

23 July 2021

██████████
General Manager Policy
Policy and Advice Division
Australian Prudential Regulation Authority

Dear ██████████

QBE Submission: Consultation – Draft Guidance on Remuneration

QBE welcomes the opportunity to comment on the draft *Prudential Practice Guide CPG 511 Remuneration* (CPG 511) which was released on 30 April 2021.

This submission is on behalf of QBE Insurance Group Limited and the Level 1 insurers comprising QBE Australia Pacific (collectively “QBE”).

As previously shared in our submissions on the draft *Prudential Standard CPS 511 Remuneration* (CPS 511) (dated 22 October 2019 and 12 February 2021), QBE is supportive of APRA’s objectives to improve accountability and achieve greater balance in assessing performance so that remuneration arrangements promote effective management of both financial and non-financial risks, sustainable performance and long-term soundness.

However, as highlighted previously, CPS 511 raises a number of significant challenges for QBE. These include:

- the creation of a competitive disadvantage for QBE due to proposed lengthy deferral periods for variable remuneration which remain significantly more onerous than in any other jurisdiction regulating insurance firms in which QBE operates (as approximately three quarters of our workforce is located outside of Australia);
- the significant burden on the Board and the People and Remuneration Committee in relation to the approval of remuneration arrangements and variable remuneration outcomes for employees in newly identified specified roles;
- the complexity caused by inconsistent and overlapping regulatory requirements in Australia and internationally, including the different categories of employees captured by differing regulations; and
- requirements that add substantial complexity with limited benefit.

Appendix A of this letter outlines QBE’s views on the implementation challenges that CPG 511 raises, where the guidance creates new concerns or goes beyond the requirements of CPS 511 and where we believe CPG 511 would benefit from greater clarity. This submission does not re-state all the issues we have raised in our previous submissions on CPS 511, although these concerns remain.

In the absence of CPS 511 being finalised and based on APRA’s indication that it does not expect to make material revisions to the current proposals (as outlined in Consultation – Draft Guidance on Remuneration), this submission is based on how draft CPG 511 interacts with the revised draft CPS 511 which was released on 12 November 2020.



We would be pleased to provide any further information that assists APRA's consideration of our feedback.

Your sincerely

[Redacted signature]

[Redacted name]
Group Chairman



Appendix A: QBE's feedback on draft guidance *Prudential Practice Guide CPG 511 Remuneration (CPG 511)*

For ease of interpretation, QBE has provided the feedback below in the same order as draft CPG 511. As such, the order of the feedback is not reflective of QBE's views on the importance of any of the issues raised.

1. Role of the Board

Board reporting

The suggested reporting requirements will result in a significant increase in the volume of information required for management to collate and for the Board and Remuneration Committee to review. This is evident in **paragraph 18** which states that "*good practice would be for the RemCo to be provided with formal documented performance and risk assessments for individuals in specified roles, and summaries for relevant cohorts*".

As raised in our previous submission dated 12 February 2021 (2021 submission), QBE has a large number of employees that will require their remuneration outcomes to be reviewed and approved by the Remuneration Committee (and Board) at an individual level. As much of the individual assessments will relate to personal or development objectives, there is a questionable benefit in the Remuneration Committee reviewing full performance assessments across a large number of employees. QBE believes that a summary report of performance and risk assessment ratings for senior managers and executive directors (rather than the detailed assessment that led to the selection of the relevant ratings) would provide sufficient visibility to allow the Remuneration Committee and Board to consider whether remuneration outcomes are appropriate.

Further, it is unclear what the cohort summary reporting achieves against the objectives of CPS 511. Aggregated data, particularly as it relates to variable remuneration recommendations, will provide little insight on cohorts and limited additional value to the Remuneration Committee and Board, in part due to the significant volume of information. The summary information on performance and risk assessment ratings for large numbers of employees, will provide little (or no) clear increase in insight, usefulness or benefit. QBE suggests the reporting expectations for cohorts as outlined in **paragraph 19** be restated to require summary reporting of overall performance distributions, number of employees meeting/not meeting minimum corporate standards and number of adjustments made.

