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Submission on Draft CPS 511

Dear General Manager

We set out EY's response to the Australian Prudential Regulation Authority (APRA or the Regulator) request for comments regarding the Draft Prudential Standard CPS 511 (draft CPS 511). EY supports many of the proposed changes in draft CPS 511 and expects these changes to lead to better remuneration practices and outcomes. In particular, EY supports:

- Increasing the link between risk management and remuneration outcomes.
- Requiring the remuneration policy to cover all employees and all remuneration arrangements and the Board to have oversight of all remuneration arrangements.
- Enhanced compliance reviews and introducing evidence-based effectiveness reviews of the remuneration framework.

EY considers that a number of proposed changes require further consideration or clarification. As such, our submission sets out the EY response in Part 1 and responds to APRA's specific questions in Part 2.

Specifically, EY considers that:

- The policy intention for limiting the use of performance conditions either by category or weight (Clause 38) is better served through Board discretion;
- The policy intention for extending deferral for 6 or 7 years (Clauses 53 and 54) is the same intention as for the 4 year BEAR deferral and, as such, we propose relying on the 4 year BEAR period;
- The clawback period (Clause 57),when combined with a 6 or 7 year deferral period, does not align to financial, strategic or legal horizons; and
- An entity's remuneration policy should not capture the details of a third party's employees (Clauses 18(c) and 19(d)).

Please let us know if you would like to discuss the submission.

[redacted]

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1. EY submission on draft CPS 511

EY supports many of the proposed changes in draft CPS 511. We expect the focus on remuneration outcomes, the expanded remit of the remuneration policy to cover all of the APRA regulated entity's ("Entity") employees, and the strengthened review process will lead to better remuneration practices and outcomes. We outline below our submissions relating to the proposed prescriptive changes, the impact these may have on the Australian financial services industry, and other points for APRA's consideration.

APRA's objectives of draft CPS 511, which are referenced throughout this report, are to ensure the remuneration arrangements of all APRA-regulated entities promote:

- Effective management of both financial and non-financial risks;
- Sustainable performance and long-term soundness; and
- (For an RSE licensee) promote the financial interest, and reasonable expectations, of beneficiaries.

1.1 EY does not support the following changes

The following table summarises the proposed changes that EY does not consider appropriate or required to achieve APRA's objectives. Further detail regarding why EY does not support these changes is outlined throughout the report.

Proposed change	Comment on the proposed change	EY's alternative
a) **Prescribing how performance conditions should operate:** Limiting financial performance conditions to not more than 50% of the total measures used to allocate variable remuneration, and requiring that no individual financial performance measure comprise more than 25% of total measures.	The Discussion Paper states that the intended policy outcome is to improve the relationship between non-financial risk management and remuneration outcomes. However, there is nothing preventing entities from adopting non-financial performance conditions that are completely unrelated to risk, which could lead to poor industry outcomes. Additionally, prescribing how performance conditions should operate could increase the likelihood of incentives being paid, making incentives unaffordable for entities, stifling innovation in remuneration arrangements and putting APRA regulated financial institutions at a disadvantage	The proposed changes requiring Boards to ensure remuneration outcomes are aligned with risk management, conduct, and performance (without prescribing the weighting of performance measures) are sufficient to meet the policy intention. This approach is also in line with the BEAR policy intention and provides flexibility for Boards to establish measures that are appropriate to the risk profile of the business they oversee.

