



23 July 2021

[REDACTED]
General Manager Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

By email: [REDACTED]

Dear [REDACTED]

Remuneration Standard Response Paper

The Australian Financial Markets Association (AFMA) welcomes the opportunity to respond to APRA's consultation on the Prudential Practice Guide Draft (the Guide) CPG 511 Remuneration. AFMA commends APRA's ongoing consultation processes in relation to the remuneration standard and practice guide. We believe the significant investment of effort to ensure the settings are optimised is appropriate given the significance of remuneration requirements to the competitiveness of the industry.

AFMA has been actively involved with every part of APRA's consultation processes and will be pleased to continue to provide insights and information from the industry as the project draws towards its close. We welcomed the refinements announced in the updated draft of the standard and have provided further feedback to APRA to inform the final standard drafting process.

While our comments in this submission are directed at the draft Prudential Practice Guide, APRA may intend for some matters we raise to be dealt with in the final revisions to the standard rather than the Guide. The intertwined nature of the consultation processes means we cannot be fully confident of where elements will be addressed, so we ask that our submission be received with an understanding that some of our suggestions may be misdirected in suggesting amendments to the Guide.

Thank you for considering our comments in the attached submission. Please feel free to contact us for more information via the Secretariat.

Yours sincerely

[REDACTED]

[REDACTED]

Senior Director of Policy

General Comments

AFMA finds the Prudential Practice Guide CPG 511 to generally be sensible and providing further helpful insights into APRA's expectations around complying with the CPS 511 Remuneration Standard. The great majority of the Guide is fully supported and our comments are limited to a number of areas where further detail or additions might be of assistance.

Asset threshold

AFMA is of the view, as expressed in previously in relation to the standard itself, that for foreign ADIs, there should be recognition of home jurisdiction remuneration regulations, particularly in relation to deferral periods. Duplicating these requirements for some staff adds unnecessary complexity, especially given the far lower risks posed to the Australian jurisdiction of foreign ADIs due to their more limited contact with Australian deposits. For these same reasons we reiterate our request that higher thresholds for inclusion in the scheme should be applied to foreign ADIs.

AFMA appreciates that further clarity has been provided on the asset test to be used with the specification of *total assets* and the reporting standards from which it should be derived. We note that the BEAR/FAR regime uses a different asset test, the *total resident assets*. We note that foreign ADIs no longer need to complete any of the forms noted in the footnote of the practice guide¹.

AFMA supports consideration of greater alignment of the thresholds by using the same *total resident assets* reference figure.

We note that the BEAR/FAR figures are indexed (and for large ADIs the threshold is now \$107 billion up from the original \$100 billion), while the SFI definition contained in the Guide does not appear to be indexed. This is likely to introduce a creep downwards over time to include institutions where it may be less efficient to have the SFI requirements.

AFMA supports indexing the levels in CPG 511 in a manner similar to BEAR to address this risk.

BEAR/FAR also defines the asset size as the average of the final report for the three most recent financial years. This measure is designed to prevent firms bouncing in and out of the standard which would cause administrative difficulties and inconsistent implementation for firms in relation to matters such as deferral arrangements. AFMA's assessment is that as currently drafted this may be a risk for the remuneration standard, particularly if firms have total asset numbers near the threshold.

AFMA supports adopting a similar average of the three most recent final reports approach in CPG 511.

¹ Reporting Standards ARS 322.0 Statement of Financial Position, GRS 300.0 Statement of Financial Position, LRS 300.0 Statement of Financial Position, HRS 602.0 Financial and Capital Data and SRS 320.0 Statement of Financial Position. ARS 322.0 was previously reported by foreign ADIs but is no longer

Pro-rata/allocation system

AFMA has previously raised our support for a BEAR/FAR pro-rata system and noted the criticality of this element for the smooth implementation of the scheme. Pro-rata arrangements are important for senior officers outside of Australia and for roles with interactions with entities other than the ADI. The absence of pro-rata arrangements would make attracting international staff into roles that involve some supervision of the Australian entity difficult and could increase costs.

The pro-rata system should ensure that the scheme applies to individuals only to the extent they spend their time on ADI-related matters. Earlier resolution potentially through the standard or a revised CPG would assist implementation of the scheme.

De minimis

Related to the pro-rata scheme AFMA suggests a de minimis exclusion for individuals who spend under 10 per cent of their time on ADI-related matters.

