

## **Senate Standing Committee on Economics**

### **ANSWERS TO QUESTIONS ON NOTICE**

#### **Treasury Portfolio**

Supplementary Estimates 22-23 October 2008

**Question: sbt 29**

**Topic: Executive Remuneration Packages**

**Hansard Page: Written**

**Senator Eggleston asked:**

1. On Wednesday at the Press Club, the Prime Minister floated the idea of curbing executive greed through capping executive pay by linking it to risk exposure. How would risk be rated for this purpose? Would it include operational and financial risk as well as business risk?
2. The goals and objectives of businesses differ from business to business and within businesses over time, yet the capacity to tailor remuneration packages to suit the goals and objectives of individual firms will be limited by this policy measure. Has APRA contemplated the impact of this and if so, is there not a risk that it may hinder the growth of business?
3. How many additional resources would APRA require in order to facilitate and regulate such a scheme?
4. This measure is to ensure that Australia's financial institutions are sound, yet the Prime Minister himself has boasted that Australia ranks equal second out of 134 nations for the soundness of its banks. The fact that within the current financial turmoil Australia's banks are showing themselves to be some of the strongest in the world, highlights that the evils that this measure is aimed at preventing simply do not exist. Has APRA, during the development of this policy, come across examples that could justify such a move and if examples do exist, without naming those institutions, what are the total funds held by these institutions? What portion of the Australian financial market does APRA view as having unacceptably low levels of capital reserves relative to their debt risk?
5. How would APRA enforce financial institutions to increase their capital holding ratios for multi-jurisdictional organisations that may have their head offices in Australia or overseas?
6. On the list of the higher paid executives in Australia that this measure will cover, overseas CEOs feature prominently. NAB, ANZ the Commonwealth Bank, and Westpac, have all recruited senior executives from overseas. Given the international nature of financial markets there is a great risk that without flexibility in remuneration options, many of these high calibre personnel will be lost to more attractive offers from overseas. If this move restricts the remuneration of Australia's more successful CEOs relative to overseas CEOs in relative businesses, is there not the risk that Australia could suffer a talent exodus?

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7. Generally speaking, the payment of excessive bonuses has been more prominent within the realm of investment banking, yet APRA does not regulate this sector to the degree that it does for licensed deposit-taking banks. Will APRA be taking steps to increase its control in this area? If so, through what mechanisms would this occur and if not, why are banks targeted when the performance of Australia's banking sector is indicative of exemplary risk management?

#### Answer:

1. The Prime Minister's announcement was oriented towards ensuring that the incentives applicable to executives encourage them to be good long-term stewards for the prudentially regulated firms for which they are responsible. APRA has a well-established approach to evaluating risk for prudential purposes within APRA-regulated institutions (banks, credit unions, building societies, friendly societies, life insurers and general insurers). This approach covers operational, financial and other risks. In developing a policy on executive remuneration, APRA will be examining further the relationships between risk, risk management and executive remuneration.
2. APRA's approach will be principles-based, with the intention of there being enough flexibility in application to accommodate the differences across businesses without hindering their commercial goals.
3. This remains to be seen. Creating the relevant prudential standard or prudential practice guide will require a small team, in the order of three to five people for a period of a few months. Once created, APRA's requirements regarding executive compensation will become part of APRA's full suite of prudential requirements and institutional practices will then be monitored by APRA supervisors against those requirements. APRA does not anticipate that supervision of executive compensation matters would materially increase APRA's overall supervision resourcing requirement.
4. APRA has not yet fully developed any policy in this area and has only limited information about the remuneration arrangements in individual firms, beyond that publicly disclosed by them. Regarding capital, APRA has stated publicly that all regulated institutions are currently meeting APRA's requirements. APRA's policy, when introduced, will be aimed at further improvements in risk management by reference to the structure of executive compensation.
5. APRA-authorized institutions comprise locally incorporated companies, some independent and some subsidiaries of foreign companies, together with some branches of foreign companies. APRA's requirements for executive compensation, when introduced, will apply to these institutions only: APRA would not seek to influence executive compensation in any other institutions or any parts of institutions not regulated by APRA.
6. Nothing in APRA's intended approach necessarily constrains the amounts paid to executives, whether they are local or imported. There is no intention by APRA to constrain flexibility in levels of executive remuneration except to the extent that remuneration structures included inappropriate or unwise incentives.
7. Most government-initiated efforts to date to influence executive remuneration, in Australia and elsewhere, have relied on disclosure of remuneration details. By

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contrast, the APRA approach will rely on APRA's powers to influence directly the institutions it regulates.

APRA has no authority over non-regulated institutions and therefore will not be applying its executive remuneration requirements to them. The scope of APRA regulation is a matter for the government, whose policy to date regarding banks and bank-like institutions is that APRA regulation should apply only to deposit-taking institutions.