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10 minutes on..

APRA's new standard on remuneration

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1. Overview

What is APRA's new standard on remuneration?

- Last Tuesday 23 July 2019, APRA released a Draft Prudential Standard CPS 511 on Remuneration and an accompanying Discussion Paper for consultation.
- It sets outs APRA's heightened expectations for remuneration policy and governance practices, with the aim of ensuring remuneration arrangements promote effective management of both financial and non-financial risks, sustainable performance, and long-term soundness of the entity.
- The draft standard and the discussion paper can be found here.
- CPS 511 is intended to take effect on 1 July 2021.
- APRA has requested written submissions in response to proposals set out in the Draft CPS 511 and the accompanying discussion paper, by 23 October 2019.
- Following this, APRA intends to finalise the new standard in late 2019 or early 2020.
- Further consultation on the supporting prudential practice guide and additional requirements for reporting (both yet to be issued) can be expected following finalisation of CPS 511.
- APRA intends to review the effectiveness of CPS 511 three years from its initial effective date.

What entities will be impacted?

- The new standard applies to all APRA-regulated entities, with some requirements only applicable to larger institutions.
- Non-regulated and non-financial services (FS) entities are also likely to be impacted as market practice and expectations regarding variable pay design and governance will shift as a result.

What are the biggest changes?

1. **The breadth and depth of remuneration arrangements Boards are expected to oversee** has grown to cover all remuneration arrangements. This includes some service provider remuneration arrangements.
2. **A proportionate approach is proposed**, however the number of entities and roles captured by the most stringent remuneration deferral and clawback requirements is significant, and differs from how authorised deposit taking institutions (ADIs) have been delineated under the BEAR.
3. **Prescribed remuneration deferral periods** of 7 years for CEOs and 6 years for other Senior Managers and highly-paid Material Risk Takers (MRTs), plus requirements to apply clawback for up to a further 4 years post-vesting or payment.
4. **An explicit focus on non-financial risk management** including a limit on financial metrics of 50%, applying across the entire organisation and across the total amount of variable remuneration.

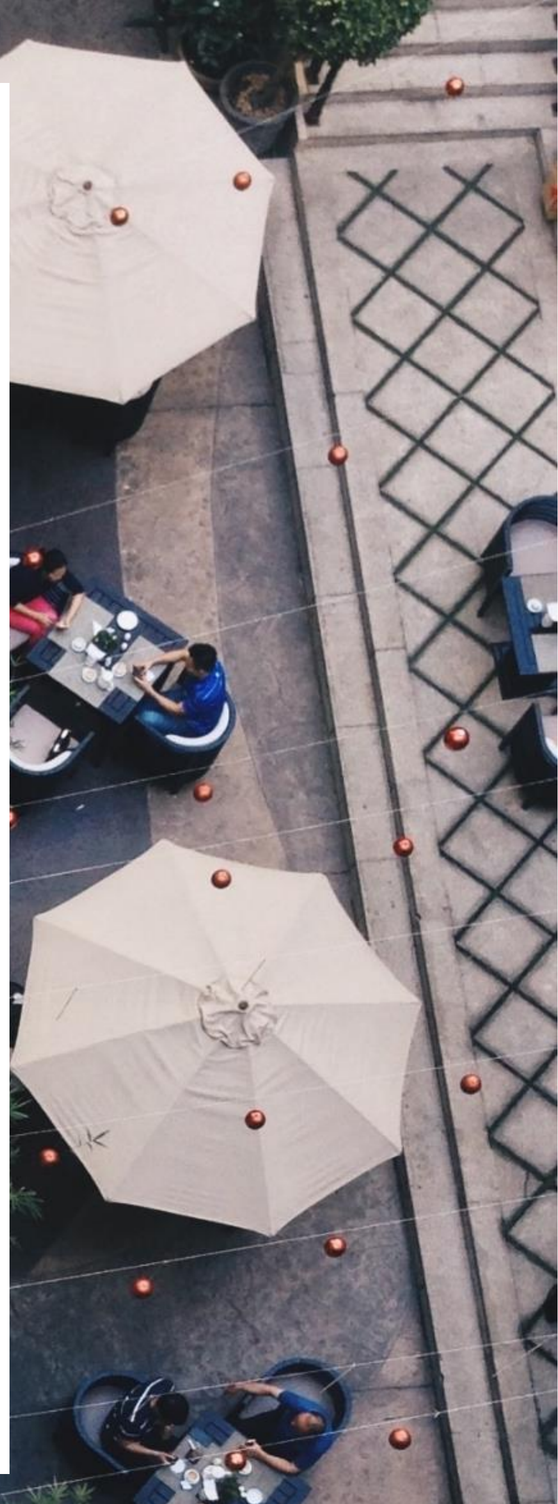
What should I do next?

