FINANCIAL CONDUCT AUTHORITY

Staff incentives, remuneration and performance management in consumer credit

Findings from our thematic review and proposed new rule and guidance

Consultation Paper

CP17/20**

July 2017

How to respond

We are asking for comments on this Consultation Paper (CP) by 4 October 2017.

You can send them to us using the form on our website at: www.fca.org.uk/cp17-20-response-form.

Or in writing to:
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Email:
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1 Summary

Why we are consulting

1.1 We are proposing a new rule and guidance on staff incentives, remuneration and performance management to address concerns about how consumer credit firms pay and incentivise their staff and manage the risks arising from these arrangements.

Who this applies to

1.2 This consultation affects all firms engaged in consumer credit activity that have staff who deal directly with customers.

1.3 This consultation does not relate to any firm (for example, a firm that is part of a banking group regulated by the Prudential Regulation Authority) that is subject to:

a. any of the remuneration codes in SYSC 19A (IFPRU Remuneration Code), SYSC 19B (AIFM Remuneration Code), SYSC 19C (BIPRU Remuneration Code), SYSC 19D (Dual-regulated firms Remuneration Code), SYSC 19E (UCITS Remuneration Code) and SYSC 19F[1] (Remuneration and performance management of sales staff)

b. remuneration provisions made by an EEA regulator pursuant to any of the following: (i) CRD[2]; or (ii) AIFMD[3]; or (iii) the UCITS directive[4]; or (iv) Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

1.4 It may also be of interest to trade bodies that represent firms engaged in consumer credit activities. The content will be most relevant to:

c. senior management tasked with the design or approval of incentive schemes, performance management processes or related control arrangements

d. line managers tasked with implementing incentive schemes, performance management processes or related control arrangements

e. compliance, risk management or quality assurance staff and staff who are part of an incentive scheme

1 SYSC 19F comes into effect from 3 January 2018 in relation to MiFID remuneration incentives. See Policy Statement 17/5 published 31 March 2017: www.fca.org.uk/publication/policy/ps17-05.pdf
2 www.handbook.fca.org.uk/handbook/glossary/G1966.html
3 www.handbook.fca.org.uk/handbook/glossary/G3100.html
4 www.handbook.fca.org.uk/handbook/glossary/G1199.html

1.5 This consultation may be of interest to consumers and consumer organisations. The proposed rule and guidance will help ensure that all credit firms take appropriate steps to identify and mitigate risks arising from staff incentives and remuneration, and so reduce the risk of poor sales or collections-related behaviour.

The wider context of this consultation

1.6 The way staff are paid and managed may influence the way they behave with customers. We recognise that firms may want to incentivise their staff to achieve more (eg increasing sales or collections, providing better service, or improving efficiency), but we believe they should take steps to ensure that any resulting risks of non-compliance are adequately identified and managed.

1.7 Before we took over responsibility for regulating consumer credit in April 2014, our predecessor, the Financial Services Authority (FSA), carried out work on financial incentives across a variety of firms including banks, insurance companies and investment firms, issuing guidance in FSA-FG13/01 Risks to customers from financial incentives (January 2013)[5].

1.8 In our 2015/2016 Business Plan[6] we explained that improvements in incentives were necessary to ensure markets work well. We announced that we would also review incentive schemes in consumer credit firms. We said we would assess how these firms are managing the risk that their reward arrangements could encourage undesirable behaviours that might lead to poor outcomes for consumers.

1.9 Firms operating in the consumer credit sector have a wide range of business models. In a large number of firms, particularly smaller firms, consumer credit is ancillary to their core business (eg retailers, motor dealers). There is also a greater focus on incentivising collections (eg for customers in arrears), not just sales. So we wanted to assess through a thematic review how firms in this particular sector were managing the risks arising from their incentives and performance management.

1.10 In July 2015 we published guidance in FG15/10 *Risks to customers from performance management at firms*[7] , which is relevant to consumer credit firms as well as other firms engaged in retail financial services. This review considers further how the issues identified in our previous work apply to consumer credit firms and how they interact with our findings on financial incentives for these firms.

