INTERIM REPORT
Focused Review on Incentive Systems of Front Offices in Retail Banks

November 2021
ABOUT THIS REPORT

This report provides an interim update on a focused review on incentive systems of front offices in retail banks, commenced by the Hong Kong Monetary Authority (HKMA) in March 2021. The report shares initial insights in the review, gathered from the activities undertaken so far, and areas that we intend to examine in more detail as we gather a more comprehensive set of data over the second phase of the review.
FOREWORD

A sound bank culture is essential in ensuring banks deliver the right values and good customer outcomes, and hence plays an indispensable role in upholding sustainability of the banking system in the long run. At the HKMA, we have always been passionate about promoting sound culture in the banking sector. Over the past two years, we have spearheaded various initiatives in the cultural landscape, including self-assessment on banks’ culture, as well as culture dialogues with banks’ leadership.

This year, we have taken up the challenge of diving deeply into the incentive systems of front offices in 20 retail banks, given the critical role that incentive systems play in driving desirable behaviours and affecting customer outcomes. This Focused Review is conducted by the HKMA with the support of an external consultant, Kiel Advisory Group. It examines the incentive systems of front offices especially in relation to their sale and distribution of banking, investment, and insurance products to customers, as well as analyses the perception and behaviour of frontline staff in the banks through a range of activities (including an employee survey, focus group discussions and interviews with staff, as well as document reviews).

Up till now, as one of the key activities of the Focused Review, we have completed an industry-wide employee survey, with an overall response rate of 70%, which is encouraging. Given the scale and breadth of the Focused Review, we would like to provide an update on the progress of the review, and share with the banking industry the preliminary insights gathered so far, including:

► Common themes on staff perception of front office incentive systems;

► Key characteristics of front office incentive systems and behaviours that differentiate banks with more positive perception of customer and conduct outcomes by frontline staff; and

► Common front office incentive frameworks and practices.

Building on the preliminary observations we share in this interim report, we are now advancing to the next phase of the Focused Review to explore and identify further themes and practices. Upon completion, we aim to provide some useful guidance and reference to the banking industry. We trust this will advance bank culture development in Hong Kong to the next level. We would also like to take this chance to thank the participating banks and their staff for their unreserved participation in this important culture initiative.

Arthur Yuen
Deputy Chief Executive
Hong Kong Monetary Authority
EXECUTIVE SUMMARY

As part of the ongoing supervisory work to promote sound culture in the banking sector, the HKMA commenced, in March 2021, a Focused Review on the incentive systems of front offices in the sale and distribution of banking, investment, and insurance products of 20 retail banks (hereafter referred to as the 'Focused Review'). With a view to identifying industry-wide practices and an aim for better alignment of incentive systems of bank staff with bank customers’ interest, the HKMA appointed an external consultant, Kiel Advisory Group to assist in the Focused Review. This report provides an interim update on the Focused Review undertaken by the Banking Conduct Department of the HKMA with the support of the external consultant, and shares the initial observations based on data gathered from the activities undertaken so far.

During the first phase of the Focused Review, in addition to document review which is ongoing, an industry-wide employee survey of around 18,000 frontline staff has been completed as a key component of the review, assessing staff perceptions of incentive systems, bank culture, customer and conduct outcomes, as well as their individual motivations.

Initial observations detailed in this report are intended as preliminary insights identified in the first phase that will evolve as the Focused Review progresses and further data is collected in the next phase. Observations described in this report include:

► Insights from the survey on common attitudes, mindsets, and perceptions of frontline staff across the banking industry in Hong Kong.

► Key characteristics of incentive systems, attitudes, and behavioural norms in front offices, for banks with more staff that have positive perceptions of customer and conduct outcomes, compared to those with less staff that have positive customer and conduct outcomes.

► Preliminary insights from documents reviewed so far, showing some common front office incentive practices and frameworks across the industry.

Next steps will include additional data collection via focus groups and interviews with staff of the selected banks, and further document review.
## GLOSSARY OF TERMS

<table>
<thead>
<tr>
<th>TERM</th>
<th>DEFINITION</th>
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<tbody>
<tr>
<td><strong>Accelerator</strong></td>
<td>A variable remuneration arrangement whereby a higher rate of reward is earned with higher levels of staff performance (e.g., a higher percentage of commissions after a sales target or tier is achieved).</td>
</tr>
<tr>
<td><strong>Business/financial outcomes</strong></td>
<td>Any outcomes that deliver profit to the bank, such as revenue from the sale of products and provision of services, cross-sales, and referrals.</td>
</tr>
<tr>
<td><strong>Business/financial targets</strong></td>
<td>Business objectives set by the bank, relating to the sale of products and provision of services, cross-sales, and referrals.</td>
</tr>
</tbody>
</table>
| **Customer and conduct outcomes** | Generally, customer and conduct outcomes are practices that impact the treatment of customers.  
• Good outcomes: business practices that ensure that customers receive fair treatment and fair outcomes.  
• Poor outcomes: business practices that do not ensure that customers receive fair treatment and fair outcomes, such as misconduct and mis-selling. |
| **Fixed remuneration**        | The guaranteed level of monetary reward paid to staff, typically comprising base salary and fixed allowances.                              |
| **Incentive systems**         | Formal and informal structures used by banks to motivate and shape behaviour (e.g., performance management, remuneration).              |
| **Intrinsic motivation**      | A person’s drive to engage in an activity because it is inherently satisfying (e.g., enjoyment from providing helpful advice to customers). |
| **Multiplier**                | A method of assigning additional weight to a performance factor (e.g., revenue) by multiplying it in the calculation of an overall performance rating or variable incentive amount. |
| **Stepped increase**          | Applied to sales, a stepped increase determines that staff only earn additional payments for sales above a minimum or a ladder of target levels (i.e., must meet the threshold to get any additional payment). |
| **Variable remuneration**     | The level of monetary reward paid to eligible staff, and may include periodic discretionary bonuses and performance-based incentives such as sales commissions. |
INTRODUCTION
Incentives are a critical driver of human behaviour. In the financial sector, incentives are a highly visible feature of the environment. Banks are rewarded for achieving positive outcomes for their customers, shareholders, employees, and other stakeholders. There are also disincentives (penalties or consequences) that motivate banks to avoid adverse outcomes. At a basic level, banks tend to pursue objectives they are rewarded for, and avoid activities that might lead to negative consequences.

