NAB SELF-ASSESSMENT

on governance, accountability and culture

November 2018

National Australia Bank Limited ABN 12 004 044 937 AFSL and Australian Credit Licence 230686.

FOREWORD

On the day of its release in May 2018, NAB's Board and Executive Leadership Team discussed APRA's Prudential Inquiry into the Commonwealth Bank of Australia (CBA). We asked ourselves this question: "if you replaced every instance of "CBA" with "NAB", to what extent would the findings of that inquiry remain valid?" Subsequently, APRA formally requested that we conduct an in-depth self-assessment to answer that question.

In undertaking the self-assessment, we have explored our governance, accountability and culture frameworks and practices, in some areas going beyond the issues highlighted at CBA. Many of the findings from the CBA review resonate at NAB. Many do not. And there are other issues that we have identified that may be unique to NAB, but of no lesser importance.

Our self-assessment comes at a time when we have been confronted by the Royal Commission's examination of various conduct matters, both at NAB and across the financial services sector. The Royal Commission has been a necessary and important process to make our sector stronger, and an opportunity that we at NAB have welcomed.

The matters that have received attention have led to deep reflection within NAB and recognition that we have not met the standards our customers are entitled to expect of us. The Board takes these matters seriously. They should have been dealt with better and faster.

The self-assessment process was led by the Board. It has provoked considerable introspection, motivating us to shine a sharper light on weakness in our governance, accountability and culture frameworks and practices and explore the extent to which they might explain instances of poor regulatory compliance and unsatisfactory outcomes for our customers.

It revealed that we do a good job of many things, most of the time. But we certainly don't get it right for all of our customers, every single time. And we have a long way to go to achieve our vision, to be 'Australia's leading bank, trusted by customers for exceptional service'.

Too often the voice of the customer has been missing from our decision-making. And too often we have been prepared to accept good intentions rather than hold ourselves to account for operating with the required degree of urgency, consistency and discipline.

We have been reluctant to set exacting standards and have not moved quickly enough to address weaknesses when they were recognised.

We must take action to better manage our non-financial risks. And we are. We are tackling complexity and investing to ensure our systems and processes support our people to consistently deliver regulatory compliance.

We are creating clearer lines of accountability, lifting our expectations of leaders and ensuring our remuneration framework incentivises the right behaviours, at all levels, to support and build the culture we want.

At the Executive level, we are measuring and incentivising performance for the long-term and in the interests of all stakeholders, particularly our customers. Where NAB falls short, the Board has greater discretion to hold leaders accountable and this is reflected in the significantly reduced remuneration outcomes for 2018.

We are working to better understand customer complaints and deal with persistent issues. And we are working to fix problems faster and better. But we have more to do.

The self-assessment has identified the need for further improvements across the bank. These too will be actioned.

We accept that we will be assessed on the changes we make and the actions we take to put customers first. We know that trust is the foundation for a sustainable business. We understand that we will rebuild trust only by demonstrating that we exist to serve customers.

Of course, the ability to provide a good return to our shareholders is essential. We cannot operate without reliable access to risk capital. But profitability should not be confused with purpose. We have articulated our purpose in these terms: 'back the bold who move Australia forward'. Our purpose emphasises the role we play in backing families, businesses, communities and, more broadly, national economic and social development.

The Board is determined to earn the trust of our customers and the community, and is ambitious to achieve our vision and purpose.

We value the insights of our customers and our people, and thank those employees who contributed to this self-assessment. We accept the challenges identified through this process and take full accountability for driving improvements in our business.

Ken Henry AC
Chairman

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EXECUTIVE SUMMARY

This report is the outcome of NAB's self-assessment into the effectiveness of the bank's governance, accountability and culture frameworks and practices, undertaken at APRA's request.

The NAB Board, working closely with NAB's Executive Leadership Team, was heavily involved to ensure that the self-assessment had sufficient depth, challenge and insights to result in meaningful action and change.

KEY FINDINGS

Overall, while the self-assessment identified many strengths, it also identified significant shortcomings in certain aspects of NAB's approach to non-financial risk management.

Weaknesses were found in areas such as conduct, compliance and the integrated management of operational risk.

NAB did not bring enough focus to customer outcomes, did not set exacting enough standards, and did not move quickly enough to address weaknesses when they were recognised.

In the instances where NAB fell short, one or more of the following characteristics were present:

Customers' interests weren't always placed at the forefront of decision-making.

NAB has not consistently elevated customer considerations through decisions, oversight and risk management, too often focusing simply on what was expedient for NAB.

NAB's approach to managing compliance and conduct risk was not sufficiently robust or effective.

NAB's approach to compliance has lacked rigour and discipline, and the voice of the Compliance function has been too weak. NAB has been slow to develop an effective approach to managing conduct risk.

Leaders too often weren't clear enough on who was accountable for resolving complex cross-divisional issues, and the bank was too tolerant of slow progress.

Accountability for important issues was often left unclear by senior leadership, particularly when matters crossed divisions. Failures and delays were too readily accepted, with 'complexity' frequently blamed.

Remuneration and performance management didn't consistently and visibly sanction poor behaviour or reward good behaviour.

NAB's approach to assessing behaviours and outcomes, and rewarding or disciplining individuals, hasn't historically been robust and targeted enough. This has undermined the development of NAB's desired culture.

And importantly, at times NAB's Board and senior executives weren't as inquiring, challenging and demanding as they should have been.

There were times when the Board and senior executives, in their oversight roles, should have set higher expectations for leaders, been more focused on customer outcomes, and been more relentless about issues being fixed.

NAB'S CULTURE

The self-assessment looked deeply into NAB's culture to better understand why these characteristics existed. In most instances, NAB's people acted in accordance with the bank's values. However, five cultural inhibitors were evident in the situations where the bank did not live its desired culture.

The inhibitors, as described below, are an articulation of the many and varied observations across all levels of the bank and can be seen as a root cause for many of the shortcomings identified in this report. They are written from the perspective of NAB's people, Board and Executive Leadership Team.

EXECUTIVE SUMMARY

1. We haven't brought the rigour and discipline required to get it right every single time.

   We encouraged a 'get it done' attitude, at the expense of enforcing strict disciplines about what gets done where, and how it gets done. Further, we have not been ruthless in consolidating and decommissioning systems and keeping them up to date. We allowed complexity to grow. We also appointed generalist leaders in roles requiring specialist expertise, hindering our response to issues.

2. We have over-relied on our people to make up for deficiencies in our systems and processes.

   Too often we defaulted to the collaboration, discretionary effort and goodwill of our people particularly those who interact every day with our customers instead of building better processes, systems and tools to support them.

3. We have not consistently brought the collective intensity or individual resolve required to fix complex issues.

   The bank is often seen at its best in a crisis, where we tackle issues decisively and work together to solve urgent problems. This sense of urgency has not always translated to our everyday actions. Senior leaders have been unwilling to take accountability for resolving complex issues that extend beyond their direct spans of control. We have not consistently recognised that customer detriment is a crisis.

4. We have not listened to or learned enough from our customers, regulators and employees.

   Where we've gone wrong has usually been preceded by internal or external signals and warnings. Despite this, we have been too quick to create and accept a convenient narrative to explain our decisions, actions and mistakes. This means we've responded late, and missed or resisted signals that challenged our existing position and presented an opportunity to purposefully question our viewpoint.

5. While we have a strong commitment to customers, we have too often put other priorities first.

   We too rarely asked what the impact of our decisions would be for our customers. We failed to be guided by the reality that good customer outcomes are critical to sound financial performance. We let the perception evolve among employees that delivering on short-term financial results remained the primary focus, despite extensive changes to remuneration frameworks.

HOW NAB'S RESPONDING

Overall, the Board remains of the view that the bank continues to appropriately manage the financial risks it faces – and specifically the credit, market and liquidity risks which underpin prudential strength and stability. However, the self-assessment underlined that significant improvements are needed in aspects of non-financial risk management. Without such improvements, NAB will remain some distance away from its vision of being ***'Australia's leading bank, trusted by customers for exceptional service'***.

Management has identified a clear set of actions that will complement the transformation under way and to help earn back the trust of customers and the community.

NAB has more to do to bring the voice of the customer firmly into its decisions and governance, accountability and risk management practices. This must be supported by embedding the right skills and capabilities and lifting significantly the bank's investment in, and focus on, conduct and compliance.

NAB will overhaul its approach to the way it identifies, manages and fixes issues, particularly when they affect customer outcomes. And leaders will focus heavily on developing the disciplined culture the bank aspires to, reinforced by sound remuneration, performance and consequence management frameworks.

The full set of actions can be found in Chapter 10: Actions.

The Board will discuss and review the self-assessment's findings with APRA, with updates to be provided to customers, employees and shareholders through regular reporting mechanisms such as NAB's annual reporting.

Senior leadership is resolute in its ownership of these changes and the Board will be vigilant in its oversight of the adequacy and sustainability of their implementation.

1. INTRODUCTION

1. INTRODUCTION

1.1 SCOPE OF THE SELF-ASSESSMENT

On 1 May 2018, APRA released the Final Report of the Prudential Inquiry into Commonwealth Bank of Australia (the APRA Inquiry). NAB's Board and Executive Leadership Team (ELT) immediately recognised the value of assessing whether similar issues might exist in NAB. Shortly thereafter, APRA wrote to NAB requesting that NAB produce a report assessing its governance, accountability and culture frameworks and practices in the same way that APRA had done for Commonwealth Bank of Australia (CBA). This report is the outcome of that self-assessment.

In this self-assessment, the definitions of the three core themes in the APRA Inquiry report have been adopted as follows:

- Governance: the way in which decisions at NAB are made, including how financial objectives, values and strategic priorities impact on decision-making and risk management, and how decisions once made are implemented.
- Accountability: the way in which NAB employees, both individually and collectively, fulfil their responsibilities and the consequences of them not doing so.
- Culture: the norms of behaviour for individuals and groups within NAB that determine the collective ability to identify, understand, openly discuss, escalate and act on current and future challenges and risks.

The objectives of the self-assessment were to:

- Form conclusions on the current strengths and any shortcomings regarding the application and effectiveness of NAB's governance, accountability and culture frameworks and practices.
- Identify responses to those conclusions aligned to NAB's vision to be Australia's leading bank, trusted by customers for exceptional service.

The scope of the self-assessment was confined to recent business practices and prevailing culture, having considered evidence, as described below, dating back to five years ago.

Consistent with the approach taken by the APRA Prudential Inquiry into CBA, the self-assessment considered eight separate but interconnected areas: the role of the Board; senior leadership oversight; risk management and compliance; issue identification, escalation and resolution; financial objectives and prioritisation; accountability; remuneration; and culture.

In line with APRA's request, this self-assessment incorporated:

- Depth: enabling the Board to assess whether governance, accountability and culture are embedded in the practices and behaviours and enforced within the various levels and across the bank.
- Challenge: self-challenge to provide the Board with fresh perspectives of the strength of governance, accountability and culture within NAB.
- Insights: to inform the Board of areas requiring attention and improvement, and how better practice can be achieved.

Further, APRA instructed that the scope should be "group-wide, covering all material cross-industry operations in Australia". Matters related to specific divisions, including the bank's operations in New Zealand, were considered where they received or warranted Group-level attention and were relevant to the assessment of NAB's governance, accountability and culture frameworks and practices.

While the review included an assessment of NAB's management of the material risk categories to which the bank is exposed, it focused largely on those categories where there have been recent incidents and where there are shortcomings. For NAB these primary categories of concern relate to non-financial risks, being operational, compliance and conduct risks.

NAB defines operational, compliance and conduct risks as follows:

- Operational risk: The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This includes legal risk, but excludes strategic or reputation risk.
- Compliance risk: The risk of failing to understand or comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary incentives, and internal policies, standards, procedures and frameworks.
- Conduct risk: The risk that any action of the Group, or those acting on behalf of the Group, will result in unfair outcomes for customers.

Responses for addressing identified shortcomings were considered in light of existing initiatives and programs of work, particularly the program of work to accelerate NAB's strategic transformation. Many of the reported shortcomings were known before the self-assessment, with work already under way to address them.

1.2 GOVERNANCE AND MANAGEMENT OF THE SELF-ASSESSMENT

This self-assessment report has been endorsed by the Board.

Consultation with and review by Board

The Board remained engaged and was consulted throughout the self-assessment.

A sub-group of the Board comprising the Board Chairman and the Chairs of the Board Risk Committee, Board Audit Committee and Board Remuneration Committee met regularly with the self-assessment review team to consider emerging findings, how they were being articulated in the report, and proposed responses. Additionally, all members of the Board reviewed the full report and had an opportunity to provide individual input into it before it was endorsed by the Board.

1. INTRODUCTION

Engagement with Executive Leadership Team

A high level of engagement and interaction was maintained with the ELT throughout the self-assessment. This was facilitated through multiple workshops with:

- the ELT; and
- a sub-group of four members of the ELT.

This was done in order to communicate and help validate emerging observations and findings and to seek input to the development of actions to respond to observations.

Advisory Committee

An Advisory Committee was set up to provide direction to the review team. It consisted of a small group of senior leaders from customer-facing divisions, Commercial Services, Technology & Operations, and Risk.

Self-assessment review team

The review team consisted of NAB subject matter experts supported by a team from PwC.

PwC was engaged to provide advice on the design of the self-assessment and the methodologies used, to support the review team's activities, and to bring external challenge and insights to the NAB team.

1.3 APPROACH TO THE SELF-ASSESSMENT

The self-assessment included a range of activities to evaluate strengths and shortcomings regarding the application and effectiveness of NAB's governance, accountability and culture frameworks and practices:

- documentation review;
- interviews;
- case studies; and
- focus groups.

The review team has also taken into account the outcomes from the August 2018 Employee Engagement Survey to complement the analysis, particularly in relation to risk culture. Other key reports considered include the report of the Assessment of NAB's Risk Management Framework (CPS 220 Comprehensive Review), conducted by Ernst & Young in September 2018 as part of the triennial review mandated by APRA Prudential Standard CPS 220: Risk Management (CPS 220).

Each of these activities is discussed in more detail below.

Document review

In excess of 1,000 documents and papers were reviewed, typically dating back 12 to 24 months. These documents included: frameworks; policies; standard operating procedures; charters and terms of reference; Audit and Risk reports; regulator correspondence and reports; Board, Board sub-committee and management risk committee agendas, meeting papers/reports and minutes; and reports prepared by external parties.

Board and management interviews

More than 50 formal interviews were conducted with an extensive range of stakeholders including:

- non-executive directors;
- the Group Chief Executive Officer and Managing Director (CEO) and ELT (current and previous);
- a number of Executive General Managers (EGMs) and General Managers (GMs), Internal and External Audit, the Group Company Secretary, and the Independent Customer Advocate (Bank); and
- representatives from two key regulators.

In addition to these interviews, workshops were held with the ELT and the Risk Leadership Team (consisting of the Group Chief Risk Officer (Group CRO) and direct reports) to facilitate group discussions. There were also multiple subsequent workshops with members of the ELT and other senior management across the bank.

Case studies

Three specific incidents were selected for review as case studies. The analysis of these incidents involved examining evidence dating back five years. These were the primary case studies:

- Securities in Order (SIO): concerned an issue, first identified in March 2014, regarding the ineffective design of processes to ensure security documents were 'in order' (i.e. signed, sealed, checked and filed before being used as security for a loan draw down).
- Introducer Fraud: concerned misconduct in connection with home loan applications submitted through the NAB Introducer Program between 2013 and 2016.
- Enterprise Data Management Strategy and Governance Weaknesses: concerned the management of information and data as a strategic asset after both management and APRA highlighted the need for improvement in 2013.

In addition to these three primary case studies, other incidents were analysed to provide additional perspectives on the governance, accountability and culture frameworks and practices of NAB.

As for the primary case studies, the evidence considered in relation to these other incidents dated back a number of years. Where relevant, these other incidents are identified in the body of the report.

Focus groups

A total of 23 focus groups were conducted across the bank in Melbourne, Perth, Brisbane, Maroochydore, Sydney and Wollongong. Over 150 employees from across NAB took part in the focus group sessions, including senior leaders, branch managers, customer-facing teams and operations teams. The sessions were independently facilitated by PwC (without NAB review team members present) requiring participants, among other things, to identify factors at NAB that could contribute to a significant negative impact on customer outcomes and/or the reputation of the bank.

1. INTRODUCTION

Customers

Particular attention was paid to customer outcomes throughout the four self-assessment activities and by supplementing them with further specific activities involving NAB's internal customer-focused functions: reviewing customer complaints data; considering insights from the Independent Customer Advocate (Bank); examining customer data collected by Customer Journey teams; meeting representatives of Customer Advisory Councils; considering Customer Experience Board meeting materials; and reviewing the results of a complaints data pilot.

Self-assessment criteria

In forming conclusions on the strengths and shortcomings of the application and effectiveness of NAB's governance, accountability and culture frameworks and practices, the review team was guided by detailed assessment criteria. Those criteria were based on an understanding of better practice and the expectations of NAB's leadership and Board, partly informed by the 35 recommendations in the APRA Inquiry.

1.4 STRUCTURE OF THE REPORT

This report is set out in 10 main chapters.

In line with the three themes identified in the scope, chapters 2–9 cover the observations and findings in relation to NAB's governance, accountability and culture. Each chapter includes a summary, background context, review observations and the actions NAB will implement to address identified shortcomings. They are set out as follows:

Governance

- Chapter 2: The Role of the Board
- Chapter 3: Senior Leadership Oversight
- Chapter 4: Risk Management and Compliance
- Chapter 5: Issue Identification, Escalation and Resolution
- Chapter 6: Financial Objectives and Prioritisation

Accountability

- Chapter 7: Accountability
- Chapter 8: Remuneration

Culture

- Chapter 9: Culture

Actions

- Chapter 10: Actions draws together the responses that NAB has committed to in order to meet customer, community and regulator expectations and achieve NAB's vision of being Australia's leading bank, trusted by customers for exceptional service.

The NAB Group is referred to as 'NAB', 'the bank', or 'us' throughout this report.

2. ROLE OF THE BOARD

2. ROLE OF THE BOARD

2.1 SUMMARY

The NAB Board is responsible for the overall governance and strategic direction of the bank and for overseeing the delivery of performance including the management of risks.

The Board acknowledges instances through the period covered by this self-assessment where it should have been more searching and/or demanding of management, and therefore more effective. A more intense focus on customer outcomes and enhanced reporting on non-financial risks would also improve governance activities. The oversight of remuneration and consequence management is much improved in recent times but should strengthen further. And while the Board sets a clear 'tone from the top', it should seek greater feedback on the 'echo from the bottom'.

The self-assessment found that the Board has an appropriate combination of relevant experience and skills, and that its role is clearly understood by directors and management. Agendas for Board and committee meetings are well planned and dynamic, with time set aside for reflection. Good practices are in place for coordination and communication between the Board and its committees.

In response to these findings, the following actions will be taken:

#1 The Board will require and oversee a significant lift in the importance given to the voice of the customer and a more intense focus on customer outcomes, and is instituting structural (e.g. Board committee) changes to support this.

#2 The Board will continue to promote a clear tone from the top and seek greater insights on how well this has cascaded below executive management.

#3 The Board will require and oversee enhancements to non-financial risk reporting, in particular to ensure key matters are escalated early and clearly and that adequate agenda time is allocated to them.

#4 The Board will maintain its heightened focus on setting clear directions and expectations for management, being sceptical as well as supportive; and being relentless on the timely, appropriate and sustainable closure of important issues.

#5 The Board will both lead and drive a further maturing of remuneration consequence management practices and require an uplift in remuneration governance activities more generally.

2.2 BACKGROUND

The Board has nine non-executive directors elected by NAB shareholders and one executive director (the CEO). The Board's role is to set the strategic direction for NAB's business and oversee the bank's operations and performance through the creation of sustainable value. Directors must act in the best interests of the company and fulfil the responsibilities laid out in the Board Charter, a public document available on the bank's website.

There are four standing Board Committees to support the Board's oversight of specific areas of governance. They are:

- Board Risk Committee (BRC).
- Board Audit Committee (BAC).
- Board Remuneration Committee (RemCo).
- Board Nomination & Governance Committee.

The Board also establishes other committees with specific remits when the circumstances require.

Over the last two years the Board met 35 times, including four joint meetings with the BAC and two joint meetings with RemCo. The agendas of all those meetings sought to allocate appropriate time to strategic and risk management priorities, including operational, compliance and conduct risks.

Each Board Committee and each director may escalate any matter to the Board at any time.

The Board and each Committee has unfettered access to relevant senior executives, risk and financial control personnel and other relevant internal and external parties, including Internal Audit and the external auditor Ernst & Young.

The Board and each Committee maintain an annual 'dynamic planner' in order to map out the year in advance and proactively address mandatory matters and issues that demand particular focus, while remaining agile and responsive to emerging issues.

Board Risk Committee overview

The BRC's responsibilities are to:

- establish NAB's risk appetite and oversight of NAB's risk management strategy and risk profile;
- review management's plans to mitigate risk;
- promote a risk-based culture across the bank; and
- oversee the effectiveness of the risk management framework.