2. Remuneration Framework

Specified roles

Paragraph 23 restates the requirement under CPS 511 that "*the variable remuneration outcomes for persons in specified roles must be approved by the Board or relevant oversight function, on either an individual or cohort basis*". As outlined in our 2021 submission, QBE does not believe the Group Board is best placed to approve the remuneration arrangements of all employees in specified roles across the group due to the increased volume and limited knowledge of the extended group of individuals requiring approval. QBE suggests that CPG 511 is revised to clarify that, where appropriate, the delegation of the responsibility for approving remuneration arrangements by the Group Board to the respective Divisional Board should be permissible. This reduces the burden on the Group Board and places the responsibility with the Board with the most knowledge of the individuals. Divisional Boards across QBE include a majority of independent non-executive directors and the Group Board would retain oversight via reporting of divisional outcomes up to the Group Board.

As outlined in point 1 (Role of the Board), there will be practical challenges in managing the approval requirements for cohorts due to the large number of employees involved. It is also unclear what benefit will be gained by the Board being required to approve the remuneration



outcomes of cohorts on an aggregate basis. QBE believes that after the fact reporting on performance distributions, aggregate variable remuneration outcomes and any adjustments is sufficient oversight of these cohorts.

Paragraph 25 implies that the number of senior managers in larger organisations may be small (it “*may be appropriate to include a range of executives from the next level below direct reports to the CEO*”) however, QBE has over 50 senior managers across the group. We reiterate the recommendation in our 2021 submission that an accountable person (as defined by Financial Accountability Regime (FAR)) as opposed to a senior manager (as defined by CPS 511) should be within scope as a specified role. This will focus the requirements only on those employees with the greatest accountability and impact on the entity’s risk profile and ensure consistency between CPS 511 and FAR.

Material risk-takers

QBE suggests further clarity be provided on the identification of a material risk-taker (MRT) and that it is limited to the most senior employees in the organisation. The definition of a MRT in CPS 511 is “*a person whose activities have a material potential impact on the entity’s risk profile, performance and long-term soundness*”. This definition is broad and does not provide sufficient information to ensure MRTs are identified consistently across the industry.

Paragraphs 27 and 28 in CPG 511 do not provide additional clarity. A potential implication of inconsistent identification of MRTs throughout the industry is talent competition ramifications, particularly relating to the extended deferral requirements for those MRTs who are identified as highly-paid material risk-takers (HPMRTs).

Paragraph 28 states that “*a prudent entity would consider the identification of **groups** of material risk-takers as well as individuals, including those that may collectively affect financial soundness*”. It is unclear what criteria APRA requires organisations to use to identify groups of MRTs. Furthermore, the intended implications are unclear. For instance, would an individual who is part of a group of MRTs, but not an MRT in their own right, be subject to the same requirements as an individual MRT. QBE seeks further clarity on APRA’s expectations with regards to the identification and treatment of groups of MRTs.

Additional guidance in relation to HPMRTs has been added in **paragraph 29** stating that “*good practice would be for an entity to also monitor and include material risk-takers with remuneration close to the \$1 million level*”. As outlined in our 2021 submission, a key concern with the HPMRT definition is that it will result in uncertainty for employees about the deferral requirements that will apply to them. It is vital to provide some certainty to employees through clear communication at the start of the performance year on which deferral rules will apply to their variable remuneration. Indicating that variable remuneration **close to** the \$1million level **may** result in deferral provides too much ambiguity to employees, and a timing issue for organisations when trying to determine the appropriate deferral requirements, especially given that actual remuneration outcomes are not known until year-end. It will also result in further complexity to administer incentive programs due to the introduction of a new threshold i.e. close to \$1 million, which would be up to entities to define. QBE suggests this guidance is removed as it goes beyond the standard and is not practical to implement.

HPMRT definition

QBE outlined several concerns with the HPMRT definition in our 2021 submission and CPG 511 has not yet addressed the concerns raised. The inclusion of benefits in the definition of fixed remuneration is complex and difficult to calculate. Quantifying the value of benefits at the individual level is challenging due to benefit offerings varying across geographies, a large number of low value benefits being offered by innumerable providers and individual utilisation. In addition, there is limited value in including this data as the cost of benefits will unlikely vary significantly year-on-year and are unlikely to recategorise someone from a MRT to a HPMRT.



