Public Consultation: Impact of Sales Incentives on the Sale of Consumer Credit Products

Response to Public Consultation received from Consumers International

FinCoNet
INTERNATIONAL FINANCIAL CONSUMER PROTECTION ORGANISATION

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About Consumers International

Consumers International (CI), working together with our 240 Members in 120 countries, is the only independent and authoritative global voice for consumers. Together we ensure consumers are treated safely, fairly and honestly. We strive to put them at the heart of the practices of global corporations and influence international bodies such as the UN, OECD and G20 to act in their interest.

Introduction

Consumers International welcomes FinCoNet's consultation on Impact of Sales Incentives on the Sale of Consumer Credit Products. In 2014, Consumers International published a report entitled *Risky business: The case for reform of sales incentives schemes in banks.* Our research concluded that both financial and non-financial sales incentives schemes were an important root cause of mis-selling and irresponsible lending, and contributed to financial instability.[1] Sales incentive schemes are also a key driver of bank culture and were both a cause and a symptom of the aggressive sales-based culture that dominated many banks in the run up to the financial crisis. We agree that further intervention on sales incentives has the potential to make a significant positive contribution to how credit is sold to consumers. The recent Wells Fargo case shows that there is more that needs to be done to combat the risks to consumers from inappropriate sales incentives. Senior executives need to be held accountable for consumer detriment caused by inappropriate sales incentive schemes by being subject to enforcement action by supervisors and having bonuses clawed back.

We support the existing provisions in the Guidance but recommend that it is enhanced in the following ways:

- The necessary pre-conditions of the overarching regulatory framework should include consumer representation, transparency and independence.
- The Guidance on effective oversight should include examination of incentives relating to those involved in managing and supervising staff selling consumer credit products, collective incentives given to members of branches or sales teams and incentives given to staff involved in complaints handling, arrears handling, collections and foreclosure.
- The Guidance on cross-selling should be expanded to cover sales incentive for other financial products sold alongside consumer credit products.
- The Guidance on consumer-focussed culture should be expanded to cover how the impact of changes to sales incentive schemes, including those made as part of cultural change initiatives are monitored and measured. Supervisors should also examine how sales performance, figures and targets are communicated within the firm and what emphasis is given to these figures as opposed to other customer measures.
- The Guidance on general duties and specific responsibilities should be expanded to cover restrictions supervisors could place on sales incentive schemes including placing limits on the specific structure of sales incentive schemes and introducing requirements around the governance of sales incentive schemes. Supervisors should also require incentive schemes to include measures relating to the quality of sales and ensure that unfair treatment of

[1] Consumers International (2014), Risky business: The case for reform of sales incentives schemes in banks http://www.consumersinternational.org/media/1529404/sales-incentive-report_riskybusiness_final2_151014.pdf

consumers, mis-selling or irresponsible lending can cause a reduction or clawback of incentives.

- Supervisors should undertake specific thematic reviews of sales incentive schemes to identify the risks that are arising, how they are being managed by firms and highlight potential solutions. Supervisors should communicate the results of these thematic reviews with the market and highlight areas of good and poor practice so that all firms are clear on the standards that they should achieve.
- The Guidance on Oversight of Different Sales Networks should include consideration of occasions where staff are providing information about the product rather than specific advice. It should also highlight the Guidance also applies where the activity of the firm is in whole or in part outsourced to third parties and that responsibility for compliance remains with the firm undertaking the outsourcing.
- The Guidance on Governance and Oversight should be expanded to cover the need for clear allocation of responsibilities regarding the approval of incentive schemes, the identification of risks from the schemes and the measures put in place to manage these risks. As part of these Governance arrangements the supervisor should require all banks to have a named individual senior executive responsible for approving the sales incentive schemes for frontline staff and controlling the risks of mis-selling. In the event that an inappropriate sales incentive scheme leads to consumer detriment, the supervisor should take enforcement action against the executive responsible and ensure that bonuses are clawed back.
- The Guidance on Monitoring should be expanded to cover the need to gather appropriate Management Information on the operation and risks of sales incentive schemes and undertaking sufficient monitoring of quality of sales. Firms should also establish effective mechanisms for gathering feedback from frontline staff about the operation of sales incentive schemes, and this should include the operation of effective whistleblowing arrangements.
- We welcome the Guidance's recognition of the limits of using disclosure to consumers to reduce the risks of sales incentive schemes. In order to ensure effective corporate governance, the Guidance on disclosure should be expanded to cover appropriate disclosure to shareholders of the risks of sales incentive schemes that have been identified, the action taken to mitigate them and any concerns raised by frontline to staff through whistleblowing mechanisms.
- The Guidance on promotional incentives to consumers should be expanded so that supervisors consider the impact of the time-limited nature of some incentives and the need for promotion of the incentives to include full details of the cost of the consumer credit product such as the APR.

In the Annex to this response we have included a version of the Guidance showing our recommended amendments and additions in ***bold italics***.

