



# RESPONSE PAPER

## Strengthening prudential requirements for remuneration

12 November 2020

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# Executive summary

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An effective remuneration framework is an important component of a resilient financial system; long-term financial soundness requires prudent incentive structures and clear accountabilities for outcomes. In introducing an updated prudential standard for remuneration, APRA's goal is to lift minimum standards of practice, through enhancing board oversight, increasing the use of non-financial measures in remuneration design and ensuring there are appropriate financial consequences for poor risk management. APRA's approach is risk-based and proportionate, with more comprehensive requirements for larger and more complex regulated entities.

Strengthening prudential requirements for remuneration is a key priority for APRA, within its broader objective to enhance governance, culture, remuneration and accountability across all regulated industries. The global financial crisis, APRA's supervisory findings and the recent Royal Commission<sup>1</sup> have demonstrated continued shortcoming in remuneration arrangements. In particular, senior executives have been financially rewarded, despite failings in risk management and poor community outcomes. A revised regulatory framework, providing a foundation for entities to adopt a more holistic view of executive performance, is needed.

As the industry moves beyond the initial stages of COVID-19 stress, and the focus shifts to supporting growth, it is important that the examples of weak practices observed in earlier years are not repeated. To underpin prudent long-term growth outcomes, entities must broaden incentive structures away from a sole focus on short-term financial performance.

New prudential requirements for remuneration will be a key area of APRA's supervisory focus in the period ahead. Successful implementation of revised CPS 511 across all industries is designed to deliver:

- stronger **incentives** for individuals to proactively manage non-financial risks;
- appropriate financial **consequences** where material risk incidents have occurred; and
- increased **transparency** to drive stronger board accountability for remuneration outcomes.

## Proposed new requirements

APRA initially consulted on a new draft prudential standard for remuneration in July 2019. During the consultation, APRA hosted over 40 industry engagements and received 76 submissions. APRA received most feedback on the proposal for a 50 per cent limit on the use of financial performance measures to determine remuneration outcomes. Industry commonly described this proposal as limiting flexibility in remuneration design. Concerns were also raised about the prescriptive nature of certain other requirements, with industry

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<sup>1</sup> Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2019) *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report*.






highlighting the risk that the board's role could shift away from oversight and that overly long deferral periods could be detrimental to attracting talent.

In response to feedback, APRA has revised its original set of proposals and is conducting a second consultation on a revised standard (revised CPS 511). The revised proposals will strengthen market practice and address the Royal Commission recommendations, through more principles-based minimum requirements. Revised CPS 511 sets key requirements for sound remuneration practice, to ensure that an entity's framework includes the components to promote effective risk management, sustainable performance and long-term soundness. With a more principles-based approach, boards have more flexibility to strengthen remuneration practices in a way that is appropriate to their business model and particular risks.

In revised CPS 511, APRA has maintained its focus on non-financial risks, by requiring entities to give material weight to these measures in remuneration design, rather than a prescriptive hard limit. APRA's revised deferral requirements remain strong relative to international peers, but have been marginally reduced so APRA-regulated entities are not at a competitive disadvantage. Boards remain accountable for remuneration outcomes but will be required to provide stronger oversight on the effectiveness of remuneration arrangements. Changes have been made to reduce administrative burden.

In responding to industry feedback, APRA has carefully considered options to minimise regulatory burden, particularly for smaller and less complex entities. While draft CPS 511 included some elements of proportionality, APRA has further reduced requirements of non-Significant Financial Institutions (non-SFIs) in the revised standard. Under revised CPS 511, non-SFIs will not need to meet minimum deferral, clawback and review requirements. They will be subject to simpler overarching remuneration design requirements. In certain areas, the revised CPS 511 proposals are less onerous than existing CPS 510 and SPS 510 requirements.

For the largest and most complex entities, Significant Financial Institutions (SFIs), the core elements of revised CPS 511 are illustrated below, representing the strongest areas of reform relative to current market practice. Taken together, these core measures will require SFI boards to strengthen incentives to manage non-financial risks, regularly assess for risk management failings and have deferral arrangements that allow boards to reduce remuneration for poor risk outcomes. These measures will be reinforced with stronger market discipline and heightened supervision. While many regulated entities have already made progress to improve remuneration frameworks, further change is required to entrench the minimum standards set out in revised CPS 511.

		Current market practice	Revised CPS 511 for SFIs
1	 <b>Governance</b>	<ul style="list-style-type: none"> <li>• <b>Varying board oversight</b> of the remuneration framework, based on minimum principles in CPS/SPS 510.</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthened board <b>oversight</b> through explicit responsibility for approving remuneration outcomes.</li> </ul>
2	 <b>Non-financial measures</b>	<ul style="list-style-type: none"> <li>• <b>Limited use</b> of non-financial measures; no existing requirement.</li> </ul>	<ul style="list-style-type: none"> <li>• Require <b>material weight</b> to non-financial measures.</li> </ul>
3	 <b>Risk adjustment</b>	<ul style="list-style-type: none"> <li>• <b>Principles-based adjustment</b> of variable remuneration downwards to zero, required under CPS/SPS 510 and the BEAR.</li> </ul>	<ul style="list-style-type: none"> <li>• Variable remuneration <b>outcomes</b> must reflect risk outcomes using tools such as the <b>risk and conduct modifier, malus and clawback</b>.</li> </ul>
4	 <b>Deferral</b>	<ul style="list-style-type: none"> <li>• <b>Minimum deferral</b> obligations for ADIs and limited to accountable persons, under the BEAR.</li> </ul>	<ul style="list-style-type: none"> <li>• Extended <b>deferral</b> obligations and allow for <b>pro-rata vesting</b>.</li> </ul>
5	 <b>Disclosure</b>	<ul style="list-style-type: none"> <li>• Limited and <b>high-level</b> prudential requirements for transparency that only apply to ADIs, in APS 330.</li> </ul>	<ul style="list-style-type: none"> <li>• Heightened prudential requirements for <b>transparency</b> to balance principles-based requirements.</li> </ul>

**Governance:** Revised CPS 511 will lift expectations of SFI boards and introduce new review requirements to enhance board oversight of the remuneration framework. To meet APRA's requirements, boards will need to be more engaged on remuneration decisions and outcomes.

**Non-financial measures:** SFI boards will be required to ensure incentives give material weight to non-financial measures to encourage a more balanced approach to risk management in the pursuit of financial performance. Short-term and long-term incentive arrangements that have predominantly relied on financial objectives must now incorporate non-financial measures. Of all the core proposals in revised CPS 511 illustrated above, this will represent the greatest change from current practices. While APRA will require these design principles, entities will have the flexibility to design incentives to align with their business strategies.

**Risk adjustment:** Entities will be required to have a process to adjust remuneration outcomes of individuals, to zero if appropriate, where they are found to be responsible for risk and conduct incidents. Existing practices, typically implemented through modifiers, will need to be tightened to ensure effective and consistent application. This will ensure that entities no longer reward executives for financial performance, if there are significant failings in non-financial risk management.

**Deferral:** SFI boards across all industries will be required to lengthen minimum four-year deferral periods set by the Banking Executive Accountability Regime (BEAR) and proposed under the Government's Financial Accountability Regime (FAR). In line with Financial Stability Board (FSB)'s *Principles of Sound Compensation Practices*, the longer deferral periods will strengthen incentives to focus on the long-term, and pro-rata vesting will allow for a gradual distribution of payments. The revised deferral periods are 6 years for a Chief Executive Officer (CEO), 5 years for a senior manager and executive director and 4 years for a highly-paid material risk-taker (HPMRT). Pro-rata vesting allows the payment of deferred amounts to commence from year 4 for a CEO, senior manager and executive director and from year 2 for a HPMRT.

**Disclosure:** With the revised CPS 511 setting minimum standards that are principles-based, there is a corresponding need for greater transparency. To reinforce accountability, APRA proposes to require entities to demonstrate publicly how they are satisfying the key principles in the standard. APRA plans to enhance disclosure requirements and is considering proposals that would have entities publish aggregated details of remuneration outcomes and adjustments for material risk incidents. These are intended to complement *Corporations Act 2001* requirements. Consultation on disclosure proposals will commence in 2021.