The BRC is supported by the Group CRO and the NAB Second Line of defence team (Risk) which develops and maintains the Risk Management Strategy (RMS) and Risk Management Framework (RMF).

Over the last two years the BRC met 25 times, including five joint meetings with the BAC and four joint meetings with RemCo. The Group CRO, two partners from Ernst & Young and the EGM Internal Audit attended every scheduled BRC meeting. The BRC also holds workshops on matters that require deeper consideration.

2. ROLE OF THE BOARD

Board Audit Committee overview

The BAC's responsibilities are:

- the integrity of NAB's accounting and financial statements;
- internal and external audit activities; and
- NAB's Whistleblower policy and program.

The BAC is supported by Group Finance, Internal Audit and Ernst & Young. The EGM Internal Audit attends both BAC and BRC meetings (as do two partners from Ernst & Young) to ensure audit matters have the right levels of visibility and attention.

Over the last two years the BAC met 24 times, including five joint meetings with BRC and four joint meetings with the Board. The BAC also holds workshops on matters that require deeper consideration.

Board Remuneration Committee overview

RemCo's responsibilities are to:

- oversee NAB's remuneration, policies and practices;
- make recommendations on the remuneration of the CEO and other senior executives;
- manage the design and implementation of incentive plans taking into consideration legislative, regulatory and market developments and the bank's RMF; and
- review the performance of relevant executives and make recommendations on incentives and remuneration.

RemCo is supported by the People and Risk divisions. The Chief People Officer meets regularly with the Chair of RemCo. The Chief People Officer, EGM Performance & Rewards and the Group CRO attended every scheduled RemCo meeting.

Over the last two years RemCo met 26 times, including four joint meetings with the BRC and two joint meetings with the Board. RemCo also holds workshops on matters that require deeper consideration.

Board Nomination & Governance Committee overview

The Board's Nomination & Governance Committee is responsible for:

- reviewing the size and composition of the Board and succession plans to maintain an appropriate mix of experience, skills and diversity;
- evaluating the performance of the Board;
- recommending Board appointments and renewal; and
- reviewing relevant corporate governance principles and policies for the bank.

Over the last two years the Nomination & Governance Committee met 10 times.

2.3 REVIEW OBSERVATIONS

2.3.1 COMPOSITION OF THE BOARD

Board qualifications and experience

The Board has an appropriate range of relevant and deep skills and expertise. These include experience in leadership, strategy, customer experience, banking and financial services, risk management and compliance, finance, technology, international markets, people and remuneration, and governance.
The experience and skills needed by the Board have changed over time and will continue to do so. The Board is highly attuned to such changing needs in periodically refreshing the Board's composition.

All Board members recognise the need to continually develop their knowledge. Board education sessions and deep-dives (i.e. in-depth examination and analysis) are now run more regularly than in the past. In January 2018 the Board held an off-site meeting to assess and determine the role of the Board during the NAB transformation. A secondary focus of the offsite was technology; the Board went on a study tour in June to consider emerging technologies and their potential impacts for NAB and the transformation. The Board also recognises the importance of getting 'outside in' perspectives to Board discussions.

The Board undertakes an annual review of Board and Committee effectiveness, during which individual performance conversations are held between the Chairman and each individual director. As such, both individual and combined performance is assessed. The results, along with a review of the depth and diversity of skills and experience, are: (i) used to determine focus areas for the Board and each of its Committees over the forthcoming year; and (ii) incorporated into Board succession planning and the selection of new directors. Every three years there is an external and independent assessment of Board, Committee and individual director effectiveness. The next such assessment will be in 2019.

Committee membership

There has been careful planning of Committee composition. In 2015, it was decided to have fewer members on each Committee to enable more detailed and broader discussions. A necessary consequence of this was dedicating time at each Board meeting for the Chair of each Committee to give comprehensive updates of their meetings. All directors have access to all Board and Committee packs, all directors hear the comprehensive updates at each Board meeting and all directors have access to all of the Board and Committee minutes.

The previous external and independent Board assessments, the annual self-assessment process and the interviews of directors and senior executives through this self-assessment indicate that the Chairs of the Committees, along with the Board Chairman, are effective in their roles.

There is no apparent over-reliance on any individual member of a Committee, nor of the Board. For example, the BAC Chair is an expert in assurance and technical accounting and is mindful of actively involving other members of the BAC.

2. ROLE OF THE BOARD

2.3.2 OPERATION OF THE BOARD AND ITS COMMITTEES

Working relationships and agendas

The Board is observed to work well together as a team, with good levels of confidence in each other and clear recognition and leverage of the experience, knowledge and skills that each member brings. Interviews, including with executives, revealed that Board members actively participate and are fully engaged in the Board's business.

The Chairman and CEO are seen to have a constructive and open relationship, meeting or conferencing every week to discuss what is happening within NAB and how the senior leadership is performing. The Chairman and CEO also speak frequently outside of these weekly discussions.

The Board runs on a dynamic agenda designed around the concept of 'Run the Bank' and 'Change the Bank'. Day-to-day operations and performance are addressed in Run the Bank, while strategy and initiatives to transform the bank are addressed in Change the Bank. There is a concerted effort to separate and allocate time between both, with two distinct dashboards and scorecards reporting on how each is progressing.

This self-assessment has identified:

- examples of the agenda being dynamically adjusted to ensure adequate time is spent on key topics;
- the Board being actively engaged in the design of agendas and topics for deep dives; and
- joint Board/management workshops and business immersion activities.

However, in some instances insufficient agenda time was allocated to important issues. An example is NAB's response to the 'fees for no service' matter which the Australian Securities and Investments Commission (ASIC) commenced a project to review in 2015. NAB is now in the process of agreeing a customer remediation program with ASIC in relation to this. Until recently, insufficient agenda time was requested by management or the Board on this matter.

Some years ago, the Board introduced reflection time at the end of every Board meeting. This is to allow directors to reflect on the monthly board program as a whole, for themes to be identified and to clarify areas of concern or focus. Private sessions are also held at the beginning of every Board and Committee meeting, when directors meet without management to consider the agenda before them, identify and discuss the themes of the meeting to come, and raise any concerns.

Practices are in place for coordination and communication between the Board and its Committees, including:

- Deliberate overlapping memberships; for example, the BAC Chair is a member of the BRC and the BRC Chair is a member of RemCo.
- Updates at each Board meeting from each Committee Chair on the key matters discussed at each Committee meeting.
- Joint Committee meetings where a combined discussion is required (e.g. BAC/BRC for risk, compliance and audit issues, and BRC/RemCo for consideration of variable reward outcomes in light of the prevailing risk environment).
- Quarterly meetings of the Chairs of the Board and each Committee. Each Committee Chair also meets individually with the Board Chairman on a regular basis.

Focusing on the customer

While customer outcomes and conduct are clearly priorities for the Board, it needs to further improve its oversight of those matters, partly through receiving better reporting (see Section 2.3.4 below) and through more specific attention. In mid-2018, the Board requested more detailed management information on the 'voice of the customer', and more customer reporting is now provided to the Board on a monthly basis. This will not only help to provide greater context for the customer matters coming before the Board, but also make it easier to identify issues earlier.

Following the global financial crisis and partly in response to the Group of Thirty (G30)'s 'A Call for Sustained and Comprehensive Reform' in banking conduct and culture, many large European and US banks established a separate board committee focused on matters such as conduct, compliance, ethics and reputation. This recognised that these matters required time, information and a style of oversight that existing committees were not equipped to provide without compromising their prevailing priorities. Given that the Board wants to focus on customers and ensure appropriate customer outcomes, it has decided to introduce a Customer Outcomes Committee.

> **ACTION #1:**
>
> The Board will require and oversee a significant lift in the importance given to the voice of the customer and a more intense focus on customer outcomes, and is instituting structural (e.g. Board committee) changes to support this.

2.3.3 TONE FROM THE TOP/ENGAGEMENT

Setting the tone

Over recent years, Australian regulators and other global influencers (such as the Financial Stability Board and G30) have emphasised the important role that a Board plays in setting the tone from the top. This has been reflected in NAB's RMS, which requires the Board to set and reinforce an appropriate tone from the top.

The following are examples of how the Board has sought to set and role model the tone from the top, on a day-to-day basis:

- The Board has invested significant time and energy on NAB's Purpose, Vision and Values, which were jointly launched to employees by the Chairman and CEO.

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- The Board recently announced significant changes to executive remuneration practices to address changing community, regulator and the Board's own expectations. Other changes have been made to the remuneration structures for front-line employees, well in advance of the Retail Banking Remuneration Review (Sedgwick Review) requirements.
- The Board has a program of customer engagements, in both metropolitan and regional locations.
- Board meetings are held once a year in regional areas.
- The Board actively engages with regulators, with regular scheduled meetings (including recent meetings with ASIC, APRA and Australian Transaction Reports and Analysis Centre (AUSTRAC)).
- The Board gives strong recognition to the stature of control functions, such as Risk and Internal Audit, and promotes their importance.
- The Chairman regularly delivers speeches to external forums, addressing difficult issues with a clear and unequivocal message, and these are shared with NAB employees.

The Board also recognises the need to be more explicit on how it will set the tone from the top. Through its decisions, its actions and in its conversations with management, the Board will continue to reinforce the importance of: focusing on doing the right thing for customers; being quick to fix customer issues (and fix them sustainably); and, removing any undue bias (management's or the Board's) towards financial constraints in decision-making.

Engagement/feedback

All evidence points towards a sound working relationship between the Board and management. The directors do not feel intimidated by management and are comfortable to set the tone and to challenge management.

Committee Chairs regularly spend time with executives outside the scheduled meeting program; for example, the BRC Chair with the Group CRO and the BAC Chair with the EGM Internal Audit and the Chief Financial Officer (CFO).

The Board undertakes regular business immersion activities and interacts with employees in their place of work, listening first hand to their concerns and perspectives.

The Board and BRC intend to further increase the opportunities for First Line executives (including below the ELT) to attend and interact more frequently with the Board and BRC and hear the directors' tone and feedback. This will also assist in identifying any filtering of messaging by more senior executives.

The Board also intends to do more to celebrate and recognise leaders who role model positive customer, risk and compliance behaviours, especially those leaders taking on accountability for the more difficult and complex activities required to successfully manage the challenges faced by NAB.

While the Board currently receives a degree of regular reporting which helps it to gauge the extent to which the tone they are setting is cascading through the bank – such as employee engagement measures and specific updates on risk culture – it is the start of a journey and much more will need to be done to better understand whether the tone from the top is being echoed from the bottom.

As described further in Chapter 9: Culture, financial institutions, regulators and professional bodies globally are developing approaches to assessing culture in banks, combining 'hard' data (in areas such as customer complaints, Net Promoter Score (NPS, a measure of customer advocacy), whistleblowing, control and compliance discipline, and reward outcomes) and perception data from employees and other surveys, focus groups and internal audits. NAB is committed to investing in and adopting these better practices, with regular reporting through to the Board. The Board will supplement this reporting with judgements it forms based on interactions with management and employee and on indicators from regulators and other stakeholders.

ACTION #2:

The Board will continue to promote a clear tone from the top and seek greater insights on how well this has cascaded below executive management.

2.3.4 REPORTING TO THE BOARD

Reporting generally

In 2015, a 'two plus five' rule was introduced for Board papers, whereby primary papers must not exceed two pages, with no more than five pages of attachments. This was designed to instil greater discipline in how management highlights key issues and concerns. It is designed so that management must think deeply, and describe issues crisply. This has also reduced the tendency of management to 'present' to the Board and helped directors to engage more deeply on the issues, implications and decisions.

Past reporting has focused too much on the financial impact to NAB, rather than impacts on customers. As noted earlier, before mid-2018 the Board did not receive nearly enough insight or detailed reporting on the voice of the customer, including insights and trends from customer complaints. While improvements in customer complaints reporting have been made, further progress is considered a priority and will be addressed by Action #1 above.

Four years ago, the Second Line introduced the practice of adding a Risk View in papers from management to the BRC. The same practice exists at the Group Risk Return Management Committee (GRRMC), the most senior executive risk committee, chaired by the CEO and attended by the entire ELT. Including a Risk View in papers allows the Risk team to express their views on the matters raised by management. This is seen to have added to the quality and robustness of conversation, in both management and BRC meetings.

The Group CRO report is presented at every GRRMC, BRC and Board meeting to ensure that all directors are receiving an overview of risk matters. It is presented at GRRMC first to ensure the ELT is collectively across all the risk issues set out in the Group

2. ROLE OF THE BOARD

CRO report. While this report has improved considerably in recent years, it has not always been evident that the key messages have been crisply and clearly drawn to the attention of the GRRMC, BRC or Board. The written CRO report is supplemented in the GRRMC, BRC and Board meetings by verbal commentary from the Group CRO concerning the key risk issues and recent developments since the report was written, to ensure timely discussion of the most important emerging topics.

Interviewees considered reporting on traditional financial risks to be strong, with the Board receiving succinct metrics on credit, liquidity, market and balance sheet risks; insights on emerging macro-economic and geo-political issues; and regular analyses into specific financial matters.

The Third Line reporting from Internal Audit is also well regarded by the Board, BAC and BRC. The self-assessment found that responsible First Line management are now more frequently requested to present to BAC and/or BRC on 3-star rated audit issues and on their response and status of progress.

Non-financial risk reporting

The quality of overall Second Line risk reporting in relation to non-financial risks is also seen as much improved in providing the BRC with an aggregate picture of risk. Metrics have continually evolved and become more detailed on operational and technology risks and in trend analysis of compliance and regulatory matters.

However, as further explained in Chapter 4: Risk Management and Compliance, the reporting of non-financial risks (including NAB's Risk Appetite Statement (RAS) and risk settings) needs to continue to mature. In particular, the reporting of conduct and compliance matters needs to be enhanced.

Some of the initiatives that would provide the Board with better oversight of the changing risk profile and of important matters include better lead indicators on non-financial risks, aligned to the risk appetite; more holistic reporting of matters affecting the bank's reputation; a regular aged remediation report to highlight slippage and enable the Board to have greater rigour in setting targets to remediate customers and improve underlying controls; and generally more benchmarking and outside-in learning. Having regard to the above, the Board could have been more demanding and helped drive earlier improvements to aspects of the non-financial risk reporting.

ACTION #3:

The Board will require and oversee enhancements to non-financial risk reporting, in particular to ensure key matters are escalated early and clearly and that adequate agenda time is allocated to them.

In relation to the reporting of non-financial risks, directors have previously identified – and the self-assessment confirmed – a number of instances in the past when management has:

- Been over-optimistic or has failed to call out key challenges with sufficient clarity/seriousness; for example, the early reporting to directors of the 'fees for no service' matter was brief and high-level, even though it was emerging as a serious issue.
- Under-estimated the complexity of remediation and the ability to both plan and deliver it in a reasonable period; for example, NAB's response to ASIC's enforceable undertaking relating to NAB's wholesale spot foreign exchange (FX) business.

This affects the ability of the Board to govern effectively but also highlights the importance of the Board's role in challenging management to be realistic in facing into issues. The next section comments on how the Board challenges management, including asking searching questions to help to reveal such instances.

2.3.5 BOARD CHALLENGE AND CLOSURE OF ISSUES

The Board has a clear, shared intent to be "challenging and supportive" of management. To achieve this, it seeks to create an environment in Board and Committee meetings that inspires open and honest and transparent discussion of key topics. The Board expects management to have thought through and analysed matters thoroughly, but also encourages them not to feel that they must have all the answers before engaging in an open dialogue with the Board.

In being challenging, the Board is conscious that pushing management to deliver too quickly can in fact drive an issue to be resolved in an unsustainable or inappropriate manner.

Such challenge by the Board has, at times, included an emphasis on injecting consideration of customer outcomes into management decision-making. A good example is a recent proposal from management regarding the commercial structure of a product, whereby the Board rejected the initial proposal on the basis of inadequate consideration of customer interest in the business case. This challenge caused management to reassess and ultimately revise the initial option presented.

The Board seeks to ensure all key stakeholders – including regulators and employees – are appropriately considered in significant decisions.

Having reflected during this self-assessment, the Board recognises that there have also been times when it could have been more searching (or testing) of management or demanded more urgency in closing issues. The bank's initial response to the FX enforceable undertaking mentioned above is an example of this.

In the past there have been instances where the Board has tolerated the closure of 3-star audit issues taking longer than necessary. In March 2014, Internal Audit raised a 3-star audit matter highlighting insufficient compliance across NAB business units with processes for executing and ensuring the good order of securities documents. Despite the audit rating, the issue was not promptly addressed. In 2016, a legal judgement against NAB exposed NAB's risk of holding unenforceable securities in the absence of standardised compliance. Further, as noted in Chapter 4: Risk Management and Compliance, the Group's rating for compliance risk management has been Red since 2013 (except for a brief period at Amber in 2016).

2. ROLE OF THE BOARD

Chapter 9: Culture outlines a number of cultural inhibitors, which at times the Board has also demonstrated:

- One is that the bank doesn't always listen and learn effectively. For example, given the bank's experience of conduct risk issues associated with payment protection insurance in the UK, senior management and the Board could have been more proactive in developing and fully embedding a holistic conduct risk management framework.
- At times the Board could have put customer impacts more directly at the centre of Board questioning. In the fees for no service matter, for instance, in early Board conversations directors could have further tested management on the customer implications of the approach being adopted, which would have led to speedier resolution.
- Another has been a tendency at NAB to compare itself with peers and measure itself against industry standards, which, among other things might mean the bank is less intense and ambitious in closing a matter than it might otherwise be.

For some time the Board has been lifting the degree to which it tests management, and the intensity applied to closing and remediating significant matters. This resolve has only been strengthened since the releases of the APRA Inquiry report and the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission).

ACTION #4:

The Board will maintain its heightened focus on setting clear directions and expectations for management, being sceptical as well as supportive; and being relentless on the timely, appropriate and sustainable closure of important issues.

2.3.6 REMUNERATION AND CONSEQUENCE MANAGEMENT

The Board oversees and challenges both the design and operation of NAB's remuneration policies and practices and is conscious of the need to rigorously test their effectiveness to ensure that they are driving the desired outcomes and behaviours.

As further explained in Chapter 8: Remuneration, in recent times the Board has initiated, reviewed or overseen a range of reviews and resulting changes to remuneration and performance frameworks, and has taken steps to improve clarity over how and when it will exercise discretion over variable reward.

A key role of RemCo is to ensure reward outcomes appropriately reflect conduct and risk management considerations. While collective adjustments have been applied, applying individual downside adjustments has been a challenge historically, due partly to unclear accountabilities and the frequency of changes in roles and responsibilities. The process in the 2018 financial year for identifying the individual accountabilities of senior leaders and determining downside consequences was much improved.

However, the self-assessment identified, or confirmed, a number of opportunities to further improve the processes and outcomes. These include the need to improve the links between risk topics discussed at the BRC and the flow through to remuneration consequences, and the need to increase oversight of the performance and remuneration outcomes for Material Risk Takers (MRTs).

RemCo would also benefit from improved data and insights to help test the ongoing effectiveness of remuneration policies and practices in driving desired behaviours across the bank.

ACTION #5:

The Board will both lead and drive a further maturing of remuneration consequence management practices and require an uplift in remuneration governance activities more generally.

3. SENIOR LEADERSHIP OVERSIGHT

3. SENIOR LEADERSHIP OVERSIGHT

3.1 SUMMARY

At NAB, while each member of the ELT has specific decision-making rights and accountabilities based on their role, formal and informal mechanisms have created a strong sense of team. With the CEO's influence and emphasis, the ELT accepts the need to consider, support and constructively challenge each other's proposals and initiatives, for the good of the overall bank.

The ELT brings a strong focus on customers; however the quality and depth of focus and information regarding complaints and customer outcomes has been limited, indicating a need to bring a more complete customer voice into senior leadership discussions. As with the Board, there is a need for a more specific focus on the echo from the bottom to validate whether the ELT's tone from the top is flowing through the bank.

In many respects the ELT's oversight of risk and issues through the GRRMC is mature and well managed. However, the ELT has not applied sufficient intensity and urgency to a number of long-standing issues and known weaknesses, particularly when these crossed divisional boundaries, contributing to slow progress on resolution.

While the executive-level oversight of financial risks is generally mature and strong, the oversight of non-financial risk has lacked a comparable level of discipline and intensity. The key supporting committee beneath the executive level for oversight of non-financial risks has not been used for, or provided, effective support to the GRRMC. These shortcomings have become more apparent in recent years as the scale and nature of matters the GRRMC needs to consider have increased.

As outlined in Chapter 4: Risk Management and Compliance, this has diminished the effectiveness of the management of conduct risks. This also applies to the bank's approach and investment in compliance risk management (noting the actions under way to address this).

Finally, despite the benefits of a more end-to-end approach to risk management afforded by First Line risk committees, the bank is not yet confident that these committees are effective in helping to manage complex risk issues or in driving the consistent and effective implementation of risk frameworks.

In response to these findings, the following actions will be taken:

#6 The ELT will drive an uplift in the voice of the customer through governance, reporting, decisions and relevant controls – incorporating a more intense focus on customer outcomes.

