

Independent governance expert report

Australian banking industry: Package of initiatives

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Executive summary

Community standards and expectations have changed over time, as have the services provided by the banking industry. Bank products and services, together with distribution and marketing methods, have also evolved in the light of changes in technology, scale economies, competition and the internationalisation of the finance industry. In this period of significant change in the banking industry, the interests of customers have not always received sufficient attention. This has now been recognised by the Australian banks.

The industry appreciates that trust is critical to a strong and stable banking and financial services sector¹. To help build public trust and improve customer outcomes, the industry committed itself to the following six initiatives, announced on 21 April 2016:

1. Reviewing product sales commissions;
2. Making it easier for customers when things go wrong;
3. Reaffirming support for employees who ‘blow the whistle’ on inappropriate conduct;
4. Removing individuals from the industry for poor conduct;
5. Strengthening the commitment to customers in the Code of Banking Practice;
6. Supporting ASIC as a strong regulator.

The objectives of these initiatives are clear but delivering on them will not be without challenges. Determining the changes required to existing practices, reaching agreement within the industry, updating bank policies and reinforcing the behaviours expected will be a test for the industry, most particularly the leadership of each bank. Embedding new approaches will require time, an ongoing management focus, and effective engagement with staff at all levels within the banks to improve on the industry’s performance in protecting consumer interests.

My role in undertaking this review as the independent governance expert is to report on the progress of the industry in implementing its announced package of initiatives, while at the same time maintaining a focus on the Australian Bankers’ Association’s (ABA’s) goals of protecting consumer interests, increasing transparency and accountability, and building trust and confidence in banks. In undertaking this role, I will be communicating with the banks as well as various regulatory, consumer, employee and industry groups. In addition, comments from individuals and other parties on the package of industry initiatives are welcomed. Comments may be made via www.betterbanking.net.au.

While this first report is necessarily focussed on progress to establish the various reviews, subsequent reports will encompass indicators of success proposed by the banks and feedback from stakeholders in order to ascertain the extent to which the measures are addressing the fundamental objectives set out by the industry.

It should be acknowledged that this process is not commencing from a standing start and some work has already been done by the banks, regulators and other stakeholders. This emphasises the need for the industry to work with regulators and other stakeholders to ensure integrated solutions are developed. In the early consultations during this review, there has been a strong commitment by senior

¹ The full announcement can be found at <http://www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust>.

industry executives to the objectives of the initiatives, and recognition that new measures need to be complementary to other programs of work being undertaken in the industry. Regular review of progress in individual banks is expected at executive and board levels.

The ABA's implementation plan currently anticipates substantial completion of the various measures by December 2017; however the full realisation of benefits will require a sustained management focus by the banking industry and inevitably take longer for the benefits to be fully apparent to consumers.

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This report was prepared for the Australian Bankers' Association and its members in accordance with the terms of engagement dated 19 May 2016. It should not be used for any other purpose.

1 Background to the review

1.1 Introduction

The banking industry is critically important to the Australian economy, by virtue of the banking, payments and other services it provides business and consumers, and by virtue of the industry being a significant contributor to Gross Domestic Product, taxation revenue and employment in its own right. A strong banking system is a key element of a strong economy, which in turn assists in achieving important national policy objectives.

A strong banking system requires a real sense of trust in banks by the community. A very important part of this is that depositors need to be confident that their money will be safe with their bank. Another critical requirement is that consumers and businesses need to feel that banks will treat them fairly; otherwise they will be hesitant in dealing with banks.

The Australian banking system has had a very good record, decade after decade, of keeping depositors' money safe, and in this context most would agree that trust in the banking industry is high. By contrast, there have been a number of different events in recent years concerning the delivery of financial services which have raised legitimate questions about whether the Australian banks are always living up to community expectations of fairness. This core issue has generated very significant attention in public debate.

The banking industry has recognised it needs to do more to build confidence in the manner it delivers services and respond to community expectations that the behaviour of banks meets high ethical standards. Reflecting this, the industry announced a package of initiatives on 21 April 2016 to bridge this gap. As previously mentioned, there are six initiatives which the industry has committed to: reviewing product sales commissions; making it easier for customers when things go wrong; reaffirming industry support for employees who 'blow the whistle' on inappropriate conduct; removing individuals from the industry for poor conduct; strengthening industry commitment to customers in the Code of Banking Practice; and supporting ASIC as a strong regulator.

As the ABA said in its media release announcing these initiatives:

“This package aims to address community concerns ... Consumers expect banks to keep working hard to make sure they have the right culture, the right practices and the right behaviours in place.”²

The ABA also stressed that the overall objectives of the package of initiatives are to “to protect consumer interests, increase transparency and accountability, and build trust and confidence in banks”. A key element of the package of initiatives is a commitment by the industry that there be quarterly reports on progress in implementing the initiatives, prepared by an independent expert. This report is the first such report.

² The full announcement can be found at <http://www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust>.

It is important to underline that the role of the independent expert is not to design or deliver any one of the six initiatives. Rather, the role is to oversee and report on progress with implementation of this package of initiatives. The phrase the ABA used in the 21 April 2016 media release was “an impartial third party to oversee the process”.

If everyone involved in this package of initiatives– banks, regulators, and third-party stakeholders – keep at the forefront these three objectives of protecting consumer interests, increasing transparency and accountability, and building trust and confidence in banks, then there can be a sound basis for genuine progress in responding to current community concerns.

It is the outcomes that matter most from these initiatives, and it will be particularly important for the banks to measure their performance in these critical areas over time. Inevitably, the banks will also need to be willing to adjust their policies and practices as required to deliver on the objectives which they have set.

Against this context, this first report is organised as follows:

- chapter 2 sets out the industry package of initiatives in more detail;
- chapter 3 explains the scope of, and my approach to, the role as independent governance expert for this review;
- chapter 4 summarises the progress made by the industry to this time.

