

# **Retail Remuneration Review**

## **Issues Paper**

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## Executive Summary

This Issues Paper summarises current practices and seeks further information about product sales commissions and product-based payments paid in respect of 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 Paper is part of an Independent Review into such payments commissioned by the Australian Bankers' Association. The Review is also required to comment on the principles that banks might apply when structuring remuneration more generally.

The roles in scope in relation to product-based payments are staff of banks (Tellers<sup>1</sup>, Sellers<sup>2</sup> and their supervisors and near managers ('Managers')) as well as third parties (including Brokers, Aggregators, Franchises, Introducers and Referrers). The Review is intended to build upon (but not duplicate the work of) the Future of Financial Advice (FOFA) reforms. It is also to have regard to the findings of Australian Securities and Investments Commission's (ASIC) contemporaneous inquiry into mortgage broking, which has yet to be published.

In Australia and globally there has been an erosion of public trust in the banking industry, which is a significant part of the environment in which this Review is being conducted. Key figures within the banking industry are openly acknowledging that a significant trust deficit has emerged because practices have developed that have not been, or have been seen not to be, in the interests of customers. They are calling for this deficit to be addressed. This Review is intended to assist in that process by identifying opportunities to modify or remove remuneration practices that entail an unacceptable risk of promoting behaviour by retail staff that is inconsistent with the interests of customers. In that respect both the perception and the actual scale of the risk would seem to be important.

Remuneration practices vary between banks. Although a few do not, the vast majority of banks provide incentives, bonuses or product-based payments/product sales commissions to at least some of their retail staff or to third parties acting on their behalf (such as mortgage brokers) that are directly or indirectly related to product sales. There is a risk that such incentives may lead to behaviours or practices that lead to poor outcomes for customers. Banks have typically put 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 in place. Some have announced an intention to go further in this direction in the year ahead. Others, on the other hand, argue that their culture has been historically strongly service oriented and significant change is not required.

Conflicted remuneration, which may include product sales commissions and volume-based payments resulting from product sales, has 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 or Financial Advisers in pursuit of higher rewards, to the detriment of their customers. These prohibitions do not, by virtue of certain exceptions in the FOFA reforms, typically apply in those parts of retail banking that are in scope for this Review.

The Review's work to date has tentatively identified some practices of some banks that have high risk of incentivising poor selling practices leading to poor customer outcomes, which those banks should consider changing. These include practices that deliver significantly increased incentive payments as certain sales

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<sup>1</sup> Tellers are defined to be frontline staff who primarily refer customers to other parts of the business or to other staff. Banks may call such individuals 'teller', 'concierge' and 'consultant'.

<sup>2</sup> In this report remuneration arrangements are reported separately for those who sell home loans, Sellers: General and certain financial advisers. Sellers: General are defined to include personal bankers, small business banker-equivalent roles and call centre roles that can sell products to customers.

thresholds are achieved (described below as accelerator-type payments). Similarly, arrangements deserve careful scrutiny that provide incentives based on cross sales such as add-on insurance products, or that deny access to incentives otherwise available unless sales or cross-sales targets are also met. Further, some incentives schemes are complex, running the risk that staff or Managers will resolve any confusion or uncertainty by assigning more emphasis to sales-related activities than is intended. Careful simplification<sup>3</sup> could reduce this risk.

Moreover this work has also highlighted the importance of ensuring that risk mitigation strategies are effective, which may be a challenge for the many banks that acknowledge that a ‘sales culture’ is now deeply embedded in the DNA of their organisation. This highlights the need to ensure that, for those banks, their performance management, compliance checking and remuneration systems are well aligned and supported by effective strategies to change the sales culture. Schemes with discretionary elements are often seen as useful measures to allow Managers to reduce the risk of poor behaviour by bringing a wide range of factors to bear when making assessments of performance and eligibility for rewards. Some regulators abroad, for example, suggest they are less risky than formulaic approaches, which can be ‘gamed’. Reliance on Manager discretion to mitigate risk in this way, therefore, increases the importance of ensuring that appropriate cultural norms apply in the workplace. Culture change programs and further scaling back the significance attached to product sales in performance discussions and reward systems will assist in this regard.

Many anecdotes, typically sourced from staff who attended consultations, are reported in this paper that suggest areas for further examination, including by bank management. A number of these at the very least highlight poor management practices such as poor communication skills that may reduce the effectiveness of the relevant bank’s risk mitigation strategies. However, few submissions to date have provided clear evidence that the risks in banks’ current arrangements lead to such significant *systemic* risks of poor outcomes for retail banking customers as would warrant the outright banning of product-based payments. As previously noted I have formed tentative views that some banks should re-examine elements of their present practices and I concur with those who believe it is appropriate to reduce the emphasis on product-based payments whenever possible. This will reduce risk and help to rebuild public trust. I will form final views on all these matters after the next round of submissions, however.

Several submissions to the Review argued that the submission author’s capacity to provide informed views is constrained by a lack of information about what approaches to remuneration banks have adopted. The purpose of this paper is partly to remedy that deficiency (see chapters 3, 4, 5 and Appendix B) and partly to seek further submissions from stakeholders and others to inform the last stage of the Review and the development of final findings and recommendations. The issues on which views are sought are set out in Chapter 6, as follows:

1. The role of targets
2. Does size of rewards or their structure matter most?
3. Should bank obligations be strengthened?
4. What is the difference between a ‘sales’ and a ‘service’ culture?
5. What role may the remuneration arrangements applicable to very senior managers play in conditioning the behaviour of front line staff?
6. Issues specific to remuneration of third parties
7. What is a poor customer outcome (and what is the link to agent remuneration)?

Submissions are requested by February 10 and should be emailed to [submissions@retailbankingremunerationreview.com.au](mailto:submissions@retailbankingremunerationreview.com.au)

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<sup>3</sup> As discussed in section 6.2.1 – Complexity, there is a balance to be struck between simplicity and greater complexity. A reward system based only on one measure (sales performance, for example) may be very risky.

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## **Part 1**

### **Introduction and background**

# 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). The terms of reference are at Appendix A.

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. In particular, this Review has been established to address concerns that pay and incentive structures in banks may conflict with good customer outcomes.

I have been asked to examine whether or not product sales commissions and product-based payments in 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.

## 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 in relation to product-based payments 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 of the Review 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)
- Small business lending.

### 1.1.1 Issues not in scope of this Review

A number of issues are not in scope of this Review. Importantly the Terms of Reference exclude issues that have been, or are currently, subject to detailed examination in other fora. Issues not in scope include:

- *Life Insurance* – Legislation has been introduced into the Federal Parliament that, consistent with the intent of the recommendations of the Trowbridge Review, will restrict remuneration arrangements to a model based on a fixed level of commission (phasing down over time) supplemented by a two-year clawback for lapsed policies<sup>4</sup>.

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<sup>4</sup> The Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016 has been introduced. The Bill will enable ASIC to permit changes to remuneration subject to certain requirements. See also: J Trowbridge, *Review of retail life insurance advice: final report*, FSC, 26 March 2015.

In addition, the Federal Joint Parliamentary Committee on Corporations and Financial Services has recently established an Inquiry into the Life Insurance Industry. The Inquiry is examining, among other things, claims handling in the life insurance sector.<sup>5</sup>

Australian Securities and Investments Commissions (ASIC) has also recently published its Review of Life Insurance Claims<sup>6</sup> that found, among other things, 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 merit. ASIC is continuing its focus on life insurance.

- *Financial Advice* – Advice-related business models that comply with Future of Financial Advice (FOFA) reforms are not in scope. That is, providers of personal financial advice on Tier 1<sup>7</sup> products (including complex products) are not in scope.
- *Stronger Super reforms* – These removed the payment of commissions on default superannuation. This is not in scope.
- *Wholesale banking customers* – Product sales commissions and payments sold, offered or distributed to wholesale customers are not in scope.

## 1.2 Conduct of the Review

The Review commenced on 12 July 2016.

Nine public submissions and a number of confidential submissions were received. The public submissions have been posted on the Review website at [www.retailbankingremreview.com.au](http://www.retailbankingremreview.com.au).

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

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

In conjunction with data gathering, I have also discussed relevant issues with banks, regulators, remuneration experts, consumer advocates, academics and bank staff.

I have also been assisted by the Banking Advisory Group and the Stakeholder Advisory Panel.<sup>8</sup>

A second round of consultations will be conducted following receipt of submissions in February 2017.

## 1.3 Issues Paper structure

This Issues Paper (Paper) is structured in three sections: introduction and background (chapters 1 and 2); pay in the retail banking sector (chapters 3, 4, and 5); and key issues (chapter 6).

The section on pay in the retail banking sector is based on analysis of the extensive data provided by thirteen banks to the Review as well as their submissions and follow-up interviews and consultations. It provides an overview of the common and outlier practices concerning how staff (Tellers, Sellers and their Managers) and

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<sup>5</sup> See: [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/LifeInsurance](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/LifeInsurance)

<sup>6</sup> See: <http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>

<sup>7</sup> Tier 1 products are all financial products, other than basic deposit products (e.g. bank deposit), non-cash payment products, general insurance products, except for personal sickness and accident, and consumer credit insurance products

<sup>8</sup> See Terms of Reference attached at Appendix A.

third parties are paid and given incentives. It also identifies risk factors in those practices and outlines other factors that serve to amplify or mitigate these risks. The factors that amplify risk not only include incentive payments and structures themselves, such as accelerator payments and some gateway arrangements, but also management and cultural factors within organisations such as a target-driven sales culture.

The issues section lists the range of issues I have identified as being of key importance. A central question is whether product-based payments and product sales commissions should be removed and, if so, what they should be replaced with? In addition, I consider there are several key factors that should be considered in finalising the Review and I am seeking public feedback on these. Some issues relate to gaining a broader understanding of the context in which remuneration is structured in retail banking. Others address matters on which I seek further information in order to inform findings and possible recommendations for the final report. These include:

1. The role of targets
2. Does size of rewards or their structure matter most?
3. Should bank obligations be strengthened?
4. What is the difference between a 'sales' and a 'service' culture?
5. What role may the remuneration arrangements applicable to very senior managers play in conditioning the behaviour of front line staff?
6. Issues specific to remuneration of third parties
7. What is a poor customer outcome (and what is the link to agent remuneration)?

## Submissions

I am seeking written submissions on the issues and questions raised in this Paper. Feedback about the issues raised will greatly assist the Review and help to inform my findings and conclusions. Submissions are requested by 10 February 2017.

You can email your submission to: [submissions@retailbankingremunerationreview.com.au](mailto:submissions@retailbankingremunerationreview.com.au)

## 2. Background

There is an ongoing concern about sales culture within banks and how banks pay and provide incentives to staff to sell their products.

The concern over culture and products being sold inappropriately to customers has been raised by consumers, consumer advocates, media and members of parliament as well as other stakeholders. The head 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.”<sup>9</sup>*

A number of submissions to this Review have provided examples and case studies of products sold to customers that were not in their interest and that resulted in poor customer outcomes. Examples typically include 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 (CCI) to customers who cannot claim on the policy. Other examples include customers being sold loans and credit products that the customer was not seeking, and did not require, by bank staff remunerated by product-related payments or whose overall performance pay was heavily influenced by their sales record.

In addition, bank staff have also provided examples to this Review of a target-based sales-driven culture where their perception is that the imperative is not customer service per se but to sell. Some of these examples have been reported in this paper.

Although the circumstances are very different, concern about sales culture within banks is not an issue unique to Australia.

In the US the recent case of fraudulent activity within Wells Fargo Bank – which involved bank employees engaging in a widespread and illegal practice of secretly opening deposit and credit card accounts without customer authority – highlighted how incentive structures can drive poor behaviour and poor customer outcomes.<sup>10</sup> It was reported that employees felt extreme pressure to open as many accounts as possible.<sup>11</sup>

In the UK, the Regulator has issued guidance on risks to customers from financial incentives. They have identified a range of incentive practices that they consider can be a key driver of mis-selling – mis-selling being defined as a failure to deliver fair outcomes for consumers.

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<sup>9</sup> 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/Four_Major_Banks_Review); [http://www.aph.gov.au/Parliamentary\\_Business/Committees/House/Economics/RBAAnnualReport2015/Public\\_Hearings](http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/RBAAnnualReport2015/Public_Hearings)

<sup>10</sup> 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-unauthorized-accounts/>; see also Consent Order issued by the US CFPB: [http://files.consumerfinance.gov/f/documents/092016\\_cfpb\\_WFBconsentorder.pdf](http://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf)

<sup>11</sup> See for example: [http://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html?\\_r=0](http://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html?_r=0); <http://money.cnn.com/2016/09/13/news/companies/wells-fargo-scandal-sales-goals/index.html>; <http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html>

## 2.1 Customer outcomes

A key part of this Review is to assess whether or not, and how, product-based payments and products sales commissions could lead to poor customer outcomes.

It is perhaps surprising that there is no commonly accepted definition in Australia of a poor customer outcome. In the UK context the Financial Services Authority (FSA)<sup>12</sup> 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
- Customers buying on an advised basis are recommended suitable products.<sup>13</sup>

So far in the Review I have been guided by this characterisation, which implies that the opposite would constitute poor customer outcomes. In chapter 6 I seek feedback regarding the adequacy of this approach.

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.<sup>14</sup> The legal framework also places stronger obligations upon the seller as the level and nature of information exchange progresses.

This is depicted in figure 1 below.

Product-based payments to employees and third parties and product sales commissions in the sale of retail banking products, however, are not prohibited by the current regulatory framework.<sup>15</sup>

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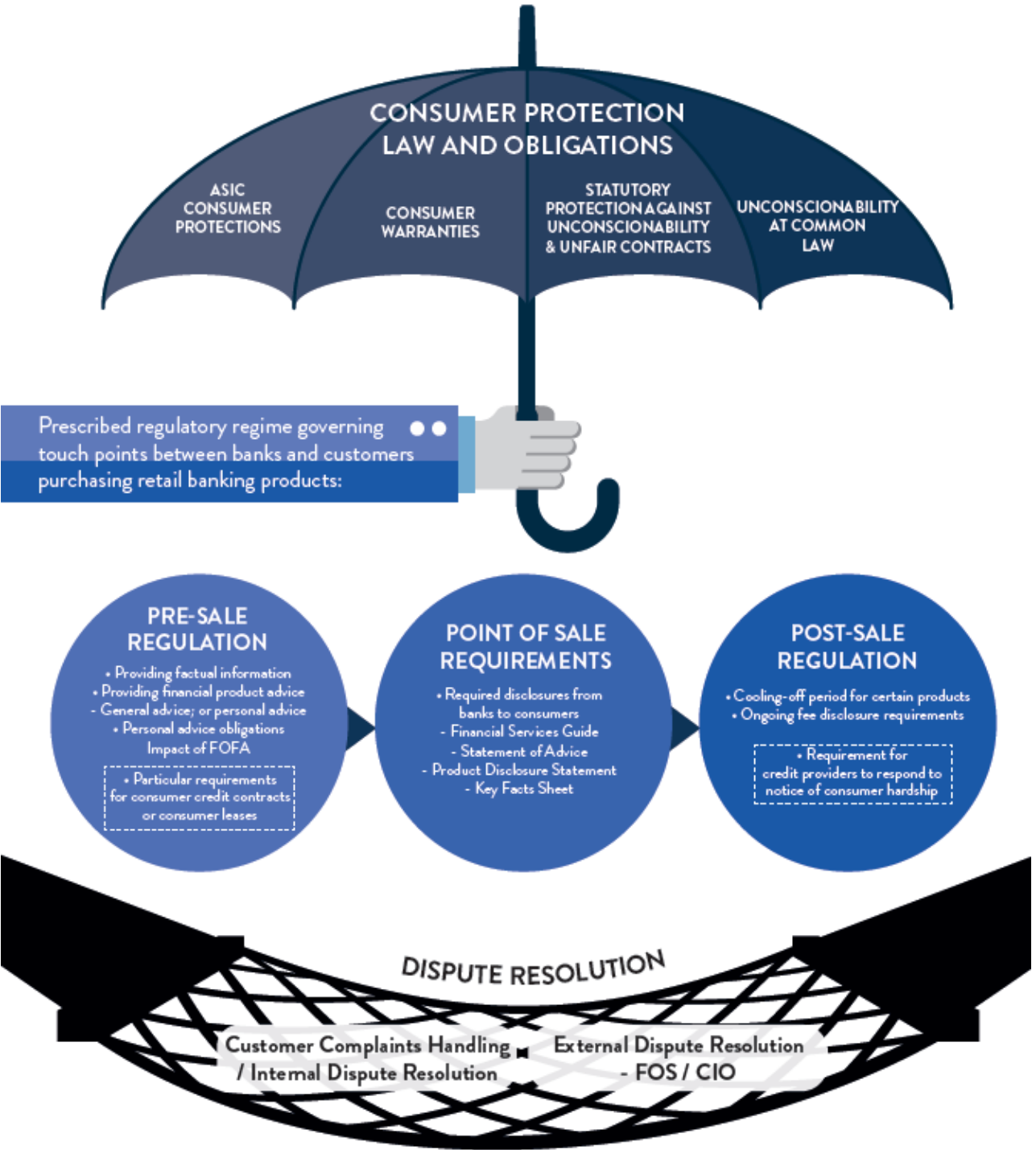
<sup>12</sup> The FSA was the body responsible for the regulation of the financial services industry in the UK between 2001 and 2013. Since then, the FSA responsibilities have been split between the Financial Conduct Authority and the Prudential Regulation Authority

<sup>13</sup> FSA, *Final Guidance: Risks to customers from financial incentives*, January 2013, p 9.

<sup>14</sup> See Chapter 7 of the Corporations Act 2001; Chapter 3 and Schedule 1 (National Credit Code) of the National Consumer Credit Protection Act 2009.

<sup>15</sup> For example, benefits payable to agents or employees of banks for financial product advice relating to basic banking, general insurance or consumer credit insurance products are not conflicted remuneration under Regulation 7.7A.12H of the Corporations Regulations 2001, and credit facilities are excluded from the definition of “financial products” under s 765A of the Corporations Act 2001. However, commissions on consumer credit insurance are capped at 20% of premiums under s 145 of the National Credit Code. See further below.