These core elements of revised CPS 511 are mutually reinforcing. Stronger incentives to manage non-financial risks proactively are only effective if there are appropriate consequences where risks have not been prudently managed. Boards need to be more engaged in aligning incentives and ensuring appropriate remuneration outcomes, and need to demonstrate this publicly.

### **Implementation timetable**

To provide entities with additional time to transition to the new requirements, a phased implementation of the final standard is proposed. Larger and more complex entities will be expected to comply with the new requirements in 2023, while smaller entities (non-SFIs) will not need to comply until 2024.

APRA intends to finalise CPS 511 in the second quarter of 2021. APRA requests industry feedback on revised CPS 511, giving focus to the revised proposal to limit financial performance measures, with a three-month consultation period ending on 12 February 2021.

APRA will also consult on a new prudential practice guide in early 2021 and commence consultation on draft reporting and disclosure requirements by the fourth quarter of 2021. As previously foreshadowed, a review of the effectiveness of CPS 511 is intended four years from its effective date to ensure the standard is delivering on intent.

In revising CPS 511, APRA has collaborated with the Australian Securities and Investment Commission (ASIC). The findings of ASIC's corporate governance reviews reinforce the need for reform and many key CPS 511 requirements align with ASIC's findings. With respect to the FAR, APRA is continuing to work closely with the Treasury to ensure there is appropriate alignment with CPS 511 and to support an entity's implementation of both.

## **Structure of this paper**

The introductory chapter of this paper provides a summary of the proposals in revised CPS 511. When referring to later chapters:

- Chapter 1 to chapter 7 outline the technical feedback from industry, and how APRA has responded in revised CPS 511;
- Chapter 8 outlines APRA's proposal for greater proportionality in revised CPS 511, which will be relevant to smaller entities as it gives clarity on the reduced requirements being imposed;
- Chapter 9 sets out APRA's approach for a phased implementation of CPS 511; and
- Chapter 10 provides initial ideas on disclosure proposals.

# Glossary

<b>ADI</b>	Authorised deposit-taking institution
<b>BEAR</b>	Banking Executive Accountability Regime set out in Part IIAA of the Banking Act 1959.
<b>Board</b>	The board of directors, or a group of individual trustees in the case of a RSE licensee.
<b>CEO</b>	Chief Executive Officer.
<b>Clawback</b>	The recovery of an amount corresponding to some or all variable remuneration subject to recovery that has been paid or vested to a person.
<b>Conduct risk</b>	The risk associated with action or inaction by a person covered by an entity's remuneration policy that does not meet applicable: <ul style="list-style-type: none"> <li>(i) legal and prudential obligations;</li> <li>(ii) requirements or standards of a recognised professional body; or</li> <li>(iii) policies and procedures covering conduct and ethical standards set out by an entity.</li> </ul>
<b>Deferral period</b>	Includes the period over which performance is assessed and only where the measures of performance are forward-looking. The deferral period must also include any required service, retention and holding periods.
<b>Executive director</b>	Means a director that is not a non-executive director, where director is defined in APRA's definitional standards.
<b>Highly paid material risk takers</b>	Material risk-takers whose total fixed remuneration (which includes salary, superannuation, allowances and benefits) plus actual variable remuneration is equal to or greater than 1 million AUD in a financial year of the entity.
<b>In-period adjustment</b>	An adjustment made to variable remuneration during the period set for measuring the performance under a variable remuneration arrangement.
<b>Long-term incentive</b>	The amount of a person's variable remuneration that is subjected to a performance period which spans a specified number of years following the inception of the variable remuneration component.
<b>Malus</b>	An adjustment to reduce the value of all or part of deferred variable remuneration before it has vested.
<b>Material risk taker</b>	A person whose activities have a material potential impact on the entity's risk profile, performance, long-term soundness or for a RSE licensee, impact on performs its duties and exercises its powers in the best financial interests of the beneficiaries.
<b>PHI</b>	Private health insurer.
<b>RSE</b>	Registrable superannuation entity.
<b>Remuneration arrangement</b>	An arrangement that includes measures of performance, the mix of forms of remuneration (such as fixed and variable components, and cash and equity-related



	benefits) and the timing of eligibility to receive payments. All forms of remuneration are captured by this Prudential Standard, regardless of where, or from whom, the remuneration is sourced.
Remuneration framework	The totality of systems, structures, policies, processes and people within an entity that identify, measure, evaluate, monitor, report and control or mitigate all internal and external sources of risks relating to remuneration.
Senior manager	A person as defined in the Industry Acts, or in relation to an RSE licensee, has the meaning given in Prudential Standard SPS 520 Fit and Proper.
Short-term incentive	The amount of a person's variable remuneration that is subjected to a performance period which is the financial year immediately preceding the inception of the variable remuneration component.
Significant financial institution	Where an APRA-regulated entity is of a certain asset size as specified by APRA from time to time, has complexity in operations or remuneration practices, is a member of a group or as otherwise determined by APRA.
Specified role	A person in the category of senior manager, executive director, material risk taker (including highly paid material risk takers) and risk and financial control personnel.
Variable remuneration	The amount of a person's total remuneration that is conditional on objectives which include performance criteria, service requirements or the passage of time.
Vesting	The process by which the person becomes the legal owner of the variable remuneration.

# Revised proposals

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## Background

The current prudential framework for remuneration<sup>2</sup> was developed in 2010, following G20 reforms stemming from the global financial crisis that sought to address inappropriate risk taking incentivised by poorly designed remuneration practices. More recently, findings from various APRA reviews and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry<sup>3</sup> (Royal Commission) have demonstrated the need for further reform. In particular, experience has shown significant financial and non-financial risks can crystallise when the interests of stakeholders, such as shareholders, customers and executives, are misaligned.

## Revised CPS 511 and second consultation

In July 2019, APRA released draft CPS 511 for consultation. Following significant stakeholder engagement, APRA is now consulting on a revised CPS 511, which reflects a more principles-based approach to lifting minimum standards. Importantly the revised set of proposals address the recommendations of the Royal Commission and align to the Financial Stability Board's (FSB) *Principles of Sound Compensation Practices*.<sup>4</sup>

Table 1 below sets out the revised CPS 511 proposals, against the original draft proposals, and explains the principles that have driven the changes. Compared to the draft proposals, APRA has taken a more principles-based approach, including to limiting the use of financial metrics in variable remuneration. The revised proposals will also introduce longer minimum deferral periods for SFIs, though these are marginally shorter than originally proposed. There will be a further reduction in regulatory burden for non-SFIs which, under the revised proposals, are not required to comply with deferral and clawback requirements or review requirements. Revised CPS 511 is less onerous than existing CPS 510 and SPS 510 in certain areas, such as there is no longer a requirement for non-SFIs to have a board remuneration committee. This will minimise the impact of these proposals.

Revised CPS 511 retains a consistent set of minimum requirements across all APRA-regulated industries. However, the more principles-based approach to CPS 511 allows entities greater flexibility to address requirements to each entity's own particular risks and circumstances.

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<sup>2</sup> The current prudential framework for remuneration covers Prudential Standard CPS 510 Governance for authorised deposit-taking institutions, general insurers, life companies and private health insurers (CPS 510), and in Prudential Standard SPS 510 Governance for registrable superannuation entity licensees (SPS 510), Prudential Practice Guide PPG 511 Remuneration and Prudential Practice Guide SPG 511 Remuneration.

<sup>3</sup> Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2019) *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report*.

