Retail Banking
REMUNERATION REVIEW

Retail Remuneration Review

Assessment of Progress

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Executive Summary

A lot has happened in the Australian banking industry since the Retail Banking Remuneration Review (2017 Review) was published[1], including most recently the deliberations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (FSRC)[2]. The 2017 Review provided an independent examination of product and sales commissions and product-based payments in retail banking in Australia. My Recommendations (Recommendations) included that banks should begin to take action to address my Recommendations as soon as possible, with any transition completed by the performance cycle beginning in 2020. The ABA has commissioned this mid-term independent industry level assessment of progress in implementing the 21 Recommendations of the 2017 Review.

A key principle of the 2017 Review (and the Issues Paper that preceded it) is that rewards and incentives arrangements do not operate (and are best not assessed) in a vacuum[3]. They:

- 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 current assessment addresses the policies that banks have adopted (or have firm plans to adopt) in respect of variable remuneration, performance management and the desired workplace culture. Although consultations with some staff provided useful insights[4], a *systematic* assessment has not been conducted into how effectively the policy changes have been implemented in practice[5]. Indeed, so recent are the changes it is premature to attempt such an assessment, especially in respect of bank culture. Those are more properly matters for the review originally proposed in my Recommendations for 2021.

Banks are moving at different speeds (partly reflecting relative resource constraints but also because some have a greater need to change than others[6]). Overall, substantial progress has already occurred. The clear trend is towards policies that will be fully consistent with the Recommendations in respect of in-scope bank staff[7] well in advance of 2020. Of course, it will be for later judgement whether that promise is realised in all cases.

Although some individual banks still have adjustments to make, progress generally across the industry to date in respect of in-scope bank staff includes:

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[1] Full report available at https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL_Rem-Review-Report.pdf.

[2]The Final Report of the FRSC (Final Report), at recommendation 5.5, recommends, amongst other things, that "Banks should implement fully the ecommendations (of the 2017 Review)". It recommended not just implementation but that their intent should be honoured (see FSRC Final Report (Volume 1), p.370).

[3] Retail Remuneration Review Issues Paper, section 2.2 *Remuneration and incentives payments in context*.

[4] The Financial Sector Union organised a roundtable for us with staff drawn from several states and banks. Some observations, which in each case were supported by evidence, have been included in this Report.

[5] Nor have I revisited the 2017 Recommendations in the light of later evidence and argument.

[6] Some smaller banks and some foreign owned banks believe that their initial culture is closer to the desired one.

[7] In-scope staff of retail banks comprise Tellers, Sellers and their supervisors and near managers (Managers) and their equivalents in call centres. See Attachment B for a fuller description of these roles.

- A decisive shift to 'whole of role' assessment of performance and rewards for all in-scope staff, with greater focus on customer experience or satisfaction, and with financial indicators typically accounting for only a third or less of any formal assessment;
- The most concerning elements of previous arrangements, such as direct links between sales achieved and variable pay, and the use of accelerators or accelerator-like modifiers[8] linked to sales, have all but gone**;** and
- The maximum achievable rewards for in-scope staff, especially specialist lenders, have fallen with a bias to come down further[9].

The adjustments remaining often involve further steps to reduce the likelihood of miscommunication about the desired practices and culture, especially in terms of any lingering perceived direct link between sales performance and rewards. These include how scorecards are applied in practice[10], the design and use made of leaderboards and how targets are set and monitored.

Customer measures are still evolving. The Net Promoter Score[11] (NPS) and customer satisfaction measures remain the primary measures. However, I have noted there is an encouraging attempt to capture the quality of the relationship across all interactions with the customer, not just those that lead to a sale. Banks have invested significantly to support this cultural shift. Communication of some sophisticated messages about the purpose of some measures and how they are consistent with a predominantly customer rather than a predominantly sales focus can present challenges. Staff feedback includes some scepticism as to whether culture has changed fully in line with the intended philosophy.

Those banks seeking major cultural renewal (this includes all the major banks) acknowledge that progress may be uneven because the legacy culture in some parts of their business is entrenched. They report supporting these efforts with substantial investments to build internal capability, including amongst managers of front line staff. The latter may include skilling managers to coach front line staff[12] in how to have effective conversations with customers and to make balanced 'whole of role' assessments of performance.

The use of manager discretion to assess performance and behaviours has increased and may become more important in the future, especially if targets become more team based. Some banks have introduced or strengthened calibration or moderation processes to help ensure that discretion is exercised consistently and well[13]. Some banks have discovered that a downside to a compliant and collaborative culture can be a reduced tendency to challenge and question. These banks are also encouraging staff to speak up so that ideas can be shared and tested.

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[8] An accelerator is an arrangement whereby a higher rate of reward is earned with higher levels of performance, for example, increasing volumes of sale. A modifier increases or decreases the bonus or incentive otherwise payable once a condition has been met. See section 3.3.3 of this Report for further detail.

[9] There is some uncertainty about the ultimate resting point for variable remuneration of specialist bankers such as home lenders because that segment of the labour market is in flux.

[10] No bank has a direct link between an individual's sales performance and their reward in 2019. However, four banks have scorecards in which 'performance relative to (financial) target' independently generates a variable reward.

[11] The Net Promoter Score (NPS) is an index ranging from negative 100 to positive 100 that measures the willingness of customers to recommend a company's products or services to others.

[12] Front line staff refers to in-scope Tellers and Sellers. See Attachment B for further information about these roles.

[13] See section 2.1.1.4.

Progress is generally slower and much more mixed in respect of Recommendations that relate to third parties**.** Although substantial reforms to governance seem to be in prospect, changes to broker[14] remuneration to date have been modest. Payments other than commissions have typically been removed. The move to pay brokers commission based on the loan drawn down net of offsets is a step in the right direction but does not fully meet the intent of my original Recommendation, which favoured the introduction of a lender-paid fee for service related to the effort required of the relevant third party rather than relative to loan size, with some deferred payment mechanism (effectively truncated trail payments). The situation in respect of third parties is complicated by differences in the preferred policy positions of key regulators and reviewers, which hopefully should be resolved by the time of the 2021 review.

The findings are summarised more fully in Section 2, which also identifies seven emerging issues as banks move to embed my 2017 Recommendations and makes three supplementary recommendations for further work. Importantly I recommend that the review to be conducted in 2021 should explicitly address bank culture, for which purpose arrangements should be made in advance to generate the necessary data to inform any such future review.

I have been ably assisted by an independent team in a secondment capacity, supporting me to collect and collate the data, and logistical support from the ABA. I have been very grateful for the volumes of data provided by banks to support the Assessment process. Time lines were condensed, and it has been a huge task at the 'wrong end' of a busy year. I appreciate this support and the frankness of the subsequent discussions. Of course, the views expressed are my own.

[14] For simplicity I do not differentiate between 'broker remuneration' and that of aggregators or broker groups.

Contents

1 Introduction

1.1 Scope of this Review

This independent review has been commissioned by the Australian Banking Association (ABA) to assess and report on the progress made by their participating member banks to implement the 21 Recommendations (Recommendations) of the 2017 Retail Banking Remuneration Review (2017 Review[15]). The ABA had committed publicly to implement all Recommendations[16]. Several member banks made public commitments to that effect also.[17] The Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (FSRC Final Report) recommended that "banks should implement fully the recommendations" of the (Sedgwick) Review[18].

The 2017 Review examined product sales commissions and product-based payments in retail banking in Australia. Such payments are linked to the number or value of products sold, offered, or distributed to retail and small business customers. The Recommendations of the 2017 Review built on the Future of Financial Advice (FOFA) reforms[19]. They also suggested the principles that banks might apply when structuring remuneration more generally and addressed related issues concerning bank culture and approaches to performance management.

The 2017 Review specifically examined the arrangements that led to incentives, commissions and bonus payments (variable reward payments) for retail staff of banks (Tellers, Sellers and their supervisors and near managers (Managers)) as well as third parties (including Brokers, Aggregators, Franchises, Introducers and Referrers) and made recommendations intended to reduce the risk that practices current at the time could lead to poor outcomes for customers. These roles remain in scope for the current exercise. Together these roles may deal with a range of products, including various deposit accounts and loans such as mortgages, and a range of insurance products, including consumer credit insurance (CCI).

Recommendation 1 of the 2017 Review states:

> *"I recommend that all banks begin to implement the recommendations in this Report as quickly as systems and other changes can be introduced. If transitional arrangements are necessary, full implementation should be achieved by no later than the performance year that begins in 2020."*[20]

A key principle of the 2017 Review (and the Issues Paper that preceded it) is that rewards and incentives arrangements do not operate (and are best not assessed) in a vacuum[21]. They:

- *"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*

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[15] Sometimes referred to as the Sedgwick Review (for example in the FSRC Interim and Final Reports).
[16] https://www.ausbanking.org.au/media/media-releases/media-release-2017/banks-to-change-the-way-they-pay-their-staff, URL current at February 2018.
[17] For example https://www.commbank.com.au/guidance/newsroom/CBA-to-implement-all-sedgwick-review-recommendations-201704.html and https://news.nab.com.au/news_room_posts/nab-commits-to-implementing-final-sedgwick-recommendations/, URLs both current at February 2018.
[18] FSRC: *Final Report*, Recommendation 5.5, p.36.
[19] Corporations Amendment (Future of Financial Advice) Act 2012.
[20] 2017 Review, section 3.1, p.8.
[21] Issues Paper, section 2.2, p.13.

- *"Are discharged in the context of each workplace's culture (as, indeed, is the performance management system)."*[22]

The starting point for this assessment is therefore an examination of the remuneration arrangements in place for in-scope roles as at the date of bank responses to my request for information in December 2018. In addition, I am required to examine the plans of each bank for any further changes to remuneration structures for in-scope retail bank staff; their approaches to governance, culture and performance management; and governance and remuneration structures for third parties. The objective is to assess progress in implementing the 2017 Recommendations by the performance year commencing in 2020, consistent with the first Recommendation of the 2017 Review.

A key finding of the 2017 Review was that there was "*not sufficient evidence of significant systemic risks of poor outcomes for customers to support an outright ban on all product-based payments in retail banking*"[23]. Some practices were nonetheless found to carry an unacceptable risk of promoting behaviour that was not aligned with the interests of customers, and I recommended these cease. Some of these related to management practices that may reduce the effectiveness of the bank's risk mitigation strategies and practices related to the way incentives and remuneration were structured. The need for change was true of both direct (that is in-scope staff) and some third party channels. The Recommendations were framed against an emerging 'trust deficit' within the community in respect of banking and were intended to signal a sharp break with the past. The deliberations and findings of the FSRC have reinforced the urgency for such changes to be made within the banking sector.

The Terms of Reference are set out in Appendix A. They summarise the aims of this work as to:

1. Assess that the implementation of the Recommendations has been meaningful
2. Ensure the industry is on track to meet its commitments, and
3. Ensure the intent, integrity and spirit of the Recommendations are being implemented

1.1.1 Issues not in scope of this Review

Consistent with the Terms of Reference, this review has not revisited my original Recommendations in the light of later evidence, for example, in the context of the FSRC. It has taken comfort from the fact that the FSRC Final Report has recommended not just implementation of my 2017 Recommendations but that their intent should be honoured[24].

The focus of the current assessment is the *policies* that banks have adopted (or plan to adopt) in respect of remuneration (especially variable remuneration), performance management and the desired workplace culture. Although consultations with current staff working in retail banking roles provided useful insights, a *systematic* assessment has not been conducted into how effectively the policy changes have been implemented in *practice*. Indeed, the changes are often so recent that it would be premature to attempt to do so[25]. Those are more properly matters for the review originally proposed in my Recommendations for 2021.

[22] Issues paper, section 2.2, p.13.
[23] 2017 Review, section 4.1, p.12.
[24] FSRC: Final Report, p.370.
[25] Moreover, as in the 2017 Review, a number of important issues that had been previously examined in other fora are not in scope of this Review. These include life insurance, financial advice covered by the Future of Financial Advice (FOFA) reforms, superannuation and wholesale banking. Further detail regarding the rationale for these exclusions is set out in section 1.1.1 of the Issues Paper.

1.2 Approach and Conduct of the mid-term Review

A significant data gathering exercise supports this assessment. A questionnaire was issued to banks on 29 November 2018, with responses requested by 13 December. A copy of the questionnaire will be made available on the ABA website[26]. Banks were asked to support their responses with evidence. In a number of cases additional material was also requested to inform my understanding. Over 600 documents were provided as a consequence.

Sixteen member banks[27], including the four largest banks, responded to the questionnaire. My understanding of each bank's circumstances, intentions and practices has been greatly assisted by subsequent discussions with senior representatives of each bank, at times including the CEO, including the four largest banks[28].

The focus of this report is at the level of the industry and the policy changes that banks have adopted. I have separately supplemented this, however, with direct, individual feedback to a number of banks about the completeness of their interpretation of my 2017 Recommendations and/or the pace of their reform efforts.

As with the 2017 Review, I have been assisted greatly by consultations with the leadership of banks and discussions with some members of the Financial Sector Union (FSU). These have provided an invaluable perspective 'from the banking chamber'. While these discussions have been instructive, as previously noted there has not been time for an independent *systematic* assessment of the extent to which apparently significantly changed policy positions of many banks have been reflected in the day to day experience of front line staff. Moreover, it is premature to make reliable assessments of the extent to which the culture has changed in the many banks that are actively seeking to effect change.

1.3 Events that have led to the current assessment

I originally recommended a review should effectively occur after the start of the 2020 performance year (which I have suggested here would best now occur in 2021) to assess the extent of implementation of my 2017 Recommendations. However, the ABA has commissioned this mid-term assessment to aid industry (and community) understanding of the pace and directions of change. This follows some comments in the FSRC Interim Report that questioned the extent of change in response to my 2017 Recommendations[29].

1.4 Acknowledgements and thanks

This process involved the gathering and analysis of data containing complex subject matter and was conducted over a very short period of time. The assessment has only been made possible because of the generous contribution of time and ideas from many quarters.

I especially thank the member banks of the ABA for the timeliness and comprehensiveness of their responses to requests for information and the cooperative spirit in which our subsequent exchanges took place. I also thank the members of the FSU that contributed their perspectives; the subject matter experts who provided invaluable technical advice (namely Mercer in respect of the questionnaire and remuneration matters, and Gilbert + Tobin in respect of legal matters); staff of the ABA, who secured resources and managed logistics; and the members of the small, independent secretariat, Anna Hopley, Gayle King,

[26] https://www.ausbanking.org.au/.

[27] Thirteen banks participated in the original review in late 2016 and early 2017.

[28] The acting CEO in the case of the NAB.

[29] FSRC: Interim Report, section 9.4, p.308.

Nicholas Croft and Grace Watts, who lent expertise, commitment and professionally supported this work. Their assistance was critical to getting this Report completed to a professional standard and on time.

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

1.5 Report structure

This Report contains 5 sections:

1. Introduction;
2. Consolidated Findings, Emerging Issues and Recommendations;
3. Substantial progress – variable remuneration structures for bank staff;
4. Encouraging progress - governance, culture and performance management; and
5. Mixed progress – third parties.

2 Consolidated Findings, Emerging Issues and Recommendations

2.1 Consolidated Findings

The nature of the task facing banks to align their policies with the Recommendations of the 2017 Review is not uniform. As the 2017 Review noted:

> *"Both remuneration practices and the extent to which culture is dominated by sales vary significantly across banks, and sometimes even between groups or roles within banks. Accordingly, the implications of adopting these recommendations will be different for different banks."*[30].

That said, banks generally have begun to make the necessary adjustments to their policies in respect of their own in-scope staff. In some cases, the adjustments required were relatively simple. For many, though, quite significant changes were needed. Banks have moved at different speeds. Some banks, especially amongst the smaller banks, have been informed by their perception of their position as employers in the labour market (though many banks in this category also believe they had smaller adjustments to make than some of the larger banks). The better resourced, larger banks have also had greater capacity than some other banks to move quickly.

