

21 October 2016

Mr Stephen Sedgwick AO
Reviewer
Independent Review of Product Sales Commissions & Product Based Payments
In Retail Banking
Via Email: submissions@retailbankingremunerationreview.com.au

Dear Mr Sedgwick

Independent review of product sales commissions and product based payments

The Customer Owned Banking Association (COBA) appreciates the opportunity to provide input into the ABA-commissioned independent review of product sales commissions and product based payments.

The ABA's response to the review is a matter for ABA members but COBA is making this submission because the review may lead to proposals for regulatory or legislative reform. Any such regulatory or legislative reform could affect COBA members, even though COBA members have not engaged in conduct that has led to poor consumer outcomes.

In testimony this month to the House of Representatives Economics Committee, major bank CEOs conceded that they have:

- let down their customers;
- lost touch with their customers;
- not treated customers with the respect they deserve; and
- opened up a trust gap with customers.

COBA seeks to ensure that measures to solve problems created by major banks do not unnecessarily reduce the flexibility of COBA members to operate their businesses in the interests of their number one stakeholder: the customer.

Customer owned banking institutions need to be strong and profitable businesses to be sustainable in a market dominated by four major players and COBA is sensitive to the risk of anti-competitive outcomes from constraints and restrictions agreed between those dominant players.

The ABA's Independent Governance Expert Report in July 2016 noted that "to a greater or lesser extent, nearly all the Australian banks have used product sales commissions and product based payments as a lever of competitive strategy."

Only around half the banking institutions in our sector use product sales commission and product based payments but this may change. For example, more customer owned banking institution are using broker channels to distribute home loans.

The ABA, in its 23 September submission to your review, noted that you have been asked to consider whether regulatory approvals may be needed: "Changes could be

implemented in the form of legislative reform, which would ensure that all banks and other participants in retail banking are subject to the same regulatory requirements and standards. Alternatively, the banking industry could seek authorisation from the ACCC.”

The key consideration we ask the review to bear in mind is the risk of dampening competition or chilling innovation by the major banks’ smaller competitors by forcing smaller competitors to comply with regulation framed by the major banks. The best way to achieve better consumer outcomes is by fostering more, not less, competition in the retail banking market.

Customer owned banking sector

COBA represents Australia’s customer-owned banking sector which consists of 85 institutions trading as mutual banks, credit unions and building societies. Our sector has \$101 billion in total assets, 10 per cent of the household deposits market, 12,000 staff and 4 million customers.

The 18 mutual banks in our sector are former credit unions and building societies that have re-branded but continue to operate under a mutual corporate structure.

Customer owned banking institutions offer the full range of retail banking products and services, including home loans, credit cards, personal loans, transaction accounts, savings accounts and term deposits.

Customer owned banking institutions are:

- Public companies structured under mutual ownership principles set out in ASIC Regulatory Guide 147 *Mutuality – Financial institutions*;
- Authorised Deposit-taking Institutions (ADIs) regulated by APRA under the *Banking Act 1959*;
- Australian Financial Services Licensees regulated by ASIC under the *Corporations Act 2001*; and
- Australian Credit Licensees regulated by ASIC under the *National Consumer Credit Protection Act 2009*.

The customer owned banking sector has market leading levels of customer satisfaction stemming from our focus on putting customers first. According to Roy Morgan Research¹, mutual sector customer satisfaction was 90.3% in September 2016 compared to 79.8% for the major banks. Our strong focus on customer relationships is shown by mutual sector customer satisfaction increasing to 93.9% when we are a customer’s main financial institution (MFI). This compares to 81.7% for the major banks. Customer owned institutions hold seven of the top eight highest individual MFI customer satisfaction ratings.²

For the last four years, a customer owned banking institution has won Roy Morgan’s Bank of the Year Customer Satisfaction award (Victoria Teachers Mutual Bank in 2012 & 2013, P&N Bank in 2014 and Teachers Mutual Bank in 2015) beating their major bank and regional bank rivals. Customer owned banking institutions have also won Canstar Blue’s Most Satisfied Customers Challenger Bank award (non-major bank) for the last five years running (Heritage Bank in 2012, 2014 & 2016, Police Bank in 2013 and Teachers Mutual Bank in 2015).³

Customer-owned banking institutions serve metropolitan and regional communities and can have a national, regional or local footprint or a focus on particular communities such as education, police and the defence force. The head offices of COBA’s five largest members are outside Sydney and Melbourne: CUA in Brisbane; Heritage Bank in

¹ Roy Morgan Research, Customer Satisfaction: Consumer Banking in Australia Report September 2016

² These seven institutions include four mutual banks, two credit unions and one building society.

