The Hayne report raises some fundamental questions for the financial services market and role of remuneration.

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Gordon Gecko meets his nemesis

A theme threaded through the text of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry's interim report was that a key driver of behaviour is remuneration contingent on profit and sales.

The Commissioner, the Honourable Kenneth Madison Hayne, stated in his interim report:

"All the conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned.

"If there are exceptions, they are immaterial. For individuals, the conduct resulted in being paid more. For entities, the conduct resulted in greater profit.

"The governance and risk management practices of the entities did not prevent the conduct occurring.

"The culture and conduct of the banks was driven by, and was reflected in, their remuneration practices and policies."

Prior remuneration fixes have not addressed key concerns

After the financial crisis, the focus was the effect of risky behaviour on remuneration (See HERE). The Royal Commission's report states that this focus (and regulatory changes to address it) was confined to financial risk and not reputational or regulation risk. It indicates that APRA has failed to recognise this, and has not, it seems, fully embraced the latest international standards on conduct risk released by the FSB (see HERE).

The Sedgwick review (See HERE) examined financial incentives for retail staff leading to changes in the way the banks remunerate their front-line employees. This has led to banks reducing the focus on sales via a balanced scorecard approach. However, some “non-financial” measures are seemingly financial measures in sheep’s clothing. Of the multiple “customer” measures the commission examined from two of the banks, only one (net promoter score) reflected customer satisfaction. The other customer measures related to sales volumes. Net promoter score was also far from perfect because it only recorded the customer’s happiness with the service at the time of the transaction, not whether the customer was serviced according to their best interests or whether the law was adhered to.

No longer remunerate top management on profit?

The Royal Commission report concluded that removing sales and profit incentives purely among the customer-facing staff was hardly likely to work.

“It will always be in the interests of any manager (no matter how senior) to have subordinates carry out their work in a way that will allow the manager to achieve whatever incentive targets have been set for that manager.

Eliminating incentive-based payments for front line staff will not necessarily affect the ways in which they are managed if their managers are rewarded by reference to sales or revenue and profit.”

In summary, Commissioner Hayne suggests that incentives focussing on profits are:

- Not good for consumers, and therefore
- Inappropriate for all levels of staff, not just front line staff.

As Commissioner Hayne observed elsewhere in his report:

“In considering that question [i.e. transparency] it is important to recognise that the interests of shareholders are not the same as the interests of customers. It may be that they are opposed. Shareholders will see what happens at the entity only through the lens of dividend and share price. Some shareholders will take a short term view of both dividends and share price, others may have a longer term view. But customers are concerned only with how the entity's conduct affects them in their dealings with the entity.

The big question

The remuneration question raised by Hon. Kenneth Hayne with the biggest ramification is should incentive payments be abolished altogether?

"The unstated premise for so much of the debate about remuneration of both bank staff and intermediaries, that staff and intermediaries will not do their job properly and to the best of their ability without incentive payments, must be challenged," he states.

"Why do staff (whether customer facing or not) need incentives to do their job *unless* the incentive is directed towards maximising revenue and profit? How can staff (especially customer facing staff) be encouraged to do the right thing (to ask 'Should I') except by the line manager observing, encouraging counselling and supporting the staff in that task? What is the point of allowing an incentive payment for doing the assigned task in a way that meets but does not exceed what is expected of that staff member?"

See the interim Royal Commission report HERE. All of it is well worth a read. However, if you lack the time, the good bits on remuneration are from page 317 onwards.