Definition of sales incentives

We welcome the broad definition of sales incentives in the consultation paper covering both financial and non-financial incentive schemes. Consumers International identified the following rewards and punishments given to staff as part of financial and non-financial sales incentive

schemes. It is important that the application of each of these rewards and punishments is covered by the Guidance.

Reward	Punishment
Financial	
• Annual/Quarterly/Monthly bonuses • Increases in salary • Spot awards • Collective bonuses for teams/branches	• Loss of bonuses • Decreases in salary
Non-Financial	
• Competitions and Prizes (either for staff who meet specific targets or top %) • Gifts - Cinema/Restaurant/Sporting tickets/vouchers • League tables • Promotion • Leaving early / Extra holiday	• Performance management • Performance Improvement Plans • Enhanced monitoring • Loss of status • Humiliation / Peer Pressure • Extended working hours • Demotion • Dismissal / Redundancy

Questions for consultation

Necessary Pre-conditions of the Regulatory Framework

1. Do you agree that a. to c. above are necessary pre-conditions of the overarching regulatory framework if supervisory initiatives are to be effective in the field of sales incentives and responsible lending?

2. Are there any other pre-conditions that you consider necessary for supervisory initiatives to be effective in the field of sales incentives and responsible lending?

3. Do you have any other comments related to these pre-conditions?

Yes we agree that a. to c. are necessary pre-conditions of the overarching regulatory framework if supervisory initiatives are to be effective in the field of sales incentives and responsible lending. In addition, we would also see the following as necessary pre-conditions[2]:

Consumer representation: The supervisor(s) should have appropriate mechanisms for consulting consumers and their representatives.

[2] Consumers International (2011), Safe, fair and competitive markets in financial services: recommendations for the G20 on the enhancement of consumer protection in financial services

Independence: The supervisor(s) should be independent of the industry, free from conflicts of interest and include a balance of members with industry and consumer expertise on its governing body.

Transparency: The supervisor(s) should be transparent in its decision-making and should clearly publicise occasions where it has taken action against specific practices and products or misleading financial promotions.

Appropriate Oversight

4. Do you agree with this Guidance on Appropriate Oversight?

5. If you do not agree with this Guidance on Appropriate Oversight, please identify the specific aspects you do not agree with and explain why.

6. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Appropriate Oversight? We welcome in particular information based on your experience or examples.

7. Do you have any other comments related to this Guidance on Appropriate Oversight?

We agree with the proposed Guidance on Appropriate Oversight but believe that it should be supplemented in the following areas:

Incentives given to staff at all levels of the firm, including those involved in managing and supervising staff selling consumer credit products: Within many banks, the 'first line of defence'[3] against inappropriate sales and irresponsible lending will come from line managers, branch managers, supervisors, compliance staff or team leaders. In these circumstances, setting an incentive scheme for these managers/supervisors/compliance staff that focuses on sales can create a conflict of interest and lead to weak supervision. These risks are heightened if these managers/supervisors/compliance staff undertake a significant role in checking the quality/compliance of the sales.

Even if sales incentives for staff involved in selling to consumers are removed there may still be a risk of irresponsible lending or mis-selling if these incentives remain at higher levels within the bank. Branch, regional and product managers may place implicit or explicit pressure on frontline staff to meet sales or revenue targets. It is important that supervisors exercise appropriate oversight over the incentives given to staff at all levels within firms and include examination of them in their assessment of whether sales incentives encourage lending practices that are not in the best interests of the individual consumer or consumers generally.

Incentives given to individual members of staff and collectively to groups of staff such as branches or sales teams: When sales incentives/targets are given on a collective basis within a branch or call centre they can still lead to inappropriate sales and pressure for frontline staff. The focus on collective sales targets could also encourage the growth of a sales-based culture within the organisation – where sales performance is seen either implicitly or explicitly as the most important factor in measuring the contribution of individual staff. The Central Bank of Ireland found that it was common for banks to impose 'collective targets' on branches whereby high minimum threshold

[3] KPMG (2009), The Three Lines of Defence

performance levels were required in order to unlock incentives for staff on an all or nothing basis. It concluded that: "Such a situation raises the risk of a constant, group focus on selling at all times and potential to put pressure on individuals within the qualifying group to perform so that all staff entitled to such a group type incentive receive it – no one individual may want to be the reason for the group not qualifying for the incentive."

Incentives given to staff involved in complaints handling and arrears handling, collections and foreclosure: Responsible lending includes both the sale of the initial consumer credit product and the ongoing treatment of consumers after they have taken out the loan/credit product, including how they are treated if they have a complaint or enter financial difficulty. In the UK, some banks gave frontline staff and branch managers incentives schemes that penalised them for paying redress to customers, even when the bank had made an error and the complaint was justified.[4] Incentive schemes for staff involved in arrears handling should encourage them to make decisions based on the best interests of customers. If staff are incentivised according to the amount of money they recover from the borrower then they may have a focus on the short-term rather than considering other arrangements that would be in the best interests of customers. Incentive schemes should help ensure that decisions around forbearance or repossession are suitable given the specific personal and financial circumstances of borrowers – dealing sensitively with borrowers who may have particular vulnerabilities. It is important for the supervisors to ensure that the incentive schemes for staff dealing with consumers in payment difficulties are aligned with the need to exercise reasonable forbearance.

