Issues Paper Submission February 2017 – Commonwealth Bank of Australia Group

The role of targets

1. Is there a realistic alternative to setting targets as an aid to the management of a large organisation?
   - Targets are one method through which organisations set goals aligned to their strategic objectives, vision and values. At Commonwealth Bank, this vision is 'To excel at securing and enhancing the financial wellbeing of people, businesses and communities'. For a large organisation, there are no practical alternatives to establishing and achieving goals other than target setting. Targets are important for aligning and communicating the expectations of all stakeholders, including customers, shareholders and customers.
   - Targets can support good customer outcomes; they communicate the standard of customer experience and outcomes that employees are expected to consistently meet. As an example, in the retail bank[1], the inclusion of customer experience as a key metric in frontline incentives schemes has resulted in consistently high levels of customer satisfaction. More broadly Commonwealth Bank has adopted targets in senior leadership performance and remuneration systems that have contributed to significant positive outcomes in recent years, including a substantial uplift in customer satisfaction, diversity and inclusion outcomes.
   - Targets can be based on financial outcomes, non-financial outcomes, or a combination of the two. Targets can use output or input measures which are known as activity measures. The difficulty in assuring the quality of the activity undertaken has meant that outcomes-based targets are commonly used.

2. What is the appropriate role of targets in managing performance and assessing rewards payable to an individual?
   - The appropriate role of targets is to:
     - Communicate goals which are aligned to an organisation's strategic objectives, vision and values;
     - Align employee priorities and rewards with the interests of customers and other stakeholders;
     - Motivate employees to apply discretionary effort; and,
   - Facilitate a discipline of fairly and objectively assessing performance and reward outcomes while also rewarding those who have met or exceeded expectations. Bank shareholders, many of whom are customers, expect increased transparency of how organisations set and assess targets. This is to ensure that employees are held to account and are rewarded for targets that reflect sufficient value-add for shareholders.

3. What is the nature of the risk attached to setting targets that are sales or product-related compared to others such as service metrics?
   - Targets can create risk if they imply or drive unreasonable outcomes, for example if they are unachievable or set for inappropriate performance measures. These risks may be amplified when combined with a culture that is not focused on the interests of its customers.
   - Sales and product-related metrics have the potential to have a more significant impact on the financial wellbeing of a customer relative to non-financial measures.

[1] Examples and references to the 'retail bank' in this paper relate to the Retail Banking Services (RBS) business unit within Commonwealth Bank. Unless stated, it is not in reference to the retail arm of Bankwest.

- For both financial and non-financial targets it is important that risk mitigants are in place such as:
  - Setting targets using a holistic approach incorporating objective, fact-based data including micro-market information and engagement with employees and their managers;
  - Target setting processes that are responsive and adaptable to changing market conditions;
  - Targets that are measurable, robust, transparent and understood, including any unintended consequences (e.g. gaming);
  - Applying managerial discretion where there is a formulaic scheme in order to reflect broader contextual factors including risk; and,
  - A fair and reasonable review and appeals process; including access to independent channels through which customers and employees can voice concerns.
- In the retail bank we currently apply discretion to override formulaic outcomes where the broader context, including risk issues. We are also refining our target setting approach to more explicitly include market factors, structural and the resourcing allocated at the local level.

4. Is such a risk lowered if targets are set and eligibility for rewards is assessed less frequently (e.g. annually compared to monthly?)
   - There are trade-offs when determining the frequency of target-setting and reward payments. On the one hand, targets set and assessed less frequently offer a longer period of time in which to verify that performance outcomes have been achieved in accordance with an organisation's expectations. On the other hand, less frequent target setting and assessment periods mean that there is a larger amount at stake at that particular point in time and makes target setting more difficult. This may increase the risk that some individuals could act poorly nearing the end of the performance period to try to obtain their reward.
   - Targets that are set more frequently can alleviate pressure by allowing employees to start afresh in the next reporting period. More frequent payments may also be an important part of the employee value proposition, particularly when incentive pay represents a high portion of total pay.
   - Over the last few years Commonwealth Bank has moved a number of its schemes to longer payment periods. We believe this helps us to mitigate risk by allowing any issues of poor conduct or poor customer outcomes to come to light prior to a payment. It also enables a longer period and sample size upon which metrics like customer satisfaction can be based and reduces the administrative impost associated with more frequent assessments.

