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General Manager - Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
Via email: policydevelopment@apra.gov.au

Dear Sir or Madam,

Subject: Consultation on draft Prudential Standard CPS511

Thank you for providing us with an opportunity to make a submission in response to the draft Prudential Standard CPS 511 – Remuneration (Standard) and discussion paper, released for consultation on 23 July 2019.

We support the intent of the draft Standard and the need to strengthen the governance of remuneration. We agree that financial incentives have, in some incidences, contributed to poor customer outcomes and serious misconduct.

However, we are not convinced that the level of prescription in the proposed Standard will achieve the best outcome for the customers, shareholders and the industry in general. The prescription of performance measures and deferral periods does not recognise the vastly different organisational objectives, cultures and people strategies that financial services organisations have.

Bendigo and Adelaide Bank's purpose is "to feed into the prosperity of our customers and their communities, not off it". We strongly believe a purpose-driven culture and a responsible remuneration model are essential to achieving positive customer and community outcomes.

We have a long-held view that remuneration structures which are leveraged towards short-term and individually focussed performance are incompatible with our strategy and risk poor culture and behaviour. Therefore, the Bank has historically limited the proportion of incentive-based pay, particularly incentive-based pay that is linked solely to individual performance; this approach has supported our long-term outlook for customers and shareholders. We also believe that the absolute value of incentive-based pay will have just as much, if not more, influence on the appropriateness of the incentive design than the mixture of financial and non-financial measures and the length of deferral.

Therefore, we are supportive of the ABA's industry response to the draft Standard and ask that APRA focus a principles-based approach to regulating incentive plan design. This is a reasonable approach, given we are yet to fully understand the long-term impact of the implementation of the Sedgwick recommendations and the Banking Executive Accountability Regime (BEAR).

In addition, there are several specific elements of BEN's current approach to remuneration that the draft Standard will impact. We believe that our approach to remuneration has served our customers, employees and shareholders well, and that the following examples highlight the problematic nature of the level of prescription found within the draft Standard.

For reference, a summary of BEN's executive remuneration is provided in attachment 1.

50/50 split of financial and non-financial measures.

The Standard focuses on grouping performance measures into financial and non-financial. While this is a simple approach, it ignores several complications, such as the requirement to effectively define and agree on the treatment of risk-adjusted financial measures. Further, it does not necessarily support the intent of changing behaviour. Commissioner Hayne acknowledged the importance, but also the difficulty, in measuring the 'how'[1] to balance the 'what'. We agree with this intent, but when considering how specific measures impact employee behaviour it is important to consider other factors. Factors such as the collective versus individual nature of the measures, the ability of individuals to influence the measures, and the quantum of the incentive will all have a significant impact on likelihood of the incentive leading to poor customer outcomes.

BEN's bonus pool is wholly dependent upon the group's financial performance (as distinct from an individual's performance). The value of the pool is kept modest - capped at $20 million for all employees, including executives. Employees must pass performance, risk and compliance, and values and behaviours gateways to be eligible for a bonus. However, the size of the pool – driven by financial performance - is the single most significant contributor to individual employees' bonus and executives' STI payments.

However, there is a limited ability for any one individual to impact cash earnings to the extent that it would affect their bonus. This, combined with the relatively modest cash bonuses provided to our executives, means that the focus on cash earnings does not create an incentive to act with self-interest over the interests of our customers.

We suggest that the Standard is drafted in a way that allows boards to use their judgement to ensure that a range of factors, including financial performance, customer outcomes, people outcomes, bonus quantum and risk, are considered when determining bonus outcomes. For example, paragraph 38 of the Standard could refer to "equal consideration" of financial and non-financial measures when allocating variable remuneration.

Definition of variable reward

A key element of BEN's executive remuneration framework is 'deferred base pay'. The intent of deferred base pay is to deliver a portion of an employee's fixed remuneration as shares, which are held in trust for 2-years. This creates long-term shareholder alignment, without the inherent optionality that the performance measures in long-term incentives create.

Participants have beneficial ownership when the shares are granted, including dividends and voting rights. The shares are subject to a 'genuine risk of forfeiture' based on a service condition, with the ability to apply malus for fraud, dishonesty, serious misconduct and breach of legal duties. However, for all intents and purposes, the Board considers this fixed remuneration that has exposure to the

[1] P251 vol 1 final report Hayne

share price. The risk of forfeiture is a safeguard and allows for alignment of the taxing point with when executives can realise the shares.