Challenges / Opportunities

The Consumers International report identified a number of ways in which the risks of miss-selling and irresponsible lending can remain even after firms have made some reforms to incentive schemes.[5] These included occasions where firms have sought to claim that they no longer have any "sales targets" in place but, in fact these have simply been relabelled. For example, instead of being told to sell a certain number of customers a consumer credit product, staff are told to find a certain number of customers who have a "need" for the consumer credit product and provide it to them. If the way in which the firm determines whether the customer has a "need" for a consumer credit product is not well defined then these "customer need" targets can pose exactly the same risks as "sales targets".

A particular challenge for supervisors is likely to be an increase in "discretionary" incentive schemes. These are schemes where the link between sales and financial/non-financial incentives is not formulaic but can rely on a significant element of discretion. This might be portrayed by firms as a way to reduce risk. However, it can make it more difficult to manage these risks – the factors that have been used to award financial and non-financial incentives might not be uniform or recorded centrally. Even though formulaic rewards linked to sales might have been removed, managers could use incentive schemes to indirectly reward sales. These might be the case if sales managers are biased towards those staff selling the most products when allocating bonuses. The rise of discretionary schemes is likely to make supervisors oversight of incentive schemes more difficult. It will require supervisors to determine how the schemes are actually applied by talking to and

[4] FSA (2010), Review of complaint handling in banking groups
[5] Consumers International (2014), Pages 38-40

surveying frontline staff. They will also need to gather and analyse information from within firms to check that incentive schemes are not being used indirectly to reward sales.

Supervisors will also need to pay close attention to whistleblowing or other procedures that staff can use to raise concerns about inappropriate incentive schemes. They will need to investigate how concerns are examined and dealt with by the firm. Just as importantly, supervisors will need to speak to or survey sales staff to discover their views on their firm's incentive schemes and whether they feel able to raise any concerns they may have with managers and senior staff. In the Wells Fargo case staff who rung the Wells Fargo "Ethics Line" to report concerns were fired.[6]

Cross Selling

8. Do you agree with this Guidance on Cross Selling?

9. If you do not agree with this Guidance on Cross Selling, please identify the specific aspects you do not agree with and explain why.

10. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Cross Selling? We welcome in particular information based on your experience or examples.

11. Do you have any other comments related to this Guidance on Cross Selling?

The existing Guidance on Cross Selling should be supplemented to cover both occasions where the consumer credit product is sold alongside another product (such as the example given for car finance) and also occasions where another financial product is sold alongside the consumer credit.

The Guidance should therefore be amended to read "Supervisors' oversight should seek to ensure that sales incentive schemes do not encourage the cross-selling of credit products ***or other financial products alongside credit products*** without proper consideration for the needs of the consumer."

The Consumers International report highlights several case studies where the cross-sSelling of other financial products alongside consumer credit products has led to both mis-selling and irresponsible lending. This can particularly be the case where the extra profits made on the additional financial product are used to cross-subsidise the cost of the consumer credit product – reducing it to an extent to which the sale of the consumer credit product is not profitable for the bank:

Payment Protection Insurance: In the UK, PPI was sold on the basis that it protects a borrower's ability to maintain loan repayments should they be unable to keep up their repayments due to accident, sickness, or unemployment. PPI was generally sold alongside the credit, with the same bank typically arranging both the credit product and the insurance. There were significant problems in the market for PPI, with it being widely mis-sold to consumers who would never have been able to claim on it. Banks automatically included PPI when consumers requested a quote for a personal loan. They provided misleading information at the 'point-of-sale', and put pressure on consumers to purchase the insurance. In some cases, consumers were misled that purchasing PPI would increase their chances of obtaining credit. The product was complex and the information provided failed to highlight the key exclusions or to explain the total price of the insurance to consumers. For certain

[6] I called the Wells Fargo ethics line and was fired, CNN Money, 21st September 2016, http://money.cnn.com/2016/09/21/investing/wells-fargo-fired-workers-retaliation-fake-accounts/

types of PPI, a lump sum covering the cost of the insurance was added to the amount the consumer borrows, so they ended up paying interest on both the insurance premium and the loan. This meant that to pay for the PPI premium, a consumer could end up borrowing substantially more than they intended. Over £38.6 billion has now been set aside by banks and building societies to pay redress.[7]

Insurance and investment products sold alongside mortgages: In the Netherlands, the business model of DSB bank was to sell mortgage and consumer loans at low interest rates in combination with life and disability insurance. To pay for this insurance the amount of the premium was added to the loan in a single upfront lump-sum. The bank also sold investment products alongside the loans with a proportion of the customer's monthly payment invested in the stock market in the hope that the growth of the investment would be sufficient to repay the loan. DSB's profits relied heavily on the commissions and premiums gained from selling the insurance and investment products.

