Consumers International

Risky Business: The case for reform of sales incentives schemes in banks

- Inappropriate sales incentives schemes are:
  - An important root cause of mis-selling, irresponsible lending and financial instability
  - An undermanaged form of risk
  - Driver of banking culture
- Recommendations:
  - Review capital requirements
  - Increase accountability of senior executives
  - Reform schemes and manage risks

The research

- Reviewed case studies of mis-selling and financial stability from CI's members
- Surveyed financial regulators – thank you FinCoNet members
- Surveyed 90 of the largest banks in the G20 & OECD countries
- Surveyed unions through UNI Finance
- Reviewed 27 bank annual reports and risk disclosures
- Reviewed action taken at an international level and surveyed national conduct and prudential regulators
- CI members provided case studies and other material

Cash or Cabbage?

Reward **Punishment**

How did we get here?

- Focus on growth and short-term measures of profit and incentivisation of senior executives
- Banks became financial conglomerates leading to drive for cross-selling
- Variable pay and commission to encourage staff to deliver organisation's objectives
- Targets and points-based incentives schemes introduced
- Financial incentives and bonuses
- Targets and performance management

Not judging frontline staff

"The vast majority of bank staff want to do the best for their customers but can't because they are under constant pressure to hit ever-demanding targets, which increase every year. A failure to hit those targets can result in staff being subject to performance improvement plans and in some cases being dismissed for under-performance." – UK Union, Affinity

Root causes of mis-selling / Irresponsible lending

Poor quality / Unsuitable products

Mis-selling and financial instability case studies

- Sub-prime mortgage crisis
  - Countrywide “Hustle” programme
  - WaMu “President’s Club”

- PPI mis-selling in UK - £24.3 bn
  - Double points for PPI with loans at RBS
  - £100 for each policy sold at Firstplus

Mis-selling and financial instability case studies

- Risky investment products in Australia – AUS$5.7 bn
  - Upfront commissions and poor controls
- Hybrid securities in Spain - €2.9 bn
  - Staff instructed to pressure customers to meet branch quotas
- Structured products in Hong Kong – HK$5.6 bn
  - Double salary for hitting targets / poor monitoring
- Insurance products and collapse of DSB bank in the Netherlands - €215 million

Impact

Emiliano, 73, was mis-sold preference shares in Spain. He and his wife Begoña, both blind with no children, cannot join a senior home anymore as they had planned to do.

