

Retail Banking Remuneration Review

Report

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Executive summary

This is the final report of my Independent Review of product sales commissions and product based payments in retail banking in Australia (Review). Such payments are linked to the number or value of products sold, offered, or distributed to retail and small business customers. The Review¹ is intended to build on the Future of Financial Advice (FOFA) reforms and identify options for strengthening the alignment of retail bank incentives, practices and good customer outcomes. It is also required to comment on the principles that banks might apply when structuring remuneration more generally.

I examined the arrangements that lead to incentives, commissions and bonus payments (variable reward payments) for retail staff of banks (Tellers, Sellers and their supervisors and near managers (Managers)) as well as third parties (including Brokers, Aggregators, Franchises, Introducers and Referrers). These roles together may deal with a range of products, including various deposit accounts and loans such as mortgages, and a range of insurance products, including consumer credit insurance (CCI).

After receiving feedback on the Retail Remuneration Review: Issues Paper (Issues Paper) published in 17 January 2017 (available at <http://retailbankingremreview.com.au/>), it remains my view that there is not sufficient evidence of significant *systemic* risks of poor outcomes for customers to support an outright ban on all product based payments in retail banking.

Nonetheless, as foreshadowed in the Issues Paper, some current practices carry an unacceptable risk of promoting behaviour that is inconsistent with the interests of customers and should be changed. Some of these relate to management practices that may reduce the effectiveness of the bank's risk mitigation strategies. Other practices relate to the way incentives and remuneration are structured. The need for change is true of both direct (i.e. staff) and some third party channels - a view reinforced by my reading of the Australian Securities & Investments Commission's (ASIC) recent report into the mortgage broking sector² (the ASIC Report).

New approaches to retail bank remuneration are by no means a panacea. But the Issues Paper³ has documented instances in retail banking and across the financial services sector more broadly, both in Australia and abroad, in which incentives have at least appeared to drive behaviour that was not in the best interests of customers and, on occasion, scandalously so. The 21 recommendations I propose, if fully implemented in the spirit in which they are intended, will complement other initiatives the Australian Bankers' Association (ABA) has underway in the Banking Reform Program and will assist in addressing a trust deficit that some key leaders believe has emerged in respect of the banking industry. The recommendations have also been drafted with that objective in mind. They are deliberately intended to signal a sharp break with the past.

Effective leadership is key. Leaders drive culture. Whether they do it by accident or by design, and whether culture is set by those at the top of the organisation or by 'local leaders' in each work group, depends on the credibility, consistency and quality of the systems and governance senior leaders put in place.

A feature of the proposed approach, therefore, is that banks address the issues holistically, meaning that they each act to ensure that their approaches to remuneration, performance management, leader development and cultural renewal are aligned. Fundamental also is that practices that have a similar effect on incentives and the risk of inappropriate behaviour should be reformed in a similar way irrespective of the name assigned to it or the channel through which it occurs and, in particular, that reforms should be applied consistently across both the direct (i.e. staff) and, with appropriate adjustments, the third party channels.

Time is not on the side of the industry. I suggest that each bank implement these proposals in their own institution irrespective of whether they perceive other banks are moving similarly. Each bank has a responsibility to its customers and shareholders to nurture trust in their institution. Decisive action will

¹ For the Terms of Reference of the Review, refer to <http://retailbankingremreview.com.au/>

² ASIC, *Report 516: Review of mortgage broking remuneration*, March 2017

³ See Section 2 of the Issues Paper

clearly signal that it stands for 'doing the right thing' irrespective of what approaches its competitors adopt.

The data compiled for the Issues Paper shows that virtually every bank will need to change some practices in respect of at least some roles in order to comply with my recommendations. However, the proposals will affect banks differently. Some have already progressed well on the journey towards a less sales dominant culture, for example, while others may be less advanced. Other banks – often smaller banks – believe they have a strong affinity with their customer base and that their culture and practices are already well aligned with the objectives that underpin the proposals.

Individual employees may also be affected differently, depending on how their remuneration is currently structured. For some, especially some Home Lenders (who can currently earn several times their fixed pay from incentives directly tied to sales under some schemes) and in-scope Financial Advisers⁴, the changes could be quite significant. Over time this may require a rebalancing between fixed and variable reward for those employees who continue to perform well when assessment processes better prioritise the customer over sales. However, some may prefer to continue to work in an environment that offers large potential upside to their remuneration and may choose to seek employment elsewhere. Others may leave because they do not find the new priorities conducive to suitably high performance on their part.

However, it is possible that change may be slower than desirable, for the industry as a whole. I have been heartened by the public support that many banks have given to this process, in some cases publicly committing to implement my recommendations. Nonetheless, it is prudent that a further independent review be conducted in three years to assess progress in implementing these recommendations and examine whether regulatory or legislative change is required (see Recommendation 15).

A consolidated list of the recommendations appears in Section 3. I have recommended that each bank implement these proposals as soon as systems and other processes can be amended and by no later than 2020, if a transition period is required. Adoption of these recommendations will mean that in respect of in-scope retail bank staff (importantly, including Home Lenders) and their Managers:

- Incentives are no longer paid to any retail staff based directly or solely on sales performance (see Recommendations 2 and 7);
- Instead, eligibility to receive any personal incentive payments will be based on an assessment of that individual's contribution across a range of measures, of which sales (if included at all) will not be the dominant component (Recommendations 3, 4, 5, and 6); and the maximum available payments will be scaled back significantly for some roles (Recommendation 8);
- Retail bank culture will be demonstrably ethically and customer oriented (Recommendation 9);
- A significant investment will have been undertaken, as necessary, to ensure that performance is managed consistently with such a philosophy, supported by proactive steps to develop leadership and management skills at all levels so that management practices match the intent of the recommendations (Recommendations 10, 11, and 12); and
- With clear and consistent leadership shown by the Board and the most senior managers of the bank (Recommendations 13 and 14).

Although recommendations are also addressed to Introducers and Referrers (Recommendation 20) and in respect of Franchisees (Recommendation 21), the discussion of third party channels is dominated by Mortgage Brokers. My approach generally aligns with that adopted in the ASIC Report. Some recommendations are proposed for adoption quickly (for example to cease bonus payments to Mortgage Brokers⁵ in some circumstances – Recommendation 16), while others require further work to ensure they can be implemented effectively and in a competitively neutral way (see Recommendations

⁴ Most Financial Advisers are subject to the FOFA rules in respect of product based payments and product sales commissions and are therefore outside the scope of this Review. In-scope Financial Advisers only include individuals who are bank staff and who provide personal and general advice to retail and small business customers on Tier 2 products only

⁵ Mortgage Brokers and Aggregators refer to those who are involved in the sale of home loans and mortgage products

17 and 18). The latter relate to the adoption of alternative approaches for Mortgage Broker and Aggregator remuneration and governance. An issue is whether legislative or regulatory change is desirable to preserve competition and/or overcome inertia or any competitive disadvantages that a 'first mover' might fear they would otherwise incur. Ultimately the details of any new approaches would be settled via commercial negotiations, and should preserve competition and the viability of mortgage broking.

I understand that ASIC has a range of powers, whether through legislative instrument (such as a class order) or a new licence condition, for example, that could be employed if the industry cannot or does not address this issue adequately without such an intervention. However, they are untested. I encourage ASIC to explore such possibilities and to exercise such powers, if necessary to effect beneficial change in this instance. However, another avenue to support reform may be available if ASIC's powers are currently insufficient. The government is currently consulting the industry about the possibility of strengthening ASIC's powers to intervene against poorly designed and distributed products. These proposals do not explicitly recommend conferring a discretionary power on ASIC to address 'conflicted remuneration'⁶. I have therefore recommended that whether to extend ASIC's intervention powers where necessary to address 'conflicted remuneration' should be revisited in three years' time in the light of progress in the implementation of recommendations 16, 17 and 18. (Recommendation 19).

I have been ably assisted by an independent small part-time team in undertaking this Review, with financial and logistical support from the ABA. I have benefited enormously from submissions and open-minded discussions with many in the industry and elsewhere (including ABA member banks and some bank staff) and the guidance of the Stakeholder Advisory Panel⁷. All have respected the independence of the Review.

The opinions expressed are, of course, my own.

⁶ In this context, conflicted remuneration is used in the same context as para. 13 of the ASIC Report (i.e. has its everyday meaning)

⁷ The Stakeholder Advisory Panel is made up of representatives from the Consumer Action Law Centre, Finance Sector Union of Australia and the Professional Standards Authority

Table of contents

1.	Introduction	1
1.1	Scope of this Review	1
1.2	Report structure	2
1.3	Acknowledgements and thanks	2
2.	Overview and context	4
2.1	Change is necessary	4
2.2	Success will require a holistic approach	5
2.3	Time is not on the industry's side	5
2.4	Banks and individuals will be affected unevenly	6
3.	Consolidated recommendations	7
3.1	Implementation date for recommendations	8
3.2	Remuneration structures for retail bank staff	8
3.3	Governance, culture and performance management	9
3.4	Remuneration of third parties	10
4.	Remuneration structures for bank staff	12
4.1	No longer link variable rewards directly to sales	12
4.2	Eligibility for rewards should be broadly based	14
4.3	The customer is key	16
4.4	Discontinue some high-risk practices	19
5.	Governance, culture and performance management	21
5.1	Reassess culture	21
5.2	Review the performance management system as well	23
5.3	Discretion is good but managers need support	24
5.4	Reassess use of leaderboards and recognition programs	26
5.5	One in, all in	27
5.6	Strengthen governance	28
5.7	Improved clarity for the customer?	29
6.	Third parties	33
6.1	Reform the remuneration of Aggregators and Mortgage Brokers along similar lines to staff	33
6.2	Introducers and Referrers	39
6.3	Commercial equipment finance brokers	40

6.4 Franchise models	40
Appendix A – Remuneration practices in the UK: summary paper	41
Appendix B – Banking product and remuneration legal framework	47
Appendix C – UK comparison: Delivering fair customer outcomes.....	55
Appendix D – Submissions and consultations	56
Appendix E – Glossary	57

1. Introduction

I was appointed by the Australian Bankers' Association (ABA) to undertake an Independent Review of product sales commissions and product based payments in retail banking in Australia (Review)⁸. The Review is intended to build on the Future of Financial Advice (FOFA) reforms and identify options for strengthening the alignment of retail bank incentives, commissions and bonus payments (variable reward payments), practices and good customer outcomes. It is also required to comment on the principles that banks might apply when structuring remuneration more generally.

This is my final report (Report). It follows the publication of the Retail Remuneration Review: Issues Paper (Issues Paper) on 17 January 2017 – available at <http://retailbankingremreview.com.au/>⁹ - which, amongst other things, reports the results of a major exercise to gather data about the practices banks follow in providing variable reward payments to retail banking staff and third party remuneration. The Terms of Reference can be found on the Review website.

Since the publication of the Issues Paper, a further 21¹⁰ public and private submissions were received, and a second round of consultations was conducted in Sydney and Melbourne - with banks, regulators, peak industry bodies, remuneration experts, consumer advocates, academics and other interested stakeholders. See Appendix D for further detail.

The Report provides 21 recommendations for reform. A consolidated list of these recommendations appears in Section 3.

1.1 Scope of this Review

The Review is charged principally with examining product sales commissions and product based payments received directly or indirectly by people selling retail banking products. Such payments are linked to the number or value of products sold, offered, or distributed to retail and small business customers. The Review is also required to comment on the principles that banks might apply when structuring remuneration more generally.

The roles in scope are staff of banks (Tellers, Sellers and their supervisors and near managers ('Managers')) as well as third parties (including Brokers, Aggregators, Franchises, Introducers and Referrers).

Products that are in-scope include:

- Basic banking products (e.g. transaction accounts, term deposits, travellers cheques);
- Non-cash payment products (e.g. travel money cards);
- General insurance products (except for personal sickness and accident);
- First Home Saver Accounts (FSHA);
- Consumer credit insurance (CCI);
- Consumer credit products (mortgages, personal loans and credit cards); and
- Small business lending.

⁸ As outlined in the Issues Paper, this Review is one of six separate initiatives announced by the ABA on 21 April 2016. These aim collectively to build public trust and restore consumer confidence in the banking industry. This Review is intended to address concerns that variable reward payments and incentive structures in retail banking may conflict with good customer outcomes. It is required to examine whether or not product sales commissions and product based payments in retail banks could lead to poor customer outcomes as well as to provide observations and insights to assist banks reform their practices, including in respect of remuneration more generally. Refer to Section 1 of the Issues Paper

⁹ Amongst other things, the Issues Paper provided an overview of common and outlier pay practices in the retail banking sector – which was based on extensive data provided by thirteen banks as well as their submissions, follow-up interviews and consultations. The Paper also identified seven issues on which feedback was sought, namely the role of targets; the size and structure of awards; bank legal obligations; difference between a sales and service culture; remuneration of senior managers; remuneration of third parties; what is a poor customer outcome and what is the link to agent remuneration

¹⁰ Bringing the total number of public and private submissions received throughout the process to 45

1.2 Report structure

This Report contains six sections:

- Introduction;
- Overview and context;
- Consolidated recommendations;
- Recommendations – remuneration structures for bank staff;
- Recommendations – governance, culture and performance management; and
- Recommendations – third parties.

Section 2 addresses why changes to remuneration arrangements in retail banking, for both staff and third parties, are critical to rebuilding public confidence in the banking industry and reducing the risk of poor customer outcomes. While changes to remuneration arrangements are critical, they alone are unlikely to be sufficient to reduce risks of mis-selling and poor customer outcomes.

Section 3 contains a consolidated list of the key recommendations, which are discussed in further detail in succeeding sections.

Section 4 concerns the recommendations that relate to bank staff. Those addressed to governance, culture and performance management are covered in Section 5.

Section 6 deals with remuneration arrangements of third parties. I have formed similar opinions to the Australian Securities & Investments Commission (ASIC) in areas in which this Review overlaps the ASIC Report¹¹ and have similarly identified some incentives that should be wound back. My recommendations in respect of mortgage broking are intended as a contribution to the debate that the ASIC Report should generate.

Three other studies were commissioned as part of this Review. I asked Mercer to examine retail banking practices in the United Kingdom (UK). They report a trend in the UK retail banks away from an emphasis on sales towards a focus on customer outcomes. The executive summary of this report is contained in Appendix A. The full report is available on the Review website at <http://retailbankingremreview.com.au>.

I also asked Gilbert + Tobin to prepare a summary of the current legal framework in Australia as it relates to this Review. This is in Appendix B. They were also requested to assess the Australian legal framework that relates to the 'fair outcomes' against which the UK regulator assessed mis-selling¹². This is documented in Appendix C.

Appendix D provides further information on the submission and consultation process and Appendix E contains a glossary of terms used throughout the Report.

1.3 Acknowledgements and thanks

This process involved complex subject matter and was conducted over a relatively short period, which has only been possible because of the generous contribution of time and ideas from many quarters.

I especially thank the member banks of the ABA, and the many individuals and organisations that provided submissions or agreed to be consulted as part of this Review, for the cooperative spirit in

¹¹ ASIC, *Report 516: Review of mortgage broking remuneration*, March 2017

¹² FSA, *Final Guidance: Risks to customers from financial incentives*, January 2013, p 9

which those exchanges took place. See Appendix D for further information on the submission and consultation process.

I also thank the members of the Stakeholder Advisory Panel¹³; the subject matter experts who provided invaluable technical advice (namely Mercer in respect of remuneration matters, and Gilbert + Tobin in respect of legal matters); staff of the ABA, who secured resources and managed logistics; and the members of the small, independent part time team who lent expertise, commitment and professionally supported this work. Their assistance was critical to getting this Report completed to a professional standard and on time.

ASIC's Report into its examination of mortgage broking was both timely and comprehensive and has added to the richness of Section 6.

All parties have respected the independence of this Review. Of course, the opinions contained herein are my own.

This Report has been based on information provided by the banks and other parties which I have assumed for the purposes of this Report is accurate and complete. However, neither I nor any other person involved in the preparation of this Report undertakes responsibility arising in any way from reliance placed by a third party on this Report. Any reliance placed is that party's sole responsibility.

¹³ The Stakeholder Advisory Panel is made up of representatives from the Consumer Action Law Centre, Finance Sector Union of Australia and the Professional Standards Authority

2. Overview and context

Views expressed in response to the Issues Paper have been mixed. Some stakeholders, such as consumer groups and the Finance Sector Union (FSU), continue to argue for a legislated ban on product based payments, both for retail banking staff and third parties. Other stakeholders, such as Mortgage Brokers, have argued that commissions in their sector do not pose an unacceptable risk of poor outcomes for customers. Some banks that believe they have a strong affinity with their customer base (this is especially but not exclusively the case for smaller banks¹⁴), argue that their existing culture and practices are also satisfactory. A number, however, have been moving to reduce the significance of product based payments in retail banking and propose to take further steps in the period ahead to deemphasise sales and strengthen the focus on customers.

2.1 Change is necessary

It remains my view that there is not sufficient evidence of significant *systemic* risks of poor outcomes for customers to support an outright ban on all product based payments in retail banking. Nonetheless, as foreshadowed in the Issues paper, some current practices carry an unacceptable risk of promoting behaviour that is inconsistent with the interests of customers and should therefore be changed. Some of these relate to management practices that may reduce the effectiveness of the bank's risk mitigation strategies. Other practices relate to the way incentives and remuneration are structured. The need for change is true of both retail banking staff and some third party channels - a view reinforced by my reading of the recent ASIC Report into the mortgage broking sector.

In forming proposals for action, I am also conscious that public trust in the banking industry has declined both in Australia and elsewhere. Key figures¹⁵ in the industry have acknowledged that a significant trust deficit has emerged because some practices have not been, or have been seen not to be, in the interest of customers. They are calling for this deficit to be addressed.

New approaches to remuneration are by no means a panacea. But the Issues Paper has documented instances in retail banking¹⁶ and across the financial services sector¹⁷ more broadly, both in Australia and abroad¹⁸, in which incentives have at the least appeared to drive behaviour that was not in the best interests of customers and, on occasion, scandalously so. The 21 recommendations I propose, if fully implemented in the spirit in which they are intended, will complement other initiatives the ABA has underway in its Banking Reform Program and will assist in addressing the trust deficit. The recommendations have been drafted with that objective in mind. They are deliberately intended to signal a sharp break with the past.

¹⁴ Some banks maintained that their culture is ethical and more values or customer-driven than sales driven. These usually were smaller banks, often with a strong affinity to particular customer groups or regions. In some cases, sophisticated programs are in place continually to reinforce such a culture. Others, this being a smaller cohort, believe that a sales orientation remains important and that their internal risk mitigation strategies are sufficiently strong to minimise any risk of mis-selling

¹⁵ The Governor of the Reserve Bank of Australia recently commented: "In terms of behavioural issues...I think it comes down to incentives within the organisations, and that is largely remuneration structures...If there was one thing I could focus on...is making sure that the remuneration structures within financial institutions promote behaviour that benefits not just the institution but its clients". See:

http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review;
http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/RBAAnnualReport2015/Public_Hearings

¹⁶ Examples including consumer credit insurance (CCI) – ASIC, *Report 256: Consumer credit insurance: A review of sales practices by authorised deposit taking institutions*, 19 October 2011, *Report 361 consumer credit insurance policies: Consumers' claims experiences*, July 2013 commissioned by ASIC and produced by Susan Bell Research

¹⁷ ASIC, *Report 492 A market that is failing consumers: the sale of add-on insurance through car dealers*, 12 September 2016; Introduction of FOIA reforms to address, among other things, the role of commission arrangements relating to product sales and advice as well as the potential for conflict of interest - see Section 2.3.2 of the Issues Paper

¹⁸ In the case of Wells Fargo approximately 1,500,000 deposit and approximately 500,000 credit card accounts were fraudulently opened. Wells Fargo received fines totalling US \$185 million for the fraud. Of this, the US Consumer Financial Protection Bureau (CFPB) fined \$100 million, the largest penalty they have ever imposed. See media release issued by the Consumer Financial Protection Bureau (CFPB): <http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-authorized-accounts/>; see also Consent Order issued by the US CFPB: http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf

2.2 Success will require a holistic approach

Changes to remuneration arrangements alone will not be sufficient to rebuild trust and reduce the risks of poor customer outcomes that motivate my proposals. Remuneration is but one component of a complex and interlocking system of governance through which an organisation is managed, especially a large, complex or geographically dispersed one. Other significant factors are the arrangements by which targets are set and performance is managed, the organisation's appetite for risk, the nature of its control and compliance functions, and the culture of a workplace. See Section 2.2 of the Issues Paper for a fuller discussion.