#7 Review and drive changes such that the GRRMC – supported by more effective Group and First Line risk governance committees – brings more rigour, discipline and intensity in the areas of conduct, compliance and operational risk.

3.2 BACKGROUND

NAB's organisational structure

NAB's organisational structure consists of three customer-focused divisions (Business and Private Banking; Consumer Banking; Corporate and Institutional Banking) aligned to NAB's target customer segments, supported by six bank-wide divisions: Customer Experience (responsible for product and service design and delivery), Technology & Operations, Risk, People, Finance and Commercial Services.

In May 2018, NAB announced its intention to exit its Advice, Superannuation & Investment Platforms and Asset Management businesses, currently operating under MLC and other brands. Separate ownership will allow this business to determine its own strategy and investment priorities to better deliver for customers and enhance its competitive position.

NAB also has a wholly owned subsidiary, the Bank of New Zealand (BNZ), which encompasses retail, business, agribusiness, corporate and insurance franchises and markets sales operations in New Zealand. As a separately regulated entity, BNZ has its own Board Risk Management Committee and Executive Risk Committee.

Executive Leadership Team role and 'operating rhythm'

The ELT consists of the CEO and his direct reports, all of whom are the heads of the divisions described above.

The CEO retains overall responsibility for the management of NAB's business activities, including strategy, the bank's business plan, risk management and people and culture management.

Divisional heads are responsible for developing and implementing strategies, managing performance, risk management and people and the culture of their respective divisions, in alignment with and in support of NAB's strategy.

Each divisional head participates as an active member of the ELT, including considering, supporting and constructively challenging (if appropriate) the proposals and initiatives of other ELT members.

The operating rhythm of the ELT involves weekly meetings that focus on strategy, customers, risk, people, and business performance. Built into this operating rhythm are the following:

- GRRMC: The most senior executive risk management committee responsible for managing and overseeing bank-wide risks and issues including non-financial risks.
- Customer Experience Board (CXB): Established in January 2017 to develop, approve, monitor and drive the implementation of NAB's strategic objectives relating to NPS uplift, customer experience and digitisation.
- Quarterly reviews of business performance.
- People days focused on talent management, succession planning and performance assessments.

3. SENIOR LEADERSHIP OVERSIGHT

Executive risk committees

The GRRMC meets monthly. Its membership comprises the ELT and the Group Treasurer. The Chief Credit Officer and EGM Internal Audit are also attendees. GRRMC decisions are made by the CEO in consultation with the members.

The GRRMC is supported by three sub-committees, which collectively cover all material risks as defined in the RMS:

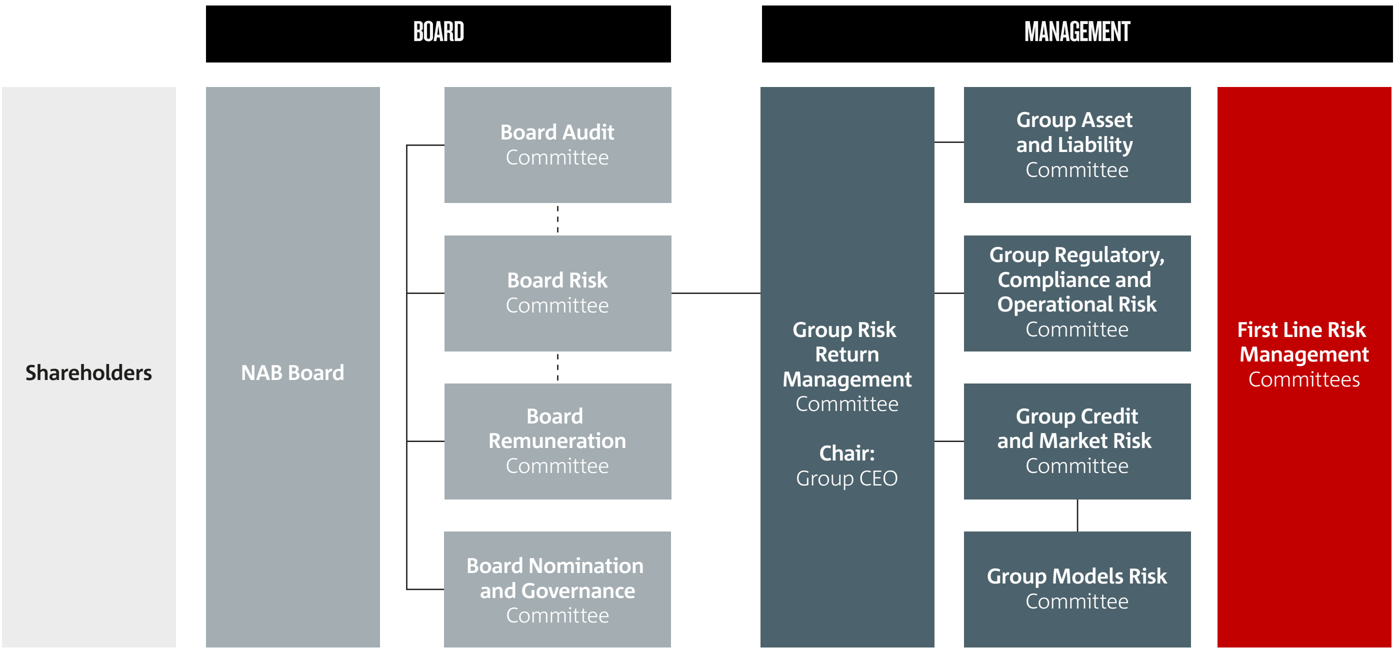
- Group Asset and Liability Committee: meets monthly; provides oversight of management's balance sheet structure and risk settings, and oversight and monitoring of Group Treasury and its risk profile.
- Group Credit and Market Risk Committee: meets monthly and is responsible for bank-wide management and oversight of credit and market risk, and reviews the quality and composition of NAB's credit risk portfolio.
- Group Regulatory, Compliance and Operational Risk Committee: meets two-monthly and is responsible for oversight of the management of non-financial risks, covering operational and compliance risks including conduct and prudential regulatory risk.

Three additional risk management committees operate to address risks across NAB's divisions. They are structured along end-to-end customer delivery processes ('value chains'), which span the bank's functions across divisions and bring together product design and delivery, distribution, and some aspects of technology and operations. Within NAB these committees are referred to as Value Chain Risk Management Committees (VCRMCs). They meet two-monthly and have cross-divisional membership.

There is also a dedicated Technology and Operations risk management committee, which meets monthly. This committee is responsible for overseeing the risks and controls within NAB's technology and operations division.

The board of each licensed entity in the NAB Group is accountable for discharging its respective fiduciary duties, and compliance with licence conditions and legal and regulatory obligations. National Wealth Management Services Limited (NWMSL) is the passive holding company for licensed entities in the NAB Group. NWMSL also provides management services to licensed entities, including in respect of risk management and compliance.

Figure: 3.1 Risk Governance Structure



3. SENIOR LEADERSHIP OVERSIGHT

3.3 REVIEW OBSERVATIONS

3.3.1 OPERATION OF THE EXECUTIVE LEADERSHIP TEAM

While each ELT member retains decision-making rights and accountabilities for the strategies and performance of their divisions (and for the CEO, the Group), there are several formal and informal mechanisms to encourage their collective participation, challenge and alignment on decisions at the group level.

In interviews, ELT members frequently observed that the ELT operates with a strong sense of team and described the expectations set by the CEO that they debate key decisions and discuss disagreements over matters raised by other ELT members. This is formally defined in each ELT member's Banking Executive Accountability Regime (BEAR) Accountability Statement as "participating as an active member of the ELT, including considering, supporting and where appropriate constructively challenging the proposals and initiatives of other ELT members". The recent decision by NAB to hold mortgage rates steady for now, is a good example of the type of decision discussed at ELT.

While the ELT itself does not have a specific charter, the operating rhythm guides activities and formal charters or terms of reference exist for the GRRMC and CXB. The ELT spend a day together weekly, incorporating these formal elements into this meeting, including the GRRMC meeting.

From a customer perspective, the ELT regularly discusses customer matters at the CXB, with standing agenda items including customer insights direct from customer-facing divisions and outcomes against customer experience targets. Periodically the CXB receives analysis of customer complaints and quarterly updates from the Customer Advocate; however, these are not yet at the depth and breadth required to provide deep insight and enable a more comprehensive focus on customer interests and outcomes.

ACTION #6:

The ELT will drive an uplift in the voice of the customer through governance, reporting, decisions and relevant controls – incorporating a more intense focus on customer outcomes.

From a people and culture perspective, the ELT's focus is on leadership and talent development, and culture. The ELT worked with the Board to develop NAB's purpose and to refresh NAB's vision, values and behaviours, and with the EGMs, has been actively involved in launching them. While this demonstrates a focus on the tone from the top, more structured feedback is required (as it is with the Board) on the echo from the bottom regarding the implementation of the bank's target culture. For example, self-assessment focus group participants revealed some scepticism from front-line employees regarding the transformation initiatives under way and their potential impact to enable employees to assist customers effectively.

A number of non-financial risk matters have emerged over recent years that indicate the ELT as a collective could have been more challenging of one another or of the broader bank. In an example of a decision taken to the GRRMC (discussed in Chapter 6: Financial Objectives and Prioritisation), the GRRMC minutes showed there was significant debate on a particular proposal. Although the ELT were not aligned and agreed, the proposal was allowed to proceed to the BRC under the responsibility of a single ELT member, where it was rejected.

3.3.2 SENIOR LEADERSHIP OVERSIGHT OF BANK-WIDE RISKS AND ISSUES

Through the GRRMC, the ELT's oversight of bank-wide risk is subject to a structured and formal process including with reporting to the BRC. The GRRMC's remit includes all of the bank's identified material risk categories and the time provided is generally split equally between matters of financial and non-financial risk. The GRRMC, like the Board, operates a dynamic planner to provide flexibility into agendas to prioritise discussions on critical topics. Agendas are agreed in advance between the CEO, Group CRO and the Committee Secretary.

The CEO, as Chair, has clear accountability for the GRRMC's decisions and meeting minutes and interviews with ELT members indicate that debate and challenge occur often, particularly more recently, on matters brought before the GRRMC.

A number of improvements have been made to the operation of the GRRMC, for example, the improvements to the reporting of Matters of Interest (MOIs, described further in Section 5.2) and the Group CRO's Risk Targets report (quarterly report on risk management performance). The external assessment of the bank's RMF under CPS 220 described the governance arrangements to be adequately designed.

Despite this, there are several examples where the ELT/GRRMC have not applied sufficient intensity or urgency to long-standing issues and known weaknesses, particularly when these cross divisional boundaries. This was true of two of the case studies considered by the self-assessment, where cross-bank issues remained open and unresolved for several years (examined further in Chapter 7: Accountability). This is likely to have contributed to a broader organisational tolerance for slow and delayed progress on issues that were considered complex. Several interviewees described some recent examples that demonstrate more willingness by the ELT to acknowledge and address such long-standing problems.

In addition, and as explained in Chapter 4: Risk Management and Compliance, risk reporting requires improvement to include the following: greater focus on the impact of risks on customer outcomes and NAB's reputation; risk indicators that take a forward-looking approach; specific rather than general measures on compliance; regulatory obligations and issues management and resolution; and increased use of measures that enable greater outside-in perspective.

3. SENIOR LEADERSHIP OVERSIGHT

3.3.3 SENIOR LEADERSHIP OVERSIGHT OF NON-FINANCIAL RISK

Although the ELT's overall approach to oversight of risk has many positive attributes, the self-assessment has observed that the oversight of non-financial risk – that is compliance, conduct and operational risk – has lacked the rigour, discipline and intensity required. This is particularly evident when compared to the maturity of approaches adopted for financial risks – noting that this distinction may be unhelpful given the inherent connection between these two broad categories of risk.

Conduct risk has been a continued focus of both Internal Audit reports and NAB's own assessments brought before GRRMC over an extensive period. Despite this and NAB's UK experience indicating the significance of this issue, GRRMC has not acted with sufficient rigour and intensity regarding the implementation and adoption of a framework for the management of conduct risks. As outlined in Chapter 4: Risk Management and Compliance, this has diminished the effectiveness of the management of conduct risks. Chapter 4 also highlights a number of shortcomings in the bank's approach and investment in compliance risk management (including the actions under way to address this).

These shortcomings have become more apparent in recent years, with a greater impact on the bank as issues have been identified and the scale and nature of matters the GRRMC would have to consider has increased.

Effectiveness of Group Regulatory Compliance & Operational Risk Committee

While the GRRMC sub-committees are designed to support GRRMC, the sub-committee that deals with non-financial risks (the Group Regulatory Compliance & Operational Risk Committee – GRCORC) has not been used for, or provided, effective support to the GRRMC.

Relative to its charter, the GRCORC spends a disproportionate amount of time on policy and framework endorsement, with issues that should have come before GRCORC tending to be tabled at other risk committees or escalated directly to GRRMC.

The GRCORC is fully comprised of Risk (Second Line) members with Internal Audit (Third Line) and Enterprise Controls (First Line) representatives in attendance. First Line risk owners are not required to attend, which limits the GRCORC's effectiveness in challenging management with respect to high or excessive risks and significant events.

The depth and breadth of information routinely reported to GRCORC further indicates the procedural focus of its activities. Specifically, the reporting on risk appetite, compliance, issues and customer complaints is considered inadequate to enable informed discussion and challenge and for effective oversight of the risks in remit.

Effectiveness of Value Chain Risk Management Committees

The VCRMCs were established in 2017 to reduce the likelihood of risk issues in end-to-end processes falling between gaps created by the previous divisional risk management committees. The objective of the VCRMCs is to take an end-to-end view of risk and enable cross-divisional action on risks and issues and the sharing of insights and challenge.

The focus on end-to-end risk profiles, with representatives from the divisions present at meetings, is seen to have improved visibility and discussion of risks and issues across the value chains.

Since their introduction much work has been done to implement the VCRMCs. However, they are not yet fully effective and there is a lack of clarity on a number of aspects of their operation. This includes:

- The role of the VCRMCs in relation to specific non-financial risk classes, such as conduct risk.
- The relationship between the VCRMCs and the Technology & Operations division's risk management committee and the level of cross-reporting required to enable effective oversight of risks.
- Alignment of VCRMCs decision-making authorities and divisional ELT member responsibilities (including how BEAR is operationalised within the bank).
- Escalation and reporting lines to the GRRMC, the Board or regulators.
- Appropriateness of composition, for example, Compliance and Financial Crime Risk are not currently represented, rather reliance is placed on the attending divisional CROs to represent on these risks.

In addition, the depth and quality of information reported on customer outcomes, compliance and conduct issues and emerging risks to the VCRMCs, is insufficient to appropriately manage these risks and issues.

Finally, these committees are not recognised in the formal risk governance framework, have no delegated accountabilities or mandatory requirements, and are not ultimately accountable through a Board-overseen performance framework.

ACTION #7:

Review and drive changes such that the GRRMC – supported by more effective Group and First Line risk governance committees – brings more rigour, discipline and intensity in the areas of conduct, compliance and operational risk.

4. RISK MANAGEMENT AND COMPLIANCE

4. RISK MANAGEMENT AND COMPLIANCE

4.1 SUMMARY

NAB operates its RMF so as to support the effective management of material risks, and to provide the Board with a comprehensive view of those risks. NAB's RMF is also designed to satisfy the requirements of CPS 220. An independent comprehensive review of the framework is conducted every three years. The most recent review, in 2018, found NAB's RMF design was adequate and appropriate when assessed against the requirements of the prudential standard. The application of the RMF, however, was found to be partially effective – with weaknesses identified in certain aspects including risk governance and reporting, non-financial risk management, and policy complexity.

Within non-financial risk management, compliance and conduct are particularly important given the bank's duty to obey the law and deliver financial services to customers efficiently, honestly and fairly. Maintaining adequate compliance arrangements requires significant discipline, given that in September 2018, NAB's Australian operations were subject to 2,732 unique compliance obligations (see Section 4.3.3).

The self-assessment identified many areas for improvement across risk management and compliance.

Within NAB's RMF, not enough emphasis has been placed on customer outcomes in its risk frameworks, policies and controls.

While the First Line at NAB clearly own risks and controls, and resources to support this are in place, the quality and effectiveness of controls and control documentation needs to be significantly improved.

As outlined in Chapter 3: Senior Leadership Oversight, more work is required to make risk governance forums work effectively and efficiently, across both First and Second Line-led committees.

The Second Line owns bank-wide risk reporting and risk and compliance frameworks, as well as providing oversight and challenge to the First Line. Within reporting, NAB has established the Risk View, a structured way for the Second Line to provide observations and challenge. While generally effective, the quality is inconsistent and can be too passive or unclear. More broadly, there remain examples in risk reporting where items of significance to customer outcomes or the bank's reputation have not been called out clearly enough. And as outlined in Chapter 5: Issue Identification, Escalation, and Resolution, issue tracking also needs to be improved.

The voice and stature of Compliance has not been strong. It has not been granted a veto authority in cases where it considers compliance arrangements to be inadequate. And it has not historically insisted on establishing controls that can positively demonstrate evidence of compliance. Weaknesses in compliance practices at NAB have manifested in too many breaches, and in the slow identification and reporting of breaches.

Despite conduct risk being defined as a material risk in the bank's 2017 financial year RMS (published October 2016), and the bank's experience in the UK, the development and embedding of a disciplined bank-wide approach to conduct risk management has not happened with sufficient pace or urgency.

Risk's resourcing is observed to be low in compliance, where a significant increase in staffing is underway. It will also likely need to increase in conduct, technology risk, cyber, data and privacy.

Finally, Risk's role in change would benefit from earlier involvement, and stronger visibility through risk governance forums.

In response to these findings, the following actions will be taken:

#8 Update NAB's Risk Management Framework to integrate a stronger focus on customer outcomes.

#9 Strengthen the effectiveness of First Line risk management through:

(i) Lifting the standard of overall risk governance, including clarity of accountabilities.

(ii) Increasing the capability of First Line to proactively and consistently identify and monitor risks.

(iii) Improving First Line understanding, design, documentation and execution of effective controls.

#10 Improve the effectiveness of Second Line's policy, oversight and reporting activities, including:

(i) Driving improvements in non-financial risk reporting including strengthening the Risk View, better escalating significant matters, and monitoring issue ageing.

(ii) Changing policies and reporting to help support an evidentiary approach to compliance, and revising authorities to support a stronger voice of Compliance.

(iii) Linking, integrating and deepening conduct risk management under an approved framework.

(iv) Increasing depth of capabilities and resourcing in critical operational risk and compliance areas.

(v) Engaging Risk earlier in change activities, and improving governance of risk arising from change.

4.2 BACKGROUND

NAB's Risk Management Strategy and Risk Management Framework

NAB's RMS describes the key elements of the RMF for managing risk across the bank. The underpinning principle of the RMS is to take the right risk with the right controls for the right return. NAB seeks to achieve this through a strong risk culture and its RMF.

The RMF integrates risk management processes into NAB's strategic planning, appetite, policies, reporting and governance, in order to support effective and coherent bank-wide management of risk. The Board is ultimately responsible for the RMF. The Board may approve the delegation of specific authorities to executive management for aspects of management of the RMF.

4. RISK MANAGEMENT AND COMPLIANCE

Key elements of the RMF are the Three Lines of Defence (3LoD) model, Risk Governance, Risk Appetite, Risk Measurement & Modelling (including Event Management), Risk Reporting and Monitoring.

Material risks

Material risks are defined in the RMF as risks that may adversely affect the financial and non-financial outcomes for the bank. They are managed in accordance with the RMF, specific policies, and related procedures, and are assessed as part of ongoing business operations and in response to changes in the business or external environment. They fall into the following categories:

- Credit
- Market
- Balance Sheet & Liquidity
- Operational
- Compliance
- Conduct
- Regulatory
- Strategic

Material risks are confirmed as part of the annual review and update of the RMS.

Three Lines of Defence

In line with most large financial institutions, NAB uses a 3LoD risk management model. The risk accountabilities of the First, Second and Third Lines are documented in the RMS for each component of the RMF. The 3LoD model is defined as follows:

- First Line (the business): Owns and manages risks and controls (including identifying and assessing risks and controls) within their business and across the value chain in line with risk appetite.
- Second Line (Risk and Compliance): Develops and maintains the RMF and ensures the effectiveness of the risk and control environment by establishing risk appetite and providing oversight (including risk insight, oversight, advice and challenge).
- Third Line (Audit): Provides independent assurance over the RMF and its application by the First and Second Lines.

Risk appetite

Risk appetite defines the risk boundaries within which NAB must operate to achieve its strategic objectives and financial targets. Risk appetite can operate both as a defence against excessive risk taking and as a mechanism to identify opportunities to achieve the bank's strategic objectives. Limits for each material risk are defined in the Board-approved Group RAS and in RASs for other legal entities as required. Each RAS is operationalised via detailed risk metrics, policy and First Line communications, which translate relevant risk settings into specific guidance for business leaders and front-line teams. The Group RAS includes risk appetite limits that quantify the maximum levels of risk NAB is prepared to take. Quantitative risk appetite limits have been established for all financial risks, as well as for operational risk and compliance – but not yet for conduct risk.