Watch: http://www.youtube.com/watch?v=sFNneZLoz8E&list=PLDE9E37227C587709

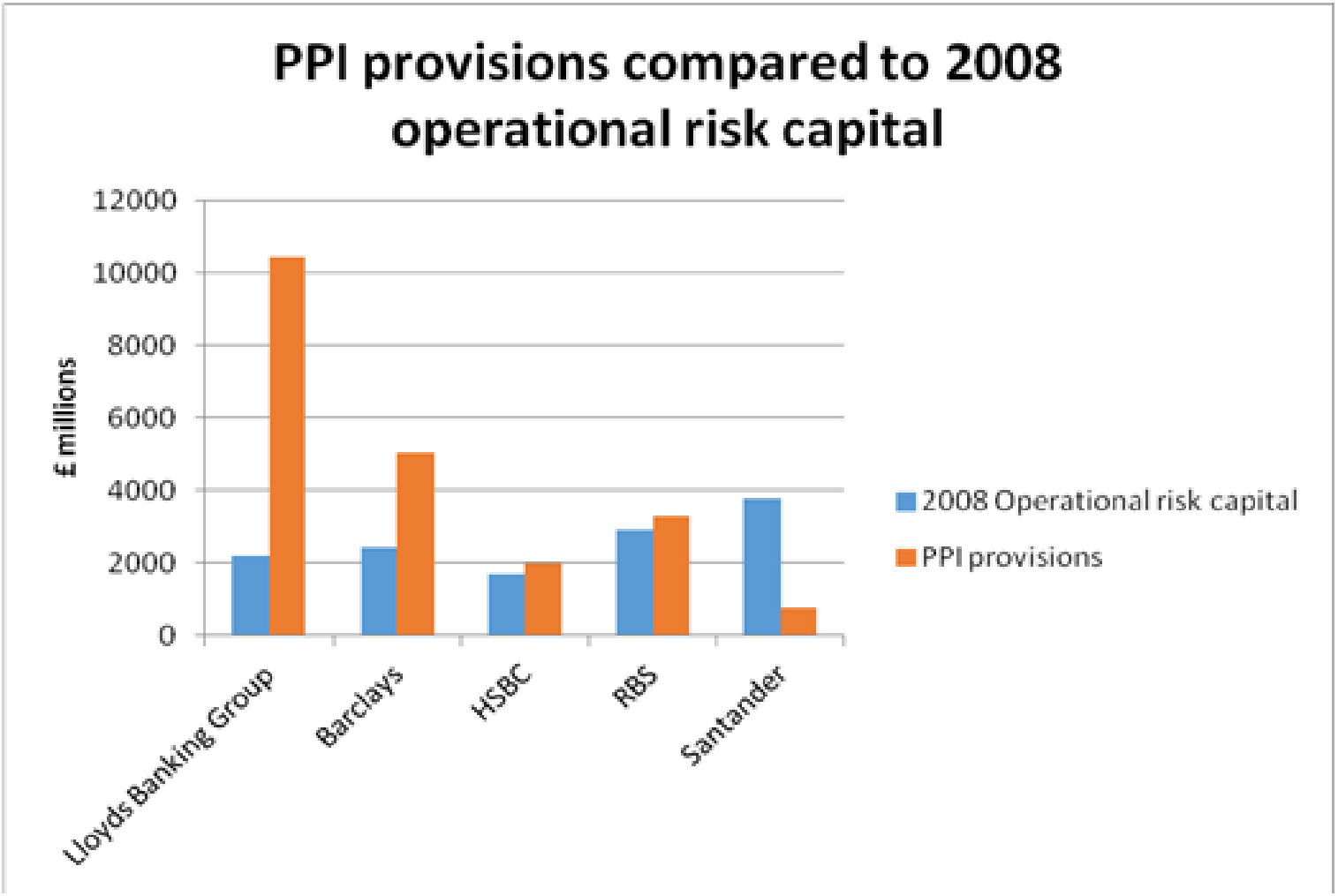
Impact of inappropriate sales incentives

- Irresponsible lending leading to:
  - Booms and busts in housing markets
  - Consumer detriment from mortgage/loan arrears and loss of homes from foreclosure/repossession
- Inappropriate products and unsuitable advice leading to losses to consumers and banks
- Collapse of banks and taxpayer support/bail-outs
- Erosion of trust and confidence in banks and the banking system

Operational risk

- Banks set aside capital to cover operational risk
- Losses from operational risk can be greater than from normal lending
- Compounding effect of losses
- Banks quick to conceal and slow to recognise losses

Operational risk – UK case study



High risk features

- Created by the structure of sales incentives schemes
- Created by the lack of monitoring, management information and other controls
- Which can remain even after sales incentives schemes have been reduced or reformed

Measuring the effectiveness of changes (Which? - Here to help? Research)

	Overall average (371)	Lloyds Banking Group (140)	RBS (71)	HSBC (66)	Barclays (66)	Santander (28)
I feel pressurised into selling by the culture	43%	56%	35%	41%	33%	29%
I feel pressurised into selling by my manager	37%	46%	31%	33%	30%	25%
The sales targets drive employees to sell even when it's not appropriate*	40%	45%	43%	39%	35%	23%
I know that some of my colleagues have mis-sold products to meet targets*	46%	47%	51%	53%	37%	31%
I am uncomfortable with the bank's approach to sales	32%	37%	32%	33%	27%	14%
I have to focus on sales over service	31%	39%	28%	32%	20%	18%

Regulatory action

- International regulatory action focused on senior executives, high earners and traders (MRTs)

National action:

