

**Royal Commission into Misconduct in the Banking, Superannuation  
and Financial Services Industry**

SUBMISSIONS OF THE FINANCE SECTOR UNION IN RELATION TO THE  
FOURTH ROUND OF CASE STUDIES

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**A Outline of submissions**

1. These submissions deal with the fourth round of case studies.
2. At parts B and C to these submissions, the Union makes general comments about two themes that arose in several different contexts in relation to both agribusiness and the interaction of Aboriginal and Torres Strait Islander people with financial institutions. These two themes are the central issue of culture, and the impact of service reduction, particularly by way of branch closures in rural areas. The balance of the submissions directly addresses the questions posed by Counsel Assisting.

**B The dominant role of culture**

3. There is a crisis in community confidence in Australian financial services institutions.
4. There is an important role for improved, appropriate regulation which is sufficiently stringent and clear to minimise systemic risks, and to address and provide remedies for misfeasance and unconscionable conduct. However, regulation is only one part of the solution.
5. The key challenge is to address the toxic culture that exists in the Australian financial services sector.
6. Aside from the forced assessment of CBA's culture directed by APRA,<sup>1</sup> not one of the financial institutions has admitted to any ongoing cultural issues.
7. So far in the Royal Commission there has been a consistent pattern of stories from consumers who have been adversely impacted by inappropriate products having been sold to them. Despite the consistency in the stories, there has been a pattern of bank witnesses denying systemic issues. Mr Steinberg, in the face of a concession that ANZ had acted in a manner

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<sup>1</sup> <https://www.commbank.com.au/cs/newsroom/apra-endorses-cba-remedial-action-plan-201806.html>.

below community standards in respect of seven different customers within a single part of the bank, asserted that there were no “*systemic issues*”.<sup>2</sup>

8. In the same week as these submissions are prepared, an interview with the CEO of NAB was published in the Australian Financial Review.<sup>3</sup> The article provides:

Thorburn is apologetic but he doesn't have much truck with critics who argue the banks have a systemic cultural problem.

“We also have to remember that this is a royal commission into misconduct. So we're seeing a slice – an accurate and painful one – of cases where things have gone wrong, and not the large majority of good conduct. Our people's behaviour, commitment and ethics is overwhelmingly positive.

9. The Union disagrees with Mr Thorburn that there is no systemic cultural problem. The misconduct identified by the Commission has its genesis in systemic, cultural issues. Mr Thorburn, Mr Steinberg, and other bank executives continue to fail to acknowledge those issues, or that they, as the leadership of the banks, are part of the problem.

10. As indicated above better regulation, while vital, is not a complete solution. The experience of Union members is that currently regulation, be it internal or external, creates complexities in their work but does not change the expectations of management on the outcomes they are required to achieve. These institutions continue to require, promote, and incentivise sales by their employees at the expense of compliance and customer outcomes. Internal compliance procedures can be overlooked in favour of sales outcomes until there is a substantial breach.

11. There have been repeated instances where regulatory changes or recommendations led to minor change in practice, but no change to culture or conduct within banks. Changing the rules without changing the culture has only superficial impact.

12. This is shown by international experience. The Union notes the evidence of Stephen Green, the Chairman of HSBC, to the Future of Banking Commission.<sup>4</sup> He said:

‘It is as if, too often, people had given up asking whether something was the right thing to do and focused only [on] whether it was legal and complied with the rules’.

...

No banking business can afford to do without a board-led, senior management-supported, ethical approach to behaviour– to understand that there is a purpose to the business that you do, which is not simply measured by short-term profitability... is profoundly important. Unless that culture is there in an organisation, no amount of rule setting and no amount of careful compliance is going to be an adequate substitute.’

13. Martin Wheatley, the Chair of the English Financial Conduct Authority<sup>5</sup> made a similar observation:

So, how do we get firms to do the right thing, whether the regulator is watching or not? How do we get senior management – not just in banks but players in the global markets as well – to be accountable for doing the right thing.

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<sup>2</sup> T3302.03.

<sup>3</sup> Andrew Thomson, “Hayne must not stop risk-taking: NAB CEO Andrew Thorburn”, Australian Financial Review, 12 July 2018.

<sup>4</sup> Quoted in the Final Report of the Future of Banking Commission at page 55 ([https://i.telegraph.co.uk/telegraph/multimedia/archive/01656/Bankpdf\\_1656684a.pdf](https://i.telegraph.co.uk/telegraph/multimedia/archive/01656/Bankpdf_1656684a.pdf)).

<sup>5</sup> <https://www.fca.org.uk/news/speeches/looking-ahead-2014>.

The traditional regulatory mechanism for dealing with cultural weakness has always been to enhance the rules. To close loopholes in the law as and when they appear. To require more disclosure or compliance with specific processes.

The problem with this approach is twofold. First: it is, 'static'. So it is closing stable doors after horses have bolted. Second – and perhaps counterintuitively – we know it can encourage the behaviour it seeks to stamp out.

As an example, if we trace back to around 2005 to 2008, the breeding ground for many of the conduct cases we're dealing with today – like PPI and benchmark manipulation – we find them occurring in a period that saw Financial Services Authority (FSA) guidance expand by some 27%. In other words, growing the rulebook did not prevent cultural weakness.

Which is why, in his excellent book *Ethicability*, Roger Steare argues for a more sophisticated interpretation of integrity in business – one that is not simply defined by the ethics of obedience – so what is legally right or wrong – but actually looks towards the ethics of care and the ethics of reason.

Steare makes the very good point that: 'At their worst, rules, laws, regulations and red tape have a tendency to multiply because they remove our responsibility for deciding what's right'.

14. The Union notes that there have been repeated inquiries and investigations into what is wrong in the Australian banking system. Many, such as the Sedgwick Review, recommended formal changes to regulation, or the imposition of self-regulation. These reviews have not altered the underlying reality of a crisis of trust in Australian banks.
15. The issue of the Sedgwick Review is a clear and relevant example. Sedgwick recommended, in the relatively limited sphere of retail banking, a reduction in sales targets and conflicted remuneration for front line and junior management. The Union supports those recommendations although it believes that they do not go far enough.
16. Sedgwick noted that there needed to be a change underlying in culture. The review excluded from examination remuneration practices for senior managers and executives, or other drivers affecting those who set targets and control culture. In the period since the Sedgwick Review, the proportion of a retail banker's performance metrics dedicated to formal sales targets has been reduced. However, it has been supplemented with "customer needs analysis" processes like the "A-Z Reviews" at ANZ, where customers are quizzed as to their finances with a view to selling the customer as many products as possible.
17. Frontline staff are now being placed on performance management (which endangers their ongoing employment), and their eligibility for bonuses determined, by reference to how many customer needs analysis processes they cause to occur. From the perspective of the bank, a customer needs analysis process is an indirect measure of sales. The banks know that they will make more sales by causing more of these review processes to occur.
18. Similarly, despite the recommendations of the Sedgwick Review, banks continue to use scorecards and leader boards to compare sales performance. These are now often described as "Informal Visual Aids" or "Visual Management Tools". A change in nomenclature does not change function. Such tools have no purpose beyond attempting to increase sales volumes. Union members continue to describe teleconferences with regional managers which can occur up to several times on a single day, for the purpose of reporting sales progress and outcomes. KPIs remain directly, or indirectly through "behaviours" measures, focused on sales and revenue and not on ethical behaviour or the customer interest.

19. Mr Sedgwick saw the risk of these sorts of illusory changes, and cautioned against them. He wrote:<sup>6</sup>

A feature of the proposed approach, therefore, is that banks address the issues holistically, meaning that they each act to ensure that their approaches to remuneration, performance management, leader development and cultural renewal are aligned. Fundamental also is that practices that have a similar effect on incentives and the risk of inappropriate behaviour should be reformed in a similar way irrespective of the name assigned to it or the channel through which it occurs and, in particular, that reforms should be applied consistently across both the direct (i.e. staff) and, with appropriate adjustments, the third party channels.