It is important to acknowledge that this process is not commencing from a standing start. The work undertaken to prepare this first report has shown that a deal of consideration has already gone into the issues and initiatives across the broader industry – not just the banks and regulators, but also by many third-party stakeholders. While few are underestimating the significance of the changes required, there is early evidence of a quiet and genuine commitment to tackle these issues with a view to beneficial improvement, as well as acceptance that organisational leadership will be critical to long-term success. Regular review of progress in individual banks is expected at executive and board levels.

It is also important to recognise that while these initiatives have a predominately consumer focus, they will need to be integrated with other elements of banks’ broader responsibilities and business imperatives.

2 Industry initiatives to strengthen community trust

2.1 Introduction

This chapter sets out in more detail the banking industry's package of six initiatives, based on the ABA announcement of 21 April 2016³, along with the stated objectives of each initiative.

2.2 Reviewing product sales commissions

Building on the 'Future of Financial Advice' reforms, the industry has committed to immediately establishing an independent review of product sales commissions and product based payments with a view to removing or changing them where they could lead to poor customer outcomes. A key element of this initiative is working with regulators to implement changes, and where necessary, seek regulatory approval or legislative reform to better enable implementation of that review's findings.

The industry's objective for this initiative is to strengthen the alignment of remuneration, incentives and customer outcomes.

In addition, each bank has committed to ensuring it has overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices.

2.3 Making it easier for customers when things go wrong

This initiative has the objective of ensuring retail and small business customers have a voice and problems are resolved in a more efficient manner than occurs at present. It will also focus on ensuring complaints are escalated and responded to within specified timeframes by each bank.

Under this initiative the industry has committed to enhancing existing complaints handling processes by establishing an independent customer advocate in each bank to ensure customer complaints directly relating to the bank, and the third parties appointed by the bank, are appropriately escalated and responded to within specified timeframes.

The industry has supported the Government's announcement of a review into external dispute resolution, including the Financial Ombudsman Service (FOS) conducting a review of its terms of reference with a view to increasing eligibility thresholds for retail and small business customers. The industry has also supported the broadening of the external dispute resolution schemes and will work

³ The full announcement can be found at <http://www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust>.

towards an industry-wide position to inform the Government's review. In addition, the ABA has indicated it will work with the Australian Securities and Investments Commission (ASIC) to expand the Commission's current review of customer remediation programs from personal advice to all financial advice and products.

The industry has also stated it will evaluate the establishment of an industry wide, mandatory last resort compensation scheme covering financial advisers, including supporting a prospective scheme being introduced where consumers of financial products who receive a FOS determination in their favour, would have access to capped compensation where an adviser's professional indemnity insurance is insufficient to meet claims.

2.4 Reaffirming support for employees who 'blow the whistle' on inappropriate conduct

The industry has committed to establishing the highest standards of whistleblower protections by ensuring there is a robust and trusted framework for escalating concerns. Protection of whistleblowers, including independent support and protection against financial disadvantage, are to be standardised across banks.

2.5 Removing individuals from the industry for poor conduct

The ABA has proposed the implementation of an industry register which would extend existing identification of rogue advisers to any bank employees, including customer facing and non-customer facing roles. This is directed at preventing recruitment of individuals who have breached the law or codes of conduct.

The objective of this initiative is to demonstrate the banks' commitment to improve practices to deal with 'bad apples' and promote good conduct and ethical behaviour across the industry.

2.6 Strengthening commitment to customers in the Code of Banking Practice

The Code of Banking Practice is the banking industry's customer charter on best practice banking standards, disclosure and principles of conduct. The ABA has proposed bringing forward its review of the Code of Banking Practice, which will be undertaken in consultation with consumer organisations and other stakeholders. The stated goal of the ABA is to have this review completed by December 2016.

The industry's objective for its review is to ensure the Code of Banking Practice adequately covers expected standards for banks and their relationships with customers, including the standard for engagement between both parties.

2.7 Supporting ASIC as a strong regulator

The industry has committed to working with Government and ASIC to implement a ‘user pays’ industry funding model to enhance the ability of the regulator to investigate matters brought to its attention. Consistent with this objective, the industry has also stated its intention to work with ASIC to enhance the current breach reporting framework to provide more consistency in how its regulatory guidance is interpreted. This is intended to ensure the regulator has access to better and more timely reports to support its activities.

2.8 Concluding remarks

It is clear from my early consultations that stakeholders are interpreting the scope of some of these initiatives in different ways. Formal terms of reference for the reviews of product sales commissions and the Code of Banking Practice have now been published. Formal scope documents for the other initiatives are to be prepared. Achieving clarity of scope for all the initiatives will better inform stakeholders and be of critical importance to ensure the industry is able to deliver on the various measures and assess the outcomes for each of the initiatives. This of course is always a fundamental requirement of initiatives of this nature.

A number of measures proposed by the industry build on reviews or other projects that are already under way. The successful implementation of the industry measures will depend on the extent to which they become integrated solutions, complementing those existing reviews, a fact that is acknowledged in the ABA’s planning. Close engagement by the ABA with government and regulators will be an important process element to avoid unnecessary duplication of effort, or in the worst case, conflicting measures across elements of the financial services industry. As previously indicated, solutions also need to be integrated with other elements of banks’ broader responsibilities and business imperatives.

It will take some years, with strong industry leadership, if the industry is to be successful in achieving the package’s ultimate objectives although implementation of particular measures is anticipated progressively. All of the initiatives involve a two-step process:

- 1) The initial development of principles or proposals to address the various initiatives for endorsement by the industry
- 2) Implementation of agreed principles or proposals by the banks, where not currently in place, as well as arrangements to assess implementation and monitor the success of the initiatives over time against their objectives.

While some initiatives are able to be delivered in the near term, other initiatives would most likely benefit from a staged approach with intermediate milestones to allow the industry to demonstrate progress towards the goal. In this context, if there are to be changes in approaches to be taken by the banks in implementing the package of initiatives, there is some attraction in banks being on a similar timeframe to avoid the potential for competitive disadvantage.

