



General Manager
Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
ADIpolicy@apra.gov.au

7 May 2019

Dear Mr Brennan

Submission on the Banking Executive Accountability Regime – determination of ‘variable remuneration’

This submission is made by the Head Office Advisory Team at Herbert Smith Freehills in response to the draft legislative instrument titled ‘Schedule – kinds of remuneration that are not variable remuneration’ (**Draft Instrument**) released by the Australian Prudential Regulation Authority (**APRA**) on 1 April 2019.

We are supportive of APRA’s proposal to apportion the variable remuneration of an accountable person so that the BEAR remuneration obligations only apply to the portion of their remuneration that relates to their accountable person role and not to any broader roles within a corporate group.

There are two aspects of the Draft Instrument that we would suggest amending to achieve the purpose of the Draft Instrument, which we have explained below.

1 Primary focus on responsibilities rather than source of payment or positions held

We suggest that the Draft Instrument be amended so that the determination of what is ‘variable remuneration’ for the purposes of BEAR focuses on the scope of the accountable person’s responsibilities that relate only to the ADI and its subsidiaries, rather than the source of the payment and the positions held by the accountable person which we consider to be less relevant considerations.

We acknowledge that in some cases, the source of an accountable person’s remuneration and their employing entity may be an accurate indication of the scope of their role and responsibilities. However, there may be circumstances where the source of payment or position held does not reflect the true nature and scope of an accountable person’s responsibilities. For example, a Chief Risk Officer (**CRO**) may oversee risk management for an ADI as well as the broader corporate group. If the CRO is paid or employed by a subsidiary of the ADI due to a particular corporate group structure, in its current form, the Draft Instrument could not be relied on to exclude the part of the CRO’s remuneration that relates to their non-ADI role.

We are concerned that by focusing on the source of the payment and the employing entity, rather than the responsibilities and related activities that are being compensated by the payment, the Draft Instrument could be too limited in its application.

To address this issue, we suggest that APRA consider amending the Draft Instrument so that it is available where the accountable person performs responsibilities that relate to a non-ADI entity (i.e. without the need for a formal position to be held) and deleting the requirement in relation to the source of the payment.



2 Guidance re flexibility in approach to apportioning remuneration

It would be very helpful if APRA included additional sentence(s) in the Draft Instrument, or related guidance, expressly stating that each ADI may make its own determination as to how it apportions an accountable person's remuneration.

We believe that a range of factors may be relevant to an ADI's determination. These might include time allocated to the ADI's operations and the size of the ADI's operations when compared to the broader group. However, we are concerned that there is a misconception in the market that the apportionment must be based on time.

In our preliminary discussions with clients, we have had a number of questions as to how, in practice, the apportionment should be determined. Part of the reason for this is that executives are not generally remunerated in a way that clearly delineates between their various responsibilities within a corporate group.

While APRA has not provided any formal guidance regarding the apportionment of variable remuneration, it is implicit in section 4.3 of the information paper released by APRA titled 'Implementing the Banking Executive Accountability Regime' (**Information Paper**) that entities will use 'time spent on business related to the ADI or ADI group' to determine the portion of an accountable person's remuneration that is 'variable remuneration' under BEAR. While this is a logical approach, and will be adopted by some in practice, it may not be the 'best' approach for all ADIs.

Reasons that particular ADIs may elect not to use time as the sole basis for apportionment include:

- the fact that it can be difficult to determine 'time spent' because activities are not always performed for a single entity within a corporate group (eg the ADI) but are often performed for the group as a whole (for example, the CRO will design a group-wide risk management framework). In our experience, time-based recording is also not common practice and an accurate approximation may be difficult to determine; and
- by focusing on 'time spent' there may be a perverse outcome where accountable persons 'spend' less 'time' on the ADI if this would result in less remuneration being subject to the BEAR provisions. This effect would run contrary to the underlying objective of BEAR to promote diligence and accountability within ADIs.

An example of an alternative measure is for an ADI to determine the number and size of entities (eg by revenue) that are being serviced by the accountable person and to use this as the basis for determining the proportion of the person's remuneration that relates to the ADI and its subsidiaries. For example, if the ADI and its subsidiaries account for \$100m of the broader group's \$500m revenue, their variable remuneration for BEAR purposes could be considered to be 20% (i.e. \$100m/\$500m).

We believe that clarification from APRA that it recognises various approaches would allay concerns for some ADIs.

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We would be happy to discuss this with APRA further and to suggest drafting changes to the Draft Instrument. Please do not hesitate to contact us.



HERBERT
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FREEHILLS

Yours sincerely

Priscilla Bryans
Partner
Herbert Smith Freehills

Anna Coroneo
Senior Associate
Herbert Smith Freehills

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