20. Within all Australian banks, the dominant culture remains focused on short term profits and short term share prices. This culture of sales is a focus at every level of bank operations. Regional or State Managers who fail to achieve sufficient increases in sales and revenue are demoted or dismissed. Where employees raise concerns about culture, or ethical lapses, they are given adverse behavioural ratings and are categorised as not being team players.
21. These cultural goals are reinforced by incentive payments. APRA's recent examination of remuneration practices showed that the average bank CEO obtains 70% of their remuneration as "short term" or "long term" incentive payment.<sup>7</sup> The reference to long term incentive payments is a misnomer – the average period of vesting of such rewards is three to four years.<sup>8</sup>
22. The expectations imposed by senior executives on bank employees are largely unchanged. The remuneration structures for CEOs and other senior executives remain heavily focused on short term, and short-medium term (misleadingly referred to as long term) incentive payments. The contrast with rural business, which operates on a 7-10-year profit cycle is clear. For CEOs, long term incentive payments vest, on average, after 3.3 years.<sup>9</sup>
23. The Union notes that the Letters Patent establishing the Royal Commission referred to:

whether any findings in respect of the matters mentioned in paragraphs (a), (b) and (c):

(d) are attributable to the culture and governance practices of a financial services entity or broader cultural or governance practices in the relevant industry or relevant subsector; or result from other practices, including risk management, recruitment and remuneration practices, of a financial services entity, or in the relevant industry or relevant subsector;

24. The Union submits that the Commission's consideration of the impact of targets and incentive payment schemes on the behaviours of front line staff is vital. However, the Commission has not yet considered the impact of executive remuneration practices on bank culture and operations. In the respectful submission of the Union, it is crucial that these matters are addressed in detail.
25. There is a broad consensus in academic and public review discussions that a pre-requisite to improving bank culture is "buy in" from management. Mr Sedgwick wrote in his review:

Effective leadership is key. Leaders drive culture. Whether they do it by accident or by design, and whether culture is set by those at the top of the

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<sup>6</sup> Sedgwick Review, Executive Summary, (i).

<sup>7</sup> APRA, *Information Paper – Remuneration Practices at Large Financial Institutions*, April 2018 page 12 (<https://www.apra.gov.au/sites/default/files/180328-Information-Paper-Remuneration-Practices.pdf>).

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

organisation or by 'local leaders' in each work group, depends on the credibility, consistency and quality of the systems and governance senior leaders put in place.

26. To date there has been no meaningful engagement from CEOs and other senior bank executives with the need for cultural change. When, on occasions, there is some assessment of culture, banks tend to seek assistance from the same sets of consultants who make similar sets of recommendations.
27. Broad ranging reviews and assessments of culture – in which all stakeholders including customers and employees are listened to with a genuine desire to improve – are now commonplace in the United Kingdom but yet to occur in Australia. Unless and until there is a willingness to acknowledge the existence of deep cultural issues, and to commit to a process of improving culture not simply as a generator of profit but as a central economic and social participant, there will be no genuine restoration of trust to the sector.

#### C Access to local financial services

28. A theme common to each of the two sets of case studies – agribusiness and interactions with Aboriginal and Torres Strait Islander people – is the impact on customers of staff who are not properly trained, do not have sufficient insight into their customer's situation, or do not have deep and ongoing relationships with the customers.
29. The Union identifies service reduction, service centralisation and branch closures as key factors working against staff being able to develop a deep understanding of particular issues that impact on different groups of customers.
30. The information released by the Commission in its discussion paper,<sup>10</sup> the public information released by APRA,<sup>11</sup> information referred to by Counsel Assisting, and the ANZ material tendered into evidence provide significant insight into these ongoing issues.
31. APRA publish regular data as to banks' "points of presence" and "branch levels of service".<sup>12</sup> APRA changed their definitions for the 2016/17 financial year such that the data cannot be easily compared to previous years.
32. The APRA point of presence material shows a 14.38% reduction in face to face points of presence in the period June 2007 to June 2016 (a reduction from 13,648 to 11,685 points).<sup>13</sup>
33. However, the reduction has occurred at a far greater rate in very remote, remote and moderately accessible locations when compared to highly accessible locations.

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<sup>10</sup> Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry "*Background Paper Number 18, Some Features of Financial Services in Regional and Remote Communities*", <https://financialservices.royalcommission.gov.au/publications/Documents/fsrc-paper-18.pdf>.

<sup>11</sup> <http://webarchive.nla.gov.au/gov/20161017034234/http://www.apra.gov.au/adi/Publications/Pages/points-of-presence.aspx>.

<sup>12</sup> Points of presence includes four types of service channels: face-to-face points of presence offering a branch level of service, other face-to-face points of presence, automatic teller machines (ATMs), and EFTPOS machines (see [https://www.apra.gov.au/sites/default/files/documents/adipop\\_explanatory\\_notes.pdf](https://www.apra.gov.au/sites/default/files/documents/adipop_explanatory_notes.pdf)).

<sup>13</sup> [http://content.webarchive.nla.gov.au/gov/wayback/20161017034234/http://www.apra.gov.au/adi/Publications/Documents/2016\\_PoP.xlsx](http://content.webarchive.nla.gov.au/gov/wayback/20161017034234/http://www.apra.gov.au/adi/Publications/Documents/2016_PoP.xlsx).

34. The APRA data shows:

<i>By remoteness</i>	<b>30 June 2007</b>	<b>30 June 2016</b>	<b>Number</b>	<b>% change</b>
Highly Accessible	10,078	9,060	-1,018	-10.10%
Accessible	2,068	1,585	-483	-23.36%
Moderately Accessible	855	607	-248	-29.01%
Remote	437	293	-144	-32.95%
Very Remote	210	132	-78	-37.14%
Unknown	-	8	8	
<b>Total</b>	<b>13,648</b>	<b>11,685</b>	<b>-1,963</b>	<b>-14.38%</b>

35. While APRA focuses on “face to face” points of presence, the Union submits the more important measure in regional areas is “branch level of service” points of presence. By this measure the reductions are somewhat less overall, but even more disproportionately focussed on remote and very remote locations.

<i>By remoteness</i>	<b>30 June 2007</b>	<b>30 June 2016</b>	<b>Number</b>	<b>% change</b>
Highly Accessible	5,072	4,762	-310	-6.11%
Accessible	870	712	-158	-18.16%
Moderately Accessible	342	263	-79	-23.10%
Remote	176	125	-51	-28.98%
Very Remote	68	42	-26	-38.24%
Unknown	-	-	-	
<b>Total</b>	<b>6,528</b>	<b>5,814</b>	<b>-624</b>	<b>-9.56%</b>

36. From the Union’s experience, this material understates the extent of the change because it does not consider reductions in levels of service being offered by the financial institutions. The APRA data records no change if an institution keeps a branch but reduces hours, staff numbers, or, significantly in terms of farm finance, ceases offering certain types of service. The APRA material fails to record, for example, the centralisation of agribusiness functions.

37. In her opening submission to this round of hearings, Counsel Assisting referred to information provided to the Commission as to service levels in rural areas. She described correspondence received from banks about changes to branch numbers and branch managers.

38. For ANZ, she advised the Commission that there had been a reduction from 424 branches / business centres in rural areas in 2008, to 333 in 2018.<sup>14</sup>

39. The data referred to by the Commission does not reveal the extent to which the closures are for the 2016-2018 period or earlier in the time frame. However, a series of documents were tendered<sup>15</sup> which showed that rather than slowing, in 2016 ANZ proposed to accelerate the rate of branch closures. The documents suggest<sup>16</sup> that ANZ closed 50 branches in FY2016/17 (split evenly at 25 closures of metro branches and 25 closures in rural locations) and intended

<sup>14</sup> T2078.30.

<sup>15</sup> Exhibit #4.206 Branch Options Final Recommendation (ANZ.700.008.0060), and Exhibit #4.207 Accelerated Branch Closures Presentation dated 26/04/2017 (ANZ.700.008.0002).

<sup>16</sup> The documents were briefing papers prepared by senior ANZ executives for provision to the ANZ CEO. The witness who gave evidence for ANZ advised that he was not aware of the documents, including whether their recommendations had been accepted or rejected. However, there is no reason to be believe that the recommendations have not been implemented.

to close a larger number in each of FY17/18 and FY18/19. Advice to the Union from the ANZ is that it closed 73 branches in the period from January 2017 to April 2018.

40. The Union submits that it is reasonable to assume that by the end of this financial year, ANZ will operate less than 300 rural branches (and perhaps as few as 280 rural branches), a reduction of about 30% in eleven years.
41. These numbers only tell part of the story as they do not include, at all, reductions in service delivery. Over the last months the Union is aware of several distinct decisions by banks to close and consolidate various business banking functions, including agribusiness. The Union is aware of decisions made by ANZ over the last six months to reduce the number of experienced agribusiness specialists with specific areas of subject matter expertise in regional and rural communities, in favour of centralised, regional centre or city-based business bankers with limited specific knowledge of or expertise in issues facing farmers and rural customers.
42. We note the effect of these changes was raised in the evidence of Mr McMahon and Mr Wheatcroft. The effects include staff churn which is an inevitable consequence of a non-stable environment, and a loss of expertise in the staff dealing with specialised customer matters. Mr McMahon said:

...there was complaints about not knowing who to talk to, about people – there was an enormous change in staff, people would have a manager for a short time, and then that manager would be gone. The clients really needed to have someone that understood their business, and as – as in Western Australia – you have to have the funding absolutely necessary at the time, and if that wasn't available, the – the consequences for a business is it's not just that particular year. With farming it can go on for several years after that.