To achieve good bank-level performance, banks generally develop strategies for motivating staff to apply their skill and energy in support of the bank’s objectives. The types of things that motivate staff are varied. Some sources of motivation are outside the direct control of banks (e.g., the degree to which an individual is intrinsically motivated by status or achievement). However, there are many rewards that banks can offer to help motivate their staff. These rewards can be tangible, such as fixed remuneration for meeting role requirements, or bonuses for meeting specific targets. They can also be intangible, such as pride in solving a customer’s problem or praise from a supervisor for meeting development goals. As with banks, incentives can also function to discourage individuals from undesirable behaviour (disincentives). Having a bonus reduced due to compliance breaches is an example of a disincentive.

Although the basic concept of rewards and penalties is reasonably straightforward, in practice there are many details and choices involved in operationalising incentives. A few choices that banks face include: What types and mix of incentives should they offer? How should good performance be defined? What level of reward should apply for different levels of performance? What kinds of disincentives should a bank apply? How should incentives and disincentives be combined?

To deliberately use incentives as a motivational tool, banks need to make decisions on each of these issues. Sometimes the ‘right’ answer is not easy to see, and the effect of incentives on individual and group behaviour can be counter-intuitive. The cost of making poor decisions about incentive design can also be profound, ranging from under-utilisation of talent, to poor customer outcomes such as mis-selling. Hence, it is important for banks to approach the issue of incentive design with care.

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The Focused Review is part of the HKMA’s ongoing supervisory work to promote sound culture in the banking sector. With a view to identifying industry-wide practices and an aim for better alignment of incentive systems of bank staff with bank customers’ interest, the HKMA appointed an external consultant, Kiel Advisory Group to assist in the Focused Review. Specifically, the Focused Review is examining the front office incentive systems of 20 retail banks in Hong Kong, including how incentive systems are designed and implemented, how they affect behaviour of frontline staff, and ultimately how they influence customer outcomes. We are particularly interested in the role of incentives in minimising potential misconduct and mis-selling behaviour in the sale and distribution of investment, insurance, and banking products.

The Focused Review aims to understand the effect of incentives on front office behaviour. The external consultant, using their expertise and experience in conducting reviews of this nature, will apply behavioural science to analyse the perceptions and behaviours of frontline staff in the selected retail banks.

Behavioural science techniques reflect a range of key principles, which are key to the methodology used for this review, including:

- **Evidence-based.** Conclusions are based on valid, reliable data.
- **Objective.** Techniques are employed to reduce bias and ensure a balanced perspective.
- **Neutral.** The approach is primarily inductive, that is, designed to understand the current reality from a variety of perspectives, especially from frontline staff.
- **System-oriented.** The approach recognises the system of influences on behaviour and seek insights that reflect this context.
- **Confidential.** Ensuring that staff feel comfortable contributing their perceptions and experiences to the review is an important way for us to gather honest insights.

When the review is complete, findings will provide industry-wide insights covering:

1. Incentive practices that are associated with more positive customer outcomes, which may minimise the potential risk of misconduct and mis-selling.
2. Incentive practices that tend to be associated with less positive customer outcomes, which may increase the potential risk of misconduct and mis-selling.
The Focused Review is in the process of collecting a comprehensive set of information, including both quantitative and qualitative data, and both objective occurrences and subjective perceptions. See graphic below for details on the main data collection methods. The comprehensive set of data will be collated and analysed to form the final observations, covering:

- Perceptions of bank staff and management.
- Bank documents related to front office incentive systems.
- Customer and conduct outcomes.

### Sources of information in the Focused Review

<table>
<thead>
<tr>
<th>Source Type</th>
<th>Why</th>
<th>What</th>
<th>How</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Survey</strong></td>
<td>Efficient and robust insight into staff observations of behaviour and outcomes, and perceptions of beliefs and values.</td>
<td>An anonymous online survey of frontline staff.</td>
<td>Invited all frontline staff across the 20 selected banks.</td>
</tr>
<tr>
<td><strong>Focus Groups</strong></td>
<td>Use various activities to surface shared mindsets and perceptions.</td>
<td>Facilitated discussions with groups of participants of the same level of seniority.</td>
<td>Sample of bank staff in a variety of frontline and functional roles.</td>
</tr>
<tr>
<td><strong>Interviews</strong></td>
<td>Use behavioural science techniques to establish trust and openness, gaining candid insights.</td>
<td>One-on-one discussion between bank staff and interviewer.</td>
<td>Sample of staff from a variety of frontline and functional roles from selected banks.</td>
</tr>
<tr>
<td><strong>Documents</strong></td>
<td>Provide insights into established policies and procedures, and other mechanisms.</td>
<td>Systematic collection and analysis of documents provided by selected banks.</td>
<td>Information will be requested based on emerging insights as the review progresses.</td>
</tr>
</tbody>
</table>
WHAT HAS BEEN COMPLETED SO FAR

The Focused Review commenced in March 2021, the graphic on the right shows the main components of the review. At this stage, the following activities have been conducted:

► **Industry-wide survey.** Among a total of around 25,000 frontline staff invited to participate in the survey, around 18,000 frontline staff completed the survey, representing a 70% response rate. The number of responses in each bank was large enough to be considered statistically representative.

