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15 major implications of APRA's Prudential Standard CPS 511 Remuneration

On 23 July 2019, APRA released a draft new prudential standard on remuneration (CPS 511) with the aim of ensuring the remuneration arrangements of APRA-regulated entities produce appropriate incentives and outcomes.

Willis Towers Watson's initial review of CPS 511 suggests the following key changes:

Issue	Key highlights
1. Remuneration policy coverage	▪ CPS 511 sets additional minimum deferral and clawback requirements for special role category employees in 'significant financial institutions (SFIs)' (including major banks, other local ADIs, foreign ADIs, superannuation entities, general insurance and life insurance companies). ▪ The CPS 511 deferral periods for SFIs exceed the deferral requirements under current Banking Executives Accountability Regime (BEAR).
2. New definitions of 'material risk taker (MRT)' and 'highly-paid material risk taker'	▪ MRTs are now defined as all persons other than senior managers, whose activities have a material potential impact on the entity's performance, risk profile, and long-term soundness. ▪ CPS 511 introduces the new category of "highly paid MRT", whose total fixed remuneration (which includes salary, superannuation, allowances and benefits) plus maximum potential variable remuneration is equal to or greater than AUD1 million in a financial year.
3. Board accountability	▪ Board must "actively oversee" remuneration policy (including the structure and terms of remuneration arrangements) for all employees and contractors (contractors is newly added). ▪ For large companies, this may involve monitoring of up to 25 or 30 different remuneration structures and incentive arrangements.
4. Added approval responsibilities	▪ Remuneration committee (RC) to recommend and board to approve individual remuneration outcomes for all senior managers and highly paid MRTs, which could be from 100 to over 200 executives on individual basis (currently, typically to only top 10 to 15 executives) ▪ Recommendations and approvals on a collective basis for all other MRTs and risk and financial control personnel
5. RC workload	▪ RC must obtain comprehensive reporting to allow it to assess remuneration outcomes of all employees. ▪ It is not inconceivable that RC may need to meet every month for up to half a day each meeting.
6. Financial metrics capped at 50% for all employees	▪ 50% cap on financial measures in variable remuneration, and 25% cap for any one financial performance measure ▪ Could have major impact on LTI plans, which tend to have financial KPIs ▪ LTI plans may require setting 4 to 7 year performance targets for 3 to 5 separate KPIs. Setting appropriate threshold, target, stretch performance levels for these long-term, and potentially non-financial KPIs could be complex.
7. Deferral for special role categories	▪ CEO: Deferral of 60% of total variable remuneration for at least 7 years, with vesting only permitted after 4 years and no faster than on a pro-rata basis over the next 3 years ▪ Senior managers and highly-paid MRTs: Deferral of 40% of total variable remuneration for at least 6 years, with vesting only permitted after 4 years and no faster than on a pro-rata basis over the next 2 years
8. Clawback for special role categories in SFIs	▪ Minimum clawback period of 2 years from date of payment or vesting, or 4 years if an investigation is underway ▪ Specific clawback criteria include material misstatement of financial statements.

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9. Post-employment vesting	▪ No accelerated vesting of variable remuneration on cessation of employment (except on death, serious incapacity, serious disability or serious illness) ▪ Same vesting conditions apply as for continuing employees
10. Criteria for reductions in variable remuneration – all employees ("malus")	▪ Unvested deferred variable remuneration must be reduced for criteria including: a significant downturn in financial performance; significant adverse outcomes for customers or beneficiaries. ▪ New provision, malus for financial underperformance in the future, could cause uncertainty and anxiety.
11. Review of remuneration framework.	▪ Must review compliance of remuneration framework with CPS 511 at least annually ▪ Must be a comprehensive independent review of effectiveness of remuneration framework at least every 3 years

Although not explicitly stated in the standard, we anticipate that this will impact the following:

Issue	Key highlights
12. Cost of governance	▪ There will likely be an increase in the number of RC members, and and in the number of RC meetings. RC cost of governance will likely go up. ▪ We may also see an increase in RC fees to compensate for increased reputational risks for NEDs.
13. Deleveraging of pay	▪ Institutional deleveraging of pay may occur – with higher fixed and lower variable pay levels. ▪ We have seen this happen in other jurisdictions when regulators have tried to limit incentive compensation.
14. Significant changes to compensation frameworks	▪ We are already beginning to see some companies eliminate sales incentives, or move away from individual incentives and towards team-based incentive structures. ▪ These could have significant implications to compensation frameworks across financial services, and eventually impacting other industries as well.
15. Talent pool implications	▪ Global executives may be less attracted to move to Australia or to financial services industry. ▪ Conversely, Australian talent may have more impetus to seek opportunities overseas; or to move to other industries.

We understand that APRA intends to finalise the standard latest by early 2020, with the proposed requirements likely to commence from July 1, 2021.

For more details and comprehensive commentary, please visit
https://www.willistowerswatson.com/en-SG/Insights/2019/08/15-major-HR-implications-of-APRAs-proposed-CPS511.

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