If you don't – for example, with sugar, if you don't give it the correct fertiliser and sprays at – at the correct time, that's potentially going to affect the crop production for the next couple of years, and that – and that in turn affects not only the customer but also the bank's position as well, because the – the value of the property goes down. Everyone – it's very easy to see the effects of a failure to manage those crops, and all – all the prospective buyers, if that's what ultimately happens, would see that that property hasn't been managed to the correct way or to the usual format. So certainly timeliness is – is a massive issue.

43. Mr Steinberg, who gave evidence for ANZ, accepted that maintaining continuity of relationships is important in the context of agribusiness customers. However (and somewhat disingenuously given the program within ANZ to close rural branches) he identified the key barrier to this as being the behaviour of the employees:<sup>17</sup>

COUNSEL ASSISTING: Given the seasonal nature of agriculture, do you accept that it's particularly important for banks to maintain continuity in their relationships with agribusiness customers?---

MR STEINBERG: I think that that is a – an ideal position to have. The reality, Ms Orr, is that in banking and in all other businesses, people do come and people go. People move into different roles, people leave the bank, resign. So I would accept that that is a preferable position to have. Unfortunately, it doesn't always work out that way.

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<sup>17</sup>

T3208.11.

44. The evidence further reveals that ANZ considered alternatives to branch closures, and further suggests that ANZ plans the branch closures twelve months to two years in advance.<sup>18</sup> Both of these matters are revealing and warrant further examination.
45. ANZ identified as an alternative to rural branch closures the sale of rural branches, or reducing the operating hours of branches.
46. The sale option would have meant that branches would remain open, allowing communities ongoing access to a local branch. It may have meant a transfer of employment for staff, but would have ensured continuity of relationship between banker and customer.
47. The ANZ rejected the option of selling rural branches as the assessment was made that, in the event of simple branch closure, there would be limited loss of customers. Conversely, in the event of branch sale, customers would transfer to the new entity. The document prepared for the CEO notes, in very large font “*Historically we experience remarkably low customer attrition when closing a branch in regional, rural or remote areas*”.
48. Banks have actively worked to minimise customer attrition as a result of branch closures. As is discussed elsewhere in these submissions, banks have increasingly focused on increasing customer “stickiness”. This is a concept whereby customers are encouraged to have increasing numbers of associations and products with the bank, making their ability to change banks more difficult. Similarly, banks have focused on reducing access to products that involve branch engagement (like, for example passbook accounts), in favour of products accessible over the internet or phone. This is notwithstanding the fact that ANZ aware that its customers are more reliant on branches than other bank’s customers.<sup>19</sup>
49. ANZ’s assessment was that if they sold the branches, the sale value would not compensate the bank for the loss of customers.
50. It does not appear that ANZ considered, other than with regard to reputational risk, the effect on customers of the loss of the local branch. At least one of the branches considered for sale was the last in the town. ANZ did not consider that a retained local service would provide a higher level of expertise, and likely a better service, than what could be provided from a more distant location by ANZ. ANZ did not consider the effect on the local community, the retrenched employees, or the loss to local businesses of a local bank branch.
51. The ANZ proposal noted the availability of some banking services via the post office, and increased reliance on internet and telephone banking. From the Union’s experience these options involve significantly inferior service. As an example, Union members in remote areas describe how cheques deposited at Australia Post generally take six days to clear, as opposed to three days if deposited at a branch. Internet and telephone banking are more difficult in many remote areas where internet services are poor and mobile reception limited. The closure of a local branch may lead to the removal of an ATM machine and greater reliance on private ATM machines. These machines generally charge significant fees for deposits and other transactions.
52. Further, the benefit to ANZ available from the closures are, in context, very small. ANZ identified a productivity benefit from the closure of 34 branches in FY16 and a further 50

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<sup>18</sup> Exhibits #4.206 Branch Options Final Recommendation (ANZ.700.008.0060), and Exhibit #4.207 Accelerated Branch Closures Presentation dated 26/04/2017 (ANZ.700.008.0002).

<sup>19</sup> Exhibit #4.207 Accelerated Branch Closures Presentation dated 26/04/2017 (ANZ.700.008.0002).



branches in FY17 of \$22 million.<sup>20</sup> In the 2016/17 financial year, ANZ's profit was \$6,938 million.<sup>21</sup> The branch closures contribution to this profit was only 0.32%.

53. The Union's experience is that ANZ does not more than advise customers of a proposed closure in accordance with the minimum required under the ABA Branch Closure Protocol. This requires banks to provide customers 12 weeks' notice if the branch is not the last bank in town, and 24 weeks if it is. On ANZ's evidence they have generally made the decision to close the branch one to two years before it occurs. Greater lead time may permit alternate arrangements, including genuine alternatives like community banks to be arranged. There is no good or ethical reason preventing ANZ from providing customers greater lead time. It is unreasonable and unethical for the bank to continue to engage new customers and offer new loans in circumstances where a decision has been made to close a local branch, and that fact is not disclosed.

## **THE FARMING FINANCE AND AGRIBUSINESS CASE STUDIES**

### **D The ANZ (Landmark) case study**

#### **D-1 What does it mean for a bank to act fairly and reasonably towards a customer in a consistent and ethical manner?**

**What does that obligation require of a bank in relation to agribusiness customers in an enforcement context?**

#### ***Key Points***

- Current obligations contained in the Banking Code of Practice is too vague and uncertain.
- To date, courts have been unwilling to assume the Banking Code of Practice establishes significant legal obligations but have generally viewed as an aspirational statement, or an obligation to act in good faith.
- Banks appear to understand that the Banking Code of Practice involves significantly more than a simple good faith obligation.
- Bank employees are central to banks meeting their obligations under the Banking Code of Practice.
- Content of the obligations should involve a requirement that Banks act ethically in all dealings.

54. The ANZ Landmark case study involved thirteen rural customers. Mr Steinberg gave evidence for ANZ on the case study which focused on two matters – the Cheesemans and the Harleys.<sup>22</sup> In both cases, the customers had had loans with Landmark which had been acquired by ANZ in 2010. In both cases the customer had encountered financial difficulties such that they were in default of their loan obligations. In both cases the customers had taken significant steps, including selling much of their property, to satisfy a significant portion of their debts to ANZ. In both cases, ANZ demonstrated an unsympathetic approach which failed to consider genuine

<sup>20</sup> Exhibit #4.206 Branch Options Final Recommendation (ANZ.700.008.0060) at ANZ.700.008.0077

<sup>21</sup> ANZ Bank, *2017 Annual Report* p. 16  
([http://shareholder.anz.com/sites/default/files/2017\\_anz\\_annual\\_report.pdf](http://shareholder.anz.com/sites/default/files/2017_anz_annual_report.pdf)).

<sup>22</sup> The Union refers to the Summary of certain evidence in the ANZ Landmark case study (RCD.9999.0061.0001).

and reasonable offers from the customers and prioritised short-term certainty over other outcomes.

55. Both customers lost their primary residence because of the conduct of ANZ, in circumstances where that outcome should have been avoidable.
56. The events to which the case studies related occurred primarily in the period between 2010 and 2014, although in respect of the Harleys, the issues with the bank were ongoing until February of this year.
57. In both cases Mr Steinberg conceded a series of steps taken by ANZ fell below community standards and expectations.
58. The reference to an obligation to “*act fairly and reasonably towards a customer in a consistent and ethical manner*” arises from the Code of Banking Practice.<sup>23</sup> That obligation in full provides:
- “We will act fairly and reasonably towards you in a consistent and ethical manner. In doing so we will consider your conduct, our conduct and the contract between us.”
59. The Union notes that in both cases the Code applied to the customers as “small business customers” and that they would be on the outer edge of the definition of small business for the proposed revised code.<sup>24</sup>
60. The Union also notes the comments of the Commissioner that these obligations have some overlap with those in s.912A of the *Corporations Act*, and (to the extent it applies) the National Credit Code obligations to provide services in a manner which is efficient, honest and fair.
61. The Union notes that parties are asked to provide detail as to what the content of this obligation should be. Such enquiry is important. To date, the Courts seemed to have viewed the obligation as too vague to have much legal impact, more as an aspirational set of “dos and don’ts”<sup>25</sup> and at a high point, a good faith obligation. In *Sam Management Services (Aust) Pty Ltd v Bank of Western Australia Ltd* [2009] NSWCA 320 Young JA said:

72 This appeal has been made viable because of the inclusion in the contract between the parties of the Code of Banking Practice, a document which was probably never prepared by its drafters to form part of a legal document. It is drafted as a lay person’s document to be understood in a quick reading by a person considering dealing with the bank. It thus lacks the precision that one would expect in a term to be included in a contract dealing with megadollars.

73 The relevant clause in the Code of Practice is 2.2 which provides: -

“we will act fairly and reasonably towards you in a consistent and ethical manner. In so doing we will consider your conduct, our conduct and the contract before us.”

