

Submissions of the Finance Sector Union
in respect of the Interim Report of the
Royal Commission into Misconduct in the
Banking, Superannuation and Financial
Services Industry

Submissions of the Finance Sector Union in respect of the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Table of Contents

1.	Introduction	4
1.1.	The Union’s vision of the change needed in the sector	4
	Summary of Proposals for Consideration.....	5
2.	The right culture is central.....	6
2.1.	A culture of maximising profit at the expense of customers	6
2.2.	What do we mean when we talk about culture?	6
2.3.	Where does culture come from?	7
2.4.	The culture problem is across the sector	7
2.5.	The banks still do not accept that they have a culture problem	7
2.6.	Building Good Culture.....	9
3.	The disconnect between the expressed values of banks and how they operate..	9
3.1.	Public Values	10
4.	Conflicts around employment practices	11
4.1.	Current employee remuneration is a crucial driver of poor culture.....	11
4.2.	KPIs, performance expectations and sales culture	11
4.3.	The regulation around conflicted pay is too limited	12
4.4.	The elimination of variable pay should not be an excuse for bank greed.	13
4.5.	Transparent pay structures and sectoral bargaining.....	14
	Proposals for consideration	14
5.	Conflicts around service (intermediaries, referrers, etc) and product providers	15
5.1.	Introducers and referrers.....	15
5.2.	Mortgage brokers and other intermediaries.....	15
5.3.	Vertical integration and external contractual relationships	16
	Proposals for consideration	17
6.	The impact of “management by measurement”	17
6.1.	Reliance on KPIs and other targets that reduce complex process to binary check box decision making	18
6.2.	Professionalisation	18
6.2.1.	Tier 1 – “Fit and proper person” test and training framework.....	19

6.2.2.	<i>Tier 2 – Licensing and professional obligations</i>	20
6.2.3.	<i>Level 3 – Senior Executive Accountability</i>	20
6.3.	The impact of computer systems and off-shoring	21
	Proposals for consideration	21
7.	Management out of touch with staff and consumers – the need for better and more responsive governance and culture	21
7.1.	Compliance.....	22
7.2.	Whistleblowers	22
7.3.	360 Degree reviews.....	23
7.4.	Stakeholder advisory committees	23
7.5.	The myth that culture can't be regulated	24
	Proposals for consideration	25
8.	The culture within the regulators	25
	Proposals for consideration	27
9.	A Financial Services Code is needed to simplify the law	27
9.1.	A Financial Services Code should be recommended	28
9.1.1.	<i>The Code should simplify the system of regulation</i>	28
9.1.2.	<i>The Code should seek to be based on clear principles such as the Commission's "very simple ideas"</i>	28
9.1.3.	<i>The Code should include Community Service Obligations</i>	28
9.1.4.	<i>The Code should confer rule making power on the regulator</i>	29
9.1.5.	<i>The Code should establish a standards framework for finance sector workers</i>	29
9.1.6.	<i>The Code should prohibit or substantially limit variable pay</i>	30
9.1.7.	<i>The Code should establish a Culture Oversight Division of a regulator</i>	30
9.1.8.	<i>The Code should provide better access for consumers to seek remedies</i>	30
9.1.9.	<i>The Code should enhance the regulators enforcement powers</i>	31
9.1.10.	<i>The Code should extend the operation of the criminal law in financial services</i>	31
	Proposals for consideration	31
	Appendix One – Responses to questions in Chapter 10 of the Interim Report	32
9.1.10.1.	<i>Consumer lending</i>	32
9.1.10.2.	<i>Financial Advice</i>	34
9.1.10.3.	<i>Small and medium enterprises</i>	36
9.1.10.4.	<i>Agricultural lending</i>	37
9.1.10.5.	<i>Remote Communities</i>	39
9.1.10.6.	<i>Regulation and the regulators</i>	40
9.1.10.7.	<i>Entities: Causes of misconduct</i>	42
9.1.10.8.	<i>Restatement of questions</i>	44
	Appendix Two – Finance Sector Union – Workplace Culture Survey 2018	49

1. Introduction

- [1] The Finance Sector Union is the only trade union entitled to represent workers across the Australian financial and insurance services sector. The Union has sought to actively engage in the Royal Commission process – it has been the only entity that is neither a large bank or regulator that has been granted leave to appear in each round of the Commission’s hearings. The Union is the largest membership-based organisation in the sector with a membership larger than all the other professional organisations combined.
- [2] This Royal Commission has been appropriately skeptical and critical of the industry in a manner that the many inquiries and reviews over the past two decades have not. Given the strength of its work, the Commission has an opportunity to make material and substantial improvements in the sector where previous inquiries and reviews have failed.
- [2] About 458,000 Australians work in the financial and insurance services sector. Of these, about 170,000 are employed by one of the big four banks or AMP. In addition to the health and viability of the sector being crucial to the national economy, the sector is a very large employer.
- [3] Poor leadership culture in both financial services entities and regulators is the central issue evident throughout the hearings of the Royal Commission. The solutions that the Commission should recommend are not simple and may not lead to any quick fixes. Problems have developed over an extended period, and require concerted effort from government, regulators, sector workers and their Union, financial institutions and their shareholders to fix.
- [4] In preparing this submission the Union has undertaken the largest ever sector wide culture survey. The survey questions addressed issues raised by the Royal Commission. A copy of the survey is attached to these submissions as an appendix. The Union has also undertaken detailed further consultation, including with focus groups drawn from employees in each of the big four banks, community owned banks, and other sector employers.
- [5] The Union’s submission is structured with an examination of the cultural problems, and what sort of culture we should pursue in the sector. There is then an examination of specific issues analysed in the Interim Report:
- Part 2 examines the nature and importance of culture;
 - Part 3 deals with the disconnect with the expressed values of banks and the way they operate;
 - Part 4 deals with conflicts affecting employees including remuneration structures and targets;
 - Part 5 deals with issues around intermediaries and vertical integration;
 - Part 6 deals with the impact of “management by measurement”;
 - Part 7 deals with the need to develop better feedback processes for boards and bank leadership;
 - Part 8 proposes a review of the regulation covering the sector to simplify the law and establish a Conduct Oversight Division of APRA;
 - Part 9 deals with culture issues in the regulators;
 - Part 10 addresses the overly complex status of the current law, and proposes a Financial Services Code; and
 - Part 11 provides responses to the specific questions posed in Chapter 10 of Volume 1 of the Interim Report.

1.1. The Union’s vision of the change needed in the sector

- [5] The finance sector should fairly and diligently serve the needs of customers.
- [6] The problems and issues identified by the Royal Commission are not small and their causes not simple. The common factor is the prevailing management culture across the sector which believes that it can extract enormous short-term profits without doing substantial damage to the banks they are entrusted to run.
- [7] The Commission should make bold and substantial recommendations that will address these cultural issues.
- [8] The recommendations from the Commission should identify steps that will cause, and support, improvements in culture. The Union believes that the Commission’s recommendations should focus on the following:
- **Remuneration and other employment practices:** Proposals should seek to minimise (and where possible eliminate) misaligned incentives and conflicts in the work of bank employees. Proposals should include broadening the definition of conflicted remuneration, and then prohibiting it. There is no good reason why employment arrangements based simply on an expectation of performance, and payment for work done, should not be standard.
 - **Conflicts around services:** Proposals that will minimise other conflicts that lead to customers’ best interest being subjugated to the economic interest of the banks, intermediaries or contracting parties. Such proposals should involve the prohibition of referrer schemes, and changes to intermediary arrangements to the extent that they operate on a fee for service basis.
 - **Professionalism:** The professionalisation of work in the industry. The sector requires a workforce with independent professional obligations, training, minimum qualification standards and independent, transparent disciplinary processes.
 - **Regulation:** The simplification of conduct regulation.
-

- **Regulators:** Promoting more assertive, confident regulators, supported by an improved legal framework of obligations and penalties, that ensures that they fully and appropriately exercise regulatory powers.
- **Culture:** The development of mechanisms to promote and monitor culture within each bank. The Union believes that a Culture Oversight Division should be established within APRA.

Summary of Proposals for Consideration

Remuneration

Item 1 That the Commission consider extending the definition of conflicted remuneration to include all variable or contingent pay.

Item 2 That the Commission consider a prohibition on all conflicted remuneration (defined as all variable or contingent pay).

Item 3 That the Commission consider the process for the elimination of conflicted pay in a manner that is fair to employees, does not create risks of misconduct and does not provide a windfall profit to banks. Such process should be controlled by an independent arbiter such as the Fair Work Commission.

Item 4 That the Commission recommend the development of a model for sector wide employment practices, including sectoral collective bargaining.

Conflicts around services

Item 5 That the Commission consider the prohibition of referrer and introducer schemes.

Item 6 That the Commission consider:

- recommending the extension of prohibitions on conflicted remuneration to mortgage brokers and other intermediaries; and
- recommending the introduction of a licensing, education and training framework for mortgage brokers (and other intermediaries) like that that should be required of financial advisers.

Item 7 That the Commission consider measures to minimise and manage conflicts around vertical integration and exclusive and preferred contractual relationships.

Professionalisation

Item 8 That the Commission consider a process for professionalisation of work in the sector.

Item 9 That the Commission consider a three-tiered professionalisation model under which:

- Tier 1 would involve a fit and proper person test, and, training framework;
- Tier 2 would involve licensing, disciplinary procedures and the imposition of professional and ethical obligations; and
- Tier 3 would involve registration of senior executives with pro-active accountability obligation modelled on the UK Senior Managers Regime.

Whistleblowers

Item 10 That the Commission should consider what improvements to the law to protect whistleblowers in financial institutions are warranted.

Culture

Item 11 That the Commission should consider whether Boards of Directors of banks should be required to include employees, consumer or other stakeholder representatives.

Item 12 That the Commission consider whether banks should be required to establish a Culture Oversight Committee which reports to the Board of Directors and comprises consumer, union and management representation.

Item 13 That the Commission consider requiring that APRA establish a new Culture Review Section empowered to conduct regular Culture Reviews of the kind undertaken in the Netherlands DNB.

Regulators

Item 14 That the Commission consider recommending the establishment of a framework to undertake a culture review of both ASIC and APRA.

A Financial Services Code

Item 15 That the Commission consider the establishment of a review of the legal framework of the conduct regulation of banks with a goal of establishing a comprehensive Financial Services Code.

Such code would:

- be based on clear principles such as the Commission's "very simple ideas";
- simplify the system of regulation;
- include community service obligations;
- confer rule making power on the regulator;

- establish a standards framework for finance sector workers;
- establish a Culture Oversight Division of a regulator;
- prohibit or substantially limit variable/conflicted pay;
- provide better access for consumers to seek remedies;
- enhance the regulators enforcement powers; and
- extend the operation of the criminal law in financial services;

2. The right culture is central

2.1. A culture of maximising profit at the expense of customers

Too often, the answer seems to be greed – the pursuit of short term profit at the expense of basic standards of honesty. How else is charging continuing advice fees to the dead to be explained? But it is necessary then to go behind the particular events and ask how and why they came about.

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.¹

[9] Australian banks are fixated on short term profits and sales at the expense of the interest of consumers and staff, and the medium and long term interests of the corporation and their shareholders. This is in stark contrast to most people who work in the finance sector, who want to deliver the best outcome for their customers.

[10] In its examination of misconduct in the finance sector, the Commission found that culture is a central issue.²

[11] The crucial matters that must be challenged are the organisational goals and aspirations set by large shareholders and boards of directors; and the targets and strategies implemented by executives and management. These matters determine whether the default position is to push the law to its boundaries or to act within its spirit, and what decisions to make when the law is silent.

[12] Australian banks hold an extraordinarily privileged position because they play a central role in the national economy, and in the lives of almost every Australian. They are provided guarantees by government and are protected against many forms of competition by law. The corollary of their privileged position is a responsibility to their employees, customers and the community at large.

“We are constantly pushed to quote and sell insurance, wealth, and home loan products. I always ask the customer as it is our responsibility however if we do not “make a sale” I feel as if we are bullied and pressured to badger the customers until they say yes. I don't think it is right. If a customer says no they the staff should not get into trouble for it.”

Respondent - FSU Workplace Culture Survey 2018

2.2. What do we mean when we talk about culture?

[13] Culture is a broad term. It is important to understand what we mean when we talk about culture as it has a central role to the instances of misconduct identified by the Commission.

[14] Kotter and Heskett describe culture as “the shared attitudes, behavioural patterns, and values that cohesive human groups pass on from one generation to the next”.³ Closer to home, ASIC has described culture as:

“a shared set of values or assumptions. It reflects the underlying mindset of an organisation. It lies at the heart of how an organisation and its staff think and behave. It shapes and influences people’s attitudes towards, for example, customers and compliance.”⁴

¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, Executive Summary.

² Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, Interim Report, 301.

³ John Kotter and James Heskett, Corporate Culture and Performance (The Free Press, 1992).

⁴ Greg Tanzer, Commissioner, Australian Securities and Investments Commission “The Important of Culture to Improving Conduct Within the Financial Industry” (Speech delivered at Thomson Reuters’ Third Regulatory Summit, Sydney, Australia, 27 May 2015).

- [15] For people working in the finance sector, the culture of their employer is clear in how they are paid, managed, and disciplined. Culture is far broader than how an organisation deals with risk or interacts with regulators. The culture of the finance sector is the blueprint for how each organisation conducts every aspect of its business. Culture determines how it deals with customers, regulators and its employees.

2.3. Where does culture come from?

- [16] The Commission observes that *"the culture of the banks was driven by, and was reflected in, their remuneration practices and policies"*.⁵ This reflects a broader complexity of culture – it both drives behaviour, and is in turn a reflection of behaviour.
- [17] The Commission has identified an overwhelming culture of greed within the finance sector, which is a significant driver of behaviour.⁶ However, the source of this culture is at the most senior levels of the organisation, as the Commission states:
- "...staff and others engaged by an entity will treat as important what they believe that entity values. Rewarding volume and amount of sales is the clearest signal that selling is what the entity values. What staff and others believe that the entity values informs what they do. It is a critical element in forming the culture of the entity."*⁷
- [18] Management structures within financial institutions play a critical role in setting culture through how they interact with their staff through remuneration arrangements and regulation of conduct. As is stated in the Interim Report, the prevalence of misconduct across substantially all major financial entities demonstrates that the problem is broader than individual employees engaging in misconduct.
- That characterisation serves to contain allegations of misconduct and distance the entity from responsibility. It ignores the root causes of conduct, which often lie with the systems, processes and culture cultivated by an entity. It does not contribute to rebuilding public trust in the financial advice industry.*⁸

2.4. The culture problem is across the sector

- [19] The approach of the Royal Commission to the first four rounds of hearings used case studies to identify specific instances of misconduct with a view to the *"identification and useful exploration of issues having a wider application than the particular case"*.⁹
- [20] With this approach, it is important to acknowledge that the case studies were not isolated incidents or limited to just the entity being examined. For the people working in much of the finance sector, the examples of misconduct examined are consistent with their experience.
- [21] The cultural failure identified is systemic and pervasive across much of the sector, not simply a failure within each institution. The poor behaviour is baked into the profits government, the banks and their shareholders each expect.
- [22] It is notable that the misconduct issues identified by the Commission have not occurred in the customer owned banking sector where the focus remains on the customer (shareholder) interest, rather than profit. This observation is supported by Union members within customer owned banks who describe far fewer instances of unethical behaviour, or conduct where the customer's interest is not paramount.
- [23] Fixing the culture requires a recognition that damage is being done to reputation and long-term shareholder value in the pursuit of short-term profits. Action must be taken across the sector, in the national interest, rather than relying on the internal processes of each bank.

2.5. The banks still do not accept that they have a culture problem

- [24] The resistance of Australian banks to this Royal Commission is well documented. Until the week the Letters Patent were issued, each of the banks and their trade association, the Australian Banking Association (ABA), had been vocal in asserting that the Commission was unwarranted.
- [25] When the ABA on behalf of its members agreed to the Royal Commission, they appeared to do so primarily to end the distraction caused by those calling for it. The response to the calling of the Royal Commission is apposite. They said:
- All banks believe that a lengthy, \$75m Royal Commission is unwarranted and fails to recognise that Australian banks are already changing, currently undergoing the largest reform program in decades. However, the continued political turmoil and uncertainty presented an unacceptable risk to the stability of our system, the reputation of our banks and the interests of our customers, employees and shareholders.*
- [26] The same release said:

⁵ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 301.

⁶ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, Executive Summary.

⁷ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 55.

⁸ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 87.

⁹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 12.

