

**Banking, Insurance, Life Insurance, Health Insurance and Superannuation (prudential standard) determination No. 3 of 2023**

**EXPLANATORY STATEMENT**

**Prepared by the Australian Prudential Regulation Authority (APRA)**

*Banking Act 1959*, section 11AF

*Insurance Act 1973*, section 32

*Life Insurance Act 1995*, section 230A

*Private Health Insurance (Prudential Supervision) Act 2015*, section 92

*Superannuation Industry (Supervision) Act 1993*, section 34C

APRA may, in writing, determine, vary or revoke a prudential standard that applies to an APRA-regulated entity under:

- (1) subsections 11AF(1) and (3) of the *Banking Act 1959* (Banking Act), in relation to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised banking NOHCs);
- (2) subsections 32(1) and (4) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers, authorised non-operating holding companies (authorised insurance NOHCs) and subsidiaries of general insurers and authorised insurance NOHCs;
- (3) subsections 230A(1) and (5) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies, friendly societies and registered life non-operating holding companies (registered life NOHCs);
- (4) subsections 92(1) and (5) of the *Private Health Insurance (Prudential Supervision) Act 2015* (PHIPS Act), in relation to private health insurers; and
- (5) subsections 34C(1) and (6) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), in relation to Registered Superannuation Entity Licensees (RSE licensees).

On 28 September 2023, APRA made Banking, Insurance, Life Insurance, Health Insurance and Superannuation (prudential standard) determination No. 3 of 2023 (the instrument), which revokes *Prudential Standard CPS 511 Remuneration* made under Banking, Insurance, Life Insurance, Health Insurance and Superannuation (prudential standard) determination No. 1 of 2021 and determines a new *Prudential Standard CPS 511 Remuneration* (CPS 511).

The instrument commences on 1 January 2024.

## 1. Background

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system.

APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of entities. The Banking Act, Insurance Act, Life Insurance Act, PHIPS Act and SIS Act allow APRA to issue legally binding prudential standards that set out specific prudential requirements with which APRA-regulated entities must comply.

APRA regularly reviews its regulatory regime and amends its prudential requirements as a result of a number of factors, including:

- international developments;
- changes in financial market conditions or changes in risk management practices, in response to identified weaknesses in the prudential framework; and
- to reduce potential negative impacts of emerging industry issues.

A resilient financial system requires prudent remuneration arrangements – in design, governance and outcomes. CPS 511 sets out requirements to ensure that APRA-regulated entities maintain remuneration arrangements which appropriately incentivise individuals to prudently manage the risks they are responsible for, and that there are appropriate consequences for poor risk outcomes.

Since 2010, changes to market conditions and practices, findings from various APRA reviews and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry<sup>1</sup> have demonstrated the need for stronger remuneration requirements. In particular, the Financial Stability Board has released updated statements and guidance in support of its *Principles of Sound Compensation Practices*.

## 2. Purpose and operation of the instrument

The purpose of the instrument is to revoke the existing prudential standard on remuneration and determine a new prudential standard, CPS 511 which has been updated to incorporate new remuneration disclosure requirements for all APRA-regulated entities. Aside from the new remuneration disclosure requirements, the updated CPS 511 does not, in any way, alter requirements in the existing prudential standard.

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<sup>1</sup> The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2019) *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report*.

Broadly, CPS 511 is designed to establish and maintain:

- stronger incentives for individuals to manage the risks they are responsible for;
- appropriate consequences for poor risk outcomes; and
- increased oversight, transparency and accountability on remuneration.

The newly incorporated disclosure requirements will assist in achieving these objectives through facilitating consistent disclosure requirements for all APRA-regulated entities. The disclosures will demonstrate how their remuneration practices have been strengthened under CPS 511. Specifically, the disclosures seek to achieve this through requiring entities to set out:

- how remuneration is aligned with performance and risk;
- details of consequences for poor outcomes; and
- for variable remuneration, how non-financial measures have been included in determining remuneration outcomes.