Does size of rewards or their structure matter most?

5. How best can we address the trade-off between simplicity, on the one-hand and, on the other, elements to guard against the risk of incentivising poor outcomes for customers? *[Complexity]*
   - Simplicity in incentives is one of Commonwealth Bank's remuneration principles. However, defining and assessing performance can often be complex.
   - As the Reviewer points out, complexity comes from different sources:
     - Scheme design such as the number of measures or gates;
     - The number of schemes across an organisation;

    - The alignment between the business strategy and the performance framework; and,
    - The requirement for schemes to meet various stakeholder expectations including customers (e.g. customer outcomes and experience), regulators (e.g. deferrals, risk/compliance, balanced scorecards) and shareholders (e.g. appropriate funding and performance models).
- At Commonwealth Bank we have tried to manage this trade-off by:
    - Establishing guidelines for the design of incentive schemes including gates, the number of measures
    - Aligning schemes with business strategy, supported by clear and consistent messages from leaders;
    - Having a holistic performance management system with methods such as peer calibration to ensure that there is a balanced and consistent view of performance;
    - Introducing modest change to incentive schemes incrementally and learning and refining over time;
    - Ensuring there is a robust governance process to test the need for new schemes and challenge the simplicity of schemes prior to approval and post implementation;
    - Providing scheme notes, examples and/or calculators to employees and managers;
    - Identifying and investigating outlier performance; and,
    - Establishing minimum weightings, rationalising the number of schemes and removing employee promotions based on product sales in the retail bank.

6. Should banks discontinue the practice of using accelerator-type payments? [Accelerators and similar devices]
    - We believe in the principle of performance based pay to support a high-performance organisational culture. Our view is that remuneration outcomes should be appropriately differentiated across teams and individuals to reflect the contribution to results, including customer outcomes. These financial and non-financial contributions, and the discretionary effort applied in achieving them, can be disproportionate across an employee population and as such, the remuneration outcomes should reflect this. The fair and equitable differentiation of reward outcomes is a core tenet of enabling a high-performing organisational culture and we support, in principle, the use of accelerators to enable this. Nonetheless we also accept that there are circumstances in which inherent risk can be introduced as a result of their adoption. It is important to distinguish between types of accelerators and the context in which they are used.
    - Broadly we define an accelerator payment as one where there is a material increase in the rate of reward upon achievement of a threshold level of performance.
    - We believe accelerators, including in the form of multipliers, should be permitted for non-financial metrics such as risk quality and customer service metrics as they allow meaningful recognition of individuals who achieve more challenging goals and have a disproportionately positive contribution to the business and its customers.
    - For financial metrics we support accelerators where incentive payout rates are applied progressively and the level of acceleration is moderate and not applied retrospectively. We believe this presents less risk when used within a balanced scorecard scheme with adequate safeguards. In contrast, a stepped accelerator model can create a disproportionate incentive to get to the next threshold level of

performance. Diagram 1 below illustrates the distinction between a stepped and a progressive accelerator.

- In the absence of accelerators, incentive plans would either:
  - Deliver more uniform or less differentiated payments to an equivalent employee base. This would fail to fairly recognise the efforts of those who have contributed the most; or
  - Result in higher initial thresholds to reduce staff participation to ensure the scheme delivers value to shareholders.