Although the pace of change varies, substantial progress has already occurred in the industry overall to put policies in place aligned to my Recommendations. The clear trend is towards policies that will be fully consistent with the Recommendations in respect of in-scope staff well in advance of the target date, that is, before the performance year that begins in 2020. Of course, it will be for later judgement whether that promise is realised in all cases. Moreover, as previously noted it is too early to assess how well bank practices and bank culture have changed to conform with the revised policy intent. There are reasons to believe that the pace of change even within a bank may be uneven.

Progress is generally slower and much more mixed in respect of Recommendations that relate to third parties**.** Although substantial reforms to governance seem to be in prospect, changes to broker[31] remuneration to date have been modest. The situation in respect of third parties is complicated by differences in the preferred policy positions of key regulators and reviewers.

A full list of the 2017 Recommendations is in Appendix C.

2.1.1 Good progress overall in reforming remuneration of bank staff.

Substantial progress has been made by virtually every bank to close the gap between the policies in place at the time of the 2017 Review and policies that are consistent with my Recommendations in respect of in-scope bank staff. One or two banks, informed by their perception of their position as employers in the labour market, have moved more slowly than other banks but have now adopted firm policies they will roll out in 2019. Some banks, especially the largest banks, see themselves as undertaking a 'once in a generation' refresh of both their remuneration and performance management policies for in-scope bank staff and of their workplace culture to more clearly emphasise customer service over sales. They believe that these reforms are also in the best long-term interests of their shareholders because they are expected to put the banking relationship with customers on a more sustainable footing.

Although substantial progress has been made by early 2019 there are frequently still further improvements planned for the next two years. Mostly these adjustments are relatively small (an exception being the

[30] 2017 Review, section 2.4, p.6.

[31] For simplicity I do not differentiate in this discussion between 'broker remuneration' and that of aggregators or broker groups.

further downwards adjustments required to the maximum potential variable rewards of some Home Lenders). I have also encouraged some banks to make adjustments they were not previously contemplating. At least one bank, however, is contemplating quite significant further changes for front line staff that may either remove personalised variable rewards or remove variable rewards altogether for general staff (that is not specialist bankers). It is unclear whether and, if so, when such adjustments might occur.

2.1.1.1 *Links to sales are almost gone*

It is particularly noteworthy that, consistent with my 2017 Recommendations, the most risky elements of the previous renumeration arrangements are all but gone. I have observed the following changes:

- Performance and access to variable rewards are now typically assessed on a 'whole of role' basis, sometimes using a 'balanced scorecard'. With only a few exceptions scorecards assign a weight to financial indicators of 50% in the aggregate or, more commonly, 33% or less. Those with the higher weights have firm policies in place to meet the 33% Recommendation on time.

- Both the 'what' and the 'how' are assessed to minimise the risk that good sales secured by poor behaviour is rewarded. Indeed, poor behaviour is most often (not always) an automatic disqualification for eligibility for variable reward (a 'gateway'). Banks that allow a degree of discretion (rather than apply a behavioural 'gateway') all state that discretion is never exercised to reward poor behaviour.

- Toxic practices like accelerators linked to sales had all but gone by late 2018 (and will be gone by 2019). One bank applies an accelerator-like mechanism to determine the amount of variable rewards payable under some schemes (for example, applicable to specialist bankers such as home lenders). In one scheme, improvements in performance above target attract twice the improvement in reward than an equivalent improvement attracts before the target has been reached. The effect on variable pay is relatively small. The signal to these sellers about what is valued may be powerful, however, and I suggest that the practice be discontinued.

- By late 2018 few schemes remained in which rewards were directly linked to the achievement of sales targets**.** The one bank that preserved this practice outside of a scorecard committed to remove these links by 1 January 2019. However, an assessment of the links between financial performance and rewards needs to consider some cases in which the link is nuanced. Thus:
    - Performance against targets is still often a factor taken into account when assessing performance or rewards, for example as a component of the 'scorecard', or as an element of a discretionary assessment of performance, or as a gateway[32].
    - In some cases, an individual's access to a variable reward is calculated by applying financial performance indicators independently of others. Banks that adopt this practice usually classify their approach as scorecard based. However, consistent with the approach adopted in the 2017 Review[33] I have classified such practices as a direct link between the achievement of financial targets and the amount of variable reward payable[34]. Payments calculated on this basis may send mixed messages at a time when the bank is trying to reorient its culture away from sales towards customer service. This risk would be minimised if rewards were instead tied explicitly to the weighted overall score across the

[32] Ten banks apply such a gateway.
[33] 2017 Review, section 4.2, p.15.
[34] In other words, as per Approach 2 in section 3.3.1 of this report.

scorecard[35]. Four banks have at least one scheme of this type (usually applicable to specialist bankers such as home lenders).

- However, less encouragingly**,** almost half of banks formally continue to use some form of leaderboard. Many of these have reoriented them to provide a 'whole of role' perspective. Some banks use this approach to provide team or branch based data to enable team members to assess how they are performing relative to other teams. A few, though, continue to provide information about an individual's progress in meeting their personal targets, which may be discussed at a team meeting. In some cases, the bank's formal position in respect to leaderboards is overridden in the local context - for example, a manager may translate team targets into personal ones and use a leaderboard to publicly track the progress of each individual. I have received credible evidence that at least some managers continue to operate in this way. However, I have been unable to assess the prevalence of such practices in the time available. Moreover, some staff have observed that leaderboards by their nature unnecessarily risk sending mixed messages about the bank's determination to reshape a 'sales culture', suggesting that the intent of the Recommendation would be met more reliably by changing some practices[36]. The frequency with which financial data becomes available relative to other measures of performance may be a case in point.

2.1.1.2 *Maximum potential variable rewards have fallen, so far*

A key 2017 Recommendation was that variable rewards for retail bank staff and their direct managers should be 'relatively small' compared to fixed remuneration[37]. Only a few schemes remain in which access to a variable reward is uncapped. Indeed, the maximum achievable rewards have been pared back dramatically over the past two years, with most banks by the 2019 performance year limiting such payments for in-scope retail staff and their managers to the equivalent of a maximum 50% of fixed remuneration and significantly less for tellers and other generalist roles.

- Remaining uncapped schemes are mainly of the 'profit sharing' type. These are more likely to be offered to senior managers. The risks attached to uncapped remuneration in such circumstances are not large and I believe these arrangements could be consistent with the intent of my 2017 Recommendations.

- There are important outliers, however. Significantly higher maximums are often (not always) available for home lenders and some other specialist lenders. Although these maximums have been reduced significantly over the last two years, some such schemes still potentially provide access to significant variable rewards. Most banks, of varying sizes, have formally adopted policies to limit variable remuneration to below 50% of fixed pay, often significantly below that for some roles. Some banks, however, while having reduced the maximums available for their capped schemes compared to two years ago, offer significantly higher maximums. Relatively few bankers earn the largest rewards, though.

- The trend to lower variable rewards has often, though I understand not always, been accompanied by selective increases in fixed pay in partial compensation. Most banks are closely watching these developments, especially in respect of home lenders and other specialist bankers. A number are holding their options open about the potential maximums they will offer in 2020, arguing that

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[35] Mathematically the reward payable would be identical under both approaches. The perception of a direct link to financial indicators could be reduced, though.
[36] See Section 4.2.2.1.
[37] See section 3.2.4 for a discussion of the rationale for the Recommendation.

market considerations will eventually settle the matter. It will be for later determination whether the arrangements that apply in 2020 are consistent with my Recommendation.

2.1.1.3 *Progress with customer metrics but challenges remain*

A shift in emphasis is underway from assessing performance and eligibility for variable rewards in terms of sales and products towards measures based on customer experience or the depth of the relationship with the customer. The metrics are still evolving, however:

- The predominant measures are the Net Promoter Score (NPS) or some measures of customer satisfaction. These may be calculated individually (or verbatim comments made by customers within NPS surveys may be capable of providing feedback about individuals) but are more likely to be branch-based or bank-based measures. These have limitations as measures of the outcomes achieved by customers[38], however.

- Greater attention is now paid to complaints data (including the time to respond to and resolve complaints, and verbatim comments that can be used, amongst other things, to inform behavioural ratings of in-scope staff and the performance assessment of senior managers).

- Some experimentation is underway with different kinds of customer surveys to throw light on 'outcomes', for example, a phone call to a customer. However, much work remains to be done here, for example to assess the value of undertaking a longitudinal survey of customers.

- Some banks are using activity measures in an attempt to capture the depth of the relationships with customers (for example, the number of conversations had with customers, ostensibly irrespective of whether a sale has occurred, and the number of subsequent referrals to more specialised bankers that may provide products that can address identified 'customer needs').

- Some are using manager judgement and observation to assess the quality of the interactions between a staff member and a customer (as well as inspecting files that provide a record of the interaction with the customer).

An issue for consideration is whether all these approaches are genuinely 'customer' measures rather than sales in disguise.[39] Banks argue strongly that these measures do not require a sale to be activated. There has not been time to test this systematically against the perceptions of staff, a (relatively small) number of whom told me during the FSU roundtable that their branch-level experience is different to the formal position of the bank. This should be a key element for a future review. Indeed, a related issue concerns associated performance conversations between managers and front line staff, and how customer centric these are in practice. Amongst other things, the 2021 review should be structured to assess whether, in practice, there is excessive unconscious bias towards taking sales outcomes into account when making such assessments.

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[38] And if all such measures are branch based (that is, not personalised) the variability in assessments of individual performance (and thus eligibility for and the amount of rewards) may become more sensitive to the variability of performance against financial measures than the weights in a scorecard may imply. Discretionary approaches can reduce this risk since factors such as the manager's observation of each individual can be brought to bear.
[39] Some may be better viewed as process measures for example error rates in applications for credit.

Some banks regard the metrics, tools and/or interventions they have employed to secure insights into the attitudes, 'needs' and expectations of their customers as a key strategic asset. Amongst other things, this is an interesting insight into the strategic thinking of some leaders.

2.1.1.4 *Manager discretion is applied more commonly, subject to checks and balances*

I have observed a trend to greater use of discretion[40]**.** Discretion is being applied: in assigning ratings to elements of the scorecard or performance assessment; in assigning overall performance ratings that feed into eligibility for rewards; and in determining the amount of reward to be paid. It seems that the number of schemes that are entirely discretionary has increased since the 2017 Review.

The processes to assess performance and access to rewards are now clearly linked, based on the same data sets. This means there is much less room for 'mixed messages'.

Moreover**,** calibration or moderation processes have become both more formalised and more important as assessments of performance and eligibility for rewards have become less mechanistic and formula driven. Calibration promotes consistency and equitable treatment between individuals that are in equivalent circumstances. It also helps to moderate the influence of those managers that still display the sales orientation of yesterday's cultural setting with a fixation on sales on performance assessments and access to rewards. Calibration is also commonly[41] applied when considering gateways or the impact of behavioural concerns on the eligibility for or scale of rewards.

2.1.1.5 *Cultural renewal*

A number of banks are actively seeking to reorient their culture and behaviours.

Some banks, especially smaller community-oriented banks and some foreign owned banks, believe that they have only a small, if any, gap between current practices and a truly customer centric culture. Other leaders, including of the largest banks, have instituted systematic processes to reframe their bank's culture, particularly to more explicitly prioritise customer interests over sales, with supporting changes to internal expectations of appropriate behaviour when dealing with customers:

- Some banks have refreshed their statements of values and purpose, and or have embarked on a systematic effort to ensure that staff understand those values and the bank's vision or purpose.

- Some banks report placing greater emphasis on 'should we' and behaviours, not just 'can we' and sales.

- Efforts to drive cultural change are typically supported by substantial programmes to reskill managers to enable them to succeed in their expanded roles, including to communicate the bank's values and the importance of good customer service.

- Often the coaching is in respect of how to conduct fruitful conversations with customers rather than how to make sales per se; and how to provide feedback in respect of behaviours and against a multifaceted scorecard (as opposed to simply sales metrics - sometimes succinctly described as ensuring the manager acts more as 'coach' rather than solely as 'judge').

[40] All 16 participants use discretion in performance assessments or rewards allocation in one way or another.
[41] Thirteen banks employ manager-assessed gateways, accompanied by calibration, for at least some roles.

- As with approaches to measuring customer relationships noted previously, some banks regard the tools and interventions they have employed to secure this reframed culture and/or behaviours as a key strategic asset.

Banks seeking to make major changes typically describe the reorientation of performance and reward assessments (and associated cultural renewal) as a journey. Some explicitly regard current arrangements as transitional, particularly in the way that financial measures and associated targets are expressed. A few (seemingly successful to date) experiments have been conducted with team targets, for example.

Clearly, this renewal will take time. It is premature to attempt an assessment of progress in changing culture to date. The nature of this journey and the evolution of how targets are defined and applied will bear examination in a future review.

There is a growing tendency to determine the total funding available for variable remuneration for in-scope roles having regard to broad measures of the success of the enterprise, with adjustments for risk. In a few cases, staff variable rewards are effectively a profit-sharing arrangement. One or two banks are actively considering refinements to current practices that move towards profit sharing type arrangements for more junior front line staff. Others are considering removing variable reward for some front-line staff[42] (not banking specialists like home lenders). Such developments, if they occur, would most likely be consistent with the intent of my 2017 Recommendations.

2.1.2 The picture is more mixed in respect of third party channels.

Banks are vulnerable to essentially the same financial and non-financial risks for mortgages arranged through the third-party channels as they are for loans arranged by their own staff. However, the 2017 Review found that the banks' capacity to monitor behaviour and enforce standards of behaviour when brokers are dealing with customers is highly variable. Accepting that identical arrangements cannot be insisted upon; the 2017 Review made several Recommendations to better align remuneration and governance in third party channels to those applied in the proprietary channel. The 2017 Review also found that the risks of misselling inherent in what ASIC has termed the 'standard commission model'[43] are unacceptable in the context of the trust deficit banks face and, consistent with the Recommendations in respect of the proprietary channel, should be changed.

Progress in implementing third party Recommendations has been patchy:

- Banks have substantially wound back soft dollar payments and various volume based additional rewards for aggregators or, if appropriate, brokers etc. This is consistent with my 2017 Recommendations.

- Moreover, substantial improvements have been made or, more typically, are contemplated to the governance of the aggregator and mortgage broking channel, to better align it to the 'end to end' oversight banks typically have of their proprietary channel. These will take some time to develop and implement under the auspices, at the time of writing, of the Combined Industry Forum (CIF)[44].

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[42] One small bank already does not pay any variable rewards to front line staff.

[43] For definition, see ASIC Report 516: Review of mortgage broker remuneration, p.241.

[44] Combined Industry Forum Progress Report: Working towards a better mortgage broking industry for customers, Section About Us states - In 2017 the mortgage broking industry came together to form the Combined Industry Forum (the Forum), to take action on governance and remuneration practices to achieve better consumer outcomes. The Forum consists of representatives from banks and customer owned lenders, aggregators and brokers, consumer groups (represented through CHOICE), the Australian Banking Association (ABA), the Mortgage & Finance Association of Australia (MFAA), the Finance Brokers Association of Australia (FBAA), the Customer Owned Banking Association

A promising start has been made. A full assessment of the adequacy of the industry's response needs to await the 2021 review, however. Some banks, typically the larger banks, have independently moved to tighten their existing governance and oversight arrangements along similar lines to my Recommendations.

- However, the industry has not responded satisfactorily to my Recommendation to redesign the standard commission model to reduce the inherent risks.
  - This observation applies equally to mortgage broking and to payments made to Introducers and Referrers. The reform to calculate commission payable on the amount of loan drawn down, net of any funds held in offset accounts, is a step in the right direction. My stated preference in the 2017 Review, however, was to introduce lender-funded payment arrangements related not to the value of the loan but to the effort required to identify and meet the customer's needs[45]. Although the longevity of current trail commissions is difficult to justify, some component of deferred remuneration will help to better align broker, banker and customer interests around arranging a loan that best meets the customer's needs, as understood at the time the loan is taken out.
  - I appreciate, however, that this is a hotly contested public policy issue and there is a range of different views that banks face. Hopefully the legal and regulatory framework within which mortgage broking operates will have been clarified by the time of the 2021 review.

