Equity Trustees

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General Manager
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Dear Sir/Madam

Submission in response to APRA's Discussion Paper on "Strengthening prudential requirements for remuneration" and Draft Prudential Standard CPS 511 (*collectively referred to as "Draft Standard"*)

EQT Holdings Limited (Equity Trustees) was established as an independent trustee and executor company in 1888 and has become one of Australia's leading trustee companies. We help our private and corporate clients grow, manage and protect their wealth now and for generations to come. Our mandate is to always act in our clients' best interests, ensuring they feel safe, valued and cared for. Equity Trustees holds, through our subsidiary, Equity Trustees Superannuation Limited, a Registrable Superannuation Entity Licence, acting as trustee for 14 superannuation funds.

The Board of Equity Trustees is a strong advocate of excellent corporate governance, including remuneration practices. We believe our current remuneration framework and governance practices are effective in their current form – it has rewarded Executives when the Company has performed strongly against its balanced scorecard (a mixture of both financial and non-financial measures) and has not rewarded Executives when the Company has not. Our governance processes have always placed beneficiaries' needs above the trustee's. We understand the same cannot be said for a select number of other organisations in the financial services industry.

There are many legislative requirements, standards and guidance notes in APRA-regulated industries, however, as a professional trustee, many of these simply codify what a professional trustee should practice without guidance. A professional trustee should always organise itself to place beneficiaries' interests above all else and design all aspects of its business for this to happen, including its remuneration practices. A trustee's remuneration practices and incentives should appropriately balance the needs of beneficiaries and the trustee, be designed to avoid conflicts and to reward the right behaviours.

Equity Trustees is supportive of having in place well-designed remuneration arrangements and is very disappointed that the practice of some trustees has caused APRA to introduce the above Draft Standard. Equity Trustees is very supportive of ensuring that appropriate remuneration practices operate in the superannuation industry, however, we do not support the highly prescriptive proposals in relation to remuneration design, outcomes and deferral

and clawback proposed in the Discussion Paper. Unlike participants in APRA's other supervised industries, ***superannuation trustees already have a legally enforceable obligation to act in members best interests***. Therefore, it is highly questionable whether the introduction of significant cost and complexity in the structure and administration of remuneration arrangements for superannuation trustees will result in materially improved member outcomes.

Superannuation Industry Impact

Ahead of detailing our specific comments on the Draft Standard, Equity Trustees makes two observations of the impact the Draft Standard will have on the superannuation industry:

1. The proposed Draft Standard has the effect of making remuneration packages in the superannuation industry less attractive than in non-APRA regulated industries. Naturally, this will lead to executive talent choosing to pursue careers in non-APRA regulated industries.

   At a time where APRA has been concerned about the performance of trustees in parts of the superannuation industry, this Draft Standard further shifts the attractiveness of pursuing a career in a non-APRA-regulated entity.

   This will weaken trustee oversight and place trustees at a disadvantage to their service providers. This will, no doubt, weaken member outcomes.

2. The Draft Standard is unnecessarily complex and will increase the administrative burden on trustees. The expense associated with an increase in administrative burden is always borne by members.

   Equity Trustees strongly encourages APRA to simplify the Draft Standard and reduce its complexity.

Specifically, we make the following detailed comments.

1. **The Draft Standard will make it *very* difficult to attract <u>and</u> retain talent in APRA-regulated entities**

   In the Discussion Paper, APRA specifically request feedback on whether the proposals "*would impact the industry's ability to attract skilled executives and staff.*" The proposals categorically will.

   Perhaps the most pertinent example of this risk is in Investment Management where superannuation trustees are competing with non-APRA regulated entities to attract talent and have historically struggled to do so. We do not believe that many talented executives and employees would be prepared to wait a minimum of three or four years to start receiving a pro-rata component of their variable remuneration (*refer point 2 below*) if they have the opportunity to work in similar roles without such a

deferral period. Given the direct correlation between investment returns and member outcomes this has the potential to result in poorer member outcomes both through failure to attract talent and/or the reversal of the trend towards insourced investment management.

In addition to difficulties attracting talent, we believe the industry would also struggle to retain top talent, for the same reasons.

An inability to attract and retain skilled executives in other capacities will also occur. For example, executives who have superior skills in, say, leadership, custody, insurance, service, administration, etc., can all work in the superannuation industry but not be subject to APRA oversight. The proposed Draft Standard will clearly drive talent out of RSE licensees. The impact is likely to mean that trustees will have less skill and talent than the providers they oversee which will not assist member outcomes. Skilled executives and employees are *exactly* the type of people APRA will need in organisations to ensure that the interests of beneficiaries are paramount.

Finally, APRA should clarify the intent of paragraph 61 – if it is to remove the protection of professional indemnity insurance for directors and officers from executives this will likely increase the cost of fixed remuneration and drive more conservative candidates from APRA regulated industries, a result which is at odds with improving member outcomes and protecting member interests.

2. **The Draft Standard does not contemplate organisations like Equity Trustees where only a subsidiary is regulated by APRA**

Equity Trustees Superannuation Limited (ETSL) is an RSE licensee and subsidiary of EQT Holdings Limited. EQT Holdings Limited is not APRA-regulated however ETSL is. The Draft Standard does not contemplate this type of corporate structure, as it assumes the head of the group is also APRA regulated.