- We ask the Reviewer to consider the following points in making his recommendations in order to ensure there is a consistent approach across the industry:
  - Defining accelerator-type payments (i.e. when the rate of reward increases materially, multipliers, profit-share rates);
  - The parameters for the acceptable use of accelerators i.e. can accelerators be used for non-sales / financial metrics; team based; or between target and below target performance to allow increased participation in a scheme;
  - Whether the type and size makes a difference e.g. modest continuous increase vs significant stepped increases, whether the accumulation rate is applied progressively or retrospectively; and,
  - Are accelerators acceptable within a balanced scorecard if there is increased monitoring of behaviour.

7. If yes, what other devices are suitable to reward high performers? *[Accelerators and similar devices]*
   - There are several devices that organisations could use to reward high performers. We support the use of non-financial rewards such as recognition schemes,

development and career opportunities. This means that top performance is defined holistically and not solely based, or heavily weighted towards, sales performance.
- Sales volume commissions i.e. where the share of revenue rates remain flat, is another alternative. While this approach may be an effective way of rewarding high performers, sales volume commissions have been criticised for over-emphasising the importance of sales relative to other factors such as customer needs.

8. Should banks discontinue the practice of applying gateways to incentives payments based on the achievement of financial measures? *[The emphasis attached to volume-based financial targets]*
   - We believe that financial gateways are an important feature in frontline incentive schemes, however, we support removing a hard gate requiring 100% of financial targets to be met before any bonus is paid.
   - In their place we recommend that lead-ins (as per Diagram 1), that is, partial payments commencing at a level close to target performance, are used. While a lead-in provides limited access to incentives, it reduces the risk of mis-selling by employees who would otherwise fear missing out on a payment altogether.
   - Lead-ins should therefore be set at a level that is achievable for a significant proportion of the eligible population.
   - As the use and weighting of non-financial metrics increases, a financial lead-in is more likely to become important as achieving non-financial measures may not deliver direct financial outcomes in the same period as the reward payment. This could result in misalignment between the experience of stakeholders such as customers and shareholders. The use of financial lead-ins, combined with a customer-centric performance orientation, safeguards both the customer and shareholder interest.

9. Should banks discontinue the practice of assessing performance and eligibility for rewards on the basis of product-based payments? If yes, on what basis? *[The emphasis attached to volume-based financial targets]*
   - As suggested by the Reviewer, we believe that product-based payments or financial performance should not be the sole determinant in assessing performance whether at the senior executive or frontline level.
   - Our performance and remuneration models all incorporate aspects of non-financial performance, including conduct. The principle applies beyond remuneration to other motivational systems and accordingly we have ceased product-based promotional and recognition campaigns in the retail bank.
   - We do believe, however, that employee accountability for financial performance is vital to align the organisation with shareholder interests. Similarly, accountability for delivering good customer outcomes is also fundamental to our beliefs and approach.
   - As such our perspective is that financial metrics should be included as one component of a scorecard to support a balanced assessment of performance and product neutrality. Other measures such as customer satisfaction, meeting regulatory and compliance requirements, and demonstrating values or ethical behaviour should also be included.

10. Alternatively, should banks limit the weight applied in total to financial measures to, say 35% in these assessments? *[The emphasis attached to volume-based financial targets]*
    - At the Commonwealth Bank we have set internal guidelines across all Group employees, regardless of whether or not they are customer facing. These guidelines outline an appropriate range for the weighting of financial measures from senior manager to frontline roles.

- It is also important that there are strong safeguards and governance and a culture that supports holistic performance and prioritises good customer outcomes. We continue to evaluate ways to enhance our approach to assessing performance in a balanced manner.
- In determining the limit there should also be appropriate consideration given to the overall incentive design including pay mix that is, fixed versus variable. For example, it is possible to have a measure represent 10% of a scorecard and yet be designed in such a way that outperformance on this measure could generate a significant proportion of the overall incentive payment. The inappropriate application of discretion could also increase the prominence of financial measures beyond the intended weighting.
- It is also important that there are strong safeguards and governance and a culture that supports holistic performance and prioritises good customer outcomes.
- We support the Reviewer's findings that the perceived value of reward, and therefore motivational impact, can vary significantly based on context. Therefore while we would consider limits to the financial weighting, the overall design of the incentive scheme remains an important consideration.