The survey asked questions about staff perceptions in relation to their individual motivations, bank incentive systems, behaviour and bank culture, and customer and conduct outcomes.

Responses to the survey have been analysed at an industry level, as well as by sub-groups to identify different patterns and associations with perceived customer and conduct outcomes.

► **Document review (ongoing).** Information regarding front office incentive systems have been collected from the 20 selected banks. The information and documents collected so far have been systematically examined to identify some initial common practices, themes, and differences within the sample of selected banks.
RESPONSE RATE AND BREAKDOWNS

Overall survey response rate

70%

By Staff Level
- Frontline Staff: 82%
- Supervisor: 17%
- Senior Leader: 1%

By Channel
- Branch: 87%
- Call Centre: 10%
- Other: 3%

By Customer Group
- Retail Customers: 82%
- SME Customers: 3%
- Retail & SME: 15%

By Product Area
- Products: General Banking, Insurance, Investment
  - One product area: 72%
  - Two product areas: 13%
  - Three product areas: 15%
FOCUS ON FRONTLINE PERCEPTIONS

The Focused Review is gathering comprehensive data to analyse the perception and experience of bank staff in relation to front office incentive systems. This approach aims to meet a key goal of the review, that is, to understand the effects of incentives on frontline staff behaviour, rather than banks’ compliance with regulatory requirements. By asking bank staff to share their perceptions and observations, we aim to provide a more complete picture of how and why front office incentives operate the way they do. The graphic below further illustrates the way perceptions influence behaviour and outcomes, and the important role of staff surveys and conversations in the review process.

Surveys and conversations provide critical data on the way bank staff perceive their front office incentives, and how these perceptions influence their behaviour.

STAFF OBSERVE THEIR ENVIRONMENT

► In their day-to-day work, staff observe their environment, and form an understanding of their banks’ policies and systems, communication and decisions by senior leaders, risk and control mechanisms, and typical behaviour of colleagues and supervisors.

PERCEPTIONS SHAPE STAFF BEHAVIOURS

► The way individuals interpret the environment informs their view of what is acceptable, rewarded, and valued (or not), by their senior leaders or by others.

► In turn, these perceptions also shape the way staff act and make decisions, both consciously and unconsciously. When groups of staff share similar perceptions, norms develop and become a part of the bank’s culture.

STAFF BEHAVIOURS DETERMINE OUTCOMES

► Behaviours are the observable actions of staff, what they say and do. For example, behaviours may be related to the ways in which frontline staff treat customers, provide information, offer advice, and handle any concerns.

► Customer and conduct outcomes result from complex interactions between customers and banks, which are influenced by many factors in the environment including the bank’s strategy, systems, and staff. This review will examine two factors in particular: incentive systems and frontline staff.
DETAILLED SURVEY METHODOLOGY

SURVEY DESIGN AND DEVELOPMENT

- **Scope.** Background research was carried out to identify key factors to assess, which included incentive systems, characteristics of staff, bank culture, and customer and conduct outcomes.

- **Survey content generation.** Using the above framework of factors as a foundation, survey questions were developed using the knowledge and expertise of behavioural scientists and risk culture specialists.

- **User feedback testing.** Staff from selected banks participated in this testing to ensure that survey questions are easy to understand and unambiguous, and that meaningful responses can be provided.

- **Validation testing.** The refined set of survey questions was then put through a validation process. This involved collecting responses from a representative sample of people within the financial sector, using an independent data collection platform. Data analysis was then conducted to ensure that survey questions aligned with the framework.

- **Final set of survey questions.** The survey questions were further refined following validation. The final survey included 39 rating-scale questions, 1 open-ended question, and 8 demographic questions. Bank staff could complete the survey in either English or Chinese.

SURVEY ADMINISTRATION AND ANALYSIS

- **Survey administration.** The survey was administered using Qualtrics, with more than 25,000 staff from the 20 selected banks invited to participate. Respondents answered the survey in their language of choice (English or Chinese).

- **Data cleaning.** The set of survey responses received was cleaned to remove invalid data, namely responses where administration protocol was not followed.

- **Data analysis.** The final set of survey responses was analysed to obtain common themes across the industry, including analysis of overall response patterns for each of the factors measured (incentives systems, staff characteristics, culture, customer and conduct outcomes), associations between the factors, response patterns of specific groups of staff, and response patterns across different banks.
RESPONSE SCALE

Participants were presented with a series of statements about their experience of incentives, conduct and customer outcomes in their bank, and asked to indicate how strongly they agreed with each. Response options ranged across a 5-point scale, from ‘Strongly Disagree’ to ‘Strongly Agree’, and participants also had the option to select ‘Not Applicable’.