In many banks the cultural orientation towards sales is deep seated. This orientation has been built over many years, in some instances exacerbated by incentives arrangements. Winding back the associated risks of mis-selling and poor outcomes for customers will require a coordinated effort across all aspects of the governance framework and will take time. Success requires complementary changes to management policies and practices and workplace culture that together ensure that customer interests are better protected in the design and sale of retail banking products. Otherwise, the good intentions reflected in changes to remuneration arrangements could be undone by Managers that continue to praise and reward Sellers more fulsomely than those who make fewer sales immediately but build good relationships with customers.

Effective leadership is key. Leaders drive culture. Whether they do it by accident or by design, and whether culture is set by those at the top of the organisation or by 'local leaders' in each work group, depends on the credibility, consistency and quality of the systems and governance senior leaders put in place.

The Review therefore advances recommendations that encompass both remuneration and these broader aspects of leader development, management skill, culture and governance. The process to achieve renewal, especially cultural renewal, may take some years to complete. Early and significant action as per the recommendations in this Report, however, will assist to build on the current momentum for change evident in many banks and shorten the time until the cultural and necessary other shifts are completed. Without cultural change, progress in better balancing shareholder and customer needs may be short-lived. These recommendations are designed to signal a sharp break with previous practices and reinforce efforts to change a sales culture in the industry.

2.3 Time is not on the industry's side

Some in the industry, including the ABA, in submissions to the Review have argued that change is required across the industry and, for competitiveness reasons, should be pursued on an industry-wide basis. Collaborative action and even discussion by banks on such matters may risk contravening the *Competition and Consumer Act* and may need regulatory approval or legislation to manage this risk.

Legislative change would not be a straight forward or quick process. The cessation of product based payments linked directly to sales, for example, could be undermined in respect of home lending unless it applied also to mortgage broking. I have therefore proposed that banks not only change their remuneration of Home Lenders but also move voluntarily to strengthen the alignment between those arrangements and their remuneration of Mortgage Brokers and Aggregators¹⁹. However, any legislation or regulatory change to similar effect would need careful consideration to apply these approaches to both Mortgage Brokers and direct sales by bank staff in a competitively neutral way, which could take some time.

Regulatory approval is also likely to take some time and, as the recent approach to place a cap on commissions in their sector by the Insurance Council demonstrates, may not succeed. It would take time for negotiations to occur between the member banks of the ABA and possibly other stakeholders, for example, to reach agreement on what kinds of approval should be sought and from which regulator or regulators. Further time would elapse before the regulators reached and promulgated their views.

¹⁹ Mortgage brokers and aggregators refer to those who are involved in the sale of home loans and mortgage products

Similarly, time would be required to draft and consult the many players in the industry about changes to ASIC's guidelines or regulations. I make proposals, however, that are intended to explore such legislative or regulatory issues so that decisions can be taken in timely fashion.

However, I do not believe that the industry has the luxury of time if it is to address these issues credibly. Instead I suggest that each bank adopt the recommendations in this Report for implementation in their own institution irrespective of whether they perceive other banks are moving similarly. This course is proposed because each bank has a responsibility to its customers and shareholders to nurture trust in their institution. Moreover, decisive action will provide a clear signal to staff, customers and other stakeholders that their bank stands for 'doing the right thing' irrespective of what approaches its competitors might adopt.

In a sense, the larger the bank, the greater the responsibility and opportunity. Encouragingly, the large banks have already begun to move on these matters. Some have even publicly committed to adopting the recommendations of this Review. I congratulate them and encourage both them and others to be bold and move fast in the directions proposed in this Review.

2.4 Banks and individuals will be affected unevenly

Both remuneration practices and the extent to which culture is dominated by sales vary significantly across banks, and sometimes even between groups or roles within banks. Accordingly, the implications of adopting these recommendations will be different for different banks. Some, for example, have already begun to move in this direction or have a culture they believe is already sufficiently customer focused. For others, however, the changes required will be substantial for at least some retail staff roles, and their journey of cultural renewal may prove challenging.

Moreover, a move away from direct sales-related remuneration may be less attractive to some staff who self-selected such roles because of the potential variable reward upside²⁰. One response from banks may be to increase fixed pay to retain talented individuals with an appropriate mix of sales and other skills. This would increase the requirement to ensure that performance management practices are effective and consistent with the objectives that underpin the reforms to remuneration. Another response may be to acquiesce in the separation of some staff in search of jobs that offer sales-contingent variable rewards. Although a necessary element of cultural renewal, this response may occur unevenly across banks.

Placing less emphasis on remuneration as a motivational device for staff will also test the leadership skills of some. Indeed, a key element of the change will be to assist Managers to reorient the thinking of some staff (and, possibly, their own) away from extrinsic rewards based on sales and variable reward pay towards a more intrinsic one based on achieving high levels of customer satisfaction and a quality relationship between the bank and its customers.

My proposals are specifically directed at the members of the ABA, which commissioned this Review. However, I encourage non-member banks and others in related components of the financial services sector (such as those who distribute wealth products and non-bank participants in the mortgage broking industry) to examine applicability of the recommendations to their operations.

Although I have been encouraged by the broad support that some banks have given to the need for reform, it is possible that change may be slower than necessary, for the industry as a whole. It is prudent, therefore, that I recommend that the need for regulatory or legislative change should be reviewed in three years (see Recommendation 15 for further detail).

²⁰ A phenomenon known as 'sorting'. See Section 2.2.1 of the Issues Paper

3. Consolidated recommendations

In summary, I propose that each retail bank should review their approaches to tasking and managing the performance of staff, the way they structure variable rewards and incentives payable to them and the workplace experience of retail staff to ensure these systems reinforce each other and are progressively aligned with the recommendations below.

Adoption of these recommendations will mean, over time, that:

- Incentives are no longer paid to any in-scope retail staff based directly or solely on sales performance (see Recommendations 2 and 7);
- Instead, eligibility to receive any personal variable reward and incentive payments will have regard to an assessment of that individual's contribution across a range of measures, of which sales (if included at all) will not be the dominant component (Recommendations 3, 4, 5, and 6) and the maximum available payments will be scaled back significantly for some roles (Recommendation 8);
- Retail bank culture will be demonstrably ethically and customer oriented (Recommendation 9);
- A significant investment will have been undertaken, as necessary, to ensure that performance is managed consistently with such a philosophy, supported by proactive steps to develop leadership and management skills at all levels so that management practices match the intent of the recommendations (Recommendations 10, 11, and 12); and
- With clear and consistent leadership shown by the Board and the most senior managers of the bank (Recommendations 13 and 14).

Taken together my proposals are consistent with developments in recent years in retail banking in the UK (see Appendix A). The regulatory and other environmental factors differ significantly between the two countries. Moreover, it is still relatively early days since the changes were introduced and the impacts on overall financial performance are hard to disentangle from those of other changes (for example to performance management practices). Nonetheless, the experience in the UK is instructive and suggests that a trend to reduced emphasis on sales in performance management and staff rewards systems can be consistent with an effective and competitive banking industry. Appendix A reports²¹, based on the responses to the survey, the impacts of changes to variable reward design focus on "increased employee engagement/ retention, improved customer outcomes and strengthened individual behaviour. Particular themes include:

- Removing revenue/ sales from performance assessments has not noticeably or adversely affected business outcomes since implementation;
- Variable reward that is now focused on customer outcomes and individual behaviour has resulted in employees focussing on delivering the best outcomes for customers; and,
- A more discretionary approach to individual performance has enabled a more collaborative working culture."

As required by the Terms of Reference I also make recommendations in respect of payments made to third parties such as Mortgage Brokers, Introducers and Referrers and Franchises. These have been informed both by the work of this Review and the ASIC Report.

All recommendations are summarised below and discussed in more detail in succeeding sections.

²¹ See p 19 of Mercer, *Remuneration practices in the UK detailed review: Independent review into retail banking remuneration for the ABA*, April 2017

3.1 Implementation date for recommendations

1. I recommend that all banks begin to implement the recommendations in this Report as quickly as systems and other changes can be introduced. If transitional arrangements are necessary, full implementation should be achieved by no later than the performance year that begins in 2020²².

Note: This recommendation applies to retail bank staff and third parties (Recommendation 2 to 21)

3.2 Remuneration structures for retail bank staff

I recommend that the following apply to all retail bank staff roles in scope for this Review, namely Tellers, Sellers (including Home Lenders and in-scope Financial Advisers²³) and Managers:

2. Banks remove variable reward payments and campaign related incentives that are directly linked to sales or the achievement of sales targets (including, but not limited to cross sales, referral targets, and profit and revenue targets);

Note: Some banks remunerate in-scope Financial Advisers under a fee for service model in which variable reward payments are not related directly to the products sold/ advised on. Fee for service or fee for advice models have been specifically excluded from this Review as per the Terms of Reference.

3. Eligibility to receive any variable reward payment should be based on an overall assessment against a range of factors that reflect the breadth of the responsibilities of each role;

Note: a number of approaches may meet this criterion, including approaches which involve:

1. Appropriately constructed scorecards; and
2. Assessments based on manager discretion.

However, some banks will need to revise how they apply scorecards to fully meet this requirement (see Section 4.2). Banks should be able to demonstrate credibly that any manager discretion is applied in ways consistent with my recommendations. Discretion could be applied to establish an overall assessment (or rating) or the amount of variable reward or both.

4. Any financial measures included in an overall assessment consistent with Recommendation 3 should:

- Be product neutral (i.e. not encourage the sale of one product over another); and
- In the case of a scorecard, together attract a maximum effective weight of 50 percent as quickly as systems and other changes can be introduced, falling to 33 percent or less by 2020;

5. All customer measures are genuinely customer-centric and tailored to the role being assessed, and progressively reflect a focus on customer outcomes not just customer loyalty/ satisfaction;

Note: Some banks classify as 'customer', measures that are arguably financial in character such as cross-product sales or the number of products accessed by each customer and the like. These will need revision to fully satisfy this recommendation.

6. Credible behavioural or equivalent values gateways be applied to determine whether an individual can access any variable rewards to which they might otherwise be entitled;

Note: In general terms, these minimum gateways would require ethical behaviour, a customer focus and similar behavioural traits.

²² The timing of the performance cycles in any calendar year vary between the banks. A three-year adjustment period is consistent with the original intent of the FOFA reforms

²³ Financial Advisers, for the purpose of this Review include individuals who are bank staff and who provide personal and general advice to retail and small business customers on Tier 2 products only. Refer to Section 3.1.4 of the Issues Paper for further detail

7. Variable reward payments no longer include any:
 - Accelerators related to financial measures;
 - Accelerator-like modifiers related to financial measures;
 - Other mechanisms related to financial measures that have such an accelerator-like effect on the value of variable rewards available; and
 - Financial gateways, including but not limited to those that relate to the number or value of cross sells;
8. Variable reward payments ultimately amount to a relatively small proportion of fixed pay, with a progressive reduction in the maximum variable reward amount payable in any schemes that require a transition period to implement this recommendation²⁴.

3.3 Governance, culture and performance management

I further recommend that:

9. Each bank formally examine its workplace culture and institute formal processes to redress any conscious or unconscious bias towards sales in preference to ethical behaviour and customer service;

Note: There is, of course, no necessary conflict between 'sales' and either ethical behaviour or a customer focus. The intention is to make clear that the latter is to prevail in the event that circumstances may place them in conflict.
10. Each bank examine its performance management system and make changes as necessary to ensure that the embedded signals and incentives to staff are aligned with Recommendations 2 to 8;
11. Each bank ensure Managers reflect predominantly an ethical and customer focus when: communicating with staff, exercising any discretion while managing performance, and in allocating variable reward payments;

Note: Recommendations 9, 10, 11 and 12 may require a significant investment in leadership development and management skill.
12. Each bank reconsider what use is made, if any, of leaderboards, recognition programs and campaigns as well as any other methods that have similar effect (including informally in branches or call centres) and ensure any continuing role in using these methods is consistent with the intention to de-emphasise sales relative to ethical behaviour and customer outcomes;

Note: Continued use of leaderboards or sales-centric recognition schemes may be perceived by some as the continuation of a sales culture.
13. Consistent with the objectives of the recommendations for frontline staff, the variable reward payment and performance management arrangements of all senior and (retail bank) middle level executives be based on:
 - a. Their overall performance against a number of measures that reflect the nature and breadth of their role; with
 - b. Customer oriented, ethical behaviour and non-financial measures accounting for the dominant factors in that assessment;

²⁴ For some schemes and some roles this will prove a challenge and is unlikely to be accomplished quickly (for example in the case of Home Lenders these payments, currently, may be up to six times the fixed pay in some isolated cases)

14. Boards and Chief Executives:

- a. Visibly and effectively oversee the implementation of these recommendations for at least the next five years and report publicly, in their Annual Report to shareholders, for example, on how retail staff are remunerated and their performance assessed; and
- b. Ensure that effective, safe channels are in place to obtain feedback from frontline staff about their perceptions of the effectiveness of efforts to reform the bank's culture, performance management and remuneration arrangements, including in respect of whistleblower arrangements;

15. The ABA commission an independent reviewer to report publicly in three years²⁵ about how well banks have changed their practices and implemented the recommendations and assess whether further regulatory or legislative change is required.

3.4 Remuneration of third parties

Note: The following are intended to apply approaches to third party channels similar to those recommended for the direct (staff) channel.

I recommend that:

16. In respect of remuneration of Mortgage Brokers:

- a. Banks cease the practice of providing volume based incentives that are additional to upfront and trail commissions;
- b. Banks cease non-transparent soft dollar payments in favour of more transparent methods to support training etc.; and
- c. Banks cease the practice of increasing the incentives payable to Brokers when engaging in sales campaigns;

17. Banks adopt, through negotiation with their commercial partners, an 'end to end' approach to the governance of Mortgage Brokers that approximates as closely as possible a holistic approach broadly equivalent to that proposed for the performance management of equivalent retail bank staff;

Note: These arrangements are not expected to exactly duplicate those applied to staff. A scorecard would meet this recommendation but is not the only viable approach.

18. Banks adopt approaches to the remuneration of Aggregators and Mortgage Brokers that do not directly link payments to loan size and reflects a holistic approach to performance management (see Recommendation 17):

- a. To establish in a timely fashion how best to address Recommendations 17 and 18, banks with a significant recourse to the Broker channel, but at least the four major banks, each report regularly to ASIC on their progress; and
- b. With enhanced oversight by ASIC (and other regulators as necessary) to monitor market responses;

Note: Options for alternative payment arrangements could include: commission based payments that take the loan to value ratio (LVR)²⁶ or the loan type, or the quality of the advice given to the customer into account; and, preferably arrangements between lenders, Mortgage Brokers and Aggregators that are not product based such as lender-funded fees for service. Trailing payments of some kind might continue (with existing trail commissions grandfathered).

An issue is the general feasibility of alternative arrangements and whether such changes will require regulatory reform. An overarching principle, however, must be that competition and the viability of

²⁵ Effectively, in respect of the arrangements in place for the performance cycle that begins in 2020

²⁶ See proposal 1 in para. 115 to 119 of the ASIC Report

mortgage broking is preserved. Accordingly, any fees for service must be lender rather than customer funded. Although a new payment structure may emerge and the impact of some broad parameters examined, prices consistent with it should be left to commercial negotiations between the parties, as currently. This and Recommendations 16 and 17 apply to Mortgage Brokers and any authorised representatives.

19. The independent review proposed under Recommendation 15 or, at the latest, any post implementation review of the operations of the proposed product intervention power for ASIC, examine whether the government should legislate to extend ASIC’s intervention powers to address conflicted remuneration in circumstances in which the industry cannot or does not address Recommendations 16, 17 and 18 adequately without such an intervention.

Note: I understand that ASIC has a range of powers, whether through a legislative instrument (such as a class order) or a new licence condition, for example, that could be employed if the industry cannot or does not address this issue adequately without such an intervention. I encourage ASIC to explore such possibilities and exercise such powers as necessary to effect beneficial change. However, this recommendation supports the creation of another avenue if ASIC’s powers are currently insufficient.

20. In respect of Introducers and Referrers:

- a. Banks examine their governance of these arrangements to ensure that existing practices are appropriate; and
- b. ASIC, in due course, investigate whether the upfront commission paid to Introducers and Referrers is justified²⁷;

21. Banks that provide products or services through Franchisees examine their governance and, as appropriate, remuneration arrangements and seek to make changes that are consistent with the recommendations of this Review.

The following sections provide greater context and further details in respect of the recommendations presented above.

²⁷ Data available to the Review suggests that Introducers and Referrers receive upfront commission of a similar amount as Mortgage Brokers. However, they are legally able to perform only a very restricted set of functions compared to a Mortgage Broker. Also refer to finding 11: “Those who merely refer consumers to lenders are paid almost as much as brokers, despite doing much less than brokers” within the ASIC Report for further detail

4. Remuneration structures for bank staff

The Review recommends that all banks begin to adopt the recommendations in this Report as quickly as systems and other changes can be introduced. In some cases, the scale of adjustment may be such that transitional arrangements are necessary. If so, I recommend that full implementation be achieved by no later than the performance year that begins in 2020²⁸.

The recommendations in Sections 4 and 5 apply to all retail banking staff roles in scope for this Review, namely Tellers, Sellers (including Home Lenders and in-scope Financial Advisers²⁹) and Managers, while the recommendations in Section 6 apply to third parties.

Recommendation 1

All banks begin to implement the recommendations in this Report as quickly as systems and other changes can be introduced. If transitional arrangements are necessary, full implementation should be achieved by no later than the performance year that begins in 2020

4.1 No longer link variable rewards directly to sales

Remuneration practices vary between banks. Although a few do not, the vast majority of banks provide incentives, commissions or bonus payments to at least some of their retail staff that are directly or indirectly related to product sales. There is a risk that such incentives may lead to behaviours or practices that result in poor outcomes for customers. The risk is highest when the linkage is direct, for example when a reward is paid for every sale made above a threshold or target, and the risk of poor outcomes increases for the cross selling of add-on products such as consumer credit insurance.

Commissions and volume-based payments resulting from product sales have been banned in some circumstances in the financial services industry in Australia and in some other countries. This reflected public concern that these payments encouraged inappropriate practices by Sellers (including Financial Advisers and Home Lenders) in pursuit of higher rewards, to the detriment of their customers. These prohibitions do not typically apply in those parts of retail banking that are in scope for this Review because of certain exceptions in the FOFA reforms.

Banks, generally, are conscious of the risks that product based payments entail and have checks and balances in place to mitigate such risks. A number have told the Review that they have scaled back over time the significance of product-related payments and strengthened the checks and balances in place to mitigate the risks of mis-selling³⁰. Some have announced an intention to go further in this direction in the year ahead. Others, on the other hand, argue that their culture is already sufficiently service oriented and significant change is not required.

Sufficient evidence has not been presented to the Review of significant *systemic* risks of poor outcomes for customers to support an outright ban on all forms of remuneration linked to product sales.