Proposed change	Comment on the proposed change	EY's alternative
	compared to non APRA regulated institutions.	
b) **The 6 or 7 year deferral timeframe:** Requiring Significant Financial Institutions to defer a portion of remuneration for 6 or 7 years (depending on role), so there is sufficient time available to make necessary adjustments to variable remuneration if misconduct is uncovered.	The BEAR 4 year timeframe already allows entities to align deferral with risk horizons and was introduced with the same policy intention. The proposed change could disadvantage Australian financial services companies, reducing competitiveness, increase pay in the financial services sector, increase member fees in superannuation, result in tax liabilities where an executive ceases employment and create unnecessarily long deferral arrangements for smaller institutions captured in the SFI definition.	APRA should not proceed with this change and instead rely on the 4 year BEAR deferral period. The BEAR deferral period can be reviewed once extended across the industry. If this deferral period is seen as insufficient, following implementation across the industry, the results of a review can guide an appropriate extended deferral timeframe.
c) **Clawback:** Requiring Significant Financial Institutions to subject vested incentives to clawback for 2 or 4 years.	Adding a potential 2 or 4 year clawback period on top of a 7 year deferral period is too long and likely to be statute barred.	In addition to a 4 year BEAR deferral, a 2 / 4 year clawback period may be appropriate (noting that a 4 year clawback period will extend the total period (4 years deferral and 4 years clawback) beyond the 6 year *Limitation of Actions Act 2008* timeframe. In conjunction with a 6 or 7 year incentive deferral, a 4 year clawback period is too long.

Proposed change	Comment on the proposed change	EY's alternative
d) **Scope of remuneration policy:** The remuneration policy to include the remuneration of employees of third parties.	It is not appropriate for third party remuneration arrangements to be captured by an entity's remuneration policy. The change will result in remuneration policies that are too long given the amount of information that would appear in the remuneration policy. Additionally, one third party could be subject to conflicting remuneration policies of two or more regulated entities. For example, the proposed change may capture remuneration arrangements of an external consultant in certain circumstances.	The Entity should be responsible for overseeing the structure of payments between the entity and third party service provider, to ensure those payments are in line with the remuneration objectives.

1.2 Prescribing how performance conditions should operate

1.2.1 The proposed change

Draft CPS 511 states that financial performance measures must not comprise more than 50% of total measures applying to incentives, and each individual financial measure must not comprise more than 25% of total measures. APRA notes in the Discussion Paper this change is to encourage the balance in managing financial and non-financial risk, given that current practices "have not allowed for non-financial outcomes (such as poor customer outcomes) or risks to be given sufficient weight in assessing performance."

We understand and support the policy intention that APRA is trying to achieve. However, we do not support the method to achieve the objective. In our experience the myriad of circumstances in which a Board may wish to (or should consider) apply a remuneration consequence does not lend itself to distilling into single performance conditions or applying a prescriptive construct to all financial services entities.

1.2.2 Limiting the use of financial performance conditions will not solve the misconduct problem

EY considers that limiting the use of financial performance conditions may:

- *Not solve the problem of improving non-financial outcomes or risk* – APRA wants entities to reward for better management of non-financial risk yet no boundaries have been prescribed as to what may comprise these non-financial measures. Poorly designed non-financial performance conditions will not address the risks associated with misconduct and, in some instances, may actually result in worse risk outcomes. The academic paper ‘On the folly of rewarding A, while hoping for B’[1] shows that reward systems that are not clearly aligned to their objective fail.

Performance conditions only take into account the specific metrics that go directly to the calculation of that performance condition. They do not consider whether the condition has improved risk practices or reduced misconduct. For example, The Prudential Inquiry into the Commonwealth Bank of Australia (CBA) report highlights that CBA maintained high Net Promoter Scores, while at the same time having customer complaints that had not been “promptly or effectively addressed.” This is an example where a non-financial performance metric was achieved but did not reduce misconduct or non-financial risk.

- *Increase the likelihood of incentives being paid:* APRA’s proposal for organisations to incorporate a minimum of 50% non-financial measures could result in most, if not all, incentive structures operating as if they had a performance “scorecard”. The portfolio effect of this will mean participants are more likely to meet some of the KPIs more regularly, resulting in more regular and potentially higher incentive payments than under current arrangements.

- *May make incentives unaffordable for entities* – Financial performance conditions ensure that organisations can afford the incentives. De-emphasising financial measures to no more than 50% of total measures could result in incentive payments being made irrespective of financial performance or the entity’s capacity to pay. For example, if a company underperformed on financial measures due to a risk breach but met targets for non-financial measures unrelated to the risk breach, incentive payments would be made. Therefore, companies may need to review funding decisions and arrangements.

