

National Australia Bank

Overview of misconduct

- 5.1 The Royal Commission has heard shocking cases of misconduct where NAB has put profits before its customers' best interests. NAB bankers were given envelopes 'stuffed with cash' for loan bribes¹, forged customers signatures and manipulated incentive programs to generate payments for themselves as part of an NAB program designed to capture home loan market share.
- 5.2 It was revealed that the NAB Introducer Program, which was in operation from 2013 to 2016, provided third parties ('introducers') with commission payments for referring home loan applications to NAB. The Interim Report noted that NAB had reviewed 11,000 files and had identified about 1,360 customers who may have been affected by the misconduct. However, 'NAB could say only that the amount it expected to pay out was between \$9 million and \$23 million' and had not offered compensation to any affected customers at the time of the hearing in March 2018.²
- 5.3 The Royal Commission heard evidence that hundreds of NAB financial advisors and their support staff falsely claimed to have witnessed more than 2500 forms signed by their customers. Furthermore, while the financial advisors were allowed to keep three-quarters of their bonuses, NAB has been slow to compensate the victims.³
- 5.4 It was revealed that NAB charged a default interest rate of 18 per cent to a farming family as they struggled to recover from flooding and later

1 B Butler, 'Bankers were given envelopes 'stuffed with cash' for loan bribes', *The Australian*, 14 March 2018, p. 1

2 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 13.

3 B Butler, 'NAB slow to compensate victims', *The Australian*, 25 April 2018, p. 17

battled drought. The Interim Report noted that NAB did not tell the customers about its hardship policy, or offer any relief under that policy.⁴

5.5 In addition to the cases of misconduct examined at the Royal Commission:

- NAB has been accused of not disclosing the full extent of a \$120 million customer refund to the Australian Securities and Investments Commission (ASIC) for 11 months and attributing the charging of fees for no service as a communication problem with its members.⁵
- In another fee-for-no-service scandal, ASIC has accused NAB's superannuation businesses NULIS Nominees and MLC Nominees of potentially breaching the criminal law on 77 occasions.⁶
- NAB agreed to settle its case with ASIC in relation to rate rigging for approximately \$50 million.⁷

Financial Services Royal Commission

5.6 The National Australia Bank Group (NAB) was the subject of four case studies in the Royal Commission's interim report, one for each of the first four rounds of hearings.

5.7 NAB CEO and Managing Director, Mr Andrew Thorburn, described the Royal Commission's interim report as fair and balanced despite the confronting and upsetting issues it exposed for NAB and the Australian banking industry.

5.8 NAB attributed the cause of misconduct to a 'drift' in focus from building relationships with customers to an emphasis on profit. Mr Thorburn stated:

I've been in banking for 30 years, and I think in the last 20 we've drifted. When you drift, you don't know that it is happening. It looks incrementally sensible, others are doing it and there's a system that reinforces it. Shareholders appreciate it if you're making good and better profits.⁸

4 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p. 418.

5 S Danckert, C Yeates & R Williams, 'NAB accused of not telling ASIC about \$120m refund', *Sydney Morning Herald*, 8 August 2018, p. 1.

6 B Butler & M Roddan, 'ASIC accuses NAB of \$100m super rip-off', *The Australian*, 7 September 2018, p. 19.

7 Australian Securities and Investments Commission (ASIC), 'ASIC accepts enforceable undertakings from ANZ and NAB to address conduct relating to BBSW', *Media Release 17-393*, 20 November 2017.

8 Mr Andrew Thorburn, Group CEO and Managing Director, National Australia Bank Group (NAB), *Transcript*, p. 17.

- 5.9 A theme throughout the inquiry was concern about the extent to which instances of misconduct have either gone unpunished or the consequences have not reflected the seriousness of what has occurred.
- 5.10 NAB informed the committee that more than ten staff were terminated as a result of the Royal Commission. Mr Thorburn stressed that NAB was being more vigorous in its evaluation of staff over the past year. For example, 700 staff had a reduction in their variable pay. Of these over 300 either were terminated or resigned as a result of investigations into their conduct.
- 5.11 Mr Thorburn noted the majority of NAB's 33,000 staff act with integrity and the actions of a 'vast minority... have had a tremendous impact on our reputation'⁹ However, the Royal Commission's interim report was particularly critical of this idea:
- That generally similar conduct occurred in all of the major entities suggests that the conduct cannot be explained as 'a few bad apples'.
- That characterisation serves to contain allegations of misconduct and distance the entity from responsibility. It ignores the root causes of conduct, which often lie with the systems, processes and culture cultivated by an entity.¹⁰
- 5.12 Mr Thorburn acknowledged that misconduct identified in the interim report and by the committee was also the result of systemic failures in processes to manage risk and compliance.