2.2 Emerging Issues

As noted, my assessment is that, overall, the industry has made substantial progress in implementing policies that address almost all the Recommendations of the 2017 Review. It will be for a subsequent review to determine whether the policy renewal is completed appropriately, and whether the workplace practices and the culture of banks have moved in ways that fulfil the promise that permeates the 2017 Recommendations and the banks' responses to them.

In a sense the banks are 'shooting at a moving target'. It is clear that the conditions of their 'social licence to operate' have changed. Some of the new environment will in time be reflected in changes to the legislative and regulatory environment, including (possibly) in respect of third parties. The broad directions have been laid down in a number of reviews, most comprehensively in the FSRC Final Report. Legislation and regulatory change to give expression to specific changes is still evolving, as is community expectations of how banks should operate. What is clear though is that 'profit over customer' is no longer (if it ever was) tolerated.

A central tenet of the regulatory environment for well over a decade is that an 'unquestionably strong' banking system underpins the resilience of our economy. The maintenance of reserves that ensure the banking system is 'unquestionably strong' as the economy (and the need for credit) expands requires consistent profitability across the sector. That is both a business imperative for the sustainability of each bank and a fundamental pre-condition for the stability of our economy. Legitimate concerns about how necessary profitability has been secured in recent years means that 'how' each bank operates is an important component of the debate about the contemporary 'social licence'. My 2017 Recommendations were a contribution to that debate in respect of the retail operations of banks.

(COBA) and the Australian Finance Industry Association (AFIA). Twelve of the 16 banks that are participating in this assessment are members of the CIF.
Section 10.2, p.23 of the afore mentioned report lists the participating members of the CIF.

[45] 2017 Review, section 6.1.2, p.36.

Seven issues are still unfolding in respect of how retail banks meet the intent of the 2017 Recommendations, namely:

- The proper role of targets;
- What constitutes a 'relatively small' maximum potential variable remuneration (compared to fixed pay);
- Customer metrics, including in respect of the *outcomes* achieved by customers;
- Discretion and manager capability;
- Third party remuneration;
- The interests of shareholders; and
- Bank culture and the risk of 'change fatigue'.

The first five of these issues are explored further in Sections 3, 4 and 5, respectively.

The remainder of this section addresses the last two issues.

2.2.1 The Interests of Shareholders.

Regulators and shareholders alike have encouraged Boards and senior executives of banks to ensure that their businesses are profitable. As noted above, prudential regulators have sought to create a banking system that can reliably underpin a vibrant economy. They have required banks to earn profits and hold reserves that ensure they are 'unquestionably strong'[46]. Relatedly, until comparatively recently the public discourse about risk management was focussed on the identification and management of financial risk. These preoccupations were certainly amongst the factors that stood our banking system in good stead during the Global Financial Crisis a decade ago.

Similarly, institutional and other shareholders have put much weight on the relative financial performance of the listed banks and have at times been sceptical of moves by bank managements to include non-financial and/or not easily measurable metrics in their assessment of the position of the bank or of the entitlement of senior managers to variable remuneration.

A strong banking system remains essential. Recent debates, however, in the context of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services and elsewhere, have highlighted the importance for banks that they identify and manage non-financial risks as well as they historically have addressed financial risks. As noted above, the terms of banks' social licence are changing. Legitimate concern about how necessary profitability has been secured in recent years now means that 'how' each bank operates is important in the debate to determine the contemporary 'social licence'.

Senior managers understand that addressing such concerns is in the long-term interests of shareholders. The costs of remediating past transgressions are substantial and will take time to work through. At the least, current reforms to bank practices and culture are intended to increase the probability that such costs can be avoided in future. It is less clear, however, how deeply at least some shareholders appreciate the nexus between cultural renewal, short term financial performance, and the longer-term sustainability of the sector. This element of the debate deserves further attention.

2.2.2 Bank culture and the risk of change fatigue

Emerging bank culture is addressed extensively in Section 4 of this report. That material will not be repeated here. The purpose of this section is to acknowledge a point not elsewhere addressed, namely that bank culture is likely to come under increased scrutiny in the next few years. There is no 'one size fits all' approach to defining a desirable bank culture that will meet the needs of all workforces and the customers

[46] Australian Prudential Regulation Authority (APRA) - Information Paper: Strengthening banking system resilience - establishing unquestionably strong capital ratios. [19 July 2017].

whom they serve. There is a risk, however, that regulators will come under pressure to 'do something' to regulate bank culture.

Regulators should proceed cautiously. Culture needs to be a deeply embedded responsibility of bank managements and Boards. It would be ultimately counterproductive to turn their consideration of such issues into a 'tick box' compliance exercise. I suggest that the major banks have a role to play in ensuring that this debate is customer focussed and principles based, with the responsibility for ensuring a proper culture resting squarely with them. Their authority may have been diminished in recent times, but their responsibility has not.

2.3 Recommendations

I have not revisited my 2017 Recommendations. This was outside my terms of reference. They stand. However, at a number of places throughout the following report I make suggestions to ensure that the intent of some Recommendations is clear, in the light of some interpretations that have been placed on them to date.

This sub-section addresses a further three high level recommendations that are intended to support the implementation of my 2017 Recommendations.

2.3.1 A further review

The assessment in section 2.1 reflects the outcome of my examination of each bank's policies as at end 2018 and those firmly committed to be in place shortly thereafter. I note, however, that a significant number of banks were either uncertain about the specific arrangements to apply in the 2020 performance year (for example, in respect of the caps on variable pay, having regard to unknowable future market conditions) or were considering significant changes to take further their current reforms. Moreover, it will be some years before a reliable assessment can be made about whether the intent of each bank's policy changes and the desired cultural reform agendas have been delivered in practice.

Recommendation 1: *a further assessment of the banks' progress in implementing the 2017 recommendations occur in the first half of 2021 (this is more specific as to timing than the original recommendation 15).*

NOTE: This work will require sufficient time and high quality data to enable, amongst other things, an assessment to be made of progress in achieving cultural renewal where required. The 2021 reviewer should be identified and consulted well in advance of the actual assessment so that appropriate data can be collected not only about then current policies but also about how they are implemented in practice, and the state of contemporary bank culture. One option, for example, would be to secure the agreement of each bank to incorporate specific questions to establish how the performance management system operates in practice and the cultural climate as part of each bank's regular surveys of staff. Another might be to conduct a purpose built survey. In assessing and developing options of this kind, someone with expertise in designing and interpreting such a data gathering exercise should support the reviewer.

2.3.2 Customer metrics

My impression is that customer metrics are far less sales oriented than was the case previously. However, this should be tested with survey or other evidence about contemporary practices. This, too, should be a focus of any subsequent assessment in 2021. The analysis needs to occur at two levels: the policy, and the practice at branch[47] level. Data gathering to support this analysis also should be planned and executed in advance of the actual assessment. Despite good intentions, it has proven difficult to develop significant scalable new measures of customer experience that accurately capture both the customer experience and the outcomes secured by a customer from an interaction with a bank, including over time. This is common across the world.

Recommendation 2: *ABA establish whether there is sufficient support for collaborative work to develop principles that should underpin metrics that capture the outcomes customers achieve.*

NOTE: *Although some banks have expressed interest in such an initiative in discussions, others have expressed reservations on the basis that the resolution of this issue is an important strategic business asset. If necessary, this work may involve a subset of the ABA membership. Consultations with ASIC and the ACCC may be necessary to identify and assist with navigating any competition law issues. (See section 4 for further detail.)*

2.3.3 Remuneration of Third Parties

The Combined Industry Forum has made substantial progress in addressing most of my original Recommendations in relation to third party governance and the elimination of volume-based payments to aggregators / brokers over and above commission payments. However, market dynamics (and significant reluctance in some quarters to acknowledge the residual risk) have meant that a viable alternative to the standard commission model has not emerged. Desirable reform seems unlikely without regulatory change.

Recommendation 3: *That the ABA:*

- *reconsider the approach adopted by the CIF to the 'standard commission model' for the remuneration of mortgage brokers / aggregators in the light of the findings of Royal Commission into Misconduct in the Banking, Superannuation and Financial Services and my 2017 recommendations; and*
- *as necessary, work with relevant agencies, including ASIC and the ACCC, to secure regulatory reform that will permit the introduction of a fee for service remuneration model for aggregators / brokers and introducers etc that preserves the viability of the third party channel but links payments to the effort expended in securing the loan for the customer rather than the value of the loan secured, with appropriate deferred payment options (not long lived trail commissions).*

NOTE: This may in time require temporary oversight of fee setting by the ACCC. (See section 5.2.4 for further detail.)

[47] 'Branch' should be taken to cover other workplaces such as call centres or specialised retail business units.

3 Substantial progress – variable remuneration structures for bank staff

3.1 Context of this section & changes since the 2017 Review

This section will review the progress towards implementation of Recommendations 2 to 8 inclusive for in-scope retail bank staff.

Remuneration of in-scope retail bank staff has historically included both fixed and variable reward payments, as well as non-monetary inducements. Although there are exceptions, banks typically in the past have had several plans or schemes in place that regulate access to variable rewards for in-scope roles. One notable feature of the data gathered for this assessment, however, has been a distinct trend since the last report to reduce the number of separate schemes in operation. Similarly, there is an evident trend to rebalance remuneration to place greater emphasis on the fixed component, especially for roles that historically have enjoyed access to relatively high variable rewards (expressed as a proportion of fixed pay)[48]. Manager discretion and judgement have also become more prominent.

Variable rewards may be related directly or indirectly to sales of retail products. The 2017 Review noted:

> *"One such practice is the linking of the size of a variable reward payment directly to the achievement of sales targets or similar measures such as cross sales or referrals. The effect of this practice is that sales success is rewarded irrespective of performance against other measures such as customer-oriented measures. The risk is that staff or other observers interpret this as a signal that 'only sales matter', or 'sales matter most', even when staff must demonstrate certain minimum standards of behaviour towards customers to qualify for any incentive payment at all. This risk is accentuated if the workplace culture is heavily sales oriented, which some banks concede is likely to be the case after many years in which sales performance has been highly valued and rewarded. The reputational and other risks associated with these practices are heightened when the banking industry is already perceived as having a trust deficit that needs to be addressed"*[49].

Since the release of the 2017 Review:

- The Australian Prudential Regulation Authority (APRA) conducted their own review of industry remuneration practices in June 2017 and reported their findings in "Remuneration practices at large financial institutions", in April 2018.
- The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services has reported. Amongst other things, the Commissioner was critical of banking culture in general[50] and recommended that banks fully implement the letter and spirit of my 2017 Recommendations.

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[48] Of course, there are notable exceptions to both trends.

[49] 2017 Review, section 4.1, p.13.

[50] For example: "Banks, and all financial services entities recognised that they sold services and products. Selling became their focus of attention. Too often it became the sole focus of attention. Products and services multiplied. Banks searched for their 'share of the customer's wallet'. From the executive suite to the front line, staff were measured and rewarded by reference to profit and sales." - FSRC: *Interim Report*, page xix.

3.2 Assessment of progress by late 2018 / early 2019

The following sections provide an overall assessment of progress achieved by December 2018 (or reliably known at that time to be imminently in prospect) in revising policies to reflect my 2017 Recommendations in respect of banks' in-scope retail staff.

3.2.1 There is more than one way to skin a cat: Recommendations 2,3 and 4

> ***Recommendation 2:*** *Banks remove variable reward payments and campaign related incentives that are directly linked to sales or the achievement of sales targets (including, but not limited to cross sales, referral targets, and profit and revenue targets);*
>
> ***Recommendation 3****: Eligibility to receive any variable reward payment should be based on an overall assessment against a range of factors that reflect the breadth of the responsibilities of each role;*
>
> ***Recommendation 4:*** *Any financial measures included in an overall assessment consistent with Recommendation 3 should:*
>
> - *Be product neutral (that is not encourage the sale of one product over another); and*
> - *In the case of a scorecard, together attract a maximum effective weight of 50 percent as quickly as systems and other changes can be introduced, falling to 33 percent or less by 2020;*

A number of approaches to variable remuneration can be consistent with both the letter and the intent of these Recommendations. The 2017 Review (and the Issues Paper that preceded it) noted that there is a '*range of variable reward approaches banks currently employ. These include:*

> *• Approach 1 - Performance scorecard approach: This approach records performance against several weighted elements or measures which are used to determine overall performance. These weighted measures may include sales, customer satisfaction and/ or the extent of compliance with policies, procedures, or behavioural standards. An overall performance rating and/ or variable reward amount may be determined by formula or through the application of judgement by a manager.*
>
> *• Approach 2 - Variable rewards related to performance against specific measures or targets: An individual receives a variable reward payment that is directly related to their achievement against a specific measure(s) or target(s), which typically will include measures that are sales- related (for example the payment of a percentage of total product sales generated or of the amount by which a sales target is exceeded). To comply with Recommendation 2, this approach should as quickly as possible phase out the use of sales and similar financial measures.*
>
> *• Approach 3 - Variable rewards based on management discretion against individual performance measures or targets: The variable reward amount is based on management's assessment of an individual's performance against targets or other measures. These typically include financial targets as well as non-financial measures. This approach would be consistent with Recommendation 2 if and only if the manager's judgement takes all factors into account and is not predominantly driven by sales (see also Recommendations 3 and 11).*
>
> *• Approach 4 - Enterprise Agreement (EA) prescribed variable rewards: The EA governs eligibility for payment with the bank's EA prescribing a specific variable reward amount subject to each individual meeting minimum performance standards. "* [51]

[51] 2017 Review, section 4.2, p.14.

At the time of the 2017 Review retail banking remuneration was dominated by Approaches 1 and 2. Almost every bank[52] adopted these approaches.

As later sections will make clear there has been a trend evident in this review towards greater reliance on Approaches 1 and 3, and away from Approach 2 (see figure 3.1). Although a reasonable generalisation, however, the claims of each bank in this respect need careful assessment. Importantly for my present assessment, the 2017 Review went on to say:

> *"In providing their data to the Review a number of banks classified their approach as a scorecard (that is approach 1). Our analysis of it, however, led us to reclassify it as approach 2. This was because the variable reward amount was assessed having regard to each indicator separately. I therefore recommend that banks which currently use or plan to use the scorecard and similar approaches review their design and structure and ensure that they align to my Recommendations."*[53]

Similar adjustments were required this time also.

3.2.1.1 *The role of financial targets is changing (and potentially misunderstood)*

It is difficult to run an organisation as complex as a bank without some recourse to targets. Targets provide powerful signals about what is expected of employees. Financial targets have a clear role to play in ensuring the continued soundness of the bank. The issue for this assessment is how those targets are set, to whom they are applied and what use is made of them in assessing performance and allocating variable rewards. For in-scope roles the trend is clearly towards targets that encompass the 'whole of role'.

Frontline staff are more likely these days to see targets about customer metrics, possibly including referrals and conversations with customers, included amongst the range of matters for which they are assessed, as well as risk and/or compliance and financial targets.

Sellers are particularly likely to have sales-oriented targets in the metrics for which they are accountable[54]. But, increasingly, other metrics will also be included, such as customer based measures.

Virtually no bank still overtly calculates in 2019 variable remuneration for retail staff solely by direct reference to an individual's performance relative to their sales target(s). The one that explicitly operated such a scheme in 2018 had amended its policies before the Questionnaire was issued to discontinue the practice from 1 January 2019.

However, four banks in 2018 continued to calculate variable rewards for some staff, typically specialist bankers such as home lenders, having regard to their performance against at least one financial element of a scorecard *in isolation from* the other elements of their scorecard. These financial metrics are typically described as 'performance relative to target' and measured as a proportion of target achieved. Sometimes access to any variable reward at all is contingent on having met such a target (or a high proportion of it) – in effect a financial gateway.

Consistent with the approach adopted in 2017, these practices have been reclassified as Approach 2 for the purposes of this assessment. Figure 3.1 shows the proportion of banks that employ each approach (or a combination of approaches) for at least some in-scope roles. Only 19% of banks apply approach 2. Scorecards, approach 1, are now dominant.