³ Note Canstar Blue does not have an ‘all bank’ category.

Toowoomba; People's Choice Credit Union in Adelaide; Greater Bank in Newcastle; and, IMB Bank in Wollongong.

The customer owned model has an important role to play in the retail banking market because consumers are entitled to genuine choice. Trust is more critical in financial services than in most industries because consumers find themselves at a disadvantage compared to the firms they're dealing with. ASIC's benchmark consumer research reveals that almost a third of Australians find dealing with money stressful and overwhelming.

The Financial System Inquiry (FSI) found that: "To build confidence and trust in the financial system, firms need to take steps to create a culture that focuses on consumer interests." The FSI specifically recommended that the interests of financial firms should be aligned with those of consumers.

The customer owned model achieves this alignment and this is reflected in the sector's market-leading customer satisfaction ratings, highly competitive pricing and community focus.

Mutual banks, credit unions and building societies are subject to the same regulatory framework as listed banks and are competing in the same business of retail banking but their reason to exist is entirely different. Customer owned banking institutions exist to meet the needs of their customers rather than to maximise returns for a separate group of shareholders.

The ethos of a business and its fundamental objective are likely to be more important to avoiding poor customer outcomes than remuneration structures.

In May 2016, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) strongly criticised lending practices and culture of certain listed banks. In a report on impairment of loans, the PJC said: "The committee considers that the banks' compulsion to deliver ever-increasing returns to shareholders has become the overriding driver of behaviour and culture in the banks."

Superficially similar remuneration practices in a listed bank and a customer owned banking institution could produce very different outcomes for the customers of each institution. In a customer owned institution, staff understand that the key stakeholder is the customer and the fundamental objective is serving the customer. In a listed bank, the key stakeholder is the shareholder and the fundamental objective is to maximise returns to the shareholder.

Employees and the customer owned model

COBA members educate their staff about the customer owned model to ensure that staff understand the core proposition: that each customer is an equal owner of the business and the business only exists to serve its customers.

The education process is delivered through induction programs, ongoing training and directly reinforced by senior management.

The Customer Owned Banking Code of Practice (COBCOP) includes the following key promises:

- We will be fair and ethical in our dealings with you. We will always act honestly and with integrity, and will treat you fairly and reasonably in all our dealings with you.
- We will focus on our customers. We will place a high priority on service, competitiveness and customer focus.
- We will deliver high customer service and standards. We will issue and distribute products and provide services that are useful, reliable and of value to our

customers. We will make sure our staff and agents or representatives are well trained.

- We will recognise our customers' rights as owners. As customer owned banking institutions our customers are our owners.

In some institutions, an employee's induction into our philosophy begins during recruitment. These employers introduce potential recruits to the model before the first interview to help them see whether this institution is the right fit for them. Once on board, induction programs educate new employees about why the customer owned model is different from other banking models. These programs include sessions about the history and philosophy of that particular institution as well as the credit union and building society movements and the COBCOP.

COBA members reinforce the customer focused culture during regular briefings, ongoing training, refresher courses, and events such as staff conferences. Managers ground discussions on strategy and targets in the customer owned context.

COBA members provided the following quotes about their approach:

"Our training model is customer centric with an emphasis on customer relationships as the basis for 'sales through service' model"

"New employees are initially introduced to the customer owned model and our points of difference to the broader finance industry. They gain insight into how the credit union was formed, our heritage and our vision and purpose."

"On commencement and annually we all complete Customer Owned Banking Code of Practice training which outlines the philosophy of the industry."

"Training and development from induction to leadership training all focus on customer rather than sales outcomes."

"Customer owned model education is reinforced for all employees through our regular team briefings, weekly communications and sales conferences."

"All new employees attend a face-to-face induction which includes facilitated discussion about mutual banking and the Code of Practice."