<sup>4</sup> <https://www.fsb.org/work-of-the-fsb/policy-development/building-resilience-of-financial-institutions/compensation/>

Table 1. Amendments to consultation proposals

	Original draft CPS 511	Revised CPS 511: SFIs	Revised CPS 511: non-SFIs	Reason for change
<b>Board oversight</b>				
Oversee framework and policy	✓	✓	✓ Streamlined	To reduce operational burden and ensure effective oversight
Ensure risk outcomes reflected in remuneration	✓	✓ Less prescription	✓ Streamlined	
Approve remuneration for specified roles	✓ HPMRT on individual basis	✓ HPMRT reduced to cohort basis	✓ HPMRT reduced to cohort basis	
<b>Remuneration framework</b>				
Promote long-term objectives	✓	✓	✓	To clarify policy intent that focus for third-party providers is assessing conflicts of interest
Covers all employees	✓	✓	✓	
Covers arrangements of third-party service providers	✓	✓ Re-focused	✓ Re-focused	
<b>Remuneration design</b>				
General design principles including malus	✓	✓	✓	
Limits on financial measures	50% cap on total measures; 25% cap on each individual measure	Material weight to non-financial measures; and adjust for adverse risk and conduct outcomes	✗	More principles-based approach to deliver stronger focus and allow flexibility
<b>SFI Deferral and clawback</b>				
CEO	60% for 7 years, pro-rata vesting from year 4 (SFIs only)	60% for 6 years, pro-rata vesting from year 4	✗	Strengthen practices and minimise impact of longer deferral periods on staff recruitment and retention
Senior manager and Executive director	40% for 6 years, pro-rata vesting from year 4 (SFIs only)	40% for 5 years, pro-rata vesting from year 4	✗	
HPMRT	40% for 6 years, pro-rata vesting from year 4	40% for 4 years, pro-rata vesting from year 2	✗	

	Original draft CPS 511	Revised CPS 511: SFIs	Revised CPS 511: non-SFIs	Reason for change
	(SFIs only)			
Clawback	✓ (SFIs only)	✓ Simplified	✗	Clarify intent for application given legal complexity
Reviews				
Annual compliance	✓	✓	✗	
Triennial effectiveness	✓	✓ Simplified scope	✗	
Disclosure				
Disclosure requirements	✓ Conceptual	✓ Initial ideas	✓ Initial ideas	

## Next steps

To reinforce APRA's reform objectives, revised CPS 511 will be supported by:

- ongoing supervision of entities' remuneration arrangements, which will commence with a deep dive implementation review on a sample of entities once arrangements are in place;
- a new draft prudential practice guide that outlines better practice, which will facilitate entity implementation and APRA's ongoing supervision of the requirements;
- new reporting and disclosure requirements to support the supervision focus, starting with a data study to inform the development of these requirements; and
- as previously foreshadowed, review of the effectiveness of CPS 511 four years from its effective date to ensure the standard is delivering on intent.

Table 2 provides a timeline of the next steps to achieving APRA's reform of remuneration. The widespread interest and feedback on the consultation proposals, particularly the limit on the use of financial measures, warrants a second consultation on the revised standard. The consultation on the revised standard will run for 12 weeks until 12 February 2021.

**Table 2. Timeline of next steps**

Date	Step
12 November 2020	Revised CPS 511 released and second consultation commences for 3 months.
12 February 2021	Close of second consultation on CPS 511.
Q1 2021	Draft CPG 511 consultation commences; and Commence data survey – 2 months.

Date	Step
Q2 2021	Release finalised CPS 511; and Close of data survey and consultation on draft CPG 511.
Q3 2021	APRA determines and notifies entities that are SFIs.
Q4 2021	Release finalised CPG 511; and Commence consultation on reporting and disclosure.
Q1 2022	Close of consultation on reporting and disclosure.
1 January 2023	CPS 511 in force, phased implementation starts; and Repeal remuneration related requirements in CPS 510 and SPS 510.
Q4 2022	Release finalised reporting and disclosure requirements.

# Chapter 1 - Industry consultation

## 1.1 Consultation feedback

APRA undertook extensive consultation on its proposals from July to November 2019. A total of 76 written submissions were received from entities across five industries and other key stakeholders including shareholder groups, proxy advisors, industry bodies, governance institutions, remuneration consultants and consumer groups. To enable appropriate discussion of the issues raised, APRA also directly engaged with stakeholders across the five industries through face-to-face meetings and webinars with over 380 registered attendees.

APRA has carefully considered the feedback provided and issues raised. On the whole, industry supported APRA's overall reform objectives to strengthen remuneration practices and to align remuneration outcomes with performance and risk outcomes. However, submissions raised concerns that the level of prescription in the proposed standard would not achieve intended outcomes. Table 3 below outlines the themes of feedback raised during consultation.

The majority of submissions highlighted the risks of the 50 per cent limit on financial measures. Certain entities and shareholder groups suggested that Total Shareholder Return (TSR) or Return on Equity (ROE) were appropriate measures to capture all relevant financial and non-financial risks.

In APRA's view, this is too narrow an assessment. Historical experience has shown that TSR and ROE reflect entity-wide assessments of performance, and do not reinforce individual accountability for effective management of non-financial risk. TSR and ROE can also be significantly lagging indicators of the effectiveness of non-financial risk management, which can lead to too much variable remuneration being awarded in the short-term. Deferral periods provide a safeguard, but the Royal Commission showed that some non-financial risks can take a long time to emerge, in which case individuals might have moved on.

**Table 3. Overarching themes of feedback**

Topic	Industry comments	APRA response
Board oversight	While industry recognised the need to improve board engagement, the prescription in draft CPS 511 could distract the board from its oversight role and make it less effective.	Chapter 2
Remuneration design - Service providers	A majority of entities questioned the effectiveness of the proposal. Feedback noted that accessing information about incentive structures at a third-party service provider would be challenging given the confidential nature of remuneration.	Chapter 3
Limit on financial measures	Majority of submissions noted that the proposed hard 50 per cent limit may entrench scorecard-based remuneration models and preclude other remuneration models and innovation in remuneration arrangements. There were also concerns relating to the negative consequences of focusing	Chapter 4

Topic	Industry comments	APRA response
	on non-financial measures, which may be immature, lack transparency and not be independently verifiable.	
Highly-paid material risk-takers (HPMRT)	Industry suggested that the broad definition resulted in too many people being captured, particularly given the need for the board and board remuneration committee to recommend and approve the remuneration outcomes of individual HPMRTs.	Chapter 5
Deferral	The deferral obligations proposed were described as long, weighted toward banking practice, and for the HPMRT cohort considered disproportionate to their potential impact on the organisation. This could impact on regulated entities' ability to attract and retain appropriate talent.	Chapter 6
Clawback	Respondents highlighted that clawback has little domestic and international precedence, is legally costly to undertake and would impact on competition for talent.	Chapter 6

## 1.2 Collaboration with ASIC

Strengthening remuneration practices across the financial system is a shared priority with ASIC. This year, ASIC provided guidance to boards regarding their oversight and exercise of discretion for variable pay outcomes of key management personnel, following targeted reviews of corporate governance practices.<sup>5</sup> The findings of these reviews reinforce the need for reform in remuneration and have contributed to collaborative efforts between APRA and ASIC to align regulatory expectations of domestic remuneration practices. Although the focus of prudential and conduct regulators differs, the underlying intent of many key revised CPS 511 requirements are reinforced by ASIC's review findings.

## 1.3 The Financial Accountability Regime

On 22 January 2020, the Government released a paper outlining proposals to extend the Banking Executive Accountability Regime (BEAR) to all APRA-regulated entities, under the Financial Accountability Regime (FAR). The FAR proposed minimum deferral requirements and adjustments to the variable remuneration of all accountable persons. APRA is continuing to work closely with the Treasury to ensure there is appropriate alignment with CPS 511 and to support an entity's implementation of both. Upon finalisation of the FAR legislation APRA will review whether any changes to CPS 511 are required.

<sup>5</sup> <https://asic.gov.au/regulatory-resources/corporate-governance/corporate-governance-taskforce/>

# Chapter 2 - Board and the board remuneration committee

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## 2.1 Governance and oversight

APRA's objective is to strengthen governance and oversight of an entity's remuneration framework by the board and board remuneration committee. In APRA's view, boards have not been sufficiently engaged on remuneration and focused on compliance.

### 2.1.1 Comments received

Industry acknowledged the need to strengthen the roles and responsibilities of the board and the board remuneration committee. However, there were reservations about the level of prescription in draft CPS 511. Submissions suggested that this prescription could impose operational responsibilities on the board and committee and undermine the ability to oversee execution of the business strategy and delegate operations to management. Certain submissions sought clarity on management delegation and interactions between the board and committee.