As an **APRA-regulated entity**:

- **Undertake a stocktake of the remuneration arrangements** that exist across your organisation, including service contracts.
- **Review your remuneration arrangements and governance practices** against the requirements of the Draft CPS 511.
- **Consider where the greatest gaps/impacts are** for your organisation, and develop a workplan.
- **Be clear on the non-financial aspects of 'success' at your organisation**. Determine if/how these non-financial aspects can be measured (or enhanced) to encourage better non-financial risk management and appropriate conduct.
- **Consider making a written submission** to APRA.

Non-regulated, and non-FS companies, are not required make to make any change. Nevertheless, given the broadly held view that incentive pay in particular should demonstrate greater sensitivity to the full range of role accountabilities, it would be wise to consider change that aligns with the intent of the regulation. For example, ensuring remuneration outcomes reflect a more balanced set of considerations in-year and over time, and that the impact of remuneration arrangements on behaviour is more actively monitored and improvements are made as necessary.

[1] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry



2. Proposed requirements by different categories of persons

Categories of persons		Design of Variable Remuneration (VR)		Remuneration consequence	Governance	
		Performance measures	**Deferral**	**Remuneration adjustment tools**	**Remuneration Committee (RemCo)**	**Board**
All persons		• Financial measures limited to 50%, and individually capped at 25%	• *Principle based only* – **Design of VR arrangements must incorporate** assessment of whether remuneration objectives have been met in a **multi year framework over the entity's business and strategic time horizon**	• In-period • Malus • Clawback • Overriding discretion/judgement	• Oversee the design, operation and monitoring of the remuneration framework	• Approve the remuneration policy • Actively oversee the remuneration framework
Additional requirements for Special Role Categories (SRC)	**Risk and Financial Control Personnel (RFCP)**	*As per all employees, plus:* • Function objectives • Not influenced by the performance of the business activities they control			• Recommend VR outcomes on a *collective* basis for (1) RFCP and (2) other MRTs	• Approve VR outcomes on a *collective* basis for (1) RFCP and (2) other MRTs
	MRTs	*As per all employees*				
	Highly-paid MRTs[1]		• **For Significant Financial Institutions (SFIs)[2] only,** 40% of VR deferred for 6 years (pro-rata vesting after 4 years)[3]	• **For SFIs[2] only,** clawback for up to 2 years from date of payment/vesting; plus an additional 2 years in circumstances involving persons under investigation[3]	• Recommend VR outcomes on an *individual* basis	• Approve VR outcomes on an *individual* basis
	Senior managers (SM) (excl CEO)					
	CEO		• **For SFIs[2] only,** 60% of VR deferred for 7 years (pro-rata vesting after 4 years)[3]			

1 Those with total fixed remuneration plus maximum potential VR equal to or greater than A$1m.
2 SFIs are defined as APRA-regulated entities where the following total asset sizes are exceed: ADIs – A$15 billion; General and life insurers – A$10 billion; and Funds under management for registrable superannuation entities (RSE) licensees – A$30 billion.
3 For non-SFIs, rules apply as per 'All persons'.