"Employees participate in corporate activities such as our lunch with a difference program, where our CEO talks about the organisation's mutual and customer focus."

"The philosophy of the organisation is inculcated into all staff at their induction and includes a strategy overview from the CEO."

"We focus on customer service and needs at our annual staff conference. Each year we have three actual members and a non-member attend and tell us from their perspective what they expect from their financial institution."

"For all new staff we provide an orientation that includes 90 minutes with myself as CEO explaining the credit union model and the credit union culture and specifically our strategic plan and focus."

"The customer centric model is reinforced at every opportunity, and our people openly and frequently tell us that this is why they join and why they stay with the bank."

"The customer owned model is covered at induction for all new employees, where we talk about members owning the organisation and the mutual model more broadly."

Product based payments and the customer owned model

Customer owned banking institutions are diverse, with big differences in size, strategy and customer base. These differences are also reflected in remuneration practices.

As noted above, around half of the institutions in our sector choose not to use these forms of payments. These members choose not to use brokers and prefer fixed remuneration policies or the use of alternative informal reward and recognition programs.

Broadly speaking, where staff remuneration involves commissions and product based payments it is in the framework of a balanced scorecard approach. Commissions paid to external agents include, most notably, remuneration for mortgage brokers.

Employee remuneration structures allow our institutions to recognise and reward good performance. Good performance is typically measured against a balanced scorecard which includes both sales and non-sales-based metrics. While customer owned institutions are not subject to the profit-maximising motive of listed banks, they still require adequate sales growth to be sustainable businesses, delivering value now and in future. The balanced scorecard approach allows institutions to balance multiple objectives such as sales and customer satisfaction.

Superficially similar remuneration structures could have very different outcomes depending upon the goals and culture of the institution. A remuneration structure linked to a profit-driven listed bank model is not likely to have the same outcomes as a remuneration structure grounded in the customer owned model.

While the risks of poor customer outcomes are naturally tempered by our customer first model, our institutions also take a number of steps to mitigate risks of poor customer outcomes. These include measuring sales at branch or portfolio level, post-sales file reviews, customer surveys, 'mystery shopping', and setting reasonable and conservative targets.

Non-sales metrics include quality of customer interactions, net promoter score, individual behavioural competencies, compliance and adherence to company values.

COBA members provided the following quotes about their approach:

"Positive customer outcomes are embedded within our organisation's culture and our behaviours are aligned to providing positive customer outcomes."

"Our performance reviews are balanced between a number of criteria including sales performance and compliance objectives. These compliance objectives include customer best interest obligations."

"Our sales and service model ensures conversation focuses on the member requirements with the underlying principle of 'No need no sell'."

"Employees must be able to demonstrate conduct in support of the values, one of which is Focus on Members."

"We emphasise that the primary responsibility of each and every staff member is to fully understand the needs and expectations of our members and to ensure that our product and or service offering is the right one for that member."

"Our sales model emphasises 'sales through service' which requires identification of specific customer need and linking a relevant product to that need, rather than a sales emphasis based on profit to the company."

"If we can't prove or show that our customer is in a better position under our product or service, we won't sell recommend the product or service to them."

"Sales training is based on long term relationship selling, not hard product sales."

"To encourage the balance between encouraging sales performance and avoiding poor customer outcomes, our frontline employees are instructed to have needs based conversations with customers."

"We continually talk to our front line people about our need to achieve certain results to enable us to fund the operations of the credit union, but this point is always tempered by our overarching value of putting people first and looking for mutual opportunities to enhance a customer's financial wellbeing."

"Our sales process includes building rapport and spending a large proportion of time listening to the customer's needs before matching their needs to a solution (product or service). This process encourages sales performance by giving customers options and results in higher customer satisfaction."

Thank you for the invitation to provide this submission to your review and for taking the time to meet COBA.

In our view, there is no problem with encouraging good performance and a sales culture in a model where the customer always comes first and the products are highly competitive and meet customer needs.

We see no evidence that remuneration practices in our sector are leading to poor consumer outcomes.

The culture of a banking institution is the most important factor driving consumer outcomes, in particular whether or not there is a culture of pursuing "ever-increasing returns to shareholders".

I can be contacted on 02 8035 8448 to discuss any of the matters raised in this submission.

Yours sincerely



LUKE LAWLER
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