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General Manager, Policy Development  
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By email

Dear Sir,

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## **Strengthening prudential requirements for remuneration**

### **Who we are**

Governance Institute of Australia is a national membership association, advocating for our network of 40,000 governance and risk management professionals from the listed, unlisted and not-for-profit sectors.

As the only Australian provider of chartered governance accreditation, we offer a range of short courses, certificates and postgraduate study. Our mission is to drive better governance in all organisations, which will in turn create a stronger, better society.

Our members have primary responsibility for developing and implementing governance frameworks in public listed, unlisted and private companies, as well as not-for-profit organisations and the public sector. They have a thorough working knowledge of the operations of the markets and the needs of investors. We regularly contribute to the formation of public policy through our interactions with Treasury, ASIC, APRA, ACCC, ASX, ACNC and the ATO.

Governance Institute's members consider that overall, the revised draft *Prudential Standard CPS 511 Remuneration* (Standard) will better achieve APRA's objective of improving the accountability and the governance of remuneration in APRA-regulated entities than the original consultation draft. Governance Institute's members commend APRA's responsiveness to the extensive feedback it received on the original draft and for the decreased level of prescription in the Standard.

Our submission highlights areas where Governance Institute's members consider:

- the drafting of the Standard could be clarified
- the Standard does not yet achieve APRA's stated objectives,
- there appears to be an inconsistency between APRA's stated intention in the Response Paper (Response Paper), or
- where it would be useful for APRA to provide guidance.

Our specific comments are set out below.

### **Our comments**

#### **Chapter 1 – 1.3 The Financial Accountability Regime (FAR)**

As redrafted the Standard is more aligned with the Banking Executive Accountability Regime for ADIs and the FAR proposals. However, our members consider that work remains to be done to

ensure that the requirements align. APRA notes in section 1.3 of the Response Paper that it is working closely with Treasury to ensure that there is appropriate alignment with the Standard and FAR to support an entity's implementation of both but that it may carry out further consultation. It increases the regulatory burden on entities for APRA to undertake further consultation on the Standard once the FAR regime is finalised. Our members report that entities have already started preparing to implement the Standard. Given the importance of remuneration and its impact on all levels of an organisation and all APRA-regulated entities, it would be preferable to defer finalising the Standard until work is complete on the FAR regime.

**Governance Institute recommends** that the approach to the alignment of BEAR and FAR be settled and agreed, with appropriate industry consultation, before the Standard commences.

## **Chapter 2 – Board and the board remuneration committee**

### **Differential governance requirements**

APRA has revised the Standard to provide for differing governance requirements for significant financial institutions (SFIs) and non-significant financial institutions (non-SFIs). Our members acknowledge that APRA has taken this approach to reduce the over prescription in the original draft Standard and to reduce the regulatory burden of the Standard for non-SFI's, but they consider that this may have unintended consequences.

Recommendation 8.1 of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (Principles and Recommendations) recommends that listed entities have a remuneration committee. In addition, entities in the S&P/ASX 300 Index are required under the ASX Listing Rules to have a remuneration committee consisting solely of non-executive directors.<sup>1</sup> It is good governance for an entity to have a remuneration committee, or where there is no remuneration committee for the entity to disclose its processes for setting remuneration for directors and senior executives and ensuring that the remuneration is appropriate and not excessive. The Principles and Recommendations are the leading Australian statement on good governance practices, and it would be unfortunate to depart from accepted good governance practice.

In addition, there are likely to be listed entities which APRA determines are 'non-SFIs' which on one hand, are required under the current Australian standard for good governance practice to report on an 'if not, why not' basis on whether they have a remuneration committee, but on the other hand are not required to have a remuneration committee under the Standard. This is potentially confusing and proliferates the number of differing governance requirements for smaller APRA-regulated entities.

**Governance Institute recommends** that the Standard require entities to report on an 'if not, why not' basis as to whether they have a remuneration committee. This would enable smaller entities which have more complex remuneration arrangements to maintain a remuneration committee without increasing the regulatory burden. APRA could also provide more detail about its expectations in relation to remuneration committees in guidance.

### **Board oversight of remuneration**

Under paragraph 33 of the Standard an SFI must document and report the results of the reviews required under paragraphs 31 and 32 of the Standard to the Board Remuneration Committee. These reviews, particularly the independent review required under paragraph 33, will be important material for boards to consider when making their own independent judgement

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<sup>1</sup> See Recommendation 8.1 [Corporate Governance Principles and Recommendations](#), 4<sup>th</sup> edition, February 2019 at page 29.

in fulfilling their directors' duties on the compliance of remuneration frameworks with the Standard and their effectiveness.

As currently drafted, the Standard seems to suggest that boards will not have access to these reports but need to rely on management's report on the results. Management reporting on its own remuneration creates a potential conflict of interest which seems at odds with the intention of the Standard to increase board accountability for remuneration.

**Governance Institute recommends** that APRA review paragraph 33 of the Standard to ensure that directors have access to the material they need to make their own independent assessment of the compliance of remuneration frameworks with the Standard and their effectiveness. One possible approach could be that the remuneration committee directly engages the party preparing the independent report who then presents their report to the Committee.