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<sup>23</sup> Code of Banking Practice, clause 3.2.

<sup>24</sup> Each of the Cheesmans and Harleys had debts of about \$2.5 million to Landmark as at 2011. By the definition proposed in the amended Code of Banking Practice, businesses with total debts of \$3 million or more are not considered small business and not entitled to the protections of the Code of Banking Practice.

<sup>25</sup> *Commonwealth Bank of Australia v. Starrs* [2012] SASC 222 at [118].

74 The clause in a legal document is so fraught with ambiguity. Its exact meaning was not canvassed before us so that it would be unwise to attempt to be definitive in its construction. Assuming it must be given some meaning in a commercial document, it probably does not operate to beyond requiring the bank to act in good faith towards the customer.

75 However, the principal purpose of these remarks is to suggest to bankers that the cross reference in legal documents to their promotional material is likely to lead to complications in litigation.

62. Contrary to the observations of Young JA, Mr Steinberg on behalf of ANZ understood the obligation imposed by clause 3.2 (or clause 2.2 of the 2004 Code which was to the same effect) had more substance than simply being akin to marketing a good faith obligation. The evidence in relation to the Phillott matter was:

Counsel Assisting And, in general terms, can you explain what it was about ANZs conduct towards Mr Phillott Junior that breached the obligation in clause 2.2?---

Mr Steinberg Well, there were – there were two aspects, as I understand it. The first aspect was in that ANZ took responsibility for some of the dealings that Landmark had with Mr Phillott in relation to the original lending to – to the customer. And then the second aspect was, post ANZs acquisition, the manner in which we communicated with Mr Phillott and the fact that we felt we did not work constructively with him in a way to resolve the issues with him.

Counsel Assisting Those are the ways in which you say ANZ breached clause 2.2 in relation to Mr Phillott Junior?

Mr Steinberg Yes.

Counsel Assisting Right. You've also

The Commissioner Well, could I understand that. You say you did not act constructively. Are you saying you did not act fairly and reasonably? Are you saying the bank did not act fairly and reasonably?-

Mr Steinberg I – I think that the bank did act in a consistent manner in terms of its dealings there. There was a history of requesting debt repayment over a period of time. I think the dealings were consistent, but I think they weren't fair and they weren't reasonable.

Counsel Assisting And the fourth element to which you have not referred is ethical. Did the bank act in an ethical manner?

Mr Steinberg I think it's – it's fair to say we didn't.

63. On a second file within the case study concerning the Hirsts, Mr Steinberg apparently initially considered that the Bank had breached the obligation, but later resiled from this position.<sup>26</sup> In the case of the Harleys and the Cheesmans, Mr Steinberg denied the proposition that the bank had breached its obligations. In so doing he relied particularly on the consistency of the bank's conduct.

64. It was apparent from the responses of Mr Steinberg that ANZ understood its obligation under clause 3.2 as being substantially more than simply acting in good faith. Even on the matters in which Mr Steinberg resisted the contention that the bank had breached its obligation, his

- response contained a concession the obligation was more than an obligation to act in good faith.
65. Mr Steinberg accepted that the obligation to act fairly, reasonable, consistently, and in an ethical manner went beyond an assessment about whether the bank *had the power* to do something and involved an assessment about whether the bank *should* do something.<sup>27</sup> The Union submits that this distinction only goes part of the way to identifying what the bank's obligation to act ethically should be: the obligation should also inform the conduct of the bank in drawing up contracts (and in so doing impact on the powers of the bank), or determining what products are sold to which customers.
66. From the Union's perspective the obligation to act "fairly and reasonably towards a customer in a consistent and ethical manner" is synonymous with a broad, appropriate obligation of acting ethically towards the customer.
67. Such an obligation sits in the spectrum between a good faith obligation, and that imposed by a fiduciary relationship.
68. The Union submits that there is a need for this obligation to be properly, and more comprehensively defined with sufficient certainty and clarity as to create clear expectations of behaviour. The Union submits that it is not appropriate for such an obligation to be located in an instrument of self-regulation, that can be misunderstood as essentially marketing material for the banks. If the code is to have scope and effect in rebuilding trust in the financial services sector, it must exist in such form that it cannot be dismissed by judges as no more than aspirational.
69. It is striking that Mr Steinberg believed that the obligation was less onerous than meeting "community standards and expectations". He accepted that ANZ conduct fell below community standards and expectations in respect of seven matters.<sup>28</sup> but only acknowledged that the bank had failed to meet the obligation to act "fairly and reasonably towards a customer in a consistent and ethical manner" in two of those matters.
70. The Union submits that the Code of Banking Practice obligations are intended to and should encroach into what the entities would otherwise be lawfully permitted to do. It should not be a proper answer to say that the bank could not have breached its obligation because the contractual term it relies upon permitted it to act in the manner it did. Put the other way, it goes without saying that already actionable conduct such as acting in breach of contractual or statutory obligations is not "fair and reasonable", or ethical, and if the Code obligation is limited to such measures it would have no work to do.
71. In attempting to properly define the obligation, the Union notes that it is not possible for banks to act ethically towards their customers if they are not acting ethically towards the community generally, towards potential customers, or towards their employees. By way of example, the Union submits that it is inconsistent with the banks' obligations to impose unrealistic sales targets on staff, or to continue to utilise sales measures based on significant conflicts of interest.
72. For bank employees, an obligation on banks to act ethically has more than a professional dimension, but also an employment and personal dimensions. Bank employees, like most individuals, seek to act ethically in the course of their work. It is central to the mission of increasing and restoring professionalisation to bank workers that they be permitted to do so.

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<sup>27</sup> T3300.37.

<sup>28</sup> T3190.06.

73. Bank employees are central to ensuring that banks operate in a fair, reasonable, consistent and ethical manner. The evidence of Ms Gartmann in the Ruralbank case study of this round of hearings in apposite:

- Counsel Assisting And I just want to finally on this topic understand, Ms Gartmann, what Rural Bank does to ensure that it acts fairly and reasonably towards its customers in a consistent and ethical manner?
- Ms Gartmann So firstly, having the right staff and having them appropriately trained and skilled, and appropriately monitoring and oversight their performance, and how they do their role, is an – a first priority for us in ensuring that our customers are dealing with people that know the industry and that are acting appropriately. So I see that as a highest priority.
- Counsel Assisting Are there other priorities – are there other things you would like to add that are part of ensuring you treat your customers fairly and reasonably?
- Ms Gartmann I think that that largely – and that’s not just – our front line staff as well as every staff member within our lending value chain should be considering the customer and their interests, and balancing that up with those of shareholders as well, in making appropriate considerations and decisions. So it’s not just our front line staff that need to do that, it’s everybody within the business. And, therefore, having people within the business – even if they’re not directly interacting with agricultural customers – need to have an understanding of the agricultural industry.

74. It is striking that Ms Gartmann had no strategy beyond having the right staff, and ensuring that there was appropriate training and supervision in place, to deal with this obligation.

75. Without in any way suggesting that the following are comprehensive, the Union submits that the following propositions all fit within the obligation to act ethically. Given the Union’s constituency, such propositions have a bias around matters within the Union’s expertise:

- (a) That, in selling or recommending loans or other products, employees are not subject to such sales targets or other pressure that may lead them being conflicted, or otherwise acting contrary to the customer’s interests;
- (b) That employees are provided sufficient training and resources to adequately service customers with particular focus on ensuring that customers are offered products that are appropriate for them in all circumstances;
- (c) That responsibility for the provision of services to the customer is not transferred between employees, or between parts of the bank unnecessarily, and without there also being a transfer of knowledge and commitments that have arisen in connection with the customer;
- (d) That banks will not place unreasonable pressure on customers to acquire financial services, and will respect decisions by customers to reject new services;
- (e) That banks maintain a strong and meaningful system of protections for whistle-blowers;
- (f) That banks will engage in alternate dispute resolution procedures prior to taking formal action against the customer;
- (g) That banks disclose to customers dispute settlement procedures, and policies that may assist in the event of hardship;

(h) That the terms of contracts entered into between banks and customers are not unfair.

**D-2 What weight should a bank give to the interests of the customer when making decisions about agribusiness customers experiencing financial difficulty?**

**How should a bank balance the competing interests of the customer and the bank in that context?**

***Key Points***

- Banks should consider the interests of all stakeholders in their decisions. Particular care should be had when the decision will adversely impact a stakeholder.
- Where a decision is about a customer experiencing financial difficulty, banks look for alternate options that achieve the bank's objectives without adversely impacting the customer
- There is tension between the profit horizons of banks – generally one to four years, and those of many rural business, whose cycle between periods of profit may last seven or more years.