Conversely, nothing has emerged since publication of the Issues Paper that has changed my view that some practices of some banks entail an unacceptably high risk of incentivising poor selling practices,

²⁸ The timing of the performance cycles vary between the banks. A three-year adjustment period is consistent with the original intent of the FOFA reforms

²⁹ Financial Advisers, for the purpose of this Review include individuals who are bank staff and who provide personal and general advice to retail and small business customers on Tier 2 products only Refer to Section 3.1.4 of the Issues Paper for further detail

³⁰ Refer to Section 5 of the Issues Paper

potentially leading to poor customer outcomes. The need to address those risks is heightened in the current climate of poor trust in the industry.

One such practice is the linking of the size of a variable reward payment directly to the achievement of sales targets or similar measures such as cross sales or referrals. The effect of this practice is that sales success is rewarded irrespective of performance against other measures such as customer-oriented measures. The risk is that staff or other observers interpret this as a signal that ‘only sales matter’, or ‘sales matter most’, even when staff must demonstrate certain minimum standards of behaviour towards customers to qualify for any incentive payment at all³¹. This risk is accentuated if the workplace culture is heavily sales oriented, which some banks concede is likely to be the case after many years in which sales performance has been highly valued and rewarded. The reputational and other risks associated with these practices are heightened when the banking industry is already perceived as having a trust deficit that needs to be addressed.

A fee revenue share model is used by some banks for in-scope Financial Adviser roles. Fee for service or fee for advice models have been specifically excluded from this Review as per the Terms of Reference.

Recommendation 2

Banks remove variable reward payments and campaign related incentives that are directly linked to sales or the achievement of sales targets (including, but not limited to, cross sales, referral targets, and profit and revenue targets)

³¹ This is known as a gateway. Refer to Sections 3.3.9, 6.2.3 and 6.2.4 of the Issues Paper for further detail

4.2 Eligibility for rewards should be broadly based

The Issues Paper³² reports on the range of variable reward approaches banks currently employ. These include:

- Approach 1 - Performance scorecard approach: This approach records performance against a number of weighted elements or measures which are used to determine overall performance. These weighted measures may include sales, customer satisfaction and/ or the extent of compliance with policies, procedures, or behavioural standards. An overall performance rating and/ or variable reward amount may be determined by formula or through the application of judgement by a manager.
- Approach 2 - Variable rewards related to performance against specific measures or targets: An individual receives a variable reward payment that is directly related to their achievement against a specific measure(s) or target(s), which typically will include measures that are sales-related (e.g. the payment of a percentage of total product sales generated or of the amount by which a sales target is exceeded). To comply with Recommendation 2, this approach should as quickly as possible phase out the use of sales and similar financial measures.
- Approach 3 - Variable rewards based on management discretion against individual performance measures or targets: The variable reward amount is based on management's assessment of an individual's performance against targets or other measures. These typically include financial targets as well as non-financial measures. This approach would be consistent with Recommendation 2 if and only if the manager's judgement takes all factors into account and is not predominantly driven by sales (see also Recommendations 3 and 11).
- Approach 4 - Enterprise Agreement (EA) prescribed variable rewards: The EA governs eligibility for payment with the bank's EA prescribing a specific variable reward amount subject to each individual meeting minimum performance standards.

Approaches 1 and 2 dominate retail banking remuneration. Almost every bank³³ adopts these approaches.

These four approaches provide very different signals to staff and their Managers about the importance assigned to individual measures of performance.

Recommendation 2 could be satisfied by removing any sales or financial measures from an approach 2 scheme. These schemes are most often applied in respect of Home Lenders, for whom sales-based metrics have been an important component of performance management and variable reward payments for some time. Moreover, the Mortgage Broker channel is almost wholly remunerated on a commission basis. The complete absence of sales in performance assessments and variable reward payments may therefore pose significant adjustment problems, at least until managers adopt a different approach to employee motivation. Some banks may therefore favour preserving some sales focus during the transition period.

An approach along the lines of approach 2 that excludes financial measures would at least have the virtue of breaking any direct link between variable reward payment and sales. (Refer to Recommendations 4 and 5 for further discussion of the construction of appropriate measures). This still leaves the risk, though, that some aspects of performance will be perceived as being dispensable since rewards will be paid based on performance against each measure independently. Assessments that have regard to overall performance minimise this risk.

A properly constructed scorecard will facilitate an overall assessment. The assessment could be established by the application of a rigid formula that converts a performance rating against each indicator into an overall rating and thence into an allocation of variable reward. On the other hand, the application of manager discretion can also allow a broad range of factors to be taken into account.

³² See, for example, Chapter 3 and Appendix B of the Issues Paper

³³ As set out in the Issues Paper, only a few banks have adopted variable rewards based on management discretion against individual performance measures or targets (approach 3) and Enterprise Agreement (approach 4)

Indeed, schemes that rely on manager discretion reduce the risk of errant behaviour as sales or other targets are approached by reducing the certainty that simply meeting the target will trigger a larger reward when the variable reward pay determination is struck. Discretion could be applied to establish an overall assessment (or a rating) or the amount of variable reward or both.

The UK regulator has issued guidance in support of such a scorecard approach to at-risk remuneration³⁴. I propose that banks adopt a broadly similar approach in that assessments of performance and of eligibility for variable rewards should be based on a broad range of measures. This is the essence of a well-constructed scorecard (see Section 4.3). However, as the previous discussion illustrates, other approaches may also satisfy this objective.

Adoption of a broad-based approach to performance assessments and access to variable rewards could, at the least, help to redress any lingering public perceptions that banks wish to pursue sales first and foremost, possibly to the detriment of some customers in some circumstances. The more transparent and robust the process, the more likely that such perceptions can be countered. If manager discretion is a component of the arrangements, banks should be able to demonstrate credibly that such assessments are consistent with the recommendations of this Review.

Some may wish to assess their compliance with Recommendation 3 by considering the totality of the approach they adopt. They may have regard, for example, not just to the components of a scorecard but also to any non-financial gateways or modifiers that are applied. Such an approach is not unreasonable. It should be applied with care, and preferably sparingly, however. This is because gateways are binary in nature. A gateway is either complied with, and the individual able to be considered for a variable reward, or they are excluded. A more nuanced approach can be taken if the same element is applied not as a gateway but as an explicit performance indicator.

In providing their data to the Review a number of banks classified their approach as a scorecard (i.e. approach 1). Our analysis of it, however, led us to reclassify it as approach 2. This was because the variable reward amount was assessed having regard to each indicator separately. I therefore recommend that banks which currently use or plan to use the scorecard and similar approaches review their design and structure and ensure that they align to my recommendations.

Recommendation 3

Eligibility to receive any variable reward payment should be based on an overall assessment against a range of factors that reflect the breadth of the responsibilities of each role

To be clear, in some banks the pool of funds available for distribution to individuals or teams as variable reward is determined 'top down'³⁵. Practices vary in that respect. In some, however, financial measures such as the overall profitability of the enterprise or of business units within it will substantially, though not necessarily solely, affect the size of the pool available for distribution. At their heart, practices of this kind reflect the reality that the enterprise's sustainability is determined by its financial soundness and profitability.

My recommendations are not necessarily inconsistent with such practices. Overall sales performance may influence the availability of variable rewards to the bank or a large unit within it, provided an individual retail bank staff member can reasonably be expected to believe that they are highly unlikely to affect that outcome through their personal sales success. In that case, the incentives for an individual to engage in inappropriate behaviour so as to increase the pool are minimal. The more senior the manager, however, the less likely that becomes and the more necessary it is to determine any such a pool having regard to a mix of measures both financial and otherwise.

³⁴ Refer to the FCA, *Consultation 15/1 Risks to Customers from performance management at firms*, March 2015 and FCA, *Guidance TR14/4 Risks to Customers from financial incentives – an update*, March 2014

³⁵ In other cases the pool may be determined 'bottom up' as the aggregate of individual entitlements or as a combination of both approaches (for example where each individual's entitlement may be scaled down proportionately if certain financial metrics are not met for the business or business unit overall)

4.3 The customer is key

In designing a scorecard or another broad-based approach there are significant benefits if the measures are constructed to show a clear emphasis on customer service and good customer outcomes, with significantly less focus than in the recent past on sales. The measures embedded should capture the key aspects of each role but within general principles that ensure attention is paid to customer focused measures.

Product neutrality

If appropriate to the role, the measures may include financial measures. If so, the risk of mis-selling is minimised if the measures are seen to be product neutral (i.e. that they are not perceived to encourage the sale of one product over another). Views differ about what the 'product neutrality test' requires in practice. Some banks argue that aggregate sales revenue is suitably neutral. Others argue that the effort required to effect some sales is disproportionate to the value of the sale. In that case, revenue based measures may favour the easy to execute sales rather than the complex ones, especially if the latter is low valued. Activity based costing may assist to identify the effort required to effect sales of different products. It is not straightforward to establish, however, the validity of any judgements reached about the relative effort required, which may undermine the credibility of such an approach with staff or other parties.

The Review makes no finding in principle about which approach to product neutrality is preferred. Banks, however, should be prepared to defend, both to their Board and, if necessary, publicly, the decisions they make in this regard. Sale based measures have the advantage of simplicity. They need to be applied with care, however, to minimise the risks identified above.

Financial measures in scorecards

'Financial measures', as referenced throughout the Report, include, but are not limited to product sales, cross selling, referrals, profit and revenue targets, an increased customer base or increased use of certain products by each customer. These may be compiled at both individual and team/ branch level. The Issues Paper showed there is considerable variation in the reliance placed on financial measures in scorecards currently. These are outlined in the table below, which is based on information that appeared in the Issues Paper:

Scorecard weighting range				
Performance measure	Tellers	Sellers – General	Sellers – Home Lenders (3)	Manager
Individual financial target <i>(Exc. cross selling)</i>	25% – 80% (1)	0% – 75% (2)	20% – 85%	n/a
Financial target – cross selling (4)	n/a	0% – 40%	0% – 25%	0% – 35%
Branch/team financial target	n/a	n/a	n/a	0% – 100% (5)
Non-financial measures <i>e.g. customer satisfaction, compliance objectives and technology/customer education</i>	20% – 75%	15% – 100% (6)	10% – 60%	0% – 100% (5)

- (1) For Tellers, individual financial targets relate primarily to referrals. For all other roles financial targets relate to products sold and/or referred. For a number of banks, meeting the referral target is only considered if that specific referral has led to a product sale.
- (2) Of this range, the individual financial targets (excluding cross selling) within the scorecards of Sellers – General is concentrated in the range of 40% to 50%.

- (3) Only a small number of Home Lenders are remunerated under this approach compared to the number of Home Lenders that fall under approach 2.
- (4) Cross selling is the sale of additional or 'add-on' products in addition to the primary product(s) an individual is rewarded on.
- (5) Banks who are on the lower and upper end of this range are outliers. The branch/team financial target range is mostly concentrated in the middle of this range.
- (6) Of this range, the non-financial measures are concentrated in the range of 50% to 60%.

n/a: No banks within this category or insufficient banks to determine an illustrative range.

Consistent with the intention to signal a sharp break with more sales centric approaches of the past, it is recommended that banks move as quickly as possible:

- Where banks adopt a scorecard, to reduce the aggregate effective weight assigned to financial measures (in each retail staff scheme) to no more than 50 percent as quickly as systems and other changes can be introduced and falling to 33 percent or less within three years; and
- Where banks use discretionary decision making they should be able to demonstrate credibly that performance against any financial measures did not play a significant part in determining the variable reward amount (a point that applies more generally in the context of Recommendation 3).

The more formulaic the approach to calculate a performance rating or incentive payment the more important it is to develop measures that can reliably differentiate between the performances of teams or individuals. Otherwise the variability in ratings or pay may be determined by the variability in any sales measures included in the calculation, even at weights that satisfy Recommendation 4. If sustained for any length of time this would undermine the credibility and the intended effectiveness of the changes to the reward system. This is a powerful argument in favour of the application of manager discretion, provided that discretion is applied consistently with these recommendations.

Recommendation 4

Any financial measures included in an overall assessment consistent with Recommendation 3 should:

- a. Be product neutral (i.e. not encourage the sale of one product over another); and*
- b. In the case of a scorecard, together attract a maximum effective weight of 50 percent as quickly as systems and other changes can be introduced, falling to 33 percent or less by 2020*

New approaches to capturing the customer dimension

Many banks are moving to increase the emphasis placed on the customer dimension in their performance measures and in the service offer they propound to customers. However, the measures to support such an orientation appear rudimentary. A concerted effort to refine existing measures or invent new measures is necessary to give credibility to efforts to reduce the emphasis on sales performance.

Typically, data is collected about whether a customer would recommend the bank to a friend or the level of satisfaction a customer expresses against a numerical scale (sometimes called the Net Promoter Score). Points made to the Review about these types of customer measures include:

- The customer is typically approached just after an interaction with a staff member, well before the customer will know the effectiveness of the product they may just have been sold.
- Care has to be taken to differentiate between the impact on the customer's feedback of factors related to the brand, the branch or the bank staff member with whom they dealt.

The latter is particularly important if staff-specific measurements are required to enable the manager to differentiate between staff for their performance assessment or incentives entitlement. A customer's feedback may have been influenced, for example, by a recent IT outage or adverse press coverage concerning a bank product, or by an untimely queue in the branch rather than the quality of the service provided by an individual staff member. Feedback motivated by all such factors is valuable and may be appropriate to inform the assessment of some staff, including some not in customer-facing roles – but such feedback needs to be correctly classified.

Several banks informed the Review that they have work in hand to improve the quality and usefulness of customer-focused performance measures. Some take note of any verbal comments supplied by the customer or complaints received. Many banks examine a sample (at least) of the documentation that they require staff to generate to support an exchange with a customer as a form of quality control. Some banks also report that they are seeking to develop measures that capture the outcomes achieved by customers, though this is in the early stages.

This is unlikely to be straightforward. It would undermine the credibility of the approach, for example, if such measurements included ones that are arguably financial in character such as cross sales or the number of products accessed by each customer or the increase in customer base/ increase of product use by a customer. Some banks will need to revise their customer measures to ensure that they are appropriately classified and that the approach adopted is consistent with these recommendations.

I continue to accept, however, a comment made by a senior bank member during the first consultation period. This was to the effect that a true reorientation toward service will not occur until there is as much effort devoted to measuring the quality of the customer experience and outcomes as there is to measuring the activities of staff and the sales generated.

Recommendation 5

All customer measures are genuinely customer-centric and tailored to the role being assessed, and progressively reflect a focus on customer outcomes not just customer loyalty/ satisfaction

Preserve the use of effective behavioural gateways

One feature of current practice that should not be lost is the common practice of requiring bank staff to meet minimum behavioural standards or to at least minimally demonstrate appropriate customer-centric, ethical values to qualify for any kind of incentive payment. Of course, other non-financial gateways, for example regarding compliance with bank policies and the like, may also be applied if the bank so wishes (see also the discussion in Section 4.2 about the relative merits of using gateways compared to equivalent performance measures to differentiate good performance).

Recommendation 6

Credible behavioural or equivalent values gateways be applied to determine whether an individual can access any variable rewards to which they might otherwise be entitled

4.4 Discontinue some high-risk practices

Accelerators and financial gateways

The Issues Paper identified some other practices and mechanisms that entail a heightened risk of promoting mis-selling and potentially poor outcomes for consumers. These were found to some degree in schemes applicable to all in-scope roles but are particularly prominent in the case of Home Lenders. Most banks had at least one high risk practice for at least one role. These high-risk elements include:

- Practices that deliver significantly increased incentive payments as certain sales or other financial thresholds³⁶ are achieved (described as accelerator and accelerator-type payments in the Issues Paper, which may include certain modifiers³⁷);
- Practices that deny access to incentives otherwise available unless sales, referrals or cross sales targets are also met; and
- Practices that provide incentives based on cross sales such as add-on insurance products.

The Issues Paper³⁸ provides many examples of such practices. In each case, they deliver a strong incentive to pursue sales or cross sales in order to qualify for additional rewards.

Financial gateways operate by denying access to incentive payments otherwise achievable unless certain sales, referrals or cross sales targets are met. This may encourage inappropriate behaviour to ensure that the relevant targets are met. Although sometimes motivated by a wish to encourage staff to establish whether customers have unfulfilled needs, cross sales targets similarly increase the risk that some add-on products or additional products will be sold inappropriately. At the very least these devices increase the pressure to achieve sales (or referrals or other financial targets) as the target is approached.

Their existence also adds to the complexity of some incentives schemes, increasing the risk that staff or managers will resolve any confusion or uncertainty about the relative importance attached to different measures of their performance by assigning more emphasis to sales-related activities than is intended. Indeed, in the context of a deeply embedded sales culture their existence may be taken as confirmation that a high value is attached to sales performance compared to other aspects of performance.

The Review therefore recommends that banks cease such practices.

Recommendation 7

Variable reward payments no longer include any:

- Accelerators related to financial measures;*
- Accelerator-like modifiers related to financial measures;*
- Other mechanisms related to financial measures that have such an accelerator-like effect on the value of variable rewards available; and*
- Financial gateways, including but not limited to those that relate to number or value of cross sells*

³⁶ Several devices are currently employed by some banks for some roles (e.g. accelerators related to financial measures, and some 'accelerator like' devices that have a similar effect such as certain modifiers) that have the effect of increasing the reward achievable per unit of sales (or other financial measurement) once a certain threshold has been reached. The threshold may be a sales target or some proportion of such a target. The proportion may be higher or lower than 100%. There may be more than one threshold in a plan. Accelerators and accelerator-like devices apply the higher reward rate to all sales above certain thresholds. See Section 3.3.7 of the Issues Paper. One bank applies accelerator-like arrangements to a customer advocacy metric

³⁷ A 'modifier' increases or decreases the bonus or incentive payable once a condition has been met. Certain modifiers can have a similar effect to an accelerator whereby the total reward amount increases at a higher reward rate above certain targets – in this case, the higher rate of payment may apply to the entire reward, not just the incremental amount payable above the last threshold. Accelerator-like modifiers typically include exceeding financial targets. In one case, achieving cross sales targets can increase the reward otherwise payable to a Seller or a Manager by up to 70%. See Section 3.3.3 of the Issues paper

³⁸ See Section 6.2.4 of the Issues Paper

An argument was put to the Review in response to the Issues Paper that accelerator-like arrangements should be preserved to enable appropriate recognition of high performers. However, I believe that argument is misconceived.

It is conceivable that some consistently very high volume sellers may also consistently meet, to a high degree, the other performance expectations embedded in, for example, a scorecard. In those circumstances, it would be quite appropriate for that individual to receive a higher variable reward than another who performs less well, overall, if a personalised pay regime is in place. The important points are that (a) the trigger for a higher payment is not sales per se but their performance overall; and (b) the payment is not directly related to the value of sales secured.

Keep maximum variable reward low relative to fixed pay

One generally accepted principle is that the risk of aberrant behaviour is reduced if the potential reward from incentivised behaviour is appropriately small. My recommendations support that principle. In some circumstances the incentives potentially available to some staff can be very significant, especially for some Home Lenders and Managers³⁹. During a transition to more modest maximum variable rewards, a bank may decide to increase fixed pay of a consistently high performer to maintain their total remuneration while reducing the maximum variable reward attainable, consistent with this Recommendation. In some cases, protracted negotiations may be necessary to vary the terms of employment of some high-volume Sellers whose other attributes are consistent with ethical cultural norms.

If access to significant payments is necessary for a time, existing caps on the maximum available variable reward payment should be progressively reduced during the transition to the full implementation of these recommendations. In some cases, variable reward is currently uncapped.

One consequence of placing less reliance on access to variable reward to motivate and reward performance is that manager skill in managing performance consistently and in line with the expected values and behavioural norms will become more important. Accordingly, it is desirable also to upgrade leadership and management skill, which may require a significant investment if a sales culture is deeply ingrained (see also Section 5).