#### **Chapter 6 – Deferral and clawback**

Governance Institute members' note that APRA has revised the SFI deferral requirements. Governance Institute members consider that APRA's intention in relation to vesting as noted in the Response Paper does not quite align with the actual drafting of paragraph 51 of the Standard. It is unclear whether the relevant percentage must be deferred for the whole period and then pro-rata vesting is permitted or whether pro-rata vesting is permitted after four years or two years in the case of highly paid material risk takers who are not senior managers.

**Governance Institute recommends** that APRA review the drafting of paragraph 51 of the Standard to ensure it reflects APRA's intention as outlined in the Response Paper.

#### **Chapter 9 – Implementation of CPS 511**

Governance Institute's members are pleased to note that APRA has revised the implementation date of the Standard given the considerable feedback from industry. One issue that remains is that for many entities the proposed implementation dates for the Standard do not align with their performance year which is likely to cause practical difficulties. This is the reason we suggested in our October 2019 [submission](#) that the implementation date align with entities' financial years.

**Governance Institute recommends** that the implementation date for the Standard align with regulated entities' financial years. This could be achieved by providing that entities are to implement the Standard for their first full financial year commencing on or after the relevant implementation date.

#### **Chapter 10 - Reporting and disclosure**

Governance Institute's members are pleased to note that APRA intends to engage with entities to minimise any undue burden in relation to reporting and disclosure requirements. Nonetheless the fact remains that remuneration reporting and disclosure is problematic. As noted in our October 2019 submission remuneration in Australia operates within a confusing patchwork of law, guidance, and the accounting standards. Unless it is carefully framed further reporting and disclosure is likely to increase rather than decrease confusion in the area.

Our members consider the purpose of public disclosures around risk adjustments to remuneration, is to give investors, employees and other stakeholders an understanding of the behaviours that a board will not condone, rather than to publicly identify individuals. Any guidance APRA gives in this area should provide for generic rather than individual disclosures, given the potential for litigation. It would be counterproductive if entities were required to seek legal advice in each situation.

Governance Institute's members also encourage APRA to consider where possible enabling entities to satisfy reporting and disclosure requirements under the Standard by cross referencing existing reporting and disclosure.

**Governance Institute recommends** that where possible APRA consider enabling entities to satisfy reporting and disclosure requirements under the Standard by cross referencing existing remuneration reporting and disclosure and to make generic rather than individual disclosures in relation to risk adjustments to remuneration.

### **Further guidance**

There are a number of places in the Response Paper where APRA notes it intends to issue a new CPG 511 guidance document and other guidance to accompany the Standard. This guidance will be important for industry when making the transition to the new Standard. Governance Institute's members consider it would be preferable for APRA to consult on the guidance as soon possible. Settling the form of the guidance to the Standard sooner rather than later will better enable APRA-regulated entities make the transition to the new Standard.

**Governance Institute recommends** APRA consult on the new Guidance to the Standard at the earliest opportunity to assist in a smooth transition to the new Standard.

### **Other matters**

#### **Standard – Paragraph 37**

Paragraph 37 provides that:

*The determination of each component of a person's variable remuneration must:*  
*(a) give material weight to non-financial measures where the remuneration is*  
***performance related;***

The use of the words 'performance related' appears to introduce a new definition. The footnote makes it clear that components of 'variable remuneration that are entirely dependent on share price performance or profitability' would not be permitted. Our members consider that it would assist with interpretation of the Standard if APRA were to clarify what the term is intended to include.

### **Application of the Standard to Groups**

Paragraph 57(a) provides that where an APRA-regulated entity is part of a group the Board of the regulated entity may use a 'group Board Remuneration Committee' for the regulated entity. Paragraph 57(b) provides that the regulated entity may adopt and apply a 'group remuneration policy' that is also used by a 'related body corporate or a connected entity' on the conditions set out in paragraphs 57(b) (i) – (iii).

Our members note that in practice this may be unworkable because a subsidiary Board Remuneration Committee is unlikely to have 'jurisdiction' over the employees of related parties or connected entities.

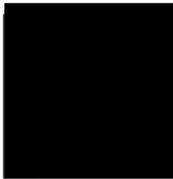
### **Remuneration arrangements for service providers**

Paragraphs 19 and 20 of the Standard contain various requirements in relation to the remuneration framework and the remuneration policy for APRA-regulated entities. Paragraph 20(c) makes a reference to the remuneration arrangements for service providers that are not related bodies corporate or connected entities of an APRA-regulated entity.

Our members consider that the new draft Standard has partially addressed the issue in relation to paragraph 19(d)(ii) of the original consultation draft, referred to in our October 2019 submission. However, they consider that the number of individuals potentially captured by the revised draft remains extremely broad. Our members recommend that APRA either explicitly limit the group it intends the Standard to cover within the Standard or addresses this issue in guidance.

If you wish to discuss any of the issues raised in this letter, please contact [REDACTED].

Yours faithfully,

A large black rectangular redaction box covering the signature of the sender.

[REDACTED]  
CEO