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

Response to Public Consultation received from the Bank of Mauritius

FinCoNet
INTERNATIONAL FINANCIAL CONSUMER PROTECTION ORGANISATION

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

Annexure

General comments

We generally agree with the Guidance set out in the consultation paper and provide below, some broad comments.

- The sets of guidance in the document does not, in our view, take into account smaller economies like Mauritius, where capacity and resource constraints may require a more flexible and practical approach in the implementation of the guidance.

- In addition, supervisors could be recommended to implement the guidance on a risk-based approach depending on the risk or preponderance of the products in their respective jurisdictions.

- Financial literacy and empowerment of customers are two key issues which may be appropriately canvassed in the document alongside the responsibilities of firms to act fairly and equitably towards their customers.

Our comments on the questions for consultation are provided hereunder.

Necessary Pre-conditions of the Regulatory Framework

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.

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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?
Yes.

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?
In the case of several supervisors responsible for consumer protection and/or different supervisors regulating institutions which engage in sale of credit, the supervisors should coordinate their actions so as to provide fair conditions to all these institutions. Further, rules and regulations applied by different supervisors should not be contradictory. There

is also a need to ensure that all credit providers in a given jurisdiction are duly supervised to ward off the risk of regulatory arbitrage.

3. Do you have any other comments related to these pre-conditions?
Supervisors should be afforded with enhanced capacity building and training to properly understand and exercise those powers.

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.

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

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.
n/a

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.
Supervisors may carry out a survey within the industry (including credit providers, credit intermediaries & consumers) to gather relevant information for the purpose of gaining adequate oversight on credit products, distribution channels, incentives, promotions and sales practices in the jurisdiction. Based on the findings, supervisors will be in a better position to gauge the level of standards or enforcement that would be required.

Supervisors may also have recourse to the concept of mystery shopper (a supervisor in disguise) to assess the approach of sales persons across different credit providers when they sell/promote credit products to customers.

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

B. Guidance on Cross Selling

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

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

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.
n/a

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.
Cross-selling, by itself, is the promotion/selling of products to a customer who is being serviced for another specific product in the first place and hence, is often done without considering the needs of the consumer. Nevertheless, aggressive cross-selling should be discouraged to inhibit irresponsible lending.

11. Do you have any other comments related to this Guidance on Cross Selling?
There is a need to enhance the financial knowledge of the general public so that consumers are better aware of the conditions they will be agreeing to when signing up to a specific plan. Informative documents may be posted on the supervisor's website to increase awareness of the public. Further, licensees should be cautioned for abuse of cross selling and may even be fined for misleading the public.

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; and
- 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.

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

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.
n/a

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.

Adequate training should be provided to sales staff to broaden their understanding of the characteristics of such products and services in order to reduce the occurrence that incorrect information is conveyed to the public.

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

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.

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 risks 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;
- limiting the variable component of an individual's remuneration (e.g. as a proportion of total remuneration); and
- requiring that incentives be disclosed to the consumer.

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

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.
n/a

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.
We are of the view that credit providers and their staff would not consent to "requiring incentives to be disclosed to the customer" as, in addition to the remuneration of an employee being a confidential matter, this is the internal policy of the organisation. It would therefore not be appropriate to explicitly disclose sales incentives (monetary/non-monetary) of sales personnel to the customer.

19. Do you have any other comments related to this Guidance on General Duties and Specific Responsibilities?
The general obligations may include a requirement for credit providers to coach their staff appropriately so that they do not indulge in mis-selling. Furthermore, it is deemed that the remuneration of sales staff should, preferably, not be linked to volume of sales.

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, should be subject to appropriate standards and supervision.

The standards set and the approach to their supervision should:
- apply consistently across the channels through which a given credit product is sold; 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).

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

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.
n/a

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.
Given that credit intermediaries may not necessarily belong to the same industry as the credit providers, the recommended standards for sales practices should be stipulated in the contracts between the credit provider and its intermediaries/agents so that the overall architecture of the sales network follows the same approach. This would also solve the issue of the propensity for an undesirable practice in one sales channel migrating to another, since the parties would be bound by the contract to follow standard practices.

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

F. Guidance on Oversight and Governance

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 firms' product oversight and governance arrangements.

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

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.
n/a

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.
n/a

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

G. Guidance on Monitoring

Supervisors' oversight should include an assessment of firms' 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;
- 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 proper support and priority for 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; and
- that firms periodically review the efficacy of their policies and procedures in this regard.

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28. Do you agree with this Guidance on Monitoring?
Yes.

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

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.
n/a

31. Do you have any other comments related to this Guidance on Monitoring?
Alert systems should be able to detect irregular behaviour across transaction records of sales staff and promptly trigger warnings for corrective actions to be applied. For instance, the volume of sales by a particular sales staff being much higher than the average over a period of time may signal that this staff is indulging in suspicious sales practices.

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 skepticism 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.

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32. Do you agree with this Guidance on Disclosure?
Yes.

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

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.
While we presume that the disclosure of incentives to consumers may, to a certain extent, offer protection to consumers, it is deemed from a practical point of view that this would not create a 'healthy level of skepticism' for consumers in general but instead may give rise to the contrary, as it is human nature (especially in the context of customers) to be overly skeptical when apprised of certain sales practices and this might create a disruption in the market for credit products. A healthier way to instigate consumers to challenge the incentives would be to increase the level of financial literacy and awareness on the types and implications of credit products, so as to avoid a surge in consumer/household indebtedness.

Further, the main principle of consumer protection should lie on appropriate design of the policy for sales incentives, reinforced by proper oversight and governance, which is, as stated in the paper, a much more effective mitigant than disclosure alone.

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

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.

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

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.
n/a

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.
n/a

39. Do you have any other comments related to this Guidance on Promotional Incentives to Consumers?
Supervisors should employ a rational approach towards their oversight on incentives offered to consumers as the prohibition of certain incentives may be seen as a constraint to the existence of a competitive market. Although some promotional incentives may be viewed as unfavourable towards the consumer due to hidden costs, there are other incentives from which the consumer can definitely gain. As such, the onus should be on the customer on whether to be induced by (and possibly benefit from) these incentives.

Therefore, caution should be exercised before prohibiting any promotional incentive to consumers. Even in cases where the benefit is outweighed by the cost of the credit, there is a need for comparison with other costs of credit for similar products on the market to be able to determine the actual net opportunity cost and net benefit from a credit product.