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[redacted]
General Manager
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Australian Prudential Regulation Authority
By email: PolicyDevelopment@apra.gov.au

Dear [redacted]

Remuneration Standard Response Paper

The Australian Financial Markets Association (AFMA) welcomes the opportunity to respond to APRA's *Strengthening prudential requirements for remuneration Response Paper*.

AFMA commends APRA for a responsive consultation process to this point which has allayed some of the industry's most pressing concerns with the original draft. There were concerns that the original arrangements around financial metrics were not workable and that the deferral periods particularly for Highly Paid Material Risk Taker (HPMRT) staff would make ADIs uncompetitive in attracting this type of talent – both of these were addressed in your revised standards.

Members were also concerned around implementation timing, but the announced timetable has addressed these concerns.

We offer more suggestions in this submission with a view to further refinement of the standard and look forward to continued engagement over the course of the year as the standard is finalised and industry moves to the implementation stage.

Please do not hesitate to contact me with any questions relating to the submission.

Yours sincerely

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Key issues

At a high level the main issues remaining for AFMA in the updated draft include:

- Reflecting the level of risk posed foreign ADIs should have their home jurisdiction requirements (including for deferral) recognised as sufficient locally where they are FSB compatible.
- The proposed Significant Financial Institution (SFI) threshold of $15 billion remains too low for ADI entities. While noting the guidance that more criteria than the threshold will be considered to determine whether institutions are significant at the proposed level, too many entities of no significance to the national economy could be caught by the SFI requirements. This includes institutions with small presences such as foreign ADIs, many of which have few staff.
- Too broad a category of SFIs exacerbates the impacts on the competitiveness to ADI firms and results in an uneven playing field. ADIs face competition not just from regional bank competitors but also from the less regulated shadow banking sector both domestically and internationally. Disadvantaging these businesses is at odds with the broader Government strategy on global competitiveness.
- An easy to implement pro-rata system in line with FAR/BEAR is a necessary feature of the standard to ensure that individuals are captured by the standard only to the extent they spend time on ADI-related matters, recognising that many roles will cross both ADI and non-ADI entities within a group structure.
- The requirements have duplicative overlap with FAR/BEAR and for many firms would add to requirements placed on them by their home jurisdiction.

We expand on these points in the sections that follow.

AFMA has made numerous arguments in our prior submissions explaining why the $15 billion threshold is too low, why the risk profiles for the economy of foreign ADIs mean the test is inappropriate for these entities, and how local regulator inconsistencies in the calculation of the asset figure (compared to standard international IFRS practice) would see some firms included only as a result of domestic regulatory accounting oddities.

We continue to strongly support those arguments. They are not repeated here for reasons of brevity and we refer you to our previous submissions.

Preserving the rational for the foreign ADI regime

It is important that there is alignment of APRA's policies with the broader government objectives as far as possible without compromising prudential safety. In this regard we are concerned that there is a gradual decline in the rationale for the foreign ADI framework.

Australia has benefited enormously from the entry of foreign banks and their financing of the Australian economy and provision of thousands of jobs. The foreign ADI framework allows firms to bring the benefit of their balance sheets to the Australian economy without the requirements to establish a local subsidiary. This framework reflects the limited solvency risks that the Australian economy is exposed to with foreign banks whose creditors are mostly offshore.

It is in the national interest for the barriers to entry for foreign banks to be minimised to maximise the benefit to the economy. These wholesale firms were not the focus of the Royal Commission. The proposed standard will be a disincentive for firms to bring senior staff and even modest balance sheets into Australia under the foreign ADI rules. The minimal prudential risks posed by foreign ADIs should be reflected across the range of APRA requirements including remuneration.

AFMA suggests a first principles strategic assessment be undertaken to ensure that the foreign branch model remains sustainable and does not decay into offering limited differences to the requirements of establishing a local subsidiary.

Recommendation

Consistent with the risk they pose foreign banks should have their home jurisdiction requirements recognised including for deferral periods where those requirements meet FSB standards. In the alternate, AFMA supports the consideration of more appropriate metrics for foreign banks.

Significant Financial Institution (SFI) threshold

AFMA raises no concerns with the requirements for non-SFI firms. However, the proposed burdens and competitive disadvantages for SFI firms are significant and we believe should be reserved for larger firms for whom the burdens will be proportionately more manageable.

AFMA notes that some foreign ADIs with balance sheets above $15 billion only have a few dozen staff locally. These firms should not be potentially within capture for the scheme as the regulatory burden is disproportionate to their size, particularly given the duplicative requirements we discuss in a later section.

Recommendation

If the current metric is kept, then a threshold around the mid-point of the BEAR regime medium enterprise level at around $50 billion would be more likely to create appropriate outcomes. AFMA suggests that any calculation of assets use the standard IFRS approach rather than local idiosyncratic rules.

Competitive neutrality

APRA is required to balance the objectives of competition, contestability, and competitive neutrality as part of its enabling legislation.[1]

ADI firms as a group face competition from non-bank firms domestically and bank and non-bank firms internationally.

Domestically, as far as possible ADIs should not be disadvantaged compared to non-ADIs when performing similar functions. Wholesale banking businesses are people businesses and attracting the best talent is a core challenge. The changes in relation to HPMRT have been very welcomed in this regard, but there are still significant differences in the requirements for deferrals for senior managers and CEOs.

[1] Australian Prudential Regulation Authority Act 1998, s8 (2).