3. Key implications

	Key implications for APRA-regulated entities	Actions to take now
Scope	**A broader set of remuneration arrangements[1] for the Remco and Board to oversight** • Given all arrangements for all employees are now in scope, **most companies will be required to preside over additional remuneration arrangements** (likely upwards of 10 for the larger entities versus an average of three to five arrangements today). • **Some service provider remuneration arrangements with their employees and contractors may be caught** by the new standard (such as investment management services provided for a RSE Licensee). As we've seen with reform of third party remuneration arrangements under the Sedgwick Review, Mortgage Broker remuneration inquires and Future of Financial Advice (FOFA), it will be challenging to deliver. Third party arrangements are often long-standing, commercial arrangements and the regulated entity has very little influence over the service provider's reward and HR practices. This will prove particularly complex where the third party provides services to multiple APRA-regulated institutions. **For non-regulated entities:** Market and community expectations will likely increase for all regarding the scope of RemCo and Board responsibilities when it comes to remuneration.	**All companies:** • Undertake a stocktake of all remuneration arrangements in place. • Review the governance frameworks in place for all remuneration arrangements and relevant service agreements. Identify gaps in RemCo and Board level oversight. **APRA-regulated**: • Stocktake and review to also cover relevant service agreements.
Roles with specific requirements	**A longer list of individual roles whose remuneration outcomes must be prudentially managed** • **The new MRT definition will capture a much broader population** as a result of (1) removing the test of VR significance, and (2) going beyond those who can materially impact the financial soundness, to the overall *"long-term soundness"* (eg could include senior traders, investment managers, and certain frontline staff). **Less flexibility in remuneration framework design, with specific prescribed design features for a number of roles in larger entities** • Highly-paid MRTs will be subject to the most stringent remuneration deferral and clawback requirements. **The A$1m threshold will dictate a prescribed remuneration structure for a sizeable cohort of executives and employees,** particularly given the threshold is based on potential earnings, meaning that many individuals, whose take-home pay would fall well below the million-dollar mark if long-term incentives (LTIs) don't pay out, will still be captured. The definition of total potential remuneration in this case makes the requirement more onerous than those in the UK and EU where actual remuneration is used.	**APRA-regulated**: • Review your current approach to identify MRTs against the proposed definition. • Identify any additional employees/contractors who meet the proposed definition. • Confirm how many MRTs would qualify as a highly-paid MRTs, and examine the nature of captured roles. **All companies**: • Consider the types of roles which may have material impact on your entity's risk profile, performance or long-term soundness. Confirm whether such remuneration arrangements are appropriately governed.

1 Definition of remuneration arrangement is consistent between CPS/SPS 510 and CPS 511 in that it includes the 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. Furthermore *"All forms of remuneration are captured by this Prudential Standard, regardless of where, or from whom, the remuneration is sourced."*

3. Key implications (cont'd)

Design of VR (inc. performance measures)

Key implications for APRA-regulated entities

Incentive design changes are likely to be required for all roles in scope

- While **the requirement to introduce at a least 50% weighting on non-financial metrics** is largely reflective of current industry practice in short-term incentive (STI), this **will bring about significant shifts in LTI plan designs** given only 16% of the ASX 100 currently use non-financial measures in their LTI plan[1].
  - **Introducing non-financial metrics**, and in many cases a second financial metric (given the maximum 25% weighting on individual financial metrics), **will increase complexity of incentive plans**. Care should be taken to ensure the motivational impact of LTIs is not diminished.
  - There will be a **greater requirement for institutions to demonstrate how non-financial measures align with longer term wealth creation**, to facilitate shareholder support of these metrics, particularly given the view by some, reinforced by our research[1], that non-market measures are more likely to vest. Threshold and target performance and payout levels will need to be carefully calibrated, notwithstanding the challenges of calibrating such targets in the absence of historical performance tracking against such metrics, and particularly over lengthening LTI performance periods (see the 'Deferral' section).
  - **Taking a more discretionary approach may appeal to some stakeholders** as an alternative to placing limits on financial measures (as APRA has speculated). Although institutions may find it more challenging to rationalise positive adjustments for exceptional performance and risk outcomes.
- The requirement to **ensure conflicts of interest are assessed and mitigated in the design of remuneration arrangements**, including for all employees and some service contracts, **will have significant industry wide impacts**. This change may be more acutely felt by insurance and superannuation institutions with structures comprising of numerous distinct entities or third party providers, and who have not previously applied the Sedgwick Recommendations or FOFA requirements. Impacts include:
  - VR design changes such as revised metrics, payout curves, and shifts to fixed pay from variable.
  - Erosion of the perceived value of customised incentive plans, as design features such as financial accelerators and modifiers, financial gateways, cross-selling metrics are removed.
  - The need for institutions to re-negotiate existing and some future service contracts.
- The requirement that **RFCP** VR arrangements **must not be influenced by the performance of the business activities they control**, could be interpreted such that **no portion of variable pay** can relate to the **performance of the business unit they oversee, or for some roles (eg CRO, Head of Compliance, Head of Internal Audit) the company** that they oversee. In practice, this may result in certain RFCP no longer being eligible for the Group STI and/or LTI, without refinements to the plan design, eg remove or substantially reduce weightings on Group financial metrics.