CPS 511 adopts a proportionate approach, meaning that larger and more complex entities (significant financial institutions (SFIs)) are subject to higher requirements than smaller and less complex entities.

Under CPS 511, the determination of variable remuneration must include consideration of both financial and non-financial risk management. Entities must also ensure that there are appropriate consequences for adverse risk and conduct outcomes.

SFIs are required to assign a material weight to non-financial measures when determining variable remuneration, and have risk adjustment mechanisms to reduce variable remuneration, potentially to zero, where warranted.

Variable remuneration of senior executives at SFIs will also be subject to deferral requirements, combined with provisions for in-period adjustments, malus and clawback.

Smaller and less complex entities (non-SFIs) will be subject to simpler requirements for remuneration design and governance arrangements.

A proportionate approach has also been adopted for remuneration disclosures. SFIs are required to make both quantitative and qualitative disclosures. This reflects the fact that these entities typically have more complex remuneration arrangements and higher proportions of variable remuneration.

### ***Exercise of discretion by APRA***

CPS 511 provides for APRA to exercise various discretions. Decisions made by APRA in exercising those discretions are not subject to merits review. This is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

Under the Banking Act, Insurance Act, Life Insurance Act and PHIPS Act, a breach of a prudential standard is a breach of the enabling legislation, as each enabling Act provides that regulated entities must comply with the standard. Under the SIS Act, it is a condition on all RSE licences that the RSE licensee must comply with the RSE licensee law, which includes prudential standards. However, there are no penalties prescribed for breach of the prudential standards under any of these Acts. Instead, an entity's breach of the enabling legislation or an RSE licence condition is grounds for APRA to make further, substantive decisions under the relevant enabling legislation in relation to the entity. Those decisions may include the decision:

- (a) to issue a direction to the regulated entity, including: a direction to comply with the whole or part of a prudential standard (section 11CA of the Banking Act, section 104 of the Insurance Act, section 230B of the Life Insurance Act, section 131D of the SIS Act); and a direction to comply with all, or specified obligations, which includes prudential standards (section 96 of the PHIPS Act); or
- (b) to revoke: an authority to carry on banking business (section 9A of the Banking Act); a banking NOHC authorisation (section 11AB of the Banking Act); an authority to carry on insurance business (section 15 of the Insurance Act); an insurance NOHC authorisation (section 21 of the Insurance Act); registration of life insurance business (section 26 of the Life Insurance Act); a life NOHC authorisation (section 28C of the Life Insurance Act); or to revoke an authority to operate an APRA-regulated superannuation fund (section 29G of the SIS Act).

It is only at this stage that an entity is exposed to a penalty, loss of licence or imposition of a penalty if it breaches the direction (50 penalty units each day under section 11CG of the Banking Act, section 108 of the Insurance Act, and section 230F of the Life Insurance Act; 30 penalty units each day under section 104 of the PHIPS Act; and 100 penalty units each day under section 131DD of the SIS Act).<sup>2</sup> In nearly all cases,<sup>3</sup> the decisions are preceded by a full consultation with the regulated entity to raise any concerns they may have in relation to the decision.

The decisions of APRA to impose a direction are subject to merits review (section 11CA of the Banking Act, section 104 of the Insurance Act, section 236 of the Life Insurance Act,

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<sup>2</sup> The exception is section 54B of the SIS Act, which provides that breach of a covenant under sections 52 or 52A is a civil penalty provision. The covenants include a requirement to comply with prudential standards in relation to specified topics (conflicts, capital requirements for operational risk, MySuper and choice products). CPS 511 is not a standard in relation to any of these topics.

<sup>3</sup> The Banking Act, Insurance Act and Life Insurance Act specifically provide that APRA does not need to consult where APRA is satisfied that doing so could result in a delay in revocation that would be contrary to the national interest or the interests of depositors with the body corporate (subsection 9A(4) of the Banking Act), contrary to the national interest (subsection 15(4) of the Insurance Act), or contrary to the public interest (subsection 26(5) of the Life Insurance Act), respectively.

section 168 of the PHIPS Act, and section 344 of the SIS Act), which is appropriately available at the point where an entity could be exposed to a penalty.

