



12 February 2021

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

Dear Sir/Madam,

QBE Submission: APRA Response Paper – Strengthening prudential requirements for remuneration

QBE welcomes the opportunity to comment on the revised proposals outlined in APRA's Response Paper and on the revised draft *Prudential Standard CPS 511 Remuneration* (CPS 511) which were released on 12 November 2020.

This submission is on behalf of QBE Insurance Group Limited and the Level 1 insurers comprising QBE Australia Pacific (collectively "QBE").

QBE remains supportive of APRA's objective to improve accountability and achieve greater balance in assessing performance so that remuneration arrangements promote effective management of both financial and non-financial risks, sustainable performance and long-term soundness. Several key challenges were raised in QBE's prior submission dated 22 October 2019 (our "2019 submission"), along with a range of alternative suggestions for APRA's consideration.

QBE acknowledges the changes APRA has made to the revised draft CPS 511 which seek to address these key challenges in some form. However, some key challenges remain for QBE, in part because of the various geographies in which QBE operates. In particular:

- the application of CPS 511 to QBE as an authorised Non-Operating Holding Company (NOHC) continues to create an uneven playing field with our industry peers in key markets outside of Australia (as approximately three quarters of our workforce is located outside of Australia);
- the deferral periods remain too lengthy and make Australian-listed organisations unattractive to executives based overseas and reduce our international competitiveness;
- the significant burden on the Board remains;
- unnecessary complexity will be introduced due to the inconsistency of CPS 511 with the Financial Accountability Regime (FAR); and
- various proposed definitions in the standard remain unclear.

This document is focused on the key challenges for QBE, some were included in our 2019 submission and some have arisen due to the revisions made to draft CPS 511. These are outlined in Appendix A. We have included suggestions for alternative approaches that we believe meet APRA's objectives and there are a few areas where we would welcome further clarity.



We would be pleased to provide any further information that assists APRA's consideration of our feedback.

Your sincerely

[Redacted signature]

[Redacted name]

Chairman



Appendix A: QBE's feedback on draft CPS 511

Key areas of challenge for QBE

1. Competitive disadvantage for entities with significant international operations

Summary of the key challenges:

- Prescriptive deferral requirements will have significant implications for organisations with an international footprint.
- Layering of multiple and inconsistent requirements across different jurisdictions.

The application of the standard to APRA-regulated entities is set out in paragraphs 2 to 8 of draft CPS 511. Our interpretation is that CPS 511 will apply to QBE Insurance Group Limited as an authorised NOHC and requirements must be applied appropriately throughout the Group, including entities that are not APRA-regulated.

QBE acknowledges the revisions APRA has made to draft CPS 511 that address some of the concerns highlighted in our 2019 submission. In particular, the reduction of deferral periods for a Chief Executive Officer, senior manager, executive director and highly paid material risk-taker (HPMRT) is welcomed. However, the deferral periods are still lengthy when compared internationally and the introduction and application of these prescriptive deferral requirements for employees in specified roles throughout the Group will have significant implications for QBE.

a) Competitive disadvantage

QBE has a significant international footprint, with approximately three quarters of our workforce located outside of Australia. Organisations like QBE, with a large proportion of its operations outside of Australia, will still be significantly impacted when attracting and retaining talent in both overseas and Australian markets. Australia should be an attractive destination for high quality global executives to want to base themselves here. However, the CPS 511 proposals around deferrals, which are far more stringent than in "home country", have already cost QBE the opportunity to employ good foreign talent. This experience may not be unique to QBE. We are concerned that this may become even more prevalent if the currently proposed rules/deferrals are implemented without some amendment to more closely reflect the rules/deferrals applied by regulators in an executive's home jurisdiction.

The prescribed deferral periods in CPS 511 remain significantly more onerous than in any other jurisdiction regulating insurance firms in which QBE operates. To provide context to this issue for QBE, the next most significant deferral requirements are observed in the UK where category 1 and 2 insurance firms (there are 5 categories of insurance firms based on risk profile), are required to defer 40% of variable pay over a three-year vesting period. In the USA, where QBE has a significant employee presence and is utilised as a key talent pool, there are no specific regulated deferral requirements.

The deferral requirement for a senior manager is particularly concerning for QBE as we have a sizeable population of employees (approximately 70, with approximately 50% of those located outside of Australia) across the Group classified as a senior manager. The deferral requirement of five years (with pro-rata vesting from four years) remains too lengthy and this creates a significant competitive disadvantage for QBE relative to our global insurance peers who are not subject to similar regulatory requirements in international jurisdictions.