For non-regulated entities: Whilst the use of non-financial measures will increase, broader market acceptance will likely be influenced by whether or not there is demonstrable impact on shareholder value over the long term. Selection and calibration of non-financial metrics utilised by regulated entities will be critical to achieving this.

Actions to take now

All companies:

- Review the balance between financial and non-financial measures across all variable reward arrangements used to allocate variable pay (eg STI and LTI), for all employees and relevant service providers.
- Consider which non-financial metrics are most relevant to your business objectives, drive long-term soundness and are aligned with the interests of key stakeholders.

APRA-regulated:

- Review all current remuneration arrangements against potential conflicts of interest (eg sales measures, accelerators).
- For RFCP, review alignment of existing measures with the authority and objectives of control functions.

1 PwC, 10 minutes on...2018 Executive remuneration trends: Movement under the spotlight, July 2019 (link)

3. Key implications (cont'd)

Deferral

Key implications for APRA-regulated entities

Modifications to VR frameworks to incorporate longer and more substantial deferrals, possibly resulting in a shift towards fixed remuneration

- While the major banks implemented longer, 4 year deferral practices and clawback requirements last year for Accountable Persons under the BEAR, **the proposed standard**, specifically the SFI requirements, will capture another 17 ADIs, 8 general and life insurers and 17 superannuation entities, **going well beyond the most senior roles in our largest institutions.**
- The deferral requirements for SFIs, are **more stringent compared to the BEAR requirements, typical market practice in Australia, and other highly regulated jurisdictions**, such as the UK and EU. As such, these changes may negatively impact mobility across industries or jurisdictions, and may lead to APRA-regulated institutions finding it harder to attract talent from other industries (eg in the digital and customer space).
- With average CEO tenure at 5 years[1], **limited value may be derived from LTI awards** (ie via partial vesting from the first 2 awards) which take 7 years to fully vest for a CEO, that is unless 'good leaver' status is granted upon termination. A possible implication is that entities will seek to **modify the leaver provisions** such that awards remain 'on foot' for more categories of leavers (eg termination by mutual agreement or without cause), pro-rated for years of service. However, the competitive nature of talent markets means that this change will be unlikely where talent moves to a competitor.
- **The prohibition of accelerating the vesting** of awards for leavers may have **adverse tax implications**, where a taxing point is triggered for the leaver.
- **Differentiating the deferral requirements of CEOs and other SMs** and highly-paid MRTs **adds complexity**, requiring differentiated terms in long-term incentive plan rules between CEO and direct reports, and potentially amongst peers/individuals at the same organisational level.
- As **deferral periods and complexity of incentive plans increase**, we may observe **greater emphasis on fixed remuneration** as many re-evaluate the 'value' of the total remuneration package under these requirements.

For non-regulated entities: As observed with the introduction of CPS 510, deferral requirements for APRA-regulated entities became the 'norm' across the majority of large listed entities. As such, it is likely that lengthier deferral periods will come to be expected for all, albeit perhaps not to the same extent.

Actions to take now

All companies:

- Solicit stakeholder views on what is a reasonable definition of the entity's business and strategic time horizon, consider the appropriateness of existing deferral arrangements accordingly.

APRA-regulated (particularly SFIs):

- Review the remuneration framework for potential SRC roles to understand the extent of existing gaps to proposed deferral quantums and periods.

