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TRANSCRIPT OF PROCEEDINGS

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THE HONOURABLE K. HAYNE AC QC, Commissioner

**IN THE MATTER OF A ROYAL COMMISSION
INTO MISCONDUCT IN THE BANKING, SUPERANNUATION
AND FINANCIAL SERVICES INDUSTRY**

MELBOURNE

10.00 AM, MONDAY, 26 NOVEMBER 2018

Continued from 23.11.18

DAY 65

**MS R. ORR QC and MR M. HODGE QC appear with MR M. COSTELLO, MS E.
DIAS, MR A. DINELLI, MR T. FARHALL, MR M. HOSKING and MS S.**

ZELEZNIKOW as Counsel Assisting

MS W. HARRIS QC appears with MR D. THOMAS and MR M. SHERMAN for NAB

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Commissioner, the first witness today is Andrew Thorburn.

5

<ANDREW GREGORY THORBURN, SWORN [10.00 am]

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<EXAMINATION-IN-CHIEF BY MS HARRIS

THE COMMISSIONER: Thank you very much, Mr Thorburn. Do sit down. Yes, Ms Harris.

15 MS HARRIS: Thank you, Commissioner.

Mr Thorburn, your full name is Andrew Gregory Thorburn?---It is.

20 Your business address is level 3, 700 Bourke Street, Melbourne?---Yes, it is.

Do you appear today in response to a summons issued by the Royal Commission?---Yes, I do.

25 Do you have that summons with you in the witness box?---I do.

Commissioner, I tender the summons.

THE COMMISSIONER: The summons to Mr Thorburn will be exhibit 7.79.

30

EXHIBIT #7.79 SUMMONS TO MR THORBURN

35 MS HARRIS: Mr Thorburn, have you made two statements in response to the Commission's Rubric 7-13, a principal statement, and then a short supplementary statement?---I have.

40 And the short supplementary statement corrects, does it not, an error in the compilation of the exhibit to your principal statement?---Yes, it does.

Do you have those statements and their exhibits in the witness box with you?---Yes, I do.

45 Mr Thorburn, are there any amendments that you wish to make to either of those statements?---No.

Commissioner, I tender those statements. There are two. The first is the principal statement of 19 November 2018. The second is the supplementary statement of 24 November 2018, together with exhibits.

5 THE COMMISSIONER: The first of those statements and its exhibits is exhibit 7.80.

10 **EXHIBIT #7.80 STATEMENT OF MR THORBURN AND ITS EXHIBITS DATED 19/11/2018**

15 THE COMMISSIONER: The second supplementary statement and its exhibits is exhibit 7.81.

20 **EXHIBIT #7.81 SUPPLEMENTARY STATEMENT OF MR THORBURN AND ITS EXHIBITS DATED 24/11/2018**

25 MS HARRIS: If the Commission pleases.

THE COMMISSIONER: Thank you, Ms Harris. Yes, Mr Hodge.

25 **<CROSS-EXAMINATION BY MR HODGE [10.02 am]**

30 MR HODGE: Thank you, Commissioner.

Mr Thorburn, you are the CEO and managing director of the National Australia Bank?---Yes, I am.

35 And you lead the executive leadership team and manage the business and operations of the NAB Group?---Yes, I do.

And you were appointed to your current position in August of 2014?---That's correct.

40 And you were at the National Australia Bank since about 2005?---Yes, that's correct.

And then before then, you had worked in other banks, including CBA and St George?---That's correct.

45 What I wanted to start by asking you about, Mr Thorburn, was the letter that you personally wrote to the Commission, and that came at the beginning of the submission that the National Australia Bank made in response to the interim report.

Commissioner, that is POL.9100.0001.1010_0001. If we go over to the second page we see your letter – or the beginning of your letter, Mr Thorburn. Have you got a - - -?---Can I just check what tab? Is that in my tab here - - -

5 I am not sure that it's in your - - -?---Okay. It's fine, I can see it on the screen. That's fine. I am familiar with the letter.

10 One of the points you make at the bottom of that first page is that in your view there are four – or at least four significant changes which have occurred inside banks over the last 30 years, and that helped to explain why things have gone wrong. And I will just take you through - - -?---Yes.

15 - - - the four of them. The first change you identified was that focus has shifted away from customers leaving the industry open to the challenge that it puts profits before people?---Yes.

And then over the page, the second change you identified was the move from a long-term view to a short-term one?---Yes.

20 The third change you identified was that there was a move from base pay to greater incentive compensation?---Yes.

And you said that this had led to most people receiving variable awards calculated by reference to short-term considerations?---Mmm.

25 And the fourth change that you identified was that banks have become more complex, and you said this was partly due to increasing regulation and compliance obligations?---Yes.

30 As to the first change, you make the point that:

If we get the customer experience right, if we serve our customers' interests well we will build a sustainable business for all stakeholders.

35 ?---Yes. Yes.

I just want to start by trying to understand that point and what you mean by a sustainable business?---Well, Mr Hodge, I – I think all businesses have got to start with focusing on your customers, and the products and services you bring to them to help them achieve their goals. And that should be the primary focus of a bank. And when I started in banking, that was, indeed, the sole focus. And there are, of course, other things that are important. Risk management, growth in profits. They're all important. Particularly the profits piece, they come as a result of you focusing on your customers, earning their trust so they stay with you and do their business with you because you are serving them well. That should be the primary focus of any business, including a bank.

And your identification of this as the first change, does that carry with it the implication that you think, in part, some of your business, the NAB business, has become unsustainable?---Well, yes. I think if you go to my other points where I talk about becoming short term, focus too much on the next six or 12 months, focus too much on the profit, which is the outcome of serving the customer well, then I think you start to build some unsustainable foundations. You don't invest enough, you don't listen to customers enough. And the mindset of the leaders is not about three to five years and being stewards of – you know, I took the baton in August '14. This company has been going 150 years and my – my role should be to make it stronger and better for the long run not just for the next one or two or three years. So I think, that does cause some of this drift that I referred to.

So one respect in which you think the current business is not sustainable is to continue to focus on the very short term?---Yes. Yes.

And another issue that I think you are trying to highlight was that part of this is a move towards a sales culture?---Well, I – I don't think I said that in there. But I think you are correct. And I think that started to happen. That was like a symptom of focusing on the short term. Focusing too much on growth, short-term growth that's not really sustainable and a sales culture was introduced, not just in our bank, in the system. And I think that created wrong outcomes as well. Unintended consequences.

And does it also follow then that an aspect of modern banking in Australia that you think is unsustainable is the continuation of that sales culture?---Yes. I think if – if you have that in your bank and it's not focus – so I don't think sales shouldn't be a term we use or a mindset. What you should be thinking of is understanding your client, understanding their needs, understanding their financial situation, and bringing your products and services to help them achieve their goals. That should be the purpose of building a relationship with clients. And in so doing, you build a long-term relationship with that client. And, yes, you will get more business but that – that's a by-product, an important by-product of that process of caring for your client and being a steward and a partner.

I want to come back to that point in a moment. What I wonder is whether somebody listening to the points that you're making might think that what you're advocating for is a shift toward or some would probably say back to a more service-oriented and utilitarian view of banking?---Well, I think definitely a shift back to – I mean, we can't go back – we've got to go back in some ways but we can't because the world has changed so fast and there's so many different technologies now and competitors. So I'm not harking to the past for, you know, anything other than getting the basics right, but it should be service-based. It should be relationship-based. It should be stewardship-based. It should not be sales based. And I think, Mr Hodge, if we don't do that inside our company and in the sector, we will continue to make mistakes and be exposed because it's not really sustainable. Now, I'm not saying that, you know, growing your business isn't important but your motivation must be to look after your client. That's the primary objective.

Well, let's just tease that out. Presumably, the reason for growing your business is to generate and increase the amount of profits that the business is making?---Well, I think that's one of – one of the important goals of any organisation. I mean, shareholders provide you capital and in the case of a bank it's very important. So, 5 yes, a sustainable, quality return over time, through cycles is what we should be doing for shareholders, yes. And that's important.

And the generation of profits is in the shareholders' interests?---Well, obviously, it's in the shareholders' interest if it's – if it's quality and sustainable, not if it's not. And 10 in our case we pay out 80 per cent of our profits to our shareholders. Nearly 600,000 Australians. So that's important. But what a profit does, it makes you viable. It means you can raise debt overseas, it means you can invest in new products and services and better compliance systems and better technology. So it's not just in the interests of shareholders, it's in the interests of building a sustainable company. And 15 customers actually are ultimately one of the very important beneficiaries of that.

I am not sure we're really disagreeing. I think the point you're trying to make is it's one thing to say it's in shareholders' interests to make profits but to speak of that in terms of just the profit over one year or three years misses the point, that you're 20 trying to cater to shareholders who are in there for the longer term?---Yes, that's right. Yes.

And that it might not be in the interests of a shareholder who's going to hold shares in your bank for five years or 10 years for you to do things now that will generate an 25 immediate profit but will have significant repercussions in the future?---Yes. Especially if those actions are not based on building trust with clients and – and sustainable.

And one of the points that then seems to come out of that is that the need to produce 30 a profit can motivate both good and bad behaviours?---Yes, it can.

And you would say, I think, that if you offer good products and good service, then that will attract and retain customers, and in that way make profits for your shareholders?---Absolutely, yes. 35

And that's the type of sustainable business that you want to achieve?---Yes. Absolutely.

And if your business doesn't have effective controls, then the problem that might 40 create is that it will then engage in risky behaviour that will generate a profit but is not sustainable in the long term?---That is correct. And also you will make mistakes, which will damage your customer experience. You will make mistakes such that your reputation as an organisation of being trustworthy also gets damaged. Yes. That's right.

45

There's a lot of consequences of not having sufficient controls. One is that you will likely, at some point in time, have to remediate and make good any loss that you've caused to other people?---That's correct. Yes.

5 Another consequence is that, in general, it will damage your reputation and your brand, and that then means you won't attract as much business?---Yes. And also you've got to think of your people. We've got 33,000 staff. I mean, they should be proud bankers who live in the way that I – I talked about, Mr Hodge. And if you make mistakes like that, they can lose confidence too.

10 Now, as to the second issue that you identify in your letter, which is focusing on the short term rather than the long term, what do you think has been the cause of that?---Well, I think there are two broad causes. The first is the world has got faster. You know, people want things now. When you push your button on Uber you expect
15 it to turn up, like five minutes is a long time. You know, people can communicate via Snapchat, all sorts of things. The world is just a cycle, expectations of things happening right now for me immediately have gone up. And if you're building a long-term business, that can't be always the way you respond to the signals. The second thing is that – my view is as the bank has got very significant in Australia in
20 terms of their market capitalisation, and, in fact, the – tracking the index every day and tracking a share price is very good example of the first point, you know, has my wealth gone up or down. And, really, you shouldn't be thinking of it like that if you're a bank shareholder. Markets became the focus, quarterly earnings and updates became the focus. Half year updates, repeat. And then I think, Mr Hodge,
25 one of the things that came into play which I think has caused a really significant impact, that has been that incentives for executives started to be locked on to that – that cycle. And then you're in a cycle of executives looking at one and two and three-year returns and talk – and really thinking about shareholder return, not about the broader metrics and reputation of your business which, really, is what you should
30 be focused on.

Let's try to explore some of those ideas. As to the first idea, that the whole world has got faster, I'm not sure I really understand that proposition. Presumably, how your bank is managed is ultimately a question for you and your ELT?---Yes.

35 I am – without wanting to be unfair there's not going to be that many millennials in your ELT, I would imagine, none I would suspect?---Lots of millennial clients.

Sure. But you are the ones who are making decision - - -?---Absolutely.

40 - - - as to how you are going to manage the business?---Yes.

You're surely not saying you and your executives have just got caught up in the world being faster and that that has caused you to manage for the short term?---Yes,
45 well, when I said that was one of the causes I think the expectations of having new products and services out in the market quickly to cater for increasingly granular subsets, I am saying that expectation has created the expectation that we can move

faster. And yet if you're not investing in new and modern technology enough your technology systems can't keep up with it.

5 So the idea is there's increasing identifiable demand for subsets of customers in the market for new products for those customers. Is that the first proposition?---Yes. Sorry, my broad point on the first one is I think the expectations of the bank and companies being able to innovate and move into the market with new products and services has become heightened. And if you don't have that, somehow your brand is seen to be lagging. And that's fuelling let's introduce new products and services
10 more quickly. That was my first point.

All right. I just wonder whether the real issue that you're trying to get at is the second point, and that is that you are in a situation where your shareholders are looking at your share price performance daily, and looking at your quarterly updates
15 and your half yearly updates and your annual updates, and then your senior executives' remuneration has been tied in the past to that sort of performance. And that means everything gets focused on a very short-term view of what's happening with your share price?---Well, I agree with all you said. Apart from the inference that maybe it's the shareholders' fault. And I don't think it is. I think it's the role of
20 the CEO and the board and the management actually, as per your challenge in the first point, to manage the business steadily, with good principles, good risk management, good leaders, good product development, quality. And so, you know, we're being buffeted by that. We responded to that. But actually – and that's – that's our bad not – I'm not blaming shareholders for that.

25 I think your point is the shareholders may or may not be focused on the short term, but the board and the executives ought to be able to focus on the long term regardless of what the shareholder focus is?---Yes. That's – that's a good conclusion. Yes.

30 And that to the extent then that there has been, as you've said, a shift towards focusing on a very short-term view, that must, therefore, be a failing of the board and the senior executives?---Yes. I think it's a common failing and I don't think it's intentional. I think one of the things – in writing this letter to the Commissioner, you know, I've really reflected on a lot of what has happened this year. And the
35 Commissioner has brought things right in front of me and I've reflected on things I haven't before. Yet I've been a banker for over 30 years. So I think it has not happened intentionally. It has just been a drift that has happened and it should be the accountability of the board and the CEO and the management to make sure that in the future that doesn't happen as much.

40 And how does it get fixed then? It's all the very well to say it shouldn't happen in the future, but it has happened, you say, unintentionally in the past. So how do you address it?---Well, the first thing is you need to come back to why the company exists. You need to go back to the first touchstone. And in our case, our purpose to
45 back the bold to move Australia forward or a vision, both of which have been approved by the board, which is to be trusted by customers for exceptional service. So you've got to come back to why do we exist and what is our vision. Now, our

purpose is a 50 year thing and our vision should be at least five years. So I think the first thing is you've got to come back to those basic and fundamental questions. The second thing is you need to be investing increasingly in better systems, better risk tools, better product development, new and modern systems which enable you to
5 keep your investment fairly steady, not less and more, so that you're building quality over time. And the third thing is you need to get your measures and incentives. One of the very important drivers of the human system inside any company are lined up to the first point. And so I think we've made some ground here. We need to do more. So if you go to measures now and you look at our – our people, they have four
10 or five key result areas. It must have customer, it must have risk. It should have financial as well. I think that's really important but it has got to have balance in it. And secondly, on incentives, you know, we have moved nearly all our people off those shorter-term sales incentive scheme which encourage – going back to your word – sell, achieve volume, get rewarded. Now we've moved people on to an
15 annual variable reward scheme which means that they need to achieve performance across a number of measures. And increasingly, particularly for senior people, any incentive is deferred. In the case of myself and our executives, 60 per cent for four years. So I think those sort of things start to move us towards thinking and having symbols and controls to help us achieve what you asked.

20 Can we just take the three points that you raised in turn. The first was you made the point about having a vision and a purpose. I think I might confuse them. A vision should be for 50 years - - -?---Other way around.

25 Purpose should be for 50 years, vision should be for five years?---Yes.

Presumably, whatever those terms mean in any particular way, that's not a change for the bank. The bank must have always had a vision and a purpose?---Well, in the last two years the purpose and vision have been – we never had a purpose. And our
30 chairman and myself led that work inside the company to work out what is our purpose. And I think it was very thorough and very disciplined. We went back and looked at a lot of artefacts and there have even been books written about the bank and why we existed. So we've got to go right back to where we are at our best. So the purpose was new. It was approved two years ago. The vision was renewed this
35 year.

All right. It seems – it sounds so complicated when you say it, but you're a bank. Presumably your purpose is to be a bank. Is it?---Yes.

40 Is that - - -?---Well, yes, but – yes, but you need – what is a bank and what does it do? So what the purpose says and the vision say about how that should happen. So take the purpose: backing bold people, often business people, because those people actually move our – our country forward. And that's actually what the bank should be about. And the vision to be trusted by customers for exceptional service. Yes.
45 So you've got to click down from the bank, because we feel we need a few more descriptors for our people to make it clear how we want to be, and why.

And we might come back to this when we come to your fourth point, but it seems like, as a bank, your purpose would be to take deposits and lend money and to do that as well as you could. Is that over-simplifying what you should be doing?---No, I think that's the functional activities of a bank.

5

All right?---But all banks do that. If you can have a purpose and a vision that really orientate your people from their head and their heart to living the purpose and vision, I think you start to bring the experience into play so that you serve your clients in that way and hopefully you're an even better bank than others. So they're two separate things. The activities of banking which is what you described and more what you stand for and how your people interact with clients and why they come to work to do what they do every day.

And then – I was just checking that I had this right – but the second point that you made or the second change you needed to make was to invest in your systems and processes. And I think you were saying make consistent investment?---Yes.

Is that right?---Yes.

And has that been a problem for your bank, making consistent investment in the necessary systems and processes?---Well, I think we've made – we've made reasonably consistent investment over the last five to seven years. I think prior to that, unfortunately, we had some issues which meant that too much of our investment was going into fixing businesses that ultimately ended up being divested in the UK, in particular. So that distracted us a lot. But I think in the last five to seven we have invested more. Now, I think some of that hasn't entirely worked. You know, they're big projects and they don't always deliver what you expect. But late last year, the end of the 2017 financial year, for the previous six months myself and our executive team and the board have been talking about how do we start to think about the longer term future. Not just the next one or two years but the next three to five. And we saw some considerable changes coming. This was before the Royal Commission. And we elected, as a company, to invest – we normally invest around \$1 billion a year. To increase that over the next three years by \$500 million per annum. So a collective impact of one and a half billion dollars more because we felt we needed to modernise the bank, address legacy systems, improve controls, product development and start to address a number of these issues. We have increased considerably for 2018, '19, '20 our investment in these sort of these activities. Then we are going to have to review it at that time because we are going to have to continue to invest to make the bank strong. I think that's a good example of us trying to pre-emptively think about stepping into it and investing more to make the bank simpler.

The third idea or point that you made was about remuneration, and you spoke about that at some length. And that seems to, in the end, be the most significant issue. You want to align - - -?---Yes.

45

- - - the remuneration of your executives and your staff with the outcomes that you're trying to achieve?---Yes. I think I mentioned two bits. The measures, like how are

you measured in your job, one, and two then the incentives – if you do receive an incentive, what it's paid for and over what time period. Because one of the points I make in my note, Mr Hodge, as you've drawn us to, is that when I started in banking it was just fixed pay. And progressively incentives and variable pay have been more and more significant. And so I think that is one thing that we do need to address. I think we've made good steps with more to come, I'm sure.

That's the third reason you raise in your letter. And I will come to that in a moment. Can I just - - -?---Yes.

- - - ask you to focus on one thing, and that is about vesting of remuneration. You made a point which is there has now been a change for your senior executive leadership team so that 60 – is it 60 per cent of your variable remuneration will vest?---Is deferred for four years.

Four years?---Yes.

And is that part of – or – well, is that part of making sure that you and your executive leadership team are focused on what the outcomes will be in four years' time rather than the outcomes now or for the next year?---Well, I think there are a number of reasons we did it. The first one is this point: that you want executives to be thinking about longer term. So each year if you get incentives it is rolled out. So you've got four years and then another year. So you're getting people to think about the longer term. And because it's vested in the bank shares – vested in bank shares – obviously you're trying to think of how do we run this business in the longer run to improve our value for shareholders. Because I'm a shareholder. So I think that's the first reason. The second reason is it is a BEAR requirement now. Now, it's a BEAR requirement for me but actually we decided to do it for our whole executive team. That's the second – second reason.

And in terms of the conditions on the vesting of that sort of deferred award, is it an issue to make sure that there are realistic conditions on whether it vests or not?---Yes.

Maybe – perhaps if I help you out - - -?---Yes.

- - - with this. One of the – one of the issues for NAB in the past, I think, has been that the vesting of LTIs has been very rare?---Yes.

Over the last few years. Do you agree?---Yes, I do.

And that, presumably, is because whatever the conditions for vesting are, have just not been able to be satisfied?---That's correct.

And a consequence of that, I would assume, is that you and your senior executives probably don't think of that sort of deferred long-term incentive as something you're really going to get if the conditions are unrealistic for vesting?---Yes. Although the

terms of those were clear and they're set by the board and the shareholders. But they've really been around shareholder return. That has been the main item that has been measured on.

5 And the change that has been made to the system, those sorts of shareholder return conditions, they won't apply any more, will they, to the deferred - - -?---No, that's correct. The – the total compensation has come down. It has become potentially more certain. It's deferred for longer. And then if the executive is there in four years and there's no other – I think one of the other items that's always looked at – and I
10 think increasingly so – is there any reason why this should not vest for the executive. So if it is going to vest, the board still has the – at their discretion to not vest it. And they've exercised that in recent times and this year, in particular. So it can be withdrawn, is what I'm saying, by the board at its discretion.

15 So what you're – what you're hoping that you've moved from is, on the one hand, a system where there were LTIs but given the TSR metric that was used, it was unlikely that they were going to vest and as time went on each year you would know those LTIs are probably not going to vest. I mean, that seems to have been the realistic situation you were in. Do you agree?---Yes. Well, there's two – there's two
20 bits of variable reward we previously had, Mr Hodge. The first was deferred STI. That was the shorter term bonus. It was deferred for two years. That wasn't subject to shareholder hurdles – or TSR. It was the LTI component. Now, I think, just to come to your point around – I mean I just think about the way I think about it. It was – it was, to me, more a recognition that if we over time achieved the shareholder
25 return, we – we would get it. But if we didn't, we wouldn't. So to me, it wasn't – I didn't think of it as realistic or unrealistic. To me it was just something – it didn't change the way I did my work. And if it – if it happened, then that was good. If it didn't, so be it. So it wasn't something I thought of as unrealistic or realistic is all I'm just trying to push into.

30 I understand?---Yes.

The change – from your personal perspective, though, the change that has been made is something that you think will refocus you - - -?---Yes.

35 - - - and your executive leadership team on the long term?---Yes, I do.

All right. Now, if we then move to the third change that you identify, which is the move away from fixed pay?---Yes.