76. Customers in financial difficulty, along with shareholders, employees, other customers and the community generally are stakeholders in a bank. Banks should consider the interests of all stakeholders in all decisions.
77. The fact that a decision will have a significant and adverse impact on a customer (or some other stakeholder) should mean that the bank should be cautious and careful in making the decision.
78. A corollary of a decision having an adverse impact should be that the bank should consider if there are alternate options that meet the bank's objectives without the impact on the customer.
79. The Union notes that the question assumes that the bank's interest and the customer's interest are competing. While there are no doubt instances where consumers and bank interests may compete, the Union submits that in many cases, bank and customer interests align. Assuming that there is an inherent conflict between these interests reduces the possibility of a focus on mutually beneficial outcomes.
80. The Union submits that addressing this question is central to the development of better culture within banks. Rather than simply understanding their role as extracting profits from their customers, banks have a responsibility to support and develop the economy and the community generally.
81. A feature of current disconnection is the tension between the profit horizons of the banks and rural business. Banks operate on a far shorter timeframe than many farmers, whose cycle between periods of profit may be five to ten years. For bankers, a long term incentive is one that is delayed for three to four years.<sup>29</sup> The primary focus is on generating profits in the short term – one to two years.
82. The evidence of Mr Steinberg in connection with the Landmark case study is relevant. It was apparent from his evidence that ANZ understood its interest as being better served by a write

<sup>29</sup> APRA, *Information Paper – Remuneration Practices at Large Financial Institutions*, April 2018 page 12 (<https://www.apra.gov.au/sites/default/files/180328-Information-Paper-Remuneration-Practices.pdf>).

down and a realisation of the loss, than carrying the debt, even if the final return to the bank was less favourable.<sup>30</sup>

83. In several parts of his evidence, the failure of ANZ to consider whether there were other options that achieved the bank's objective but did less damage to the customer, was apparent. This was clear in the cases where external administrators were called in, and in cases where the bank insisted on sales at a time of the year when profit would be at a low point.
84. As has been repeatedly demonstrated from evidence to the Royal Commission, financial services entities can have extraordinary power over the lives, homes and livelihoods of individuals. The Union submits that being entitled to operate as a financial services entity should involve various community service obligations. Such obligations should be owed to shareholders and other stakeholders – consumers, employees and the community generally. Such obligations should be incorporated into an understanding of what is in the interests of the bank.
85. Where possible, farmers being provided as much opportunity as possible to trade out of debt should be the default position. This is particularly the case where the customer is genuinely attempting to discharge their obligations to the banks, as was the case in the Landmark case studies considered in detail.
86. The forced sale of property at a time in a cycle particularly disadvantageous to the seller should be avoided. Customers undergoing financial difficulty, particularly where those financial difficulties are part of the more generalised trend (such as from drought, flood or other matters that may affect classes of customers) warrant significant consideration.
87. The Union submits that a wider definition and understanding of the bank's interest would mean that the institution would be more likely to adopt an approach contemplated by the Royal Commissioner, looking at trying to recover the greatest amount possible, even if it may mean a further delay.
88. A further element of this is that it is in the bank's interest to be properly informed about issues relevant to the customer. The bank has, as a corollary, an obligation to be informed of the customer's interest and to maintain a capacity to engage with the customer. Mr Steinberg accepted the proposition that the continuity of relationship between farmer and agribusiness customer was important. This continuity is important for many reasons: it enables a relationship of trust to be built, it enables the banker to develop expertise in issues relevant to the customer, and, in many ways as a product of those matters, it enables the banker and customer to develop a genuine understanding of whether the issues the customer is dealing with are of the normal, cyclic kind which impact agribusiness, whether the issues have arisen because of singular or one off events that can be addressed (for example the live export ban), or whether the issues are reflective of a genuine and persistent flaw in the customer's business that cannot be readily resolved.
89. A repeated feature of the case studies in agribusiness were the close relationships that exist between agribankers and their customers. The Union's experience is that the traditional relationship that existed between customers and bank managers continues in many places between farmers and agribankers. Part of the balance between the bank's interest and the customer's interest should be the maintenance of that relationship, with the corresponding elements of knowledge, trust and forbearance.

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<sup>30</sup>

T3274.32.

**D-3 In what circumstances is it both best for the customer and best for the bank to appoint an external administrator?**

90. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

E The Rabobank Case Study

***Key Points***

- Performance of appraisals, or other steps involved in the subjective assessment of loans should not be performed by employees who have KPI targets or incentive payments associated with volume of loans.
- Sales targets and incentive payments based on loan volumes are generally inappropriate, and particularly so in the context of rural banking where there can be dramatic fluctuations.

**E-4 Is it appropriate for financial services entities to conduct internal appraisals, as opposed to obtaining independent valuations of farms and other rural property?**

**If so, in what circumstances is it appropriate?**

91. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

**E-5 Is it appropriate for staff involved in origination of the loan to conduct or otherwise be substantively involved with such appraisals?**

92. The Union submits that any instance where a conflict of interest may arise should trigger an assessment of how the conflict should be managed.

93. In the Rabobank case study, the relevant manager had sales targets on new loans.<sup>31</sup> These targets included bringing in \$15 million in new loans each year.<sup>32</sup>

94. The Union notes that Rabobank continues to set sales targets for bankers of this kind.<sup>33</sup> Further, in the event the banker met their KPIs (including the sales target) they would become entitled to a bonus.<sup>34</sup>

95. It follows that a conflict between the banker's interest and the customer's interest potentially arises. Rabobank assert that they control for this risk by internal measures that ensure that address risk and loan quality.

96. The Union submits three matters flow from this scenario.

97. The first is, in circumstances where the ongoing employment and remuneration of the banker are contingent on loan volumes, it is inappropriate for the same banker to be involved in subjective assessments (such as valuations). The system created by Rabobank means that the banker has "skin in the game" and accordingly, will potentially be influenced by that in undertaking a task such as a valuation. The influence will not necessarily be to inflate the valuation. One can equally imagine a banker aware of the conflict seeking to control it by

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<sup>31</sup> T3344.38.

<sup>32</sup> T3345.30.

<sup>33</sup> T3345.46.

<sup>34</sup> T3347.30 There was some discussion about whether there was a simple relationship between meeting KPIs and bonus entitlement. It appears that Rabobank maintains a discretion in terms of bonus eligibility to account for "seasonal variations" that may arise. Broadly however, there is a direct correlation.



undervaluing. Either option (and indeed simply the loss of objective independence) undermines the validity of the valuation and thereby leads to a poorer outcome for the customer.

98. The second is that transferring responsibility for the valuation to another employee (such as a manager) who is also subject to targets or incentivised around loans volumes does not resolve the issue in any material way.
99. The third is that Rabobank's continued reliance on sales targets and volume-based bonuses is inappropriate. The Union submits that such targets and bonuses are inappropriate generally. This submission has force in the context of agribanking where the impact of weather, commodity prices and government policy can cause enormous fluctuations in value, and where the consequence of default (as was seen in this case study and the Landmark case studies) is so significant.

**E-6 Should there be minimum levels of qualification, skill, and experience before a bank employee can be authorised to conduct appraisals?**

**If so, what are the appropriate minimum levels?**

100. The Union supports the provision of appropriate training, and more generally an increase in professionalisation in all aspects of bank employment.
101. The Union believes that banks must ensure that employees are suitably trained before performing valuations. While the union supports the imposition of minimum standards, it is important that such a process not simply be a system of credentialisation where individuals with qualifications are preferred over employees with extensive experience and knowledge.
102. However, the Union believes that the issue is of secondary importance, and the more significant issue is the avoidance of conflicts. In addition to performing a valuation role, the manager in the Rabobank case study was subject to several other conflicts – he was “acting” to varied extents for each of two purchasers and a vendor of the property.
103. The evidence from the Rabobank case study was not that the valuation of the Brauer's property was wrong per se. Rather, it was a lack of confidence in the valuation because of the conflicts of the manager, and because the valuation was so closely aligned to achieving transfers of the properties. The more general proposition that arises is that if the person doing the valuation also has KPIs around volumes of loans, or incentives around new loans, then there is a risk that their valuations will be assessed as influenced or will be influenced by a desire to ensure that loans are made.

**E-7 Should there be a code that sets out the requirements for the conduct of internal appraisals by financial services entities, either in respect of rural properties or more generally?**

**If so, what form should that code take?**

104. In light of the evidence before the Commission, the Union supports the development of a sector wide code or practice guidelines.
105. The Union is aware that different financial institutions have different policies in place around the preparation of valuations.
106. External valuations are more independent of the bank's interest than internal valuations. Should there be a subsequent significant revaluation which, for example, may entitle the bank

to act on the loan, they are less likely to raise concerns that the initial valuation was not appropriate.

107. External valuations also cost more money. That cost is ultimately generally borne by the consumer.
108. It follows that there is a competitive advantage for those financial institutions that do not require external valuations over those that do require such valuations. Given independent valuations are generally to be supported, the Union submits there is a role for a code or minimum requirements for the preparation of valuations.