APRA-regulated:

- Review the plan rules, including the vesting period and leaver provisions (for both 'good' and 'bad' leavers).
- Seek tax advice on the structuring of deferred awards to avoid adverse tax implications for leavers.

1 PwC's Strategy&, CEO Success case study (link)

3. Key implications (cont'd)

Remuneration consequence

Key implications for APRA-regulated entities

Enhanced focus on the impact of risk and conduct on remuneration outcomes, will likely require a formal remuneration consequence framework and process to be put in place

- **The specific criteria for the application of malus and clawback** (including the differential criteria for the application of malus vs. clawback) **is helpful and will ensure that non-financial risks and conduct matters are considered** more routinely and with more consistency within and across entities. However, in our experience (both here and in the UK and EU), as long as the decision around the quantum of the risk adjustment is clear, and the materiality of the consequence is appropriate, companies don't stand to gain much by differentiating between the types of risks that should apply to in-period vs unvested vs vested VR. **The difference in criteria may result in companies having to clawback vested VR even when it may be more practical to adjust the in-period awards or deferred VR via malus.**
- **The definition of misconduct risk** ("*risk associated with action/inaction that falls short of expected standards, including legal, professional, internal conduct and ethical standards*") **is broad and goes beyond the typically narrow interpretation of 'conduct' as compliance with the code of conduct**. As a result, this will likely require organisations to review and update their code of conduct to ensure alignment with the standard, consequently, the nature (and therefore number) of conduct incidents that currently go through a formal adjustment process, may end up being much larger.
- There may be **tax implications for both individuals and companies in implementing a malus and clawback policy**. For example, for companies utilising an Employee Share Trust where malus or clawback is applied to existing or prospective equity awards; for individuals where variable pay is clawed-back.

For non-regulated entities: Key implications are likely to be similar. Investors, proxies and the community all now have enhanced expectations regarding remuneration adjustments and deliberate and transparent use of discretion. As such, all listed companies will be expected to have a process for considering remuneration consequence, to ensure outcomes are fair and appropriate from the perspective of multiple shareholders.

Actions to take now

All companies:

- Review malus and clawback criteria and consider coverage of non-financial risk and conduct matters.
- Seek tax and legal advice for the company and general advice for individuals when implementing malus and/or clawback provisions.

APRA-regulated:

- Review the current process to identify when consideration of VR adjustments would be triggered (eg conduct, safety, etc.) and confirm to what degree this aligns to proposed definition of misconduct risk.
- Examine existing relevant policies that inform remuneration consequence decisions, for alignment or contradictions (including performance management, remuneration, and conduct policies).