40 And why is it that you think that move occurred?---Well, it will be a bit of chicken and egg here so bear with me while I get this – explain it. So the first thing is the bank became more focused on growth. The bank became more focused on end year profits. And it started as a tool to align and maybe motivate and incentivise the – the
45 leaders to actually be aligned – very aligned with the shareholders and earning additional pay over and above what they could, if they achieved those goals. So I think that's the first point. The second point is, you know, deregulation, you know,

was occurring, and continued to occur. You had foreign banks and – coming in. And the competition for talent, you know, to get the best people into your company and keep them there, I think this was used as a tool to incentivise people to come to your organisation or to stay with your organisation. And I think even as a subset of that, you know, banking is a global industry. Some core banking skills you can get right in the Australian market, you know, frontline bankers and things like that but when you look at technology and data and artificial intelligence and robotics and those sort of things, now it is a global pool. So if you want the best people, which we should, for our customers and shareholders in the company, you know, you're going into a global pool not just in banks, IT companies. So, in a way, your remuneration had to be – and needs to still be competitive to attract them. So that would be the main reasons, I would say. .

I think you've identified two reasons and we will deal with the second one first but the first reason you've identified is this move towards short-term financial considerations was aligning the interests of the employees with the interests of – or the performance of the employees with the interests of shareholders?---I put it another way. It was to align and incentivise, particularly management, but then it trickled down towards more short-term shareholder outcomes.

All right. And then the second point you made was that it was necessary and continues to be necessary in order to compete in the global talent pool?---Yes. Yes. And domestically, yes.

So I just want to make sure we've understood that second point and the potential economic consequences of any changes in relation to remuneration. Is the issue one of absolute remuneration or is the issue one of there is a certain type of potential employee who has a very strong interest in being able to earn variable remuneration depending upon their particular performance?---I think there's both. I've seen both. I think both are at play.

And in terms of the changes that your bank has made in response to Sedgwick, have they decreased your ability to compete in that global talent pool?---No, because Sedgwick really was squarely focused on the retail part of our bank. And I think most – as you go up, most of that talent pool is coming from within Australia. Maybe New Zealand, Canada, UK but I think mainly Australia. So Sedgwick, I think, was more the retail line and that was more tellers and customer advisers and branch managers to get them more oriented in a different way. So it hasn't affected – impacted our ability to get talent. And it was – it was done – it was also done across Australia, too.

And the – I'm sorry, what was done, you mean the changes were made across – the changes?---Sedgwick. Yes, so all the banks, you know, have moved to do Sedgwick so it has evened out.

45

If we just sort of think through what that means economically, your point is at the level of tellers, home loan advisers, the frontline staff who are the ones affected by Sedgwick, most of that talent pool comes from within Australia?---Yes.

5 And - - -?---Yes.

- - - given that all of the banks have made or are making changes to try to reflect Sedgwick, there's, therefore, nobody suffers - - -?---Nobody is disadvantaged.

10 - - - a first mover advantage?---Yes.

There is another level of employee then – I think you referred particularly to people with expertise in relation to technology - - -?---Yes.

15 - - - and digital systems. I think you said robotics as well?---Yes, yes.

Who would be in a global talent pool?---Yes.

20 And at that level then you haven't made changes to how they're remunerated?---No, we have made some changes with these recent variable reward changes that we've made to the bank and the – and the nature of the 60 per cent deferral at the top of the company, and 40 per cent. Because I think that will be a general trend that we will continue with. And I – I – I think you – if you're going to be hiring people out of a global talent pool – which we need to do – you need to just be competitive in your
25 financial package. I believe that most people actually, as long as you get that competitive, that financial package, people come because of the other things I talked about. I really believe that. Like the purpose and the vision and the culture and building for a long-term business and having pride in the badge and being stewards and doing that for the greater good of our customers and the country. I think most
30 people come to – come to work for those reasons. They're the intrinsic deep motivators.

If you get the remuneration right to begin with. Is that right?---Yes, but it – it just has to be competitive, is point one. So, you know, you can't be – you know, it's hard
35 to hire somebody from a global talent pool if the basic pay is 50 per cent less. I mean, they may love Australia but that's a pretty big step. And I think that's – it has got to be competitive in that sense. I think also this is where we go to this point around the type of variable pay, because I – I sort of think we need to keep pushing into it but we still need it. But it should be much more balanced and much more long
40 term, and I think those sort of things are – are important. And it is important that people in a year who over-achieve can have the chance to earn more than others who, you know, have a solid year or perhaps less of a year. So I think it does give you a chance to discriminate. And I think that's an important thing. So if you're looking at people who do really well you can pay them more for that year.
45

And just again to focus for a moment on the global talent pool, your point is if you defer 60 per cent of the remuneration – of the variable remuneration for four years

that doesn't put you so out of step with global peers as to be a problem for recruiting?---Not – no, not in – not in – not in principle, no. I think we need to do it anyway, so we should – we should just do it.

5 So then if we come back to the first reason that you gave for why there had been this change over the course of the last – well, in recent years to banks moving towards short-term financial considerations. I think, as we've already discussed, profit itself might drive good or bad behaviours?---Yes.

10 And your point about saying that you need to be able to reward an employee who has an exceptional year is, I assume, touching on something which is that the best way to motivate people, it turns out, is money?---No.

You don't think so?---No. No.

15 What do you think the best way to motivate somebody is?---Well, the best way to motivate people is to go back to what I said. Most people want to come and work in our bank or in a bank to serve customers, to do a good job for them, to feel as though they're making a difference to people in some of the biggest decisions they will
20 make in their lives. I mean, one of the most significant causes of stress is money, and so we have the skills to help people through that, to start a business, to grow a business, to buy their first home, to start saving for retirement. I think the people who have – I have dealt with in – in our bank and banks over many years, most
25 people want to do that and do it well. Now, second – secondly, they need to live. So financial compensation is important. And if they do well, like an incentive payment, you know, is a real act of recognition and appreciation. Now, Mr Hodge, in our – in our bank and in banking I've seen some terrible cases of people who don't meet that rule. I'm not saying it's all like that. I'm just saying that's who we want to hire. Actually, in my experience, that's what most people want to do.

30 I think – I'm concerned you think I'm trying to trap you, when I'm just trying to get you to agree to what seems to me to be a very basic proposition about how a capitalist society works. Which is that if you pay somebody more for a particular outcome you expect that they will achieve that outcome?---Yes, yes.

35 And therefore variable remuneration is something that you've obviously found in your bank is an effective way to motivate people to achieve particular outcomes?---Yes. So I just – on the basis of no trapping, I think the first thing is that we've had the wrong incentive schemes in many cases. We've had the wrong
40 incentive schemes. You know, we've re – take the inducer case. I am sure you are coming to it. That was like – we put the bait right there for people. Right there. Now, they stepped over the line. That's their own decision. I'm not excusing that. But like we put incentive schemes in place which caused to reinforce and quick repeat cash. Not good. But now we've got a variable reward scheme where it's
45 annual, it's centralised, it's based on achieving a number of things across four or five key result areas, it's deferred, it's deferred for the longer term for executives. It's starting to get more sustainable. So that's the first point. The second point is to me

it's a – it's more a recognition than a driver. Right. It's like if you get the people I was talking about, they will do the right thing, they will work hard, they will want to do well for colleagues and for clients, they will be proud to work in our bank because it does the right thing. And, yes, at the end of the year if they've done well they could get an incentive payment but it's not what's driving them through the year. That's – so it's a difference between my motivation and hunger to do something which earns me that – and I am sure some people are like that – as opposed to my job is to be a professional and to do those things I have said. If I do really well I might get a variable reward payment at the end. Excellent.

Again, I don't think we're disagreeing about anything. Your point is you can construct variable remuneration in a way that will incentivise bad behaviour?---Yes.

And that's - - -?---Yes.

- - - not what you want to do?---Not at all.

And all I'm trying to suggest to you is the converse of that would seem to be you can construct variable remuneration in order to incentivise good behaviour?---Yes. As I say, yes, and I think we're doing that more so.

That is what you want to try to do?---Yes, it is.

And when it comes to the idea of selling, from NABs perspective if a customer is sold a product that is useful to them and that the customer can afford, and that is within the risk appetite of NAB, then that's in the long-term interests of NAB?---Yes, it is, although I'm just – I'm just reacting to even the selling notion. I – you know – anyway. So I'm agreeing with you.

I'm not – I just don't have another verb other than sell that I can offer you, Mr Thorburn, I'm sorry?---Right. Okay. I will think of one.

And that improves the profit of NAB?---Yes.

And it does so in, from your perspective, a sustainable way?---Yes.

And, therefore, if you can construct your variable remuneration to achieve that, that's a good outcome?---That is a good outcome.

And your point about the introducer case study is that, conversely, if you construct a remuneration structure which might have the potential to reward fraudulent conduct, that's a bad remuneration structure?---Yes.

And the issue then is trying to figure out the right way to do it, which presumably involves an element of judgment?---Yes.

And NAB, like the other banks that we've talked about, has made changes to its reward structure in response to the Sedgwick review?---Yes.

5 And Mr Sedgwick expressed the view that – or considered incentives very closely as part of his independent review for the ABA?---Yes, he did. Yes.

10 And he recommended that for retail bank staff, including home lenders and their managers, incentives no longer be paid based directly or solely on sales performance?---Yes.

And he also recommended that retail bank culture will be demonstrably, ethically and customer oriented?---Yes.

15 Do you think NAB has an ethically oriented culture?---Overwhelmingly, yes. Unfortunate cases where I would have to say no.

20 And what do you understand by an ethically oriented culture?---Well, that you would always do what is right by the law, by regulations, by disclosure requirements to the likes of the Stock Exchange, by way of transparency, and by way of doing what the policies inside the company require you to do. That's the first thing. And the second thing is that ethical must go to the heart of the relationship with the customer, so that you really understand what your client – what their situation is, you listen to them, you summarise it, and then you only give them products and services that meet their need. And sometimes you should say no, especially if it's a credit product because maybe they're not in a position to be able to do it properly even though they think they may be able to. I think they're the two strands I would pull on ethical, Mr Hodge.

30 And do you think it also has to affect the more general judgments that the senior executives make about things like remediation?---Yes.

That is they have to approach these things in an ethical way?---Yes. That fits within – yes, I'm happy with that.

35 Would NAB ever consider moving to a fixed pay model with no variable component for its frontline staff?---For frontline staff only you are talking, as opposed to more generally?

40 Yes?---Well, I think we've – you know, Sedgwick and the changes that have come in have been really good steps. I think we must continue to evolve it. I could see some argument for it, yes. I think most of the incentive potential for frontline people is quite small anyway, maybe 10 or 15 per cent of their base pay. It's paid annually now, which is good. I would still be a bit worried if we did it – we would have to think through the unintended consequences but one of which would be – you know, 45 you've got really good bankers, and I think being able to recognise them with an incentive payment – let's say they're at 10 per cent and you could give them 1.5 times that so they get 15 per cent, I think that's a – that's a good thing if it's for the

right banker, for the right reason in terms of their performance over the whole year. So I would be a bit concerned that we may lose people to either other competitors or if it was a level playing field to, non-bank competitors in financial services or other companies where their skills could be applied. So I – I – sorry, it's a long answer.
5 Yes, I think, is the answer. I think we should consider it but I'm just calling out some things we would have to think through if we pursued it.

And what about at the more senior level. Would it be practical to try to move to a purely fixed remuneration basis?---There I would be – I would accentuate the point
10 about the risk of being able to retain and attract key people, particularly specialists from within Australia and globally. I do think we should think about are we getting some of these things right, the balance scorecard, the deferral for four years. You know, maybe the percentage of variable pay, Mr Hodge, could be reduced and more in fixed. So it's like a more fixed pay, less variable pay. But I – I would have some
15 – some concerns about abolishing it because I think it would make our sector – which is a very important one for Australia – less competitive and I don't think we would be able to retain and attract the talent we need to make our banking system really excellent.

20 Can I ask you about the change – or the Sedgwick changes and the anticipated potential adverse consequences. Was there a concern that it might be harder to motivate the top performing quartile of employees if they no longer could receive the same level of variable remuneration?---Well, no, it wasn't, because number one, I think we stepped into why we needed to make the change and I think we had some
25 very good reasons why we needed to make the change. And I think we communicated to them pretty well. And we had been progressively moving in this direction. So it wasn't like a new message. And the second thing is because Sedgwick was commissioned by the ABA, and all the banks agreed to adopt it by 2020 – now, we've done it, as others have, earlier – I think it enabled any sort of
30 disadvantage commercially of – of, you know, not paying – having variable reward for some of your best people they may go to other banks, they know it's not going to happen there either. I think for those two reasons I think we've been able to navigate it well.

35 I understand. I think I may have asked my question badly?---Sorry.

You made changes to the way that your – to the way everybody was remunerated as a consequence of Sedgwick – sorry, everybody within the front-facing - - -?---Yes.
40 Yes.

- - - system. There were, presumably, top performing staff who were able to earn more under the old model compared to what they could earn under the new model?---I don't – I don't know that specifically, but I think what would have changed really, Mr Hodge, is the frequency. And the narrowness of the measure. So
45 what they were paid for and how often has changed significantly under Sedgwick. So – you know, a top performer, let's say a banker in a branch, a top performer could

still get, you know, a very good incentive which I think could be quite competitive. It's just that it's done based on their whole performance for the whole year.

5 I'm not here trying to get into the issue of competitiveness between banks. What I'm just trying to understand is the before and after. Under the old CXI model that you had, I had understood the internal NAB conclusion was that the CXI model tended to produce more exponential outcomes than what was the proposed future STI model that you've now implemented?---That – you might well be right.

10 All I am trying to get at is, is there a – has there been any issue for NAB with finding that its previous top performers are not performing as well as they used to as a consequence of the change to the remuneration model?---I haven't – I haven't heard anything to that effect, Mr Hodge.

15 All right. And then what I then want to understand is when we move over to this new system or when you move fully into your new system of STIs, is how, from the employees' perspective, it will work. So I might just ask you some questions. This will no doubt demonstrate my ignorance but I understand that now for all employees who are within the STI model, the amount of STI they receive in a year is their STI
20 target multiplied by an adjustment that depends upon the number of days they've worked across the entire year, multiplied by the performance adjustment less effectively a risk adjustment?---So the way I explain it is that we have a variable reward that's centrally managed and administered annually. It's based on rating people against their scorecard of these four or five KRAs. If they do have a variable
25 reward it is a percentage of their fixed pay. So that gives them a target potential variable reward. So if they were earning \$100,000 and it was 50 per cent, it will be \$50,000 being their target. They may achieve somewhere between zero and, I think if you're talking about the general population, 200 per cent of that. If it's above
30 50,000 it needs to be deferred for a period of time. But their rating that they achieve goes through a process of not just for scorecard and it – we do look at risk factors, yes. So we do look particularly at like senior people, the risk factors. Then whatever their potential payment is it is multiplied by what we call the one NAB score which is the overall multiple that the board determines for the year. So yes, it is a bit
35 confusing but that's how I would explain it.

No, no, I think that's quite helpful. You've got an STI target which is some percentage of - - -?---Fixed pay, yes.

40 - - - whatever your fixed remuneration is. That's the starting point. Assuming you've worked a full year, then there's no adjustment for number of days. That gets multiplied by whatever your performance multiple is?---Yes.

Which could be anywhere from zero to two?---Yes, that's right.

45 And then there's a deduction that is made for – I termed it risk but I think it's conduct gate reductions - - -?---Yes.

- - - is how you refer to it. Is that right?---Yes.

And then there could also then be a multiple which is the one NAB multiple which is applied across everybody?---That's right.

5

And the one NAB multiple is determined by the board?---That's right.

And I want to just come back then to the performance multiple and the conduct gate. The way in which your performance multiple is determined is by going to your balance – or seeing how you rate across your balance scorecard?---That's right.

10

And that tries to take into account, you said, a number of KRAs is that right?---Yes, key result areas or objectives, yes.

And the idea then is that you will be rated across each of those four or five key result areas and that will then produce your performance multiple?---Then the people need to make a judgment because they will say are you achieved on this one, not achieved on the next, highly achieved, outstanding and then they will have to, you know, do a weighting to come out with what they believe is the most appropriate rating for you for the year. And that rating obviously, if you get highly achieved or outstanding you get a potentially higher incentive payment than if you got achieved. But there is – there is a judgment by people leader and – people leaders in that process.

20

So if we – I will bring up an example which I hope is somewhat helpful. If we bring up NAB.007.079.0006. We might need to zoom in slightly for that to be legible. Are you able to read that at all, Mr - - -?---I think it's an iPad and I'm trying to – but it's not working.

25

Everyone does that?---I can't really see it but let's give it a go. I can see some bits.

30

I might see if I can get you a hardcopy, because otherwise that's - - -?---If you take me to the bits so I can see, that would be helpful. Thank you.

I just want to try to understand how an employee understands, in the end, that they're being rated. So this has a core role and a performance plan?---Yes.

35

And what is the difference between the core role and the performance plan?---Perhaps the way to think of it is the core role is their basic role that they're required to – to fulfil. Essentially maybe for their fixed pay. And the performance plan is more like a stretch. Similar measures and KPIs, but perhaps a bit more of a stretch where the incentive payment could come into play if it was achieved.

40

And so when we look at their core role, their core role has six different KPIs – sorry, seven different KPIs that are each allocated 14.29 per cent for their role performance weighting?---Yes.

45

- And then their performance plan has four different KPIs that are each allocated a 25 per cent weighting in their STI?---Yes.
- 5 And a number of those are concerned with what's described as generating attractive returns?---Yes. That's one of the – the KPIs, yes.
- 10 And I think your point about – that you've made already about STIs is that it still has to take into account contribution to financial performance. That's still part of the role - - -?---Yes, it is.
- - - of the employee?---Yes.
- 15 And then there are other things that are supposed to adjust for, take into account different considerations, things like improve customer advocacy, simpler and faster for our customers, proactively risk and compliance?---Yes.
- 20 And so all of these things will then get a rating as well?---Yes. So I think the first step is that the people leader would need to assess the banker on their core role.
- Yes?---And then any – and then they look at the performance plan objectives to determine whether any incentive payment would be achieved with – with the weightings of 25 per cent each.
- 25 And in the end, though, once they have got their full year outcome for each of their four KPIs, which will – for each of them I understand they will have a rating of 1 to 5 from not achieving expectations to outstanding achievement of expectation?---That's right.
- 30 Is that right? So then they will – they will have some number, each number is a product of the exercise of some judgment, is that right, by the supervisor?---Yes.
- And then the supervisor will at the end then make a further judgment as to how that rating translates into a performance multiplier?---That's right.
- 35 And I suppose what I wonder is, in the end, are employees going to find this to be a more or less transparent structure?---Than previously?
- 40 Yes?---Well, I think it's transparent. But – I think we're on a journey on this one, Mr Hodge because, you know, it's complex. And I think we need to simplify it. But I think, you know, we're moving - - -
- 45 Is this the simplified version?---No, it needs to be simplified. So, you know, I think it's transparent. It reinforces an important message. This is a servicing banker, I think, in our contact centre. It is really saying if you go to the KPIs there are a number about customers and about risk you need to get right. And it's also about generating attractive returns, growth, but also done in the right way, and you are going to be rated, you know, quite rigorously on all of those. So in that sense it has

brought rigour and discipline and broadened for the banker – so if the banker ever thought that my job is only to sell, I think this dispels that notion, although, you know, we’re learning – we have to apply it in a – in a more simple and effective way, I think, but we’re getting one message through here.

5

Recalling that Sedgwick recommended that there be no direct link to sales as part of the variable remuneration for frontline bankers, does this still have a direct link?---You would have to go to the generate attractive returns, probably at the top. After – so these two are – the first two look as though they’re waiting times on calls. 10 These bottom two are about customer needs. And see it says based on 10 needs identified per team per week. Let’s take customer needs identified. So that is talking to a customer, understanding their financial needs, and being able to identify them and then satisfy them or refer them to a specialist if it’s that sort of a need that the banker can’t do themselves. So I think it does meet the Sedgwick criteria, because 15 previously it would have been probably about sales and particularly when you get into home loan roles about volume of sales, dollars, and I think that’s where some of the problems occurred. So I think it does meet Sedgwick.

This no longer refers to dollar values or volumes. That’s one of the points that you are - - -?---Yes.

20

Points you’re making?---That’s right.

And I think certainly in the case of some of the performance plans, they will still be linked to things like lending referrals - - -?---Yes.

25

- - - or what’s described as - - -?---Yes.

- - - home loan needs met?---Yes. Yes.

30

I’m assuming home loan needs met means the customer has taken out a home loan?---Yes. And the – the other products and services they may need to help them achieve their goal of buying a home or buying an investment property, yes. But previously I think it was a lot more related to the product growth and number of sales 35 and the value of those sales.

Yes. And so it seems to me the point that you’re trying to get at is – I don’t want to use your expression that we’re on a journey – but there is a thought process that you’re working through to try to figure out the best way to remunerate your staff to 40 achieve the things that you want to achieve?---Yes.

40

And you would like that to be simple and transparent?---Yes.

If it was possible. That’s what you aim for?---Yes.

45

Realistically, having – does NAB have 4000 staff at the moment? How many - - -?---Well, like, we’ve got 33,000 in total, right. So you’re going to have 10,000

bankers, and you will have hundreds with this, who are servicing bankers. So there's a lot we need to do. So if we can automate it and simplify it, I think that will help.

5 How would you automate it?---Well, no paper. You know, we can – we can just have a better HR systems which enable any employee – and we can do this now – look up on screen, once they go through their ID, they can look in their own portal and see their scorecard. They can also see managers – what we also have a discipline something called 11 plus one. 11 conversations with your manager a year, plus one at the end of year to wrap it altogether. You should be able to go into the HR portal
10 and see your scorecard, see comments on progress from your manager and points around your 11 one on ones that you've had. So that's – that's automating it because it makes it real time and you have less paper and I think that helps.

15 Yes. I just wanted to be clear. When you said automated, that sounded potentially disturbing but you – in the sense that there would just be a computer or algorithm that would determine what your employees' short-term incentive was going to be but you are talking about digitising it?---Yes, digitising, yes.

20 And – I tender that document Commissioner.

THE COMMISSIONER: Financial year '19 direct consumer servicing banker performance plan NAB.007.079.0006, exhibit 7.82.

25 **EXHIBIT #7.82 FINANCIAL YEAR '19 DIRECT CONSUMER SERVICING BANKER PERFORMANCE PLAN(NAB.007.079.0006)**

30 MR HODGE: Thank you, Commissioner.

35 THE COMMISSIONER: Mr Thorburn, what message does the person who is the subject of this plan take away from it?---Well, Commissioner, I believe what the message they will take away is that, firstly, achieving in a number of areas is very important. Second, those areas, at least 50 per cent of them are about the customer and their relationship and their engagement with us, not what we're selling them, to come back to that term. And thirdly, that the risk elements of a person's role must be very clear and it is their own personal responsibility to understand them and to achieve them.

