Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Financial Accountability Regime Bill 2021 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy Bill 2021 [Provisions] and related bills

Division/Agency: Australian Prudential Regulation Authority
Question No: APRAQON01
Topic: The FAR and Prudential Standard CPS 511 Remuneration
Reference: Page 55, Hansard Thursday 27 January 2022
Senator: Paul Scarr

Question:

CHAIR: My final question, before I share the call with my colleagues, is in relation to remuneration and the prudential standards around remuneration. A number of stakeholders have raised the issue that APRA's current prudential standards around remuneration would be inconsistent with what's proposed under FAR. I can't remember which is which, but one is forward looking and the other is backward looking, and there needs to be an adjustment in that regard. Is that on APRA's radar?
Dr Carmody: Thank you for the question. I think possibly a bit of reflection of some of the older versions of that standard. We've been working very hard to ensure that the work we're doing on that prudential standard is as compatible as possible with the FAR legislation. We think the version that was recently finalised late last year actually has very good alignment with the wording of FAR. The language won't be exactly the same but, for example, the language that was referred to about forward looking was a feature of an early draft of that prudential standard. It has since been removed following feedback and consultation. I suspect to some extent some of those concerns may not be there, in our view, in the final standard.
In terms of review processes, we've got no short-term plans to review that prudential standard. It will be reviewed within a four-year period. We have a regular cycle of reviews for all of our prudential standards. As it stands we feel that, unless there are significant changes to the legislation for FAR's right of passage, it's actually very closely aligned.
Probably another point to pick up there which I think one of the other witnesses commented on—it may have been the ABA—is that, importantly, FAR actually sets a minimum baseline. There are aspects of CPS 511 that quite deliberately go further than FAR in certain respects. For example, it talks about overall remuneration arrangements across the whole organisation, not just for accountable people. It can go down to, for example, very significant risk-takers in the organisation who might be taking a lot of risk but might not be at the level of an accountable person—maybe traders who are large risk-takers and that sort of thing. It's got issues there. It also talks about things like having material weight given to non-financial measures for outcomes as well. Some of those have been quite deliberately designed to align to international best practice in this space. Also it's got some more onerous arrangements in place for the most significant financial institutions as well. There are some areas where, at that larger set, it actually goes further on things like deferral, whereas the FAR regime itself is really quite narrowly focused on a minimum standard for deferrals. By design, CPS 511 goes further, but where there is common ground we think it's actually quite consistent already.
CHAIR: Dr Carmody, could I ask you to take on notice to do another check—or get someone else to do another check—on that given the concern was raised by a number of stakeholders. Perhaps you could provide us an answer to the question on notice, being: in APRA's view is the relevant prudential standard consistent with FAR. I expect your answer's going to canvass that but I appreciate APRA taking another look at that and checking whether or not there is that consistency from your perspective.
Dr Carmody: I'm very happy to take that on notice.

Answer:

Overall, the FAR and APRA's *Prudential Standard CPS 511 Remuneration* (CPS 511) are consistent. The proposed FAR legislation sets a minimum requirement for deferral of variable remuneration for Accountable Persons at all financial institutions subject to the regime. CPS 511 is broader, focused on a wide range of remuneration practices across APRA-regulated entities and applied to a broader range of individuals. In the specific area of variable remuneration deferral, CPS 511 adopts a risk-based approach and, for significant financial institutions (SFIs[1]) it requires longer deferrals than the minimum requirements of the FAR. CPS 511 also requires deferral requirements to be in place for certain groups of employees beyond the Accountable Persons covered by the FAR. The language used in CPS 511 was drafted to be consistent with the proposed FAR legislation.

	FAR (Proposed)	CPS 511	Comparison
Scope	**Entities:** Covers all regulated institutions. **Persons:** accountable persons (directors and senior executives) who earn more than $50,000 in deferred variable remuneration.	**Entities:** Covers all regulated institutions. SFIs are subject to heightened prudential requirements, compared to smaller and less complex entities. Non-SFIs do not have specific deferral requirements. **Persons:** SFI CEOs, senior managers, executive directors and highly paid material risk-takers (total fixed remuneration plus actual variable remuneration >=$1 million) who earn more than $50,000 in deferred variable remuneration.	***Intended to be different.*** FAR variable remuneration deferral obligations apply to institutions regardless of size. CPS 511 variable remuneration deferral obligations apply to SFIs only, with these obligations heightened than that required under FAR. For non-SFIs CPS 511 imposes no deferral requirements and so the FAR minimum requirements would apply if the legislation comes into effect. CPS 511 goes further for SFIs capturing additional persons that are classified as highly paid material risk-takers, given their potential impact on an entity's risk profile.

[1] A significant financial institution means an APRA-regulated entity that has total assets in excess of minimum thresholds or has been determined as such by APRA having regard to matters such as complexity in its operations or remuneration practices, or its membership of a group. These institutions have the potential to materially impact the financial system.

	FAR (Proposed)	CPS 511	Comparison
Meaning of Variable Remuneration	Variable remuneration is the amount of a person's total remuneration that is conditional on achievement of objectives.	"Variable remuneration is the amount of a person's total remuneration that is conditional on objectives, which include performance criteria, service requirements or the passage of time."	***Consistent.*** CPS 511's definition uses the same approach as FAR and adds some examples to clarify the term "objectives".
Start of deferral period	Deferral period for variable remuneration starts at the beginning of the performance period (typically the beginning of a financial year). The Explanatory Memorandum supporting the FAR Bill further states: Para 1.114: "The deferral period is intended to be consistent with provisions of APRA's prudential standard to regulate remuneration in regulated industries (Prudential Standard CPS 511 Remuneration), that also requires deferral of variable remuneration for an overlapping class of persons in those industries. This approach will provide for consistent compliance requirements under the two frameworks."	Deferral period for variable remuneration starts at the beginning of the performance period (typically the beginning of a financial year).	***Consistent.*** The approaches are consistent noting in particular that the **references to forward looking performance measures were removed** from the final CPS 511 and CPG 511.
Percentage of Variable	An accountable entity is required to defer 40% of the variable remuneration of all accountable	A **SFI** is required to defer for a:	***Intended to be different.***

	FAR (Proposed)	CPS 511	Comparison
Remuneration to defer	persons for a minimum period of 4 years with no pro rata vesting permitted.	**CEO –** 60% of variable remuneration for a minimum period of 6 years with pro rata vesting permitted after 4 years; **Senior Manager or Executive Director –** 40% of variable remuneration for a minimum period of 5 years with pro rata vesting permitted after 4 years; and **Highly-Paid Material Risk-Taker** who is not a senior manager – 40% of variable remuneration for a minimum period of 4 years with pro rata vesting permitted after 2 years. Non-SFI's have no specified deferral requirements.	CPS 511 imposes more stringent requirements for SFIs. For non-SFIs CPS 511 imposes no deferral requirements and so the FAR minimums would apply if the legislation comes into effect.
	The amount required to be deferred, is based on the value of variable remuneration as if it had been paid at the start of the performance period.	The amount required to be deferred, is based on the value of variable remuneration awarded in the performance year.	There are no differences in the calculation methodology. While these words are slightly different, they result in the same amount to be deferred.