

## How many Regulators does it take to manage Executive Pay?

Spare a thought for those in the Financial Services sector who have to report on executive remuneration. Not only is actual and proposed regulation from every authority, institute and commission growing by the day, but no-one seems to feel restricted by country borders.

Many New Zealand financial institutions already have to comply with both Australian and New Zealand regulation. Some may now have to also provide data that complies with EU, UK and US legislation and regulation. APRA<sup>1</sup> alone has identified 10 dimensions of executive pay, ranging from governance to deferred vesting timeframes, and indicated that 'all significant staff' fall within its ambit (and who do we define as 'insignificant')?

So, between APRA, ASIC, ASX, NZX, the NZSC, the UK FSA, the European Forum, the EU Committee of Banking Supervisors and the US TARP (Troubled Assets Relief Programme) legislation, where should people concentrate their efforts?

Starting closest to home, NZX has remained mercifully quiet on executive remuneration. Rules state that subject to procedural requirements, Directors' remuneration must be disclosed. So far, equities are still acceptable. Executive remuneration disclosure requirements are minimal.

APRA represents the other extreme. While it has not yet finalised its revised regulatory stance on executive pay, it has indicated that, for all prudentially regulated organisations (i.e. banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry) it is likely to scrutinise the following aspects of remuneration for all significant staff.

Significant staff are loosely defined as 'all personnel whose decisions can have a material effect on the financial performance of the organisation.... including senior executives [and perhaps] sales staff, traders and other personnel. In other words, potentially everyone.

For these people, APRA will be interested in:

- Structure of packages (rather than quantum), and in particular whether they encourage inappropriate risk-taking;
- Governance of the company's remuneration practices, with the whole Board, not just the remuneration committee, required to competently govern the remuneration practices (not principles) of the company;
- All remuneration components, including fixed pay, and short- and long-term incentives (STIs and LTIs);
- Risk adjustments for incentive payments; there is not yet any indication of the types of structures and review provisions that may be acceptable;
- Seeing performance and payment periods extending past 1 year (suggesting that the only acceptable STIs will be those with deferred payment elements);
- Guidance on the calculation and payment mechanism of incentives.

While APRA describes its proposed guidance as 'Prudential principles' rather than regulation or legislation, its practices of regular prudential reviews and active supervision mean companies will have to demonstrate compliance with these principles.

In summary, not only an enormous task, but a real distraction for organisations that have other things on their plate, as well as a significant incursion into company autonomy. While no-one would argue with these points as principles, it is questionable whether entrenching them into the prudential compliance framework is the most effective approach.

*1. Executive Remuneration – The Regulatory Debate. 16 March 2009 Speech by John Trowbridge, Australian Prudential Regulatory Authority Executive Member to the 2009 Remuneration forum*