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Wednesday 10 February 2021

Mr Gideon Holland
General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

via email: policydevelopment@apra.gov.au

Dear Mr Holland,

Draft Revised Prudential Standard CPS 511: Remuneration

Thank you for the opportunity to provide comments on the draft Revised Prudential Standard CPS 511: Remuneration (**Standard**).

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership reflects the diversity of Australia's director community, our membership of more than 45,000 is drawn from directors and leaders of not-for-profits, large and small businesses, and the government sector.

Executive Summary

The AICD remains supportive of APRA's objective to engage in stronger supervision of remuneration frameworks and focus on non-financial risk management. We recognise the significant impact that remuneration structures can have on firm culture, conduct and performance. We note that this was central to the findings of both the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) and the prudential inquiry into the Commonwealth Bank of Australia.

The AICD considers it critical that boards retain responsibility and accountability for structuring executive remuneration and setting remuneration frameworks that are tailored to their organisation's strategy and risk profile.

We welcome APRA's efforts to address much of the industry's feedback on the Standard's first iteration. There are however certain aspects of the revised Standard that we continue to have concerns about, in particular:

- the level of reporting expected to the board remuneration committee, which is at odds with our understanding of recent regulatory review findings that information flows should be focused on quality over quantity;
- the lengthy deferral periods that are proposed to apply to all APRA-regulated entities, which continues to remain out of step with international practice;
- the prescriptive and mandatory criteria for the application of clawback, which does not fully recognise the complexity of the relevant employment law considerations;

- the broad definition of a "Significant Financial Institution" (**SFI**), which establishes too low a threshold relative to the Banking Executive Accountability Regime (**BEAR**); and
- the lack of a more tailored application to RSE Licensees and mutuals, which does not recognise that variable remuneration is less common and complex in the superannuation and mutual bank sectors.

The AICD remains committed to working in consultation with APRA on suggested further refinements to the Standard, as well as the development of a new CPG 511. Our comments will follow the structure of the Chapters in APRA's consultation paper.

Changes made following consultation

1. As mentioned, we welcome APRA making changes to CPS 511 following its initial consultation. We particularly welcome the decisions to:

   - streamline the board's oversight role and clarification that boards do not have to approve individual remuneration outcomes, but rather will be required to approve on a cohort basis;
   - replace the proposed 50 per cent cap on financial measures for variable remuneration with a requirement that 'material weight' be assigned to non-financial measures;
   - move to a more principles-based approach and reduce requirements for non-SFIs; and
   - reduce the minimum deferral periods.

   The AICD supports the amendments proposed in the revised draft on these issues, subject to further comments set out below.

Board and the board remuneration committee

2. The AICD supports requirements for the board to actively oversee an entity's remuneration framework, including approving remuneration policy and establishing a Board Remuneration Committee.
3. We note that APRA is proposing to release guidance on matters such as board, committee and management interaction and delegations as well as cohort reviews in a new prudential practice guide on remuneration CPG 511. We look forward to consulting with APRA further on these proposals.
4. As previously stated, while we agree that information flows to the Board Remuneration Committee are critical, we are concerned about the reference in paragraph 29 to the Board Remuneration Committee needing to receive "comprehensive" reporting that will allow it to assess whether remuneration outcomes of all remuneration arrangements align with the entity's remuneration objectives. It would be regrettable if this were perceived as mandating a particular volume or granularity of information.
5. Accordingly, we suggest that the word "comprehensive" be removed from paragraph 29, to emphasise that information flows should be focused on "quality over quantity" - as suggested in both the Royal Commission final report and ASIC Corporate Governance Taskforce report on director and officer oversight of non-financial risk. This might also be the subject of clarification in the new CPG 511.

Remuneration design

6. We welcome clarification that entities are not required to influence the remuneration arrangements of third-party service provider employees or contractors. As set out in our previous submission and as noted by APRA, this was a particularly acute issue for RSE licensees. Some further clarification in CPG 511 of how entities are to "identify and address inconsistencies" with respect to remuneration by service providers would be welcome.

7. It remains unclear whether APRA will require APRA-regulated entities, as part of its prudential supervision, to pay variable remuneration in accordance with paragraph 19 of the Standard. This is particularly relevant to some RSE licensees, mutual banks and others who have traditionally paid only fixed remuneration. In our view, variable remuneration should not be mandated and the matter should be left to board discretion provided they are effectively managing both financial and non-financial risks, sustainable performance and the entity's long-term soundness. This should be specified in the Standard.

Limit on financial measures

8. The AICD welcomes the removal of the 50 per cent cap on financial measures. We note the consultation paper states that this model should mean scorecards are not embedded as the sole means to determine remuneration outcomes. We understand that flexibility will be allowed in remuneration design; specifically, that modifiers and gateways will be allowed, as well as different weightings, dependant on the firm, its current market position and performance, and the individual's role. In our opinion, this should be clarified in the Standard and the new CPG 511.

9. In our consultation with directors, we have heard some confusion expressed as to the meaning of "material weight". We recommend that this term be further clarified, either in the Standard or in the new CPG 511. For example, the UK's Prudential Regulation Authority (**PRA**) remuneration structure requirements indicates that financial and non-financial measures should be "appropriately balanced". Rule 15.4 of the PRA Rulebook on Remuneration states "when assessing individual performance, financial as well as non-financial criteria are taken into account". These terms might be incorporated into APRA's new CPG 511 guidance to better reflect the flexibility that the Standard aims to allow.

