



Australian Banking Association

23 July 2021

[REDACTED]
General Manager Policy
Australian Prudential Regulation Authority
policydevelopment@apra.gov.au

Dear [REDACTED]

The Australian Banking Association (**ABA**) thanks the Australian Prudential Regulation Authority (**APRA**) for the opportunity to provide feedback on draft Prudential Practice Guide CPG 511 Remuneration (**draft CPG 511**).

The ABA recognises the influence remuneration can have on corporate culture and the importance of appropriately designed remuneration frameworks, supported by effective policies and robust governance. Over the past four years the industry has worked to align remuneration frameworks with customer centric and risk culture, proactively as well as in response to independent and regulatory reviews. The industry's focus and genuine progress was noted Mr Stephen Sedgwick AO in his final review of retail bank remuneration arrangements: *'The risks of mis-selling and poor outcomes for customers in retail banking are substantially reduced consequently.'*¹

This submission is predicated on the assumption that draft CPG 511 reflects the requirements of revised draft Prudential Standard CPS 511 – Remuneration (**revised draft CPS 511**) as issued in November 2020 and that APRA's policy position remains unaltered since issuance. Therefore, this submission should be read in parallel with the ABA submission on the consultation on revised draft CPS 511². Taken together, the matters raised in this submission and the one for revised draft CPS 511 reflect the ABAs current position on CPS/CPG 511. There are two priority areas which we detail in the annexure:

Commencement Date: The commencement date for CPS 511 is noted as 1 January 2023. In this context, the ABA strongly recommends that the obligations apply to the performance years commencing on or after 1 January 2023. This will provide Authorised Deposit-Taking Institutions (**ADIs**) sufficient time to comply with the requirements and aligns with APRA's earlier timing commitments regarding implementation timeframes³.

Service Providers: The ABA remains concerned with the proposed obligations for the oversight of the remuneration frameworks of service providers by ADIs. As context, the remuneration arrangements of certain types of service providers, such as mortgage brokers, are already legislated and regulated by the Australian Securities and Investments Commission (**ASIC**). This will likely create overlapping requirements for these service providers, potentially placing ADIs into an intractable situation. Additionally, ADIs are limited in the way they can identify conflicts and influence service providers' remuneration frameworks.

The ABA seeks continued engagement in the regulatory reform set out in CPS 511 and CPG 511. We would be pleased to discuss the content of this submission in more detail.

Kind regards,

[REDACTED]

[REDACTED]
Policy Director

¹ Stephen Sedgwick AO, (2021) 'Retail Banking Remuneration Review – Final Report' ([Link](#)) p.8

² ABA (2020) Submission to the consultation on revised draft CPS 511 – Remuneration ([Link](#))

³ Response Paper 'Strengthening prudential requirements for remuneration', section 9.2

Annexure

1. Commencement date

The proposed requirement that remuneration structures of regulated ADIs be compliant with CPS 511 by the commencement date of CPS 511, 1 January 2023⁴, does not provide ADIs with sufficient time to carefully review their frameworks and implement appropriate changes, in compliance with the revised standard.

The ABA strongly recommends APRA revise the effective date for compliance with CPS 511 to the performance year commencing on or after 1 January 2023.

Rationale

In May 2021 APRA reconfirmed its proposal that remuneration structures of APRA-regulated entities must be compliant with CPS 511 by the commencement of the standard on 1 January 2023.