Figure 1: Australian regulatory framework



## 2.2 Remuneration and incentives payments in context

### 2.2.1 Bank employees

Typically, the remuneration available to bank employees has both a fixed and a variable component. Variable reward pay and, in some cases, the annual increase in fixed pay (together referred to as ‘at risk pay’ in this chapter) may depend on the performance of an individual or a team. In addition, retail bank employees may also be eligible to receive other monetary or non-monetary rewards provided on an ad hoc basis to recognise special effort or the attributes of an individual or team. Chapter 3 summarises the information we have received from banks about the arrangements that apply currently to in-scope retail banking staff and their immediate managers.

The structure of incentives and rewards may vary between business units or roles, depending on the needs of each and their objectives. These arrangements serve several functions:

- They provide *recognition and financial rewards* to well-performing or well-regarded employees;
- They *signal* to employees what more senior management value in that work place, or the goals that are to be achieved; and
- They act as a *sorting device*, since different approaches to their design may attract different types of employees. This can affect who applies to be recruited to particular roles, who is promoted and who leaves the organisation.

For example, a scheme that potentially delivers a high proportion of pay at risk, and that provides substantial open-ended rewards that become larger the more a sales target is exceeded, is more likely to attract persons interested in selling and happy to accept the risk that pay may vary considerably between years. The selection of such staff for recruitment or promotion may colour an organisation’s instinctive way of doing things (‘its culture’) after many years of recruitment and promotion of similarly minded people.

Although some have flatter structures than others, banks are typically hierarchical organisations. Individuals are tasked by and held accountable by more senior personnel, up to the Board. The larger and more geographically dispersed the organisation, the greater the need for quite formal systems of governance within it. As figure 2 below illustrates, remuneration arrangements, including incentives and rewards, are one part of the system by which more senior managers direct, influence and hold accountable the activities of an individual or a unit within an organisation. The rewards and incentives arrangements:

- Work alongside (and may, in part at least, rely upon) the formal performance management system, which is typically designed to provide clarity to staff about what is expected of them and facilitate a measure of accountability to more senior managers; and
- Are discharged in the context of each workplace’s culture (as, indeed, is the performance management system).

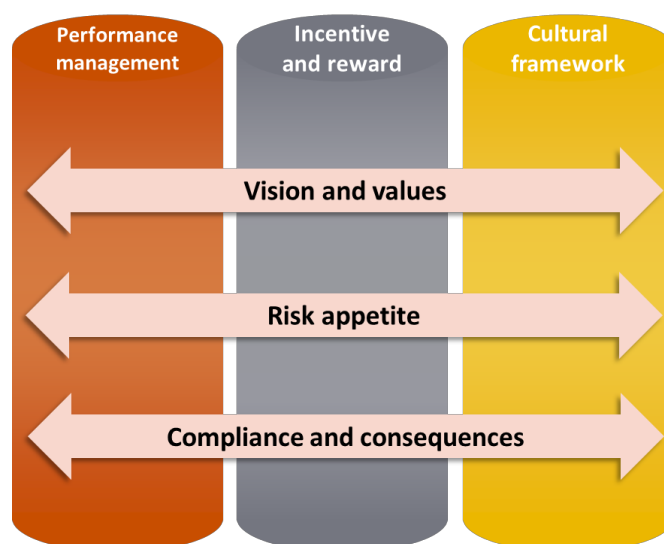
The incentives built into the remuneration arrangements may be magnified or moderated by the way in which performance is managed and by the established mores or practices of the workplace (that is, its culture). A heavily sales-oriented management, for example, may instinctively value and rate more highly successful sales people when assessing their performance and more readily award them discretionary rewards. This may be fully consistent with the objectives of the organisation. Alternatively, it may work against attempts to establish a more service-oriented approach, if that is the organisation’s current objective.

Other aspects of governance may similarly moderate or magnify the incentives built into remuneration arrangements. These include:

- The values of the organisation and its stated purpose or vision;
- The appetite for risk;
- Systems to test compliance with regulatory obligations or the organisation's policies and procedures; and
- The consequences (actual or perceived) of non-compliance.

Behaviour of individuals within an organisation will be affected by their understanding of or belief about matters such as these. Any assessment of the impact of the incentives embedded within a bank's remuneration arrangements needs to consider the interaction between those incentives and those embedded in other aspects of an organisation's governance such as those discussed above. Indeed, many banks rely upon such systems to help mitigate the risks of misbehaviour or inappropriate selling that may be inherent in the rewards and incentives arrangements.

**Figure 2: Systems that direct, influence and hold accountable the activities within an organisation**



## 2.2.2 Third parties

### 2.2.2.1 Brokers, Aggregators and Franchises

Many banks transact with customers through third parties such as Brokers, Aggregators, or Franchises, as well as through their own employees. The reliance placed on third-party channels varies between banks and between products<sup>16</sup>. Mostly, banks do not deal directly with the agents that interact with customers. Rather, remuneration, and any incentives embedded within it, is paid to a business entity, which in turn has a financial (possibly also an employment) relationship with those individuals.

Although banks may undertake due diligence to establish the adequacy of key aspects of the third-party's governance, they have limited oversight of (and may have limited influence over) how performance is managed, workplace culture, etc. In those circumstances the strength of the contractual arrangements with the third party and the effectiveness of the compliance checks in place take on greater significance. These become the key devices available to the bank to mitigate any risks that remuneration arrangements might entail about the interaction between the agent and the end customer. Typically, a bank will reserve to itself the final decision

<sup>16</sup> Some banks have limited branch networks and rely extensively on third-party channels or technology. Mortgages are heavily sold through third-party channels, even by banks with extensive branch networks.

about whether or not to supply the requested facility (for example, a residential mortgage) to the customer. Chapter 4 also summarises the information banks have provided on this aspect.

#### 2.2.2.2 Introducers and Referrers

Introducers and Referrers provide another third-party channel through which customers may engage with a bank. In this case, someone external to it (for example, an accountant or a financial planner) may recommend the bank or its product to a customer of theirs. Sometimes remuneration is paid when a referral results in the provision of a service by the bank (a 'sale'). This remuneration may or may not have been disclosed to the customer. The decision to conclude a 'sale' rests with the customer and the bank. However, there are typically minimal avenues available to the bank to monitor the initial exchanges between the customer and the Referrer<sup>17</sup>. The context in which the referral is made may therefore be unclear to the bank, which may pay an upfront incentive to the Referrer of almost the same magnitude as it would to a Broker managing the same loan application.<sup>18</sup>

## 2.3 Banking product and remuneration legal framework

### 2.3.1 Banking product legal framework

Banking products are classed as financial products or credit products under Australian law and separate rules apply to each classification.

Financial products are regulated primarily by the Corporations Act 2001 (Cth). Credit products are regulated primarily by the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act).

For the purpose of this Review, products sold to retail<sup>19</sup> and small business consumers include products that are classified as follows:

- **Financial products:**
  - Basic banking products; for example, transaction accounts, term deposits and travellers cheques;
  - Non-cash payment facilities; for example, travel money cards; and
  - General insurance products
- **Credit products:**
  - Credit cards, personal loans and mortgages

As flagged earlier in this Chapter, when a consumer has contact with a bank, regardless of whether the contact is by phone, internet or in person, then various legal obligations, particularly based on the above laws, apply to the bank, staff and third parties who interact with the consumer.

The legal obligations are before sale, at the point of sale and post-sale.

These are not only in relation to the information provided to the consumer and how sales can be conducted but also extend to post-sale and include complaint-handling mechanisms.

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<sup>17</sup> Bank staff may also receive incentives for referral activities that they undertake. These interactions between customer and Referrer are subject to the governance and oversight discussed in the section 2.2 above.

<sup>18</sup> See section 4.

<sup>19</sup> Under sections 761G and 761GA of the *Corporations Act 2001*, in broad terms the definition of 'retail client' depends on the nature of the product being sold but refers to customers who are not classed as wholesale customers (clients), businesses other than small businesses, professional or sophisticated investors and clients with high net worth.

These legal obligations are aimed at protecting consumers.

They include advice<sup>20</sup> obligations and disclosure<sup>21</sup> obligations (such as disclosure of remuneration<sup>22</sup>), as well as mechanisms for complaints handling, dispute resolution and responsible lending obligations<sup>23</sup>.

### 2.3.2 Banking remuneration legal framework

In respect of remuneration in the banking sector, apart from the impact of Future of Financial Advice (FOFA) reforms,<sup>24</sup> the Fair Work Act obligations and the regulation of consumer credit insurance under the National Credit Code, it is open to banks in how they structure the remuneration of their staff and third parties.

The following section briefly outlines FOFA and Fair Work Act obligations as they relate to retail banking.

#### Future of Financial Advice (FOFA) Reforms

The FOFA 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 was a regulatory response to a series of financial product and services provider collapses following the global financial crisis (GFC)<sup>25</sup>. The policy intent of FOFA was 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. 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 interests... distortions to remuneration, which misalign the best interests of the client and adviser, should be minimised."<sup>26</sup>

The requirements introduced by FOFA include, among other things, a ban on conflicted remuneration<sup>27</sup>.

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<sup>20</sup> There are various requirements in the provision of advice and this will depend on whether or not factual information, general advice or personal advice is provided to the customer. If personal advice is provided, the person providing the advice is required to consider the best interests of the customer among other things: *Corporations Act 2001* s 961B.

<sup>21</sup> There is quite prescriptive legislation that dictates what is required to be disclosed to a customer. The nature and extent of the information that is required to be disclosed to a customer will depend on whether or not the advice provided is general or personal and what, if any, product is provided to the customer. The various forms of disclosure documents that may be required to be provided to a customer include: Product Disclosure Statements; Financial Services Guide; Statements of Advice; and Key Facts Statement. See sections 952 and 1021 of the *Corporations Act 2001*, and section 33C of the *Insurance Contracts Act 1984*.

<sup>22</sup> The Financial Services Guide that accompanies the provision of a financial product or service must include information about the remuneration (including commission) or other benefits that any employee of that bank (or a related entity) receives from that provision: see *Corporations Act 2001* ss 942(2)(e) and 942C(2)(f).

<sup>23</sup> A credit licensee is required to conduct an overall assessment as to whether or not a particular credit product is 'not unsuitable' for the consumer before providing credit. See Part 3–2, Division 3 of the *National Consumer Credit Protection Act 2009*.

<sup>24</sup> The *Corporations Amendment (Future of Financial Advice) Act 2012* and the *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (the FOFA Acts) amended the *Corporations Act 2001* to implement FOFA, and were supplemented by the *Corporations Amendment (Financial Advice Measures) Act 2016*. These inserted and refined a new Part 7.7A dealing with best interests obligations and remuneration along with a number of consequential and transitional provisions.

<sup>25</sup> For example, the collapse of Storm Financial and Opes Prime.

<sup>26</sup> 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.

<sup>27</sup> Apart from a ban on conflicted remuneration structures, there were other key changes including the introduction of best interest duty that requires advisers to act and provide advice that is in the client's best interest (see Division 2); an obligation to disclose ongoing fees and charges (see Division 3); and an opt-in obligation (see section 962K).

The ban on conflicted remuneration/payments<sup>28</sup> that is part of the FOFA regime does not extend to most retail banking products as these are specifically exempt. The exemptions apply to basic banking products, general insurance products and consumer credit insurance.<sup>29</sup>

The rationale for exempting basic banking products from the conflicted remuneration provisions was that the products are simple and more easily understood, and consumers generally understand that employees of banks sell their employer's product.<sup>30</sup>

The best interest duty that is part of the FOFA regime does, however, apply when bank staff provide personal advice. A modified best interest duty applies to personal advice where the financial advice relates to basic banking products, general insurance products and consumer credit insurance (or a combination of the three). The full best interest duty applies to all other personal advice. Note:

- General advice is defined under the *Corporations Act 2001* as all financial product advice that is not personal financial advice;
- Personal advice is defined as advice that considers one or more of a person's objectives, financial situation and needs. When providing personal advice, advisers are held to a higher standard.<sup>31</sup>

In addition, FOFA does not apply to credit products (loans, mortgages, credit cards, etc.) as these are not classified as financial products.<sup>32</sup> Credit products are regulated separately under a different regime (often described as the responsible lending regime under the NCCP Act). Under the responsible lending regime, a credit licensee must make reasonable inquiries and take reasonable steps to ensure a product is not unsuitable for a consumer before providing credit.

In short, different rules apply to the offer, sale and distribution of different types of retail banking products. This Review was initiated, in part, to build on the FOFA reforms and examine remuneration structures across retail banking products.

### **Fair Work Act**

The *Fair Work Act 2010* (Cth) (**FW Act**) contains provisions that protect employees against breaches of the terms of modern awards and collectively bargained employment agreements (i.e. Enterprise Agreements or **EA**).

Many employees engaged to sell retail banking products at banks are subject to an EA. An EA is a contract that sits alongside an individual employment contract, and records the substance of collective bargaining between an employer and an employee (for example, certain working conditions, leave entitlements or remuneration).

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<sup>28</sup> Conflicted remuneration is defined as any benefit given to an Australian Financial Services Licence (AFSL) holder or its representative that, due to the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the choice of financial product that is recommended or the financial product advice given – *Corporations Act 2001* (Cth) s 963A.

<sup>29</sup> See *Corporations Act 2001* ss 963D, 963B(a), and 75A(h); regulation 7.7A.12H of the *Corporations Regulations 2001*.

<sup>30</sup> See: Future of Financial Advice Information Pack, 28 April 2011, section 2.8. "There will be a limited carve-out from the ban on volume payments...for basic banking products where employees of an Australian Deposit-taking Institution (ADI) are advising on and selling their employer ADI basic banking products. As these basic banking products are often sold by frontline staff, the carve-out is largely intended to address the more routine activities of frontline staff, such as Tellers and specialists. While these employees may provide either general or limited personal advice in relation to these basic banking products, these products are generally easier for consumers to understand, and consumers more readily understand that the frontline employee of the ADI is in the business of selling the employer's product."

<http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf>

<sup>31</sup> See s 766B of the *Corporations Act 2001*. In practice distinguishing between general and personal advice is often difficult.

<sup>32</sup> See s 765A of the *Corporations Act 2001*.

The FW Act prohibits an employer from contravening the terms of an EA,<sup>33</sup> and doing so can result in fines by the Fair Work Commission (**FWC**). Further, it is generally not open to an employer to contract out of obligations they owe under an EA. However, the FW Act requires that EAs include a term enabling an employee and his or her employer to agree on an individual flexibility arrangement (**IFA**) varying the effect of the EA to meet the genuine needs of the employer and employee<sup>34</sup>.

Subject to applications to remove ambiguity or uncertainty, EAs can only be varied jointly by the employer and employees and approved by the FWC. Depending on the terms of an EA, an employer may need to engage in bargaining to vary or introduce a new EA to give effect to changes to their reward and incentives arrangements. The FW Act sets out what the FWC must have regard to and when they must approve and may refuse an application to vary an EA.

As noted above, an employer and individual employee may also enter into an IFA to vary the effect of the EA on an individual employee.

The above separate legislative regimes have implications for how banks set remuneration arrangements for staff. These also limit banks' ability to act unilaterally in certain circumstances.

### **Consumer Credit Insurance under the National Credit Code**

Commissions paid for consumer credit insurance (CCI) are capped at 20% of premiums under section 145 of the National Credit Code. This cap was introduced in 1996 following concerns that high commissions paid in relation to CCI were increasing prices and risked promoting improper sales practices.

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<sup>33</sup> FW Act s50.

<sup>34</sup> FW Act s202.

## **Part 2**

### **Pay in the retail banking sector**

### 3. Remuneration of bank staff

This chapter provides an overview of the remuneration structure for retail bank staff as set out in the Terms of Reference based on data collected from participating banks. The data relates to the roles of Tellers, Sellers and their supervisors and their managers (Managers). Consistent with the Terms of Reference, data was not collected on the remuneration arrangements of executives and most senior managers of each bank.

Remuneration structures typically include fixed pay (i.e. salary) and variable reward payments (that may include product-based payments/product sales commissions) as well as non-monetary inducements or rewards (for example, vouchers for demonstrating desired behaviours, which may include sales success, as part of a recognition program and/or campaign).

Sales of retail products may affect remuneration of bank staff either directly or indirectly. Sales may directly affect pay through product-based payments/product sales commissions calculated using a formula related to sales volumes achieved (i.e. a dollar amount per sale or a percentage of the total revenue generated from the sale of specific products).

However, remuneration payable to staff may also be indirectly affected by sales success. These reward systems are linked to an assessment of an individual's (or a team's) overall performance, which may include performance against both financial (for example, the value or mix of sales achieved) and non-financial measures. These reward systems are described in more detail in section 3.3. Sometimes rewards that may otherwise be payable can only be accessed if sales targets are also met. (See section 3.3.9, Gateways.)

Almost all banks that participated in this Review link the pay and incentives of their staff to sales performance (either directly or indirectly). However, many of those banks are seeking to reduce the role that sales behaviour plays in setting variable remuneration for retail staff, at least formally<sup>35</sup>.

#### 3.1 Role overview

##### 3.1.1 Tellers

Tellers are defined to be customer-facing staff who primarily refer customers to other parts of the business or to other staff. Banks may call such individuals 'teller', 'concierge' and 'consultant'. Some roles discharged within contact centres cannot sell products but only have authority to refer a customer to other staff. Such roles have been reported alongside Tellers in section 3.3 below.

##### 3.1.2 Sellers: General (Sellers)

General Sellers are defined to include personal bankers, small business banker-equivalent roles and call centre roles that can sell products to customers.

Examples of banking products sold and/or referred by personal bankers and call centres include general and life insurance, home loans, savings and investment products, lending products such as personal loans and credit cards, wealth and superannuation products.

Small business bankers sell and/or refer banking products relevant to small businesses. These products include investment loans, general insurance, business transaction accounts, business loans, asset finance and business credit cards, etc.

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<sup>35</sup> The Reviewer is seeking feedback about whether or not the culture of managers has changed sufficiently to give full effect to this intention.

### 3.1.3 Sellers: Home Lenders (Home Lenders)

Home Lenders refer to 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. These roles may also cross-sell and/or refer other banking products to retail and small business customers.

### 3.1.4 Sellers: Financial Advisers (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<sup>36</sup> only. Under the Terms of Reference for this Review, advice-related business models that comply with the Future of Financial Advice (FOFA) reforms and associated exemptions contained in law and regulations are out of scope.

