Parliamentary Budget Office

Policy costing

Cap the obscene pay packages of banking executives	
Party:	Australian Greens

Summary of proposal:

The proposal would place a limit on the remuneration payable by providers of financial services.

- A cap on base remuneration would be set at ten times annualised average weekly earnings (currently $869,795).
- A cap on variable remuneration would be set at five times annualised average weekly earnings (currently $434,898).

The caps would apply to 'accountable persons' of authorised deposit-taking institutions as described in the Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018.

The cap would also apply to 'accountable persons' of Australian Prudential Regulation Authority (APRA)-regulated superannuation funds and insurance providers defined as executives on the board of such institutions.

The proposal would take effect from 1 July 2019.

Costing overview

Policy background

The Banking Executive Accountability Regime establishes accountability obligations for authorised deposit-taking institutions and their senior executives and directors. This new proposal would place a limit on base and variable remuneration payable by providers of financial services. Base remuneration is the amount payable to a person for the performance of their duties in the course of their employment. Variable remuneration is conditional on the achievement of pre-determined objectives and can be forfeited if these objectives are not met.

Financial impact

The proposal is estimated to decrease the fiscal and underlying cash balances by $184 million over the 2019-20 Budget forward estimates period. This impact reflects a net decrease in revenue, explained by a reduction in personal income tax revenue and an increase in departmental expenses, partially offset by an increase in company tax revenue.

The profile of the revenue implications is affected by the timing of company tax instalments for affected institutions.

Departmental expenses of $1 million per year for the Australian Taxation Office (ATO) reflect the estimated cost of implementation and administration of the proposal. This is broadly consistent with the departmental expenses provided to APRA to administer the Banking Executive Accountability Regime.

A breakdown of the financial implications of this proposal over the 2019-20 Budget forward estimates period is included at Attachment A. The proposal would be expected to have an ongoing impact beyond the 2019-20 Budget forward estimates period.

Uncertainties

The costing is subject to significant uncertainties given the difficulties in obtaining reliable data to estimate the number of individuals who would be subject to the remuneration caps, and the remuneration outcomes for these individuals. There is also uncertainty as to how the amount and composition of executive remuneration may change, particularly in light of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, and the operation of the Banking Executive Accountability Regime. The extent to which affected institutions and individuals may change their behaviour to respond to the Banking Executive Accountability Regime and to mitigate the impact of the proposal is also uncertain. There are also implementation risks associated with the proposal depending on the design of the legislation and enforcement of the remuneration cap.

Table 1: Financial implications ($m)[a][b]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Fiscal balance	-71	-21	-51	-51	**-184**
Underlying cash balance	-71	-21	-51	-51	**-184**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.
(b) Figures may not sum to totals due to rounding.

Key assumptions

The Parliamentary Budget Office has made the following assumptions across the different categories of affected financial institutions.

Remuneration

- Major banks: remuneration of executives of the four major banks reflects their remuneration reports.
- Chief Executive Officers of small authorised deposit-taking institutions: the average remuneration of Chief Executive Officers of small authorised deposit-taking institutions is the same as the average remuneration of executives of the major banks.
- Executives of small authorised deposit-taking institutions: the average base and variable remuneration of executives of small authorised deposit-taking institutions are below the caps.
  - This is based on a sample of remuneration reports of small authorised deposit-taking institutions.

- APRA-regulated superannuation funds and insurers: the remuneration of 'accountable persons' for APRA-regulated superannuation funds and insurers reflects the average remuneration of a representative sample of executives of funds and insurers.
- Growth: base and variable remuneration would grow in line with historical annualised average weekly earnings.

Number of accountable persons

- Major banks: the major banks would each nominate 20 'accountable persons' that would be affected by the remuneration caps.[1]
- Smaller authorised deposit-taking institutions: the Chief Executive Officers of smaller authorised deposit-taking institutions would be affected by the remuneration caps, but other 'accountable persons' would be remunerated below the cap.
- Average board size: the average board size of APRA-regulated superannuation funds and insurers is the same as the average board size of Australian firms.
- Foreign firms: half of all general and life insurance firms are foreign-owned and would not be affected by the proposal.
- Subsidiaries: half of all APRA-regulated superannuation funds are a branch of an authorised deposit-taking institution that is already affected by the proposal.

Behavioural responses

- A proportion of remuneration that is above the caps would not be captured by the proposal due to affected institutions finding ways to get around the remuneration cap or mitigate the impact.
  - For instance, income could be split between family members, or a proportion of income could be deferred to future years.
  - In the absence of this behavioural response, the cost of this proposal would be about 40 per cent higher over the 2019-20 Budget forward estimates period. A larger behavioural response would make the overall revenue impact less negative.
- Executives would not have the ability to bring forward a portion of taxable income from 2019-20 to 2018-19 to mitigate the impact of the proposal.
  - Shareholders of the major banks have recently rejected a number of executive remuneration packages in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and have been assessed to be unlikely to support a bring-forward in payments.

[1] See, for instance, APRA 2018. *BEARs and CUBs*. [Online] Available at: https://www.apra.gov.au/media-centre/speeches/bears-and-cubs [Accessed 21 May 2019]

Methodology

- Average remuneration was based on a sample of base and variable remuneration data sourced from selected 2018 annual reports of authorised deposit-taking institutions, APRA-regulated superannuation funds and insurance companies.
- The data were used to estimate the average base and variable remuneration amounts for accountable persons in each industry.
- The decline in personal income tax revenue was calculated as the difference between the average remuneration and the remuneration cap, multiplied by the top marginal tax rate (including the Medicare levy).
- The increase in company tax revenue was calculated as the decrease in deductions for affected institutions, multiplied by the large company tax rate.
  - Remuneration amounts exceeding the cap would no longer be a deductible expense for companies affected by the proposal and would therefore lead to an increase in company tax revenue.
- This revenue cost was then revised downwards as behavioural responses were incorporated, reflecting the assumptions outlined above.
- The modelling has taken into account the timing of tax collections.
- All revenue estimates have been rounded to the nearest $10 million.
- Departmental expense have been rounded to the nearest $1 million.

Data sources

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Attachment A – Cap the obscene pay packages of banking executives – financial implications

Table A1: Cap the obscene pay packages of banking executives – Fiscal and underlying cash balances ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Revenue					
Personal income tax	*-120*	*-140*	*-140*	*-140*	***-540***
Company tax	*50*	*120*	*90*	*90*	***360***
Total – revenue	**-70**	**-20**	**-50**	**-50**	**-180**
Expenses					
Departmental					
Australian Taxation Office	*-1*	*-1*	*-1*	*-1*	***-4***
Total – expenses	**-1**	**-1**	**-1**	**-1**	**-4**
Total	**-71**	**-21**	**-51**	**-51**	**-184**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms.
A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.
A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms.
A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.