- *Stifle innovation in remuneration arrangements designed to enhance non-financial outcomes* – APRA’s prescriptive approach may limit the variety of incentive arrangements currently in place to improve risk outcomes (e.g., the use of gateways and modifiers, application of financial affordability criteria to incentive pools, a move to profit share arrangements). Proscriptive changes can result in negative unintended consequences rather than focusing entities directly on improved non-financial risk management.

- *Puts APRA regulated financial institutions at a competitive disadvantage* – the 50% financial condition limit applies to all remuneration arrangements within an APRA regulated Group. This would, for example, limit a fund manager employed by such an entity from being wholly incentivised for the performance of the fund that they manage. Yet the financial condition limit would not apply to the many fund managers that are not employed by APRA regulated entities. Similar situations would arise across the industry, for example between entities and non-bank lenders, and entities competing overseas.

[1] On the folly of rewarding A, while hoping for B. Kerr, Steven. The Academy of Management Executive; Feb 1995

1.2.3 We have seen a marked increase in the use of Board discretion

In its review of remuneration arrangements in large financial institutions, APRA found an absence of significant downward adjustment of remuneration at executive level, which may have lead to the conclusion that discretion is not a useful tool for oversight of remuneration outcomes.

EY has noted a significant change in how remuneration adjustment provisions are considered and used. At the time the remuneration review was conducted by APRA, entities typically considered the application of downward adjustment of remuneration to be for significant circumstances only, largely reflecting guidance from APRA. For example:

- To protect the financial soundness of the entity (CPS 510, SPS 510);
- Subdued or negative financial performance of the entity (PPG 511 Attachment 2); and
- Where the individual has been found to have exposed the institution to risk beyond its risk appetite or control (PPG 511, SPG 511).

As can be seen, a high bar was set by the regulator as to when a remuneration reduction should be affected. However, since the report on remuneration arrangements in large financial services was released in 2018, and APRA's Inquiry into CBA, a significant shift has occurred in how entities review remuneration outcomes, with a broader range of inputs now considered (e.g., risk and conduct). EY suggests that APRA review the recent remuneration reports of the major banks who have disclosed the number of remuneration adjustments, highlighting the application of remuneration adjustment provisions and the effectiveness of Board discretion as a solution.

The other change is the introduction of the BEAR regime, and accountability statements for Directors that highlight their role in remuneration oversight.

EY has worked with entities to draft consequence management frameworks and malus provisions. We consider a principles-based approach, which allows for Board discretion, is more effective than a prescriptive approach, as it allows the Board to consider a variety of factors and the specific circumstances of each incident. It is incredibly difficult to foresee the range of circumstances in which an entity may wish to consider adjusting remuneration based on risk outcomes or performance, and specifically adding a risk KPI invariably leads to circumstances not being captured.

Some trade off between positive and negative practices is invariably required; for example, where a risk incident occurs that is outside tolerance, but is remediated quickly and effectively in accordance with the risk management policy (or vice versa). The range of factors that relate to any one risk incident can only be effectively assessed through a principles-based framework with discretionary overlay.

1.2.4 An alternative approach to limiting the use of financial performance conditions

There is a disconnect between APRA's stated aim in better management of non-financial risk and the proposal to limit the use of performance conditions.

EY considers that the policy objective could be achieved through the use of board discretion and a focus on remuneration outcomes. As part of draft CPS 511, APRA has established a framework to enable this, which we proposed be expanded to include:

- Entities and their Boards be responsible for aligning remuneration outcomes to non-financial risk outcomes;
- The alignment be monitored through annual Board reporting and the tri-annual effectiveness review;
- Directors be accountable for outcomes through BEAR accountability statements;
- Entities be required to disclose (in aggregate and in non-identifiable terms) the remuneration outcomes applied (the number of assessments, but not the individual remuneration quantum); and
- This be a focus of APRA's proposed review of draft CPS 511 three years after implementation.