In many respects, APRA has been increasingly enforcing governance separation of RSE licensee subsidiaries from their parent. Yet in this instance, APRA wants to pull other non-dedicated RSE licensee executives into the accountability regime but deny them any influence in managing the RSEs. This is clearly inconsistent and sends mixed messages to businesses overseeing RSE licensee activities.

In addition to the matters raised in point 1 above, this would likely result in multiple remuneration frameworks and non-alignment between members of the Executive, both in terms of performance objectives and remuneration outcomes. From a shareholder's (i.e. EQT Holdings Limited) perspective, this is highly undesirable and not conducive to creating a cohesive working environment or ensuring the long-term viability of an organisation. We encourage APRA to consider providing an exemption or framework equivalent approval for APRA-regulated entities that are a subsidiary of a holding company.

3. **The proposed deferral periods are too long and the small differential in deferral periods between CEOs and Executives is pointless**

   Again, APRA have sought feedback on the "*impacts of the proposed deferral and vesting requirements for SFIs.*" Put simply, the deferral periods are too long. As indicated above, we do not believe that Executives and CEOs will wait a minimum of three or four years respectively to start receiving their variable remuneration and a further two or three years for full vesting, when they have the ability to work in the non-APRA regulated environment. A six to seven-year period is too long to focus the attention of almost all Executives and not useful to driving a long-term, successful operation.

   The extended deferral period is likely to be ineffective in motivating executives, which will potentially result in some trustee companies being unprofitable and unviable, which will negatively impact members in the longer term. Notwithstanding our comments about retention, it is unrealistic to think that executives (including CEOs) will remain in an organisation for six or seven years and it is often undesirable from a risk management perspective for them to do so. The current proposals would stem a healthy level of turnover.

   Finally, the differential in deferral periods between CEOs and executives is small given the difference in roles and responsibilities and is pointless. Our view is that if deferral periods are mandated, payments should be able to begin vesting after one year and be able to be fully vested by the end of year four and there should be no differential between CEOs and executives.

4. **The percentage of variable remuneration that is deferred should be relative to the size of variable remuneration**

   We understand that APRA is not intending to constrain the overall amount of remuneration. In its current form, however, the Draft Standard proposes to defer 60% of variable remuneration for CEOs and 40% for Executives. These percentages are irrespective of the quantum of variable remuneration.

   In our experience, there is a significant difference in the quantum of variable remuneration for similar roles in the industry (*for example, for CEOs it can range between 50% and 200% of fixed remuneration for variable incentives*). Rather than having deferral percentages based on role, we encourage APRA to consider a framework where deferral is greater when variable remuneration is 150% or greater of Total Employment Cost and have no deferral when variable remuneration is much smaller at, say 25% or less (and pro-rata in-between).

   In addition, Equity Trustees believes that the $50,000 minimum for deferral is too small and will unintentionally capture employees who do not have any real control over the activities of the company. As mentioned at the start of our letter, it will also

be an administrative burden for employers and drive up costs unnecessarily for members.

5. **The limit of 25% for individual financial measures is not necessary and will not be a good use of remuneration spend in many organisations**

   The Draft Standard calls for a 50% limit on financial measures, but with no single measure to exceed 25%.

   Equity Trustees has recently reviewed its Long-Term Incentive Plan and the review showed there is no second financial measure that is fit-for-purpose for our organisation, and it would not be a good use of our remuneration spend to introduce as second measure for no value-adding reason. For EQT Holdings Limited, and no doubt, many proprietary companies, growth in Earnings Per Share is the prime driver of shareholder value creation and is a measure most able to be influenced by executives and there is no need for any second measure.

   Equity Trustees is supportive of and currently practices a balanced scorecard approach, however we would suggest an overall limit of 50% on financial measures is sufficient without further stipulating the number of measures to be included within the 50%.

6. **It is unrealistic to expect RSEs (and RSE Licensees) to oversee the remuneration practices of third-party providers**

   Paragraph 19(d) of the Draft Standard calls for trustee oversight of remuneration arrangements of outsourced service providers.

   Oversight of third-party providers is a fundamental role of RSE Licensees. However, this should not extend to oversight of remuneration frameworks of third-party providers. RSE Licensees do not have any influence over the remuneration practices of their providers, even if their practices were considered inappropriate. As an RSE Licensee, Equity Trustees performs extensive due diligence on third-party providers prior to appointing them, and throughout the course of the service agreement. If their remuneration practices were relevant to the service delivery, they would be considered in the normal course of the third-party appointment process. The extension of requirements to specifically oversight remuneration practices would materially increase cost, have little impact and therefore ultimately be detrimental to member outcomes.

We are of the strong view that many of the superannuation issues explored at the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, and which APRA are attempting to address through the Draft Standard, resulted from a failure to appropriately manage conflicts of interest and/or conflicts resulting from structural considerations (for example, vertical integration). Many of the new requirements of the Draft Standard relate to variable remuneration and infer that these new requirements

may prevent misconduct from occurring and/or that misconduct is less likely to occur where there are limited variable remuneration arrangements. However, we would submit that a more effective mechanism to avoid such instances would be taking steps to address the structural conflicts of interest in the industry.

Equity Trustees is comfortable for this submission to be published on the APRA website.

In addition, we would welcome the opportunity to meet with you in person to discuss our submission. It is important for the future of our industry that we get this right.

Yours faithfully