

TO General Manager, Policy
Policy and Advice Division
Australian Prudential Regulation Authority

By email: policydevelopment@apra.gov.au

7 OCTOBER 2022

Dear APRA

Remuneration reporting and disclosure requirements - CPS 511 - Consultation submission

We refer to APRA's discussion paper dated 6 July 2022 seeking feedback on the proposed disclosure requirements, reporting requirements and centralised publication set out in the discussion paper, the proposed amendments to Prudential Standard CPS 511 Remuneration (**CPS 511**) and the accompanying reporting standard CRS 511.0 and reporting template (together, the **Proposed Regime**). We appreciate the opportunity to provide feedback in respect of the Proposed Regime.

Our feedback and recommendations are focussed on:

- (a) the practical compliance challenges of the Proposed Regime and in particular, the duplication of reporting for listed entities, and the time and resource constraints associated with the enhanced disclosures required by the Proposed Regime;
- (b) concerns that the perceived benefits associated with the public disclosure of the information contemplated by the Proposed Regime may be outweighed by other unintended consequences (particularly for un-listed entities), and our view that APRA's policy objectives could be adequately achieved through reporting of the required information to APRA in a timely manner rather than through broader public disclosure by entities; and
- (c) several technical concerns, including the application of the Proposed Regime, for groups of companies with multiple APRA-regulated entities.

Our feedback mostly concerns the effect of the Proposed Regime on significant financial institutions (SFIs). Our feedback will also apply to non-SFI entities to the extent they have concurrent obligations under the Proposed Regime.

1 Practical compliance challenges presented by the Proposed Regime

The Proposed Regime will create the following practical compliance challenges:

- (a) the Proposed Regime will unnecessarily duplicate existing remuneration reporting for listed companies. APRA's discussion paper dated 6 July 2022 notes:

Where there are existing disclosure requirements under the Corporations Act or the SIS Act, the disclosure requirements under CPS 511 are intended to align, complement and facilitate greater transparency, rather than duplicate disclosures.

However, based on our discussions with industry, it is most likely that duplicate disclosures will be required because of the breadth of information required to be disclosed and practical timing limitations, as set out below:

- (i) the breadth of remuneration information required to be disclosed under the Proposed Regime extends significantly beyond the remuneration disclosure requirements in the *Corporations Act 2001* (Cth) (**Corporations Act**). Specifically, the Proposed Regime will require disclosure of information which exceeds the current Corporations Act reporting requirements in the following respects: remuneration information for an expanded cohort of persons beyond individual KMPs, the basis of reporting the expanded cohorts will also differ from individual KMPs to cohorts of specified roles (more on this below), enhanced details of remuneration design including non-financial measures, enhanced details of remuneration outcomes, and enhanced details of downward adjustment of variable remuneration. In most cases, it will not be practical for listed companies to expand their Corporations Act remuneration reporting requirements for CPS 511 purposes because, among other things, the systems and processes to gather and report that information have been established for a specific purpose, and to meet the specific requirements of the Corporations Act and Listing Rules including timing requirements (as discussed below);
- (ii) the remuneration disclosure requirements of the Proposed Regime will most likely not be able to be completed within the timeframe required for reporting under the Corporations Act. While the proposed reporting timeframes (within 4 months of the end of an entity's financial year) is aligned to the Corporations Act, industry feedback indicates this is an unrealistic timeframe for the additional information required by the Proposed Regime (we have commented further on this in section (c) below). The Corporations Act reporting requirement already presents challenges for the remuneration processes of listed companies with the result that systems and board processes are focussed on obtaining the necessary consideration and approvals of KMP remuneration, and ensuring this information is finalised in time for auditing and reporting requirements. The disclosures required by the Proposed Regime cover a cohort of roles which is significantly larger than the typical KMP population. Based on feedback we have received from industry participants (and the practical operation of the remuneration processes), it will not be possible to compile and report on the expanded information required by the Proposed Regime within the 4 month timeframe required for the publication of the remuneration report in a reliable manner;
- (iii) remuneration reports of ASX listed companies have been subject to criticism and feedback in recent times for being too complex and difficult to understand, and better practice has seen a simplification of reporting in this area often with the benefit of feedback from stakeholders (eg institutional investors and proxy advisers) which has taken on critical importance given the "two strikes rule".¹ The inclusion of the extensive additional information required by the Proposed Regime is likely to be counterproductive to the improvements in clarity of remuneration reporting in recent times and also require renewed engagement with stakeholders whose concerns may have been previously addressed;

¹ For example, PricewaterhouseCoopers, *Remuneration Reporting - Streamlined* (May 2017), p. 2; Egan Associates, *Towards a Simpler Remuneration Report*, (<https://eganassociates.com.au/towards-a-simpler-remuneration-report/>); and Productivity Commission, *Inquiry Report on Executive Remuneration in Australia* (19 December 2009), p. 30.