Recent improvements to the RMF by NAB

Over the last three years, a number of significant changes and improvements have been made to NAB's RMF and the effectiveness of the 3LoD model:

2014:

- Implementation of the Risk Management Accountabilities (RMA) model which clearly defines the risk management accountabilities of First, Second and Third Line functions.

2015:

- Implementation of risksmart, a single system of record for non-financial risks, including operational risks, compliance obligations and associated controls.

2016–2017:

- Introduction of formal risk management performance assessments (performed by Risk) for the CEO, ELT and EGMs.
- Implementation of formal mechanisms to measure, assess and report on the risk management performance of all business units at NAB.
- Redesign of NAB's risk governance model including the creation of VCRMCs aligned to customer experience (e.g. Personal, Business).
- Improvements to NAB's risk appetite framework, providing clearer boundaries on risk limits.
- Redesign of risk reports by the First and Second Lines.

2018:

- Increased application of data analytics to support monitoring and oversight.
- Strengthening of the credit, market and balance sheet risk management practices implemented through a range of initiatives, including: the simplification of the Delegation of Commitment Authorities; investments in enhanced credit-decisioning tools; simplification of the model risk management practices; and implementation of new market risk reporting systems.
- Improvements to the Group CRO's risk performance assessment provided to the BRC and RemCo.

While these changes have materially improved and strengthened the effectiveness of NAB's RMF, the environment continues to challenge and place new demands on the framework. Annual reviews and updates are made to the RMF and these are complemented by annual or twice yearly updates to the GRRMC and BRC by the Risk function.

4. RISK MANAGEMENT AND COMPLIANCE

4.3 REVIEW OBSERVATIONS

4.3.1 RISK MANAGEMENT FRAMEWORK

CPS 220 independent review findings

In accordance with the requirements of CPS 220, every three years NAB undertakes a comprehensive independent review of its risk management framework. Ernst & Young conducted this review for NAB in 2018, concluding: "… NAB's RMF (is) Adequate and Appropriate, and the application of the RMF (is) Partially Effective".

Ernst & Young found that while the RMF largely satisfies the CPS 220 regulatory requirements, a number of improvements were required, specifically:

For the First Line:

- Reorient risk information to fully enable VCRMCs, including more customer metrics.
- Improve the consistency of application and clarity of accountabilities for Enterprise Controls.

And for the Second Line:

- Complete the implementation of the Second Line operating model and build targeted resourcing.
- Enhance non-financial risk management (including risk appetite metrics) and simplify risk policies.
- Further develop the risk culture framework, and links between risk and remuneration.
- Improve the usability of risk IT systems.

This self-assessment identified similar observations on the application of the RMF. They are described in more detail in subsequent sections.

Voice of the customer

The self-assessment has also observed there is an opportunity to elevate the voice of the customer in the RMS and RMF. While a number of changes and initiatives have been introduced across the First and Second Lines to simplify risk policies, systems and processes, the RMS and RMF should be reviewed to ensure they give appropriate attention and focus to the customer. For example, a relatively small but powerful change may be to incorporate 'customer' into the key principle that supports the RMS which is currently 'taking the right risks, with the right controls, for the right returns'.

Focusing on customer impact will naturally raise the profile of risks such as system interruption, data security and privacy breaches, and conduct and compliance.

ACTION #8:

Update NAB's Risk Management Framework to integrate a stronger focus on customer outcomes.

4.3.2 FIRST LINE RISK MANAGEMENT

First Line risk and control ownership

Under NAB's 3LoD policy, First Line (business management) owns and manages risks and controls.

First Line risk management responsibilities are set out and defined in the RMS and RMA. They include control design and testing risk profiling, managing compliance, managing events and compliance breaches and ensuring NAB continues to build and maintain a sound risk culture that is supportive of risk appetite. First Line management is also accountable for ensuring events and conduct issues are adequately investigated, remediated and closed, with oversight provided by Second or Third Line functions (see Chapter 5: Issue Identification, Escalation and Resolution).

Aligned to these accountabilities, First Line is responsible for maintaining the accuracy of information recorded in risksmart relating to risks, compliance obligations, controls, events, issues and actions for their business. Despite significant ongoing focus and investment in risksmart data quality over recent years, there remain recognised gaps in completeness and accuracy of this data.

There is a need to further uplift the consistency of competencies across elements of the First Line, including risk identification, risk profile monitoring, and designing high quality controls. To support this change, Second Line operational risk should provide more oversight of methodologies and practice.

While accountabilities are defined in the RMA, First and Second Line responsibilities continue to be blurred. For example, Second Line is heavily involved in controls designed in certain customer and compliance-related initiatives across the bank.

Cascading risk and control responsibilities under BEAR

NAB implemented BEAR on 1 July 2018, giving APRA a clear articulation of the accountabilities of the Board, ELT and other selected senior leaders.

NAB is currently documenting the delegation of BEAR risk accountabilities to the next level of leaders, and updating polices, risk and control profiles, and committee charters and responsibilities to support and reinforce these accountabilities.

Value Chain Risk Management committees

First Line business leaders have established VCRMCs to help oversee and govern risks arising across end-to-end processes.

While these committees have become a critical component of enterprise risk management at NAB, they are not recognised in the formal risk governance framework, have no delegated accountabilities or mandatory requirements, and are not ultimately accountable through a Board-overseen performance framework.

4. RISK MANAGEMENT AND COMPLIANCE

Reliance on Enterprise Controls

To help business leaders meet their risk management accountabilities, there is a centralised Enterprise Controls function within Technology & Operations that is responsible for testing the operational effectiveness of controls. Divisionally aligned teams within Enterprise Controls are also in place to support business leaders to adhere to the RMF, including First Line risk reporting and governance, risk profiling, event management and controls design.

While much progress has been made in building out the Enterprise Controls capability, problems with inconsistency, variable quality and lack of clear outcomes have prevented the full value of this significant investment (384 full-time equivalent roles) being realised.

This observation is reflected in an overdue 3-star Internal Audit issue. The CPS 220 Comprehensive Review report also highlighted that the implementation of "a consistent First Line risk management model has been a persistent challenge with inconsistent application, changes of leadership, under-resourcing and ambiguity over accountabilities", and in its most recent report to NAB on operational risk management (10 October 2018), APRA again raised an issue in relation to NAB's First Line assurance model, including recent changes to the control assurance framework.

Management has taken steps to address these issues, including elevating leadership of the function to an EGM level, centralising reporting lines to drive more consistent outcomes, and taking steps to uplift the quality of the team.

While the First Line owns risks and controls, and the self-assessment observed examples of good practice, there are also many examples of business leaders outsourcing the design and maintenance of their controls to Enterprise Controls. In such cases, documented controls can be poorly aligned to targeted business outcomes, not well integrated to key business processes, incomplete and quite different in nature to the controls that business leaders rely on in practice.

ACTION #9:

Strengthen the effectiveness of First Line risk management through:

(i) Lifting the standard of overall risk governance, including clarity of accountabilities.

(ii) Increasing the capability of First Line to proactively and consistently identify and monitor risks.

(iii) Improving First Line understanding, design, documentation and execution of effective controls.

4.3.3 SECOND LINE RISK MANAGEMENT

In March 2017 the Group CRO initiated a review of the risk management function operating model. The two important objectives for this review were to:

- Transform NAB's Risk function so it can effectively anticipate and respond to what are expected to be fundamental changes in the financial services industry over the next 10 years, including in regulation, customer expectations, technology innovation and digital and a changing threat landscape (cyber security risk, model risk through increased use of machine learning, and financial crime).
- Ensure NAB's risk management capabilities and priorities support the bank's strategic transformation by building key enablers in areas such as data analytics, automated credit decision-making, and more real-time, forward looking risk reporting.

A new operating model and leadership structure was announced in November 2017 and came into full effect on 1 April 2018, resulting in the following:

- Compliance and Operational Risk functions were elevated with both functions now reporting directly into the Group CRO.
- Compliance oversight was consolidated into a central team.
- A Group Risk function was established to drive greater consistency and performance across the Risk division in core activities such as reporting, analytics, oversight reviews and model validation.

The self-assessment and the CPS 220 Comprehensive Review did not identify any significant issues in relation to the design of Risk's new operating model. However, interviewees and the CPS 220 Comprehensive Review both highlighted that a period of stability is needed to embed the new operating models across both the First and Second Lines of Defence.

Specific areas where there are capability or effectiveness gaps in Risk are discussed in the following sections.

Risk Reporting

Risk reporting by First and Second Line functions is recognised by interviewees and the Board as having improved in recent years. Some of the key changes are:

- The Group CRO Report which is submitted to the GRRMC and Board meetings was simplified and streamlined in 2016. It now has greater focus on emerging risks and concerns.
- More forward looking indicators and charts have been included.
- There is a simpler and clearer summary of performance against risk appetite.
- A Risk View is included in each material risk update and paper to BRC and GRRMC.

Prior to the introduction of the Risk View, papers represented a consensus position, and it was difficult to differentiate between the views of First Line and Second Line. Typically papers are now authored by the First Line and have Second Line views presented separately. Interviewees believe that this has increased transparency of Risk's position and challenge and has promoted more direct debate on the key risk and compliance issues and actions required. However, the quality of the Risk View is inconsistent and, at times, too passive or unclear regarding actions required, or timeframes mandated, for issue resolution.

4. RISK MANAGEMENT AND COMPLIANCE

Despite improvements, there remain examples where items of significance to customer outcomes or the bank's reputation have not been called out clearly enough.

The self-assessment has identified the following improvement areas for risk reporting:

- Ensure risk reporting brings appropriate focus to the impact of risks on customer outcomes and the bank's reputation.
- Develop more forward-looking risk indicators, particularly for emerging or changing non-financial risks.
- Establish additional metrics on key compliance and regulatory obligations including, for example, breach reporting, customer remediation and complaints (in progress).
- Develop and report additional qualitative and quantitative metrics for conduct risk (see below).
- Improve risk reporting alignment across the bank and VCRMCs.
- More holistic reporting of matters affecting the bank's reputation.
- Improve tracking and reporting of timeliness of issue resolution (see Chapter 5: Issue Identification, Escalation and Resolution).
- Ensure risk reports adequately communicate learnings from events and breaches as well as providing examples of better-practice risk or compliance approaches.
- Sharpen the application of the Risk View so it clearly and consistently identifies the concerns, issues or action required.

The self-assessment also identified the opportunity to improve NAB's governance, risk and compliance system capabilities to enable NAB to respond rapidly and reliably to emerging issues, risks, events and breaches; and to improve analysis and reporting of risk appetite, risk profiling, issue management, compliance management and risk performance.

Compliance

The bank has a duty to obey the law. As such, an effective and mature compliance framework is a foundational requirement.

At the end of September 2018, NAB's Australian operations were subject to more than 528 sources of law, regulations and codes creating 2,732 unique compliance obligations. This translates to 14,033 individual requirements across NAB's operational structure.

In addition a large volume of regulatory changes in recent years has affected NAB's Australian business: 103 in the 2017 financial year and 83 in 2018. These changes need to be individually assessed, owners identified, obligations and controls reviewed and registers updated.

Within Board and management reporting, NAB has assessed its compliance risk rating as Red since 2013 (except for a brief period at Amber in 2016).

In this context, the self-assessment found management of the Compliance function has been too closely intertwined with operational risk. This has resulted in Compliance ceding its authority and veto rights to the First Line. With some exceptions, the First Line has applied a risk-based approach to managing compliance obligations, incorrectly risk-accepting some compliance risks or issues without appropriate escalation.

Interviewees confirmed that the voice and stature of Compliance have not been strong. The function was viewed primarily as the custodian of frameworks, policies and escalation channels by both First and Second Line functions, and has not been granted a 'veto authority' in cases where it considered compliance arrangements to be inadequate. Examples of areas where the accountability and authorities of Compliance need to be clearly set and executed include:

- product approval and review process;
- surveillance;
- licence management;
- breach management (in progress);
- regulatory change (in progress); and
- consequence management for breach events.

While there has been significant focus on and attention to the effectiveness of key controls for Compliance, NAB has not historically insisted on establishing controls that can positively demonstrate evidence of compliance.

As set out in the recent report on breach management by ASIC (Report 594 "Review of selected financial services groups' compliance with the breach reporting obligation"), NAB must improve its breach identification, investigation, escalation, reporting and customer remediation processes. These gaps and weaknesses represent serious compliance failures and are delivering poor outcomes for customers.

Regulators have observed that the level of resourcing in NAB's Compliance function is below that of peer banks. While the bank has approved over 50 additional compliance specialists (an increase of approximately 90%), further increases are likely to be required. The bank has also found that it can take quite a long time to recruit capable risk and compliance resources, as the local market for such talent is highly competitive.

In 2018 NAB established a new EGM role of Chief Compliance Officer, reporting directly to the Group CRO, to provide a firmer base for strengthening the capabilities and voice of Compliance.

Conduct Risk

NAB is acutely aware of the importance of managing conduct risk to prevent unfair outcomes for customers. However, despite it being defined as a material risk in the bank's 2017 financial year RMS and the bank's experience in the UK, the development and embedding of a bank-wide approach to conduct risk management has not occurred with sufficient pace or urgency.

This has resulted in a high variance in the maturity of customer-outcome related risk assessments and assessment of conduct risk exposures. It has also contributed to a lack of integrated oversight mechanisms such as monitoring, surveillance and assurance to detect conduct failings and emerging risks, and has led to gaps in control coverage and weaknesses in control effectiveness. Further, it has slowed the progression of reporting beyond basic

4. RISK MANAGEMENT AND COMPLIANCE

qualitative commentary with no quantitative measures or bank-wide assessment against appetite which has clouded visibility and limited the ability to pre-empt or identify emerging risks.

In particular, customer complaints are being under-utilised as an indicator (lead or lag) of conduct issues and poor customer outcomes. There is a weakness in the feedback loop and an inconsistent level of the rigour and investigation into complaints needed to mitigate the risk and identify potential systemic issues.

These issues and weaknesses were reinforced in a recent internal audit report on the effectiveness of NAB's Conduct Risk Framework, resulting in a 3-star issue being raised. The findings were echoed in the CPS 220 Comprehensive Review report.

Operational Risk

Over the last three years, NAB has taken steps to improve both its operational risk and IT risk management frameworks. In 2018, as for Compliance, NAB established a new EGM Operational Risk position, reporting directly to the Group CRO.

Overall, the self-assessment interviewees identified that a number of improvements are required, the key ones being:

- The adequacy and reliability of the control environment requires improvement. While 95% of NAB's key controls for operational risk are rated effective, investigations into operational risk losses and events are finding weaknesses and gaps in control design and effectiveness. As mentioned above, improving competencies within the First Line generally, and within Enterprise Controls specifically will be critical in this regard, but so will be improving the oversight by Group Operational Risk.
- Gaps exist in NAB's issues management, reporting and oversight processes. This is supported by the long outstanding nature of many of NAB's operational risks reported to GRRMC and Board such as Data Governance and SIO. More discipline is required to ensure actions taken fully address causes, and issues are not closed until sustainable outcomes have been achieved (see Chapter 3: Senior Leadership Oversight and Chapter 5: Issue Identification, Escalation and Resolution).
- The fast evolving external environment (e.g. regulation, cyber risk) and NAB's internal environment (e.g. the transformation program, the adoption of cloud technology, changes to insourcing/outsourcing arrangements) are driving changes in NAB's strategies, risk appetite and control environment. Areas where NAB continues to adapt and strengthen risk appetite, risk profiling and control activities include technology risk, cyber, data and privacy. As these critical operational risk classes develop, it is likely that they will require additional Second Line capabilities and resourcing.

Operational Risk Profiling

NAB is currently elevating its operational risk profiling to the Board, GRRMC, VCRMCs and Technology & Operations Risk Management Committee to provide a holistic and forward-looking view of the operational risk profile. These changes are:

- Increasing the reporting frequency (from twice a year to monthly).
- Improving visibility, alignment and clarity of risk profiles and risk accountabilities across risk governance forums (including establishing a common risk taxonomy).
- Driving a greater focus on excessive rated risks or ineffective controls and related action plans.
- Identifying the relevant BEAR accountable executives for reported risks.

Risk in change

The overall strategic planning process, including oversight of changes arising within the annual investment program, is covered in Chapter 6: Financial Objectives and Prioritisation. Looking at projects and change more broadly, the self-assessment identified a number of potential issues associated with NAB's approach to managing risk (both delivered risk and execution risk):

- While risk governance committees' scopes include oversight of delivered and execution risk in change activities, little agenda time is focused in this area.
- First Line control design and Second Line risk oversight (through sign-off of delivered risk assessments) are too often engaged late in the change planning process.
- NAB's project methodology does not prescribe Board oversight or independent project health assessments for larger projects.
- The existing governance approach sees First Line executives being both responsible for delivering change in their area, and responsible for governing this change as Chair of their respective Customer Delivery Committees (CDCs).

4. RISK MANAGEMENT AND COMPLIANCE

ACTION #10:

Improve the effectiveness of Second Line's policy, oversight and reporting activities, including:

(i) Driving improvements in non-financial risk reporting including strengthening the Risk View, better escalating significant matters, and monitoring issue ageing.

(ii) Changing policies and reporting to help support and evidentiary approach to compliance, and revising authorities to support a strong voice of Compliance.

(iii) Linking, integrating and deepening conduct risk management under an approved framework.

(iv) Increasing depth of capabilities and resourcing in critical operational risk and compliance areas.

(v) Engaging Risk earlier in change activities, and improving governance of risk arising from change.

5. ISSUE IDENTIFICATION, ESCALATION AND RESOLUTION

5. ISSUE IDENTIFICATION, ESCALATION AND RESOLUTION

5.1 SUMMARY

Expectations regarding issue identification, escalation and resolution (issue management) at NAB are outlined in relevant policies, supported by a range of systems and processes.

Issue management behaviours are influenced by these structures, and are also a reflection of the mindset, culture, and priorities of the organisation.

The self-assessment has shown that while NAB has frameworks and systems in place to support issue management, there are gaps in both the design and the effectiveness of these practices. This has manifested in a failure to rapidly identify compliance breaches, and the slow resolution of some critical issues (particularly complex issues which spanned divisional boundaries).

The issue management practices do not bring enough focus to the potential or actual impact of issues on customers, and NAB continues to have weaknesses in its ability to identify systemic issues related to customer complaints. NAB has taken positive steps to improve consistency and timeliness of customer remediation, though further steps are required.

While regulatory relationships are seen as open and constructive, they can be overly transactional. Further, there are inconsistencies in the way NAB tracks and manages obligations and commitments across different regulators.

In response to these findings, the following actions will be taken:

#11 Improve compliance-related controls and monitoring to evidence ongoing compliance and more quickly identify, report and remediate any breaches.

#12 Review and redesign issue management practices to:

(i) Better incorporate the voice of the customer.

(ii) Improve timeliness of resolution (including accountability, resource allocation, monitoring and links to remuneration).

#13 Establish clear targets and refine processes – including root cause analysis, reporting and oversight – with the objective of reducing high-severity complaints.

#14 Continue to invest to lift the effectiveness of customer remediation practices, reporting and governance.

#15 Review regulatory relationship practices to move beyond transactional interactions, and ensure that all regulatory expectations and commitments are captured and monitored effectively.

5.2 BACKGROUND

Definitions

In NAB's Operational Risk Management policy:

- "Issues" are gaps in the risk or control environment, which if uncorrected could lead to events.
- "Events" are problems that have actually occurred (which may or may not result in a loss).
- "Actions" are activities undertaken to address events or issues.

In this chapter, the term "issue management" refers to identifying, escalating and resolving the above three items. While issues, events and actions are captured within the Operational Risk Management Policy, they could relate to risks from any risk category.

Operational risk policies

NAB's operational risk policies establish requirements regarding identification, recording, tracking and closing risk issues and events. All employees at NAB are responsible for identifying and capturing risk events, while business leaders are responsible for identifying and capturing risk issues. Once identified, issues and events must be documented and recorded in risksmart, including the issue/event owner, target resolution date, and criticality. Events must be captured within five business days, to enable timely breach reporting.

Business leaders must identify and record time-bound actions to address issues and events. Before high-rated issues and events can be closed, confirmation is required by the relevant divisional CRO.

Monitoring and reporting of issues, events and actions

High-rated risk actions (related to issues and events) must be reported quarterly to business leaders to ensure adequate progress is achieved. This reporting is overseen by the appropriate divisional risk team.

More material issues satisfying specified criteria are designated as MOIs by the Group CRO; such issues are tracked and reported monthly at the GRRMC and the BRC. MOI reporting includes detailed updates on each issue (via a report loaded to the Committee reporting system), plus a summary of issue resolution status in the Group CRO Report (including in recent months elapsed time open and expected resolution date).

In the 2018 financial year, this reporting was supplemented with year-end progress targets for selected issues. Outcomes versus targets were included in the report provided by the Group CRO to RemCo (for consideration in executive and senior management remuneration outcomes). Issues tracked on this Risk Targets report have generally shown good progress during the period.