Investment products: Australian consumers were encouraged to take out consumer credit products (including borrowing against the value of their home) to invest in the stock market.

Consumer-focused Culture

12. Do you agree with this Guidance on Consumer-focused Culture?

13. If you do not agree with this Guidance on Consumer-focused Culture, please identify the specific aspects you do not agree with and explain why.

14. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Consumer-focused Culture? We welcome in particular information based on your experience or examples.

15. Do you have any other comments related to this Guidance on Consumer-focused Culture?

Financial and non-financial incentive schemes for staff impact directly on their behaviour and are also an important driver of the 'culture' within a bank. Incentive schemes were both a symptom and a cause of the aggressive sales-based culture which permeated many banks in the run up to the financial crisis.[8] Incentive schemes highlight to staff the objectives and measures that are most important for them to achieve on a day-to-day basis,rewarding behaviour that meets these objectives and penalising behaviour that does not.

Incentives schemes influence whether staff will act in the best interests of customers and whether they will challenge or ignore behaviour that damages customers' interests. Changes to incentives schemes are vital to secure a much-needed change in the behaviour and the culture of banks. Without changes to incentives schemes, no amount of 'mission statements' or 'customer charters' will change the culture of banking to be more focussed on customers and prudent risk-taking.

Therefore, we welcome the intention that supervisors should take into account the role that sales incentive schemes have in setting the culture within firms providing or distributing credit products. This Guidance should be enhanced by including the following points:

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[7] New City Agenda (2016), The top 10 retail banking scandals, http://newcityagenda.co.uk/the-top-10-retail-banking-scandals-50-billion-reasons-why-shareholders-must-play-a-greater-role-in-changing-bank-culture/

[8] In addition to Consumers International (2014) please also see New City Agenda (2014), A report on the culture of British retail banking

How the impact of changes to incentive schemes, including those made as part of any cultural change initiative within the firm, are being monitored and measured: Virtually all banks are currently undertaking programmes of work to change or reinforce their culture. Regulators will need to exercise oversight of these programmes and monitor how these changes are being implemented and measured by the board of the firm.

How sales performance, figures and targets are communicated within the firm and what emphasis is given to these figures as opposed to other customer measures: This should entail examining how the 'tone from the top' of the institution emphasises sales as the primary objective of the institution.

Challenges / Opportunities

One challenge that will be faced by supervisors is that there are no rigorous and reliable metrics that can be used by supervisors to measure 'culture'. New City Agenda's report concluded that:

> "[For a] culture measurement exercise is to be meaningful, it needs to examine how the culture looks at the coal face. This does not just mean talking with staff who are hand-picked by the senior management. It involves trying to get a slightly more objective and realistic view of what is actually happening on the front line through processes like random sampling or talking with union representatives. Exit interviews may also serve as an excellent way of gauging the culture of an institution. We suggest that front line staff be surveyed on at least an annual basis...Such a survey should be methodological, rigorous and well-resourced, and its results should be reported on publicly. As part of the survey, front line staff should be asked questions about how they are actually assessed and measured. This may be helpful in determining the extent to which banks have progressed beyond an aggressive sales culture."

Guidance on General Duties and Specific Responsibilities

16. Do you agree with this Guidance on General Duties and Specific Responsibilities?

17. If you do not agree with this Guidance on General Duties and Specific Responsibilities, please identify the specific aspects you do not agree with and explain why.

18. What challenges and opportunities do you consider relevant for the implementation of this Guidance on General Duties and Specific Responsibilities? We welcome in particular information based on your experience or examples.

19. Do you have any other comments related to this Guidance on General Duties and Specific Responsibilities?

We agree with the existing Guidance on General Duties and Specific Responsibilities but believe that it should be enhanced in the following areas:

Placing limits on the specific structure of incentive schemes: Supervisors should consider placing restrictions on high-risk elements that may exist within the structure of incentive schemes. The report from Consumers International highlights a number of high-risk features relating to the structure of incentive schemes. Supervisors should pay particular attention to schemes with cliff edges which mean that there are high rewards for making marginal sales. This can occur if staff are required to meet a specific sales threshold, such as 50 sales per quarter in order to receive any bonus at all, or have to meet a specific target to receive a large bonus.

Introduce specific requirements around the governance of incentive schemes: Supervisors should ensure that there is appropriate governance around the approval and monitoring of sales incentive schemes. We give further details of the possible requirements in our answer to questions 24-27. Supervisors should also ensure that firms should document these processes and retain records for auditing by the supervisor.

Requiring incentive schemes to include measures relating to the quality of sales and ensure that unfair treatment of consumers, mis-selling or irresponsible lending can cause a reduction or clawback of incentives: As part of the design of remuneration policies and practices, institutions need to consider mechanisms for monitoring and managing risks that might arise from these policies and practices. These should include sales quality monitoring to determine whether regulatory requirements are being met and root cause analysis to assess the patterns of, and reasons for, complaints made by consumers. Mis-selling or irresponsible lending should lead to the loss of sales incentives by frontline staff and management at all levels within the firm. It is important that sales quality monitoring is undertaken in sufficient quantities to make clawback a realistic possibility.