F The CBA (Bankwest) Case Study

**F-8 Do remuneration and incentive policies that reward bank employees for the volume of loans sold create an unacceptable risk that bank employees will prioritise the sale of loan products over the bank’s responsible lending obligations; over the bank’s statutory obligations, including to provide loans in a manner that is efficient, fair and honest, and to have in place adequate arrangements to ensure that customers are not disadvantaged by any conflict of interest that may arise in relation to the provision of loans; and over the bank’s obligations to act fairly and reasonably towards customers in a consistent and ethical manner?**

***Key Points***

- Remuneration and incentive policies that operate on the volume of loans are a form of conflicted remuneration. Conflicted remuneration creates significant risks of negative outcomes and should be avoided.
- KPIs and sales targets where employees are required to meet certain targets to maintain employment have a similar, but more pernicious, effect of contributing to poor decisions and should not be permitted.
- The provision of incentive payments based on profits and growth in the value of loans to senior managers and others who determine culture and strategy is equally, if not more important, than the issue affecting front line staff.
- Simple reliance on “control measures”, while maintaining a consistent direct and indirect focus on increasing sales, is unfair and inappropriate.

109. Remuneration and incentive policies that reward bank employees on the volume of sales are a form of conflicted remuneration. Other practices, such as for example the setting of volume based KPIs and targets, have even more pernicious effects.
110. The Union submits that remuneration and incentive policies that reward bank employees for volumes of loan sold or require bank employees to achieve certain sales targets create a significant risk of outcomes that are contrary to the bank’s obligations, and which fall below acceptable and appropriate standards.
111. Indeed, the Union submits that such a proposition should no longer be regarded as controversial. It was a proposition that has been examined both in Australia and overseas on numerous occasions, with a consistent response – practices and culture that prioritise quantity of sales over other metrics are invariably associated with adverse outcomes.
112. Poor outcomes associated with targets and conflicted remuneration have been a feature of case studies in each round of the Royal Commission. The Union refers to submissions by relevant parties to previous rounds of this Royal Commission on this issue.

113. Submissions by Choice and other submissions on behalf of consumer advocacy organisations each clearly acknowledged the significance of the risks created by such policies.<sup>35</sup> ASIC's position was similar. In the first round ASIC submitted:<sup>36</sup>

ASIC has long recognised that conflicted remuneration is a misaligned incentive that can and does create a supply-side driver of poor conduct.

114. ASIC restated its position in its submissions to the second round of submissions on financial advice where it submitted:

[ASIC's] position is that, in principle, any exception to the ban on conflicted remuneration, by definition, has the ability to create misaligned incentives, which can lead to inappropriate advice.

115. Indeed, even in this round, the issue arises not just in the context of this case study, but also in relation to the case studies relating to Rural Bank, and Rabobank. It is a consistent theme of the Royal Commission.

116. Given the obvious issue created by the practice, the Union submits that the Commission would find that the risk created is unacceptable.

117. The Union submits that the Commission should further consider this issue in two important respects. The first is that such policies which provide for incentive payments are generally secondary to KPI linked sales targets. The second is that the issue of such policies should not be limited to front line sales staff, but should be considered in the context of all bank employees.

#### KPIs

118. The Bank West case study involved a farming family, the Ruddys, and the conduct of a manager who, on the evidence, appears to have relied upon unrealistic valuations to enable loans to be made that would not otherwise have been made.

119. Ms Taylor, who gave evidence for Bankwest conceded that Bankwest principally judged performance of employees like the manager based on whether they were making sales.<sup>37</sup>

120. Counsel Assisting summarised the evidence<sup>38</sup> as:

The evidence establishes that at the time Bankwest offered the facilities to the Ruddys, 60 per cent of its KPIs for employees like the bank manager were weighted towards 45 profitable growth. Half of that was allocated to asset sales targets.

Provided that employees met a risk gate opener, they could then be eligible for short-term incentive payments. The evidence established that in the 2011 financial year, Bankwest employees were able to double their base salary through such bonus arrangements. This created a culture of prioritising sales to the detriment of diligent and prudent conduct in relation to loan approvals. The Ruddys' bank manager received his base salary and was eligible for a short-term incentive for up to 57 per cent of his salary by way of additional bonus.

121. The Union notes a key driver for employees who were the subject of this "remuneration and incentive scheme" was meeting their KPIs. While the manager in question did meet the KPIs,

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<sup>35</sup> Submissions of Choice on Round 1 Consumer Lending at page 4.

<sup>36</sup> Submissions of The Australian Securities and Investments Commission Consumer Finance on Round 1 Consumer Lending - para [3].

<sup>37</sup> T3461.32.

<sup>38</sup> T4117.43.

others who did not were likely the subject of performance management and, potentially dismissal.

122. Short-term incentive payments were the second half of the management system in play at Bankwest.
123. The first half of the management system was that to meet minimum job requirements (referred to as KPIs) staff had to achieve certain asset sales targets.
124. The Union submits that tying sales targets to KPIs and minimum performance requirements is a greater and more pressing “misaligned incentive” than STI payments. There is a preeminent risk that an employee whose livelihood is potentially imperilled by failing to sell sufficient products will act in an inappropriate way.
125. Critically, the Union notes that while the amount of STI payments has been reduced, “financial KPIs” (which in plain language are sales targets) remain as at the time Ms Taylor gave evidence, the largest of the KPIs applicable to bank employees.<sup>39</sup>

Senior employees

126. The Union refers to the Sedgwick Review which has previously been considered in the context by this Royal Commission. The Sedgwick Review was limited to retail banking, and accordingly did not apply to business banking or agribusiness except to the extent that those activities take place in retail branches.
127. The loans to the Ruddys were not retail banking and, to the extent financial institutions have made changes to their practices since the Sedgwick recommendations, such changes would not apply to this manager. The Union submits that the limitation of the Sedgwick Review to consumer banking is one of the key defects of the review.
128. However, a more pressing defect in the Sedgwick Review was the failure to address senior manager and executive remuneration practices, who were excluded from the examination and recommendations. The proportion and amount of additional payments which may be achieved through incentive payments generally increases with seniority of employees.
129. For senior employees, the issue tends not to be about the volume of sales of a kind of product, per se. Rather, such employees are provided additional rewards on achieving general benchmarks of growth and profitability. However, sales and promotion of specific products are the building blocks of the general growth and profit.
130. The impact of senior manager and executive behaviour is clear. Such individuals set both the cultural tone of the institutions, and the performance expectations. These in turn are translated into KPIs and incentive payment systems for front line staff. Issues around expectation and non-financial rewards were relevant in the Ruddy case study. Bankwest named the relevant bank manager as its “Rural & Regional Champion” for 2010 and 2011<sup>40</sup> and he was rewarded with a trip to Hayman Island. Such rewards send clear, positive messages to all employees as to the type of staff member their employer wants them to emulate.
131. The Union notes APRA’s recent Information Paper, “*Remuneration Practices at Large Financial Institutions*”.<sup>41</sup> The paper focused on a review of senior executive remuneration which was conducted during the second half of 2017. The Executive Summary provided:

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<sup>39</sup> T3462.33.

<sup>40</sup> T3463.44.

<sup>41</sup> APRA, *Information Paper – Remuneration Practices at Large Financial Institutions*, April 2018 (<https://www.apra.gov.au/sites/default/files/180328-Information-Paper-Remuneration-Practices.pdf>).

The global financial crisis in 2008 laid bare the potentially disastrous consequences of getting the balance of incentives and accountability wrong, by encouraging practices by individuals that were detrimental to the long-term interests of the financial institutions that employed them. A combination of misaligned incentives and ineffective accountability created poor risk cultures and undermined risk management, leading to unbalanced and ill-considered decision-making.

...

The review found that remuneration frameworks and practices across the sample did not consistently and effectively meet APRA's objective of sufficiently encouraging behaviour that supports risk management frameworks and institutions' long-term financial soundness. Though all institutions had remuneration structures that satisfied the minimum requirements of APRA's prudential standards, the frameworks and practices often fell short of the sound practices set out in the relevant prudential guidance and were therefore some way from better practice.

The review focused on three main themes:

- design of risk management performance measures;
- remuneration outcomes; and
- Board Remuneration Committee oversight.

Amongst other things, the review found room for improvement in: • ensuring practices were adopted that were appropriate to the institution's size, complexity and risk profile;

- the extent to which risk outcomes were assessed, and weighted, within performance scorecards;
- enforcement of accountability mechanisms in response to poor risk outcomes; and
- evidence of the rationale for remuneration decisions.

Based on these findings, there is considerable room for improvement in both the design and implementation of executive remuneration structures within the Australian financial system.