3. Key implications (cont'd)

	Key implications for APRA-regulated entities	Actions to take now
Governance	**The expanded scope and oversight obligations will add considerably to the workload of both management and boards** • **Annual approval of remuneration** will be **required by the Board** for all SMs as well as anyone with the potential to earn A$1m. In the largest institutions, this could multiply Board approvals by 10 times. • The **breadth and depth** of remuneration arrangements that boards are now expected to **actively oversee has grown**. Some of these arrangements are currently governed by management committees, particularly those that only apply to a very small number of employees, those with external service providers and/or those that pose very few misconduct risks. To **elevate all arrangements to the same level of scrutiny is a practical challenge** with questionable benefits. • We expect that delegations may be appropriate to discharge oversight responsibilities, where there are escalation and reporting processes in place to provide directors with comfort over their expanded accountabilities. Saying that, institutions **should not underestimate the extent of additional activity** that will be required to meet these 'oversight' obligations. In particular **RemCos of SFIs, who typically meet between 5 to 8 times per year** for several hours, already have packed agendas with a predominant focus on CEO and executive remuneration only. It is highly unlikely that this **will come even close to the time required** to deliver on this standard and boards and management teams will need to adjust accordingly. • Whilst many large institutions have taken steps to **formalise the consultation by the RemCo with the Board Risk Committee** (BRC), many institutions reported that the BRC input into risk assessments remains limited[1]. Achieving this in a practical and efficient manner will continue to be a challenge.	**All companies:** • Review the governance frameworks in place for all remuneration arrangements. Identify gaps in RemCo and Board level oversight. • Review and formalise the input required so that RemCo can make decisions within the context of non-financial risk and conduct. This may include consideration of customer, safety, risk and technology aspects of performance for example. **APRA-regulated:** • Update charters and governance process maps to ensure appropriate coverage by the Board and RemCo. • Review delegations of authority and escalation paths. • Review and bolstoring reporting. For example, the quality of risk and consequence management data.
Compliance and effectiveness review	**Effectiveness reviews will need to be planned to include the prescribed content areas, and require greater collaboration between reward, HR, risk, and other internal control functions** • Given the scope of the standard **now covers all remuneration arrangements**, this is likely to have a **significant impact on the scope of the reviews** (both annual and triennial). • Conducting the **triennial effectiveness review** should have **a broader business benefit** than purely compliance. For example, it may be a **tool for institutions to meet their accountability obligations under the BEAR** (or the equivalent accountability regime), that is to '*take reasonable steps to prevent matters arising that would negatively impact on the ADI's prudential standing or prudential reputation*'. • In our experience, the type of **data inputs required** to assess how effectively remuneration practices are satisfying policy objectives and reducing risks of misconduct **are not always readily available** and may be fraught with accessibility issues. Careful planning of the data requirements, early requests and a clear rationale will assist in execution and the robustness of their findings. • While only the triennial effectiveness review is required to be completed by "*operationally independent, appropriately experienced and competent persons*", it is likely that **Internal Audit personnel will need to bolster their reward technical capabilities** to take on this role. **For non-regulated entities:** A greater focus on governing the implementation and effectiveness of remuneration arrangements, in addition to governing remuneration policy, will likely become the expectation for all.	**All companies:** • Review the current process in place for reviewing the remuneration policy, including how effectively it is achieving its objectives. • Develop an 'effectiveness' measurement framework, including outcomes, measures, and data sources to be monitored. **APRA-regulated:** • Engage with control functions early (risk, compliance, legal, internal audit) to confirm ongoing input/involvement/ roles and accountabilities. • Consider the need to upskill the internal audit function in reward technical knowledge.

1 APRA, Information Paper: Self-assessments of governance, accountability and culture, May 2019 (link)

4. Topics likely to be further explored during consultation

Definitions and Interpretation

Covered persons
To what extent are employees of service providers and contractors in scope?

Highly-paid MRTs
Is it appropriate for highly-paid MRTs to be captured based on potential earnings rather than actual? Is A$1m the right threshold?

Remuneration framework
To what extent do other HR frameworks, like the performance management, system fall into the definition of the 'remuneration framework'?

Start of the deferral period
How is the "inception of VR component" defined? Is it when the award is granted, the decision is made to grant, or at the start of the performance period?

Malus and clawback criteria
Is it necessary and/or practical to have a different set of trigger criteria for malus and clawback?

Potential gaps and unintended consequences

Sign-on and buyouts
CPS 511 does not address APRA's earlier findings on sign-on/buyout packages (ie not being aligned to risk adjustment principles)

Identifying MRTs
CPS 511 does not provide an approach to identifying MRTs, in spite of APRA's previous findings on significant inconsistencies across the industry

Effectiveness of scorecard design
By placing limits on certain types of metrics, the number of metrics is likely to increase – further compromising effectiveness

RFCP remuneration framework
CPS 511 is not explicit on pay mix requirements for RFCP, notwithstanding APRA's previous comments on it being important to safeguard the independence of these personnel

Transition

Existing employment contracts
Will existing arrangements under employment contracts be grandfathered?

Implementation timeline
Will organisations be required to comply with the standard by 1 July 2021 or from performance years starting on 1 July 2021?

Coordination with other regulatory requirements
Could other industry-wide remuneration changes and associated timelines be synchronised? (eg FOFA grandfathering lifts on 1 January 2021, ASIC Corporate Governance Taskforce)

In addition to the draft standards, the discussion paper briefly touches on two other aspects also to be explored during consultation:

1) APRA intended approach to supervision

APRA notes that it will *"intensify its supervision of remuneration practices under the new standard, with a focus on design, implementation and outcomes".*

2) Disclosure requirements

APRA highlights its intention to propose additional requirements for reporting and public disclosure of executive remuneration. Examples mentioned are:

- Publication of the entity's remuneration policy
- Publication of specific performance metrics used for variable remuneration for senior executives and their current and historical values, and
- Details on the incentives provided or risk adjustments made to executives or other staff.