Highly-paid material risk-takers

10. We support the decision to amend the definition of highly-paid material risk takers (**HPMRT**) to focus on actual pay for the reasons set out in our last submission.

11. In consultation, directors have raised ongoing concerns with the definition of highly-paid material risk takers, especially for entities with foreign employees paid in another currency. Foreign exchange movements may push those employees into the "highly-paid" band and subject their variable remuneration to new restrictions, even where their remuneration in their domestic currency is unchanged. APRA may wish to consider this issue in either its Standard or in the new CPG 511.

Deferral and clawback

12. We remain concerned about the length of the deferral period and the delayed commencement of pro-rata vesting. This places APRA-regulated entities under competitive disadvantage both internationally and against other non-APRA-regulated domestic sectors (e.g. funds managers, property). APRA-regulated entities are particularly disadvantaged in roles that are not industry specific such as risk, technology, customer relations and human resources. In our consultation with

directors, we have been informed that the deferral and pro-rata vesting arrangements are already causing firms difficulties in the recruitment of senior executives, including at C-Suite level. We have been advised that qualified candidates are informing organisations that they have decided not to pursue Australian financial sector opportunities because of their concerns around the proposed regime.

13. We note that Figure 3 of the Consultation paper compares the deferral arrangements for authorised deposit-taking institutions, but this does not reflect the three-year maximum deferral period that applies to insurers in the UK and EU. It also fails to include remuneration arrangements for pension funds. By way of comparison, Canada, a jurisdiction with a mature pension fund system similar to Australia's superannuation system, does not require any deferral of remuneration at any financial services institution, including pension funds.

14. We recommend a closer alignment with the EU's arrangements with a maximum five-year deferral period. Failing that, we suggest that pro-rata vesting occur earlier. We recommend that CEO vesting occur after three years, senior manager and director after two years and HPMRT after one.

15. We reiterate our concern with the draft Standard's provisions on clawback. Clawback is subject to important employment law considerations and the cost of clawing back may exceed the value of the remuneration to be paid. The "reasonable steps" requirement in paragraph 56 of the draft Standard therefore might compel an entity to commence clawback irrespective of commercial, practical or legal considerations.

16. We do not support the prescriptive criteria for clawback as set out in paragraph 55 of the Standard. In our view, this should be left to the discretion of boards. We recommend deleting the words "including all the following" onwards. Alternatively, APRA could consider including guidance on the application of clawback for those entities that elect to apply a clawback mechanism.

SFIs and proportionality

17. We reiterate our concerns about the broad definition of significant financial institutions (**SFI**) under the revised Standard and suggest a proportional approach more closely aligned with BEAR. We also have concerns about a single threshold for SFIs and recommend a transitional period to allow APRA-regulated entities to adapt to the increased requirements on SFIs, as they cross those thresholds. We note this might be considered in the new CPG 511.

RSE licensees

18. We reiterate our concerns about the application of this Standard to RSE licensees, many of whom are profit-to-member organisations who have, for historic and cultural reasons, traditionally not paid variable remuneration. We remain concerned that the complexity of the requirements around variable remuneration may encourage RSE licensees to abandon variable remuneration and move to fixed remuneration.

19. APRA would be aware that over recent years RSE licensees have increasingly been in-sourcing their investment management functions in an attempt to reduce agency risk and drive down the costs of investment management. Directors have informed us that APRA has encouraged that approach. This relies upon the ability for RSE licensees to recruit and retain investment professionals, who would otherwise work for fund managers and other investment organisations. Fund managers are not subject to regulation by this regime and this will place RSE licensees at a significant competitive disadvantage when recruiting for these roles.

Reporting and Disclosure

20. We accept that given public concerns around governance in APRA-regulated entities that there should be additional disclosure in the interests of promoting greater transparency and accountability. We caution that APRA does not rush to a "disclosure for disclosure's sake" model, which might end up providing confusing information, which provides no real insights to users or stakeholders. We set out specific answers to your questions below:

    1. What principles should inform the types of information required to be disclosed for prudential purposes?

        - Proportionate to needs.
        - Anonymised to protect the privacy of individuals (noting listed entities will be subject to more granular reporting requirements).
        - Sufficiently general to retain some level of commercial confidence.

    2. How could prudential disclosures complement disclosures required under the *Corporations Act 2001* (Cth) (**Corporations Act**)?

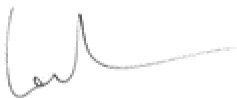
        - There is less public interest in identifying specific remuneration for individuals in unlisted entities, so anonymity should be retained where possible.
        - Corporations Act principles and requirements on quantitative disclosure should be incorporated, where relevant, to avoid duplication in reporting.

    3. Would a proportional approach to disclosures, similar to that proposed for revised CPS 511, promote market discipline for the appropriate cohort of entities?

        - Yes. There should be more limited reporting and disclosure requirements for non-SFIs, particularly on quantitative measures.

We hope our response will be of assistance. If you would like to discuss any aspects further, please contact David McElrea at dmcelrea@aicd.com.au or Laura Bacon at lbacon@aicd.com.au.

Yours sincerely,



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