



Terms of Reference: Retail Banking Remuneration Review

Objectives

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

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

To achieve this, the independent review will:

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

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

Scope

Staff and roles in retail banking

The review will cover product sales commissions and product based payments received directly or indirectly by people selling banking products as a result of the number or value of products sold, offered or distributed to retail² and small business³ customers.

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

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



Remuneration structures

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

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

Retail banking products

The types of retail banking products in scope of the review include:

- Basic banking products (e.g. transaction accounts, term deposits, travellers cheques)
- Non-cash payment products (e.g. travel money cards)
- General insurance products (except for personal sickness and accident)
- First Home Saver Accounts (FHSA)⁴
- Consumer credit insurance (CCI)⁵
- Consumer credit products (including mortgages, personal loans and credit cards), and
- Small business lending.

Scope exclusions

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

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

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



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

Mortgage lending

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

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

Customer outcomes

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

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

Independent Reviewer

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

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

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

For matters relating to the independent review, Mr Sedgwick can be contacted confidentially.

Consultation

The reviewer will conduct the review publicly in consultation with:

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



Submissions

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

The format for submissions included a cover page with:

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

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

Submissions closed on 9 September 2016.

Final Report

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

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

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

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

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

Timing

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

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

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

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



Independence

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

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

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

While the banking industry will fund the review, the banking industry will not have any influence over the findings and options identified by the reviewer beyond our input as a participant in the review, and the reviewer and

secretariat will act independently and not in the interests of, or on behalf of, the ABA or its member banks.

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

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

Confidentiality

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

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

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

Competition Law

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

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



References

¹<http://www.bankers.asn.au/media/media-releases/media-release-2016/banks-act-to-strengthen-community-trust>

² As defined in section 761G of the Corporations Act 2001.

³ A business employing less than 100 people (if the business is or includes the manufacture of goods) or 20 people otherwise.

⁴ The Australian Government has abolished the FSHA scheme as of 1 July 2015. Some banks will have customers who continue to be FSHA holders, and therefore, the review will include these products.

⁵ Consumer credit insurance (CCI) may be sold, offered or distributed by a bank or through brokers and other intermediaries. Where CCI is distributed through insurance brokers, the review will include these products and channels.

⁶ As defined in section 761G of the Corporations Act 2001.