An issue for consideration is whether to provide guidance about the appropriate maximum variable reward. In providing guidance to implement the FOFA reforms ASIC was persuaded not to specify precise guidance. After much reflection, I, too, have been persuaded to adopt that approach. In adopting it, however, I want to be clear that some variable reward pay currently available seems to be excessively large and in those cases the mix between fixed and variable reward needs to be rebalanced, beginning as soon as possible. That applies particularly to some Home Lenders.

Recommendation 8

Variable reward payments ultimately amount to a relatively small proportion of fixed pay, with a progressive reduction in the maximum variable reward amount payable in any schemes that require a transition period to implement this recommendation

³⁹ Based on the data gathered, there were instances where Home Lenders received a variable reward which was almost up to six times their fixed pay and Managers received up to 1.5 times their fixed pay as a variable reward

5. Governance, culture and performance management

As previously noted, banks are complex organisations governed by interlocking systems that assign tasks to individuals and hold them accountable, remunerate staff in ways that seek to recognise good performance, and ensure compliance with the bank's policies and procedures. Often the intent of these systems can be moderated or magnified by culture within a business unit or team. The performance management, remuneration and cultural frameworks are most effective when they are aligned. Misalignment can cause confusion, if not outcomes inconsistent with the organisation's true intentions. My recommendations are therefore holistic, and not simply directed to remuneration in isolation.

5.1 Reassess culture

The Issues Paper acknowledged⁴⁰ that many banks had, in the past decade or so, pursued strong financial performance, leading at least some banks to re-orient the culture of the workforce from 'service' towards 'sales'.

Financial strength remains the bedrock upon which the effectiveness of the Australian banking system is built. Nevertheless, banks that acknowledged to the Review during the consultation process that such a cultural transition had occurred within their organisation, usually also stated that they were now seeking to reduce the emphasis placed on sales performance relative to customer service, without undermining the bank's financial soundness. I have been impressed by the number of senior bank staff who accept that cultural change is key to rebuilding trust in the industry and mitigating risks of poor outcomes for customers. The change they seek is to ensure that there is a genuine focus on ethical behaviour and assisting customers to identify and best meet their financial needs rather than making sales.

Not all banks are of that mind. Some maintained that their culture is ethical and more values or customer-driven than sales driven. These usually were smaller banks, often with a strong affinity to particular customer groups or regions. In some cases, sophisticated programs are in place continually to reinforce such a culture. Others, this being a smaller cohort, believe that a sales orientation remains important and that their internal risk mitigation strategies are sufficiently strong to minimise any risk of mis-selling.

Leadership is essential to change culture

Leadership is critical in successfully pursuing cultural change and can be exercised at many levels within an organisation. It is incumbent, of course, upon Boards and CEOs to drive and monitor cultural change. However, efforts to support and require cultural renewal are properly directed at all levels in the organisation.

A move to less sales-centric performance management and remuneration arrangements may challenge some managers whose experience is heavily sales oriented. The fact that many such managers may be in place because of past sales success suggests banks should take active steps to assess the cultural frame of reference of work groups within the organisation and identify any conscious or unconscious bias towards sales in preference to ethical behaviour and customer service. Programs should be developed to redress any such biases and ensure that 'local leaders' have a shared understanding of how the bank's revised policies should be implemented; and the skills to communicate performance goals, assess staff performance and give relevant feedback against more customer oriented performance criteria. Indeed, a key element of the change will be to assist managers to reorient the thinking of some staff (and, possibly, their own) away from extrinsic rewards based on sales

⁴⁰ The Governor of the Reserve Bank of Australia recently commented "In terms of behavioural issues...I think it comes down to incentives within the organisations, and that is largely remuneration structures...If there was one thing I could focus on...is making sure that the remuneration structures within financial institutions promote behaviour that benefits not just the institution but its clients." See http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review; http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/RBAAnnualReport2015/Public_Hearings

and pay towards a more intrinsic one based on achieving high levels of customer satisfaction and a quality relationship between the bank and its customers.

The credibility of such approaches to renew the culture would be enhanced if matched with a significant, well-resourced, visible and sustained program to change culture and reskill many managers to better ensure that their actions reflect the desired culture. Of course, there is no necessary conflict between 'sales' and either ethical behaviour or a customer focus. The intention is to make clear that the latter are to prevail in the event that circumstances may place them in conflict.

Indeed, the study commissioned by the Review into recent trends in UK retail bank remuneration notes that the journey of many UK banks towards customer focused remuneration arrangements has entailed significant cultural renewal supported by a substantial investment in leader development and training.

Recommendation 9

Each bank formally examine its workplace culture and institute formal processes to redress any conscious or unconscious bias towards sales in preference to ethical behaviour and customer service

Cultural renewal is a matter that each bank needs to pursue having regard to its own history and approaches. This is a matter for them. However, Recommendations 10 to 12, below, canvass three issues that I believe warrant serious attention.

5.2 Review the performance management system as well

The rewards and the performance management systems are two sides of the same coin. They work powerfully to reinforce desired behaviours when they are aligned but can cause confusion and leave opportunities for sales cultures to dominate when they are not.

The role of target setting featured prominently in the feedback provided during the first phase of the Review. Some staff and their representatives in the FSU argued that:

“The remuneration models in place encourage this behaviour because they do not value a responsible decision not to sell an inappropriate product. Rather, the banker who makes this decision risks losing out financially every time they forgo a sales opportunity. If they do it enough times they even risk their job security because of the threat of being sacked for failing to meet targets.

The union believes that a debate about the percentage value of a target, eligibility for rewards or what are acceptable incentives is a red herring. Any target driven sales regime (regardless of the remuneration amounts contained within) must see the customer as a sales opportunity to be exploited during every interaction, and require employees to ignore the genuine needs of the customer in their attempts to secure the sale.”

Feedback since the Issues Paper has confirmed that it is very difficult to run a large financial organisation successfully without setting goals or targets of some kind. The important issues are how targets are set, how they are communicated and how performance against them is assessed.

Targets are more likely to drive poor behaviour, for example, if they are reasonably perceived to be unrealistic in the context of the work group to which they are applied. And targets will less likely be accompanied by poor behaviour if they reflect the breadth of the objectives of the organisation, including in respect of its customers.

Moreover, not all indicators of desirable performance may be quantitative. Effective communication of the breadth of an organisation’s goals as its culture is changing may require recourse to a mix of quantitative and qualitative targets or success indicators, including in the customer domain. It seems likely, therefore, that performance will continue to be managed against some form of targets for a number of roles in many banks for some time. It will be important to ensure that such an approach is well aligned to reinforcing the objectives that underpin the preferred approach to variable reward payments.

In addition to undertaking an examination to identify any sales-oriented cultural biases (see Recommendation 9), the Review recommends that each bank reassess and, as necessary, revise their performance management system to ensure it will effectively support the goals of the proposed approach to remuneration. This, it seems, has been a key feature of reforms in the UK⁴¹.

Recommendation 10

Each bank examine its performance management system and make changes as necessary to ensure that the embedded signals and incentives to staff are aligned with Recommendations 2 to 8

Such a step would also be reinforced by separate proposals to revise the banks’ legally enforceable Code of Banking Practice⁴².

⁴¹ In Mercer’s report, see Appendix A for the Executive Summary, UK banks are said to now consider changes to the remuneration framework only following reforms to the performance management framework, to ensure reward as a whole reinforces the appropriate culture

⁴² The Final Report for the Independent Review of the Code of Banking Practice was released on 20 February 2017. It includes a number of recommendations made to revise the Code of Banking Practice. <http://cobpreview.crkhoury.com.au/>

5.3 Discretion is good but managers need support

Manager discretion may apply at various stages throughout the performance assessment and remuneration cycle. Practices vary across banks. However, discretion may be applied to determine:

- Whether or not an employee satisfies a gateway to be eligible to receive the variable reward (e.g. whether their behaviour is consistent with the bank's values and its expectations of staff);
- The assessment against specific elements of a performance scorecard or of matters relevant to a qualitative assessment of performance;
- An individual's overall performance (whether reflected in a scorecard rating or otherwise);
- The amount of incentive or variable reward payable; and/ or
- The aggregate bonus pool available for distribution to retail (and other) staff⁴³.

Manager discretion allows a wide range of information to be brought to bear in assessing an individual's performance or eligibility for an incentive. Such assessments can more readily also have regard to factors specific to a work group or team, such as a need to strengthen collaboration within a group or to strengthen relationships with the local community. They may also be informed by the manager's judgement of the contributions of individuals in circumstances in which reliable quantitative measures are difficult to construct.

Approaches that are entirely formulaic, on the other hand, also have strengths and weaknesses. A formula may bring clarity and certainty for the individual. However, rigid systems may be gamed, increasing the likelihood that complex checks and balances or gateways will be required and inducing costly investments in data collections and systems to identify and counter such behaviour. Even when a formula is applied to estimate the variable reward to which an individual may be entitled, discretion will still be required if a behavioural/ values-based gateway is in place.

The application of discretion in assessing eligibility for (or the size of) variable rewards is consistent with the approach recommended by some regulators such as the UK regulator⁴⁴. The Review accepts that discretion could be a valuable element of any effective performance/ remuneration system. This is subject to two qualifications, however, especially in the case of an approach that is purely discretionary (i.e. discretion is applied in determining an individual's overall performance and the individual's variable reward amount), at least until new cultural and leadership norms are deeply embedded:

1. Appropriately robust arrangements need to be in place to ensure consistent judgements inform manager discretion, both between managers and over time; and
2. That banks credibly undertake a sustained effort to change any predominantly sales-oriented culture and to strengthen leadership skills, especially of their middle managers.

⁴³ In some cases I understand this is intended to allow the Board or the most senior managers in the organisation to adopt a scorecard-like approach in determining the bonus pool available for distribution to staff, having regard to a range of factors including the financial performance of the organisation and its standing with customers and the public. Such an approach appears to be prevalent in the UK sample. In one case the bank applies discretion to establish a pool that is then distributed uniformly amongst certain groups of staff so as to strengthen a 'one-bank' team-based culture

⁴⁴ Refer to FSA, *Final Guidance Risks to Customers from financial incentives*, January 2013

Banks that employ manager discretion typically reported to the Review that arrangements are in place to support managers through peer review or other processes, to ensure managers are accountable and to moderate aberrant judgements. However, the Review has consistently heard from the staff that spoke to us and from the FSU that there is a real risk that manager judgements are coloured by a deeply ingrained sales culture. Such a culture can be reinforced if those managers are themselves assessed on the basis of sales-related measures. A credible change to the incentives arrangements for frontline staff is therefore likely to require both the remuneration of managers aligning with the objectives proposed for frontline staff (Recommendation 13) and that effective programs be deployed to strengthen leadership and middle manager skills.

Recommendation 11

Each bank ensure Managers reflect predominantly an ethical and customer focus when: communicating with staff, exercising any discretion while managing performance, and in allocating variable reward payments

5.4 Reassess use of leaderboards and recognition programs

Personal or team-based assessments and rewards?

Some banks base rewards or other recognition programs and campaigns on branch or team performance, or use branch performance as a gateway to access individual rewards. These may relate to sales-based performance measures or non-financial measures. Branch performance may also be ranked and disclosed via leaderboards and the like, or through recognition schemes that recognise and reward good sales performance.

Views differ about whether team-based approaches ameliorate or magnify any risk of mis-selling. Sales-based reward systems, for example, will continue to incentivise sales, whether the targets are personal or team-based. Some believe that team-based targets reduce the pressure on individuals to sell. However, some staff argued that peer pressure to perform can be heightened when targets are team-based, especially when combined with management practices that publicise and provide personal recognition to strong performers within the team (such as 'leaderboards').⁴⁵

Other staff have reported that team targets can be translated into personal targets by some managers as part of their approach to staff performance management. Manager behaviour towards individuals, especially those in danger of not reaching their (share of) target(s), may in turn be adversely affected by how well the branch is performing if the Manager's bonus is tied to branch performance.

The Review is agnostic about whether targets and performance measures more broadly should be personal or team based. Team based approaches would seem a better option when pursuing customer focused outcomes since the strength of the relationship with a customer is likely to improve if staff work actively together to support customers and develop a seamless relationship with them. However other approaches may be equally effective.

Leaderboards and similar sales-focused devices

Consistent with the need to send clear signals to frontline staff that a better balance is to be struck between sales and customer oriented measures of performance I propose that banks reconsider the use of leaderboards, recognition programs and campaigns based predominantly on sales⁴⁶ and similar methods in the management of staff, with a view to phasing them out whenever possible. This could well be informed by an investigation to establish whether such techniques are used by managers informally as part of their management of their team.

A strong case can be made that the continued use of leaderboards, sales-centric recognition programs and similar devices will be perceived as the continuation of an embedded sales culture. If their continued use is sanctioned, however, this should only occur if the focus includes a range of customer and other measures that reflect the breadth of the goals applicable to the role. This suggestion also reinforces the need to re-engage at least some managers, as part of the cultural renewal of the organisation, in how to secure good performance if sales are no longer the principal benchmark of success. It is notable that the need to strengthen leader development and management skills are strong sub themes to Recommendations 9, 10, 11 and 12. In many instances this may require a significant investment by the relevant bank.

Recommendation 12

Each bank reconsider what use is made, if any, of leaderboards, recognition programs and campaigns as well as any other methods that have similar effect (such as informally in branches or call centres) and ensure any continuing role in using these methods is consistent with the intention to de-emphasise sales relative to ethical behaviour and customer outcomes

⁴⁵ For example, 'huddles' to share suggestions to assist 'slower' Sellers to meet their targets, which some staff reported can occur several times a day in some work groups

⁴⁶ Such programs are usually based on providing extra benefits to top sellers, either over a period or during a sales campaign. Rewards may be small (for example a low valued voucher) or large (an expensive overseas conference). They may attract no specific reward apart from recognition amongst peers and superiors. Individuals will receive a reward by solely meeting sales targets which may be on an individual or team/ branch basis. For further detail, refer to Section 3.4.1 of the Issues Paper

5.5 One in, all in...

In a hierarchical organisation like a large bank the extent of consistency and alignment of the performance assessment criteria in play at each layer of the organisation is important to achieving a consistent cultural orientation. The quantum of variable reward available is likely to vary with seniority. The precise measures that capture the nature and quality of an individual's contribution is likely to vary with their role. Nevertheless, some principles should be common across all layers of the organisation, namely:

- Assessments of individuals to be based on overall performance against a number of measures; and
- Sales or financial measures more generally should not dominate customer focused criteria in that assessment.

An argument has been made to the effect that it is easier to achieve this alignment of objectives between the CEO (or the 'C-suite' more broadly) and frontline staff such as Tellers than it is between those on the frontline and middle/ group managers or some single product sales staff member. The most senior managers are likely to be assessed against a broad range of measures, for example, rather than a direct relationship to sales per se. The performance measures applicable to the middle/ group managers, on the other hand, may be dominated by the success of the product lines for which they have responsibility.

Time did not permit (and the Terms of Reference did not require) comprehensive data gathering about the remuneration arrangements of those more senior than the immediate managers of in-scope retail bank staff. A product or sales focus may well be a legacy of past approaches to performance management and rewards for such middle managers. If so, it reinforces the need to reorient those performance measures now to include customer and other measures with a weight that reflects the proposed new norms. This is particularly important for those managers whose messaging to more junior staff may be otherwise coloured by the more sales-oriented metrics of their own performance or remuneration arrangements. More generally, it reinforces the need to ensure that any cultural renewal is directed at all levels within the organisation.

Recommendation 13

Consistent with the objectives of the recommendations for frontline staff, the variable reward payment and performance management arrangements of all senior and (retail bank) middle level executives be based on:

- a. Their overall performance against a number of measures that reflect the nature and breadth of their role; with*
- b. Customer oriented, ethical behaviour and non-financial measures accounting for the dominant factors in that assessment*

5.6 Strengthen governance

In view of the public interest in this issue, I suggest that Boards and senior management should visibly increase their oversight to ensure that policy changes to variable rewards and performance management are endorsed by them and speedily implemented as intended. This would be particularly valuable during the early years of a transition to the full implementation of new arrangements. Effective feedback from frontline staff would be a valuable component of such efforts, of which whistle blower channels⁴⁷ are an important fail safe.

Australian Prudential Regulation Authority (APRA) guidelines⁴⁸ already impose certain obligations on Boards to ensure that the remuneration of critical staff is consistent with the prudent management of risk. Many jurisdictions impose similar requirements. These often stem from an assessment that poor governance contributed to the Global Financial Crisis and/or because misbehaviour from some key risk takers in the past imperilled the soundness of some globally significant financial institutions. APRA's statutory focus is upon ensuring that regulated entities meet their financial promises under any reasonably foreseeable adversity. Their focus is thus upon preventing financial failure. An important underpinning of this recommendation is an assessment that the community now expects that Boards will also pay close attention to the management of the risk of poor outcomes for customers, and the associated reputational risks.

Recommendation 14

Boards and Chief Executives:

- a. Visibly and effectively oversee the implementation of these recommendations for at least the next five years and report publicly, in their Annual Report to shareholders, for example, on how retail staff are remunerated and their performance assessed; and*
- b. Ensure that effective, safe channels are in place to obtain feedback from frontline staff about their perceptions of the effectiveness of efforts to reform the bank's culture, performance management and remuneration arrangements, including in respect of whistleblower arrangements*

I suggest also that a further independent examination be conducted in three years' time to assess how well these recommendations have been adopted. That assessment should have regard to the arrangements proposed by each bank for the performance cycle that begins in 2020. Such a review could also address whether legislative options or regulatory change should be seriously considered.

Recommendation 15

The ABA commission an independent reviewer to report publicly in three years about how well banks have changed their practices and implemented the recommendations and assess whether further regulatory or legislative change is required

⁴⁷ The ABA released new guiding principles in December 2016 to assist banks in ensuring that their whistleblower policies meet the highest standard. In addition, an inquiry was conducted by the Parliamentary Joint Committee on Corporations and Financial Services into whistleblower protections in the corporate, public and not-for-profit sectors

⁴⁸ APRA CPS510 and PPG 511, for example provide guidance to banks about the management of financial risks to the institution stemming from remuneration arrangements

5.7 Improved clarity for the customer?

A key part of this Review is to assess whether, and how, product based payments and product sales commissions could lead to poor customer outcomes.

The legal framework

As set out in the Issues Paper, the Australian regulatory framework imposes a range of requirements on banks in the sale of financial products that are broadly aimed at preventing poor customer outcomes. These requirements apply before sale, at the point of sale and post-sale. They include obligations about the provision of advice, and disclosure obligations intended to address asymmetry of information between banks and customers as well as mechanisms for complaints handling and dispute resolution. The legal framework draws distinctions between the provision of factual information to allow a consumer to make informed decisions, the provision of general advice and the provision of advice tailored to the circumstances of the individual.⁴⁹ The legal framework also places stronger obligations upon the Seller as the level and nature of information exchange progresses.

Appendix B, prepared by Gilbert + Tobin, provides a fuller summary of the legal framework.

An issue for the Review relates to the distinction between information and advice. The FSA's tests include that "customers understand the key features of the product or service and whether they are being given advice or information". Retail bank customers have a range of financial literacy skills and, in all likelihood, a range of understandings and expectations of the nature of their relationship with their bank(s) and with those with whom they deal in the bank. Some have high financial literacy. Others have less well developed skills but extensive knowledge through recourse to comparison sites and the like. Others are not literate about financial matters and expect their long-standing relationship with a bank will be reflected in their being 'looked after' by the bank. Some commentators argue that banks should therefore be held to a higher standard than most other sellers⁵⁰.

It would be surprising if the legal distinctions between product information, and general and personal advice under the Corporations Act are well understood⁵¹ by all bank customers. Given the current levels of mistrust in financial institutions in general, and banks in particular, this may itself become a source of confusion or suspicion about the behaviour of banks. Following the report of the Financial System Inquiry (FSI), in particular the Inquiry's Recommendation 40⁵², the Government has announced that it will rename general advice to improve consumer understanding. It has undertaken to consult a wide range of stakeholders and to conduct consumer testing before finalising the new term⁵³. It remains to be seen, however, whether a change of name will be sufficient assistance to consumers to understand the basis on which they are interacting with a financial services provider and eliminate any confusion or misunderstanding.