The proposed approach is consistent with the BEAR regime, as noted in paragraph 1.72 of the BEAR Explanatory Memorandum:

> If an accountable person engages in behaviour inconsistent with their BEAR obligations then the ADI is obliged to withhold the accountable person's variable remuneration with the amount withheld to be proportionate to the severity and consequences of the breach.

Our proposed framework ensures Boards are accountable for monitoring and holding executives and employees accountable for the performance (including appropriate risk management) of the business, in a way that is aligned to its unique strategy.

1.3 The 6 or 7 year deferral timeframe

1.3.1 The proposed change

Draft CPS 511 sets deferral timeframes for significant financial institutions – 40% (for Senior Managers and Highly Paid Material Risk Takers) and 60% (for CEOs) of total variable remuneration must be deferred for 6 or 7 years respectively (with tranche vesting available after 4 years). The Discussion Paper states that the policy intention is to ensure that sufficient time is available to make necessary adjustments to variable remuneration if misconduct is uncovered.

EY supports the policy intention but considers that the deferral timeframe is too long. For example, BEAR has the same policy intention, yet sets a four year deferral. We propose that APRA rely on the 4 year deferral period, and augment that with a 2/4 year clawback period. Once BEAR has been fully implemented APRA could review industry practice to determine whether the 4 year period has met the stated policy intention.

1.3.2 The proposed 6 or 7 year deferral timeframe is too long

EY considers that the increase to the deferral timeframe may:

- *Increase pay in the financial services sector* – Given the time value of money, longer deferral means that the present value of remuneration will reduce. In our experience, in order to effectively compete for talent in the market, entities will increase remuneration quantum to compensate employees for this reduction, resulting in an overall increase in remuneration in financial services. We note, time value is a much lower discount than actual value.

APRA regulated entities compete with broader financial services organisations and general industry for talent. Potential employees will typically choose the shorter deferral and clawback periods, and less pay at risk of being reduced, which is available in organisations not subject to draft CPS 511. APRA regulated entities may therefore need to pay more to attract talent from broader industry.

- *Reduce competitiveness in the financial services sector* – draft CPS 511 applies to the international operations of Australia's financial entities. Requiring entities to apply draft CPS 511 in their international operations will significantly disadvantage Australian businesses in attracting talent, when compared to their competitors, thereby reducing the competitiveness of the APRA-regulated Australian financial services sector.

  A recently appointed CEO remarked to EY that he would never have moved to Australia had he known that draft CPS 511 was imminent, given that any remuneration earned will be deferred for seven years (which may be long after the executive has completed their Australian role).This example supports the argument that if draft CPS 511 is introduced in its current form, this will impact the attraction of global talent to the Australian financial services industry.

  Based on average CEO tenure of 6 years (amongst ASX 100 APRA regulated entities, since 2000, excluding current incumbents), the average CEO will be entitled to vesting of only 25% of their deferred incentive during their tenure (assuming all performance conditions are achieved). As a result, entities may struggle to attract key talent, who could take roles with non-APRA regulated entities and be entitled to vesting of more of their incentives over the same tenure. Under BEAR, CEOs would be eligible for 50% of their deferred incentive during a 6 year period.

  The proposed 6 or 7 year deferral period and pro rata vesting after four years is also longer than international requirements and consistent across financial services industries (e.g., between insurance companies and banks). For example:

  - For banks in the European Union (EU), the deferral period is currently 3 – 5 years (and will be extended to 4 – 5 years in December 2020) under the Capital Requirements Directive[2],
  - For banks in the United Kingdom (UK) under Prudential Regulation Authority (PRA) and Financial Conduct Authority remuneration rules, the deferral period is 5 or 7 years. Further, while a 7 year deferral period applies to Senior Managers of banks in the UK, pro rata vesting is available after 3 years (rather than 4 years, as proposed by APRA).
  - For insurance companies in the EU and UK under PRA Solvency II remuneration requirements, the deferral period is 3 years.

  Therefore, if APRA were to introduce 6 or 7 year deferral periods and pro rata vesting after four years, this will impact the attraction of global talent to the Australian financial services industry.