Some of the initiatives are designed to prevent adverse customer outcomes; others are designed to provide better outcomes for customers when things go wrong. Taken together, the package of initiatives is designed to improve on the industry’s performance in protecting consumer interests.

3 Role of the independent governance expert

3.1 Introduction

As previously mentioned, an element of the ABA's package of initiatives announced on 21 April 2016 was a commitment to appoint an independent governance expert to report on the industry's progress implementing the initiatives. This occurred on 19 May 2016. The letter of engagement relating to my appointment as the independent governance expert is included at Appendix C.

3.2 Engagement objectives

The objective of my engagement is to ascertain and report publicly on the industry's progress in delivering on this package of initiatives, and in particular whether the industry or individual banks are progressing the initiatives in good faith and consistently with the intention of the industry package. I may also make specific recommendations to assist in developing and implementing the industry announcement if required, but may not expand or change the nature of the initiatives.

In undertaking this role I will be particularly focussed on three core aspects:

- understanding and reviewing the reasonableness of the industry's work plans to implement the package;
- monitoring and reviewing the progress reported by industry in implementing these plans, including any proposed changes to the plans as new information comes to light;
- being satisfied that the ultimate impacts of this package on bank customers will, with appropriate industry leadership, be consistent with the overall intent of the package, and in particular whether they will better protect consumer interests, increase transparency and accountability, and build trust and confidence in banks.

My primary role, as the independent expert, is to form an independent judgement of whether the banking industry is making appropriate progress towards delivering on its commitments, on the basis of the evidence provided by the ABA and banks as well as through consultations with regulatory, consumer, employee and industry groups and feedback from other interested parties. I have also been requested to provide guidance to the industry in further refining initiatives and key milestones, identifying roles and responsibilities for implementation plans, and establishing timeframes for completion of measures.

In addition to my primary role, I may provide observations on the effectiveness of the initiatives to meet their stated goals in addition to providing input on the establishment of key success indicators. It is envisaged that these key success indicators will provide a basis to measure the success of the initiatives in meeting the industry's broader objectives of protecting consumer interests, increasing transparency and accountability and rebuilding trust and confidence in the banks. Over the course of exercising my role as independent expert, these success indicators may need to be refined to reflect changes as the initiatives are developed and implemented. The success indicators, however, are intended to be used to consistently provide a basis for monitoring and reporting on the banks' progress in achieving the outcomes of the specified initiatives. At the same time, these

indicators are expected to inform individual banks of their own progress, allowing for any adjustments that may be required to their policies.

My quarterly reports will review progress on delivery of the various measures that the industry has committed to, take into account the views of various stakeholders and generally report in summary form the advice provided by the Chief Executive Officers (CEOs) of the banks and the ABA on progress.

3.3 Methodology

Given my primary role, the methodology for my review will focus on assessing the extent to which the measures relevant to each initiative have progressed against the agreed implementation plan.

The industry will assume responsibility for establishing timeframes for the milestones underlying each measure, but such timeframes will be formulated in consultation with me as required. It should be noted that some milestones are outside of the control of the industry, for example those that may require regulatory authorisations and/or legislative change. Timeframes may, therefore, be reviewed and refined where necessary, but such changes, along with the rationale for those changes, will be reported as part of the review of implementation plan status.

The implementation plan is outlined in Chapter 4 and Appendix A in further detail.

This review is not an audit. While I will be able to assess progress in development of the various measures, progress being made by banks will be advised by the banks or other stakeholders. Information will be gathered from relevant stakeholders on their progress each quarter, and it is expected that, for those measures to be implemented by the banks, bank CEOs will provide attestations to support their status. Other substantive evidence may be requested from time to time depending on the nature of the measure. Consistent with the terms of my engagement, where such information is identified by the bank as confidential, it will only be used in an aggregated form to assess progress with implementation.

As noted above, my review will also seek to understand how the banks measure success in relation to the objectives of the package of initiatives. This will entail gathering information on existing key performance indicators and understanding how these are evolving over time. It will also inform the development of industry-wide key success indicators which can ultimately be used by the industry to evaluate the ongoing effectiveness of the initiatives over the longer term.

PwC Australia has agreed to support me in the execution of my responsibilities, including to provide expert advice on banking matters.

3.4 Approach to stakeholder engagement

The measures outlined in the ABA's announcement anticipate input from a range of stakeholders. Successful implementation of the initiatives will involve broad consultations with these various regulatory, consumer, employee and industry groups in order to facilitate integrated solutions. Input will be sought from stakeholder representatives on the measures being implemented, whether any other significant measures are required and the nature of the key success indicators to be established. While feedback from these other stakeholder groups is important, consultation will be in the context of the initiatives being assessed and will not broaden the scope of this review. A summary of the banks and other stakeholders consulted as part of this first report are listed in Appendix B.

Comments from individuals and other parties on the package of industry initiatives may also be provided via www.betterbanking.net.au.

3.5 Concluding remarks

My role as the independent governance expert is to report on the progress of the industry in implementation of its announced package of initiatives, while at the same time maintaining focus on the goal of meeting the objective of each initiative. Whilst this first report is necessarily focussed on progress to establish the various reviews to allow the initiatives to be implemented, over time the focus of my reports will encompass indicators of success proposed by the banks and feedback from stakeholders in order to ascertain the extent to which the measures are addressing the fundamental objectives set out by the industry.

4 Industry progress with implementation of the initiatives

4.1 Introduction

This chapter sets out the implementation plan developed by the ABA for the package of initiatives. It is important to bear in mind however that planning is not yet complete so the ABA's current plan may be varied; a more thorough plan is expected by the next report. Also recognising that achieving the best outcome is more important than achieving a timetable for its own sake, it is to be expected that the implementation plan will continue to evolve over the next 18 months.