11. Should banks discontinue the practice of applying cross-sales gateways or modifiers? *[Cross-selling incentives]*
    - As inferred in the Issues Paper, cross-sales can be classed as referrals from branch employees to specialists, or when more needs are met than originally requested by the customer or when a specialist fulfils a customer need that is not their primary area of specialty, for example, a home lender providing a transaction account.
    - Identifying additional needs and ensuring that our customers have a range of products that meet their financial requirements and goals is a key part of our business and is what customers expect of their bank. Research has shown that 87% of customers have a preference to have a holistic relationship with one bank[3]. Additionally, ensuring that customers are referred to the appropriate specialist irrespective of their point of contact with us, is an important part of ensuring good customer outcomes.
    - Cross-sales metrics also help improve customer outcomes by encouraging a collaborative culture aligned with our values. The importance of meeting customer needs is reinforced by providing recognition to employees only when customers use the product sold (demonstrating a fulfilled need) or there is a positive referral. A positive referral could mean that a customer attends an appointment or proceeds with a product or service that is offered by the specialist.
    - We agree that cross-sales gateways could over-state the relative importance of sales and therefore, we would consider <u>a phased</u> approach to reducing cross-sales as gates either by role or product-type.
    - There is risk that by removing gates for all roles there will be an adverse customer and commercial impact. It is important that when customers are interacting with their bank that employees have a broader objective to help customers understand their financial needs and goals. The risk of moving away from rewarding employees for identifying needs is that many customers will not be made aware of products that add value if it is not presented by the customer as their primary need. For example

[3] Source: RFI Advisory, Cross-Sell Insights Report

customers who want a home loan benefit greatly from a "cross-sale" of home and contents insurance or income protection.
- We also note the experience in the UK following changes in regulation where there was a significant decrease in the sales of products falling into the category of 'unknown needs'. Insurance sales were particularly impacted and declined significantly, up to 67% for life insurance between 2013 and 2015 according to research provided by Finalta. This potentially increases the risk that some customers were under-insured.
- Removing all forms of cross-sales targets for specialist roles could therefore result in customers not being offered the full suite of products that they need.

12. If yes, what other approaches are available to encourage and reward employees that assist customers to identify and meet their needs? *[Cross-selling incentives]*
    - Identifying and meeting customer needs is a core proposition for the Commonwealth Bank. We have implemented many methods to assist employees to meet customer needs including:
        - A balanced approach to performance management. All employees have a balanced approach to their performance that considers their achievements (KPIs) alongside how they have demonstrated the values and effectively managed risk;
        - KPIs for all employees that support a customer centric culture: for examples, in frontline roles these could include measures such as Customer Experience Scores, Financial Health Checks and qualitative feedback;
        - Weekly team discussions on servicing customer needs; and,
        - Group-wide recognition programs, where employees are recognised for outstanding service and/or demonstrating our values. These are shared as examples of best practice, including meeting customer needs.
    - It is our view that these methods complement, rather than replace cross-sales targets, and together reinforce the importance of meeting the full range of customer needs.

13. Are cross-sales incentives more likely to lead to poor customer outcomes than general sales targets? *[Cross-selling incentives]*
    - We are aware of the experience in other markets that support the view that cross-sales incentives are more likely to lead to poor customer outcomes than general sales targets. However, we have not found evidence of this occurring systemically within the Commonwealth Bank.
    - In retail banking customers' needs may range from a simple transaction account to a more complex home loan and these needs are fulfilled by employees with different levels of expertise and accreditation.
    - For example, a branch employee may talk to a customer who is starting their own business and may need a range of transaction accounts. As part of the conversation they may also identify that the customer needs to hire equipment and are unsure whether they have the right personal insurance coverage. The conversation results in a referral to other specialists. Without recognition for cross-sales and the encouragement to identify a range of customer needs, the initial transaction would be fulfilled. However, it is less likely that the other, genuine needs would have been identified. This would have been a poorer customer outcome.