Conduct thematic reviews on incentive schemes: Supervisors should conduct detailed thematic reviews to assess the risks of sales incentive and performance management schemes in operation within firms. Normal supervision may cover a wide range of issues with individual firms and may not cover the issue of sales incentive schemes with the required depth. Supervisors should undertake specific thematic reviews of sales incentive schemes. These should be used to identify the risks that are arising, how they are being managed by firms and highlight potential solutions. Supervisors should communicate the results of these thematic reviews with the market and highlight areas of good and poor practice so that all firms are clear on the standards that they should achieve.

Oversight of Different Sales Networks

20. Do you agree with this Guidance on Oversight of Different Sales Networks?

21. If you do not agree with this Guidance on Oversight of Different Sales Networks, please identify the specific aspects you do not agree with and explain why.

22. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Oversight of Different Sales Networks? We welcome in particular information based on your experience or examples.

23. Do you have any other comments related to this Guidance on Oversight of Different Sales Networks?

We agree with the existing Guidance on Oversight of Different Sales Networks. It is important that the Guidance applies both to "tied agents" and the direct sales force of the firm and all intermediaries or advisers involved in the sale of consumer credit products. The Guidance could be clarified by highlighting that it also applies where the activity of the firm is in whole or in part outsourced to third parties, or carried out by another entity in other ways. Institutions should ensure that, in doing so, they comply with the requirements established in the CEBS Guidelines on outsourcing.[9]

[9] This includes, in particular, CEBS Guideline 2, which provides that 'the ultimate responsibility for the proper management of the risks associated with outsourcing or the outsourced activities lies with an outsourcing

The Guidance could also be clarified to highlight that it applies whether or not the specific sales channel is also providing specific advice to consumers and that there is a need to ensure that staff who are not authorised to provide a personal recommendation to buy the particular product do not imply to the customer that they are. The Guidance should highlight:

Sales incentives for which staff are only providing 'information' around the product rather than specific 'advice' that is suitable for a customer's circumstances: These schemes pose a particular risk as they may encourage staff to stray into 'recommending' the product to individual consumers. The impression may be given to the consumer that the product meets their needs and is suitable for their circumstances. Risks from these type of sales incentives schemes may be particularly difficult to monitor because, to persuade the customer to purchase the product, the member of staff may contradict written information about the product.

In Hong Kong, information disclosed to consumers regarding structured investment products was lengthy and complicated, with prospectuses stretching to more than 200 pages. Banks claimed that their sales processes only provided "information" to consumers about the products and not regulated investment "advice" that the product was suitable for their circumstances. However, the sub-committee of the Hong Kong Legislative Council appointed to study the issues arising from the sale of these products noted that from "the perspective of some customers, the line between the two was far from clear, as it was often the case that they had been introduced to such products by the bank staff who also persuaded them to subscribe for these products for higher returns."43

<u>Oversight and Governance</u>

24. Do you agree with this Guidance on Oversight and Governance?

25. If you do not agree with this Guidance on Oversight and Governance, please identify the specific aspects you do not agree with and explain why.

26. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Oversight and Governance? We welcome in particular information based on your experience or examples.

27. Do you have any other comments related to this Guidance on Oversight and Governance?

The guidance on Governance and Oversight should be expanded to ensure that the structure or incentive schemes, the risks involved and the processes that need to be put in place to manage them are considered at appropriate levels within the firm. Responsibility for these tasks should be allocated clearly to named senior executives on the board of the firm. The UK regulator found that, "There was often inadequate governance and oversight of the design, approval and review of incentive schemes, with risks not identified, assessed or adequately mitigated. Senior management at firms often agreed to incentive schemes without sufficiently understanding the risks that could arise".[10] In the past, incentive schemes could be approved by a committee dealing with Human Resource issues and risks might not be considered by other committees or senior executives. UK bank RBS awarded its frontline staff "double bonus points" when they sold a loan with PPI. The

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institution's senior management'. See Committee of European Banking Supervisors (2006), Guidelines on Outsourcing

[10] FSA (2013), Risks to customers from financial incentives

number of bonus points awarded also increased as the size of the loan increased. This meant that frontline staff could earn higher points for persuading customers to borrow more and to take out PPI. Gordon Pell, former chief executive of RBS retail said that he did not sign off the RBS staff incentive scheme and was not aware that there were double points for PPI sales.

Governance includes the need for clear allocation of responsibilities regarding the approval of incentive schemes, the identification of risks from the schemes and the measures put in place to manage these risks. As part of these governance arrangements, the supervisor should require all banks to have a named individual senior executive responsible for approving the sales incentive schemes for frontline staff and controlling the risks of mis-selling. In the event that an inappropriate sales incentive scheme leads to consumer detriment then supervisors should take enforcement action against the executives responsible and ensure that bonuses are subject to clawback. The structure of the sales incentive scheme and the controls that are put in place to manage risks should also be reviewed and approved by the remuneration and risk committees.