An unintended consequence of the above is the likelihood that entities will need to provide a more compelling remuneration proposition in order to attract executives based overseas, through higher remuneration quantum and/or changes to pay mix (placing greater emphasis on fixed remuneration).

Both strategies increase the cost base. Further, they will reduce the variable component of an employee's total remuneration which reduces the ability to apply appropriate adjustments for risk and conduct outcomes, which is contrary to APRA's objectives.

b) Multiple regulatory requirements

QBE acknowledges that APRA is working closely with Treasury to ensure there is appropriate alignment between CPS 511 and FAR. Particular focus should be given to the overlap of employees captured by CPS 511 and FAR and the inconsistency between the deferral requirements. There are also variations between the scope of remuneration regimes in Australia and international jurisdictions, with some of QBE's international based employees potentially being subject to four regulatory regimes with different regulatory requirements (refer to the Appendix to our 2019 submission for further detail). Applying regulatory requirements to a large number of international based employees increases unnecessary complexity. This is particularly relevant to varied deferral requirements.

Alternatives for consideration:

QBE believes an accountable person (as defined by FAR) as opposed to a senior manager (as defined by draft CPS 511) should be within scope of CPS 511 to focus the requirements only on those employees with the greatest accountability and impact on the entity's risk profile and ensure consistency between CPS 511 and FAR. In addition, it is suggested the deferral requirements are aligned between CPS 511 and FAR, as the FAR requirements are more aligned to international practice.

To address the issues of competitive disadvantage and complexity of multiple regulatory requirements, QBE believes that the relevant regulatory requirements for each jurisdiction should apply to employees in those jurisdictions (applied locally). This recognises that local regulations already exist and prevents the unnecessary layering of additional requirements.

As is the case currently, the APRA regulated entity would continue to be required to maintain a compliant remuneration framework and remuneration policy as well as ensure remuneration outcomes are aligned with risk and performance outcomes, reflect an appropriate application of adjustment tools (such as clawback and malus) and reflect the organisations own deferral requirements.

It should be noted that even with the above recommendation, the challenge to attract overseas based senior executives to Australia will remain an issue. Therefore, further consideration could be given to the suggestion that for employees being asked to relocate to Australia in order to work for an Australian domiciled organisation, their existing local remuneration regulations could continue to apply.



2. Board approval of remuneration outcomes

Summary of the key challenges:

- Significant burden on Group People & Remuneration Committee (PARC) to make a recommendation to the QBE Group Board on remuneration on an individual basis for senior managers across the Group.
- Significant burden on Group Board to approve remuneration on an individual basis for senior managers across the Group.

QBE recognises the importance of having the Board and Board Remuneration Committee accountabilities for remuneration for employees with high levels of responsibility.

The requirements in the original draft CPS 511 placed a significant burden on the Board and the Board Remuneration Committee in addition to confusing the roles of management and the Board. As such, the revisions APRA has made to draft CPS 511, particularly in relation to the approval of remuneration arrangements and variable remuneration outcomes for HPMRTs, which is now required on a cohort basis, are welcomed.

However, the requirements in draft CPS 511 continue to require the Board to approve the remuneration for a senior manager on an individual basis, following a recommendation from the Board Remuneration Committee. As noted above, this would apply to approximately 70 employees across the Group, some of whom are several reporting layers from the Group Chief Executive Officer. QBE does not believe QBE's Group Board and Group PARC are best placed to perform this activity. It is a significant burden on the Group Board and Group PARC and is a significant increase to their responsibilities under APRA's current Prudential Standard CPS 510 Governance.

Alternatives for consideration:

QBE suggests that where appropriate, delegation of the responsibility for recommending and approving remuneration arrangements by the Group PARC and Group Board to the respective Divisional PARC and Board should be allowable, and clearly specified in the standard. These Divisional Boards include a majority of independent non-executive directors. The Group PARC and Group Board would retain oversight via reporting of divisional outcomes up to Group.



3. Complexity

Summary of the key challenges:

- The definition of a HPMRT remains complex and will result in variability year-on-year for employees.
- The minimum deferral threshold remains too low and will result in unnecessary complexity to administer.

QBE welcomes the revisions APRA has made to draft CPS 511 in its attempts to reduce complexity. However, QBE is still concerned with aspects of the standard which result in complexity and will drive up administration and compliance costs. Specifically:

a) HPMRT:

QBE acknowledges that APRA has addressed some of the concerns raised by industry in relation to the definition of a HPMRT, which now means a material risk taker whose total fixed remuneration plus **actual** variable is equal to or greater than 1 million AUD in a financial year. However, several issues remain:

- As the definition relies on **actual** variable remuneration outcomes, there will be variability year-on-year for HPMRTs. Employees will not know whether deferral will apply to them until the end of the year and this may vary each year. This definition will cause complexity and uncertainty for employees.
- For employees based overseas, **foreign exchange rate fluctuations** could impact whether they meet the 1 million AUD threshold and are therefore subject to extended deferral or not.
- The inclusion of superannuation and benefits in the definition of **fixed remuneration** is complex and difficult to calculate, particularly with differing arrangements and calculation methodologies across different jurisdictions. Certain benefits may require an actuarial calculation, such as the value of defined benefit superannuation arrangements.