### 2.1.2 APRA's response

APRA's objective is for the board and the board remuneration committee to bring rigour and challenge to its oversight of the remuneration framework. APRA has removed some prescription and sharpened its focus on overarching principles to ensure that boards:

- take an entity wide view to effectively govern implementation and outcomes of the remuneration framework;
- improve oversight of incentives and how behaviour may drive or impact the entity; and
- understand how different elements within the remuneration framework interact to appropriately govern and support prudent remuneration practices.

The revised board requirements incorporate the FSB's guidance, and do not impose responsibilities beyond international better practice.<sup>6</sup> They clarify the responsibilities between management, the board and board remuneration committee, without unnecessary prescription. APRA will provide guidance on better practices for board and committee interactions and management delegation in a new CPG 511.

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<sup>6</sup> In relation to ADIs, this includes the Prudential Regulation Authority (United Kingdom) and European Banking Authority (Europe).



## 2.2 Board approval of remuneration outcomes

APRA's objective in requiring board approval of remuneration outcomes is to improve board engagement, challenge and accountability. Draft CPS 511 proposed that the board approve the remuneration outcomes of specified roles, some on an individual basis and others on a cohort basis, following committee recommendations. This was intended to impose heightened accountability on staff with higher responsibility levels and entity impact.

### 2.2.1 Comments received

Industry sought clarity on how the proposals for board remuneration committee recommendations and board approvals would work together in practice. The proposals were considered board-heavy and described as having the potential to limit management accountability or dilute senior management's role in setting the remuneration outcomes of certain staff.

Another key concern was that individual approvals of a large number of specified roles would impose a significant burden on the board. HPMRTs were noted as particularly arduous. Industry suggested that this could diminish the board's ability to provide oversight of the remuneration framework more broadly and distract from other board duties.

### 2.2.2 APRA's response

In APRA's view, requiring the board to approve remuneration outcomes, following committee recommendations, will strengthen board engagement, oversight and accountability. However, APRA does not consider it an effective use of a board's time to understand every employee's individual remuneration arrangement or individually approve the remuneration outcome of each person in a specified role, other than the CEO, senior managers and executive directors.

APRA has amended HPMRT recommendations and approvals to be on a cohort basis and, as detailed in chapter 5 of this response paper, the definition of HPMRT has also been narrowed. These changes address industry concerns about the burden on an entity's board, whilst ensuring there is appropriate oversight that is consistent with the collective impact of HPMRTs on an entity's risk management and long-term soundness. APRA plans to outline better practice examples for cohort reviews in a new CPG 511.

## 2.3 Board reporting

APRA's objective is that the board and board remuneration committee have appropriate information to facilitate a holistic appraisal of remuneration outcomes and to underpin effective decision making and oversight of remuneration outcomes. While there is currently mixed practice across industries, draft CPS 511 contained key proposals for the board remuneration committee, to ensure that they critically examine information reported by management rather than simply relying on it being accurate and complete.

### 2.3.1 Comments received

Feedback acknowledged that the quality of reporting from management is of central importance to decision making by the board remuneration committee. However, respondents

questioned why accountability should rest with the committee, instead of management. Industry also sought clarification about the content of information, particularly with respect to individual and cohort-based remuneration recommendations.

### **2.3.2 APRA's response**

APRA has retained the original drafting in CPS 511. In APRA's view, it is the responsibility of the board remuneration committee to guide management about appropriate reporting of information, as part of its role to provide oversight of the remuneration framework. APRA's intent is that entities focus on insightful, rather than voluminous, information and analysis that validates remuneration decisions. In the new CPG 511, APRA plans to outline examples of better practice.

# Chapter 3 - Remuneration design

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This chapter covers CPS 511 proposals relating to general design requirements for remuneration. APRA's specific proposals to limit the use of financial performance measures in variable remuneration are covered in chapter 4.

## 3.1 Service providers

Draft CPS 511 proposed to strengthen an entity's oversight and risk assessment of remuneration arrangements with third-party service providers. This was intended to address gaps in existing CPS 510 and SPS 510 requirements. The proposals were to:

- expand the scope to capture explicitly the employees of the third-party service provider rather than setting the requirement at the service contract level;
- expand the focus from financial soundness to also include risk, sustainable performance and long-term soundness; and
- require an assessment of third-party service provider remuneration arrangements to be part of the entity's remuneration framework.

### 3.1.1 Comments received

Entities were concerned that the draft CPS 511 proposals could affect their capacity to contract with service providers, especially for key business functions. This was a particular focus of superannuation entities, given their significant reliance on service providers to undertake major functions such as administration, investment management and insurance. Entities also raised concerns that draft CPS 511 implied they needed to have influence over the remuneration arrangements of third-party service providers. Stakeholders highlighted this as impractical, particularly where the contract size was immaterial relative to the overall business of the third party, or when dealing with an internationally based provider.

### 3.1.2 APRA's response

APRA's intent is that entities make prudent assessments of how the service provider's remuneration arrangements may result in actions or risks that could adversely impact an entity's risk profile, sustainable performance, beneficiaries or customers. Service providers that distribute or sell retail products on behalf of the entity, such as brokers or customer advisors, should be subject to a heightened focus.

Under the revised CPS 511, APRA has clarified that entities are required to make an overall assessment of a service provider's remuneration arrangements. They are not required to influence the remuneration arrangements of third-party service provider employees or contractors. The revised proposal requires a risk assessment and provides entity discretion on the process. Revised CPS 511 also enables an entity to determine its own actions to mitigate risks. APRA intends to outline better practice examples in a new CPG 511.

# Chapter 4 - Limit on financial measures

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## 4.1 Initial consultation proposal

The Royal Commission recommended that APRA limit the use of financial metrics in connection with long-term variable remuneration. APRA sought to promote a balance between financial and non-financial measures and draft CPS 511 proposed that:

- financial performance measures must not exceed 50 per cent of the total performance criteria used to determine variable remuneration; and
- individual financial performance measures must not comprise more than 25 per cent of the total measures used.

The draft proposals were to apply to all staff receiving variable remuneration and across all incentive plans. APRA did not specify particular non-financial measures, but highlighted examples of better practice from international jurisdictions which were more progressed. APRA noted that an entity would be expected to justify its selection of non-financial measures, and that these must be tailored and specific to the entity's business.

## 4.2 Comments received

APRA's proposal to limit financial performance measures was the primary topic addressed in over three-quarters of submissions. Submissions generally acknowledged APRA's overall objective, but questioned the appropriateness of a prescriptive approach, which could introduce a number of risks; for example:

- a one-size-fits-all approach would not account for varying remuneration design, strategy and risk appetite across entities and industries;
- design alternatives would be limited, by forcing adoption of a scorecard approach and discouraging consideration of other remuneration tools e.g. gateways and modifiers;
- APRA's broader goal of encouraging active use of board discretion could be undermined, potentially creating a compliance exercise in practice; and
- entities could still pay up to 50 per cent of an award, even if non-financial performance outcomes was significantly poor.

A common critique was that the proposal placed excessive weight on non-financial measures at the expense of financial measures. A number of industry participants cautioned that:

- there is a lack of maturity in the use of non-financial measures. Without clarity on definitional issues there will be operational inconsistencies;
- in comparison to financial performance measures, non-financial measures may not be as reliable, verifiable and transparent; and
- when the above is coupled with entity discretion on choice of metrics, inappropriate non-financial measures not related to risk will lead to poor design and misaligned outcomes.

On the other hand, some submissions suggested ways to support APRA's objective of increased focus on non-financial risks in variable remuneration. A number of stakeholders emphasised the importance of market discipline, suggesting that APRA implement tougher public disclosure requirements for non-financial measures that focused on the rationale for the measure, the target set for performance assessment, and how it best suits the operations of the entity.

### 4.3 APRA's response - revised proposal

APRA has revised its approach and now proposes to limit the use of financial measures in a broader and stronger way. APRA carefully considered industry's concerns particularly in light of Commissioner Hayne's comment that the optimal balance will be a process of trial and error and, as such, different for each organisation and at each staff level.

#### Limiting the use of financial measures

APRA has reverted to first principles and reframed the problem. APRA recognises that a hard limit on performance measures embeds scorecards as the sole means to determine remuneration outcomes. A principles-based approach provides for flexibility to accommodate various remuneration structures while still requiring entities to demonstrate they are giving material weight to non-financial risks.

#### Revised proposal

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.