5. ISSUE IDENTIFICATION, ESCALATION AND RESOLUTION

Compliance breach assessment and reporting

Compliance-related events that are potentially reportable are tagged and forwarded to Compliance for review and investigation. These events are escalated to the Significant Event Review Panel (SERP), which is chaired by NAB's Chief Compliance Officer (with an equivalent Breach Review Committee for the Wealth division). SERP assesses whether these events satisfy prescribed requirements for breach reporting. Under legislation, breaches (or likely breaches) which satisfy reporting criteria must be reported to the relevant regulator within 10 days from NAB becoming aware of the breach. For regulatory frameworks which do not include a breach reporting requirement (such as the National Consumer Credit Protection Act), NAB reports breaches to the relevant regulator regardless.

Reportable regulatory breaches are reported in the Group CRO's reports to BRC and the Board and typically include the nature of individual breaches, trends in breach volumes, and timeliness of breach reporting.

Audit and Regulatory issues

Issues raised by Internal Audit and APRA are captured in the Global Assurance Issue Tracking System (GAITS). 'Star' ratings are assigned to reflect the severity of the issue. High severity audit issues are reported regularly to the BAC. Audit and regulatory issues require Internal Audit or regulator confirmation to close.

Whistleblower

The NAB Whistleblower Program, managed by Internal Audit, was established for employees who wish to raise concerns anonymously. Employees can access the program in a number of ways, including through FairCall, an independently monitored external hotline provided by KPMG.

At Board level, BAC has accountability for oversight of NAB's Whistleblower Program. Because of access and sharing restrictions the self-assessment did not review the program's performance, but an external review is scheduled to be undertaken in the 2019 financial year.

Complaints

All customer-facing employees are responsible for capturing and resolving complaints raised with them in the first instance. NAB actively tracks and works to improve first point of contact resolution. If a complaint is more complex or requires more time It is handled by a dedicated function (NAB Resolve). Complaints are captured in a system called the Feedback and Information Repository (FAIR). Complaints trends and themes are reported directly to the ELT, with complaints volumes and monthly customer feedback reported to the Board. Complaint reporting is also reviewed by VCRMCs and the CXB.

Resolving more significant issues

For significant issues, a project may be raised, in accordance with NAB's Project Execution Framework. Such programs will be allocated specific funding and resourcing, overseen by a designated sponsor, and governed by a project advisory board. Project delivery risk is regularly assessed and reported to CDCs. A Delivered Risk Assessment process exists to identify and manage risks to business activities that may arise from larger change programs.

Customer remediation

Events with a customer impact must be additionally assessed to identify whether customer remediation (compensation or other) is required. In July 2018, the GRRMC approved the establishment of a centralised remediation function to bring a consistent approach to such remediation. The following remediation principles have been established:

Remediation Principles

- NAB will review events and initiate remediation for all applicable issues that have resulted in adverse customer outcomes as soon as we become aware of these issues.
- NAB will ensure that customers are at the centre of the design of all remediation programs.
- All NAB customers who have suffered harm or detriment are made good (i.e. remediated) – i.e. put into the position they would have been in if the harm/detriment had not occurred (includes customers who are no longer with NAB) wherever this is possible.
- All remediation programs are to be designed as Opt Out unless there is a material barrier to doing so – e.g. customer engagement is required to understand whether remediation is required.
- There should be equitable and consistent treatment between affected customers – both through any remediation program and in alignment with business-as-usual remedies.
- Assumptions should be made in the customer's favour if the data that should have been retained is incomplete.

Management of 'Excessive' risks

From the beginning of the 2019 financial year NAB has set a risk appetite that requires any 'Excessive' risk to have an accompanying BEAR-endorsed plan to reduce residual risk to an acceptable level within a specific time frame. ('Excessive' risks are those that have a high residual risk severity and probability).

5. ISSUE IDENTIFICATION, ESCALATION AND RESOLUTION

Regulatory engagement

Responsibility for regulatory affairs resides with the Group CRO. The Group CRO has established a regulatory engagement procedure which states NAB's approach to regulatory interaction, including identifying roles and responsibilities. This includes a central role for the Regulatory Strategy and Affairs (RSA) function, which is responsible for co-ordinating and, in some cases, leading regulatory interactions in a way which is professional, transparent, open, cooperative, constructive and in line with the NAB Values. RSA also tracks actions and monitors deadlines to ensure that commitments made to the regulators are delivered against any agreed timeframes.

5.3 REVIEW OBSERVATIONS

5.3.1 WILLINGNESS TO RAISE ISSUES

Employees generally demonstrate a willingness to speak up on risk issues. The 2018 Employee Engagement Survey reported that, in their immediate teams, 87% of employees said risk issues are identified and reported quickly and openly. Also, 74% of employees indicated that they can report an instance of unethical conduct without fear of retribution. Issues in NAB's Introducer Program were originally raised through NAB's Whistleblower Program. However, as outlined in Chapter 9: Culture, employees also indicate discomfort at challenging overtly the decisions and behaviours of others.

5.3.2 BREACH REPORTING

During the self-assessment, ASIC published Report 594 "Review of selected financial services groups' compliance with the breach reporting obligation" (September 2018). Relevant findings for NAB are:

- Delayed identification of incidents: NAB took an average of 1,849 days (median: 1,228 days).
- Time taken from investigation to lodgement of breach report: the NAB average was 139 days (median: 93 days).
- Failure to report to ASIC within 10 business days after becoming aware of a significant breach (84 delayed breach reports, representing 76% of all late breaches reported by the financial groups reviewed by ASIC).
- Delayed remediation for consumer loss: NAB took an average of 265 days (median: 234 days).
- Monitoring, benchmarking and internal reporting of compliance and breach notifications could be improved.
- Timely application of consequence management is required alongside sound record keeping for consistency and transparency.

Since 2015 NAB has made concerted efforts to improve its approach to breach reporting and will continue to review and improve processes and systems. The number of significant breaches reported to ASIC in more than 10 business days has steadily declined since a peak between July and December 2014. No breaches were reported outside the required timeframe during 2018.

In 2018 a number of changes have also been initiated to strengthen NAB's breach management activities:

- Central oversight by Compliance of compliance breaches and events (Wealth Risk continues to oversee NAB wealth breaches).
- Changes to the SERP governance and decision-making process with a focus on root cause analysis, timeliness of escalation and remediation plans.
- Changes to consequence management review and reporting for significant events.

ASIC has stated that one important reason for the breach reporting framework is to allow issues affecting customers at one institution to be investigated at other institutions. In order to satisfy ASIC's requirements in this respect NAB will need to introduce clearer measurement of outcomes to enable more rapid breach identification.

ACTION #11:

Improve compliance-related controls and monitoring processes to evidence ongoing compliance and more quickly identify, report and remediate any breaches.

5.3.3 VOICE OF THE CUSTOMER IN ISSUE MANAGEMENT

The default assessment, articulation and reporting of issues and events has been with reference to their potential impact on NAB, not on its customers. Events are assessed according to a Risk Impact Assessment Matrix, which includes dimensions relating to Profit & Loss impact, possible regulatory intervention, employee safety, reputation (relating to possible negative press reports), and customer (relating to the potential for non-availability of systems).

In the 2018 financial year NAB expanded the Risk Impact Assessment Matrix to include a more comprehensive assessment of customer impact, including specific recognition of aggregate customer detriment.

More broadly, the voice of the customer is rarely used in characterising and reporting risk issues and events, except in the case of individualised remediation negotiation. Framing issues in terms of their potential impact on customers or actual detriment caused (as described by customers in complaints) is a powerful but under-used mechanism that would better align risk management activities to NAB's vision.

5. ISSUE IDENTIFICATION, ESCALATION AND RESOLUTION

5.3.4 COMPLEX ISSUE MANAGEMENT AND CLOSURE

Notwithstanding good recent progress on issues reported through the Group CRO's Risk Targets report, in general MOIs have been open for very long periods; periods which are considered by the Board to be outside of acceptable standards.

At the time of the self-assessment 37 MOIs had been open in their current form for an average duration of 20 months. Some are linked to previous MOIs, suggesting the underlying issues have been open for longer than that. Since October 2018, the summary reporting provided to the Board on MOIs has included elapsed time and expected closure dates, along with allocation of a BEAR Accountable Person for each MOI.

Although a number of factors contribute to extended timeframes, the review of case studies and historic reporting has highlighted some important elements:

- Management is overly optimistic of its capacity to remediate identified issues. This has resulted in proposed timelines for solutions being exceeded.
- Issues have typically been treated as a series of allocated actions in risksmart rather than as an integrated, managed, and governed project. For such a project to be effective, ownership (or sponsorship) must be taken by the relevant business owner.
- Closed issues have recurred because of non-sustainable or incomplete solutions.
- Assignment of accountability is ineffective, with responsibility being allocated without the appropriate level of seniority; being fragmented across multiple parties; or not being effectively transitioned in cases of employee movement or turnover.
- There is inadequate provision of resourcing, attention or priority – with budgets being managed to what is perceived to be affordable rather than what is required to deliver a sustainable solution. This is a particular challenge when changes to non-integrated, legacy systems had been assessed as relatively simple, but resulted in being expensive to deliver.
- Management of actions rather than outcomes is evident – where the completed actions have not proved effective at addressing the original issue.
- There is a tolerance for timeframes that are comfortable rather than stretching, or for a large number of stage gates where progress between each is only incremental.
- Tasks tend to be assigned to generalists rather than to specialists with the expertise required to drive targeted interventions.
- The project governance framework does not mandate Board approval and oversight for larger or more sensitive projects.
- The reporting framework has not held a spotlight to long-dated issues, changes of deadlines/scope, or failures to deliver against agreed commitments.

Employees have commented that NAB has had a tendency to confuse activity with progress when it comes to resolving larger, more complex MOIs.

Further, while policies establish minimum standards for action plan reporting, there are not yet consistent and effective standards in place. It is possible actions are not being delivered in a timely way and that such delays are not being appropriately recognised and dealt with – supporting the need for an agreed reporting approach through prescribed governance forums.

ACTION #12:

Review and redesign issue management practices to:

(i) Better incorporate the voice of the customer.

(ii) Improve timeliness of resolution (including accountability, resource allocation, monitoring and links to remuneration).

5.3.5 RESOLVING CUSTOMER COMPLAINTS

NAB's track record in listening to and learning from customer complaints has been poor. A focus on complaints through NAB's Customer Journeys and Customer Pain Points programs has resulted in some recent improvements.

However, customers continue to report that NAB's complaints handling process is slow. NAB has not always been quick to recognise recurring patterns and deal with them diligently. Persistent issues exist in data and categorisation quality, and identification and resolution of root causes.

Since May 2018, NAB has had an open 2-star Internal Audit issue relating to the lack of a systematic way of identifying complaints which in aggregate represent an operational risk event (triggering assessment, reporting, and rectification requirements).

It is also evident from many Committees and from customer feedback that in certain cases there is too much time between complaints being received, and specific events being raised.

Complaints are categorised in the first instance by the employee who enters the complaint, by selecting the appropriate category from a drop-down list in FAIR. Feedback from NAB Resolve and the business owners who receive the categorised complaints reveals that this manual process does not have the required level of accuracy. NAB Resolve is exploring improved techniques such as voice-to-text conversion and machine learning to support a more consistent and accurate categorisation process. Such techniques should also seek to distinguish high-severity complaints (those which could indicate compliance breaches, customer detriment, systemic system and process quality issues, or internal or external party misconduct) from others to allow for appropriate escalation and response.

While complaint volumes are tracked, NAB has not historically had consistent measures in its risk appetite or executive scorecards to reduce high-severity customer complaints. Such targets, supported by appropriate reporting and governance, can deliver significant improvements in customer outcomes.

5. ISSUE IDENTIFICATION, ESCALATION AND RESOLUTION

ACTION #13

Establish clear targets and refine processes – including root cause analysis, reporting and oversight – with the objective of reducing high-severity complaints.

5.3.6 CUSTOMER REMEDIATION

Historically NAB has had an inconsistent approach to customer remediation. Remediation activity has been the responsibility of the business within which the issue arose. While this has reinforced an accountability-at-source expectation, it has meant that customers have potentially received different treatment and an inconsistent experience depending on where in the organisation the issue occurred.

Lack of experience in remediation teams has also contributed to errors being made, with examples of NAB having to remediate the remediation.

Regulatory expectations such as those outlined in ASIC's Regulatory Guide 256 "Client review and remediation conducted by advice licensees" (September 2016) had not historically been adequately recognised nor embedded in NAB's policies and processes. NAB was slow to respond to specific regulatory feedback with respect to the design or delivery of remediation programs (such as whether remediation programs were opt-in for the customer). Fragmented remediation has also made it difficult for the Board and ELT to bring appropriate holistic oversight and intensity to remediation efforts.

Within NAB there are examples of customer remediation taking too long to complete. In particular NAB's remediation of customers affected by inappropriate advice (from 2009 – 2015) and NAB's remediation of the fees for no service matter (2009 – 2018) are both expected to continue until at least the end of 2019.

In 2018 NAB established a Centre for Customer Remediation to bring a consistent approach to customer remediation programs, provide certainty in resourcing, establish and maintain clear policies and procedures, and establish a basis for reporting and oversight to the Board and ELT.

Further investment will also be made in areas of more complex and challenging complaints, such as in the agribusiness and small and medium enterprise lending areas, where specific expertise and skills are needed to effectively resolve concerns.

ACTION #14:

Continue to invest to lift the effectiveness of customer remediation practices, reporting and governance.

5.3.7 REGULATORY INTERACTIONS

Regulatory relationship management

At NAB's request, APRA and AUSTRAC took part in interviews during the self-assessment and provided observations in relation to NAB's issue management. ASIC was asked but declined to take part in an interview.

Across a range of formal communications from regulators, NAB's engagement has been described as "open and constructive".

However, interviews with regulators and members of the ELT revealed that the protocols NAB has adopted in regulatory interactions have at times led to interactions that are overly transactional in nature, missing the opportunity to be more proactive and relationship-development oriented.

Tracking and delivering against regulatory expectations

An August 2018 Internal Audit report described inconsistencies in NAB's ability to capture, monitor and govern delivery against non-prudential regulatory commitments. Management has committed to developing a process to manage these regulatory commitments more consistently.

In addition, NAB has not always listened and learned effectively when regulators have signalled their expectations via regulatory reports.

As an example, in 2011 ASIC produced Report 256 "Consumer credit insurance: A review of sales practices by authorised deposit taking institutions". In this report, ASIC identified a number of concerns regarding the sale of Consumer Credit Insurance through Authorised Deposit-taking Institutions (ADIs), and laid out expectations for the industry. In 2017, ASIC asked ADIs to submit to audits to test their adherence to those expectations. NAB's review showed that despite the original report having been published in 2011, compliance with all of the recommendations within the report had not been achieved through the 2013 – 2017 review period.

ACTION #15:

Review regulatory relationship practices to move beyond transactional interactions, and ensure that all regulatory expectations and commitments are captured and monitored effectively.

6. FINANCIAL OBJECTIVES AND PRIORITISATION

6. FINANCIAL OBJECTIVES AND PRIORITISATION

6.1 SUMMARY

To build a sustainable business, NAB recognises the need to operate with a focus that sees obligations to all stakeholders, and particularly the interests of its customers and shareholders, as ultimately aligned. This requires everybody at NAB to strike the right balance of priorities when making decisions and when trading off between immediate return and longer-term value.

The self-assessment found that the bank has demonstrated a willingness to make decisions which favour long-term over short-term financial results, with the recent decisions to increase investment spend and simplify and transform the bank a clear example. Further, NAB's annual investment spend has allocated significant amounts to risk-related initiatives, with participants in the most recent strategic planning process feeling that the voice of risk in investment allocation was present and effective.

While this is positive, the self-assessment also observed that a material portion of investment is being allocated to reduce complexity and accumulated operational (particularly technology) and compliance risk, which may indicate that more investment should have been requested or allocated to these objectives in prior periods.

Further, in a number of instances management has identified capacity and capability gaps and has sought to increase operating expenses to address these risks. With the introduction of BEAR accountabilities, it would be helpful to systematically review capacity and capabilities to ensure no significant gaps in the management of specific risks remain.

More broadly, it was observed that a focus on financial returns (and increasingly customer experience) is deeply embedded and strongly weighted in NAB's organisational thinking and practices. As a result, NAB's formal priorities, processes and people (often unconsciously) give prominence and preference to the short-term financial objectives over other factors, such as customer outcomes. NAB has not applied a consistent, explicit framework for guiding decision-making and at times decisions and trade-offs did not explicitly consider all stakeholders, were limited by perceived constraints or have been misinterpreted as they cascaded through the organisation.

Finally, while NAB brings a clear focus to customer experience, more work is required to establish a consistent approach to considering customer outcomes, customer interest and value to customers in goal-setting, decision-making and performance management, as well as in conduct-related frameworks such as Products@NAB.

In response to these findings, the following actions will be taken:

#16 Implement a more specific and explicit approach to support BEAR Accountable Persons in evaluating and assessing the adequacy and appropriateness of operational capacity and investment to address the risks for which they are responsible. In support of this, update NAB's categorisation, measurement and reporting of risks to better align to BEAR accountabilities.

#17 Establish a consistent and explicit decision-making approach for important decisions, that includes consideration of the impacts on customers, employees, risks, reputation and financials.

#18 Revise NAB's approach to the design, management and governance of products and services to identify and assess value delivered to customers, and to monitor the quality of delivery of that value.

6.2 BACKGROUND

NAB's strategic planning process and performance objectives

NAB's annual Board-endorsed strategic planning process sets business performance objectives aligned with NAB's risk appetite and business strategy. The outputs of the strategic planning process are the Strategic and Financial Plan, Funding Strategy, Capital Management Strategy and Group Risk Appetite Statement. These collectively form NAB's business plan.

At Board and ELT level, a five-year Group Strategic and Financial Plan is developed, with a formal Group Budget approved before the start of each financial year. The most recent Strategic and Financial Plan and the 2019 financial year Group Budget were completed and approved in September 2018.

On 2 November 2017, NAB announced an acceleration of the bank's long-term strategy to respond to changing customer expectations, competitive dynamics and risk and regulatory requirements.

The long-term strategic objectives of NAB are:

- NPS positive (#1 of major Australian banks);
- Cost-to-income ratio towards 35%;
- #1 ROE of major Australian banks; and
- Top quartile employee engagement.

The announcement also included a forecast increase in investment spend of $1.5bn over the 2018–2020 financial years, offset in part by an aggregate $1.0bn of targeted cost savings over the same period. These cost savings are forecast to be achieved through a reduction in 6,000 FTE roles due to productivity benefits of simplification and automation and a flatter organisational structure, and reduced third party costs. An additional 2,000 FTE are expected to be added to support investment and the capabilities needed to deliver the strategy.

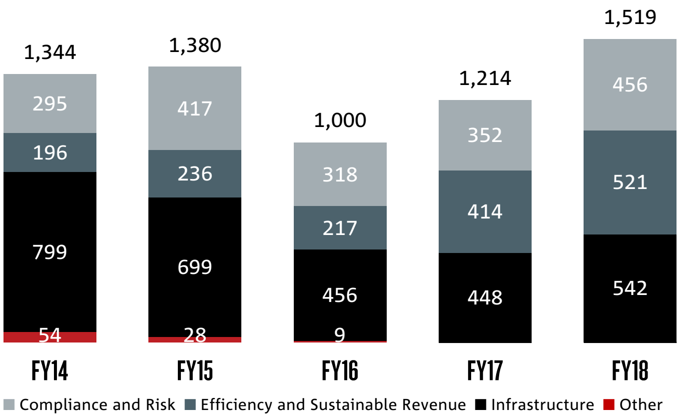
NAB's key performance indicators against its objectives are primarily reported to the ELT and monitored by the Board through the CEO, CFO and Group CRO reports and two dashboards, Run the Bank and Change the Bank. These dashboards include metrics that have been agreed with the Board to measure performance and monitor progress towards achieving the overall strategic objectives described above. The Board also receives regular deep-dives on key metrics set out in the two dashboards.

6. FINANCIAL OBJECTIVES AND PRIORITISATION

Growth Fund investment allocation

Every year, NAB allocates a significant amount of money (the Growth Fund) to investment across a range of priorities:

Figure: 6.1 NAB Project Investment Spend



The annual Group Budget process includes the allocation of funding to planned investment priorities for the given year. In doing so, it seeks to align NAB's financial capacity with its delivery capacity and investment need from a strategic (including risk and regulation) perspective. As in any large business, the requests for investment spend in any given year exceed what can be accommodated, both financially and operationally.

To support acceleration of NAB's strategy, drive focus and reflect priorities more appropriately, a dedicated steering forum considers all investment proposals from all divisions. These include regulatory change, risk and compliance management and core system refresh/maintenance proposals.

These proposals are then debated and ultimately prioritised collectively by the ELT, considering risk and the ability to execute given the supply and demand on specific teams with tailored skill sets.

The Growth Fund allocation is further refined throughout the year to cater for new requirements from regulators or the changing environment within the financial services industry.

