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### **Consultation on revised draft Prudential Standard CPS 511 Remuneration**

The Westpac Group (**Westpac**) appreciates the opportunity to provide a submission in response to the revised draft *Prudential Standard CPS 511 Remuneration (Draft Standard)* that was released for consultation on 12 November 2020 alongside APRA's *Response Paper: Strengthening prudential requirements for remuneration (Response Paper)*.

As emphasised in our submission to the first consultation in July 2019, Westpac fully supports a more principles-based regulatory framework as articulated in the Draft Standard. We are confident that the framework will play a key role in supporting the design and application of stronger and, where relevant, proportionate minimum standards for remuneration across APRA-regulated entities.

Overall, we believe that the Draft Standard appropriately balances simplicity and practicality with APRA's objective to promote stability in the financial system while mitigating or, where possible, eliminating the risk of unintended consequences arising through the framework's implementation.

While we welcome most of the changes outlined in the Draft Standard, we recommend that APRA further review five items to maximise the effectiveness and implementation of the reforms.

#### **1. Commencement date for APRA-regulated entities with a financial year that is not based on the calendar year**

Westpac notes that CPS 511 will commence on 1 January 2023 for Authorised Deposit-taking Institutions (**ADIs**) that are Significant Financial Institutions (**SFIs**) and that the proposed requirements would not apply to a person's variable remuneration if the opportunity to earn the variable remuneration arose before this date.

The performance period(s) for the assessment of variable remuneration for many financial institutions does not align to a calendar year. For example, Westpac's financial year (and associated remuneration arrangements) runs from 1 October to 30 September. It will be important for certainty across the industry for APRA to confirm that the commencement date for CPS 511 only applies to performance years starting on or after 1 January 2023 for SFIs. We understand that Westpac would only be required to comply with the final standard from financial year 2024 (starting on 1 October 2023).

We also do not believe it would be appropriate or practical to have components of the standard with different commencement dates given the importance of implementing reforms as part of a comprehensive package of changes (i.e. the effective date of the overall standard being 1 January 2023 per paragraph 9 with the potential for the applicability to variable remuneration to differ as specified in paragraph 10).

## **2. Definition of variable remuneration to exclude buyouts**

Under the Draft Standard, variable remuneration is defined as the amount of a person's total remuneration that is conditional on objectives which include performance criteria, service requirements or the passage of time. This is a welcome proposal given the ongoing uncertainty associated with the present definition of variable remuneration under the Banking Executive Accountability Regime (**BEAR**) regime.

Westpac notes APRA's intention to outline better practice under Consolidated Practice Guide 511 (**CPG 511**), noting the Large ADI Cohort<sup>1</sup> has previously raised concerns with APRA regarding the inclusion of buyout awards within the meaning of variable remuneration.

Buyout awards are made on a discretionary basis in recognition of awards which are forfeited by a new hire on resignation from their previous employer. As far as practical, forfeited awards are replicated on a like-for-like basis. Where buyout awards are subject to malus, they will be consistent with the underlying adjustment principles in CPS 511 and accordingly should not require further deferral.

The inclusion of buyout awards as a form of variable remuneration will potentially require the extended deferral requirements to apply to buyout awards which would impact the ability to adopt a like-for-like award and have a substantial impact on market practice.

For this reason, and in line with the principles developed by the Large ADI cohort, Westpac's position is that buyout awards should be excluded from the definition of variable remuneration and/or required to be replicated on a like for like basis in line with the deferral period of the original award<sup>2</sup>, noting that buyouts for new hires from other SFIs would over time reflect the deferral requirements under CPS 511.

## **3. Guidance for non-financial measures at a Group, divisional and individual level**

Westpac notes that CPG 511 will include guidance to help APRA-regulated entities identify and manage appropriate non-financial measures to support the determination of each component of a person's variable remuneration where the remuneration is performance related.