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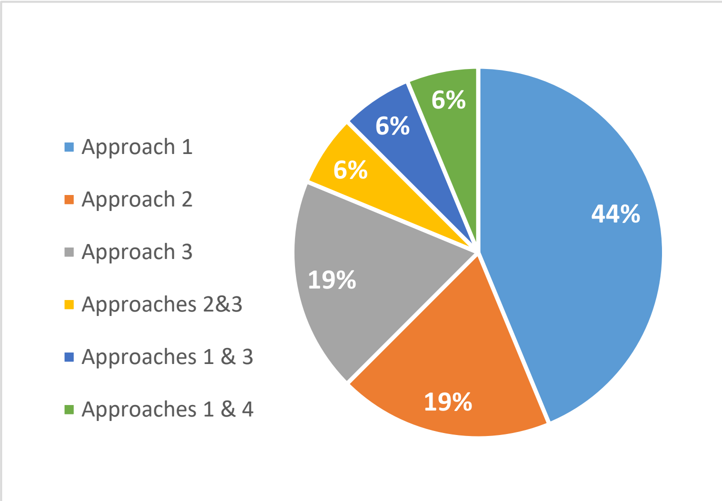
[52] As set out in the Issues Paper, only a few banks in 2016 had adopted variable rewards based on management discretion against individual performance measures or targets (approach 3) and Enterprise Agreement (approach 4).
[53] 2017 Review, section 4.2, p.15.
[54] Typically, along with other targets that relate to compliance, training undertaken and error rates or productivity measures.

Figure 3.1: Variable Remuneration Approaches



In discussion it emerged that many banks that use 'performance relative to target' as an indicator in a scorecard (especially amongst those that link remuneration to such indicators separately) regard this as a transitional step as they seek to reorient thinking towards 'customer over sales'. If so, a relatively quick phase out would seem desirable.

Having regard to the above, my assessment is that substantial progress has been made to delink sales directly to reward for front line staff, including for specialist bankers such as home lenders and their managers. However, there is still more to be done to minimise the risk that sellers will receive 'mixed messages' about the importance of sales. I would encourage those few banks that still remunerate on the basis of financial indicators separately, despite having ostensibly adopted a scorecard approach, to reconsider the practice[55]. Mathematically the change will make little difference to the reward available to an individual seller. Perceptions may be quite different between the two approaches, however. This issue should be taken up in the 2021 review.

Managers are more likely to have branch or business unit financial targets. This is not inappropriate. The issue is how they communicate and translate these targets for those that report to them. During FSU consultations those present conveyed scepticism about how well front line staff were insulated from the pressures managers face over targets. It has not been possible to test how widely held such scepticism is amongst in-scope staff. That issue should be addressed more systematically in the review recommended for the first half of 2021.

3.2.1.2 *Communicating the purpose of targets is fraught*

As noted above, it is difficult to see how an organisation as complex as a bank could function without targets and metrics that track progress against targets. An evolving issue is which targets are defined for which purposes, how their role is communicated effectively, and how individuals are properly held to

[55] In one case (a smaller bank) the size of an individual's potential reward in one scheme was determined by their performance relative to their financial targets (called a budget in that model). The proportion of the potential reward payable was then calculated by reference to a scorecard which included other measures in addition to 'performance relative to target'. This personalisation of the variable reward potentially achievable based on the individual's performance relative to budget is, I believe, inconsistent with the intent of my Recommendation.

account and recognised for their contribution in meeting them. Acknowledging the power of targets to signal 'what is important', a number of factors could contribute to sceptism about their 'real intent'. Targets can drive behaviour even when remuneration is not at risk. Even team targets can pose challenges, especially if the dynamics of the team are competitive or, paradoxically, prizes loyalty.

Although exceptions exist, overwhelmingly home lender financial measures are based on personal rather than branch level metrics. These personalised financial targets often form part of an individual's role description, and as such, can operate as a gateway to participate in variable remuneration[56].

Interestingly, financial measures are increasingly being defined and measured at team or branch level for front-line staff. Yet, I encountered significant sceptism about whether such targets (financial or customer) were being applied fully in ways that policy had intended. The fact that some managers translate team targets into personalised ones increases the risk of scepticism. This risk is likely to be stronger if a manager has a long tradition of managing against sales metrics and is still building their broader coaching capability.

Moreover, non-financial metrics are relatively broad brush (for example, branch NPS). They are typically less frequently measured that many financial indicators. Leaderboards (and team conversations in respect of them) are thus likely to be dominated by discussions about those metrics that can be compiled frequently, namely activity measures and sales and/or cross sales achieved.

As any politician can tell you, a feature of contemporary society is the need to simplify messages even if the subject matter is complex and sophisticated. 'Message overload' may well be at work for some in-scope retail staff. A case in point in retail banking is the linkage between activity-based customer metrics and what they imply about the nature of the relationship with customers. Senior managers may genuinely wish to redefine the nature of the relationship with a customer more clearly towards service. But there are many links in the chain of 'whispers' that pass on the message initiated 'from the top'. The less skilful the local manager in conveying sophisticated messaging about the purpose of activity-based customer metrics the greater the likelihood they will be seen by front line staff to be stalking horses for sales.

The more personalised the metrics and the more public the leaderboard the higher the risk that individuals will feel pressured to meet or exceed targets, even if there is no remuneration attached. During the FSU roundtable with some staff, I received feedback to the effect that hard targets can dominate the leaderboard discussions by some managers, including because of the frequency of these metrics, and that team targets can lead to peer pressure to perform.

Some banks seek to counter the rhythm of such 'hard' metrics with a parallel rhythm based on team 'huddles' (and other devices) with a customer service focus. It has not been possible to sample or test the effectiveness of such approaches. The capacity of such approaches to redress any scepticism about the reorientation of performance assessment towards customer and away from sales per se may be heavily influenced by the quality and relevance of the customer metrics that are 'paid attention' in leaderboards, informal feedback from the manager etc.

Example: Sharing Successes

At least one bank has implemented regular meetings (sometimes called 'Huddles') that people leaders host with their teams, which involve sharing customer service stories or customer comments and complaints for group discussion. These occasions may also provide leaders with the opportunity to highlight great performance by particular team members in assisting customers and help drive sharing of best practice behaviours amongst the team.

[56] Refer to section 3.2.3.1 for further discussion on 'whole of role' assessments that act as gateways.

How targets are set, communicated and monitored is clearly an important element not just of performance management but also of the cultural change journey. In an era in which communication is dominated by the need to simplify sometimes sophisticated or complex messages it is critical to pay careful attention to the messages received (and not simply to crafting the messages to be sent). Perception can rapidly become the reality.

3.2.1.3 *Manager discretion is growing but requires care*

One clear trend is an increasing reliance on manager judgement and discretion. These may be applied:

- to inform the value to be assigned to an element of a scorecard;
- to make an overall assessment of performance; and/or
- to determine the amount of variable reward to award to an individual.

A feature of this assessment is the increased reliance on Approach 3[57], which places great weight on manager discretion. This is reflected both in the policy changes that many banks have adopted and the intentions that some have to go further, possibly to move towards wholly discretionary approaches for at least some in-scope roles[58].

Discretionary approaches, as the 2017 Review noted, provide considerable advantages. These include capacity to take factors into account that could not be anticipated when the original performance expectations are set (which may affect 'the degree of difficulty' an individual faces in practice, for example) and to minimise the risk that a formula based on rigid metrics can be 'gamed'.

The 2017 Review also noted:

> *"The more formulaic the approach to calculate a performance rating or incentive payment the more important it is to develop measures that can reliably differentiate between the performances of teams or individuals. Otherwise the variability in ratings or pay may be determined by the variability in any sales measures included in the calculation, even at weights that satisfy Recommendation 4. If sustained for any length of time this would undermine the credibility and the intended effectiveness of the changes to the reward system. This is a powerful argument in favour of the application of manager discretion, provided that discretion is applied consistently with these recommendations."*[59]

The trend towards team-based metrics[60] strengthens the importance of manager discretion. An experiment by one bank of a team-based approach to the key business related KPIs has shown early promise. However, recourse to less personalised performance metrics provides an interesting challenge in providing personalised performance feedback and, if they continue, personalised rewards. Manager judgement and discretion will become increasingly important in those contexts, as will trust that those judgements are both consistent and well based.

Example: Team Targets

[57] Four banks are assessed as following Approach 3 for all in-scope roles, and one other bank uses Approach 3 for Managers only.
[58] Note that in some cases future work may include moves towards common variable rewards (or even no variable rewards) for some in-scope roles. The latter would be unlikely to involve specialist seller roles such as mortgage lenders. Either development may further change the nature of the discretion that managers will exercise in future.
[59] 2017 Review, section 4.3, p.17.
[60] Eleven banks have at least one team-based metric amongst the in-scope roles, including in respect of the customer.

One bank has commenced a Team Target pilot in a section of their branch network, where product or financial targets are set at the branch level as opposed to the individual level. Early feedback from participants has been positive, with reports of a greater focus on customer needs and on ensuring the customer speaks to the person at the bank most able to help them. It is early days. However, these results apparently did not cost financial performance, with no adverse impact on sales reported.

Discretionary systems place great reliance on the capability of managers to make consistent, well based and informed assessments. Managers need to convey clear expectations initially and, eventually, provide clear and consistent explanations of their assessments. Banks that are moving in this direction are typically investing in securing stronger capability in this regard (see section 4.3, below). Progress is likely to be uneven if the existing culture is heavily sales oriented. The messaging 'from the top' to managers and front line staff alike needs to be sufficiently sophisticated to acknowledge the tension that exists between sales, service and profitability (at least in the short term) while meeting the need of many staff to 'keep it simple' given the barrage of internal and externally-generated messaging of recent years. The degree of difficulty should not be underestimated. Some banks have very active programmes in place to build manager capability in such matters. Others should examine their own circumstances to satisfy themselves that the risks of miscommunication are adequately addressed.

3.2.1.4 *Product neutrality seems to be in place*

An issue identified in the 2017 Review is whether financial targets or measures of performance are 'product neutral' or whether, instead, they risk biasing a seller's interaction with a customer to favour one product over another that may better suit the customer's needs.

Views differ about what 'product neutrality' requires in practice. Some banks argue that aggregate sales revenue is suitably neutral. Others argue that the effort required to effect some sales is disproportionate to the value of the sale. In that case, revenue-based measures may favour the 'easy to execute' sales rather than the complex ones, especially if the latter is relatively low valued.

The 2017 Review made no finding in principle about which approach to product neutrality is preferred. It noted, however, that "banks should be prepared to defend, both to their Board and, if necessary, publicly, the decisions they make in this regard"[61]. Revenue based measures have the advantage of simplicity. They need to be applied with care, however, to minimise the risks identified above.

Substantial progress seems to have occurred since the 2017 Review:

- Cross sales targets are now infrequently incorporated into a performance assessment or scorecard[62]. The banks that persist with cross sales targets may wish to revisit this practice.
- There is a growing tendency to use activity measures to capture customer relationships rather than financial measures (for example the number of 'conversations' had with customers rather than the value of products sold as a consequence)
- The two banks that apply different weights to different classes of product typically do not differentiate between products within a product class (for example as between different types of credit card or between different home loan products). They argue that assigning differential

[61] 2017 Review, section 4.3, p.16.

[62] Seven examples were found amongst all the in-scope roles across the 16 banks. Moreover, campaigns that generate financial rewards based on product-based sales have virtually disappeared. Small rewards (for example theatre tickets may still be offered, however).

weights between product classes captures differences in the effort required by a banker to support a customer who has a need that a product class will help to satisfy. A credit card, for example, may be much simpler to explain and process than a mortgage. Although on their face reasonable, it has not been possible to verify such claims in the time available.

3.2.1.5 *Financial measures in scorecards now usually attract the recommended weight*

Recommendation 4 includes: "In the case of a scorecard, [financial measures] together attract a maximum effective weight of 50 percent as quickly as systems and other changes can be introduced, falling to 33 percent or less by 2020".

A small minority of schemes did not meet the 33 percent benchmark as at December 2018. The exceptions typically[63] have firm plans to remedy the situation in 2019'. Table 1 below depicts the situation as at December 2018. In every case, the few banks operating schemes above the 33% benchmark for financial metrics in 2018 had firm plans to remedy their situation in 2019 (see the relevant footnotes).

Table 1. Scorecard weighting range

Performance Measure	Tellers	Seller – General	Seller – Home Lender	Seller – Financial Adviser	Manager
Customer	10% - 100%	8% - 60%	0% - 40%	13% - 50%	8% - 50%
Financial	0% - 45% (1)	8% - 100% (2)	10% - 85% (3)	13% - 40% (4)	0% - 100% (5)
People	10% - 50%	0% - 41%	10% - 33%	10% - 20%	10% - 41%
Process	0% - 30%	0% - 40%	0% - 30%	n/a	0% - 30%
Risk	n/a	0% - 10%	0% - 10%	0% - 13%	0% - 10%
Other	0% - 50%	0% - 50%	0% - 50%	10% - 38%	0% - 55%

(1) The one scheme for Tellers that was weighted at 45% in the scorecard was to be reduced below the 33% threshold on 1 January 2019, resulting in all variable remuneration schemes for Tellers complying with the Recommendation.
(2) All three schemes for the Seller – General role that were above the 33% threshold had firm plans to reduce their weightings to 33% or below through the 2019 calendar year.
(3) Two schemes for Seller – Home Lender were above the 33% threshold, with one to be reduced below the 33% threshold on 1 January 2019 and the other to be reduced on 1 July 2019.
(4) The one scheme for Seller – Financial Adviser that was above the 33% threshold in 2019 was being reduced to 30% in 2019.
(5) All three schemes for the Manager role that were above the 33% threshold had firm plans to reduce their weightings to 33% or below through the 2019 calendar year.

3.2.2 Customer metrics have improved, but there is work to do: Recommendation 5

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

[63] Only two (smaller) banks did not provide evidence of firm plans to meet this benchmark. Their intention to do so was conveyed in discussions, however.

The attention paid to customer-focussed measures has increased majorly since the 2017 Review, especially in respect of high value / higher risk of misselling environments such as home loans[64]. Previously mortgage sellers received incentives that conformed to Approach 2 above, namely rewards were directly linked to sales.These have been all but phased out[65] in favour of approaches that incorporate the customer perspective in a significant way. Moreover, some banks have refreshed their codes of conduct, statements of purpose or values, manager training and the like to give greater prominence to the need to 'put the customer first'. Of course, they expect the bank will reap financial rewards in the long term from such an orientation and that, therefore, this reorientation is consistent with the best interests of shareholders.

3.2.2.1 *Emerging customer metrics*

At the time of the 2017 Review, as now, the predominant customer focused measures are based on customer satisfaction or the Net Promoter Score. Although widely used, both in other industries and internationally, these metrics have their limitations. These were explored in the 2017 Review[66], which went on to say:

> *"Several banks informed the Review that they have work in hand to improve the quality and usefulness of customer-focused performance measures. Some take note of any verbal comments supplied by the customer or complaints received. Many banks examine a sample (at least) of the documentation that they require staff to generate to support an exchange with a customer as a form of quality control. Some banks also report that they are seeking to develop measures that capture the outcomes achieved by customers, though this is in the early stages."*[67]

Work of this kind was reported both in responses to the questionnaire administered to banks during the data gathering phase and in subsequent discussions. My firm impression, indeed, is that this work is more pervasive than it was previously. Some features that are novel or more widely applied than at the time of the 2017 Review include:

- More frequent incorporation of manager assessments of the quality of the interaction with customers into the assessments of the performance of individuals[68];

- The promulgation to front line staff of guidance (supported by training) about how to conduct an empathetic sales-sensitive but not directly sales-oriented conversation with a customer; and

- The introduction of surveys of customers at times removed from the last interaction with a bank in respect of a product (say a year after the drawdown of a home loan)[69].

3.2.2.2 *Is concern justified that customer metrics are disguised financial metrics?*

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[64] Thirteen banks with a 'Home Lender' variable rewards scheme in place have at least 1 customer measure included in the metrices against which performance and reward are assessed.

