

23 July 2021

[REDACTED]  
General Manager, Policy Development  
Policy and Advice Division  
Australian Prudential Regulation Authority

via email: [REDACTED]

Dear [REDACTED]

### **Draft Prudential Practice Guide CPG 511: Remuneration**

Thank you for the opportunity to provide comments on the draft Prudential Practice Guide CPG 511: Remuneration (**Practice Guide**).

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 46,000 is drawn from directors and leaders of not-for-profits, large and small businesses and the government sector.

As previously indicated, we are supportive of APRA's objective to engage in stronger supervision of remuneration frameworks and focus on non-financial risk management. We support the more principles-based focus of the Practice Guide, which reflects amendments made to Prudential Standard CPS 511: Remuneration (**Standard**).

### **Executive Summary**

1. While broadly supportive of the Practice Guide, and its distinction between the role of management and the board, we make the following points:
  - we welcome the clarification that entities may choose not to offer variable remuneration and recommend that, if there are any additional requirements, they be specified;
  - the wording on the role of the board in paragraph 56 should more clearly reflect the oversight role of the board;
  - the Guide should make clear that boards may delegate decisions on risk and conduct adjustments given the board's governance and oversight role;
  - the implementation date of both the Standard and the Practice Guide should be the performance year commencing on or after 1 January 2023;
  - further specific consultation should take place with ADIs over the practical limitations of their ability to oversight mortgage broker remuneration arrangements via approved aggregators.

## General comments

2. We retain concerns previously expressed about the Standard which are also reflected in the Practice Guide and we reiterate our view that the Standard should be amended to address these issues.<sup>1</sup> This includes concerns about:
  - the level of reporting expected to the Board Remuneration Committee (**BRC**), 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. We note that the recently released Financial Accountability Regime (**FAR**) draft legislation provides for less onerous deferral periods and amounts for CEOs and senior managers and executive directors other than the CEO. In our view the Standard should align to the FAR periods;
  - the prescriptive and mandatory criteria for the application of clawback, which does not fully recognise the complexity of 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 (and to the yet to be legislated FAR); and
  - the lack of a more tailored application to Responsible Superannuation Entity (**RSE**) Licensees and mutuals, which does not recognise the different remuneration practices in those sectors.
3. Putting those concerns to one side, we are otherwise broadly supportive of the Practice Guide. Generally, and subject to some important points below, it seems to appropriately reflect the difference between the role of the board and management. It does impose somewhat onerous conditions on boards and the BRC but, as already noted, these are largely drawn from the provisions in the Standard.

## Remuneration design

4. We strongly welcome the statement in paragraph 38 of the Practice Guide that “Entities may decide not to offer variable remuneration, if this does not support their objectives or business model.” As we noted in our submissions on the Standard, the practice in some profit-to-member RSE licensees and mutual and community banks is to pay only fixed remuneration.
5. We understand that entities could potentially still meet the requirements of the Standard and Practice Guide through malus and clawback. We note that all entities would still be required to align fixed remuneration with performance and risk.
6. Our understanding is that APRA has no additional expectations for entities that do not have variable components in their remuneration, including if/when they become SFIs. If, as part of its supervision, APRA intends to impose additional requirements on these entities then the Practice Guide should be explicit, otherwise they are justified in regarding the matter as settled.

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<sup>1</sup> AICD submission, Draft Revised Prudential Standard CPS 511: Remuneration (10 February 2021)  
<https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/policy/pdf/2021/aicd-submission--apra-cps-511-10022021.ashx>

## Material weight – variable remuneration

7. Paragraph 56 of the Practice Guide appears to suggest that the board should be responsible for determining the material weight applied to variable remuneration outcomes across the business. This perhaps inadvertently, overstates the role of the board. In the AICD's view it would be reasonable for the board to set parameters on how material weight might be defined as well as certain policies. However, the Board should not be expected to determine material weights at the level of the individual, outside the specific requirements of the Standard.
8. We assume that the above implication in Paragraph 56 is unintentional. We note that paragraph 47 of the Standard provides that the BRC (via the full board) must approve remuneration arrangements and variable remuneration outcomes individually for senior managers and executive directors and on a cohort basis for highly-paid material risk-takers, other material risk-takers and risk and financial control personnel. We also note paragraphs 58 and 59 of the Practice Guide support the principle that the board is not intended to be directly involved in determining every individual's material weighting.
9. In the interests of clarification, we propose that some minor drafting changes should be made, our suggestion is below:

56. *In assessing whether material weight is being applied effectively in the design and determination of variable remuneration outcomes, a prudent Board would consider whether the weighting:*

*a) is a sufficient incentive to influence **an a cohort or** individual's behaviour, priorities and decisions;*

*b) is robust and cannot be overshadowed or diminished by performance or out-performance on financial measures;*

*c) is applied to measures over which the **cohort or** individual has a reasonable degree of control and influence;*

*d) is applied to measures that effectively support the objectives of the remuneration framework, including risk management; and*

*e) has been demonstrated to work in practice to incentivise prudent outcomes overtime, where this is possible to determine.*

## Role of the board in risk and conduct adjustments

10. We have some concerns that the section on risk and conduct adjustments could be read as implying that the board is responsible for making those adjustments. Our understanding is that APRA considers that the board must have oversight of adjustment mechanisms of variable remuneration such as in-year, malus and clawback considerations, however there is no explicit (operational) need for the board to be involved in *all* cases of downwards adjustments. Boards may choose to delegate these decisions to management or may reserve them to themselves.
11. In our submission, it would be appropriate for some minor drafting changes to that section of the Practice Guide in the interests of clarification. We suggest the following:

70. A prudent ~~Board~~ **entity** would consider a wide range of evidence and ensure appropriate mechanisms are in place to escalate issues, **including to the Board**.

74. .... This scale would support ~~a Board~~ **an entity** in distinguishing between adverse outcomes, significant failures and material failures, and in applying consistency across different cases.

### Implementation date

12. We note that both the Practice Guide and the Standard require APRA-regulated entities to be compliant by their commencement date of 1 January 2023. However, we have received feedback that the scale of change required by them is such that an implementation timeframe of more than one performance period will be required to properly identify potential alignment gaps, develop appropriate solutions and implement required changes.
13. As such, we suggest that the implementation date be amended to the performance year commencing on or after 1 January 2023.

### Practical limitations of ADI oversight of mortgage broker remuneration arrangements

14. We are advised that a common mortgage broker model consists of ADI's engaging directly with approved aggregators (also called 'Head Groups') who then have separate contract and remuneration arrangements with their respective mortgage brokers. This means ADIs may have difficulty fulfilling the proposed requirements around third-party service providers. Some further clarification around the proposed extent of the duty, and engagement with ADIs about the practical limits of their roles, would be appropriate, in our opinion.
15. This complexity further justifies an amendment to the implementation date.

### Next steps

We hope our response will be of assistance. If you would like to discuss any aspects further, please contact [REDACTED] at [REDACTED]

Yours sincerely,

[REDACTED]

[REDACTED]

General Manager, Advocacy