- *Increase member fees in superannuation* – EY notes the increasing trend of superannuation funds internalising asset management in order to reduce fees for members. Mandating how and when

[2] We note, APRA outlines in Figure 6 of *Discussion paper: strengthening prudential requirements for remuneration* dated 23 July 2019 that the deferral period for CEOs in Europe is 7 years.

asset management staff receive variable remuneration may result in superannuation funds losing talent to asset managers that are not APRA regulated, with funds shutting down their in house management functions, and member fees increasing as a result.

- *Result in tax liabilities where an executive ceases employment* – draft CPS 511 states an entity must not accelerate vesting of unvested variable remuneration where a person ceases employment (unless under ‘good leaver’ circumstances). However, tax is typically triggered on equity incentive awards upon cessation of employment (regardless of whether the award has vested). As such, an executive with a 6 or 7 year deferral period may be liable for tax well before they are able to realise value from their incentives. Additionally, if malus or clawback is triggered at a later time, the tax paid by the employee prior to the award vesting would not be refunded by the Australian Taxation Office, so the employee would be out of pocket.

- *Create unnecessarily long deferral arrangements for smaller institutions captured in the SFI definition* - the current definition of SFIs captures too large a basket of entities and proposes deferral period timeframes which are not appropriate for smaller organisations which are likely to have less of an impact on the financial services industry. It would be more suitable for smaller entities currently captured in the SFI definition to demonstrate how they have reflected the time horizon of risks relevant to the business portfolio in their variable remuneration design, rather than align to prescriptive timeframes suitable for larger and more complex institutions.

The Discussion Paper uses LIBOR manipulation as an example to justify longer deferral periods. It notes that there was evidence of misconduct as early as 2005, but that this was not reported to regulators until late 2007. It is important to note that if this were to occur now in Australia:

- The misconduct would be within the 4 year BEAR deferral period, allowing the entity to apply a remuneration consequence;

- The entity would be required to report the misconduct to APRA under BEAR for the relevant Accountable Person.

The deferral arrangements should be seen in light of the overlapping obligations with BEAR.

1.3.3 BEAR has the same policy intention

The Parliament recently passed the BEAR regime for ADIs and has announced that this regime will be expanded to other APRA regualted entities. BEAR requires that entities defer variable remuneration for at least 4 years. The Explanatory Memorandum for the BEAR regime stated that the 4 year deferral period:

> ... ensures that accountable persons have clear incentives to make decisions which account for longer term effects. It also ensures that accountable persons are properly held to account for those decisions that have negative future consequences

BEAR also allows entities to set longer deferral periods to align with their risk horizon.

BEAR has not yet been fully implemented across ADIs, nor across the industry. Given that both regimes are seeking the same policy intention it may be preferable to allow BEAR to be implemented, and then review whether the policy intention has been met. The review could form a fact base for what the appropriate timeframe for deferral should be.

1.3.4 An alternative approach

EY proposes that APRA:

- Rely on the 4 year minimum deferral timeframe under BEAR, with a 4 year clawback period.
- Increase guidance for future BEAR implementations that the intention is to align remuneration and risk horizons.
- Wait until BEAR has been extended to the financial services industry and review whether the 4 year deferral period has met the policy intention. If not, use this research to determine an appropriate deferral timeframe.
- Limit the SFI definition to focus on large and complex entities who are likely to have a material and systemic impact on the financial services industry. APRA may wish to align their definition of an SFI with the BEARs definition of a "large ADI"[3].

1.4 Clawback

1.4.1 The proposed change

Draft CPS 511 requires that variable remuneration paid to a CEO, Senior Manager, or Highly Paid Material Risk Taker of a Significant Financial Institution, must be subject to clawback for 2 years, or 4 where a person is under investigation.

We understand that the intention is to allow a portion of remuneration to remain 'at risk' post vesting/payment.

