17 February 2020

Mr Gideon Holland
General Manager – Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

Via email: Policy.Development@apra.gov.au

Dear Mr Holland

Consultation on remuneration requirements for all APRA-regulated entities

COBA welcomes the opportunity to provide a submission to APRA on its second-round consultation on remuneration requirements for all APRA-regulated entities.

COBA is the industry association for the customer owned banking sector. Our sector has $144 billion in assets. Uniquely, our members are owned by their customers rather than a separate set of shareholders. As a result, our model better aligns the interests of customers, our staff and the institution compared to their investor-owned peers. Many of the cases before the Royal Commission are examples of what happens where these interests diverge. Given our customer-ownership, our members are not ASX-listed ADIs and our simple remuneration structures reflect this.

COBA supports the intent of APRA's proposals. However, the implementation of CPS 511 on our sector must recognise that customer owned banking institutions bring a different model to the retail banking market. In line with this, COBA welcomes APRA's proposed proportionate approach to non-significant financial institutions and accompanying additional implementation time for non-SFIs. However, to truly recognise this mutual difference, APRA must increase the ADI non-SFI threshold to $20 billion to cover all mutual ADIs.

APRA should also ensure that any proposed disclosures are proportionate and do not create an excessive burden on non-ASX listed entities, and entities that already disclose some of this information (i.e. ADIs). APRA should also provide more guidance on service provider risk assessments to ensure that entities are able to make reasonable decisions about materiality and relevance given the potential to cover hundreds of service providers.

We provide more detailed comments on the draft CPS 511 standard in **Attachment 1**.

If you have any questions about any aspect of our submission, please do not hesitate to contact [redacted].

Yours sincerely

[redacted]

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Attachment 1: Comments

Supporting proportionality

COBA welcomes APRA's approach to proportionality in the draft CPS 511 standard. This approach recognises that there is not a 'one size fit all' approach to regulation. Reducing the minimum requirements for non-significant financial institutions (SFIs) will reduce the compliance costs and benefit competition while not creating undue prudential risk. As noted in APRA's paper, this proportionality reflects non-SFIs "smaller size, less complex business models and simpler remuneration arrangements". Our sector fits this profile as simple and small retail banks without highly lucrative equity-based remuneration.

While COBA welcomes the two-tier system, COBA believes that APRA should ensure that proportionality is not just limited to the two-tier system and that SFI requirements are applied proportionally given the potential for mutual ADIs to at some point be considered SFIs due to asset growth (noting our comments below).

APRA should also clarify in its upcoming guidance that there are no requirements for APRA-regulated entities to pay variable remuneration. Given mutual ADIs have different business structures compared to larger ADIs, some do not pay variable remuneration and we want to ensure that there is continuing clarity that the increasing focus on remuneration does not create an expectation to pay variable remuneration.

In line with this, APRA should ensure that the standard is structured in a manner where it is clear which parts of CPS 511 apply to variable remuneration. For example, the draft CPS 511 should make it clear that the sections related to 'remuneration design' and 'remuneration outcomes' relate to variable remuneration or incentive programs.

Supporting additional implementation time for non-SFIs

COBA welcomes APRA's proposal to provide an additional year in implementation time for non-SFIs. This aligns to COBA's underlying principles of proportionate regulation.[1]

The proposed APRA finalisation timeline for CPS 511 and its final prudential practice guide is likely to support an informed and smooth transition to the new environment. COBA's long-standing view is that it is critical to ensure that ADIs have at least one year from the release of final standards and guidance to allow ADIs to efficiently these standards. This is likely to be the case for both SFIs and non-SFIs if APRA meets its proposed timelines.

The response paper states that APRA expects SFIs to develop self-assessments and implementation plans. APRA should consider whether there are any broader and relevant learnings from this process that could be shared with other regulated entities, including non-SFIs, to reduce the transition and implementation costs (noting different requirements for non-SFIs).

Increase the ADI SFI threshold to $20 billion in assets to cover all mutual ADIs

COBA believes APRA must increase the SFI threshold for ADIs to $20 billion to cover all mutual ADIs. This increase aligns with our longstanding views on the BEAR small ADI threshold[2] and APRA's proposed simple capital framework threshold.[3]

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[1] COBA speech on the impact of regulation on competition

[2] COBA submission on BEAR – Size of an ADI – Draft Legislative Instrument

[3] See draft APS 110

COBA submits that no customer owned banking institution should be categorised as an SFI, given:

- the principal aims of APRA's CPS 511; and
- that APRA's proposed SFI threshold for ADIs is designed generally "to capture publicly listed entities, material foreign-owned banks and others of similar size and sophistication".

Increasing the asset threshold to at least $20 billion would provide APRA the opportunity to apply an appropriate level of proportionality and graduation into the final CPS 511. Increasing the asset threshold to at least $20 billion would also help maintain the fairness of the CPS 511 in relation to how it would impact the market for executive talent within our sector.

Leaving the proposed threshold unchanged runs the risk of reducing the competitiveness of 'SFI categorised' institutions to recruit executive talent. COBA's view is that the threshold should be increased to ensure that these peer institutions are subject to the same CPS 511 requirements, given there is now a clear and significant jump in the number of SFIs requirements. For our sector, by the time CPS 511 comes in there is the potential for multiple mutual ADIs to be above the current assets threshold. If APRA believes a mutual ADI is a SFI then it should designate it rather than rely on a size threshold.

Aligning of requirements with existing regimes

COBA notes that ADIs that are now subject to both the CPS 511 Remuneration and an overlapping regime that include remuneration elements in the Banking Executive Accountability Regime (BEAR), and its future replacement of the Financial Accountability Regime (FAR).

