

20th July 2006

The Hon Peter Costello MP
Treasurer
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600

Dear Treasurer

APRA PRUDENTIAL STANDARDS ON GOVERNANCE

In May 2006 APRA announced new prudential regulation on corporate governance that mandates minimum standards for compliance in a one size fits all approach. This is a source of great frustration to a range of parties in the business community, for two major reasons, as outlined below.

Lack of flexibility

APRA's new prudential governance standards overlap the *Principles of Good Corporate Governance* of the ASX Corporate Governance Council, and are inconsistent with them on the most significant regulatory dimension: they lack the flexibility offered in the ASX Corporate Governance Council *Principles* through the 'if not, why not' disclosures. These disclosure arrangements allow a company to adopt or continue a different arrangement from the mainstream model because of its particular circumstances. The onus is on the company to explain to the shareholders and public why the alternative is better for the particular company. This formulation first appeared in Canada in the early 1990s and is in widespread use there, in the United Kingdom and in several European countries.

The collapse of HIH resulted in changes to APRA and the approach taken with prudential regulation. The Royal Commission's recommendations did not require that the same standards should be applied to all companies. Justice Owen was clearly of the view that flexibility is compatible with good governance.

'I think that any attempt to impose governance systems or structures that are overly prescriptive or specific is fraught with danger. By its very nature corporate governance is not something where 'one size fits all'. Even with companies within a class, such as public listed companies, their capital base, risk profile, corporate history, business activity and management and personnel arrangements will be varied. It would be impracticable and undesirable to attempt to place them all within a single straitjacket of

structures and processes. A degree of flexibility and an acceptance that systems can and should be modified to suit the particular attributes and needs of each company is necessary if the objectives of improved corporate governance are to be achieved.

Another danger with an overly prescriptive approach to systems and structures is that it may unwittingly encourage a superficial or 'tick the box' approach to the achievement of governance objectives.¹

The recent Banks Report, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, also commented on the need for a flexible regime, if indeed governance is to be regulated at all. It said:

'The Taskforce's view is that if APRA considers it necessary to impose regulation in this (governance) area, it should have regard to the principles underlying the Australian Stock Exchange Corporate Governance Council regime and incorporate a similar level of flexibility. The Taskforce considers that the requirements should be implemented flexibly to ensure arrangements can be tailored to individual entities.'²

APRA's prudential standards on governance impose a new layer of regulation on entities that are already regulated by the ASX and ASIC. This overlapping regulation will have major effects. These financial institutions and insurance companies account for around one-third of the market capitalisation of the stock market as a whole.

For companies affected by both standards it will no longer be sufficient to meet the ASX Corporate Governance Council *Principles*, nor will their directors and management have operational flexibility to get the best result for the company as provided by these *Principles*. Such a mandated approach risks stifling innovation as companies are forced to conform to APRA's inflexible governance model or risk sanctions.

Lack of Transparency

The lack of transparency in APRA's regulatory approach is the second major concern for the signatories to this letter. APRA has stated that it will determine regulatory policy by private agreements rather than by the consistent application of transparent standards.

We urge you to support a more transparent system of prudential regulation and one that offers all regulated entities the same opportunities to seek exemptions from APRA.

We strongly support public disclosure of variations in governance that are allowed or disallowed by APRA, and the reasons for any such decisions. Precedent could then

¹ The Failure of HIH Insurance (Report of the HIH Royal Commission), Volume 1: A Corporate Collapse and its Lessons, April 2003, p105.

² Rethinking Regulation (Report of the taskforce on Reducing Regulatory Burdens on Business), January 2006, p95.

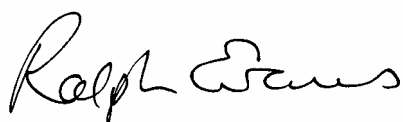
apply to new applications for exemptions. We also recommend a regulatory impact statement from APRA reporting on the exemptions and the circumstances on which they are based.

Equally we would not want APRA's mandated approach to become a model for other regulatory schemes, particularly for listed companies. It would be damaging to the Australian stock market if the restraints imposed by APRA on the financial institutions were to be extended to all companies regulated by the ASX.

We understand that financial markets raise additional regulatory issues that are not common to all companies and shareholders. Some aspects of prudential regulation may be best conducted in private to protect the financial stability of an institution, but the same caution is not needed with corporate governance. Disclosure to the market is a fundamental principle of good governance. In the words of the great US Supreme Court Justice, Louis Brandeis in 1913 'Sunlight is the best disinfectant, electric light the most efficient policeman.'

We would welcome the opportunity to meet and elaborate on these concerns, and to discuss how APRA's new Prudential Standards on governance will be implemented and administered.

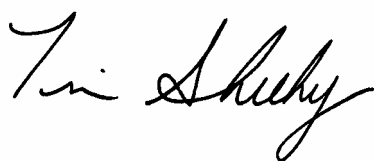
Yours sincerely,



Ralph Evans
Australian Institute of Company
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Stuart Wilson
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Association



Tim Sheehy
Chartered Secretaries Australia



Gary Fitton
Australian Employee Ownership
Association