1.4.2 The proposed timeframe is too long

While clawback is untested in Australia, EY considers it to be likely enforceable in Australia, due to enforcements in other common law jurisdictions. We note, a number of changes may be required by companies to enforce clawback on fixed and / or variable remuneration (e.g., introduction of trading restrictions on shares to prevent employees from selling shares prior to the end of the clawback period).

However, the timeframe proposed, in addition to the 6 or 7 year deferral period, is too long. The timeframe will mean that entities may be unable to enforce clawback due to timing enforced by the *Limitation of Actions Act 2008* (Cth). APRA proposes that entities amend their incentive plan rules and employment contracts in order to be able to enforce clawback. Given that each of these are contracts, they are subject to the Statute of Limitations. This Act states that a party to a contract has six years to bring an action from the date the cause of action arose. Given this, an 11 year clawback period (7 years

[3] BEAR defines a large ADI as an ADI that has 'total resident assets value' greater than or equal to $100 billion.

deferral and 4 year clawback) is too long to be practically workable before the action becomes statute barred.

As mentioned in Section 1.3, the proposed SFI definition captures a large basket of entities. Smaller and less complex entities captured in the proposed definition of SFIs should be able to design flexible clawback mechanisms, which best suit their circumstances and business environment.

1.4.3 An alternative approach

EY propose that APRA rely on the 4 year deferral timeframe under BEAR. If this approach is adopted, a 2 / 4 year clawback period is appropriate (noting that a 4 year clawback period will extend the total period (4 years deferral and 4 years clawback) beyond the 6 year *Limitation of Actions Act 2008* timeframe).

We do not support a 2 or 4 year clawback period on top of a 6 or 7 year deferral period. This is too long and likely to be unworkable.

As mentioned in Section 1.3, EY propose that APRA limit the SFI definition to focus on large and complex entities who are likely to have a material and systemic impact on the financial services industry.

1.5 Application to third parties

1.5.1 The proposed change

Draft CPS 511 requires that an entity include in its written Remuneration Policy:

> The structure and terms of arrangements that apply to a person… employed by… a body that is not a related body corporate… and which has a service contract with the entity where… the primary role of the body is to provide risk management, compliance, internal audit, financial control or actuarial control services to the entity."

EY is concerned that the expanded wording requires entities to include the details of the third-party's employee remuneration in the entity's remuneration policy.

1.5.2 The proposed change is impractical

EY considers this requirement is unworkable and impractical:

- It is not appropriate for third party remuneration arrangements to be captured by an entity's remuneration policy. In some cases, the third-party's remuneration arrangements will be more complex than the entity to which it provides services.
- It will make remuneration policies too long, given an entity that obtains services from a number of service provides will have extensive provisions in its remuneration policy.
- A third party could be subject to conflicting remuneration policies of two or more regulated entities.
- A third party may be legally unable to provide the remuneration information due to the application of privacy laws.

1.5.3 An alternative approach

EY proposes that the entity be responsible for overseeing the structure of payments between the entity and service provider (not the remuneration of the service providers’ employees), to ensure those payments are in line with the remuneration objectives. This would satisfy the policy intention and limit the impact on entities.

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2. Responses to questions posed by APRA

2.1 Remuneration framework

2.1.1 Is triennially an appropriate frequency for conducting independent reviews of the remuneration framework?

EY considers three years an appropriate frequency.

EY notes that CPS 220 (Risk Management) also requires that an independent review be conducted every three years. Although these reviews are only entering their second cycle, EY has noted increased importance placed on risk management by the entities, their boards, and the Regulator. Given this, a similar cycle for remuneration is appropriate.

2.1.2 What areas of the proposed requirements most require further guidance?

EY suggests that the areas most requiring further guidance are:

Application to fixed pay only remuneration frameworks

A number of the entities that will be subject to the draft Standard do not operate a variable remuneration structure. APRA should provide guidance on how these entities should achieve APRA's policy objectives and apply the Standard. For example, how fixed pay is reviewed and increased, how performance is measured, and how employees are recognised and promoted may all give rise to similar issues as variable remuneration.