BEN's position is that this should not be considered variable remuneration, and it does not meet the definition of *"remuneration that is conditional on the achievement of objectives".* The setting of deferred base pay is done in the same way in which we set cash base pay, and the vesting is not conditional on the achievement of any objective, except for remaining employed by BEN and not triggering a risk adjustment.

The impact of classifying deferred base pay as variable remuneration means that it must be included in the deferral calculation and will also be subject to claw-back. This impacts the effectiveness of the program, by adding increased risk to an element that is intended to be considered fixed, as well as increasing the portion of reward that is deemed to be short-term variable remuneration.

This classification will impede us from using strategies that have been previously well received by our stakeholders. For example, our Managing Director and CEO was granted four years of deferred base pay on her appointment. This created immediate long-term alignment with shareholders, with the grants vesting in four equal tranches after 2, 3, 4 and 5 years. The grant was made before the effective date of the BEAR. It could not be made under the current BEAR requirements, or the proposed requirements of the draft Standard, without BEN granting a significant LTI grant to ensure that the required percentage of variable remuneration was deferred for 4-years and beyond.

Fixed grants of equity create strong alignment with stakeholders, without encouraging excessive risk-taking, which other incentives may. Therefore, we suggest that the definition of variable remuneration is amended to only include remuneration where the grant value and/or the vesting varies with respect to changes in performance.

Deferral requirements

The average maximum bonus (including deferred base pay) for BEN's executive KMP, excluding the CEO, was $380,000 for FY19 (although no bonuses were ultimately paid for FY19 because the group's financial performance for that year was below the threshold to create a bonus pool). CPS511 will require that 40% (circa $150,000) of this amount is deferred for a minimum of 4-years, and then vested in three equal tranches of circa $50,000 if all the performance criteria are achieved. The increased deferral period has a significant dilutive effect on the value of this remuneration. This dilutive impact is acutely felt by organisations that pay modest bonuses, compared to those that have typical total incentives of more than $1,000,000 for the impacted employees.

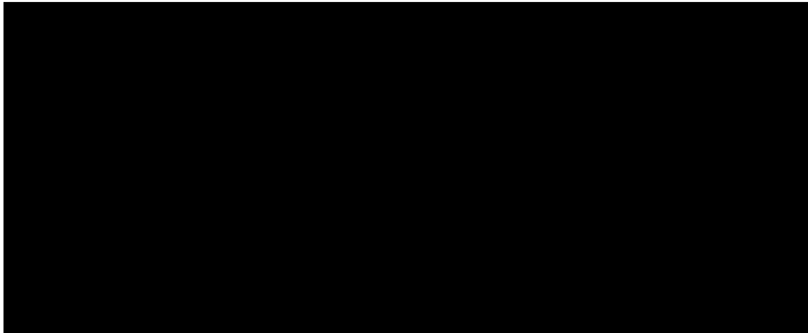
Further, the Financial Stability Board (FSB) has stated in several papers that the "*The FSF Principles for Sound Compensation Practices"* are intended to apply to significant financial institutions[2]. In its Sixth Progress report on Compensation (2019), the FSB listed five Australian ADIs as 'banks considered significant for the purposes of the Principles and Standards.' [3]

Given that the BEAR deferral requirements have only recently been implemented, we believe it is reasonable for APRA to maintain the 4-year requirement under BEAR and monitor its impact. If APRA insists on longer deferral and clawback periods, then it may wish to consider that this aspect of

[2] SB, 2018, p3 footnote 4 https://www.fsb.org/wp-content/uploads/P090318-1.pdf
[3] FSB, 2019, p49 https://www.fsb.org/wp-content/uploads/P170619-1.pdf

CPS511 only be applied to significant financial institutions, as defined by the FSB. Other ADIs, such as BEN, would still be required to meet the BEAR deferral requirements.