### 3.1.5 Managers

Managers, for this purpose, are 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). Details of the remuneration arrangements applicable to their more senior managers is out of scope, although the Terms of Reference require the Reviewer to reflect on the principles that might apply to setting remuneration more broadly than in respect of retail bank staff.

## 3.2 Fixed pay

For the majority of banks, fixed pay is typically internally consistent across retail banking role types. The average fixed pay for Tellers is less than the annualised Average Weekly Earnings in Australia<sup>37</sup>, while Home Lenders, on the other hand, are typically paid more than the Average Weekly Earnings in Australia. The average fixed pay for Sellers varies depending on the nature of the Seller role.

Retail staff typically receive pay increases on an annual basis (possibly with out-of-cycle pay increases due to promotions or ad hoc adjustments). Fixed pay increases can either be prescribed by an enterprise agreement (EA) or reflect management decisions based on factors such as market relativity and/or the individual's performance.

The coverage of EAs may vary between banks and, within a bank, may depend on the individual's role or base salary. For example, Tellers generally fall under an EA where an EA is in place. EA-prescribed increases currently range typically from 2% to 4% across banks. To be eligible to receive the fixed pay increase, individuals may be required to meet certain criteria such as minimum performance, risk and/or behaviour standards.

Fixed pay increases are generally common amongst those performing a role regardless of whether or not the individual is covered by an EA. However, some instances were reported where the fixed pay increase was significantly greater than the EA-prescribed amount or, for roles not covered by an EA, where an individual received a larger fixed pay increase than the majority of individuals performing the same role. Reasons for this vary with examples including geographic differences in pay or mobility between roles or locations.

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<sup>36</sup> 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.

<sup>37</sup> The annualised weekly National Average as at May 2016 as reported by the Australian Bureau of Statistics.

### 3.3 Variable reward payment

In addition to fixed pay, all staff are typically eligible to receive variable reward payments that can include bonuses, incentives or product-based payments/product sales commissions ('rewards'). It is important to note that all staff who perform the roles of Tellers, Sellers: General, Home Lenders and Financial Advisers as well as Managers receive a mix of fixed and variable reward payment.

Tellers' variable reward payment potential is significantly less than the Seller and Manager roles. Home Lenders and Financial Advisers have a potential to earn significant variable reward payments in comparison to other Sellers.

Data has been collected about the practices that Australian banks currently follow in providing rewards and incentives to staff who perform the roles of Tellers, Sellers: General, Home Lenders and Financial Advisers as well as Managers<sup>38</sup>. This section provides a brief summary of current practices. Greater detail is provided in Appendix B. In interpreting the data it is important to note that some banks apply more than one scheme for different types of roles that conform to the generic role descriptions used. The frequency of reward payments varies across banks and roles. It ranges from monthly to annual payments. The information in this Paper is reported as annualised figures<sup>39</sup>.

In some cases the reward amount paid is set by a formula. In other cases management has a degree of discretion. In some cases individuals or teams receive an allocation from a 'pool'. Some banks that use a pool have provided an explanation on how the pool amount is determined. These include:

1. The pool amount is determined at the discretion of the Board or its delegate; or
2. The pool amount is based on the business results during the applicable year (e.g. Return on Equity and/or Cash Earnings Growth); or
3. A percentage of fixed pay for all eligible staff.

A pool may apply across the whole bank or may apply specifically to a unit/section within the bank. An individual's share of the pool may in turn depend on an assessment of their relative contribution to their team's result.

Most banks operate more than one reward scheme. For example, one bank has two schemes (covering all customer-facing staff and their Managers); another bank has ten schemes. Practices vary considerably among banks. However, these plans are typically structured in one of four ways, namely:

1. Performance scorecard approach;
2. Variable rewards related to performance against specific measures or targets;
3. Variable rewards based on management discretion against individual performance measures or targets; and
4. EA-prescribed variable rewards

#### 3.3.1 Approach 1: Performance scorecard approach

Most banks have adopted a 'scorecard' approach to paying bonuses and incentives to staff. The scorecard records performance against a number of elements or measures. These may include sales, customer satisfaction

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<sup>38</sup> The majority of staff Financial Advisers are remunerated under an approach that is specific to their role and are covered in section 5 of Appendix B.

<sup>39</sup> In addition banks have provided information based on the most 'recent performance period', which varies from bank to bank and may be annual, quarterly, etc.

and/or the extent of compliance with policies, procedures, or behavioural standards. The types of measures used and the weights assigned to them in arriving at an overall score are presumably designed to send signals about the relative importance attached to each measure.

### 3.3.2 Approach 2: Variable rewards related to performance against specific measures or targets

Under this approach, 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). Most of the schemes that apply to Home Lenders fall within this approach.

In this approach, remuneration may be directly and formally linked to product sales (i.e. product-based payments/product sales commissions). This differs from approach 1 (performance scorecard approach), which is indirectly linked to product sales since other measures are usually combined with sales performance. The importance of sales to the overall result will depend on the value assigned to sales-related elements in the computation.

Most banks also adopt this approach for at least some roles.

### 3.3.3 Approach 3: Variable rewards based on management discretion against individual performance measures or targets

The bonus and incentive amount under this approach is based on management's assessment of an individual's performance against targets or other measures included in the bank's performance management arrangements. These typically include financial targets as well as non-financial measures. The value management assigns to each measure considered in the assessment of the individual's performance may not be transparent to the individual. Such assessments may be subject to peer review or to review by more senior managers. They are likely to be heavily influenced by the culture of the workplace and, possibly, the skills of the managers.

Only a few banks have adopted such an approach.

### 3.3.4 Approach 4: EA-prescribed variable rewards

While most banks that have an EA in place set out that an individual who is covered by the EA may be eligible for a variable reward payment, the majority do not specify the details of the arrangements such as the prospective amount.

Under this approach, the bank's EA prescribes a specific potential bonus and incentive amount subject to each individual meeting minimum performance standards, with no other individual financial target gateways being used.

Only a few banks have adopted such an approach.

### 3.3.5 Performance measures

The elements of performance considered under any of the four approaches listed above can be categorised as follows:

1. *Financial*: Such measures and targets include the volume of revenue or sales and/or referrals achieved (either in absolute terms or, more typically, relative to targets), which may include cross selling<sup>40</sup>. Measures may relate to individual or team performance or both. Sometimes, especially where rewards

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<sup>40</sup> Cross selling is the sale of additional or 'add-on' products to customers in addition to the primary product(s) an individual is rewarded on. Some banks have classified cross-sales measures to 'customer' segments of their scorecard. For the purposes of this review such measures have been reclassified as 'financial'.

are team-based, such measures may also include overall measures of financial performance of the bank or a specific business unit such as profitability or return on equity.

2. *Customer*: These measures and targets relate to customer satisfaction or feedback such as: the proportion of surveyed customers who would recommend the bank to a friend; and/or the average rating achieved in surveys to capture customer satisfaction; and/or the number of complaints received; and/or growth in the customer base. These metrics may be individual or team-based.
3. *Risk and Compliance*: Banks typically devote significant resources to monitoring the activities of individuals and teams, independently of each business unit, to assess compliance with bank policies and procedures. These may relate to documentary standards, regulatory compliance (for example, in respect of general advice), adherence to the bank's risk appetite and the like.
4. *Process*: This can include service delivery standards (such as call waiting times) or the 'quality' of conversations conducted with customers, or progress in implementing strategy or bank wide initiatives in an efficient manner.
5. *People*: Although usually more relevant to the assessment of Managers, this can include achieving an appropriate level of staff engagement, successfully managing a team and/or providing a minimum amount of coaching sessions to the team.
6. *Community*: For some banks, their assessment of a Manager may include measures of engagement with the local community.

Scorecard approaches (approach 1, above) typically employ a broad range of measures – see Appendix B. However, financial targets (including targets for cross selling) typically<sup>41</sup> figure prominently, most applying an aggregate weight to financial elements of around 50%, often much higher. Specifically, many Tellers and Sellers (General) who use the scorecard approach have 50% of their scorecard weighted to financial targets while Financial Advisers and Home Lenders generally have 50% to 65%. With regards to Managers, many have a financial performance measure that is weighted between 45% and 55% of their overall scorecard.

Financial factors also feature significantly in measure-specific reward systems (approach 2, above). Sometimes, though not often, branch financial measures are included in the assessment of an individual. For Tellers, the financial variables concern their referrals of customers to other bank staff.

### 3.3.6 Product neutrality

Some reward plans that link incentives to the sale of products do not differentiate between the types of products sold when calculating an entitlement to a payment. The reward is based on the total value of sales or revenue, irrespective of the mix of products that make up that value. Others assign different values to the sales of different products. Sometimes this is justified as achieving a better alignment between the potential reward available and the effort required to make the sale. In other cases the relative values reflect strategic objectives of the management; for instance, they may wish to raise the attractiveness of the sale of particular products either temporarily (e.g. during a campaign to build market share in some product) or more generally. An issue that needs to be assessed is which approach is more likely to be viewed as 'product neutral' – in other words, as one that minimises the risk of providing inappropriate incentives to Sellers. See section 6.2.7 below for further detail.

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<sup>41</sup> Practices vary widely. One bank includes no direct financial variables in assessing the eligibility of staff for a bonus. A few rely totally on measures of financial success, subject to behavioural and similar gateways.

### 3.3.7 Accelerators

The term ‘accelerator’ (or ‘stepped payment’) refers to an arrangement whereby a higher *rate* of reward is earned with higher levels of performance such as increasing volumes of sales. For example, a sale may attract a commission of 2.5% for each dollar of sale above a threshold but a larger commission, say a percentage point higher, may become payable for sales that are 25% above that threshold. The higher payment is typically applied to sales in excess of the last threshold. Some banks apply accelerators in approach 2 or accelerator-like devices in approach 1 for some roles, especially Home Lenders (see Appendix B). This form of incentive may create increased risk if staff try to maximise their sales before the end of the incentive period.

### 3.3.8 Modifiers

Some banks apply ‘modifiers’ under schemes that conform to approaches 1, 2 or 3. A ‘modifier’ increases or decreases the bonus or incentive payable once a condition has been met (e.g. increases or decreases the incentive payment by, say, 30%). Modifiers that increase the incentive payable typically include exceeding financial targets, exceeding customer satisfaction targets and/or exceeding behaviour standards. In one case, achieving cross-sales targets can increase the reward otherwise payable to a Seller or a Manager by up to 70%. The availability of increased incentives for meeting financial targets through mechanisms like this potentially have similar impact on behaviour as an accelerator (for which reason we have referred to them as ‘accelerator-type’ arrangements in this paper). Modifiers that decrease the variable reward amount typically include not meeting compliance/risk rating standards, being on formal performance management and/or not meeting behaviour standards.

### 3.3.9 Gateways

A ‘gateway’ is a condition that must be met before potential bonus/incentive/product sales commissions and product-based payments can be accessed by the individual. In all four approaches listed above, banks use gateways to determine an individual’s eligibility to receive a reward. Examples of gateways include meeting minimum behaviour standards, minimum performance standards, compliance/risk ratings and/or meeting financial targets (for example, meeting sales or cross sales targets). Many of the banks employ gateways – indeed, typically performance is assessed against more than one gateway before an individual can access any potential reward.

The following table shows the number of plans that use each type of gateway for each approach:

Number of reward plans					
Gateway	Approach 1	Approach 2	Approach 3	Approach 4	Financial Advisers
Behaviour and conduct	79	32	0	2	1
Risk and compliance	76	31	0	2	6
Performance	76	24	0	6	2
Training	18	9	0	0	1
Individual financial threshold	1	9	0	0	4
Customer	2	2	0	0	0
Individual cross-sell threshold	0	3	0	0	0
Branch financial threshold	2	1	0	0	0
Referrals	0	2	0	0	0

Some gateways are viewed as an important component of a strategy to minimise the risk of mis-selling or poor customer outcomes. The application of financial gateways, however, is not necessarily consistent with such a philosophy.

### 3.3.10 Caps

Some banks apply caps on the total bonus or incentive that can be earned or, in the case of approach 2, a cap on the reward that can be earned under each performance measure. While many schemes for Tellers have caps in place, they are rarely triggered due to the very limited reward amount earned by these role types.

### 3.3.11 Deferrals

A deferral is a mechanism used by banks whereby a component of an individual's variable reward payment is delayed or 'held back' for a set period, but is then released to the individual in the form of either cash or equity once certain conditions have been met.

#### Use of deferrals across the banks

In most instances, deferrals are triggered once a payment threshold is met. Once the threshold is met, a percentage ('deferral percentage amount') of the amount above the threshold will be deferred. The deferred amount will be held by the bank for a set period ('deferral period').

Approximately half of banks have in place deferral mechanisms. The majority of these apply the deferral to all roles (i.e. the deferral policy is set at a group level). However, some banks:

- Apply the deferral to some roles only; and/or
- The deferral rules (the deferral percentage and/or the length of the deferral) may vary per role

In some instances the more senior roles have higher deferral percentages and/or a longer deferral period.

All banks that have a deferral mechanism have applied it in the previous performance year to individuals who met the applicable thresholds. Apart from Home Lenders and Financial Advisers, as well as Managers, however, the rewards earned by retail staff are typically too low to trigger deferral thresholds.

The table below provides detail on the deferral mechanisms banks reported most frequently:

Deferral rules	Range
Threshold (per annum)	\$50,000 to \$150,000 (1)
Deferral percentage amount	25% to 100%
Deferral period	1 to 3 years (2)

- (1) The most common deferral threshold is \$100,000. One bank does not use thresholds, but rather withholds a percentage of the individual's variable reward payment depending on the seniority of the individual. Where the deferral period is more than 1 year, the majority of banks release the withheld amount gradually over the remaining period.
- (2) For a number of banks, if the total amount over the threshold is less than \$10,000 then no portion of that amount will be withheld.

The majority of Financial Advisers are remunerated subject to separate deferral arrangements. See section 3.3.5 above.

### 3.3.12 Clawbacks

Clawbacks, in the context of staff, is a mechanism whereby all or part of an individual's variable reward payment is recovered by the bank from the individual if certain conditions are met. In some instances the reward may be forfeited entirely if the payment has not yet been made to the individual.

Clawbacks are generally triggered in the event of misconduct, fraud/illegal acts by the individual or if the reward payment has been based on inaccurate information. In one bank, a clawback may be triggered if an individual is subject to formal performance management.

While the majority of banks reserve the right to claw back the reward based on an individual's behaviour, only a few banks have in place specific clawback policies and processes. Clawbacks were rarely invoked in the previous performance year for roles relevant to this Review.

## 3.4 Recognition programs and campaigns

As well as fixed pay and variable reward payments, individuals may also be eligible to receive other monetary (cash and vouchers) and non-monetary (cinema tickets, dinner, conference, etc.) 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.

The majority, but not all banks, have recognition programs and campaigns that their customer-facing staff and Managers may participate in. Some recognition programs and campaigns are 'open' throughout the entire performance year but some are for a specific period. A number of recognition programs and campaigns with performance-based eligibility criteria (i.e. that relate to the number of product(s) sold or referred) were held towards the end of the performance period/financial year.

### 3.4.1 Eligibility criteria

Eligibility criteria currently used by the banks include, but are not limited to, performance based on:

- Individual sales and/or referrals (which may be based on sale/referral of specific products or may be cross-selling focused); and/or
- Team sales and/or referrals; and/or
- The individual's sales performance relative to others in their team (often captured by the frequent updating of the team/business unit 'leader board'); and/or
- Top-performing team or branch (this may include both financial and non-financial measures); and/or
- Exhibiting behaviours in line with the bank's values; and/or
- Positive customer feedback and/or customer service.

Selection of the recipient(s) of the reward is done either via a committee or by management based on peer nominations or by random selection from those who meet the eligibility criteria. Alternatively, the reward may be available to every individual who meets the eligibility criteria.

### 3.4.2 Reward types

The recipient of a recognition program or campaign reward may receive a monetary or a non-monetary reward or they may be assigned points that can be redeemed for a monetary or non-monetary benefit.

For a small number of banks, the points accrued under a specific recognition program or campaign count towards a specific performance measure (i.e. approach 2 under section 3.3.2) and when the performance measure is met or exceeded, the individual will receive a direct reward payment.

#### 3.4.3 Value

The value of rewards from recognition programs and campaigns range from nominal amounts (that can accrue) to tens of thousands of dollars across individuals and/or teams.

## 4. Remuneration of third-party channels

This chapter provides an overview of the remuneration structures that banks apply to third parties who sell or refer banks' retail products, especially mortgage lending, to retail customers. Third-party channels include Brokers, Aggregators and Franchises, Introducers and Referrers and certain Financial Advisers (specifically excluding Financial Advisers covered under section 2 and those excluded from the Terms of Reference). In addition this chapter also discusses remuneration structures of staff who manage the third-party channels and their Manager as defined in section 3 above.

Remuneration structures for third-party channels may include upfront commissions, trailing commissions, bonus/other monetary reward payments as well as non-monetary payments (primarily 'soft dollar' rewards that are non-monetary rewards given in addition to commissions and/or bonuses) that are given by the banks to the third-party channels that sell and/or refer their products.

This section is based on information received from banks as part of the Review information request and subsequent consultation meetings. As noted in the Terms of Reference, ASIC is currently reviewing the mortgage broking industry and, in particular, the consideration of remuneration structures and payment arrangements in mortgage broking. Data sought for the purposes of this Review was more limited than that gathered by ASIC, which is undertaking a broader review into the mortgage broking industry, and, consistent with the Terms of Reference, it is hoped that the final report will be informed by the data ASIC has collected.

### 4.1 Third-party overview

#### 4.1.1 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 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.

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 *exclusively* sell branded products on behalf of the primary bank.

#### 4.1.2 Introducers and Referrers

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. Introducers and Referrers include, but are not limited to, Financial Advisers, solicitors, accountants and real estate agents.

#### 4.1.3 Financial Advisers

Similar to Financial Advisers as defined in chapter 2, for the purpose of this Review, third-party Financial Advisers only include those who sell or refer the bank's Tier 2 products. Under the Terms of Reference for this Review, advice-related business models that comply with the Future of Financial Advice (FOFA) reforms and associated exemptions contained in law and regulations are out of scope.

The majority of banks primarily have relationships with Financial Advisers to sell and/or refer Tier 1 products, unless they are engaged as Referrers to refer Tier 2 products. As such, Financial Advisers are not included in the third-party data.