Financial performance measures

If APRA maintains the limit on the application of financial performance measures, EY suggests that APRA provide guidance on how the following would be treated:

a) conduct/risk gateways (i.e. a condition that must be met in order to be eligible for variable remuneration)

b) conduct/risk modifiers (i.e. a leaver to vary a remuneration outcome based on conduct and risk factors)

c) financial limits on a performance pool (i.e. a financial performance threshold an entity must meet before any incentives will be paid)

For example, would (a) and (b) be considered non-financial measures? Would (c) be treated as a financial measure given it determines the pool rather than the individual outcome? What portion of variable remuneration would (a), (b) or (c) impact?

Financial and Risk adjusted performance measures

APRA is proposing in draft CPS 511 to limit the use of financial metrics that are not risk adjusted. It would be useful for APRA to issue further guidance on what would be considered a 'financial measure' and a 'risk adjusted measure'.

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For example:

- *Share price* - A company's share price is typically valued by market participants using a pricing model incorporating the 'risk free rate'. Therefore share price is commonly considered to be 'risk adjusted'.

- *Total shareholder return (TSR)* - TSR is commonly considered a market, investment return measure, rather than a financial measure (including by the Australian Accounting Standards).

Additional guidance would include examples of financial risk adjusted measures.

APRA also seeks to limit the weighting of any single financial condition to 25% of the total conditions applying to variable remuneration. It would be useful for APRA to clarify how this may work in practice where conditions are similar, for example:

- *Relative Total Shareholder Return* – where the return of the company is tested relative to a comparator group of companies; and

- *Absolute Total Shareholder Return* – where the return of the company is tested against a target specific to the Company.

Additionally, it would be useful for APRA to clarify whether the weighting on any single financial condition is calculated as a simple aggregate of the number of measures or as a dollar weighting. APRA should also clarify when the weighting is determined (e.g., at the time of the award being communicated, measured or paid).

2.2 Board oversight

2.2.1 Are the proposed duties of the Board appropriate?

EY considers that the duties of the Board are appropriate and aligns with what EY understands are leading practices amongst APRA regulated entities.

One unintended consequence could be that the additional requirements increase the time commitment of Directors.

2.2.2 Are the proposed duties of the Board Remuneration Committee appropriate?

EY considers that the duties on the Remuneration Committee are appropriate and align with what EY understands are leading practices amongst APRA regulated entities.

EY suggests that the requirement that Boards receive comprehensive reporting to allow it to assess whether remuneration outcomes of all remuneration arrangements align with the entity's remuneration objectives (clause 29) be reconsidered. In practice this will be an onerous task for larger organisations. Instead, the Board should consider the findings of the independent effectiveness review and an overview of remuneration arrangements and payments in the organisation.

2.3 Remuneration design

2.3.1 APRA is proposing that financial performance measures make up no more than 50 per cent of variable remuneration measurement and individual financial performance measures are limited to 25 per cent:

- **Is this an appropriate limit?**

EY does not support limiting the use of financial performance measures. Refer to section 1.3.

- **If not what other options should APRA consider to ensure non-financial outcomes are reflected in remuneration?**

EY considers that the policy rationale could be achieved through board discretion and a focus on remuneration outcomes:

- Entities and their Boards be responsible for aligning remuneration outcomes to non-financial risk outcomes;
- The alignment be monitored through annual Board reporting and the tri-annual effectiveness review;
- Directors be accountable for outcomes alignment through BEAR accountability statements;
- Entities be required to disclose (in aggregate and in non-identifiable terms) the remuneration outcomes applied (the number of assessments, but not the individual remuneration quantum); and
- This be a focus of APRA's proposed review of draft CPS 511 three years after implementation.

APRA should refer to the annual reports of the major banks to see how Board discretion can work in practice.

Refer to section 1.2 for further information.

2.3.2 What would be the impacts of the proposed deferral and vesting requirements for SFIs?

EY considers that the proposed deferral requirements are too long. EY proposes that instead, APRA rely on the BEAR legislation limits. Refer to section 1.5 for further information.