REPORTING OF RESULTS

This report presents the results for most of the survey questions as the total percentage of participants, across all banks, that Agreed or Strongly Agreed with the statement (see Example A at right). Grouping the percentage of respondents that Agree and Strongly Agree helps visualise the results.

In Section B of the Interim Insights, we discuss some survey statements about practices associated with weaker perceived outcomes (see Example B at right). For consistency, and to help readers interpret results for these questions, the percentage of participants that responded positively to these statements is reported – that is, those that Disagreed or Strongly Disagreed that such practice occurs in their bank.

NOTE ON INTERPRETING THE RESULTS

It may be helpful to note that the figure reported for each survey question only represents the percentage of respondents that selected the reported response (shown in italics below the graphs – either Agree/Strongly Agree, or Disagree/Strongly Disagree).

The remaining (unreported) responses include those from participants that selected ‘Neutral’ or ‘Not Applicable’, as well as those that selected the opposite of the reported response option.
INTRODUCTION

The Focused Review has been underway for several months. Given the scale and breadth of the review, it is expected to be completed in around Q1 2022. Data collected at this stage provides several emerging observations, broadly falling into three parts:

A. **Staff perceptions of front office incentives across the industry.** Common themes across the selected banks related to the way frontline staff experience financial and non-financial incentives, and their impact on norms in the industry.

B. **Perceived customer and conduct outcomes.** Analysing survey responses in banks with more staff that have positive perceptions of customer and conduct outcomes, compared to those with less staff that have positive perceptions of customer and conduct outcomes.

C. **Incentive practices.** Preliminary information gathered from bank documents thus far, showing common characteristics of front office bank staff remuneration and incentive systems.
The Focused Review aims to understand how front office incentives can influence good outcomes for customers.

This section of the report highlights common themes related to front office incentives observed from the survey, on staff perceptions across the selected banks. The section provides observations to address four key questions:

1. How important are financial incentives to frontline staff?
2. Besides pay, what else incentivises frontline staff?
3. Do senior leaders and supervisors have a clear view on the impact of incentives?
4. Do frontline staff feel rewarded for being customer-centric?

The insights in Section A and Section B are based on and illustrated by results from the survey. Please see page 15 for a detailed explanation of the survey response scale, how the results are presented in this report, and how best to interpret them.
The survey confirmed findings from numerous other sources\(^1\) that financial incentives are an important factor that staff consider when accepting a job in the banking industry. Respondents tended to agree that they are primarily motivated by salary package when choosing a job, and that they look for opportunities to earn incentives on top of fixed pay. This was especially the case for frontline staff.

### FINANCIAL REWARDS ARE VALUED, ESPECIALLY BY FRONTLINE STAFF

**I primarily consider salary package (including possible incentives) when choosing a job.**

<table>
<thead>
<tr>
<th></th>
<th>All respondents</th>
<th>By staff level</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Frontline Staff</td>
</tr>
<tr>
<td>% Agree/Strongly Agree</td>
<td>74%</td>
<td>74%</td>
</tr>
</tbody>
</table>

**I find it important to have opportunities to earn incentives on top of my fixed pay.**

<table>
<thead>
<tr>
<th></th>
<th>All respondents</th>
<th>By staff level</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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</tr>
<tr>
<td>% Agree/Strongly Agree</td>
<td>74%</td>
<td>75%</td>
</tr>
</tbody>
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The survey asked frontline staff about things that motivate their behaviour at work. We found that financial incentives were not the only factor that influences frontline staff effort. Intrinsic motivators were also important to frontline staff at all levels – that is, the drive to perform work activities for the inherent satisfaction they bring, rather than the promise of a separate, external reward (e.g., financial incentives). These findings suggest that intrinsic motivators play a crucial role in shaping frontline staff behaviour, and should be an important consideration in how banks design their incentive systems.

2. INTRINSIC MOTIVATORS ARE IMPORTANT TOO

A RANGE OF INTRINSIC MOTIVATORS INFLUENCE STAFF BEHAVIOUR

<table>
<thead>
<tr>
<th>Motivator</th>
<th>Description</th>
<th>% Agree/Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>REPUTATION</td>
<td>I feel a sense of responsibility to uphold this bank's reputation.</td>
<td>91%</td>
</tr>
<tr>
<td>SERVING CUSTOMERS</td>
<td>I find it rewarding to achieve good outcomes for customers.</td>
<td>90%</td>
</tr>
<tr>
<td>TEAMWORK</td>
<td>I feel more motivated to perform if I am contributing to team objectives.</td>
<td>83%</td>
</tr>
<tr>
<td>CAREER GROWTH</td>
<td>I am motivated to progress my career with my current organisation.</td>
<td>76%</td>
</tr>
</tbody>
</table>
The survey showed that frontline staff, supervisors, and senior leaders tended to have somewhat different perceptions about the incentives of their bank. Frontline staff felt that their incentives emphasised performance on their business targets as a priority, whereas their supervisors felt that incentives were more balanced. Senior leaders had more positive views about the degree to which incentives reinforced desired behaviour through reward and penalty. These differences in perceptions may reveal a gap between the intended design of the incentive systems and the lived experience of frontline staff.

### 3. PERCEPTION DIFFERS AMONG STAFF LEVELS

The survey showed that frontline staff, supervisors, and senior leaders tended to have somewhat different perceptions about the incentives of their bank. Frontline staff felt that their incentives emphasised performance on their business targets as a priority, whereas their supervisors felt that incentives were more balanced. Senior leaders had more positive views about the degree to which incentives reinforced desired behaviour through reward and penalty. These differences in perceptions may reveal a gap between the intended design of the incentive systems and the lived experience of frontline staff.