Moreover, although disclosure requirements⁵⁴ have been expanded over time to require the provision of more information to customers before a transaction is concluded, it seems that these mandatory documents have become so complex that they are frequently not read by the purchaser. A further regulatory response has been to require the seller to provide, in addition to the product disclosure statement (PDS), a simpler statement of 'Key Facts'. These apply to some products such as credit

⁴⁹ See Chapter 7 of the *Corporations Act 2001*; Chapter 3 and Schedule 1 (National Credit Code) of the National Consumer Credit Protection Act 2009

⁵⁰ See Section 6.3 of the Issues Paper, which examines three arguments commonly advanced

⁵¹ There are different obligations that apply when providing factual information, general advice and personal advice (as noted in Appendix B). Higher obligations apply when providing personal advice. When personal advice is provided the adviser must consider and act in the customer's best interest. See *Corporations Act 2001* ss 766B and 961B

⁵² FSI recommends the renaming of 'general advice' and requirement for advisers and mortgage brokers to disclose ownership structures http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx

⁵⁴ A Product Disclosure Statement (PDS) has become mandatory in many cases. These disclosure statements, which are required throughout the financial services industry, are typically written by lawyers to protect the seller legally from the risk that a misrepresentation will be made about the product

cards, home building insurance and home loans.⁵⁵ There may be scope to extend this approach to other product lines such as consumer credit insurance, for which there are cases that suggest that customers did not appreciate the terms of the policy they had been sold.⁵⁶

Arguably the complexity of financial services presents challenges not only for the purchaser. In a large institution with many products available for its customers, there may well be misunderstandings amongst customer-facing staff about the strengths and weaknesses of a product. Banks typically invest significant resources in staff training to minimise the risks of such misunderstandings. Many also undertake compliance checks to guard against the risk that misinformation will be provided to a customer or that misrepresentations will be made, either inadvertently or because of incentives staff receive to sell.

As part of the Government's response to the FSI, *Improving Australia's Financial System 2015*, the Government accepted the FSI's recommendations to introduce:

- Design and distribution obligations for financial products to ensure that products are targeted at the right people (FSI Recommendation 21); and
- A temporary product intervention power for ASIC when there is a risk of significant consumer detriment (FSI Recommendation 22).

Both of these proposals are designed to prevent consumer harm. Submissions were requested to respond to these proposals by 15 March 2017⁵⁷. It is to be hoped that timely action will follow to strengthen this aspect of the legal framework.

I understand, that one of the proposals (proposal 3.3) in the consultation paper is that distributors must put in place reasonable controls to ensure products are distributed in accordance with the issuer's expectations. Identifying the extent of any risk of mis-selling from remuneration practices, and adopting an appropriate mitigation strategy, is an example presented of such a control. I support this being explicitly included as a control measure, on the understanding that a bank's responsibilities would apply equally in respect of its staff and any third party distributors of the bank's products.

Similarly I would support action in respect of ASIC's powers to intervene temporarily, if necessary, to prevent significant consumer detriment. The proposed intervention powers do not explicitly extend to conflicted remuneration, however. In Section 6.1.2 I suggest there is a case to look again at that restriction.

Poor outcomes for customers

I noted in the Issues Paper that it is perhaps surprising that there is no commonly accepted definition in Australia of a poor customer outcome. In the UK, the FSA⁵⁸ uses the term 'mis-selling' as a proxy for poor customer outcomes. Mis-selling is defined by the FSA as a "failure to deliver fair outcomes for consumers". They go on to list fair outcomes as including:

- Customers are treated fairly;
- Customers understand the key features of the product or service and whether they are being given advice or information;
- Customers are given information that is clear, fair and not misleading – information that enables them to make an informed decision before purchasing a product or service or before trading; and

⁵⁵ See *Insurance Contracts Act 1984* s 33C; *Insurance Contracts Regulations 1985* rr 9, 13 and 21; *National Consumer Credit Protection Act 2009* ss 133AC, 133AD and 133BC

⁵⁶ Refer to Consumer Action Law Centre submission dated 13 September 2016 case study 1 - <http://retailbankingremreview.com.au/wp-content/uploads/2016/10/Consumer-Action-Law-Centre-Submission.pdf>

⁵⁷ See <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Design-and-distribution-obligations-and-product-intervention-power>

⁵⁸ The FSA was the body responsible for the regulation of the financial services industry in the UK between 2001 and 2013. Since then, the FSA responsibilities have been split between the Financial Conduct Authority and the Prudential Regulation Authority

- Customers buying on an advised basis are recommended suitable products.⁵⁹

Feedback received after the publication of the Issues Paper is that different parts of the Australian regulatory framework effectively incorporate all these elements. Appendix C, prepared by Gilbert + Tobin, provides a mapping of these tests against the Australian legal framework.

The Consumer Action Law Centre, argue in their submission that the FSA tests do not go far enough to protect consumer interests, saying:

“The FSA conception neglects to address whether the consumer derives a benefit or value for the product or products purchased, and does not address the need for after-sales service or the long term nature of financial services—which require the maintenance of an ongoing client-trader relationship.”

Other submissions have supported the extension of certain aspects of FOFA to the sale of retail banking products. They argue that the so called ‘best interests’ duty should apply to all interactions between customers and all retail banking staff (or, at least, the Sellers amongst them). In certain circumstances bank employees will be required to act in the best interests of their customer and to place the interests of their customer ahead of their own. At present, the best interests duty that is part of the FOFA regime only applies to situations when bank staff provide personal financial advice (advice provided where the employee has, or in the circumstances a reasonable person might expect them to have, considered one or more of a retail customer’s objectives, financial situation or needs). A modified version of the best interests duty applies when the financial advice relates to basic banking products, general insurance products and consumer credit insurance (or a combination of the three).⁶⁰

Currently as basic banking and insurance products in retail banks are commonly sold without advice (i.e. with the provision of factual information and relevant disclosure) or with general advice, this means the best interests duty under FOFA does not apply or only applies in a modified form (in the case of personal advice) in the context of most retail banking. In addition, credit products (such as credit cards, personal loans and mortgages) sit outside the FOFA regime. Accordingly, most retail banking roles that are in-scope of this Review are in practice generally exempted from the strongest of the FOFA requirements in that they generally involve work that does not trigger them. All, however, are covered by the general consumer protections outlined in Appendix B.

It is important to note that a significant number of submissions and representations to this Review specifically raised concerns with the inappropriate sale of add-on insurance products and cross selling of insurance products that were not wanted or suitable for the customer; for example the sale of consumer credit insurance to customers who cannot claim on the policy.⁶¹ My recommendations are intended, in part, to significantly reduce the risk of inappropriate cross selling, including of insurance products that are not appropriate for the customer’s needs. Effective action by the government to implement the FSI’s Recommendation 21 (see last sub-section) should also assist. However, the point of sale is not the only concern in respect of insurance products, as it is often not until a consumer attempts to claim on a policy (or their claim is denied) that they become aware that it was not suitable for their needs.

ASIC’s work on life insurance is instructive in this regard. ASIC found in its recently published Review of Life Insurance Claims⁶² that some insurers have included incentives and performance measurements for claims-handling staff that are in apparent conflict with the obligation to assess each claim on its merits. ASIC made a number of recommendations including that the government should strengthen the legal framework covering claims handling. The Minister for Revenue and Financial Services⁶³ agreed to

⁵⁹ FSA, *Final Guidance: Risks to customers from financial incentives*, January 2013, p 9

⁶⁰ As noted in the Issues Paper (p17) the policy rationale for excluding basic banking products and general insurance is that these products are recognised as simple in nature and are more widely understood by consumers. See also the Australian Government Treasury submission to the Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011* at <http://www.aph.gov.au/DocumentStore.ashx?id=068da878-d79f-4306-a5e9-c58e8ef2ed0c>. As Treasury noted, because these products are recognised as being simple in nature and more widely understood by consumers “This means that there is a lower risk of consumer detriment in relation to the provision of advice on these products. For this reason, exclusion from the obligation to give priority to the interests of the client. [and a modified best interests obligation]... more appropriately balances the benefits to consumers with the compliance costs to providers.” (p 5-6)

⁶¹ See Issues Paper, p 10

⁶² See: <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-498-life-insurance-claims-an-industry-review/>

⁶³ See: <http://kmo.ministers.treasury.gov.au/media-release/092-2016/>

“removing the current exemption for ‘insurance claims handling’ from the definition of a ‘financial service’ in the Corporations Act” noting that removing such an exemption would allow ASIC to take action on conduct such as incentive schemes for claims staff that conflict with insurer’s obligations.

The design of insurance products is beyond the Terms of Reference of this Review and has not been the subject of our consultations. Nevertheless, the Minister’s proposal seems sensible, particularly if it is extended to general insurance and is not confined to life insurance. Similarly, there would seem to be merit in the proposal (supported by consumer advocates and ASIC among others) to extend to insurance contracts the prohibition of unfair terms in standard form contracts under the Australian Consumer Law.

More generally, this Review has advanced several proposals that are intended to help improve trust, namely further steps to mitigate the risk of mis-selling that arises from some product based payments in retail banking. In that respect, both the perception and the actual scale of the risk are important. If implemented in the spirit in which they are intended, I believe they would make a substantial contribution over time to restoring trust. However, regulatory reform to make it easier for customers to understand the nature of the services they can legitimately expect from their bank will also assist; as will reforms to strengthen ASIC’s powers of intervention, including (if necessary) in respect of conflicted remuneration⁶⁴. Credible, timely responses to the other elements of ABA’s Banking Reform Program will also be critical (and especially whistle blowing and updating of the Code of Banking Practice).

⁶⁴ See also Section 6.1.2

6. Third parties

The work of the Review in respect of third parties has been dominated by issues associated with the remuneration of Brokers, Aggregators and Introducers and Referrers in the mortgage market. This reflects the tenor of the discussions held with banks. However other third party relationships considered included some Franchise arrangements and other arrangements such as commercial equipment finance brokers, commercial and retail brokers and agribusiness lending.

6.1 Reform the remuneration of Aggregators and Mortgage Brokers along similar lines to staff

In addressing the remuneration of Mortgage Brokers, I have had regard to both the processes that have informed this Review and the recent ASIC Report into that sector.

The following is intended as a contribution to the public debate, since the Treasurer has called for submissions on the issues raised in the ASIC Report by 30 June 2017. I believe that my analysis and proposals are consistent with ASIC's findings and are aligned with specific proposals in the ASIC Report. I believe that my suggestions are feasible, though challenging to deliver. Pursuing these proposals may entail a degree of risk. Such risk should be substantially mitigated, though, if banks are transparent about their willingness to participate in this work, report publicly on their progress and ensure they maintain a competitive offering to potential borrowers. It would also assist if aspects of it were progressed in conjunction with ASIC.

In considering these matters, the Review has been conscious that many potential borrowers value the service that Mortgage Brokers provide. As well as advice about where to source a loan, this service may include assistance to new borrowers to navigate the home loan process and education about this type of debt instrument and its implications. Any compulsory move to reduce or eliminate commissions to Mortgage Brokers in Australia should consider whether it is best accompanied by regulatory change sufficient to ensure that the resulting arrangements preserve competition⁶⁵.

Mortgage Brokers typically have a commercial relationship with an Aggregator, which maintains a list of home lenders. Mortgage Brokers draw from this list when working with potential borrowers. Successful mortgages attract a payment from the lender⁶⁶ which is directly related to the value of the loan drawn down. Typically, they receive a payment soon after the loan is drawn down, with further payments over time for some years, provided the loan remains in place (which ASIC calls the "standard commission model" of upfront and trail commissions⁶⁷).

Upfront and trailing commissions incentivise sales. Where a Mortgage Broker can earn a significantly higher commission if they sell one product rather than another⁶⁸, they are incentivised to sell that product. Similarly, commissions that are based on the value of the loan create incentives for Mortgage Brokers to recommend that borrowers take larger loans⁶⁹. ASIC states in its report that upfront and trail commissions 'create conflicts of interest', which the evidence available to them suggests has real consequences⁷⁰.

Several factors suggest that there are significant risks of mis-selling attached to current arrangements to remunerate Mortgage Brokers. These include:

⁶⁵ In the Netherlands, commission payments to Brokers have been banned. However, some Australian banks rely very heavily on Brokers for key components of their business, maintaining only a limited branch network, and Mortgage Brokers contribute a substantial part of the new mortgage activity of even the largest banks. The changes in the Netherlands were accompanied by regulatory changes intended to preserve competitive neutrality between Broker and bank channels. The role of Mortgage Brokers in the Netherlands is more substantial than that of most mortgage Brokers in Australia since they also provide broad financial advice

⁶⁶ Usually to the Aggregator, which passes some or all of the commission on to the Brokers as the commercial arrangements between them require

⁶⁷ Refer to ASIC's Report para. 26

⁶⁸ Para. 29 of the ASIC Report refers to this as a 'lender choice' conflict of interest in its report and found evidence in support of it

⁶⁹ Para. 30 of the ASIC Report refers to this as a 'product strategy' conflict of interest in its report and found evidence in support of it

⁷⁰ Refer to ASIC's Report para. 29

- Although there is some variation, that upfront and trail commissions offered by banks, as per the ASIC Report, are clustered around 0.50% to 0.80%. and 0.10% to 0.35% respectively⁷¹;
- That banks seeking to increase market share through a sales campaign often improve both the terms and conditions they offer the borrower and the commission they pay the Mortgage Broker;
- That some banks told me during consultations that they believe they need to offer volume based incentives to Mortgage Brokers over and above the upfront and trail commissions to remain competitive;
- That, similarly, many banks said they need to offer significant 'soft dollar' payments to Mortgage Brokers;
- That data presented to the Review during the consultation process (and confirmed in the ASIC Report⁷²) show that mortgages arranged through the broker channel are likely to be larger, paid off more slowly, and more likely to be interest-only loans than those provided to equivalent customers who dealt directly with bank staff; and
- A few banks reported during consultations that they had changed (or were intending to change) trail commission arrangements because some customers draw down a larger loan amount than they need, with the surplus being deposited in an offset account or a loan account (i.e. as a redraw amount).⁷³

Feedback from Mortgage Brokers and Aggregators after the publication of the Issues Paper was to deny that these factors imply an excessive risk of mis-selling, noting that checks and balances are in place to address such risks and that the ultimate responsibility to assess the credit worthiness of the borrower and determine whether to provide a mortgage lies with the relevant bank. They note also that the banning of mortgage exit fees in 2011 has facilitated switching between lenders, which provides a simple remedy to a customer who, after taking a loan, discovers that another product better meets their needs. In such a case the trail commission ceases, which Mortgage Brokers believe is an important disincentive to mis-selling.

Neither ASIC nor this Review has found compelling evidence of systemic harm that would warrant the outright banning of such payments. Nonetheless I believe, analogously to direct sales channels, changes can and should be made to reduce the risk of mis-selling, including in view of the heightened public concern about the potential for mis-selling in parts of the financial services sector currently.

6.1.1 Cease additional payments

I propose that banks cease:

- volume based incentives that are additional to upfront and trail commissions;
- temporary increases in commissions to support campaigns to increase product sales; and
- soft dollar payments.

These proposals are intended to improve transparency and reduce the risk (actual or perceived) that such payments increase the risk of mis-selling. Each of these payments is unrelated to the effort required by the Broker to service a potential borrower's needs. The ASIC Report has specifically called for Mortgage Brokers to move away from these payments, stating that this Review offers the banks an opportunity to progress that objective⁷⁴.

⁷¹ Refer to ASIC's Report para. 415 and 427 for further detail

⁷² ASIC confirmed this finding both in the raw data and after making comparisons of borrowers with like characteristics

⁷³ This may not significantly disadvantage the borrower. It may increase the Broker's upfront commission, however. A few banks said during consultations that they had modified trail commissions so they are only payable on the borrowing net of funds in an offset account. CHOICE reported some instances in which potential borrowers were encouraged to take a larger loan than they needed during a mystery shop. See <https://www.choice.com.au/money/property/buying/articles/mortgage-broker-shadow-shop>

⁷⁴ See ASIC's proposals 2 and 3, outlined in paras. 119 to 123 of the ASIC Report

An argument has been put that customers are not disadvantaged if a Mortgage Broker favours one bank's loan over another offering equivalent terms because the first bank offers the Mortgage Broker a better deal on either commission or on additional payments such as these. That argument is not without merit. What it overlooks, however, is that a customer may subsequently incur higher transaction costs (including in respect of their own time) either in managing the systems of two banks or through incurring the costs associated with changing their accounts to the bank with which they hold the mortgage.

Also overlooked is that such additional payments may not be disclosed to the customer. It is unclear, for example, whether Mortgage Brokers disclose the impact of potential volume based payments or 'soft dollar' contributions to a potential borrower. The extent of any disclosure may depend on whether the Mortgage Broker considers these to be payments "in the nature of the commission"⁷⁵, including because those payments most likely are uncertain at the point of sale. At the least a move away from current arrangements will improve transparency.

The proposal to cease additional volume based payments for these third parties is consistent with the recommendations to move bank staff who are Home Lenders away from variable rewards linked directly to sales and to cease accelerators and similar devices related to financial measures that increase the reward per unit of sale as the volume sold rises.

A commercial negotiation will no doubt be required to ensure that both parties, the relevant bank and the third parties, are satisfied that sufficient remuneration is available to compensate the third parties for the effort required to invest in the necessary systems and support potential borrowers to make informed choices about competing mortgage products. A fundamental principle is that any changes to remuneration should preserve competition in the mortgage market.

Recommendation 16

In respect of remuneration of Mortgage Brokers:

- a. *Banks cease the practice of providing volume based incentives that are additional to upfront and trail commissions;*
- b. *Banks cease non-transparent soft dollar payments in favour of more transparent methods to support training etc.; and*
- c. *Banks cease the practice of increasing the incentives payable to brokers when engaging in sales campaigns*

6.1.2 Explore new approaches to governance and remuneration

Banks have generally adopted risk mitigation devices to help guard against mis-selling through their third party channels. Practices⁷⁶ vary but may include: examining a sample of documentation that details the nature of the information exchange between borrower and Mortgage Broker; monitoring complaints about Mortgage Broker behaviour; assessments of the quality of the documentation presented to the lender for their consideration; the Mortgage Broker's success rate in submitting prospective loans that pass the lender's credit checks; the operation of trail commissions etc. However, the bank is typically not the direct employer of the third party brokers through which it deals, which reduces the number of avenues available to mitigate the risk of inappropriate behaviour.

⁷⁵ As per the ASIC Report para. 528, "Aggregators pass on the commissions received from lenders to broker businesses or brokers in one form or another. In doing so, they receive payment from the broker business or broker for their aggregation services"

⁷⁶ The ASIC Report questions the effectiveness of some of these, suggesting the focus is on 'portfolio level' indicators rather than individual loans (see ASIC's Report para. 999)

In this section I advance two key proposals intended to reduce the strength of the link between loan value and remuneration payable to a Mortgage Broker and to strengthen governance within the Broker channel, respectively, without undermining the effectiveness of the broker channel⁷⁷.

In respect of governance, the ASIC Report states that it:

“Did not identify a clear focus on ensuring good sales conduct and positive consumer outcomes either in the design or review of remuneration structures or in monitoring the conduct of brokers or lenders’ staff... Lenders’ oversight of aggregators and broker businesses tended to focus on a portfolio view of negative loan performance (e.g. arrears and defaults) or other circumstances that may result in commission clawback (such as early termination of loans). However, this oversight did not seem to be intended to drive good sales conduct or positive consumer outcomes.”