132. Relevant, but unexamined by the Royal Commission is the extent to which the targets, remuneration and incentive policies imposed on the Ruddy's bank manager by Bank West were a product of institutional targets or associated with senior executive remuneration outcomes. As noted above this question is squarely within the Letters Patent.
133. There was a later assessment that the manager had acted inappropriately and that his conduct had caused losses to May 2012 of \$374,000. There is no evidence as to whether any assessment was made of the conduct of those senior employees who installed the problematic targets and incentives, and who rewarded his conduct, or whether the incentive payments obtained on the back of the manager's problematic sales were clawed back.

#### Response of the Financial Services Entities

134. The consistent response of the Financial Services Entities to this issue is that there is nothing wrong with conflicted remuneration provided there are sufficient control measures in place. In the Bankwest case study, Ms Taylor's evidence was that the issue had been resolved by changes to process around valuations.
135. The Union does not contend that appropriate control measures should be ignored.
136. However, such an approach as a solution to the issue of conflicted remuneration is misguided.

137. The banks' approach is to place enormous cultural, management and financial pressure on employees to achieve sales and profits, and then to attempt to control the predictable consequences of that pressure. The better approach is to avoid applying the pressure.
138. Limitations on, and where possible the removal of, sales-based targets and incentive payments are a clear and straightforward way to reduce this pressure.

G The NAB Case Study

**G-9 To what extent does default interest reflect the cost to financial services entities of carrying impaired loans?**

139. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

**G-10 Should there be a moratorium on the charging of default interest in respect of farm debts secured by farm debt mortgages during periods when the farm property is affected by natural disaster?**

**If so, how should such a moratorium be implemented? By legislation, by an industry code, or by some other means?**

**In what circumstances should the moratorium come into effect?**

**In what circumstances should the moratorium be lifted?**

140. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

**G-11 Should there be a moratorium on the taking of enforcement action in respect of farm property while that property is, or soon after that property has been, affected by natural disaster?**

**If so, how should such a moratorium be implemented, in what circumstances should it come into effect, and in what circumstances should it be lifted?**

141. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

**G-12 Should provision be made in the farm debt mediation Acts or another legislative instrument or binding code to facilitate earlier discussion between financial services entities, farmers, and third parties such as rural financial counsellors in cases where farmers face actual or probable financial distress? Should there be a uniform Farm Debt Mediation Act?**

**If so, is any of the current Acts in a suitable form for uniform adoption?**

142. The Union supports alternative dispute resolution procedures and submits that there should be a requirement that banks genuinely engage in an ADR process before taking any action to enforce contractual rights under a debt contract. We note that such an arrangement is currently in place for some, but not all Australian jurisdictions.

H The Bendigo and Adelaide Bank (Rural Bank) Case Study

- H-13 How should banks balance the competing interests of strengthening the long-term relationships with their customers and being prepared to act decisively, where necessary, particularly to safeguard shareholder interests?**
- H-14 How should banks balance portfolio growth against the need to monitor and manage their existing clients?**
- H-15 Do banks have appropriate policies in place for dealing with external events that may impact an agribusiness loan portfolio? If not, what should those policies entail?**
- H-16 Should banks be required to contact individual customers when they become aware of misconduct in relation to their accounts?**
143. The Union answers questions H-13 to H-16 together. From the Union's perspective the answer to each is essentially the same.
144. The Union submits that the appropriate response is on developing, fostering and maintaining an appropriate culture within the financial institution that is ethical and takes account of institutions obligations to all stakeholders – customers (both borrowers and depositors), shareholders, staff and the community generally.
145. The Union refers to and repeats its submission at Part B above which discusses culture.

**CASE STUDIES CONCERNING THE INTERACTIONS BETWEEN ABORIGINAL AND TORRES STRAIT ISLANDER PEOPLE AND FINANCIAL SERVICES ENTITIES**

I The ACBF and the Select AFSL, trading as Let's Insure Case Studies

- I-17 Is the current regulatory framework in respect of funeral expenses products adequate?**
- In particular, should the framework be amended so that funeral expenses products are not excluded from the definition of financial product by virtue of section 765A(1)(y) of the Corporations Act and regulation 7.1.07D of the Corporation Regulations 2001.**
146. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

J The Case Study concerning establishment of an ANZ account in a remote location

**J-18 Do banks take sufficient steps to promote the availability of fee-free accounts to eligible customers?**

***Key Points***

- Banks do not take sufficient steps to promote fee-free accounts, or other accounts appropriate to low income customers.
- Bank systems drive customers towards higher cost accounts, and greater numbers of accounts and products.
- Staff are required to ask scripted and prompted questions aimed at obtaining more business for the bank.
- There has been no cultural change away from a sales focus following the Sedgwick Review. Rather, customer needs analysis processes have replaced sales targets as a key driver of new business.
- The use of scripted and prompted questions may be inappropriate in connection with Aboriginal and Torres Strait Islander people where cultural concepts like gratuitous concurrence exist.

147. The Union’s experience is that banks do not generally take sufficient steps to promote the availability of fee-free accounts.
148. The overwhelming pressure on bank staff is to promote sales, and to promote products that are more lucrative for the banks.
149. Branch staff are trained and required to ask customers questions as to their needs, and financial aspirations. There are generally two iterations of the process.
150. The first which is a series of questions, often prompted by software that the banker is required to ask. Such questions may be less involved around a simple transaction (for example a withdrawal), and more involved on a complex act, like opening an account.
151. The second is a more formal series of questions that may be asked by a banker within the branch. Different banks have different names for this process – in the ANZ Bank it is known as an “*A-Z Review*”.

A-Z Reviews and other customer questioning

152. Over the last three to five years each of the banks have developed more sophisticated processes to engage with customers and attempt to identify potential opportunities for sales. A key element of this has been the development of scripted and prompted questions, which are often marketed to customers as opportunities to “*make the most of your bank accounts*”,<sup>42</sup> or to “*take control of your finances*”.<sup>43</sup> At NAB it is known as a “*Mindmap*” while at the Commonwealth Bank it is known as a “*Financial Health Check*”.
153. The experience of Union members is that banks are increasingly focused on creating multiple relationships with the same customer – trying to ensure that all of the customer’s banking and financial needs are performed by one bank. This is done not just to maximise the sales opportunities each customer offers, but also because it increases customer “stickiness”; the extent to which the customer’s financial dealings are so enmeshed in one institution it

<sup>42</sup> <https://www.commbank.com.au/cs/consumer-finance/get-your-free-financial-health-check-with-commbank-201709.html>.

<sup>43</sup> [http://campaigns.anz.com/bank-accounts/az-review/?pid=odm-hb-td-hp-12-15-acq-az\\_review](http://campaigns.anz.com/bank-accounts/az-review/?pid=odm-hb-td-hp-12-15-acq-az_review).



becomes very difficult for them to leave. The Union notes the relatively limited customer loss identified by the ANZ around branch closures as a consequence of such stickiness.

154. Such sales opportunities include, as in this case study, savings accounts, and extend to credit cards, loans, insurance and superannuation. The Union notes the recent enforceable undertakings provided by ANZ and CBA in connection with sales of superannuation.<sup>44</sup>
155. These semi-formal question processes have grown directly from the implementation of the recommendations from the Sedgwick Review which led to a reduced proportion of a retail banker's performance metrics being dedicated to formal sales targets. Union members now report that sales targets have been subsumed into "behaviour" performance metrics. Sales targets remain as entrenched in the KPIs of bank workers as they were previously.
156. There is a strong analogy between the development of these processes as a consequence of the limiting of strict sales targets, and the introduction of illusory fee for service arrangements as a consequence of the elimination of trailing commission arrangements. In both cases there has been no underlying change to culture, or expectations. Rather, the same goal is achieved through a somewhat more circuitous route.
157. In many cases the questions asked by the bankers are scripted, and/or prompted by the bank's computer system. The Union understands that in some cases the systems generate the questions from information collected by reviewing previous transactions made by the customers. Information about customers previously gained in early transactions is also stored and relied upon. For example, the Commonwealth Bank requires tellers to enter into the system any cards for other banks that they may see in a customer's wallet or purse. This information is later used in prompted questions about centralising accounts.
158. Even where customer needs analysis processes are not scripted, they are highly trained for and directed.
159. The specific circumstances of the case study are relevant. The Union notes that, based on information provided to ANZ management by the ANZ staff member, there remains a dispute about the specifics of the exchange. Aside from taking issue with some elements of the exchange as described by Ms Do, the version of events that would be told by the employee has not been presented. Ms Do's description of the extended interaction is lengthy. It includes:

[21] After arriving at the branch, we met with the Banker. During the meeting, I told the Banker that my client and her sister would each like to open an Access Basic account, because they wanted to open fee free transaction accounts that did not incur overdrawn or dishonour fees. My client and her sister provided the necessary documentation to prove that they were eligible for an Access Basic account, including their health care cards and Centrelink income statements I also told the Banker that my client and her sister would like to open savings accounts. The Banker suggested that the Progress Saver savings account was the most suitable option.