All decisions to revoke authorisations/registrations under the Banking Act, Insurance Act, Life Insurance Act and SIS Act are subject to merits review, unless specifically excluded by the enabling legislation.

Revocation of an authorisation to carry on banking business or a banking NOHC authorisation is subject to merits review unless either:

- (a) APRA has determined that access to natural justice and merits review is contrary to the national interest or contrary to the interests of depositors with the body corporate; or
- (b) (in the case of ADIs only) the authority is an authority that is to cease to have effect on a day specified in the authority (subsection 9A(8) of the Banking Act).

Revocation of an authorisation to carry on insurance business or an insurance NOHC authorisation is subject to merits review (sections 15 and 21 of the Insurance Act).

Revocation of registration as a life insurance company or a life NOHC authorisation is subject to merits review (section 236 of the Life Insurance Act). The situation in relation to cancellation of registration under the PHIPS Act is different to the other enabling legislation.

### ***Adjust and exclude powers***

CPS 511 gives APRA the discretion to adjust or exclude a provision of the prudential standard (paragraph 18). The power to create such a discretion is provided for under subsections:

- 11AF(2) of the Banking Act;
- 32(3D) of the Insurance Act;
- 230A(4) of the Life Insurance Act;
- 92(4) of the PHIPS Act; and
- 34C(5) of the SIS Act.

APRA may exercise this power when it is satisfied that the adjustment or exclusion of a specific requirement for one or more specified regulated entities will better support APRA in meeting its objectives. For example, the adjustment or exclusion may be necessary to obtain a better prudential outcome than would be the case if the prudential requirement were applied unaltered to a particular regulated entity. A tailored approach would give APRA comfort that the prudential requirements apply appropriately to protect the interests of depositors, policyholders and fund members. APRA will also take into account other considerations, such as efficiency, competition, contestability, competitive neutrality and regulatory burden, including comparisons with an entity's peer group.

The exercise of APRA's powers is governed by a robust decision-making framework which is documented in APRA's internal policies. This framework supports APRA in fulfilling its mandate by limiting decision making to those senior APRA officers with the appropriate experience and skill to exercise prudent judgement. The framework also requires decision makers to seek advice from internal technical experts.

### ***Documents incorporated by reference***

Under paragraph 14(1)(a) of the *Legislation Act 2003* (Legislation Act), CPS 511 incorporates by reference the following documents as in force from time to time:

- Acts of Parliament and associated delegated laws; and
- Prudential Standards determined by APRA under:
  - subsection 11AF(1) of the Banking Act;
  - subsection 32(1) of the Insurance Act;
  - subsection 230A(1) of the Life Insurance Act; and
  - subsection 92(1) of the PHIPS Act.

Under paragraph 14(1)(b) of the Legislation Act, where CPS 511 incorporates by reference another Superannuation Prudential Standard determined by APRA under section 34C of the SIS Act, the Superannuation Prudential Standard referred to is the version that exists at the time the Instrument was determined.

All documents incorporated by reference in this standard are available on the Federal Register of Legislation at [www.legislation.gov.au](http://www.legislation.gov.au).

### **3. Consultation**

In July 2022, APRA released a Discussion paper on proposed revisions to CPS 511 to incorporate disclosure requirements for remuneration frameworks and outcomes. This included a set of revised policy proposals for consultation.<sup>4</sup>

APRA also met with stakeholders, including individual entities, industry associations and remuneration consultants to discuss the proposals and to seek feedback.

In June 2023, APRA released a response to submissions to the July 2022 consultation. This set out APRA's response to issues raised. These included:

- amendments to commencement of disclosure requirements and adjustments to provide regulated entities additional time to make the required annual disclosures;
- removal of proposed quantitative disclosures for risk and financial control personnel and replacement with summary qualitative information on remuneration outcomes for this cohort;

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<sup>4</sup> Refer to [APRA strengthens transparency on remuneration and bank disclosures | APRA](#), July 2022.