#### 4.1.4 Vertically integrated third-party channels

In some instances, banks may have a shareholding in a particular third-party organisation, such as an Aggregator that sells and/or refers that particular bank's products. However these third-party channels are remunerated in the same way, attracting the same commission percentage, as the bank's other third-party channels that are considered top performers (i.e. the data provided by banks does not show a difference in terms of remuneration structure and reward including soft dollar and bonus payments between vertically integrated third parties and others with which the bank has a relationship).

#### 4.1.5 Use of third parties

Retail banking products that are delivered via third-party channels include home loans, savings and investment accounts, wealth/superannuation products, commercial loans, other loans (e.g. personal loans, car loans etc.), small business lending and insurance products.

The percentage of products typically delivered by third-party channels compared with those sold by the banks' staff differ by product and by third-party channel. Some banks are solely reliant on third-party channels to sell and/or refer certain products (mainly home loan related) while others are less reliant on third parties.

The main products delivered by Brokers, Aggregators and Franchisees compared with products sold by bank staff relate primarily to home loans, followed by savings and investments products and other lending products. The primary products delivered by Introducers and Referrers also relates to home lending products but this percentage is significantly less than the percentage delivered by Brokers, Aggregators and Franchises.

## 4.2 Third-party rewards

Although the details may vary between banks, third-party channels are typically rewarded based on the products sold and/or referred, essentially on a commission basis. In consultations more than one bank acknowledged that if a bank wishes to conduct a campaign to increase sales of its mortgage product, for example, it would typically increase the commission rate available on such sales for a period. This appears to be an industry practice from which few banks are prepared to depart, at least on a unilateral basis.

#### 4.2.1 Upfront commission

The majority of third-party arrangements include an 'upfront commission', though the calculation of the commission is different across the banks and third-party channels.

Brokers, Aggregators and Franchises can receive a commission that is a percentage of measures such as the number of home loans settled, the loan approval limit or the value of the product. Some banks will provide the upfront commission based on net new funds under management drawn in a certain period (e.g. the month prior to payment), with the percentage of the commission increasing as the funds under management/volume of sales increases.

In the case of Introducers and Referrers, they may receive the upfront commission only if the customer applies for and draws down a qualifying loan, or is based on the volume of referrals, with higher volumes qualifying for a larger commission payment. In some instances the commission may be based on a percentage of the value of the product (e.g. payment is based on 75% of the credit facility) rather than the entire value of the product.

The amount of upfront commission paid may be different between the bank's top third-party channels, including vertically integrated third-party channels (i.e. vertically integrated third party channels and top third party channels receive similar commissions) and those that are not the top-performing third-party channels.

#### 4.2.2 Trailing commissions

Third-party channels may also receive an ongoing 'trailing commission' for subsequent periods that the customer continues to hold that product. Some banks pay either a flat fee or a fee that increases over time to their third-party channels subject to the conditions set out below. This trailing commission may be different between a bank's top third-party channels, including vertically integrated third-party channels, and those that are not considered to be in the top-performing bracket.

The amount of trailing commission may increase the longer the customer continues to hold that product. In the majority of banks, a trailing commission will cease if the customer defaults or is in arrears on the product, if the third party engages in misconduct or if the outstanding balance of the loan falls below a certain amount.

#### 4.2.3 Range of commissions

##### Upfront commission

All banks pay upfront commission to their third-party channels (i.e. Brokers, Aggregators and Franchises as well as to Introducers and Referrers).

The majority of Brokers, Aggregators and Franchises receive an upfront commission that is typically less than 1% of the value of the product delivered while a small number of banks pay a dollar amount per product sold on certain types of products. The exact range of upfront commissions varies across all the banks.

Many banks also pay a percentage upfront commission to Introducers and Referrers whilst a number of banks pay a flat fee based on the loan amount, with the flat fee increasing as the loan amount increases. The percentage commission paid to Introducers and Referrers is slightly less than the percentage commission paid to Brokers, Aggregators and Franchises, with the majority paying no more than 0.66%.

##### Trailing commission

Brokers, Aggregators and Franchises receive a trailing commission that is either:

1. A fixed commission percentage that varies across banks and is generally no more than 0.25%. In some instances the value of the trailing commission percentage may increase if the number of products sold/referred by the third-party channel increases (i.e. cross selling); or
2. A trailing commission percentage that increases every year in which the product is still held by the customer.

Most banks do not pay trailing commissions to Introducers and Referrers.

#### 4.2.4 Clawbacks

In the case of loans, all banks have clawback mechanisms in place to take back the commissions paid if the loan is repaid/settled/closed or refinanced within a specific period. Such clawbacks are intended to prevent product 'churn' whereby customers are sold another loan that refinances the original, triggering another upfront commission for the third-party channel. As such, the use of clawbacks in the context of third-party channels is different from those described in Chapter 3, Appendix B and used for staff.

The majority of clawbacks will occur if the loan is repaid/settled/closed or refinanced between 0 to 24 months, with the clawback amount decreasing over time (e.g. if the loan is refinanced within 0 to 12 months then 100% of the commission paid will be clawed back but if the loan is refinanced within 12 to 15 months 50% of the commission will be clawed back).

The clawback amounts range from 100% of the commission paid to 25%, with the majority of banks clawing back 50% to 100% if the clawback event is triggered.

#### 4.2.5 Bonus

In addition to upfront and trailing commissions, some banks provide bonus monetary rewards to third-party channels. Examples of these include:

1. Monthly, quarterly and/or annual payments that may be limited to the 'top-performing' third-party channels (e.g. based on the number of sales/referrals from that third-party channel or funds under management for a set period); and/or
2. Ad hoc 'good will' commission payments at the bank's discretion.

#### 4.2.6 Soft dollar rewards

Most banks, in addition to the commissions and/or bonus set out above, provide non-monetary rewards to their third-party channels; these are known as 'soft dollar' rewards.

These rewards include, but are not limited to, sponsorships, conferences and other training events, hospitality (e.g. golf days, sporting events, lunches and dinners) and payments to help defray marketing expenses.

The data provided to the Review suggests that the total value of these soft dollar benefits per bank ranges from several hundreds of thousands to several million dollars per annum. However these figures are best considered as indicative only since some banks that provide soft dollar rewards to third parties were unable to report the aggregate amount paid.

### 4.3 Monitoring

Banks have monitoring arrangements with third-party channels to ensure their continued adherence to the terms of the contract and their obligations to the bank including risk, compliance and conduct requirements.

Monitoring practices vary, including the breadth of the monitoring undertaken, its frequency and the focus of the monitoring. Monitoring practices may include conducting regular formal or informal reviews of the third-party channels' governance and compliance framework, monitoring and supervision; third-party due diligence; as well as assessing a sample of customer files to ensure responsible lending criteria have been met. The reviews and file assessments may be conducted both by the bank's team managing the third-party channels and/or by the bank's compliance and audit teams.

### 4.4 Staff who manage third parties

Within each bank, third-party channels are managed by specific individual(s) and/or team(s). These individuals/teams may be responsible for overseeing the third-party channels' financial performance, their compliance with obligations, growing the third-party channels used by the bank and organising soft dollar benefits to third parties, etc.

Bank staff who manage third-party relationships are remunerated in line with the information set out in Chapter 3 above, specifically the variable reward approaches described in sections 3.3.1 and 3.3.2.

For the majority of banks, the notable difference between staff who manage third parties and those as set out in Chapter 3 is the staff's specific performance objectives, under the variable reward payment, and their interdependency on the performance of the third-party channels that they manage. For example, individuals who are remunerated on a performance scorecard approach for one bank have 55% of their scorecard based on

managing the relationship with the third-party channel, 32.5% of which is related to the financial performance of the third parties they manage.

Other examples of staff performance objectives include:

- Lending settlement targets and new lending settlement targets; and/or
- Increase in lending growth and/or new customers targets; and/or
- Third-party channel cross-selling targets; and/or
- Funds under management targets achieved from third-party channels.

## 5. Features intended to reduce the risk of poor customer outcomes

This chapter sets out systems, processes and features that banks report they have in place, that are intended to reduce any risk of poor customer outcomes inherent in the design of their remuneration structures (risk mitigation measures) as set out in Chapter 3 and discusses the effectiveness of these risk mitigation measures. Both this chapter and the next include anecdotes provided by some staff during our consultations. These illustrate some important issues that may warrant further investigation by bank managements. They also include examples drawn from banks practices, as reported in responses to our survey.

It would be surprising if any of the features listed below could in isolation fully mitigate the risk of poor customer outcomes. While the majority of banks employ some or all of these measures, their effectiveness most likely varies. A range of factors will be at work which, importantly, includes how the risk mitigation strategies have been operationalised in the context of the history, culture and practices of particular teams/business units and management styles. A strong and deeply embedded sales culture, for example, is difficult to change quickly. Attempts to do so need to be sustained, credible and possibly dramatic to have an ongoing effect.

### *Selling branches and clean-up branches*

*“Some branches are renowned for problem selling. We are a good branch. There are selling branches and clean-up branches. We clean up after the selling branches.”*

The features below can be assessed in light of the risk mitigation measures outlined in Financial Services Authority’s document *Final Guidance on Risks to customers from financial incentives* (January 2013).

### 5.1 Non-financial measures

Most banks employ financial targets as an element of their performance management and rewards and recognition frameworks. However many frameworks also include non-financial measures as part of their assessment of an individual’s eligibility for a reward payment (‘gateway’) or as an element of an individual’s performance. These may include: measures of customer satisfaction; whether or not the bank’s policies and procedures have been complied with (which may include whether or not the individual’s behaviours are consistent with the bank’s values and expectations); whether or not documentation meets appropriate standards; and the nature of ‘conversations’ conducted with customers to establish their ‘needs’<sup>42</sup>.

#### **EXAMPLE**

*The performance scorecard for one customer-facing role contains 100% non-financial measures. These measures are in the categories of risk management, process, customer and people. The Managers of staff in this role also have 100% non-financial measures in their scorecards. To be eligible to receive a reward, these roles are required to meet minimum risk and behaviour standards and minimum performance standards determined by their scorecard.*

When banks use non-financial measures, particularly as gateways or as segments in a scorecard, they are attempting to ‘balance’ the potential impact of financial measures on the sales orientation of staff and mitigate the risk of inappropriate behaviour or mis-selling. It is frequently argued that the larger the weight or value

<sup>42</sup> Note that cross-sell targets or measures are regarded by some banks as customer (non-financial) measures rather than as a financial measure. Some banks regard cross sales as an indicator that ‘customer needs have been identified and met’. For the purposes of this review they are treated as product-related/financial measures.

assigned to non-financial measures the lower the risk posed by financial targets that are included in total performance objectives. Similarly it is frequently argued that gateways based on an assessment of the appropriateness of employee behaviour, for example, are a key element of such a risk mitigation strategy.

However, some have argued to the Review that some non-financial measures incentivise activities that are not necessarily in the best interests of customers. For example, some banks measure Tellers (and Managers) on the number of customers who are diverted/assisted to effect a transaction through self-service channels rather than via the Teller. The bank's intention is to process as many transactions as possible through such channels, cutting costs and responding to business threats posed by technologically enabled competitors, including new entrants. Banks argue customers benefit from 24/7 access and greater convenience/flexibility. For some customers, however, such an approach may not be in their best interests – indeed, one Teller described this as a 'self-service industry' not a customer service one<sup>43</sup>.

### ***Walk out working***

*"Part of my behaviour metric in my scorecard is that 60% of my customers need to walk out working (leaving branch with work to do). If they don't I am not giving the customer the tools to use digital banking – my behaviour has not given customer service."*

A further consequence for banks is that such a business model maximises the time available to customer contact staff (whether contact is in person or through call centres) to focus on assisting customers to establish their 'needs'/sales opportunities. Many banks correspondingly capture data about activities they believe identify how well bank staff identify 'customer needs' (and refer a 'sales opportunity' to a Seller) while in conversation with a customer<sup>44</sup>. These are also frequently reflected in cross-sales or referrals targets and the like, which some banks classify as non-financial targets for the purposes of their rewards system. In this Review such targets are treated as financial or sales-based measures.

### ***Review of your banking***

*"Concierge metrics are not on conversations; they are on branch sales. If no contribution, no tick, no bonus."*

Whether or not these activities lead to good or poor outcomes for customers will depend on the circumstances. The sale of a well-tailored home insurance policy to a previously uninsured person is different from the sale of consumer credit insurance to a customer who could never claim on it. The former most likely constitutes a good customer outcome while the later does not. A cold call that leads to the refinance of a home loan at a cheaper interest rate is arguably a good outcome for a customer, all other terms of the contract being equal.

Non-financial measures that incentivise staff to sign customers up to new deposit accounts can lead to poor outcomes if customers are encouraged to establish multiple transaction accounts, potentially increasing fees payable (or reducing interest income) and inconveniencing the customer in managing them.

### ***Multiple accounts***

*One Teller encouraged a customer to open 9 separate accounts, which helped the branch meet its target for new accounts opened. Subsequently, after discussions with another Teller, the customer closed the unnecessary 8 accounts. The second Teller was reprimanded.*

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<sup>43</sup> Others thought it ironic that customers were encouraged not to come into the branch but were then cold called and asked if they wished to come in for a (sales) discussion.

<sup>44</sup> Many banks establish targets and capture such data for staff in branch and for those in call centres. Targets and measures relate both to customer-initiated contacts and to those that staff are expected to initiate themselves ('cold calling').

Whether or not these measures respond to the needs of the bank for sales or the needs of the customer for service is an issue that some staff to whom we spoke view sceptically. The fact that some banks only count for performance purposes those activities that lead to a sale justifies such scepticism.

## 5.2 Gateways

Most banks require individuals to pass one or more 'gateways' to receive a reward. Most bank's gateways are related to assessments of the individual's compliance with expected standards of behaviour and values, approaches to risk identification and management, process compliance, training requirements, customer satisfaction ratings and an overall performance rating (that may or may not itself be at least partly based on meeting financial targets). These can be powerful checks on behaviour that could lead to poor outcomes for customers. In some cases, though, financial measures such as sales (or cross-sales) targets are employed as gateways. Financial gateways are a powerful signal of the value the bank attaches to selling, which adds to the risk of mis-selling otherwise inherent in the structure of the rewards framework.

### EXAMPLE

*One bank uses behaviours, compliance and minimum performance for most of their reward plans. For one role, they reported 41 instances in which monthly payments were forfeited due to behavioural gateways not being met and 19 instances due to compliance gateways not being met.*

Sometimes gateways, especially behavioural ones, rest heavily on the judgement of Managers. In practice such judgements may be affected, at least in part, by established practices and cultural norms. Some banks have acknowledged that their culture has been heavily sales focused for many years and is in transition to a greater orientation towards customer service. Others argue that their long-established cultural traditions are heavily values based and that those values abhor inappropriate selling. Some smaller well-established banks with a long-serving management team, community-based entities or customer-owned banks frequently made assertions of this kind to the Review.

## 5.3 Deferrals and clawbacks

A deferral relates to the delay of the payment of at least part of a reward to which an individual is entitled. Typically, staff who have a capacity to earn significant variable reward payments (such as Home Lenders and Managers) are more likely to trigger a deferral than Tellers, who only earn very small rewards. In the case of Financial Advisers, deferrals are generally applicable regardless of the reward amount earned.

Rewards may be delayed to give time for the longer-term consequences to emerge of actions taken in the short term that were intended to maximise sales and personal rewards. The emergence of evidence of misbehaviour may lead to the cancellation of deferred payments (i.e. clawbacks). Deferrals are intended to moderate the risk that staff will pursue inappropriate behaviours in order to maximise short-term benefits. Deferrals may also strengthen the alignment between staff interests and those of shareholders if deferred sums are vested as equity<sup>45</sup>.

Only a few banks have formal mechanisms to claw back some or all of a reward if the recipient is subsequently found to have been directly or indirectly involved in an inappropriate event or behaviour (e.g. misconduct or fraudulent activities). Such mechanisms are intended to deter the behaviours that would trigger a clawback.

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<sup>45</sup> However, one argument made to the Review was that the value of significant deferred payments is so heavily discounted by the recipients as to seriously undermine the power of this effect.

#### **EXAMPLE**

*In one bank an individual who demonstrates poor behaviour will not only fail the gateway and thus forfeit any incentive for that performance period, but will also forfeit any rewards deferred from prior periods.*

## **5.4 Caps**

Some banks impose caps on the maximum amount that an individual can earn as a reward. These are imposed to help mitigate and manage the risk that some individuals may be tempted to engage in inappropriate behaviour if the potential rewards are seen to be very large. The threshold to trigger a cap is, however, often higher than the variable reward payments received by staff included in this Review and they are therefore not applied frequently to them.

#### **EXAMPLE**

*Under one plan a separate cap is in place for five of the six performance objectives that could attract an incentive payment. In addition, however, the total variable reward amount achievable from all measures combined is further capped at the individual's salary. The maximum benefit any eligible individual received in practice in the last performance period was about half their fixed pay.*

## **5.5 Non-financial modifiers**

Modifiers refer to a discount or a multiple (to the assessed amount) of a reward if certain supplementary conditions are met. They are intended to add value to an award in the event of good behaviour or the achievement of highly sought-after outcomes and to reduce the value of the reward where the individual has insufficiently demonstrated appropriate behaviours or results.

#### **EXAMPLE**

*One bank applies both a behaviour and risk modifier to all variable reward plans.*

*The behaviour modifier can increase the reward by 25% if the individual demonstrates exceptional behaviour or reduce the reward by 25% if the individual only partially demonstrates the desired behaviour. Where the individual rarely demonstrates the desired behaviour, they will not be eligible to receive any reward.*

*The risk modifier can reduce the variable reward by 25% or lead to forfeiture of the entire variable reward in the current performance period as well as any deferred amounts that are to be received in that period.*

Relatively few schemes involve modifiers in this way nor are they used in isolation. Some, on the contrary, use modifiers in ways that encourage sales-related behaviours, especially cross sales.