As outlined in our 2021 submission, we suggest that fixed remuneration is removed from the definition of a HPMRT (we suggested that HPMRTs are defined on the basis of having a maximum potential variable remuneration equal to or greater than AUD 750,000 in a financial year). This approach retains the focus on employees with the highest amount of pay at risk and reduces complexity for organisations. An alternative consideration may be to provide guidance for entities within the CPG, to set their own criteria for determining the \$1m threshold thus recognising the varied practices across organisations. However, if fixed remuneration remains in the definition, we suggest that benefits are either specifically excluded from the definition or that a clarified and simpler methodology be stated in CPG 511, for example, a percentage of fixed remuneration for each jurisdiction to capture an approximate benefits cost per country.

The inclusion of sign-on and buy-out awards in the definition of variable remuneration also has implications for the identification of HPMRTs. The definition of variable remuneration in CPS 511 (paragraph 18(u)) is “*the amount of a person’s total remuneration that is conditional on objectives, which include performance criteria, service requirements or the passage of time*”. As per CPG 511, **paragraph 63** states “*good practice is to apply deferral to each material component of an individual’s variable remuneration including, for example, any one-off payments such as sign-on awards and buy-outs*”. The variability and generally one-off nature of these awards will lead to a variability of employees who may be included as a HPMRT year-on-year. Using the current definition and guidance, employees will only be able to be identified as a HPMRT at the end of the performance year when the value of annual incentive awards is known, once sign-on and buy-out arrangements, including vesting timelines, have already been agreed.

This is a particularly challenging issue that needs to be addressed. Buy-out awards are often structured to mirror the payment of remuneration foregone from a previous employer and are critical to secure key talent. It is therefore not appropriate to apply the specific deferral requirements under CPS 511 to these awards. Further, if a sign-on or buy-out award, in combination with any annual incentive, results in an employee exceeding the threshold, it would be complex to alter the deferral arrangements (that would already be in place) for either the sign-on award, buy-out award or the annual incentive to ensure appropriate deferral is applied to the entirety of their variable remuneration.

Example:

Employee started at QBE in February 2022 and received a buy-out award of \$300,000, with 50% granted in cash (payable after one year in 2023) and 50% granted in equity (vesting after two years in 2024). This buy-out award mirrored the variable pay being forfeited at a prior employer and was used as an incentive to join QBE. The employee’s fixed remuneration is \$500,000. They are classified as an MRT.

At the completion of the 2022 performance period, the employee is due to receive \$250,000 as their short-term bonus, payable in March 2023. Based on the HPMRT threshold of \$1million, the employee is a HPMRT for 2022. Their fixed remuneration (\$500,000) plus actual variable remuneration of \$550,000 (made up of buy-out (\$300,000) plus actual bonus (\$250,000)) all equals \$1.05m for 2022. It is unlikely that the employee would be a HPMRT in the following year based on their standard remuneration arrangements (due to the absence of a buy-out award) and so the benefit of including them in this category for one year is unclear.

As outlined in our 2021 submission, QBE suggests amending the definition of variable remuneration to exclude one-off payments relating to the commencement of employment, so that sign-on and buy-out awards are specifically excluded from the CPS 511 deferral requirements. However, if the definition remains unchanged in CPS 511, then QBE suggests



guidance in CPG 511 is amended to exclude one-off payments or provide further clarity on APRA's expectations of "material" (for example, provide a materiality threshold).

Risk and financial control personnel

QBE believes that further guidance on the RFCP cohort is warranted. The draft CPS 511 definition of RFCP being "*persons whose primary role is in risk management, compliance, internal audit, financial control or actuarial control*" implies that **all** employees performing these functions would be included in the RFCP specified role category.

QBE believes the RFCP cohort should be restricted to senior level RFCP employees only, as not all RFCP would have a material influence and the requirement for the Board to review remuneration for all RFCP employees, even at a cohort level, is excessive. Furthermore, QBE also requests the CPG 511 provide further clarity on Line 1 risk and compliance roles. The current definition implies these employees would be captured due to their primary role being a risk and control function. QBE believes that Line 1 risk and compliance roles should be excluded from the RFCP cohort as their primary role is to provide risk advice (as opposed to being a control role) and they are not independent from the business they support. Further, their performance and remuneration arrangements are determined by line managers within the business.