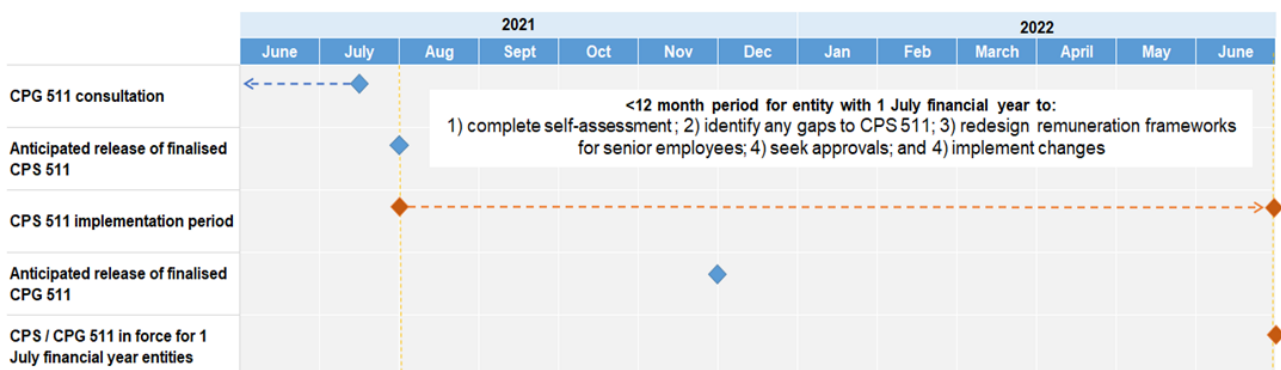
Setting the compliance date to the first performance year after 1 January 2023 would not alter the CPS511 commencement date, however it will provide sufficient time to for ADIs to carefully redesign their remuneration frameworks, for Boards to review and challenge them, to set up robust systems to implement the changes and then support embedding of changes through communications and change management.

The revised compliance date is also better aligned with APRA's timing commitment in the Response Paper⁵, which was to provide the industry 'at least 18 months' for implementation.

Example

The following example illustrates the timing challenge posed by a requirement for compliance by 1 January 2023. The example assumes the final CPS511 will be published on 30 July 2021. Note that the longer the delay in releasing the final standard, the more pressure the timing puts on effective and appropriate design and implementation.

In this scenario, an entity with a 30 June financial year-end will have less than 12 months to complete the self-assessment, identify any gaps to CPS 511, redesign their remuneration governance and frameworks, and implement any changes, as demonstrated in the timeline below.



The ABA proposes that CPS 511 (and CPG 511) provide a transition period such that regulated entities' compliance would be required from the beginning of the performance year commencing on or after the 1 January 2023 commencement date.

This extended timeframe would provide impacting ADIs with adequate time not only effective solution design, but also for an appropriate implementation strategy, including the phased implementation of CPS511 requirements and/or piloting of particular elements ahead of final implementation.

⁴ APRA, 2020 Revised draft Prudential Standard CPS 511, Paragraph 9(b) [\[link\]](#)

⁵ Response Paper 'Strengthening prudential requirements for remuneration', section 9.2.



2. Service providers

2.1 Overview

The ABA refers APRA to our submission to the consultation on revised draft CPS 511. We reiterate that the proposed requirements for service providers in revised draft CPS511 are expansive and would bring into scope service providers which APRA has indicated not to be in scope (i.e.: those service providers which do *not* sell or distribute products⁶ on the behalf of an APRA-regulated entity).

The ABA understands that it is only certain types of service providers which are of concern to APRA, presumably as it is deemed that remuneration structures which are sales-centric may increase conduct risk, in turn adversely impacting the prudential stability of ADIs. Therefore, a minimal change to the requirements of CPS/CPG 511 which APRA could make would be to limit the scope of the standard to service providers for which APRA holds particular concern and/or produce a definition of service provider⁷.

Notwithstanding, the ABA believes that there are greater challenges with compliance with the service provider requirements as presently drafted. These are:

- Some service providers identified by APRA are already subject to significant remuneration regulation. The ABA acknowledges that the remuneration frameworks of other service providers identified by APRA are not subject to regulatory requirements. For these entities, APRA's goals may be better achieved the remuneration arrangements of those entities were considered by the Council of Financial Regulators.
- There are practical limitations to ADIs identify potential conflicts or risks with the remuneration frameworks of service providers, and even greater constraints in relation to influencing these .
- Even in the case where an ADI can identify a conflict with a service provider's remuneration arrangements, it is unclear how the ADI would undertake 'enhanced oversight' of another entity; and changes to or termination of the service provider arrangement may introduce market and competition issues for the ADI⁸. Moreover, service providers may often have relationships with more than one ADI, which complicates matters further.