Yours faithfully,



Bendigo and Adelaide Bank Limited

Attachment 1:

Figure 1: Bendigo and Adelaide Bank – Executive Remuneration Framework

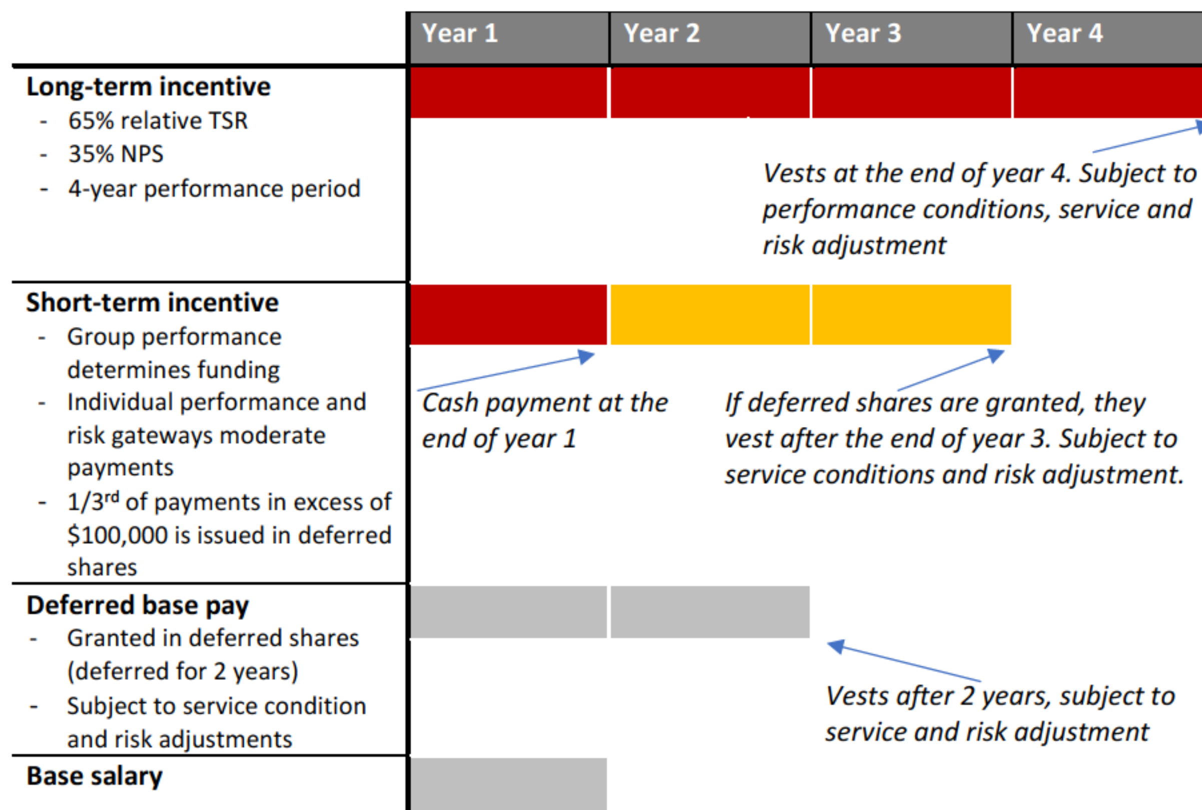


Figure 2: Executive STI payment calculation process

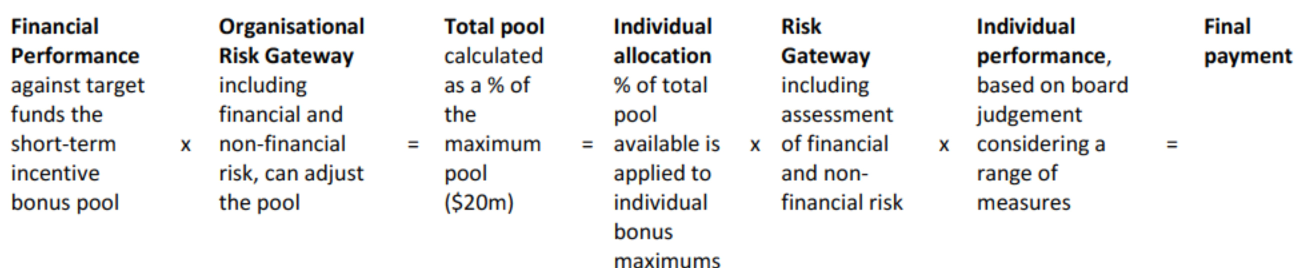


Figure 3: FY19 KMP (disclosed) incentive opportunities

KMP	Position	Fixed base	Deferred Base	Cash STI	Deferred STI	LTI	Awarded as Cash	Awarded as Equity
M Baker	Managing Director	45%	20%	10%	5%	20%	55%	45%
R Fennell	Consumer Banking	50%	12%	12%	6%	20%	62%	38%
Other executives (average)		55%	11%	14%	-	18%	69%	31%