6.3 REVIEW OBSERVATIONS

6.3.1 INVESTMENT SIZE AND PRIORITISATION

Decisions made regarding the size and allocation of investment are critical to the prudent management of the bank.

In 2017 the Board encouraged management and chose to increase investment spend to support a faster transformation of the bank, in order to better position NAB to succeed in a changing customer, competitive and regulatory environment. Within NAB, this is seen as evidence of an organisational willingness to make choices which favour long-term sustainability over short-term financial results.

There is not a perception within NAB that risk and compliance investments lack priority. In fact, during self-assessment interviews, it was observed that linking a proposed investment to risk, regulatory or compliance requirements would tend to secure a move favourable investment priority.

Significant investment in risk, regulatory and compliance-related projects was approved in the 2019 financial year strategic planning process. ELT requested that Risk identify, report and assess the residual risks arising from any deferred or rejected investment applications. Following that review, Risk recommended that the allocation of the total investment pool be increased for projects related to risk and compliance, process, control and system improvements (known in NAB as 'industrialisation'), and the ELT adopted this recommendation. Interviews with those involved in this process, including ELT members and Risk, showed that the process was widely seen as thorough and balanced and that challenge was welcomed to ensure priorities were appropriate and risk effectively considered.

While this reflects positively on the process undertaken this year, it is also apparent that a material portion of current investment is being allocated to reduce accumulated complexity, operational (particularly technology) risk, and compliance risk. This may indicate, on balance, that more investment should have been requested or allocated to these objectives in prior periods.

Increases in operating expenses have also been required in certain areas, where it has been identified that business-as-usual capacity and capabilities were not at the required level to effectively manage risks or deal with issues. Where changes to expenses are material (such as larger remediation costs), this can be recognised via a change to budget, through a planned variance, through reallocating planned investment spend to operating expenditure, or through allocating the costs to a central cost centre. For smaller changes, business leaders are generally expected to find efficiency gains to fund the change within their agreed budget. While this is not an uncommon practice, care must be taken by both the First and Second Lines to ensure that the accumulated impact of such changes does not add up to more significant unrecognised and ungoverned residual risk.

The self-assessment identified that there is a separate assessment in progress in one division under the supervision of the relevant BEAR Accountable Person to ensure that the residual risk position for all BEAR responsibilities are understood, appropriate plans and investment are in place if required and/or risk is formally accepted. This assessment is not yet complete or under way for other divisions.

ACTION #16:

Implement a more specific and explicit approach to support BEAR Accountable Persons in evaluating and assessing the adequacy and appropriateness of operational capacity and investment to address the risks for which they are responsible. In support of this, update NAB's categorisation, measurement and reporting of risks to better align to BEAR accountabilities.

6. FINANCIAL OBJECTIVES AND PRIORITISATION

6.3.2 CONSIDERING TRADE-OFFS IN DECISION-MAKING

The Board and ELT clearly recognise the need for decisions to take into account the consequences for all of NAB's stakeholders, its standing and reputation – as well as the need to adjust to changes in the external environment.

NAB's target behaviours include "taking a stand for the customer" and NAB has at times visibly taken the lead in delivering positive customer outcomes at the expense of short-term financials.

The Board and ELT also acknowledge that the formal mechanisms and informal practices for considering financial risks and returns for NAB have been embedded over a long time and are most prominent in decision-making as a result. Ensuring that key decisions are genuinely balanced and aligned with NAB's vision will require deliberate and consistent practice and reinforcement.

In self-assessment interviews, discussions with senior executives, and reviews of proposals and papers it was clear that the way important decisions are analysed and made is not explicitly guided by a consistent set of principles that would encourage a balanced consideration of consequences and stakeholders (including the 'can we' / 'should we' question).

As a result:

- Important decisions have, in some examples, been proposed without explicit consideration being given to consequences for all relevant stakeholders. For example, a recent management paper proposed changes to a particular commercial arrangement. The paper clearly considered the financial aspects of the decision, but was silent on the impacts to customers. The BRC rejected the proposal, directing management to give more consideration to the customer.
- Examples were observed of decisions being limited by perceived local budget or resourcing constraints. This curtailed the exploration of options, and at times did not allow for the right response for the bank or customers.
- Decisions made at senior levels, featuring trade-offs balancing multiple factors, have at times been misinterpreted as they cascaded through the organisation. For example employee focus groups indicated that despite changes to scorecards, sales remain the most prominent motivator.

In addition, while mechanisms exist to assess individual performance with respect to customer experience, risk and compliance outcomes, and behaviours and values, for many the assessment of financial results, and direct impact of this measurement on performance, was perceived to be much stronger.

ACTION #17:

Establish a consistent and explicit decision-making approach for important decisions, that includes consideration of the impacts on customers, employees, risks, reputation and financials.

6.3.3 CONSIDERING VALUE TO CUSTOMER AND CUSTOMER OUTCOMES

NAB's strategic ambition to be in positive NPS territory and #1 in priority segments is a well understood and measured customer objective within NAB. NPS has driven significant investment and focus and reflects a strong commitment to customer experience, but may have created a narrowing belief that improving the customer experience equates to a broader commitment to customer service as a whole.

The ability to create an exceptional customer experience is one component of customer service, as is considering the customer's interest appropriately and delivering on commitments reliably. There are many cases where these objectives will be achieved together, but it does not mean that one necessarily follows the other. For example, the practice detailed in the Royal Commission of not witnessing beneficiary nomination signatures correctly; while many employees felt that this made it easier for customers, it instead called into question the validity of these documents and subjects customers' wishes to potential risk.

The self-assessment found that the consideration, definition and measurement of value to customers and customer outcomes is not subject to the same discipline and systematic rigour as financial outcomes and customer experience.

In other international markets where significant emphasis has been placed on mis-selling and customer outcomes for many years, significant focus has been applied to ensuring 'value' to customers of products and services becomes a primary factor in organisational decision-making, sometimes at the expense of short-term returns.

This, in turn, has created an environment where employees feel empowered to challenge the status quo and revisit past decisions, reinforced by a high degree of monitoring of product/service performance and sales practices metrics, often at the most senior levels of the organisation.

The primary dashboard used by the Board for monitoring business-as-usual performance (the Run the Bank dashboard) contains only one metric to indicate the quality of customer outcomes, being aggregate customer complaints for the quarter. In comparison, 20 metrics measure customer experience, 18 measure employee trends, 33 cover "attractive returns" and 23 relate to risk, many of which have a financial impact.

As outlined in Chapter 4: Risk Management and Compliance the overall approach to conduct risk and particularly product-level monitoring and reporting requires significant improvement if customer outcomes are to become a prominent part of NAB's performance management.

One of NAB's key governance mechanisms for ensuring products are suitable for customers is the Products@NAB framework, the principles of which include: "We will review our product groups to gain satisfaction that our products deliver the expected outcomes for customers".

6. FINANCIAL OBJECTIVES AND PRIORITISATION

Despite being in place since 2015, the Products@NAB framework has only been applied to NAB's products – it has not been applied to services provided by NAB (for example, the fees for no service matter) nor has it been applied to third party products distributed by NAB (though this is changing). An Internal Audit review into product governance and mis-selling risk in May 2018 rated this framework Unsatisfactory, citing inadequate minimum standards to control against mis-selling to customers, including defining the target market of each product.

Any review of Products@NAB should also take into account how the inherent tension between financial and customer interests is balanced given the scope of the framework includes both the commercial return and customer interests related to the product.

ACTION #18:

Revise NAB's approach to the design, management and governance of products and services to identify and assess value delivered to customers, and to monitor the quality of delivery of that value.

7. ACCOUNTABILITY

7. ACCOUNTABILITY

7.1 SUMMARY

Accountability is critical to realising NAB's vision. It is essential to rebuilding trust – demonstrating that employees are answerable to each other and to NAB's stakeholders – particularly for managing risk and dealing with issues. And it is also critical to NAB achieving its transformation – which demands clarity, discipline and resolve to deliver long-term, sustainable change across the whole bank.

The self-assessment identified that too often NAB has failed to establish clear accountability for complex, cross-divisional issues and risks. Unclear accountabilities and an unwillingness to reach across organisational boundaries have resulted in ambiguous ownership, slow progress and missteps in addressing important issues. Ineffective progress has often been exacerbated by a combination of favouring generalists over specific experience (meaning plans are prone to failure and change) and instability of key roles as leaders commonly rotate within NAB, making long-term accountability difficult. There are notable exceptions to this, particularly in times of crisis, when large organisational events occur, and in recent experiences where ELT members have stepped in to take over issues together.

The Board and the ELT have valued the impetus provided by BEAR and have used this to create more clarity and reflect on how they discharge their responsibilities. This is an ongoing process and a clear opportunity exists to cascade these lessons and practices throughout the organisation to 'operationalise' accountability.

Finally, the way in which NAB has held leaders to account has lacked the visibility and consistency required to create and reinforce unambiguous expectations among all employees. It is important that NAB's focus be broader than remuneration. It must acknowledge that holding people to account includes performance management overall, including rewarding and celebrating the role-modelling of NAB's values and behaviours.

In response to these findings, the following actions will be taken:

#19 For all material issues, the CEO to assign an ELT member to be accountable for ensuring overall issue resolution, supported by all team members as necessary to deliver required change.

#20 Further embed accountability principles and practices developed under BEAR, so that leaders beneath the ELT have an equally clear understanding of their responsibilities and expectations of them.

#21 Further improve the ability to assign and document individual accountability for risk performance (positive and negative) – including for Material Risk Takers and a broader population of employees.

7.2 BACKGROUND

NAB places a high degree of importance on accountability. It is reflected in several of the values and underpinning behaviours that describe what is expected of everyone at NAB, in particular in the value of "Do the right thing" and the associated behaviours of "Act with integrity" and "Be true to your word" and the behaviour of "Step in, step up, speak your mind".

A number of frameworks exist that define the formal elements of authority and accountabilities across the bank. These include a Delegation of Authorities framework, RMA, BEAR Accountability Statements for Accountable Persons and, to a lesser extent, role purpose statements. Accountabilities are further reinforced through individuals' performance plans (scorecards), which include a specific risk management measure, and assessment of whether individuals demonstrate NAB's values and behaviours.

Delegations of Authority

Formal delegations of authority are made in accordance with the principles of NAB's Delegation of Authorities framework, most importantly: "that the person who has delegated or sub-delegated authority remains accountable and responsible for any decisions or actions taken by the person or body to whom it is delegated".

The Board delegates specific authorities to the CEO (and other officers) to manage the business through a formal document that is reviewed and approved annually. The CEO then on-delegates certain specified authorities to members of the ELT through another formal document which is also reviewed and approved annually.

Delegated Commitment Authorities, which outline authorities for approving loan applications in both First and Second Line, are also formalised.

Risk Management Accountabilities

NAB uses a 3LoD risk management model across the bank and legal entities (explained in Chapter 4: Risk Management and Compliance). The accountabilities of the First, Second and Third Lines for managing risks are documented in the RMS for each component of the RMF.

Banking Executive Accountability Regime (BEAR)

Effective 1 July 2018, BEAR imposed a new accountability regime on NAB as an ADI, and on its Accountable Persons – NAB's directors, the ELT and the EGM Internal Audit.

BEAR requires Accountable Persons, when carrying out their responsibilities, to conduct themselves with honesty and integrity; and with due skill, care and diligence; to deal with APRA in an open, constructive and co-operative way; and to take reasonable steps to prevent matters arising that would adversely affect NAB's prudential standing or reputation. NAB as an ADI is subject to similar obligations.

7. ACCOUNTABILITY

Under BEAR, NAB is required to provide APRA with statements that detail the roles and responsibilities of each Accountable Person (i.e. Accountability Statements) and an accountability map that identifies the lines of responsibility of each Accountable Person through NAB's business.

Application of consequences

The process by which performance consequences are applied to remuneration is explained in Chapter 8: Remuneration.

7.3 REVIEW OBSERVATIONS

7.3.1 CLARITY OF ACCOUNTABILITY

Although NAB has formally articulated many elements of accountability for employees, and particularly senior leaders, challenges in assigning and taking accountability persist, despite some recent examples of improvement.

A key challenge in assigning accountability to a single owner relates to the design of NAB's organisational structure, in which end-to-end processes for delivering products and services to customers span several divisions. This challenge is exacerbated by a lack of assigned ownership for end-to-end processes. In recognition of this challenge, the VCRMCs described in Chapter 3: Senior Leadership Oversight were designed to provide a forum to bring together relevant executives from across the bank to assess risk and issues and agree accountabilities to manage and resolve them.

Accountability for risk management

A lack of clarity regarding the definition and/or application of risk management accountabilities has been a consistent theme in Internal Audit and APRA reviews.

In its May 2016 Risk Governance Prudential Review of NAB, APRA concluded that while high level risk management accountabilities were defined across the 3LoD, accountabilities for material risks and processes that spanned the bank as a whole were unclear and needed to be reflected in performance management and remuneration reviews.

More recently, in its July 2018 Operational Risk Prudential Review, APRA identified a number of issues with governance and delineation of accountabilities for decisions that span divisions (further described in Chapter 3: Senior Leadership Oversight).

Two additional factors have also affected acceptance of risk management accountabilities (as examined in Chapter 4: Risk Management and Compliance). First, there is an over-reliance by senior leaders on the First Line risk management teams who are responsible for performing many risk activities on their behalf. Second, the complex and overlapping accountability model for compliance plans and compliance obligation ownership has detracted from meaningful analysis of the bank's position against its compliance obligations.

The impact of BEAR on clarity of accountability

At the Board and ELT level, the focus on assigning and ensuring clarity of accountability, has recently improved with the introduction of BEAR.

As part of the BEAR implementation, work was undertaken to map accountabilities to roles. This exercise was designed to ensure clear accountability ownership, and to highlight any potential gaps or ambiguities. Workshops were held by the Board and ELT to test the clarity of accountabilities through scenario testing. The workshops were useful to ensure common understanding of accountabilities, and to clarify and determine how accountabilities apply in more complex situations.

In interviews, it was stated that this exercise achieved its objective of clarifying understanding of accountabilities. Further, those ELT members recently appointed to new roles further observed that the Accountability Statements provided for greater discipline and rigour in managing handovers, particularly understanding the status of risks and issues. NAB intends to maintain this scenario analysis approach (a practice that APRA is now encouraging all ADIs to undertake).

ACTION #19:

For all material issues, the CEO to assign an ELT member to be accountable for ensuring overall issue resolution, supported by all team members as necessary to deliver required change.

7.3.2 EFFECTIVENESS OF ACCOUNTABILITY

Accountability for resolving 'complex' issues

The self-assessment found that a common feature of slow or ineffective progress on issues has been unresolved questions of overall accountability for their resolution.

In particular, leaders have not acted with conviction to settle questions of accountability for issues that span NAB's divisional boundaries and require a coordinated approach to resolve. Such issues were often described in interviews as "complex", and are prone to being fragmented in to multiple accountabilities without clarity regarding who at the most senior level is accountable for resolution. As a result, slow progress has been tolerated at ELT and Board levels.

Findings of 3-star rated internal audit reports consistently highlight the lack of well-defined accountabilities and ownership as a root cause, particularly where the issue straddles several divisions.

The self-assessment also identified that a common feature of ineffective progress on issues is the effectiveness with which individuals have demonstrated and exercised their accountability.

First, where accountability is taken or assigned for a large program of work or issue, the frequency with which leaders change roles, are subject to a restructure or leave NAB during a long-term project reduces the ability (and likely commitment) to ensure long-term solutions are delivered. This is compounded by a recognised lack of a strong, detailed project management discipline that would reduce reliance on individual leaders to see solutions through.

7. ACCOUNTABILITY

In one case study reviewed for the self-assessment, the issue was first raised by Internal Audit in 2014 as a 3-star finding. Because the solution spanned several divisions, accountability for resolving the issue was split into separate and discrete actions, assigned to different accountable leaders. In 2017, Internal Audit found that in the three years in which the issue had remained open there had been three formal changes in ownership. In addition, of the 12 senior leaders the original report was addressed to, none remained in that role and only three were still at NAB. Progress is widely perceived to have occurred only since two ELT members recently took ownership for its resolution.

Second, NAB has had a tendency to appoint leaders with generalist skillsets to roles requiring specialist expertise. This has limited the ability for those accountable to fully understand the issues and create an effective plan in their response.

In another case study covering NAB's approach to Enterprise Data Management, delays in progress were primarily due to accountability being allocated to individuals with insufficient seniority and limited relevant experience. The recent step to appoint an EGM-level leader with experience of similar issues in other markets has significantly improved confidence in the direction being taken.

BEAR is improving clarity of accountabilities and is motivating a focus on the practices that support their demonstration at the ELT and Board level. The principles of BEAR and supporting practices have not yet been rolled out beyond the Accountable Persons to operationalise accountability at NAB.

ACTION #20:

Further embed accountability principles and practices developed under BEAR, so that leaders beneath the ELT have an equally clear understanding of their responsibilities and expectations of them.

7.3.3 ACCOUNTABILITIES IN PERFORMANCE AND REMUNERATION

The way in which NAB has held leaders to account has lacked the transparency and consistency required to create and reinforce unambiguous expectations amongst all employees.

The inability to appropriately assign individual accountability has been a challenge due to unclear accountabilities and the frequency of changes in roles and ownership of issues. This, in turn, lessened the impact of variable remuneration in promoting prudent risk-taking behaviours.

Including a specific risk goal in the performance management framework provides a mechanism for evaluating the exercise of risk management accountabilities by all NAB employees. For example, remuneration consequences apply for failing to meet a target level of Achieved on the risk goal. In the 2018 financial year, for the first time at NAB all employees were given a centrally developed risk goal and criteria for performance assessment. To ensure relevance and appropriateness, the goal was tailored for role type (EGM, GM, People Leader or Team Member).

In addition, as described in Chapter 4: Risk Management and Compliance, in 2016 NAB introduced formal Risk Management Performance assessments (performed by Risk) for the CEO, ELT and EGMs. These are used to determine their achievement on the risk goal. However, until the 2018 financial year, this mechanism had not been used effectively to apply consequences to remuneration outcomes. In the 2018 financial year improvements were made in the detail, quality and disclosure of the Risk Management Performance assessment used to determine consequence management and remuneration outcomes. One of the improvements was a deeper review of accountability for significant current and prior year matters, which allowed for individual consequences to be applied reflecting the risks, breaches and poor customer outcomes currently being faced by NAB.

While challenges exist in assigning accountability and applying consequence management and downside remuneration adjustments, more work is required to celebrate and reward those who role-model NAB's target culture. It is especially important to recognise and reward those who take on accountability for the more complex activities required to manage the challenges faced by NAB, particularly because of the signal it sends to all employees. The Culture Embed Plan outlined in Chapter 9: Culture includes plans to improve performance management and recognition, including encouraging and sustaining target behaviours.

ACTION #21:

Further improve the ability to assign and document individual accountability for risk performance (positive and negative) – including for Material Risk Takers and a broader population of employees.

8. REMUNERATION

8. REMUNERATION

8.1 SUMMARY

The Board and ELT place high importance on ensuring remuneration policies and practices encourage a strong culture and good outcomes for customers and shareholders, and meet all regulatory requirements.

Over the last 18 months, NAB has introduced a new executive remuneration framework and has also made a number of changes to general employee and sales force remuneration arrangements, overseen by the Board.

However, the self-assessment has revealed that NAB can and should do more.

First, improved analysis and reporting is needed to support key remuneration decisions being made by RemCo and the Board, and to test and oversight the ongoing effectiveness of NAB's remuneration practices.

Second, governance activities should be further strengthened through better coordination and flow of information between RemCo and BRC, and greater oversight of the MRT population.

Finally, clarity over how and when discretion in variable reward will be exercised, particularly in relation to discharge of individual accountabilities, requires improvement. Although the depth of risk assessments provided to RemCo by the Group CRO has improved, further enhancements are required, including better recognising and rewarding positive risk behaviours.

While many changes to the remuneration framework have been introduced over 2018 to increase alignment to risk and customer outcomes, the effectiveness of such changes must be judged through their implementation.

In response to these findings, the following actions will be taken:

#22 Improve the quality of data and insights provided to the Board, to facilitate a more data driven approach to testing the effectiveness of NAB's remuneration practices throughout the bank.

#23 Monitor the effectiveness of recent remuneration framework changes, including the impact of changes driven by the Sedgwick Review recommendations for retail banking.

In addition, Action #5 from Section 2: Role of the Board, and Action #20 from Section 7: Accountability, are also relevant.

8.2 BACKGROUND

Remuneration is just one aspect of the organisational systems and practices that encourage (or discourage) certain outcomes, behaviours and mindsets. As such, NAB's approach to remuneration is balanced with an equal focus on leadership, performance management, and the basis on which people are recruited, recognised, promoted, disciplined, and terminated.

In recent years, a range of changes have been made to each of these elements, which are expected to take some time to flow through to an observable shift in culture.

The Board and management are highly attuned to recent customer, shareholder, regulator and community attention on remuneration and their wide divergence of views. They continually assess whether remuneration practices are aligned to the bank's vision and contribute to its strategic objectives, and where it is assessed as appropriate they do not, seek to make further changes.

