their fundamental duty to act in the best interests of a company or best financial interests of members, nor are we aware of any examples where long-tenured directors have been singled out for breaches of directors' duties. Tenure is often cited as a factor going to independence, which is quite a different issue from the ability to discharge fundamental fiduciary obligations as has been suggested here. There are many directors who are not independent but continue to discharge their duties.
- (c) The Discussion Paper states that there are almost 200 directors with tenure of more than 10 years, in the context of 1,500 non-executive directors across all APRA-regulated entities. On

¹³ See pages 13 and 29 of the Discussion Paper.

these numbers, implementing Proposal 8 would require 13% of the current director pool to retire from their current roles. The AFR has suggested an even higher percentage for larger institutions, reporting that:

...nearly a quarter of directors on the boards of the nation's largest superannuation, insurance and banking institutions could be forced out the door should the new tenure limit proposed by the industry regulator come to pass.¹⁴

Even allowing for a reasonable transition period, this would represent a material reduction in the pool of available and qualified directors (noting that Proposals 4a. and 4c. would increase the number of qualified directors needed by regulated groups).

Sourcing sufficient qualified directors would present additional challenges for (and very likely have a disproportionately greater disruptive impact on) regulated mutuals (including mutual ADIs and health insurers), as they have a different business and operating model to other financial institutions, which often include bespoke eligibility or selection criteria for directors, such as specific geographic or other requirements connected to the history and origins of the relevant mutual entity. We query whether imposing a tenure limit will ultimately have a net member benefit for those mutual entities.

Allowing for case-by-case exceptions on application to APRA is unlikely to result in an efficient or adequate resolution of these concerns.

A better alternative would be to provide a recommendation or guideline in relation to director tenure, in the context of independence rather than the ability to discharge fundamental fiduciary obligations, which can then be considered and applied by Boards as appropriate to their circumstances. A general exception permitting chairs to serve for a longer term (such as 12 years) where they were a director prior to their appointment as chair would also assist to support the continuity of board leadership and retention of corporate knowledge.

Yours sincerely

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¹⁴ Joshua Peach and Lucy King, 'These are the high-profile directors APRA is pushing out the door', The Australian Financial Review, (online, 6 March 2025) <<https://www.afr.com/markets/equity-markets/these-are-the-high-profile-directors-apra-is-pushing-out-the-door-20250306-p5lhhh>>.