Westpac agrees with APRA's view that issues regarding non-financial measures, including the lack of maturity, transparency and the potential for inappropriate non-financial measures, can lead to poor outcomes. Having regard to these issues, Westpac requests further guidance from APRA in the following areas:

- Examples of measures at a Group, divisional and individual level noting that the majority of APRA-regulated entities currently do not operate non-financial performance measures in their long term incentive arrangements;
- Confirmation that the 'material weight to non-financial measures' requirement can be assessed holistically through the variable remuneration process, rather than being limited to performance metrics. For example, an APRA-regulated entity may use some or all of the following design features and processes to comply with the requirement:
  - Gates<sup>3</sup>;
  - Pre-grant assessments;

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<sup>1</sup> The Large ADI cohort was an industry working group formed to review and respond to the BEAR consultation paper released in July 2017.

<sup>2</sup> For example, the Prudential Regulation Authority's Remuneration Rule 15A.3 requires the duration of retention, deferral, performance and clawback arrangements applied to a buy-out, or part of a buy-out, to apply no faster than the awards they replace.

<sup>3</sup> Comprise mandatory minimum behavioural, risk management and compliance requirements to be eligible for a fixed pay increase or variable remuneration.

- Performance metrics;
- Vesting conditions; and
- Remuneration adjustment processes.

In addition, Westpac requests confirmation that a performance management system that includes individual goals that are not weighted and assesses behaviour equally alongside goal achievement is appropriate.

#### **4. Reinforcing the standard and the effectiveness of further guidance**

Westpac is committed to supporting the significant efforts by APRA to undertake further measures and actions to reinforce the new standard through heightened supervision including a deep dive implementation review across a sample of APRA-regulated entities, CPG 511, new disclosure requirements and the review of the effectiveness of CPS 511 four years from its' commencement date.

In addition to the above considerations relating to the non-financial measures, Westpac welcomes clear guidance to ensure compliance with the new requirements including the implementation of the deferral obligations, annual compliance review requirements and board reporting.

Westpac anticipates that the guidance will include detailed better practice examples to support compliance and alignment. However, Westpac also emphasises the importance of consistency and clarity in requirements and APRA's expectations. For example, the Response Paper specifies that clawback is only to apply in 'exceptional circumstances after other adjustment tools have been exhausted', however this is not specified in the Draft Standard.

Westpac also notes differences in the timing of the release of CPS 511 and CPG 511 which could result in a level of uncertainty and an inefficient use of resources across the industry in finalising self-assessments and implementation plans. Given the importance of CPG 511, Westpac believes that CPS 511 and CPG 511 should be released at the same time (or in close proximity). Releasing the package of changes concurrently will provide increased clarity for APRA-regulated entities to conduct their self-assessments and develop implementation plans and allow industry the adequate time for change management in supporting compliance with the new requirements.

In terms of the proposed disclosure activity, Westpac supports the intent behind enhanced disclosure of remuneration outcomes and adjustments with flexibility for APRA-regulated entities to explain aspects of their approach in line with stakeholder, risk and commercial considerations. Westpac also agrees that the disclosure requirements should include voluntary and prescribed elements while mitigating confidentiality concerns.

#### **5. Interaction with existing and new legislative requirements**

Westpac highlights the importance of consistency and alignment of regulatory and legislative requirements. We understand that CPS 511 will operate alongside and supplement the BEAR deferred remuneration obligations and the proposed Financial Accountability Regime (**FAR**) regime.

While there does appear to be some requirements that now more closely align to the proposed FAR remuneration related requirements, there also remain significant differences between fundamental aspects of the FAR and CPS 511. For example, the proportion of variable remuneration to be deferred for the CEO varies. We stress the importance of APRA working with Treasury to ensure full alignment prior to the release of CPS 511 to avoid issues and unintended consequences across the industry.

We would appreciate the opportunity to meet with APRA to discuss our submission. In the meantime, please contact us if you have any specific questions or comments in relation to our submission.

Sincerely



**Chairman, Board Remuneration Committee**