Recent changes include:

- On 1 October 2017, NAB employees, including branch managers and call centre managers, moved from sales-based incentive plans to the Group Variable Reward Plan with a balanced scorecard of Customer, Risk, Financial and Transformation measures.
- Effective 1 October 2018, branch and call centre employees moved from their specialist incentive plans to the Group Variable Reward Plan with a balanced scorecard.
- On 19 September 2018 NAB announced changes to its executive remuneration framework, effective from the 2018 financial year. The new framework removes complexity and encourages performance that considers the perspectives of a broad range of NAB stakeholders. It also seeks to align executive outcomes with the shareholder experience by deferring 60% of variable reward in dividend paying shares for at least four years. The Board has discretion to adjust variable reward outcomes in-year or through further deferral, forfeiture or clawback.

NAB is also fully compliant with the Sedgwick Review's recommendations regarding retail banking remuneration, in advance of its 2020 deadline, with the BEAR requirements relating to remuneration, and with other remuneration requirements in the jurisdictions in which NAB operates.

8. REMUNERATION

NAB's remuneration framework

NAB's remuneration framework covers all employees. For the 2019 financial year 97% of employees are on the Group Variable Reward Plan and the remaining 3% are on specialist sales incentive plans. All specialist sales incentive plans are under review.

The remuneration framework has two components: fixed remuneration and variable reward.

- Fixed remuneration comprises an annual cash salary and is set with consideration of role complexity and responsibilities, capabilities, experience and knowledge, individual performance, and internal and external market role relativities. Adjustments are only made to fixed remuneration so that it remains competitive or to reflect changes in role scope. Fixed remuneration is regularly benchmarked against market data.
- Employees are eligible to receive a single variable reward, with a portion paid in cash (this percentage changes depending on the level of the employee) and the rest deferred in NAB shares. Deferred shares are subject to a minimum four year deferral period for the ELT and either two or three years for a number of other roles from the 2019 financial year.

The Board has discretion to extend the deferral period, and to forfeit the variable reward deferred shares during the deferral period (in response to resignation, dismissal for cause, or failure to meet threshold conduct requirements), or clawback deferred shares in certain circumstances.

How a variable reward is calculated

For employees in the Group Variable Reward Plan, individual outcomes for a financial year are determined in accordance with a set formula. The formula considers both the bank's performance and the individual's performance over the financial year along with the individual's target variable reward opportunity:

Individual target		**Individual score**		**One NAB Score**
Variable Reward opportunity ($)	**X**	**(reflects performance against a balanced scorecard)**	**X**	**(which reflects the Group's performance)**

The actual variable reward for an individual can be higher or lower than their target variable reward opportunity, but will not exceed their maximum variable reward opportunity, and will depend on the individual score and the One NAB Score for the financial year.

The Board retains the discretion to adjust any variable reward outcome as it sees fit. The Board did decide to apply further reductions in 2018.

Consequence management

NAB introduced a number of changes to its consequence management framework in 2015, including developing the Employee Conduct Management Policy; replacing compliance with conduct gates and aligning expectations to those set out in the Code of Conduct; and centralising of serious misconduct issues to the Workplace Relations team.

Further changes to the remuneration framework over the 2018 financial year mean that conduct and risk management are now considered through:

- Conduct gates: if an employee receives an Amber Conduct Gate in their final performance outcome, their variable reward will be reduced by 25%. A Red Conduct Gate results in no variable reward for the current performance year and forfeiture of any variable reward deferred amounts from prior years that are still in restriction.
- Risk goal: if the Risk goal is not met, the individual's variable reward outcome will be reduced. The framework also allows for outperformance to be recognised against risk elements, rewarding good risk behaviour.
- Deferral: variable reward deferral applies to all amounts above $50,000 from the 2019 financial year and ranges from 30% deferred for two years to 60% deferred for four years. Variable reward deferral is subject to forfeiture conditions.
- Clawback provisions: remuneration adjustment arrangements have been put in place for Accountable Persons under BEAR and certain UK MRTs or Senior Managers.

To ensure that Risk, Compliance and Financial Control employees retain their independence from business decisions, less weight is given to variable reward for these roles.

RemCo regularly monitors consequence management outcomes to help ensure management is addressing poor conduct and risk management issues and taking appropriate action. The consequence management process is supported on a monthly basis through the Group CRO report, quarterly risk culture updates, six monthly updates to the BRC and RemCo on risk performance, and a full year update on risk performance that includes a recommendation on any bank-wide risk management consequence.

In 2018, the Workplace Relations team managed 1,215 Code of Conduct breaches, of which 307 resulted in employees exiting the business, and 908 resulted in coaching or other remedial actions, including loss of variable reward.

There are also examples of deferred reward or equity being forfeited where no conduct gate was identified or applied during the relevant performance period, and where employees had left NAB before issues were identified and consequences imposed. For example, five employees had their deferred reward forfeited as a result of the incorrect witnessing of beneficiary nominations forms issue. Prior executives also had deferred equity forfeited in the 2018 financial year for matters associated with risk management.

8. REMUNERATION

RemCo is responsible for reviewing, assessing and recommending to the Board remuneration policies and practices that encourage both good customer outcomes, and sustainable bank outcomes; enhance long-term shareholder returns; nurture a strong culture; and are in accordance with applicable regulatory requirements and global regulatory trends.

Activities of RemCo in 2018 were as follows:

- Completed its strategic review of NAB's executive remuneration framework and practices. The changes comply with laws, including BEAR.
- Approved closure of a number of legacy sales-based reward plans, to achieve compliance from 1 October 2018 of the Sedgwick Review's recommendations regarding retail banking remuneration, ahead of the 2020 deadline.
- Oversaw quarterly consequence management outcomes for conduct, regulatory and prudential breaches and incidents of behaviour that are inconsistent with NAB's risk appetite, desired culture, Code of Conduct or values.
- With the BRC, considered NAB's collective remuneration outcome taking into account the bank's overall result against the RMF, risk appetite and qualitative factors. Considerations included progress against resolving issues, prudential compliance, breaches and incidents, timeliness of escalation and management of events and breaches. Customer and reputational impacts were also considered. This resulted in the Board determining a One NAB Score of 80% for the Group, further reduced to 70% for the ELT.
- Considered individual risk management performance and the impact on individual variable reward outcomes. This included a detailed assessment of individuals' involvement in customer, risk and reputation matters, with specific consequences applied where appropriate. In respect of the 2018 year, the Board exercised its discretion and forfeited deferred variable reward for a number of individuals, including former executives, as a result of such matters.
- Considered selected strategic people topics as part of an expansion of its remit in 2018. The expansion was to facilitate a deeper focus on NAB's people strategy through the three-year transformation program.

8.3 REVIEW OBSERVATIONS

8.3.1 BOARD OVERSIGHT OF REMUNERATION PRACTICES

The Board has recently initiated, reviewed or overseen a range of reviews and resulting changes to both remuneration and performance frameworks as follows:

- A review of all sales incentive arrangements across NAB and implementation of the Sedgwick Review recommendations.
- A review of executive remuneration, arrangements undertaken throughout 2017 and 2018 with a high degree of engagement with stakeholders in order to respond to customer, shareholder, regulator and other stakeholder expectations. The Board used the new framework to assess the 2018 performance outcomes for the CEO and ELT, which are set out in NAB's 2018 Remuneration Report.
- A detailed review of formal end-of-year risk performance reporting to ensure appropriate data was being shared between management, the BRC and RemCo in order to help them assess performance against the RMF and inform variable reward decisions.

The Board has taken steps to improve clarity over how and when it will exercise discretion over variable reward. Specifically, RemCo asked for an increased level of individual and collective performance data to consider when making recommendations, particularly for ELT reward outcomes.

As a result, the level of granularity in performance assessments provided to RemCo and the Board noticeably increased. This included the Group CRO providing the Board with a detailed risk management performance assessment against the bank's risk management objectives for each ELT member.

However, following the Group Remuneration Policy Effectiveness and Compliance Review in May 2018, which recommended testing remuneration policies against both regulatory requirements and NAB's stated remuneration objectives, RemCo also observed that management information provided to it could be further improved. In particular, better data and insights would improve the assessment of whether remuneration policies are driving desired, or undesired, behaviours across the bank.

Further, RemCo has identified the need to improve the links between risk topics discussed at the BRC, and consequence management outcomes; noting that it can be difficult to assess executive accountability for the appropriateness of customer outcomes without greater detail from management.

ACTION #22:

Improve the quality of data and insights provided to the Board, to facilitate a more data driven approach to testing the effectiveness of NAB's remuneration practices throughout the bank.

8.3.2 REMUNERATION GOVERNANCE MODEL

There continues to be regular cooperation between Board committees, including the BRC and RemCo, on people-related matters. Annual joint meetings are held to discuss risk management performance and related reward recommendations. The Group CRO attends all RemCo meetings to provide a risk perspective on relevant matters.

However, the self-assessment reinforced the recommendations in governance improvements that were made during the Group Remuneration Policy Effectiveness and Compliance Review.

First, RemCo identified a need for improved coordination between the BRC and RemCo; and for more data, insights and evidence to flow from BRC to help determine the application of both remuneration consequence and consequence management more broadly.

8. REMUNERATION

Second, the need to improve the oversight of performance and remuneration outcomes for individual MRTs. Historically, dedicated papers concerning MRTs were only presented to RemCo at the end of each financial year, with adhoc references to this population occurring over the year. Papers provided to RemCo for the 2018 financial year were vastly improved and included individual level data on MRT performance outcomes and recommended incentive allocations, as well as an attestation from the Group CRO on these having been reviewed and approved.

In addition, RemCo has implemented a number of recommendations from the annual Board and Committee Effectiveness Review, including requiring management to focus more on outcomes than process in discussions and papers; be more proactive in addressing emerging risks; and engage earlier with RemCo on strategic people-related issues to support a higher quality discussion at Board meetings. (Action 5 in Chapter 2: Role of the Board also applies here.)

8.3.3 ASSESSMENT OF RISK AND CONDUCT WITHIN THE REMUNERATION FRAMEWORK

The self-assessment found that NAB's remuneration frameworks are well designed in theory, with conduct and risk management appropriately incorporated into performance assessments. However, application of the frameworks remains a challenge and needs to be continually monitored and reported on to ensure the right outcomes.

Senior executive performance reviews are balanced, with performance being assessed against five equally weighted objectives of customer, risk, financial, people and leadership and strategy.

Qualitative measures have been more clearly expressed, to further assist RemCo in its application of a discretionary adjustment to the amount of variable reward from 2018 onwards that takes into account risk, quality of financial results, customer, people and financial returns.

Further changes to the remuneration framework introduced over 2018 have improved alignment to risk and customer outcomes. This includes increased weighting on the risk-adjusted financial metric when determining the Group Variable Reward outcomes; mandated risk and customer goals for all employees; increased deferral amounts and time periods for those earning over a threshold amount; and a reduction in the prevalence and number of sales-based incentive plans.

Many of these design elements have been introduced only recently. As such, ensuring this level of change is embedded, and that the changes are operating in practice as intended, should be a key oversight focus for ELT and the Board.

ACTION #23:

Monitor the effectiveness of recent remuneration framework changes, including the impact of changes driven by the Sedgwick Review recommendations for retail banking.

8.3.4 APPLICATION OF REMUNERATION CONSEQUENCE

Collective reductions to remuneration for all employees have occurred under Board discretion (for example in 2014, 2017 and 2018) for a range of regulatory compliance, customer service outcome and bank reputational matters.

NAB's approach to individual remuneration consequences continues to mature, with consequences in 2018 being applied to leadership roles in a way that better reflected individual accountabilities and performance.

The Board was provided with information regarding proposed consequence, management and targeted reductions to individual variable reward. This information included accountabilities, customer, risk and reputation outcomes and risk management performance considerations. The Board also received a table of 2018 financial year risk matters relevant to those GMs, EGMs and ELT where individual targeted reductions were proposed.

Individual adjustments in 2018 for the ELT and senior leaders affected a number of individuals and ranged from forfeiting deferred reward through to specific individual percentage reductions (ranging from 10% to 75% for ELT members) to variable reward for specific risk-related matters.

However, appropriately assigning individual accountability and applying individual downside adjustments for leadership roles has been a challenge historically due partly to unclear accountabilities and the frequency of changes in roles/responsibilities (see Chapter 7: Accountability). Further, Board visibility of consequences for customer-facing employees on sales and service incentive plans has been restricted to forfeited equity only.

For employee populations where remuneration outcomes are less visible to the Board, ensuring that the framework is applied with rigour and consistency, and that local people leaders apply consequence management on a day-to-day basis, remains an important focus.

There is a perception by employees that consequence is applied more readily to customer-facing roles than to those in support function roles or senior leaders. Analysis of outcomes does not support this, which may suggest that the perception is due to lack of visibility in how consequence management is applied to other roles. This perception is changing. According to the 2018 Employee Engagement Survey, 72% of respondents agreed with the statement “people who deliver strong results aren’t excused from following rules”. This is up 20% from 2016.

It should be noted that for consequence management to work effectively, it must be broader than remuneration frameworks and practices (see Chapter 9: Culture for more detail. Action 20 in Chapter 7: Accountability also applies here.)

9. CULTURE

9. CULTURE

9.1 SUMMARY

The self-assessment's review of multiple data and information sources revealed there are many situations where employees at all levels demonstrated NAB's values; they acted with passion for customers, were bold, worked to win together, showed respect, and sought to do the right thing. NAB is rightly proud of this, and will seek to sustain these attributes through any changes made.

But these values are not lived all of the time.

Five cultural inhibitors were consistently apparent in the situations where NAB did not live its targeted culture through its behaviours. NAB's culture today is not defined by these inhibitors: they are intermingled with demonstration of the values that characterise NAB at its best. However, this intermingling does not allow for NAB's people to live its target culture, and realise its vision.

NAB's culture isn't an abstract concept that exists separate from its people. It is a reflection of its people. As such, unlike the other chapters in this self-assessment, this chapter is written from the perspective of 'we' – our people, the Board and the ELT.

These five cultural inhibitors, summarised below, are examined in the section that follows:

1. We haven't brought the rigour and discipline required to get it right every single time.
2. We have over-relied on our people to make up for deficiencies in our systems and processes.
3. We have not consistently brought the collective intensity or individual resolve required to fix complex issues.
4. We have not listened to or learned enough from our customers, regulators and employees.
5. While we have a strong commitment to customers, we have too often put other priorities first.

In response to these findings, the following actions will be taken:

#24 Continue the 'industrialisation' program of work, including ensuring adequate metrics are in place to monitor whether expected improvements are being realised.

#25 Review the leadership capability model and talent management practices to raise the emphasis on quality and rigour of execution.

#26 With oversight from the Board, implement the Culture Embed Plan to support the achievement of NAB's desired culture.

9.2 BACKGROUND

Culture in context

Much of the self-assessment has focused on formal business and risk practices in NAB, and the extent to which these practices transcend commercial concerns to emphasise the importance of delivering positive customer outcomes and of earning trust.

These formal practices include rules and procedures, and the governance mechanisms to oversee them. But not all practices are formal. Culture, an informal practice, is the self-sustaining pattern of behaviour that determines how things are done within an organisation, how its people interact and work. An organisation's culture might reflect a strong focus on financial outcomes, on effective safety and risk management, on taking a stand for customers, or on societal impact. Just as with rules and procedures, an effective culture balances these priorities and assigns value to each. An ineffective culture disproportionately values one over another. The criticism of the financial services industry culture relates largely to the perceived under-representation of risk and customer interest relative to short-term financial outcomes.

Some aspects of culture are visible: in a culture with a strong customer focus one might observe a ritual such as the daily Customer Huddle. Other aspects of culture manifest as organisational habits: keystone behaviours that occur regularly, supported by associated narratives and assumptions, and 'hard-wired' through reinforcing systems and processes. Finally, some aspects of culture are invisible: mindsets and values that are widely shared.

While its informality makes culture complex to see, understand and change, it is what people actually do – their actions and behaviours – that matters most, rather than what they say. And it is the actions and behaviours of leaders that are the most powerful determinant of culture and have the greatest influence on achieving real cultural change. The culture that leaders walk past is the culture that they accept.

Culture in NAB

Sustainably successful organisations shape their culture to reflect their purpose and vision, through both words and actions. In recognising that culture is central to delivering for its customers and shareholders, NAB has reflected deeply over the last few years on the bank's purpose, vision, values and behaviours.

In 2017, the CEO together with the Chairman, launched NAB's purpose – **back the bold who move Australia forward** – first with NAB's senior leaders, and then with the support of NAB's senior leaders to all employees.

In September 2018, the CEO again with the Chairman launched NAB's refreshed vision – to be **Australia's leading bank, trusted by customers for exceptional service**. Along with the refreshed vision, a set of new behaviours (detailed in Figure 9.2.1) aligned to the five values were defined to describe the actions expected of everyone working at NAB.

9. CULTURE

Figure 9.2.1: Our Values and Behaviours

PASSION FOR CUSTOMERS	BE BOLD	WIN TOGETHER	RESPECT FOR PEOPLE	DO THE RIGHT THING
Get it right for our customers, every singe time **Take a stand for our customers**	**Be exceptional** **Step in, step up, speak your mind**	**One NAB, One Badge** **Make it simpler and faster**	**Show care for everyone** **Be candid with each other**	**Act with integrity** **Be true to your word**

The target culture will be instilled through leaders who walk the talk and activate the culture every day. NAB has already initiated a plan to embed its desired culture, by mobilising leaders and holding all employees to account.

In developing this plan NAB has identified five main levers. These are:

- Delivering consistent customer standards.
- Developing outstanding leaders.
- Uplifting performance management and recognition.
- Simplifying policies and practices.
- Aligning selection and onboarding systems and processes.

Work to embed the target culture is under way, supported by the analysis done for the self-assessment. Communication of the vision, values and behaviours, together with the ongoing delivery of NAB's strategy including the Culture Embed Plan and the lessons learned from this self-assessment, strengthen alignment of the vision with everyday routines and behaviours across the bank.

9.3 REVIEW OBSERVATIONS

Measuring culture is not a simple science, given that culture is about unwritten rules and the unspoken assumptions that shape behaviour.

For the last four years, NAB has sought to measure risk culture, using employee survey data and behavioural indicators. Specific culture statements have been added to the employee engagement survey to enable trend reporting. Further, NAB engaged an external consultant to perform a survey to analyse and benchmark NAB's risk culture.

The results from those surveys and other measures are included, where relevant, in the findings below. Many of these measures have also been reported in regular updates to GRRMC and BRC over the last two years. However, NAB recognises that this reporting must be more systematic in future, with clear targets set for risk and for other relevant aspects of culture, linked to the bank's purpose, vision and values. Where measures do not demonstrate that the target culture is being consistently achieved, this must in future be highlighted in sufficient detail to enable actions to be taken and monitored, in the appropriate business and functional areas and levels of management.

Regulators and professional bodies globally are developing standards for measuring culture in banks, based on work on safety culture in high-risk industries. NAB is committed to adopting these better practices. These practices will combine 'hard' data (in areas such as customer complaints, NPS, whistleblowing, control and compliance discipline, and reward outcomes) and perception data from employee and other surveys and focus groups.

The five cultural inhibitors represent a disconnect between the values and behaviours to which NAB aspires and what is often observed in practice. These cultural inhibitors can be seen as root causes for many of the observations in this report.

CULTURAL INHIBITORS IDENTIFIED

1. We haven't brought the rigour and discipline required to get it right every single time
2. We have over-relied on our people to make up for deficiencies in our systems and processes
3. We have not consistently brought the collective intensity or individual resolve required to fix complex issues
4. We have not listened to or learned enough from our customers, regulators and employees
5. While we have a strong commitment to customers, we have too often put other priorities first

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1. We haven't brought the rigour and discipline required to get it right every single time

Operational discipline

Banks have not traditionally taken as rigorous an approach to process standards, systems and process quality as 'high-reliability' organisations in industries such as engineering, oil and gas, and aviation.

At NAB, lack of operational discipline is apparent in how work gets done. We have traditionally encouraged a 'get it done' attitude, allowing new methods and practices to emerge organically to fix problems and exploit opportunities where they occur. We haven't enforced strict disciplines about what gets done where: what's the responsibility of front office, middle office, and back office. We haven't enforced a 'one way, same way' approach, maintaining many ways to get things done.

We haven't been ruthless in consolidating and decommissioning systems, or in keeping systems up to date. We've announced changes to products and services before putting in place the system and operational capabilities required to deliver them consistently and reliably. We've solved quickly through a tactical fix, but haven't gone back to deliver the strategic solution. Through all of these behaviours, we've allowed complexity to grow.

By doing what it takes to get it right for the customer this time, we've made it almost impossible to get it right for the customer every single time.

The Board and ELT have recognised this lack of operational discipline and are undertaking a program of work, funded under the technology strategy, to industrialise processes, systems and controls.

> **ACTION #24:**
>
> Continue the 'industrialisation' program of work, including ensuring adequate metrics are in place to monitor whether expected improvements are being realised.