4.2 Governance arrangements

The governance arrangements which the ABA has put in place to oversee implementation of the package of initiatives, over and above the appointment of an independent governance expert, are soundly based.

In particular, the Board of the ABA is overseeing development and implementation of this package, with reports to be provided at each regular Board meeting and with the potential for additional meetings if required. The CEO of the ABA is directly accountable to the ABA Board for progressing the implementation of relevant measures. The Chairman of the ABA (Mr Andrew Thorburn, CEO of National Australia Bank) has underlined the importance of the proper governance at the ABA Board-level.

The ABA Board has established an Industry Strategy Working Group to oversee the implementation of the package of initiatives at a more granular level. This is chaired by Mr David Gall (Chief Risk Officer of National Australia Bank) and comprises representatives from the banks, most of whom report directly to their organisation's CEO, and the ABA.

Additionally, a number of banks have nominated a senior executive with responsibility for implementation of the initiatives. It is nevertheless recognised that implementation of the various initiatives still needs to be appropriately resourced across the banking industry to ensure delivery against the implementation plan.

4.3 Overview of implementation plan

The ABA has developed an implementation plan in consultation with me for key measures comprising each initiative, including specification of initial deliverables for each measure. A summary of the implementation plan is outlined below with further detail presented in Appendix A.

Initiative	Summary deliverables	Expected implementation period
1. Reviewing product sales commissions	Independent review report on product sales commissions	Jul 16 - Mar 17
	Individual bank policies on remuneration and incentives; informed by the independent review	Apr 17 - Dec 17
	Potential regulatory approvals	Apr 17 - Dec 17
2. Making it easier for customers when things go wrong	Industry position on the role of a customer advocate and appointment of a customer advocate in each bank	Jul 16 - Jun 17
	Industry position on operation of preferred EDR system completed for contribution to government review	Sep 16 - Jun 17
	ASIC regulatory guidance on client remediation programs	Jul 16 - Sep 16
	Industry position and model for last resort compensation scheme settled	Sep 16 - Sep 17
3. Reaffirming support for employees who 'blow the whistle' on inappropriate conduct	Industry position on whistleblower protections and implementation of whistleblower framework aligned with industry principles in each bank	Jul 16 - Jun 17
4. Removing individuals from the industry for poor conduct	Completion of position paper on an industry register and industry register established	Sep 16 - Dec 17
5. Strengthening our commitment to customers in the Code of Banking Practice	Independent review report on the Code of Banking Practice	Jul 16 - Dec 16
	New Code of Banking Practice	*
6. Supporting ASIC as a strong regulator	Industry agreement on funding model	Aug 16 - Jun 17
	Industry position on breach reporting regime completed for contribution to ASIC consultation	Aug 16 - Dec 16

* Timeframe to be agreed once recommendations and transitional periods are better understood

4.4 Progress against key milestones

Initiative 1: Reviewing product sales commissions

The industry is focusing on the review of product sales commissions and product based payments in retail banking. The objective of this review is to identify any commissions or payments which could lead to poor customer outcomes, and where such commissions or payments are identified, remove or change them to strengthen the alignment with customer outcomes. In addition, the banks will ensure they have overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices broadly across their banks.

The ABA has established an independent review to be undertaken by Mr Stephen Sedgwick AO in accordance with terms of reference. Further details on the review are available at www.betterbanking.net.au.

This review will be supported by legal and remuneration expertise, being Gina Cass-Gottlieb (Gilbert + Tobin Lawyers) and David Heazlett (Mercer) respectively, as well as be informed by a Stakeholder Advisory Panel. The panel members are: Mr Gerard Brody (Consumer Action Law Centre), Mr Geoff Derrick (Finance Sector Union of Australia), Ms Sarah Saunders (National Seniors) and Dr Deen Sanders (Professional Standards Authority).

In accordance with the terms of reference and the implementation plan, recommendations from the review are expected to be published by March 2017.

The findings of this review will assist each bank to have overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices. It is expected these principles will be in place by December 2017, however, changes and communication of the changes may require additional time due to the potential impact on agreements and contracts and other practical considerations, such as alignment with performance reviews and other workplace-related matters.

The plan includes allowance for the potential to obtain regulatory approvals to enable a more open approach between banks in remuneration policies.

Initiative 2: Making it easier for customers when things go wrong

The banks have committed to enhancing existing complaints handling processes, including by establishing an independent customer advocate in each bank to ensure complaints are appropriately escalated and responded to within specified timeframes. While all banks have complaints handling processes, the industry is seeking to establish guiding principles for the role of a customer advocate in individual banks.

The working group established on this initiative has met and is considering a background paper prepared to assist the banks to give consideration to various legal and operational issues. The principles are to be agreed by December 2016, with implementation occurring in each bank by June 2017.

Under this initiative, the industry has stated its intention to support the broadening of external dispute resolution schemes, however, the timing of developments on this front are to be determined by government. This measure is in the very early phases of planning, with the ABA liaising with banks and other stakeholders to gather initial views about how best to provide customers with clear and straight-forward access. It is anticipated that an industry position is to be drafted by December 2016 with further engagement through to June 2017.

The ABA has advised that it has made submissions to ASIC to discuss the development of their regulatory guidance on client remediation programs. It is anticipated that new regulatory guidance will be issued by ASIC in September 2016.

In relation to the industry's proposed measure to evaluate the establishment of an industry wide mandatory last resort compensation scheme, a background paper is being developed by the ABA for circulation to banks. Concurrently meetings have been held with FOS, ASIC and other stakeholder groups to further develop a framework for the scheme. It is clear from discussions that much consideration of this matter has been undertaken already by FOS.

Initiative 3: Reaffirming our support for employees who 'blow the whistle' on inappropriate conduct

Initiative 3 aims to promote the highest standards of whistleblower protections and ensure a robust and trusted framework for whistleblowing is established in each bank. It is intended that the protection of whistleblowers, including independent support and protection against financial disadvantage, will be standardised across banks.