- We support our employees to help customers identify their needs and have invested in technology and training to ensure that these conversations are conducted in a consistent manner. Providing employees with recognition for cross-sales ensures that the customer conversation focuses on identifying customer need, not just transaction fulfilment, that the customer is referred to the right specialist employees when necessary and that they are offered the full suite of products to meet their needs.
- In our view, an effective way to ensure that a customer's needs are met is to have incentive arrangements that support all frontline employees to identify customer needs, fulfilled by the most suitable employee. The role of cross-sales is to encourage this proactive employee behaviour through recognition. This ensures customers are offered the full suite of products and services that meet their financial needs regardless of how they interact with us. Sales targets that do not encourage collaboration drives a siloed culture to the detriment of customers.
- In order to mitigate the potential risk that rewarding cross-sales in incentives may pose, it is important that organisations:
    - Have a culture that promotes good customer outcomes;
    - Take a balanced approach to target setting and performance assessment;
    - Deliver product neutrality;
    - Offer products and services that are designed to support financial wellbeing; and,
    - Use monitoring and controls to safeguard customers from any unintended consequences.

14. What is the best way to mitigate the risk that business unit/branch-based targets will lead to inappropriate pressure on individuals to mis-sell? *[Branch vs individual targets]*
    - Based on our experience, there are a number of methods that, in combination, we would advocate as effective ways of mitigating the potential risk that team-based targets may pose:
        - Rewarding managers for financial and non-financial outcomes, values and risk, using a balanced scorecard approach;
        - Aligning performance expectations across job families, supported by a team-based incentive model which reinforces shared-success;
        - Managerial discretion to provide flexibility in formula-driven schemes;
        - Needs-based conversation training and coaching for team leaders and members;
        - Only recognising the sale of a product when there is evidence that the customer has used the product;
        - Reviewing the quality of customer outcomes;
        - Reviewing and removing business tools that could be used to drive personal competition within business units and teams;
        - Education and emphasis on the importance of ethical behaviour and good customer outcomes;
        - Multi-layered monitoring and controls that identify outlier and inconsistent performance;
        - Independent testing and assurance of control effectiveness;
        - Senior leadership committees responsible for overseeing identified issues and the consequences that are applied; and,
        - Independent channels for customers and employees to raise concerns.

15. Is there a case for banks to adopt scorecard-based approaches in order to minimise the risks of mis-selling? *[A scorecard or specific measure?]*

- Commission or revenue sharing schemes have the benefit of being easily understood and their use is widely supported by sales employees. However, regardless of the application of gates or modifiers for behaviour, commission-based schemes reward for selling more, be that numbers or size. This results in conflicting messages.
- We believe that that a balanced scorecard assists in minimising any risk of mis-selling and sends a clear signal to employees regarding core priorities that balance the needs for all stakeholders. However, a scorecard-based approach is most effective when it is:
    - Simple;
    - Incorporates an assessment of behaviour, customer and risk management in a meaningful way;
    - Reinforced by aligned messages from leaders; and,
    - Reinforced by culture and performance management systems.

16. Are there any market or other impediments to such a development, including in respect of mortgage brokers or other home lenders? How might any such impediments be addressed? *[A scorecard or specific measure?]*

- The retail bank uses a scorecard-based approach in the incentives offered to mortgage broker head groups which captures customer experience and risk.
- The implementation of balanced scorecards for individual mortgage brokers would be challenging. Most significant is the bank's ability to capture the data required to support a balanced scorecard approach and without breaching privacy laws.

17. Should banks adopt the principle that sales incentives should be 'product' neutral' *[What constitutes product neutrality?]*
    - We believe that banks should adopt the principle that sales incentives are product neutral. We define product neutrality as removing potential bias that may incentivise an employee to sell a particular product over another.
    - There are often occasions where multiple product options are available to suit a given need. Given the differing profitability of the product and the processing effort required, product neutrality plays a large part in ensuring employees offer the most suitable product or service that meets the customer's need.