At the individual level, an adjustment for adverse risk and conduct outcomes alone would not satisfy the need to give material weight to non-financial measures.

Current industry practice in balancing financial and non-financial risks has not gone far enough. While APRA has observed the consideration of non-financial risks in remuneration design, it is not standard practice and there is inconsistent implementation. Industry must strengthen the way they adjust variable remuneration. An entity must, at the individual level, apply non-financial measures and then bolster the outcome by enforcing accountability for poor risk and conduct. The revised proposal provides for stronger outcomes, but allows increased flexibility for entities to meet the requirement in a way that accommodates their remuneration models and best suits their particular risks and circumstances.

#### Material weight to non-financial measures

Under revised CPS 511, an entity must give material weight to non-financial considerations where performance measures exist. This must apply to each component of an individual's variable remuneration, or each incentive plan. Entities that have adopted non-financial measures in short-term incentive (STI) plans will now be required to incorporate non-financial measures in long-term incentive (LTI) plans as well.

An entity that currently predominantly relies on financial measures to determine the entity-wide bonus pool, allocate the pool to business units, or in an individual's scorecard, must now adopt non-financial measures in a way that ensures the individual's variable remuneration gives material weight to non-financial considerations. Entities may also consider how they need to tailor non-financial measures to staff at different levels and in different divisions.

Industry has sought greater clarity on non-financial measures and APRA plans to develop a framework to help entities to determine appropriate measures in a new CPG 511. Revised CPS 511 also provides clarity on the definition of financial measures.

### **Adjustment for adverse risk and conduct outcomes**

To reinforce the focus on non-financial measures, entities will be required to adjust variable remuneration for adverse risk and conduct outcomes. APRA anticipates that most entities will design a risk and conduct modifier to meet the requirement. Under the revised proposal, an entity would be expected to scale variable remuneration, including potentially to zero, for known risk and conduct incidents. APRA expects this would occur following assessment of performance for a STI, and prior to the grant being made for an LTI.

Many entities already use modifiers but in some cases these are limited to financial modifiers or purely based on discretion. To meet APRA's requirement, many of these entities will need to strengthen their approach to more robustly apply modifiers.

### **Royal Commission recommendation 5.3**

The revised proposal will limit the use of financial metrics used for STI and LTI plans. At present, LTI plans are commonly solely based on total shareholder return (TSR) and return on equity (ROE). Under this revised proposal, an entity can no longer rely on these measures and must give material consideration to non-financial measures in the design and outcome of LTI awards. The adjustment for adverse risk and conduct outcomes is a mechanism that further limits the outcome of financial metrics used for LTIs.

### **Disclosure**

Given a more principles-based approach and consistent with industry feedback, APRA proposes to introduce new disclosure requirements. Under these proposals, entities would be required to demonstrate publicly how they are incentivising staff to manage risks, including non-financial risks, and how they are holding staff to account for adverse risk and conduct outcomes. Current disclosure obligations do not explicitly address performance targets and consequence management and greater market discipline in these areas will reinforce more prudent outcomes. APRA's initial views on specific disclosure requirements are outlined in chapter 10 of this response paper.

# Chapter 5 - Highly-paid material risk-takers

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This chapter covers the definition of a HPMRT. Chapter 2 covers board decisions for remuneration outcomes of HPMRTs. Chapter 6 covers minimum deferral periods.

## 5.1 Definition of HPMRT

APRA's draft proposals sought to ensure that remuneration of employees who are highly paid and can have a material impact on the entity's risk profile, performance and long-term soundness were subject to heightened scrutiny regarding risk and conduct.<sup>7</sup> Under draft CPS 511, a HPMRT was defined as "a material risk-taker whose total fixed remuneration (which includes salary, superannuation, allowances and benefits) plus maximum potential variable remuneration is equal to or greater than 1 million AUD in a financial year."

## 5.2 Comments received

Feedback highlighted maximum potential variable remuneration as an inappropriate measure to be used in the definition of HPMRT. Entities noted that there can be a large variance between an individual's potential and actual variable remuneration. Additionally, some remuneration structures, such as profit share plans, do not operate with a maximum potential variable remuneration component.

Submissions also questioned the focus on total remuneration, rather than variable remuneration. Feedback noted that the broadness of the definition would likely create significant implementation and compliance costs. The number of individuals captured under this definition was considered disproportionate to the risk. A small number of stakeholders suggested that the determination of HPMRTs should be left to board discretion.

## 5.3 APRA's response

APRA has made some adjustments to the definition of HPMRT. APRA has adjusted the measure of variable remuneration from maximum potential to actual, with clarification that this be within the relevant financial year. APRA expects that this will reduce the number of captured HPMRTs, reduce the complexity of the calculation and reduce implementation costs. APRA expects that the revised definition will work with all remuneration structures, including profit share and discretionary variable remuneration arrangements. APRA has retained the 1 million AUD threshold in the HPMRT definition, noting that this provides a suitable threshold for employees that should be subject to heightened scrutiny.

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<sup>7</sup> In addition for an RSE licensee, a HPMRT means a person whose activities have a material potential impact on performing its duties and exercising its powers in the best financial interests of beneficiaries.

# Chapter 6 - Deferral and clawback

A key reform objective is that entities have in place appropriate deferral and clawback measures to strengthen the focus on long-term outcomes by ensuring that there are consequences for risk issues or misconduct that may emerge several years after the event.

Draft CPS 511 proposed that all entities must consider deferral and clawback as part of remuneration design. For SFIs, specific deferral and clawback requirements were proposed for a CEO, senior manager, executive director and HPMRT.

## 6.1 Deferral

Where variable remuneration is over 50,000 AUD, APRA's original proposal was that an entity must defer at least 60 per cent of a CEO's total variable remuneration for at least seven years with pro-rata vesting in the last three years. For a senior manager and HPMRT, the proposal was to defer at least 40 per cent of total variable remuneration for at least six years, with pro-rata vesting in the last two years.

### 6.1.1 Comments received

A broad range of stakeholders raised concerns about the proposed deferral obligations and these are summarised in Table 4. The major issues focused on length of deferral periods, which industry considered could impact staff recruitment and retention. Some submissions questioned the alignment to the BEAR.

Table 4. Summary of industry feedback on SFI deferral proposals

Issue	Industry feedback
Recruitment	Industry considered the length of deferral periods and clawback proposals would impact staff recruitment and retention, both between SFIs and non-SFIs, and outside the APRA regulated environment. HPMRTs were a key area of focus.
Deferral period for a senior manager and HPMRT	Deferral periods were considered disproportionate to the overall responsibility and accountability that these roles may have. It was also noted that HPMRTs would typically have less impact on the entity's risk profile, compared to CEOs and senior managers.
Deferral threshold	The 50,000 AUD threshold was considered too low given the cost and complexity for the entity to administer compliance.
Inception	Clarity was sought to understand when deferral starts.
Sign-on bonus and buy-out	Clarity was sought on whether a sign-on bonus or buy-out would be captured as variable remuneration and for the purposes of calculating the 50,000 AUD threshold.



Issue	Industry feedback
Accelerated vesting of deferred variable remuneration	Industry highlighted a case to exclude staff with lower responsibility-levels and for a carve-out to cover the tax liability on any deferred variable remuneration when a person terminates employment with an entity.
Alignment with the BEAR	Industry questioned divergence from the BEAR, regarding deferral periods, portions and thresholds.
Alignment with international jurisdictions	APRA's proposed deferral periods went beyond global practices of insurers and pension funds.
Reduction in value	Industry noted that longer deferral periods reduce the value of variable remuneration, given forfeiture risk on resignation and time value of money.
Shift to fixed remuneration	There was some concern that longer deferral periods may cause a shift towards higher fixed remuneration, to avoid deferral obligations.
Transition and grandfathering	Industry considered grandfathering provisions necessary to preclude application of CPS 511 deferral requirements to existing employment contracts.

### 6.1.2 APRA's response

In APRA's view, deferral of variable remuneration plays an important role in incentivising employees to take into account the long term effects of their decision making. It also enables an entity to strengthen consequence management. However, APRA acknowledges that overly long deferral periods can have unintended consequences such as on an entity's ability to attract and retain certain staff.