#### **EXAMPLE**

*The same bank also applies a modifier to some of its variable reward plans whereby the total variable reward amount may increase by up to 70% if cross-sell targets have been exceeded.*

## **Part 3**

### **Key issues**

## 6. Issues on which we seek feedback

Incentives, bonuses and product-based payments/product sales commissions are part of a complex set of arrangements that guide and order the operations of banks across multiple delivery channels (see section 2.2). These rewards can exert powerful forces on the actions of individuals. Senior managers whom we consulted are very aware of the risk that rewards will encourage approaches or activities that exceed, underachieve or are contrary to the effect that they seek to achieve. This occurs because humans are themselves complex and may interpret incentives differently from those who created them. Moreover, messages may be lost or modified in transmission in a large workplace, including as Managers seek to interpret potentially complex messages for their staff. All banks therefore have arrangements intended to mitigate such risks, which include the risks of mis-selling, potentially leading to poor outcomes for customers.

In this examination of bank incentive systems and associated risk mitigation strategies, I have identified seven sets of issues on which I would like further feedback from banks, key stakeholders and the general community. Some are intended to assist me to better understand the context in which rewards operate or to test views received. Others are more directly linked to matters on which I may later make findings. The identification of a matter as one on which I am seeking feedback at this stage therefore does not necessarily imply that it will feature specifically in any recommendations or findings of the final report.

The Terms of Reference emphasise the role that sales or product-based remuneration practices may play in producing poor outcomes for customers of retail banks. As noted in section 1, this follows other experience in the financial services industry, notably financial planning and life insurance, that led to regulatory changes intended to limit the risks that conflicted remuneration arrangements would encourage Sellers, including Financial Advisers, to favour their own financial interests over those of the customer.

Many anecdotes are reported in this paper that suggest areas for further examination, including by bank management. A number of these at the very least highlight poor management practices that may reduce the effectiveness of the relevant bank's risk mitigation strategies. However, few submissions to date have provided clear evidence that the risks in banks' current arrangements lead to such significant *systemic* risks of poor outcomes for retail banking customers as would warrant the outright banning of product-based payments. I have formed tentative views that some banks should re-examine elements of their present practices and I concur with those who believe it is appropriate to reduce the emphasis on product-based payments whenever possible. This will reduce risk and help to rebuild public trust. I will form final views on all these matters after the next round of submissions.

Some submission authors argued that their capacity to provide substantive evidence was limited by the lack of public knowledge about the remuneration arrangements that banks apply. Nonetheless, banks are investing heavily in strategies to mitigate the potential risks in their remuneration arrangements in retail banking. Moreover, many banks state that they are moving progressively to de-emphasise the role previously assigned to sales or product-based incentive payments in the remuneration of their staff and to strengthen their risk mitigation strategies.

While many banks are moving to de-emphasise sales-related remuneration in retail banking for employees, there is less evidence that banks are doing likewise in their broking channels. Some banks have stated that their scope to change such practices is constrained by market forces and an unwillingness to risk market share by upsetting established remuneration norms. That unwillingness may itself suggest that the relative remuneration available from banks may affect the behaviour of mortgage brokers. As noted later in section 6.6, I wish to explore this issue further once ASIC has completed and reported on its investigation into mortgage broking.

In this section, risks of mis-selling arising from remuneration-based incentives are generally seen to be common across sales channels. Although mitigation options are fewer (see section 5), the risks are similar whether or not

the agents acting for the bank are staff or third parties. Issues specific to the third-party channels are addressed later in this chapter.

In addressing the Terms of Reference, at least conceptually, I am exploring the major issues in two stages. The first is to establish whether or not there is a risk (and, if so, how strong) that an incentive will lead to misbehaviour or mis-selling by the bank's agent (whether staff or third party); and what kinds of risk mitigation are available. The second stage is to address whether or not customers will experience a poor outcome if such a risk materialises. Perhaps surprisingly, a commonly accepted definition of 'a poor customer outcome' has yet to emerge in retail banking. This issue will be further explored in section 6.7.

This chapter raises seven sets of issues on which further feedback or information is sought; namely:

1. The role of targets
2. Does size of rewards or their structure matter most?
3. Should bank obligations be strengthened?
4. What is the difference between a 'sales' and a 'service' culture?
5. What role might the remuneration arrangements applicable to very senior managers play in conditioning the behaviour of frontline staff?
6. Issues specific to remuneration of third parties
7. What is a poor customer outcome (and what is the link to agent remuneration)?

## 6.1 The role of targets

Targets are often employed as part of an incentives and rewards system or as an aid to assess performance within a performance management system. An individual may become eligible for a reward, for example, if a certain target is achieved or exceeded; or if they achieve a certain rating in their performance assessment that is at least in part related to whether or not specific targets are met. The rewards may be monetary or non-monetary; of large scale or small. The targets may be financial (for example, a certain level or mix of sales) or not (for example, a measure of customer satisfaction). They may relate to team outcomes or to those secured by an individual. The link to the incentives or performance management system may be formulaic (for example, such that the individual can calculate precisely the financial consequence of exceeding a target) or more discretionary (for example, where performance relative to a target is but one factor a Manager will consider in assessing a person's contribution to team performance).

Some have argued to the Review that a bank's approach to the setting and assessment of performance against targets can be a more powerful driver of behaviour towards consumers than the possibility of the receipt or withholding of a reward, especially a small reward. Some argue this is particularly the case when continuing employment is at risk if targets are missed consistently. Peer pressure and recognition schemes that compare the performance of individuals with others within the team/business unit (e.g. 'leader boards') can, it is argued, have similar effects.

### **Making my numbers**

*"If I am not on my numbers by 2.00pm I know I will have to have a performance conversation..."*

*"I know that if it is Thursday and I haven't made my target by Friday I will be performance managed on Monday."*

In the case of sales-based targets, the risk of misbehaviour increases as the target is approached, especially if a reporting deadline is looming. However the nature of the risk may in practice depend on the circumstances. Seemingly unrealistic or stretch targets may accentuate this risk; alternatively, employees may cease to apply effort if success appears not to be a possibility. It is also argued by some that any risk posed by targets is reduced if targets are annual rather than monthly: this may depend, though, on whether or not the prospect of losing a larger annual payment will increase the risk of poor behaviour as the target is approached compared to the risk associated with the opportunity to receive more frequent but smaller payments.

In some circumstances the system may be 'gamed' to either delay or bring forward sales because of the possible financial benefits that may accrue. The risk of outcomes adverse to customers' interests is more likely to be higher when targets are sales related than when they are genuinely service related<sup>46</sup>. The risks of poor outcomes for the customer may also be higher when dealing with credit products or add-on products (such as discretionary insurance). These issues will be further explored below. (Refer to section 6.2 for further detail.)

Although the extent to which they apply at the level of an individual varies, few large organisations manage their business without setting goals and targets of some kind. They serve to communicate priorities and key business success factors to the workforce (and potentially to external observers). The evidence from academic literature is that skills vary amongst Managers and staff in communicating and understanding performance goals and in the giving and receiving of feedback, including in respect of performance against targets. Banks are unlikely to be any different from the generality of organisations in that respect.

In view of the strength with which this matter has been raised in consultations I would value feedback on the following questions:

- 
1. Is there a realistic alternative to setting targets as an aid to the management of a large organisation?
  2. What is the appropriate role of targets in managing performance and assessing rewards payable to an individual?
  3. What is the nature of the risk attached to setting targets that are sales- or product-related compared to others such as service metrics? (See also section 6.2 below.)
  4. Is such a risk lowered if targets are set and eligibility for rewards is assessed less frequently (e.g. annually compared to monthly)?
- 

## 6.2 Does size of rewards or their structure matter most?

It has been asserted that the risk of inappropriate behaviour is greatest when the sums at risk are larger relative to fixed pay. Yet many banks invest considerable effort in campaigns or recognition programs that provide quite modest rewards even in absolute terms let alone relative to fixed pay. This is particularly the case for retail banking staff, the bulk of whom (apart from Home Lenders and Financial Advisers) have access to relatively small incentive payments. This suggests that the size of the reward is less material for most retail staff (with the possible exception of Home Lenders and Financial Advisers) than how it is structured.

Several features of current incentives arrangements are matters of further interest to the Review and on which feedback is sought. These include:

1. Complexity;
2. Accelerators and similar devices;
3. The emphasis attached to volume-based financial targets;

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<sup>46</sup> See also section 5.

4. Cross-selling incentives;
5. Branch vs Individual targets;
6. A scorecard or single measures?
7. What constitutes product neutrality?
8. Formulaic or discretionary approach?

### 6.2.1 Complexity

Complex remuneration structures may increase risk. The key risk is not understanding how the remuneration structure works. For example, there is the risk that staff perceive that their performance assessment is based entirely on their sales performance (or almost entirely so). Staff may not fully understand the intended impact of all risk mitigation devices such as gateways or believe that key components of their scorecard are beyond their capacity to influence other than sales (or referrals). Individuals may not recognise the behaviours or cultural norms that senior management is attempting to achieve if they perceive confused or conflicting signals in complex remuneration structures. Confusion (if not cynicism) may also occur if financial performance measures are presented as non-financial measures (as sometimes occurs in respect of cross-selling targets) or if sales (or cross-sales) targets are employed as gateways to incentive payments. Moreover some Managers, when required to make discretionary judgements against complex or seemingly conflicting performance measures, may rely excessively on instinct formed by a legacy sales culture. Guidance issued by regulators in the United Kingdom encourages banks to avoid complex schemes<sup>47</sup>.

In this Review it was evident, from the data-gathering and review process, that many remuneration structures, policies and processes are complex and, at times, internally inconsistent. Examples include:

- **Number of elements included in an incentive plan:** Incentive plans often involve multiple, possibly seemingly inconsistent, elements that both the bank's agent (staff or third party) and the Managers need to assess and weigh before eligibility for an award can be determined. These can include multiple performance measures of both financial and non-financial character, and gateways (sometimes including sales-related gateways), accelerators and modifiers. These may be formalised in conjunction with a scorecard, but may not be. They may be formula based or discretionary or a combination of both (for example, a pure sales commission subject to meeting a discretionary assessment that the individual's behaviours are consistent with the bank's professed values). Some scorecards, for example, require an assessment of ten different measures, each with a weight attached to determine the contribution to the overall assessment score, plus up to four gateways, accelerators and modifiers. The resulting complexity is often justified on the basis that it is needed to counter the risk that too few measures would lead to distorted signals and behavioural incentives. Complexity, however, can only add to the risk of miscommunication and perceptions of inconsistency; or to a focus on the easily understood and controllable elements, namely sales, referrals, etc.
- **Number of variable reward plans per bank:** Although an individual member of staff need only know the precise detail of the scheme that is applicable to their role, management and others who administer remuneration need to clearly understand the exact detail across numerous schemes. In addition, senior managers and those who approve the design of the remuneration schemes are required to thoroughly understand the remuneration frameworks that are being implemented. However, if there are a multitude of schemes all with varying elements, there is a risk that banks may create remuneration structures that in aggregate are so complex that risks to poor customer outcomes cannot be identified.

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<sup>47</sup> Refer to the Financial Conduct Authority Guidance Consultation 15/1 *Risks to Customers from performance management at firms* (March 2015) and Financial Conduct Authority Guidance TR14/4 *Risks to Customers from financial incentives – an update* (March 2014).

- **Inconsistent features across the variable reward plans:** The caps, modifiers, gateways and frequency of the payment may be different across the plans within the same bank, the rationale for which is unclear.

#### EXAMPLE

*One bank has adopted eight variable reward plans that apply to customer-facing staff and Managers. The gateways for these plans vary from needing to meet risk and behaviour requirements, branch financials and branch cross-selling targets for one plan to the achievement of a minimum performance rating, and risk and behaviour requirements for another plan. Only two of the eight variable reward plans have the same gateways.*

Arguably, one simple scheme to administer and understand is a straight commission scheme (where the reward is a set proportion of revenue earned, for example) supported by a gateway that will deny eligibility to individuals who do not exhibit appropriate behaviours. The remuneration typically paid to mortgage broking entities most nearly approximates this model. Such an approach, however, places inordinate weight on the capacity of Managers to consistently and appropriately identify and respond to behaviours that are inappropriate. It may also be taken by staff and others to signal that sales are their most important (possibly only) objective.

I have tentatively concluded that some schemes involving multiple elements are too complex and risk may be reduced by simplifying them somewhat. In the light of this discussion I would value feedback on the following question:

- 
5. How best can we address the trade-off between simplicity, on the one hand and, on the other, elements to guard against the risk of incentivising poor outcomes for customers?
- 

#### 6.2.2 Accelerators and similar devices

A number of devices (e.g. accelerators<sup>48</sup>, and some modifiers) have the effect of increasing the reward achievable per unit of sales (or other performance measure) 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 used in schemes of Australian retail banks apply the higher reward rate to all sales above certain thresholds. Modifiers<sup>49</sup> can have a similar effect whereby the total reward amount is increased 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.

I have tentatively concluded that, no matter what the device, the effect of such arrangements is to increase the Seller's incentive to exceed their target or the next threshold sales level, with increased potential that a poor outcome will ensue for at least some customers.

In the light of this discussion I would value feedback on the following questions:

- 
6. Should banks discontinue the practice of using accelerator-type<sup>50</sup> payments?
  7. If yes, what other devices are suitable to reward high performers?
- 

<sup>48</sup> See section 3.3.7.

<sup>49</sup> See section 3.3.8.

<sup>50</sup> Accelerators and modifiers that have a similar effect on rewards.

**EXAMPLE - Accelerator**

*In one model for a Financial Adviser the individual earns a rising share of the revenue generated above a threshold/sales target. In the range 50-100% of the threshold, a payment equivalent to 30% of the revenue is due but the share rises to 35% once 100-150% of the target is reached and to 40% if more than 150% of the target is reached. This is an example of a pure accelerator.*

*In this scheme the critical first threshold is reduced by up to 25% if the individual has a sufficiently large ongoing book of revenue, which further rewards staff who have previously generated high sales volumes and makes it easier for them subsequently to qualify for larger commissions.*

**EXAMPLE - Accelerator**

*In one plan an individual receives a cash award each month if their sales targets are met. If the targets are met for at least 9 of the 12 months and their annual sales target is exceeded by at least 25%, they receive an additional \$2,000 plus 0.05% per dollar above the target. .*

**EXAMPLE - Accelerator**

*One bank increases the reward payment from the 0.23% payable once the sales target is met to 0.30% if the individual reaches 150% of the financial target. The 0.30% applies to only the amount greater than 150% of the target.*

**EXAMPLE - Accelerator**

*In another case commission of 0.08% is paid on new deposits up to \$5m, 0.12% on deposits between \$5m and \$10m and 0.16% on deposits over \$10m. These payments are capped at \$10,000 a month.*

**EXAMPLE – Accelerator-type mechanism**

*One bank applies a modifier that can increase the overall reward payment by up to 60% subject to the individual meeting sales targets.*

### 6.2.3 The emphasis attached to volume-based financial targets

Financial targets may include product sales targets, targets for cross selling products, and targets for referral of products to another area within the bank (for example, by a Teller). In some plans, such financial measures may be the only factor relevant to calculating the variable reward payment. This is more likely for Managers and for individuals responsible primarily for the sale of mortgages (including Home Lenders and third-party channels). In some plans financial targets are used as gateways to determine eligibility to receive the rewards.

Placing too much emphasis on financial measures may drive behaviour inconsistent with a bank's desired culture if individuals feel pressure to sell even at the expense of good customer outcomes. As noted previously, staff perceptions of the intent of a reward plan can powerfully affect behaviour, possibly in directions inconsistent with management's intent. Feedback from some staff, for example, is that cross-sales targets are more

concerned with selling than with meeting customer needs. Gateways related to the behaviour of the individual and compliance checks are often employed as part of a strategy to mitigate such a risk. Even so, many banks are moving to reduce over time the emphasis they place on financial measures, especially sales targets, in the assessment of staff performance and the calculation of their entitlement to variable rewards. Such a trend is desirable and will reduce risk, especially if the baseline culture of the bank has become heavily sales oriented over time. The use of cross sales targets, especially in respect of add-ons like insurance products, and the adoption of financial measures as gateways, however, warrant particular attention. Perhaps paradoxically, the emphasis on cross sales (or 'meeting customer needs') may be increasing in some cases.

#### **EXAMPLE**

*One Manager scorecard entirely comprises financial targets. A weight of 50% is assigned to state sales, with the remainder related to the performance of the Manager's own team. In relation to the Manager's own team, the bonus is unavailable unless 60% of the team achieve or exceed their personal sales target with a further 20% achieving at least 80% of their personal target.*

#### **EXAMPLE**

*One plan awards the individual \$45 for every percentage point achieved above the sales target and \$30 for every product that is cross sold above a cross-selling target.*

Remuneration plans typically require individuals to meet minimum standards to be eligible for an incentive payment. Mostly these gateways are behaviourally or procedurally/compliance based. Banks often rely on such gateways to mitigate the risk of inappropriate selling. In a few instances, however, the gateways include financial metrics such as meeting a minimum number of (or value of) sales, cross sales and/or referrals. Such gateways powerfully increase the risk of poor customer outcomes as the individual will not receive any of their reward unless minimum sales targets are met. The risk would seem to be higher where cross-sales targets are used for this purpose.

#### **EXAMPLE**

*Under one plan a payment is due only if the seller meets both home loan volume targets and cross-selling targets.*

In the light of this discussion I would value feedback on the following questions:

8. Should banks discontinue the practice of applying gateways to incentives payments based on the achievement of financial measures?
9. Should banks discontinue the practice of assessing performance and eligibility for rewards on the basis of product-based payment? If yes, on what basis?
10. Alternatively, should banks limit the weight applied in total to financial measures to, say, 35% in these assessments?

#### 6.2.4 Cross-selling incentives

Cross-selling relates to sales in addition to the main activity of the Seller (or additional to the original enquiry by the buyer/customer if they have approached the bank of their own volition). Such targets seem to carry particular risks of inappropriate outcomes, especially for products that are discretionary add-ons to the primary

product such as insurance products sold in conjunction with a line of credit or a mortgage. An example is the sale of credit insurance to a credit card holder who was ineligible ever to make a successful claim on the policy as set out in the Consumer Action Law Centre submission. A number of banks employ cross-sales targets or measures to encourage customer-facing staff to have conversations intended to assist customers identify and meet their needs for financial services (and thus identify sales opportunities for the bank).

