

MORROW SODALI

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About Morrow Sodali

Morrow Sodali is a leading provider of strategic advice and shareholder services to corporate clients around the world. The firm provides corporate boards and executives with strategic advice and services relating to corporate governance, shareholder and bondholder communication and engagement, capital markets intelligence, proxy solicitation, shareholder activism and mergers and acquisitions. From headquarters in New York and London, and offices and partners in major capital markets, Morrow Sodali serves more than 700 corporate clients in 40 countries, including many of the world's largest multinational corporations. In addition to listed and private companies, its clients include mutual funds, ETFs, stock exchanges and membership associations.

RE: Proposed Prudential Standard CPS 511

Morrow Sodali appreciates the opportunity to contribute to the Australian Prudential Regulation Authority's ("APRA") consultation on remuneration at APRA-regulated entities (Prudential Standard CPS 511).

We are deeply committed to our responsibility acting as advisors to listed companies and we are responding to this consultation in the hope that it will contribute to an effective and practical implementation of the Royal Commission's recommendations, and broadly benefit listed companies of the ASX.

Non-financial Measures

APRA proposes that each component of a person's variable remuneration:

- give material weight to non-financial measures, where the remuneration is performance related; and
- be adjusted, potentially to nil, for adverse risk and conduct outcomes, based on clearly identified risk criteria.

It is commonly observed that incentives subject to non-financial measures vest partially or in full in years when financial performance has been substantially down. Financial and non-financial measures, in our experience, are only effectively implemented where they are identified as clear value creating objectives that firmly align with value creation for both the company and shareholders. Publicly listed entities with effective non-financial measures in their current remuneration structures provide comprehensive rationales in their disclosure of what measures are being utilised and how and why these measures create value. Therefore, we suggest that a requirement to provide enhanced disclosure and a robust rationale behind the selection of non-financial measures is added to the Standard.

In addressing the need for risk and conduct management, particularly after the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, we understand the calls for material weightings towards non-financial metrics. Unfortunately, 'non-financial measures' is an incredibly

broad selection of measures, many of which may not improve remuneration structures or indeed have the desired effects of this revision. To avoid the Standard from being too prescriptive, we would suggest APRA provides a sample list of measures that would be considered acceptable to help guide companies.

We agree with the addition of downward modifiers or gates for incentive awards. Understanding the response to the Hayne Royal Commission, it is important to focus on risk and conduct, however we would encourage this to more broadly encourage the possibility of having modifiers and gates that incorporate material ESG metrics where these are deemed 'fit-for-purpose'. In this approach, executives are not rewarded for doing 'the right thing'. They are rewarded for the financial outcomes once the modifier/gate has been applied, which would be aligned more closely with the broader communities' expectations on executives should be rewarded. In other words, the financial measures reward for 'what' executives achieved, whereas the non-financial measures control 'how' that financial performance was achieved.

Performance Periods, Deferral and Clawback

Alignment with shareholders through long-term equity holdings for executives can only be positive and we share the view that short-termism can contribute to poor outcomes for companies and stakeholders.

Aligning with jurisdictions overseas such as the UK market with five-year share exposure period requirements coincides with our view that long-term incentives that reward for performance for any less than five years typically do not align with long-term strategic objectives and business plans of listed companies. However, we are concerned that the current draft of CPS 511 allows for the five-year period to be satisfied with shorter performance periods with restricted/deferral periods. Whilst we agree this will enhance alignment with shareholders when it comes to short-term incentives, this provision will still allow LTI performance periods of less than five years. We would prefer to see the progressive introduction of a requirement for longer performance periods with a minimum of five years for LTI plans to ensure executive performance is more strongly aligned with shareholders and long-term business planning. Restricted deferral periods, of course, can still be applied to these LTI awards to enable malus/clawback arrangements and ensure that incentive outcomes are complemented by sustainable performance of executives.


When looking into deferral periods and clawback, we think it wise to consider introducing mandatory holding periods beyond termination for good leavers to ensure that executives act in the best interest of shareholders and do not attempt to 'game' performance measures prior to completing their tenure. This will enable clawback where historically it has failed to be applied in an effective manner. By enforcing holding periods, this limits the risks and legal challenges of clawing back awards within a given timeframe where awards have been exercised.

Concluding remarks

Morrow Sodali trusts that our comments are helpful to APRA's refinement of the Prudential Standard CPS 511. We would be pleased to respond to any queries you may have in relation to this submission.

Yours sincerely




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