Reforms to remuneration

- 5.13 The committee was particularly critical of executive remuneration and poor accountability. The committee scrutinised NAB about the consequences for executives when misconduct was identified.
- 5.14 Mr Thorburn responded that senior executives are judged against a performance plan and if they failed to deliver, their variable reward will be reduced. Mr Gall added:
- At the senior level, a number of executives will have deferred compensation – it is earned in previous years. If it's a serious act of malfeasance, they will lose that deferred equity as well.¹¹

9 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 14.

10 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, Vol 1, p. 87.

11 Mr David Gall, Chief Customer Officer, Corporate and Institutional Banking, NAB, *Transcript*, p. 5.

- 5.15 The committee also pressed NAB on their reforms to remuneration structures more generally. Mr Thorburn insisted NAB had improved remuneration structures over time when he stated:

Since we've been coming here to this committee, we've progressively made changes. And the royal commission has really forced us to look at some of the issues to correct them further.¹²

- 5.16 However, the committee continued to probe NAB on reforms to remuneration given the strong link between incentives and misconduct highlighted in the NAB introducer case study in the interim report:

The evidence shows that from as early as April 2015, NAB was aware that one of the potential root causes of the conduct was the Star Sales Incentive program that the relevant bankers were operating under, which rewarded bankers with bonuses for achieving certain targets for the sale of home loans. The investigation of the conduct confirmed that the incentive program was driving inappropriate behaviour.¹³

- 5.17 Mr Thorburn insisted the performance management system, which 97 per cent of NAB staff are evaluated under, had been reformed. Like the other major banks NAB uses a balanced score card that gives more weight to compulsory customer service and risk measures than the financial or sales component.

- 5.18 Mr Thorburn assured the committee the variable or bonus pay received by NAB staff was very much dependant on their ability to demonstrate behaviours consistent with NAB's customer-centric values. This included his own remuneration, as Mr Thorburn explained:

It [the board] looks at my performance and all the issues inside the bank, and the good things the bank has done as well as the mistakes and reputation issues. It takes that into account in determining any variable reward I get.¹⁴

Customer remediation

- 5.19 The committee asked for an update on NAB's progress in remediating customers affected by misconduct, particularly those customers affected by NAB's wealth business.

- 5.20 On 16 October 2018, NAB announced an additional \$314 million would be set aside for refunds and compensation to customers affected by issues in

12 Mr Andrew Thorburn, Group CEO, National Australia Bank (NAB), *Transcript*, p. 5.

13 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 2, p 7.

14 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 27.

- NAB's wealth business, including advisor service fees, plan service fees the costs of implementing remediation processes and compliance.¹⁵
- 5.21 Mr Thorburn also noted over recent years NAB has already provided about \$200 million in remediation. However, Mr Thorburn also stated 'I acknowledge that we've taken too long to find it and fix it.'¹⁶
- 5.22 The committee pressed NAB on the pace of the remediation arguing that despite acknowledging the misconduct the major banks were far too slow to inform and remediate customers. An observation also made in the Royal Commission's interim report.
- 5.23 Mr Gall confirmed in the case of planned service fees most customers have been reimbursed. However, NAB was still working through customers who are owed refunds for adviser service fees and some of these clients would not yet have been informed.¹⁷
- 5.24 Mr Thorburn advised the committee the delays were due to getting access to data and systems over the past 10 years but given the resources NAB is devoting to remediation; NAB intends to complete this process by 2019.
- 5.25 The committee also asked NAB whether it was willing to go further than refund customers and provide compensation for the mental health impacts some customers has suffered as a result of their disputes with NAB.
- 5.26 Mr Thorburn noted this has occurred in some particularly complex farm dispute cases but it was not a regular practice. Mr Thorburn added:
- the compensation does include an additional amount for the emotional grief they've been through. It's not a specific process that's separate to that, but I do think we try to include that to be a bit more generous to cover that.¹⁸
- 5.27 The committee asked NAB to report back on the progress of its remediation work including the number of customers who have been remediated and the dollar figures received. Mr Thorburn agreed this could be done at the next round of hearings.