40 What behaviours do you regard this system as reinforcing?---Well, one of the things we say in our values, Commissioner, is to do the right thing. So the first thing is that you are really building a relationship with customers and you are listening to them in order that you can look after their needs better. Secondly, that – that growth is important, that – that – you know, the bank growing through winning more business
45 and doing more with clients, particularly existing clients, is important, that we need to have some element of a growth mindset in the organisation. And then the behave – the final behaviour is that risk is my responsibility. You know, the – making sure

that I disclose to the customer everything they need to know, that they know, you know, the interest rates and the fees, that if they're setting up an offset account, that I do that, and my – you know, I think that the risk is not something that's about other people, the risk for a banker is about what they need to do in their role.

5

Yes.

MR HODGE: Can I take an example, Mr Thorburn, to try to work through an aspect of your answer. We talked about the idea that there would be a target for some of the roles when it comes to generating attractive returns, the number of home loan needs met. And that's the type of target that you're familiar with?---Yes.

10

And so presumably, if the employee manages to exceed whatever the target number of home loan needs met, then they will be rated as exceptional?---They could be, yes.

15

And I think the point you are trying to drive at is that might sound like an encouragement to sell, but it's probably not really a problematic type of target?---Well, I think it could be in and of itself, but I think if you look at the – the broader scorecard and what they're being asked to look at and how they're measured, it minimises it. Secondly, and most importantly, it is how your leader coaches and talks to you about performance. You know, if they're only talking about how you're going on attractive terms, that's not good. They should be talking about you're building empathy with clients, can I sit in and observe how you do that and give you feedback because, you know, I should be a coach. So I think the leader's behaviour, crucial. The most significant impact on culture in the bank. But I think we've minimised it not just by those two things but if you then look at the – previously the home lender would have been driven to and incentivised around if I can do five loans at \$500,000 each equals two and a half million, bang. We've taken all that out. We've taken out the two and a half million dollars. We've just said you need to sit down, listen to your clients and there will be some needs come out of that. And I think that's an important part of the discovery process, to understand what the client is trying to do. And you do want certain needs to be picked up. You know, they may need a home loan and they will go through a process. It could be a fixed rate, it could be a variable rate, it could be a split rate, if it is fixed, how long it goes for, a transaction account, an offset account, a credit card. So I think they're the – that's what comes out of a home loan needs process, that you want your bankers to be focused on.

20

25

30

35

And so I could, I think, pick up three points that you're making about why this type of target is not a problem. The first is this is not a target by itself, that there are – the scorecard requires consideration of a number of other things. And what you're trying to do is make sure that you have a more holistic assessment of the employee's performance?---Yes.

40

The second point is there is a cultural issue, which you hope that your leaders will instil within your employees the right type of culture or the right way to go about dealing with customers?---Yes.

45

And that's something you're working on - - -?---Yes.

- - - always trying to develop and improve?---Yes.

5 And the third point is this is a very different type of target from a target that is a pure dollar value target?---That's right.

And so, for example, it's – when you think about this type of target, it's unlikely that a customer is wandering into a NAB branch thinking they're going to check their
10 balance and then find themselves suddenly sold a home loan for a home they didn't even know they wanted. That's an unlikely outcome?---Yes.

That's not the type of outcome that's being incentivised by this?---No.

15 What's being incentivised by this is that the customer wants a home loan, people come to banks because they want certain products, and the employee is actually trying to – they may not even need to identify that need but they're trying to meet that need. That's the point of the type - - -?---Yes, yes. Of course under responsible lending guidelines they've got to do that very thoroughly. Yes.

20 I want to move then to the fourth point that you make in your letter. And that is about complexity. And you say that's the big change that has happened. I can bring that back up. It's POL.9100.0001.1010. And if we go to _0003?---Yes.

25 You will see your fourth point:

Banks have become more complex in part due to increasing regulation, compliance obligations and legacy systems.

30 ?---Mmm.

Is part of the problem, do you think, that banks have moved away from their traditional roles of accepting deposits and lending money?---Well, I – I – I think that's added to the complexity.

35 Certainly, in the case of NAB - - -?---Yes.

- - - you would say many of the problems that you would – that you have had have been in your wealth division?---That's right.

40 And that's obviously a division outside of the traditional role of the bank?---Yes. Yes, it is.

45 And that's an area where there has been increasing regulation?---Yes.

There has been – or there are a lot of compliance obligations that - - -?---Yes.

- - - NAB has found difficult at times?---Yes.

And where there are all sorts of legacy systems - - -?---Yes.

5 - - - particularly in relation to how you collect money, retain money, pay commissions and that sort of thing?---Yes. Although I think it does – this point does apply to a bank – banking as well.

10 Yes. I wonder whether, in your view, now with the benefit of hindsight, the move by retail banks into other areas, and particularly into wealth, has been a failure?---I think if you looked at the – I mean, if you looked at the raw – raw evidence, I would probably have to agree it had – had been. I don't think it needed to be, but it probably has been.

15 When you say you don't think it needed to be, why is that?---Well, firstly, I think for many customers, clients are – when they come to, particularly a large bank, say like NAB, they do believe that we would offer a broad range of banking and wealth management products. And when we sit down and talk to them about banking type needs, it easily moves into saving for retirement, protecting yourself against
20 disability or unemployment or protecting your family in the event of death if you have a mortgage. I don't think that's a – that's a natural conversation a banker would have. And so thinking of wealth management as something that's way out there, I think it's sort of just outside the banking circle. So that's the first point. It's a natural conversation. And – and I think many people would have seen that the banks do and could provide those sort of services. The second thing is, though, in NABs case we bought MLC in, I think, around 2000. It's a long time ago. We're now in the process of divesting it but that's a separate story. What we did over those 18 years I think we made some missteps which caused us to be in the position we're
25 now divesting it. That's why I say, you know, when we started I'm sure we thought it was going to be successful and we would integrate it and we were going to make it really a core part of the bank platform so that when you went on internet banking you would see your superannuation balances, and if you had a share portfolio. But that didn't happen. So I would say it hasn't happened because there's more and more compliance and regulatory risk on the wealth side. We didn't probably understand that to the extent we did – should have. We didn't integrate MLC right into the bank. It was like a separate business unit. And it was more a standalone type business unit. And I think those things – and we didn't invest in it enough, to be honest. And that was partly for our reason – you know, we had a couple of other strategic issues we were dealing with which we decided to put money into or had to put money into,
30 particularly the UK which probably took it away from putting it into something like MLC. That's why I say it didn't need to be like that but I think it has probably been like that.

45 Do you think one of the issues might have been that the skills, experience and systems that banks have for managing the risks and obligations associated with accepting deposits and lending money have turned out to be very different from the types of skills, experience and systems required to properly manage the manufacture

of wealth products and the provision of financial advice?---Yes, I think – I think they are different. Yes. I think we’ve had – we’ve had over – over, say, the last 10 years which I’m a bit more familiar with in the NAB, we’ve had good expertise. We’ve had wealth experts, you know, at the top level and various levels of general and executive general managers. So I don’t think we lack that. I think it probably comes back to those other points. I think we could have integrated it and upgraded it and addressed its systems and today we would have a much more integrated and successful business that I would be saying is going really well and helping our clients and helping shareholders. So I don’t – I don’t think it’s so much about capability. I think it’s more about those other things I mentioned.

Finally, before we leave your letter to the Commissioner, you also say in that letter on the first page of the letter which is _0002, that you were initially not in favour of the establishment of a Royal Commission but you were wrong?---Yes.

And you say that the Royal Commission has provoked a critical self-examination and driven change for customers?---Mmm.

I’m interested in understanding why you think it took a Royal Commission to provoke that kind of critical self-examination?---That’s a good question. Well, because in my personal and professional experience, most – most transformation opportunities come out of pain. So it’s like you are confronted – sorry, Commissioner, no, no, not - - -

THE COMMISSIONER: I will take it in the spirit in which it is offered, Mr Thorburn?---Yes. Sorry, not Hayne, pain.

The equation has been drawn since I was about six, Mr Thorburn?---Yes, it has, actually. Yes. So, look, I mean, I have been a banker over 30 years and I was in – Mr Hodge I referred to it in this letter and elsewhere as a drift. Like – I’m sorry just to use this but this is how I have explained it to our people. I said I have love fishing and I drift fish. No anchor. You know, you start here and after 20 minutes you say how did I get here. And it’s the tides take you. So I’ve been in the system and I believe I have the right integrity and capabilities and skills but I didn’t see it. You know, I kept probably just defending it because I thought it was right. But when I saw the confronting stories – well, no, I will go back half a step back to the acceleration of our plan where we said we want to spend one and a half billion dollars more. I started to see that we need to simplify the bank, less products, upgrade systems, improve our talent, better compliance. I think I saw that, one. But two, the Commission, when you read the case studies you say this is like so upsetting and so damning, what went wrong. I remember one of the ones was the default interest. One for one of our clients who was at the Commission. I said to our team, “Why is it 18 per cent?” And there wasn’t a really good answer to that. Why do we – you know, why do we hit people so hard when they are in difficulty. I just went back to the first 20 years of my career where that sort of wasn’t the mindset we had. And it just got too complex and we’re not challenging enough. You know, people inside the bank are perhaps a bit passive and we’re reinforcing the current system not

because we want to it is just that we're in the drift fishing boat. So I think what has happened this year is we've been confronted by some of the things we needed to be confronted by and out of that is coming good change and I believe will cause us to think about what is the purpose of the bank and it's about earning your clients' trust and building a long-term sustainable business over five to 10 years. That's what we're getting back focused on.

Well, how do you make it last?---Yes. Well, there's going to be a little bridge we have to go over, Commissioner, it will take a little while because we're trying to change a whole cohort of behaviour and mindsets and systems but we've got to get back to some of the things we've talked about here. One of the things I talk about more than most things to our leaders is why do we exist as a company, our purpose, our vision, our values, our behaviours. The second thing is we have tried to dramatically simplify the bank. You know, we had, would you believe, up to 12 layers between me and the frontline. I mean, now we're down to 94 per cent is within seven, we will get that to 100 next year. That's taking a lot of middle management who are – who are, like, observing things. They're not bad people. They're just – they're there to comply, not to change things. Reducing the number of products. We want to reduce our number of products by half. We want to reduce our systems by at least 25 per cent. Then getting to how are you measured. Go to your balance scorecard. It's not about selling and growth and revenue, it's about risk and it's about customers and advocacy.

But it's also, as you said, about the immediate leader?---It is about the immediate leader.

The immediate supervisor?---Yes, yes, yes.

Dealing with a particular person at whatever level in the organisation?---Yes, absolutely right.

Now, again, it may be wrestling a column of smoke, Mr Thorburn, but how do you make it last? We've got to the point of saying change is needed. You say you've got to the point of we are making change?---Yes. Yes.

I'm trying to look beyond that because I think that's what I'm required to do?---Yes. Yes. Well, I was trying to answer it, Commissioner, by referring to some of those things. Then I was going to go to measures and incentives, how people are measured and how they're rewarded I think some of the questions Mr Hodge put to me about the variable reward that we have and how we simplify the bank. I think if we could simplify our compliance and regulatory obligations, that would help as well. We need to automate a lot of these things, Commissioner, because at the moment they're manual in the bank and therefore they're prone to error. We need to invest a lot more in controls because controls should prevent and detect the problem. We haven't had enough emphasis on that. But let me just try to land on this last point that you challenged me on, because you're right, around – you know, to me the

biggest driver of culture in an organisation in my experience has been leaders, the behaviour of leaders.

It has got to be?---The behaviour of leaders.

5

Yes?---So what we're doing is – we have, say, 3000 people leaders. We are really going back to first principles with those leaders. We are explaining it is – it is – it is about character, not just performance. In fact, the way we define we want in a leader Commissioner is by the term epic. E stands for empathy, you know, the ability to relate to other people, to relate to colleagues, to relate to clients, to show you have a heart and emotion. P is to perform. I is to imagine, and C is to connect. We are trying to go back to first principles and a lot of that curriculum is being overhauled as we speak and I'm the sponsor if it – I'm the personal sponsor of it. I think this would be – could be the biggest impact I can have on the company, to build leaders who have those sort of capabilities, not just at the top level but the top thousand, the top 2000 leaders. I think we're investing a lot more in that and we're measuring people on that. Things like employee engagement surveys and feedback to leaders. You know, recently we've sent out to leaders those – from – from data, those we think who are doing that well and those who are not. So I think this is the big challenge, and, you know, some – it's said that some of the most important things can't get measured. And these sort of things we have to put some measures around but in the – in the sense it is a contact sport and you really need to be coaching leaders and expecting more of them. So that's where I think we're spending more and more of our time, money and effort and that is the goal.

25

MR HODGE: Perhaps to help you just further think through your answer to the Commissioner, if you just go back and think about the answer you gave about five or six minutes ago as to why you think it hadn't been possible to have this self-examination before the Royal Commission. I could pick out of that these ideas: the first that there was a lack of – a lack of challenge. That is, you hadn't been challenged in order to think about these things. And then the second, that there had been a lack of internal, perhaps leadership and recognition of the problems. Is that – do you agree those are two of the points you're trying to make?---Yes. That's – that's a good summary, yes.

35

And it seems that in relation to the lack of challenge, that there are a few different issues with challenge. The first is one way in which you might be challenged is externally by competitors?---Mmm.

40

Do you agree?---Yes.

45

Now, the reality is there are four big banks in Australia of which you are one. It's going to be very difficult to shift the competitive landscape in some way to alter the competitiveness and the challenge that will come from your major competitors. Do you agree?---We shouldn't be relying on that. Like - - -

You shouldn't be relying on challenge from your competitors?---We've got to come back to our own vision, our own purpose.

5 Sure?---Our own standards, our own – so that should be driving us. Not – sorry, am I understanding what you're saying?

No, no, I think we're agreeing. Ultimately, you have to make the right decisions?---Mmm.

10 Your point is that one of the reasons that you may not have made the right decisions or reflected on things adequately was the lack of challenge, and that's what the Royal Commission gave you?---Yes. Well, the Royal Commission has given us real cases of real customers where we've made terrible mistakes. And, you know, that has been an important part of the questioning of how did this happen.

15 And so if we follow that through logically, one way in which that challenge might have been introduced in the past, and, therefore, might be introduced in the future, would be by having an active regulator in relation to conduct matters that challenges you externally?---Yes. Yes.

20 And it may be that improving the level of challenge coming from the conduct regulator to the bank would be a way of trying to make sure as an ongoing process that you're thinking through these issues?---Yes. I think that's – that's good.

25 And a second way in which this might happen, which is sort of a blurring of external and internal challenge is that you have an ongoing supervision relationship with APRA?---Yes.

30 And APRA comes and looks at things and, in theory, would challenge you on a lot of these types of issues, these cultural issues, remuneration issues, decision-making issues that you're talking about?---Yes.

35 And so it may be that there needs to be an improvement or a change in the level of challenge that is coming from that – I will say prudential regulator but we're really talking about there is the forward-looking regulator who is coming in and looking at what the internal outcomes are of the bank?---I would agree with what you're saying. Although, I think one of the things that we said in our draft APRA self-assessment, which I think you would have seen, is we haven't listened to regulators enough. So it's like challenge is one thing and I think that's useful. But we need to be on – in receive mode more. Now, that depends a bit on the relationship. It's a bit more challenging with a conduct regulator than a prudential regulator but I'm saying we need to lift the bar there. We should be – they should be helping us get better. We shouldn't be thinking of it as they're trying to catch us out.

45 THE COMMISSIONER: It is also related, is it not, to a point you made earlier. You spoke of the Commission raising real cases, in effect, publicly. Is that right?---Yes.

The real cases it raised publicly were cases within your organisation?---Yes.

5 That is, they were cases known to your organisation. What happened was that there was public scrutiny of the way in which the entity had reacted to those cases. What does that say about the need for different supervision and governance within the bank to recognise the reality and importance of the kinds of case that have been the object of public scrutiny and publicity?---Yes, because we've got to get this right. We surely can't have this every year. But we've got to build our own - - -

10 MR HODGE: We all agree on that?---We've got to build our own muscle and strength, Commissioner, you are right. Let me just think about this. I think one of the things has been – I want to go back to, you know, in the last five years in the bank and banking there has been good people with good intent, and even some of the things that we were trying to do sort of at the time sounded right, but we were sort of
15 working off a technical grounding, not the spirit of what's right here for the customer. So if you come back to, you know, not to use Mr Hodge's words but, you know, the role of a bank is to have deposit accounts, lend money and make money. That's not the purpose of the company. That's not – that's what we do. What our purpose is to serve our clients. To build trust. To build trust. To have trust with
20 them. And anything that you're seeing inside the bank, complaints, or problems, you should say is this enhancing trust or breaching it or breaking it. And if it's – if it's not enhancing it, you've got to get on to it a lot quicker. So I think we've got to get our mindset back to why do we exist, what is our role and it is to earn the trust of customers. And anything you're seeing inside the bank, both through controls that
25 should pick it up and make sure it's not hidden, but I do think, come back to leaders, Commissioner, and why leaders believe they are playing a role in the bank, and that is to build trust with clients. And I think that will help flush these things out much more aggressively.

30 THE COMMISSIONER: But does the significance of public exposure of these - - -?---Yes, yes.

- - - events - - -?---Yes.

35 - - - mean that bad news has not filtered up the system in the bank towards the top of the bank where it has reached a level where an appropriate reaction can be had to the bad news story?---Well, I think it's that appropriate reaction and why that hasn't happened. Because I think, Commissioner, most of these bad news has been – has been inside the bank. We've known. I've known. The board has known, senior
40 people. They were all known. It was our reaction to it. Now, if you think of this is as, look, our job is to manage things and resolve this within the funding appetite we've got and subject to the profit and, like, if we can afford it, right, if you take that line of thinking, equals wrong answer. Like if you come back to – our job is to earn the trust of our clients and if we make mistakes we should get on to that as the first
45 priority as much as we can, and – and fund that and put right capabilities and right remediation. I think that's the mindset shift we need to have inside the company.

Yes?---And it's - - -

MR HODGE: Commissioner, is that a convenient time to take a break?

5 THE COMMISSIONER: Yes, how long do you want, Mr Hodge?

MR HODGE: I was going to suggest a 15 minute break.

10 THE COMMISSIONER: As long as 15?

MR HODGE: I will take 10, if that's the - - -

15 THE COMMISSIONER: I will go and consult the vendor at 10 then, Mr Hodge. I will come back at 10 to midday.

MR HODGE: Thank you, Commissioner.

20 **ADJOURNED** [11.41 am]

RESUMED [11.51 am]

25 THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Thank you, Commissioner.

30 Mr Thorburn, I want to turn briefly to customer remediation. NAB has recently established what it terms a customer remediation centre of excellence?---Yes.

35 And there was a study tour to the UK and conversations with the KPMG remediation centre which led to the establishment of your centre. Is that right?---I think it was around the same time, Mr Hodge. I'm not sure it led to it, but, yes, it was in the mix.

One of the things that NAB learned from its study tour was that remediation programs should be seen as an investment?---Yes. Yes.

40 Does NAB view remediation as an investment or as a distraction, do you think?---I think if you go back to my premise around our vision and purpose, earning the trust of customers, when you've made mistakes, for whatever reason, and you know them, you've got to fix that in order to ensure that you have ongoing trust with the client. And not just with those clients but with others who hear about it. So I think it's an important capability that we have that we will need for some time.

45 Do you think in the past that it – NAB has had a tendency to view remediation as a distraction?---I wouldn't say a distraction. I would say it's like one – one of the

many tasks we have to do. It – it didn't have the priority that it should have, but I wouldn't say that we thought of it as a distraction, no.

5 And is the consequence of it not being thought of as a priority that, in your view, a lot of the remediation programs that NAB has undertaken have just been too slow?---Yes.

10 How does the customer remediation centre of excellence compare with Project Guardian which was tasked to oversee fees for no service remediation?---So the customer remediation centre of excellence I think works off some principles. The first is that where you have material and complex cases, you do need capability and reporting to – to be able to elevate progress. And you need it to be centralised. You can't have it in the business, because the business will suffer from two things. The first is the many things they have to do, and that's legitimate. And secondly, you
15 know, they may not want to, in some cases, raise the problems. I hope that will happen less and less in the future, but, you know – or they will be analysing it for too long, or going to legal agreements rather than, really, you know, what we all know should be the answer. So I think for those two reasons we've centralised it, and I think that will make a far bigger, positive impact on raising issues and getting them
20 addressed quickly, and – and money back in customers' hands if we've made mistakes.

25 Is it still the business itself that carries out the remediation, but it's supported by the remediation – sorry, customer remediation centre of excellence?---Yes. I think what – because we're – you know, we're up and moving and, you know, it's serious, but we're learning as we go through this. I think you do need to have local business ownership, because they know the clients, they know the products, they know the regulatory situation, know the capabilities they need. And so – and also you want them to be accountable. You know, their clients, their mistakes, they should own it
30 rather than just throw it over to someone else to fix it. But what you want in the centre of excellence is transparency of progress, metrics, our dashboard that throws up how progress is going. You also want them to do some leadership role in saying you need more – you haven't got the right sort of capability. So a challenge role. And you also want them to say I actually think part of the reason they're going too
35 slow is they just don't have the right resources so we need to give them more money. So I think you need both. It can't be totally centralised or decentralised and I think we've got a good balance at the moment. We just have to keep learning.

40 Can I just understand an aspect in relation to resourcing. NAB announced last year what it described as a transformation of the bank?---Yes.

And that's known as the accelerated one NAB program?---Yes.

45 And that program involves significant cuts to employee numbers. Almost 6000 employees, I think, will be let go?---I would say, Mr Hodge, that is the outcome of us dramatically – investing in the bank and dramatically simplifying it means we will needless of certain jobs in three years' time.

And is that likely, do you think, to come at a cost to compliance and remediation?---No, it should not. In fact, we're investing more the – the one and a half billion I referred to over three years on top of the one. So that's four and a half billion dollars. And this year, I think, from memory, we've got almost \$500 million of the 1.5 we're spending is in what we call risk and compliance. So it's getting probably more investment than it has before and it's needed.

I see. If we just come back to this idea of the customer remediation centre of excellence being a centralised unit but supporting the business. As we understand it, the centre is accountable for the remediation but the business generally has oversight of the remediation. Is that an accurate description of how it works?---Maybe. The – the centre has accountability for ensuring that all the – all the major programs are identified, resourced, have clear timelines and they are resourced properly to deliver as quickly as we can. That's where I would go to to find that. But the business has responsibility for undertaking the activities in the timeframe that we've agreed, because they're best to do it, for the reasons I outlined earlier.

So is there a risk that the business would ultimately end up overriding the views of the centre so that, once again, you end up in a situation where finance trumps compliance?---Well, I mean, you're always going to have some tension in these sort of processes, but I don't think so, because the centre of excellence, you know, it's – it's very senior, it consolidates all the reporting. So, in a sense, it has a very powerful and influential role. It can bring the facts to bear on any particular case. So I don't think the business would be able to trump – it's probably – it would probably work the other way if the truth be known but over time we have to be careful that it doesn't go one way or the other because the centralisation team they, probably don't have all the knowledge they need to make the right decisions either. You know, sometimes going too fast is the wrong thing. You need to get the data and the information right. So I think there's always a bit of tension but I don't think, at the moment, Mr Hodge, that's – that's a risk.