[65] Although almost no banks now directly link rewards to sales against target for home lenders, as previously noted, four banks that nominally apply a scorecard-based approach nonetheless calculate eligibility for reward based on financial metrics independently of the other components of the scorecard (see section 3.2.1.1).

[66] See, for example, 2017 Review, p.17 & p.18.

[67] *Op. cit.* p.18.

[68] At least 4 banks have reported doing this.

[69] Relatively few banks reported doing this systematically. However, it is possible that more banks contact customers at discrete intervals as part of their strategy to engage customers in conversations about their 'banking needs'.

The 2017 Review also noted:

> *"It would undermine the credibility of the approach, for example, if such measurements included ones that are arguably financial in character such as cross sales or the number of products accessed by each customer or the increase in customer base/ increase of product use by a customer. Some banks will need to revise their customer measures to ensure that they are appropriately classified and that the approach adopted is consistent with these Recommendations."*[70]

There were no instances during this assessment in which clearly financial measures (such as sales volume or cross sales) were classified as 'customer'. A few large banks, however, include measures of customer 'reviews', 'needs met', 'customer conversations' or the customer 'experience'. Typically, these are activity metrics, for example of the numbers of such interventions or the number of referrals from general front-line staff (for example tellers, call centre staff or other 'customer service officers') to more specialist staff. The quality of such conversations is often assessed through a review of the record of each conversation (or a sample) or by direct observation of the intervention by the manager to see how expressed customers' needs were responded to and how unexpressed needs were discovered.

The formal activity-based metrics do not usually directly track sales that result[71]. Nonetheless feedback from some in-scope staff during the FSU-arranged Roundtable was that some managers do not distinguish between 'the conversation' or 'the referral' and 'the occurrence of a sale' as formally as the policy would intend, putting their (conscious or unconscious) bias towards sales on display as a consequence. This led them to question the real intent of these customer measures. The theme of several contributions from staff was that the predominant emphasis in their workplace was concern for sales achieved, rather than the nature of the relationship established with the customer[72].

My assessment is that customer metrics are dramatically less sales oriented than may have been the case previously, and attempt to capture information to guide the relationship the bank has with a customer. However, I have been unable to test using a staff survey or other *systematic* evidence whether this impression accurately reflects the way these policies have been implemented and/or perceived in practice. This should be a focus of any subsequent assessment in 2021.

3.2.2.3 *Further work needed re personalised metrics and outcomes-based measures*

Work to better link customer satisfaction to the efforts of individual staff is essential when a score card is applied in a formulaic way. Branch or product-based customer metrics, for example, risk leaving variability in sales / financial performance as the major discriminator of the relative performance of individuals (and therefore relative access to variable rewards if the scheme makes provision for discrimination between individuals). We identified as that many as twelve home lender scorecards that seemed to carry this risk. Greater recourse to manager discretion will help to address this risk, but only if managers have the necessary skills.

Developing measures that are directly focused on customer outcomes remains a work in progress. Australian banks are not alone in this. Other jurisdictions, for example the UK, are similarly (un)placed. Such measures are far from straightforward to develop. Several banks believe that their customer metrics are

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[70] 2017 Review, section 4.3, p.18.

[71] Although one scheme did not recognise a referral for the purposes of the individual's scorecard until a certain 'sales stage' had been met. Of course, sales data is usually captured as a metric relevant to an individual seller or a sales team.

[72] For these clearly committed staff the mantra was 'if you put lipstick on a pig, it is still a pig'. Most of them thought their manager (or, more often, their manager's manager) was still sales focussed. How representative this view may be is impossible to establish in the time available.

evolving towards ones that should be correlated with good customer outcomes in the longer term since they are focussed on the quality of the relationship that the customer experiences with the bank and not simply the volume or number of products the customer accesses. However, this issue will repay continued attention. The following, taken from the 2017 Review, remains appropriate:

> *"I continue to accept… a comment made by a senior bank member during the first consultation period. This was to the effect that a true reorientation toward service will not occur until there is as much effort devoted to measuring the quality of the customer experience and outcomes as there is to measuring the activities of staff and the sales generated."*[73]

3.2.3 Desirable gateways are in place and very few accelerators apply now: Recommendations 6 and 7

> ***Recommendation 6:*** *Credible behavioural or equivalent values gateways be applied to determine whether an individual can access any variable rewards to which they might otherwise be entitled;*
>
> ***Recommendation 7:*** *Variable reward payments no longer include:*
>
> - *Accelerators related to financial measures;*
> - *Accelerator-like modifiers related to financial measures;*
> - *Other mechanisms related to financial measures that have such an accelerator-like effect on the value of variable rewards available;*
> - *Financial gateways, including but not limited to those that relate to the number or value of cross sells;*

3.2.3.1 *Behavioural gateways (and equivalent approaches) are in place*

A common feature is the requirement that staff meet minimum behavioural standards or other requirements. These are referred to as 'Gateways'[74]. Gateways are binary - an individual either passes or fails – and not all banks have adopted this approach to ensuring that inappropriate behaviour is not rewarded. The 2017 Review accepted that a discretionary approach may validly apply more granular responses than a binary (gateway) approach.[75] As is clear from its wording, the intent of Recommendation six can be met without a formal gateway in some circumstances. Some five banks have reported a discretionary approach in respect of eighteen in-scope roles.

In a number of cases an individual's overall performance in their role acts as a gateway to determine eligibility to receive variable remuneration. In effect, variable pay is not available unless an individual's performance rating exceeds a benchmark. Six such examples were found in the data gathering exercise[76].

Where discretion is applied to conduct and similar matters, an issue pursued during discussions was whether, in practice, discretion is exercised to always exclude from rewards those who exhibit inappropriate behaviours that put customers at risk. These assurances were readily supplied. Indeed,

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[73] 2017 Report, section 4.3, p.18.

[74] Every bank uses at least one non-financial measure as a gateway. The most commonly applied gateways are compliance related for example compliance with bank policies in respect of risk (12 banks), completion of compulsory training, or the error rates in documentation and the like. Other common approaches include: 9 banks use a behavioural gateway, 9 use a company values gateway, and 5 use a code of conduct gateway.

[75] See 2017 Report, section 4.2, p.14.

[76] In one case this test worked as a modifier, that is, those who did not meet the test had the variable remuneration to which they would otherwise have been entitled set at zero.

usually at least one banker present for such a discussion was a participant in the bank's calibration or moderation processes and could attest to this from first-hand experience. More than once the reply was of the form: "these days significant misconduct is likely to lead to separation of the individual from the bank, even amongst successful sellers". A more general point was also frequently made, namely that consequence management[77] has become more prominent and systematic in recent years. I have no reason to disbelieve those making these statements and have accepted them at face value. On that basis, all banks are assessed as currently meeting the *intent* of Recommendation 6.

An issue, however, is the transparency with which banks apply such tests. Privacy concerns usually override transparency in a workplace. Staff do not always see the financial consequences of misconduct and may only speculate about the reasons behind a departure from the bank. I would encourage Human Resources teams and senior leaders to use anonymised case studies and the like to ensure that staff understand how discretion will be applied if a hard gateway is not in place. Some banks have already adopted such an approach.

The FSRC Interim report contains the following:

> "… for most of the last decade, remuneration arrangements ... for all staff, both frontline staff and senior executives, have rewarded sales and profitability. Doing the 'right thing' has not been rewarded. And even in the more recent past, 'balanced scorecards' and 'conduct gateways' have too often used doing the 'wrong thing' as a disqualifying criterion. But penalising default is not the same as rewarding the right and proper performance of a task. Penalising default encourages hiding mistakes; it does not encourage doing the 'right thing'. It does not encourage the intermediary or the employee to ask, 'Should I, should the Bank, do this?'"[78]

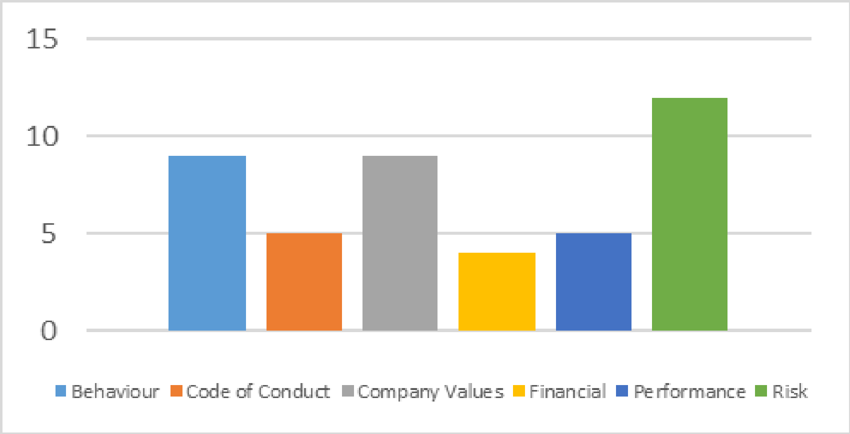
The Royal Commissioner has a point, of course. Two developments that I have observed might provide him a measure of comfort. Virtually all recognition programs are now geared to singling out exemplars of good behaviour or customer service or the bank's 'values in action' rather than sales per se. Most of the largest banks (and some others) now include a 'should we' element to their statements of desired values and / or behaviours. Accepting that it is too early to assess whether the intent of such statements is reflected in practice systematically, other banks might find it advantageous to adopt a similar approach[79]. This is also a matter for future examination.

3.2.3.2 *Few financial gateways remain*

Recommendation 7 prohibits the use of gateways based on financial measures. The incidence of financial gateways has declined substantially since the 2017 review. Only four banks[80] reported using financial gateways in the data we gathered. One bank noted that this gateway was discretionary, that is it operated more as a modifier that could reduce variable reward that might otherwise be paid and would be removed as of January 2019. The remaining banks would be well advised to cease the use of financial gateways.

[77] These participants cited changes to training around consequence management (including an increased use of case studies), harsher application of penalties for even accidental misconduct (although not necessarily a reduction to zero of variable pay in such cases), and the recording of penalty deductions on pay statements, a clear reminder to the staff member of the consequence of their (in)action(s) for variable remuneration.
[78] FSRC: Interim Report, p.69.
[79] Many smaller banks seek to be deeply embedded in the communities that they serve. They believe such approaches are deeply embedded in their DNA, which has been asserted consistently across both the 2017 and this review. While accepting the bona fides of these statements, an objective assessment has not been possible.
[80] All these banks used at least one non-financial gateway, usually on a 'discretionary' basis.

Figure 3.2: Number of respondent banks using each type of gateway



3.2.3.3 *Accelerators and accelerator-like mechanisms are virtually gone*

Accelerators deliver significantly increased incentive payments as certain sales or other financial thresholds are achieved. Accelerator-type payments have a similar effect[81]. The 2017 Review reported that several devices were then employed by banks that met these definitions. These significantly increase the risk of misselling.

Only two banks reported a scheme that incorporated an accelerator in the 2018 data gathering phase. Policy decisions have been taken by both banks to remove them in early 2019. Assuming that intent has been realised, accelerators are gone.

Accelerator-like mechanisms have also virtually disappeared. There is *one* exception, however, in which the variable remuneration for some roles increases as certain financial targets are approached. However, the rate of increase in reward after the target has been reached is twice the rate below target (and nothing is available if the outcome is less than 85% of target). The incentive for misconduct is moderated by other aspects of the scheme and the risk is not substantial. The signal such an approach sends is inconsistent with the intent of my Recommendations, however. The need to keep communication simple was emphasised on several occasions during my discussions with banks. The clear risk is that a sales oriented person will interpret mechanisms of this kind as an encouragement to exceed target by as much as possible. I hope that others do not emulate such an approach.

3.2.4 Maximum achievable rewards have come down: Recommendation 8

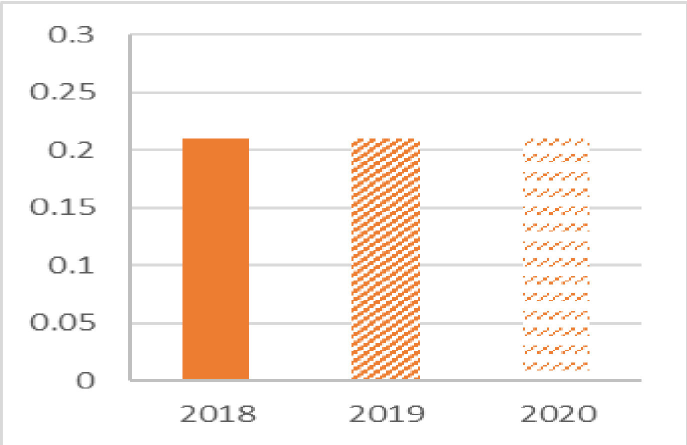
> ***Recommendation 8:*** *Variable reward payments ultimately amount to a relatively small proportion of fixed pay, with a progressive reduction in the maximum variable reward amount payable in any schemes that require a transition period to implement this recommendation*.

The changes since the 2017 Review have been very substantial. One bank has increased the on-target variable reward it offers for one of its schemes, although to a level within the range offered by most banks. The general trend, however, has been to reduce the maximum available variable rewards (relative to fixed pay), frequently (but not always) with an upwards adjustment to fixed pay for those who previously were in regular receipt of significant variable rewards.

[81] Issues Paper, section 3.3.7, p.25.

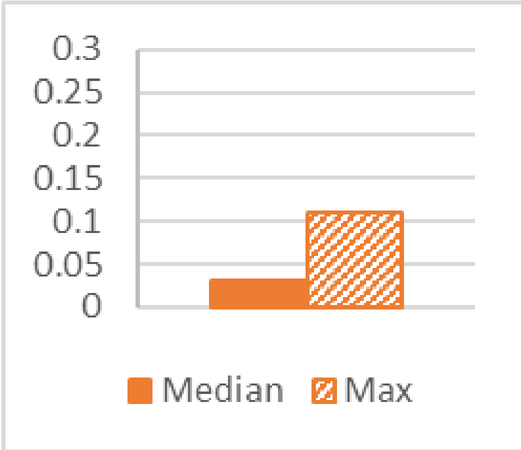
Variable remuneration offered to general front-line staff such as tellers, call centre staff and various grades of 'customer service officers' remains relatively modest. Figure 3.3 shows that maximum variable reward available for tellers across all banks does not exceed 21% of fixed pay. However very few tellers (and equivalents) receive that much. Banks were requested to report the level of variable remuneration paid at the 90th percentile (P90)[82] in 2018. Figure 3.4 shows the highest reported P90 was 11%, while the median[83] P90 reported was only 3% for this group, substantially lower than the highest reported maximum variable remuneration as a percentage of fixed remuneration.

Figure 3.3: Highest reported maximum VR over time for Tellers (times fixed pay).



Note: The number of respondent banks dropped off after 2018, as not all banks had yet determined their max VR.

Figure 3.4: Highest and median reported P90 for Tellers in 2018 (times fixed pay).



Note: The lowest reported P90 for Tellers in 2018 was 1.29%

Moreover, some banks are actively considering a move to rewarding tellers and equivalent roles either on a profit-sharing basis or through slightly higher fixed pay without access to variable rewards. The former may provide rewards that are broadly identical between individuals in the same role. Some smaller banks adopt this approach currently.

At least one large bank is looking at approaches that would similarly not in future link reward to an assessment of an individual's relative performance. It remains to be seen where this examination will lead.

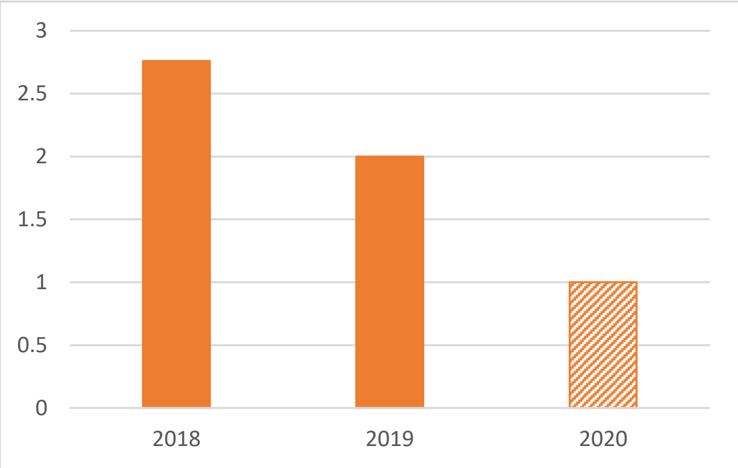
In each case where such a model is either operational or in contemplation, the funding pool available for distribution would be related to the overall (risk adjusted) performance of the enterprise or business unit. Although indirectly sales related, it would be difficult for an individual to believe that their sales performance could reliably influence their personal reward. Such approaches might therefore be viewed as entailing low risk of producing misselling or misconduct.