I propose that banks work with their commercial partners to put in place new approaches to governance in the Mortgage Broker channel that approximate as closely as possible the general approach to performance management (and remuneration arrangements, see below) proposed in earlier recommendations relating to staff. Of course, the arrangements are not expected to be exactly the same across the broker and direct (i.e. staff) channels. The intention, nevertheless, is that Mortgage Broker performance be assessed holistically, with a more customer-centric orientation, along similar lines to the above proposal in respect of staff, and not simply or principally in respect of sales⁷⁸.

A certain amount of trial and error may be necessary and no doubt commercial discussions will occur to apportion costs. Both the bank and the Aggregator and each Mortgage Broker will have commercial interests that they need to protect. Success, however, may result in less conflicted and less risky approaches to remuneration than currently apply, without undermining the viability of mortgage broking.

This recommendation is addressed to each bank individually, but particularly to the largest banks and to banks with an ownership interest in an Aggregator (i.e. vertically integrated). Each bank, in turn, will need to decide whether to adopt this suggestion. I encourage each to do so, since it is in the bank’s long term interests to explore options to minimise reputational risks in commercially appropriate ways. I suggest that the process be very transparent; that the relevant parties make public how they are responding to this recommendation; and that banks report publicly on the outcomes. I also encourage ASIC to play an active role in facilitating revised governance along these lines in the industry (see also Recommendations 18 and 19). I understand that it has regulatory powers that could be employed to assist in the implementation of this recommendation, if necessary, whether through a class order or a new licence condition.

Recommendation 17

Banks adopt, through negotiation with their commercial partners, an ‘end to end’ approach to the governance of Mortgage Brokers that approximates as closely as possible a holistic approach broadly equivalent to that proposed for the performance management of equivalent retail bank staff

The second proposal is to move away from payments to Aggregators and Mortgage Brokers that are related to the value of the loan in favour of arrangements more nearly tied to the effort required to secure a loan. Some argued to the Review that loan size and loan complexity are correlated, providing a justification for current arrangements. More persuasive to me were arguments that loan complexity,

⁷⁷ The ASIC Report para. 931 also notes: “Responses generally indicated that many of the factors that ASIC considers are important indicators of culture are not adequately addressed by lenders, aggregators and broker businesses. Although entities may seek to address their culture in other ways, we have highlighted potential risks to entities by not taking the steps discussed in this section”. See also para. 932 and 933 for further detail

⁷⁸ The arguments in favour of a move to a more customer-centric approach and away from remuneration and performance assessments directly related to sales volume or value are canvassed in Sections 4 and 5 and will not be repeated here. The essence of that approach is that individuals are ultimately to be managed and rewarded on the basis of an assessment of their overall performance against a range of factors such as sales achieved, compliance with appropriate behaviours and policies, and customer satisfaction etc

and thus the effort required by Mortgage Brokers to secure a loan on behalf of the consumer, may be more closely correlated with the characteristics of the borrower. An alternative to a value-related commission, therefore, might be fees for service paid by the bank but set either as a flat amount or related to the characteristics of the borrower.

ASIC has also proposed⁷⁹ that lenders improve the standard commission model so that “brokers are not incentivised purely on the size of the loan”. They suggest commissions could be affected by a range of factors, including the LVR⁸⁰ of the loan, the loan payment type, or the credit risk of the borrower and be structured in ways that do not encourage “the creation of larger loans that initially have large offset balances”. They further suggested that the “ABA and other stakeholders – including other lenders and Mortgage Brokers – should consider how they can work together to respond to this proposal”. Others have suggested in consultations that commissions could be modified to reflect the quality of the interaction between broker and borrower. In effect commissions would be governed by similar principles that banks would apply in assessing performance against a scorecard for their staff.

Some commentary has questioned the role of ABA or the banks in this matter. However, banks have a legitimate interest, especially because they both provide the funds that support the operations of Mortgage Brokers and bear the risks (financial and potentially reputational) if a loan is inappropriately large or inappropriately structured. Ultimately, a commercial negotiation would be required to establish such arrangements and preserve the financial viability of the mortgage broking industry. In broad terms, average remuneration per brokered mortgage may not be dramatically different to the current remuneration, but the risks (perceived and actual) of poor customer outcomes would be reduced. I would envisage that some form of trail payments would continue⁸¹, with trails under existing arrangements ‘grandfathered’. To be clear, it is a fundamental principle of this Recommendation that, in any new arrangements, competition should be preserved and the viability of the mortgage broking industry maintained. It is for this reason that client funded fee arrangements are not supported by the Review.

It is possible that an individual bank would be unwilling to move in this direction for fear of suffering a first mover disadvantage. This could arise, for example, if a fee based payment structure led to a lower payment for simple cases and a larger payment for complex ones, relative to current commissions (or the reverse for a fixed fee approach). A third party may favour the lender offering the higher payment, other things equal, with unpredictable consequences for a bank’s market share, its risk profile or average costs. This suggests strongly that progress will be slow and remain essentially commission-based unless a legally safe structure can be created to proactively explore options for reform.

I therefore propose that the banks with a significant recourse to the Mortgage Broker channel move to investigate and, as soon as possible, adopt an alternative payment system with strong oversight by ASIC. Each bank should report regularly to ASIC on their progress in implementing this recommendation (and Recommendation 17), with enhanced oversight by ASIC (and other regulators as necessary) to monitor market responses and assess whether a case should be made for regulatory change to support it. I believe this work should commence quickly and conclude as soon as possible.

There would be great value in ASIC becoming formally involved in this work. Indeed, I strongly encourage ASIC’s participation, if resources permit.

⁷⁹ See the ASIC Report proposal 1 in para. 115 to 119

⁸⁰ ASIC’s Report identified that upfront commission paid by all lenders to Aggregators ranged from 0.375% to 1.1% as disclosed in their term sheets - see para. 415. ASIC also identifies the factors that could affect the rate of upfront commission paid on a specific loan which includes LVR, credit risk of the borrower, type of home loan, credit limit of the home loan, loan payment type and whether the loan was an owner-occupied or investment property – see para. 419 to 425 for details

⁸¹ This is an ‘on balance’ judgement. Trail payments provide an incentive to brokers to ensure that a mortgage is appropriate to the customer’s needs and reduces the incentive for brokers to recommend unnecessary refinancing of loans in order to qualify for a new ‘upfront’ commission. However some churn is desirable and should not be discouraged – for example if loan products become available that better suit the borrower’s needs

Recommendation 18

Banks adopt approaches to the remuneration of Aggregators and Mortgage Brokers that do not directly link payments to loan size and reflects a holistic approach to performance management (see Recommendation 17):

- a. *To establish in a timely fashion how best to address Recommendations 17 and 18, banks with a significant recourse to the Mortgage Broker channel, but at least the four major banks, each report regularly to ASIC on their progress; and*
- b. *With enhanced oversight by ASIC (and other regulators as necessary) to monitor market responses*

Based on my consultations I am somewhat hopeful that there is sufficient momentum for change that banks, especially the industry leaders, will take the steps necessary to implement this and the previous recommendation in timely fashion. However, there are no guarantees; and collusive behaviour between banks, even in pursuit of beneficial change, may be illegal. It remains a risk that the nature of the potential commercial risks attached to a first mover in respect of remuneration will overwhelm good intentions. It would be prudent, therefore, to ensure that ASIC has powers to intervene when necessary to provoke desirable change and that it exercise them when necessary to effect beneficial change that otherwise would not occur.

I understand that ASIC has regulatory powers that could be employed to assist in the implementation of this recommendation, if necessary, whether through legislative instrument (such as a class order) or a new licence condition. For example, ASIC has recently released a consultation paper proposing to use such a power to prohibit certain forms of commission payment that are common in the car finance industry⁸².

At the time of writing it is unclear how applicable such an approach might be in respect of mortgage broking. I encourage ASIC to explore this possibility and to exercise such powers if necessary to effect the recommended beneficial change. However, another avenue to support reform may be available if ASIC's powers are currently insufficient. Treasury has recently sought submissions on whether to strengthen ASIC's product intervention powers to prevent consumer harm. I understand, that these powers would not necessarily extend to addressing conflicted remuneration. If these recommendations have not been substantively implemented by banks within three years, I recommend that it would be prudent to extend or supplement ASIC's product intervention powers to enable it to address this issue in circumstances in which the industry cannot or does not address this issue adequately without such an intervention. The independent review proposed under Recommendation 15 and any post implementation review of the operations of the proposed product intervention power would both present an opportunity to revisit this issue.

Recommendation 19

The independent review proposed under Recommendation 15 or, at the latest, any post implementation review of the operations of the proposed product intervention power for ASIC, examine whether the government should legislate to extend ASIC's intervention powers to address conflicted remuneration in circumstances in which the industry cannot or does not address Recommendations 16, 17 and 18 adequately without such an intervention

⁸² Refer to ASIC consultation paper 279: Flex commission arrangements in the car finance industry

6.2 Introducers and Referrers

Both this Review and the ASIC Report have found that Introducers and Referrers receive almost as much upfront commission as Mortgage Brokers and Aggregators⁸³. Given the limited work undertaken by Introducers and Referrers compared to Mortgage Brokers, the upfront commission paid to them for a successful 'sale' appears to be disproportionately high in comparison to Mortgage Brokers and Aggregators. Introducers and Referrers may legally⁸⁴ provide only limited support to their clients, for example. This is a matter for the commercial judgement of the relevant banks.

The ASIC Report has proposed that

'The remuneration of referrers be reviewed by lenders to ensure it is not leading to poor outcomes. We will follow up with lenders to ensure that they are properly managing risks with referrers. We also propose that lenders significantly increase their governance and oversight of the referrer channel as for brokers to ensure that misconduct is not occurring'.

There was no evidence available to the Review that led us to conclude that poor outcomes were resulting from Introducer and Referrer activity. Given the limited role available to Introducers and Referrers, the remuneration related risk would seem much lower than in the case of staff or Mortgage Brokers.

Nonetheless, in all the circumstances⁸⁵, I agree with ASIC that banks should review their arrangements with Introducers and Referrers to ensure they remain appropriate. ASIC may wish to investigate the practices of these third parties and the justification for such payments in due course. One issue for consideration is whether such payments persist at these levels because banks are reluctant to take the competitive risk of being the first to move rates down to a more justifiable level.

Recommendation 20

In respect of Introducers and Referrers:

- a. Banks examine their governance of these arrangements to ensure that existing practices are appropriate; and*
- b. ASIC, in due course, investigate whether the upfront commission paid to Introducers and Referrers is justified*

⁸³ Refer to Section 4.2.3 of the Issues Paper and Finding 11 of the ASIC Report

⁸⁴ Introducers and Referrers are not required to hold a credit licence provided they fall within the exemption provided by regulation 25 of the National Consumer Credit Protection Regulations 2010. Unlicensed Introducers cannot undertake any other credit activities and cannot 'sell' products. However, they may refer customers to the bank and provide the bank with the customer's name and contact details along with a brief description of the purpose for which the customer may want the credit – provided that they have disclosed any commissions or other benefits they may receive from the referral

⁸⁵ Refer to the ASIC Report para. 102 which includes a summary of cases relating to ASIC investigation of alleged misconduct by some Referrers

6.3 Commercial equipment finance brokers

The Review received submissions and representations from commercial equipment finance brokers. They questioned whether the analysis in the Issues Paper applied to their circumstances.

These Brokers act as intermediaries between banks and commercial borrowers and, in general, provide equipment finance to them. Commercial equipment finance sits outside the National Consumer Credit Protection (NCCP) regime as it is commercial in nature and is not credit provided for personal domestic purposes.⁸⁶

This type of finance is outside the scope of the Terms of Reference of this Review as it is commercial in nature. In case of any doubt about their applicability, however, my recommendations should not be construed as applying to these types of arrangements.

6.4 Franchise models

A few banks have commercial relationships and supply banking products and services through franchise arrangements. These may relate to a particular product line (for example mortgages) or cover the full range of the bank's products.

A general principle that has underpinned my approach in this Report is that arrangements that have a similar effect should be addressed consistently. Hence the recommendation to cease accelerator incentives is addressed to any practice or device that has a similar effect, namely to increase the rate of payment per unit as sales or sales-related targets are exceeded. Similarly, the recommendations in respect of governance and remuneration are intended to apply equivalent disciplines across both direct and third party channels.

Accordingly, I recommend that banks that provide products or services through Franchisees should examine their governance and, as appropriate, remuneration arrangements and seek to make changes that are consistent with the recommendations of this Review as they apply to similar activities.

Recommendation 21

Banks that provide products or services through Franchisees examine their governance and, as appropriate, remuneration arrangements and seek to make changes that are consistent with the recommendations of this Review

⁸⁶ National Consumer Credit Protection Act 2009 (Cth) sch1 s 5(1)(b)

Appendix A – Remuneration practices in the UK: summary paper

Executive summary

Background to the Review

Mercer has been engaged to review variable pay arrangements for customer-facing staff in UK retail banks, to support the Independent review into remuneration at Australian retail banks being conducted under the auspice of the Australian Bankers' Association (ABA). This Review covers the structure of variable pay, how it has evolved over time, and participants' views on the impact of changes on employee behaviours, customer outcomes and business performance.

The Review is focused on retail banking services (including mass affluent, but excluding wealth management, private banking, and ancillary services) within UK banks, and on the three predominant customer-facing roles in the branch network and their equivalents in telephone banking (Frontline Staff or Customer Service employees, Advisers⁸⁷, and Managers).

Sixteen banks agreed to participate in this Review, including the largest UK banks, with total assets of between c.£1,800bn and c.£4bn. These participants comprise approximately 85% of the UK retail banking market based on headcount⁸⁸.

Summary

The approach to “incentive” pay in retail banks in 2017 is almost unrecognisable compared with practices in 2006 when the then Financial Services Authority ('FSA') launched Treating Customer Fairly ('TCF')⁸⁹.

Participants today report significant areas of overlap in variable pay design – the “new normal” can be characterised by:

- One variable pay plan for Frontline Staff, Advisers and Managers, generally paid annually;
- Variable pay is funded at a corporate level, allocated out on the basis of individual performance;
- The total funding available for distribution as variable pay is based on risk-adjusted profit for business performance, with business performance viewed through the lens of a scorecard capturing, in particular, customer outcomes / satisfaction and risk management against the risk appetite;
- Allocation of variable pay to individuals is based on an individual performance assessment (again with a broad balanced scorecard defining good performance and behaviour for individuals, and not including revenue or sales volume measures).

A number of banks now report a shift away from simply ensuring variable pay is compliant with regulator guidance and towards considering changes to variable reward following reforms to the performance management framework, to ensure reward as a whole reinforces the appropriate culture.

Around two-thirds of participants indicated that they have made this journey or are on this pathway. Amongst these participants, certain key themes in variable pay design are observed:

⁸⁷ For clarity, Advisers includes mortgage advisors

⁸⁸ Source: Total banking population - BBA, <https://www.bba.org.uk/about-us/members/>, 14 February 2016; Banking population at participants – latest Annual Report, 14 February 2016

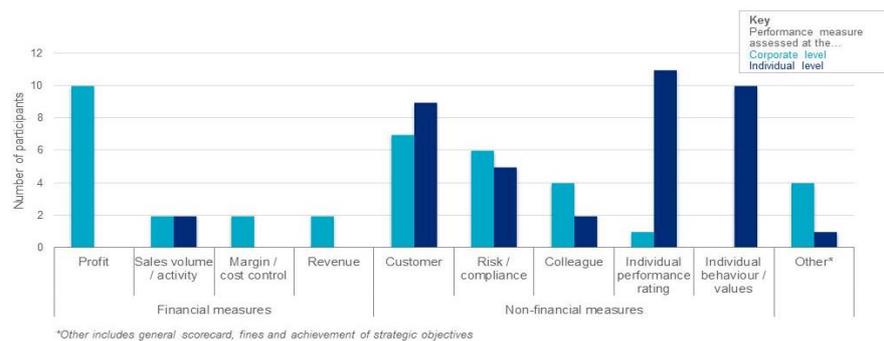
⁸⁹ TCF is aimed at mitigating risks to customers by improving information flow and minimising the sale of unsuitable products. The then Financial Services Authority, and now the Financial Conduct Authority, has published various guidelines on remuneration for sales / customer-facing staff for institutions in the UK. Examples of good practice guidelines on variable pay structures include: performance assessments which are ultimately discretionary, based on a balanced scorecard of measures with less than 50% linked to sales or financial performance and a material element on 'how' outcomes were achieved; an individual behaviour gateway; no 'accelerators'; caps on variable pay opportunities; etc.

- (i) *More discretionary approach to individual allocation:* Around one-half of participants allocate variable pay based on a discretionary performance assessment of the individual by the line manager against a balanced scorecard of measures, rather than a formulaic assessment of the individual's performance against quantitative targets, to help ensure variable pay focuses on driving the appropriate customer outcomes and individual behaviour.
- (ii) *No variation in individual allocation:* Two participants award variable pay based on a flat share of the variable pay pool based on organisation performance, owing to a desire for a consistent 'cross-bank' one-team approach to reward.
- (iii) *No variable pay:* Three participants have removed variable pay for customer facing staff entirely, predominantly to increase focus on customer outcomes and to avoid "the distraction of incentives" (this has required a strong and well managed approach to performance management).

Practices that were prevalent in 2006 when the then FSA launched TCF and are virtually non-existent now include:

- A dramatic reduction in the number of variable pay plans within each bank, often with a reduction to a single variable pay plan across the whole bank or whole retail division today;
- Revenue / sales performance were the predominant individual performance assessment measure – now revenue / sales performance measurement is in a few cases a marginal element of the overall performance assessment and eligibility for award or (more often) not part of the scorecard at all;
- A move from a direct-drive variable pay award to performance assessments being based on a scorecard of metrics with no direct (or a marginal) link to revenue / sales performance;
- Funding for plans driven primarily from product sales – to a judgement for funding informed by an organisation-wide performance scorecard;
- Highly individualised plans – to a consistent approach to variable pay across the organisation, with individual allocation based on individual performance/behaviour, customer outcomes and risk management within the risk appetite along with a broader focus on "team";
- From a significant use of levers within plans (kickers, accelerators, modifiers or gateways linked to sales, etc.) – to an environment in which these are universally no longer employed.

Figure 1: Prevalence of performance measures



Those we interviewed in the HR function of the banks do not report significant shifts in performance vs. their competitors despite the fact that the measurement of performance in variable pay plans itself has changed radically. Previously banks focused on revenue and sales performance, whereas there is today a focus on customer outcomes and satisfaction with the premise that revenue and sales performance will follow albeit such performance will be more sustainable. This may be because of a whole market shift (allowing that not all banks have moved at the same pace), but may also be because incentives can be seen to have a marginal effect on business performance when considered against product quality, pricing, location / access and, most importantly, a refocus on service and strong customer orientation.

In assessing the effectiveness of variable pay arrangements, participants generally report assessing the correlation between performance and reward to help ascertain the effectiveness of variable pay design, with 'performance' meaning the financial performance of the bank. Banks also report considering wider aspects of performance, although aspects considered vary between banks and may include achievement of business goals, customer feedback, customer loyalty, and/or employee surveys.

The majority of participants consider it to be 'early days' to fully assess the impact of changes to variable pay design over recent years. Further, some participants note that recent changes to variable pay design are only one aspect of a broader cultural or reward agenda, and therefore it is difficult to isolate the impact of changes.

However, where impacts of changes to variable pay design were noted, these focus on increased employee engagement / retention, improved customer outcomes and strengthened individual behaviour. Particular themes include:

- Removing revenue / sales from performance assessments has not noticeably or adversely affected business outcomes since implementation;
- Variable pay that is now focused on customer outcomes and individual behaviour has resulted in employees focussing on delivering the best outcomes for customers; and,
- A more discretionary approach to individual performance has enabled a more collaborative working culture.

