Equity Trustees

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Dear Sir/Madam

Written submission in response to APRA's Discussion Paper on "Strengthening prudential requirements for remuneration" and Draft Prudential Standard CPS 511

Further to the release of APRA's revised draft Remuneration Standard, CPS511, on 12 November 2020 for consultation, this letter provides Equity Trustees' response to the proposed Standard. It should be read in conjunction with our response of 8 October 2019 to the original draft consultation.

Equity Trustees was established as an independent trustee and executor company in 1888 and has become one of Australia's leading specialist trustee companies. By offering a diverse range of financial and fiduciary services, we help our private, corporate and superannuation 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 a Registerable Superannuation Entity Licence acting as trustee for fourteen superannuation funds.

The Board of Equity Trustees is a strong advocate of good corporate governance, including remuneration practices. We believe our current remuneration framework is very effective in its current form – it has rewarded Executives when the Company has performed strongly against its balanced scorecard (*a mixture of financial and non-financial measures*) and has not rewarded Executives when the Company has not. It has engendered behaviour that has always put our clients' interests first. We understand from the Royal Commission the same cannot be said for a select number of other organisations in the financial services industry.

We welcome the proposed amendments to the draft Standard relating to:

- Oversight of the remuneration practices of third-party service providers; and
- The removal of prescription in relation to individual financial measures

In both instances, by adopting a principles-based approach, APRA has struck an appropriate balance in providing some latitude in the mechanisms entities may employ to achieve the objective of the Standard.

We note, however, that there has been no consideration and/or amendment of the following points and would once again encourage APRA to consider alternatives, including those suggested below. In relation to these matters production of a Regulatory Impact Statement, in line with APRA's policy development process, would be very helpful for assessing the detrimental impacts in the regulatory change to ensure the expected negative impacts on member outcomes are articulated, quantified and appropriately considered:

1) APRA acknowledges the Standard will make it difficult to attract and retain talent in RSE licensees, however does not wish to introduce a differential standard for superannuation entities, preferring consistency across regulated industries in preparation for "potential future complexity" in the superannuation sector. As mentioned in our previous submission, under the proposed Standard it will be particularly difficult for RSE licensees to attract and retain talent from entities such as investment managers, custodians and administrators, and other companies that are <u>not</u> subject to APRA licensing and supervision. As a result, it is a foreseeable and likely consequence of the Standard, as written, that investment outcomes for superannuation members are likely to be negatively impacted as a result of the more moderate capabilities attracted to, and remaining in, RSE licensees. We strongly contend that it is not a good outcome for members if the best talent in the superannuation industry is working in non-APRA regulated entities, exercising a structural employment advantage over RSE Licensees that restricts RSE Licensees from accessing such talent.

   APRA's Regulatory Impact Statement should quantify this impact in terms of tolerable basis point reductions in expected investment returns and weigh it against the perceived benefit of the regulatory change.

   Equity Trustees continues to submit that the deployment of other regulatory tools in respect to addressing structural conflicts within the superannuation industry may better address the regulatory objectives than the proposed Standard. Notwithstanding, any such Standard should not put RSE licensees and more particularly, superannuation members, at a structural disadvantage in attracting and retaining talent from other non-APRA regulated employers in the sector. Reliance on the principles of the Remuneration Design section of the draft Standard, rather than the prescription of the Deferral and Clawback section in respect to RSE licensees, would provide some latitude to the industry in this regard.

2) The revised Standard continues to assume either the head of the group or the material business units are APRA regulated entities. It appears not to contemplate organisations like Equity Trustees where only a *subsidiary*, representing a small ~0.7% of the Trusts, Funds and Schemes for which Equity Trustees has a fiduciary responsibility, and ~25% of the Group's revenue, is regulated by APRA and the significant challenge and detrimental impact adopting the Standard across the Group, would have on investors and beneficiaries in other areas of the business.

