



# APRA's proposals for remuneration practices of regulated institutions

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# APRA's Consultation Package



- Components of the consultation package:
  - discussion Paper;
  - proposed extensions to APRA's prudential standards on governance for approved deposit-taking institutions (APS 510), general insurers (GPS 510) and life insurers (LPS 510); and
  - Remuneration Prudential Practice Guide (PPG 511).
- 28 May 2009 public release followed by a consultation period.
- Standards will come into effect 1 January 2010.

# Introduction – global context



The Financial Stability Forum (FSF) concluded that:

*“Compensation practices at large financial institutions are one among many factors that contributed to the financial crisis that began in 2007. High short-term profits led to generous bonus payments to employees without adequate regard to the longer-term risks they imposed on their firms. Such incentives amplified the excessive risk-taking that destabilized the global financial system. The lack of attention to risk also contributed to the large absolute level of compensation in the industry”.*

*FSF Principles for Sound Compensation Practices* available at  
<http://www.fsforum.org>

# APRA's approach



- Current gap in regulatory framework: alignment of remuneration and risk management.
- APRA intends to address gap by extending governance standards for remuneration to ensure that remuneration arrangements encourage **prudent risk-taking**.
  - Strong governance of remuneration; and
  - Alignment of remuneration with the regulated institution's long-term financial soundness and its risk management framework.
- APRA's approach is based on the *FSF Principles of Sound Compensation* endorsed by the G20 on 2 April 2009.



- The Board is responsible for the effectiveness of the design and operation of remuneration arrangements (existing requirement).
- The Board must establish a **Remuneration Committee** to ensure decisions regarding remuneration are consistent with the remuneration policy, prudentially sound and not subject to conflicts of interest.

# Remuneration Committee



- Requirements set out in governance standards.
- All institutions must have a committee unless APRA has granted them an exemption.
- Committee to be comprised of independent directors.
- Responsible for overseeing remuneration arrangements and recommending to the Board on the remuneration of executives.



- Policy to cover
  - executives
  - risk and financial control personnel and
  - those who receive a significant proportion of their remuneration packages as variable.



- The Board must have a **Remuneration Policy** that gives effect to APRA's aim of aligning remuneration with the long-term financial soundness of the regulated institution and its risk management framework.



- Requirements set out in governance standards.
- Remuneration arrangements be designed to ensure:
  - The form of remuneration is consistent with prudent risk-taking.
  - Remuneration should be adjusted for all risks.
  - Remuneration arrangements should incorporate features that allow for adjustment of performance-based remuneration according to risk outcomes, recognising their time horizons.

# APRA's approach to regulation



- Principles-based regulation
- Active supervision
- Range of supervisory options including additional capital requirements
- Aim to achieve compliance with letter and substance of regulations



# Questions