The remainder of this section is structured as follows:

Section 2.2 elaborates on the challenges introduced by the service provider requirements of revised draft CPS 511 and draft CPG 511 for mortgage broker and financial adviser remuneration given the existing remuneration obligations to which those service providers are subject, an overview of which is included in the Appendix of this document.

Section 2.3 provides further detail on the practicalities of capturing explicitly 'the employees of the third-party service provider'⁹ using the case study of the mortgage broker service provider channel.

Section 2.4 identifies an inconsistency between draft CPG 511 and the Response Paper.

Section 2.5 offers recommendations.

2.2 Existing remuneration requirements

The ABA acknowledges and is supportive of APRA's intent of improving the oversight and alignment of remuneration arrangements of select service providers with the principles of CPS 511.

However, some of the service providers APRA considers requiring particular focus, such as mortgage brokers and financial advisers, are already subject to extensive legal and regulatory obligations in respect to their remuneration frameworks (see Appendix). This oversight requirement will lead to

⁶ Refer to draft CPG 511, paragraph 35, 'Service Providers'.

⁷ For example, CPS 511 could reflect paragraph 33 of draft CPG 511 by specifying the types of service providers of concern to APRA, notably external investment managers, mortgage brokers and insurance brokers.

⁸ Refer to draft CPG 511 paragraph 36.

⁹ APRA Response Paper 12 November 2020 p19



additional compliance complexity through regulatory duplication and overlap. In the case both CPS/CPG 511 and the legislative and regulatory requirements noted in the Appendix do not fully overlap, it is unclear what additional prudential risks APRA is seeking to address in respect of the selected service providers.

2.3 Practical limitations

There are important practical limitations and challenges, for example, in the management of mortgage brokers that will impact the scope and feasibility of the CPS 511 requirements.

A common mortgage broker model utilised in the financial sector consists of credit providing regulated entities engaging directly with approved aggregators, also called 'Head Groups' on a standard contractual and remuneration basis. As a result, ADIs pay remuneration directly to the Head Groups. These Head Groups, in turn, have separate contract and remuneration arrangements with their mortgage brokers (that can be either individuals or small businesses). Under this model, ADIs do not have any direct contractual remuneration obligations with the individual mortgage broker.

It is equally important to note that in most cases, neither Head Groups, nor mortgage brokers are agents for the ADIs (other than in some cases for the specific purpose of Anti-Money Laundering / Counter Terrorism Financing). This operating model is appropriate in that these Head Groups are non-exclusive and, as such, have concurrent contractual arrangements with multiple ADIs.

ADIs have implemented processes to assess the risk and suitability of both Head Groups and mortgage brokers. Further Head Groups working with ADIs are subject to accreditation standards, agreements and payment structures. Head Groups also have requirements for ongoing reporting, monitoring of performance, and adherence to regulatory obligations and attestations under their ACL.

To prevent competition and conflict issues, ADIs may maintain standard payment structures across their accredited Head Groups. In turn, each Head Group will pay their mortgage broker under each independent mortgage broker's payment agreement.

It is therefore not practicable for an ADI to undertake 'enhanced oversight' or influence remuneration arrangements of the mortgage brokers in these instances as the Head Group's mortgage broker network is separate to from the ADI.

2.4 Drafting inconsistency

The ABA notes an inconsistency in documentation requiring clarification.