Cross sales may feature in reward plans as either:

1. A gateway for receiving an incentive (see last discussion); and/or

#### **EXAMPLE**

*One reward scheme requires staff to meet minimum risk and behaviour standards and individual cross-selling targets in order to receive a reward. The reward is calculated based on the extent to which the individual has exceeded their individual product sales targets and cross-selling targets.*

2. An element of a scorecard<sup>51</sup>. In some cases, the cross-selling target may be classified as a non-financial measure despite the substance relating to financial performance<sup>52</sup>; and/or

#### **EXAMPLE**

*In one plan a scorecard is described by the bank as being made up of 35% financial, 20% customer, 30% process/risk and 15% people measures. One of the objectives under the process/risk category requires individuals to cross sell a certain number of products and one of the objectives under the 'customer' category relates to the sum of lending drawdowns by new customers. The effective weight assigned to sales measures is thus 65%. The same cross-selling measure is classified under the 'customer' segment of a scorecard for a different role within the same bank.*

3. A stand-alone component whereby a product-specific reward will be paid if the cross sell target is met; and/or

#### **EXAMPLE**

*Under one plan an individual can receive up to \$500 per quarter solely by meeting cross-selling targets for Consumer Credit Insurance (CCI) and General Insurance (GI) products.*

4. A modifier whereby the incentive otherwise available rises if a cross-selling threshold is exceeded; and/or

#### **EXAMPLE**

*In one plan, the individual is required to meet a minimum number of wealth referrals before 'triggering' the cross-selling modifier that embodies three thresholds at which reward can rise by 30%, 50% or 70% respectively if the relevant cross selling thresholds are exceeded.*

<sup>51</sup> See section 3.3.1.

<sup>52</sup> For example, cross selling may be classified under a 'customer' or 'risk' category rather than the 'financial' category, which may give the perception that banks are disguising or hiding the level of product sale measures they employ.

5. *An element of the performance management conversation:* Cross sales may form part of the overall sales metrics relevant to a performance rating (that may in turn affect eligibility for rewards or job security).

### Playing catch up

*“If I do not meet my daily sales target I have to explain how I will catch up at morning meetings of the team. I am behind in sales of wealth and insurance products and need to catch up to keep my job.”*

I have tentatively concluded that cross-sales targets, especially those that are used as a gateway to access rewards otherwise available to a Seller (or a modifier to increase the reward otherwise available), significantly increase the risk of mis-selling. In the light of this discussion I would value feedback on the following questions:

11. Should banks discontinue the practice of applying cross-sales gateways or modifiers?
12. If yes, what other approaches are available to encourage and reward staff that assist customers to identify and meet their needs?
13. Are cross-sales incentives more likely to lead to poor outcomes for customers than general sales targets?

### 6.2.5 Branch vs individual targets

Some banks pay rewards or provide recognition on the basis of 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 leader boards and the like, or through recognition schemes that recognise and reward good sales performance.

Views differ about whether or not team-based approaches ameliorate or magnify any risk of mis-selling inherent in the reward system. Sales-focused reward systems will continue to incentivise sales, whether or not the targets are personal or team-based. Some believe that team-based targets reduce the pressure on individuals to sell irrespective of the risk of mis-selling. However, some staff have reported to us that in some team/business units, peer pressure to perform can be heightened when sales targets are team-based<sup>53</sup>. This can be accentuated by management practices that publicise and provide personal recognition to strong performers within the team (such as ‘leader boards’ or team ‘huddles’ to share suggestions to assist slower Sellers to meet their targets, which some staff have reported can occur several times a day). Other staff have reported that team targets are 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 sales performance.

#### EXAMPLE

*One customer-facing role can receive up to \$1,600 per quarter if their branch achieves two of the branch’s product sales targets and cross-selling targets. Unless the branch meets its targets, however, each individual will be denied the reward they would otherwise receive for having met their individual sales targets (that includes cross-selling targets). The relevant Manager also receives a reward payment if the branch’s product sales and cross-selling targets are met.*

<sup>53</sup> Some staff have stated in consultations that their Managers convert team targets to personal ones in any case.

### EXAMPLE

*One scheme rewards staff on both their individual performance and their branch's performance. Branch performance is assessed against branch financial targets, customer satisfaction standards and self-service education rate. The branch's performance can increase the individual's reward amount by up to 250% or reduce the reward amount by 25%.*

In the light of this discussion I would value feedback on the following question:

- 
14. What is the best way to mitigate any risk that business unit/branch-based targets will lead to inappropriate pressure on individuals to mis-sell?
- 

#### 6.2.6 A scorecard or specific measures?

Chapter 3 shows the range of approaches to incentives-based remuneration banks currently employ. Approaches 1 and 2 can be argued to provide very different signals to staff and their Managers about the importance assigned to individual measures of performance. Although the effect may be moderated by the operations of gateways or modifiers, scorecard approaches are intended to allow explicit recognition to be paid to the breadth of performance that is relevant to an assessment of the performance of an individual or a team. Indeed the UK regulator has issued guidance in support of such an approach to at-risk remuneration<sup>54</sup>. Arguably, similar signals can be sent in the design of systems that provide variable reward payments against a series of specific metrics if the same measures are included. In practice, however, such systems are typically dominated by sales-based performance measures (especially in the case of Home Lenders and Financial Advisers). Indeed, the home loans sales force is a segment that many banks believe is dominated by product-related payments because of the pulling power of the labour market for mortgage brokers, which is principally commissions-based.

In the light of this discussion I would value feedback on the following questions:

- 
15. Is there a case for banks to adopt scorecard-based approaches in order to minimise the risks of mis-selling? If so, why?
  16. Are there any market or other impediments to such a development, including in respect of mortgage brokers or other home lenders? How might any such impediments be addressed?
- 

#### 6.2.7 What constitutes product neutrality?

A number of banks that have adopted product-based remuneration practices argued during consultations that their approach was 'product neutral'. By this they meant that their system was designed not to encourage their Sellers to favour one product more than another in their dealings with clients. This, they argue, would mitigate the risk that incentives drive sales behaviour not consistent with the customer's interests. Some of these banks had also adopted cross-sales or referral targets as an element of their rewards structure, in which case product neutrality was often emphasised as a desirable feature of the approach to cross sales or referrals (e.g.

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<sup>54</sup> Refer to the Financial Conduct Authority Guidance Consultation 15/1 *Risks to Customers from performance management at firms* (March 2015) and Financial Conduct Authority Guidance TR14/4 *Risks to Customers from financial incentives – an update* (March 2014).

indifference to the types of insurances sold or referred) since the ‘day job’ of such Sellers is primarily to promote other products (e.g. mortgages).

An issue for the Review is what constitutes ‘product neutrality’. Some banks argue that remuneration in line with sales revenue is ‘product neutral’. Others argue that relative incentive payments should be aligned with the relative effort required to achieve a sale. Some products are more complex and require more time to explain well to customers, for example. Others may require more voluminous documentation and background checking.

#### **EXAMPLE**

*One bank uses a product scorecard that rewards staff more ‘points’ for selling products that are not part of their primary responsibilities as selling these products would require more ‘effort’ compared to staff who primarily sell these products. These points are then used to calculate the reward amount.*

Rewards aligned with revenue earned, some argue, may incentivise sales that are easier to conclude rather than those best suited to customer needs. At the very least, the rationale for accelerator-like payments (that increase the more the sales target is exceeded) is open to question on ‘product neutrality’ grounds.

In the light of this discussion I would value feedback on the following questions:

- 
17. Should banks adopt the principle that sales incentives should be ‘product neutral’?
  18. If yes, how is that neutrality best established?
  19. Should banks discontinue the practice of applying accelerator-like arrangements?
- 

#### 6.2.8 Formulaic or discretionary approach?

Manager discretion may apply at various stages throughout the remuneration cycle. Practices vary across banks. Generally speaking, 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);
- An individual’s overall performance rating or the value to be assigned to specific elements of a performance scorecard; and
- The amount of bonus payable.

An issue for the Review is in what circumstances such discretion is likely to moderate or magnify the risks otherwise inherent in a sales-oriented reward system. It was frequently claimed during consultations that Manager discretion has the prime benefit of allowing a wide range of information to be brought to bear in assessing whether or not the individual has satisfied behavioural gateways. Some staff reported, however, that these judgements are frequently coloured by a deeply ingrained sales culture. Such a culture can be reinforced by a preponderance of sales-based performance metrics in the assessments of the eligibility of those Managers to themselves earn a bonus. In such circumstances the emphasis on selling may be magnified rather than moderated. In those circumstances the intended mitigation of the risk of mis-selling may be reduced or nullified. Cultural reform programs and leader training, development and accountability are frequently cited by banks as a counter to such concerns.

Approaches to assess performance and eligibility for rewards 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 metrics or gateways will be required and producing a need to make costly investments in data collections and systems to identify and counter such behaviour. Even when a formula is applied to estimate the reward to which an individual may be entitled, discretion may still be required if a behavioural/values-based gateway is in place.

**EXAMPLE: Pure discretionary scheme**

*One bank's approach is purely discretionary. The manager assesses whether or not the individual has met relevant gateways. Performance objectives are personalised. The manager assesses how well the individual has met their objectives and ultimately determines what share of the bonus pool allocated to the business unit each individual should receive.*

**EXAMPLE: Mostly formulaic**

*Under one bank's scorecard approach, discretion is applied when determining whether or not the individual has met the relevant gateways. An overall performance rating is calculated by applying a formula to the outcomes achieved against each performance element of the scorecard. The rating in turn will correspond to a specific incentive payment.*

In light of this discussion I would value feedback on the following question:

- 
20. What conditions need to be met to ensure that Manager discretion is exercised in ways that minimise the risk of poor outcomes for customers?
- 

## 6.3 Should bank obligations be strengthened?

Chapter 2 sets out the current legal framework for banks and their retail customers when a transaction occurs between them as well as the legal remuneration framework.

Three types of arguments have been advanced in support of the argument that *retail* banks should be held to a high standard and required to take more steps than a typical Seller to ensure that the retail buyer is well served by the financial products they purchase from a bank:

1. *The social licence*: Banks receive certain privileges from governments and the Reserve Bank that enable them to play a key role in facilitating economic activity and enabling individuals to effect transactions and save securely for the future. The resulting 'social licence' to operate includes a requirement that they act with integrity towards their customers.
2. *An asymmetry of information*: Some financial services are inherently complex and difficult for an untrained person to understand properly. The resulting asymmetry of information between buyer and Seller imposes special obligations on the seller bank to ensure that the product is suitable for the customer's needs. The more complex the product, the stronger the obligation and the more severe the consequences for the individual if a mistake were made. As one person in the industry put it: "If the borrower is in default I can take both the house and their savings if necessary to cover the debt, which few others can do."

3. *A position of trust:* Although many customers actively undertake comparison shopping, many more do not. They typically deal with a single institution and trust that their loyalty will be repaid with integrity and a concern to protect their welfare. When they enter the bank seeking help to buy a house, they expect a fair deal on their mortgage and that any other products they are sold will be fit for purpose and relevant to their needs. For many of these customers the legal distinctions between product information, and general and personal advice under the *Corporations Act* are not understood<sup>55</sup>.

The regulatory framework is briefly canvassed in Chapter 2. Amongst the regulatory responses to the complexity of financial services has been the introduction of the FOFA reforms in addition to consumer credit law and requirements to provide more information to customers before a transaction is concluded. 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. They have themselves 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 PDS, a simpler statement of 'Key Facts'. These apply to some products such as credit cards, home building insurance and home loans.<sup>56</sup>

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. The government has also announced new measures to strengthen the oversight of ASIC to better protect consumers from inappropriately designed products.

In Australia and globally there has been an erosion of public trust in the banking industry, which is a significant part of the environment in which this Review is being conducted. Key figures within the banking industry are openly acknowledging that a significant trust deficit has emerged because practices have developed that have not been, or have been seen not to be, in the interests of customers. They are calling for this deficit to be addressed. This Review is intended to assist in that process by identifying opportunities to modify or remove remuneration practices that entail an unacceptable risk of promoting behaviour by sellers that is inconsistent with the interests of customers. In that respect, both the perception and the actual scale of the risk would seem to be important.

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<sup>55</sup> There are different obligations that apply when providing factual information, general advice and personal advice (as noted in Chapter 2). 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.

<sup>56</sup> 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.

I would therefore value feedback on the following questions:

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21. Should the regulatory framework for retail banking be strengthened? If so, then how?
  22. Are further changes required to the regulatory environment to reduce the information gap between a seller and the retail purchaser?<sup>57</sup>
  23. Is the legal distinction between the ‘provision of information’, ‘general advice’ and ‘personal advice’ useful or effective in the retail banking context?<sup>58</sup>
  24. Having regard also to the mitigation strategies available to banks, is there excessive risk of mis-selling attached to the practices outlined in Chapters 3 and 4 regarding incentives to retail banking staff and third parties that act on behalf of banks?
- 

## 6.4 What is the difference between a ‘sales’ and a ‘service’ culture?

Much has been made during the Review to date of the importance that many banks have placed over the past decade or so on strong financial performance and security, at least, of market share, reflected in at least some banks in a re-orientation of the culture of the workforce from ‘service’ towards ‘sales’. In most instances banks that acknowledged that such a transition had occurred also stated that they were now seeking to reduce the emphasis placed on sales performance relative to customer service. Some staff are sceptical about the effectiveness of such a transition.

### It’s about selling

*“It’s no longer called ‘sales’ but ‘helping customers’. But everybody knows it is about selling. For example, the bank wants more accounts opened because it makes it harder for customers to leave.”*

It needs to be acknowledged, however, that not all banks consulted during the Review were of that mind. Some maintained that their culture is more values-driven than sales driven and that those values place a high weight on the maintenance of public trust in the integrity of their organisation. Others believe that a sales orientation remains important and that their internal risk mitigation strategies are sufficiently strong to minimise any risk of mis-selling.

The Review seeks further information about what is different between a ‘sales’ and a ‘service’ culture and how best to effect a transition to ‘service’. Several of those consulted to date pointed to the practices of Disney World. Disney World operates in a very different market from that of the banks in Australia. Disney’s sales offer is of a unique customer experience rather than a commodity. A potential customer who contacts their call centre is well advanced on their purchasing journey and is arguably more than likely to be receptive to advice on how to best spend their holiday budget – the environment is very different from the selling environment of call centres operated by some banks, especially in respect of outbound (cold calling) activities.

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<sup>57</sup> Noting the Federal Government is separately examining the introduction of a product design obligation and product intervention power as part of its response to the *Financial System Inquiry (FSI)*, *Improving Australia's Financial System 2015*. See: <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Design-and-distribution-obligations-and-product-intervention-power>

<sup>58</sup> Noting the Federal Government is also separately examining this issue as part of its response to recommendation number 40 of the FSI Inquiry. The government response was: “The Government agrees to rename ‘general advice’ to improve consumer understanding. We will consult with a wide range of stakeholders and conduct consumer testing before finalising the new term.” See [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](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)

In discussion with a former employee it became clear that Disney World tracks the sales performance of its call centre staff. Net revenue per customer is a major performance metric. But so are measures of customer satisfaction, and the activity measures of the call centre place much less emphasis on keeping call times short than typically seems to be the case in Australian banks. Just as important for this person, however, was a leadership culture (and training regime) that traces its lineage back to Walt Disney himself and has been reinforced by successive successful CEOs that place the primary emphasis on the quality of the customer experience.

Many banks are moving to increase the emphasis placed on customer satisfaction in their performance metrics and in the service offer they propound to customers. However, the metrics to support such an orientation appear rudimentary. Typically, data is collected about whether or not a customer would recommend the bank to a friend (sometimes called the Net Promoter Score) or the level of satisfaction a customer expresses against a numerical scale. Often the customer is approached just after an interaction with a bank staff member, well before the effectiveness will be apparent to the customer of the product they may just have been sold. Sometimes the customer's responses feed directly into the assessment of that staff member's performance or their eligibility to receive a reward. 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. One person whom we consulted suggested, however, that a true reorientation toward service will not occur until there is as much effort devoted to measuring the quality of the customer experience as there is to measuring the activities of staff and the sales generated.

The Review seeks further information about:

- 
25. What constitutes a 'service' culture in the retail banking context?
  26. What approaches to performance management and rewards and incentives are most conducive to achieving it?
- 

## **6.5 What role may the remuneration arrangements applicable to very senior managers play in conditioning the behaviour of frontline staff?**

Data has not been collected about the remuneration arrangements that apply to managers more than two removed from customer facing retail staff. Partly this was to ensure that analysis of the data collected could be concluded in the time available. However, the nature of the remuneration arrangements desirably applied to senior staff is a relevant issue for the Review for two reasons:

- The incentives these managers face are likely to condition their approach to performance management and assessment of those who report to them (analogously to the point made previously about the direct managers of customer facing staff); and
- The Terms of Reference require the Review to provide observations and insights to assist the banks to ensure they have overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices, the scope of which is broader than retail banking.

The most senior managers are those most likely to be assessed against performance metrics that address the financial health and sustainability of the business as a whole. The growth of sales revenue may be correlated with such factors; but there are also more direct measures.

## Managers are pressured too

*“Bank managers get ten times the pressure of the sales force. The manager has no power at all. They receive multiple emails and teleconferences to talk about ‘the (sales) stats’.”*

An important strategic issue for many banks is the nature of its culture. A few banks, especially smaller and more community-based banks, believe their sales forces are well schooled in the values and ethos of the bank and their workplace culture provides a natural bulwark against inappropriate behaviour. Others are seeking to rebalance a culture that they believe has moved too far over a decade or more towards a sales orientation. In such cases, the extent to which sales metrics feature in the performance measures applied to the most senior managers is likely to provide a powerful signal of the bank’s commitment to changing its culture to de-emphasise sales and recommit to service.

On the other hand, senior managers must also be sensitive to the perceptions of shareholders and their assessment of how well the actions of the management team are aligned to those of shareholders, the ultimate owners of the bank.

Having regard particularly to the Terms of Reference noted above, the Review seeks further information about:

- 
27. What weight should be attached to sales targets in the assessment of the performance of a bank’s most senior executives?
  28. What are the key principles that banks should apply in designing the incentives that apply to their most senior executives?
- 

## 6.6 Issues specific to remuneration of third parties

In most respects the issues that emerge from third-party payments are almost identical to those previously identified in respect of staff. A major difference compared to most bank staff, however, is the widespread use of commission-based arrangements.