Monitoring

28. Do you agree with this Guidance on Monitoring?

29. If you do not agree with this Guidance on Monitoring, please identify the specific aspects you do not agree with and explain why.

30. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Monitoring? We welcome in particular information based on your experience or examples.

31. Do you have any other comments related to this Guidance on Monitoring?

Banks should have in place comprehensive monitoring schemes and risk management processes to measure regulatory compliance and the quality of sales. These should include gathering 'management information' about sales, trends and patterns that could indicate a risk of mis-selling. It should also include analysing data about complaints and identifying their root causes, which could indicate problems with the overall selling process or the conduct of members of staff. Once risks are identified, action should be taken to mitigate those risks, such as changing the remuneration scheme, sales process or product.

We believe that the Guidance should be expanded by including the following areas:

The firm should gather appropriate Management Information (MI) to be able to identify and manage risks from their remuneration policies and practices. A summary of this information should be provided to the management body responsible for approving the remuneration policies and practices. Monitoring should include sales quality monitoring, mystery shopping, contacting a sample of customers shortly after completing a sale, recording face-to-face sales conversations for later review or additional scrutiny of high-performing sales staff or those with unusual sales trends.

Sufficient monitoring of sales, both individually and collectively, should be undertaken to ensure that risks arising from incentive schemes and the conduct of individual staff members can be picked up and have an impact on the outcome of the incentive scheme.

Establishing effective procedures to gather feedback from frontline staff about the operation of remuneration policies and practices. This should include effective whistleblowing or other monitoring procedures that enable staff to raise concerns about excessive pressure or bias caused by these policies and practices. A summary of feedback, including any concerns raised and how they were investigated, should be provided to the management body.

Examining root causes of customer complaints and ensuring that feedback from customers that highlights risks are recorded and result in action taken. Customer complaints can provide an important source of feedback and an early warning system of potential problems with sales processes and risks from sales incentive schemes.

Disclosure

32. Do you agree with this Guidance on Disclosure?

33. If you do not agree with this Guidance on Disclosure, please identify the specific aspects you do not agree with and explain why.

34. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Disclosure? We welcome in particular information based on your experience or examples.

35. Do you have any other comments related to this Guidance on Disclosure?

It is increasingly recognised that there are limits to using disclosure to consumers as an effective regulatory tool. In the area of sales incentive schemes, disclosure is not a panacea for dealing with the conflicts of interest that arise. One further addition would be for supervisors to take into account "the need for firms to have conducted proper testing including Randomised Controlled Trials to measure the impact of their disclosures".

Disclosure to shareholders

The impact of the largescale misconduct caused by inappropriate sales incentive schemes typically falls on the shareholders of the firms. The shareholders of the companies need clear disclosure of the risks that firms have considered from sales incentive schemes and the actions taken to mitigate them. This disclosure is necessary so that shareholders can exercise proper oversight of the firms they own. This would have a similar objective to existing SEC rules, which require a narrative disclosure of a firm's "compensation policies and practices as they relate to the registrant's risk management".[11]

We believe the Guidance should be supplemented by an additional section:

Disclosure to shareholders

Disclosure to shareholders of the risks relating to sales incentive schemes and the action that has been taken to mitigate them could promote corporate governance and encourage shareholders to exercise proper oversight.

[11] 17 CFR 229.402 (s), https://www.law.cornell.edu/cfr/text/17/229.402. Also see SEC (2013), Shareholders Need Robust Disclosure to Exercise Their Voting Rights as Investors and Owners, https://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171492322#P24_5979

Supervisors should consider requiring the following public disclosures from firms:

The risks firms have considered that arise from their sales incentive policies and practices alongside the action they have taken to mitigate them, including how they have complied with any relevant Guidance.

The number of occasions whistle-blowers have raised concerns about sales incentive policies and practices. This disclosure should also include whether any changes to policies and practices were made as a result of concerns raised.

Promotional Incentives Offered to Consumers

36. Do you agree with this Guidance on Promotional Incentives to Consumers?

37. If you do not agree with this Guidance on Promotional Incentives to Consumers, please identify the specific aspects you do not agree with and explain why.

38. What challenges and opportunities do you consider relevant for the implementation of this Guidance on Promotional Incentives to Consumers? We welcome in particular information based on your experience or examples.

39. Do you have any other comments related to this Guidance on Promotional Incentives to Consumers?

We agree with the existing Guidance on Promotional Incentives to consumers but believe they could be expanded in the following areas so that the supervisors' oversight should consider:

Whether the time-limited nature of an incentive for taking out credit may encourage consumers to act without considering the full consequences of borrowing. A promotional incentive that is time-limited could encourage the consumer to rush into taking out credit without **considering the full consequences of borrowing**.