In order to implement this initiative the ABA has commissioned research to identify and assess whistleblowing policies and practices and to assist in deliberations by the banks on improving their policies and practices. Draft overarching principles are expected to be developed based on the findings of the research.

The working group established for this initiative has met and is considering the commissioned research and the various legal and operational issues.

Formulation of the principles, in consultation with banks and stakeholders, is expected to take place in the coming months with a completion target of December 2016. Implementation of the framework in each bank is expected by June 2017.

Initiative 4: Removing individuals from the industry for poor conduct

The industry has undertaken to implement an industry register to contain factual information about poor conduct across the banking industry.

Certain breaches of the law by financial advisers are already contained in the Financial Adviser Register (FAR) administered by ASIC. The register proposed under this initiative would have broader coverage including customer facing and non-customer facing staff.

The working group established on this initiative has met. A proposal is being developed to give consideration to the various legal and operational issues. The register raises a number of complex legal matters that will need to be clarified and resolved.

Initiative 5: Strengthening our commitment to customers in the Code of Banking Practice

The objective of this initiative is to ensure the Code of Banking Practice continues to represent best practice banking standards, disclosure and principles of conduct, thereby adequately covering standards expected today for banks in their dealings with customers.

The industry has committed to completing a review of the Code by December 2016, with banks to assess their operations and implement any changes necessary. As noted, the timeframe for implementation of the measure will be specified by the ABA once the recommendations are known. An independent review of the Code of Banking Practice has been established, to be undertaken by Mr Phil Khoury in accordance with terms of reference. Further details on the review are available at www.cobpreview.cameronralph.com.au.

Initiative 6: Supporting ASIC as a strong regulator

The industry recognises the need for a strong regulator and is committed to working with ASIC on the ‘user pays’ funding model, as well as improving breach reporting guidance to enhance consistency across banks. Industry liaison with ASIC is ongoing.

4.5 Concluding remarks

In totality the package of initiatives is significant and will involve considerable operational complexity in its implementation across the industry, given the nature of the banks’ business, the regulatory framework, people and systems issues, and the need for ongoing stakeholder engagement and consultation.

Initiative 1 (reviewing product sales commissions) and Initiative 4 (removing individuals from the industry for poor conduct) will be amongst the more demanding initiatives to implement effectively. Initiative 5 (review of the Code of Banking Practice) is planned for completion by end-2016, however, the previous review took a number of years to complete. Nevertheless progress in advancing the various initiatives in the package is being made and the industry has indicated its commitment to delivering all of the initiatives by the end of 2017.

A number of banks and other stakeholders have acknowledged the demanding timetable although it has also been recognised that the current timetable will help to ensure changes receive the right level of priority, focus and execution across the industry. Potential for resource bottlenecks given the specialised nature of some initiatives, along with the multiple and diverse stakeholder considerations (including the extent of consultation required) pose some risks to achieving the stated timetable.

In light of this, it may be appropriate for the industry to consider adopting intermediate milestones and indicators to enable the industry to demonstrate momentum while it works to longer term goals. This may take the form of monitoring of existing indicators to evidence the effectiveness of individual banks’ current programs and initiatives.

Initiative 1 (reviewing product sales commissions) carries the additional challenge that, to a greater or lesser extent, nearly all the Australian banks have used product sales commissions and product based payments as a lever of competitive strategy. This issue has been raised by stakeholders, including the need to avoid ‘lowest common denominator’ outcomes.

Finally, it is encouraging to see the degree of convergence between the industry and ASIC in the overall intent of the package of initiatives, and the willingness to work collectively to achieve that intent. This is a positive starting point.

These practical issues of implementation will be considered when reviewing the next iteration of the industry’s plans, especially given that the intent of the package of initiatives emphasises accountability and building trust.

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Appendix A Implementation plan overview

Initiative	Objective	Measures	Implementation Phases ⁽¹⁾				Summary Deliverable ⁽¹⁾	Milestone Step ⁽¹⁾	Primary Responsibility	Indicators of Success ⁽²⁾	
			Planning	Agreement of principles	Complete implementation					Existing indicators	Potential indicators over time ⁽³⁾
1	Reviewing product sales commissions	Strengthen alignment of remuneration and incentives and customer outcomes	1.1	Immediately establish an independent review of product sales commissions and product based payments, with a view to removing or changing them where they could lead to poor customer outcomes; and strengthen the alignment of remuneration and incentives and customer outcomes	Jul-16	Mar-17	Mar-17	Independent review report on remuneration (*Timing contingent on ASIC review on mortgage broking)	a) Establishment of independent review b) Assessment of information gathered and submissions received c) Preparation of draft report and engagement with stakeholders d) Publication of final report	ABA Reviewer Reviewer Reviewer	
			1.2	Each bank commits to ensure it has overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices	Apr-17	Aug-17	Dec-17	Individual bank policies on remuneration and incentives; informed by the independent review (*Changes and communication of changes and how they support good customer outcomes and sound banking practices may require additional time due to potential impact on agreements/contracts and alignment with performance reviews and other workplace-related matters)	a) Analysis of existing remuneration structures and practices and creation of initial framework b) Preparation of draft guiding principles to assist each bank meet the commitment c) Consultation and stakeholder engagement d) Finalisation of guiding principles e) Identification and development of overarching principles by each bank	Banks ABA/Industry ABA/Industry ABA/Industry Banks	
			1.3	Work with regulators to implement changes and, where necessary, seek regulatory approval and legislative reform	Apr-17	Jun-17	Dec-17	Potential regulatory approvals (eg authorisation, legislative reform) (*Timing contingent on preparation of report by independent reviewer and any regulatory approval processes required as well as legal requirements to be satisfied. Any necessary changes will need to be made across various agreements/ contracts and that may require further time)	a) Identification of responses and actions needed to remove or change product sales commissions and product based payments which could lead to poor customer outcomes b) Preparation of any documentation necessary to make any changes (such as submissions or applications for regulatory approvals) c) Regulatory approvals (where necessary) provided for banks to be able to make changes d) Banks change remuneration structures (where necessary) and communication of how and why these changes have been made	ABA/Industry ABA/Industry Regulators Banks	

