

The bonus question

ACTU Submission to Australian Prudential Regulatory Authority
consultation on remuneration requirements for all APRA-
regulated entities

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Introduction

Since its formation in 1927, the Australian Council of Trade Unions (ACTU) has been the peak trade union body in Australia. There is no other national confederation representing unions. For 90 years, the ACTU has played the leading role in advocating in the Fair Work Commission, and its statutory predecessors, for the improvement of employment conditions of employees. It has consulted with governments in the development of almost every legislative measure concerning employment conditions and trade union regulation over that period.

The ACTU consists of affiliated unions and State and regional trades and labour councils. There are currently 43 ACTU affiliates. They have approximately 2 million members who are engaged across a broad spectrum of industries and occupations in the public and private sector.

The ACTU and its affiliated unions founded industry superannuation and won the right for all workers to be entitled to super. The ACTU continues to be a leader in the superannuation sector, advocating to ensure workers retain rights over their retirement savings, and that superannuation delivers adequate retirement outcomes for workers.

The ACTU welcomes the opportunity to comment on the Australian Prudential Regulation Authority's (ARPA) discussion paper *Strengthening prudential requirements for remuneration* and draft Prudential Standard CPS511. The ACTU welcomes measures within the proposed standards to increase board responsibility over remuneration policy and implementation and for more regular reviews of remuneration policy.

The proposed requirements do not adequately address the causes of misconduct attributable to remuneration as outlined in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), and ignore the harms variable remuneration causes front-line staff, customers and members. APRA should use the opportunity the Royal Commission has offered to review whether or not variable remuneration for financial services is beneficial to the long-run interests of companies, investors, members and customers alike. Similarly, APRA should use this opportunity to review the quantum of executive remuneration. The size of average executive remuneration of banks, super funds and other financial services companies dwarfs their workers' pay and average worker pay, and executive remuneration growth significantly outpaces average wage growth.

The ACTU proposes APRA consider the following when reviewing executive remuneration:

- A holistic review of the merits and detriments of variable remuneration for both senior executives and front-line staff and its effects on customers or members,
- The reconsideration of allowing variable pay for RSEs where time-horizons for beneficiaries are divorced from executive and staff tenure,

- The removal of the definition of a ‘Significant Financial Entity’ and requiring higher standards to be applied to all financial services entities, regardless of size, and,
- Greater oversight by the regulator on the implementation of variable remuneration for frontline staff.

Questionable pay

*“When things go wrong, incentive pay advocates typically argue that the problem lay not in using incentives but in using **poorly designed** incentives.¹*

Bonuses are ostensibly a way of aligning shareholder expectations to executives’ decision-making, as well as a motivator for front-line staff to work harder or achieve better results. However, in practice, they have little effect other than to inflate the already exorbitant level of executive remuneration and suppress their workers’ pay. Evidence suggests bonuses are little to do with performance and more to do with status and power. Financial services hold a special place in the centre of the Australian economy, it is also unique in its overreliance on bonuses and variable remuneration. Variable pay is either ineffective to improve the performance of workers or detrimental to the outcomes for members and customers, and their use should be curtailed.

CEO pay and executive pay have grown massively in Australia since the mid-90s at more than double average annual wage growth annually.² This is in stark contrast to executive pay in the 1970s and early 80s, which tracked ‘fairly closely’ with average wage growth.³ The growth in executive pay has not been matched by incredible performance of companies. Rather the growth can be attributed to ‘good luck’ and an Americanisation of our executive pay structures.⁴ The increase in total remuneration is partly driven by an increased culture of bonuses and an increase in the proportion of equities paid, rather than cash.⁵ But the setting of executive pay is not determined by company performance, nor is it totally outside the CEOs’ or executives’ control. It is a direct function of the power of the CEO and other executives over the board and over their companies – simply greed. PwC found that the amount of money CEOs were paid doesn’t matter, so long as it was more than their peers.⁶ CEO’s power to set pay due to the ‘considerable influence’⁷ they have over board should be taken into account by APRA when overseeing the implementation of prudential standards. The amount of money received by executives alienates them to the

¹ Lynn A. Stout, ‘Killing Conscience: The Unintended Behavioral Consequences of “Pay for Performance”’, *Journal of Corporation Law*, 525.39 (2014), 525–61 (p. 527).

² Productivity Commission, *Executive Remuneration in Australia* (Melbourne, 2009), p. XIV.