Paragraph 31 states that RFCP would typically receive a higher proportion of fixed remuneration (versus variable remuneration) than other employees. In our view, the expectation for a higher proportion of fixed remuneration is only applicable to senior RFCP employees. QBE suggests that further guidance be provided to clarify that this is more appropriate at senior levels.

Paragraph 32 states that "*individual performance measures for risk and financial control personnel to be based **principally** on non-financial measures*". This introduces a new threshold of "principally" and it is unclear how this differs to "material". QBE suggests further clarity be provided in CPG 511 on how an entity gives weight to, and apply, the term "principally" in practice. **Paragraph 32** further states that "*to avoid potential conflicts of interest, the determination of variable remuneration for these personnel would not be carried out by managers of the business areas they monitor*". In practice, not all RFCP work within distinct control functions (an example may be financial controllers), and as such, their reporting lines may go to a line manager in the business. To preserve their independence, they would typically have a dual reporting line to a control function, and as such, determination of their variable remuneration would not be solely determined by a line manager in the business. QBE suggests that the wording in **paragraph 32** is updated to reflect this scenario and is amended to "*to avoid potential conflicts of interest, the determination of variable remuneration for these personnel would not be **solely** carried out by managers of the business areas they monitor*".

Service providers

Draft CPS 511, paragraph 20(c), requires an entity to set out in its remuneration policy "*the process to identify and address inconsistencies... that may result from remuneration arrangements of a **service provider** that is not a related body corporate or connected entity*".

Further, draft CPS 511, paragraph 40, requires an entity to "*take appropriate steps to assess and mitigate conflicts of interest in the design of its remuneration arrangements, **including service providers***".

The standard currently implies that **all** service providers, irrespective of materiality and/or services provided are subject to the above requirements.

Given the large number of arrangements which entities may have with third-party service providers, CPG 511 does not provide clarity on third-party service providers that may give rise to conflicts or risks. **Paragraph 34** states a "*prudent entity would take reasonable steps to*



identify which service providers may give rise to conflicts or risks” and this “may include a materiality threshold or definition, approved by the Board, used to identify the scale and nature of service providers that are likely to present a conflict or risk”, suggesting that an entity can determine which service providers may adversely impact an entity’s risk profile, sustainable performance and limit the requirements under CPS 511 to these providers. In the absence of a materiality threshold or definition set by APRA, QBE would welcome further guidance in CPG 511 to ensure there is a consistent approach being used across the industry and suggests that APRA provide more direction and additional examples (for both services in and out of scope) to assist an entity determine its materiality threshold or definition; or consider limiting service providers to material arrangements under *Prudential Standard CPS 231 Outsourcing*.

QBE also suggests the wording in CPS 511 is updated to clarify the approach for ‘material’ third-party service providers to ensure it is clear in the standard.

3. Remuneration design

CPG 511 is inconsistent with CPS 511 in terms of which elements of variable remuneration require a material weight to non-financial measures. Paragraph 37(a) of CPS 511 specifies that SFIs must give “*material weight to non-financial measures where the remuneration is performance related*”. QBE interprets “performance related” to exclude remuneration that is reliant on service requirements or the passage of time i.e. this could be time-based retention or sign-on awards. However, CPG 511 implies that **all** elements of variable remuneration require a material weight to non-financial measures:

- **Paragraph 43** states “*CPS 511 requires SFIs to give material weight to non-financial measures in the determination of each component of a person’s variable remuneration*”
- **Paragraph 44(c)** states “*non-financial measures can impact each and all components of variable remuneration, including any long-term and short-term incentive plans*”.

The above is an example of the complexity caused by the broad definition of variable remuneration included in CPS 511. As outlined in our 2021 submission and in point 2 above, QBE suggests amending the definition of variable remuneration to exclude one-off payments relating to the commencement of employment. However, if the definition of variable remuneration remains unchanged, it will be essential that paragraphs 43 and 44 in CPG 511 be updated to limit the guidance to performance-related variable remuneration i.e. to exclude retention or sign-on awards.