18. If yes, how is that neutrality best established? *[What constitutes product neutrality?]*
    - In our view, product neutrality is best achieved by removing factors that may bias the product or services frontline employees offer to customers.
    - In the retail bank we do not differentiate revenue rates for products which are in the same product category, and therefore, could meet the same customer need. For example, a low-rate credit card versus an awards credit card.
    - This approach removes any line of sight between the product sale and the eventual incentive payment.
    - Neutrality is also achieved through a holistic approach to reward and recognition. For example, a campaign targeting a particular product dilutes all other efforts. In the

retail bank we do not support any specific product-based promotional campaigns that reward sales-related activities. All recognition programs relating to products must relate to non-sales outcomes. An example would be educational activities where prizes were awarded to those who correctly answer questions on a product's features or those who have received customer compliments.

19. Should banks discontinue the practice of applying accelerator-like arrangements? *[What constitutes product neutrality?]*

See question 6

20. What conditions need to be met to ensure that manager discretion is exercised in ways that minimise the risk of poor outcomes for customers? *[Formulaic or discretionary approach?]*
    - Managerial discretion is an important mechanism to take into account other performance factors such as risk and values-based behaviour.
    - Managers can most effectively exercise sound judgement when they are supported by:
        - Clear expectations and guidelines. These could be articulated through communication or performance management frameworks;
        - Training and capability-building to apply quality and unbiased decision making; and,
        - Sound governance, including performance reporting and monitoring to understand outlier performance.
    - It is also important that when managerial discretion is applied to performance assessments there are checks and balances. In the retail bank we use the practice of peer review to ensure that performance assessments are consistent.

Should bank obligations be strengthened?

21. Should the regulatory framework for retail banking be strengthened? Is so, how?
    - The Australian market already benefits from a strong regulatory framework due to the long-standing role of its regulators.
    - The Australian economy requires a strong banking sector and the Australian Bankers' Association (ABA) Six-Point Plan demonstrates the industry's ongoing commitment.
    - In addition to our contribution to the Six-Point Plan, in January 2017, Commonwealth Bank released 'Our Commitments' to all employees. Our Commitments is a foundational policy and guiding framework for employees designed to strengthen the trust our stakeholders have in us. It sets clear expectations for engaging with, and balancing, the interest of our stakeholders, underpinned by our vision and values.

22. Are further changes required to the regulatory environment to reduce the information gap between a seller and the retail purchaser?
    - Further regulation in this area could result in more detailed and complex information which could make it more difficult to understand banking products and services.
    - We aim to provide easily accessible, simple and engaging information. For example, as a departure from conventional information provided to customers, Bankwest have developed Product Disclosure Statements (PDS)-on-a-page and YouTube-style videos that highlight how a customer can derive the most value from a product. In the retail bank we are simplifying the terms and conditions of all products.

- Commonwealth Bank also offers customers a range of ways to access information regarding their finances and products and services. For example, the retail bank's focus on self-service education aims to educate customers on how to effectively use digital channels. This in turn provides customers with greater control, visibility and access to their finances.
- In line with our vision, we believe increasing financial literacy will make a broad and longer-term contribution to building life-skills that enable consumers to secure their financial wellbeing. As a result, the Commonwealth Bank is investing $50 million over three years into financial literacy programs and we support complementary ASIC-led initiatives.

23. Is the legal distinction between the 'provision of information', 'general advice' and 'personal advice' useful or effective in the retail banking context?