- (iv) the remuneration report is required to be audited. The inclusion of the details required under the Proposed Regime will significantly increase the auditing requirements including both the time and cost associated with this process.

In light of the above, it is likely that there will be a duplication of reports with the remuneration report issued as a priority and the additional reporting required by the Proposed Regime to follow. This additional compliance burden should be factored into APRA's further consideration of the Proposed Regime;

- (b) the Proposed Regime will require listed APRA-regulated entities to report remuneration for a wider range of individuals on an aggregated cohort basis (including for senior risk and financial control personnel). In most cases, listed APRA-regulated entities do not currently gather that information. The systems and processes required to do so will add to APRA-regulated entities' practical compliance challenge. Further, for foreign APRA-regulated entities, specified roles remuneration information may not sit in Australia, and will require information to be gathered from foreign related bodies corporate;
- (c) there has been consistent feedback from industry participants that the timeframe for reporting under the Proposed Regime (within 4 months of the end of the APRA-regulated entities financial year: [65] of the proposed CPS 511) is an insufficient period of time for the relevant decisions to be made, and information compiled and reported in a reliable manner. The implication of that timeframe is that remuneration decisions will need to have been made prior to that time, including in respect of final in-period downward adjustments and other relevant remuneration outcome decision making required by CPS 511. For APRA-regulated entities with significant specified role populations, or for whom remuneration decision making of the kind required by CPS 511 is new, requiring remuneration decisions to be made for on a truncated timetable to satisfy the Proposed Regime may lead to poor remuneration decisions because of a lack of time for management and Board Remuneration Committees to adequately assess and determine appropriate remuneration outcomes. APRA-regulated entities are also likely to ensure their remuneration disclosures are made on appropriate accounting basis and are audited. This process will take extensive time that will be challenging for many entities to achieve within the 4 month period. Based on feedback we have received, a reporting period of 6 months would be more feasible;
- (d) the Proposed Regime requires disclosure and reporting about a range of matters which have little relationship to CPS 511, go beyond the information required to achieve APRA's stated policy objectives, and unnecessarily increase the practical compliance burden on APRA-regulated entities. Examples of these matters include:
 - (i) in rows 5 and 6 of Table 3 of [69] of the proposed CPS 511, the requirement to list the number of employees who receive severance payments and the total value of severance payments. End of employment severance payments are not a matter which CPS 511 regulates. To the extent that APRA is concerned only with variable remuneration which comprises severance payments or the treatment of variable remuneration on termination, this should be specifically identified;
 - (ii) in rows 1, 3, 4, 8, 9, 10, 11, and 12 of Table 3 of the proposed CRS 511, requiring disclosure of an employee ID, position role ID, position title, reporting level, the hire date, FTE equivalence ratio, exit date and exit reason of persons in specified roles. It is not clear why this level of individualised reporting or employee exit dates is required to achieve APRA's policy objectives;