There is no doubt that additional transparency is needed, given existing disclosures are extensive yet often do not contain meaningful information for investors or the community, as noted by APRA.

However, the challenge will be in how to achieve this without sacrificing the strategic or commercial sensitivities.

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Appendix
Summary of the proposed vs. current requirements

Summary of the proposed vs. current requirements

	Proposed: Draft CPS 511 requirements	Current: CPS/SPS 510 requirements
Scope	• **A single prudential standard** covering Banking, Insurance, Life Insurance, Health Insurance and Superannuation • Covers Group remuneration policy, objectives and **all remuneration arrangements for all employees, as well as those retained under contracts** • Covers some **service contracts, their employees and contractors**[1]	• **Two separate prudential standards**, one for RSE Licensees and one for other APRA-regulated entities • Covers Group remuneration policy and arrangements for **senior executives and limited additional staff** only • Covers some service contracts[1] • Same standards apply to all categories of roles in scope: – **Responsible Persons** (SMs[2] excl. actuaries and auditors) – **Risk and Financial Control Personnel** whose primary role is risk management, compliance, internal audit, financial control or actuarial control; and – All other persons for whom a **significant portion of total remuneration is based on performance** and whose **activities**, individually or collectively, may **affect the financial soundness of the institution** (also known as MRTs)
Roles with specific requirements	Additional standards apply to **Special Role Categories**. SRCs are defined which includes **persons in the category of Senior Manager**, **Material Risk Taker** (including highly-paid MRTs) **and Risk and Financial Control Personnel.** Higher standards to be met for all SRC in **Significant Financial Institutions**[3], with the most prescriptive requirements applying to SMs and highly-paid MRTs • **SM**: now includes all SMs as defined in CPS 520 • **MRT**: a broader definition: persons whose **activities have a material potential impact on the entity's risk profile, performance and long-term soundness**[4] • **Highly-paid MRTs**: **A new category of MRTs** whose total fixed remuneration plus **maximum potential VR** is equal to or greater than **A$1m** • **RFCP**: definition remains unchanged	• Same standards apply to all roles in scope, namely three role categories (as above)

1 Service contracts with a body that provides risk management, compliance, internal audit, financial control or actuarial control services to the institution; or where the services may, either individually or collectively with like services, affect the entity's financial soundness, or materially affect the management of financial or non-financial risks (under CPS 511), and a significant (under CPS 510) or material (under CPS 511) portion of the total payment is based on performance.
2 As defined under CPS/SPS 520.
3 For APRA-regulated entities where the following total asset sizes are exceed: Authorised deposit-taking institutions (ADIs) – A$15 billion; General and life insurers – A$10 billion; and Funds under management for registrable superannuation entities (RSE) licensees – A$30 billion.
4 For RSE licensee, it also means a person whose activities have a material potential impact on promoting the financial interest, and reasonable expectations, of beneficiary.

Summary of the proposed vs. current requirements (cont'd)