2.3.3 For ADIs, what would be the impact of implementing these requirements in addition to the BEAR requirements?

The main impact is complexity. Entities will be required to classify individuals into various populations that overlap. Different remuneration rules will apply depending on whether:

- *the person is an accountable person under to BEAR* – 4 year deferral, a portion of remuneration deferred, and remuneration reduction for breach of accountabilities;
- *the person is a Senior Manager or Highly Paid Material Risk Taker* - limit on use of performance conditions, 6 or 7 year deferral, a portion of remuneration deferred (and a different proportion than under BEAR), 4 year clawback, individual review of remuneration outcomes;

- *Material Risk Taker* – limit on the use of performance conditions, aggregate review of remuneration outcomes;

- *Risk and Financial Control Personnel* - limit on the use of performance conditions, aggregate review of remuneration outcomes, remuneration not influenced by the performance of the business;

- *Not a classified employee* - limit on the use of performance conditions.

Keeping on top of these cascading obligations will be difficult, particularly where a person may fall within multiple categories, and moves roles within an organisation. The changes are unnecessarily complex and will be difficult to comply with in practice. EY suggests APRA harmonise role categories with BEAR requirements.

We also note the following inconsistencies between BEAR and draft CPS 511:

- Differences in application – BEAR applies to Accountable Persons, whereas draft 511 applies to different classes of person. This will create complexity for entities where a person may fall into multiple categories. APRA should consider harmonising the applicable persons between draft CPS 511 and BEAR, particularly as the accountability regime is expanded to all APRA-regulated industries;

- Deferral amount – the amount of variable remuneration required to be deferred and the basis of calculation differs between BEAR and CPS 511.

- Deferral start date – The wording as to when the deferral period starts differs between BEAR ad CPS 511. We suggest this be harmonised.

- APRA declarations – BEAR contains the ability for APRA to declare that a particular arrangement is/is not variable remuneration. A similar provision does not appear in draft CPS 511.

2.3.4 Would the proposals impact the industry's capacity to attract new staff?

We consider that draft CPS 511 will impact the ability for the industry to attract and retain key staff. Refer to Section 1.3.2 for further information.

2.4 Remuneration outcomes

2.4.1 What practical hurdles are there to the effective use of clawback provisions and how could these be overcome?

Refer to Section 1.4.2.

2.4.2 Would requirements for longer vesting where clawback is not preferred address these hurdles?

EY considers that the proposed 6 or 7 year deferral period is too long. APRA should rely on the 4 year BEAR period. A 4 year clawback period in addition to the 4 year BEAR deferral period is sufficient.

2.4.3 What transitional provisions may be necessary for particular components of the new standard or for particular types of regulated entities?

APRA could consider the following transitional provisions:

- APRA should consider staggering the implementation of a longer deferral period (e.g., 6 or 7 years) given it will decrease variable remuneration quantum by 20% over any 4 year period.
- Given company performance periods typically align with financial years, APRA should consider adjusting the application timeframe of the new standard to be the first financial year following 1 July 2020 rather than from 1 July 2020. This will ensure companies with financial years commencing after 1 July 2020 will only be required to apply the standard for full performance periods.
- Limit retrospective application of the standard to reduce complexity in application by entities.
- Adjust taxing points to limit tax liabilities where an executive ceases employment (see Section 1.3.2 for further detail).
- When reviewing the application of remuneration effectiveness reviews, APRA should consider that initially companies may need to complete various areas of a remuneration effectiveness review over multiple years, as a result of limitations with systems and data.

2.5 Transparency

2.5.1 What disclosures would encourage market discipline in relation to remuneration practices?

Currently the disclosure requirements differ amongst entities creating an uneven disclosure, depending on whether an entity is listed, required to disclose to members, unlisted, or part of an international group.

EY suggests that regular reporting by entities of remuneration practices to the Regulator, may be a more effective approach than requiring entities to disclose remuneration practices. APRA could use the reporting by entities to publish best practice remuneration guides.

We note, APRA will be conducting further discussions regarding disclosure of remuneration practices and requirements may change.