Our banks do not fear scrutiny or accountability. They have actively participated in 51 substantial inquiries, reviews and investigations since the GFC and are ready to contribute to this Commission.¹⁰

- [27] These objections were despite many employees within the sector supporting calls for the Royal Commission through their Union. The Finance Sector Union has been calling for a Royal Commission to address the cultural and systemic issues within the industry for many years. These calls have been based on the experience of Union members reporting management culture which ignored, tolerated, and, on occasions, promoted misconduct at the expense of the interests of customer and the community.
- [28] The approach of the banks, throughout this time, had been to consistently seek to diminish those who call out the cultural issues, and to reduce and minimize the changes to culture. By way of examples:
- The banks lobbied for the general advice exemption to Future of Financial Advice (FOFA);
 - The banks lobbied for the grandfathering of commissions in FOFA;
 - The banks ensured that the Sedgwick Review did not consider sales-based remuneration beyond the very limited scope of front line staff engaged in retail banking and their immediate supervisors;
 - Each bank continued to increase, in their total wage bill, the share allocated to variable and contingent pay, at the expense of fixed pay;
 - Each bank continued to increase secrecy around salary arrangements for staff;
 - The banks dismissed instances of misconduct as being due to "bad apples" rather than systemic problems; and
 - The ABA described calls for a Royal Commission as "populist", "easy politics" and warned of the potential adverse effect on international confidence.
- [29] The limits of the scope of the Sedgwick Review are well documented. It is noteworthy that the Review Report suggested that recommended changes not be artificially limited by its scope:
- "Fundamental also is that practices that have a similar effect on incentives and the risk of inappropriate behaviour should be reformed in the same way irrespective of the name assigned to it or the channel through which it occurs."¹¹*
- Instances where banks have made changes beyond that recommended on a limited reading of Sedgwick are rare. The tendency has been to implement it on its strict terms, not to its spirit.
- [30] It is evident that despite community and staff outrage, and the "51 substantial inquiries, reviews and investigations" the banks did not acknowledge the fundamental cultural problem. They continued to downplay the issues. They developed systems and processes that obscure the purpose of what they are doing: "balanced scorecards" appeared to promoted more general targets but in fact maintained the fixation on sales. Indeed, the language the banks use in staff communications increasingly obscures its purpose. =
- [31] The leaders of the banks still fail to understand the nature and extent of the problem. In the week these submissions were prepared, the CEO of NAB, Andrew Thorburn said:
- "When I started in banking, it was serving customers, [that] was what was drilled into us [about] why we existed.*
- ...
- I've been in banking 30 years and I think the last 20, we drifted. When you drift you sort of, you don't know that it's happening. It looks incrementally sensible. Others are doing it. There's a system that reinforces it, so shareholders appreciate it if you're making good and better profits.*
- "[NAB's banking scandals"] happened because we drifted and we lost focus on the most important purpose [for which] the bank exists, which is to serve and enable customers to make very big financial decisions and to trust us in that process."¹²*
- [32] The cultural failure was not a "drift". Such language implies that there was no driving agenda or intention behind the changes. There was. The changes of the last 20 years were driven by an agenda to maximise profit without proper regard to the consequences.
- [33] The Union has seen no retreat from that agenda. As the Royal Commission has progressed there has been no change to the issues confronting employees - branch staff continue to be performance managed for failing to sell sufficient numbers of products; leader boards, revenue targets and sales competitions remain common; branches continue to be closed in rural and regional areas; staff continue to be retrenched and replaced by less trained staff, or automated processes; and pay increases continue to be focused on variable and contingent pay.

¹⁰ Australian Banking Association, "Royal Commission" (Media Release, 30 November 2017).

¹¹ Stephen Sedgwick, "Retail Banking Remuneration Review - Report" 19 April 2017, i.

¹² Gareth Hutchens, "NAB chief tells inquiry banks started 'drifting' from customers 20 years ago" The Guardian (online) 19 October 2018 <<https://www.theguardian.com/australia-news/2018/oct/19/nab-chief-tells-inquiry-banks-started-drifting-from-customers-20-years-ago>>.

2.6. Building Good Culture

- [34] There is no simple prescription for the right culture in the finance sector. Indeed, as has been often observed, bad culture is far easier to identify than good culture: Professor Ian Harper said, "You sure know when it's off because it smells."¹³
- [35] However, the fact that there is no single "right" culture does not mean that good cultures do not have common features, nor that there are not common steps that should be recommended by the Commission and taken by all banks.
- [36] Extensive work has been undertaken around the world on features of good bank culture. Following the London Interbank Offered Rate (LIBOR) scandal, English banks undertook a series of reviews around culture in the sector which led to the establishment of the Banking Standards Board (the BSB). The BSB has provided this Royal Commission a submission which sets out the English experience on what is good culture and how to achieve it. Their submission provides:
- The BSB's Assessment, policy and insights work are intended to provide member firms with the evidence, support and challenge to help them achieve and maintain high standards of behaviour and competence, individually and collectively. Underpinning this approach is our framework of nine characteristics, both ethical and professional, that we would expect to lead to good outcomes for customers, clients or employees and the economy and society as a whole; characteristics that we would therefore expect to be associated with any good culture in banking.*
- Our Assessment does not assess firms against a template of what a 'good' culture looks like. There is no uniquely good (or bad) organisational culture against which all others can be measured. Firms with very different cultures can produce equally good or bad outcomes for customers and clients and more broadly.*
- We do not, therefore, set out to measure or rank culture directly. Rather, we ask how far each of our nine characteristics is demonstrated by the firm and relative to other firms. We would expect a firm that strongly exhibited our nine characteristics to be better equipped and more likely to service its customers, members and clients well, than one in which these elements were lacking.*
- The nine characteristics against which firms are assessed are honesty, respect, openness, accountability, competence, reliability, responsiveness, personal and organisational resilience, and shared purpose.¹⁴*
- [37] The Union believes that there is substantial merit to these as indicia of good culture within financial institutions. However, it is important to note that these characteristics are substantially similar to those already present within financial institutions' values statements. The issue is therefore not that financial institutions are unaware of these values, or do not see the importance of them (as they play an important part in how financial institutions present to customers and markets).
- [38] While the reasons that financial institutions do not currently comply with these values may be complex, they likely boil down to greed. Financial institutions de-prioritise these values where they conflict with profit. Further, financial institutions' "...governance and risk management practices...did not prevent the conduct. The culture and conduct of the banks was driven by, and was reflected in their remuneration practices and policies."¹⁵
- [39] The Union notes that the BSB approach to achieving cultural improvements is through a self-regulatory model. Such a model is not appropriate for Australia. A self-regulatory model requires a maturity and awareness of problems that is absent from the Australian financial sector. Self-regulation, and a light touch from regulators have been dominant for more than 20 years. The evidence before the Commission this approach has failed the Australian community is unequivocal.

3. The disconnect between the expressed values of banks and how they operate

- [40] Much of the public debate that led to, or circulates around the Royal Commission, seems less about formal misconduct, and is more an observation that the banks are "dishonest" and "untrustworthy". The response of the ABA, and banks to expressed concerns consistently refers to the need to "rebuild trust".
- [41] The discussion around trust and the sense of dishonesty in the sector arises not simply from examples of misconduct, or behaviour that is potentially unlawful. It also arises because of the disconnect between the expressed values, and ideals of the banks on the one hand, and the way they operate on the other hand.

¹³ Anne Hyland, "Why corporate culture matters and how to change it" *Australian Financial Review* (online) 15 April 2016 <<https://www.afr.com/leadership/workplace/why-good-culture-will-boost-company-profits-20160413-go5q88>>.

¹⁴ Banking Standards Board, "BSB Written Evidence for the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry" October 2018.

¹⁵ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 340.

- [42] For staff this disconnect is often embarrassing and distressing. Bank workers describe a working environment in which their personal ethical standards are consistently higher than that of their employer. The values and ethical standards espoused by banks generally reflect how staff members seek to operate. However, such values stand in contradiction to directions and the expectations imposed upon employees.

3.1. Public Values

- [43] The Union identifies the expressions of public values in a number of discrete areas including banks' marketing materials; value and principles commitments published by banks, and public statements of bank CEOs and bank leaders.

- [44] Each of the banks has slogans which express a customer centric community focus. Recent slogans include:

- for ANZ "Your World, Your Way";
- for ANZ "We live in your world.";
- for Westpac "Australia. Proudly supported by Westpac";
- for Commonwealth Bank "CAN";
- for Bank of Queensland "It is possible to love a bank.";
- for AMP "Whatever your goal, we're here to help"; and
- for NAB "More give, less take."

- [45] Their vision statements speak in comparable terms:

- Westpac's vision statement is "to be one of the world's great service companies, helping our customers, community and people to prosper and grow";
- ANZ's values are about "Doing the right things well.";
- ANZ values are identified as "Integrity, Accountability, Respect, Collaboration and Excellence";
- NAB's "core values" are expressed as "passion for customers; win together; be bold; respect for people; and do the right thing";
- ANZ mission statement is - "Do your best, help people progress, be business minded.";
- ANZ's purpose is expressed as "to help shape a world in which people and communities thrive. That means strive to create a balanced, sustainable society in which everybody can take part and build a better life".; and
- CBA's vision is expressed as "To excel at securing and enhancing the financial wellbeing of people, business and communities." They express their values as integrity, accountability, collaboration, excellence and service.

"Culture has deteriorated substantially as my organisations values are not applied by leadership in this area. No's are still the primary focus and not any behaviours. Some people are duplicating tasks and doing things that benefit them no's wise instead of what benefits the customers."

Respondent - FSU Workplace Culture Survey 2018

- [46] Through their trade association the banks have recently agreed on a new Banking Code of Practice. The Banking Code of Practice is expressed to be "a strong commitment to ethical and transparent behaviour, responsible lending and greater financial protection for customers."

- [47] The expectation of behaviour expressed by the advertising representations, the value statements, and the vision statements are in many ways consistent with each other. They focus on serving the community need, and banks playing their part in the "social contract".

- [48] The Union's experience is that almost all bank workers embrace and share the values and principles set out in the banks' value statements. Indeed, much of their work within banks is consistent with these aspirations.

"Culture and workplace values start with management - if they don't have the right genuine value it impacts on staff and customers."

Respondent - FSU Workplace Culture Survey 2018

- [49] Financial services entities and their leaders are skilled at performative culture. The evidence heard by the Commission demonstrates that these expressed values are not genuine commitments and do not describe the reality of the culture within these organisations. Union members describe the disconnect between these principles and bank conduct. Internal memos, often expressed in the language of targets and sales, routinely contradict espoused values. Rather than staff being supported to do the right thing, they are encouraged and incentivised to extract profit, even where it is clearly the wrong thing to do.

- [50] In making this point the Union is not focused on the negative effects of the conduct itself. Such effects are considered throughout the balance of these submissions. Rather, the point being made is that the clear disconnect between the

expressed statement and the values of each bank, and the bank's actions, reinforces, both to staff and to the world at large, the idea of bank dishonesty.

- [51] For workers, organisational dishonesty is reflective of dishonest and unethical culture. The expectation on workers to act in an honest manner is difficult to sustain when their employer, and those in leadership, appear so frequently to be lying.

4. Conflicts around employment practices

- [52] The Interim Report correctly identifies misaligned incentives in employment arrangements as a key cause of misconduct.

- [53] While much of the attention has been on remuneration arrangements for customer facing staff, the Union identifies other elements of employment arrangements within banks as also being crucial to an understanding of the cultural issues in operation within banks. The Union particularly identifies:

- Conflicted and other variable pay arrangements for managers and others responsible for setting and enacting the sales focused culture;
- Continued reliance on sales targets and other targets that are proxies for sales in employment arrangements for customer facing staff;
- Unchanged focus on sales and revenue targets for managers, and the banks' operations at a branch, area and regional level;
- Use of culture and colleague pressure to drive sales such as by use of sales campaigns, leader boards and league tables; and
- A culture of competition and secrecy around remuneration, with a focus on contingent or performance related pay.

4.1. Current employee remuneration is a crucial driver of poor culture

- [54] Rightly, the Interim Report details how remuneration structures for bank employees are a central cause of misconduct and conduct falling below community standards. The Interim Report observes:

Remuneration policies were tailored to different parts of the staff or work of each of the major banks but substantially they were the same for almost every employee at almost every level of the organisation. At least until very recently, the central tenet of the remuneration policies of not only the four largest banks but other banks as well (apart from the mutuals) has been to reward what the organisation treats as important: sales and profit. If there were exceptions to this approach, they were immaterial.¹⁶

- [55] The Union endorses this observation with the proviso that, in the Union's experience, there has been no material change to such practices.

- [56] It remains the case that in each of the banks, the vast majority of customer facing employees are remunerated by a combination of base wage and a further contingent, variable component. Access to variable remuneration is tied, in whole or part, to sales and profit outcomes. This remains true post Sedgwick.

- [57] The Union notes the observation in the Interim Report:

The unstated premise for so much of the debate about remuneration of both bank staff and intermediaries, that staff and intermediaries will not do their job properly and to the best of their ability without incentive payments, must be challenged.¹⁷

- [58] The Union submits that the strategy that underpins the sector's focus on incentivised pay models is flawed. The experience of the Union is that, at a near universal level, bank workers would prefer a structure which focused on and valued their skills and expertise, which paid them a reasonable salary for performing their work, and supported them to act ethically, and in furtherance of the interests of the customer and their employer.

- [59] The experience of the Union is that its members report that sales and other targets, and the focus on extracting as much profit from each customer irrespective of the customer's need sets in place incentives which they need to fight against in order to do their job properly.

4.2. KPIs, performance expectations and sales culture

- [60] The experience of bank workers is that recent changes such as the elimination of sales targets for retail workers, and the introduction of "balanced scorecards", has not been accompanied by genuine cultural change.

¹⁶ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 301.

¹⁷ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 317.

- [61] For many front-line employees, the primary driver of misaligned incentives was not remuneration models, but sales targets. From the Union's experience, the suggestion that there has been a reduced reliance on such targets is, bluntly put, a lie.
- [62] The Union acknowledges that customer facing staff no longer have stand-alone sales targets but are now assessed by reference to "balanced scorecards". However, as the forensic examination of the ANZ scorecard in the Interim Report reveals, balanced scorecards, using a variety of measures that are a proxy for sales, such as A-Z reviews, and "customer conversations" continue to primarily focus on sales objectives.
- [63] The reduction in the use of stand-alone sales targets is mainly limited to customer facing retail workers. Branch managers, area managers, business bankers and others continue to operate with clear sales and revenue targets. For branch managers and area managers such targets are often expressed in a "removed" manner. Banks determine a sales and revenue target for a branch and ensuring that the branch meets its targets is both a KPI, and a threshold (or gate opener) for branch managers to obtain access to a bonus.
- [64] It is noteworthy that whereas the potential maximum bonus for frontline workers is generally limited to less than 10% of base salary, the maximum bonus of branch and area managers can be up to 100% of base salary.
- [65] Union members report continued reliance on management pressure tactics to sell products. In the period of the Royal Commission the following tactics have been observed:
- Continued reliance on leaderboards to record sales in branches with a view to ensuring that branch sales targets are met on a weekly and monthly basis;
 - Staff members being counselled, and performance managed about their failure to engaged in enough "qualifying conversations" with customers in connection with the sale of products;
 - Staff members being counselled, and performance managed about their failure to convert sufficient "conversations" with customers into sales;
 - Weekly one-on-one meetings where staff are counselled as to their failure to sell enough products, or their failure to sell enough add-on or complimentary products;
 - Group meetings where staff members who have sold the least products are identified and, in one case recorded on video, forced to eat a box of donuts in front of their colleagues;
 - Branch managers being counselled, and performance managed because of a failure to meet sales and revenue targets; and
 - Branch managers being advised that unless their branch met a sales target it was likely to be closed.
- [66] Bank workers often describe the desire to meet branch targets in terms of "keeping the peace", and "keeping the branch manager happy".
- [67] Further, while basic terms and conditions of employment for most bank employees are based on collective agreements, the rates of pay set out in the agreement are seldom used. Rates of pay, including pay increases and the terms of participation in variable pay arrangements, along with promotion, and selection for redundancy are often determined by local and proximate managers. The importance of branch managers is further entrenched by Sedgwick recommendation three that part of the balanced scorecard process be a discretionary assessment by managers. Generally, these same managers will obtain incentive payments based on the performance of the employee.
- [68] The removal of sales targets for front line workers without changing the sales and revenue expectations, or the incentive payment opportunities for branch and area managers will have no effect on the sales culture. Such a change does no more than limit the remuneration opportunities for the lowest paid employees in the banks.

"To have a proper customer service focus all targets need to be removed. This would result in no judgement of the customers' requirements big or small. We would just look after them. All our teleconferences keep banging on about pre-booked appts, sales, settlements needs met. No mention of service."