### SENIORITY AFFECTS THE WAY INCENTIVES ARE PERCEIVED

<table>
<thead>
<tr>
<th></th>
<th>Frontline Staff</th>
<th>Supervisors</th>
<th>Senior Leaders</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>3. PERCEPTION DIFFERS AMONG STAFF LEVELS</strong></td>
<td>% Agree/Strongly Agree</td>
<td>% Agree/Strongly Agree</td>
<td></td>
</tr>
<tr>
<td>In this bank, performance review conversations mostly focus on whether individual-level business targets are achieved or not.</td>
<td>Frontline Staff 55%</td>
<td>Supervisors 44%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Senior Leaders 44%</td>
<td>Senior Leaders 58%</td>
<td></td>
</tr>
<tr>
<td>In this bank, staff performance is measured against a balanced set of customer and business outcomes.</td>
<td>Frontline Staff 69%</td>
<td>Supervisors 79%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Senior Leaders 81%</td>
<td>Senior Leaders 69%</td>
<td></td>
</tr>
<tr>
<td>In this bank, staff are penalised for actions that cause poor customer outcomes.</td>
<td>Frontline Staff 63%</td>
<td>Supervisors 67%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Senior Leaders 74%</td>
<td>Senior Leaders 60%</td>
<td></td>
</tr>
<tr>
<td>In this bank, staff need to deliver good customer outcomes to receive a promotion.</td>
<td>Frontline Staff 60%</td>
<td>Supervisors 65%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Senior Leaders 70%</td>
<td>Senior Leaders 60%</td>
<td></td>
</tr>
</tbody>
</table>
4. BEING CUSTOMER-CENTRIC MAY SEEM UNDER-VALUED

The survey revealed a strong sense of conscientiousness amongst frontline staff. Respondents generally indicated that their colleagues were compliant, quick to correct customer problems, and honest when they make mistakes. However, frontline staff also responded that recognition is not consistently applied for ‘good’ behaviour. This may indicate to frontline staff who are being customer-centric that their behaviour is less valued than other dimensions of performance, especially those dimensions associated with frequent financial rewards. Over time, this could impact the degree to which staff exhibit behaviours that are customer-centric.

STAFF ARE GENERALLY CONSCIENTIOUS ...

People I work with always complete compliance requirements promptly. 88%

People I work with are quick to correct the problem when customers are unhappy about a product or service. 86%

People I work with are honest when they make a mistake. 83%

... HOWEVER FEWER STAFF FEEL THAT GOOD CUSTOMER AND CONDUCT OUTCOMES ARE RECOGNISED

In this bank, staff receive praise for treating customers fairly. 71%

In this bank, staff need to deliver good customer outcomes to receive a promotion. 61%

In this bank, staff are penalised for actions that cause poor customer outcomes. 64%
Financial incentives are valued by staff. We observed that incentives are important motivators, in particular for frontline staff and their supervisors.

Non-financial incentives are also important. Financial incentives are not the only motivators of staff behaviour. Staff also have strong intrinsic motivations, such as finding satisfaction in serving customers, pursuing career growth, and so on.

Incentives can be experienced in unexpected ways by staff at different levels. Survey findings showed that frontline staff often feel that incentives reward performance on business targets more than customer and conduct outcomes, whereas supervisors and senior leaders tended to perceive a more balanced focus.

Frontline staff may not feel that customer and conduct outcomes are valued as much as other factors. The survey found that staff generally report a conscientious attitude amongst their colleagues, but also that being customer-centric was not consistently recognised.
KEY INSIGHTS IN THIS SECTION

In addition to understanding common themes across the industry, the Focused Review aims to provide insight on how frontline incentives may ultimately influence good customer and conduct outcomes.

One way to explore this issue is to examine how banks with distinctive perceived customer and conduct outcomes might differ from other banks. Although the Focused Review is still ongoing, and thus has not yet gathered comprehensive data on outcomes at this stage, a sub-set of questions in the survey provided feedback on staff perceptions of customer and conduct outcomes in their bank.

Across these survey questions, our analysis showed that some banks have more staff with positive perceptions of customer and conduct outcomes, whereas other banks have less staff with positive perceptions of customer and conduct outcomes.

For the banks where more staff have positive perceptions of customer and conduct outcomes, we examined staff responses on a range of other survey questions (covering incentive systems, bank culture, and staff characteristics), to see which factors might differentiate the favourable perceptions of customer and conduct outcomes at those banks.

Finally, we examined typical responses from staff in banks across the industry, to illuminate which characteristics might be more of a challenge at present.

In summary, this section includes insights on the following:

1. Characteristics that differentiate banks with more positive perceived customer and conduct outcomes.
2. Characteristics that are most challenging for banks across the industry.
WHAT SUPPORTS GOOD CUSTOMER AND CONDUCT OUTCOMES?

Some banks, when compared to others, have more staff that responded favourably to survey questions about customer and conduct outcomes – examples of areas the survey explored included taking a customer perspective, and ensuring customer satisfaction with products and services. The data below shows the percentage of staff responding favourably to questions about these topics across the industry.