- (iii) rows 5-21 of Table 4 of the proposed CRS 511, require granular disclosure of remuneration outcome information. A significant portion of that information could be truncated into 3 categories: requiring disclosure of actual variable remuneration awarded, amounts downwardly adjusted, and amounts vested. Alternatively, APRA may wish to require comprehensive quantitative remuneration information reporting triennially and require this data to be reviewed as part of an APRA-regulated entity's triennial effectiveness review: [53] of CPS 511;
 - (iv) rows 3 of Table 4.1 of the proposed CRS 511 is duplicative of the information required in rows 17, 19, and 21 of Table 4 of the Proposed CRS 511; and
 - (v) in rows 13 and 14 of Table 3 of the proposed CRS 511, requiring disclosure of performance rating and risk and conduct ratings. APRA's request for information of this nature presumes that all organisations rate performance on a simple 1-5 numerical basis and that risk and conduct ratings can fit adequately into 6 possible ratings. APRA-regulated entities do not uniformly determine performance on that basis. For the reasons explained below, there is a risk that requiring entities to report along an unsophisticated numerical scale will discourage APRA-regulated entities from taking a nuanced and principled-based approach to risk and performance management;
- (e) the risk and performance information required by APRA under the Proposed Regime is along proscribed metrics (see the point above regarding performance and risk and conduct ratings). This approach:
- (i) does not accord with the sophisticated balanced scorecard-based performance rating systems utilised by a significant number of APRA-regulated entities. Balanced scorecard-based performance systems permit APRA-regulated entities to tailor the number and weight of performance measures (including non-financial performance) for specific roles in a manner that promotes and rewards effective risk management and sustainable growth. Simply put, the reporting required assumes a level of simplified uniformity which does not exist and imposes a reporting regime that does not align to the current performance measurement systems of many institutions; and
 - (ii) may encourage APRA-regulated entities to adopt simplistic template-based reporting of risk and performance matters rather than a principled based approach to financial and non-financial risk management. The information requested in CRS 511 presumes a non-principled based approach at odds with the principled objectives of APRA-regulated entities set out in [19] of CPS 511;
- (f) the detailed and granular quantitative information required to be reported in the proposed CRS 511 (including on an individual employee basis) is extensive and onerous and it is very unlikely that entities are currently capturing this information in a manner which is aligned to the requirements of CRS 511. This will require significant system enhancements and processes to capture and report on this data in a reliable way, and we would expect the costs associated with the required system changes will not be immaterial. While we consider the remuneration governance information specified in Table 1 of the proposed CRS 511 to be informative and consistent with APRA's policy objectives we query the utility of the other information identified above.

Finally, we note that [66(b)] of the proposed CPS 511 requires only disclosure of risk and financial control personnel who report directly to senior managers, rather than the entire risk and financial control personnel cohort. APRA recognises that reporting of a more "... *targeted population provides external stakeholders with clarity on how these risk functions are rewarded for the*

outcome they are driving.” Implicit in APRA’s rationale is that the risk and control personnel who ‘drive’ outcomes for the risk function are the most important to APRA and external stakeholders. If that is the case, it would be logically consistent for APRA to restrict the general definition of risk and control personnel in [18(r)] of CPS 511 to individuals who report to senior managers. This would significantly reduce the compliance burden of CPS 511 for APRA-regulated entities who have substantial risk and control personnel populations.

Recommendations

We recommend APRA give consideration to the following:

NUMBER	RECOMMENDATION
Recommendation one	<p>APRA to amend [65] of the proposed CPS 511, to require disclosure of remuneration information within six months following the end of the APRA-regulated entity’s financial year. This change will reduce the compliance burden and risk of poor remuneration decisions being made within a truncated period.</p> <p>Alternatively, APRA to give consideration to:</p> <ul style="list-style-type: none"> (a) requiring staggered reporting of remuneration information, with remuneration outcome information occurring six months following the end of the APRA-regulated entity’s financial year; or (b) only requiring detailed quantitative reporting of remuneration outcome information (and other quantitative remuneration information) on a triennial basis at a time aligned with APRA-regulated entities’ triennial effectiveness review.
Recommendation two	<p>APRA to require disclosure of information on a progressive basis to permit APRA-regulated entities time to implement robust information gathering and reporting systems and processes. For example, APRA should only require key remuneration information in the first year of the Proposed Regime, with further information being disclosable in the second and third year of the Proposed Regime’s operation.</p>
Recommendation three	<p>APRA to amend the proposed CPS 511 and CRS 511 to remove matters which do not have a direct relationship to APRA’s stated policy objective, including those noted in paragraph (d) above.</p>
Recommendation four	<p>APRA to give consideration to redefining risk and control personnel for the purpose of [18(r)] of CPS 511 to those individuals who report to senior managers.</p>

2 Technical uncertainty concerning the Proposed Regime for groups of companies with multiple APRA-regulated entities

As currently drafted, the reporting requirements in the Proposed Regime are uncertain for groups of companies with multiple APRA-regulated entities.

With respect to the Proposed Regime, it is unclear - and APRA should clarify - whether multiple APRA-regulated entities within the same group of companies are required to report remuneration separately under the Proposed Regime. For example, where a group of companies has an SFI RSE superannuation licensee and a non-SFI private health insurer, do both APRA-regulated entities need to report remuneration under the Proposed Regime? A significant and unnecessary compliance burden would apply if multiple APRA-regulated entities within the same group of companies are required to separately comply with the Proposed Regime. This issue may be particularly pertinent to insurance industry where it is common to have multiple types of APRA-regulated entities within the same group of companies.