Respondent - FSU Workplace Culture Survey 2018

4.3. The regulation around conflicted pay is too limited

- [69] The Union submits that the definition of conflicted pay should be extended to include all variable pay. It should apply to all staff at all levels - from customer facing staff, to branch managers, area managers, and others who set targets and expectations.
- [70] The Union further submits that the Commission should recommend the elimination of conflicted pay by banks.
- [71] Controls on remuneration have been central to both the FOFA reforms and the recommendations of the Sedgwick Review.
-

- [72] However, these controls are tinkering around the edges. Sedgwick proposed less focus on sales targets in variable pay for customer facing retail staff. FOFA eliminated conflicted pay for personal advice (defined narrowly) and then included a series of exemptions and grandfathering provisions.
- [73] There has been very limited change in remuneration arrangements for those not affected by the FOFA or Sedgwick Reviews. This includes anyone who is not customer facing. The impact of FOFA and the Sedgwick Reviews, as well as customer facing staff in non-retail functions such as business banking, and back office functions such as product design and marketing which directly affect customers. Neither FOFA nor Sedgwick affects bank leadership, or those responsible for bank culture. As was observed in the Interim Report:
- Much attention is given in the Sedgwick Review, and in other reports looking at the connection between culture and remuneration, to the remuneration of front line staff. But, as already noted, the general scheme of remuneration by base salary plus incentive payments has been applied at every level of employment within most banks.*
- It is important, therefore, to recognise that providing senior management with incentives based on sales or revenue and profit will inevitably affect how senior management acts with respect to more junior members of staff. It will always be in the interests of any manager (no matter how senior) to have subordinates carry out their work in a way that will allow the manager to achieve whatever incentive targets have been set for that manager.*
- It follows, then, that eliminating incentive based payments for front line staff will not necessarily affect the ways in which they are managed if their managers are rewarded by reference to sales or revenue and profit. The behaviour that the manager will applaud and encourage is behaviour that yields sales or revenue and profit. The behaviour that is applauded and encouraged sets the standards to be met and forms the culture that will permeate at least that part of the entity's business.¹⁸*
- [74] In its submission to the second round of hearings ASIC observed that "any exception to the ban on conflicted remuneration, by definition, has the ability to create misaligned incentives, which can lead to inappropriate advice".¹⁹
- [75] This point is endorsed in the Interim Report:
- That is not a point that depends on evidence. It is the unchallenged (and unchallengeable) basic premise for the conflicted remuneration provisions.²⁰*
- [76] The current definition of conflicted remuneration²¹ contains numerous exceptions and limitations, and, more generally applies only to direct customer facing staff. In so doing, current provisions perpetuate misaligned incentives.
- [77] The reality is that all variable pay tied directly or indirectly, in whole or part, to sales or profit targets are seeking to incentivise staff to sell more products irrespective of customer need. In so doing they create misaligned incentives.

4.4. The elimination of variable pay should not be an excuse for bank greed.

- [78] It follows from the discussion above that the Union believes that variable pay should be eliminated.
- [79] To date changes to regulation around remuneration has been viewed as an element of conduct obligations imposed on licensees and their representatives. Such changes remain, centrally, about the remuneration of individuals. The Union believes an approach that centers on industrial regulation of pay (which ensures that the elimination of conflicted remuneration is not simply at the expense of the employee) would be more successful.
- [80] A fundamental change to the sector such as the elimination of variable pay cannot be done simply by banks withholding funds that would previously have been paid to staff. The development and entrenchment of variable pay structures means that many bank employees are now reliant on variable pay as part of their normal income.
- [81] At the time of the FOFA changes there was a failure to consider the industrial implications of the elimination of trailing commission. A number of the cases of systemic misconduct and conduct falling below community standards identified by the Commission - for example, the fees for no service issues - arose as institutions sought to replace lost revenue streams. Such a chain of events is a clear risk of change being made without properly addressing the potential consequences.
- [82] During the course of the Royal Commission several financial institutions have taken steps to reduce variable pay. The Union is aware of a number of recent instances where the employer has simply, unilaterally, eliminated the variable component and made no adjustment to base pay. In such cases the employer continues to recover the same revenue from the employee's labour, and makes a windfall profit.

¹⁸ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 308.

¹⁹ Australian Securities and Investments Commission, Submissions to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry - Round 2: Financial Advice, 31.

²⁰ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, 97.

²¹ Corporations Act 2001 (Cth) ss963A - 963D.

- [83] The elimination of variable pay is a measure to address a greed focused culture of banks. A windfall profit for banks from such a change is a perverse and unfair outcome.
- [84] The Union submits that the Commission recommend the establishment of a framework for the reduction and elimination of variable pay. Such a framework should be overseen by an independent arbiter such as the Fair Work Commission. Such a process is vital to avoid unforeseen consequences of such necessary change, and to ensure that bank employees do not bear its brunt.

4.5. Transparent pay structures and sectoral bargaining

- [85] A feature of the current culture within banks is the encouragement of competition between staff. Such competition manifests in a number of ways, including through league tables where performance against each other is published and ranked; by staff competitions and prizes for staff who meet certain targets, and by reduced reliance on pay grades and collective employment terms and increased reliance on individual contracts (which exclude the operation of all or relevant parts of collective agreements) and pay secrecy.
- [86] Academic discussion of the issue has identified the lack of public information about quantum and pay structures as contributing both to difficulties in positive reform, and in the lack of consumer trust in banks.²²
- [87] While the elimination of variable pay for front line workers, their managers and others is required, issues will continue so long as base salaries, and other terms and conditions of employment, are individualised and discretionary.
- [88] The Union refers to the submission to the Royal Commission of Dr Stanford of the Centre for Future Work at the Australia Institute. The submission sets forth a plan for the introduction of sectoral collective bargaining. Such a process could provide the framework for increased transparency. The Union identifies increased professionalisation of work in the sector as a necessary reform. Sectoral industrial instruments would be an appropriate place for the establishment of common standards.
- [89] Reliance on a sectoral industrial instrument would also address first mover issues that prevent changes to more ethical and customer centric employment practices. It would also enable consumers to understand the remuneration structures in play in the sector which would, in turn, promote consumer trust in financial services entities.
- [90] The Union endorses the submission of Dr Stanford and the proposals contained therein.

"A better structured remuneration scheme would work better if the base pay was increase on the lower levels of employment and bonuses were based on compliance rather than sales. Just removing sales bonuses only gives the employer the option to reduce the overall income of an employee."

Respondent - FSU Workplace Culture Survey 2018

Proposals for consideration

Item 1 - That the Commission consider extending the definition of conflicted remuneration to include all variable or contingent pay.

Item 2 - That the Commission consider a prohibition on all conflicted remuneration (defined as all variable or contingent pay).

Item 3 - That the Commission consider the process for the elimination of conflicted pay in a manner that is fair to employees, does not create risks of misconduct and does not provide a windfall profit to banks. Such process should be controlled by an independent arbiter such as the Fair Work Commission.

Item 4 - That the Commission recommend the development of a model for sector wide employment practices, including sectoral collective bargaining.

²² Gail Pearson, "Commission Culture: A critical analysis of commission regulation in financial services" (2017) 36 *University of Queensland Law Journal* 155, 159.9

5. Conflicts around service (intermediaries, referrers, etc) and product providers

5.1. Introducers and referrers

- [91] Structured reliance on “introducers”, or “referrers” is a relatively recent phenomenon. While most of the attention in the Royal Commission focused on NAB’s introducer program, the Union understands that each of the banks maintains similar programs.
- [92] The central conceit of the programs are that members of the community who refer potential mortgage or other high value customers to banks are paid in the event the referral leads to the customer taking out a loan. The refer rates vary, but are about 0.46% of the loan value on average,²³ with some having additional ongoing trailing commissions. Such a rate translates to a potential payment of \$4,600 on a \$1,000,000 loan. ASIC observed that introducers are paid almost as much as mortgage brokers.
- [93] NAB’s evidence before the Commission was that the role of the introducer was to do no more than provide a name and contact details of the potential customer. NAB said that it had sought to restrict the program to professionals (although its website still promotes the program as a fund-raising suggestion for schools, community groups or sporting clubs) such as solicitors, financial planners and real estate agents.
- [94] The operation of the introducer program from the perspective of NAB employees is relevant. Developing a network of referrers is a common expectation for loan focused bank employees.
- [95] The core proposition – that referrers will be paid a substantial amount in return for the provision of a name and address in the event the person takes out a loan – presents an obvious risk for abuse. It is, in the Union’s submission, inevitable that some referrers will do more than simply provide contact details. Given the substantial rewards, referrers are likely to do whatever they can to ensure that the loan is confirmed. Given that part of the referrer program is the development of relationships between referrers and bank staff, referrers will seek to work with, assist and advocate for the loan to the staff member.
- [96] The program involves challenges to the professional obligations of the referrers. It is unclear as to whether a solicitor referrer would be in breach of their fiduciary obligation to clients, or a financial adviser referrer would be in breach of the conflicted remuneration provisions of the Corporations Act.
- [97] At its core, introducer programs like NABs reward professionals in relationships of trust with clients for exploiting those relationships. As introducers are generally exempt from the operation of the credit licensing framework and accordingly do not have an obligation to act “*efficiently, honestly and fairly*”²⁴. Nothing in the program goes to whether the product is in the client’s best interest.
- [98] The Union submits that referrer and introducer programs are a bad idea, vulnerable to exploitation and to poor customer outcomes. The Union believes that they should be prohibited.

5.2. Mortgage brokers and other intermediaries

- [99] The difficult question as to who mortgage brokers and similar external agents act for is considered in some depth in the Interim Report. It appears evident that at times the broker may be agent for the lender and at other times act as agent for the customer. More concerningly, the precise times when the broker’s allegiance shifts is blurred and is generally unknown to the consumer.
- [100] The failure by lenders and brokers to acknowledge that intermediary arrangements give rise to an actual, or perceived conflicts of interest is problematic. At a minimum, a relationship so vulnerable to conflict requires active steps to eliminate the conflicts to the greatest extent possible, as well as careful management and complete disclosure of any conflicts that remain. The current practice, in which conflicts abound and there is no meaningful disclosure is unsatisfactory.
- [101] At present brokers are generally paid on the basis of upfront and trailing commissions. Such commissions are paid by the lender to the broker in the event the customer obtains a mortgage with the bank. A comparison of retail home loan specialists and mortgage brokers is useful.

	Retail bank home lending specialists	Mortgage broker
Is there clarity in who they act for?	Yes. Bank home lending specialists are employed by the bank and act as its agent	No

²³ Australian Securities and Investments Commission – Report 516 – Review of Mortgage Broker Remuneration (16 March 2017) 100.

²⁴ National Consumer Credit Protection Regulations 2010 (Cth) reg 25.

What portion of their remuneration is variable?	Combination of fixed and variable remuneration	All variable
Do they receive commissions?	No	Yes
Is variable pay awarded solely or directly by reference to sales performance?	No	Yes
Are they subject to conflicted remuneration provisions of the Corporations Act?	Yes	No
Are they subject to regular training as to compliance and legal obligations to customers?	Yes	Not necessarily
Can their engagement be terminated in the event of serious misconduct	Yes	Not really. Lender can stop broker from dealing with their products but cannot terminate brokers employment.

[102] That variable and contingent pay to bank employees creates a risk of poor consumer outcomes is now widely accepted. The extent of the issue is exponentially greater for mortgage brokers and other intermediaries. The variable component for retail customer facing staff is generally in the order 5-15% of base salary. Mortgage brokers are paid on sales alone.

[103] It is difficult to understand why mortgage brokers should not be subject to the same requirements and limitations as financial advisers. As Gail Pearson, a leading academic in the field of financial services at the University of Sydney observes:

"How is the damage from conflicted financial advice greater than the damage for unsuitable and useless insurance or paying more for a similar home loan product?"²⁵

[104] Commission based remuneration creates misaligned incentives and are not appropriate for mortgage brokers, or any other intermediary. Like financial advisers, mortgage brokers should be remunerated on a fee for service, or salary basis.

[105] The Union acknowledges the significant role of the mortgage brokering industry. However, it believes that the current model is subject to too few checks, and too many poor incentives. Movement towards ethical and customer centric practices into the operations of banks will be of limited importance if such changes do not equally apply to non-bank actors such as mortgage brokers.

[106] The Union submits that the Commission consider:

- Recommending the extension of prohibitions on conflicted remuneration to mortgage brokers and other intermediaries; and
- Recommending the introduction of a licensing, education and training framework for mortgage brokers like that that should be required of financial advisers. Elsewhere in these submissions the Union has proposed a comprehensive system of licensing and professionalisation that should apply to all individuals (whether employed or not) who are able to have a significant effect on consumers.

5.3. Vertical integration and external contractual relationships

[107] There has been significant research, inquiry and discussion about the inherent conflicts and adverse customer outcomes associated with vertical integration. This work has already led to some legislative reform and, more significantly, appears to have contributed to the decisions of ANZ, CBA and NAB to each divest themselves of some parts of their wealth businesses.

[108] The provision of prudent financial advice in the customer's best interest is a matter of community and national importance. The divestment means that retail banks (with their geographic reach) have relinquished an opportunity. As was revealed in the financial advice round of hearings, the misconduct in the financial advice industry was not limited to the large entities, but also arose in small and medium advice businesses.

[109] Rather than focusing in where advice is being provided, the focus must be on improving the ethical standards and standing of the financial advice industry. In this context the Union does not believe that vertical integration is an

²⁵ Gail Pearson, "Commission Culture: A critical analysis of commission regulation in financial services" (2017) 36 *University of Queensland Law Journal* 155,175.

unsurmountable problem. Indeed, a focus on vertical integration may obscure the observation that similar issues arise as a result of exclusive and preferred provider contractual relationships.

- [110] The Union's observation is that divestment of wealth businesses has not led to a wider variety of products being recommended to customers. Rather, there has been a corresponding increase in relationships between banks, insurers and financial advice businesses such that staff are required to promote products of third parties in the same way as they previously promoted products issued by their employer or its subsidiaries.
- [111] Indeed, in many ways such changes are a retrograde step. Whereas previously sales targets were set and variable within the banks' internal processes, they are now fixed in contractual arrangements with third parties.
- [112] By way of example, the Union notes a recent campaign within NAB to sell Allianz Insurance. NAB have recently entered into a contractual relationship with Allianz whereby its products are promoted within NAB branches. The Union understands that sales have been below expectation and as result sales campaigns were promoted during the Soccer World Cup which occurred in June and July 2018. The internal campaign offered staff prizes for selling Allianz insurance products.
- [113] Such sales campaigns are exactly the type of campaign that were considered by the Sedgwick Review, among others. The fact that the product being promoted was external, rather than internal makes no difference to the potential for poor customer outcomes.
- [114] Similarly, the Union submits that a focus on greater diversity in approved product lists (APLs) is no comprehensive answer. The bias toward house (or contracted/promoted) products arises though a combination of sales targets, incentivised remuneration, as well as softer promotions through training and natural bias in favour of employer promoted products.
- [115] The Union does not believe that the solution to conflicts that arise from vertical integration is to ban it. Rather, the solutions involve a range of measures including:
- Prohibition of conflicted remuneration defined as all variable or contingent pay;
 - Elimination of the general advice exception (in terms of consideration of the customer best interest and an assessment of customer needs) under the FOFA provisions;
 - Avoiding incentives or drivers that promote sale of a product or class of products;
 - Improved education, training and professionalisation in the industry to promote a customer centric culture in the sale of financial services products;
 - Requiring licensees to disclose conflicts, including vertical integration and commercial relationships, in a clear and comprehensible manner to customers; and
 - Creating a standards and training framework that ensures that staff are appropriately trained and empowered to resist conflicted sales drivers.

Proposals for consideration

Item 5 That the Commission consider the prohibition of referrer and introducer schemes.

Item 6 That the Commission consider:

- recommending the extension of prohibitions on conflicted remuneration to mortgage brokers and other intermediaries; and
- recommending the introduction of a licensing, education and training framework for mortgage brokers (and other intermediaries) like that that should be required of financial advisers.

Item 7 That the Commission consider measures to minimise and manage conflicts around vertical integration and exclusive and preferred contractual relationships.

6. The impact of "management by measurement"

- [116] In addition to conflicted remuneration, the Interim Report identifies "Management by Measurement" as the key underlying factor in issues of trust in the financial services sector.
- [117] The Union identifies the following key issues in current management practices that impact upon culture and poor customer outcomes:
- the promotion of a culture where employee discretion, assessment and decision making are undervalued and reduced;
 - the failure to promote professionalisation throughout the sector;
 - reliance on KPIs and other targets that reduce complex process to binary check box decision making;
 - reliance on off-shored and external labour;
 - increased reliance on computer systems;
-

- compliance measures focused on protecting the bank, rather than protecting the customers.

[118] While the solutions for issues around employee management practices are complex, the Union believes that opportunities for improvement exist in improved industrial regulation and in the promotion of professionalisation of bank workers.