Alternatives for consideration:

Amend the definition of a HPMRT to simplify the identification of impacted individuals.

Define a HPMRT as a material risk-taker whose **maximum potential variable remuneration** is equal to or greater than AUD 750,000 in a financial year. This retains the focus on employees with the highest amount of pay at risk and reduces complexity for organisations.

b) Minimum deferral threshold:

QBE acknowledges that APRA has amended the definition of the minimum deferral threshold from variable remuneration of AUD 50,000 to **deferred** variable remuneration of AUD 50,000, which aligns with the draft requirements under FAR. However, as raised in our 2019 submission, we feel this threshold remains too low and will result in an immaterial amount being deferred.

This threshold level would result in unnecessary costs and complexity to administer, particularly in relation to pro-rata vesting. As an example, 40% deferral would apply to a HPMRT with variable remuneration of AUD 125,000 (with deferral of AUD 50,000). Pro-



rata vesting is allowed from year two through to year four (i.e. over three years), which would result in three small tranches of equity being deferred (AUD 16,666). It is questionable whether the benefit of this level of deferral outweighs the complexity to administer.

Alternatives for consideration:

Increase minimum deferred variable remuneration threshold to AUD 100,000.



4. Definition of variable remuneration

Summary of the key challenge:

The amended definition of variable remuneration is too broad and will impose deferral requirements for more types of payments, including sign-on and retention awards.

QBE acknowledges that APRA has amended the definition of variable remuneration to be the amount of a person's total remuneration that is conditional on objectives "which include performance criteria, service requirements or the passage of time". This enhanced definition of objectives will result in a broader range of payments deemed to be variable remuneration and subject to deferral requirements.

Whilst the broader definition may be suitable for different variable remuneration arrangements used within the industry (including restricted shares), it also captures other awards such as sign-on and retention awards which typically only have service requirements. These awards have a different purpose compared to variable remuneration subject to performance criteria. For instances, sign-on awards are:

- typically designed to compensate for remuneration not received from a previous employer when an individual resigns to join a new organisation (i.e. they can often mirror the payout schedule of the remuneration foregone)
- often critical to secure key talent and are likely to become more important in the future in order to attract employees from industries and/or locations that do not have the regulatory requirements for extended deferral.

Applying deferral requirements to sign-on payments will not meet the objective of the awards and may have the unintended consequence of entities making one-off cash payments payable upon an individual's commencement of employment, as opposed to equity grants which often vest over a number of years. Further, malus will not be applicable to cash payments and clawback will only apply for two years from payment. This does not support APRA's risk management objectives.

Alternatives for consideration:

QBE suggests amending the definition of variable remuneration to exclude one-off payments relating to the commencement of employment so that sign-on awards with deferral periods that mirror the payout of remuneration foregone are specifically excluded from the CPS 511 deferral requirements.



Key areas for clarification

QBE would welcome clarification on the following proposals contained in the revised draft CPS 511:

1. Commencement Date (see paragraphs 9(b) and 10)

QBE operates on a financial year ending 31 December for both financial results and performance management purposes. Paragraph 9(b) specifies the prudential standard will commence for a general insurer... or a group headed by an authorised NOHC or a registered NOHC that is a significant financial institution (including QBE) on 1 July 2023, which is halfway through our financial year. As such, despite paragraph 10, which specifies the prudential standard does not apply to a person's variable remuneration if the opportunity arose before the commencement date, it is unclear for entities with a financial year ending 31 December 2023 if the requirements for a person's variable remuneration apply to:

1. half of the financial year ending 31 December 2023 (i.e. 1 July – 31 December 2023); or
2. the full financial year ending 31 December 2023 (i.e. 1 January – 31 December 2023); or
3. the first full financial year following the introduction of the prudential standard, being financial year ending 31 December 2024 (i.e. 1 January – 31 December 2024).

If the requirements apply to a person's variable remuneration in 2023, even for half of the financial year, this would require QBE to implement the variable remuneration requirements from 1 January 2023 to ensure all remuneration arrangements for the 2023 performance year were compliant. This is earlier than what is required for entities which operate with a financial year ending on 30 June.