The complexity and overheads associated with the scheme should not be brought to bear for minor time allocations with consequently only minor financial implications for individuals. For example, the proportions of income that could be withheld for those spending 10 per cent of their time on Australian ADIs might be in the order of 2% depending on the ratio of fixed to variable income. While incurring the same administrative overheads for affected firms this outcome may not be consequential.

Similarly, where individuals work for and are remunerated by a related entity in another jurisdiction, merely booking some transactions to the Australian ADI should not invoke inclusion in the scheme.

Other matters

Deferral periods

AFMA welcomes confirmation that the deferral period commences at the beginning of the performance period for which the variable remuneration is being assessed.

CPS 511.52 refers to the deferral period beginning at the start of the performance period “only where the measures of performance are forward-looking”. Clarification would be appreciated on how this phrase should be read in this context.

For partial year periods such as buy-outs, executives commencing part-way through a financial year, and retirements occurring outside the variable remuneration cycle, AFMA requests that worked examples are provided to give firms confidence that their interpretation of the rules is appropriate.

We note that AFMA would prefer better integration and compatibility with the Financial Accountability Regime (FAR). While we understand the two schemes have different origins and objectives, having two separate and incompatible schemes aimed at remuneration overlapping for some firms and roles creates unnecessary administrative overhead and uncertainty.

We suggest that the competing elements of these schemes be rationalised into a single coherent scheme in due course. We understand that in the UK the Senior Managers identified by the Senior Manager Regime (SMR) have the deferral requirements applied to them via the prudential regulator and conduct regulator standards which reference the SMR.

We note that the Exposure Draft Explanatory Materials for the FAR Bill notes:

The deferral period is intended to be consistent with provisions of APRA's proposed prudential standard...

AFMA supports this aim of consistency in the deferral periods between the regimes but with the benefit of the CPS 511 vesting schedule.

Variable remuneration definition

AFMA would welcome more discussion on the examples of forms of variable remuneration provided within Table 2 of the Guide. There are a number of concerns including that commencement and termination benefits have been noted as presenting challenges to deferral requirements.

Clawback

As we noted in our original submission clawback is a challenging contractual arrangement and can face legal challenges in practice. AFMA is concerned that there may be incompatibilities with the clawback requirements and the Fair Work Act that might not be surmountable with contractual arrangements. AFMA suggests further legal exploration of this area is required to ensure compatibility with these other legislated requirements.

Use of number of shares for the deferral schedule

Firms report that they value the flexibility to award equity-based remuneration on a dollar value basis rather than number of shares, as this approach has benefits including relating to their accounting treatment. We seek further information on why APRA would view dollar basis equity as a less optimal practice. Where firms elect to make equity awards on a value basis AFMA suggests these deferred components be treated similarly to cash deferrals.

Supervision by the Board of risk and financial control staff

The Guide calls for Boards to “closely monitor the remuneration of all risk and financial control personnel as a cohort”. In some firms these functions are large and contain large numbers of non-senior staff.

The proper role of Boards should not be compromised into managerial functions. ADI Boards need to be across around 75 risk classes including credit, financial crime, information security and many other critical risks. Given the expansive risk landscape and their proper role as governance rather than management bodies, Boards should focus on ensuring they have the right triggers, thresholds, relevant skills, a clearly defined risk appetite, and the judgement and ability to question and intervene more deeply when required, rather than being responsible for oversight of the remuneration of more junior staff.

AFMA suggests the remit of Boards be limited to more senior risk and financial control staff.

Third parties

In AFMA’s view the service provider related guidance could be further developed. While at a high level they are comprehensible, it is not clear how it should integrate with other regulatory requirements around conflicted remuneration such as ASIC RG 246.

More generally and consistent with APRA’s work in relation to third party suppliers elsewhere such as in CPS 234, more work needs to be done to harmonise regulatory requirements around third parties with reasonable commercial realities in market based economies, and with the reasonable limits of the extension of regulatory reach into entities outside the regulated population.

Commencement year

Members seek clarity around the operational flexibility of the scheme for the first year. The standard has a commencement date of 1 Jan 2023 for SFI ADIs, which may not match bank remuneration financial years. Options might include applying the requirements of the scheme to a period of less than a full year or it may be more efficient to allow firms the flexibility to extend the first year to the end of the first remuneration period. In the event part years are the preferred outcome (for example from the start date of the scheme on 1/1/23 to a remuneration FY ending September) AFMA requests confirmation that only the proportion of remuneration within this date window should be deferred and subject to the regime.