That the mention of a gift or other incentive in a promotion for a consumer credit product should trigger a requirement for the firm to disclose the actual cost of the credit product such as the APR and the APR/interest rate after any initial promotional period: Short-term promotional deals can offer benefits to consumers in terms of lower cost. However, it is important that consumers are made aware of the longer term cost of the consumer credit product at the point at which they sign up for the initial deal.

Annex

The text below shows the contents of the Guidance including the changes that we recommend in this response. The additions to the Guidance are shown in ***bold italics***.

Necessary Pre-conditions of the Regulatory Framework

These pre-conditions include:

a. Having one or more oversight bodies that are explicitly responsible for consumer protection in relation to consumer credit (referred to in the report as a 'primary regulator', though please note that the Guidance in this Consultation Paper focuses on the role of the supervisor);

b. The scope of the supervisor(s)' jurisdiction being comprehensive of the various sales channels that might be employed to sell credit; and

c. Affording the supervisor(s) with a range of appropriate supervisory and enforcement powers and the resources to exercise those powers.

d. The supervisor(s) should have appropriate mechanisms for consulting consumers and their representatives.

e. The supervisor(s) should be independent of the industry, free from conflicts of interest and include a balance of members with industry and consumer expertise on its governing body.

f. The supervisor(s) should be transparent in its decision-making and should clearly publicise occasions where it has taken action against specific practices and products or misleading financial promotions.

A. Guidance on Appropriate Oversight

Supervisors should include in their approach to responsible lending the assessment of whether sales incentives encourage lending practices that are not in the best interests of the individual consumer or consumers generally.

This should include the oversight of:

- All types of consumer credit products and sales channels within the supervisor's remit;

- Incentives to staff and credit intermediaries who sell consumer credit products; and

- Incentives offered to consumers to promote a credit product or otherwise incentivise a consumer to borrow.

- Incentives given to staff at all levels of the firm, including those involved in managing and supervising staff selling consumer credit products.

- Incentives given to individual members of staff and collectively to groups of staff, such as branches or sales teams.

- Incentives given to staff involved in complaints handling and arrears handling, collections and foreclosure.

B. Guidance on Cross Selling

Supervisors' oversight should seek to ensure that sales incentive schemes do not encourage the cross-selling of credit products ***or other financial products alongside credit products*** without proper consideration for the needs of the consumer.

C. Guidance on Consumer-focused Culture

Supervisors' oversight should take into consideration the role that sales incentives play in setting the culture within firms providing or distributing credit products. This should include the oversight of:

- Variable remuneration arrangements, which can encourage sales staff and credit intermediaries to focus on the achievement of sales volume at the expense of consumers' best interests.

- The extent to which incentive arrangements which are poorly designed from the perspective of protecting the best interests of consumers can act as an obstacle to other consumer protection measures, such as advisory or disclosure requirements.

- How the impact of changes to incentive schemes, including those made as part of any cultural change initiative within the firm, are being monitored and measured.

- How sales performance, figures and targets are communicated within the firm and what emphasis is given to these figures as opposed to other customer measures.

D. Guidance on General Duties and Specific Responsibilities:

Supervisors' oversight of responsible lending should include both general obligations on the firm to act in the best interests of the consumer and more detailed requirements on sales incentives. ***To inform the type of restrictions that should be put in place, sales incentives supervisors should conduct detailed thematic reviews to assess the risks of sales incentive and performance management schemes in operation within firms.***

The following are examples of the types of restrictions that could be placed on sales incentives:

- Banning the payment of specific types of incentives where the risk(s) arising from the incentive cannot be managed in a manner that protects the best interests of consumers.

- Placing limits or other restrictions on the types of incentives that can be granted.

- Placing limits or other restrictions on the amounts that can be paid as incentives.

- Limiting the variable component of an individual's remuneration (e.g. as a proportion of total remuneration).

- Placing limits on the specific structure of incentive schemes.

- Introducing specific requirements around the governance of incentive schemes.

- Requiring incentive schemes to include measures relating to the quality of sales and ensure that unfair treatment of consumers, mis-selling or irresponsible lending can cause a reduction or clawback of incentives.

- Requiring that incentives be disclosed to the consumer.

E. Guidance on Oversight of Different Sales Networks

The sales incentives of all those involved in the selling of credit products, from front line sales staff involved in direct sales to credit intermediaries ***and tied agents***, should be subject to appropriate standards and supervision. ***This also applies where the activity of the firm is in whole or in part outsourced to third parties, or carried out by another entity in other ways. Institutions should ensure that, in doing so, they comply with the requirements established in the CEBS Guidelines on outsourcing.***

The standards set and the approach to their supervision should:

- Apply consistently across the channels through which a given credit product is sold, ***whether staff are providing specific advice about the credit product or just information about the product***; and

- Include, as well as sales staff and credit intermediaries (and their practices), the overall architecture of a given sales network. This should include taking into consideration:

- The propensity for a practice restricted or prohibited in one area to migrate to another; and
- The importance of non-sales functions and management practices to the effective operation of controls in this area (as set out further below in Guidance G. on Monitoring).