In response, APRA has reduced the SFI deferral periods for a CEO, senior manager, executive director and HPMRT. The revised deferral proposals are summarised in Table 5.

**Table 5. Revised deferral obligations for SFIs**

Role	Original proposals	Revised proposals
CEO	60% for 7 years Vesting after 4 years on a pro-rata basis in years 4, 5, 6 and 7.	60% for 6 years Vesting after 4 years on a pro-rata basis in years 4, 5 and 6.
Senior manager and executive director	40% for 6 years Vesting after 4 years on a pro-rata basis in years 4, 5 and 6.	40% for 5 years Vesting after 4 years on a pro-rata basis in years 4 and 5.
HPMRT	40% for 6 years Vesting after 4 years on a pro-rata basis in years 4, 5 and 6.	40% for 4 years Vesting after 2 years on a pro-rata basis in years 2, 3 and 4.

## Deferral for a CEO

APRA has amended the deferral period and vesting requirement for a CEO, from seven to six years, with pro-rata vesting in years 4, 5 and 6. This revision more closely aligns with the typical term of Australian CEOs. Decisions a CEO makes can impact the entity beyond their departure and the revised deferral and vesting will help to ensure some variable remuneration stays on foot for the consequence management process. Pro-rata vesting from year four aligns with the BEAR, which sets a four year deferral period. It also aligns to key FSB principles.


Figure 2 below profiles revised CPS 511 minimum deferral requirements for a CEO. In this example, the entity is required to defer 60 per cent of the CEO's variable remuneration for six years, with distributions commencing from year four on a pro-rata basis. In effect, the 60 per cent that is deferred is distributed between years four and six. This example also shows that 40 per cent of the CEO's variable remuneration is not subject to CPS 511 deferral requirements and vesting is at the discretion of the entity.

Figure 2. Minimum deferral requirements for a CEO of a SFI

Deferral Length	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Common Practice	60%							
CPS 511	20%			20%	20%			

Note: 40% of total variable remuneration is not subject to CPS 511 deferral requirements. 60% of variable remuneration must be deferred.

### Key

	Deferral period, malus applies		Award vests
	Clawback period		

## Deferral for a senior manager

For a senior manager, APRA has reduced the requirement from six to five years, with pro-rata vesting in years 4 and 5. The revised proposal is shorter than the deferral period set for a CEO, to reflect that a senior manager has a comparatively lower impact on the entity's risk profile and accountability. Similar to the CEO, the proposal for pro-rata vesting from year four aligns to the BEAR and is consistent with FSB principles.

## Deferral for a HPMRT

APRA acknowledges the feedback that the responsibilities and risk impact of a HPMRT are typically less than that of a senior manager. In re-examining the deferral period for a HPMRT, APRA considered the trade-offs between increasing the 1million AUD threshold for HPMRTs and shortening the deferral period. APRA resolved that increasing the threshold would impede the objective of imposing heightened scrutiny on those with high earnings and high impact.

To balance its objectives, APRA has reduced the deferral period and vesting requirement for a HPMRT, from six to four years, with pro-rata vesting in years 2, 3 and 4. This seeks to

reduce undue impacts on staff recruitment and retention, but will require entities to strengthen existing practices and subject HPMRTs to greater accountability.

### ***Deferral proportions***

APRA has not amended the proportions to be deferred for a CEO, senior manager and HPMRT. Industry did not provide significant feedback on the proposed proportions, which align to those imposed under the BEAR and are commensurate with international practice.

### ***Deferral period***

APRA has clarified the approach to determining deferral periods. For a STI, the deferral period would include the 12 month performance period but not precede that, even if one or more of the measures look back beyond this date. For a LTI, the deferral period may include the period over which the performance is assessed and any service period required. In a new CPG 511, APRA will outline better practices including relating to sign-on awards, where the deferral period is expected to start when employment commences.

### ***Deferral threshold***

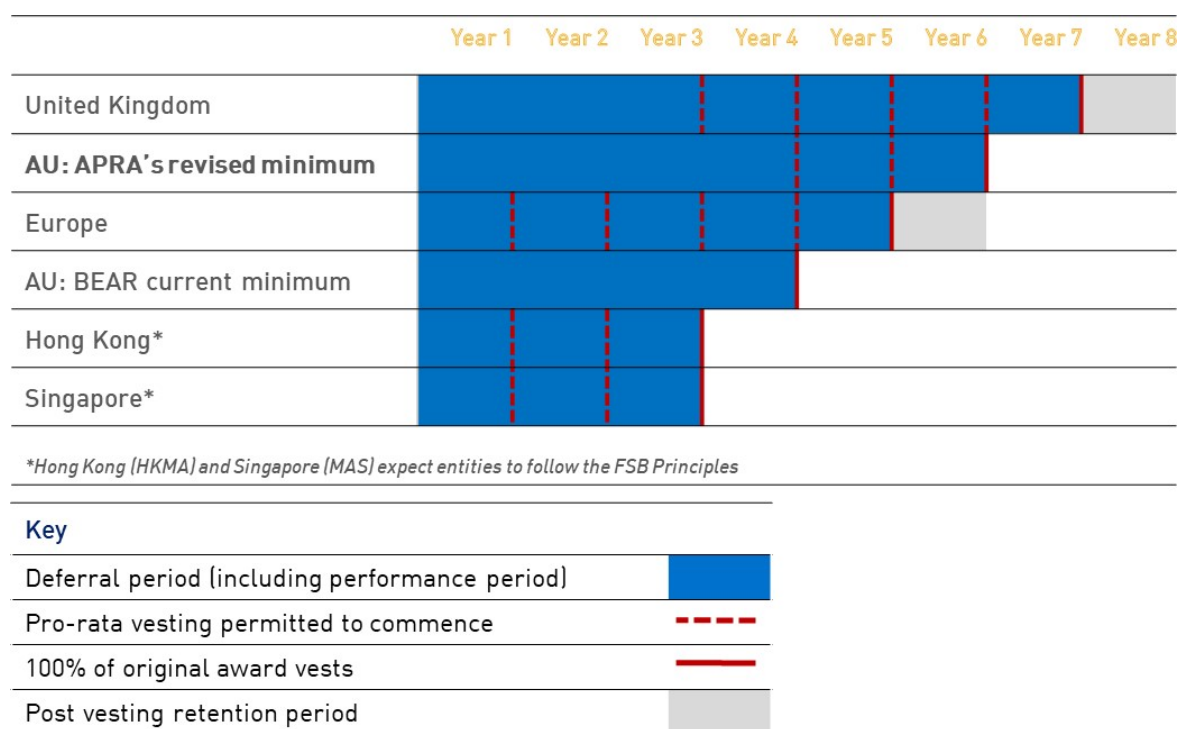
APRA's intent in setting a minimum deferral threshold was to concentrate deferral obligations on roles where variable remuneration makes up a significant portion of total remuneration. To achieve this objective, APRA's revised CPS 511 sets the deferral threshold at 50,000 AUD of deferred variable remuneration. This is consistent with the BEAR.

### ***Alignment with international jurisdictions***

APRA has carefully considered the revised proposals in light of international standards, and sought to align with better practice. APRA has taken a consistent approach to setting deferral requirements across all APRA-regulated entities. The drivers for stronger requirements have been evident across all industries, as reflected in the Royal Commission and recent APRA supervisory review findings.

A comparison of APRA's requirements to international practices are provided below, at Figure 3. This compares APRA's revised minimum deferral period for a CEO, compared to other key international jurisdictions for banks.

Figure 3. CEO deferral of international peer banking regulators



### Exceptions for accelerated vesting

In draft CPS 511, APRA proposed to prohibit accelerated vesting of unvested variable remuneration for a person no longer employed or engaged by the entity, but carved out instances where that related to death, serious incapacity, serious disability or serious illness as done in the BEAR. However, during consultation a number of entities raised concerns about a misalignment of timing between the payment of tax (at termination) and the receipt of earnings (at end of deferral). To reflect the feedback provided during consultation, the revised CPS 511 will allow partial vesting of the tax amount at termination. Revised CPS 511 does not replace ADI requirements under the BEAR. APRA will continue to engage with Treasury on the design of the FAR. Upon finalisation of this legislation, APRA will review whether changes are necessary to this proposed exception.