BANKS DIFFERED IN THEIR STAFF PERCEPTIONS OF CUSTOMER AND CONDUCT OUTCOMES

<table>
<thead>
<tr>
<th>PERCEIVED OUTCOMES</th>
<th>Banks with more staff with positive perceptions of customer and conduct outcomes(^1)</th>
<th>Industry average</th>
<th>Banks with less staff with positive perceptions of customer and conduct outcomes(^2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ensuring customer satisfaction of products and services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Satisfying customers when they complain</td>
<td>94%</td>
<td>89%</td>
<td>81%</td>
</tr>
<tr>
<td>Making sure customers are satisfied with products</td>
<td>88%</td>
<td>81%</td>
<td>71%</td>
</tr>
<tr>
<td>Helping customers understand products well</td>
<td>80%</td>
<td>68%</td>
<td>60%</td>
</tr>
</tbody>
</table>

\(^1\) Banks with more staff that have positive perceptions of outcomes = banks where the overall % favourable response on a set of survey questions relating to perceived customer and conduct outcomes was 1 standard deviation (SD) above the industry average.

\(^2\) Banks with less staff that have positive perceptions of outcomes = banks where the overall % favourable response on a set of survey questions relating to perceived customer and conduct outcomes was 1 SD below the industry average.

See details in Appendix (p. 39).
MORE BALANCED FOCUS

In banks where more staff have positive perceptions of customer and conduct outcomes, they also experience less emphasis on financial targets, and more on customer and conduct outcomes.

BALANCE IS ASSOCIATED WITH BETTER PERCEIVED CUSTOMER AND CONDUCT OUTCOMES

<table>
<thead>
<tr>
<th>Industry Average</th>
<th>Banks with more staff that have positive perceptions of customer and conduct outcomes</th>
<th>Banks with less staff that have positive perceptions of customer and conduct outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>People I work with prioritise fair customer outcomes over bank revenue. % Agree/Strongly Agree</td>
<td>74%</td>
<td>65%</td>
</tr>
<tr>
<td>In this bank, staff receive praise for treating customers fairly. % Agree/Strongly Agree</td>
<td>71%</td>
<td>60%</td>
</tr>
<tr>
<td>In this bank, staff believe they need to prioritise business targets over customer outcomes. % Disagree/Strongly Disagree</td>
<td>47%</td>
<td>30%</td>
</tr>
<tr>
<td>In this bank, staff are ranked based on their sales and/or revenue. % Disagree/Strongly Disagree</td>
<td>22%</td>
<td>9%</td>
</tr>
<tr>
<td>In this bank, incentives are mostly awarded for whether individual-level business targets are achieved or not. % Disagree/Strongly Disagree</td>
<td>21%</td>
<td>11%</td>
</tr>
<tr>
<td>In this bank, people who generate the most sales and/or revenue are highly respected. % Disagree/Strongly Disagree</td>
<td>18%</td>
<td>10%</td>
</tr>
</tbody>
</table>
INTERNALISING BANK VALUES

When there is less pressure to prioritise business results, staff may feel that better customer and conduct outcomes can be achieved, and that their behaviours are aligned to their bank’s values.

BALANCE IS ASSOCIATED WITH BETTER PERCEIVED CUSTOMER AND CONDUCT OUTCOMES

<table>
<thead>
<tr>
<th>Survey Item</th>
<th>Industry Average</th>
<th>Banks with more staff that have positive perceptions of customer and conduct outcomes</th>
<th>Banks with less staff that have positive perceptions of customer and conduct outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>I find my job to be meaningful.</td>
<td></td>
<td>76%</td>
<td>84%</td>
</tr>
<tr>
<td>% Agree/Strongly Agree</td>
<td></td>
<td>67%</td>
<td></td>
</tr>
<tr>
<td>I am motivated to progress my career with my current organisation.</td>
<td></td>
<td>76%</td>
<td>83%</td>
</tr>
<tr>
<td>% Agree/Strongly Agree</td>
<td></td>
<td>67%</td>
<td></td>
</tr>
<tr>
<td>People I work with discuss this bank’s values in our day-to-day activities.</td>
<td></td>
<td>65%</td>
<td>74%</td>
</tr>
<tr>
<td>% Agree/Strongly Agree</td>
<td></td>
<td>54%</td>
<td></td>
</tr>
<tr>
<td>In this bank, supervisors generally place pressure on staff to meet business targets.</td>
<td></td>
<td>24%</td>
<td>41%</td>
</tr>
<tr>
<td>% Disagree/Strongly Disagree</td>
<td></td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>In this bank, I would worry about losing my job if I missed my business targets.</td>
<td></td>
<td>24%</td>
<td>40%</td>
</tr>
<tr>
<td>% Disagree/Strongly Disagree</td>
<td></td>
<td>11%</td>
<td></td>
</tr>
<tr>
<td>In this bank, performance review conversations mostly focus on whether individual-level business targets are achieved or not.</td>
<td></td>
<td>23%</td>
<td>39%</td>
</tr>
<tr>
<td>% Disagree/Strongly Disagree</td>
<td></td>
<td>11%</td>
<td></td>
</tr>
</tbody>
</table>
REWARDING DESIRABLE BEHAVIOUR

SOME BANKS HAVE MORE STAFF WHO PERCEIVE HIGH STANDARDS OF BEHAVIOUR AMONGST THEIR COLLEAGUES

In banks where staff have more positive perceptions of customer and conduct outcomes, staff also perceive higher standards of behaviour amongst their colleagues— for example, maintaining ethical standards without using grey areas.