- Broadly, the distinction between 'general advice' and 'personal advice' is useful because this helps customers to understand when they are being provided with solutions "tailored" to their personal circumstances and when they are being provided with 'advice' that has not been "tailored" to their own personal circumstances. Also, when general advice is provided, customers have greater access to affordable (normally no charge), more widely available and helpful information. However, consistent and clear regulatory interpretation relating to these terms is essential.
- For some time Commonwealth Bank has supported achieving greater customer understanding around these terms, especially general advice.
- We also support achieving greater consistency and clarity around the regulatory interpretation of general advice and personal advice to ensure greater certainty in customer interactions, in particular in situations where a customer's needs may change and the best solution moves from general advice to personal advice.
- The legal distinction between general and personal advice can in some circumstances be difficult to interpret with regulatory confidence, especially at scale. For example, banks hold, collect and receive personal information about their customers for many purposes and in many different situations. This should not impact any general advice or factual information provided to these customers in other contexts, or in relation to other products and services, if their personal information has not been considered. We believe that it is often in customers' interests for us to provide them with general advice or factual information rather than personal advice even where some personal information may be otherwise available separately.
- It may be helpful for the Reviewer to consider the practical difficulties of applying these terms under existing interpretation. Ultimately, Commonwealth Bank believes there are distinct customer benefits in addressing the following issues relating to these terms:
    - Achieving greater clarification in applying the terms in certain circumstances including where customer information is maintained;
    - Consistency of interpretation across providers; and
    - Addressing challenges associated with enabling digital delivery of financial advice or guidance.

24. Having regard also to the mitigation strategies available to banks, is there excessive risks of mis-selling attached to the practices outlined in Chapter 3 and 4 regarding incentives to retail banking employees and third parties that act on behalf of banks?

- In our frontline channels we have built greater analytical and investigative capability to identify and monitor conduct risk and have introduced consequence management frameworks to consistently address poor conduct.
- In our third party channels, our legal arrangements with broker head groups are a binding agreement on the professional standard expected of brokers and include provisions to claw back payments in instances of poor conduct.
- Additionally, all home loan applications from our proprietary lenders and third party brokers are verified and assessed in line with our strict lending policies. For added assurance, all loan applications originated via a broker are subject to additional reviews prior to funding approval.

What is the difference between a 'sales' and a 'service' culture?

25. What constitutes a 'service' culture in the retail banking context?
    - At its simplest level, a service culture places great importance on the customer and strives to deliver a customer-centric experience and outcomes.
    - This is equally true in retail banking while also balancing the needs of other stakeholders. This balance is articulated as part of our vision and reflected in the way we define the value of 'Service' at the Commonwealth Bank, particularly for our leaders. At Commonwealth Bank, 'service' is one of our five values which we have defined for team members and team leaders and are incorporated as a core part of our performance framework across the Group.
    - For a team member at Commonwealth Bank, 'Service' means:
        - I help often
        - I care about understanding meeting customers' needs
        - I represent CBA well at all times
    - For a team leader at Commonwealth Bank, 'Service' means:
        - I provide clarity on balancing different stakeholder interests
        - I set high service standards for my team and share best practice
        - I coach and encourage others to deliver exceptional service
    - In the retail bank, we have made changes throughout the employee lifecycle to reinforce the importance of our values, including our value of Service. This has influenced how we recruit, recognise, develop and assess retail employees.

26. What approaches to performance management and rewards and incentives are most conducive to achieving it?
    - Performance management and incentive practices are most conducive to achieving a service culture when service/customer is a clear and consistent performance expectation that is formally assessed.
    - Performance expectations need to be supported by coaching and guidance, role modelling and recognising and celebrating good examples of service.
    - Prior to an employee joining, it is also important that there is good cultural-fit between a candidate and an organisation. At the Commonwealth Bank, candidates are assessed against our values as part of the recruitment process.
    - Cultural assessments of intact teams also offer leaders valuable insight into the service and customer related attitudes of teams/business units.

What role may the remuneration arrangements applicable to very senior managers play in conditioning the behaviour of frontline employees?