15 NAB, 'NAB announces additional costs for customer remediation matters', *ASX announcement*, 16 October 2018.

16 Mr Andrew Thorburn, Group CEO, National Australia Bank (NAB), *Transcript*, p. 15.

17 Mr David Gall, Chief Customer Officer, Corporate and Institutional Banking, NAB, *Transcript*, p. 14.

18 Mr Andrew Thorburn, Group CEO, National Australia Bank (NAB), *Transcript*, p. 16.

CEO actions to address customer complaints

- 5.28 Throughout the hearing the committee sought to identify the specific actions taken by Mr Thorburn to demonstrate he understood the effect of a dispute with NAB for individual customers.
- 5.29 Mr Thorburn estimated he had met with about 20 aggrieved customers to listen to their issues and assured the committee other senior NAB officials have reviewed several more customer files.
- 5.30 Mr Thorburn, like ANZ CEO, Mr Elliott, gave out his email address so NAB customers could contact him directly and request NAB review their cases. Mr Thorburn stated:
- I come back to my offer that, if there are National Australia Bank customers, I would be happy for them to contact me directly on andrew.thorburn@nab.com.au.¹⁹
- 5.31 The committee asked what a customer should expect from NAB if they chose to contact Mr Thorburn, to which Mr Thorburn responded:
- What they should expect from me and from our company is a prompt response and a review within a reasonable period of time to suggest some next steps. Often, that will probably involve suggesting some mediation²⁰
- 5.32 The committee intends to follow-up at future hearings on efforts of CEOs to improve complaints handling mechanisms and the pace of remediation.

Complaint handling mechanisms

- 5.33 The committee focused on interrogating the improvements NAB had made to complaint handling processes.
- 5.34 Mr Thorburn noted NAB had introduced centralised a customer complaint and resolution team, resourced with over 100 staff to deal with current customer issues.²¹
- 5.35 In addition, NAB uses a central system to collect information on all complaints which ensures consistent reporting across the bank.
- 5.36 Like the other major banks, Mr Thorburn reported NAB has given greater attention to complaints at more senior levels. Monthly reports are discussed at board level and in the case of material remediation; Mr Thorburn reported he has met with senior executives to monitor the progress of these cases.

19 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 7.

20 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 10.

21 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 11.

- 5.37 Mr Gall reported to the committee that NAB has roughly halved the time taken to remediate customers.²²
- 5.38 Mr Thorburn noted that NAB also has an independent customer advocate, an avenue that helped resolve simpler retail complaints. However, Mr Thorburn observed more challenging complaints can arise in business or farm lending with larger amounts. Mr Thorburn acknowledged NAB would need to help these customers reach a mutually beneficial outcome.

Bank Executive Accountability Regime

- 5.39 Like the other major banks, NAB was positive about the introduction of the Bank Executive Accountability Regime (BEAR).
- 5.40 Regarding the implementation of the BEAR, Mr Thorburn stated 'I would say it's more than helpful. It has been really good at helping us understand clarity for accountability for executives.'²³
- 5.41 Mr Thorburn told the committee that 22 NAB directors and executives are registered with APRA as part of the BEAR.²⁴
- 5.42 The committee pressed Mr Thorburn to explain how the BEAR has changed NAB's operations. Mr Thorburn stated NAB worked through a series of case studies to identify gaps in accountability. For example, Mr Gall noted the BEAR had been helpful in cases where:
- Typically, it's where the service or the process that we're doing crosses multiple divisions across the organisation. That might be multiple customer divisions, but it might also be end-to-end, so making sure that that accountability is understood right through from the customer-facing to the operations and technology areas.²⁵
- 5.43 Mr Thorburn noted BEAR statements were an important feature of the annual performance discussions he had with NAB executives.
- 5.44 The committee was assured a senior NAB executive covered by the BEAR was responsible for oversight of the customer remediation process.

22 Mr David Gall, Chief Customer Officer, Corporate and Institutional Banking, NAB, *Transcript*, p. 29.

23 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 12.

24 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 12.

