Retail Remuneration Review

Issues Paper – Executive Summary

Stephen Sedgwick AO

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Executive Summary

This Issues Paper summarises current practices and seeks further information about product sales commissions and product-based payments paid in respect of retail banking products. Such payments are linked to the number or value of products sold, offered, or distributed to retail and small business customers. The Paper is part of an Independent Review into such payments commissioned by the Australian Bankers' Association. The Review is also required to comment on the principles that banks might apply when structuring remuneration more generally.

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

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

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

Conflicted remuneration, which may include product sales commissions and volume-based payments resulting from product sales, has been banned in some circumstances in the financial services industry in Australia and in some other countries. This reflected public concern that these payments encouraged inappropriate practices by Sellers or Financial Advisers in pursuit of higher rewards, to the detriment of their customers. These prohibitions do not, by virtue of certain exceptions in the FOFA reforms, typically apply in those parts of retail banking that are in scope for this Review.

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

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

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

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

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

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

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

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

Submissions are requested by February 10 and should be emailed to submissions@retailbankingremunerationreview.com.au

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