More generally, the manner in which CPS 511 and the Proposed Regime apply to groups of APRA-regulated entities is unclear and requires clarification. By way of example:

- (a) for 'head of group' APRA-regulated entities, it is unclear how parts of CPS 511 apply. APRA currently explains how the 'head of groups' should apply CPS 511 throughout their group in [5] and [6] of CPS 511.² However, those construction rules result in an uncertain interpretation for aspects of CPS 511. With respect to the Proposed Regime, it is unclear whether the Proposed Regime requires the 'head of group' to disclose the remuneration for senior managers and the other specified roles of:
 - (i) non-SFI APRA-regulated entities; or
 - (ii) non-APRA regulated entities;
- (b) for APRA-regulated entities that are within a 'head of group' consolidation (but are not the head of group) there are no interpretation or construction rules within CPS 511 which tell those entities what parts of CPS 511 apply to them. For example, it is not clear whether the board of an APRA-regulated entity who is not a 'head of group' is required to comply with the remuneration approvals requirement in [50] of CPS 511. It is also not clear what role the board of an APRA-regulated entity who is not a 'head of group' is where persons performing a specified role for that entity are employed and remunerated by the 'head of group' or by a non-APRA regulated entity (which is common in many corporate groups). Requiring duplicate approvals by both the board of the 'head of group' and a subsidiary which is also APRA regulated seems unnecessary for this class of employees;
- (c) further, where the 'head of group' is an SFI but its APRA-regulated subsidiary does not meet the SFI threshold, is the subsidiary required to comply with the SFI or non-SFI requirements?

The application of CPS 511 and the Proposed Regime would greatly benefit from further drafting clarification and guidance from APRA. Without clarification, APRA-regulated entities may inadvertently fail to comply with the requirements of CPS 511, or may unnecessarily duplicate the compliance requirements associated with CPS 511 in circumstances where APRA does not intend for that to occur.

² For example, applying a literal interpretation of [57] of CPS 511 for a 'head of group' results in an absurd interpretation when [5] and [6] of CPS 511 are applied.

Recommendations

We recommend APRA give consideration to the following:

NUMBER	RECOMMENDATION
Recommendation five	APRA to clarify the grouping provisions in [5] and [6] of CPS 511 to remove the legal uncertainty surrounding the application of those arrangements for groups of companies particularly comprising SFI and non-SFI entities. At a minimum, APRA should clarify whether multiple APRA-regulated entities within the same group of companies must comply individually with the Proposed Regime.

3 Public disclosure of remuneration reporting

While we support and recognise APRA's policy intent, we query whether the public disclosure on a corporate website of the information required by the Proposed Regime is necessary to achieve APRA's policy objectives or whether these could be more effectively achieved through reporting to APRA with appropriate confidentiality protections for particularly sensitive information as discussed below.

There are serious concerns that the public disclosure of remuneration information by non-listed entities, who are not currently required to make public remuneration disclosures, will create a number of unintended adverse consequences. In these circumstances, non-listed APRA-regulated entities should not be required to make public disclosure of their remuneration arrangements where APRA's policy objectives could be adequately achieved through disclosure only to APRA.

Further, the reporting requirements for listed entities with potential sanctions under the 'two strikes regime' already operate effectively to provide substantial oversight over remuneration practices and consequence management for listed companies with shareholders regularly taking decisive action where they do not consider reasonable consequences to have been applied. Most leading listed companies now publicly disclose the consequences applied for material adverse risk and conduct events.³ Accordingly, the Proposed Regime's additional public disclosure requirements are unnecessary regulatory overreach. For listed APRA-regulated entities, the public policy objective of the Proposed Regime is already being adequately achieved by the market.

We have expanded on these points below:

- (a) first, there is no principled basis for public disclosure of remuneration information for non-listed APRA-regulated entities. Public disclosure in the form required by the Proposed Regime was not a recommendation of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Public disclosure in the form required by the Proposed Regime is not required by APRA's international peers in comparable OECD economies. It is not clear (and we do not think it is the case) that the reporting of aggregated information on a cohort basis will permit a meaningful account to be made of whether an entity is "*meeting their obligations to prudently manage remuneration practices*". Further, unlike the existing Corporations Act reporting requirements where disclosure is required to benefit shareholders who can (and frequently do) take meaningful

³ By way of example: Westpac Banking Corporation, ASX Release, 4 June 2020 (pages 1 - 2 and Section 7 of Attachment 1); and Commonwealth Bank of Australia, 2019 Annual Report, p. 84.

action in response to remuneration reporting, we consider it is unlikely that consumer/member decisions would be influenced by remuneration decisions of an APRA-regulated entity particularly for entities that sell financial products or services that are not regularly renewed, for example, life insurance products. Instead, we think public disclosure of remuneration information will create a significant compliance burden and unintended consequences as discussed further below;