6.1. Reliance on KPIs and other targets that reduce complex process to binary check box decision making

- [119] A crucial element of “management by measurement” is increased focus on metrics and targets to assess performance.
- [120] Targets on sales, up-selling and the like continue, albeit to a reduced level. As institutions’ reduce reliance on formal sales and revenue targets, such metrics have been replaced with other points of assessment that are, ostensibly, as clear to measure. Common examples include identified targets for A-Z reviews and similar customer engagements; customer meeting targets, POC (cold calling) targets.
- [121] Institutions have also focused on measurement of “behaviours”, such as “depth of conversation”, or “delighting the customer”. The measurement of these behaviours is generally done by reference to external events, such as, for example, the rates of conversion from A-Z reviews to sales outcomes.
- [122] Banks also focus on “net promoter scores” (NPS) in assessing the performance of staff. NPS are ratings determined by customer feedback, generally in response to an email or text message. They are normally expressed as ratings out of ten (i.e. the top rating is ten), where any rating below nine is considered a fail.
- [123] There are numerous problems with NPS as a measurement of staff performance. A number of banks have acknowledged the central flaw that customers are generally rating the bank’s performance, not that of the individual employee they engaged with. Further, a focus on customer satisfaction is not the same as a customer-centric culture. However, the management fixation with identifying metrics that are able to be reduced to a number mean that NPS continues to be used in each of the large banks. The Union submits that reliance on metrics such as NPS is an indicator of poor underlying culture.
- [124] A further element of performance assessment is compliance related KPIs. For most bank workers, this metric is achieved by no more than a combination of them taking ten consecutive days leave, undertaking a training course or watching a webinar and not being the subject of an adverse finding on compliance. As noted in the Interim Report, such measures incentivise hiding errors, and a tick a box approach.
- [125] As described elsewhere, while formal sales targets for front line retail staff have become a reduced focus, there has been no corresponding change in targets for branches. Measurement of branch performance remains as focused on sales and revenue as it ever was. While targets are generally set by reference to the size of branches (most banks operate a tiered structure), there is negligible, if any, relationship between the targets set for banks and the demographic of the branch’s customers. Comparably sized branches, even where one may be in an area with high numbers of retired customers, or customers dependent on welfare, and the other not, will have the same targets for credit card sales, or new mortgage business. Branch targets are generally a gate opener for bonuses for branch managers. Branch managers, particularly in small and rural branches, report that they are told that a failure to meet a revenue target may lead to the branch being closed.
- [126] The Union accepts that ongoing development of staff is necessary for the individual and the enterprise. Such development may include supervision, performance assessment, feedback, and mentoring.. However, current practices involve the training to undertake activities which will require the employee to engage in unethical conduct with a risk of poor customer outcomes.
- [127] The Commonwealth Bank’s “Next Best Conversation” process is an example of such management practice. “Next Best Conversation” involves customers being mined for data whenever they visit a branch, such as for example by the teller recording observations as to which other banks’ cards were in a customers wallet or recording a customers comments during a friendly conversation about future holidays. The Commonwealth Bank System in turn uses this information to drive active approaches to the customer – be it to change banks or to buy travel insurance. Bank staff are trained and managed by reference to how well they record “Next Best Conversation” information.
- [128] The Union believes that greater professionalisation of the sector is central to improving culture. Part of a process of professionalisation is a recognition that supervision requires expertise and judgment. Attempts to reduce performance assessment to a series of marks will inevitably incentivise promotion of positives (such as sales, and meetings), and the hiding of negatives (such as errors). A key factor in the assessment of good culture that minimises risk is the existence of performance management processes that genuinely evaluate the performance and contribution of the employee, rather than simply marking them against a checklist.

6.2. Professionalisation

[129] The experience of the Union and bank workers is that the decreased levels of trust in financial institutions have run parallel to an erosion in bank’s expectations in employees around issues of judgment and discretion.

- [130] The stripping away of discretion from bank workers has been coupled with far more prescriptive management, such as through use of targets, scripted conversations and the like.
- [131] The Union submits that an emphasis on a professional culture, as opposed to a scripted and directed one, is central to avoiding and limiting reputational and other prudential risk, minimizing poor customer outcomes and restoring trust to the sector.
- [132] The Union believes that for too long the poor cultural impulses of senior management have been permitted to operate largely unchecked by any counter balance. In the same way that the Commission must recommend measures that assist regulators to be an appropriate counter balance, the Commission should also recommend measures that support other stakeholders to be a counter balance. In the context of employees, this involves the promotion of education and professional and ethical obligations, coupled with support for whistleblowers, sectoral industrial regulation, and the elimination of practices, such as conflicted remuneration that incentivise poor behaviour.
- [133] Professionalisation alone is not a panacea, any more than any other proposal for cultural improvement. It is simply part of a bigger strategy. The clear benefit of professionalisation is the establishment of frameworks pursuant to which employees are encouraged, required and empowered to act ethically, in accordance with the law, and in the best interests of the customer. Such a process increases the likelihood of resistance and resilience against management expectations that are contrary to what is legally appropriate or in the customer, or customer demands which are inappropriate. Greater levels of professionalisation are likely to increase the possibility of whistleblowing, and accountability.
- [134] The process for professionalisation cannot be left to the industry, and will not be achieved by self regulation. The impulse of banks is to resist the development of professional or ethical obligations that operate outside of the employment relationship.
- [135] The Union does not believe the professional obligations of all bank workers should be the same. Some work within banks, for example financial advice, is more readily translated into a discrete profession. However, the Union believes that features of professionalisation are important and applicable for all workers in the sector whose actions may impact on customers.
- [136] The Union submits that the Commission should recommend:
- introducing a 'fit and proper person' test for working in the sector;
 - increased education and training requirements, including introducing minimum qualification standards and continuing education obligations for workers;
 - the introduction of disciplinary and accountability obligations that operate outside of, and independent of the employment relationship;
 - a credentialing, licensing and registration system for some classes of workers; and
 - that the professionalisation process be administered by a regulator.
- [137] The Union believes that this process could operate in concert with a Senior Executive Accountability Scheme, which would extend the current BEAR beyond its far too limited focus on prudential soundness. However, whereas the professionalisation process is about increasing capacity, educational standards and expectations, an expanded Senior Executive Accountability Scheme should focused on accountability for decisions.
- [138] A crucial element of such a process is to ensure that transitional processes are fair. Expertise and experience must be valued and new educational obligations cannot be unreasonably imposed. Many workers entered the industry when little or no formalised training was available. Errors currently being made by the Financial Adviser Standards and Ethics Authority (FASEA) represent an example of the risks of not getting the transition to the new system right.
- [139] The Union submits that the process for professionalisation should be undertaken as part of the development of an industry industrial instrument. The Fair Work Commission has extensive experience in identifying employment classification and qualification levels which form a crucial part of the process.
- [140] The Union's professionalisation model is based on three tiers, with escalating obligations and accountability under each. It would apply to all employees, contractors and other workers engaged in the financial services sector including in banks, insurance and superannuation whose work may impact on customer outcomes. The proposed tiers are:

6.2.1. Tier 1 – "Fit and proper person" test and training framework

- [141] Tier 1 would cover all individuals with roles that may impact on customer outcomes, but did not meet the criteria for Tier 2.
- [142] Workers at this level would include tellers, sellers, verification and compliance officers as well as many other back office and other processing functions.
- [143] Tier 1 individuals would be required to undergo a "fit and proper person" check. Such a check should be administered by a regulator. Any decision to deny or revoke a check should be subject to procedural fairness and review.
- [144] Such a check would replace informal and unfair arrangements such as those currently provided for under the Conduct Background Check system administered by the ABA. As the current arrangements cover only part of the industry, its

function is only to act as an effective black list for signatories. It provides no meaningful consumer protection as individuals who should not be permitted to work in the sector can simply obtain employment with non-signatories, or be self-employed. It is also manifestly unfair as there are no appeal rights and no method to challenge.

- [145] Further the Union believes that a system of credentialing through the provision of minimum training standards should also be introduced for Tier 1 individuals.
- [146] Training should cover various matters including awareness of fundamental customer obligations, ethical standards, and work standards relevant to the work being performed should be introduced. Such standards should be mandated by the regulator and apply by reference to the responsibility of each position. Sector wide industrial instruments would underpin the implementation of such standards.
- [147] There has already been some movement towards such a system, through initiatives such as RG146. RG 146 is a training credential required for bank workers to be able to provide personal financial advice.
- [148] The Union further submits that part of the holding of such a credential should be a requirement to undertake continuing education. While the quantum of continuing education may vary, at least some of it should be undertaken by providers other than the employer, to ensure that the training is genuine skills training and to provide a counterbalance to a dominant culture likely reflected in employer provided training.

6.2.2. Tier 2 – Licensing and professional obligations

- [149] Tier 2 would cover all individuals with roles that may have a substantial impact on customer outcomes, but did not meet the criteria for Tier 3.
- [150] Workers at this level would include mortgage brokers and other intermediaries, financial advisers, business and agricultural bankers, branch managers and more senior leadership. It would also include various back office functions including compliance, IT functions, those responsible for product design or complaints processes.
- [151] Tier 2 individuals would be required to hold a licence relevant to their role. The Union identifies the following desirable features of a system of licensing:
- a record of all individuals and their licenses should be published;
 - the licensing regime would require assessment, and maintenance of standards;
 - licensed individuals would be subject to an ethical obligations to act in the best interest of customers independent of their employment obligations; and
 - disciplinary processes overseen by a regulator with power to cancel, suspend or make licenses subject to conditions by reference to the ethical and professional obligations.
- [152] The varied disciplinary processes operated by professional associations currently in place for financial advisers are a poor approach and should be rejected. As was evident from evidence before the Commission, they are vulnerable to perceptions of bias and interference, and lack of transparency. They do not engender consumer confidence.
- [153] As noted above, the Union does not submit that there should be a common professional standard for all bank workers. Educational attainment, ethical obligations and expectations are rightly different for, by way of example, home lending specialists, financial advisers, or branch managers. However, there can be a common framework that underpins standards across the sector.
- [154] The Union notes the development of FASEA. The mission of FASEA, which was established pursuant to the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017*, is to set the education, training and ethical standards of licensed financial advisers in Australia; and to professionalise the financial advice industry.
- [155] Many features of FASEA represent a prototype for the increase in professionalism across the sectors. However as is inevitable with the introduction of substantial change, there are several elements of FASEA that should be resisted and should not be incorporated into a more general professionalisation regime. These include:
- The proposal of 50 hours per annum CPE, with no discount for part time practitioners. This is five times the expectation for lawyers, or other professionals. The failure to provide any discount for part time staff means that the scheme will discriminate against women, who are disproportionately likely to be part time workers.
 - A transitional arrangements scheme that places insufficient emphasis on experience and years of work in the industry and requires all individuals to obtain a formal university level qualification. Given that no university degree existed in the area before about 2010, such a requirement is unreasonable and may unfairly discriminate against older, very experienced practitioners.
 - A lack of input from financial advisers in the development and administration of FASEA. The current Board of 10 contains no employed financial advisers. The experience of the industry is limited to two members, each of whom are CEOs of financial advice businesses.

6.2.3. Level 3 – Senior Executive Accountability

- [156] Tier 3 would be limited to named senior executives who are those responsible for the determination and implementation of strategy and culture within financial services entities.

- [157] A number of other jurisdictions have recognised the need to introduce a process of formal identification of leaders within financial services entities, and in turn to impose clear obligations and expectations of behaviour on them.
- [158] The obligations should be similar to those imposed under the UK Senior Managers Regime. As in the UK it should include a requirement that the senior executive be pre-approved by the regulator, the identification of areas of responsibility and system of individual accountability for actions taken within the areas of responsibility. Tier 3 registration would replace the current BEAR.
- [159] The imposition of personal liability creates and promotes a system in which senior executives pro-actively seek to ensure compliance, even where it is contrary to more senior management or an organisation's cultural impulses.
- [160] The change needed in the sector requires personal accountability from the decision makers and leaders. Such accountability should extend to exposure to civil penalties, and in cases of serious and wilful misconduct, criminal liability.

6.3. The impact of computer systems and off-shoring

- [161] One of the features of the evidence heard before the Commission, particularly in the consumer lending round was an increased focus and reliance on computer systems for undertaking work that involves discretion and judgment.
- [162] In the Union's experience this trend is mirrored by a trend to offshore some functions. Indeed, offshoring is often used by banks as a mid-point between local, expert decision making, and automated decision making. Off shore labour is generally provided less discretion and provided work with less training.
- [163] At its core, the trend towards computerisation assumes that customer banking decisions are essentially always binary in nature and best achieved by scripts, algorithms and standardised process.
- [164] The trend forms part of the cultural failure in banks.
- [165] An example of how the trend leads to poor customer outcomes is in the use of the published Household Expenditure Measure (HEM) in place of verification of actual expenses. An assessment of actual expenses requires an interview with the customer, and a genuine assessment of their answers²⁶. The ultimate judgment required is that of skilled and experienced individual. It cannot be undertaken by an offshore function, reviewing submitted documents, nor by a computer program.
- [166] At a more general level functions that require the exercise of judgment (such as verification of expenses) cannot normally be done by an offshore function or automated system.

"I find a disconnect between the messages we receive from executive level management and my direct management."

Respondent - FSU Workplace Culture Survey 2018

Proposals for consideration

Item 8 That the Commission consider a process for professionalisation of work in the sector.

Item 9 That the Commission consider a three tiered professionalisation model under which:

- Tier 1 would involve a fit and proper person test, and training framework;
- Tier 2 would involve licensing, disciplinary procedures and the imposition of professional and ethical obligations;
- Tier 3 would involve registration of senior executives with pro-active accountability obligation modelled on the UK Senior Managers Regime.

7. Management out of touch with staff and consumers – the need for better and more responsive governance and culture

- [167] A key way in which banks need to change their culture is to be more aware of, and responsive to the experience of consumers and staff as to how the banks operate.
- [168] The Union, as well as consumer groups, politicians from all political parties, the regulators and many academics have identified the existence of substantial cultural problems in the sector. The failure by the banks to acknowledge such issues is indicative of a deep disconnect between bank leadership and what is happening within banks.
- [169] One potential causes of this disconnect is the problems of "permafrost", and the lack of processes and avenues to ensure that bank leadership are aware of the organisational culture and issues facing employees and consumers. The concept of permafrost and the capacity of middle management to achieve the expectations of senior executives without involving them in the day to day work may be a partial explanation for this issue.

²⁶ There may be significant role for technology (such as in the comparison of customer responses as against bank statements).

7.1. Compliance

- [170] One of the most prevalent responses of banks to conduct issues has been to suggest that there has been an increased focus on compliance measures. When examined, such an approach is no more than additional “management by measurement”, where the price of being identified as “non-compliant” is loss of variable remuneration.
- [171] The Union’s experience is that compliance in retail and business banking remains limited and focused not on consumers interest, but on protecting the interests of the bank and management control over employees.
- [172] Each of the banks now identifies compliance as a “gate opener” for bonus and short term incentive (STI) payments to employees. Given how some marginal issues may be dealt with as compliance breaches, this “gate opener” for a bonus payment can operate to unfairly disentitle a worker to a portion of their income at the discretion of a manager.
- [173] For most workers the compliance components they are assessed on are:
- Completion of “training” (which involves watching videos, or undertaking tests). Union members commonly report that banks have limited interest in the training and knowledge being imparted – test answers are shared among groups – but a focus on staff members signing documents confirming that they have undertaken the training.
 - Taking ten consecutive days annual leave each year. The focus on ten consecutive days leave is predicated on the assumption that instances of fraud and misconduct usually come to light if the staff member is away for a two-week period.²⁷
 - Not being subject to a “compliance breach”. Such breaches include non-compliance with policies such as providing a medical certificate in a prescribed time period. Not doing so may lead to a compliance breach, for example.
- [174] The other focus around compliance for banks is increasingly invasive computer and recording systems where staff actions, interactions and decisions are monitored and, at times, overruled by senior staff and computer systems.
- [175] The current approach focuses on compliance as a mechanism for penalising misconduct and errors, rather than as a process for identifying and resolving matters of concern.
- [176] The NAB beneficiary signatory case study is illustrative. That case study involved a common practice within NAB around the improperly witnessing of non-lapsing binding death benefit nominations. Such nominations were frequently taken to customers’ homes by financial advisers. Customers tended to nominate their spouse, who was often the only other person present. The forms required two signatories, neither of who could be the nominated beneficiary. A practice, where there were not two witnesses present was for the adviser to sign as a genuine witness and then take the form back to NAB and have a colleague sign as the second witness.
- [177] The cause of the employees conduct was to act in the immediate interest of the customer, ensure that the form was completed, and not risk the possibility of delay or lost form by leaving it with the customer, or having another employee attend. NAB’s investigation revealed a widespread ignorance among the employees that the failure to properly witness the form may invalidate the nomination. The Union agrees with the observation in the Interim Report that this issue demonstrated a failure in training and education.
- [178] A lesson from this case study is the manner in which the compliance processes failed to assist in the identification and resolution of the issue. The primary compliance measures should have been to ensure that employees understand the potential effects of their conduct²⁸. The secondary compliance measure should have encouraged staff who identified the potential risk to speak up, without fear of repercussions. In fact, the compliance process was used by NAB in the case study to deny the employees access to their bonus for the year. A culture of punishment operates to encourage workers to hide mistakes, rather than correct them. It also denies bank leadership of a process for learning of potential risks.

“The resourcing is scattered across way too many sources and systems. There’s no genuine effort to embed this as culture of doing the right thing. Just patchwork to speak to obligations and political covering the proverbial.”

Respondent - FSU Workplace Culture Survey 2018

7.2. Whistleblowers

- [179] Central to all assessment of good culture are processes and regulation that support whistle-blowers. Whistle-blowing is a crucial mechanism for identifying misconduct, fraud and systemic errors. It is notable that one of the few instances of fraud identified in the Royal Commission – the NAB introducer scheme, was brought to the bank’s attention by a whistleblower.

²⁷ Two weeks of consecutive leave was recommended by English and US regulators for traders as a protection against fraud from “rogue traders” following the Societe General and Barings scandals.

²⁸ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, Interim Report, 143.

- [180] There is currently limited protection of whistle-blowers within banks under Commonwealth law. Each bank, and the ABA maintain whistleblower policies that ostensibly provide strong protections for whistleblowers.
- [181] The Union has acted for members who have attempted to make complaints pursuant to whistleblower policies. As a near universal experience, the process has been fraught, difficult and generally led to the employee leaving the bank's employment. It is the Union's experience that a strategy of frustration, and overly technical interpretations of whistleblower protection are employed at the expense of genuine assessment and resolution of the underlying issue.
- [182] The Union notes the Senate Whistleblower Protections Report and the subsequent Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017 which is currently before the parliament.
- [183] The Report identified significant inadequacies in the current law. The Union does not believe that the bill, if enacted, will resolve those issues.
- [184] The Union submits that the Royal Commission should consider what improvements to the law to protect whistleblowers in financial institutions are warranted.