³ David Peetz, ‘Asymmetric Reference Points and the Growth of Executive Remuneration’, 2010, p. 1.

⁴ Productivity Commission, p. XIV.

⁵ Australian Council of Superannuation Investors, *CEO Pay in ASX200 Companies* (Australian Council of Superannuation Investors, 2019), p. 5.

⁶ PwC, *Pay: What Motivates Financial Services Executives?* (PwC, 2012), p. 6.

⁷ Lucian A. Bebchuk and Jesse M. Fried, ‘Part II: Power and Pay’, in *Pay without Performance, The Unfulfilled Promise of Executive Compensation* (Harvard University Press).

concerns of customers. The amount of money extracted by executives from companies and from their customers must be capped.

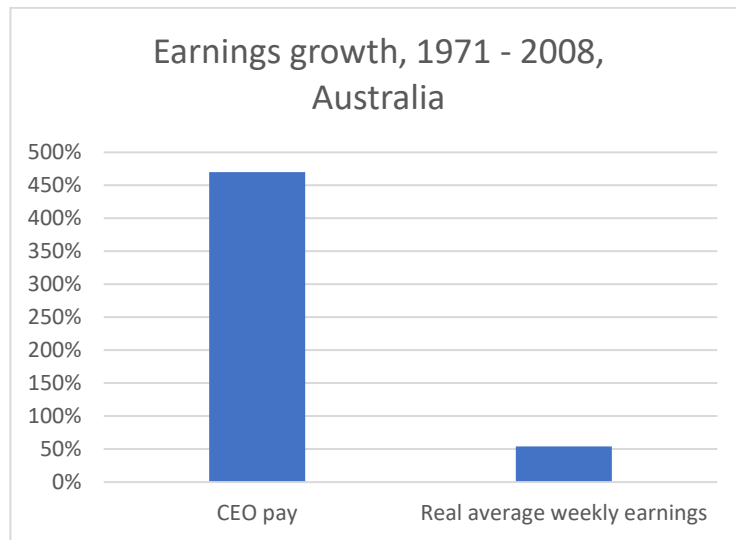


FIGURE 1: GROWTH IN CEO PAY IN AUSTRALIA COMPARED TO REAL AVERAGE WEEKLY EARNINGS GROWTH, 1971 - 2008⁸

Capping total remuneration and further capping the variable component of remuneration would make the proposed caps more effective. Mandating how variable remuneration is structured without addressing the level of variable remuneration may not address the core of Commissioner Hayne’s recommendation. In reaction to the Global Financial Crisis, the EU capped variable remuneration at 100% of base pay for bank staff. The reasoning is that bonuses encouraged excessive risk-taking and this must be curtailed due to the economic damage financial institutions caused.⁹ CEOs prefer up front rather than deferred pay¹⁰ and they may negotiate for even higher pay packages to compensate for the increase to deferred pay.

Variable remuneration has been variously shown to be either ineffective or detrimental. As the Royal Commission found, the structure of workers’ and executive remuneration can lead to poor outcomes for customers and members. The intention of bonuses is to align executive and worker behaviour to the expectations of their shareholders. Bonuses came into vogue in the US in the 80s and 90s,¹¹ and enthusiasm for bonuses was imported into Australia shortly thereafter.¹² In the US, from 1920 to the 1980s executives were paid “primarily with fixed salaries”¹³, and corporate performance was relatively good. But despite the widespread adoption of incentive-based

⁸ Peetz, p. 1.

⁹ European Parliament and of the Council, *Directive 2013/36/EU*.

¹⁰ PwC, p. 6.

¹¹ Stout, p. 532.

¹² Productivity Commission, p. XIV.

¹³ Stout, p. 532.

payments there have been “little-to-no effect, or even negative effects”¹⁴ on stock performance. Bonuses work on the assumption that despite being hired to do a job, someone will only do that job well when paid additionally to do so. This is farcical and not borne out in other industries. Where the potential for harm is so great, as demonstrated by the Royal Commission, and the benefits are absent – APRA should ask itself, ‘why allow it at all?’