The use of upfront and trailing commissions incentivises sales, as they are designed to do. Where a Broker can earn a significantly higher commission to sell one product over another, they are incentivised to sell that product, which may not be the most suitable for the customer, potentially leading to poor customer outcomes. This risk is further amplified through the use of accelerators (i.e. the commission increases the larger the volume sold by the third-party channel).

The fact that many banks are reluctant to defy industry practice and move away from commission-based arrangements and the success of campaigns based on increased commission deals suggest that the risk of commission-related mis-selling is not insignificant in this market. Indeed, data was presented to the Review that suggested that third-party mortgages 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. Noting that all such mortgages need to satisfy the relevant bank’s credit assessment and responsible lending requirements, this evidence is suggestive rather than conclusive.

In the Netherlands, commission payments have been banned for mortgage broking activities. 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 costs incurred by third-parties in providing these services need to be met (either by banks - perhaps on a fee for service basis since banks avoid incurring substantial costs that would otherwise accrue to them - or by customers through fees for advice). The growth of this market segment, however, suggests that

Brokers provide a service that many potential mortgagees value. Any move to reduce or eliminate commissions in Australia would need to include regulatory change sufficient to ensure that the changes are competitively neutral. In Australia, conflicted remuneration (such as commissions) has been banned in respect of financial advice on Tier 1 products and is being scaled back in life insurance.

In addition, given the limited work undertaken by Introducers and Referrers, the upfront commission paid to them for a successful 'sale' appears to be disproportionately high in comparison to Brokers and Aggregators.

Bonus payments for high-volume third-party channels are an additional payment, which further incentivises the third-party channels and increases the risk of poor customer outcomes. These additional payments appear to be unrelated to the effort required to make the additional sale.

The Terms of Reference require the Review to have regard to ASIC's work to examine the mortgage broking industry in Australia. The Review is hoping to gain further insights into this market segment when ASIC publishes its report, noting that the Review did not duplicate all of ASIC's data gathering in the interests of minimising the compliance burden on banks and the wider remit of the ASIC review.

Banks have generally adopted an extensive suite of risk mitigation devices to guard against mis-selling by staff who manage their third-party channels. These include compliance checks and approaches to staff performance management that emphasise values and appropriate behaviour. The bank is typically not the employer of the third parties through which it deals, which reduces the number of avenues available to mitigate the risk of inappropriate behaviour. Usually banks use contractual terms to enforce appropriate behavioural norms, which in practice may be enforced more readily in a franchise or profit-sharing model than otherwise.

Recognising that further information will come to hand when the ASIC report is published, and having regard to the need to preserve competitive neutrality, the Review seeks further information about the following:

- 
29. Is there sufficient evidence to support a case for banks to discontinue the practice of paying volume-based commissions to third parties in respect of new and increased mortgages?
  30. If a move away from commissions cannot be justified, should banks desist from paying on the basis of accelerator-like arrangements (including bonus commissions)?
  31. Is there evidence that the contractually based risk mitigation devices available to banks in respect of third parties are deficient in avoiding poor customer outcomes?
- 

## **6.7 What is a poor customer outcome (and what is the link to agent remuneration)?**

A key part of this Review is to assess whether or not (and by how much) product-based payments and product sales commissions could lead to poor customer outcomes.

It is perhaps surprising that there is no commonly accepted definition in Australia of a poor customer outcome. In the UK context the FSA 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 or not 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

- Customers buying on an advised basis are recommended suitable products.<sup>59</sup>

I have been guided by this characterisation so far in the Review, which implies that the opposite would constitute poor customer outcomes.

Much of the discussion to date has focused on the *risk* that particular incentives will lead to mis-selling. Although many anecdotes presented to the Review have suggested fruitful areas for inquiry, and sensible opportunities have been identified for at least some banks to boost public confidence and reduce the risk of mis-selling somewhat in some schemes, little concrete evidence has been presented to date that the issues are *systemic* rather than, for example, the product of poor management that has ameliorated or negated the bank's risk mitigation strategies.

These issues are crucial to the work of this Review. Accordingly I seek feedback and views on the following:

- 
32. What do you think of the adequacy of adopting the FSA's approach for the purpose of defining a poor customer outcome?
  33. Is there evidence that the risks of mis-selling are currently significant, not sufficiently mitigated by existing strategies, and systemically important?
- 

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<sup>59</sup> FSA, *Final Guidance: Risks to customers from financial incentives*, January 2013, p 9.

## Appendix A – Terms of Reference

### Objectives

The banking industry recognises that customers and the wider community expect banks to make sure they have the right culture, the right practices, and the right behaviours.

Banks are committed to improving their practices and continuing to meet customer needs and community expectations. Making sure the remuneration structures of people selling our products align with customer outcomes is important for our businesses and trust and confidence across the banking industry.

To achieve this, the Independent Review will:

- Build on the Future of Financial Advice (FOFA) reforms by identifying and collating the existing product sales commissions and product based payments that apply in relation to the sale, offer and distribution of identified banking products to retail and small business customers.
- Assess whether and how product sales commissions and product based payments in retail banking could lead to poor customer outcomes, including identifying and collating examples as part of building a framework to assess whether the payment could result in poor customer outcomes.
- Identify and test options for strengthening the alignment of remuneration and incentives and customer outcomes by either removing or changing those product sales commissions and product based payments which could lead to poor customer outcomes.
- Identify options to guide potential responses for banks, including whether regulatory approvals or other actions are needed to enable banks to make any changes or take actions to address the relevant issues.

As part of the Review, the Reviewer will be conscious of factors such as competition and customer choice in retail banking in Australia as well as the importance of recognising and rewarding good performance.

### Scope

#### Staff and roles in retail banking

The Review will cover product sales commissions and product based payments received directly or indirectly by people selling banking products as a result of the number or value of products sold, offered or distributed to retail<sup>60</sup> and small business<sup>61</sup> customers.

By focusing on roles in retail banking, the Review may include bank staff who are employees, contractors and others in customer facing roles and non-customer facing roles, such as managers and supervisors, involved in selling, offering or distributing retail banking products to retail and small business customers.

In addition to bank staff, where payments are made by the banks to non-bank sales channels or intermediaries, such remuneration structures will be in scope.

#### Remuneration structures

Product sales commissions and product based payments will be reviewed where:

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<sup>60</sup> As defined in section 761G of the Corporations Act 2001.

<sup>61</sup> A business employing less than 100 people (if the business is or includes the manufacture of goods) or 20 people otherwise.

- They include fixed or at risk payments that are a direct or formulaic (either \$ or %) for the sale of one product or multiple products or the gross revenue generated from those products, and may include performance bonus payments and other sales incentives.
- They are monetary or non-monetary and paid or given to staff or others (non-bank channels or intermediaries) by a bank.
- They could result in poor customer outcomes. The Reviewer will need to build a framework in consultation with banks and stakeholders to assess whether the payment could result in poor customer outcomes.

## Retail banking products

The types of retail banking products in scope of the Review 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 (FHSA)<sup>62</sup>
- Consumer credit insurance (CCI)<sup>63</sup>
- Consumer credit products (including mortgages, personal loans and credit cards), and
- Small business lending.

## Scope exclusions

There have been extensive and significant changes to remuneration structures across financial services over the past few years. These changes have been due to legislative reforms as well as changes driven by the industry. The Review is intended to build on these changes and now look at remuneration structures in retail banking.

The Review will, therefore, not include product sales commissions or product based payments already addressed through other reforms and reviews. Specifically:

- Remuneration structures, product design issues and quality of advice regarding life insurance products as covered by the Review of Retail Life Insurance Advice (“Trowbridge Review”). The changes identified by this review have not yet been implemented. The banking industry supports fully implementing the recommendations of the Trowbridge Review and is committed to legislative reforms to support the industry making these changes to remuneration structures.
- Advice related business models that comply with the FOFA reforms and associated exemptions contained in law and regulations.
- Stronger Super reforms which removed the payment of commissions on default superannuation.
- Fee based commissions that are transparent to the customer (i.e. fee for service or fee for advice).
- Product sales commissions and product based payments made for the distribution of commercial insurance products through insurance brokers and other intermediaries, with the exception of CCI.

<sup>62</sup> The Australian Government has abolished the FSHA scheme as of 1 July 2015. Some banks will have customers who continue to be FSHA holders, and therefore, the review will include these products.

<sup>63</sup> Consumer credit insurance (CCI) may be sold, offered or distributed by a bank or through brokers and other intermediaries. Where CCI is distributed through insurance brokers, the review will include these products and channels.

- Product sales commissions and product based payments received as a result of products sold, offered or distributed to wholesale customers including institutional banking customers, commercial banking customers and global asset fund managers.

## Mortgage lending

The Review will include product sales commissions and product based payments across mortgage lending. ASIC is currently reviewing the mortgage broking industry, and in particular the consideration of remuneration structures and payment arrangements in mortgage broking. The Review will run in parallel with the ASIC review.

Banks are committed to an outcome that takes into account the ASIC findings. Any findings and options relating to mortgage broking will, therefore, align with the ASIC review timeline and wait for the completion of the ASIC review.

## Customer outcomes

The Reviewer will also be asked to provide observations and insights from the Review to assist the banks ensure they have overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices, the scope of which is broader than retail banking.

The development of overarching principles on remuneration and incentives is another initiative in the industry announcement on 21 April 2016.

## Independent Reviewer

The ABA has appointed Mr Stephen Sedgwick an independent person with relevant qualifications and experience to conduct this Review.

Mr Sedgwick will be supported by legal and remuneration experts to inform his findings and ensure the conduct of the Review and the options for implementation that it identifies are consistent with the legal and regulatory obligations that apply to participants in the Review.

Mr Sedgwick will also have access to additional expert advice as needed from a Bank Advisory Group and a Stakeholder Advisory Panel. The Stakeholder Advisory Panel will include representation from across consumers, employees and professional standards.

For matters relating to the Independent Review, Mr Sedgwick can be contacted confidentially at [steve.sedgwick@retailbankingremunerationreview.com.au](mailto:steve.sedgwick@retailbankingremunerationreview.com.au)

## Consultation

The Reviewer will conduct the Review publicly in consultation with:

- Consumer and small business organisations
- Financial services industry representatives
- Finance Sector Union and employees of banks
- Relevant regulatory bodies
- Member banks, and
- Other interested stakeholders.

## Submissions

Submissions to the Review were invited on any of the matters covered by the Terms of Reference.

The format for submissions included a cover page with:

- Name of the person or organisation making the submission, and a statement about whether the submission is personal or made on behalf of an organisation
- Contact details
- Key points made in the submission, and
- List of (any) attachments to the submission.

Submissions needed to be provided in Microsoft Word (docx) files or in PDF format.

Submissions closed on 9 September 2016.

## Final Report

Mr Sedgwick will publish a final report. The final report is expected to provide an overview of product sales commissions and product based payments in retail banking and other industries, identify possible options for better aligning remuneration and incentives so that they do not result in poor customer outcomes and set out actions which may be considered by banks and the banking industry to implement the findings.

The findings and options will not prescribe specific remuneration structures, but will identify principles for removing and changing product sales commissions and product based payments where they could lead to poor customer outcomes.

Any findings and options identified and presented in the final report will take into account the submissions of all interested parties but will be determined and framed according to the independent judgement of the Reviewer.

The publication of the final report does not imply that the Stakeholder Advisory Panel or its individual member organisations provided any endorsement of the final report, in whole or in part.

The findings and options will be those of the Reviewer. The ABA and its member banks will need to consider the report and determine their response and any next steps. The banks are committed to meaningful change that is supported by independent advice and a transparent and public process, and they will have regard to the findings and options identified by the report in determining and implementing appropriate reforms, consistent with their obligations including under the competition law.

## Timing

A final report will be published no later than 31 March 2017, however, the Reviewer will aim to complete the Review by the end of 2016.

Depending on the completion of the ASIC review into remuneration structures and payment arrangements in mortgage broking, the findings of the ASIC review may be incorporated into the findings and options of the Independent Review final report or issued as a supplement to the final report.

Some options identified by the final report may require regulatory approval or legislative reform to enable banks to take action. Regulatory approval or legislative reform would ensure banks meet their various legal obligations, including under competition laws, and ensure any changes or further action by banks are agreed to be in the public interest.

Where regulatory approval is pursued, it is expected to occur around 6 months after the final report is provided and decisions are made about the industry's response to the final report. If legislative reform is required, the timing of implementation will be dependent on the time required for passage of the legislation through the Parliament and subsequent commencement and transition arrangements.

## Independence

The ABA will appoint the Reviewer and a secretariat to support the Review. A legal adviser and a remuneration adviser will also be appointed to provide expertise to the Review.

Gilbert + Tobin Lawyers will provide competition law and policy expertise and legal oversight to ensure all participants meet their legal obligations, including competition laws.

Mercer will provide expertise and input to the Review with regards to remuneration and incentive structures and global best practice.

While the banking industry will fund the Review, the banking industry will not have any influence over the findings and options identified by the Reviewer beyond our input as a participant in the Review, and the Reviewer and secretariat will act independently and not in the interests of, or on behalf of, the ABA or its member banks.

The Reviewer is entitled to rely upon the advice of the legal and remuneration experts in preparing the final report, but the publication of the final report does not imply that the Gilbert + Tobin Lawyers or Mercer or the ABA have provided any endorsement of the final report, in whole or in part.

Mr Ian McPhee, the independent expert appointed by the ABA to oversee the progress of the commitments announced by the banking industry, will monitor the process, progress and implementation of the findings of the Review.

## Confidentiality

The Review will involve the exchange of commercially sensitive and confidential information between banks, stakeholders and the Reviewer.

All discussions with banks and stakeholders are considered sensitive and will be treated as confidential and will not be disclosed or identified by the Reviewer unless agreed otherwise. In particular, the Reviewer will not disclose any bank's commercially or competitively sensitive information to any other bank.

All information will be stored securely and only accessible by the Reviewer and members of the secretariat. Any documents or materials received will not be copied, disclosed or distributed outside of the Reviewer unless appropriately anonymised and generalised or unless agreed otherwise.

## Competition Law

Nothing discussed or disclosed by the banks or other participants in the review process will be construed as constituting a contract (including any arrangement or understanding, whether formal or informal) as to the terms on which banks or other parties will conduct themselves with respect to any element contemplated by the Review.

This includes, without limitation, the terms on which individual banks might engage or negotiate with their employees or third parties, such as financial advisers or brokers, unless and until legal advice as to the recommendations of the Review is received and considered, appropriate regulatory approval is obtained, and the banks are satisfied that entry into any contract, arrangement or understanding will comply with all applicable laws.

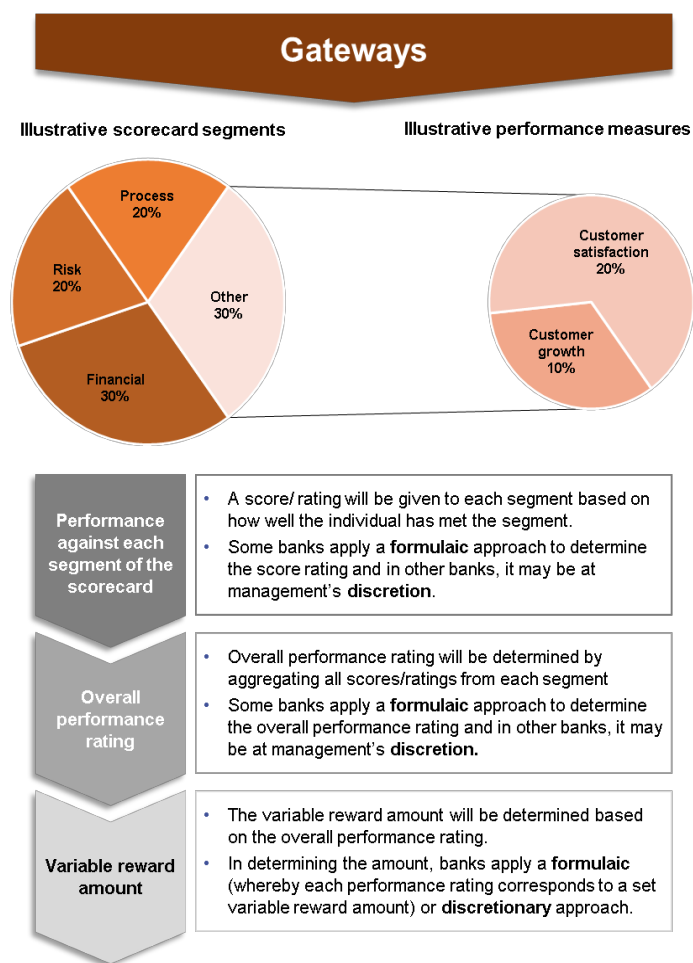
## Appendix B

### Assumptions

Appendix B sets out the at-risk reward frameworks for staff. The following important assumptions have been made in collating the data and describing the information:

- While the frequency of payments may range from monthly to annually, all figures have been annualised for ease of comparison.
- This section reflects information received from banks as at 30 November 2016, and is assumed to be complete and accurate.
- The Review has classified data on the basis of the substance of the matter, no matter how it is described in the relevant bank's documentation.
- Consistent terminology has been applied in this Review that may differ from that of some banks.
- Where no information has been provided it is assumed that the question is not applicable to that bank.

#### 1. Approach 1: Performance scorecard approach<sup>64</sup>



A performance scorecard is made up of a number of segments that group similar measures together. Measures may be individual or team-based or a combination of the two. Each measure may be assigned a weighting in order to arrive at a score for each segment. Similarly, each segment may be assigned a weighting to arrive at an overall result. Weightings vary between banks and between reward plans within banks. They may be designed to reflect the relative importance that senior management places on the attribute, activity or behaviour to which each measure or segment relates. In some schemes weightings are not formally assigned to individual elements and/or segments and managers exercise their discretion to establish an overall rating. The overall result of the scorecard leads to a potential reward. The potential payment may be determined by formula (e.g. a score of X will entitle the individual or team to a bonus of \$Y) or it may inform the exercise of discretion by management. In some

<sup>64</sup> This incentive scheme is different from approach 3 in this section as this approach has weightings and the performance measures are consistent across individuals within a role type

cases the actual payment made to an individual may also be affected – up or down – by other factors, known as modifiers.