7.3. 360 Degree reviews

- [185] At present banks maintain a high degree of performance management and performance review of all staff. Human resource departments maintain sophisticated systems of ensuring staff achieve KPIs and comply with policy.⁴
- [186] None of the banks maintain genuine 360 degree review systems or other processes whereby staff can provide feedback on management, be it intermediate management or more senior leadership.
- [187] Poorly developed review processes, staff engagement surveys, and reports on staff morale are no substitute for detailed and proper processes which provide for genuine feedback, identify issues and promote better supervisory and management practices.
- [188] A logical and appropriate manner for the introduction of genuine consultation and review processes is through industrial instruments. Such instruments, which have the force of law, can provide a mechanism for employees to ensure that processes of consultation and feedback over issues effecting employees occurs.

"I think the focus has just changed. I think the CEO should sit on the front line for a month undercover CEO and see what we have to deal with every day e.g. shortage of staff, bad systems, ticking boxes, upset customers, branch assist and departments not working together.

Respondent - FSU Workplace Culture Survey 2018

7.4. Stakeholder advisory committees

- [189] Each of the four major banks are enormous organisations. By way of comparison the Victorian public service reports that it employs 40,107 FTE. ANZ and Commonwealth Bank each reported employing more than 50,000 individuals in their most recent annual reports.
- [190] In organisations of such size and complexity, ensuring that leadership does not operate in a bubble so removed from customers and employees that they are unaware of cultural issues and risks is clearly difficult. The way each CEO seems to have been genuinely unaware of the extent of poor culture within their banks is evidence that such a disconnection is creating significant risks to each bank.
- [191] The Union submits that the Commission should recommend the introduction of measures that would require bank leadership to establish mechanisms that bypass the normal hierarchies and ensure the provision of information about culture and risk to senior leadership.
- [192] A straight forward option would be to simply require the appointment of worker representatives onto Boards of Directors.
- [193] The Union notes the model of Supervisory Boards that operates in Germany, the Netherlands and several other western European countries. Such a model involves a committee which sits above the Board of Directors and in which employees, shareholder representatives and others monitor the performance of the Board of Directors. The primary role of the Supervisory Board is the appointment and monitoring of the Board of Directors. Individuals cannot sit on both boards. The Dutch model in which the regulator undertakes culture reviews (discussed at 9.6 below) involves a report to the Supervisory Board.
- [194] An alternate option would be the establishment of Culture Oversight Committees. Such committees would include representatives of consumers, the Union (and potentially the regulator) as well as members of the senior executive. Culture Oversight Committees could oversee regular reviews of bank culture, to receive reports of culture issues and risk, and to provide advice and recommendations to Board of Directors about improvements to culture. Such committees could play a vital role in interactions with internal whistleblower procedures, customer complaints procedures, and staff grievance matters.
- [195] The Union submits that the Commission should consider requiring each of the banks to establish mechanisms to ensure the provision of information about culture and risk to senior leadership such as a Culture Oversight Committee comprising consumer, union representatives and management representatives.

7.5. The myth that culture can't be regulated

- [196] Much of the literature around culture is to the effect that it is hard to regulate for, and that cultural change is best achieved when there is "buy in" from the entities. The BSB, for example, identify the fact that they operate outside a regulatory space as a crucial element for their capacity to improve culture within their members.
- [197] The Union does not accept that regulators should not have an active role around culture. While organisational buy-in is important to achieve the best results, its absence does not mean that regulators should not be agitating to create a better culture. Cultural failures can represent a substantial prudential and systemic risk.
- [198] Observations like that of Mr Medcraft of ASIC that "poor culture is not something that can be resolved through regulation with black letter law" are unhelpful. A fundamental role of regulators is to promote a culture that minimises damage to investors and consumers, and strengthen the stability of the sector.
- [199] All activity of regulators will have an impact on organisational culture, the Union submits that there are specific measures that can be deployed to identify risky or poor cultures before misconduct occurs.
- [200] The Union refers to a model such as that deployed by the Netherlands Central Bank and discussed in Wardrop et al in "*Regulating financial institution culture: reforming the regulatory toolkit*". The Dutch model involved the establishment of a dedicated behaviour and culture team within the central bank, which is the effective prudential regulator. The team is primarily composed of organisational psychologists and conducts inspections in banks. Wardrop writes:

The object of inspections is to uncover "risky behaviour patterns" in a firm and to this end the inspections focus on "decision-making, leadership, communication and group dynamics". An on-site inspection is conducted by two DNB personnel at four consecutive stages:

- Context analysis;
- Behaviour and culture risk identification;
- Behaviour and culture risk assessment; and
- Risk mitigation

The context analysis aims to understand the context within which the firm operates and what particular issues arise around its market, business model and any particular problems the firm faces. From this analysis the team chooses to focus on a particular area, for example, the relationship between senior management and the board. It will then focus on a key decision to "zoom in" on underlying behavioural patterns.

Significantly the team also considers "the supervisory dynamics" between the usual supervisors attached to the firm - asking whether the relationship is constructive or is there a lack of trust?

...

The final phase is the mitigation phase and how the regulator responds to the findings depends on the classification. A red classification indicates a board is not aware of or does not acknowledge risky behaviour within the firm and cannot "challenge its beliefs". Often the firm will already have financial problems and so formal action by the regulator may be required including forced change. A firm in the orange category has serious risks identified that have not yet translated into major financial problems or misconduct. Here the supervisory mechanism used is face-to-face "challenge dialogue" rather than reports and letters. The supervisory stance is "confrontational" and focuses on "setting boundaries" and educating and directing. The final classification of green represents a firm that requires no interventions regarding behaviour and culture. The supervisory stance in relation to such a firm is one of trust and the aim is to maintain dialogue and ensure the firm has in place mechanism to "maintain[the] positive trend".²⁹

- [201] Wardrop notes that there is no reason why entities could not employ such a process, by way of culture reviews conducted by internal employees or consultants. Indeed, such reviews have occurred in the past. However, there is a greater risk of employees or consultants being captured or acculturated and unable to identify the culture risks in play.
- [202] A second example was APRA's Prudential Inquiry into the Commonwealth Bank. Such enquiry was conducted because of "a number of incidents" that had "damaged the reputation and public standing of the CBA group". The identified incidents involved Storm Financial, misconduct by financial advisers, fee for no service practices, use of an outdated definition of heart attack in by Commisure, breaches of anti-money laundering obligations and mis-selling of CCI. The inquiry "identified a number of shortcomings in CBA's governance, culture and accountability frameworks" made a "series of recommendations designed to strengthen these frameworks".
- [203] The APRA prudential inquiry identified cultural factors as central to the shortcomings. It identified "tell-tale markers" of poor culture.

²⁹ Ann Wardrop, David Wishart, Marilyn McMahon, "Regulating Financial Institution Culture: Reforming the Regulatory Toolkit" (2016) 27 *Journal of Banking and Finance: Law and Practice* 171.

- [204] As a result of the inquiry APRA made a series of recommendations aimed at improving governance, accountability and culture. CBA and APRA agreed on an enforceable undertaking pursuant to which CBA agreed to a process for the implementation of the recommendations.
- [205] There are some similarities between the reviews conducted by the Dutch central bank and the APRA prudential inquiry into CBA. They both involve, centrally, the regulation of culture. There are also key distinctions.
- The first distinction is the Dutch reliance of organisational psychologists rather than bankers, economists or lawyers to conduct the review. Given the somewhat illusive nature of culture and culture assessment, engagement with professionals' expert in the area has merit.
 - The second distinction is that the APRA inquiry arose only after significant consumer loss, misconduct and damage had occurred, rather than with a view to preventing it.
 - The third distinction is that the APRA inquiry was undertaken within the normal processes of APRA. The Dutch Model crucial involved the establishment of a new, separate section within the DNB.
- [206] APRA currently maintain a Governance, Culture and Remuneration Division. This division has existed for a number of years and operates within the normal APRA framework. It would not be an appropriate vehicle for the conduct of regular Culture Reviews.
- [207] The Union believes that an obligation to establish a new Culture Review Section within APRA empowered to conduct regular Culture Reviews of the kind undertaken in the Netherlands DNB should be imposed on APRA.

Proposals for consideration

Item 10 That the Commission should consider what improvements to the law to protect whistleblowers in financial institutions are warranted.

Item 11 That the Commission should consider whether Boards of Directors of Banks should be required to include employees, consumer or other stakeholder representatives.

Item 12 That the Commission consider whether banks should be required to establish a Culture Oversight Committee which reports to the Board of Directors and comprises consumer, union and management representation.

Item 13 That the Commission consider requiring that APRA establish a new Culture Review Section empowered to conduct regular Culture Reviews of the kind undertaken in the Netherlands DNB.

8. The culture within the regulators.

- [208] The Union's submission on the conduct of APRA and ASIC are informed not just by the evidence of the first four rounds of hearing but also particularly the fifth round.
- [209] The interim report starts with the premise that central issues responsible for the conduct identified are cultural within the banks, rather than the terms of the law. For reasons set out elsewhere in their submissions the Union agrees with this position. Most of the conduct identified was contrary to the current law. That does not imply the law is perfect – the Union agrees with the observation of the Interim Report that current law and regulations are overly complex.
- [210] However, as is also identified in the interim report, the question that then arises is:
- If the conduct was contrary to law, why did the regulators fail to enforce the law?*
- [211] Standard regulatory policy around enforcement, based on the Braithwaite pyramid or similar theory, are well established. They rely on the conceit that a relatively co-operative approach should be starting point of regulation, and stronger and more punitive steps should only be taken as the co-operative approach fails.
- [212] While the relative weight placed on each stage up the pyramid may vary, a regulatory model which essentially acts as though it does not possess its strongest and most forceful tools, fails. With few, limited exceptions, neither APRA nor ASIC took effective, prosecutorial action against any significant financial services entity in the period from 2008.
- [213] The cultural problems revealed in the evidence before the Royal Commission between APRA and ASIC appear distinct.
- [214] APRA, in the respectful submission of the Union, appears to perceive the prudential risk as limited to substantial, or imminent risk. Ongoing cultural failure, such as the fee for no service issues, amount to significant prudential risk. Aside from the action against CBA, APRA has focused more on reinforcing the strength (and with it the hubris of the banks) rather than addressing such issues.
- [215] APRA's testimony in Round 5, in particular, also it raise serious doubts about APRA's ability to critically assess the behaviour of regulated superannuation entities.
-

- Ms Rowell, in response to Counsel Assisting's inquiry regarding APRA's view of NULIS's conduct, stated that "I would say we would have a view that – that they (NULIS) have operated reasonably soundly on – in a general sense".³⁰
 - APRA also had not specific plans to investigate contravention of the sole purpose test in fee-for-no-service allegations are not providing a service, and were instead monitoring ASIC's investigation – even though ASIC does not have responsibility for compliance with the sole purpose test.³¹
 - APRA did not take enforcement action notwithstanding thousands of breaches of MySuper requirements by Colonial, which were to be rectified "in the short term" but were not remedied for over three years.³²
 - APRA considered Colonial's misleading letter and call script designed to avoid transferring members to MySuper products were acceptable.³³
 - APRA did not agree with the proposition that paying commissions was not in the members' best interest.³⁴
 - APRA rejected the proposition that it would be unacceptable to the regulator for misleading information to be provided to members.³⁵
- [216] ASIC, on the other hand, simply appears timid and gun shy. The Union identifies two examples of behaviour which are reflective of an extraordinarily compliant regulator, which poses no material threat to sophisticated organisations such as the banks.
- [217] The first of these was the enforcement of the changes to the unfair contract laws. These changes were given a twelve-month lead in period, after which time each of the banks was required to be compliant. ASIC essentially took no action to enquire of the banks around their compliance until the end of the twelve months and then sought to enforce a transitional period after that.
- [218] The effect of the regulator's conduct in this example was to subvert the clear terms of the legislation which required each of the banks to be compliant. A transitional period was built into the terms of the legislation. Had ASIC clearly indicated to banks that, as at the implementation date they would assess the standard form contracts against the law and take action against any bank that was in breach, it seems inevitable that the banks would have ensured that they were compliant by the implementation date, rather than seeking to negotiate on the terms of their contract with ASIC at that time as occurred.
- [219] The second example is around ASIC's engagement with ANZ over the sale of superannuation through its A-Z review. The evidence before the Commission was that ASIC effectively permitted ANZ to continue conduct ASIC believed was contrary to law for over two years. At one point ASIC threatened to commence proceedings within twenty four hours if ANZ did not make admissions. The evidence of Mr Mullaly from ASIC was:
- Hodge Now, so that I understand, at this stage ASIC has said in writing to ANZ we're going to commence a proceeding on 15 May 2017?
- Mullaly Yes
- Hodge It hasn't been qualified or conditional in any way, the statement that was made to ANZ?
- Mullaly Not that I'm aware of, no.
- Hodge You're saying what ASIC was actually looking for was for ANZ to say, "We're prepared to give an enforceable undertaking"?
- Mullaly We're looking for a response from ANZ, and I think it shows that when the group general counsel starts engaging in the process, we've got their attention.
- Hodge You've got their attention. Is that honestly what you regard as a successful application of the regulatory process?
- Mullaly I'm not sure what you mean.
- Hodge Having told them that you were going to commence on 15 May 2017, you then didn't commence on 15 May 2017?
- Mullaly No, we haven't commenced at all against ANZ.
- Hodge And why did you not commence on 15 May, as you had said you would?
- Mullaly Because we had been contacted by ANZ who indicated they wanted to engage in the process of resolving the matter, and – at the – at the very – I mean, the focus of this was to stop the conduct. We wanted the conduct to stop. And that's what happened. We were able to achieve that. We were able to achieve it in a very timely way without having to go to court.

³⁰ Royal Commission Hearings Transcript, P-5174, lines 9-10.

³¹ Ibid P-5181 line 6 to P-5182 line 11.

³² Ibid P-5185 line 36 to P-5190 line 2.

³³ Ibid P-5191-92.

³⁴ Ibid P-5194 line 15 to P-5195 line 25.

³⁵ Ibid P-5196 lines 4 to 36.

- [220] ASIC's willingness to make a threat and not carry it through would lead any reasonable person, and certainly any sophisticated bank, to the conclusion that ASIC's threats were not something to be concerned about.
- [221] Such exchanges are identified because they are symptomatic of cultural failure. While the Union supports the regulator being better funded, and having a greater array of regulatory tools, it is clear that the absence of such things was not the sole cause of ASIC's failure to act against ANZ.
- [222] In the same way as the repeated reviews of banks over the period since the Wallis Enquiry, there has been numerous reviews that have identified that ASIC and APRA have failed to take strong, proactive action against financial services entities. There has been a consistent finding in the reviews that the regulators have too cosy, too timid and to unwilling to take the banks on.
- [223] As with the cultural problems within the banks there is no simple or quick solution to these issues. There needs to be a program culture assessment and genuine reform.
- [224] The Union believes that the Commission should consider recommending the establishment of a framework to undertake a culture review of both ASIC and APRA. Such a review may seek to rely on the expertise of other Australian regulators, Directors of Public Prosecution and international regulator experience. The process should seek to identify how to achieve sustained cultural reform within each of the regulators, including through organisational restructure, reallocation of functions or regular reporting processes.

Proposals for consideration

Item 14 That the Commission consider recommending the establishment of a framework to undertake a culture review of both ASIC and APRA.

9. A Financial Services Code is needed to simplify the law

- [225] The Interim Report rightly observes that almost all the matters of concern identified in the hearings was contrary to current law.
- [226] This observation, while important, does not lead to the conclusion that the current law and regulatory framework is correct.
- [227] The Union submits that the current framework is flawed and should be the subject of significant overhaul. This is not a submission for the addition of any new layer of regulation. It is to the contrary; there are currently too many layers of regulation.
- [228] The Union does not underestimate the complexity of the financial services sector. Changes to the regulation governing the sector should not be undertaken lightly or with undue haste. It is a matter that would require substantial expert work.
- [229] However, the current system of regulation is not serving the national interest, nor adequately regulating the banks and other entities in the financial system such as AMP. The Union makes the following observations:
- The current statutory obligations imposed upon banks are set out in the regulatory framework for the system is marked by diversity of regulators, and multiple regulatory regimes. Rather than combining to form a sophisticated and comprehensive safety net of regulation, they appear to operate to simply create a confused environment with uncertainty of the roles of regulators, and the true meaning of untested statute.
 - Conduct obligations are currently imposed upon financial institutions from a number of different statutes, including the *Corporations Act*, the *Australian Securities & Investments Commission Act*, and the *National Consumer Credit Protection Act*, among others.
 - The most fundamental conduct obligation, contained in section 912A of the *Corporations Act*, confers no standing to prosecute on consumers.
 - Important consumer protection arises not from statute or regulation, but rather through a voluntary incorporation of the Banking Code of Practice into some credit contracts. The appropriateness of this document as a foundation of consumer rights must be questioned in circumstances where it has been judicially described as more promotional material than a proper statement of contractual obligations.
 - Given the size and scope of the sector, and the amounts of money involved in transactions involving banks there is an extraordinarily limited amount of litigation, or successful claims against financial institutions. Given the extent of the grievances and poor behaviour examined by the Royal Commission, such a fact may lead to an inference that the current law and regulation is difficult to enforce, or is undesirably weighted in favour of banks.
 - This inference is compounded by observation of the behaviour of the regulators. Both ASIC and APRA are well resourced compared to most private consumers. However, they have been extraordinarily reluctant to prosecute banks to judgment, apparently in part from fear of losing. Such concern may be reflected in the series of judgments which found against APRA, and in favour of banks.
 - Consistent with the observation in the Interim Report that a further layer of regulation is unlikely to assist, the development of greater volume of regulation in the period since the Wallis Enquiry is not correlated to more

comprehensive, thorough or effective regulation. Rather, it has created unnecessary complexity, and uncertainty around the legal obligations that exist.