The effect of variable pay on workers is also detrimental. Managers use bonuses as a weapon to bully staff into making sales at all costs, often for their own financial benefit. While the Royal Commission recommended the Sedgwick Review be implemented in full, ‘balanced scorecards’ remain a concern that they are simply one step removed from a financial metric for branch and regional managers.¹⁵ Banks will still set sales and revenue measures and assess managers’ pay on the performance of their employee – which will be measured through sales. The effect of remuneration on finance sector culture cannot be

understated, and without an effective remuneration overhaul for finance sector workers, misconduct is likely to persist. The regulator should have greater oversight of the pay-setting of bank and fund staff and ensure the implementation of the Sedgwick review is done in good faith.

Outside the finance sector, variable remuneration is either not found or it has been trialled and scrapped. Neither doctors, nurses, surgeons, paramedics, firefighters, engineers, hospitality workers, nor teachers are paid bonuses in Australia. Over three years, researchers studied the effects different incentives for teachers had on the test scores of students and found no difference.¹⁶ It would be ludicrous to suggest we pay a doctor a bonus for an accurate diagnosis or a firefighter for a saved home. When someone is employed to do a job, they should be paid fairly to do it well. There is no clear reason why the finance sector is a special case and should not be treated as such.

To have a proper customer service focus all targets need to be removed. This would result in no judgement of the customers’ requirements big or small. We would just look after them. All our teleconferences keep banging on about pre-booked appts, sales, settlements needs met. No mention of service.

Respondent – FSU Workplace Culture Survey 2018 (Finance Sector Union, 2018, p. 12)

Divorced incentives and split horizons

Superannuation funds hold a special place with every member. They are often the largest asset a worker will hold outside the family home and funds have the sole purpose to provide members with a dignified retirement. Custodianship of these assets can last a lifetime, but certainly outlast

¹⁴ Stout, p. 534.

¹⁵ Finance Sector Union, *FSU Submission in Respect of the Interim Report of the Royal Commission 2018*, 2018, p. 12.

¹⁶ Matthew G Springer and others, *Teacher Pay for Performance: Experimental Evidence from the Project on Incentives in Teaching* (Nashville TN: Rand, 2010).

a job. There is no design of variable remuneration for superannuation fund staff which can be justified given the different timescales members and staff have. Superannuation fund assets are meant to be invested for the long term, not the short term. No trustee could adequately design a bonus system to reflect assets which could be held in trust for more than 50 years. If variable pay is set for fund staff, they will adjust their behaviour to fit the performance indicators of that timeline.

The investment attitudes of staff and the decision-making of key personnel should be aligned to their members, and industry funds have been able to achieve this. What is notable about industry fund achievement of this is that, for the most part, they do not pay variable remuneration to their staff or executives. Rather, led by the board, they have developed a members' first culture which is embraced by their teams. This has led to outperformance of for-profit bank-owned funds. And this was highlighted in the Royal Commission findings where dead people were charged for advice in for-profit funds.¹⁷

Not written for RSEs

Superannuation funds should exist only for the benefit of members. Salaries and bonuses paid to fund staff necessarily come out of funds which could have otherwise been directed to members' retirement savings. Much of APRA's deliberation on remuneration has rested upon the conflict between shareholder interest and customer interests. But no such conflict ought to exist in the superannuation system. While the Royal Commission uncovered bank-owned for-profit superannuation funds were routinely prioritising profits over members' retirement outcomes, any conflict between the shareholder and member must always be ceded to the benefit of the member. The fiduciary duty of superannuation funds and their staff should be emphasised in any APRA guidance on remuneration, and this responsibility has not been addressed in the consultation draft.

Nothing insignificant

The proposed definition of 'Significant Financial Institution' should be either abolished or significantly amended so as to include as many participants as reasonably possible. While the definition adequately captures nearly the entire banking market, it is greatly deficient for superannuation funds and life insurers. Some for-profit superannuation funds whose misconduct was demonstrated through the banking royal commission are excluded from the higher bar of regulation. This at least should be rectified prior to issuance.

¹⁷ Commissioner Kenneth Hayne, *Interim Report of the Financial Services Royal Commission* (Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 28 September 2018).

More generally, characterising some institutions as significant and others not ignores that harm from misconduct is the same to the member whether from a large entity or small. The ability to cause harm to a large number of members or customers is increased with the size of the institution but the harm felt by each member of a fund or customer of a bank is the same. APRA should take a more customer and member-centric approach to the regulation of remuneration practices, rather than prioritising administrative issues of banks, funds or insurers.

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address

ACTU
Level 4 / 365 Queen Street
Melbourne VIC 3000

phone

1300 486 466

web

actu.org.au
australianunions.org.au

ACTU D No.

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