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Response to APRA's draft prudential standard on remuneration (CPS 511)

As an organisation that works with a number of Financial Institutions, it's pleasing to see APRA's proposed standard to strengthen prudential requirements for remuneration across all APRA-related entities. On the whole, we agree with the core elements of the reform as outlined by APRA. A focus on trust and enhancing accountability through culture, governance, remuneration and a Code of Ethics for financial advisors is an important step for the industry.

However we would like to see more:

1. Clarity around some of the definitions outlined in the draft CPS 511, and
2. Further proportionality applied.

As part of our review of the proposed standard, we also engaged with a number of our clients, including Superannuation Funds, Insurers, Credit Unions and Mutuals in a roundtable discussion. This submission reflects the views of Grant Thornton Australia as informed by feedback from our clients.

Below we outline our response to CPS 511 and the key areas where we seek more clarity from APRA.

Definition of 'material risk-taker'

As part of the remuneration framework, an area of the proposed requirements that requires further guidance is the definition of the 'material risk-taker' and how APRA assesses and differentiates between financial and non-financial risks. The current concept of a material risk-taker is vague, making it difficult to define someone fitting this structure. For example, traders on a trading desk may be considered risk-takers but have a narrow responsibility and when trading do so within certain bandwidths.

We would like to see APRA better define what types of roles would fall into this category and, conversely, what types of roles would not be expected to fall into this category.

Definition of size thresholds

The BEAR utilises concepts of small, medium & large financial institutions. CPS 511 does not use the BEAR concepts however introduces a new concept of Significant Financial Institution ("SFI"). Two competing definitions is clearly undesirable and unworkable. We request APRA continue to utilise the BEAR definitions for CPS 511 to promote certainty and better facilitate APRA's stated commitment to facilitate proportional regulation.

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Clarity on “Golden Hellos”

The draft CPS 511 is silent on sign-on bonuses or “golden hellos”. We acknowledge APRA considered this issue in their webinars however we request APRA specifically address this in the standard to provide certainty and clarity for financial institutions.

Clarity regarding remuneration governance and consequence management

More clarity is also needed from APRA around how remuneration and consequences will be governed, and what is required for the board on reporting. It is important that there is a tight governance structure and review to support the Remco making an informed and difficult decision, however, what will this look like and how will people be held accountable?

We request APRA address this, potentially in a CPG 511.

Proportionate regulation

APRA has acknowledged proportionate regulation in the draft CPS 511, however, we believe that APRA could go even further to ensure genuine proportionality across the sector.

APRA has proposed proportional implementation of the new requirements, with certain expectations only applied to **large, complex** entities. Whilst this is a great start, APRA has only differentiated SFI's – we believe this should go further to apply to different tiers within the industry.

We have discussed the desirability of a single tiered definition consistent with BEAR on the previous page.

An SFI is defined as a large and complex entity by APRA, but we believe APRA could be clearer around defining indicators of complexity. Indicators such as vertical integration, geographical footprint beyond Australia, and volume of products offered may be suitable indicators however we anticipate further work would be required on this point.

Proportionate regulation – an exemption regime

In the interests of proportionate regulation, we propose an exemption regime for various small, low-risk financial institutions.

Restricted ADIs

We believe APRA should consider specifically exempting RADIs from CPS 511. The reasons for this are:

- RADIs are typically issuing no or a minimal range of products and hence generating nil or minimal revenue. Therefore the potential for misconduct is extremely limited.
- RADIs are restricted to a small size and scale of operation and therefore do not have the potential to engage in misconduct.
- Remuneration practices in RADIs typically do not involve variable remuneration using financial metrics dependent on total shareholder return.
- While an important role of the RADI phase of licensing is to demonstrate the capability to progress to a full ADI license, we believe the RADI can demonstrate how it will meet the requirements of CPS 511 upon obtaining a full ADI license rather than having the additional burden imposed on them earlier than necessary.

Profit-to-members entities

We believe APRA should consider a specific exemption regime from CPS 511 for smaller, less complex, low-risk financial institutions.

In framing this exemption regime, we point out that no mutual ADI was found by the recent Royal Commission to have engaged in misconduct.

We propose an exemption regime for financial institutions which meet the following indicators:

1. Profit to members structure, such as mutual ADI (which does not make use of performance metrics linked to Total Shareholder Return)
2. Small financial institution
3. Not a complex financial institution
4. No individual receiving variable remuneration of \$50,000 or over

5. No history of misconduct such as fines or prosecutions

Policy options

The policy option we believe would be best is option 3 – proposed changes to the prudential framework for remuneration with proportionality applied.