Implementation plan overview

Initiative	Objective	Measures	Implementation Phases ⁽¹⁾				Indicators of Success ⁽²⁾			
			Planning	Agreement of principles	Complete implementation	Summary Deliverable ⁽¹⁾	Milestone Step ⁽¹⁾	Primary Responsibility	Existing indicators	Potential indicators over time ⁽³⁾
2 Making it easier for customers when things go wrong	Ensure retail and small business customers have a voice and problems are resolved more efficiently Ensure complaints are escalated and responded to within specified timeframes	2.1 Enhance the existing complaints handling processes by establishing an independent customer advocate in each bank to ensure retail and small business customers have a voice; and customer complaints directly relating to the bank, and the third parties appointed by the bank, are appropriately escalated and responded to within specified timeframes	Jul-16	Dec-16	Jun-17	Industry position on the role of a customer advocate Appointment of a customer advocate in each bank	a) Assessment of customer advocate function and creation of initial framework b) Preparation of draft guiding principles to assist each bank meet the commitment c) Consultation and stakeholder engagement d) Finalisation of guiding principles e) Implementation of customer advocate function in each bank	ABA/Industry ABA/Industry ABA/Industry ABA/Industry Banks		
		2.2 Support a broadening of external dispute resolution (EDR) schemes. Support the government's announcement to conduct a review into EDR, including the Financial Ombudsman Service (FOS) conducting a review of its terms of reference with a view to increasing eligibility thresholds for retail and small business customers	Sep-16	Dec-16	Jun-17	Industry position on operation of preferred EDR system completed for contribution to government review (*Timing of review to be determined by the government; potential impact on Code review)	a) Preparation of industry position on EDR b) Participation in government review of EDR c) Announcement by government (or relevant regulator) of findings of review and recommendations d) Adoption of industry position in new EDR system	ABA/Industry ABA/Industry Government ABA/Industry		
		2.3 Work with ASIC to expand its current review of customer remediation programs from personal advice to all financial advice and products	Jul-16	Jul-16	Sep-16	ASIC regulatory guidance on client remediation programs issued (*Timing of regulatory guidance to be determined by ASIC)	a) Revised submission to ASIC on consultation paper on client remediation b) Adoption of industry position in new regulatory guidance c) Implementation of any changes to ensure banks' systems and practices support client remediation programs, including better record keeping	ABA Regulators Banks		
		2.4 Evaluate establishment of an industry wide, mandatory last resort compensation scheme covering financial advisers. Support a prospective scheme being introduced where consumers of financial products who receive a FOS determination in their favour would have access to capped compensation where an adviser's professional indemnity insurance is insufficient to meet claims	Sep-16	Mar-17	Sep-17	Industry position and model for last resort compensation scheme settled	a) Identification of possible model for a last resort compensation scheme b) Preparation of industry position on a last resort compensation scheme c) Coordination of engagement and consensus building across stakeholders d) Consensus support for implementation of scheme	ABA/Industry ABA/Industry ABA/Industry ABA		

Implementation plan overview

Initiative	Objective	Measures	Implementation Phases ⁽¹⁾				Indicators of Success ⁽²⁾					
			Planning	Agreement of principles	Complete implementation	Summary Deliverable ⁽¹⁾	Milestone Step ⁽¹⁾	Primary Responsibility	Existing indicators	Potential indicators over time ⁽³⁾		
3	Reaffirming our support for employees who 'blow the whistle' on inappropriate conduct	Promote highest standards of whistle blower protections and ensure robust and trusted framework for whistleblowing	3.1	Ensure the highest standards of whistleblower protections by ensuring there is a robust and trusted framework for escalating concerns. Standardise the protection of whistleblowers across banks, including independent support and protection against financial disadvantage.	Jul-16	Dec-16	Jun-17	Industry position on whistleblower protections Implementation of whistleblower framework aligned with industry principles in each bank	e) Preparation of consensus submission to the Government f) Possible introduction of legislation to implement a scheme	ABA Government		
									a) Assessment of whistleblowing policies and practices and creation of initial framework b) Preparation of draft guiding principles to assist each bank meet the commitment c) Consultation and stakeholder engagement d) Publication of guiding principles e) Bank implementation of highest standard of whistleblowing policies	ABA/Industry ABA/Industry ABA/Industry ABA Banks		
4	Removing individuals from the industry for poor conduct	Demonstrate banks' commitment to improve practice to deal with 'bad apples' and promote good conduct and ethical behaviour	4.1	Implement an industry register which would extend existing identification of rogue advisers to any bank employees, including customer facing and non-customer facing roles.	Sep-16	Jun-17	Dec-17	Completion of position paper on an industry register Industry register established (*Contingent on model designed and whether legislative reform or regulatory change is required)	a) Identification of possible model for industry register b) Preparation of industry position c) Coordination of engagement and consensus building across stakeholders d) Consensus support for implementation of register (or alternative) e) Identification of design parameters of solution f) Preparation of supportive documentation for implementation g) Build solution h) Implementation of industry register (or alternative)	ABA/Industry ABA/Industry ABA/Industry ABA ABA/Industry ABA/Industry IT/Consultant ABA		