![Better Customer and Conduct Outcomes](image)

![High Standards of Behaviour](image)

EMPHASISING CERTAIN BEHAVIOURAL QUALITIES, RATHER THAN RESULTS, SUPPORTS BETTER CUSTOMER AND CONDUCT OUTCOMES

The survey asked respondents to select three words from a list of 30 that best described the characteristics encouraged by their bank’s incentive systems. Below are the top selected words that have 5% or more difference between groups of banks.
SUMMARY

KEY TAKEAWAYS FROM THIS SECTION

► **Differences in perceived customer and conduct outcomes.** Some banks, when compared to others, have more staff who respond favourably to questions about customer and conduct outcomes in their bank, such as fair treatment of customers and customer satisfaction with products and services.

► **More balanced focus.** In banks where more staff have positive perceptions of customer and conduct outcomes, they also tend to observe more emphasis on customer and conduct outcomes and less on financial targets.

► **Internalised focus on values.** In banks where more staff have positive perceptions of customer and conduct outcomes, they also tend to perceive less pressure to prioritise business outcomes, thus supporting internalisation of bank values.

► **Focus on behaviour.** In banks where more staff have positive perceptions of customer and conduct outcomes, they also observed more emphasis on sound culture and behaviours.
C. INITIAL OBSERVATIONS FROM DOCUMENT REVIEW

KEY INSIGHTS IN THIS SECTION

The document review is ongoing and only in its preliminary stages. The observations shared in this section of the interim report highlight some areas the Focused Review will explore further as it progresses, based on further data collection and integration between different sources of data.

Based on the information and documents provided by banks at this stage in relation to the design of remuneration frameworks and incentive systems, we explored the following questions to form initial understandings of industry practices as context for further progressing the Focused Review:

1. What is the objective of remuneration frameworks?
2. How do incentive systems reward financial performance?
3. How do incentive systems reward non-financial performance?

In response to these questions, we observed patterns across the industry. These patterns are described in more detail on the following pages.
1. INCENTIVES HAVE SEVERAL ROLES

Remuneration frameworks tend to have multiple purposes, and incorporate perspectives of different stakeholders within and external to banks.

OBSERVATIONS FROM DOCUMENTS

**REMUNERATION FRAMEWORKS SERVE MULTIPLE PURPOSES**

We observed that all selected banks referred to multiple objectives in their remuneration policies (see graphic on the right). Sometimes these objectives are complementary, such as sound risk taking and meeting legal and regulatory requirement, which broadly support risk management. However, it is also possible for different objectives to compete. For example, a conservative approach to promoting sound risk-taking may compete with certain aggressive approaches to rewarding staff performance and attracting and retaining talent.

**REMUNERATION FRAMEWORKS SUPPORT A RANGE OF STAKEHOLDERS**

Employees were the most common stakeholder named in the objectives of bank remuneration policies (see graphic on the right).

**REMUNERATION FRAMEWORK DESIGN AND IMPLEMENTATION REQUIRES INPUT FROM MULTIPLE FUNCTIONS**

Multiple internal functions were named as part of the design and operation of banks’ remuneration policies (see graphic on the right). These functions may provide diverse input on the ways that multiples objectives can be met, as well as consideration of different risks that can come about through the design of incentives.
2. FINANCIAL PERFORMANCE OUTWEIGHS NON-FINANCIAL PERFORMANCE

Staff prioritise behaviours in day-to-day work based on various considerations, including perceptions of activities that are most likely to earn them rewards. We observed that financial performance is often emphasised in incentive systems by the weighting of financial key performance indicators (KPIs), the number of opportunities for reward through financial performance, and the effect of supervisor incentives. When rewards are provided primarily around financial performance, it may motivate staff to focus disproportionately on these activities.

OBSERVATIONS FROM DOCUMENTS

FINANCIAL METRICS ARE WEIGHTED MORE THAN NON-FINANCIAL METRICS IN MANY BANKS

We observed that many banks tended to weight financial achievement more heavily than other performance objectives in calculating frontline staff incentives (see examples on the right). We also observed that financial KPIs were often capped at a higher achievement percentage (e.g., over 100% in some banks) compared to non-financial KPIs.

FINANCIAL PERFORMANCE CAN PROVIDE DIFFERENT TYPES OF REWARDS FOR FRONTLINE STAFF AND SUPERVISORS

We observed that social rewards, such as a high-performance ranking against peers or contribution to a team/branch reward, were used for high financial performance. We observed this across several TIPs where frontline staff, managers, or branches were ranked on their financial target achievement so that top performers could receive recognition.

Other team-based rewards for financial performance were observed in supervisor incentives. For example, top financially performing teams (i.e., where all team members exceeded their financial targets) could earn their supervisor a fixed incentive payment regardless of their performance on non-financial indicators.

MANY OPPORTUNITIES EXIST FOR STAFF TO MAXIMISE PAY VIA FINANCIAL PERFORMANCE

Many banks used tactical incentive programs (TIPs) in addition to their core incentive programs. These programs are short-term, non-regular incentive schemes that provide additional rewards to staff, and may thus emphasise financial performance. We also observed examples of non-linear payment structures such as accelerators and stepped increases, which increase the rate (or proportion) of rewards at higher levels of financial achievement.
3. NON-FINANCIAL FACTORS BEING LESS SALIENT

The structure of performance criteria and incentive calculations can provide implicit messages to staff about the relative value placed on various objectives. While we observed that non-financial performance is a factor in incentive systems, it was uncommon for non-financial performance to be used to provide staff with additional rewards in the same way as financial performance.