Draft CPG 511 paragraph 36 states (bolding added):

*Where an entity has identified a potential conflict in the remuneration arrangements of a service provider and the intent of its own remuneration framework, CPS 511 requires an entity to take steps to address this risk. This could include enhanced oversight, **changes to the service contract** or termination of the arrangement, depending on the materiality of the conflict. Good practice would be to maintain a record of the assessment of the potential conflicts of third-party service providers, and monitor the effectiveness of measures that have been put in place to manage risks'*

However, the Response Paper states:

[entities]"are **not required to influence the remuneration arrangements** of third-party service provider employees or contractors."¹⁰

The ABA supports a concurrent industry review of final draft CPS 511 and final draft CPG 511 to check for consistency before the instruments are finalised.

¹⁰ APRA, 2020., [Response Paper - Strengthening prudential requirements for remuneration](#) Section 3.12 p19



2.5 Recommendations

In summary the ABA recommends:

- For APRA to achieve its objectives, in relation to aligning the remuneration frameworks of select service providers:
 - For those service providers whose remuneration arrangements are currently regulated, APRA could identify the residual prudential risk it is seeking to address through CPG/CPS 511 so that the ABA can offer constructive options for how the required oversight might be managed.

For example, one solution might be that CPS 511 could require ADIs to seek assurances from service providers. In the case of mortgage brokers, this could include receiving assurances from Head Groups, that the remuneration frameworks of direct or managed brokers are aligned to paragraph 19, and 36-37 of draft CPS 511 as it relates to Remuneration Design.
 - For those service providers whose remuneration arrangements are currently not regulated, APRA could refer the matter to the Council of Financial Regulators.
- For APRA to limit the scope of service providers in CPS 511, as it has listed as examples in draft CPG 511 paragraph 33, to those service providers for which APRA holds particular concern.

3. Other matters

3.1 Forms of variable remuneration

The ABA highlights that the definition of variable remuneration in revised draft CPS 511 paragraph 18(u) can have multiple interpretations.

Variable remuneration is defined as:

‘the amount of a person’s total remuneration that is conditional on objectives, which include performance criteria, service requirements or the passage of time’ (revised draft CPS 511 paragraph 18(u))

The focal element of variable remuneration ‘objectives’, can be interpreted as follows:

- Interpretation 1 Performance Criteria AND
[Service Requirements or the Passage of Time]
- Interpretation 2 Performance Criteria OR
Service Requirements OR
The passage of time

The ABA suggests the definition of variable remuneration be amended to align with the intended interpretation.

If the intended interpretation is Interpretation 1, where performance criteria is a fixed component of objectives and therefore variable remuneration, different types of remuneration may or may not meet this definition depending on the context in which it is offered. For example:

- A **cash** reward may include a performance element, or it may not.



- Some **termination payments** do not have performance elements. Some include statutory and contractual requirements (e.g.: payment in lieu of notice period, leave accruals, long-service leave entitlements).
- **Buy-outs** may or may not have performance measures.
- **Guaranteed** cash payments are, by definition, not conditional on performance.
- **Fringe benefits** are not easily applied to the CPS/CPG 511 requirements as entities typically cannot adjust, defer, or apply malus and clawback to these types of payment.

The ABA suggests that paragraph 40 and Table 2 are prescriptive and that instead, a principle-based guidance for variable remuneration types could be provided. As an alternative approach, the ABA suggests that APRA could provide parameters for general categories of variable remuneration. For example, the EBA's 'guidelines on sound remuneration policies'¹¹ provides principle-based definitions of variable remuneration and fixed remuneration. Where the EBA does note specific forms of variable remuneration, it does so by providing examples to explain a concept. Similarly, APRA could provide parameters or 'guard rails' for types of variable remuneration it considers should be avoided or tightly controlled, rather than identifying specific types of variable remuneration which are to be 'avoided' or 'tightly controlled'.

3.2 International banks

The ABA notes that some ADIs are local subsidiaries of global banks. These global banks are subject to the remuneration obligations of their regulator of origin. For example, specific members of the ABA are already subject to the requirements of their head office regulators such as the Prudential Regulation Authority (PRA), the Central Bank of the Netherlands (DNB), the European Central Bank (ECB), European Banking Authority (EBA) and national supervisory authorities within the European Union (EU)¹². Therefore, there could be inconsistencies between the obligations required by head offices and CPS 511.