Fifteen banks currently offer frontline staff personalised variable rewards. Notably, all of the largest banks have significantly reduced the maximums now available for in-scope roles, including significantly for the specialist bankers that previously were facing potential variable rewards several times their fixed pay (see Figure 3.5). The change has been smaller for other banks, many of whom offered maximums less than were on offer at the largest banks in the first place.

[82] "P90" is a statistical concept. In this case, it records the highest percentage of fixed pay received by 90% of those who received variable remuneration in this year (2018).
[83] Remuneration at which half of the recipients received more than this amount while half received less.

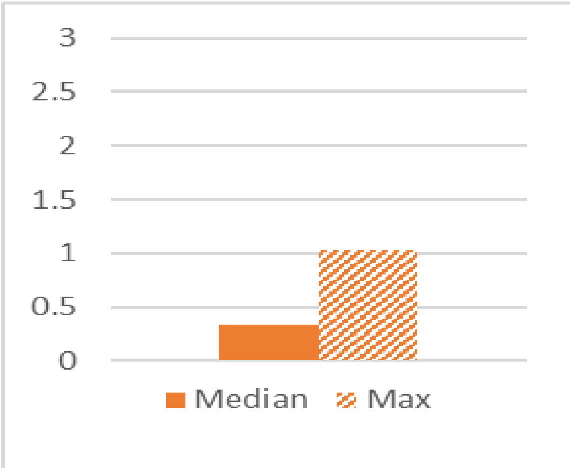
There is still some variation within the banks for these roles – most now offer potential maximum variable payments that are less than 50% of base remuneration, while some are offering potential maximums that amount to up to twice fixed pay, though typically with a firm policy to effect further reductions in the next year or so. These compare to potential maximums as much as 6 times fixed pay in isolated cases in the 2017 Review, but more often up to 3 times. There is significant uncertainty about longer term arrangements in some cases, however (see Figure 3.5).

Figure 3.5: Highest reported maximum VR over time for home lenders (times fixed pay).



Note: A number of banks did not provide a maximum for 2020, on the grounds that this would be determined closer to the time.

Figure 3.6: Highest and median reported P90 for Home Lenders in 2018 (times fixed pay).



Note: The lowest reported P90 for Tellers in 2018 was 1.29%

Payments at such extremes are relatively rare (see Figure 3.6). The fact that they are available may condition the behaviour of some, however, which is why consistent high performers are better remunerated through differential fixed pay rather than variable rewards[84]. Between year variations in performance would then need to be addressed through the bank's performance management procedures.

It is clear that most[85] banks regard variable pay for their specialist bankers such as home lenders as highly market dependent. A number of banks, large and small, have formally reserved their position in respect of 2020 until they better understand the dynamics of this labour market. Their competitive position in this labour market is an overriding consideration. So, too, are developments in the mortgage broker sector, which presently offers uncapped pay, but which may be heavily constrained in future, depending on the government of the day's response to the recommendations of the FSRC Final Report and other contributions, including the 2017 Report.

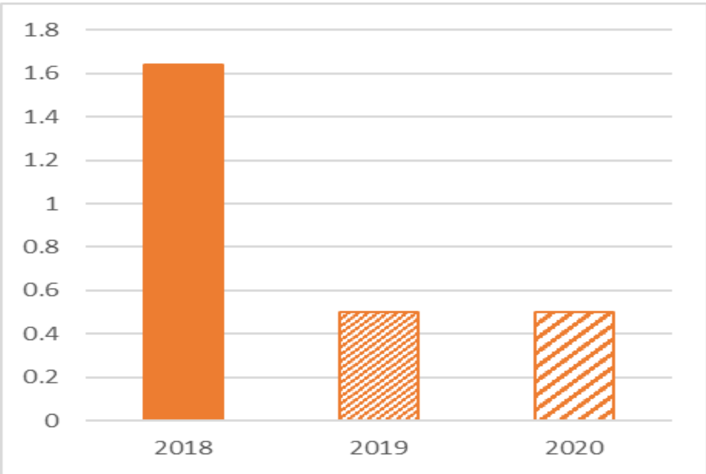
The move to rebalance pay in favour of more fixed and less variable rewards (presumably not on a dollar for dollar basis given the uncertainty attached to variable pay) is understood to have already caused turnover within the home lending areas at some banks. Some movements have been towards banks that offer higher fixed pay. Some have self-selected towards roles outside banking that continue to offer high upside remuneration either in mortgage broking or elsewhere. Some banks ventured to me in discussions

[84] and encouraged to leave if there is a conflict between their sales techniques and the bank's desired behaviours.
[85] a few banks have not adopted this approach, offering fixed pay and intrinsic rewards for in-house staff related to their core purpose and community base. That said, specialist bankers are clearly the most market sensitive element of the labour market for many banks.

an opinion (which cannot be tested) that not all those who have left the industry would have fared as well under a balanced scorecard regime as they had under previous strictly sales related remuneration schemes.

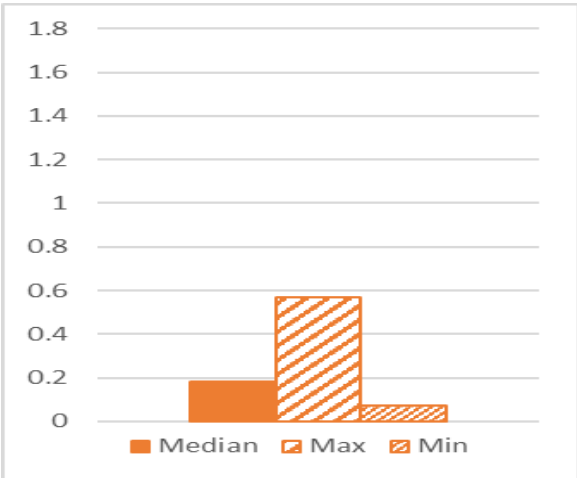
The figures below report variable remuneration maximums for managers over the 2018 – 2020 period. Some banks reported small increases in maximum. However, Figure 3.7 shows that the highest maximum variable remuneration reported declined in 2019. Notably, half of the participant banks reported a P90 for manager positions at slightly below 20% of their fixed remuneration (see Figure 3.8).

Figure 3.7: Highest reported maximum VR over time for Managers (times fixed pay).



Note: A number of banks did not provide a maximum for 2019 or 2020, on the grounds that this would be determined closer to the time.

Figure 3.8: Highest and median reported P90 for Managers in 2018 (times fixed pay)



Note: The lowest reported P90 for Tellers in 2018 was 1.29%

3.2.4.1 *What is an appropriate variable pay maximum?*

Determining the appropriateness of variable pay maximums presents a conundrum for an assessment of this kind. Prudential regulators across the western world typically argue that those with the capacity to 'bet the bank' should have a high proportion of their pay at risk and that there should be real consequences, reflected in pay, if risk adjusted returns for the business are poor in any year or a risk event materialises down the track (executed through malus or clawback provisions[86] if this truth comes to light with a lag).

The position I adopted for the 2017 Review is that variable rewards for in-scope staff should be relatively small. This is because staff in these roles can rarely, if ever, 'bet the bank' through their individual decisions[87]. Their actions can, however, adversely affect individual customers. The objective of my 2017 Recommendations was to reduce substantially the risk that incentives related to a banker's employment arrangements will encourage behaviours that are inconsistent with the interests of customers[88]. *The severity of such impacts can vary but scale should be irrelevant for an ethical organisation.* Restricting

[86] See Appendix B Glossary for definitions.
[87] The collective behaviour of mortgage lenders in some countries may have 'bet the bank' in the lead up the GFC. While remuneration (or the operations of the target-driven performance management system) may have played a role, poor policies and an inadequate understanding of the risks attached to loan securitisation undertaken by other functions within the banks concerned were pivotal.
[88] I note, and respect, the comments made by Justice Haynes in his FSRC Final Report to the effect that a bank's reward system should not simply punish the bad but also reward the good. I believe that my 2017 Recommendations, viewed in their entirety, are consistent with that view.

variable rewards to a relatively low proportion of fixed pay is one of a suite of measures that I recommended in 2017 intended to reduce incentives for poor behaviour that may adversely affect individual customers.

What constitutes a 'relatively low' proportion? There is no simple answer. In at least one jurisdiction, the Netherlands, there is a regulatory cap of 20% on variable remuneration, including in respect of in-scope managers. I had not specified a fixed limit in the 2017 Review. Several banks have sought clarification of my view, subsequently.

I am reluctant to nominate an invariable rule. My preference is to set down some principles. No doubt APRA's view, which will ultimately set the tone for the market, will become more apparent in due course.

A key principle, which was volunteered also by some individuals with whom I raised this matter during discussions is that remuneration for lower paid front-line staff (who are likely also to have limited financial reserves) should be structured so as not to put their lifestyle at risk if variable remuneration has to be cutback (whether because of personal or business level performance in any given year). This argues for relatively low variable rewards for lower paid staff, but possibly greater scope for variable rewards as base pay rises.

Delivery against that seemingly simple principle in the 'real world' is not straightforward[89]. Rebalancing towards higher fixed pay (which seems to be in train as a general proposition[90] for most, if not all, in-scope roles) requires greater personalisation of fixed pay[91] (to reward staff with consistently higher productivity or contributions) and/or greater recourse to withholding fixed pay increases, termination, demotion or similar devices to equitably respond to less than adequate performance. In effect the 'heavy lifting' currently undertaken by the pay system will transfer to the performance management system. This underlines the importance of ensuring that these systems (and the entity's cultural norms) are aligned. It also explains why some senior managers favour the continuation of some access to variable rewards for lower paid staff, even if the amount is relatively small. It provides a signalling device well short of demotion or termination, for example.

For the purposes of the current assessment I have been encouraged by the fact that almost all teller and equivalent roles now have access to variable remuneration no higher than 15% of fixed pay[92]. The maximum remuneration of specialist bankers such as mortgage lenders has fallen significantly, though the pace of change is not uniform, and some are uncertain about the end point. The professed tendency of most of the major banks, who set the tone for this market, is downwards. I have tentatively concluded that target variable remuneration for such specialist roles by 2020 should be no more than 50% of fixed remuneration, and preferably less. However, the reviewer in 2021 will need to form a view having regard to market conditions at the time. A lower norm may be appropriate if mortgage broking has moved substantially towards a fee for service model, for example.

[89] This issue has been an enduring feature of the Australian industrial landscape since at least the Harvester judgement of 1907.

[90] Banks may be becoming more discriminating about fixed pay, as previously they were in respect of variable pay.

[91] Including through the withholding of fixed pay rises otherwise due.

[92] Two banks currently exceed this figure slightly. In both cases their data shows it is rare for the maximum to be paid.

4 Encouraging progress - governance, culture and performance management

4.1 Context of this section & changes since the last review

This section will review progress towards implementation of Recommendations 9 to 14, inclusive, of the 2017 Review.

As noted in the 2017 Review:

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

My Recommendations were therefore holistic, and not simply directed to remuneration in isolation.

Culture, governance and remuneration were extensively covered in the recent FSRC. Included in the FSRC, Final Report, Section 6, *Culture, governance and renumeration, are the following*:

- "In looking at culture and governance, every entity must consider how it manages regulatory, compliance and conduct risks. And it must give close attention to the connections between compensation, incentive and remuneration practices and regulatory, compliance and conduct risks."[93]
- "By shaping how the business is run, governance shapes culture."[94]
- "... a culture that fosters poor leadership, poor decision-making or poor behaviour will undermine the governance framework of the entity."[95]
- "Remuneration and incentives, especially variable remuneration programs, tell staff what the entity rewards. Hence, remuneration and incentives tell staff what the entity values."[96]

4.2 Assessment of progress by late 2018 / early 2019

4.2.1 Circumstances vary across the industry, but many banks want to change their culture: Recommendations 9, 10 and 11

> ***Recommendation 9:*** *Each bank formally examine its workplace culture and institute formal processes to redress any conscious or unconscious bias towards sales in preference to ethical behaviour and customer service.*
>
> ***Recommendation 10:*** *Each bank examine its performance management system and make changes as necessary to ensure that the embedded signals and incentives to staff are aligned with Recommendations 2 to 8.*

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[93] FSRC; Final Report, Section 6, p.333.
[94] FSRC; Final Report, Section 6, p.334.
[95] FSRC; Final Report, Section 6, p.335.
[96] FSRC; Final Report, Section 6, p.335.

***Recommendation 11**: Each bank ensure Managers reflect predominantly an ethical and customer focus when communicating with staff, exercising any discretion while managing performance, and in allocating variable reward payments.*

4.2.1.1 *Workplace culture*

Banks assess the need for cultural renewal differently. Some, typically though not exclusively the smaller community-based entities and some foreign owned entities, believe that their culture is already sufficiently ethically driven, and customer focussed. These banks have nonetheless revisited their policies and made changes as necessary. Many others, though, and certainly the largest banks, acknowledge that an excessive sales orientation had developed over time, which obscured the focus on the customer. They have sought to redress that balance. A number reported increased efforts to embed the company's values and to promulgate a more consistent understanding of appropriate behaviours towards customers while seeking to assist them to identify their 'expressed' and 'unexpressed' needs. Some report that they place emphasis on 'should we' and behaviours, not just 'can we' and sales.

Example: Fostering Values-based Leadership
Some banks have made a targeted investment to train its people leaders to embed the vision, behaviours and values of the bank with a strong focus on customer-centricity. In one case, leaders are encouraged to deliver face to face sessions locally with their teams and staff participate in multi-business unit sessions to ensure consistency with the messaging across the wider group. The program has used new innovative platforms including social media to reach staff at all levels and regions.

Some have reported that their internal culture is collaborative and compliant, a downside of which is that there is a reluctance to 'challenge'. These banks are seeking to encourage a more open and more questioning environment internally.

Example: Framing Decision-making
Feedback from the employees of one of the banks was that they had a great culture, but mistakes were still being made because of the time spent on making decisions. To address this, they have created a decision-making framework where employees are encouraged to take a step back at key decision points to allow for discussion on successes and failures. This has instilled a no blame culture with an emphasis on the 'should we'.

Through the consultation process, some banks have acknowledged that what would have been an acceptable culture five years ago is no longer acceptable. The community's, their Board's and possibly even (though less certainly) their shareholders' expectations have changed. In such cases, communications that promote desired ethical behaviours and customer service are getting more focus, with leaders reinforcing this message in internal communications to staff, supported by a large investment in programs intended to provide guidance about how desired behaviours are most readily achieved. This shift is also reflected in the changes made to reward structures and preferred assessments of performance. In some respects, however, there is still uncertainty about where community expectations will settle. The terms of the 'social licence' that banks enjoy have changed. While the directions of change are clear, the fine details are not yet settled

It was evident to me that many of those banks seeking cultural change had begun their change journey even before my 2017 Review. The intense external scrutiny of the last year or so, however, has added urgency to the desired pace of change. Several factors now in play should assist to secure change, including:

- Intense external scrutiny has produced the 'burning platform' that assists a change resistant organisation to accept the need for change; and

- Change is being pursued holistically across remuneration, performance management and important elements of behaviour that strengthen a customer centric culture, which ensures that staff are receiving consistent and aligned messages[97] about both the need for and the desired direction of change.

On the other hand, the cacophony of external calls for change and the magnitude of the changes being communicated may lead to inertia born of change fatigue. For some, the relentless onslaught of criticism may induce them to stop listening. Change is never easy! But, even accepting that criticisms of past behaviour are justified, contemporary critics may consider the benefits of 'cutting the change agents some slack', at least until their bona fides can be established.