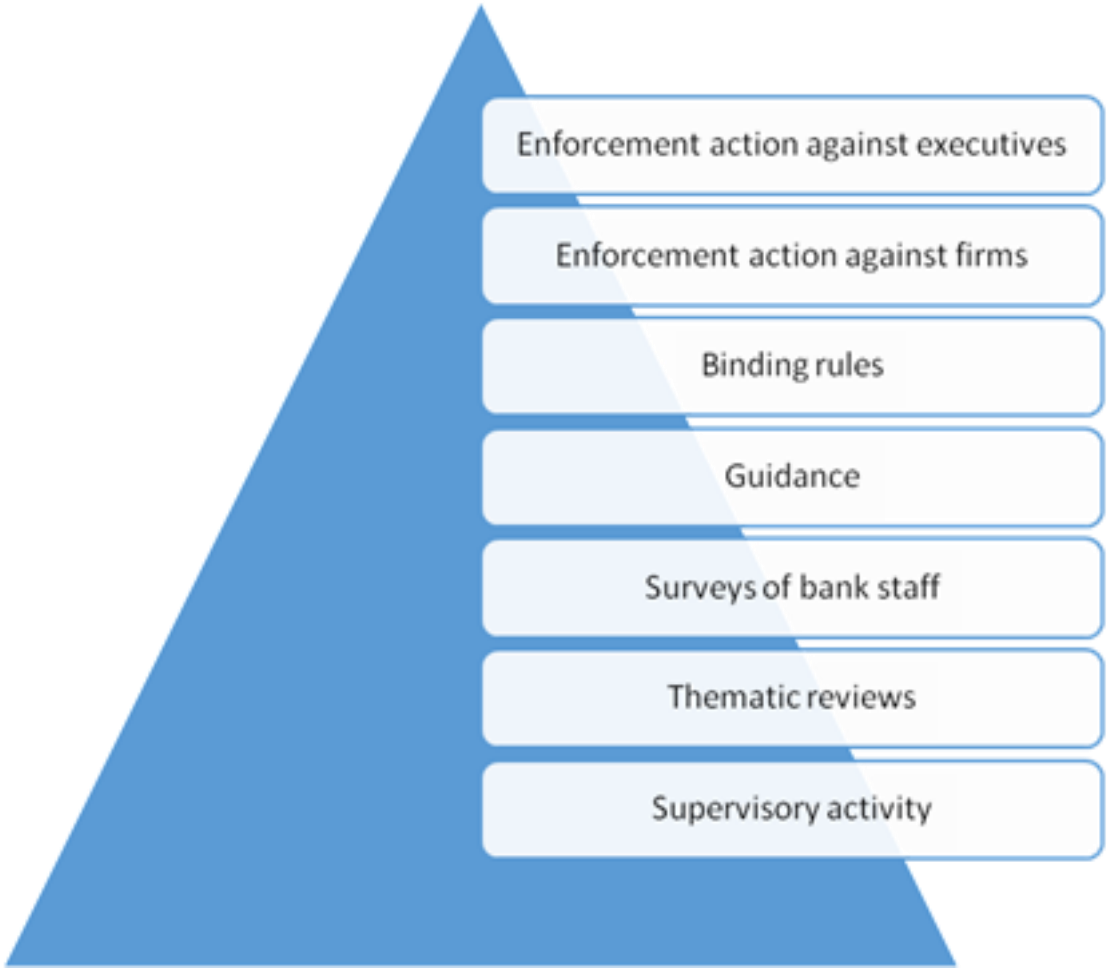
FCA (UK) thematic review revealed:

- Incentive scheme features increased risk of mis-selling
- Firms failed to identify and control risks.
- schemes were so complex that management did not understand them

FCA issued guidance – change in firms practices

FCA follow up

Regulatory interventions



Solutions

Conduct regulators:

- Revises rules – include cabbages! tackle sales culture, pressure staff face to meet targets, including threats of disciplinary action or dismissal
- Thematic reviews – proactive approach
- Individual Executives responsible for schemes
- Enhanced whistle-blowing mechanisms
- Monitoring of schemes – increased transparency, survey frontline staff and consult unions
- Share findings, practices and concerns (FinCoNet) to support better global monitoring and regulation

Solutions

- **Prudential regulators** should incorporate risks from sales incentives schemes in stress tests

- **FSB** should expand its principles and standards to include sales incentives schemes (rewards and punishments)

- **G20** should request review of capital requirements for operational risk

Solutions

- **Banks:**
  - Review and reform schemes as part of wider cultural change to focus on customer needs
  - Enhance whistle-blowing- avoid conflict of interests
  - Allocate individual responsibility at senior level
  - Monitor implementation
  - Increase transparency – regulator and reporting

Thank you!

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