OBSERVATIONS FROM DOCUMENTS

REWARDING STAFF FOR ACHIEVING NON-FINANCIAL OBJECTIVES WAS LESS COMMON THAN PENALISING STAFF FOR NOT MEETING THEM

We observed limited examples of the use of rewards to drive achievement on non-financial factors (e.g., compliance, values-aligned behaviour, and customer outcomes). Instead, we observed that non-financial KPIs were used more often as a deduction mechanism for failing to meet objectives than as a booster for exceptional non-financial performance, with some deductions up to 100% of incentive amount (zeroing out).

LESS CAPACITY FOR STAFF TO ‘OUTPERFORM’ ON NON-FINANCIAL METRICS

We observed less opportunities for frontline staff to earn additional rewards through outperformance (i.e., above 100% achievement) on non-financial performance factors. An example we observed included the use of a ‘positive’ multiplier (e.g., 1.05x) applied to incentive calculations for staff who demonstrate complete compliance with all requirements.

NON-FINANCIAL KPIs WERE SOMETIMES USED TO ‘QUALIFY’ STAFF FOR INCENTIVES

We observed some examples of non-financial KPIs, such as for conduct and values, being used as qualifiers (also called ‘gate openers’) for incentives in performance assessments. Frontline staff may respond to this arrangement with motivation to achieve high standards of non-financial performance because it seems to be part of what earns them a reward.

More often, however, non-financial KPIs were framed as deductions or disqualifiers (also called ‘gate closers’) for incentives in performance assessments, applied retrospectively. As their achievements have already been calculated separately, frontline staff may respond by focusing on minimum standards of non-financial performance so that their reward is not taken away.

▲ Non-financial performance assessments were either used to qualify or disqualify staff for variable remuneration.
The Focused Review will be gathering more information on incentive practices. While the document review process remains ongoing, these observations of some key features of remuneration policies, and of established financial and non-financial performance metrics for frontline staff, are important in understanding the design of front office incentive systems in retail banks.

Initial observations show that incentive system design is complex. Documents reviewed so far show that: (i) banks often consider a range of objectives, stakeholders, and viewpoints when designing their incentive systems; (ii) financial performance can be more emphasised than non-financial, through heavier weightings, more opportunities to earn, and social or team-based benefits of high performance; and (iii) non-financial performance often have less opportunities for rewards, but can lead to penalties.
NEXT STEPS
In this interim report, we have highlighted a series of preliminary insights on the way incentive systems influence the behaviour of frontline staff. These insights are based on data collected through the industry-wide survey, as well as information and documents reviewed so far.

We emphasise that at this stage, our insights should be considered preliminary. As we undertake the second phase of the Focused Review, we will collect more data that will enable us to deepen our understanding and build on the insights generated so far. We have outlined some of the key questions that we will continue to explore as the review progresses.

**KEY QUESTIONS TO ADDRESS**

- How incentive systems drive behaviours of frontline staff, and how they affect customer outcomes in the sale and distribution of banking, investment, and insurance products.
- How to better align incentive systems and customer outcomes, and the role of incentive systems in minimising potential misconduct behaviour and mis-selling practices.
- What are the incentive practices that may help to achieve good customer outcomes, or contribute to poor customer outcomes.
IN CLOSING

As we continue the next phase of the Focused Review and undertake the remaining activities, the key questions outlined above will help shape some of our enquiry, as well as incorporating other, broader and/or more specific questions, as we continue to explore the data we have currently collected.

Combining factual and perception-based data will provide a more complete picture of incentives. The review will explore, challenge, and refine these observations in upcoming interviews, focus groups, and further document review.

Finally, as we close this interim report, we again thank the selected banks for their active participation so far, and look forward to their ongoing engagement and support as we continue with the Focused Review.
WHY COMPARE GROUPS OF BANKS

To more easily identify and highlight the factors that support banks to achieve better overall customer and conduct outcomes, it is useful to examine relative differences and similarities between the perceptions of frontline staff from different groups of banks. Specifically, we compared banks with more staff that have positive customer and conduct outcomes versus banks with less staff that have positive perceptions of customer and conduct outcomes.

WHAT SUPPORTS GOOD CUSTOMER AND CONDUCT OUTCOMES?

HOW THE ANALYSIS WAS CONDUCTED

Overall, the survey results were split into two segments: banks with more staff that have positive perceptions of customer and conduct outcomes, and those with less staff that have positive perceptions of customer and conduct outcomes. Differences between the two segments were then compared, in relation to their incentives systems and behavioural norms. Detailed steps undertaken as follows:

1. **Favourable Responses:** We calculated the percentage (%) of staff who responded favourably to a set of survey questions relating to customer and conduct outcomes.

2. **Banks with more staff that have positive perceptions of customer and conduct outcomes:** For the set of survey questions relating to customer and conduct outcomes, this group of banks had a percentage of favourable responses that was 1 standard deviation or more above the industry average.

3. **Banks with less staff that have positive perceptions of customer and conduct outcomes:** For the set of survey questions relating to customer and conduct outcomes, this group of banks had a percentage of favourable responses that was 1 standard deviation or more below the industry average.

4. **Comparisons:** The two groups of banks described above were then compared on their responses to other survey questions, to understand differences in their incentive systems and behavioural norms (results presented on pp. 25-28).

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1 Standard deviation (SD) is a statistical measure of the variation in data around an average. Scores that exceed 1 SD above or below the average can be considered as being markedly different to most others in the sample. The figure ‘Favourable responses on customer and conduct outcomes’ above outlines an example.