F. Guidance on Oversight and Governance

The structure of incentive schemes, the risks involved and the processes that need to be put in place to manage them should be considered at appropriate levels within the firm. Responsibility for these tasks should be allocated clearly to named senior executives within the firm. In the event that an inappropriate sales incentive scheme leads to consumer detriment, then supervisors should take enforcement action against the executives responsible and ensure that bonuses are clawed back. The structure of the sales incentive scheme and the controls that are put in place to manage risks should be reviewed and approved by the remuneration and risk committees

Supervisors' oversight of product oversight and governance of credit products should include an assessment of incentives comprised in credit products. This should include the oversight of:

- The role, if any, that incentive arrangements play in how credit products are designed;

- The relationship between incentives and how consumers are targeted;

- The relationship between the scale of the target market and volume of sales rewarded by the incentive scheme; and

- The scope and strength of the firm's product oversight and governance arrangements.

G. Guidance on Monitoring

Supervisors' oversight should include an assessment of arrangements for monitoring the operation of incentives within their firm.

This oversight should include consideration of the following:

- Ensuring that firms have measures and procedures in place to adequately and effectively monitor the implementation of incentive schemes so as to avoid poor outcomes for consumers. ***A summary***

of the Management Information from this monitoring should be provided to the management body of the firm;

- Monitoring should include sales quality monitoring, mystery shopping, contacting a sample of customers shortly after completing a sale, recording face-to-face sales conversations for later review, or additional scrutiny of high-performing sales staff or those with unusual sales trends.

- That the governance structure includes appropriate alert systems within the firm to detect high risk situations as they emerge and address them appropriately;

- That financial and non-financial reward arrangements and practices include qualitative metrics by which staff are rewarded, such as quality of service, complaints analysis or loan performance over a period of time;

- That there is sufficient monitoring of sales, both individually and collectively undertaken to ensure that risks arising from incentive schemes and the conduct of individual staff members can be picked up and have an impact on the outcome of the incentive scheme;

- That there is proper support for and priority given to control functions whose input goes towards any qualitative scoring affecting staff incentives. This should include having reward arrangements for staff in control functions that are sufficiently independent of the arrangements for sales staff and credit intermediaries to secure the independence of these control functions;

- That firms periodically review the efficacy of their policies and procedures in this regard.

- That firms establish effective procedures to gather feedback from frontline staff about the operation of remuneration policies and practices. This should include effective whistleblowing or other monitoring procedures that enable staff to raise concerns about excessive pressure or bias caused by these policies and practices. A summary of feedback, including any concerns raised and how they were investigated, should be provided to the management body of the firm.

- Examination of the root causes of customer complaints and ensuring that feedback from customers that highlights risks are recorded and result in action taken.

H. Guidance on Disclosure

Disclosure to consumers of incentives received by a salesperson can be beneficial for the protection of consumers' best interests. These benefits include promoting education and a healthy level of scepticism and self-reliance, which may encourage consumers to take extra measures such as shopping around or seeking a second opinion.

The approach of supervisors to disclosure as a protection for consumers should take into account:

- That it should always be seen as complementary to (and not a substitute for) the other tools to mitigate poorly designed incentive arrangements, such as those listed in the other FinCoNet Guidance to Supervisors on the setting of standards in the field of Sales Incentives and Responsible Lending;

- The propensity for disclosure to have perverse behavioural effects such as inappropriately increasing the level of trust a consumer places in the salesperson, and giving the salesperson a sense

of moral licence (having disclosed their conflict) to disregard their duty to continue acting in the best interest of the consumer; and

- The need for it to provide a meaningful opportunity for the consumer to understand, interrogate and challenge the incentive arrangement disclosed.

- The need for firms to have conducted proper testing, including Randomised Controlled Trials, to measure the impact of their disclosures.

Disclosure to shareholders

Disclosure to shareholders of the risks relating to sales incentive schemes and the action that has been taken to mitigate them could promote corporate governance and encourage shareholders to exercise proper oversight.

Supervisors should consider requiring the following public disclosures from firms:

- The risks firms have considered that arise from their sales incentive policies and practices alongside the action they have taken to mitigate them, including how they have complied with any relevant Guidance.

- The number of occasions when whistle-blowers have raised concerns about sales incentive policies and practices. This disclosure should also include whether any changes to policies and practices were made as a result of concerns raised.

I. Guidance on Promotional Incentives to Consumers

Supervisors' oversight should include consideration of the benefit of promotional incentives offered to consumers versus the cost of the credit product.

This oversight should consider:

- Whether the benefit is significantly outweighed by the cost of the credit;

- Whether specific disclosures or warnings are required for misleading incentives; and

- When to prohibit or restrict this practice on the grounds that the apparent benefit of the promotional incentive is in fact illusory.

- Whether the time-limited nature of an incentive for taking out credit may encourage consumers to act without considering the full consequences of borrowing.

- That the mention of a gift or other incentive in a promotion for a consumer credit product should trigger a requirement for the firm to disclose the actual cost of the credit product such as the APR and the APR/interest rate after any initial promotional period.