Emerging themes in variable pay design

The ways in which individual performance is assessed⁹⁰ is reported to have materially changed; this is reflected in the new approaches to variable pay design and the allocation of awards to individuals. Predominant observations include:

- A move from performance assessments being based on outcomes, to 'what' outcomes are achieved as well as 'how' they were achieved;
- Increased focus on and investment in performance management and leadership training;
- Removal of a formal calibration process (owing to the strengthened leadership training); and,
- Increased focus on rewarding recognition through, for example, ad hoc awards for exceptional behaviour or performance⁹¹.

Overall themes in variable pay design, individual performance assessment and individual allocation can be considered on a continuum, as follows:

⁹⁰ The scope of this Review does not cover performance management frameworks; key themes are those reported from interviews with Reward Leads in light of the increased role of performance management and linkage to variable pay outcomes

⁹¹ Note, recognition programmes are subject to governance processes such that the 'tone from the top' is appropriately reflected in rewards provided, and rewards not given for, say, revenue or sales performance.

Figure 2: Key themes in variable pay design

Approach to individual variable pay allocation	No variable pay	More discretionary	Less discretionary
Variable pay funding	n/a	Corporate variable pay pool based on risk-adjusted profit and considering performance against a scorecard of metrics capturing customer, risk management, etc.	
Individual allocation	n/a	Based on performance rating	Based on performance rating and performance vs. a scorecard
Performance rating	25-box grid Based on individual performance outcomes and behaviours		1-5 Based on individual performance outcomes Considers behaviours
Individual performance assessment	Guidance for performance rating is linked to high-level performance categories and examples of measures and behaviours to be considered		Based on a scorecard comprising specific metrics for the individual's performance to be assessed against
Communication of performance metrics	Not communicated. Performance management conversations relate to general behaviour with a customer focus		Communicated with at least a bi-annual 'check-in'
Approach to calibration	No formal calibration process		Guided
Level of variable pay	n/a	More modest	Less modest

Key themes by bank category

UK retail banks can be categorised as shown in the table below:

	Description
Mainstream UK banks	<ul style="list-style-type: none"> Typically comprise the seven largest UK retail banks The bank predominantly operates in financial services
Challenger banks	<p>Small-to-medium sized institutions where:</p> <ul style="list-style-type: none"> Banking is the sole or main activity <p>or</p> <ul style="list-style-type: none"> Banking forms a business arm or a sub-section of a larger organisation's overall activity

The overall approach to variable pay design across these two categories is broadly consistent, with developments over recent years reflecting TCF guidance.

However, at mainstream banks (compared to challengers):

- 1) variable pay is typically a more modest proportion of the pay mix; and,

2) the approach to assessing team / individual performance can be seen to be more discretionary in approach.

With regard to (2), it should be noted that the measures used to assess team / individual performance at mainstream and challenger banks are very similar, and are based on an assessment of ‘what’ outcomes were achieved as well as ‘how’ these were achieved.

In particular, the assessment typically considers non-financial performance measures based on customer outcomes and risk management within the risk appetite, and individual performance and behaviour / values.

Mainstream banks more typically link variable pay outcomes to the individual performance rating (which is in turn based on a holistic discretionary assessment of *both* what outcomes, were achieved and how these were achieved). While some challengers take this approach, around half of challengers (predominantly those for whom banking is the sole or main activity) assess individual performance outcomes against a scorecard of measures. The individual performance rating is then based on ‘what’ scorecard metrics were achieved, with behaviour / values being a consideration (rather than a predominant determinant) in this assessment.

The majority of mainstream banks report having reviewed some element of their variable pay arrangements in the last 12 months, compared to around two-thirds of challenger banks. The time period since the last review at the remaining challengers varies from one-to-two years ago to more than four years ago.

While changes to variable pay over recent years have been to move more in line with TCF guidance at both bank categories, mainstream banks more readily report now shifting focus towards ensuring variable pay design reinforces the appropriate culture, with changes to variable pay design now typically following reforms to performance management and recognition more generally. While some challengers are also on this pathway, responses are more mixed.

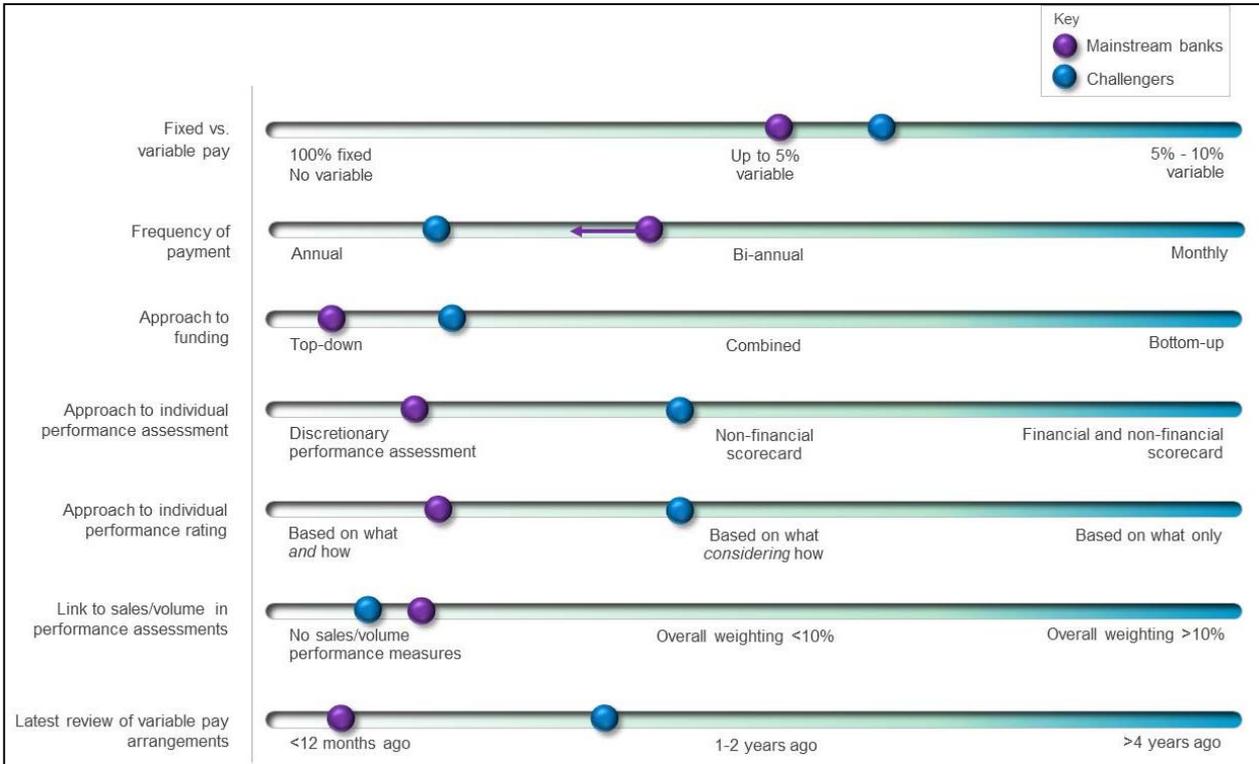
Only one mainstream bank reports a specific intention to make changes to variable pay arrangements over the next 12 months; its aim is to move from bi-annual to annual payment. In contrast, a number of challengers report the intention to make changes, including increasing the focus on non-financial performance, and increasing discretion in the individual performance assessment approach. These changes are in line with TCF guidance.

It is reasonable to assume that differences in approach between mainstream and challenger banks are likely to have evolved due to the more intense scrutiny of the mainstream banks and therefore the earlier, more pressing need to be compliant with regulatory guidance.

Figure 3: Fixed: variable pay mix at mainstream and challenger banks (average, at target)



Figure 4: Key themes in variable pay design by bank category



Key themes by employee type

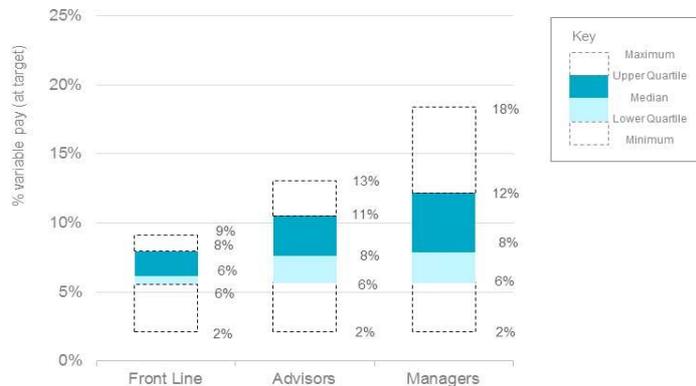
Participants report little variation in variable pay arrangements for the three customer-facing staff considered in this Review (Frontline, Advisers and Managers).

Where differences were reported (at six participants), these relate to an increase in variable pay opportunity with responsibility.

However, the approach to increasing variable pay opportunity with responsibility varies, with one bank increasing the opportunity for Advisers only, another increasing the opportunity for Managers only, and the remaining four banks increasing the opportunity for both Advisers and Managers albeit to different extents.

Where Advisers have a higher opportunity, this is between 1.2x and 2x the opportunity for Frontline staff at target. Target variable pay opportunities for Managers can be up to 2.5x those for Frontline staff.

Figure 5: Fixed: variable pay mix by staff category (average at target; excludes banks with nil variable pay)



One participant also reports an increased weighting on financial metrics in the individual performance assessment for Advisers and, to some extent, for Managers. However, this participant is unusual in linking the individual performance assessment to financial performance and is intending to reduce this.

Appendix B – Banking product and remuneration legal framework

Legal framework regulating retail banking remuneration

Introduction

The purpose of this paper is to provide an overview of the legal framework relevant to the sale of retail banking products by banks, including the legal and regulatory obligations around banking products that are aimed at consumer protection. In particular, this paper covers those aspects of the legal framework that are most relevant to bank employee (rather than third party) retail banking remuneration.

This paper has been prepared at the request of Mr Stephen Sedgwick AO in connection with the independent review he is conducting into how banks pay staff, commissioned by the Australian Bankers' Association.

Overview of legal framework

The sale of banking products by banks in Australia is primarily regulated by Chapter 7 of the *Corporations Act 2001* (Cth) (**Corporations Act**).⁹²

This regime is aimed at:

- (a) addressing market failure caused by market participants failing to act with integrity; and
- (b) disclosure regulation designed to address the information asymmetry between industry and clients and the lack of transparency in financial markets.⁹³

Notably, the financial product and services provider collapses that occurred in the global financial crisis (**GFC**)⁹⁴ led the Commonwealth Government to introduce the Future of Financial Advice (**FOFA**) reforms to the Corporations Act and Corporations Regulations. These reforms built on the existing consumer protection framework by introducing a range of measures in the area of providing financial advice (both general and personal advice). FOFA addressed, among other things, the role of commission arrangements relating to product sales and advice as well as the potential for conflict of interest. At the time the Government's response was guided by two overriding principles one of which was "*that financial advice must be in the client's best interest... distortions to remuneration which misalign the best interests of the client and adviser, should be minimised.*"⁹⁵

In addition, the *National Consumer Credit Protection Act 2009* (Cth) (**Consumer Credit Code**) requires Credit Licensees to carry out suitability assessments of their prospective customers⁹⁶. This is because in some cases credit products may be unsuitable for certain consumers and, on occasion, ensuring transparency may not be sufficient to address this unsuitability.

⁹² Also, *Corporations Regulations 2001* (Cth) (**Corporations Regulations**); although other regimes apply, in particular the *National Consumer Credit Protection Act 2009* (Cth)

⁹³ Financial System Inquiry Final Report (Canberra: AGPS 1997) (Chair: S Wallis), pp 237-238 cited in Everett and McCracken's *Banking and Financial Institutions Law*, McCracken et al, Thomson Reuters 2013 (8th Ed), page 49

⁹⁴ For example the collapse of Storm Financial and Opes Prime

⁹⁵ Hon Chris Bowen MP, Minister for Human Services, Minister for Financial Services, Superannuation and Corporate Law, *The Future of Financial Advice Information Pack*, 26 April 2010, p 2

⁹⁶ Consumer Credit Code s 115(1)

The consumer protection provisions contained in the Australian Consumer Law (**ACL**)⁹⁷ and the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**)⁹⁸ supplement the regulatory regime contained in the Corporations Act.

The combined regulatory regime therefore seeks to ensure that consumers of financial products are adequately protected through:

- (a) protective measures designed to ensure that consumers are provided with adequate information and that the interests of consumers are prioritised over banks and their staff; and
- (b) enforcement measures which aim to ensure that deviation from the conduct expected of financial services employees is appropriately addressed.

We set out key features of the means by which the regulatory regime seeks to achieve these objectives in the following paragraphs.

Protective measures

There are a number of aspects of the regulatory regime which seek to ensure that customers are adequately protected when acquiring financial products or services. In particular:

- (a) **(Disclosure)** Banks and their employees are required to provide consumers with documents which disclose information relevant to the specific financial product which the consumer is acquiring. This is designed to ensure that consumers have sufficient information to make an informed choice regarding the merits of the financial product or service they are acquiring.
- (b) **(Suitability assessment)** The Consumer Credit Code also requires Credit Licensees to carry out suitability assessments of prospective consumers before a credit contract can be provided to the consumer.⁹⁹ The purpose of this requirement is to seek to ensure that, notwithstanding the information which the client has been provided, consumers do not enter into credit contracts which are unsuitable for them given their requirements and objectives in relation to the credit contract and given their financial situation.¹⁰⁰
- (c) **(FOFA protections)** The FOFA reforms have introduced a number of changes which seek to strengthen the disclosure regime. These reforms explicitly require bank employees to prioritise consumers' interests over their own. The FOFA reforms also require that certain remuneration must be disclosed to consumers and that some forms of remuneration are incompatible with consumers' best interests. The mechanisms used to give effect to these reforms include the best interests duty, the requirement to provide an annual fee disclosure statement for certain products and the ban on conflicted remuneration.
- (d) **(Future protections)** The recent *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth)¹⁰¹ will introduce a range of new requirements for bank employees who provide personal advice to retail clients in relation to financial products. These include increased education requirements, oversight from an independent standards body, the introduction of a code of ethics and the requirement to pass a benchmarking exam before being authorised to provide financial advice. As these requirements do not take effect for some time, they are not considered further in this paper¹⁰² (although they can be expected to provide further protection for consumers of financial products).

⁹⁷ Contained in Schedule 2 to the *Competition and Consumer Act 2010* (Cth) (**CCA**)

⁹⁸ CCA s 131A

⁹⁹ Consumer Credit Code s 115(1)

¹⁰⁰ Consumer Credit Code s 117(1)

¹⁰¹ Commencement date of 15 March 2017

¹⁰² E.g. the code of ethics does not apply until 1 January 2020 (See Corporations Act s 1546F inserted as part of these amendments) and existing staff will have until 1 January 2021 to complete the benchmarking exam (See Corporations Act s 1546B(3) inserted as part of these amendments)

Disclosure requirements

Where a provider gives financial advice to a retail customer, or sells or otherwise provides a retail customer with certain products, they may be required to disclose certain information to the customer, including information:¹⁰³

- (a) regarding the customer's rights;
- (b) regarding the dispute resolution system the provider has in place;
- (c) disclosing any relevant associations or relationships that the provider may have;
- (d) about the remuneration the provider can expect to receive;
- (e) about the product (if a product is provided).

There is quite prescriptive legislation which dictates what disclosure is required to be provided to a customer. The nature and extent of the information that is required to be disclosed to a customer will depend on whether the advice provided is general or personal and what, if any, product is provided to the customer. The various forms of disclosure documents which may be required to be provided to a customer include:

- (a) a Financial Services Guide (**FSG**);
- (b) a Statement of Advice (**SOA**);
- (c) a Product Disclosure Statement (**PDS**); and
- (d) a Key Facts Sheet (**KFS**).

There are consequences for banks and their employees if they fail to comply with these requirements. It is an offence for a providing entity:

- to fail to provide a disclosure document where required;¹⁰⁴ and
- to provide a disclosure document which does not comply with the content requirements.¹⁰⁵

It is also possible in certain circumstances for a customer who suffers loss or damage to recover that loss or damage from the person who failed to provide a PDS, SOA or FSG where required or failed to provide a compliant PDS, SOA or FSG.¹⁰⁶

Consumer Credit Code

Consumer Credit Suitability Test

One of the main reasons for the introduction of regulation around consumer credit was the fear that credit providers were allowing consumers to enter into credit obligations which were ill-suited to that customer leading to default and bill-shock.

Credit Licensees are therefore required to carry out suitability assessments of their prospective customers. It is a condition of credit licences that records of these suitability assessments be kept by the Credit Licensee, including any material on which that assessment was based.

Requirements of the Assessment

This assessment requires that the Credit Licensee make reasonable enquiries about:

- (a) the consumer's requirements and objectives in relation to the credit contract; and

¹⁰³ Note that a Key Facts Sheet must be provided to all natural persons. This is not limited to retail customers. See *Insurance Contracts Regulations* 1985 r 4A (2)

¹⁰⁴ *Corporations Act 2001* (Cth) ss 952C and 1021C; *Insurance Contracts Act 1984* s 33C (5)

¹⁰⁵ *Corporations Act 2001* (Cth) ss 952D, 952E, 1021D and 1021E; *Insurance Contracts Act 1984* s 33C (5)

¹⁰⁶ *Corporations Act 2001* (Cth) ss 953B and 1022B

- (b) the consumer's financial situation (to determine if they can meet financial obligations under the contract).

Unsuitability Threshold

Without limiting the circumstances in which a Credit Licensee should find that a credit contract will be unsuitable for a consumer, a credit contract will generally be unsuitable¹⁰⁷ where:

- (a) the consumer will be unable to comply with their financial obligations under the contract, or
- (b) the contract will not meet the consumer's requirements or objectives.

Consumers are entitled to ask for a copy of their assessment as to suitability for a particular credit contract, where they have been deemed 'not unsuitable'.

Additionally, the regulations prescribe two further categories of credit contracts which are presumed to be unsuitable:

- (a) multiple small credit contracts, where a single medium credit product is available for the total amount;
- (b) reverse mortgages (i.e. re-borrowing against a house in which title has already passed to the consumer).

FOFA

The FOFA reforms supplement the disclosure requirements above by requiring the disclosure of specific details regarding the fees charged by the bank, by imposing the best interests duty which aims to ensure that customers' interests receive priority over bank employees and by prohibiting certain remuneration.

These obligations apply both at an institutional and a personal level. In this respect these obligations require institutions to have appropriate systems and processes in place to provide customers with sufficient information and that individual participants also act with integrity.

Best interests obligation

In certain circumstances bank employees will be required to act in the best interests of their client and to place the interests of their client ahead of their own. These obligations apply where a bank employee is dealing with a retail client and where they provide personal advice (advice provided where the employee has, or in the circumstances a reasonable person might expect them to have, considered one or more of a retail client's objectives, financial situation or needs).

Whether the best interests obligation applies is assessed on a case-by-case basis, depending on the facts around the particular interaction between the bank employee and the client. However, there are certain circumstances where the best interests obligation will not apply by virtue of exceptions in the FOFA reforms. In particular, they will not apply where a bank employee is providing factual information (distinguished from advice as objectively ascertainable information, the truth or accuracy of which cannot reasonably be questioned)¹⁰⁸ or general advice (advice other than personal advice). Further, they will not apply to credit contracts (including mortgages) which are regulated by the Consumer Credit Code.¹⁰⁹ Finally, where personal advice is provided in relation to basic banking products (basic deposit products, facilities for non-cash payments and traveller's cheques)¹¹⁰ a modified version of the best interests duty will apply.¹¹¹

By way of example, this means that a retail bank employee simply providing factual information or general advice would not be subject to the best interests obligations. Whereas, if the customer were to

¹⁰⁷ Consumer Credit Code s 118(2)

¹⁰⁸ ASIC RG 244.24

¹⁰⁹ Corporations Act 2001 (Cth) s 765A(h); Corporations Regulations 2001 (Cth) rr 7.1.06(1)(a) and 7.1.06(1)(f)

¹¹⁰ Corporations Act 2001 (Cth) s 961F

¹¹¹ When the modified best interests duty applies bank employees obligations are limited to taking steps to identify the client's personal circumstances and the subject matter of the advice they are seeking; See Corporations Act 2001 (Cth) s 961B(2)(a) – 961B(2)(c)

provide the bank employee with detailed information regarding their personal circumstances and the employee were to respond by recommending particular products, the best interests obligation would likely be triggered.