- (b) second, it is not clear why the separate and individual disclosure of information relating to the CEO's remuneration is necessary to assess whether an entity is prudentially managing their remuneration practices particularly given the personal nature of the information. This could also be achieved through senior manager cohort reporting including the CEO with an indication as to whether the CEO has received an adjustment as part of this cohort as opposed to publicly disclosing the quantum of remuneration outcomes for the CEO. If the disclosure indicates that no adjustment was made for the CEO following a material risk event, legitimate questions could then be asked of the entity. There are a number of consequences which flow from the Proposed Regime:
 - (i) disclosure of the CEO's remuneration arrangements for non-listed entities will result in sensitive and confidential information being made available to competitors where this has not previously been the case;
 - (ii) the public disclosure of CEO remuneration adjustment outcomes may drive a culture of reluctance to downwardly adjust variable remuneration, because of the opprobrium associated with public disclosure of remuneration information. This would achieve the opposite to APRA's desired policy objective;
 - (iii) there will be a further adverse impact on industry's ability to attract and retain talented individuals to serve in a specified role. APRA recognises this detriment on page 14 of the discussion paper but describes it as 'contestable'. We consider that the Proposed Regime will actively discourage the best and brightest talent to seek executive positions in the financial services industry;
 - (iv) a further unintended consequence may be for the creation of artificial CEO, senior manager and executive director remuneration benchmarks, which may lock-step those persons' remuneration without regard to individual or company performance. Similarly, smaller APRA-regulated entities may struggle to attract and retain talent in circumstances where their entity falls short of the industry remuneration benchmarks;
- (c) a further unintended consequence relates to the potential litigation risk that may attach to the information being disclosed. The Proposed Regime will require entities to identify:
 - (i) variable remuneration component adjustment triggers for persons in specified roles; and
 - (ii) the proportion of variable remuneration downwardly adjusted, which is a proxy for the "*proportionate ... severity of the risk and conduct outcome*": [36] of CPS 511. It would be a simple task to extrapolate the downward adjustment of variable remuneration event to a public risk and conduct event.

Disclosure of these facts may occur during the course of contested litigation against the entity in circumstances where the underlying basis for a downward variable remuneration event and its perceived severity may relate to matters which are the subject of the litigation, and have been identified through an independent investigation report which is confidential and subject to legal professional privilege. Disclosure of those matters to the public may

present challenges to the legal privilege that attaches to the investigation's report, as there is a risk a court may find that the maintenance of legal privilege over an investigation report into the adverse risk or conduct event is inconsistent with the publication of the outcome of the report's findings. Either way, we would expect these reports and the underlying rationale for any adjustments to attract the attention of litigants (particularly class action lawyers) exposing entities to potential disadvantage in the litigation process. This may discourage entities from seeking to commission a frank and independent enquiry into an adverse risk or conduct event for fear that the contents of that investigation's report will be exposed through the public disclosure of remuneration information;

- (d) finally, industry feedback indicates a real concern for employee data privacy. In circumstances where there is a small population of employees in specified roles (e.g. 6 senior managers) there is a concern that individual employee's personal information could be identified. Further, given the breadth of information requested by CRS 511 (including disclosure of position titles, etc) individual's remuneration information may be easily identifiable.

The concerns identified above could be remedied by requiring APRA-regulated entities to disclose remuneration information only to APRA and providing the information provided to APRA with appropriate protection as confidential information under s.57 of the *Australian Prudential Regulation Authority Act 1998* (Cth) (or at least allowing entities to make submissions the information should have such protection in appropriate circumstances). Under this model, APRA would be able to continue to exercise its supervisory jurisdiction and achieve the policy objectives set out in APRA's discussion paper. APRA has already established a practice of seeking information from entities regarding management accountability and remuneration consequences applied following a material adverse risk or conduct event which has been shaping industry behaviour and response. This is an appropriate and effective exercise of APRA's supervisory processes and can continue to be achieved through reporting to APRA rather than through the public reporting of data on a corporate website which is likely to achieve media headlines rather than meaningful analysis or qualitative assessment of an institution's remunerations practices.

Recommendations

NUMBER	RECOMMENDATION
Recommendation six	APRA to consider requiring APRA-regulated entities (particularly non-listed entities) to disclosure remuneration information only to APRA and not publicly.

Please let us know if you would like to discuss the contents of this submission further.

Yours faithfully

King & Wood Mallesons

King & Wood Mallesons

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