[22] The Banker then asked my client and her sister a number of questions and filled in their answers on her computer. She went through this process firstly with my client, and then with her sister.

[23] Some of the questions related to their income, the amount that they paid in rent and their other regular expenditure. My client was confident in answering these questions, as they related to fixed amounts of money that she was familiar with.

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<sup>44</sup> <https://asic.gov.au/about-asic/media-centre/find-a-media-release/2018-releases/18-206mr-asic-accepts-court-enforceable-undertakings-from-cba-and-anz-over-superannuation-product-distribution/>.

[24] The Banker then asked my client and her sister some more abstract questions about their savings goals such as: "How much would you like to save?"; "What are you saving for?"; and "How quickly would you like to save that amount?". It was apparent to me that my client did not understand the substance or purpose of these questions, because my client was looking confused, and because she gave brief and vague responses. These responses were taken literally by the Banker. For example, when the Banker asked what my client was saving for, she looked quizzical and answered: "Maybe furniture". When the Banker asked my client how much she would like to save my client's response was "maybe a couple of thousand". The Banker said something like: "So let's say \$5000".

[25] Throughout this period, I could see that the Banker was continuing to record my client's responses on her computer. The Banker then suggested that my client should save \$100 per fortnight. The Banker said that she would set up a direct debit arrangement so that the savings would be paid directly from my client's Centrelink payment into her Progress Saver savings account.

160. The questions of the kind posed to the customer with Ms Do are typical of the questions that tellers and other bank employees are required by the banks to ask customers. Such a process inevitably minimises the offering of low fee products and focuses instead on higher value products.
161. The Union refers to Exhibit #4.202.10.3<sup>45</sup> which was tendered into evidence, and in particular to page 49 of that document which sets out targets for the performance of A-Z Reviews. ANZ imposes on bank employees (like the one Ms Do spoke to) the requirement that they conduct ten A-Z Reviews each week. This requirement is a KPI and employees who fail to meet it may be subject to performance management and, ultimately, the termination of their employment.
162. It is telling that there is nothing in Exhibit #4.202.10.3, and particularly the expectation on A-Z Reviews, that would vary by reference to where the employee worked. The requirement to conduct these reviews is the same for the employee at the Toorak, or Point Piper Branch as it is for the employee at the Katherine branch. Bank employees describe being counselled on refusing to undertake A-Z Reviews with customers for whom it is clearly inappropriate. For employees in areas where there are significant numbers of low socio-economic status customers or significant numbers of people receiving government benefits, they will be unable to comply with their employment obligations if they do not pursue such customers, for whom the process is clearly not appropriate, for opportunities to open more accounts or purchase more financial services.

#### Gratuitous Concurrence

163. The Union notes as a second point, particular to Aboriginal and Torres Strait Islander people, is how cultural concepts like gratuitous concurrence likely interact with scripted and prompted selling techniques. Mr Boyle described gratuitous concurrence as follows:

MS ORR: Now, returning to the obstacles identified by Mrs Edwards, another obstacle that Mrs Edwards identified related to the trust that Aboriginal and Torres Strait Islander people can place in others. You refer in your statement to the concept of "gratuitous concurrence". Are you able to explain what that means?

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<sup>45</sup>

Exhibit #4.202.10.3.  
- Exhibit "TCT-10", being copies of the Measures dated 2016 to March 2018 (ANZ.800.638.0001).

MR BOYLE: Yes. Gratuitous concurrence is a tendency for Aboriginal and Torres Strait Islander people to agree to a proposition that's put to them, or to make affirmative noises in response to a proposition that's put to them, regardless of whether or not they agree with that proposition. So that's the first way that gratuitous concurrence plays out. And the second way is where an indigenous person will answer "yes" to a question that they don't understand, rather than want to appear silly, and so there is a tendency among Aboriginal and Torres Strait Islander people not to want to appear rude to a financial services provider, for example, and they will agree "yes, yes" even without understanding what they're being asked

164. The normal approach of bank employees to customers, as required to by their employer, is to ask questions with a view to selling more products. Such an approach is having a disproportionately poor impact on Aboriginal and Torres Strait Islander customers, who are more likely to acquiesce to propositions whether they actually agree or understand the proposition.

**J-19 Are banks' identification requirements appropriate for Aboriginal and Torres Strait Islander customers?**

**If so, are those identification requirements sufficiently understood and implemented by staff on the ground?**

***Key Points***

- Bank staff are not sufficiently trained in relation to identification issues that may impact Aboriginal or Torres Strait Islander people.
- Banks should do more training of staff in connection with identification and other issues relevant to Aboriginal and Torres Strait Islander people.
- Banks should do more to employ Aboriginal and Torres Strait Islander people, and to convert trainee employees to ongoing employees.

165. The Union does not believe that bank staff are sufficiently trained to deal with specific issues concerning identification for Aboriginal and Torres Strait Islander people. The Union submits that all banks should undertake additional training of staff to ensure that staff, particularly those who work in areas where there are more Aboriginal and Torres Strait Islander people, are appropriately trained.

166. Equally significantly, the Union believes that banks should do more to employ Aboriginal and Torres Strait Islander people as bank workers. The Union notes that there have been trainee programs focused on Aboriginal and Torres Strait Islander people, but that the conversion of people from trainee to ongoing employee is far too low.

167. The Union notes the observations of Mr Edwards and Ms Boyle in their evidence:

MS ORR: Do you think it would be valuable for indigenous people to be employed by financial services entities to assist in engagement with indigenous people?

MS EDWARDS: You know, I think – you know, most financial services, and particularly the banks, with reconciliation action plans, as long as they're ones that are actually going to be – you know, they're – you know, competent in – in working within that document, and listening to Aboriginal and Torres Strait Islander staff that, you know, say what their challenges are. You know, I think that – you know, it would be – you know, very beneficial to have Aboriginal and Torres Strait Islander people within branches, because I know myself if I go into a branch and I see an

Aboriginal and Torres Strait Islander person there, that's the person that I want to know, that I would like to deal with.

MS ORR: Mr Boyle, do you have any views about that?

MR BOYLE: I certainly think that more employment of Aboriginal and Torres Strait Islander people in the financial services industry would assist institutions to understand the issues and would certainly make it easier for indigenous people, particularly those in regional or remote areas, to access the services. Just having a voice that understands a person's needs or the difficulties that they're facing can make them feel much more comfortable, and it can also make people more open and less likely to fall into practices like gratuitous concurrence. If they're dealing with another Aboriginal and Torres Strait Islander person, they can form a bit of a relationship and often feel more comfortable asking questions and asserting their rights, so certainly I would support more employment of Aboriginal and Torres Strait Islander people in the financial services sector.

168. The Union submits that increasing levels of Aboriginal and Torres Strait Islander employment would increase awareness among all bank employees of issues such as common difficulties around identification.

**J-20 Do financial services entities have in place appropriate policies and procedures to assist Aboriginal and Torres Strait Islander people to overcome obstacles associated with geographical remoteness, to address the cultural barriers to engagement that some of these people face, to address the linguistic barriers to engagement that some of these people face, and to address the obstacles posed by the financial literacy levels of some of these people?**

**If appropriate policies and procedures are not in place, what changes should be made to those policies and procedures to deal with those matters?**

169. The Union does not believe that there are appropriate policies or procedures in place. The Union submits that in addition to the development of policies and procedures, banks should commit to improved training of current and future staff, and greater recruitment of Aboriginal and Torres Strait Islander employees.

170. The Union otherwise repeats its submission at paragraphs 147 – 168.

**J-21 Should more banks have a telephone service staffed by employees with specific training in assisting indigenous consumers?**

171. The events described by Ms Do demonstrate the need for improvements in training to staff, and the potentially the need for staff with specialist training. The Union again submits that the recruitment of more Aboriginal and Torres Strait Islander people as employees would be likely to assist.

K The ANZ Informal Overdraft Case Study

**K-22 Is it appropriate for informal overdrafts to be available in connection with basic accounts?**

**If so, what policies and procedures should banks put in place to minimise the risk of consumer detriment in respect of those products?**

172. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

**K-23 Would it be appropriate or lawful for informal overdrafts to be offered on an opt-in rather than an opt-out basis to recipients of government benefits in circumstances where the costs of utilising the informal overdrafts are high and where informal overdrafts may not be adequately notified to customers? Is that lawful and is it appropriate?**

173. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

**K-24 Should any other aspect of the current regulatory regime in respect of informal overdrafts be reformed to minimise the risk of consumer detriment?**

174. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

**K-25 Do ADIs presently have adequate policies in place for the implementation of the code of operation?**

175. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.