27. What weight should be attached to sales targets in the assessment of the performance of a bank's most senior executives?
    - A core tenet of Commonwealth Bank's executive reward approach, and that of all public companies, is that performance and reward align to shareholder interests and the delivery of long-term value creation. As such, executive reward models need to incorporate a component of financial performance.
    - Financial performance for the Group is not solely delivered by the achievement of sales, but also the efficient use of capital, management of risk, etc. so there are broader financial targets applied to this population.
    - The short-term performance scorecards for our senior managers that support revenue generating business units include:
        - Group and business unit Cash NPAT and PACC
        - Customer satisfaction
        - Technology
        - People (talent management, safety, diversity, engagement and culture)
        - Productivity
    - The performance of our senior leaders, including the CEO and Group Executives, is managed through a balanced scorecard using financial and non-financial performance measures that are set at the beginning of the performance period and are used to drive their incentive outcomes.
    - The performance outcomes are used to determine the incentive outcome and are modified by the results of individual risk assessments and an assessment of the alignment between their performance and the Group's visions and values.
    - The weighting applied to financial outcomes for senior managers of revenue generating businesses is typically 45%. Specific sales targets are not directly part of our senior manager's performance scorecards.

28. What are the key principles that banks should apply in designing the incentives that apply to their most senior executives?
    - As the Reviewer highlights, there is a link between how senior leaders are remunerated and the behaviour of frontline employees. Senior executive remuneration at Commonwealth Bank has been designed to foster balanced outcomes in line with our vision and is based on the following principles and practices:
        - Performance-based remuneration for our most senior executives includes a mix of short-term and long-term awards that reward performance over the short and longer term. Incentive outcomes are driven by performance that is managed through a balanced scorecard approach, using financial and non-financial performance measures that are set at the beginning of the performance period and overlayed with a review of risk conduct and alignment to the Group's vision and values;
        - Rewards are aligned with shareholder interests and our business strategy;
        - Exceptional and sustainable performance is rewarded, while also managing risks associated with delivering and measuring that performance;
        - There is flexibility to meet changing needs and emerging market practice;
        - Remuneration structures and policies are transparent, easy to understand, administer and communicate;
        - The risk management framework is integral to remuneration decision making;

- Remuneration is reviewed from a 'total reward' perspective (i.e. monetary and non-monetary benefits) and within the context of the broader employee value proposition;
- Manager discretion should be applied with consideration of objective inputs, criteria and guidelines.

Issues specific to remuneration of third parties

What is a poor customer outcome (and what is the link to agent remuneration?)

32. What do you think of the adequacy of adopting the FSA's approach for the purpose of defining a poor customer outcome?
    - The FSA's definition sets a standard for assessing customer outcomes that aimed to address significant and systemic issues in the banking industry in the United Kingdom at that time. It captures many of the considerations that would characterise a poor customer outcome.
    - In the retail bank we have been developing a framework for evaluating a poor customer outcome at the point-of-sale. For a customer, a poor outcome would be where they:
        - Purchased a product they didn't need
        - Purchased the wrong product
        - Borrowed more than they needed or could afford
        - Did not understand the product features
        - Found the channels to buy or use the product to be inconvenient
        - Did not receive the product in time

33. Is there evidence that the risks of mis-selling are currently significant, not sufficiently mitigated by existing strategies, and systemically important?
    - We recognise that there is an inherent risk of mis-selling in retail banking however we do not believe that it is systemic or that current methods are ineffective in managing this risk.
    - As outlined in our previous submission we have made significant changes in the retail bank to strengthen our control environment including:
        - Removing a point-per-product system which created a direct link between the number and value of products sold and an individual's reward;
        - Creating a product-neutral sales model providing equal credit for products within like categories i.e. those products that meet the same customer need and require a similar level of effort to fulfil and process;
        - Reviewing all retail product sales crediting to ensure a sale is only recognised where a customer need has been met; and,
        - Reviewing marketing campaigns with an associated employee incentive. Since our last submission we have gone further and stopped the use of employee incentives related to product-based campaigns.