25 Mr David Gall, Chief Customer Officer, Corporate and Institutional Banking, NAB, *Transcript*, p. 12.

Competition in the financial system

- 5.45 The degree of competition in the financial system was also raised in the NAB hearing. The committee sought NAB's view on whether a lack of competition had protected the profitability of the major banks despite scandals prior to the Royal Commission.
- 5.46 Like each of the CEOs before him, Mr Thorburn asserted there was a strong degree of competition in the financial system. The committee pressed Mr Thorburn on this point, again citing findings from the Productivity Commission's Inquiry into Competition in the Financial System.
- 5.47 In particular, the committee focused on the combined market shares of the major banks, noting as a group they are the dominant force that controls the market. The Productivity Commission stated that this gives:
- ...the major banks the ability to pass on cost increases and set prices that maintain high levels of profitability – without losing market share.²⁶
- 5.48 Mr Thorburn would not engage on this point, rather he focused on NAB's individual performance and listed a range of competitors including:
- You've got brokers, you've got fintech players and you've got foreign banks... We've got new, direct banks getting provisional or full licences from APRA competing against us... There are regional banks at play now. There's Bendigo Bank, Bank of Queensland, Suncorp... so it feels today, as a competitor in the market, it's as tough as it ever was.²⁷
- 5.49 The committee countered with further examples of Productivity Commission research on estimates of the pricing power of Australian-owned banks.²⁸
- 5.50 The analysis showed the four major banks are the dominant force in the Australian market, able to charge prices above their costs. Mr Thorburn responded by noting another observation from the Productivity Commission:
- Banks' net interest margins and return on equity – both important indicators of profitability – declined substantially over

26 Productivity Commission, 'Competition in the Australian Financial System', *Inquiry Report*, No. 89, 29 June 2018, p. 104.

27 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 22.

28 Productivity Commission, 'Competition in the Australian Financial System', *Inquiry Report*, No. 89, 29 June 2018, p. 9.

the past three decades, as a result of deregulation and the rise of brokers.²⁹

5.51 Mr Thorburn characterised deregulation and the rise of brokers as signs of competition. Mr Thorburn also defended the need for a profitable bank for employees, customers and shareholders.

5.52 However, Mr Thorburn acknowledged, profit above all other objectives had led to misconduct and resulted in the opprobrium faced by the major bank CEOs when he stated:

...we are being punished. Good morning; we're here. I think we have been punished because of what's happened in the last two years, where, by our own admission, we've fallen short of community and customer standards. This committee and the royal commission have laid that bare.³⁰

Small-medium enterprise lending

5.53 Mr Thorburn described NAB 'as Australia's largest business bank' because NAB is more rapidly expanding its share of business lending than the other major banks. Mr Thorburn estimated NAB was increasing its growth in business lending by about 4 to 5 per cent.³¹

5.54 Mr Thorburn told the committee that part of the expansion in business lending was owing to the introduction of an unsecured lending facility for small businesses called 'QuickBiz'.

5.55 Mr Thorburn explained the difficulty which prevents some SMEs from obtaining loans is the lack of physical security or three to five years of history.

5.56 However, Mr Thorburn recognised '...a lot of the businesses are good, well-run, cash-flow businesses' therefore when questioned on this topic he asserted NAB was active in the business lending market.³²

5.57 The committee sought to confirm if NAB had implemented the recommendations from the Carnell review, particularly the removal of non-monetary default clauses. Mr Thorburn confirmed NAB had implemented the recommendations.

29 Productivity Commission, 'Inquiry into Competition in the Australian Financial System', *Final Report*, August 2018, p. 115.

30 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 22.

31 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 12.

32 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 6.

- 5.58 Mr Thorburn highlighted the special concession NAB made to agribusiness customers including ending the use of default interest rates for farmers in drought-declared areas.
- 5.59 However, the committee pressed NAB to explain why it had not extended this concession more broadly to all businesses in drought affected areas. Mr Thorburn explained:
- We dealt with what we knew and could in a fast way, which was: agri-clients in drought-affected areas, because drought-affected is one particular part, but agri-clients, because of the nature of their cash flow and commodity prices and things like that, are particularly vulnerable. So that is why we did that.³³
- 5.60 Mr Thorburn informed the committee he was awaiting a broader review of default interest rates and more could be done to assist customers noting ‘...we’ve become too complex. There are too many products and too many specific legal clauses not in plain English. I do acknowledge that.’³⁴

Access to credit

- 5.61 The committee asked NAB for its view on the need for further regulation in the financial system noting the observation made in the Royal Commission’s interim report:
- I begin from the premise that breaches of existing law are not prevented by passing some new law that says ‘Do not do that’. And given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity.³⁵
- 5.62 Mr Thorburn agreed there is a case for simplification of existing regulation noting ‘We’re collecting a lot of information. We’re sending it to different agencies and regulators. They could be coordinated more.’³⁶
- 5.63 Mr Thorburn also affirmed the need for greater enforcement of existing laws and higher penalties but cautioned very harsh penalties could restrict the supply of credit. Mr Thorburn observed:

33 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 24.