The CPS 511 standards and guidance should clarify that there are related legislated accountability regimes in place the BEAR and FAR that ADIs need to be considered in implementation. COBA members have also noted that the overlapping coverage of 'senior managers', 'accountable persons' and 'specified roles' is unnecessarily increasing the complexity of governance regulation for small ADIs, particularly where a person is subject to both BEAR and CPS 511 requirements.

Ensuring any proposed disclosures are proportionate and aligned to existing disclosures

All ADIs, including COBA members, currently provide annual prudential remuneration disclosures under APS 330 Public Disclosures. COBA believes that any future disclosures should remain consistent with the current publication to reduce the transition costs for ADIs.

COBA strongly supports a proportionate approach to any reporting and disclosure. APRA should suggest no or dramatically reduced reporting for non-SFIs compared to their much more complex SFI peers, given their relative simplicity and reduced systemic impact. Any potential disclosures requirements must also recognise that not all APRA-regulated entities are ASX-listed and, as such, certain disclosures could represent an unnecessary burden on non-ASX-listed entities such as mutual ADIs.

COBA considers that a key change to existing disclosure regime will relate to consequence management. If there is the potential for consequence disclosure, there is the risk that this may disincentivise boards to adjust variable remuneration given the increased external scrutiny. This is counterproductive to the intent of the standard. This situation is noted in APRA Chair Wayne Byres' appearance before the Financial Services Royal Commission[4]:

> I think there are pros and cons. It – it's a bit of a double-edged sword. So on one hand you would say if there's – if there's an expectation that rewards are disclosed, it might be reasonable to have more information to explain how those awards were determined.

[4] Royal Commission transcript, 29 November 2018, P-7407

> There will be sensitivity about these issues, obviously, and in some cases the disclosure – I guess the thing that's in the back of my mind is the risk that the disclosure in and of itself actually deters people from making adjustments, because of the, you know, external reaction to whatever that issue is. And that boards might – they may wish to penalise someone, but they may not wish to have that broadcast more broadly.

Reducing the burden of service provider risk assessments

Retaining strategic board role in the service provider risk assessment process

The draft CPS 511 para 20 outlines that a Board-approved policy must set out "the process to identify and address inconsistencies with paragraph 19 of this Prudential Standard that may result from the remuneration arrangements of a service provider that is not a related body corporate or connected entity of the APRA-regulated entity".

This proposal has the potential to go against good governance given the involvement of the Board at a process-level. It may be more appropriate that this policy outlines key criteria, boundaries and escalation points regarding this process as opposed to getting the Board involved in examining a process that could be used to assess potentially hundreds of diverse service providers.

Identifying service providers for risk assessment

APRA should provide further guidance on the scope of service providers it expects to be subject to be the focus of these CPS 511 risk assessment requirements. This guidance will allow entities to target their limited resources on the key sources of prudential risk.

The draft CPS 511's expanded service provider scope creates the potential for entities to need to assess hundreds of different service providers. It is critical that there is a materiality and relevance filter approach to enable regulated entities to identify which service providers will need to be subject risk assessment given that resources are not limitless, and many service providers are unlikely to have material impacts on entities resulting from their remuneration policies.

For example, service providers can currently include (but not limited to):

- law firm and professional services firms,
- recruitment agencies and consultants,
- trade providers for branch and facility maintenance (shopfitters, cleaners),
- a wide range of information technology service providers,
- industry associations,
- mortgage brokers, and
- critical service providers such as payments and core banking system providers

The original draft CPS 511 and current CPS 510 currently outline some criteria to filter the scope of service contracts. These include:

- where the "primary role of the body is to provide risk management, compliance, internal audit, financial control or actuarial control services to the entity" or
- services that "may affect the entity's long-term soundness or materially affect the management of financial or non-financial risks, and where under the services contract, a material amount of the total payment to the body is based on performance."

This guidance will allow ADIs to focus their limited resources onto the providers that are more likely to create material risks with their remuneration policies and take steps to mitigate these risks. This aligns to a risk-based and proportionate approach.

Guidance on the undertaking the risk assessments

COBA welcomes APRA's shift towards ADIs assessing and mitigating risks as opposed to expecting ADIs to directly influence external policies. While entities should retain discretion to undertake these activities, COBA members have noted that they would like to see some guidance and examples better practice in these risk assessments and mitigation steps.

Coverage of Risk and Financial Control Personnel (RFCP)

COBA believes that RFCP requirements should be limited to those whose decision-making or advice is likely to have a material impact or influence on an entity's prudential stability. At present, the current scope covers the most junior RFCP staff which would create an unnecessary burden for small ADIs.

COBA's view is that including these roles would significantly increase Board reporting requirements for variable remuneration outcomes. COBA questions the additional value that the Board, or Board Remuneration Committee adds when approving remuneration for such a wide range of roles on a cohort basis. These low-level roles would detract from senior staff who have a more material impact on outcomes.

APRA should also clarify its expectations around whether a different remuneration framework should apply to RFCPs compared to other staff. If such as expectation exists, COBA's view is that applying this to these low-level roles seems unnecessary given they are not able to materially influence the business performance.

Cohort approval guidance

COBA members seek more guidance on how APRA expects entities to undertake the 'cohort approval' required under the CPS 511 para 49 (SFIs) and para 71 (for non-SFIs).

Non-financial materiality threshold and interaction with self-funding variable remuneration

COBA members seek more clarity on the use of non-financial materiality performance measures when it comes to the example of 'gates' for self-funding variable remuneration programs.

Clarity on no malus or clawback requirements for non-SFIs

COBA members seek clarity that there are no malus or clawback requirements for non-SFIs. CPS 511 para 65c implies that there are required options as remuneration adjustment tools. COBA's interpretation is that they are not minimum requirements for non-SFIs under CPS 511 given paras 51 to 55 are not mirrored in the non-SFI section.