Aon Hewitt
Talent, Rewards & Performance

The Quiet Corner of Financial Services

Retail Banking's Human Capital Crisis

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That seemingly quiet corner of financial services, Retail Banking, has erupted into what some think is approaching a real human capital crisis. Performance and rewards programs deemed by regulators, management, and HR as "lower relative risk" during the financial crisis have become a top concern for Board of Directors, management, and employees. The recent news about Wells Fargo and similar cases are perhaps the most visible examples of what may be disconnects between the vision and values of a firm and its implementation.[1] The roots of these issues are not about a single firm, or of a single dysfunctional element. They are about a fundamental issue that presents itself when basic practices, methods of transparency, and management tools are insufficient. This is especially true when considering the design and implementation necessary to manage effectively in a complex, large scale environment. It is a distributed problem requiring an integrated, holistic solution.

So where does the issue lie? The answer is complex, which is always a sign we need to go back to basics. The landscape of Retail Banking has changed significantly in the last decade. Leadership, talent, performance, and reward systems must more aggressively and effectively evolve with this change. Many of these problems impact other lines of business, such as wealth, insurance, and commercial banking. Firms need to make "no regrets" bets on putting in place the right HR infrastructure, cultural elements, and processes. It is necessary to define, measure, and ensure appropriate compensation system design and relate supporting behaviors and management routines. These fundamentals should be underpinned by reliable data and analytics capability. Taken together, risk can be materially reduced.

While nuances of location and sector will remain regardless of industry, there is a need for firms to strengthen or create a transparent, ethical culture, and align HR programs to that mission. To close the gap on these efforts, firms need to develop leaders that role model customer-centric behaviors, utilize performance management to incent transparency and fairness, and leverage human capital analytics to make sure there are progress markers along the way.

In this article, we will examine the leading indicators that may have instigated the crisis and provide you with our recommended approach to prioritizing and adapting current incentive compensation and human capital programs. Specifically, we will examine:

- **Leadership and culture as the epicenter of the issue.** The key in evolving Retail Banking is to pay careful attention to culture and the far-reaching implications of talent decisions.

- **The issues within Retail Banking as not purely a compensation issue.** The headlines in the news were created by having challenges beyond simple compensation into assessment, development, and workforce and organization design.

- **Complexity and lack of transparency of performance and reward programs leading to the potential governance failure.** There is opportunity to review and re-examine these programs in light of recent failures.

1 "Wells Fargo Isn't the Only Bank That Draws Cross-Selling Complaints." *Wall Street Journal*, 2016. http://www.wsj.com/articles/wells-fargo-isnt-the-only-bank-that-draws-cross-selling-complaints-1475058602.

- **Digital transformation and how customers utilize branches should be the focal point for all parties (regulators, management, and staff) involved in redesigning these programs.** The long-term implications of this evolution will require forethought and collaboration by many across the industry.

- **Human capital analytics and its role in driving change and transparency.** Management and leaders can make better decisions and prevent systemic issues by leveraging data and related insights.

But first let us examine the core issues that created an environment for such systemic breakdowns. Though never the flashiest area of financial services, there are several components of the current human capital systems in Retail Banking that set the table for the current crisis. Here is a short list of some major themes, organized around Aon's human capital strategy framework:

"'Firms need to make 'no regrets' bets on putting in place the right HR infrastructure, cultural elements and processes.'"

Leadership, Culture, Development, and Assessment

Leadership is responsible for setting and driving the business and human capital strategy to meet the complex needs of customers, investors, regulators, and employees, and serves as important role models to the rest of the organization. Their behavior is the most observable and their actions can have a profound effect on the rest of the hierarchy. This is especially pertinent for ethical behavior, as there are strong linkages between ethical management behavior and overall ethical culture of a firm or organization.[2] Furthermore, leaders must role model, reinforce, and orient employees around the customer (and not the product or cost). From our research on growth, we found that high-growth organizations are extremely customer-centric and are able to break down organizational boundaries in the interest of serving the customer and growing the firm overall.