The executive who is accountable for the centre of excellence is Sharon Cook. Is that right?---That's right.

Ms Cook is the group general counsel?---She is the chief commercial and legal officer of the bank. So more than – more than legal. It's a – it's a commercial role as well.

And so she has obligations under BEAR?---Yes.

Including in relation to the centre of excellence?---That's right.

And when was the centre of excellence introduced?---During this year. Maybe May/June, or thereabouts.

And have you noticed any improvement in how NAB is dealing with remediation as a consequence of the introduction of the centre?---Yes. I – I have a lot more

confidence, because, you know, there's six or eight major programs under there, and what I'm seeing now is transparency of reporting and information, and issues being raised. I mean, we're getting that – I'm getting a summary weekly. We can see it monthly in a more formal way. So I feel more confident now because there's less greyness and less place to hide. You can see exactly where things are at. And you're getting the business to give a view and the centre to give a view, too, if there is any disagreement, which there hasn't been, but, you know, you could see that occurring if it needed to.

10 We might come back to remediation when we deal with fees for no service. Just before we turn to that topic, I want to very briefly ask you some questions about the introducer program. Not about the case study that was dealt with in round 1 but the introducer program more generally. I understand your view to be, from your witness statement, that you're satisfied that the introducer program is now fit for purpose, in effect, what you've brought into place?---I wouldn't disagree with that. I – I have spent some time understanding not just how it happened but what the controls and checks we've got and how we govern it and how we run it. I've met with a number of executives on more than one occasion to satisfy myself of that. Although, as I say in my witness statement, Mr Hodge, I would say it's a – under review in inverted commas. I think it's a watching brief, maybe is a more correct term, that I would like to just be really, really confident that, you know, it is sustainable in its current form but I feel confident that we've gone through some very sensible steps to this point.

25 And I will try to summarise it as best I can. But your view as to the way the introducer program works now is that the – aside from some legacy sporting and community clubs, I think, that the introducers now will be people who have some sort of – they're professional businesses in some way associated or connected with the financing or the obtaining of a loan. Is that right?---That's right.

30 So that would be people like conveyancers, solicitors, financial planners?---Yes, accountants, real estate agents.

Real estate agents?---Yes. Yes.

35 And those people, if they've signed up to the introducer program, would be paid some commission on the – when a loan is actually drawn down and for the – there's some qualifications - - -?---Yes.

40 - - - on the time which the calculation is made and things like that?---The essence of that is right.

And there's also some clawback provisions that you have in your agreements that relate to misconduct that occurs?---Yes. Yes.

45 And what I'm then trying to understand is what is the benefit to a customer of this type of introducer program?---I think what the customer gets is, if you like, an

endorsement from the person they're dealing with, who they're already dealing with on financial matters, and there will be most likely an element of relationship and trust that already exists there. And they are getting advised that if you go to see this banker at NAB, they are competent and they do a good job. You know, they know
5 what they're doing, they go through a good process, and I endorse them on that basis. So it's a – I think what the customer is getting is a potentially confident step they can take to see a banker who does the right thing and is very knowledgeable. Whereas, otherwise, they would – they could spend a lot of time thinking about who do I go to and where do I start. I think that's the main benefit, as I see it, to the customer.

10 I have to say, that seems like the main benefit to you rather than to the customer. That is, what you obtain is having one of these professionals effectively offer either explicitly or implicitly their endorsement to the customer of going to NAB. That's a benefit to you, isn't it?---As well?

15 It's certainly – as a starting point it's a benefit to you?---As well. Well, I think if you think of a customer, a person who is dealing with one of those professional groups and the sort of nature of what they're talking about, whether it's their small business accounts or it's a will or it's a planner who's looking at their financial situation and
20 they're thinking about, "Okay, maybe I should get a different sort of a loan. Maybe I should get a fixed rate. Maybe I should buy an investment property." You know and they're talking about those sort of things. So the customer is talking to their current adviser. And I think all the adviser is then saying is, "Look, if you do want to do that, if you go down to NAB there's a banker down there called – and my experience
25 has been they're very good at what they do. They are very thorough, they are very professional." So you could consider that as part of that step. They might say I am not going to do that, I am going to go to a broker, or somewhere else. I know my neighbour does this. Whatever. I think it's really an opening of a door. And what they're relying on is the trust in the professional relationship they have with the
30 person. So it's like any – anybody, two humans referring somebody to someone else. I still – I do feel, Mr Hodge, it's a – it is a benefit to the customer for convenience and speed and confidence in seeing somebody who is endorsed by somebody that they respect.

35 If the adviser was just acting in accordance with their professional duties going to make a genuine recommendation as to what the customer should do, why does NAB need to pay the adviser?---Well, I think there will be many where that happens where there is no payment. I mean, I actually, in my experience, I've been in banking a long time, it happens a lot. But where you've got a business who – the nature of
40 what they do is financial matters, we have – have said it's important that sort of incidental or supplementary to it. It can't be a big part of their business. We still think it's a legitimate commercial transaction to pay the referrer. Now, I – you're pushing into some risks in this. I agree. And that's part of the reason I want to keep our finger on it because it could be open to the wrong sort of behaviour but I think
45 we've really contained it to the moment and we've got some better controls in place to prevent it from happening. So I think it's a legitimate commercial activity but it does rely, for example, that – in that conversation I referred to earlier, the adviser

saying, "And if that happened, I would be paid a fee." You know, so there's some transparency in that. There's a little bit of operational risk already. But my answer to your question is I think it happens a lot where there's no payment. But I don't think it's unreasonable that in some cases where you have a formal agreement, that people can be paid for it. Especially if they're seeing a lot of people and they're in the financial business.

Let's perhaps just take a few elements of that. As you've said, one of the things that the professional is required to do is to disclose the fact that they're going to receive the commission. They're required under your contact with them?---Yes.

You agree with that?---Yes.

But as I am sure you know, and as the Commission published some research about this just before the commencement of module 7, disclosure of that type of conflicted remuneration by professionals doesn't actually seem to have the type of effect you would desire that it has, which is that a customer would become very – a client would become very suspicious of why the recommendation was being made?---Yes.

You're aware of that?---Yes.

This is just - - -?---Yes.

- - - as it turns out, what behavioural economics has shown us over the course of a number of years. And you've made the point that there are probably many cases that where professionals make a recommendation to a client to go to a particular bank, to go to a particular person at a bank, and then not receiving a payment?---Yes.

But, of course, that is something that's totally outside of the introducer program. The introducer program, as you have simplified it down, is something where you pay professionals to at least implicitly endorse your products to their clients?---Yes. I think in – it probably more endorse a person that they know, or it could be a group of people, yes. But, of course, the process that then has to follow is that, where we didn't get this right in the introducer program is the banker needs to see the client. So we're not necessarily approving it.

Sure. You've stripped out some of the elements that led to fraud and breach of the responsible lending obligations. And what you seem to have simplified it down into is a program where you – and this is my word which I suspect you will disagree with – where you corrupt the professional relationship between an adviser and their client?---Yes, I disagree with the word.

With that word?---Mmm.

And if it was the case, for example, that FOFA didn't have carve-outs for credit products then it would seem to follow that it would not be possible for you to pay

financial advisers to effectively endorse your products. Do you think that's right?---I think so.

It would be a form of conflicted remuneration?---Yes, as I understand it, yes.

5

I want to move then to another topic, and that is fees for no service. You've addressed some adviser service fees or fees for no service events in the statement that you've given?---Yes.

10 I'm going to ask you some questions about that just so you know to begin with, what I'm going to exclude is anything to do with the plan service fees, which, as you know, is now the subject of Federal Court proceedings that have been brought by ASIC - - -?---Yes.

15 - - - against your trustee NULIS?---Yes.

So I'm not – the questions I'm going to ask are just going to be about adviser service fees and some of the adviser service fee events. Now, you're familiar with those events. You've - - -?---Yes.

20

- - - addressed them in your statement?---Yes.

And those events were the subject of significant breach reports to ASIC and APRA?---Yes.

25

One of the events was a NAB financial planning event which involved the charging of advice fees by NAB financial planning to customer who had transferred to MLC Direct?---Yes.

30 And that meant the customer had no linked adviser when the fees were charged?---Yes, that's right.

And the fees were, nevertheless, retained by NAB financial planning?---Yes.

35 But there was no advice service provided?---Yes.

And the other event that you've discussed in your statement is concerned with the discovery that there were accounts of deceased members that had been charged service fees?---That's right.

40

And in your statement, you say that in around 60 per cent of cases there was adviser activity on the accounts following the death of the client, such as by assisting family members?---Yes.

45 But you agree even that wasn't actually authorised conduct?---Yes.

And in your statement, you offer two reasons – I’m sorry, you offer some reasons for why you think the two events occurred?---Yes.

5 For the NAB financial planning event concerned with MLC Direct you say there was a breakdown in a manual process by which clients were to be segmented when the adviser data required it?---Yes.

And you explain that due to data limitations that did not always occur?---Yes. Yes.

10 Would it be helpful if I brought up - - -?---Yes, it would actually be helpful. Could I just see that?

15 Could we bring this up – if we bring that up – if we bring up Mr Thorburn’s statement, it’s paragraph 171, subparagraph (c) at page .0051. The witness statement is WIT.0001.0180.0001. Mr Thorburn, one of your counsel is just pointing out you’ve got a hard copy in front of you?---Okay. Could you just tell me the tab?

20 Paragraph 171. It should be the very first document will be the actual witness statement?---Got it.

And it’s page 50?---171.

Page 50 - - -?---Yes, yes.

25 - - - paragraph 171?---I have it. Thanks.

And you see subparagraph (c)?---Okay. Yes.

30 Continuing:

As a result of the limitations of the data and the segmentation report and the limited documented guidance in the segmentation report, the manual examination and assignment process did not always occur.

35 ?---Yes, yes.

And as we’ve discussed, that then meant the clients were transferred to MLC Direct, which was the section that actually provided general advice - - -?---Right.

40 - - - rather than personal advice?---That’s right. Yes. Yes.

And the fees were, nevertheless, retained. And presumably, there was a point in time at which it was identified that this stream of revenue was coming into MLC Direct?---Yes. Yes.

45 But, nevertheless, NAB didn’t stop charging the fees immediately when that was identified?---That’s correct. Yes.

And in relation to deceased members, you say the conduct occurred as a consequence of a lack of process to reduce adviser service fees to zero after being notified of the member's death?---That's right.

5 And the issue was only identified after CBA – or after the revelations about CBA during the second round of hearings in the Royal Commission?---That's right.

Now, in the case of NAB financial planning and the retaining of fees by MLC Direct, the problem was not so much discovered as explored after customer complaints were received and an event was raised in NAB's event management policy?---Yes.

10

And so in both cases, it would seem something external prompted NAB to look at the issue?---Yes. I think that's right.

15 Why do you think that it took external events for NAB to discover these issues?---Well, I think the – there wasn't the intent that this would happen but I do think the words you used previously, Mr Hodge, that were in my witness statement, ineffective process design, I just don't think we set this up properly with proper processes and controls that would then identify much earlier that there was a
20 problem. And also it was a design error and flaw. I don't think it was the intention to do that at all. But we didn't put it in place properly. So what we ended up relying on, which happens from time to time and is not entirely a bad thing, is you have a customer complaint and it then causes you to say, "Actually, maybe we should go back and follow the thread to make sure that this is not more commonplace." So,
25 ineffective process design, I would say, is – is the answer.

Somebody, though, must have made the decision within NAB that the process would be that when there was no linked adviser the customer would be transferred to MLC Direct?---Yes. I – you would think so.

30

Well, it must be the case?---No, that's – yes, because people were doing that manually, you're correct. But I don't know whether it was lack of training, you know, lack of – lack of knowledge as to why that wasn't picked up at the time, or whether it was because of, you know, as soon as you start to read things about
35 segmentation reports, that indicates, you know, there's a lot of manual processes and data and it just would have been one of those files that could have been so complex and operationally complex that the right level wasn't looking at it and the right capability. So I think it will be a human oversight as opposed to any intention that we see a problem here and we're not going to raise it.

40

The thing, though, that I think you're saying needed to be picked up wasn't that it was being done, it was that it shouldn't be being done?---The transfers?

Yes?---Yes. Yes.

45

And do you agree with the proposition – or do you accept that to retain fees charged for a service when NAB did not provide that service is dishonest?---It's wrong. It's

absolutely wrong. I think dishonesty goes a – goes sort of to intent, is the only distinction I would draw. And I don't think I've seen this case and others – some exceptions – where there was an intention to not do the right thing or maybe even a view, as you're suggesting, an intention for it to be a problem from the start and
5 someone to ignore it. I don't think that – so I think it was wrong that we didn't pick it up. And I think we got on to it reasonably quickly but it was a process error. So I would say it was an unfortunate – it broke trust with our clients and took us too long to find it and to fix it. So there's a problem for us. But the dishonesty would go to why – the intent and I don't feel it was dishonest in that respect.

10 And I just want to make sure, as best I can, I've understood what you think was or was not intended. It was certainly intended to transfer the client to MLC Direct?---Yes.

15 It was certainly intended to retain the fees?---Yes, although I don't think the people doing that knew that. I don't think they connected dots on this one.

I see. You think they didn't understand that by transferring the client to MLC Direct they would be retaining the fees?---Well, they may – when you say it like that and
20 you look at one client, of course it's so obvious but I just don't think that would have been what was happening at the time. They would have been doing bulk transfers. I think this was – and it would have been quite manual processes, and we may not have had the right capability. We certainly didn't have the right checks and balances in that process, I agree with that, but I'm just not sort of agreeing, Mr Hodge, with
25 the – your view that – that we – we knew what we were doing and that it was dishonest.

Let's just, as best we can, try to work it through. You knew that MLC Direct – this was known within the business – MLC Direct was not providing personal
30 advice?---That's right.

And it was known within the business that these clients were – had previously had an adviser and, therefore, were paying ongoing advice fees and now they didn't have a linked adviser?---That's right.

35 And it was known within the business that the fees weren't being turned off because no one was turning the fees off?---Yes.

And it was known within the business that the clients were just being transferred
40 over to MLC Direct to now be the adviser of record?---Yes.

All right. And is your point that notwithstanding that all of those things were known, nevertheless there wasn't a recognition that this was a dishonest thing to do? Or let me put it in a slightly more neutral term; I can see the challenge you have with the
45 word "dishonest". Is it your view that notwithstanding that all of these things were known, there wasn't a recognition that what NAB was doing was wrong?---No, I think what I'm saying is that the first we knew this was an issue, ie, we were doing

something we should not have done was when we had complaints. I don't believe – now, I'm not agreeing that this is right but I'm just saying that you've taken to three logic data points and when you look at them you say, well, I can't disagree with that, but I don't think it was like, "Okay, we're going to transfer, we're going to not have
5 advisers, we should turn it off." I don't think there was someone sitting there thinking we should do that. I think it was a big segmentation report. It will have lots of people in it, it's a pick and drop into MLC. It's an operational error and oversight. Poor process design and probably the wrong – you know, not the right capability. That's where the mistake was made, Mr Hodge, but it wasn't let's do it and see if we
10 can get away with it. I don't think that happened at all. The first issue that pops up is we have a complaint and then I think we've tried to act reasonably quickly after that.

Now, what has now happened is that you've introduced long-term controls, including
15 automatically switching off ongoing fees?---Mmm.

That's right?---Yes.

And there has also been what I think you termed detective controls have been
20 introduced to try and identify if these events arise again?---Yes.

And when you – I'm sure you agree, these are, whilst they might be prudent, they're steps that are reactive to the fact that the events have already occurred. Do you agree?---Yes, I do.
25

And do you wonder why it is that those types of controls weren't put into place in the first place?---Yes.

And do you have an answer?---Well, I think – some of which I've already said in
30 earlier conversations with yourself and the Commissioner about this was a separate business. It was complex. It had legacy systems. It wasn't integrated into the bank. And I – I don't think one of the things we've been good at, Mr Hodge, in the bank or in NAB Wealth has been, you know, controls. I think we're getting better but I think at this time – go back to 2015, I think we – you know, we weren't - - -
35

2015 is when it was discovered?---Yes. The period prior to that, '12, was it, '12. Yes. So I just think the control piece and the automation of it, that's where we're trying to push into now is to have far more readily identified controls owned by the first and second line that are funded and automated, and I think – I think perhaps you
40 want more discernment and challenge in the process. There would have been someone here who probably should have thought, "Hang on let me raise this with my supervisor because this is not what should be happening." So I think there's a range of – that's a cultural point, this last one. And then manual processes in complex systems with segmentation reports in Excel spreadsheets, or whatever it was, I mean,
45 that's a recipe for mistakes. So automating controls that are robust and tested more regularly, I think, are where we're going now. And that's a good thing.

Presumably, another way of fixing the problem to stop it occurring in the first place would be to simply not have ongoing service fees?---That – that would be a dramatic way to fix it.

5 Well, it may or may not be a dramatic way to fix it. It would be a way to fix it?---Yes. Well, we shouldn't – the problem here wasn't the fee, though. It was the fact that we didn't have proper controls around a group called MLC Direct that should not have, because that's a general advice service, it wasn't so much the fee itself. I mean, you could extend your logic into - - -

10 THE COMMISSIONER: What do you mean by that, Mr Thorburn, it wasn't the fee itself? The fee was charged for something that wasn't done?---Yes.

15 Yes. What do you mean by it wasn't the fee itself?---Well, I think Mr Hodge's question was, well, you could solve this whole thing by just not having any fee at all.

20 Yes?---And I think having fees for certain services that you're clear with your client around and then are provided is a possible very legitimate commercial activity that a bank could do. That wasn't the issue. The issue was we did not have sufficient controls in place to ensure that when the fee should have been turned off, it wasn't.

25 Well, let me put that proposition in other words. The other words are that this money fell into the pocket of NAB accidentally. Isn't that the proposition?---Well, I can't disagree with that, Commissioner. Like – it wasn't intended to be ours but it became ours. Yes.

Yes.

30 MR HODGE: One of the reasons – or one of the fundamental issues is, isn't it, that the relationship between the fee and the service was so disconnected that it was possible that you would just keep charging fees without actually providing a service?---Could you just say that again, Mr Hodge, please?

35 Well, if you think about it, if you provided a service and then after you provided the service you invoiced the client - - -?---Yes.

- - - for the particular service that you had provided, then this issue wouldn't occur?---Yes.

40 That is, if financial planners effectively operated like every other professional?---Yes, I can see why you say that.

45 And hence, the reason why I wonder if financial – you agree that financial advisers ought to be professionals?---Well, I think they are professional, in a sense, it's a matter of how you define what is a profession. I think there has been a lot of work done in the – in – there's a number of – many very good financial planners who have excellent accreditation and professional qualifications and take long-term views with

their clients. I think – so I think it has gradually become professionalised. If you go back, I don't know, 10 or 15 years ago, many came out of life insurance and were commission – it was a commission system. I think we've gone a long way since there but clearly there needs to be further improvements.

5

In the past financial advisers were effectively a distribution network for insurance rather than financial products?---Yes.

Do you agree?---Yes.

10

And what has changed – what has fundamentally changed, at least with FOFA, is that they're not supposed to be a distribution network any more?---No.

They're supposed to be a professional, like an accountant or a lawyer as a professional providing independent advice to a client?---Yes.

15

And those types of professionals, ordinarily the way in which they operate is they provide a service. After they've provided a service they charge for that service?---Yes. Yes.

20

They don't have ongoing fee agreements where month some small percentage of somebody's assets gets debited and transferred over to the professional?---Well, that latter bit shouldn't be happening, because it's a fee for service. It shouldn't be a commission, like based on assets, but your broad point of a planner says they will – well, that's the – that's the fee for service notion, that a client and a planner would agree a fee. And the fee would be paid by the client to the planner for certain activities. Now, I think we – we need to be clear on those activities, and I – I think it's – I don't have a fundamental problem with why they wouldn't pay that fee on a monthly or quarterly basis.

25

30

Just so I make sure we've understood each other. There are financial planners who are still charging a fee for service but a fee that is calculated by reference to a percentage of assets under management?---Yes, that's grandfathered commissions.

35

Not – I don't mean as grandfathered commission. That's just the basis upon which their fee is calculated. Do you know that?---Yes. But the move that we have led and are working on is that there is a much more transparent upfront fee that's agreed between the client and the planner. But my – my point was this invoicing piece that you were talking about, I – I don't see if the fee is \$12,000 a year that that could be paid \$1,000 on a monthly basis.

40

After the service is provided, you mean?---Well, maybe – if it's an ongoing – you know, if you're talking to your planner regularly, you know, you may go a few months where nothing happens. You may have your annual or, you know, twice a year consultation, but you may not talk to the planner for months but you may talk to them a lot over a – if you've got a particular transaction, you're getting a will done or

45

you're setting up a new super fund or something like that. So this – you know, I don't have a fundamental problem with they could pay as they go.

5 How many Australians do you think really need to be paying a thousand dollars a month for financial advice?---Well, I obviously don't know the number, but, I mean, I think that's a decision for individuals to make. You know, a lot of people have investment properties, they have super funds, they require wills, they may inherit some money. And I think all those lead to a situation where you could have a planner where there's an ongoing fee charged of that amount and an ongoing
10 relationship because if the planner is doing their job, they're really helping you. Not just with those things but things like tax. So I think that's a – that's a question for individuals depending on the complexity and their circumstances.

15 The problem, though, as we've discovered, is that often the – or certainly in some cases, the financial adviser isn't providing the service and, nevertheless, the fee is being charged. Do you agree?---Yes.

And that's an industry-wide problem?---Yes.

20 And it's a problem that you would think has its roots in the fact that traditionally you got paid a commission because you were part of a distribution network, and you didn't have to provide a service, and now it has been rebranded as a fee for service but you're still not providing a service. Do you agree?---I can see why you say that. I think there has been – there has been various evolutions, and I think the last one
25 came when FOFA came in. So, yes, I think you're right. There's people transitioning in mindset. I think a lot have progressed very well and there's some – some that haven't, and that's not a good thing.

30 And in addition to the two events that we've talked about, the MLC Direct event and the fees charged to deceased estates, there is this broader issue across both NAB financial planning and also your licensees where fees have been charged by the advisers but the services haven't been provided?---That's right.

35 And at the moment, you still don't know the extent of this issue within either NAB financial planning or your advice licensees?---I think we're more and more confident about the NAB FP side, Mr Hodge, the aligned advisers, I agree with your – your proposition there.