Defining non-financial measures

Paragraph 52 states that “*non-financial measures for an individual are expected to be targeted on the key risks they are responsible for and can influence*” and that “*group-wide or division-wide measures can help drive collective accountability, but only where the individual has a reasonable degree of control and influence on the outcome*”. For entities that adopt a scorecard approach to variable remuneration, it is likely that the material weighting for non-financial measures will be applied at the group or divisional level and these scorecards will apply to all employees. However, individuals will also separately have non-financial personal performance objectives that are relevant to their role and where they have influence over the outcome. QBE suggests that APRA clarify its expectations that the application of non-financial measures may be applied at both a group/divisional and also an individual level.

Deferral

Paragraph 62 states that “*to determine the amount to defer and the vesting schedule, SFIs would use the total value of variable remuneration awarded in the financial year*”. There are multiple methods to determine the value of certain components of variable remuneration i.e. fair value and face value, and so more clarity is sought on the approach to value variable remuneration. Further, QBE has interpreted ‘awarded in the financial year’ to exclude vesting



of deferred awards that were granted in a prior financial year (to avoid double counting) and welcomes further clarity in CPG 511 to confirm this.

Paragraph 62 further states that *“for equity-based remuneration, good practice is to use the number of shares rather than dollar value for the vesting schedule”*. It is unclear why the number of shares rather than the dollar value for the vesting schedule is considered good practice and how this would be practical across all financial services organisations noting their varied remuneration frameworks. QBE would value an expanded explanation in the final CPG 511 on this.

Paragraph 63 suggests that good practice would be to *“apply deferral to each material component of an individual’s variable remuneration including, for example, any one-off payments such as sign-on awards and buy-outs”*. As outlined in point 2, applying deferral to one-off payments are problematic and QBE suggests that they are excluded from the deferral requirements.

4. Risk and conduct adjustments

In relation to in-period adjustments (including in-year, malus and clawback), **paragraph 65** states that *“to provide the legal basis for action, these design features would be built into relevant employment contracts”*. This goes beyond what is needed to implement these requirements, as these design features, including clawback, can be established and communicated through incentive plan documentation and do not need to be included in employment contracts. Further, it is not appropriate that APRA determine what should be built into employment contracts, particularly noting QBE’s global footprint and complexity associated with employment contracts in various jurisdictions, including those outside of Australia. QBE suggests this wording is removed in order to provide flexibility for entities to best determine how to implement the requirements.

Downwards adjustments

Paragraph 71 states *“considerations of in-period risk adjustments to be made on a timely basis, including but not limited to the regular performance assessment”*. An entity may well review certain significant adverse risk and conduct outcomes during the year and apply immediate consequences i.e. termination. However, this approach is not appropriate for all outcomes that may lead to an adjustment, such as minor conduct matters. In-period risk adjustments may not be able to be made, or quantified, at the time the outcome is considered, in the absence of the full year performance information and determination of incentive pools. It is suggested this paragraph be reworded to reflect that an entity can determine the appropriate timing for consideration of in-period adjustments. QBE suggests more appropriate wording is *“considerations of in-period risk adjustments need not be limited to the regular performance assessment cycle. Where appropriate, considerations of in-period adjustments may be made on a more timely basis.”*

Assessing severity

Paragraph 73 in CPG 511 allows flexibility for an entity to determine the most appropriate adjustment tool to apply after consideration of the severity of the risk and conduct outcome and whether sufficient consequence has been applied. This flexibility is also expressed in APRA’s wording in the Response Paper that clawback would only be used in exceptional circumstances *“after other adjustment tools have been exhausted”*. However, this flexible approach is inconsistent with CPS 511 which adopts a more prescriptive approach. CPS 511 details specific criteria for malus and clawback with the requirement that an entity take reasonable steps to appropriately apply malus or clawback when any of the criteria are satisfied. QBE supports the flexible approach outlined in CPG 511 and suggests that the wording in the standard is revised to clarify that an entity can determine the appropriate adjustment tool to apply as appropriate to the circumstances.



5. Review of the remuneration framework

Given CPS 511 becomes effective on different dates for ADIs (1 January 2023), insurers (1 July 2023) and any other APRA-regulated entity (1 January 2024), QBE would welcome further clarity on APRA's expectations for when the different industries should complete the first annual and triennial reviews (as mentioned in **paragraph 77**). In particular, the effective date for insurers if halfway through the calendar year, therefore QBE would welcome guidance on whether the first annual review should be completed by 1 July 2024 (12 months from the effective date of the standard) or 31 December 2024 (within the first full calendar year).