There must be careful thought regarding culture and the implicit and explicit messages sent by leaders and managers. This notion is especially important in the risk and compliance functions within banking firms, where traditionally the focus has simply been on "checking off boxes." These employees must feel empowered so they can call out unethical behavior regardless of hierarchy and trained so they can spot unethical behavior and act quickly. Across the organization, employees should be assessed for their likelihood to engage in risky behavior, which can reduce financial risk by minimizing behaviors related to compliance violation and support cultural improvement by hiring compliance-oriented employees.

Recommendations:

- Create thoughtful **career and succession plans** that allow for high-potential associates to have an immediate impact on the organization.
- Conduct a **culture audit** to ensure that organizational behaviors match with purported mission and vision statements.
- Get better at hiring talent that has the specific skills and personality to match the future needs of the branch. Utilize **personality assessments** such as Aon's ADEPT-15® to help identify personality characteristics that contribute to unethical behavior and establish a Risk profile.

2 Meul Kaptein. Understanding unethical behavior by unraveling ethical culture. Human Relations. May 2011.

Workforce and Organization Design

Many retail banks have seen a loss of accountability occur within the middle management ranks. Years of organizational flattening have created greater disparity between individual contributors and leaders with decision-making rights, which led to the transfer of power to the top of organizational hierarchies.[3] By itself, flattening is not necessarily bad as it can help firms become more agile. However, organizations must be careful to account for a loss of oversight, especially among middle managers who traditionally screened for ethics violations.

Recommendations:

- Add additional **risk control mechanisms** into human capital processes to keep employees accountable at the branch or team level.
- Hold **employees accountable** for ethical behavior at the branch manager or team leader level and factor these behaviors into **promotion decisions.**
- Create a **risk control function** that is **empowered** and does not sit under a business function. Ensure they have the resources and capability to conduct full audits and reviews.

3 Julie Wulf. The flattened firm: Not as advertised. *California Management Review*. 2016;55(1).

Total Rewards

Retail Banking incentive programs are some of the most complex within the industry (or any industry for that matter). These incentive programs were built to promote employee engagement, productivity, and satiate the needs of marketing managers who had an ever growing list of products and services. The challenge is to redirect the focus and energy of these programs from a “sell every product you can” view to a “understand and respond to a customer’s needs” view.

The low-interest rate environment, coupled with the pressures from shareholders and regulators, have caused current leadership in many retail banks to be slow to evolve their perspective on performance and reward. Many of them were raised within the same platform they are now challenged with reinventing. New and more innovative ways are needed to attract and retain talent within Retail Banking.

As the customer interaction within the branch became more complex, so did performance management. Specifically the establishment and review of performance goals tied to multiple lines of business (Mortgage, Wealth, and Small Business), role profiles (Teller, Sales, and Management), and geographies created significant administrative burden and complexity. Outdated philosophies and technology regarding performance management amplified the lack of rigor and accountability regarding the behaviors occurring within the branch.

Many Retail Banking incentive programs still emphasize a pay for product (or sales credit) component to their performance metrics. The weighting of these measures as a percentage of incentive is a major driver of behavior. Given the regulatory scrutiny and digital transformation of the branch banking system, we can now rebalance the transactional emphasis with customer experience and compliance/risk metrics. Additionally, retail bank performance goals must be reasonable and move beyond simple top-down goals. The way top-performing companies accomplish this is to ensure that the more aggressive goals are allocated to markets, territories, or branches with the most opportunity, as identified in a bottom-up assessment and not just a top-down allocation of targets. Essentially, there must be balance between three elements: events that employees can control, outcomes that benefit the consumer, and outcomes that benefit the corporation.

Furthermore, it is important to pay a fair and livable salary to those bank tellers and representatives that interact with the customer every day. These employees are the front line of your organization and it is essential that they are engaged and feel the organization is compensating them fairly. There is ample research to show higher salary (and percentage of salary as compared to variable pay) can have a positive effect on ethical behavior.[4] The median pay for bank tellers in 2015 was $514 a week, which is under the poverty line for a family of five, and just above it for a family of four.[5] In addition, since 2008 bank tellers have only seen a 1.5 percent increase in their salary each year, which just barely keeps up with inflation.