Implementation plan overview

Initiative	Objective	Measures	Implementation Phases ⁽¹⁾				Indicators of Success ⁽²⁾				
			Planning	Agreement of principles	Complete implementation	Summary Deliverable ⁽¹⁾	Milestone Step ⁽¹⁾	Primary Responsibility	Existing indicators	Potential indicators over time ⁽³⁾	
5	Strengthening our commitment to customers in the Code of Banking Practice	Ensure the Code of Banking Practice adequately covers expected standards for banks and their relationship with customers, including standards for engagement between both parties	5.1	Complete a review of the Code of Banking Practice by the end of the year.	Jul-16	Dec-16	Dec-16	Independent review report on the Code of Banking Practice	a) Establishment of independent review b) Assessment of information gathered and submissions received c) Preparation of draft report and engagement with stakeholders d) Publication of final report	ABA Reviewer Reviewer Reviewer	
			5.2	Work with banks to implement changes to improve the operation of the Code of Banking Practice within their individual organisations	Agree to timeframe once recommendations and transitional periods are better understood		New Code of Banking Practice (*Contingent on EDR review by government; transitional period and subsequent implementation of changes dependent on the extent of the changes)	a) Identification of responses and actions needed to improve the operation and performance of the Code b) Preparation of any changes to the Code and associated materials c) Publication of the new Code d) Banks make changes to reflect the standards contained in the new Code	ABA/Industry ABA/Industry ABA Banks		
6	Supporting ASIC as a strong regulator	Demonstrate banks' commitment to a well regulated banking and financial services industry	6.1	Work with the Government and ASIC to implement a 'user pays' industry funding model to enhance the ability for ASIC to investigate matters brought to its attention	Aug-16	Oct-16	Jun-17	Industry agreement on funding model (*Implementation will be subject to consultation with and agreement by government)	a) Participation in consultation on users pays funding model b) Consideration of industry position in new model c) Implementation of an industry funding model which is accountable, transparent and encourages better and more efficient regulatory activities	ABA/Industry ABA/Industry Government	
			6.2	Work with ASIC to enhance the current breach reporting framework	Aug-16	Oct-16	Dec-16	Industry position on breach reporting regime completed for contribution to ASIC consultation (*Timing of review to be determined by government)	a) Preparation of industry position on breach reporting regime b) Participation in Government/ASIC review of breach reporting c) Adoption of industry position in revised regulatory guidance d) Banks implementation of changes to systems and practices to support new breach reporting system	ABA/Industry ABA/Industry Government Banks	

Footnotes:

1. Based on advice from the entity with primary responsibility for implementation
2. These indicators are to inform individual banks of progress in achieving the objectives of the initiatives over time
3. Indicators will be provided/updated during the course of the implementation phase for the initiatives

Appendix B

Stakeholder consultations undertaken to date

Discussions were held with the following organisations in preparation of this first report:

- Australian Bankers' Association
- Australian Prudential Regulation Authority
- Australian Securities and Investments Commission
- Australia and New Zealand Banking Group
- Bank of Queensland
- Bendigo and Adelaide Bank
- Commonwealth Bank of Australia
- Consumer Action Law Centre
- Council of Small Business Australia
- Finance Sector Union
- Financial Ombudsman Service
- ING Direct
- Macquarie Bank Limited
- National Australia Bank
- Suncorp Group
- Westpac Banking Corporation

Appendix C

Letter of engagement

19 May 2016

Ian McPhee AO PSM
via email

Dear Mr McPhee

Letter of engagement

Thank you for our recent discussions on suitable arrangements to be put in place to oversee and report on the implementation of the banking industry's recently announced package of initiatives to protect consumer interests, increase transparency and accountability and build trust and confidence in banks.

This letter sets out the arrangements we have agreed for your appointment as the independent governance expert overseeing and reporting on progress with implementation of the industry's announcement. We have agreed these arrangements following consideration of the advice provided by Gina Cass Gottlieb of Gilbert + Tobin.

Background

On 21 April, the banking industry announced a package of measures, including initiatives to address consumer concerns about remuneration, the protection of whistleblowers, the handling of customer complaints and dealing with poor conduct.

As part of that announcement, the industry committed to putting in place governance arrangements around:

- 1) The implementation of the industry's package of initiatives.
- 2) The review process.
- 3) Quarterly public reporting.
- 4) An independent expert to oversee implementation.

Overall process

In summary, and as discussed with you, the role of the independent governance expert is to ascertain and report publicly on the progress the industry is making to deliver upon its commitments in its 21 April statement.

To enable this to work effectively, the industry will work with you to ensure:

- The initiatives are specifically and clearly defined
- Roles and responsibilities for the initiatives are clearly set out, and
- Specific milestones and target dates are established, against which progress can be measured and reported.

We would anticipate that, to fulfil your role, you would seek input from individual banks and the Australian Bankers' Association (ABA) on the progress they are making, including evidence to substantiate that progress. You will have the option to meet with banks individually, or collectively through the ABA.

You would also seek input from a range of other stakeholders, including regulators, consumer representatives, community organisations, unions and other industry associations, on their views regarding progress and the industry's efforts.

More detail on the governance arrangements and your role, based on the advice provided by Gilbert + Tobin, is set out below.

Specifying initiatives and key milestones

The industry, in consultation with and guided by you in your role as the independent expert, will further specify the nature of each announced initiative and the key milestones associated with the implementation of each of those initiatives.

The further specification of each initiative is intended to establish between the industry, yourself and the public a clear understanding of what each initiative will involve, including what is in and out of scope and what is required and expected of each participant.

Milestones will be specific enough to ensure you can maintain reasonable oversight of the industry's reported progress in implementing each initiative, and report or respond to any delays or difficulties in a timely way. However, they will not be so detailed as to introduce inflexibility or delay into the process or appear to reflect a desire to report something every quarter rather than representing meaningful progress.

Specifications and milestones may be reviewed and refined where doing so would improve the process or its outcomes, but only in consultation with you and other key stakeholders who may be affected. Any changes to specifications and milestones may be reported by you in your quarterly reports.

Assigning roles and responsibilities

In consultation with and guided by you in your role as independent expert, the industry will assign roles and responsibilities in relation to each milestone. Key roles and responsibilities are likely to rest with:

- Individual banks
- The ABA
- External advisers, and
- Other participants, such as regulators, consumer representatives, community organisations, unions and other industry associations.