Leadership capability

When evaluating leaders, we have placed an emphasis on big picture ideas, financial acumen, problem-solving skills, and getting things done or producing results, rather than the ability to build and lead highly reliable delivery systems. Our talent approach has been to rotate generalists to increasingly complex roles. This has led to the overuse of consultants. Generalist leaders struggled to execute with discipline across areas where they lacked technical knowledge. Unsurprisingly, we failed to gain traction quickly, or suffered setbacks and delays when unanticipated problems emerged.

Leaders in high-reliability organisations know the critical importance of process and control design, and quality assurance. Such leaders:

- follow through and check the solution implemented has had the intended impact and has addressed the root cause;
- establish leading indicators which signal risks emerging before they become a problem; and
- encourage a culture where any employee, no matter how junior, feels empowered and duty-bound to 'stop the line' if quality problems emerge.

These are not traits that NAB has consistently demanded of our leaders.

These factors are evident in some of the self-assessment case studies, such as NAB's approach to establishing an Enterprise Data Management capability. This program had many false starts, with generalist leaders finding it difficult to identify the right steps to take to build a sustainable, self-reinforcing capability. We focused too much on governance, and not enough on the operational disciplines and infrastructure required to deliver practical, visible improvement. In 2018 NAB recruited a Chief Data Officer who has much deeper experience in the field; under her leadership the pace of change has dramatically improved.

> **ACTION #25:**
>
> Review the leadership capability model and talent management practices to raise the emphasis on quality and rigour of execution.

2. We have over-relied on our people to make up for deficiencies in our systems and processes

Because of the complexity of policies, systems and processes, NAB depends on the collaboration, discretionary effort and goodwill of our people, particularly in the customer-facing roles, to deliver on our commitments to customers and to ensure risks are appropriately managed.

An example of this over-reliance is an observation made by a focus group participant: "What tends to happen at NAB – you have committed people who have ownership of a process and make the manual processes work because they're committed to their work...but they might be managing a large number of manual processes to do their job and what happens when they leave? No one knows how to get that thing done anymore."

Feedback from focus group participants and the employee engagement survey also indicates that many employees feel overworked and that the lack of enablement with appropriate systems and tools – coupled with the amount of change – is challenging their ability to get it right for our customers. This is exacerbated by the pace of change, where we often default to increasing what is required of our people before or without building the processes, systems and tools to enable consistent and reliable customer service delivery.

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3. We have not consistently brought the collective intensity or individual resolve required to fix complex issues

Intensity on speed to resolution

The bank is often seen at its best in a crisis, where we tackle issues decisively and with speed. Employees express their pride at bringing the 'best of NAB' to help customers when natural disasters strike, such as cyclones, floods or bushfires. Our leaders and teams are clearly capable of bold action, and of working together across divisions to solve urgent problems.

This sense of urgency has not always translated to our day-to-day operating environment. As outlined in Chapter 2: Role of the Board and Chapter 4: Issue Identification, Escalation and Resolution, we have taken too long to fix issues, and to remediate affected customers. As one senior executive observed: "When a customer suffers detriment due to our error, that's a crisis – but we don't always treat it that way".

Courage to take on accountability without control

Issues do not respect divisional boundaries; the most difficult issues are those that extend beyond direct spans of control and require coordination, trust and courage to solve.

Internal Audit has examined past audit issues to identify root causes for slow resolution. One important factor they identified is the reluctance of senior managers to take accountability for resolving issues that extend beyond their direct area. Often this is because the corporate support, funding and resources, that would give leaders the confidence to act with courage and take on accountability for resolving complex issues, is not there.

We are starting to see the behaviours of reaching across divisional boundaries actively role modelled. In 2018, one long-standing lending issue, spanning front office, back office and technology, saw much greater progress than in prior years when the Chief Customer Officer Business & Private Banking and the Chief Technology and Operations Officer (CTOO) worked cooperatively to fix the issue. The Chief Customer Officer Business & Private Banking maintained accountability, but placed trust and reliance on the CTOO to solve critical aspects of the issue.

With BEAR, we have recognised an opportunity to 'start from the top' with all material issues, with the CEO first assigning a relevant ELT member accountable for resolution, supported as necessary by all team members to deliver required changes.

Collaboration and teamwork

NAB has a culture that values relationships and collaboration. Our people informally refer to "Nice NAB", reflecting a dominant culture of politeness and respect. While this is admirable, it can sometimes lack the edge required to deliver for our customers. First, this politeness doesn't always translate into full cooperation – the 2018 Employee Engagement Survey found only 45% of employees agreed that there is effective cooperation between different teams. Second, sometimes we step away from issues that we know should be raised or from the constructive conflict necessary to develop breakthrough solutions. And finally, we may not develop the levels of trust required to deliver truly high performance, where all members can fully rely on each other to deliver, and where feedback is timely, candid and in service of the vision.

Courage to set ambitious standards

Too often we fall into the trap of thinking "this is how things are", accepting sub-optimal outcomes and attributing these poor outcomes to externalities that we see as being beyond our control. We compare our practices to our peers as a benchmark, and may act with less urgency when we consider something to be an 'industry' issue (particularly when we perceive a first-mover disadvantage). This is not taking a stand for customers.

Declaring victory too early

The self-assessment has observed a habit of declaring victory too early, for example, when we perceive we are first to make a change. We haven't always executed well, or subsequently confirmed that the change has achieved what was intended. Additionally, we haven't brought the discipline to revisit our judgements as the environment has changed.

Celebrating and supporting those who step in and step up

Exhibiting all the attributes outlined above takes courage and conviction. As an organisation we have not done enough to back our people who have been bold enough to move such complex issues forward. We can do more to call them out, and to lean in with resources and priority to help them.

4. We have not listened to or learned enough from our customers, regulators and employees

We have too often responded late, missed or resisted the internal or external signals that challenge our existing position and that present an opportunity for us to question our point of view. Further, we often wait for certainty or direction before digging deeper or staring in to the bigger questions. As a result, we are often reactive – missing the opportunity to engage early with regard to challenges from regulators, customers and our people.

We've been too quick to create and accept a convenient narrative to explain our decisions, actions and mistakes. But errors at NAB have usually been preceded by signals and warnings, be it in past experience, regulatory communications, or feedback from customers.

9. CULTURE

Customer voice

NAB's target behaviours now include "Getting it right for the customer, every single time". Among other things, getting it right for customers requires that products and services are: designed to meet the needs of targeted customers; distributed with integrity and honesty in a simple and efficient way; and serviced accurately in accordance with promised terms.

NAB employees indicate they are motivated to get it right for the customer. Results from the 2018 Employee Engagement Survey show that 79% of NAB people agreed with the statement "I am encouraged to look at things from our customer's perspective in my day-to-day work" (above the top quartile benchmark of 73%).

Getting it right includes dealing with, and learning from, customer complaints. As one Board member commented: "The best companies not only respond quickly to customer complaints, they see them as a fabulous source of information to drive service innovation."

Our track record in listening to and learning from customer complaints has been poor, although significant improvements have recently been implemented. Customers report that we act slowly throughout the complaints handling process; that there are shortfalls and delays in identifying the most significant issues.

We have not always been quick to recognise recurring patterns and deal with them diligently.

Getting it right means delivering great experience, and delivering outcomes that will stand the test of time. Lifting customer experience (as measured by NPS) is one of our core objectives under the bank's strategy. However, while we have established a clear method for measuring experience, we have not yet established the same discipline in measuring customer outcomes. And, in some cases we have allowed practices to emerge where immediate experience is in conflict with longer-term outcomes, for example, the practice detailed in the Royal Commission of not witnessing beneficiary nomination signatures correctly. As described in Section 6.3.3, many employees felt this made it easier for customers, but it subjects their wishes to potential future challenge.

Regulator voice

Regulators have access to a wealth of knowledge that we cannot observe directly. Examples are findings from breach reporting and investigations across the industry, messages from legislators and advocacy groups, private conversations with international regulatory bodies, and the combined experience of their employees. The voice of the regulator is expressed through many mediums: through legislation, regulatory guides, letters and direct interactions, industry reports, enforcement actions undertaken, endorsement of codes of conduct, and speeches and media releases. Regulators make observations not just about what has gone wrong, but also about how things could be better. Some messages are direct, some are subtle. All should be considered seriously.

As described in Chapter 2: Role of the Board, Chapter 4: Risk Management and Compliance and Chapter 5: Issue Identification, Escalation and Resolution, we don't always listen to and learn effectively from regulators. We have disciplines in place to ensure legislated obligations are captured, internalised, and supported by specified processes and controls although interviews and case studies show that these are not always well understood, well integrated, or consistently effective. We have less established disciplines to manage regulatory messaging that exists outside legislation. And at times, we have failed to take away the messages from the regulator, to reflect, and to adapt accordingly.

Employee voice

As highlighted in Chapter 5: Issue Identification, Escalation and Resolution, most employees agree that risk issues are identified and reported quickly and openly and that they can report an instance of unethical conduct without fear of retaliation. But they are less comfortable disclosing failures and mistakes and challenging overtly the decisions and behaviour of others.

Our people also say there are things that make it hard for them to provide exceptional service to customers. In the recent employee engagement survey employees commented on feeling sales pressure, having inadequate access to relief employees to cover absences at branches, and having to work with complex systems and processes that make it difficult to do their job. In addition, many employees perceive there to be an arbitrary harshness in the consequences imposed for breaches. Some of this feedback has persisted through many survey cycles, indicating that our people are not seeing desired change.

5. While we have a strong commitment to customers, we have too often put other priorities first

Banking is built on trust, and trust has many elements. Our customers expect us to be safe and stable, applying sound financial management practices and acting prudently, with long-term sustainability in mind. Our customers also expect us to deliver services fairly, honestly and efficiently.

In certain circumstances these interests can appear to be in conflict. It is how we choose to act and respond in these moments that define the level of trust our customers will be willing to place in us.

Taking a stand for the customer in decision-making

Our purpose is to **back the bold who move Australia forward**, a powerful motivator to all of NAB's employees. We have a passion for customers and our genuine intent is to put our customers' interests first. In September 2018 we introduced to our target behaviours the concept of 'taking a stand for the customer'.

During the self-assessment, our people questioned whether we clearly adhere to this standard, every time. Among other factors, they stated they have experienced an organisational dynamic that placed more emphasis on short-term financial management than customer outcomes.

9. CULTURE

We need to ensure we're taking a stand for our customers in all of our decisions, including:

- Systems and controls: Have we made it easy for our bankers to get it right for our customers, every time? Have we built the quality assurance that will tell us, right away, if things are going wrong?
- Maintenance: Are we investing enough, sustainably, to keep the systems our customers rely on stable and secure?
- Third parties: When we enter business relationships (including originating via intermediaries), do we confirm that they maintain or enhance the quality, depth and reliability of services for our customers?
- Customer remediation: If we get it wrong, how quickly do we fix it for our customers? How easy do we make it for them? If the right approach is unclear, do we err in their favour?

The self-assessment also revealed an example of these principles in action, starting at the top. When management made a recommendation regarding the restructuring of a particular contractual arrangement, the Board did not feel the decision focused enough on how it would affect customers. The Board rejected the recommendation.

To support and enable NAB to live by these principles, employees across the bank routinely participate in Customer Huddles. These huddles focus on reviewing insights and feedback from customers (including NPS verbatim comments, complaints, customer stories) within their teams to support the identification of issues and create action plans to drive improvements in their local teams and across the bank.

Taking a stand for the customer in every interaction

Some time ago we recognised the need to systematically reinforce our commitment to our customers in what we communicate, measure and manage to ensure the right customer outcomes. We changed our remuneration practices, refocusing incentives and performance measures (as outlined in Chapter 8: Remuneration).

Despite these changes, and communicating about NAB's priorities, some focus group participants said they still perceive that the pressure to deliver the short-term numbers remains the primary focus. Old rituals (such as the visible 'Leaderboard' for sales) have not all been removed and replaced consistently with new ones such as weekly or fortnightly leader-led Customer Huddles. As observed by a respondent to the employee engagement survey: "I ... don't think there is enough emphasis on people doing the right thing by customers. And this needs to change. We reward sales stars over service stars".

ACTION #26:

With oversight from the Board, implement the Culture Embed Plan to support the achievement of NAB's desired culture.

10. ACTIONS

10. ACTIONS

10.1 ACTIONS SUMMARY

The Board and ELT of NAB have reflected on the findings of the self-assessment and the response that is required to address both the symptoms and the causes of these issues.

Fundamentally, the self-assessment has reinforced the importance of the bank's vision to be 'Australia's leading bank, trusted by customers for exceptional service'. The bank is already on a path towards this vision, under a transformation strategy which the bank believes is well aligned to addressing many of the issues identified in this self-assessment. But there is much more work to do.

The bank is under no illusion about the significance of the changes required to address the findings and recognises the high standards and resolve required, as an organisation and as individuals, to successfully change. Many of the issues that have been raised reflect practices and norms that have built up over a long time, are deeply embedded and will not change overnight.

The environment is likely to present further challenges, require more reflection from the bank and place more demands on the bank's people to make the right decisions and hold course.

As a result, in forming the response to the self-assessment the bank has focused on both the goals that will guide its response and the initial actions required.

These guiding goals define the standards that the Board will expect and ELT will drive to ensure the response truly addresses the issues identified:

- **Bringing the voice of the customer firmly into the bank** – in the way we make decisions and into our governance, accountability and risk management practices.
- **Improving the rigour and discipline of our delivery** – emphasising the skills and experience needed and engineering our systems, processes and controls to get it right for our customers every single time.
- **Strengthening our accountability and risk management practices** – strengthening risk ownership for our leaders and lifting significantly the bank's capabilities, investment and focus on conduct and compliance.
- **Overhauling our approach to issues** – identifying and fixing issues with intensity, purpose and addressing the root causes.
- **Realise NAB's desired culture** – visibly rewarding the right behaviours and sanctioning the wrong behaviours through sound remuneration, performance and consequence management approaches.

Initial actions have been identified through this self-assessment and are set out in Section 10.2. Many of these actions build on work already in progress under the bank's transformation. Other actions represent additional work that the bank must undertake.

Oversight of the response

With the finalisation of the self-assessment, the Board will discuss the review and its findings with APRA. The Board will oversee the establishment of a program of work to deliver the identified actions, to track progress towards the defined goals, and to course-correct as appropriate. Updates will be provided to customers, investors and employees through regular reporting mechanisms such as NAB's annual reporting.

ELT leads have been allocated to each area and will have accountability for the delivery of the actions outlined.

Figure 10.1 NAB's goals in responding to self-assessment findings

10.2 INITIAL ACTIONS IDENTIFIED

The actions identified within each individual chapter of the report, aligned to the guiding goals are listed below.

Bringing the voice of the customer firmly into the bank

#1 The Board will require and oversee a significant lift in the importance given to the voice of the customer and a more intense focus on customer outcomes, and is instituting structural (e.g. Board committee) changes to support this.

#6 The ELT will drive an uplift in the voice of the customer through governance, reporting, decisions and relevant controls – incorporating a more intense focus on customer outcomes.

#8 Update NAB's Risk Management Framework to integrate a stronger focus on customer outcomes.

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#12 Review and redesign issue management practices to: (i) Better incorporate the voice of the customer.

#17 Establish a consistent and explicit decision-making approach for important decisions, that includes consideration of the impacts on customers, employees, risks, reputation and financials.

Improving the rigour and discipline of our delivery

#11 Improve compliance-related controls and monitoring processes to evidence ongoing compliance and more quickly identify, report and remediate any breaches.

#18 Revise NAB's approach to the design, management and governance of products and services to identify and assess value delivered to customers, and to monitor the quality of delivery of that value.

#24 Continue the 'industrialisation' program of work, including ensuring adequate metrics are in place to monitor whether expected improvements are being realised.

#25 Review the leadership capability model and talent management practices to raise the emphasis on quality and rigour of execution.

Strengthening our accountability and risk management practices

#3 The Board will require and oversee enhancements to non-financial risk reporting, in particular to ensure key matters are escalated early and clearly and that adequate agenda time is allocated to them.

#7 Review and drive changes such that the GRRMC – supported by more effective Group and First Line risk governance committees – brings more rigour, discipline and intensity in the areas of conduct, compliance and operational risk.

#9 Strengthen the effectiveness of First Line risk management, through:

(i) Lifting the standard of overall risk governance, including clarity of accountabilities.

(ii) Increasing the capability of First line to proactively and consistently identify and monitor risks.

(iii) Improving First Line understanding, design, documentation and execution of effective controls.

#10 Improve the effectiveness of Second Line's policy, oversight and reporting activities, including:

(i) Driving improvements in non-financial risk reporting including strengthening the Risk View, better escalating significant matters, and monitoring issue ageing.

(ii) Changing policies and reporting to help support an evidentiary approach to compliance, and revising authorities to support a stronger voice of Compliance.

(iii) Linking, integrating and deepening conduct risk management under an approved framework.

(iv) Increasing depth of capabilities and resourcing in critical operational risk and compliance areas.

(v) Engaging Risk earlier in change activities, and improving governance of risk arising from change.

#15 Review regulatory relationship practices to move beyond transactional interactions, and ensure that all regulatory expectations and commitments are captured and monitored effectively.

#16 Implement a more specific and explicit approach to support BEAR Accountable Persons in evaluating and assessing the adequacy and appropriateness of operational capacity and investment to address the risks for which they are responsible. In support of this, update NAB's categorisation, measurement and reporting of risks to better align to BEAR accountabilities

#20 Further embed accountability principles and practices developed under BEAR, so that leaders beneath the ELT have an equally clear understanding of their responsibilities and expectations of them.

Overhauling our approach to issues

#4 The Board will maintain its heightened focus on setting clear directions and expectations for management, being sceptical as well as supportive; and being relentless on the timely, appropriate and sustainable closure of important issues.

#12 Review and redesign issue management practices to: (ii) Improve timeliness of resolution (including accountability, resource allocation, monitoring and links to remuneration).

#13 Establish clear targets and refine processes – including root cause analysis, reporting and oversight – with the objective of reducing high-severity complaints.

#14 Continue to invest to lift the effectiveness of customer remediation practices, reporting and governance.

#19 For all material issues, the CEO to assign an ELT member to be accountable for ensuring overall issue resolution, supported by all team members as necessary to deliver required change.

Realising NAB's desired culture

#2 The Board will continue to promote a clear tone from the top and seek greater insights on how well this has cascaded below executive management.

#5 The Board will both lead and drive a further maturing of remuneration consequence management practices and require an uplift in remuneration governance activities more generally.

#21 Further improve the ability to assign and document individual accountability for risk performance (positive and negative) – including for Material Risk Takers and a broader population of employees.

#22 Improve the quality of data and insights provided to the Board, to facilitate a more data driven approach to testing the effectiveness of NAB's remuneration practices throughout the bank.

10. ACTIONS

#23 Monitor the effectiveness of recent remuneration framework changes, including the impact of changes driven by the Sedgwick Review recommendations for retail banking.

#26 With oversight from the Board, implement the Culture Embed Plan to support the achievement of NAB's desired culture.

APPENDIX – GLOSSARY

APPENDIX – GLOSSARY

3LoD	Three Lines of Defence
ADI	Authorised Deposit-taking Institution
APRA	Australian Prudential Regulation Authority
APRA Inquiry	APRA's Prudential Inquiry into CBA
ASIC	Australian Securities and Investments Commission
AUSTRAC	Australian Transaction Reports and Analysis Centre
BAC	Board Audit Committee
BEAR	Banking Executive Accountability Regime
BNZ	Bank of New Zealand
BRC	Board Risk Committee
CBA	Commonwealth Bank of Australia
CDC	Customer Delivery Committee
CEO	Group Chief Executive Officer and Managing Director
CFO	Chief Financial Officer
CPS 220	APRA Prudential Standard CPS 220 Risk Management
CPS 220 Comprehensive Review	Assessment of NAB's Risk Management Framework conducted by Ernst & Young in 2018, as part of a triennial review mandated by CPS 220
CTOO	Chief Technology and Operations Officer
CXB	Customer Experience Board
EGM	Executive General Manager
ELT	Executive Leadership Team
FAIR	Feedback and Information Repository
G30	Group of Thirty, Consultative Group on Economic and Monetary Affairs Inc
GAITS	Global Assurance Issue Tracking System
GALCO	Group Asset and Liability Committee
GCMRC	Group Credit and Market Risk Committee
GM	General Manager
GRCORC	Group Regulatory Compliance and Operational Risk Committee
Group CRO	Group Chief Risk Officer
GRRMC	Group Risk Return Management Committee
MOI	Matter of Interest
MRT	Material Risk Taker
NPS	Net Promoter Score
NWMSL	Nation Wealth Management Services Limited
RAS	Risk Appetite Statement
RemCo	Board Remuneration Committee
RMA	Risk Management Accountabilities
RMF	Risk Management Framework
RMS	Risk Management Strategy
Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
RSA	Regulatory Strategy & Affairs
Sedgwick Review	Retail Banking Remuneration Review
SERP	Significant Event Review Panel
SIO	Securities in Order
VCRMCs	Value Chain Risk Management Committees