4 Ronald Morgan. Self and coworker perceptions of ethics and their relationships to leadership and salary. *The Academy of Management Journal*. 1993.
5 U.S. Bureau of Labor Statistics: http://beta.bls.gov/dataViewer/view/timeseries/LEU0254553300.

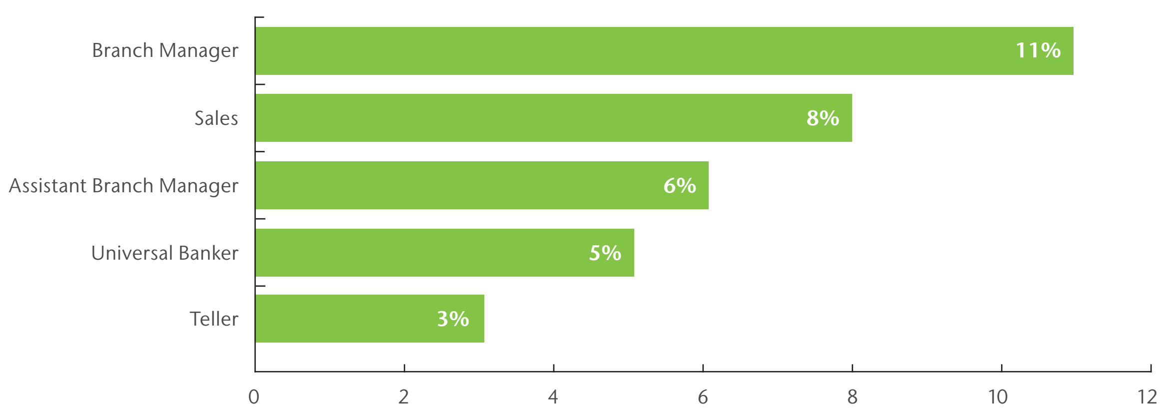
Total Rewards (Continued)

Additionally, best-in-class firms measure engagement as a leading indicator, a measurement that can help to indicate where trouble spots exist within the organization (and, in particular, branches). Low engagement can be identified in advance and used as a tool to head off disastrous events. In fact, highly engaged employees are 36 percent more likely to stay at their organizations, and also are likely to exert additional effort for the firm.[6]

Recommendations:

- Focus on **team-based goals** and how they will drive the **customer experience**. We have seen through our engagement surveys that a highly engaged, motivated, and culturally aligned branch staff has a direct impact on a firm's bottom line.[7]
- Extend **performance goal setting** and **measurement periods** to allow for more objective review by plan administrators.
- Improve the **governance of the HR programs** in retail. Move the conceptualization and administration of the incentive programs outside of the retail line of business. Obtain more market data regarding changes to staffing and pay structures across a diverse set of peers.
- Consider the effectiveness and potentially eliminate **small balance incentive programs** within Retail Banking businesses. As the chart below shows, most branch roles have less than 10 percent of salary delivered in variable pay. We have to question the effectiveness of such plans given the risks and potential for miss-selling that has potentially occurred.

Incentive as a Percentage of Salary (Median)



6 Ken Oehler, PhD, and Chris Adair, PhD. Say, stay, strive? Unleash the engagement outcome you need. Aon Hewitt Global Employee Engagement Database. 2015.
7 Ken Oehler, Ph.D. and Chris Adair, Ph.D. 2015 trends in global employee engagement. *Aon Hewitt.* 2015.

Human Capital Analytics

Strength of Talent Pool

+

Specialized Skill/ Knowledge

+

Onboarding/ Training Time

=

Turnover Cost

Lastly, management and leadership must have a lens to view human capital across the organization and analytics can help to provide the frame. Analytics are becoming more and more engrained into the decision-making process for leaders and when done well can make the case for ROI and show impact on the bottom line. However, analytics without insight does little to add value. Employees within human capital analytics functions must tie their hypotheses to business goals to ensure transparency.