- clarification that where regulated entities are part of a group, the entities will not need to make separate disclosures to the group disclosure, thereby removing possible duplication and reducing burden; and
- clarification of various minor technical matters.

#### **4. Regulation Impact Statement**

The Office of Impact Analysis (formerly the Office of Best Practice Regulation) has advised that these changes as proposed were unlikely to have more than a minor regulatory impact, hence a Regulation Impact Statement is not required.

#### **5. Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at the Attachment to this Explanatory Statement.

## ATTACHMENT

### **Statement of Compatibility with Human Rights**

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

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The legislative instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

### **Overview of the Legislative Instrument**

The purpose of the instrument is to determine a new *Prudential Standard CPS 511 Remuneration* (CPS 511).

CPS 511 sets out requirements to ensure that APRA-regulated entities maintain remuneration arrangements which appropriately incentivise individuals to prudently manage the risks they are responsible for, and that there are appropriate consequences for poor risk outcomes. CPS 511 adopts a proportional approach, meaning larger and more complex entities (Significant Financial Institutions) are subject to higher requirements. It also requires regulated entities to make certain disclosures in relation to remuneration outcomes on both an individual basis for larger and complex entities, and qualitative disclosures for all regulated entities.

CPS 511 is designed to create:

- stronger incentives for individuals to manage the risks they are responsible for;
- appropriate consequences for poor risk outcomes; and
- increased oversight, transparency and accountability on remuneration.

### **Human rights implications**

#### *The Right to Privacy*

The publication of personal information related to remuneration outcomes on an individual basis engages the right to privacy under Article 17 of the International Covenant on Civil and Political Rights (ICCPR), an international instrument listed in section 3 of the HRPS Act.

Article 17 of the ICCPR prohibits the arbitrary or unlawful interference with a person's privacy, family, home and correspondence, and attacks on reputation. Full realisation of the right to privacy includes a right to secrecy of personal information from the public.

Prudential Standards that allow for the disclosure of personal information should be reasonable, necessary and proportionate to meeting the legitimate objective of increasing transparency in the banking, insurance and superannuation industries.



CPS 511 imposes a new requirement for APRA regulated entities that are complex entities (Significant Financial Institutions) to publicly disclose personal information comprising remuneration information of the CEO of the entity or, if the entity is part of a group, the Head of a group of which the entity is part.

The disclosure requirements are important in ensuring that there is transparency on how entities are meeting the objectives of CPS 511 and facilitate consistent disclosure requirements for all APRA-regulated entities.

To ensure that the objective of increasing transparency is balanced against privacy considerations, the disclosure requirements in CPS 511 are subject to a number of limitations.

First, with the exception of the CEO, remuneration information about other senior managers and other risk-takers is only required on a cohort basis where the cohort is not less than five individuals.<sup>5</sup>

Secondly, the disclosure of personal remuneration information is only directed at CEOs, who occupy significant decision-making positions and hold significant influence over the governance and management of APRA-regulated entities. It is reasonable to limit their right to privacy as that limitation is in the interest of the depositors, policy holders and members whose assets they manage. Additionally, certain CEOs are also required to disclose their personal remuneration information under other legislative requirements<sup>6</sup> and CPS 511 is proposed to facilitate comparable, rather than addition, disclosures in those instances.

The provisions of CPS 511 are, therefore, reasonable, proportionate and necessary in the circumstances. Consequently, the limitation to the right to privacy is reasonable according to Article 17 of the ICCPR.

## **Conclusion**

The instrument is compatible with human rights because to the extent that CPS 511 limits human rights, those limitations are reasonably, necessary and proportionate.

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<sup>5</sup> CPS 511 paragraph 67.

<sup>6</sup> See, for instance, *Corporations Act 2001* sections 300A and 300C.