### Other feedback

APRA intends to provide further guidance in a new CPG 511 to support implementation of the deferral obligations. In response to feedback about a potential shift to fixed remuneration, APRA will also monitor changes in industry practice for remuneration design as industry implements the final standard.

Industry also questioned the appropriateness of different requirements across the banking, insurance and superannuation sectors. In APRA's view, different requirements between industries may create an imbalance in competition for talent across APRA-regulated industries. Lesser requirements for insurance and superannuation would also not reflect the existing and potential future complexity of SFIs in these two industries, and, the potential impact of poor remuneration design. APRA has instead taken a proportionate approach, differing requirements based on the size and complexity of entities.

## 6.2 Clawback

Draft CPS 511 proposed clawback requirements on a CEO, senior manager and HPMRT of a SFI. Proposals included minimum clawback criteria and periods. APRA's objective was for entities to have the appropriate infrastructure and governance to effect clawback, if and when this would be appropriate.

### 6.2.1 Comments received

A large number of submissions detailed the legal complexities associated with giving effect to clawback, noting that this would severely limit its use as a practical remuneration adjustment tool. Submissions noted that the cost of litigating a clawback claim may often exceed the variable remuneration itself, and that this would ultimately be borne by shareholders or RSE members. Submissions explained malus to be an easier, more practical tool to apply as it does not have the same enforcement risks.

Significant feedback was also received on the clawback criteria, which was noted as overly broad and open to interpretation. Industry commented that the inclusion of financial loss in the clawback criteria would potentially limit innovation or calculated risk-taking. Feedback suggested that clawback be reserved for instances of fraud or severe misconduct. A number of submissions also suggested the clawback period be aligned to, and inclusive of, the deferral period and not extend beyond this.

### 6.2.2 APRA's response

APRA is proposing several adjustments to the drafting of the clawback proposals to clarify policy intent that clawback would only be considered for exceptional circumstances:

- removing the requirement to extend the clawback period for another two years for those under investigation. This would be considered better practice;
- clarified that clawback would only be used in exceptional circumstances, after other adjustment tools have been exhausted; and
- revising the clawback criteria, which have been extended and aligned to the malus criteria. Amendments include adding a materiality threshold to reflect that it is a tool that would only be utilised in exceptional circumstances, clarifying the focus on conduct and adding material error or misstatement as grounds for clawback.

# Chapter 7 - Other amendments

## 7.1 Improving clarity

### 7.1.1 Definitions

APRA has modified a number of terms and definitions to improve clarity and consistency in application. Table 6 below outlines these amendments.

Table 6. Amendments to improve clarity

Topic	APRA revision
RSE licensee obligation	Amendments to reflect Government proposals to modify trustee obligations under the recent budget measures.
Variable remuneration	Clarity is now given to the definition of variable remuneration through providing examples of objectives.
Relevant oversight function	Clarity is given on the responsibilities of the relevant oversight function, particularly on consulting with other board risk committees. APRA maintains that the relevant remuneration oversight function of foreign ADIs, category C insurers and Eligible Foreign Life Insurance Companies (EFLICs) be given equivalent roles and responsibilities as a board.
Remuneration objectives	The intent of an entity's remuneration framework must flow through design, adjustments and to outcomes. In the original draft CPS 511 this intent was termed remuneration objectives, however this can be confused with performance objectives. APRA has removed the term and the revised requirement now reflects the criteria underlying the intent, with a strengthened linkage to risk.
Remuneration design criteria	Criteria relating to risks and time horizons, remuneration adjustments and malus is simplified to reflect APRA's intent in the design of variable remuneration arrangements.
Special role categories to specified roles	Special role categories, a term created for the purpose of CPS 511, is now simplified to specified roles.
Senior manager and executive director	The scope of specified roles is refined and now excludes non-executive directors; in draft CPS 511, they were part of the senior manager definition. Specified roles now appropriately capture senior managers and executive directors.

### 7.1.2 Responsible persons and accountable persons

Industry sought clarity regarding how the specified roles proposed in CPS 511 related to responsible persons under *Prudential Standard CPS 520 Fit and Proper* (CPS 520) and *Prudential Standard SPS 520 Fit and Proper* (SPS 520). For ADIs, industry also sought clarity how these roles related to an accountable person under the BEAR.

Under revised CPS 511, specified roles include senior managers, executive directors, HPMRTs, material risk takers and risk and financial control personnel. Senior managers and executive directors under revised CPS 511 will generally be responsible persons under CPS 520 and SPS 520 and accountable persons under the BEAR. The roles and responsibilities of other types of specified roles will determine whether they will meet the definition of a responsible person under CPS 520 and SPS 520 and be established as an accountable person by the entity.

## **7.2 Review of the remuneration framework**

APRA has observed the current review of the remuneration policy under CPS 510 and SPS 510 to be insufficient to enable a view of whether the policy is working as intended. Under draft CPS 511, APRA proposed that the remuneration framework be subject to an annual compliance review and triennial effectiveness review, and mandated that the board remuneration committee consider and address review findings. This tightening of review requirements was intended to improve governance of remuneration and address a key Royal Commission recommendation.

### **7.2.1 Comments received**

Stakeholders queried the need for an annual review of compliance and whether it would result in meaningful insights. There was suggestion that a compliance review be conducted every two years, or the review only be required following a material change to the entity's business operations.

Industry participants were broadly comfortable with the proposed triennial effectiveness review, recognising that there is a similar review under CPS 220 and SPS 220 of the risk management framework. Some submissions queried whether it was appropriate for the triennial review to apply to smaller entities due to the potential compliance burden.

### **7.2.2 APRA's response**

APRA has retained the annual compliance review requirement, on the basis that a routine appraisal of the remuneration framework against the standard will strengthen its operating effectiveness. The annual review is expected to be conducted internally and take the form of a self-assessment.

APRA has also sharpened the scope of triennial reviews to ensure a deeper dive into the entity's remuneration framework is undertaken, which leverages the experience of an operationally independent, appropriately experienced reviewer. APRA plans to provide more guidance on review requirements in a forthcoming prudential practice guide.

Under revised CPS 511, non-SFIs will not be required to undertake effectiveness or compliance reviews. Further details are provided at Chapter 8.

## **7.3 Transition arrangements**

APRA sought feedback from industry on what transition arrangements would be necessary to support implementation and whether they should vary by industry.

### **7.3.1 Comments received**

The majority of submissions noted that there would be significant implementation challenges to renegotiate and redesign existing employment contracts if APRA expected all remuneration arrangements to comply with the final standard by the proposed commencement date. A number of entities noted that existing arrangements should be grandfathered, given they would have been contracted in good faith and there would be significant cost and disruption to staff to renegotiate based on APRA requirements.

Some industry participants suggested that APRA postpone commencement of the final standard to accommodate the extension of the BEAR to the insurance and superannuation industries. Industry highlighted the importance of alignment between the prudential requirements and the new legislation.

### **7.3.2 APRA's response**

Transition arrangements in revised CPS 511 will not require renegotiation of existing employment contracts at the commencement date of the finalised standard. However, all new and renewing remuneration contracts entered after the implementation date must be compliant. APRA expects that entities will start adopting the new requirements as soon as possible, to ensure that there is a timely transition of all remuneration contracts to a stronger remuneration framework.



# Chapter 8 - SFIs and Proportionality

Under draft CPS 511, APRA included some elements of proportionality. Under these proposals, a subset of requirements, including those relating to deferral and clawback, would only apply to SFIs.

## 8.1 Proportionality

Under revised CPS 511, APRA has further reduced minimum requirements for non-SFIs. APRA has streamlined governance expectations, simplified remuneration design requirements and removed review requirements. This approach is consistent with non-SFIs' smaller size, less complex business models and simpler remuneration arrangements.

The core requirements for non-SFIs relate to remuneration design and governance. Non-SFIs should refer to chapters 2, 3 and 7 for details of these requirements, under the revised proposals.

Figure 4 below demonstrates the differences in requirements for SFIs and non-SFIs, under the revised CPS 511. It also includes a mapping of revised CPS 511 proposals to requirements currently in force under CPS 510, SPS 510 and the BEAR. The more proportionate approach to differentiating minimum requirements for SFIs and non-SFIs will minimise compliance costs and ongoing regulatory burden for non-SFIs.