40 In relation to NAB FP, you've agreed on a review and remediation program with ASIC?---Yes, we have.

45 And under that program, you will be going back and testing for all of your ongoing service agreements whether or not the services were provided to justify the retaining of the fees?---Yes. Although the first 33,000 of the 80,000-odd that we're looking at, we're not really doing that. We're just paying – paying the fee back. And that will be done over the course of the next few months.

And is that 33,000 because you don't have records of engagement between the financial adviser and the client or because it's not cost effective to review whatever the arrangements were – whatever the records are?---I think it's probably both.

5 And I think what we've – I think what you've agreed with already is that if a financial adviser retains fees when he or she has not provided the services that were to be provided for those fees, that that is dishonest?---Well, only if they know.

I understand?---If they know and they don't do anything about it, dishonest, yes.

10 We're talking about something slightly different?---Right. Sorry.

I understand the point you are making?---It's the word that's getting me.

15 Yes. When we were talking about dishonesty before I thought that your objection was to it being applied to a situation like the MLC Direct situation or the deceased estates situation because you thought nobody may have intended that result?---Yes.

That was the point you were making?---Yes.

20 If a financial adviser - - -?---Right.

- - - charges fees to a client and they haven't provided the service, but they retain the fees, do you think that's dishonest?---Do they know?

25 So it's if they consciously know they're not providing the service, then it's dishonest?---Yes. That's - - -

All right?---Yes. Yes.

30 And what about if they just don't care whether they're providing the service?---They don't care?

That's right. They're indifferent to it in the sense that they have no system for checking whether or not they provided the service?---Well, that's – that's – that's not dishonesty, that's just professional negligence.

35 I see. And do you think that at a minimum, if a bank like NAB owns an advice business and has authorised representatives operating under licenses that it owns, that it ought to have sufficient systems to prevent dishonesty, that is, dishonesty of a financial adviser retaining fees without providing the service and knowing they haven't provided the service?---It was going so well, the word came back, dishonest. So I just want to try and answer it, Mr Hodge, by saying the – the licensee is required to do certain things. The adviser is required to do certain things. And they're sort of two separate things because they're two different functions. And they're sort of two separate things because they're two different functions. And so it depends on, you know, where the primary fault is. Is it we don't have systems to be able to identify

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the fee that's being charged for what, and I think we do have some complications in our fee and commissions systems, or is it that the planner themselves who's not fulfilling what they should do as per their ongoing service agreements. Now, if they're – if they're doing that, if they're not caring about that, that's the professional negligence I talked about, but I – I don't think – I don't believe in this broad case it was dishonesty.

10 The advice licensees or the two advice – four advice licensees that NAB owns, they ordinarily deduct the fees from the members. Is that right?---Yes.

And then they will remit - - -?---Yes.

- - - presumably some amount, some proportion of those fees back to the advisers?---I think that's the way it works, yes.

15 And one of the problems that NAB has now in relation to its advice licensees is that they have inadequate records to be able to determine whether or not the services were actually provided?---For – for the advice licensees?

20 Yes?---I think that's one of the issues, yes. I think we're going to be working through that now to – to find how – how big that problem is. I don't think it's the only issue we're dealing with in this case, but I think that's a fair proposition.

25 And it's, to be fair, not just an issue for your bank, it's an issue for other banks and AMP as well that they don't keep – or haven't kept records of whether advice or service was provided by the authorised representatives?---Yes.

30 And on its face, one explanation for that would seem to be because, to just take NAB, you weren't interested in whether the services or advice was provided?---I don't – I don't agree with what you're saying but - - -

I'm not saying that's the explanation but that's one reason why it might have happened is because you don't – you just didn't care?---Yes.

35 Do you agree?---That's potential. Yes.

40 And is there another potential explanation that you can think of?---Well, I think when we started this we wanted to move to a more transparent fee for service for clients, so that they could choose that. I think we implemented that poorly, Mr Hodge. I don't think we had proper controls. You know, we didn't digitise files, we didn't fully track the advice that was being given. And there was a lot of change and still is between commissions and fees, and in the case of aligned planners, not just MLC products but other products. So it's a more complex case and platform, and I think that's probably the other reason, a combination of not digitising, not tracking and reporting, and multiple platforms with commissions and other people's products in there. And I think those are the other three reasons that I – I would offer.

Those reasons don't really seem to be reasons. They seem to be the things that happened. That is, you didn't digitise them, you didn't keep records of advice. You were operating multiple different systems and platforms for the payment of grandfathered commissions and ongoing service fees?---Mmm.

5

I'm interested in understanding why you think those were the things that happened. And I've suggested to you one possible explanation, which you've agreed is one possible explanation. I'm interested in whether you think there's another possible explanation?---Well, not apart from what I said, I'm sorry, because I see those as things that happened, that if they hadn't have, the issue would have been – arisen a lot faster, and we could have dealt with it far better. I think the only other reason I can think of – could you just ask your question again, Mr Hodge, just so I can see if I can be precise.

10

15 Can you think of another reason why it is that you didn't keep adequate records - - -?---Right.

- - - of the provision of the advice?---Well, then, no, those are the reasons I would – that's my – that's my best answer.

20

I want to move then to another topic, which is related to this, which is how you've gone about handling the remediation of the ASFs. And I think you agree that it has taken too long?---I do.

25 And the timeline, as we understand it, is that ASIC had made an initial request for NAB to review all of its licensees and NAB financial planning for ongoing service fee issues in June of 2015?---Yes.

30 And over time, NAB has put forward various proposals to ASIC as to how it might go about doing that?---Yes.

And one proposal that was put forward at the end of 2016 was that there be a review and the adviser would be required to point to an offer of service?---Yes.

35 And ASIC rejected that proposal?---Yes.

And the second proposal put forward in about December of 2016 was that NAB would assess whether there had been a fair exchange of value?---Yes.

40 And ASIC rejected that proposal?---Yes.

And ASIC said that it would like NAB to be able to supply direct evidence that each service outlined in the ongoing service plan agreement was provided every year for every customer that was charged?---Yes.

45

And a third proposal was presented by NAB in July 2017 which was, I think, loosely termed or referred to as the ongoing service principle. You're aware of that?---I'm not so familiar with that.

5 There was a proposal put forward in about mid-2017 that still wasn't in accordance with what ASIC wanted?---Yes. Yes.

Then in October of 2017, ASIC sent NAB an outline of suspected offending?---Yes.

10 Did you read the outline at that time?---Yes, I – I did. Yes.

And did you form a view at the time as to what NAB should do?---Differently? Differently, you mean?

15 Yes?---Well, I think it was – it probably wasn't the spark of change that it should have been, Mr Hodge, in hindsight. And, you know, there was a lot of correspondence from ASIC and other regulators. So I think we should have used that as more of a – we should change tack here. And I don't think we did enough.

20 Well, what happened once ASIC effectively put forward this outline of suspected offending, was that it was then treated as now having a legal issue involved?---I don't – I think one of the – one of the issues probably in hindsight is maybe we didn't have enough legal resources involved beforehand. I don't know whether it escalated particularly after that letter.

25 Was it the outline of suspected offending that was the trigger for Ms Cook being asked to step in and become involved?---What was – what was the date of that? Was it October '17?

30 Yes?---Yes, it could – it could have been, yes.

And - - -?---I just can't – can't recall the detail but it's logical.

35 Well, and then – and maybe to help orient you, can we bring up ASIC.0039.0003.0543. So this is a letter sent by ASIC to Ms Cook on 3 November 2017?---Yes.

And you will see what's said in the first paragraph after dear Ms Cook:

40 *I understand from your conversation today with Tim Mullaly that you have recently assumed responsibility for NABs discussions with ASIC regarding NABs fees for no service and related matters*

45 Does that help you at all to just fit together the timeline as to when - - -?---Yes, it does help, yes.

5 All right. So at that point then was the situation that Ms Cook was responsible as the
senior executive for dealing with ASIC but Mr Hagger continued to have a business
responsibility in relation to the remediation program?---No. My understanding was I
wanted Sharon to – Sharon Cook to be more involved because she was – one of her
roles is chief legal counsel. She was relatively new to the bank. And I just thought
that combination of the outside in and the legal expertise would bring more sharpness
to it. But this had been going on for quite a long time. And it had been led by the
NAB Wealth business all the way through and I think that's appropriate. And so I
still saw the NAB Wealth business, particularly Andrew Hagger, as having the
10 primary lead on it.

15 But not the lead for the discussions with ASIC?---Yes. I think the way that worked
in practice, though, was it probably still did continue like that. So I – I can – you
know, this – between here and April, there was, you know, I – I think in hindsight I
should have given it more clarity, but the way it worked in practice was it was still
led by the business and – and Sharon Cook, if you like, was the challenger, and the
legal expertise on it to see if we could bring it to a head quicker.

20 Now, this letter – or one of the things that this letter says is that NABs approach to
remediation is out of step with some of its major peers that have reported fees for no
service failures, and are close to finalising their customer review and remediation
programs for these failures?---Yes.

25 And did you see this letter at the time it came in?---I think I – I think I would have,
yes.

30 Were you aware that NABs approach was out of step with its major peers?---I wasn't
– I wasn't, Mr Hodge. I wasn't aware of the detail of it. I mean, I – I wish I had got
a bit more involved to get on top of this quicker. But I delegated this and it was one
of the many things that we were working through, and – so I didn't really – that – if
it came out to me in the letter, I didn't interrogate it to say who and why and how and
what should we do. I didn't do that.

35 You will recall the question I asked you earlier this morning about NAB having a
culture of being ethical?---Yes.

40 When you reflect on the fact that the other banks were remediating these fees for no
service issues in a way acceptable to ASIC but NAB was not, does that tell you
anything about NABs culture of ethicality?---I – I don't feel you can draw that
conclusion, and that link between the two, because I don't think we were – we were
wanting to be unethical, or we were being unethical in our dealings here. So I don't
think – and also, to flip it the other way, I'm not sure our competitors were being
more ethical because they had managed to conclude their fees for no service
program.

45 I see. And then – Commissioner, we don't need to tender that letter. It has gone into
evidence in round 5. Then if we skip forward about five months in a letter dated 13

April 2018, Ms Cook made a further proposal to ASIC in relation to remediation.
You're aware of that?---Yes. Yes, I am.

5 And we can bring that up. That's ASIC.0039.0001.1727. If we just go over the page we should see the letter. Sorry, two pages. Now, the Commission asked you a number of questions about that letter which you answered in your witness statement?---Mmm.

10 And perhaps just given the time, I will just ask you some general questions for the moment. Do you think – obviously now with the benefit of hindsight – that that letter should have been sent?---No.

And I take it it follows from that that you think that the proposal that was put forward
15 in that letter is not acceptable?---That's correct.

And is not consistent with the values or purpose or vision that you have for NAB?---Yes. That's – that's correct.

20 And the particular issue is in relation to how pre-FOFA clients were to be dealt with?---That's right.

I think you probably don't have any concern with how post-FOFA clients were to be dealt with, and, in fact, ASIC – effectively, that is the methodology that's being used
25 now?---It is, yes.

So the issue with pre-FOFA clients was that rather than reviewing whether or not you had actually provided a service to them, they would have to come to you and – after your invitation and attest to you that they had not received a service?---That's
30 right.

And then there would be further steps that you would check to see whether you had some evidence that the service had been provided?---That's right.

35 And the justification – or a justification that was offered for this was that NAB had moved early to using – moved early away from pure commissions to ongoing fee agreements?---That's right.

40 And your view that you explain in the witness – in your witness statement is that you don't think that that was an appropriate justification?---That's right.

And have you always held the view that that was not an appropriate justification?---No, I haven't – well, I – it's – it has been since that letter and what has transpired that has caused me to look at it and go back through the history to try
45 to understand what we were doing and why we were doing it. But to answer your question, Mr Hodge, I – I – at that time, you know, I didn't have a particularly different view. I – I delegated it and I had left it at that, but now I go back and look

at it, I – and as I said in my witness statement I think the pre-FOFA piece was not – was not a justifiable argument.

5 Well, you aware of it at the time that that was the justification, weren't you?---Well, if you go to the letter, yes.

I'm sorry, what do you mean – do you mean if you look at the letter?---Look at the letter, yes.

10 And you looked at the letter at the time or you're not sure?---No, I'm not sure whether I saw it before it went but I can tell you I'm accountable for it.

What do you mean by that, that you're accountable for it?---Well, I am the CEO of the company and that has gone under our letterhead.

15 I see. Can I show you a document. Can we bring up NAB.006.041.0387_E. These are the minutes of a meeting of the NAB board risk committee?---Yes.

20 And you will see they're the minutes of a meeting on 30 April 2018?---Yes.

And you were present?---Yes, I was.

And Mr – is it Gall or Gall?---Gall, yes.

25 The group chief risk officer was present?---Yes.

Mr Hagger was not at the meeting?---That's correct.

30 And he never joined the meeting, so far as we can tell?---Yes.

Ms Cook joined the meeting. If we go to page – if we go to page 3 of the document. We see at the bottom of the page, just before 55-2018, Ms Cook joined the meeting?---Yes, yes, I see that.

35 And this was concerned with adviser service fees?---Yes.

And there was a paper that Ms Cook presented on as to the status of ASICs investigation into the fees for no service issue?---Yes.

40 And we may need to look at that paper after lunch but if we just go over the page, you will see there's a reference to the fact that there was a proposal submitted on 13 April 2018?---Yes.

45 And then what's recorded in the minutes is:

Management remained of the view that its industry leading position in moving away early from commission-based remuneration for advisers prior to

implementation of the FOFA reforms should be taken into consideration when compared to peers.

?---Yes.

5

And it would seem then that this particular justification that you, I think, regard now as inappropriate was something that was specifically brought to the attention of the board risk committee on which you were present on 30 April 2018?---Yes.

10 And I take it you don't recall any challenge to that proposition?---I – no, I don't recall, Mr Hodge, no.

And it didn't strike you at the time that the position was unacceptable?---Well, something had happened in between the two, between 13 April and the 30th where a movement was changing. Would you – would you like me to say what that was?

15

Yes?---I met with Mr Shipton, ASIC Commissioner. My first meeting with him. And – on 26 April – and he made it very clear to me that, you know, things in this respect were not good and that they had been very disappointed with the legal technical way that we had tried – not tried – we had been dealing with this matter. And, you know, that was important for me because I really – it was the first time I met him and I remember the conversation covered a number of aspects but I remember this one. And, again, I walked out thinking we've got to do something to change the course here because that's not – that's not the reputation we want. That's – so whatever we're doing it's not working. And I remember talking to Sharon Cook after that meeting. So it may have been prior to this meeting or just around it to say that I – I wanted her to take sole – primary responsibility to conclude this matter with ASIC. And so – whereas the business had been leading it, that I wanted to be very clear unequivocally that I wanted her to take it forward and conclude it as quickly as possible.

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Is that a convenient time, Commissioner?

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THE COMMISSIONER: Yes. 2 pm.

MR HODGE: Thank you.

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THE COMMISSIONER: Can you be back at 2 pm, please, Mr Thorburn?---Certainly, Commissioner. Yes.

ADJOURNED

[1.03 pm]

45

RESUMED

[2.00 pm]

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Thank you, Commissioner.

5 Mr Thorburn, before lunch we had been looking at the minutes of a meeting of the board risk committee of 30 April 2018. I might just tender that at this point, Commissioner.

10 THE COMMISSIONER: Minutes of NAB board risk committee, 30 April '18, NAB.0060.041.0387, exhibit 7.83.

EXHIBIT #7.83 MINUTES OF NAB BOARD RISK COMMITTEE, 30 APRIL '18 (NAB.0060.041.0387)

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MR HODGE: Thank you, Commissioner.

20 Now, Mr Thorburn, I wanted to ask you some questions about what you've said in your statement about this letter so we might bring that up. Can we bring up page 64 of Mr Thorburn's statement, and begin with paragraph 219. If we go to the next page, where paragraph 219 is. And so in answering the Commission's questions, you said that you had reviewed this letter from NAB to ASIC dated 13 April 2018. And you have discussed it with both Ms Cook and Mr Hagger?---Yes, that's right.

25

And when did you discuss it with Mr Hagger?---Well, in particular, leading up to my witness statement. That's in particular, yes.

30 So this is after Mr Hagger had left the bank. Is that right?---No, it would have been – it would have been before, Mr Hodge. It would have been prior to 1 October. I think I would have had the discussion with him. He was still in the bank.

35 What was the date that Mr Hagger departed?---Well, I think we did a – a handover from 1 October with the new leaders, but he didn't leave until 14 November.

All right. Do you – the witness statement that you've prepared, you were sent the Rubric on 16 November 2018?---Yes. I can't recall the exact date.

40 I'm sorry?---Sorry.

That might have been the date of your statement. Your draft statement was 16 November 2018?---My witness statement?

45 The draft witness statement?---Yes, yes.

And I think you had the Rubric for about a week before?---Yes.

Or a bit longer. And that would have been in early November then that you received the Rubric?---Yes, probably – that’s probably right, yes.

5 But you discussed this issue as to who had management responsibility, did you say, before 1 October?---Sorry, was your question the letter of 13 April?

Yes?---When did I discuss that with Mr Hagger?

10 Yes?---Well, you recall, as I – as I said, that I asked Sharon Cook to take the lead role to resolve this with ASIC. And I think I had a conversation with Andrew Hagger at that time about why I wanted it to happen. I think there was a letter from ASIC dated 9 May that came in. So, look, that was in our conversation about they clearly were not happy and we needed to resolve it. And then I really thought about the letter, Mr Hodge, in the context of the Rubric when I was asked to reflect on what
15 did I think of the letter. And I – I suppose I just thought about it a lot then when I read it a few more times and I thought about what happened since and why it took so long and the tone of the letter and things like that.

20 So the thinking you did about the letter was predominantly done - - -?---Yes.
- - - after you received the Rubric?---Yes, yes.

25 But the discussions that you had with Ms Cook and Mr Hagger about the letter, they occurred earlier?---Yes. That’s right. And I actually think it was less about the letter, Mr Hodge. It was more about let’s get this resolved.

I see. And you say in your statement that Mr Hagger was the person who had management responsibility for this issue at the time the letter was sent?---Yes.

30 And management responsibility means what in this context?---In this context here, 219, if we go back to – Mr Hagger was – had management responsibility for this matter in the business sense, ASF, fees for no service. He had a lot of that contact and – with Mr Kell and others. So I saw him as the person who was still carrying forward this issue in a – in a management sense. Sharon Cook was clearly involved,
35 but, if you like, in that period up until the end of April, she was secondary, if you were to call it that – if I could call it that, in the matter.

40 She had the primary responsibility, though, for dealing with ASIC?---Yes. But that’s where I said before lunch, you – you read the – the letter and the minutes and you – that’s what it said, but I was saying in practice, in practice, between November and April, Andrew Hagger really was the person dealing with ASIC on the matter. And that’s why I said I – I could have made that a bit clearer to my people who I wanted to, you know, resolve it, because Mr Hagger carried the responsibility in practice.

45 I see. And you have asked Ms Cook about what her involvement was?---Yes.

And I think you did that - - -?---Yes.

- - - in an email?---I did that in an email - - -

I'm sorry, you might have asked her orally and then she sent - - -?---Yes, I did.

5 - - - you an email?---Yes.

If we bring that up. That's NAB.186.012.4999. So you asked her some time before 7 September - - -?---Yes.

10 - - - about her role?---Yes.

And - - -?---Yes.

- - - this is her short note of her role in the ASF negotiations?---That's right.

15

And her simple point, as she says, is that she:

... did not assume either responsibility for or accountability of our negotiations until after we received the cranky letter from ASIC dated 9 May 2018.

20

And you've accepted that?---I accept the – the essence of that, yes. Yes, I do, Mr Hodge.

25 And I'm just trying to understand, in your own mind, how does that fit with the fact that since November of 2017, the correspondence that has been occurring has been occurring between people from ASIC and Ms Cook - - -?---Yes.

- - - from NAB and that also, just so you can have all of these things in your mind, that is Ms Cook who is presenting or sponsoring the management paper that's coming to the board risk committee about the negotiations for the board risk committee's meeting on 30 April 2018 and that it's Ms Cook who is appearing at the board risk committee meeting and presenting on the issue. And that Mr Hagger is nowhere in sight?---So, clearly, they – the two of them are – were both important leaders in this resolution and taking it forward and probably dealing with ASIC. But as I saw it, Andrew Hagger had the primary responsibility for dealing with ASIC on it, Mr Hodge, like the conversations that were happening. He had relationships with particularly Mr Kell, and so often there would be a conversation there about this matter. Because I think Andrew was trying to move it to a conclusion, and he was talking with Mr Kell about that from time to time. I don't think Sharon Cook was doing that. So Sharon may have been – had a more, you know, official contact with ASIC and would be the subject of official letters, but in terms of – and whilst they worked together, in terms of calling the shot, if I may say – like about what should we do, and is this pre-FOFA piece possible, and on what basis would we feel it's possible, that was based on a conversation that Andrew had had with Peter Kell, and he felt that that was possible. So that's how I would explain it. The two were working together. They were both in the mix here. Sharon was the official person with ASIC, and that's where the letters were going to, but, really, the management

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responsibility for saying how could we conclude this and on what terms, that was mainly done by Andrew Hagger.

5 And this was known to you in April of 2018, was it?---Was it known to me? I suppose I saw it, that's the way it was working in practice. Yes. And Mr Hagger had had primary carriage of it for some time, and I – you know, I had delegated that to him, had confidence in him. He – he was – you know, I feel had the right intent to try to get to a conclusion. So that had – you know, he was mainly the person who would speak to it about what might be possible or not. He was the – so, yes, it was
10 known to me in that sense. Now, if I had have stood back I would have said hang on, let's be clear here. Who is the one person I'm holding accountable for resolution, and that was probably, in hindsight, my – my error because I should have made it much clearer, although Andrew had – carrying it. It was probably sensible in the sense that he had a lot of the relationship and contact and history on the matter.

15 So Mr Hagger was the one who would speak to it, as at April 2018?---Well, if you go back – certainly in our management meetings, where we have our executive committee meetings Andrew would be – because he had the working knowledge of it. And he was in the business, he knew the detail, he knew the history. So he would
20 speak to it in that respect. You are calling out one particular point where he wasn't there. Often he would be. So I'm not sure that was for a particular exclusion reason, that 30 April one, Mr Hodge, I – but in a – in a day-to-day sense he would be speaking to it and probably be the best informed to know where the discussions were with ASIC.

25 But the paper that was presented – perhaps we will bring that up. So if we go to NAB.006.023 .0062. I'm sorry, Commissioner, I tender that email.

30 THE COMMISSIONER: The email of 7 September '18, Cook to Thorburn, NAB.186.012.4999, exhibit 7.84.

EXHIBIT #7.84 EMAIL DATED 07/09/2018, COOK TO THORBURN (NAB.186.012.4999)

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MR HODGE: So this is the memorandum that was prepared for the board risk committee leading up to that meeting of 13 April 2018?---Yes.