34 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 25.

35 Commissioner Hayne, ‘Financial Services Royal Commission’, *Interim report*, Vol 1, pp. 289-290.

36 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 28.

The role of a bank is to manage and take risk. We're always going to be, in the case of a customer extending credit, making a judgement and it may not work out. What you don't want to have is penalties which are so severe that the bank actually steps back from doing what it fundamentally should do, which is extend credit into the economy.³⁷

- 5.64 The Royal Commission's interim report acknowledged banks play a special role in the economy by providing credit.
- 5.65 However the interim report observed the ability of banks to set their risk appetite, meaning they can decide to whom they lend and on what terms, gives them significant power over an individual customer.³⁸
- 5.66 The committee weighed the need for banks to provide credit and comply with regulations when questioning NAB on the need for further regulation to make banks more accountable. In response, Mr Thorburn asserted 'regulation isn't the panacea.'³⁹
- 5.67 Mr Thorburn rejected the connection between the tightening of credit during the GFC and the misconduct highlighted in the Royal Commission. Mr Thorburn instead attributed the misconduct to failures in bank systems to prevent fees for no service, for example 'what we did wrong...we didn't have proper controls and we didn't raise them and fix them fast enough.'⁴⁰
- 5.68 When pressed to explain how the banks could fix previous issues and prevent them from reoccurring without further regulation, Mr Thorburn repeated the point about simplification and enforcement:

I think we've got more regulation today than we've had, yet we've still got problems. I think they could be simplified, and we could be held to account a bit more.⁴¹

Mortgage brokers

- 5.69 On the role of mortgage brokers, Mr Thorburn observed their rise in popularity since the mid-1990s filled a gap left by the banks, 'the banks weren't really focused on existing clients and really wanting to deal with them and help them.'⁴²

37 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 28.

38 Commissioner Hayne, 'Financial Services Royal Commission', *Interim report*, vol 1, p. 269.

39 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 32.

40 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 31.

41 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 32.

42 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 20.

- 5.70 Mr Thorburn observed mortgage brokers now originate more than 50 per cent of home loans, cementing their place in the home loan market; however, he conceded some changes are necessary.
- 5.71 When asked if a best interests duty should be applied to mortgage brokers Mr Thorburn endorsed mortgage brokers stating 'increasingly, they're becoming more licensed and more professional.'⁴³
- 5.72 Mr Thorburn emphasised NAB takes its responsible lending obligations seriously and does not rely on brokers to assess the suitability of loans for its customers:
- We make that decision ultimately as to whether we'll extend credit to the customer. We look at their income. We definitely go through, in a great deal of detail, their expenditure to make sure they can afford it.⁴⁴
- 5.73 The committee asked NAB for its view on whether a fee for service would be a more appropriate remuneration structure for brokers rather than an upfront and trail commission. Mr Thorburn replied:
- ...when the Sedgwick report was done, there was a conversation about: should they be paid an up-front fee for a simple and a complex loan, and should we make it clearer, when we pay a trail to them – obviously that's disclosed – what they need to do for that? I think those things, right now, are under really serious investigation by our bank and also by the industry itself.⁴⁵

Branch closures

- 5.74 In his opening address, Mr Thorburn told the committee NAB is reviewing its branch network and considering new ways to retain face-to-face banking.
- 5.75 For example, NAB reversed its decision to close branches in Narooma and Dungog in regional NSW. In addition, NAB has put a moratorium on the closure of 130 branches in drought affected areas.⁴⁶
- 5.76 Mr Thorburn noted NAB employees around 7,000 people in its retail branches.

43 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 10.

44 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 20.

45 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 10.

46 Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 8.

Code of conduct for legal disputes

- 5.77 The committee asked NAB if it was a model litigant, meaning it had never used its superior resources to dissuade a customer from taking legal action.
- 5.78 Mr Thorburn admitted he could not confirm NAB had never been overbearing in a legal dispute, noting:
- In most cases we get it right but I'm absolutely certain that in some cases we have been more overbearing and more technical and more legal than we should have been, and that is something that I would like to step into and address as we go forward.⁴⁷
- 5.79 Mr Thorburn also agreed it was a good idea to develop a standard to ensure customers had a better experience during a dispute resolution process.

Tim Wilson MP
Chair
5 December 2018

⁴⁷ Mr Andrew Thorburn, Group CEO, NAB, *Transcript*, p. 6.