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

By email PolicyDevelopment@apra.gov.au

Dear Sir/Madam,

Re: Strengthening prudential requirements for remuneration (CPS511)

We refer to the Australian Prudential Regulation Authority (APRA) Discussion Paper published 23 July 2019 regarding strengthening prudential requirements for remuneration across all APRA-regulated entities in the banking, insurance and superannuation industries by issuing a new prudential standard on remuneration (CPS511).

nib welcomes the opportunity to share our views and insights with APRA in relation to the proposed new prudential standard and supports APRA's objective to better align the interests of financial institutions with those of our stakeholders, including members, customers, shareholders and the broader community.

Background

nib Group (nib) is an ASX Listed (ASX: NHF) private health insurer and travel insurance distributor with a market capitalisation of approximately $3.5 billion. We are a trusted international health partner with over 1.6 million members and more than 1,500 employees located in six countries around the world.

Through our success, we aspire to more prosperous and sustainable communities, not only the creation of enterprise value. We recognise that how we go about our business, including the examples we set, directly and indirectly impact the communities in which we operate and their sustainability. We reflect this in the remuneration framework applied across nib.

We're also cognisant that post the Hayne Royal Commission there's been significant criticism and debate of remuneration arrangements, particularly for Executives, and the potential bias of incentive arrangements towards financial performance.

As we've always maintained good commercial results, including remuneration, will follow being good at what you're meant to be doing; in our case protecting our members and travellers against the financial risks of disease and injury and allowing them to quickly access world class healthcare, wherever they are in the world.

Overall nib is supportive of the intent of APRA's draft CPS511 to strengthen the link between remuneration and accountability. In fact, we think we've made sound progress in recent years in aligning our Executive remuneration framework with the changes proposed by APRA in CPS511, including:

- Deferral and escrow arrangements for remuneration relating to nib's Short Term Incentive (STI) and Long Term Incentive (LTI) Plans respectively;
- Introducing clawback and malus conditions within our STI and LTI Plans;
- Applying a risk gate assessment for our STI Plan where our People and Remuneration Committee and Chief Risk Officer evaluate the risk culture and risk management to confirm Executive performance warrants award; and
- Mix of financial and non-financial performance metrics and hurdles within our STI Plan.

However, our assessment of the draft prudential standard is that it will unquestionably require some changes to our remuneration approach and framework to ensure compliance. Within this submission, we've outlined feedback we ask APRA to consider when finalising the new prudential standard.

Significant Financial Institutions

As nib is an Australian registered private health insurer (PHI) it is not categorised as a Significant Financial Institution (SFI). However, as APRA have indicated they will reassess the need to include PHIs as SFIs at a later stage, we put forward in this submission that the industries represented by SFIs and PHI differ considerably. On this basis we support the views of our representative body Private Healthcare Australia in in their submission to APRA regarding CPS511. We agree with PHA that PHI represents a lower risk compared to other financial institutions due to PHI having short-tail policy risk, relatively low financial exposure for PHI members compared to other financial sector services as well as the current level of 'high touch' regulatory supervision and approval for PHI premium setting.

We also put forward in nib's case our Executive remuneration framework, such as minimum STI deferral, escrow arrangements relating to LTI Plans, claw back and malus conditions relating STI and LTI as well as thorough risk gate assessment of Executive award, are appropriate and robust to ensure any misconduct is identified and aligned to remuneration outcomes.

Prescriptive approach to financial and non-financial performance measures

In our view, it is unnecessary for APRA through the new prudential standard to set a maximum 50% weighting for financial metrics within variable remuneration design. In recent years we've already seen a step change in boards looking to introduce non-financial metrics, including risk-based measures, within their respective variable remuneration frameworks.

And nib is no different. Currently (based on FY19 remuneration) our Executive STI Plan is structured so that on average our Executive team is weighted 57% financial and 43% non-financial/leadership, while our Chief Risk Officer is weighted 32% financial and 68% non-financial/leadership assessment.

Like nib, a lot of companies have implemented or looking to adopt similar changes to their variable remuneration design, which has been in response to market expectations, not through regulation.

For ASX-listed companies like nib and many other Australian financial institutions bound by APRA's regulatory supervision, it is a requirement to seek shareholder approval on matters relating to remuneration, including Remuneration Report (non-binding) and LTI Plan, including performance hurdles.

Through this process we engage and seek feedback with a range of stakeholders including major shareholders, proxy advisors and the Australian Shareholders Association. Shareholders have been overwhelmingly supportive of our remuneration strategy, at our 2018 AGM our Remuneration Report and LTI Plan both received over 98% approval from shareholders. This level of support has been the trend since nib listed on the ASX in 2007 and reinforces the view that we've aligned our remuneration framework with shareholder interests. This is even more poignant when you consider that 65% of our 123,000 shareholders are also nib health fund members.

On this basis we consider that there is no need for APRA to prescribe the maximum weightings of financial metrics (to no greater than 50%), instead the new prudential standard should require boards to consider the most approximate mix of financial and non-financial metrics into their variable remuneration design.

Through this process boards will be expected to take into consideration the expectations of their members, customers or shareholders, their business operating environment, community expectations as well as the life stage of the business and overall strategic alignment in setting and assessing variable remuneration performance. A prescriptive approach to setting maximum financial and non-financial performance measures, as proposed in CPS511, runs the risk that performance and reward is not aligned to the interests of all our stakeholders.

Transition arrangements and existing employment contracts and terms

While we support the intent of CPS511, we do seek clarification from APRA how it will apply to existing executive remuneration agreements and variable remuneration components currently on foot and unvested.

We propose to APRA that a phased and transitional approach be taken to implementing CPS511 and request clarification that it will not impact current variable remunerations arrangements which have been offered and subject to vesting prior to the effective date of the new prudential standard (being 1 July 2021).

Impact on Executive recruitment and retention

Aligning our remuneration and executive award framework with our overall business strategy and growth aspirations is critical to our ability to attract, motivate, develop and retain the right people to lead the nib Group. We fear the impact of CPS511 on the Australian financial services sector, including PHI, would put the sector at a material competitive disadvantage compared to other industries or geographies and subsequently impact our ability to attract and retain talent.

[redacted]

Yours sincerely,

[redacted]