ASIC Regulatory Guide 244 suggests that when determining whether they have satisfied this obligation bank employees ask themselves whether a reasonable advice provider would believe that the client is likely to be in a better position if they follow the advice provided.¹¹² It is important to note that whether the employee has acted in the client's best interests is to be assessed at the time the advice is provided and not with the benefit of hindsight.

Section 961B(2) of the Corporations Act sets out a list of steps a bank employee can take to assess the client's individual circumstances and the appropriateness of the product being offered considering these circumstances in order to satisfy their obligation to act in the client's best interests.¹¹³ This is not the only way that a person can satisfy these requirements but it is a "safe harbour".

While the list of steps required to qualify for the safe harbour is long and prescriptive the focus of the list is on gathering information from the client to allow the bank employee to make recommendations and provide advice which are appropriate to the client and in the client's best interests.

While the best interests obligation applies to the individual bank employee, and not the bank itself,¹¹⁴ banks "must take reasonable steps to ensure that" their representatives comply with these obligations.¹¹⁵ If a bank fails to take such steps it may face a penalty of up to \$1,000,000.¹¹⁶

Annual fee disclosure

If a bank employee provides personal advice which results in an arrangement being entered into under which the client pays fees over a period of more than 12 months, they are required to give the client an annual fee disclosure statement requirement which must include the following information:¹¹⁷

- (a) the amount of each ongoing fee paid under the arrangement by the client in the previous year, expressed in Australian dollars unless an alternative is provided in the regulations;
- (b) information about the services that the client was entitled to receive from the current and any previous fee recipient under the arrangement during the previous year;
- (c) information about the services that the client received from the current and any previous fee recipient under the arrangement during the previous year; and
- (d) information about any other prescribed matters, including information that relates to a period that begins after the previous year.

Further, every second year the client will have to notify the bank in writing that they wish to renew the agreement otherwise the agreement will end.¹¹⁸

The requirement to provide an annual fee disclosure statement depends on the same facts as the application of the best interests obligation.

Ban on conflicted remuneration

The FOFA reforms prohibited certain forms of remuneration, known as "conflicted" remuneration. Such remuneration was prohibited as it was considered incompatible with consumers' best interests

Conflicted remuneration is defined broadly as any benefit (whether monetary or non-monetary) which may reasonably be expected to influence either the choice of financial product recommended or the

¹¹² ASIC RG 244.63

¹¹³ Note that where a representative of an Australian Authorised Deposit Taking Institution provides advice regarding a basic banking product to a retail client only a limited number of these steps are required; See *Corporations Act 2001* (Cth) s 961B(3).

¹¹⁴ *Corporations Act 2001* (Cth) s 961B (1)

¹¹⁵ *Corporations Act 2001* (Cth) s 961L

¹¹⁶ *Corporations Act 2001* (Cth) ss 1317G(1E)(b)(ii) and 1317G(1F)(b)

¹¹⁷ *Corporations Act 2001* (Cth) s 962H(2)

¹¹⁸ *Corporations Act 2001* (Cth) s 962N

financial product advice provided by the bank employee to a retail client.¹¹⁹ In particular, s 963L of the Corporations Act creates a presumption that all volume based remuneration (remuneration based wholly or partly on either the number of products acquired by, or the number of products recommended to, a retail client) is conflicted remuneration.

There is a carve out for certain products such that the ban on conflicted remuneration does not extend to basic banking products, general insurance products and consumer credit insurance.¹²⁰

While there are further exceptions to the ban (see for example exceptions relating to benefits provided by the client and benefits for an education or training purpose)¹²¹ the effect of the ban on conflicted remuneration is to impose a significant external restriction on the type of remuneration structures banks can agree with their employees. Otherwise employers and employees are largely free to enter into whatever agreements they see fit, including through enterprise bargaining agreements, without further legislative restrictions.

Enforcement

The legal protective measures set out above are supported by enforcement measures that impose sanctions on banks and their employees to enforce normative behaviour. If consumers are not satisfied with the financial product or service they have acquired they are able to access their bank's dispute resolution process. All Australian authorised deposit taking institutions are required to have internal dispute resolution procedures in place and to participate in an ASIC approved external dispute resolution (EDR) scheme

Consumer law

Australia's consumer protection framework is set out in the ACL and applied by legislation in each of the states and territories. It is administered by the Australian Competition and Consumer Commission (ACCC) and by state and territory consumer agencies.

Relevantly for present purposes, consumer protection obligations relating to financial products and financial services are regulated by the ASIC Act and not by the ACL.¹²² These obligations are set out in Division 2 of Part 2 of the ASIC Act, which is administered by ASIC. The consumer protection obligations in the ASIC Act are reflected in the ACL in similar or identical terms.

The key measures for protecting consumers include prohibiting certain conduct including misleading or deceptive conduct and unconscionable conduct, implying warranties into contracts for the supply of financial services to a consumer in the course of a business and prohibiting unfair contracts.

Prohibited conduct

The current consumer protection includes a range of prohibitions and obligations including the prohibition of the following conduct:

- (a) misleading or deceptive conduct;¹²³
- (b) false or misleading representations regarding the standard, quality or price of a good or service or regarding testimonials provided by a person;¹²⁴
- (c) making a representation about payment for a part of the financial service without specifying the cash price for the service;¹²⁵

¹¹⁹ Corporations Act 2001 (Cth) s 963A

¹²⁰ Corporations Act 2001 (Cth) s 963D

¹²¹ Corporations Act 2001 (Cth) s 963C(e); Corporations Regulations 2001 (Cth) r 7.7A.14 and r 7.7A.15

¹²² CCA s 131A

¹²³ ASIC Act s 12BB

¹²⁴ ASIC Act s 12DB

¹²⁵ ASIC Act s 12DD

- (d) engaging in bait advertising. This involves advertising financial services at a specified price if there are reasonable grounds for believing that the person will not be able to supply those services at that price for a reasonable period and in reasonable quantities;¹²⁶
- (e) pyramid selling, involving promoting or participating in a trading scheme where financial products are sold with the inducement of the prospect of payments from other participants in the scheme;¹²⁷
- (f) providing unsolicited credit and debit cards and unsolicited financial services or products;¹²⁸ and
- (g) unconscionable conduct. The prohibited unconscionable conduct is not only as defined under the general law (as in where one party takes advantage of a special disability which another party possesses)¹²⁹ but extends to conduct which, in all the circumstances, is unconscionable.¹³⁰

Implied warranties

The consumer protection regime also implies a number of warranties into every contract for the supply of financial services to a consumer in the course of a business, apart from insurance contracts. These warranties include an implied warranty that services will be rendered with due care and skill and an implied warranty that, if the consumer makes known any particular purpose for which the services are required, or the result they desire the services to achieve, the services (and any materials supplied in connection with the services) will be reasonably fit for that purpose or are of such a nature and quality that they might reasonably be expected to achieve that result.¹³¹

Unfair contracts

The ASIC Act also contains provisions which invalidate unfair terms, other than core terms,¹³² in standard form contracts. These provisions apply to small businesses (businesses with less than 20 employees) and apply to transactions up to \$300,000 or \$1 million if the contract is for over 12 months. A term in a contract will be considered to be unfair, and therefore invalid, if it falls within any of the following criteria:

- (a) if the term would cause significant imbalance in the parties' rights and obligations arising under the contract;
- (b) if the term is not reasonably necessary in order to protect the legitimate interests of the party advantaged by the term; or
- (c) if the term would cause detriment, whether financial or otherwise, to a party if it were to be applied and relied on.

Dispute Resolution

As detailed above, the legal framework around the sale of retail banking products to customers by banks contains a number of safeguards which seek to prevent customer complaints from arising. In addition to these preventative safeguards the framework also requires that banks have appropriate dispute resolution processes in place to address any customer complaints which may arise. This requires a bank to have internal dispute resolution procedures in place and to participate in an ASIC approved EDR scheme.

Internal Dispute Resolution

When consumers have a complaint against their financial service provider, the first step is to try to resolve this through the provider's internal dispute resolution scheme. These schemes vary from

¹²⁶ ASIC Act s 12DG

¹²⁷ ASIC Act s 12DK

¹²⁸ ASIC Act ss 12DL, 12DM and 12DN

¹²⁹ ACL s 20; ASIC Act s 12CA; *Blomley v Ryan* (1956) 99 CLR 362

¹³⁰ ACL s 21; ASIC Act s 12CB

¹³¹ ASIC Act s 12ED

¹³² A core term is one which is the central subject matter of the contract, e.g. the granting of a loan by a bank is a core term, as is the giving of security in the form of a mortgage. However, the conditions surrounding the mortgage agreement are not core terms

institution to institution but all are required to meet the Australian Standard for complaints handling within organisations.¹³³ Complaints are to be reviewed in an objective and timely manner. It is only if a customer's complaint cannot be resolved by internal dispute resolution that the complaint can proceed to EDR.

External Dispute Resolution

Retail financial services providers in Australia are required to hold an Australian Financial Services Licence (**AFSL**). One of the terms of these licences is participation in an ASIC approved EDR scheme.¹³⁴ Currently¹³⁵ ASIC recognises two EDR schemes, the Financial Ombudsman Service (**FOS**)¹³⁶ and the Credit and Investments Ombudsman (**CIO**).¹³⁷ AFSL holders that participate in these EDR schemes agree to be bound by the decisions of these bodies. Details of the financial institution members of each ombudsman service are available on their websites¹³⁸ but, in broad terms:

- the FOS deals with complaints against major banks or other financial service provider; and
- the CIO is usually the appropriate forum for disputes with a suburban financial service provider or sole trader.

The FOS or CIO both have broadly similar processes for handling disputes. Initially the complaint is assessed against the respective ombudsman service's terms of reference to determine whether the FOS or CIO can take jurisdiction over it. If it falls within the terms of reference, the dispute then proceeds to a mandatory negotiation / conciliation stage. If this process does not resolve the complaint, it proceeds to the Ombudsman or Panel for determination.

GILBERT + TOBIN
24 March 2017

¹³³ Australian Standard AS ISO 10002–2006 Customer satisfaction - Guidelines for complaints handling in organizations (ISO 10002:2004 MOD)

¹³⁴ *Corporations Act 2001* (Cth) s 912A(2)(b)

¹³⁵ Noting that changes to EDR are currently being considered and the interim report into the review of the financial system's external dispute resolution and complaints framework (the Ramsay Review) has recently recommended that the existing ombudsman services should be rolled into a single scheme with greater scope to deal with complaints against financial services companies and credit agencies

¹³⁶ <https://www.fos.org.au/>

¹³⁷ <http://www.cio.org.au/>

¹³⁸ <http://www.fos.org.au/members/search-for-members.jsp>; <http://www.cio.org.au/members/membership-of-cio/>

Appendix C – UK comparison: Delivering fair customer outcomes

The UK Financial Services Authority's (FSA)¹³⁹ defines mis-selling, as a 'failure to deliver fair outcomes for consumers'.¹⁴⁰ The FSA guidance identifies four elements of fair outcomes. We have been asked to summarise the main aspects of the existing regulatory regime in Australia that relate to the 'fair outcomes' against which the FSA assessed mis-selling. Taking the FSA elements in turn:

1. Customers are treated fairly

Section 912A(1) of the Corporations Act requires financial services licensees to "*do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly*". Section 47(1)(a) of the National Credit Code is almost identical. The concept of fairness is further incorporated into the Australian regulatory regime through many legislative provisions including the unconscionable conduct and unfair contract terms in ss 12CA and 12BF of the ASIC Act.

2. Customers understand the key features of the product or service and whether or not they are being given advice or information

Regardless of whether customers are being given general or personal advice in Australia banks are required to provide substantial amounts of information regarding the product or service they are being sold to comply with the disclosure requirements in the Corporations Act. Depending on the circumstances this may include providing a Product Disclosure Statement,¹⁴¹ a Statement of Advice¹⁴² and/or a Financial Services Guide.¹⁴³ Customers are notified that they are being given advice by the provision of these materials but there is no requirement that customers be notified if they are being provided with factual information absent advice.

3. Customers are given information that is clear, fair and not misleading – information that enables them to make an informed decision before purchasing a product or service or before trading

In Australia, banks must comply with strict prohibitions on misleading or deceptive conduct in relation to the sale of financial products or the provision of financial advice: see s 12DA of the ASIC Act.¹⁴⁴ Further, customers are provided with information to support an informed decision by virtue of the disclosure requirements referred to in point 2 above (which ordinarily require a disclosure document to be provided before the relevant product or advice is supplied to the customer).

4. Customers buying on an advised basis are recommended suitable products

When Australian banks are providing *personal* advice, s 961B of the Corporations Act requires that they act in the best interests of their customers, s 961J requires that they put the interests of retail customers ahead of themselves and s 961G requires that personal advice must only be provided if it would be reasonable to conclude that the advice would be appropriate to the customer if the best interests duty had been satisfied.¹⁴⁵ Bank employees providing *general* advice can recommend financial products but the obligations relevant to suitability do not apply.¹⁴⁶ Regardless of the type of advice provided s115 of the National Credit Code requires credit providers to determine that a product is not unsuitable for a consumer before entering into a credit contract with the consumer.

¹³⁹ Prior to 1 April 2013 the Financial Services Authority was responsible for the regulation of financial services in the UK

¹⁴⁰ See FSA, *Final Guidance: Risks to customers from financial incentives*, January 2013, p 9. It should be noted that this document does not have legislative force but it may be relevant where the FCA considers imposing a fine on a person for failing to comply with the "Principles for Business"

¹⁴¹ Required where a bank recommends a financial product and provides personal advice to a retail customer: s1012A

¹⁴² Required where a retail customer is given personal financial advice, see Corporations Act s946A

¹⁴³ Required where a retail customer is given either general or personal financial advice, see Corporations Act s 941A

¹⁴⁴ Courts have established that the question of whether conduct is misleading is to be tested by the effect on the persons within the section of the public to whom the information is addressed – including the astute and the gullible, the intelligent and not so intelligent, that is it tested on the basis of the powers of perception and understanding of the particular audience of the information

¹⁴⁵ Sections 961G and 961J were inserted into the Corporations Act as part of the FOFA reforms that replaced the former s 945A which required banks to have a "reasonable basis" for any personal advice provided to customers

¹⁴⁶ See s766B of the Corporations Act for the difference between personal advice and general advice

Appendix D – Submissions and consultations

Submissions

In total 45 submissions were received, made up of public and confidential submissions. The public submissions have been posted on the Review website at <http://retailbankingreview.com.au>.

Submissions varied in length and detail. They came from a wide range of interested parties which included:

- Banks;
- Consumer groups;
- Brokers and aggregators;
- Industry associations;
- Professional associations; and
- Individuals.

In addition to written submissions, 13 member banks (including the four major banks) have provided detailed information to the Review in response to the Review information request about their remuneration practices and policies for the roles in-scope retail bank Tellers, Sellers and Managers as well as third parties.

The data gathering exercise and analysis has been a significant task with over 500 documents received from banks.

Consultations

85 formal consultation meetings were conducted throughout all stages of the Review. This included consultations with banks, consumer advocates, peak industry bodies, regulators, remuneration experts, the Stakeholder Advisory Panel, academics and other interested stakeholders.

Appendix E – Glossary

General	
ABA	Australian Bankers' Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities & Investments Commission
ASIC Report	ASIC Report 516: Review of mortgage broking remuneration, March 2017
EA	The <i>Fair Work Act 2010</i> (Cth) contains provisions that protect employees against breaches of the terms of modern awards and collectively bargained employment agreements; that is, Enterprise Agreements (EA).
FCA	Financial Conduct Authority
Financial measures	Includes but are not limited to product sales, cross selling, referrals, profit and revenue targets, an increased customer base or increased use of certain products by each customer. These may be compiled at both individual and team/ branch level
FOFA	Future of Financial Advice reforms
FSA	Financial Services Authority
FSU	Finance Sector Union
Issues Paper	The Retail Banking Remuneration Review Issues Paper published on 17 January 2017 and is available at http://retailbankingremreview.com.au/
Review	Independent Review of product sales commissions and product based payments in retail banking in Australia
Terms of Reference	Framework and parameters under which the Review operates. Refer to http://retailbankingremreview.com.au/
Tier 2 products	Tier 2 products as defined by ASIC's Regulatory Guide 146 include financial products that are generally simpler and therefore have lighter training standards. Tier 2 products are: general insurance products except for personal sickness and accident, consumer credit insurance, basic deposit products, non-cash payment products and First Home Saver Accounts (FHSA) issued by ADIs.
Role types	
Managers	Limited to the first- and second-line managers and supervisors of the customer facing staff (i.e. Tellers and Sellers: General, Home Lenders and Financial Advisers)

Sellers: Financial Advisers	For the purpose of this Review, Financial Advisers include individuals who are bank staff and who provide personal and general advice to retail and small business customers on Tier 2 products only.
Sellers: General	Include personal bankers, small business banker-equivalent roles and call centre roles that can sell products to customers.
Sellers: Home Lenders	Staff whose primary function and responsibility relates to the sale of home loans (including new mortgages and top-ups) to retail and small business customers.
Tellers	Customer-facing staff who primarily refer customers to other parts of the business or to other staff.
Rewards and reward types	
Fixed pay	The guaranteed level of monetary reward paid by an employer to an individual, typically comprising base salary plus Superannuation Guarantee in Australia.
Recognition programs and campaigns	As well as fixed pay and variable reward payments, individuals may also be eligible to receive other monetary and non-monetary rewards that are provided on an ad hoc basis to recognise special effort, performance or the attributes of an individual or team. Banks may also supplement the formal performance rewards with ad hoc rewards that are related to the conduct of campaigns, typically to increase sales of specific products.
Variable reward payments (rewards)	The level of monetary reward paid by an employer to an eligible individual. It includes bonuses, incentives or product based payments/product sales commissions.
Reward mechanics	
Accelerator	An arrangement whereby a higher rate of reward is earned with higher levels of performance e.g. increasing volumes of sale.
Cross selling	Sale of additional or 'add-on' products to customers in addition to the primary product(s) an individual is rewarded on.
Gateway	Condition that must be met before potential bonus/incentive/product sales commissions and product based payments can be accessed by the individual.
Modifier	Increases or decreases the bonus or incentive payable once a condition has been met.
Third Parties	
Brokers, Aggregators and Franchises	Brokers deal with and sell a range of products from numerous banks with whom they have a relationship. Brokers may be members of aggregator groups and in such cases the interaction with the bank (whose products they are selling to the customer) will occur at the aggregator level rather than at the broker level. Aggregators will also facilitate the relationship between the customer and the Broker. Brokers and Aggregators are the

	<p>primary point of contact with the customer. However, the bank itself makes its own assessment of the credit-worthiness of the proposed borrower and makes the final decision as to whether or not to grant a loan.</p> <p>Other models include profit-sharing arrangements with locally owned entities or Franchises. In both of these cases the third party operates (and may at least partially own) a branch (or several branches) that <i>exclusively</i> sell branded products on behalf of the primary bank.</p>
<p>Introducers and Referrers</p>	<p>Introducers and Referrers are not required to hold a credit licence provided they fall within the exemption provided by regulation 25 of the National Consumer Credit Protection Regulations 2010. Unlicensed introducers cannot undertake any other credit activities and cannot 'sell' products. However, they may refer customers to the bank and provide the bank with the customer's name and contact details along with a brief description of the purpose for which the customer may want the credit – provided that they have disclosed any commissions or other benefits they may receive from the referral</p>