The performance measures are usually common across individuals in the same role in each bank and can be either financial or non-financial measures or both. Examples of financial measures include product sales, product referrals and cross selling products. In each case the measures may be specified either in terms of the value of sales achieved or relative to sales targets. Examples of non-financial measures include customer education (e.g. educating customers on using self-service channels), maintaining compliance standards (e.g. adherence to policies and procedures, no compliance breaches), coaching team members, customer satisfaction, growth in customer numbers, meeting service delivery standards (e.g. average call waiting and adherence to call time standards), complaints and staff engagement (e.g. attending meetings, staff engagement survey results).

Elements (e.g. gateways, performance measures, modifiers, caps, etc.) of the scorecard approach vary across the banking industry, and a description of these elements and how the majority of banks apply these elements is provided below.

## 1.1 Gateways

In order to be eligible to receive the variable reward under this approach, individuals may be required to meet certain thresholds. These thresholds may include one or more of the following:

- Minimum performance rating as determined by the scorecard; and/or
- Minimum behaviour rating/standards; and/or
- Minimum risk rating/standards; and/or
- Minimum sales (or cross-sales) volume; and/or
- Minimum branch performance; and/or
- Minimum customer satisfaction standards.

Refer to section 3.3.9 Gateways in the body of the paper for details.

## 1.2 Performance measures

Performance measures within the scorecard vary for each role and across each bank. The following table, which is informed by the information provided by banks, indicates the majority weighting range formally assigned to the key elements of the scorecards typically applied to roles (that are covered by this Review) in retail banking:

Weighting range				
Performance measure	Tellers	Sellers – General	Sellers – Home Lenders (3)	Manager
Individual financial target (Exc. cross selling)	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 e.g. customer satisfaction, compliance objectives and technology/customer education	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.

### 1.3 Modifiers and accelerators

Some banks have mechanisms in place that decrease or increase the incentive an individual would otherwise be eligible to receive because of their assessment against the scorecard. Under this approach, banks typically apply modifiers to Sellers – General and Manager roles and do not typically apply modifiers to Home Lender roles and Tellers. The modifiers range from risk standards and personal sales performance relative to targets to branch financials. The modifier can potentially increase or decrease the reward amount by 10% to 80%, noting that there are some outlier modifiers that can significantly increase the reward amount beyond this range.

Accelerators are not usually applied in this approach.

### 1.4 Caps

Caps may be in place to limit the variable reward amount that can be received.

All banks that reward Tellers under this approach place a cap on the total reward available. Similarly, approximately half of banks that reward Sellers – General this way apply a cap. The following table illustrates the range of approaches adopted by most banks that employ this approach.

	Tellers	Sellers – General	Sellers – Home Lender	Manager
Cap on total variable reward amount	✓	✓	✓	✓
Uncapped	✗	✓	✓(1)	✓

- (1) Very few banks do not have any caps in place for their Home Lender staff under this approach.

### 1.5 Variable vs fixed pay

The table below illustrates the range of maximum variable rewards paid to individuals by the majority of banks (excluding outlier banks) that employ this approach to remuneration as a percentage of their fixed pay, noting that most individual members of staff performing the same role earn significantly less than the amounts reported below.

While the below information provides a range of variable rewards as a percentage of fixed pay, it is important to note that individuals across the banks and within the same role receive different levels of fixed pay. Therefore while the percentage of variable to fixed pay may be greater for one individual within the same role in one bank

compared to another bank, the total salary package amount (i.e. fixed pay and variable pay and other elements such as superannuation) the individuals receive may be exactly or substantially similar.

	Tellers	Sellers – General	Seller – Home Lender	Manager
If cap is applied	3% – 16%	11% – 25% (1)	5%	12% – 75%
If uncapped	n/a	20% – 47%	n/a	80% – 85%

(1) A few outlier roles had maximum variable reward amounts significantly less than the range provided above.

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

## 2. Approach 2: Variable reward related to performance against specific measures or targets

Individuals receive an incentive based on performance against each measure against which they are assessed, typically based on the extent that a target or standard has been exceeded. Performance measures may be financial or non-financial. Financial measures are directly linked to the volume and/or value of products sold (including cross selling and referrals). Indeed, plans that conform to this type of approach typically include product-based payments/product sale commissions such as payments on meeting sales targets. In the majority of cases staff targets are based on individual metrics, with only a few schemes having team- or branch-based targets.

The bonus or incentive payment is determined based on either:

- The percentage of the value of the products sold and/or referred; or
- A notional dollar amount or 'points' assigned per product/unit sold and/or referred that are then aggregated and converted to a dollar equivalent; or
- The number of products sold and/or referred; or
- An individual's financial performance relative to their branch.

The rate at which sales attracts a potential reward may vary between products. (See discussion under 'Product Neutrality' in section 6.2.7.)

In most of these schemes the potential payment increases as certain performance thresholds are exceeded (i.e. an 'accelerator' mechanism applies).

In some schemes, an individual may also receive a variable payment on meeting and/or exceeding non-financial measures (e.g. customer satisfaction and risk and compliance measures). However, this does not appear to be the norm for this approach.

### 2.1 Gateways

Eligibility to receive a reward under this approach typically depends on individuals performing satisfactorily against certain tests (or 'gateways'). These may include one or more of the following:

- Minimum performance rating as determined by the scorecard; and/or
- Minimum behaviour rating/standards; and/or
- Minimum risk rating/standards; and/or
- Products sold and/or referred, typically above minimum targets; and/or
- Mortgage settlements above minimum targets; and/or
- Minimum cross-selling targets; and/or
- Minimum customer satisfaction targets.

Refer to section 3.3.9 Gateways in the body of the paper for details.

## 2.2 Performance measures

The performance measures taken into account when assessing eligibility for performance-based rewards differ across roles and across the banks as outlined in the table below:

Performance Measure	Tellers	Sellers – General	Sellers – Home Lenders	Manager
Individual financial targets (Exc. cross selling)	✓ (1)	✓	✓	✗
Financial target – cross selling	n/a	✓	✓ (2)	✓
Branch/team financial targets	n/a	✗	✓ (3)	✓
Non-financial measures (e.g. customer satisfaction, compliance objectives)	✓	✓	✓ (4)	✓

- (1) Individual financial targets relate primarily to referrals in the case of Tellers. For all other roles, financial targets relate to products sold and/or referred. For a number of banks a referral is only counted against a target if that specific referral has led to a product sale.
- (2) Some banks have in place mechanisms whereby an individual's cross-selling performance is only taken into account in assessing their eligibility for a reward if their primary sales target has been met (typically the number of mortgages sold/settled). Conversely a small number of banks have mechanisms in place whereby a Home Lender can only receive the variable reward under their financial target (i.e. mortgages sold/settled) if they have also met their cross-selling target.
- (3) Very few banks reward individuals on the basis of team-based financial targets (i.e. number of mortgages sold by the team/settled) in place.
- (4) About one-third of banks have in place non-financial measures that apply to their Home Lenders in addition to financial measures, other than as Gateways – see 2.1 above.

A number of schemes include accelerator-type mechanisms in respect of one or more of the performance measures described above. The performance measures are made up of two or more thresholds with each threshold bracket corresponding to a set variable reward amount. Individuals will receive a higher variable reward amount if higher thresholds are met. By way of illustration, a Home Lender may earn a rising share of the revenue generated above a threshold/sales target such as in the range 0% to 150% of the threshold a payment equivalent to 0.20% of the revenue may be due but the share may rise to 0.30% once more than 150% of the target is reached<sup>65</sup>.

## 2.3 Modifiers and accelerators

Some banks have mechanisms (modifiers) in place that decrease or increase the incentive an individual would otherwise be eligible to receive because of their assessment against specific performance objectives. Under this approach, banks typically apply modifiers to all Sellers and Manager roles and do not apply modifiers to Tellers. Modifiers that decrease the variable reward amount are related to non-financial measures such as risk and behaviours whereby the amount can potentially decrease by up to 25%. Modifiers that increase the variable reward amount can also include behaviour measures as well as financial measures such as cross selling/product sales and customer satisfaction. These modifiers have the potential to increase the variable reward by up to 70%.

Accelerators refer to an arrangement whereby a higher *rate* of reward is earned with higher levels of performance; e.g. increasing volumes of sales. Approximately half the banks which use this approach apply

<sup>65</sup> The specific figures used in this example are for illustrative purposes only and not derived from information received.

accelerators to at least one of their reward plans. The accelerators are typically applied to financial performance objectives such as product sales and can increase the reward amount that can be earned by meeting and/or exceeding one or more specific performance objectives (see section 6.2.2).

## 2.4 Caps

The variable reward plans for Tellers under this approach are all capped, either on the total amount payable and/or on the reward available in respect of specific performance objectives. Schemes in respect of other roles may be uncapped. The following table summarises the types of caps that can apply under this approach:

	Tellers	Sellers – General	Sellers – Home Lender	Manager
Cap on total variable reward amount	✓	✓	✓	✓
Cap on specific performance objectives	✓	✗	✓	✗
Uncapped	✗	✓	✓	✓

## 2.5 Variable vs fixed pay

The table below illustrates the range of maximum variable rewards paid to individuals by the majority of banks (excluding outlier banks) that employ this approach to remuneration as a percentage of their fixed pay, noting that most individual members of staff within the same role earn significantly less than the amounts reported below.

While the below information provides a range of variable rewards as a percentage of fixed pay, it is important to note that individuals across the banks and within the same role receive different levels of fixed pay. Therefore while the percentage of variable to fixed pay may be greater for one individual within the same role in one bank compared to another bank, the total salary package amount the individuals receive may be exactly or substantially similar.

	Tellers	Sellers – General	Sellers – Home Lender	Manager
If cap is applied	6% – 14%	n/a	12% – 300%	n/a
If uncapped	n/a	23% – 127%	140% – 597%(1)	n/a

- (1) The reported maximum variable reward paid to Home Lenders refers primarily to a single 'high-performing' Home Lender within each bank. Other Home Lenders typically receive a variable reward payment which is equivalent to 100% or less of their fixed pay.

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

## 3. Approach 3: Variable reward based on management discretion against individual performance measures or targets

Under this approach, the reward payable is based on an assessment by the Manager of the individual's overall performance against that individual's performance objectives. The performance measures may be different between individuals performing the same role and will typically be established as part of the bank's performance management arrangements.

The Manager's assessment is typically subject to some process of 'peer review' or 'calibration' to minimise the risk that their assessment of an individual's performance is inappropriate.

Only a few banks have adopted this approach, in which case it is applied to all staff (including all customer-facing and Manager roles).

### 3.1 Performance measures

The performance measures for these roles typically include at least one measure related to product sales and/or referrals (i.e. a financial target). These measures typically involve individual financial targets for customer-facing staff and team- or state-based financial measures for Managers. The measures/targets may be different for different individuals within the same role and take into account an individual's tenure, day-to-day job responsibilities, and/or experience.

Although the performance measures may be set for each individual in discussion with their Manager, these systems typically require the mandatory inclusion of certain non-financial measures in addition to financial measures. For example, one bank has mandated that all customer-facing staff and Manager roles must include a risk- and compliance-related performance measure.

Examples of measures used by the few banks that have adopted this approach include:

Example Objective	Customer-facing staff	Manager
Financial objective	Minimum mortgage sale/settlement targets	Minimum team total sales
Non-financial objectives <i>e.g. customer satisfaction, compliance objectives</i>	100% of training completed	Team engagement and culture

### 3.2 Modifiers and accelerators

Where modifiers are used under this approach, they relate to consequence management, whereby an individual's reward can be reduced or in some cases withheld completely if an individual is considered to have engaged in improper conduct. Accelerators are not used in this approach.

### 3.3 Caps

Rewards available under most plans under this approach are capped except for those that relate to customer-facing staff who primarily sell mortgages.

### 3.4 Variable vs fixed pay

The maximum variable reward amount relative to fixed pay reported by banks as having been paid in the last performance cycle under this approach ranges from 6% to 61% across both customer-facing staff and Manager roles. While this range is a percentage of fixed pay, it is important to note that individuals across the banks and within the same role receive different levels of fixed pay. Therefore while the percentage of variable to fixed pay may be greater for one individual within the same role in one bank compared to another bank, the total salary package amount the individuals receive may be exactly or substantially similar.

## 4. Approach 4: EA-prescribed variable rewards

The EA prescribes the variable reward amount for some roles for a very few banks. For these banks, the EA prescribes a pool amount of 1% to 2% of salary costs. Individuals may receive a variable reward amount if they meet minimum individual performance standards and/or the bank financial targets are achieved.

## 5. Financial Advisers

The following variable reward approaches apply to Sellers – Financial Advisers:

1. Revenue share plan
2. Performance scorecard approach

## 5.1 Revenue share

The revenue share plan applies to Financial Advisers in the majority of banks. In this instance, the variable reward is calculated as a share of the revenue generated by the Financial Adviser. Financial Advisers may generate revenue in the form of upfront and ongoing advice fees, referral of products such as customer finance, credit cards, mortgage lending, personal investments, etc. and 'grandfathered' commissions under FOFA.

### Gateways

In order to be eligible to receive a variable reward, Financial Advisers must meet a number of thresholds that may include:

- Minimum revenue thresholds; and/or
- Minimum risk requirements/standards; and/or
- Minimum behaviour ratings; and/or
- Minimum advice quality standards; and/or
- Minimum audit ratings; and/or
- All required training/continuing professional development (CPD) hours completed.

Financial Advisers may receive an incentive payment on a monthly or quarterly basis. Under the revenue share plans operated by a few banks, Financial Advisers may receive an annual reward in addition to the monthly/quarterly amount. The approach to determine the annual amount differs from the approach to determine the monthly/quarterly amount.

### Monthly/quarterly variable reward payment

Banks apply a 'share rate' to the revenue generated by the Financial Adviser to determine what the Financial Adviser will receive as a variable reward. The share rate is a percentage of the revenue generated and is determined having regard to factors such as:

- The dollar amount of revenue generated; or
- The 'mix' of revenue generated (i.e. upfront vs ongoing advice fees).

Financial Advisers may receive either a share of all revenue generated or a share of revenue generated above a target threshold set by the bank. There is typically no cap on the monthly/quarterly variable reward.

The variable reward may also include amounts attributable to referrals Financial Advisers made to other parts of the bank. The rate of payment will typically vary depending on the product referred.

### Annual variable reward payment

Financial Advisers who receive an annual variable reward are assessed against a scorecard in line with approach 1 described under section 1, above. The performance rating may either determine the reward amount or be applied to increase the bonus paid for exceeding the target. There is typically a cap on the annual variable reward amount.

### Deferrals

A deferral mechanism<sup>66</sup> is in place for most revenue share plans. The variable reward amounts paid under this plan are subject to a different deferral process from the one outlined in section 3.3.11 Deferrals in the body of the paper. Types of deferrals include:

- 30% to 50% of the variable reward deferred for one year with the majority of banks not applying a minimum threshold; or

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<sup>66</sup> A deferral is a mechanism used by banks whereby a component of an individual's variable reward payment is delayed or 'held back' for a set period, but is then released to the individual in the form of either cash or equity.

- Deferral of the entire variable reward amount for a minimum of two months based on quality of advice rating.

Deferred rewards will be paid to the individual at the end of the designated period as cash or equity if certain conditions have been met such as meeting minimum performance requirements and/or achieving minimum risk and behaviour standards. Very few banks do not have a deferral process in place.

#### Modifiers and accelerators

Modifiers under this approach apply only to the deferred amount. Modification may be in the form of team financial performance, depending on performance outcome from scorecard, customer satisfaction, compliance, advice quality and/or document quality. These modifiers have the potential to increase or decrease the variable reward by up to 20%.

### 5.2 Performance scorecard approach

A small number of banks pay their Financial Advisers a variable reward under the performance scorecard approach. The Financial Adviser will be assessed against meeting and/or exceeding a number of measures, scores against which will be combined to establish an overall rating. For further detail on operation of this general approach, refer to section 1, above.

### 5.3 Variable vs fixed pay

Those who are under a revenue share plan can earn significantly higher variable rewards compared with those Financial Advisers who are remunerated under a scorecard approach, which can be similar to Home Lenders who fall under the uncapped approach 2 model.

## Appendix C – Glossary

General	
<b>Review</b>	Independent Review of product sales commissions and product-based payments in retail banking in Australia
<b>ABA</b>	Australian Bankers' Association
<b>ASIC</b>	Australian Securities and Investments Commission
<b>FSA</b>	Financial Services Authority
<b>FCA</b>	Financial Conduct Authority
<b>Terms of Reference</b>	Framework and parameters under which the Review operates. Refer to Appendix A.
<b>FOFA</b>	Future of Financial Advice (FOFA) reforms
<b>EA</b>	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 ( <b>EA</b> ).
<b>Tier 2 products</b>	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	
<b>Tellers</b>	Customer-facing staff who primarily refer customers to other parts of the business or to other staff.
<b>Sellers: General</b>	Include personal bankers, small business banker-equivalent roles and call centre roles that can sell products to customers.
<b>Sellers: Home Lenders</b>	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.
<b>Sellers: Financial Advisers</b>	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.
<b>Managers</b>	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)
Rewards and reward types	

<b>Fixed pay</b>	The guaranteed level of monetary reward paid by an employer to an individual, typically comprising base salary plus Superannuation Guarantee in Australia.
<b>Variable reward payments (rewards)</b>	The level of monetary reward paid by an employer to an eligible individual. It includes bonuses, incentives or product-based payments/product sales commissions.
<b>At-risk pay</b>	Variable reward pay together with the annual increase in fixed pay (if any).
<b>Reward mechanics</b>	
<b>Cross selling</b>	Sale of additional or 'add-on' products to customers in addition to the primary product(s) an individual is rewarded on.
<b>Accelerator</b>	An arrangement whereby a higher rate of reward is earned with higher levels of performance e.g. increasing volumes of sale.
<b>Modifier</b>	Increases or decreases the bonus or incentive payable once a condition has been met.
<b>Gateway</b>	Condition that must be met before potential bonus/incentive/product sales commissions and product-based payments can be accessed by the individual.
<b>Clawback (for staff)</b>	A mechanism whereby all or part of an individual's variable reward payment is recovered by the bank from the individual if certain conditions are met. In some instances the reward may be forfeited entirely if the payment has not yet been made to the individual.
<b>Clawback (for third-party channels)</b>	A mechanism in place for the bank to take back the commissions paid to the third-party channel if the loan is repaid/settled/closed or refinanced within a specific period.