4.2.1.2 *Unconscious bias*

Relatively few banks directly addressed the issue of unconscious bias in their explanation of the drivers for changes now in train[98]. Senior leaders might care to reflect on that fact.

4.2.1.3 *Performance management*

The policy frameworks now require in virtually every instance that the same data sets are interrogated to support assessments of performance and to determine access to variable rewards. Extensive calibration arrangements typically test the consistency with which judgements are made about performance and entitlements to variable remuneration. Most banks, and certainly the largest banks, are making significant investments to strengthen the capability of managers to make informed judgements and exercise discretion in a manner consistent with the desired focus on 'customer over sales'. Frequently (not always) these banks describe the object of these interventions as to help managers to operate more as a 'coach' and less as a 'judge' when providing performance feedback to front line staff about how to meet their expected performance goals and how to interact appropriately with customers.

However, this reorientation most likely will provide a major challenge[99] for managers steeped in a tradition of managing against 'hard' sales metrics and where performance rewards used to be computed mechanically in proportion to sales achieved relative to specific sales target(s). Feedback provided at the FSU-arranged Roundtable (supported with documentary evidence) suggests this issue remains real, which is not surprising, given the sales oriented recruitment, rewards, recognition, and promotions practices of many banks over the last decade or two. It will take time to secure such a reorientation on a consistent basis 'everywhere, every time'. As previously noted, this issues should be a key focus of the 2021 Review.

4.2.2 Issues still exist with leaderboards: Recommendation 12

> ***Recommendation 12:*** *Each bank reconsider what use is made, if any, of leaderboards, recognition programs and campaigns as well as any other methods that have similar effect (including informally in branches or call centres) and ensure any continuing role in using these methods is consistent with the intention to de-emphasise sales relative to ethical behaviour and customer outcomes.*

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[97] It was frequently acknowledged that previous attempts to moderate cultural norms had appeared to be piecemeal by comparison.

[98] One bank that did address this issue of unconscious bias framed the answer in terms of programmes intended to address equity concerns (gender, ethnicity etc) rather than sales.

[99] A number of banks explicitly recognised the nature of the task they face in reorienting their performance management system. One reported in their response to the questionnaire: 'Whilst our frameworks are robust, we acknowledge that the use of some of our performance management tools may be misinterpreted, as leaders adjust to the changing environment. Cultural awareness is underway and capability tools are being explored, to support our leaders.'

4.2.2.1 *Leaderboards are declining, formally, but their influence informally is potentially powerful*

The 2017 Review found that leaderboards were in widespread use. These enable managers and staff (typically in a branch or call centre) to track performance against personal or branch targets. They often identified and celebrated the star sellers (and the bottom dwellers). The feedback provided at staff roundtables facilitated by the FSU in 2016 consistently attested to the intimidating nature of such public feedback. At the time many banks also attached personal rewards to campaigns to sell products. Similarly, recognition programs frequently provided monetary or non-monetary awards to good sellers.

Almost half of banks formally continue to use some form of leaderboards. Many have reoriented them to provide a 'whole of role' perspective. Some banks use this approach to provide team or branch-based data, ostensibly to enable staff to assess how they are performing relative to other teams facing similar market conditions.

A few continue to provide information about an individual's progress in meeting their personal targets. One such bank wishes to restrict access so that only the individual concerned will see their information about progress towards targets etc, but it will take time to make the system changes that will reliably prevent others from also seeing the results. Another provides information in respect of each individual against each element of their scorecard for a few roles but in practice only shows in plain sight selected elements of the score card, including financial metrics. Data relating to the manager's assessments of each team member in respect of values and behaviours is withheld on privacy grounds, leaving financial data in sight and capable of being interpreted as a traditional leaderboard.

One bank that continues to support the use of leaderboards said that changing the information that goes on the leaderboard to focus on behaviours and good customer outcomes, has changed who tops the leaderboard. This reinforces the cultural shift and celebrates the 'new leaders. However, in discussion the risk of continuing the practice of leaderboards was acknowledged. It was also stated that this approach should be viewed as a transition step towards the discontinuation of the leaderboard entirely.

Messaging about targets and the use of a leaderboard to reinforce them influences behaviour. That is why their use persists. I would encourage banks that still make 'leaderboards' containing personalised information available to all staff within a team (that is outcomes relative to a personalised target) to consider discontinuance. Indeed, I ask all banks to re-look at how they address this issue. Many times, I have heard from senior leaders how important it is to provide consistent messages that conform to the need to keep messages to staff simple. Yet, in this area, it seems that staff are being asked to apply a high level of sophistication to properly interpret the signals.

Some staff interpret the messages as sales oriented even though their senior managers may not. The fact is that daily or weekly leaderboards, and indeed the daily sales reports that many managers insist upon receiving, focus on just one element (the one that is measurable within the daily or weekly timeframe) of what is meant to be a balanced view of a staff member's performance – ironically this is the one element that leaders wish to subordinate to customer relationships, but it is also one they can never ignore.

One issue is that 'hard data' relating to financial and activity-based targets is frequently updated whereas 'soft' data, relating to attitudes and behaviours, is only made available for inspection infrequently. Team and manager conversations are likely to be dominated by feedback about the 'hard' metrics as a consequence, which may skew perceptions of 'what management believes is important'. Some banks seek to counteract the rhythm imparted by this reality by introducing a countervailing rhythm that focuses on customer service or a discussion about the organisation's values and purpose in regular team meetings or 'huddles'[100]. Getting this messaging right is a matter that will repay manager attention.

[100] Refer to Example: Sharing Successes in section 3.2.1.2.

In the time available it has not been possible to determine whether informal recourse to 'leaderboards' or similar devices containing personalised information about progress against targets persists on a large scale. A message we received during the roundtable that the FSU convened was that some managers translate team targets into personal ones and use an informal leaderboard to track (and share information about) the progress of each staff member against their manager-determined targets. We were provided with copies of a number of leaderboards that fitted that description, including for banks whose formal policy was predicated on team based, not individualised, targets. Banks may find it useful to check what practices actually occur in branches, especially informally.

Of course, such information in respect of team members should be made available to managers to assist them to manage performance. The issue is not the collection of the data, it is who has access to it and the use to which it is put.

4.2.2.2 *Campaigns*

The policy is clear. Almost no banks, formally, continue to offer significant personal rewards in respect of product-based campaigns. Campaigns, if they are run, are more likely to have a focus on education about the features attached to a product rather than sales per se. Of course, the intention is to propound the qualities of the product(s) that are the subject of the campaign. Staff at the FSU roundtable, however, argued that leaderboards are sometimes used to track individual performance during a campaign, both in terms of the number of calls made[101] and the referrals arranged to specialised sellers. This was interpreted as a manifestation of a lingering 'sales culture' rather than a 'relationship building or customer assistance' exercise. This also is an issue worthy of substantive investigation in 2021.

4.2.2.3 *Recognition*

Encouragingly. virtually every bank has systems in place to recognise high performing individuals. Even more encouragingly, contemporary recognition programs are typically targeted to identify individuals or teams that provide good customer service and/or who are roles models in their behaviours.

4.2.3 Are we aligned? Recommendations 13 and 14

Recommendation 13: *Consistent with the objectives of the recommendations for frontline staff, the variable reward payment and performance management arrangements of all senior and (retail bank) middle level executives be based on;*

a. Their overall performance against a number of measures that reflect the nature and breadth of their role; with

b. Customer oriented, ethical behaviour and non-financial measures accounting for the dominant factors in that assessment.

Recommendation 14: *Boards and Chief Executives:*

a. Visibly and effectively oversee the implementation of these recommendations for at least the next five years and report publicly, in their Annual Report to shareholders, for example, on how retail staff are remunerated, and their performance assessed; and

b. *Ensure that effective, safe channels are in place to obtain feedback from frontline staff about their perceptions of the effectiveness of efforts to reform the bank's culture, performance management and remuneration arrangements, including in respect of whistle-blower arrangements*.

[101] Unanswered calls may not count for this purpose.

4.2.3.1 *Board / CEO engagement*

All banks provided evidence that their Board and CEO have actively considered the implications of the 2017 Review for their business. The senior leadership of those banks that believe that change is required are heavily involved in developing and monitoring programs to secure cultural change or to more deeply embed customer-centred values and behaviours. Those that have decided the change required is relatively small have addressed the issue in forming and communicating this conclusion.

Since the Banking Executive Accountability Regime (BEAR) legislation was passed in early 2018, all banks have been reviewing their remuneration policies and practices for senior executives. While the legislation does not outline an acceptable mix for variable and fixed remuneration, the requirement to defer a portion of executive remuneration for a period of four years, has resulted in a reassessment of executive level pay packages. From the submissions provided, what is notable is the change in the way performance is assessed and reward is calculated. For most CEOs performance and reward is assessed against a balanced scorecard with a healthy weight towards non-financial measures. Where details were provided, financial metrics appear to be related to the overall financial performance of the banks rather than product focussed. Customer focussed metrics and risk indicators are also significant. Information around future years (2019 onwards) was not consistently provided. One bank, however, reported a reweighting of financial measures within the CEO's scorecard from 60% in 2018 to 30% in 2019. In light of the changes outlined by BEAR and the focus on executive remuneration in the banking industry, executives at this level have substantially more of their pay at risk than front line staff and remuneration practices are being tailored to account for this change.

4.2.3.2 *Whistle blower and other avenues*

Virtually all banks reported they have whistle blower schemes in place and administer confidential surveys to staff on a regular basis. The latter usually include questions designed to test whether staff feel empowered to raise issues for consideration. Some have refreshed their programs to encourage staff to 'speak up' in circumstances that do not warrant 'whistle blower status'. Their intention is to socialise and legitimise discussion and debate about what best meets customer needs[102].

Several banks that have conducted a self-assessment in the light of CBA's APRA Review[103] (which we have sighted on request) have identified a collaborative and collegiate culture at its senior levels as both a strength and a weakness. The weakness is the reluctance to challenge or raise uncomfortable issues. All banks that have reached this conclusion are working actively to address it.

Some that employ a Customer Advocate also encourage staff to raise issues with the Advocate as necessary. Some have put anonymous reporting options in place that parallel the whistle blower or Customer Advocacy channels. Some encourage skip conversations (that is staff discussions with managers one or two levels above their own manager), partly as an avenue to enable senior managers to receive feedback about the experience of staff in their workplace.

[102] One bank, for example, observed during discussions that staff were interpreting their encouragement to 'speak up' as something relevant to a matter serious enough to warrant recourse to whistle blower procedures. This bank is trying to shift such thinking to inculcate more active discussion of issues in the workplace.
[103] Prudential Inquiry into the Commonwealth Bank of Australia (CBA) Final Report 2018.

5 Mixed progress - third Parties

5.1 Context of this section & changes since the last review

This section will review the progress towards implementation of Recommendations 16 to 21, inclusive, in relation to Third Party remuneration including Aggregators, Mortgage Brokers, Introducers, Referrers and Franchisees.

Banks are vulnerable to essentially the same financial and non-financial risks for mortgages arranged through the third-party channels as they are for loans arranged by their own staff. However, the 2017 Review found that the banks' capacity to monitor behaviour and enforce standards of behaviour when brokers are dealing with customers is highly variable. Accepting that identical arrangements cannot be insisted upon; the 2017 Review made several Recommendations to better align remuneration and governance in third party channels to those applied in the proprietary channel. The 2017 Review also found that the risks of misselling inherent in what ASIC has termed the 'standard commission model'[104] are unacceptable in the context of the trust deficit banks face and, consistent with the Recommendations in respect of the proprietary channel, should be changed. The ASIC report found "Brokers almost universally receive commissions paid by the 'supply side' of the market (that is the lender or aggregator), rather than by the consumer… …a standard commission model made up of an upfront and a trail commission"[105].

Since the release of the 2017 Review:

- Industry Associations, many banks, the aggregators, some Brokers and Industry and consumer groups formed the Combined Industry Forum (CIF) to consider and devise responses to my Recommendations and those outlined in ASIC's 2017 Review of mortgage broker remuneration[106]. In November 2017, the CIF released a report[107] responding to these proposals.
- The Productivity Commission published a report[108] in June 2018 which made a number of recommendations, including a modification to the standard commission model and the abolition of trailing commissions.
- The FSRC Final Report in February 2019 recommended that a fee-based alternative replace the standard commission model, without any trail payments

Relevantly, the FSRC Interim Report notes that the "Broker, aggregator and lender may all see the broker as 'the face of the lender', not as 'the face of the borrower'. And again, at a practical level, 'introducers' are even more clearly the face of the lender and not the face of the borrower." [109]

The FSRC Final Report added the following:

> *"Consideration of lending arranged through mortgage brokers must begin by recognising two facts. First, borrowers look to mortgage brokers for advice about how to finance what is, for many*

[104] ASIC Report 516: Review of mortgage broker remuneration, Section Key findings - Finding 1, p.9.
[105] Ibid, p.9.
[106] ASIC Report 516: Review of mortgage broker remuneration.
[107] Improving Customer Outcomes: The Combined Industry Forum response to ASIC Report 516: Review of mortgage broker remuneration, Section 4.7, p.11.
[108] Productivity Commission Inquiry Report*; Overview & Recommendations No. 89,* Section Findings and recommendations, p.43.
[109] FSRC: Interim Report, Section 6.1.1, p.56.

borrowers, the most valuable asset they will buy in a single transaction. And brokers not only give advice about what they think is best for the borrower, they submit the loan application on the borrower's behalf and, to the extent the terms are negotiable, negotiate the terms of the loan for the borrower.

"Second, as already noted, it is not easy to determine for whom a mortgage broker acts. The lender pays the broker, not the borrower. Typically, the lender pays a commission, both an upfront commission and a trail commission. The lender seeks to treat the broker as its broker, and have the broker treat it as the broker's 'preferred lender. Yet, at the same time, the lender provides in its contracts with brokers and mortgage aggregators that they act for the borrower, not the lender."[110]

The FSRC Final Report recommends that the role of the broker be clarified under recommendation 1.2 – Best interest duty, which states that when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower"[111]

5.2 Assessment of progress by late 2018 / early 2019

5.2.1 Progress on broker Incentives other than commissions

Recommendation 16: *In respect of remuneration of Mortgage Brokers:*

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

All banks have reported that they no longer (or will very soon no longer) make volume-based incentive payments, soft-dollar payments or support sales campaigns. Their implementation of this Recommendation is tied to the CIF's approach, which outlines the criteria for these payments[112].

- Banks report they have now ceased making lump sum payments or upfront bonus payments.
- All soft dollar payments for entertainment or hospitality to brokers have been capped at no more than $350 per person, per event. A payment of $350 per person, per event is not based on the volume of loans written by the broker and was chosen to align with Fringe Benefit Tax (FBT) reporting, which enables lenders and aggregators to use existing reporting for better monitoring and supervision.

[110] FSRC: Final Report, Section 2.1, p.61.
[111] FSRC: Final Report, Section 2.3, p.73.
[112] Improving Customer Outcomes: The Combined Industry Forum response to ASIC Report 516: Review of mortgage broker remuneration, Section 4.7, p.11.

- All conferences and professional development events should have a minimum of 80%[113] in identified education content and be aimed at improving customer outcomes.

- Greater transparency now applies in respect of entertainment and hospitality benefits paid[114].

- Access to education opportunities should be based on a balanced scorecard which does not consider volume. Eligibility for entertainment or hospitality should not be based on the volume of loans written.

If fully implemented this approach will clearly meet the objectives of my 2017 Recommendation. It will be for a later review to assess how well these approaches have implemented in practice.

5.2.2 Progress in prospect on mortgage broker governance

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

Most banks deal with Aggregators (or "Broker Groups') directly who in turn have a commercial relationship with the Mortgage Broker. Typically, once a loan is settled the Aggregator is paid a fee that is partly passed on to the Mortgage Broker. In some cases, however, a bank has a direct relationship with a broker and the fee is paid directly to the Mortgage Broker.