We would encourage APRA to be specific in its guidance to industry and its supervisors relating to paragraph 16 of the draft Standard in respect to the circumstances where adjustments and exclusions to elements of the Standard may be considered to reflect the idiosyncrasies of entities such as Equity Trustees. For example, APRA might wish to consider not applying the Standard to an RSE Licensee where the revenue of the RSE Licensee as a proportion of the whole Group is less than 40%.

3) We note the proposed alterations to the deferral periods and the proposed changes to treatment between SIFs and non-SIFs in this regard. As previously stated, Equity Trustees submits that the deferral periods are too long, rendering the deferred benefits ineffective, and the small differential in periods between CEOs and Executives appears to serve no purpose in the achievement of the regulatory objective and simply complicates the application of the Standard.

   In addition to exacerbating the challenges in RSE Licensees ability to attract and retain talent as outlined in 1) above, the extended period of the clawback provisions will also limit the utility of those provisions given the proximate cause for factors influencing the criteria for the application of the clawback, including those listed in paragraph 55, will become more opaque and therefore more challenging for Boards to invoke, through the passage of time.

   Equity Trustees' view strongly remains that if deferral periods are mandated, payments should be able to begin vesting after one year and be fully vested by the end of year four and there should be no differential between CEOs and Executives. Otherwise, it is likely that the Boards of APRA regulated entities will respond to the deferral requirements by making adjustments to their executive pay structures, including a shift towards a higher level of fixed remuneration – a risk that APRA acknowledged in its initial discussion paper, and the cost of which will undoubtedly be passed on to members. This will result in an increase in Executive remuneration and a diminution of the link between performance for members and outcomes for Executives.

4) We note paragraph 53 of the draft Standard continues to use $50,000 as the trigger for deferred variable remuneration. Equity Trustees has previously submitted that this sum is too small and may unintentionally capture employees with no real control over the activities of the company. More tellingly though, it recognises no proportionality of variable to total remuneration. For example, a sum of $50,000 variable remuneration in a Total Employment Cost of $1m is unlikely to influence employee behaviours in the same way as $50,000 in a Total Employment Cost of $100,000.

   Equity Trustees has previously submitted a recommendation that APRA consider a framework where deferral is greater when variable remuneration is 150% of Total Employment Cost and have no deferral when variable remuneration is much smaller at, say 25% or less (and pro-rate in between), together with a de minimis level as well. Alternatively, rather than enshrining an absolute figure that will quickly date within

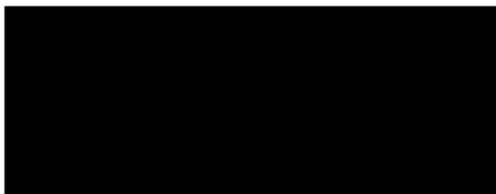
the standard in paragraph 53, APRA may consider the reframing of such a limit as a proportion of total remuneration at a point at which APRA believes such a proportion becomes material in influencing impacted employee's behaviours. This will allow RSE Licensees greater flexibility in determining where to set any variable remuneration limits.

Finally, we note that APRA has yet to release its Regulatory Impact Statement which we understand should accompany all proposed regulatory changes. Equity Trustees would submit that this should be prepared separately for each APRA regulated sector noting the potential costs and benefits will differ markedly across them. We look forward to reviewing the assessment of costs and benefits noting the costs in the superannuation sector will be borne by members and therefore inform the Board in the design of the remuneration framework and should include:

- Poorer expected investment returns as a result of RSE Licensees moderated ability to attract and retain talent, particularly in the investment management sector, from non-APRA regulated entities;
- The imposition of additional consulting and legal costs in design and periodic review of remuneration frameworks;
- The additional costs of legal advice for RSE Boards in approving remuneration frameworks, renegotiating employment contracts and periodically, invoking clawback on remuneration arrangements; and
- Assumptions relating to the increase in fixed remuneration costs (which are not performance-based) over the cycle as RSE Licensees look to rebalance their weightings of fixed and variable remuneration.

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.

Yours faithfully,



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