It is important for the provisions to have lower cost effects on smaller entities, as the additional requirements applicable to SFIs would not be applicable.

For CPS 511 to be most effective across the industry, proportionality must be applied. Smaller and customer owned banking institutions should not need to shoulder the same share of regulation and compliance burden as larger financial institutions – it should be relative to their asset and actual size and not discourage competition.

Not applying proper proportionality provides a competitive advantage to larger financial institutions against smaller entities as the associated fixed costs are more easily absorbed. Not only that, but we need to take into consideration that the business models are considerably different. For example, customer owned banks typically return 100% of profits to members in the form of reinvestment back into their local communities or as better rates and reduced fees. With profits already spoken for, there isn't as much wiggle room for reapportioning or taking on additional resources to comply with additional regulation as the bigger banks.

Grant Thornton Australia worked with the Customer Owned Banking Association (COBA) in 2018 on two papers addressing these issues – *A case for proportionate regulation* and *The cost of compliance*.

For more information, you can read them here:

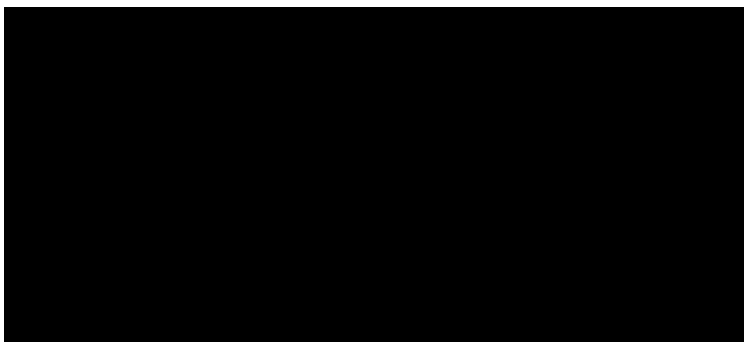
<https://www.grantthornton.com.au/en/insights/reports/a-case-for-proportionate-regulation/>

<https://www.grantthornton.com.au/en/insights/reports/the-cost-of-compliance/>

Conclusion

In summary, we believe CPS 511 is an important step for the industry but more clarity is needed around definitions, proportionality needs to be better applied, expectations of remuneration governance need to be better explained, and we recommend an exemption regime to better promote proportional regulation.

Yours faithfully



Appendix

Key Area	Current standard	Key proposed change	Grant Thornton Response
Remuneration framework	Remuneration policy for senior executives and limited additional staff only.	Remuneration policy for all arrangements, supported by remuneration objectives and a broad framework.	Agree however further clarity on definitions and proportionality is required.
Board oversight	The Board must approve the remuneration policy. The Board has responsibility for reviewing and approving remuneration recommendations for senior executives and limited other staff.	The Board must approve the remuneration policy, actively oversee the remuneration framework, approve the remuneration of senior executives and other roles and ensure risk outcomes are reflected in remuneration outcomes	Agree however further clarity is required from APRA potentially in a CPS 511.
Variable remuneration design	Variable remuneration for special categories of employees must be designed to allow adjustments to reflect business outcomes, risks inherent in business activities and incorporate appropriate time for performance to be realised.	Minimum design requirements for all employees, which promote prudent risk management and support remuneration objectives. Financial measures limited to 50 per cent and individually capped at 25 per cent. Constraints on deferral and vesting set for significant financial institutions (SFIs).	Broadly agree, however we do not agree with the SFI/non-SFI category and request APRA adopt size definitions consistent with BEAR.
Outcomes management	Remuneration policy must allow the Board to adjust variable remuneration downwards to zero if appropriate for employees in special categories.	Require adjustments to remuneration outcomes so as to align with risk outcomes; stronger review and oversight. Clawback to apply to senior roles in SFIs.	Broadly agree, however we do not agree with the SFI/non-SFI category and request APRA adopt size definitions consistent with BEAR.
Review	Remuneration policy must be reviewed on a regular basis.	Annual compliance reviews and triennial effectiveness reviews of the remuneration framework.	We do not comment on this.
Transparency	No requirements other than for ADIs (Pillar 3).	APRA to consult on measures in 2020.	We will await APRA's consultation.