For example, Retail Banking has been losing talent to other industries for the last several years. With median turnover in 2015 sitting around 37%, it becomes a significant talent (and cost) drain for banks going through this amount of transformation (see chart on next page, "Retail Brand & Call Center Turnover"). This is further compounded by the fact that many firms are geographically dispersed, and leaders may not have visibility to certain geographies. The elevated turnover levels significantly impact firms' training and development, succession, employee engagement, and culture practices.

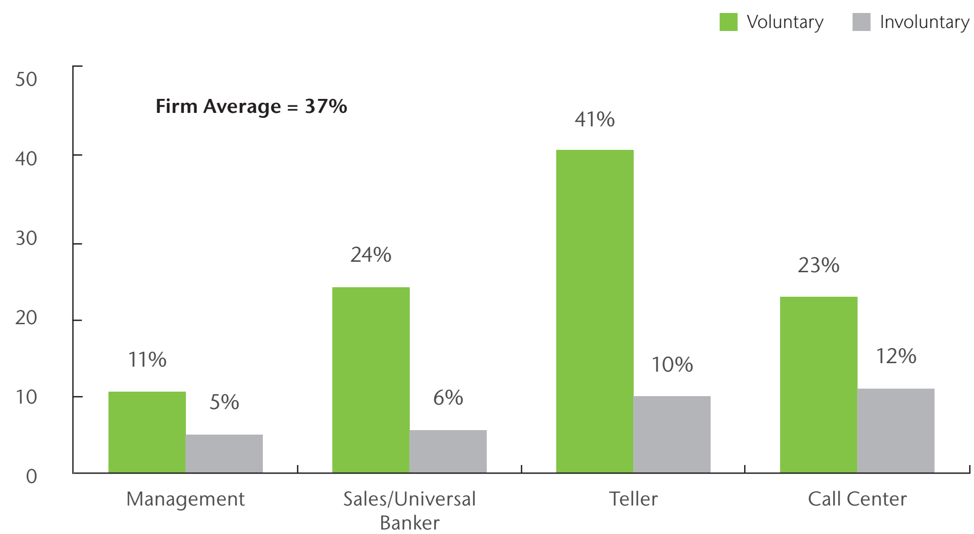
Recommendations:

- Develop or create a human capital analytics function within the firm, making sure to staff with both **technical** and **business** skillsets.
- Ensure **transparency** by tying analytics requests to specific business processes and functions.
- Empower human capital analytics functions to stay ahead of issues and shine light on systematic problems with a **direct line to leadership and risk functions.**

Human Capital Analytics

(Continued)

Retail Branch & Call Center Turnover



Absolute Turnover	Average Salary	.5x Base Salary	1x Base Salary	1.5x Base Salary
Low–250	$30,000	$3,750,000	$7,500,000	$11,250,000
High–1,000	$30,000	$15,000,000	$30,000,000	$45,000,000

Source: McLagan Retail Branch Incentive Plan & Trends Study, 17 national and regional banks
Turnover Rate=2015. Terminations/2014 Year-End Staffing Levels

Conclusion

The culture, behavior, and governance issues confronting the Retail Banking industry are not new. They are representative of systemic issues we have experienced in other financial services lines of business (e.g. mortgage banking, capital markets) as well as other industries (telecom, insurance). And similar to those experiences, we would encourage those of us who can implement change to collaborate on solutions that fit the current and long-term challenges we face. From leadership, engagement, talent assessment, performance, and reward; the challenges we face will touch all areas across the human capital spectrum. We need forward looking innovative thought, not just reactive discipline. We need to continue to evolve the value proposition for the customer, employee and shareholder while mitigating risk and promoting appropriate culture and conduct.

As we transform the physical profile of the branches to adapt to the digital evolution, we also need to adapt our philosophy regarding performance, reward, and talent in Retail Banking.

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