- In the context of an area in which there is already asymmetry of resources and knowledge, an overly complex and difficult regulatory regime entrenches the imbalance in favour of banks.

9.1. A Financial Services Code should be recommended

[230] The Union submits that the Commission should recommend the establishment of a process for a review of the legal framework of the conduct regulation of banks with a goal of establishing a Financial Services Code. The code should consolidate (and improve on) the current conduct regulation, and also incorporate existing significant self-regulation pieces such as the Code of Banking Practice.

[231] The Union further submits that the Commission recommend that such code should have the following features.

9.1.1. The Code should simplify the system of regulation.

[232] The Union agrees with the Interim Report that:

The existing law has rightly been described, in at least some respects, as labyrinthine and overly detailed. In the blizzard of provisions, it is too easy to lose sight of those simple ideas that must inform the conduct of financial services entities.

[233] The problem with the current regulatory environment is not an absence of regulation. To the contrary it is that the regulation is, at times, piecemeal and too complex. It has evolved, over the last 25 years, on the back of countless enquiries, recommendations for change and political compromise.

[234] Such evolutionary change is unremarkable. However, a feature of it is the need for periodic resets.

9.1.2. The Code should seek to be based on clear principles such as the Commission's "very simple ideas"

[235] During the third round of hearings, on Small and Medium Enterprises, the Royal Commissioner observed that there were a small number of "readily grasped ideas" that provide the foundation of the conduct regulation in the sector. These ideas were restated as "very simple ideas" in the Interim Report.

[236] The ideas are:

- Obey the law.
- Do not mislead or deceive.
- Be fair.
- Provide services that are fit for purpose.
- Deliver services with reasonable care and skill.
- When acting for another, act in the best interests of that other.

[237] Such basic concepts are important in setting a framework for appropriate regulation. While they inform much of the currently law, they do not, currently, apply across the board to the conduct of banks. They should. Clear and accessible guiding concepts like these should form the basis of a Financial Services Code.

[238] In making this submission the Union is not asserting that changes to the regulation is simple. Similarly, the Union does not submit that the regulation should be "principles based" as opposed to rule based with prescriptive obligations. Pure principles-based regulation which focuses on outcomes requires a regulator with far greater capacity and willingness to enforce the law than currently exists.

[239] Rather, the Financial Services Code, like the current legal framework, should provide a combination of rule based prescriptive obligations underpinned by clear principles.

9.1.3. The Code should include Community Service Obligations

[240] A common feature of the discussion around why there has been a loss of trust and connection to the community has been a disconnect between the values each institution espouses and the manner in which they treat customers and the community.. A number of the important elements of the value statements from each of the banks, and the Code of Banking Practice reflect the crucial role that banks play to communities, particularly rural and remote communities.

[241] The Code should incorporate Community Service Obligations including obligations for processes around branch closures.

9.1.4. The Code should confer rule making power on the regulator

[242] Under a number of provisions of the Corporations Act, ASIC has power to effectively create or modify or omit provisions of the Corporations Act. Four sections apply in connection with financial services – s.926A which relates to the licensing of financial services providers, s.951 which relates to financial services disclosures, s.992B which relates to other provisions re financial products and financial services, and s.1020F which relates to financial product disclosure.

[243] By way of example, Part 7.8 of the Corporations Act deals with “other provisions re financial products and financial services”. Section 980A provides that:

This Part contains:

- (a) *provisions (see Divisions 2 to 7) relating to conduct etc. of financial services licensees; and*
- (b) *miscellaneous provisions (see Division 8) relating to other conduct connected with financial products and financial services.*

It does not deal with financial product disclosure (which is dealt with in Part 7.9).

[244] Section s.992B provides:

Exemptions and modifications by ASIC

(1) ASIC may:

- (a) *exempt a person or class of persons from all or specified provisions of this Part; or*
- (b) *exempt a financial product or class of financial products from all or specified provisions of this Part; or*
- (c) *declare that this Part applies in relation to a person or a financial product, or a class of persons or financial products, as if specified provisions of this Part were omitted, modified or varied as specified in the declaration.*

[245] The power in s.992B is clearly very wide. It permits the effective amendment of the Act. While this power is wider than in other jurisdictions, comparable provisions exist in other jurisdictions. For example, Chapter 1 of Part 9A of the *Financial Services and Markets Act 2000* (UK) deals with rule making. Section 137A provides:

The FCA's general rules

(1) *The FCA may make such rules applying to authorised persons—*

- (a) *with respect to the carrying on by them of regulated activities, or*
- (b) *with respect to the carrying on by them of activities which are not regulated activities,*

as appear to the FCA to be necessary or expedient for the purpose of advancing one or more of its operational objectives.

[246] ASIC's use of these powers to date has generally focused on permitting conduct that may otherwise have been unlawful. There have been some instances where the power has been used to extend the reach of the law.

[247] The Union submits that a Financial Services Code should include capacity for enforceable rule making by the regulator. Such rules could play at least two important functions:

- Firstly, as a substitute for self-regulations. The Banking Code of Practice should have legal force on its terms, rather than through the circuitous route of incorporation into contracts or subject to the limits of FOS. Moreover, a regulator is better placed than banks to consult with relevant stakeholders and promulgate such regulation.
- Secondly, to address gaps in the law, and changes to systems and practices. The provision of financial services is fast changing and complex. There will always be gaps and loopholes, and entities that seek to exploit the gaps and loopholes. Enforceable rules can address this issue.

[248] Such a delegation of power must be done carefully, and the regulator should be required to exercise such powers with caution and discretion. However, safeguards, including as to oversight, disallowance, and sunsets can be incorporated into the power.

9.1.5. The Code should establish a standards framework for finance sector workers

[249] The Union submits that one of the crucial outcomes of the Royal Commission should be a focus on increased professionalisation of workers in the sector. This issue is dealt with in detail above under the heading Professionalisation at part 6.2.

[250] A corollary of professionalisation is the establishment of disciplinary processes, and a capacity to exclude individuals from work in the industry.

[251] Such a process, limited to financial advisers, is currently underway as a result of the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* and FASEA. The significant issues (particularly the CPD expectation that will disproportionately impact women and part time workers) in the FASEA framework do not diminish the importance of this process of professionalisation to building a better, and more trusted financial advice industry.

- [252] The Union believes such a process should be extended.
- [253] A standards framework should also incorporate and extend the reach of the Banking Executive Accountability Regime (BEAR). The current formulation of BEAR, which is essentially limited to a few senior executives and deals primarily with matters of prudential standing and reputation of banks³⁶ should be replaced with a Senior Executive Accountability Scheme with similar obligations and processes as the UK Senior Managers Regime.
- [254] In general terms the Union submits a three tiered framework should be included in the Code. Key features of the framework should be:
- **Tier 1** – All sector workers who have a capacity to effect customer outcomes
 - Tier 1 workers should meet a “fit and proper” person test.
 - The framework would also provide for training standards and continuing education obligations.
 - **Tier 2** – All sector workers who have a capacity to substantial impact on customer outcomes
 - Tier 2 workers would include branch managers and more senior managers, financial advisers, mortgage brokers, home loan and lending specialists, business bankers, financial product designers, and other comparable roles. It would also include back office functions such as those compliance, IT functions, those responsible for product design or complaints processes.
 - These workers would be subject to a licensing regime, which would include within it minimum education and qualification requirements, continuing education obligations, professional ethical obligations and disciplinary processes.
 - FASEA would be incorporated into this tier.
 - **Tier 3** – Senior Managers and Executives with significant power or influence over decisions and culture within banks.
 - Tier 3 workers would be subject to a registration regime, with substantial personal obligations.
 - Obligations should be similar to those imposed under the UK Senior Managers Regime including a requirement of pre-approval by the regulator, identification of areas of responsibility and system of individual accountability for actions taken within the areas of responsibility.
 - Wilful or significant breaches of obligations should expose Tier 3 registered employees to potential criminal sanction.
 - BEAR would be incorporated into this tier.

9.1.6. The Code should prohibit or substantially limit variable pay

- [255] As is identified in the Interim Report, variable pay plays a central role in misaligned incentives and poor customer outcomes.
- [256] The regulation in FOFA, and as a result of the Sedgwick Review is far too limited. The Code should prohibit variable pay for all workers in the sector.
- [257] The complexity attendant on this submission is noted, particularly to ensure that it is not simply used as a mechanism to reduce employee pay. We refer to the discussion at part 4.4.

9.1.7. The Code should establish a Culture Oversight Division of a regulator

- [258] Given the central role culture plays in avoiding misconduct and prudential risk, the important role of regulators in promoting and monitoring good culture should be included within the Code.
- [259] The culture oversight division would be empowered to investigate and review the culture within banks and take steps to ensure they meet minimum standards of good culture. Processes for culture improvement through enforceable undertakings should be mandated.
- [260] As discussed above at part 9.6 the Union supports the introduction of a new distinct Culture Oversight Division of a regulator. The role and function of such a Division should exist within the Code.

9.1.8. The Code should provide better access for consumers to seek remedies

- [261] A feature of the current law is the difficulty consumers have in obtaining relief against bad decisions of banks. The current system is a somewhat confused combination of semi-formal processes, such as FOS/AFCA which have limited utility in precedent setting, and litigation generally reliant on very general obligations in the ASIC Act.
- [262] The Union submits that private litigation by aggrieved consumers is a very important element of holding banks and regulators to account for their conduct, and ensuring that the threat of litigation has the appropriate deterrent effect.

³⁶ Wayne Byres, “Beyond the BEAR Necessities” (speech delivered at UNSW Centre for Law Markets and Regulation Seminar, Sydney, 2 May 2018) <https://www.apra.gov.au/media-centre/speeches/beyond-bear-necessities>.

[263] The Code should increase the capacity of consumers to seek recourse for damage occasioned to them as a result of conduct of financial institutions in breach of their obligations.

9.1.9. The Code should enhance the regulators enforcement powers

[264] While there remains some doubt as to whether the regulators current enforcement powers are inadequate, or just not fully exercised, it is clear that any regulation should contain clear, comprehensive and tough enforcement powers. Such powers should include:

- Greater capacity to issue banning orders, or other sanction against individuals and entities who breach obligations;
- Penalty ranges which, when ordered, would act as a genuine deterrent against poor conduct. Such ranges should be based on multiples of the damage or loss suffered as a result of the breach;
- Capacity to order disgorgement; and
- Capacity for penalty orders to be paid to the regulator, to fund enforcement and regulatory functions.

9.1.10. The Code should extend the operation of the criminal law in financial services

[265] While the current regulation contains some capacity for criminal prosecution, the Code should extend the operation of the criminal law. Potential criminal sanction against those that make significant decisions on behalf of banks and set bank culture is likely to act as a more significant incentive than where breaches are simply addressed by remediation and a negotiated enforceable undertaking.

[266] Specific criminal provision for serious and wilful breaches of obligations by senior executives and entities that breach obligations should be introduced.

[267] The Union does not believe that specific provisions are required for more junior employees where more general crimes, such as theft, fraud and obtaining a financial advantage by deception are appropriate.

Proposals for consideration

Item 15 That the Commission consider the establishment of a review of the legal framework of the conduct regulation of banks with a goal of establishing a comprehensive Financial Services Code.

Such code would:

- be based on clear principles such as the Commission's "very simple ideas"
 - simplify the system of regulation
 - include Community Service Obligations
 - confer Rule Making power on the regulator
 - establish a standards framework for finance sector workers
 - establish a Culture Oversight Division of a regulator
 - prohibit or substantially limit variable/conflicted pay
 - provide better access for consumers to seek remedies
 - enhance the regulators enforcement powers
 - extend the operation of the criminal law in financial services
-

Appendix One - Responses to questions in Chapter 10 of the Interim Report

9.1.10.1. Consumer lending		
	Question	FSU response
1(a)	What duties does an intermediary owe to a borrower?	While it may vary depending on specific circumstances, in general intermediaries owe borrowers very limited duties and probably no more than to only recommend products that are "not unsuitable".
1(b)	What duties should an intermediary owe to a borrower?	Intermediaries in the mortgage broking sector should have obligations similar to those imposed on financial advisers in connection with personal advice.
1(c)	How can entities' systems be improved to detect and prevent breaches of responsible lending obligations by intermediaries?	Financial Services Entities' (FSE) systems can be improved through: <ul style="list-style-type: none"> • greater professionalisation of employees; • elimination of conflicted remuneration and targets for employees in engagement with intermediaries; • better processes for feedback on systemic risks; • genuine whistleblower protections; • introduction of sector wide skills and classification regime; • reduction in effective sub-contracting of information gathering and verification functions to intermediaries.
1(d)	Are 'introducer' programs compatible with responsible lending obligations?	Such schemes are incompatible with responsible lending arrangements and should be prohibited.
1(e)	Do broker contracts, as they stood at the time of the hearings, meet the statutory requirement imposed by Section 912A of the Corporations Act 2001 (Cth) to have arrangements in place to manage conflicts of interests? Do broker contracts, as now made, meet those requirements?	The Union makes no submission on this question.
1(f)	What should be disclosed to borrowers about an intermediary's obligations to the lender and to the borrower?	The nature of intermediary and broker relationships is that they are vulnerable to perceived or actual conflicts of interest. If a relationship with a conflict cannot be avoided, the only appropriate step is to manage it including by full and frank disclosure of all material facts and circumstances. This should include an obligation to ensure that the consumer is advised of any obligations the intermediary may owe to the lender, and the method and quantum or remuneration arising from the transaction.
1(g)	What should be disclosed to borrowers about an intermediary's remuneration?	

1(h)	What steps, consistent with responsible lending obligations, should a lender take to verify a borrower's expenses?	HEM should not be relied upon. Lenders should take all reasonably available steps including customer's estimates, obtaining copies of bank statements (and comparing them). Where such information is not available or insufficient to satisfy the lender, the lender should conduct interviews with the customer. Records showing expenditure less than metrics like HEM may be relevant as indicative flags showing further investigation is required.
1(i)	Do the processes used by lenders, at the time of the hearings, to verify borrowers' expenses meet the requirements of the NCCP Act? Do the processes now used meet those requirements?	Beyond the observation that HEM is not appropriate as a default position, the Union does not believe that it is able to make a submission that will assist the Commission on this issue.
1(j)	Should the HEM continue to be used as a benchmark for borrowers' living expenses?	No. The Union repeats its answer to 1(h) above.
1(k)	Is the offer of a credit limit increase, where the customer has consented to receive such marketing, consistent with the NCCP Act obligation not to provide credit that is not unsuitable for the customer, having regard to their requirements and objectives?	The Union does not believe that an FSE can be satisfied that it has met its obligations if it issues such correspondence, absent any other assessment or verification.
1(l)	Is the offer of a credit limit increase based only on information held by the bank about a customer a breach of the NCCP Act obligation to take reasonable steps to verify the consumer's financial situation?	The Union believes that an FSE is required to take action beyond simply assessing material it holds in order to comply with NCCP obligations.
1(m)	When an employee or intermediary is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?	The Union does not believe that the fact that a licensee has concluded that an employee or intermediary engaged in fraud or misconduct warrants all customers being advised of that fact. The impact on the employee or intermediary of such communication must be considered. A conclusion reached by a licensee may be incorrect, or may be of misconduct that is not sufficiently serious to justify disclosure. The Union supports disclosure to customers where the misconduct has had an adverse impact on the customer. The Union also proposes the establishment of a professionalisation regime that would deal with disciplinary matters in a transparent and fair way. It may be an appropriate remedy determined by such a process that all customers are advised of conduct.
1(n)	When an employee or intermediary is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidence of misconduct?	In the event the licensee has concluded that an employee has engaged in fraud or misconduct sufficient to justify termination, the licensee should review all relevant files.
1(o)	Are certain types of add-on insurance, by their nature, poor value propositions for customers?	Evidence before the Commission shows the existence of junk insurance. The Union believes that the law should promote an ethical, customer centric finance sector. Such products are inconsistent with this goal. Further, their sale is reflective of poor culture within the FTE which is focused on sales and profit, not customer interest.