40 And you can see, just in the bottom right corner, that it's – what we've seen already, it's for agenda item 6, the board risk committee. You can see it's page 62 of 170 for the committee pack. And this is the memorandum – or the paper providing an update on the ASIC investigation into fees for no service?---That's right. Yes.

45 And then if we go to the second page we see it's summarising what has happened and it said:

Since receiving the legal opinion NAB has continued to work on the proposed ASF review methodology. NAB sent to ASIC its proposed ASF further review methodology and the proposal in relation to the regulatory response for the ASF breaches on 13 April 2018.

5

?---Yes.

10 And then you see the – at the end of the document, where it has “proposed by”, it’s somebody from dispute resolution and regulatory investigations. And the person who supports it is Ms Cook, the chief legal and commercial counsel. And it’s the person who supports it is – a paper of this type – is the senior executive who’s responsible for it. Is that right?---Yes, it is.

15 And it’s – again, I think what I’m struggling with is as you recall it now, you think it was Mr Hagger who was actually responsible for determining what the methodology was and driving that, but Mr Hagger wasn’t reporting to the board risk committee; it was Ms Cook. Is that right?---Yes, that’s right.

20 And that it was – I think what you were saying is you’re attempting to sort of take the criticism upon yourself to say it was just unclear who you had put in charge of this?---I think I could have made it clearer. You know, there is that saying everything’s leadership’s fault. So I’m the leader ultimately. These two people reported to me but I think in practice I saw Andrew Hagger as having the relationship and the knowledge of the issue. So what Sharon Cook was doing here, I think, Mr Hodge, was giving an update to the board in a – more a procedural way. The specific decision – or the letter of 13 April, the specific piece around pre-FOFA, your earlier challenge, I think that was based on Andrew’s belief that in discussions with ASIC and specifically Peter Kell, that they were open to this approach. Now, I also think in hindsight that was incorrect anyway. Leave aside whether it was – we were encouraged to or not. So it’s that sort of conversation and that sort of relationship that was being brought into the room where Sharon Cook and Andrew Hagger and others were, in the bank, senior people, considering this. So my point is Sharon was clearly giving updates to the board. She would have been knowledgeable about it, she was giving – it was more a procedural update. Whereas the specific piece around pre-FOFA, that bit in the 13 April letter, I think that was based on Andrew Hagger’s belief and recommendation which Sharon ultimately accepted, was that there could be a pre-FOFA, post-FOFA distinction.

40 And what is the basis for your belief that that’s what the source was of this pre-FOFA/post-FOFA distinction, that is Mr Hagger and his conversations with Mr Kell?---I think it was based on – I think conversations that Andrew Hagger had had with Peter Kell to - - -

45 I’m sorry?---Sorry, was - - -

I think we're at cross-purposes. How is it that you have come to know that that's how it came about?---Because I think I subsequently asked the basis on which we do this pre-FOFA/post-FOFA distinction.

5 When did you do that?---I – I can't recall, Mr Hodge, sorry.

If we go back to your witness statement and bring up page 64, paragraph 220?---Yes.

10 And do you see the first part of that says:

The remediation methodology set out in the letter was advocated for by Mr Hagger, following discussions he had had with Mr Kell of ASIC.

15 Now, I understand we, that is, the Commissioner, sent a notice to produce requiring any documents to be produced recording Mr Hagger advocating for the remediation methodology set out in the letter dated 13 April 2018 as referred to in paragraph 20 of your draft statement. And no documents were produced. Are you aware of that?---No.

20 Does it surprise you that there would be no record of Mr Hagger having advocated for that?---Yes, I could – yes, I could see – because there would have – you know, there would have been a group meeting on this. It may not have been minuted. If it was minuted, I would expect – if there was a minuted item, if there was a record of the meeting I would have expected that, but if there's no, you know, particular
25 meeting where that was decided, then I suppose the letter itself is the record of that's what we wanted to do.

Yes. It's the record of what you wanted to do. It's not the record of Mr Hagger being the advocate for it, is it?---No.

30 And then if we then bring up paragraph 221 of your statement. You say:

35 *In particular, the possibility of adopting a methodology that distinguished between the circumstances existing pre and post FOFA had been the subject of discussions between Mr Hagger and Mr Kell of ASIC prior to the letter being sent. As a result of these discussions, Mr Hagger understood that ASIC was potentially open to such an approach.*

40 ?---Yes.

And your basis for that statement is you think something that – you recall Mr Hagger having said or you having challenged at some earlier time why this was the methodology proposed?---Well, I think – is your – is your question on what basis do I make this statement?

45 Yes?---Yes. Well, I think in the – in the preparation for my appearance, Mr Hodge, I did meet with Andrew Hagger, Sharon Cook and others in the wealth business to

obviously try to understand all these matters. And I asked Andrew specifically at that time. And – but going back to, you know, post 9 May when we received that letter from ASIC, when, clearly, that was – they were deeply unhappy with that particular piece, I think I did talk to him then and Sharon Cook about why we had this pre-FOFA piece in there. So I rely on both those pieces. And probably more but they're two particular pieces I would rely on.

Can we just bring up the letter again, which is ASIC.0039.0001.1727. And then if we go to the top of – I'm sorry, if we look at the bottom of page 1 you see this is proposing that split post-FOFA and pre-FOFA method?---Yes.

And then if we go over to the top of page 2. You see the first sentence is:

I recognise that you may not have anticipated that NAB would adopt this approach for pre-FOFA customers, given the direction of our previous discussions.

?---Yes.

Do you find it easy to reconcile the proposition that is explicitly put in the letter, which is that this would be unexpected for ASIC, with the proposition that this is something that had previously been the subject of discussions between Mr Hagger and Mr Kell and that Mr Hagger understood that ASIC was open to the approach?---I think the only insight I can give on that, Mr Hodge, is I don't think the letter went to – was not sent to Peter Kell. He was copied on it. I think this was to – if we can go back, is it to - - -

Let's go back to the – I'm sorry - - -? - - - -Louise Mullaly, is it?

Third page?---Louise McCauley. Yes, Mullaly – Tim Mullaly, Joanna Bird and Peter Kell. That's correct. I think Andrew Hagger had said to me that Peter Kell had indicated he was open to it and to make sure he was copied on the correspondence. But I think the lead was probably from the other two people on this letter. So I think that's the only nuance I could say in answer to your question about the first sentence on the second page of the letter.

In terms of other executives that had responsibility, was Mr Cahill involved in the negotiations with ASIC?---No.

Mr Gall, the chief risk officer, did he have overall responsibility for NABs relationship with the regulator?---Yes, he does. Or he did.

And would he have been involved in the decisions regarding what methodology would be put to ASIC?---I think it's unlikely.

Ms Cook was the executive accountable for remediation at that time? Is it the word accountable you're laughing at?---No, now you're on remediations as opposed to negotiations and discussions with ASIC.

5 This is about remediation, isn't it?---We hadn't agreed the terms.

I see?---We're trying to agree the terms. It's taking a long time but we hadn't agreed the terms. That's what we're trying to get to here.

10 Yes?---So perhaps – do you mean who's accountable for the – the – to get the agreement?

Let's take remediation. Who was accountable for remediation at that time?---Well, I don't think we had formed formally the centre of excellence for remediation. And
15 that's what Sharon and one of our senior team lead. So now there's accountability that Sharon Cook has for remediating the customers in ASF and other material programs. As well as the business. So our pre-lunch discussion, Mr Hodge, about, you know, there's always the two groups, so – but Sharon Cook clearly has
20 accountability for that now. But I'm not sure at this point whether – I can't – I can't recall the date. It may or may not have. I don't think so. That went subsequently to the – to the board.

One of the things you say in your statement is that the proposal represented a good faith attempt by NAB to resolve its dispute with the regulator and remediate
25 customers appropriately?---Yes.

Is that still your view today?---Well, I think I've said things in – in here, Mr Hodge, about the pre-FOFA piece, and about a couple of references to tone. I – that's how I
30 stand on those. What I was trying to say here is I think Andrew Hagger and others did believe that this was a possibility and were acting in good faith. It – that's the piece I was trying to say. Now, I think in hindsight it wasn't the correct approach. I believe that. But at the time, I think Andrew Hagger was trying to work through a complex issue in dealing with the regulator and trying to conclude. He had – he had
35 the right intent. That's the good faith piece. Do you – do you see my distinction between the two?

Yes. By the time this letter was sent, ASIC had already told NAB a number of its approaches were not acceptable, including an opt-in approach?---Yes.

40 And can I suggest it's obvious, isn't it, that if an adviser has not provided the services promised under a contract, they should refund the fee that has been charged?---Well, you're right. The onus is on us as the provider, that if we say to a client we're going to do certain things, we should do them and we should be able to prove we did them.

45 You know – and I think this is something that you are particularly willing to acknowledge was mistaken – you know that this letter attempts to justify treating

pre-FOFA customers differently on the basis that NAB could have just kept them on commission-paying arrangements. That's right?---That's – that's the argument in the letter.

5 Yes. And you agree that's unacceptable?---Yes.

And can I suggest this to you: it's beyond simply unacceptable. It's absurd for NAB to be suggesting that it would not simply refund the fees that it had charged for services where it had no evidence of having provided those services, on the basis that
10 had it just stuck with commissions, it could have kept the money without having to provide a service?---Well, absurd – absurd is the word you've used. I mean, I think when you look back on it, Mr Hodge, I acknowledge we got this wrong. I think we were – we were trying to – we had the right intent, but it – you know, we – we were looking at it too narrowly and too technically, and once you look back on it you see
15 it's a very – it's obvious – there was a lot of complexity. I think that's the other thing. We were dealing with 85,000 customers. We're back to '09. You know, it was – it was a pre-FOFA/post-FOFA world. Leaving that argument aside. It was one of the most complex things we've had to face into. But I think when you look back on it now we could have resolved it a lot quicker.

20

THE COMMISSIONER: Why was it so complex? What was it about it that you say was complex?---Well, Commissioner, there was 85,000 clients. They're - - -

That's big, rather than complex, I think?---Well, the files would have – were
25 complex. What we're talking about here is financial advice on complex matters for people. It went back to 2009. We had had a number of leaders involved in the business over that time. By the time we came to really face into this, it was – a lot of those had left. We didn't have very good systems, Commissioner. We couldn't – you know, we didn't have digital – digitisation like we do now, we had to go back to
30 hard copy files and couldn't always find them and the advisers had moved on or the NAB FP planners had moved on and we couldn't always find the file. So it – it – it was big and messy and complex. And I'm sorry about that, because that's – that's – that's not good enough on our part.

35 MR HODGE: The other fundamental issue with it was that there was a revenue issue, wasn't there?---Yes.

And can we bring up NAB.030.002.6347. This is a memorandum for the board summarising material regulatory engagement for December 2016. And if we go to
40 the third page of that document. You see it's proposed by the general manager of regulatory strategy and affairs and supported by the group chief risk officer. Do you see that, Mr Thorburn?---Yes, I do.

45 And then if we go back to page 2, we see in the middle of the page a section which is Adviser Service Fees?---Yes.

Summarising the – at that stage where the negotiations were at, NABs proposal of a fair exchange of value, and that ASIC had said that wasn't customer centric and not acceptable. And you see NAB is considering its position and the potentially significant implications, including potential revenue at risk and compensation payable under various scenarios?---Mmm.

And was that ultimately the thing that was the real problem, that to agree to an acceptable methodology with ASIC was just going to cost the business more than it wanted to pay?---I actually don't think that was the – the reason. I don't think that was a sort of conscious or openly discussed matter, Mr Hodge, through this. I think - - -

It was openly recorded in a memorandum to the board?---Yes, but you – I felt your question was more pointed to were we withholding it. And I don't feel we ever did that. I – I feel that – I think it's a factor. It fits with my first four points on my letter to the Commissioner. And I think is ultimately why, when we look back on it, there were consequences applied for myself, the CFO, and the CRO, as well as others more directly involved like Andrew Hagger and Sharon Cook this year. Because once we look back on it we say if we had have provided funding much more quickly, that would have – that would have opened up the possibility that this could be – capability and resources could have been put to it. However, I do think that – that the bigger problem – not the bigger problem, the main driver was trying to get to the technical conclusion about what's an offer, when was it made, what's a review, what's the definition of that. How do we have to prove it. You know, if we send an email to say we offer this and the client says nothing, is that – do we have to go back to them, if they reply was that enough. It's more in that technical world. Now, when you step back from it, you say, well, that's not really the right way we should run a trust-based stewardship business. Right. However, other people at the time were trying to navigate their way through that and they were in it. So I think that was the main driver. It wasn't this one. I don't think this was a conscious, openly discussed constraint.

I tender that document, Commissioner.

THE COMMISSIONER: And before we deal with that, the memorandum for the board risk committee, has that gone in previously?

MR HODGE: I will tender that as well, Commissioner, thank you.

THE COMMISSIONER: Memorandum for board risk committee dated 28 April '18 concerning adviser service fees NAB.006.023.0062, exhibit 7.85.

**EXHIBIT #7.85 MEMORANDUM FOR BOARD RISK COMMITTEE
DATED 28/04/2018 CONCERNING ADVISER SERVICE FEES
(NAB.006.023.0062)**

THE COMMISSIONER: Memorandum for board material regulatory engagement, December 2016, NAB.030.002.6347, exhibit 7.86.

5 **EXHIBIT #7.86 MEMORANDUM FOR BOARD MATERIAL
REGULATORY ENGAGEMENT, DECEMBER 2016 (NAB.030.002.6347)**

10 THE COMMISSIONER: Mr Thorburn, whilst we have this on the screen and popped out in this fashion, I direct your attention to the last sentence in the pop-out?---Yes.

What do you make of that?---The last sentence?

15 Yes, in the context in which it sits?---Well, I – I take that, Commissioner, to mean if we look at our small and limited peer group, some are like us, ie, have not been able to reach agreement on the methodology. Now, I think that’s false comfort. That should not be the way we think of it now but I think at the time that was – that was noted. Whereas one had agreed to move in a more specific and decisive way.

20 The very simple criterion, the service was either provided or it wasn’t?---Yes. That’s correct, Commissioner.

25 MR HODGE: Do you think, Mr – I’m sorry, Commissioner, you didn’t have - - -

THE COMMISSIONER: No, go on.

MR HODGE: Do you think, Mr Thorburn, reflecting on that letter of 13 April 2018 that that was an ethical approach for NAB to take?---I think the – the very particular
30 issue there was the pre-FOFA/post-FOFA one. I think the discussions that Andrew Hagger and others had had over time were such that – like, I don’t think we listened to the regulator enough, clearly, in hindsight but it wasn’t as clear-cut as when we look at it now that we said something and they wrote something back. This wasn’t moving that quick and sharp. So I think I come to this point around good faith. I
35 believe it was Andrew Hagger’s and others intent that we would solve this. That even these things like value exchange were what did the client get for it. If we couldn’t get the specifics – like the Commissioner challenged me on, we either provided it or we didn’t. If we couldn’t find that, you know, is there some other way we could look at did the client receive a service we provided and what’s the worth of
40 that. So I don’t think it wasn’t ethical. I think Mr Hagger and others were truly trying to find their way through a complex set of issues, inside and outside the bank with the regulator. I think I – I would say that we – we haven’t shown our clients enough respect. And probably haven’t earned their trust through the way we’ve dealt with this. I would agree with that. But I don’t think we were intending to create this
45 issue and to be, in your words, unethical. No, I don’t. I don’t. To the people – the people I deal with, I have dealt with this on this, Mr Hodge, I believe are ethical people and bring ethical principles to work.

I don't think I said did you intend it to be unethical. I'm attempting to assess with you whether when you reflect on it now, regardless of what the intention was, this was an ethical approach?---Well, it depends what you mean by ethics. I – I don't – you know, that to me still comes to integrity, intent, doing what we said we would do. And I think there was, here, interpretation of what that meant. Like what does it mean. And I think it ended up being too technical and too legal. But the way I think of ethics, I don't think this was unethical. I do believe the outcome of it is that we have not earned our customers' trust. So maybe we're sort of agreeing in the essence of this without the specific word.

10 Do you think it was to set aside the word “ethical”, do you think it was doing the right thing?---No.

15 Okay. Do you think that the fact that you are not doing the right thing is something that should have been recognised by the senior executives?---Yes. I – I do. Well, in hindsight, now I look at it.

20 Do you think - - -?---I think at the time, Mr Hodge, they thought they were doing the right thing.

25 Well, it's not just – when we – you have a tendency when you've been answering these questions to always emphasise the name Andrew Hagger, and then say “and others” and we will explore that in a moment. But in terms of the people involved, the letter was sent under Ms Cook's name?---Yes.

The letter is – you may disagree with this but it does not look like a letter drafted by Mr Hagger?---I don't know who drafted it.

30 The approach was one that you were aware of?---Yes. I – I don't think I saw the letter before it went. I was aware of the ongoing discussions, yes.

But you know that you were at the board risk committee meeting on 30 April where it came to the board risk committee?---Mmm.

35 And Ms Cook reported on it?---Mmm.

That's right?---That's correct.

40 And this specific issue of a different approach for pre-FOFA clients justified on the basis of NABs early adoption of fees for service was discussed at that meeting?---Yes.

And Mr Gall, the chief risk officer, was there?---Yes.

45 And as I understand it nobody said then, “This is not doing the right thing”?---I'm not sure at that meeting, but the board – the board have challenged us on this, but to go to your specific point, I don't think so, no.

Because then what changes everything is that on 9 May 2018 ASIC sends a letter back which unequivocally rejects the proposal. That's right?---Yes, and before then I met with Mr James Shipton on 26 April. And that was an important conversation.

5 And after the letter on 9 May 2018, you then had Ms Cook take over fully the conduct of the remediation. Is that right?---Yes. The finalisation of the methodology with ASIC.

10 And what it seems like is that somebody looking at your statement and listening to the evidence that you've given today might think that you are, to the maximum extent possible, passing responsibility for this to Mr Hagger, the senior executive who has been made redundant and left the bank. Is that what you are doing?---No.

15 And that you're not recognising that even if Mr Hagger had been responsible for suggesting this methodology, that at least three senior executives who are still at the bank were aware of it and attended the board risk committee meeting which considered it, and they are you and Ms Cook who reported on it, and Mr Gall?---Yes.

20 And that you don't seem to have asked yourself the question why couldn't we three see that we were not doing the right thing?---Well, I think – I see that now. Your question is when we're in it on 30 April why couldn't we. And I think that was a combination of reasons. So the – there was a number of people involved, Mr Hodge. It's not just Andrew Hagger. Sharon Cook was closely involved. And they were the two who had sort of day-to-day responsibility for it. I have ultimate accountability and David Gall as chief risk officer does have some responsibility as well. But at the time, I just don't think we saw it with the clarity we do now. You know, it wasn't an agenda item on a busy board schedule. It was a matter that had been going for two years. I think I delegated that believing that we were getting close to a conclusion. And so that's the best I can say about – you know, often it's in – as you get through and you look back – and that's why this process, Mr Hodge, of my witness statement of really going back and looking at it, I think it has been a challenging exercise for me to really look at it and find out where our failings have been, and I think this has been one of them.

35 The particular issue I'm trying to get you to turn your mind to is – accepting, as you say, that no one could see at the time that what you were doing was not the right thing – why that was, and then, of course, that leads to another question, which is what that says about your organisation and your leadership going forward. So as I understand it, what you say in – I use the word defence – I don't use that in a loaded way – but what you say for you and Mr Gall is that you were considering this at a busy risk committee meeting, and not, perhaps, seeing it in the context of an agenda of things and where the process had been ongoing for exactly what it was. Is that a fair summary - - -?---That's – that was one of my responses.

45 And are there other things that you want to say about why you think you or Mr Gall couldn't see the issue?---Well, I don't think Mr Gall or I had been involved in the detail of the discussions with ASIC on this matter at all, apart from my 26 April

meeting with Mr Shipton. It was one of a number of remediation exercises that we were undertaking. And it was one of a number of regulatory matters that we were – were complex and were material that we were dealing with. So it was one of a number of things that we were grappling with at the time, and have – have continued to over the last couple of years.

And those explanations, presumably, can't account for why Ms Cook couldn't see that this was not the right thing to do, because she's not just an attendee at a busy meeting. She's not abstracted away from it. She's directly involved. So have you considered why it is that she couldn't see that this was not the right thing to do?---Well, I – I would give similar answers. I think Ms Cook, you know, she had broader responsibilities, Mr Hodge, and was involved with this, but more as a partner at this point in the time – or in the few months prior to this rather than the lead on it. And she hadn't been involved in the previous couple of years of discussions around it that the wealth business had had. So I can't answer your question why did Sharon Cook not see it. I can only give a view about why she may not have.

But as the CEO, isn't it important for you to understand and have confidence that all of your senior executive team are able to know what the right and wrong thing is to do?---Well, I do have confidence in my team to do that, Mr Hodge. But there – you know, we're human. We're going to make misjudgements. We're not going to get it all right. And then it's a question of learning from that, and changing the way we do things if we've made mistakes.

But the learning requires reflection, doesn't it? You have to go back and understand why things happen?---Yes, and I think we have.

- - - in the first place?---We have a lot.

And ultimately, I think you would agree if one of the problems within the business has been a failure to challenge decisions and to make sure that the right thing is done, that that's something that has to start at the top?---Yes, and I think we're learning to do that, Mr Hodge, to bring challenge into the room, to do that respectfully, to do that with precision, to make it not personal. And I think the voice of risk and the voice of customers is being heard a lot more inside our company today. And that is something that we need to keep working on, because I think in the last – the last couple of years when you look at these cases where we haven't got it right, there's a few common principles that we've missed, and that's one of them.

You've now agreed on your remediation method for NAB financial planning?---Yes, we have.

But you haven't agreed on it for the other four – for your four licensees that have authorised representatives under them?---Yes, that's right.

And why is that?---Well, that – why is that? Why is that? Well, I think the – the primary reason is that we took the view that the methodology would be agreed first

on the NAB FP business and then it would be applied into the advice partnership's business. So we would sort of work out how to do it and then we would deploy it – that solution into advice. I think that's the primary reason. The second reason is that these are not our employees. They're advice partnerships personnel. They're under
5 our licence. So we have less direct authority to look at files and get access to data, and information. And also, it's part of a wider industry matter because only 35 per cent of the – the planners in the marketplace are actually, you know, attached to banks. So there's a – there's a wider issue that I think there's industry work on seeing if the principles and the methodology, if you like, could be agreed once and
10 for all.

Let's just take the first reason. The first reason was, as I understood it, that you wanted to agree on the methodology for NAB financial planning and then apply that to your other licensees?---Yes.

15 You agreed on the methodology for NAB financial planning in June?---Yes. June – yes, I think – well, yes. I think maybe not concluded, concluded for a couple of months after that, but, yes, I think we got pretty much there in substance then, Mr Hodge, yes.