In addition, if the prudential standard is required to apply to variable remuneration for new joiners from 1 July 2023, this would effectively require QBE to implement the standard from 1 January 2023 so all existing and new employees are on compliant arrangements, as it would not be feasible to operate separate variable remuneration plans.

It is important that APRA releases the final practice guide as soon as possible in order to allow sufficient time for QBE to finalise significant changes to our remuneration framework. This is particularly pertinent should the variable remuneration requirements need to apply from 1 January 2023.

QBE seeks clarity on when entities with financial years ending 31 December 2023 should apply the requirements for a person's variable remuneration when the standard commences on 1 July 2023. Our preferred approach is to apply the requirements for a person's variable remuneration from 1 January 2024, this being the first full financial year post the introduction of the standard. This is consistent with the implementation of a new Accounting Standard by the Australian Accounting Standards Board, which generally apply for the first financial year commencing on or after the specified effective date.

In addition, due to the significant changes that will be required, QBE believes the implementation date should be at least two years from the release of the final practice guide.

2. Material weight to non-financial measures (paragraph 37(a))

In our 2019 submission, QBE raised concerns with the practical implications of the proposed limits on financial measures in draft CPS 511 and put forward an alternative approach to achieve the same objective. Although the revised approach that APRA has suggested differs to our proposed approach, QBE welcomes the flexibility it provides for each organisation to introduce non-financial measures in a way that best suits their remuneration framework.



This is most evident in the requirement for a ‘material weight’ to be given to non-financial measures where remuneration is performance related. Whilst the standard makes it clear that a component of variable remuneration which is entirely dependent on share price performance or profitability would not be permitted, there is no further guidance on APRA’s expectations and what matters entities should consider when implementing this requirement.

In addition, in the Response Paper APRA said entities may consider how they need to tailor non-financial measures for employees at different levels and in different divisions. As non-financial measures are likely to be applied at an incentive plan level (for example to the short-term incentive (STI) scorecard that applies to the whole Group), further guidance on APRA’s expectations is welcome. There will be unnecessary complexity if APRA’s expectation is that the weighting of non-financial measures is varied at an individual level, as opposed to function (e.g. risk and control) or seniority, as is most common practice.

QBE acknowledges that industry has sought greater clarity on non-financial measures and that APRA plans to develop a framework to help entities determine appropriate measures in a new CPG 511. QBE would welcome further clarity on APRA’s expectations for:

- what constitutes a ‘material weight’ for non-financial measures; and
- tailored non-financial measures for employees at different levels and in different divisions.

3. Clawback (paragraphs 54 to 56)

QBE welcomes the revisions APRA has made to the clawback criteria which have been extended and aligned to the malus criteria. In addition, the inclusion of a materiality threshold addresses practical challenges to implementation and acknowledges that clawback would only be considered in exceptional circumstances.

In respect of an entity setting specific criteria for the application of clawback and malus, QBE expects that each organisation will determine the appropriate meaning and/or threshold for ‘significant’ and ‘material’ in alignment with existing risk management frameworks. APRA’s Response Paper clarifies clawback would only be used in exceptional circumstances “after other adjustment tools have been exhausted”. QBE is supportive of this clarification, however, the current wording in draft CPS 511 does not clearly reflect this intent and the requirements could still be interpreted as requiring the entity to apply clawback in certain circumstances.

QBE would welcome this clarity being included in revised draft CPS 511.

4. Adjustment for adverse risk and conduct outcomes (paragraph 37(b))

A range of available adjustment tools as a consequence for adverse risk and conduct outcomes is noted and QBE acknowledges these adjustments should work in conjunction with the inclusion of non-financial measures to enhance the focus on non-financial risks.

Paragraph 37(b) of draft CPS 511 requires “the determination of each component of a person’s variable remuneration must... be adjusted, potentially to nil, for adverse risk and conduct outcomes, based on clearly identified risk criteria”. In the Response Paper, APRA said it anticipates that most entities will design a risk and conduct modifier to meet this requirement and that APRA expects these adjustments would occur following assessment of performance for a STI, and prior to the grant being made for long-term incentives (LTI).

QBE seeks clarity on APRA’s expectations of a pre-grant assessment for LTI. There are different approaches in the industry and a pre-grant assessment may be suitable for some long-term arrangements. However, for a traditional LTI award with a long-term performance period, it is more logical to treat STI and LTI consistently (i.e. apply any risk and conduct



adjustment **after** the performance period and prior to payment or vesting). This allows any adjustment to be linked to the performance period in which the adverse outcomes occurred or were identified.

QBE seeks clarity on APRA's expectations on risk and conduct modifiers to adjust variable remuneration for adverse risk and conduct outcomes, particularly in relation to LTI awards.