Internationally the standard puts Australian businesses at a significant competitive disadvantage (as the paper acknowledges[2]) to all jurisdictions except the UK. As we have argued previously, Australia does not have the same degree of freedom as the major global financial centres, like the UK, in setting regulatory policy for business that has an international dimension, as a presence in the UK for international banks is necessary for global business. Within the region, the 6-year deferral period for CEOs is twice the typical deferral period in Hong Kong and Singapore, making Australia a very unattractive destination for top talent.

Aiming to make Australian regulation the second most onerous in the world, and completely out of step with our regional competitors, is not a well-considered objective. While it may make sense for non-foreign ADIs of sufficient size if the focus is solely on prudential safety, it is at odds with the clearly expressed aims of broader Government strategy.

Policy processes should be designed to ensure better alignment with the broader aims of Government policy from the outset. The types of measures that could be considered in this regard include the use of issues papers as a first step in any consultation rather than leading with a draft standard. Leading with a draft means that tone and direction have already been set.

We also suggest that in matters that have international and economic implications, that APRA look to involve Treasury, DFAT and industry from the very first stages. It is entirely appropriate that APRA examine matters through a prudential lens as this is APRA's core objective and should guide its policy process. But the best resources for considering the economic impacts are likely to be found in Treasury, the trade impacts at DFAT, and competitive impacts are best known by industry.

To be consistent with the broader Government objectives in this instance APRA policy should align with the mandate for the Global Business and Talent Attraction Taskforce. Announcing the Taskforce, Senator the Hon Simon Birmingham, Minister for Trade, Tourism and Investment stated its aim was to: "attract high value global business and exceptional talent. The initial focus will be on three key sectors: advanced manufacturing, financial services (including FinTech) and health."

Rather than attract talent, the revised draft remuneration standard will, for CEOs and senior managers, do the opposite and create barriers to attracting high value global business and exceptional talent in finance (noting that business often follows the talent in finance).

At a minimum, APRA policy should avoid making existing barriers worse. To do this it should not create barriers that exceed those of our competitor jurisdictions Hong Kong and Singapore. It will be very difficult to attract CEOs and senior management to Australia with the proposed settings so out of step with these jurisdictions. This in turn will make it unattractive for global firms to have regional operations led out of Australia. It may also result in those ADIs with an APAC presence to consider where best to locate their operations, potentially to the detriment of the Australian workforce.

The Royal Commission recommended alignment with the FSB principles and guidance which do not require exceeding the requirements set in our competitor jurisdictions.

[2] See Figure 3 page 28 of the Consultation Paper.

Recommendation

AFMA recommends that the deferral periods for CEOs and Senior Managers be aligned with those typical in our regional competitors at 3 years pro-rata. We note that these are also consistent with the requirements of the FSB principles and guidelines as recommended by the Royal Commission.

Pro-rata application

AFMA strongly supports the establishment of a BEAR like pro-rata scheme such that the scheme applies to individuals only to the extent they spend their time on ADI-related matters.

We note that in group structures many individuals will share their time and efforts across multiple entities, many of which will typically not be ADIs. This is true for both domestic and some international staff. For Senior Officers Outside of Australia (SOOAs) the Australian entity may be only a relatively small part of their responsibilities in the region (potentially as part of a global role) given the relative size of operations in other jurisdictions.

It would be unfair and inappropriate if the provision of any time or services to the ADI entity would result in an individual's entire remuneration structure being caught by the ADI remuneration standards. The industry accepts that a pro-rata application is appropriate. We note that SOOAs could also be captured by their home country regulatory regime and be subject to regimes from two or more jurisdictions that may be in conflict with one another.

Recommendation

AFMA recommends that further work be done with industry on the pro-rata framework to ensure its workability before finalisation of the standard. Alignment with the approach in BEAR is supported. Issues around pro-rata application created significant challenges with BEAR and earlier resolution would have assisted implementation.

Regulatory overlap and duplication

The proposed remuneration standard has significant areas of overlap and duplication with the BEAR and potentially the upcoming FAR.

It is not sound practice for remuneration requirements to be dealt with through a legislated regime in BEAR and a subordinate, inconsistent remuneration standard. Having multiple sources of overlapping law and regulatory standards creates unnecessary complexity and cost for implementation and should be avoided where possible.

We note also that a key regulatory principle is that legislation takes precedence and regulatory requirements should be entirely consistent with the law, only filling in areas of uncertainty where needed. This is not the approach that is proposed.

The FAR is still being formulated by the Government. APRA should not proceed to implement a remuneration standard that is inconsistent with the interim law in BEAR but instead should work with the Government policy processes to create one simple and logical set of requirements for remuneration that might sit wholly within one source. For

example, it may be appropriate to place all remuneration requirements within the standard rather than partly in law and partly in the standard with inconsistencies between both.

Many AFMA foreign ADI members note that in addition to the requirements under BEAR and the proposed standard, they are already required by their home jurisdiction regulator to comply with similar schemes. Given the nature of foreign branches and the limited prudential risks for these firms locally it would be appropriate to recognise these regimes for equivalence.

Recommendation

AFMA recommends that the standard development be fully integrated with FAR and the creation of two separate sources of requirements for deferral requirements be avoided. APRA should aim for an integrated and clear set of requirements for remuneration that are simple to understand and apply. Given the primacy of legislation this would suggest that finalisation of the standard should not commence until FAR legislation is finalised.

Other matters

AFMA members also seek further information on APRA's expectations of the risk and conduct modifier expectations and will work with APRA to find workable solutions that meet expectations over the course of the year.