AustralianSuper

03/08/2017

Manager
Banking, Insurance and Capital Markets Unit
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The Treasury
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Dear Sir/Madam

Re: AUSTRALIANSUPER SUBMISSION TO TREASURY – CONSULTATION PAPER 'BANKING EXECUTIVE ACCOUNTABILITY REGIME'

AustralianSuper welcomes the opportunity to make a submission in response to the consultation paper on the Banking Executive Accountability Regime (BEAR).

Please note that AustralianSuper generally supports the contentions regarding the remuneration elements of the BEAR in the submissions made by Australian Council of Superannuation Investors (ACSI) and Ownership Matters in response to the abovenamed paper.

About AustralianSuper

AustralianSuper is Australia's largest single superannuation fund and is run only to benefit members. We don't pay commissions to anyone to recommend us, nor do we pay dividends to shareholders. The fund has over 2.1 million members and manages around $120 billion of members' assets.[1] Our sole focus is to provide the best possible retirement outcomes for our members.

Regulation, consumer trust and long-term investment

In general, AustralianSuper is cautious of regulation which interferes in the fundamental roles that boards perform, such as setting remuneration structures. However in this instance, AustralianSuper endorses the objective of the BEAR to impose heightened expectations of behaviour on senior executives of Authorised Deposit-taking Institutions (ADIs) in line with reasonable community expectations.

The central and privileged role ADIs play in the Australian economy coupled with the repeated failures by some ADIs to protect the interests of consumers in the last

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[1] As at 30 June 2017

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decade, demonstrates that for this particular sector, heightened prudential regulation is warranted.

In addition, the proposed regulation is important from AustralianSuper's perspective as a long-term investor because inappropriate behaviour and poor culture represent an investment risk. As such, the improved behaviour and accountability encouraged by BEAR is positive from an investment perspective including by creating more sustainable and robust ADIs, encouraging greater alignment between ADI senior management and shareholders, and enhancing ADIs standing in the community and the consequent social licence to operate.

In this submission, AustralianSuper responds to those questions particularly relevant to long-term investors. Specifically we address:

i) The proposed principles-based definition of variable remuneration (Question 8)
ii) Potential consequences of mandating deferred variable remuneration (Question 6)
iii) Appropriateness of deferring 60 percent of variable remuneration of certain executive accountable persons (Question 9)
iv) Proposed enhancements to APRA's remuneration powers (Question 10)

Proposed principles-based definition of variable remuneration

AustralianSuper is supportive of the concept of a principles-based definition relative to a prescriptive definition.

In particular, we agree with the definition that "variable remuneration includes part of total remuneration that is discretionary and conditional upon performance and the delivery of results, including individual and business performance and results."

However, we do not agree with the suggestion that this definition could "clarify that it is intended to reward performance and the delivery of results in excess of that required to fulfil a job description". We believe this is overly narrow and risks entrenching the idea that the only function of variable pay is to incentivise via the prospect additional reward rather than also potentially incentivising via forfeiture risk for underperformance. While variable remuneration can function as a 'bonus' for achieving pre-determined objectives in addition to expected 'day job' duties, in a well-designed pay structure, variable remuneration may also be forfeited if 'day job' ('gateway') levels of performance on particular issues or behaviours are not achieved. In such a pay structure, an incentive is created via the prospect of additional reward for outperformance but also via the risk that this can be forfeited if the underlying gateways are not met.

Given the importance of this definition to the operation of the remuneration aspects of BEAR, AustralianSuper believes that the dual functions of variable pay should be accommodated by the definition. As a suggested working definition, we endorse that proposed by Ownership Matters in its submission to this consultation: Variable remuneration can be defined as "those elements of pay that are not guaranteed and are conditional on achievement of pre-determined objectives in addition to continued service or at genuine risk of forfeiture".

Consequences of mandating deferred variable remuneration

There is some risk that the proposal under BEAR to specify minimal deferral will result in a shift from variable to base remuneration. We note the experience in the UK with the introduction of the Senior Managers Regime which had a similar provision and which saw this occur.

If this was to occur it would be problematic because appropriate levels of variable remuneration can be used as a legitimate tool to drive alignment between management and shareholders and ensure that management is only rewarded for performance achieved. AustralianSuper has the view that the variable pay structures for the banking sector have historically not resulted in sufficiently variable pay outcomes and this situation would become more entrenched if variable pay simply migrated to fixed pay.

In the Australian context we recognise that this risk may be small as the levels of deferral proposed by BEAR are close to the actual levels in current practice. Therefore we do not believe that BEAR will serve as an impetus for significant change of fixed versus variable pay structures.

In addition, we note that as shareholders, we have the right to vote on remuneration and would actively use that vote to object to any unreasonable migration from variable pay to fixed pay.

To further mitigate this risk, Treasury could consider whether BEAR could specify that the required ratio of deferral be calculated as a ratio of total pay rather than variable pay. This would have the effect of placing a floor on the level of variable pay at the required ratio of deferral.

Appropriateness of deferring 40 - 60 per cent of variable remuneration

AustralianSuper believes that BEAR mandating the deferral of 60 per cent of variable remuneration for CEOs and 40 per cent for other executives is appropriate.

Sufficient levels of deferral can act to assist to ensure alignment between management and shareholders. Also the potential for clawback that deferral allows, can help to ensure that management is only rewarded for performance achieved. We believe these are important features in remuneration structures in ADIs given the significant exposure that Australian investors have to this sector and the important and privileged role that ADIs have in the Australian economy and financial system.

Although the suggested levels of deferral are substantial, we believe that they are reasonable, and not overly onerous, having regard to current pay levels and practice in the sector.

Proposed enhancements to APRA's remuneration powers

In the context of BEAR we believe that the proposed enhancements to APRA's remuneration powers are appropriate.

In summary, AustralianSuper supports the principles-based approach to BEAR however, we reiterate our concerns regarding the proposed definition of variable pay. The importance of this definition to the operation of the remuneration aspect of BEAR means that it is critical that variable pay is correctly defined.

If you have any questions of us or would like further information please do not hesitate to contact me on 03 8648 3840 or agray@australiansuper.com in the first instance.

Yours sincerely,

Andrew Gray
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