9.1.10.2. Financial Advice		
	Question	FSU Response
2(a)	How do advice licensees encourage advisers aligned with the licensee to provide sound advice (including, where appropriate, telling the client to do nothing)?	The primary mechanisms available to advice licensees are remuneration structures and cultural expectation within the licensee. More generally, promotion of professionalisation within the industry, with the licensee promoting the attendant ethical obligations.
2(b)	Can conflicts of interest and duty be managed?	Yes. Most conflicts can be managed.
2(c)	How far can, and how far should, there be separation between providing financial advice and manufacture or sale of financial products?	<p>Vertical integration is but one of the many conflicts at play. Licensees may enter into contractual arrangements that create similar (or worse) conflicts than vertical integration. Elimination of vertical integration does not solve problems. The solutions include remuneration structures and improved culture (including professionalisation culture).</p> <p>Regulatory changes to eliminate exemptions from FOFA (including grandfathered commissions) and to further promote full disclosure and more open APLs should be recommended.</p> <p>Measures, such as an obligation to prepare a written demonstration that the product is better for the client than comparable third-party products should be rejected. Overly prescriptive regulation of this kind undermines the primary obligation to act in the best interest of the customer.</p>
2(d)	Should financial product manufacturers be permitted to provide financial advice? <ul style="list-style-type: none"> - At all? - To retail clients? 	
2(e)	Should financial product sellers be permitted to provide financial advice? <ul style="list-style-type: none"> - At all? - To retail clients? 	
2(f)	Should an authorised representative be permitted to recommend a financial product manufactured or sold by the advice licensee (or a related entity of the licensee) with which the representative is associated? <ul style="list-style-type: none"> - At all? - Only on written demonstration that the product is better for the client than comparable third-party products? 	
2(g)	Should the grandfathered exceptions to the conflicted remuneration provisions now be changed? <ul style="list-style-type: none"> - How far should they be changed? - If they should be changed, when should the change or changes take effect? 	
2(h)	Should the life risk exceptions to the conflicted remuneration provisions now be changed? <ul style="list-style-type: none"> - How far should they be changed? 	<p>Yes. Both sets of exceptions should be eliminated, as part of a process of eliminating conflicted remuneration throughout the sector.</p> <p>Such changes should be part of a process which also ensures that the cost of the elimination of conflicted remuneration measures is not borne by the adviser.</p>

	- If they should be changed, when should the change or changes take effect?	
2(i)	Should any part of the remuneration of financial advisers be dependent on value or volume of sales?	No. Such practices create undesirable misaligned incentives.
2(j)	Should all financial advisers (including those who now act as authorised representatives of an advice licensee) be licensed by ASIC?	Yes. Financial advisers, mortgage brokers and others with a capacity to significantly impact customer outcomes should be subject to a licensing regime administered by a regulator. Subject to an overhaul of regulator responsibilities, ASIC is the appropriate regulator.
2(k)	Are current product and interests disclosure requirements sufficient to allow customers to make fully informed choices?	The Union makes no submission on this question.
2(l)	Should the period after which a client must positively review an ongoing fee arrangement be reduced from two years to one?	The Union makes no submission on this question.
2(m)	Should platform operators be permitted to deduct fees on behalf of licensees without the express authority of the client of the platform operator?	The Union makes no submission on this question.
2(n)	When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?	The Union does not believe that the fact that a licensee has concluded that an employee or authorised representative (AR) engaged in fraud or misconduct warrants all customers being advised of that fact. The impact on the employee or AR of such communication must be considered. A conclusion reached by a licensee may be incorrect, or may be of misconduct that is not sufficiently serious to justify disclosure. The Union supports disclosure to customers where the misconduct has had an adverse impact on the customer. The Union also proposes the establishment of a professionalisation regime which would require such employees or ARs to hold licences and would provide for disciplinary matters to be addressed in a transparent and fair way. It may be an appropriate remedy determined by such a process that all customers are advised of conduct.
2(o)	When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidents of misconduct?	In the event the licensee has concluded that an employee or AR has engaged in fraud or misconduct sufficient to justify termination, the licensee should review all relevant files.
2(p)	Should negotiation and settlement be the main approach for a regulator?	No. Appropriate regulator conduct, as set out in models like the Braithwaite pyramid, requires regulators to act on a variety of manners. Negotiation and settlement should not be the default of main methods of operation.
2(q)	Should there be greater focus on general deterrence in regulatory strategy?	Yes. The failure of the regulators has placed insufficient focus on the deterrent impact of prosecution.

2(r)	Should a component of enforceable undertakings be the acknowledgment of specific wrongs?	The current practice of negotiated enforceable undertakings is not appropriate.
2(s)	Should self-reported breaches of the Corporations Act generally attract legal sanctions unless some special circumstances exist?	The Union makes no submission on this question.
2(t)	Should banning orders continue to be preferred to civil penalty proceedings in case of licensee/adviser misconduct?	The Union believes that a comprehensive professionalisation regime that would include suspension and cancellation of licences as primary actions in respect of adviser misconduct. Civil penalty proceedings may be appropriate in some cases.
2(u)	Should ASIC make more use of its Section 916G power to give a licensee information about a person who is or will be a representative of the licensee?	The Union believes that a comprehensive professionalisation regime that includes suspension and cancellation of licences for individuals is warranted. Such a scheme would potentially include a capacity for future licensees to obtain relevant material about potential advisers.
2(v)	Does Section 916G need to be amended so as to be more effective?	
9.1.10.3. Small and medium enterprises		
	Question	FSU response
3.1(a)	What inquiries should a diligent and prudent banker make when deciding whether to lend to an SME?	The Union makes no submission on this question.
3.1(b)	Does 'forming an opinion about the customer's ability to repay the loan facility' as required by Clause 51 of the 2019 Code involve bringing critical analysis to the cash flow forecasts and other business plan documents presented by customers?	The Union makes no submission on this question.
3.1(c)	If so, what level of analysis is acceptable?	The Union makes no submission on this question.
3.1(d)	Is it enough that the lender satisfy itself the borrower can repay the loan and that the business plan is not obviously flawed?	The Union makes no submission on this question.
3.1(e)	Is the standard set out in Clause 51 of the 2019 Code, which requires a bank to determine whether a customer can repay a loan based on their financial position and account conduct, a sufficient standard?	The Union makes no submission on this question.
3.2(f)	If established principles of judge-made law and statutory provisions about unconscionability would not relieve a guarantor of responsibility under a guarantee, and if, further, a bank's voluntary undertaking to a potential guarantor to exercise the care and skill of a diligent and prudent banker	The Union makes no submission on this question.

	has not been breached, are there circumstances in which the law should nevertheless hold that the guarantee may not be enforced?	
3.2(g)	What would those circumstances be?	The Union makes no submission on this question.
3.2(h)	Would they be defined by reference to what the lender did or did not do, by reference to what the guarantor was or was not told or by reference to some combination of factors of those kinds?	The Union makes no submission on this question.
3.2(i)	Is there a reason to shift the boundaries of established principles, existing law and the industry code of conduct?	The Union makes no submission on this question.
3.2(j)	If the guarantor is a volunteer, and if further, the guarantor is aware of the nature and extent of the obligations undertaken by executing the guarantee, is there some additional requirement that must be shown to have been met before the guarantee was given if it is to be an enforceable undertaking?	The Union makes no submission on this question.
3.2(k)	Should lenders give potential guarantors more information about the borrower or the proposed loan? What information could be given with respect to a new business?	The Union makes no submission on this question.
3.3(l)	Should AFCA adopt FOS's approach of putting the borrower back in the position they would be in if the loan had not been made, but not awarding compensation for losses or harm caused?	The Union makes no submission on this question.
3.3(m)	Are there circumstances in which AFCA should waive a customer's debt?	The Union makes no submission on this question.
9.1.10.4. Agricultural lending		
	Question	FSU response
4(a)	How are borrowers and lenders in the agricultural sector to deal with the consequences of uncontrollable and unforeseen external events?	There needs to be a better alignment of expectation around such events. From the perspective of lenders, this question requires improvements to focus on an ethical customer centric culture.
4(b)	Does the 2019 Banking Code of Practice provide adequate protection for agricultural businesses? If not, what changes should be made?	The Code does not provide adequate protection. Further the Code, even if varied, is not the appropriate vehicle to provide such protection. The Union supports the development of a comprehensive Financial Services Code that provides clear protections and rights of redress for customers including agricultural businesses.

4(c)	<p>How, and by whom should property offered as security by agricultural businesses be valued?</p> <ul style="list-style-type: none"> - Is market value the appropriate basis? - Should the possibility, or probability of external shocks be taken to account in fixing lending value? How? - Should the time for realisation of security be taken to account in fixing value? How? - Is the possibility, or probability of external shock sufficiently met by fixing the loan-to-value ratio? - If prudential standard APS 220 is amended to require internal appraisals to be independent of loan origination, loan processing and loan decision processes, when should that amendment take effect? 	The Union makes no submission on this question.
4(d)	Should distressed agricultural loans be managed only by experienced agricultural bankers?	<p>Yes.</p> <p>The Union supports measures to increase professionalisation in the industry, including the development of credentials for specialist areas of banking practices such as agricultural banking.</p>
4(e)	Do asset management managers need more information (such as the cost to the lender of holding the loan) to make informed commercial decisions about management of distressed agricultural loans?	The Union makes no submission on this question.
4(f)	<p>Are there circumstances in which default interest should not be charged?</p> <ul style="list-style-type: none"> - In particular, should default interest be charged to borrowers in drought-declared areas? - If it should not, how, and where, is that policy to be expressed? - Should the policy apply to other natural disasters? 	The Union makes no submission on this question.
4(g)	In what circumstances may a lender appoint an external administrator (such as a receiver, receiver and manager or agent of the mortgagee in possession)? Is appointment of an external administrator to be the enforcement measure of last resort?	The Union makes no submission on this question.
4(h)	<p>Having regard to the answers given to the preceding questions:</p> <ul style="list-style-type: none"> - Is any regulatory change necessary or desirable? - Is any change to the 2019 Code necessary or desirable? 	The Union makes no submission on this question.
4(i)	<p>Should there be a national system for farm debt mediation?</p> <ul style="list-style-type: none"> - If so, what model should be adopted? 	The Union makes no submission on this question.

4(j)	Should lenders be required to offer farm debt mediation as soon as an agricultural loan is impaired (in the sense of being more than 90 days past due)?	The Union makes no submission on this question.
<p>9.1.10.5. Remote Communities</p> <p>The questions concern how financial services entities respond to the financial needs and vulnerabilities that can be experienced by Indigenous Australians, in particular those living in remote communities.</p>		
	Question	FSU response
5(a)	Do financial services entities have in place appropriate policies and procedures to assist Aboriginal and Torres Strait Islander people: <ul style="list-style-type: none"> - to overcome obstacles associated with the geographical remoteness? - to address the cultural barriers to engagement that some face? - to address the linguistic barriers to engagement that some face? - to address the obstacles posed for some by their level of financial literacy? 	Financial services entities (FSE) do not have appropriate policies, identification requirements or training at present. Such measures should be improved, as part of cultural change including by: <ul style="list-style-type: none"> • the employment of greater numbers on indigenous people into the sector, with less focus on short term employment through traineeships, • training in services for indigenous customers should be included within the development of professionalisation training programs; • introduction of community obligations focused on ATSI people should be included in the Financial Services Code.
5(b)	Are banks' identification requirements appropriate for Aboriginal and Torres Strait Islander customers? <ul style="list-style-type: none"> - If they are, are those policies sufficiently understood and applied by staff? 	
5(c)	Should more banks have a telephone service staffed by employees with specific training in assisting Indigenous consumers?	
5(d)	Do banks take sufficient steps to promote the availability of fee-free accounts to eligible customers?	No they do not. Sales culture remains dominant. FSEs should be obliged to act in the best interest of the customer.
5(e)	If a customer seeking to open a basic bank account has no substantial income other than Centrelink benefits, should a bank ever try to sell the customer another form of account?	No. FSE should be obliged to act in the best interest of the customer.
5(f)	Should informal overdrafts be allowed on a bank account if credits to the account are only, or are substantially, by payment of Centrelink benefits?	No. FSE should be obliged to act in the best interest of the customer.
5(g)	Should the application of the 90% arrangements provided by the Code of Operation be at the discretion of the bank, the customer or both? Or should banks apply these arrangements automatically?	The Union makes no submission on this question.

5(h)	If direct debits are dishonoured for want of sufficient funds, are there cases in which dishonour fees should not be charged?	The Union makes no submission on this question.
5(i)	Are funeral policies, or particular kinds of funeral policy, financial products warranting intervention by ASIC in the exercise of its product intervention powers?	The Union believes that the law should promote an ethical, customer centric finance sector. The evidence before the Commission was that some products of this kind are inconsistent with this goal. They should be prohibited including by ASIC using its product intervention powers. Further, their sale is reflective of poor culture within the FTE which is focused on sales and profit, not customer interest.
5(j)	Should all form of funeral insurance be financial products for the purposes of Chapter 7 of the Corporations Act 2001 (Cth)?	The Union makes no submission on this question.
5(k)	Should all forms of funeral insurance be covered by Part 2 Division 2 of the Australian Securities and Investments Commission Act 2001 (Cth)?	The Union makes no submission on this question.
5(l)	Should it be unlawful to sell funeral insurance for persons under 18 years?	The Union makes no submission on this question, but yes.
9.1.10.6. Regulation and the regulators		
	Question	FSU response
6(a)	Is the law governing financial services entities and their conduct too complicated? - Does it impede effective conduct risk management? - Does it impede effective regulatory enforcement?	Yes. The current law effective conduct risk management and effective regulatory enforcement. The Union supports the development of Financial Services Code. Such a code should simply the current regulatory system, and not add further layers.
6(b)	Should there be annual reviews of the regulators' performance against their mandates?	The Union identifies culture within the regulators as a key issue to be addressed. Measures such as annual reviews of the regulators' performance may assist. There should be greater oversight to ensure that the regulators are meeting their objectives. More significant measures to reform and improve the culture within the regulators are warranted.
6(c)	Is ASIC's remit too large? - If it were to be reduced, who would take over those parts of the remit that are detached? - Why would detachment be better?	The culture within ASIC is a problem in effective regulation of the sector. The Union believes that a comprehensive review to the cultural and structural problems of the regulators is required. Such a review may conclude that ASIC's remit is too large.
6(d)	Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?	The current regime is too complex. There should be a radical overhaul.

		<p>The Union does not support such a radical simplification to a purely principles-based model of regulation. Principles based models requires high level of regulator enforcement which is not currently present.</p> <p>The Union supports the development of Financial Services Code. Such a code should simply the current regulatory system, and not add further layers.</p>
6(e)	Should industry codes relating to the provision of financial services, such as the 2019 Banking Code of Practice, be recognised and applied by legislation like Part IVB of the Competition and Consumer Act 2010 (Cth)?	<p>No. The Union believes that the substantive obligations contained in the Code should form part of the general law.</p> <p>The Union does not believe that the model of industry codes is appropriate to the sector.</p> <p>The Union further believes that rather than promoting industry codes, the rule making power of ASIC (or the relevant regulator) should be raised up. Such rules could be developed in consultation with all relevant stakeholders.</p>
6(f)	Are ASIC's enforcement practices satisfactory? If not, how should they be changed?	<p>No. ASIC's enforcement strategies are manifestly unsatisfactory. They should be improved by a combination of changes to the regulatory environment, including clearer legal obligations, and a capacity for penalties to be paid to ASIC directly, and by a culture reform program.</p>
6(g)	If the recommendations of the Enforcement Review are implemented, will ASIC have enough and appropriate regulatory tools?	<p>The Union does not oppose the specific changes proposed by the Enforcement Review.</p> <p>However, the Enforcement Review continue a path of piecemeal change to regulation in the sector. Making such changes alone will not lead to material reform or improvement.</p> <p>The Commission should focus on more fundamental change, including addressing the cultural problems within ASIC and APRA.</p>
6(h)	Should ASIC's enforcement priorities change? In particular, if there is a reasonable prospect of proving contravention, should ASIC institute proceedings unless it determines that it is in the public interest not to do so?	<p>ASIC's enforcement priorities must change. However, ASIC should maintain discretion as to when to prosecute.</p> <p>Further, a more mature approach to potential losses by ASIC must be encouraged.</p>
6(i)	Are APRA's regulatory practices satisfactory? If not, how should they be changed?	<p>No. APRA's perception of prudential risk is far too narrow. Systemic conduct and culture issues represent significant prudential risk, but have been (aside from in CBA) largely ignored.</p>
6(j)	Are APRA's enforcement practices satisfactory? If not, how should they be changed?	<p>Like ASIC, APRA should be subjected to a substantial culture and organisational review.</p> <p>APRA should cease responsibility for BEAR. A Senior Executive Accountability Scheme should be established.</p>
6(k)	Does the conduct identified and criticised in this report call for reconsideration of APRA's prudential standards on governance?	<p>APRA should establish a Culture Oversight Division that proactively monitors culture in financial institutions.</p>
6(l)	Having examined the governance, culture and accountability within the CBA group, what steps (if any) can APRA take in relation to those issues in other financial services entities?	<p>APRA should establish a Culture Oversight Division that proactively monitors culture in financial institutions.</p> <p>The Culture Oversight Division should be established a independent of APRA's Governance, Culture and Remuneration Division.</p>