These roles and responsibilities will be performed and discharged according to each participant's usual decision-making processes.

Roles and responsibilities may be redefined or reassigned where doing so would improve the process or its outcomes, but only in consultation with you and other key stakeholders who may be affected. Any changes to roles and responsibilities may be reported by you in your quarterly reports.

Establishing and reporting against timeframes

In consultation with and guided by you in your role as independent expert, the industry will establish timeframes for each milestone that is reasonably within the industry's control. Timeframes may be expressed relative to an external event or another party's actions, where appropriate.

The entities and persons responsible for each milestone will regularly report to you their progress against these timeframes. This input may not be reproduced in your reports to the extent that it is reasonably identified as commercially or competitively sensitive. However, you may report whether or not the industry or individual banks have reported and provided evidence of meeting particular milestones associated with each of the initiatives.

Timeframes may be reviewed and refined where necessary, but only in consultation with you and other key stakeholders who may be affected. Any changes to timeframes may be reported by you in your quarterly reports.

Oversight by independent expert

The industry has committed to publishing quarterly reports on its progress in implementing the recently announced package of initiatives, with the first report due by 21 July 2016. These reports will be prepared independently by you with input from:

- Individual banks and the ABA on steps taken and steps planned to achieve particular milestones, and
- Third party stakeholders, including regulators, consumer representatives, community organisations, unions, other industry associations and other relevant interested parties.

To assist with preparation of reports, you and the industry may wish to establish a reporting framework or template to ensure consistency across the participants reporting to you, and across the different initiatives being reported against. This framework may include particular qualitative or quantitative criteria against which progress is to be assessed, and you may report whether or not, in your expert judgement, you are satisfied that the industry or individual banks are progressing the initiatives in good faith and consistently with the intentions of the industry announcement.

A draft of each report should be provided to the ABA and individual banks to enable them to inform you promptly of any statements they consider to be factually incorrect. In this context, you will not be required to make any changes requested by the ABA or individual banks and must use your own independent expert judgement.

You are also invited to make specific recommendations to the ABA and individual banks where you consider it would be useful to assist in developing and implementing the industry announcement if, for example, you observe a delay or difficulty relating to implementation. Such recommendations would be focussed on progressing implementation of the industry's announced initiatives and should not be directed at expanding or changing the nature of those initiatives. It is also expected that you would consult with the ABA and individual banks in relation to any recommendations in advance of publishing your report.

In addition to these reports, you may write directly to individual banks if you identify an issue with the progress of implementation associated with a particular bank. Each bank will nominate a suitable contact for this purpose and a suitably senior contact for escalation if you consider it necessary. The contents of any letter would be confidential unless the bank chose to release it, but you may report the fact that a letter had been written if you consider doing so would facilitate the progress of implementation or increase public confidence in the oversight of the initiatives.

Confidentiality and intellectual property

On occasion, it may be necessary for a bank to provide information, particularly specific evidence of how a bank is implementing an initiative, which is commercially or competitively sensitive. That information may be provided in written form or through consultations with you. The bank will identify such information as confidential and that confidentiality will need to be respected. Without breaching confidentiality, the information may be used in an aggregated form to assess progress with implementation.

You agree that the ABA owns all intellectual property in any materials created, developed, modified or adapted by you in the course of your provision of the services (including methodologies processes, tools and documents). You agree to do all things necessary to assign all intellectual property rights to the ABA as requested. You also agree to waive any moral rights you have in the project materials.

Independence

You have been appointed to this role having regard to your work as the former long standing Auditor General of the Australian National Audit Office, amongst your other qualifications. As an expert appointment, it is expected that you will undertake the role impartially, exercising your own judgement and expertise and without undue regard for the interests and concerns of the ABA or individual banks.

Support

To assist you in your role, the industry will arrange for support to be provided to you by PwC. This support will be in the nature of:

- Secretariat functions relating to reviewing and assessing plans, reports and materials provided by the ABA and individual banks in relation to implementing the industry's initiatives.
- Assistance in the preparation and drafting of your quarterly reports.
- Assistance in relation to broader stakeholder consultation and research.
- The provision of senior banking industry expertise and advice in relation to industry practices and trends, including overseas trends as necessary.

You will be able to draw on this support directly, without going through the industry or the ABA.

Fees

Details of the fees and expenses payable in respect of the services being provided are set out in the Confidential annexure to this letter.

Term

The appointment will continue until the package of measures is substantially implemented. We anticipate this will be 18 months from the date your appointment is announced. The appointment can be shortened or lengthened through mutual agreement with the industry. At the end of the process, you have the opportunity to issue a final report on progress overall.

Acceptance

If the above arrangements are acceptable to you, I would appreciate you returning a signed copy of this letter to me. Please note that, in the interests of transparency, the industry may choose to release this letter publicly, excepting the Confidential annexure, which remains confidential to the parties.

Yours sincerely

Steven Münchenberg
Chief Executive Officer
Encl.

Ian McPhee AO PSM

Appendix D

Glossary & abbreviations

Term	Definition
ABA	Australian Bankers' Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Banking industry	Banks and banking industry associations
Banking system	Regulators, industry bodies, banks, laws and regulations
CALC	Consumer Action Law Centre
COSBOA	Council of Small Business of Australia
EDR	External Dispute Resolution
FOS	Financial Ombudsman Service
FSU	Finance Sector Union
Implementation plan	Detailed program of work, including provisional timetables for each phase of the project, planned to address each initiative
Package of initiatives	Six programs of work announced by the ABA on 21 April 2016
Measures	Actions specified to achieve the objectives of ABA's package of initiatives
Milestones	Interim deliverables required to be achieved in order to implement each measure
Success indicators	Key performance indicators to assess the effectiveness of measures in meeting the objectives of the initiatives