20 And ASIC has said that it thinks you should apply the same methodology to your licensees?---Yes.

But, as we understand it, you haven't yet agreed to that?---No. I think that is in
25 active discussion with ASIC, though, right now, Mr Hodge. That's - - -

So your first explanation, which was we needed to agree on the methodology for NAB financial planning and then we would apply it to the advice licensees, can we put that aside as not being accurate?---No, I think it's very accurate.

30 You don't want to just apply the same methodology that you've agreed for NAB financial planning to your advice licensees?---We – well, that's the – we want – we wanted to agree the methodology of NAB FP and put it into advice partnerships. And that process of discussing that with ASIC and getting agreement is underway.

35 Isn't the real nub of this the second point, which is there is a problem, and the problem is you don't have records for your advice licensees, which makes it financially very difficult for you to agree to apply the same methodology for NAB financial planning to your advice licensees?---Well, I'm not conceding the first point.
40 I still believe that is what – that is what we have done. But on this point, this is a material point, that they're not employees, they're under our licence. And to get access to files and especially going back in time, it's a bit harder. Yes.

45 And so for that reason, you can't just apply the same methodology you've agreed for NAB financial planning over the advice licensees because there's the real possibility you would have to repay almost all of the ongoing service fees that you've taken over the course of six years?---Well, Mr Hodge, if we've taken fees that we didn't

deserve, that's the answer. Like, we've just got to go through a process to find out what the answer is.

5 But the problem is you've taken – I might be wrong about this but I think it's something in the order of \$600 million, haven't you, of ongoing service fees through your advice licensees over a six-year period?---Yes, I don't know that specific number but - - -

10 In any event - - -?---Yes.

- - - it's in the hundreds of millions of dollars – it must be in the hundreds of millions of dollars, you agree?---Yes.

15 And the problem with the methodology is that the premise of the methodology you've agreed for NAB financial planning is that if you don't have a record of service being provided, you're going to refund the fees?---Yes.

20 The problem, if you tried to apply that over to your advice licensees, is that you just don't have any records or very few records – inadequate records?---Well, I think we don't know that yet. I think that's the process we're going through.

You know you don't have the records. The question is whether - - -?---Does the adviser have the - - -

25 - - - you can get them from someone else?---So that's what we have to go through to get access to those files, paper and otherwise, and with the turnover of those planners over time and moving to other, you know, other advice partnerships, you know, there's – there's some challenges there. But that's what we have to – that's what we have to do, go through that process.

30 And am I right in thinking then you're not willing to agree on just applying the NAB financial planning methodology over to your advice licensees until you've reached some sort of resolution about being able to get access to whatever records your authorised reps have, and seeing the extent of those records?---No, I think – as I understand it, what we've done with – with NAB FP we've got some very particular, now, definitions about what – what is, you know, advice, what is a financial statement, what is an offer of an advice. That's – that ended up being quite important distinctions, Mr Hodge, in what is the methodology. So we have that. That's like base case. So now what we have to do is apply that into the advice
40 partnerships and see what the outcome is.

45 But there's a reason – you haven't done that. I mean, you could just say we will apply the same methodology. You could do it right now. You could commit to it right now, couldn't you. You could do it today?---Yes, but then we have to find – we have to find out what information we have and what files there are because these were – these were independent planners under our licence. They may well have far – far better records than what we had, ironically.

What I'm trying to get at with you, Mr Thorburn – and I don't think you're disagreeing with me – is that you want to know what the records are first and figure out how you're going to get access to them before you will commit to the methodology?---That's not the way I understand it. As I understand it, we have a methodology, and now we are going into the advice partnership's business to determine once you apply that methodology, what do you find.

And you speak in your statement of an industry solution?---Yes.

What is that?---Well, as I understand it, the FSC, Financial Services Council, which is often – sorry, not often – the amalgam of sort of advice type partnerships for the industry beyond the banks, this is a common issue. It's a common question that has been put to them by regulator, and clients and planners. So I think there is a view that if they could sort of agree that it's done properly, thoroughly, professionally within the sector, that will cause the whole thing to be resolved in a much quicker way.

I'm sorry, I'm still not sure I understand. What is the industry solution, though, to this problem?---Well, I don't think they found it yet. I think that's what they're working through.

The solution is something to do with trying to identify what the records are and what will constitute an acceptable record?---Yes. And – yes. And – and – yes. And getting access to those and if people have moved from one platform to another, you know, that people work together to get the information we need. Does that make sense?

I understand?---Yes.

I don't have any further questions for Mr Thorburn.

THE COMMISSIONER: Thank you, Mr Hodge. Yes, Ms Harris.

MS HARRIS: No re-examination, Commissioner.

THE COMMISSIONER: Yes. Thank you very much, Mr Thorburn. You may step down?---Thank you, Commissioner. Thank you, Mr Hodge.

<THE WITNESS WITHDREW [2.57 pm]

THE COMMISSIONER: Now, Mr Hodge.

MR HODGE: Commissioner, the next witness is Mr Henry. Could we take a five minute - - -

THE COMMISSIONER: If I come back at, say, five past three.

MR HODGE: Thank you, Commissioner.

5 THE COMMISSIONER: Yes.

ADJOURNED [2.58 pm]

10 **RESUMED** [3.05 pm]

THE COMMISSIONER: Yes, Ms Orr.

15 MS ORR: Commissioner, the next witness is Dr Henry.

20 **<KENNETH ROSS HENRY, AFFIRMED** [3.05 pm]

<EXAMINATION-IN-CHIEF BY MS HARRIS

25 THE COMMISSIONER: Thank you very much, Dr Henry. Do sit down. Yes, Ms Harris.

MS HARRIS: Dr Henry, your full name is Dr Kenneth Ross Henry. Is that correct?---That's correct.

30 And your business address is 500 Bourke Street, Melbourne?---Yes.

You appear today on a summons issued by the Commission. Is that correct?---I do.

35 And do you have that summons with you?---I do. I have it in front of me, yes.

I tender that summons, Commissioner.

40 THE COMMISSIONER: Exhibit 7.87, the summons to Dr Henry.

EXHIBIT #7.87 SUMMONS TO DR HENRY

45 MS HARRIS: No further questions.

THE COMMISSIONER: Thank you. Yes, Ms Orr.

5 MS ORR: Dr Henry, you've been a director of NAB since December 2011?---That's correct.

And you've been the chair of NABs board since December 2015?---That's correct.

10 And before you joined NABs board you were secretary of the Department of the Treasury?---Yes, I was, yes.

You held that role from 2001 to 2011?---Early 2011, yes, that's correct, yes.

15 And so you were in that role during the global financial crisis?---Among other things, yes, I was, yes.

20 In the wake of that crisis, Dr Henry, governments and financial institutions around the world devoted considerable attention to measures designed to promote financial stability. Do you agree?---Well, yes, indeed. I was very closely involved in those matters.

And to discourage excessive risk taking by financial institutions?---Yes, that's true, yes.

25 But in the decade that followed, all over the world we've seen financial institutions continue to engage in serious misconduct, such as the mis-selling of payment protection insurance in the UK?---Well, yes, although the matters in the UK and PPI go back well beyond the global financial crisis.

30 What about the manipulation of interbank interest rates and foreign exchange rates in the UK, in Europe, in the US, and in Australia?---Well, so far as I know, nobody has yet established that there has been any manipulation of those rates in Australia.

35 What about - - -?---But in the UK, certainly.

Yes?---LIBOR, the London interbank offered rate, certainly.

40 What about the opening of fraudulent bank accounts by staff at Wells Fargo in the US?---Yes, I am familiar with that.

What about all of the misconduct reported to this Commission by financial institutions in Australia earlier this year?---Yes, indeed.

45 Why do you think that the measures taken to address the global financial crisis didn't address this sort of conduct as well?---That's a really good question. Speaking from the Australian perspective, the issues that confronted Australia in the global financial crisis had to do principally with balance sheet risks facing the Australian banks and

in particular, funding and liquidity risk. And when I joined the board of National Australia Bank at the end of 2011, those were the issues that were principally the focus of both APRA and – and National Australia Bank. It was principally to do with balance sheet risk, for obvious reasons. Matters relating to conduct came to the
5 consideration of bank boards later in the piece in Australia, I think. Earlier in Europe, that's true. And also in the United States, but the reason for that's also pretty obvious. It was really misconduct in those northern hemisphere markets that were the genesis of the global financial crisis. It wasn't misconduct in Australia that was responsible for the precariousness of the positions confronting the Australian
10 banks, it was their dependence upon offshore wholesale borrowings. So it was a funding and liquidity issue.

In a speech that you gave to the Australian Shareholders; Association conference in May this year, you said:

15

When historians of finance look back on this period, they will identify an unusual level of corporate complacency driven by relatively benign macroeconomic conditions, and a long period of impressive return on equity performance.

20

?---Yes.

Continuing:

25

They will suggest that corporate leaders fell into believing that a sector capable of generating return on equities in the mid-teens for so many years couldn't be doing a lot wrong.

30

?---Yes, indeed, yes.

And is that what you think has led to the misconduct examined by this Commission, complacency?---I don't know if that's what has produced it, but had there been less complacency, I do believe that we would have seen less misconduct, indeed.

35

And what are the other contributing factors in your view, Dr Henry?---Well, we've heard some of them, I think, in this – in this hearing this morning from our chief executive. There are many. But some go to the way that people understand their jobs, you know, just what is their job. What is their objective in their – in undertaking their job. How are they incentivised, rewarded for what things are –
40 they're rewarded, what controls are they subject to, and so on. A less complacent system would have been less tolerant of mistakes, would have been less tolerant of poor conduct, would have called it out earlier, would have done something about it earlier, would have changed remuneration practices earlier, I think.

45

Could I put a list of causes to you and see if you agree with me that these are causes of the misconduct that we have been examining in this Royal Commission. Poor

culture within financial institutions?---So, again, I would say a better culture would have prevented some of the misconduct we've seen, yes, indeed.

5 Poor risk management practices?---That one's – I know that sounds logical but it's – it's actually more difficult to – to pin the cause on poor risk management practices. Risk is a multi-facetted things. As I said earlier, most of the risks that we were dealing with in NAB when I first joined the board were to do with funding and liquidity risk, elements of balance sheet risk. We were also giving a lot of consideration to credit risk, which is the principal risk that banks focus on, 10 obviously. That – that consumed most of the time of the board risk committee at the time that I joined the board of NAB. But then we come to regulatory risk, compliance risk, and conduct risk. And I think in those non-financial risk components, regulatory compliance and conduct, I think it is fair to say that there was insufficient attention given to the management of those risks. But I hesitate to 15 say that it's all a risk problem. And the reason is because you can run your business through a risk prism. You can do that. But it would be better to have the customer at focus. Had we been more concerned about the customer circumstance, had we been running the business, all of us, in the interests of the customer rather than the profit and loss and the balance sheet, those risk categories wouldn't have mattered so 20 much.

Do you accept that another of the causes of the misconduct is remuneration practices that have incentivised the pursuit of profit but have not sufficiently promoted the interests of customers and compliance with the law?---In some cases, yes. 25

What about a lack of accountability at all levels within financial institutions?---Accountability to whom? I think this is a really important question. This is a really important question, because it's clear enough – anyway, it's clear enough now with inside National Australia Bank to identify an executive who would 30 be accountable for almost anything. And obviously, the chief executive is accountable for everything. But then the board also has accountabilities. And a really important question, which I'm sure this Commission is reflecting on as you prepare your final report, is to whom should boards be accountable.

35 And how would you answer that question, Dr Henry?---Okay. So in the strict letter of the law, as you know, boards are accountable to their shareholders. After all, it's the shareholders who – who elect directors. It's the shareholders and the shareholders only who get to vote on remuneration reports, to exercise whether they choose to do so, the so-called two strikes rule. It is the shareholders who are 40 expected to hold boards accountable. The theory is that that makes sense because it's the shareholders who have most to lose. And the reasoning behind that is that shareholders are those who subscribe risk capital. It's the riskiest form of funding provided to the corporation. And, therefore, it makes sense for the shareholders to be the ones who determine who sits on a board and whether they should be re-elected 45 and whether, in due – whether in some circumstances they should be required to step down. But if you think about the instances of misconduct that have come before this – this Commission, I would say that the people who – who we would see now as

being most adversely affected have not been the shareholders. It's other people. Customers, of course, principally customers. There are circumstances – not so much in financial services, although there as well – where it's obvious that the activities of the corporation have done most damage to the workers, rather than the shareholders.

5 There are other cases where society discovers, usually too late, that the most damage has been done to future generations, because of environmental damage. These aspects of the consequences of corporate activity go well beyond impacts on shareholders, and, yet, under our particular model – and this is a – a general model or a model of general application around the world – it's only shareholders to whom, at

10 law, the directors are accountable. In my view, the public tolerance of that model of accountability has been pretty well eroded to zero. I would say that that is the principal reason – or anyway, one of the important reasons for a loss of trust in business.

15 I want to make sure I understand your answer to my question, which was your question, to whom should boards ultimately be accountable. Do I understand that answer to be that they should not only be accountable to shareholders, but they must also be accountable to customers, to those who, in your words, are most adversely affected by the operations of the entity?---Indeed, customers, but beyond customers.

20 Beyond to who? To future generations, is that what you - - -?---Indeed, why not.

Well, it's a question for you, Dr Henry as the chair of NABs board?---I think it's a question for you as well. Right. I think it's a question for this Commission.

25 Seriously, I do. It's a very important question.

Future generations of customers. Is that who you - - -?---No, no. Sorry, beyond that.

The community?---The community. Yes, indeed.

30 So you believe boards should be accountable to our community now and our future community?---I do, indeed.

And how should boards achieve that accountability, Dr Henry?---Well, through their

35 governance of the organisation.

But what are the concrete things boards should do to ensure that the decisions that they make are made against that backdrop of an awareness of their accountability to the broader community and the future broader community?---I think the first thing

40 they should do is not seek to avoid accountability, on the basis – on an argument that provided we are looking after the interests of shareholders, we're doing everything that we could possibly be expected to do, or reasonably be expected to do.

You said that was the first thing. Are there other things?---No, I think that – that

45 kind of underpins everything, right. I think that boards should understand – and I think increasingly they do – that their responsibilities to the community go beyond their obvious responsibilities for shareholders.

In the speech that you gave in May this year, another topic that you talked about was the culture of financial services entities, and you said that:

5 *Building the right culture involves the identification of a motivating purpose and strong corporate values, talking to people about them, and embedding them in the organisation. When an organisation has a strong culture, the vast majority of people actually feel uncomfortable acting in a different way.*

10 Do you recall that?---Yes, I most certainly do.

I want to ask you some questions about that statement?---Mmm.

15 The first is you spoke about building the right culture. What is the right culture in a financial services entity?---It's a culture that is all about the customer, which – which puts the customer front and centre, and which is intolerant of practices which are not in the customer interest.

20 Do you think it's appropriate or even possible to prescribe a particular culture for financial services entities?---No, I don't think it is. I – I wish it were but I don't think it is. It's not something – it's not something that can be legislated. I don't think it's something that can be even legislated in principles and – and left to regulators to either seek to enforce, or even seek to have implemented in a supervisory capacity with particular institutions. Nevertheless, it is something which regulators – at least in Australia – no, it's beyond Australia's shores – regulators in the financial services industries have been taking a keen interest in. As you know, APRA has, for example, been taking a keen interest in risk culture matters since, I would say, about 2015. I remember we had – the NAB board had an – had a discussion with the APRA Commissioners – I think it was in 2015 – about the importance of risk culture and – and APRA and we then started on a journey on risk culture. That journey is ongoing. It's quite a long journey. We've – we've done a lot more work on it recently. I think we have a better feel for the dimensions of risk culture that really matter for a financial services entity. I think APRA does, too. But I don't think we're ever going to be able to write on a sheet of paper exactly what it is.

35 THE COMMISSIONER: What do you mean by the dimensions that really matter, Dr Henry?---Well, okay, so I think the – we talk about the dimensions that really matter, I would say, Commissioner, that the fundamental – the most important thing is what the entity sees as its purpose. I think – next to purpose, of course, is vision, what the – what the entity sees itself as wanting to achieve over the next few years. Next to that is values, which really should be enduring principles to guide the behaviour of everybody in the bank. And then, of course, next to those is behaviours. And behaviours – that's the behaviours that evidence the culture, obviously. The drivers of culture, though, obviously go beyond purpose and vision and values. Those are positive drivers of good behaviour of – of a good culture. But if those are not supported by systems of integrity – and that includes the organisational policies. It includes, for example, remuneration policies. It includes

IT systems, and so on. If those supports are not there, then the aspirational purpose and the aspirational vision can actually be demotivating. So the fundamental elements of a good culture have to include both the top-down stuff in terms of purpose and vision, and values, but also the foundational supports. I know there has
5 been quite a lot of discussion in this Commission about the importance of remuneration policy, for example, and that's – that's important. Obviously, it is. It's important, for example, that when poor conduct is revealed, that there are remuneration consequences. By the way, it doesn't have to be remuneration consequences. Of course, people could be demoted, or people could be exited from
10 the business. But fundamentally, it's about capabilities. If – if a business, in response to poor conduct – if all it does is continually impose financial consequences on people who are not equipped to do the job, performance is not going to improve. Indeed, most likely performance will deteriorate even further. And the fundamental need is to ensure that you've got the capabilities supporting the business, and that's
15 IT capabilities, but it's also human capital. The human capital capability to be able to ensure that the business is capable of achieving its purpose. There has to be a strong connection between the two, between the capabilities and the aspirational purpose. Otherwise, you get dysfunctionality, and that's corrosive of culture, obviously.

20
MS ORR: Do I take it from what you said earlier, Dr Henry, that you think that there's a role for regulators to play in ensuring that financial services entities have a culture, at least with what you describe as the dimensions that really matter?---Yes, I do. Yes, I do. Yes.

25
And what does that role look like, in your view?---Yes. I think it's a role in the financial – sorry, in – in banking, anyway – let me stick to banking – I think in banking it's a role best played by APRA rather than ASIC, for example, although even under ASICs current legislation, for example, if you look at section 2 of the
30 ASIC Act, and you look at the principal purpose of ASIC, I think it's arguable that ASIC should be taking an interest in the culture of corporations in Australia. That would be in section 2A, if I recall correctly. I think that's arguable. But in respect of banking and superannuation and insurance, APRA certainly should be taking an interest in the culture of the organisations that it supervises, and I think it is.

35
You think APRA - - -

THE COMMISSIONER: Taking an interest in the form of questioning, challenging
- - -?---Yes, I think so.

40
- - - nudging or beyond that?---Beyond that, indeed. Beyond that. So, for example, CPS 220, which I'm sure - - -

45
MS ORR: The prudential standard issued by APRA?---I'm sure that has been discussed a bit here. In that APRA requires that the boards form a – essentially make an assessment of the risk culture of the organisations for which they are responsible. And – so that's going beyond the matters that you raised, Commissioner. And, you

know, I have – I have, on a number of occasions, participated in discussions with APRA Commissioners about just the nature of a healthy risk culture of a – of a bank early on. It must have been 2016, I think, I participated in a – a workshop that APRA convened where they invited various bank chairs and other chairs, indeed, to
5 – to talk about the elements of a healthy risk culture. I think that we’re getting – at least I think we’re now at a position where everybody agrees that this is a topic that must be discussed. You know, that – yes, it’s fundamentally important.

10 You mentioned CPS 220, Dr Henry, which is the prudential standard in relation to risk management?---Yes.

And you mentioned the part of it that relates to risk culture?---Yes.

15 Clause 9 of that prudential standard deals with the role of the board?---Yes.

And one of the things that the board must ensure is that it forms a view of the risk culture - - -?---That’s right.

20 - - - in the institution?---That’s right.

What more should APRA do, other than ensuring that you and your fellow board members have formed your own view of the risk culture in the organisation?---Okay. So, firstly, I don’t know whether this is the appropriate forum to say, but I will say it here now anyway, we have said consistently to APRA the word “ensure” is a bit
25 strong. It’s really difficult for a board to be held accountable for ensuring anything, just as it’s rather difficult to hold APRA to that – to that standard of ensuring an appropriate risk culture. Nevertheless, it is - - -

30 Can I just pause there for a moment?---Yes.

Because I just want to take that up with you. If it’s not the board who ensures - - -?---No, it’s the word “ensure”.

35 But someone, surely, must be responsible for ensuring that there is an appropriate risk culture. If it’s not the board, who is it?---No, the board has the principal role to play - - -

Yes?--- - - - in – in respect of the development - - -

40 Yes?--- - - - of the culture of the organisation. It’s just the use of the word “ensure”. Model, lead, encourage, those words are – are more obvious than “ensure”. Ensure is a bit of a strict standard. But anyway - - -

45 This is in the context of the obligation on the board?---Yes.

Are there others then within the organisation who have a level of responsibility for risk culture that extends beyond modelling, leading and encouraging?---Well,

certainly, so there are the development of – so, for example, controls and monitoring – no, not monitoring – not monitoring. I think we can actually say in that case, if you're talking about controls, we can say ensuring adherence to policies.

5 Yes?---Yes. That's okay. You can use the word ensure in respect to adherence to policies. But when you're talking about something like culture, ensuring a particular culture, I just – look, it's a step too far. I didn't want to make too much of this point, although there's – we've had any number of discussions with APRA about it. But your question about what more can APRA do, well, APRA has done more. And, as
10 you know, following a – an APRA-sponsored review of the Commonwealth Bank of Australia, APRA required that all banks undertake a similar review, a self-assessment review which, among other things – at least in our case, and I know you have this document – in our case involved quite a detailed exploration of the culture of the bank. And I think also through its leadership of the industry through its
15 supervisory practices, APRA can influence the culture of institutions. And I think it is occupying that space.

You mentioned the self-assessment - - -?---Yes.

20 - - - that NAB has done in response to the request from APRA that many entities across the industry do that in the wake of the CBA prudential inquiry?---Mmm.

Have you read the current version of the NAB self-assessment?---Yes, I have.

25 And you've read then what it says about the culture - - -?---Yes.

- - - NAB?---Mmm.

30 What concerned you in what you read about the culture of NAB?---Well, I don't think any of it was news to me. There are – the review – and it was a self-assessment, so as much as anything, it was – I mean, the board was involved, obviously, in reviewing the culture of the organisation, many people were involved at various levels of the organisation. There was no – there was nothing surprising, really, because it was our assessment of ourselves. Nevertheless, we did identify a
35 number of what we describe as cultural inhibitors in the document, and these are not – as I said, these are not newly discovered cultural inhibitors. This is our distillation of problems that we realise we had been grappling with for quite a long time. It was a – it was a valuable exercise from that perspective. It allowed us – not allowed us – it required us to put in one place a – or assemble in one place a distillation of a whole
40 pile of issues that we had been grappling with for some time.