		The Union is concerned that rather than seeking to extend culture review functions, APRA has indicated it plans to reduce a focus in this area. The Union notes APRA undertook 5 pilot reviews and also the CBA review but Wayne Byres said in a speech on 4 September 2018 titled 'Helping to regain trust' that the pilot reviews were not 'scalable' and that reviews like the CBA could not be readily replicated.
9.1.10.7. Entities: Causes of misconduct		
	Question	FSU response
7.1	<i>Conduct risk</i>	
7.1(a)	What are banks doing to meet the danger of conduct risk?	Banks, through their sales and profit cultures, are the most significant instigator of conduct risk in the sector.
7.1(b)	What are regulators doing to meet it?	Their overconfidence and hubris, focus on tick a box compliance measures, and Taylorist management by measurement functionally reduce the likelihood of their becoming aware of conduct issues.
7.1(c)	What can banks do? What can regulators do?	
7.1(d)	What should either or both be doing?	The regulators are not doing enough. In different ways they suffer from cultural malaise that means that they are co-opted into the banks, are timid and, like the FSE's themselves, have failed to recognise how deep and unimaneal issues in the sector are. The Union refers to its Proposals for Consideration are providing a comprehensive set of ideas that would assist bankss and regulators.
7.2	Remuneration	
7.2(e)	What more should be done to implement the recommendations of the Sedgwick Review?	Rather than seeking to better implement the Sedgwick Review, the Commission should recommend the elimination of all conflicted pay. The Sedgwick Review was limited to retail bank staff, did not identify product based payments as a significant systemic risk, and did not propose the elimination of bonuses or incentive payments based on sales. The scope and recommendations of the Sedgwick Review were inadequate.
7.2(f)	Should any bank employee dealing with a customer be rewarded (whether by commission or as part of an incentive remuneration scheme) for selling the client a product of the employer? That is, should any 'customer facing employee' be paid variable remuneration?	No. Variable pay should be eliminated for all bank employees. The distinction in the question between a customer facing employee and bank employee should be rejected. A prohibition on variable pay for customer facing employees while maintaining a system of incentive pay for managers and others will achieve nothing.
7.2(g)	If the answer is either 'no' or 'some should not' what follows about incentive remuneration for managers or more senior executives? If more junior	The Union repeats its answer to 7.2(g). Variable pay should be eliminated for all bank employees.

	employees should not be remunerated in this way, why should their managers and senior executives?	
7.2(h)	Should other changes be made to the remuneration practices of banks? What would they be, and how could change be required?	<p>Yes.</p> <p>In addition to the elimination of variable pay the Union believes that the following measures should be recommended:</p> <ul style="list-style-type: none"> • Sector wide classifications • Sector wide pay bands • Improved transparency and a prohibition on contractual clauses that require employees to keep rates of pay secret • Improvements to the gender pay gap. The financial services sector continues to have the largest gender pay gap, which is exacerbated by reliance on variable pay • Introduction of sectoral industrial instruments.
7.3	The BEAR	
7.3(i)	<p>Is the Banking Executive Accountability Regime ('the BEAR') relevant to the intersections between remuneration and culture more generally than in its application to particular senior executives?</p> <ul style="list-style-type: none"> - Should the BEAR be altered? - Should the BEAR be extended in application? 	The BEAR should be replaced by a Senior Management Accountability Scheme. Under the Scheme all persons responsible for the determination and implementation of strategy and culture within financial services entities would need to be pre-approved by the regulator. The Scheme should impose personal accountability on individuals, including criminal liability for serious and wilful breaches. The scheme should be modelled on the Senior Managers Regime in operation in the United Kingdom
7.4	Intermediaries	
7.4(j)	<p>Is it desirable to prescribe that some or all of those who are not employees of banks, but deal with bank customers, must act in the interests, or the best interests, of the client?</p> <ul style="list-style-type: none"> - In particular, what duty, if any, should a mortgage broker owe to the prospective borrower? - Is value-based commission, paid to the broker by the lender, consonant with that duty? - Should an aggregator owe any duty to the borrower? - Again, are the remuneration arrangements for aggregators consonant with that duty? 	<p>Intermediaries, including mortgage brokers, who have a role that may have a substantial impact on customer outcomes should be subject to licensing as part of a professionalisation regime.</p> <p>A condition of the licence should be a set of professional obligations to act in the best interests of the customer.</p> <p>Variable pay, including value based commissions should be prohibited.</p>
7.4(k)	How is a value-based commission consistent with acting in the interests, or best interests, of the client?	They are not. They should be prohibited.
7.4(l)	Should intermediaries be subject to rules generally similar to the conflicted remuneration prohibitions applying to the provision of financial advice?	Yes. The rationale for the imposition of such obligations on financial advisers applies equally to intermediaries.

		More generally, the Union submits that intermediaries, including mortgage brokers, who have a role that may have a substantial impact on customer outcomes should be subject to licensing as part of a professionalisation regime.
7.4(m)	If some or all intermediaries should owe the customer a duty to act in that customer's interests, or best interests, is it enough to prescribe the duty and direct 'management' of conflicts between interest and duty?	No. While the imposition of obligations is necessary, the law should also prescribe behaviours which are acceptable, and which are not. For example, commission-based pay arrangements should be prohibited.
7.5	Business structures	
7.5(n)	Do the events that have happened raise any issue about business structures?	The Union makes no submission on this question.
7.5(o)	Do the events that have happened invite consideration of whether structural changes should now be made?	The Union makes no submission on this question.
7.5(p)	Do the events that have happened suggest that manufacturers of financial products should not be permitted to provide, whether by employee or authorised representative, personal financial advice in relation to products of a kind it manufactures?	Banning vertical integration is not the answer. However, vertical integration, and other contractual relationships create bias and incentives that may operate against the customer interest.
7.5(q)	More particularly, do they provoke examination of how and to what extent conflicts of interest and duty arising from the structure of the business can be managed?	The Union makes no submission on this question.
<p>9.1.10.8. Restatement of questions</p> <p>Having asked a series of questions, the Interim Report then restates some of the questions around three themes - Issues, Causes and Responses. It may be that our preferred option is to focus on these questions only.</p>		
	Question	FSU response
8.1	Issues	
8.1.1	Access	
8.1.1(a)	Do all Australians have adequate and appropriate access to banking services?	<p>No. Banking is an essential service.</p> <p>A Financial Services Code should include Customer Service Obligations including:</p> <ul style="list-style-type: none"> • obligation around branch closures; • obligation to ensure provision of finance services ;

		<ul style="list-style-type: none"> obligation to not deny service or effective service by requirements to use technology.
8.1.2	Intermediaries	
8.1.2(b)	<p>For whom do the different kinds of intermediary act?</p> <ul style="list-style-type: none"> mortgage brokers mortgage aggregators introducers financial advisers authorised representatives of Licensees point of sale sellers of loans 	They currently act in the varied interests of the bank, customer and themselves, at different points of the transaction.
8.1.2(c)	For whom should each kind of intermediary act?	Intermediaries who have a capacity to have a substantial impact on customer outcomes should be subject to a professionalising process which includes a fundamental obligation to act ethically, and in the interest of the consumer.
8.1.2(d)	<p>If intermediaries act for the consumer of a financial service</p> <ul style="list-style-type: none"> What duty do they now owe the consumer? What duty should they owe? 	
8.1.2(e)	Who is responsible for each kind of intermediary's defaults?	<p>This depends on the nature of the default.</p> <p>It should be the intermediary, and potentially the AFSL.</p> <p>The Union supports the development of a Financial Services Code which would simply and improve the current regulation. Ensuring that consumers and the regulator have standing, and clear access to remedies against those responsible for (including by a failure to oversee) breaches is crucial to improving standards and culture.</p>
8.1.2(f)	Who should be responsible?	
8.1.2(g)	How should intermediaries be remunerated?	Variable pay should be prohibited.
8.1.2(h)	Are external dispute resolution mechanisms satisfactory?	No. The Financial Services Code should improve standing and dispute mechanisms for consumers and for regulators.
8.1.2(i)	Should there be a mechanism for compensation of last resort?	The Union makes no submission on this question.
8.1.3	Responsible lending	
8.1.3(j)	<p>Consumers</p> <ul style="list-style-type: none"> Should the test to be applied by the lender remain 'not unsuitable'? How should the lender assess suitability? Should there be some different rule for some home loans? 	<p>No. It is too low a threshold, and permits promotion of sales over consumer interest.</p> <p>The Commission should recommend the introduction of a Financial Services Code based on the "very simple ideas" identified by the Commission. Those ideas were:</p> <ul style="list-style-type: none"> Obey the law. Do not mislead or deceive. Be fair.

		<ul style="list-style-type: none"> • Provide services that are fit for purpose. • Deliver services with reasonable care and skill. • When acting for another, act in the best interests of that other. <p>Such a code would apply generally to the sector, including home loans and impose a more substantial obligation than “not unsuitable”.</p>
8.1.3(k)	<p>Should the NCCP Act apply to any business lending? In particular, should any of its provisions apply to:</p> <ul style="list-style-type: none"> - SMEs? - agricultural businesses? - some guarantors of some business loans? 	<p>The Commission should recommend the introduction of a Financial Services Code which would incorporate and replace the provisions of the NCCP Act.</p>
8.1.3(l)	<p>To what business lending should the Banking Code of Practice apply?</p> <ul style="list-style-type: none"> - Is the definition of ‘small business’ satisfactory? 	<p>The Commission should recommend the introduction of a Financial Services Code which would incorporate and replace the provisions of the Banking Code of Practice.</p> <p>The Union believes that the Banking Code of Practice definition of SME is not satisfactory, and a definition consistent with Mr Khoury’s recommendation should be preferred.</p>
8.1.3(m)	<p>Should lenders adopt different practices or procedures with respect to agricultural lending?</p>	<p>The Commission should recommend the introduction of a Financial Services Code.</p> <p>The Union does not believe that a different law should apply to agricultural lending, but submits that the nature of agricultural lending in a manner consistent with obligations such as an obligation to “be fair”, and to provide services that are fit for purpose requires a different approach given the particular issues around agricultural lending which can see rapid shifts in profitability, and require a medium to long term horizon.</p>
8.1.3(n)	<p>Are there classes of persons from whom lenders</p> <ul style="list-style-type: none"> - should not take guarantees; or - should not take guarantees unless the person is given particular information or meets certain conditions? 	<p>The Commission should recommend the introduction of a Financial Services Code based on the “very simple ideas” identified by the Commission. Those ideas were:</p> <ul style="list-style-type: none"> • Obey the law. • Do not mislead or deceive. • Be fair. • Provide services that are fit for purpose. • Deliver services with reasonable care and skill. • When acting for another, act in the best interests of that other. <p>A law based on these principles would prevent banks from taking guarantees from some classes of individuals, or would ensure that clear disclosure is provided.</p>
8.1.3(o)	<p>How should lenders manage exit from a loan</p> <ul style="list-style-type: none"> - at the end of the loan’s term; - if the borrower is in default? 	<p>The Union makes no submission on this question.</p>

8.1.4	Regulation and the regulators	
8.1.4(p)	Have entities responded sufficiently to the conduct identified and criticised in this report?	No. The public apologies are insufficient and appear consistent with an approach to minimise regulation or change, rather than to address the issues in the sector. Union members report that there has been no meaningful change as a result of the conduct identified.
8.1.4(q)	Has ASIC's response to misconduct been appropriate? - If not, why not? - How can recurrence of inappropriate responses be prevented?	No. ASIC's response has been manifestly unsatisfactory. ASIC has been timid and compliant. ASIC can be improved by a combination of changes to the regulatory environment, including clearer legal obligations, and a capacity for penalties to be paid to ASIC directly, and by a culture reform program. Regulators should be subject to review to consider whether there should be some reallocation of ASIC and APRA's functions between each other, or to other regulators.
8.1.4(r)	Has APRA's response to misconduct been appropriate? - If not, why not? - How can recurrence of inappropriate responses be prevented?	No. APRA's response has been manifestly unsatisfactory. APRA has been focused on macro prudential risk, and failed to identify systemic culture and misconduct problems as creating significant risk. Further APRA has been unwilling to act against misconduct out of misplaced concern that such action may undermine confidence. APRA can be improved by a combination of changes to the regulatory environment, including clearer legal obligations, and a capacity for penalties to be paid to ASIC directly, and by a culture reform program. The BEAR should be subsumed into a Senior Manager Accountability Scheme and responsibility transferred from APRA. Regulators should be subject to review to consider whether there should be some reallocation of ASIC and APRA's functions between each other, or to other regulators.
8.2	Causes	
8.1.1(s)	What were the causes of the conduct identified and criticised in this report? <ul style="list-style-type: none"> • Conflict of interest and duty? • Remuneration structures? • Culture and governance? • Regulatory response? 	Yes, to each. The Union refers to its submissions above.
8.3	Responses	
8.3(t)	What responses should be made to the conduct identified and criticised in this report?	The Union refers to the matters set out as Proposals for Consideration in the body of the Submission.

8.3(u)	<p>Are changes in law necessary?</p> <ul style="list-style-type: none"> - Should the financial services law be simplified? - Should carve outs and exceptions be reduced or eliminated? In particular, should <ul style="list-style-type: none"> • grandfathered commissions • point of sale exceptions to the NCCP Act • funeral insurance exceptions <p>be reduced or eliminated?</p>	<p>The Union believes that these proposals form the basis of an appropriate response to the issues considered by the Commission.</p>
8.3(v)	<p>How should entities manage conduct and compliance risks?</p>	
8.3(w)	<p>How should</p> <ul style="list-style-type: none"> - APRA - ASIC <p>respond to conduct and compliance risk?</p>	
8.3(x)	<p>Should the regulatory architecture change?</p> <ul style="list-style-type: none"> - Are some tasks better detached from ASIC? - Are some tasks better detached from APRA? - What authority should take up any detached task? - Should either or both of ASIC and APRA be subject to external review? 	
8.3(y)	<p>What is the proper place for industry codes of conduct?</p> <ul style="list-style-type: none"> - Should industry codes of practice like the 2019 Banking Code of Practice be given legislative recognition and application? 	
8.3(z)	<p>Should an intermediary be permitted to</p> <ul style="list-style-type: none"> - recommend to a consumer - provide personal financial advice to a consumer about - sell to a consumer <p>any financial product manufactured by an entity (or a related party of the entity) of which the intermediary is an employee or authorised representative?</p>	
8.3(aa)	<p>Is structural change in the industry necessary?</p>	



Finance Sector Union

Add your insights to deliver solutions for our industry

Workplace Culture Survey 2018

As the voice of finance workers, FSU will make a comprehensive submission to the Royal Commission. Your insights and experiences will contribute vitally to building our solutions for the finance sector.

All information provided is confidential and will be anonymous when included in the submission.

Your Details *(all required)*

First Name: Surname:

Personal Email: Personal Mobile:

Employer: Business Unit:

My role primarily involves: Service Sales Sales and Service Processing People Management

Technology Operations Other:

I work in a: Contact Centre Retail Branch Business Banking Centre Head Office Other:

Workplace Location: State:

My Performance

Performance assessment is the annual process to determine your performance and reward outcome including Incentive payments.

1. My performance assessment genuinely considers a range of factors, including financial measures, behaviours, and risk and compliance.

Yes No Not applicable

2. My performance objectives genuinely prioritise the best interests of the customer/member.

Yes No Not applicable

3. Net Promotor Score is a fair measure of my contribution at work.

Yes No Not applicable

Comments:

Risk and Compliance

This is a collection of capabilities that enable your organisation to reliably achieve objectives, address uncertainty and act with Integrity.

4. My employer's focus on risk and compliance has increased over the past twelve months.

Yes No Not applicable

5. My workload allows me to allocate appropriate time and attention to risk and compliance activities.

Yes No Not applicable

6. My employer provides me with sufficient time and resources to undertake risk and compliance training.

Yes No Not applicable

Comments:



Workplace Culture Survey 2018

My Remuneration

Remuneration Includes all fixed pay and Incentive payments and commissions that you are eligible to receive.

7. My total remuneration includes payments and/or commissions relating to the sale of specific products or services.

Yes No Not applicable

8. The removal of product payments and commissions from my role has reduced my total annual remuneration.

Yes No Not applicable

9. My annual remuneration package includes incentive payments of up to _____%.

10. I am required to participate in sales campaigns/initiatives related to the sale of specific financial products e.g. insurance, credit cards, travel cards.

Yes No Not applicable

Comments: _____

Workplace Culture

Culture is the character and personality of your organisation and what makes it unique. It is the sum of its values, traditions, beliefs, interactions, behaviours, and attitudes.

11. Changes to remuneration and performance appraisal have resulted in a more customer/member-centric workplace culture.

Yes No Remained unchanged Not applicable

12. My workplace takes into account how our actions impact customers/members and communities.

Yes No

13. My organisation's values are applied across all levels of my workplace.

Yes No

14. Over the last twelve months, culture in my workplace has improved.

Yes No Remained unchanged

Comments: _____

I received this survey from:

FSU Organiser FSU Member

FSU Workplace Rep

Please provide name: _____

I am an FSU Member

I want to join the campaign to build a better finance sector

I will attend a meeting to learn more about the campaign to build a better finance sector

I want to take a leadership role in the campaign to build a better finance sector

To share this survey with a colleague, copy the link www.bit.ly/Big-Finance-Survey and email to them.

Thanks for adding your voice.
Together we're stronger.