Figure 4. Simple outline of proportional approach proposed in revised CPS 511

Requirement	CPS 510 and SPS 510	BEAR (ADIs only)	Revised CPS 511 Non-SFIs	Revised CPS 511 SFIs
Governance	✓	✓	✓	✓
Design	✓	✓	✓	✓
Material weight to non-financial measures	✗	✗	✗	✓
Risk & conduct modifier	✗	✗	✗	✓
Deferral	✗	Accountable persons only ✓	✗	CEO, SM, HPMRT ✓
Clawback	✗	✗	✗	CEO, SM, HPMRT ✓
Reviews	✗	✗	✗	✓

## 8.2 SFI determinations

In the 2019 discussion paper, the starting point for determining SFIs was size. APRA proposed that entities with assets above these thresholds would be determined SFIs:

- ADI > 15 billion AUD;
- General insurers and life companies > 10 billion AUD;
- RSE licensees > 30 billion AUD; and
- PHIs excluded from the SFI categorisation until a later time.

APRA also proposed that additional qualitative criteria would be considered as part of the determination process. The qualitative criteria included presence in certain markets, membership of a group or the provision of critical services.

### 8.2.1 Comments received

Industry sought greater clarity on the SFI determination process, and many submissions perceived the proposed asset-based thresholds as too low. They suggested that these thresholds would capture entities that have limited variable remuneration arrangements and relatively simple business models, where there may not be a need for deferral and clawback provisions. A number of ADIs suggested APRA align to the BEAR categorisation of small, medium and large. In superannuation, some industry participants advocated capturing more complex entities that fall below the 30 billion AUD asset threshold.

### 8.2.2 APRA's response

APRA considers the draft proposed asset thresholds to be appropriate, for the purposes of uplifting remuneration practices across the industries. APRA plans to publish the thresholds in a new CPG 511.

APRA proposes to include an asset threshold of 3 billion AUD for PHIs. This is intended to provide an indicator of large and complex entities but may not capture all. APRA welcomes feedback on this proposal.

APRA has also refined the qualitative criteria used to determine SFIs. Regardless of asset size, supervisors will also consider complexity of operations and remuneration practices and membership in a group. Complexity will cover characteristics such as presence in certain markets, or the provision of critical services.

Following release of the finalised standard, APRA intends to notify entities of their SFI status with relevant reasoning by Q3 2021, to provide entities with adequate time to commence implementation work.

# Chapter 9 - Implementation of CPS 511

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## 9.1 Phased implementation approach

APRA is proposing a phased implementation of the finalised standard as follows:

- ADIs that are SFIs and groups headed by these SFIs to implement by 1 January 2023;
- Insurers and RSE licensees that are SFIs and groups headed by these SFIs to implement by 1 July 2023; and
- All other entities (Non-SFIs) to implement by 1 January 2024.

A phased implementation will focus on compliance by the largest and most complex entities first, affording smaller entities more time to transition to the new requirements.

## 9.2 Self-assessment and implementation plan

APRA intends to give industry at least 18 months between release of the finalised standard (Q2-2021) and the phased implementation dates. During this time, APRA expects that entities will review their existing remuneration frameworks so that any new remuneration arrangements and practices from implementation date are consistent with the intent of the new standard.

Following release of the finalised standard, APRA expects that SFIs will undertake a self-assessment and develop an implementation plan. Self-assessments should review the CPS 511 requirements against the entity's existing remuneration practices and identify gaps that need to be addressed. APRA may request self-assessment and implementation plans to be shared with APRA's supervision team as part of supervisory work.

APRA also plans to release a new CPG 511, to assist entities in implementing CPS 511. APRA intends to consult on CPG 511 in 1Q 2021.

## 9.3 APRA implementation review

As flagged in the Information Paper *Transforming governance, culture, remuneration and accountability: APRA's approach* released in November 2019, APRA will be conducting an implementation review of CPS 511 from a sample of entities once the standard is implemented.

The implementation review will draw on self-assessments and implementation plans, to gain a deeper understanding of implementation progress for a cross section of entities across the industries and will provide an opportunity to take pre-emptive action to address any shortfalls in the implementation of CPS 511. Closer to implementation, APRA will contact the relevant entities to notify them of their involvement in APRA's implementation review.

# Chapter 10 - Reporting and Disclosure

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As foreshadowed in the July 2019 discussion paper, APRA plans to introduce reporting and disclosure requirements for all APRA-regulated entities. APRA intends to consult on proposals for reporting and disclosure requirements by late 2021, and finalise these by late 2022.

In developing the proposed reporting and disclosure requirements, APRA will engage with entities to minimise any undue burden. APRA will also draw upon international experience, where appropriate. A data study will be conducted in 2021, to inform the initial design of the reporting standard and disclosure requirements. APRA will contact large or more complex entities directly to participate in the study. Other entities wishing to participate in the exercise should contact their APRA supervision team by 15 December 2020.

## 10.1 Disclosure proposals

APRA intends to require all APRA-regulated entities to improve the transparency of, and accountability for, remuneration practices. APRA recognises that the design of disclosure requirements will need to balance carefully the benefits of transparency on remuneration decisions with respect for commercial-in-confidence information and the privacy of individuals.

Presently, public disclosure of certain executive and director remuneration is required by listed companies in annual director reports, set by section 300A of the *Corporations Act 2001* (Corporations Act). Additionally, superannuation entities and ADIs are respectively subject to remuneration disclosure requirements under section 29QB of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and as part of APRA's implementation of 'Pillar 3' of the Basel capital framework.<sup>\*</sup> APRA intends that its disclosure requirements would expand on current ADI Pillar 3 requirements and complement existing Corporations Act and SIS Act disclosures.

However, there is inconsistent disclosure of remuneration governance and insufficient detail on remuneration design and outcomes, particularly for HPMRTs and other material risk-takers. There is also a lack of clarity regarding the inputs and outputs of the consequence management process. These gaps are impediments to effective market discipline of remuneration outcomes.

In the July 2019 consultation on draft CPS 511, industry highlighted that current disclosures can lack comparability and can be overly complex. Industry suggested that new disclosure obligations should focus on explaining how targets are chosen and met, why they are appropriate and the basis of risk adjustments.

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<sup>\*</sup> See Prudential Standard APS 330 Public Disclosure (APS 330) and Basel Committee on Banking Supervision Pillar 3 disclosure requirements - updated framework, December 2018.

APRA is considering the following:

- **remuneration governance and oversight.** Qualitative information about the remuneration policy, design, adjustment tools and the process to determine remuneration outcomes. This would allow stakeholders to evaluate the effectiveness of remuneration outcomes, governance and value creation;
- **remuneration design and outcomes.** Quantitative information, aggregated for groups of employees and specified roles, which would cover non-financial measures, performance outcomes and variable remuneration split by plans (STIs, LTIs and others). This information would enable stakeholders to gauge compliance with CPS 511 and understand how outcomes relate to performance and risk across staff levels; and
- **consequence management.** Quantitative information, aggregated for groups of employees and specified roles, which would cover the value of upward and downward adjustments by adjustment tools. This information would support stakeholders in understanding the frequency and level of risk adjustment and alignment to outcomes.

APRA is considering a standardised approach for entities to publishing certain, core quantitative disclosures. Entities would have more discretion on how they publish qualitative and other supplementary information. APRA is also considering publishing entity-level data in an external publication, to facilitate external benchmarking.

APRA invites feedback on the considerations above and these specific questions:

- What principles should inform the types of information required to be disclosed for prudential purposes?
- How could prudential disclosures complement disclosures required under the Corporations Act?
- Would a proportional approach to disclosures, similar to that proposed for revised CPS 511, promote market discipline for the appropriate cohort of entities?

# Chapter 11 - Consultation on revised CPS 511

## 11.1 Request for submissions

APRA invites written submissions on revised CPS511. Written submissions should be sent to [Policy.Development@apra.gov.au](mailto:Policy.Development@apra.gov.au) by 12 February 2021 and addressed to:

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

## 11.2 Important disclosure notice – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence.

Automatically generated confidentiality statements in emails do not suffice for this purpose.

Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA).

APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.



**APRA**