The largest banks reported that they have reviewed the list of brokers accredited to sell mortgages on their behalf and have reduced the number, usually significantly, with a focus on the recency of the broker's interactions with the bank. An objective was to ensure that brokers have sufficiently current information about the bank's procedures and expectations. Many banks also report that they have reviewed their procedures to identify cases in which a broker requires further training to better understand the bank's current requirements (which may lead to the disendorsement of a broker in some circumstances). These are complemented by stronger requirements for training of new brokers during their 'onboarding'.

The CIF has developed a number of proposals that, on their face, have great scope to meet the intent of Recommendation 17, over time. These have been accepted by most banks and include:

- More consistent governance and monitoring around the application processes (for example, common Key Risk Indicators (KRIs) have been developed and are monitored).

- a Broker Interview Guide (BIG/the Guide) has been developed to provide more consistent and comprehensive documentation of the conversation between a broker and the customer. The customer is requested to agree to the document and sign it. In addition to providing clear guidance to brokers about what is expected of them in their interactions with a potential borrower, this should help to improve the quality of post loan monitoring of that interaction. All the major banks

[113] This broadly aligns with the FOFA requirement for benefits with an education or training purpose to take up at least 75% of the time spent on a course or conference – ASIC Regulatory Guide 246: Conflicted and other banned remuneration, Appendix 1, p.77.

[114] The lender, aggregators and brokers who have chosen to implement the CIF recommendations will maintain a register of entertainment and hospitality benefits in excess of $100 (on a rolling 12-month basis, records kept for three years, advertised in the Credit Guide, monitored by aggregators and made available on request). This register is available to both the broker and the customer.

are understood to have rolled out this Guide. Some others are rolling it out as their systems evolve to support the requirements of the Guide.

- A program has been introduced to provide an external assurance report on each aggregator's implementation of their control environment[115]. To date the program has been introduced for one aggregator, with the intention that 12 of the main aggregators participate eventually. Some banks intend to rely solely on this assurance program. Others believe it will supplement their own procedures, which typically include significant independent examinations of broker files after the credit assessment has been completed and the loan agreed to in order to assess the quality of the interaction with the customer.

- The CIF is working on an industry code for ASIC's consideration that is intended to codify:
    - Good customer outcomes
    - Good strong governance
    - What brokers have signed up for
    - The role of the aggregator

The CIF states that "the Code is focussed on providing a structure for how businesses interact with each other, underpinned with good customer outcomes and placing the customer's interests first at the centre of deliberations."[116]

On their face these developments are fully consistent with the intent of Recommendation 17. However, some of these elements have yet to be fully implemented. It will be for a future review to assess how well this encouraging policy position is given effect to in practice.

5.2.3 A way still to go on Aggregator /Broker Commission Payments

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

a. *To establish in timely fashion how best to address Recommendations 17 and 18, banks with a significant recourse to the Broker channel, but at least the four major banks, each report regularly to ASIC on their progress; and*

b. *With enhanced oversight by ASIC (and other regulators as necessary) to monitor market responses;*

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

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[115] All participating banks that are CIF members note that the PwC Aggregator Audit program is part of their overall governance for third parties. Four banks covered by this assessment are not members of CIF but in their responses, three of them have indicated that they are reviewing current contracts and governance processes and will make changes to align with industry recommendations. The forth does not have a broker channel and so the recommendation do not apply.

[116] 2nd Progress Report in response to: ASIC Report 516: Review of mortgage broker remuneration, Section 7.4, p.16.

Virtually all banks (with one or two still to implement it) have adopted a revised approach to the standard commission model. Payments are now made based on the drawn down amount net of any sums held in offset accounts rather than the full amount of the loan originally approved (if different). This is a significant advance on previous arrangements. However, I do not believe that it meets the intent of my recommendation.

The 2017 Review put it this way:

> '...*(the) proposal is to move away from payments to Aggregators and Mortgage Brokers that are related to the value of the loan in favour of arrangements more nearly tied to the effort required to secure a loan. Some argued to the Review that loan size and loan complexity are correlated, providing a justification for current arrangements. More persuasive to me were arguments that loan complexity and thus the effort required by Mortgage Brokers to secure a loan on behalf of the consumer, may be more closely correlated with the characteristics of the borrower. An alternative to a value-related commission, therefore, might be fees for service paid by the bank but set either as a flat amount or related to the characteristics of the borrower'*[117].

I also saw value at that time in maintaining some kind of deferred component of such remuneration since this would help to align the interests of the broker, borrower and bank to ensure that the customer is provided with the loan that best meets their needs. I argued that borrowers would be less likely to opt out of using a mortgage broker if the lender continued to pay the fees (as they do under the standard commission model).

There are now many contributions in the debate about the most appropriate payment arrangements for mortgage brokers. I can understand, therefore, that some in the industry may have been reluctant to take precipitate action before this public policy issue has been resolved. I understand also that some who may have preferred a fee-based model felt constrained in taking unilateral action (and the competition law precludes collusion), including fears that the first mover disadvantage could be significant while the industry adjusted.

Hopefully, this issue will be resolved in public policy terms in the near future. The key features of my proposal were:

- although long trails should be abolished, a modest element of deferred remuneration should be retained.
- A fee-based upfront payment to brokers is preferable if it is attuned to the complexity of the loan and/or the effort required to develop and secure the loan rather than the value of the loan (drawn down and after offsets);
- This fee should be consistently applied to mortgages sourced internally by the banks staff or by a mortgage broker; and
- The lender[118] to pay, as currently.

[117] 2017 Review, section 6.1.2, p.36.

[118] Some have argued that the borrower should pay. The fee could be capitalised into the loan. It is argued this will facilitate transparency and customer choice. Transparency could be secured through disclosure requirements (as occurs when a script is dispensed under the Pharmaceutical Benefits Scheme, for example, to identify the taxpayer funded subsidy). The lender payment will reduce the risk, however, that the borrower chooses not to pay the fee so as to avoid the impost. 'Nudge' economics suggests that borrowers may make irrational choices when faced with a requirement to pay, especially if fees payable are not regulated.

I see little value in canvassing the arguments again in this report. No doubt a government position will emerge in due course. Suffice it to say that I believe that my proposals are pro-competitive and viable. However, it is clear that there are concerns that brokers may not have the market power necessary to secure a price sufficient to preserve the long-term viability of the mortgage broker sub-sector. I suggest, therefore that ASIC and the ACCC should be approached to provide a regulatory environment and oversight arrangements that will facilitate necessary change and ensure competition is maintained and that consumer interests are properly protected.

5.2.4 Introducers and Referrers

Recommendation 20: *In respect of Introducers and Referrers:*

a. *Banks examine their governance of these arrangements to ensure that existing practices are appropriate; and*

b. *ASIC, in due course, investigate whether the upfront commission paid to Introducers and Referrers is justified*

Introducers and Referrers don't perform the role of the broker but achieve a relatively high one-time remuneration for the service provided. They have not been governed by strong controls. Brokers may also use referrer groups such as real estate agents to help direct deal flow towards them.

It is understood that the CIF has not developed guidance in respect of payments to introducers and referrers.

A number of banks have reviewed their arrangements in respect of introducers and referrers. Typically, this led to a culling of the list of accredited entities and stronger guidance about acceptable behaviour. At least one bank has decided to discontinue using this channel.

Banks that continue to have a relationship with introducers and referrers have typically modified the upfront commission payments available along similar lines to the changes introduced for Mortgage Brokers which is to say that payments are now related to the amount of loan drawn down, net of offsets. This is progress towards implementing the intent of Recommendation 20, albeit modest progress.

5.2.5 Franchises

Only three banks have formal arrangements that involve franchisees. They have reviewed the current arrangements so as to strengthen their capacity to hold franchisees to account for inappropriate behaviour and where necessary, have strengthened their governance, oversight and reporting. One bank reported they believe there is no difference in oversight over the partner agencies and the bank's own staff.

Appendix A – Terms of Reference

Aims

1. Assess that the implementation of the Recommendations has been meaningful

2. Ensure the industry is on track to meet its commitments, and

3. Ensure the intent, integrity and spirit of the Recommendations are being implemented

Scope

1. Collation and analysis of:
    a. Current remuneration structures for retail bank staff, including remuneration packages, incentive plans, and balanced scorecard arrangements, and consistency of these current remuneration structures within the Recommendations
    b. Current remuneration policies for all bank staff relevant to the Recommendations and performance management systems, and consistency of these current policies and systems with the Recommendations
    c. Current contractual or commercial agreements with third parties, and consistency of these current remuneration structures with the Recommendations
2. Consideration of remuneration structures for retail bank staff and any remuneration policies for all bank staff relevant to the Recommendations and contractual or commercial agreements with third parties that are pending, for example, where new remuneration and/or contractual arrangements are due to commence shortly and over the coming performance period.
3. Consideration of progress made against agreed timeframes at participating banks and plans for implementing any further changes to ensure remuneration structures for retail bank staff, governance and culture and performance management, and remuneration structures for third parties will be consistent with the Recommendations
4. Consideration of responses by participating banks and whether these responses strengthen the alignment of remuneration and incentives and good customer outcomes.

Examination

1. Remuneration packages, incentive plans and balanced scorecard arrangements for retail bank staff and retail bank management in individual banks
2. Remuneration policies and performance management systems in individual banks regarding changes made and/or proposed to remuneration structures, governance and performance management systems across the bank, including, for example, public statements, media releases, internal updates (newsletters, intranet), etc
3. Examples of staff training, formal or informal, regarding the remuneration policies and performance management systems in individual banks
4. Examples of staff surveys and results as relevant to the implementation of the Recommendations and/or changes to remuneration structures Progress reports and other input from the Combined Industry Forum, including interviews with the Planning Committee of the Combined Industry Forum

5. Overarching principles on remuneration and incentives to support good customer outcomes and sound banking practices, developed under Initiative 1 of the Banking Reform Program, and
6. Other materials that an individual bank may have which are relevant to the assessment, such as implementation plans, status updates, and/or comparisons between old remuneration structures and new remuneration structures.

Appendix B – Glossary

General	
2017 Report/Review	Independent Review of product sales commissions and product-based payments in retail banking in Australia
ABA	Australian Bankers' Association
ACCC	Australian Competition and Consumer Commission
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
EA	The Fair Work Act 2010 (Cth) contains provisions that protect employees against breaches of the terms of modern awards and collectively bargained employment agreements; that is, Enterprise Agreements (EA).
FOFA	Future of Financial Advice (FOFA) reforms
FSRC	Financial Services Royal Commission – used in reference to volumes 1 of both the Interim and Final Reports.
FSU	Finance Sector Union
Issues Paper	The Retail Banking Remuneration Review Issues Paper published on 17 January 2017
Questionnaire	Remuneration Assessment Review Questionnaire as at December 2018 sent out to participants for the purposes of data gathering.
Terms of Reference	Framework and parameters under which the Review operates. Refer to Appendix A.
Tier 2 products	Tier 2 products as defined by ASIC's Regulatory Guide 146 include financial products that are generally simpler and therefore have lighter training standards. Tier 2 products are: General insurance products except for personal sickness and accident, Consumer credit insurance, Basic deposit products, Non-cash payment products and First Home Saver Accounts (FHSA) issued by ADIs.
Role Type	
Managers	Limited to the first- and second-line managers and supervisors of the customer facing staff (that is Tellers and Sellers: General, Home Lenders and Financial Advisers)
Sellers: Financial Advisers	For the purpose of this Review, Financial Advisers include individuals who are bank staff and who provide personal and general advice to retail and small business customers on Tier 2 products only.
Sellers: General	Include personal bankers, small business banker-equivalent roles and call centre roles that can sell products to customers.

Sellers: Home Lenders	Staff whose primary function and responsibility relates to the sale of home loans (including new mortgages and top-ups) to retail and small business customers.
Tellers	Customer-facing staff who primarily refer customers to other parts of the business or to other staff.
Specialist Lender/Bankers	Primary role is home lending, but some banks have defined a unique role for groups of home lenders and this role requires a higher level of qualification, training and capability.
Rewards and reward types	
At-risk pay	Variable reward paid together with the annual increase in fixed pay (if any).
Fixed pay	The guaranteed level of monetary reward paid by an employer to an individual, typically comprising base salary plus Superannuation Guarantee in Australia.
Recognition programs and campaigns	As well as fixed pay and variable reward payments, individuals may also be eligible to receive other monetary and non-monetary rewards that are provided on an ad hoc basis to recognise special effort, performance or the attributes of an individual or team. Banks may also supplement the formal performance rewards with ad hoc rewards that are related to the conduct of campaigns, typically to increase sales of specific products.
Variable reward payments (rewards)	The level of monetary reward paid by an employer to an eligible individual. It includes bonuses, incentives or product-based payments/product sales commissions.
Reward mechanics	
Accelerator	An arrangement whereby a higher rate of reward is earned with higher levels of performance, for example increasing volumes of sale.
Clawback (for staff)	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.
Clawback (for third-party channels)	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.
Cross selling	Sale of additional or ‘add-on’ products to customers in addition to the primary product(s) an individual is rewarded on.
Gateway	Condition that must be met before potential bonus/incentive/product sales commissions and product-based payments can be accessed by the individual.
Malus	A mechanism in place for the bank to require a payment as compensation for poor performance.
Modifier	Increases or decreases the bonus or incentive payable once a condition has been met.
Third Party	

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.
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.

Appendix C – Recommendations from the 2017 Review

Recommendation 1: *I recommend that all banks begin to implement the recommendations in this Report as quickly as systems and other changes can be introduced. If transitional arrangements are necessary, full implementation should be achieved by no later than the performance year that begins in 2020.*

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

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

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

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

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

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

Recommendation 7: *Variable reward payments no longer include:*

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

Recommendation 8: *Variable reward payments ultimately amount to a relatively small proportion of fixed pay, with a progressive reduction in the maximum variable reward amount payable in any schemes that require a transition period to implement this recommendation.*

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

Recommendation 10: *Each bank examine its performance management system and make changes as necessary to ensure that the embedded signals and incentives to staff are aligned with Recommendations 2 to 8.*

Recommendation 11*: Each bank ensure Managers reflect predominantly an ethical and customer focus when communicating with staff, exercising any discretion while managing performance, and in allocating variable reward payments.*

Recommendation 12: *Each bank reconsider what use is made, if any, of leaderboards, recognition programs and campaigns as well as any other methods that have similar effect (including informally in branches or call centres) and ensure any continuing role in using these methods is consistent with the intention to de-emphasise sales relative to ethical behaviour and customer outcomes.*

Recommendation 13: *Consistent with the objectives of the recommendations for frontline staff, the variable reward payment and performance management arrangements of all senior and (retail bank) middle level executives be based on;*

a. Their overall performance against a number of measures that reflect the nature and breadth of their role; with

b. Customer oriented, ethical behaviour and non-financial measures accounting for the dominant factors in that assessment.

Recommendation 14: *Boards and Chief Executives:*

a. Visibly and effectively oversee the implementation of these recommendations for at least the next five years and report publicly, in their Annual Report to shareholders, for example, on how retail staff are remunerated, and their performance assessed; and

b. Ensure that effective, safe channels are in place to obtain feedback from frontline staff about their perceptions of the effectiveness of efforts to reform the bank's culture, performance management and remuneration arrangements, including in respect of whistle-blower arrangements.

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

Recommendation 16: *In respect of remuneration of Mortgage Brokers:*

a. Banks cease the practice of providing volume-based incentives that are additional to upfront and trail commissions;

b. Banks cease non-transparent soft dollar payments in favour of more transparent methods to support training etc.; and

c. Banks cease the practice of increasing the incentives payable to Brokers when engaging in sales campaigns;

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

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

a. To establish in timely fashion how best to address Recommendations 17 and 18, banks with a significant recourse to the Broker channel, but at least the four major banks, each report regularly to ASIC on their progress; and

b. With enhanced oversight by ASIC (and other regulators as necessary) to monitor market responses;

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

Recommendation 20: *In respect of Introducers and Referrers:*

a. *Banks examine their governance of these arrangements to ensure that existing practices are appropriate; and*

b. *ASIC, in due course, investigate whether the upfront commission paid to Introducers and Referrer is justified*

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