The ABA suggests for ADIs that are local subsidiaries of global banks that CPG 511 include guidance for how to apply for an adjustment or exemption from a specific requirement of CPS 511, under paragraph 16 of revised draft CPS 511.

3.3 Material Risk Taker

There appears to be a drafting inconsistency in draft CPG 511 when compared to revised draft CPS 511, in respect to the expected approach to the identification of Material Risk Takers.

Draft CPG 511 paragraph 28 states: 'A prudent entity would consider the identification of groups of material risk-takers as well as individuals, including those that may **collectively affect financial soundness**' (bolding added).

This implies that material risk takers are to be identified on their combined potential impact on an entity. However, revised draft CPS 511 uses singular language meaning that material risk takers are to be identified on an individual basis (see paragraph 18(j)).

Further, this does not align with APRA's 2019 discussion paper for draft CPS 511 which removed the term 'collective' as was then and currently in CPS 510 - Governance stating, '*APRA is proposing to remove the consideration of collective impact of groups of individuals, given that the proposed CPS 511 would apply to the remuneration arrangements of all employees.*'¹³

If it is intended to apply CPS 511 to 'collective' MRTs, the ABA suggests this should be reflected in the actual Standard and be subject to further consultation. If this is a drafting inconsistency, which is the

¹¹ [EBA 2015 Guidelines on Sound Remuneration Policies](#). (see section 7)

¹² For example: [Capital Requirements Directive V \(CRD V\)](#) and [Guidelines on Sound Remuneration Policies](#) under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013.

¹³ APRA, 2019, Discussion Paper Strengthening prudential requirements for remuneration (23 July) p.24 ([link](#))



ABA's interpretation, this can be rectified by deleting the reference to identifying MRT's on a collective basis in paragraph 28 of draft CPG 511.

Appendix

Mortgage Broker obligations

The remuneration arrangements of mortgage brokers and mortgage aggregators have been extensively considered by the Department of Treasury (**Treasury**) and are an active area of policy for ASIC.

National Consumer Credit Protection Act

The existing legislative requirements under section 158N of the National Consumer Credit Protection Act (2009) (**the NCCP Act**) introduced bans on conflicted remuneration of mortgage brokers, and mortgage broker intermediaries as of 1 January 2021. Further, the National Consumer Protection Regulations (2010) provides detailed guidance on what is deemed or not deemed to be conflicted remuneration.

ASIC has issued regulatory requirements under *Regulatory Guide (RG) 273 Best Interest Duties (BID)*. Since 1 January 2021, ASIC RG 273¹⁴ implements the BID for mortgage brokers (and other relevant credit licensees) which requires Head Groups and mortgage brokers to act in the best interests of consumers, and to prioritise the consumers' interest when providing credit assistance ('conflict priority rule'). There are now civil penalties for breaching the obligations of the BID.

Further, the types of 'tiered servicing arrangements' that entities have with mortgage brokers is governed by the conflicted remuneration standard.

Corporations Act Part 7.8A

Changes to Part 7.8A of the Corporations Act which legislated for the development and marketing of financial and credit products came into effect on 5 April 2021.

ASIC has issued *Regulatory Guide (RG) 274 Product Design and Distribution Obligations* which obliges product issuers to take reasonable steps to develop and distribute products to their intended consume segment.

Financial adviser obligations

In respect to financial advisers, the ABA notes that recommendation 2.4 of the Royal Commission was the ending of grandfathering of conflicted remuneration arrangements. The Treasury Laws Amendment (End Grandfathered Conflicted Remuneration) Act 2019 banned this type of remuneration from 1 January 202 and ASIC updated Regulatory Guide RG 246 Conflicted and Other Banned Remuneration address these primary concerns to mirror the law.

¹⁴ <https://asic.gov.au/media/5641325/rq273-published-24-june-2020.pdf>