NORGES BANK
INVESTMENT MANAGEMENT

Australian Prudential Regulation Authority
Policy and Advice Division
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Australia

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APRA consultation on remuneration requirements

We refer to the *consultation on remuneration requirements for all APRA-regulated entities*, published by the Australian Prudential Regulation Authority (APRA) on 23 July 2019. We appreciate the opportunity to contribute our perspective on executive remuneration specifically.

Norges Bank Investment Management (NBIM) is the investment management division of the Norwegian Central Bank and is responsible for investing the Norwegian Government Pension Fund Global. NBIM is a globally diversified investment manager with 18 billion AUD invested in equities and 11 billion AUD in bonds in Australia. We are a long-term investor, working to safeguard and build financial wealth for future generations.

Following the introduction of "say on pay" in many markets, NBIM published its views on executive remuneration in 2017[1]. Our starting point is that a CEO's remuneration package should 1) be driven by long-term value creation and 2) align CEO and shareholder interests.

To achieve this, we recommend a simple approach where part of the total annual remuneration is paid in cash and a substantial proportion of the total annual remuneration in shares of the company, locked-in for five to ten years. The lock-in should be maintained beyond resignation or retirement. Requiring the CEO to invest a meaningful part of his or her remuneration in company shares is a transparent way of aligning the interests of the CEO with those of shareholders and the wider society.

We understand that share returns may not be a perfect gauge of the performance of a CEO, as non-controllable factors may drive share prices. However, we believe that the total return on shares in the long run reflects the value of the company for shareholders and society at large.

Investors need greater transparency to evaluate and vote on remuneration plans. Transparency will also limit the prospect of unanticipated and outsized awards. Therefore, we expect the board to disclose the CEO's total annual remuneration and set a ceiling for the

[1] NBIM, position paper on CEO remuneration, 2017

coming year. The total annual remuneration may contain a variable element, which reflects strategic, operational and financial achievements in the previous year, but this should not go beyond the stated ceiling.

We note APRA's proposal to revise the regulatory framework for remuneration for APRA regulated entities. We welcome its efforts to encourage sound management of non-financial risks and reduce the risk of misconduct. We also agree with APRA's observation that the growing use of complex incentive structures could lead to unintended consequences.

In the consultation document, APRA proposes a new approach to variable remuneration. While we understand APRA's objective, we believe the proposed remuneration design does not address the issues of complexity and opacity that we often observe in current remuneration practices. In our view, long-term incentive plans, with a series of performance conditions over many years, may result in unbalanced outcomes. These plans tend to have complex and opaque metrics that are open to discretion, and boards often adjust, supplement and rebalance metrics during the measurement period. This may also be the case with non-financial metrics – especially if the chosen criteria are not challenging, measurable and comparable.

Therefore, we encourage APRA to invite companies to move away from long-term incentive plans and to introduce a simpler framework for executive remuneration, comprised of salary and restricted shares that vest over a minimum of five years, and preferably longer. Concerning post-vesting retention periods, we welcome APRA's proposal to set minimum deferral periods up to seven years for senior executives.

Finally, APRA proposes to mandate board responsibility for the overall remuneration framework. We believe in a clear division of responsibilities between the board and management. In our view, management has the responsibility and necessary qualifications for defining pay policies across the wider work force, while the board, assisted by the remuneration committee, is best placed to set the remuneration for the CEO and be involved in the remuneration for other top executives.

We appreciate your willingness to consider our perspective, and we remain at your disposal should you wish to discuss these matters further.

Yours faithfully,

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