	Proposed: Draft CPS 511 requirements	Current: CPS/SPS 510 requirements
Design of Variable Remuneration (VR) (inc. performance measures)	**Financial performance measures** (eg revenue, profit or share based measures such as Total Shareholder Return) **across all VR arrangements** must not compromise more than **50% of total measures** (excludes risk-adjusted financial measures and an RSE Licensee's investment return measures) **Individual financial measures** must **not compromise more than 25%** of total measures **Must incorporate:** • appropriate **tools which allow for adjustments** when and if required • **financial and non-financial risks** that could materially impact risk profile, performance or long-term soundness • **cost and quantity of capital and liquidity** required to support business activities, where appropriate • **mitigation of conflicts of interest** • and for **RFCP**, must reflect their independence and authority; set in accordance with the objectives of their functions; and are not influenced by the performance of the business activities they control **Must not:** • **accelerate the vesting of unvested VR** for any person no longer employed/engaged (excludes death, serious incapacity, serious disability or serious illness) • **allow any person in a SRC to hedge** their economic exposure before equity or equity-linked VR are fully vested	• Must be designed to encourage behaviour that **supports long-term financial soundness** and supports the **risk management framework** of the institution • Must **incorporate adjustments** to reflect: – the **outcomes** of business activities; – **risks** related to the business activities; and – the **time necessary** for the outcomes of business activities to be reliably measured • Must **prohibit** covered persons who receive equity or equity-linked deferred remuneration from hedging their economic exposures before it is fully vested • For **RFCP**, ensure that the structure of performance-based components if any, **does not compromise the independence** of these personnel in carrying out their functions
Deferral	• **All VR arrangements** must **incorporate payout and vesting schedules** that are commensurate with the **possible range of risk and performance outcomes**; and an **assessment of whether objectives have been met in a multi year framework** over the entity's business and strategic time horizon • For the **SFIs, 60% of VR for a CEO** and **40%** for **SMs** or a **highly-paid MRTs**, to be deferred for up to **7 and 6 years** respectively, with pro-rata vesting after 4 years (not applicable where VR is less than A$50k)	

Summary of the proposed vs. current requirements (cont'd)

	Proposed: Draft CPS 511 requirements	Current: CPS/SPS 510 requirements
Remuneration consequence	• Must ensure that **VR outcomes are commensurate with performance and risk outcomes**, and are adjusted downwards, to zero if appropriate, through tools including **in-period adjustments, malus, clawback** • **Specific criteria for** the application of **malus to** include: significant downturn in financial performance; evidence of misconduct or negligence resulting in losses; significant failure of financial or non-financial risk management; failure to meet the entity's code of conduct; or significant adverse outcomes for customers, beneficiaries or counterparties • **SFIs must subject the VR to clawback for at least two years** from date of payment/vesting, and a further 2 years where an individual is under investigation. Specific criteria applies: responsibility for material financial losses; material misstatement of financial statements or other criteria on which VR was based; breach of compliance obligation; failure of accountability or fitness and propriety	• Must provide for the Board, as relevant, to **adjust performance-based components** of remuneration **downwards, to zero if appropriate**, in relation to relevant persons or classes of persons, if such adjustments are **necessary**
Governance	• **Board** must **approve the remuneration policy** • **RemCo** must assess and **make annual recommendations' to** the **Board** for approval on the remuneration arrangements and VR outcomes – **individually for SMs and highly-paid MRTs**, and **collectively for all other MRTs and RFCP** • **Board** must **actively oversee the remuneration framework** • **Board** must **establish a formal process for the RemCo to consult the Board Risk Committee and CRO** • **RemCo** must **oversee the design, operation and monitoring** of the remuneration framework • **RemCo** must obtain **comprehensive reporting** to assess remuneration outcomes alignment with the remuneration objectives • RemCo must have free and unfettered **access to other Board committees and RFCP** • Where the APRA-regulated institution is part of a Group, the **Group RemCo may be utilised**	• **Board must approve the remuneration policy** • RemCo to make **annual remuneration recommendations' to the Board for approval** for the CEO, CEO direct reports and other persons (incl. categories of persons covered by the remuneration policy) • RemCo must have free and unfettered access to RFCP • Where the APRA-regulated institution is part of a Group, the Group RemCo may be utilised

Summary of the proposed vs. current requirements (cont'd)

	Proposed: Draft CPS 511 requirements	Current: CPS/SPS 510 requirements
Compliance and effectiveness review	• **Annual compliance review** of the remuneration framework with the Prudential Standard (CPS 511) • **Triennial effectiveness reviews** (with 5 prescribed assessment criteria) of the remuneration framework carried out by operationally independent, appropriately experienced and competent • The RemCo must take appropriate and timely action to ensure the **findings** of these reviews are **adequately addressed and implemented**	• The RemCo must conduct regular reviews and make recommendations to the Board on, the Remuneration Policy. This must include an assessment of the effectiveness and compliance with the Prudential Standard (CPS 510)

How can PwC help?

To have a deeper discussion about these issues, please contact:

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