45 What were the cultural inhibitors identified?---Well, the principal – the principal ones have to do with – the first, I think, is a lack of – no, an insufficient intensity of focus on getting it right all the time for our customers. That's the first one. Most important. Secondly, I think, that our systems often led us down. Thirdly, we don't always listen as closely, as intently, to our regulators as we might, that we could learn more from them in more – in a more timely fashion than – than we might have

thought. And I know there are six. I know those are the most – the three most important. At least they're the three most important to me. I don't have the document in front of me. You do. You can remind me I'm sure.

- 5 Not consistently bringing the collective intensity or individual resolve required to fix complex issues?---Sounds right.

Continuing:

- 10 *And while we have a strong commitment to customers, we have too often put other priorities first.*

?---Yes. That's true.

- 15 I only have five, Dr Henry?---You only have five. I thought there was six. Okay. All right.

I only have five. Do you think there's a sixth?---Thank you.

- 20 So they were the cultural inhibitors – you would say not identified for the first time - - -?---Yes.

- - - as a result of this work?---Yes.

- 25 But which are articulated in this document. And are these inhibitors that NAB is working to address?---Yes, we are.

Can I talk to you a bit about what's happening at NAB in relation to culture?---Yes.

- 30 Coming back to your speech for a minute, you talked about building the right culture is involving three things: identifying a motivating purpose and strong corporate values; talking to people about them; and embedding them in the organisation. Now, last year you and Mr Thorburn launched NAB's purpose, which Mr Thorburn gave some evidence about earlier today. And Mr Thorburn explained that the purpose at NAB is to back the bold who move Australia forward. Have I got that right?---Yes, you do, yes.

- 40 And what does that mean, Dr Henry?---I thought he explained it rather well. So the purpose came from – we didn't come to this purpose quickly. You know, we didn't just go into a dark room and have a quick chat about what – what might look good as a – as a slogan for the organisation. The purpose statement was developed over a 12 month period on the basis of interviews with people right across the organisation, at various levels of the organisation, looking at the role that the bank had played through its 150 or 160 year history, and the things that – and identifying the things of which – well, the things that we thought spoke most eloquently about the role that National Australia Bank plays in Australian society. And the things that we identified had to do principally with backing people who were doing bold things, but

the bold things could be the development of a new product. For example we backed – I don't know, we backed the development of Vegemite. Vegemite failed on the first occasion. We came in again and backed it for the second time, right, and then Vegemite has become a global brand name. It was stories like that. It could mean that. It could mean backing a farming enterprise in times of drought such as Australia is presently going through. It could mean backing a small business, and NAB, of course, is the major small business bank in Australia. But it could mean backing a young family that has just secured its first mortgage, and so on. These were the kind of stories. And when we asked people in the organisation what is it that motivates you about your work, these are the stories that came through. I must say – and I spoke – myself must have spoken to hundreds of people – hundreds of people who work for NAB myself, once – once I heard making profits for shareholders. Once. All the other stories were about customers. And they weren't stories just about, "Well, you know, it's nice to be able to serve a customer in a branch." Important as that is, it wasn't – those were not the stories. The stories that people related to me – and I know Andrew had the same experience – were stories about backing people in times of difficulty. And we considered that the role that National Australia Bank plays in backing people – not just in times of difficulty, but anyway in backing people, all of these stories contributed to the development – in some way to the development of Australia, to the development of the Australian economy and society, and that this is something of which we should be proud. That there is something appropriately motivational about understanding that the corporation has an important role to play in Australia's development. And that it plays that role through the agency of its customers. This is quite motivational and it's quite important that it be seen that way. And it goes go back to the earlier discussion we were having about the matters for which a board should hold itself accountable. You know, when you've got a business that has 33,000 staff, nine million customers, \$850 billion of assets sitting on its balance sheet, about \$300 billion of deposits sitting on its balance sheet, when you're aware of that, at some point it must occur to you that just about every decision that the bank takes is going to have an impact on somebody's life. Obviously a customer. But you put a few customers together, you're talking about a community. You put a few communities together, you are talking about a region. If you put a few regions together, you are talking about Australia. And people who have the privilege of sitting on the board of a business that has that reach – to go back to the earlier conversation – they should be proud of having that accountability, not just to the shareholders – as important as that is – but an accountability to the country, and for the country's future.

In September this year, Dr Henry, you and Mr Thorburn launched your new set of values and behaviours for NABs employees, which sits underneath this purpose. Is that right?---Well, the behaviours, yes, and the link between the behaviours and the values. The values had actually been around – had been articulated some years earlier.

45 Could I ask that you look at NAB.007.049.0092, which is a report to NABs board from a couple of weeks ago from 5 November, which is about the final pillar in the

one NAB culture plan. You have seen this memorandum before, Dr Henry?---Yes, I have.

5 Could I ask you to turn to 0094, where we see a representation of the values and behaviours?---I'm sorry, can I actually scroll this, can I?

No, I'm sorry, someone will scroll it for you, Dr Henry?---Right. Yes. Thank you.

10 So these are NABs values and behaviours. And I just want to ask you about some of them?---Yes.

The first one is:

Passion for customers.

15

?---Yes.

Continuing:

20 *Get it right for our customers every single time. Take a stand for our customers.*

25 In what way do you want your staff to take a stand for your customers?---I want them to feel that – that they are encouraged – no matter what level they are in the organisation – that they are encouraged to speak up whenever they see the operations of the bank, its policies, or whatever, not being in the interests of customers. That's what I want.

30 Do you think that's clear from:

Take a stand for our customers.

?---Yes. I think so.

35 What about:

Be bold.

40 Dr Henry, in what way do you want your staff to be bold? In what way do you want them to be exceptional?---I want them to put a high value on excellence, on always getting it right, or at least as much as is humanly possible. I want them not to feel intimidated by those who are above them, to feel that if they think there's something going wrong in the organisation, that they can speak to people above them in the organisation and get their message through to the highest levels of the organisation,
45 and, if necessary, to the board.

What about “win together”. What is it that you want won?---That’s about corporate collegiality. It’s more about the together than the winning although the winning is intended to be motivating, that we come to work energised and motivated, but, importantly, that we do it together. But also and it’s in that second behaviour under
5 “win together”, that we understand that we’re not going to be successful as a team unless we make it simpler and faster.

But what is it you want your people to win? Is it winning business, for customers? What are they winning?---We want our people to be – to know that they are part of a
10 business which stands out among its peers. That’s what it’s about. That they feel proud of working for National Australia Bank, because they see it as Australia’s leading bank.

So you want them to help you win the public perception of you as the best bank in
15 Australia?---Sure. Sure. Sounds pretty good.

I don’t want to put words in your mouth, Dr Henry?---No, no.

I’m interested in - - -?--- And, indeed, it’s – of course, and it’s – well, I think that
20 was just a more eloquent way of saying what I was stumbling to, I think. And, of course, it’s consistent with our vision. Australia’s leading bank. Trusted by customers for exceptional service.

What was the process that NAB went through to choose these five values and
25 behaviours?---Well, as I said, the – the values are somewhat older than the behaviours. The behaviours were developed through a piece of work, largely, of course, as you would imagine at the executive level in the bank, but then workshopped with the board on a number of – a couple of occasions before we settled on these, but - - -

30 Are there any other values that you would like included but which didn’t make the cut?---No.

Well, one value that many other banks emphasise is accountability. Is there a reason
35 that that’s not reflected in the NAB values?---I don’t think it’s necessary. I – seriously, I think if – if our people are living these values, then of course they are holding themselves accountable. They’re holding themselves accountable for the customer experience, they’re holding themselves accountable for the bank’s reputation. They’re holding themselves accountable for team effectiveness. They’re
40 holding themselves at least partly accountable for the morale of those that they work with. I think there’s a high degree of accountability that’s at least implicit in these values. I don’t think we need to call it out as a separate value.

Even though other banks have?---Well, I wasn’t even aware of that, you see. We run
45 our own race.

But surely, Dr Henry, you look at what other banks articulate as their purpose or their values?---No, I don't.

5 So you're unaware that one of CBAs values is, "We are accountable"?---I was unaware of that until you just mentioned it, yes.

All right. Now, if we go back to the report that this is an appendix to, the memorandum, we can see when it comes up on the screen that when it speaks of the three pillars in the one NAB culture plan, the first pillar was articulating the purpose, vision, values and behaviours. Is that right?---Yes, that's correct.

10 And the second pillar was early activities to drive this mobilisation - - -?---Yes.

- - - of the target culture?---Yes.

15 What were those activities to drive mobilisation of the target culture, Dr Henry?---Well, those haven't been undertaken yet.

20 That hasn't happened yet?---I think it's in the process but it hasn't – it hasn't happened yet. I think we're still – I think we're still pretty much in the articulation phase.

25 What will the activities to drive the mobilisation of the target culture look like? Can you see the reference to activities to drive the mobilisation, about halfway down the page, Dr Henry:

Following the articulation.

30 ?---Right. I see that paragraph or sentence, yes.

35 So I just want to understand what the plan is for the activities to drive the mobilisation of the culture you're looking for?---Well, that's – that's a reference to a – a set of activities to ensure that – well, not ensure – see, I've fallen into the trap of using that word myself – but to – to have the purpose, vision, values and behaviours understood by people right throughout the bank.

And that's what I want to understand?---Right.

40 How are you going to do that? You've created this document that has the words that we've seen. How are you going to get people to understand, invest in, act in accordance with those words?---Yes. So it goes back to the things that we've discussed previously, obviously. So the principal thing is – is talking to and discussing the purpose, vision, values of the organisation, talking to people, particularly leaders talking to the people that they manage about behaviours, what are appropriate behaviours, what are not appropriate behaviours, ensuring that we have the systems in place that allow for the purpose, vision to be delivered and support appropriate behaviours and so on. It's around – it's really to do with the – building

the capabilities of people in the organisation to be able to deliver on the purpose and the vision, as I said earlier. So, for example, we have – we’ve come to – I mean, it’s an obvious thing to say, but that in embedding – sorry, in mobilising this culture we can only have outstanding leaders in the organisation. And so there are HR programs that will be required, that are being required – sorry, that are being rolled out to ensure an uplift in leadership capabilities in the organisation. That’s one example.

Do you mean by that that you’re going to replace some of the existing leaders?---Train them, upskill them. Some are being replaced, of course.

And what are you going to train and upskill them in?---Leadership.

So you feel that some of NABs leaders aren’t adequately qualified to lead your organisation?---Well, that’s not what I said, no, and it’s not what I feel.

Well, that’s my question?---Yes, yes. No, it’s not what I feel. What I feel is that this project is about an enhancement. And obviously, if we’re going to achieve an enhancement, we need to do a lot of things better.

So you want them to be better leaders?---We want better leaders, yes, we do. And I think it is the case – in fact, I know it’s the case that we will be able to develop better leaders out of the people that we have, but in some cases, that’s not going to be possible.

Can I talk to you about some of the other words that appear in this document about how you’re going to get the culture - - -?---Yes.

- - - mobilised and embedded?---Mmm.

This document talks about culture carriers, it talks about key influencers, it talks about curating culture. What do all of those things mean, Dr Henry?---Well, we don’t have absolute precision around any of those things at this stage. We understand what the concepts mean in general terms but I am not sure I could satisfy you with – in fact I am sure I couldn’t satisfy you with a very precise definition of those things.

Do you know how you’re going to curate culture at NAB?---Sure, I understand the elements – I understand some of the dimensions of the curation of a good culture and it goes to some of the matters that we’ve already discussed.

Can you identify those, Dr Henry?---Well, indeed. So ensuring that people have the capabilities to deliver on the purpose and the vision – and achieve the vision of the organisation. Leadership capabilities, importantly, most importantly. To ensure that we have the systems that support people being able to do their jobs more effectively, and that has to do with reducing complexity in the organisation. So part of curating a better culture in the organisation is dealing with the complexity of the organisation. Some of it is in making the systems easier for people to use through digital means.

And our – our digital systems have not always been as user-friendly as they’re going to need to be. They’ve not always been as fail-safe as they’re going to need to be. In many cases, there are work-arounds. In many cases, as identified in the APRA self-assessment, the systems are so complex that the organisation has relied upon people to fill the gaps. We need to deal with those things. And if we don’t deal with those things, then we won’t be curating the right culture.

Another thing that this memo talks about is embedding culture through symbolic acts and - - -?---Yes.

And an example of a symbolic act that’s given in this document is removing penalty interest for farming loans. And that was a change that NAB made after the fourth round of the Commission’s public hearings in Brisbane and Darwin?---Mmm.

Yes?---Sure. Yes.

And what does it mean to describe that change as a symbolic act, Dr Henry?---Yes. So it means that – it’s something that people in the organisation can – well, they can, in looking at it, understand what it means to say that this is going – this is a customer-centred organisation. It gives them a tangible example, like all symbols. It gives them something that helps explain what we mean when we say that we really – we really do have a passion for customers.

I see. So symbolic in the sense that it demonstrates the focus being on the customer?---Correct.

I see. Now, over the page in this document, if we go to 0093, and we look at the final sentence of the final paragraph before the heading Recommendation, we see:

A fit for purpose measurement approach will be developed that enables the measurement of culture, specific to NABs context, and the cultural drivers of business performance.

?---Yes. Yes.

So do I take from that, Dr Henry, that at NAB you haven’t yet worked out how you will measure whether you’ve succeeded in embedding this culture?---That’s correct. I don’t think anybody has.

Do you think it’s possible to measure culture as this sentence suggests, Dr Henry?---That’s our ambition.

And do you have any idea, any plans for how you’re going to do that?---That’s a big piece of work. In front of us, yes.

So is there any preliminary thinking about how that can be achieved?---I hope so. Yes.

You're not aware of what that is at this point?---Well, I'm not doing it, no. I'm not doing it. I – I haven't – I haven't seen – I haven't seen the work yet but I look forward to it very much.

5 Well, as chair of the board, what are the things that you will look for to assess yourself whether the culture that you want to create has been embedded at NAB?---Yes. So if you think about the information that a board gets – gets to see, of course, you know – we get any number of dashboards, which measure the performance of the bank against all sorts of principally quantitative but in some cases
10 qualitative benchmarks. Hundreds of them, although we are reducing the number, but, anyway, hundreds of them. We see – we see these – we see these reports typically in the chief risk officer's report every month to the board. And I think we should – we will know we've got a healthy culture when we see things like fewer incidents of noncompliance with external regulation but also with internal policies.
15 As you would know, our compliance risk rating in NAB has I think for – I think for all but one month in the time I've been on the board, anyway, has been red. We embed this culture, that cannot be red. If that's still red, then I say – I will say this culture has not been embedded. So that's one indicator. It's a pretty crude one but it's, nevertheless, an indicator. Regulatory – regulatory risk. That's currently amber.
20 As one issue gets dealt with, another one comes in and replaces it. If in, I don't know, two, three – well, let's say three years' time regulatory compliance – sorry, regulatory risk is still rated amber, I will say we don't have the appropriate culture yet. Conduct. We are giving a lot more attention to something that – well, the risk officers call conduct risk, but what we're really talking about is the appropriate
25 treatment of customers. And we have set up a – as you know, a customer remediation centre. We are capturing more measures of customer conduct, not just customer experience as revealed to us through net promoter score, and as you would know, we – we track net promoter score for the business overall, we track net promoter score for every element of the business. We track net promoter score for
30 all 700 branches around the country. We and the board, we go out and we visit branches. We've been doing this for a few years now. We go out, we visit branches. We go behind where the tellers sit. There's a screen in every branch and it tells you what the net promoter score in that branch, it tells you the net promoter score for every banker in that branch. And so we are exposing ourselves to that sort of
35 information. And for the bank overall we – we have said there needs to be a substantial increase in the net promoter score for – for the bank overall. It's part of the accelerate one NAB plan that we ticked off on 12 months ago. But we also want to see a pickup in not just customer experience but outcomes for customers. And – so we are – we are getting – well, it's called verbatims, right. Verbatims to the board
40 about poor customer experience. And – and we're trying to learn something from those poor customer experiences. And if we continue to see poor customer experiences of the sort that we have seen over the past few years, then, again, that will be another indicator to us that we don't have the right culture in the organisation. So there's quite a lot of things we can use to inform ourselves about the culture of the
45 organisation. I have found myself that one – a really important thing to do is that when you – when you become aware of an instance of poor conduct or even when questions are being asked about the conduct, I have found it useful myself to go out

and talk to the people in the area and ask them how they feel about it. What do they think are the reasons for it? Whether they agree with it. And, again, I don't think – well, again, I think that's something that the NAB directors, they have been doing, they are going to be doing more often.

5

Do you have a view on how long it's going to take to embed the culture that you want?---It could be 10 years. It could be. I hope not. But I wouldn't be at all surprised. That would not be unusual for organisations that seek to embed challenge in cultures.

10

You mentioned a number of times in that last long answer the next promoter score?---Yes.

And the use of the net promoter score by NAB?---Yes.

15

It's a significant part of the way you assess your performance with customers. Is that right?---Sure, it is, yes.

20

And can you explain how it's measured?---Sure. So firstly, there are two concepts of net promoter score. There's – there's a – a score which pertains to the organisation as a whole. I'm sure many people in the room would have had this experience, a survey organisation calls, and asks you whether you are a customer of a particular company, particular business, and if you say yes, then the question is on a score of zero to 10, how likely would you be to recommend this organisation to family or friends. And – so that's a – that's a score that pertains to the view of the organisation as a whole. Then there are the so-called episodic net promoter score measures, and I'm sure also everybody in this room has had this experience, where you have had a customer experience – it could even be servicing your car or having your car serviced, and then a little while later you get a phone call from somebody who says, “Thinking about that experience, how likely would you be to recommend that business to a friend or relative?” Same score – same – same scoring system applied. And the way the net promoter score works is that it's – it's only the scores rated nine and 10 that count as positives and the scores up to six count as negatives and those in between six and nine are regarded as neutral, and you calculate the net promoter score by subtracting the zero to sixes from the nines and 10s. And for NAB and, indeed – and here we do compare ourselves with the other banks – not surprisingly – the net promoter score for the organisation as a whole is a negative which means that those who rate us zero to six outnumber those who rate us nine and 10. And yet I think it's true that for all 700 branches in Australia the score is strongly positive.

35
40

Is that score based on the episodic - - -?---Yes.

Yes?---The branch one yes based on the episodic.

45

And the episodic surveys happen relatively quickly after the person has interacted with NAB?---They do, yes.

Do you accept that in many cases where a financial services entity does something that is against the interest of the customer it can take years for that to be discovered?---By the customer or by us?

5 By the customer?---I guess, yes, that is true.

So - - -?---But it's – but it's probably even more true, it might take us years to discover it, even longer.

10 I want to focus on what's in the mind of the customer - - -?---I see.

- - - at the time that they're answering that survey. Do you accept that at that point the customer might think that their experience with NAB was very positive, they were given the loan that they asked for, the product that they went in thinking that they needed they were sold. But they might find out many years later that that transaction was not actually in their best interests. Do you accept that?---It's conceivable. It's possible.

20 Well, let's – part of what I want to talk to you about tomorrow in some detail is the fees for no service dealings - - -?---Yes.

- - - within NAB. Do you accept that customers may well have given positive feedback under net promoter score surveys in circumstances where they had no idea for many years that they were paying fees without receiving a service?---I don't think we were even surveying the customers in those days.

30 Well, I want to understand, Dr Henry, if you accept that a measure of customer advocacy that's taken immediately after the customer interacts with NAB is not necessarily a reliable indicator of whether there is a good customer outcome - - -?---Absolutely, I do. Absolutely, I do. Sure.

It's - - -?---And we would not rely on that metric alone and we don't.

35 Because it's a measure of whether that customer is happy with NAB - - -?---Sure.

- - - at that point in time - - -?---Sure, sure, sure.

- - - immediately following?---Sure.

40 Given that you place such significance on the net promoter score in assessing your performance and the perception of your organisation with customers, is that a problem?---If it was the only thing we were relying on with respect to customer outcomes, it would be a huge problem. But we're not.

45 So what - - -?---It deals with customer experience.

Yes?---Not customer outcomes.

Yes?---They're two very different things, right.

So how do you measure customer outcomes?---Mainly – mainly through complaints from customers, to be honest. Mainly.

5

Right?---When something goes wrong.

So you rely on the customer to come forward and tell you about the poor experience that they have had?---That is usually the case, yes. And it's probably impossible to replace that with anything else, but we do try other things. So, for example, the other things we try is to have more rigour around the development of products, and there are – if I can use these somewhat – this somewhat crude phrase but release of products into the market. And truly assess them from a customer perspective before the products are rolled out. This is something we need to get better at. Obviously, if we were much better at that, then we would get fewer customer complaints. So ensuring that – or trying to ensure that on all occasions the product that is delivered to a customer is the appropriate product for that customer, that's something which involves both product design and involves – and relies upon the behaviour of the banker who has the customer relationship, and then ensuring that it is, indeed, the right product for the customer at that time. So it's better to influence – seek to influence those things rather than to rely upon ex post incident reporting and then find yourself in a world of customer remediation.

But a customer might never know that they have received inappropriate financial advice. Do you agree?---Yes, indeed. Of course.

And a customer might take some time to realise that a loan that they have been given is a loan that ultimately they are unable to service?---Likewise the bank might.

Yes. Yes?---Yes.

But I'm talking about - - -?---Indeed.

- - - how you rely on your net promoter score to understand the customer experience, because I understand your evidence to be that the customer experience is very important to NAB?---Well, yes, but it's not as important – I've also said I think it's not as important as customer outcomes.

Yes. And customer outcomes at present you assess through the lens of customer complaints?---Principally.

Yes?---Yes.

And you accept that that requires the customer to have taken the step of complaining about their experience?---Yes.

45

And it makes it very important, do you accept, for you to look very carefully at the customer complaints that are made, and for those customer complaints to be filtered through to the highest levels within the organisation?---Indeed.

5 All right. I see the time, Commissioner.

THE COMMISSIONER: Yes. What time do you suggest we should begin tomorrow, Ms Orr?

10 MS ORR: I would like to suggest 9.45, Commissioner.

THE COMMISSIONER: Are you content to be back here - - -

MR: With respect - - -

15

THE COMMISSIONER: Just a moment. Are you content to be back here at 9.45?---Indeed, Commissioner.

Thank you, Dr Henry.

20

MR: With respect, Commissioner, in the public interest do you or an associate hold a vested interest in any of these major banks? Scargetter, 40 years federal tax practitioner.

25 THE COMMISSIONER: The short answer, Mr Scargetter, is no, I do not and we will adjourn until 9.45.

MR SCARGETTER: The complicit judiciary in all of this needs to be looked at.

30

<THE WITNESS WITHDREW

[4.18 pm]

MATTER ADJOURNED at 4.18 pm UNTIL TUESDAY, 27 NOVEMBER 2018

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