5 www.fca.org.uk/publication/finalised-guidance/fsa-fg13-01.pdf
6 www.fca.org.uk/publication/corporate/business-plan-2015-16.pdf
7 www.fca.org.uk/publication/finalised-guidance/fg15-10.pdf

Thematic review findings

1.11 We reviewed the incentives and performance management policies and practices for sales and collection staff at 98 consumer credit firms for which:

- consumer credit or other financial services is the primary purpose of their business or
- consumer credit activity is secondary or ancillary to their main business (eg selling retail goods)

1.12 In both cases, we found that a significant proportion of firms had:

- high risk financial incentives and/or performance management practices likely to encourage high-pressure sales or collections
- inadequate or ineffective controls, and/or
- a lack of appreciation of the risks their incentives posed and the controls needed to address them

1.13 Chapter 2 outlines our key findings.

What we want to change

1.14 We are consulting in Chapter 3 on a proposed new rule and guidance in the Consumer Credit sourcebook (CONC) and non-Handbook guidance designed to help consumer credit firms identify and appreciate the risks their practices might pose to customer outcomes and understand what is expected of them.

Unintended consequences of our intervention

1.15 There is a risk that some firms might respond to our intervention by removing bonus schemes that incentivise good conduct that is in the interest of consumers, or that enhance those firms' ability to compliantly sell products that offer value and choice to customers. There is also a risk that firms that remove bonus schemes could apply pressure on staff in other ways.

1.16 Our communications and engagement with firms will emphasise that we expect firms to detect and manage the risks arising from their staff incentive schemes and that we do not prescribe the nature of firms' incentive schemes or ban pay schemes that reward appropriate sales or collections activity. Our engagement with firms will also reflect that we expect firms to consider risks arising from performance management as well as financial incentives.

Measuring success

1.17 Through our ongoing engagement and supervision of firms we will consider the extent to which firms are properly considering and managing the risks highlighted in our proposals.

1.18 Firms' culture and governance is a key priority for the FCA. Incentives and remuneration can be some of the most significant drivers of good or poor culture and behaviours. We will therefore conduct further work in this area to evaluate how consumer credit firms have reacted to our rule and guidance, and the effect on firms' behaviour or customer outcomes.

Next steps

1.19 We want to know what you think of our proposals. Please send us your comments by 4 October 2017. Use the online response form on our website or write to us at the address on page 2.

What will we do?

1.20 We will consider your feedback and take it into account in finalising our proposals. Once we have considered your feedback, we will publish a policy statement with final rules and guidance.

1.21 We have given feedback to the firms included in our thematic review, and will conduct further work with some of those firms to understand how they respond to the points raised in our feedback.

Other consumer credit policy work

1.22 We are undertaking a number of pieces of wider work to look at other areas of consumer credit. For example:

- In November 2016, we published a Call for Input on High-Cost Credit, including a review of the high-cost short-term credit price cap. We plan to publish a feedback statement in the Summer which will also set out our plans for further work in this area.
- In April 2017, we published the first CP to emerge from the credit card market study which proposes new rules in relation to persistent debt and earlier intervention in the credit card market. Consultation closed on 3 July.
- We expect to publish a CP soon proposing some changes to our requirements on assessing creditworthiness (including affordability) to clarify our expectations of firms and promote responsible lending.
- We have analysed responses to our Call for Input on the planning phase of the review of retained provisions of the Consumer Credit Act (CCA). We intend to publish a summary of the responses and outline the scope for the review.

2 Outcome of our thematic review

In this chapter we explain the background to our thematic review and our key findings

How we carried out the review

2.1 In August 2015, we announced we would undertake a thematic review to better understand the nature of staff incentives, remuneration and performance management in the consumer credit market[8].

2.2 We obtained information and documentation from 98 firms regarding their incentive schemes, performance management and related controls. We reviewed and analysed these responses and in some cases requested additional information or carried out telephone interviews with the firm to clarify our understanding of their responses.

2.3 We then carried out more detailed on-site visits to 25 of the 98 firms. Firms were selected to cover a broad range of business types and sizes, and to include firms that appeared high, medium or low risk from our initial document review.

2.4 The firms visited covered a broad range of sub-sectors including:

- high-cost short-term credit / guarantor lending
- home collected credit
- catalogue / internet shopping firms
- store / credit card providers
- hire purchase / conditional sale
- primary credit brokers
- secondary credit brokers
- debt collectors

2.5 We considered the risks and controls that applied to customer-facing staff in both sales and collections roles. For the purposes of our proposals, sales staff includes any employees or agents involved in selling or brokering a finance product to a customer – including subsidiary credit products used to finance the purchase of goods or services. Collections staff includes any employees or agents who collect money owed under a credit agreement. This may include collecting regular loan payments in line with the terms of a loan agreement, or pursuing amounts owed from customers who have fallen behind on payments.

8 www.fca.org.uk/publications/thematic-reviews/tr-staff-remuneration-and-incentives

2.6 We also thought it was important to take into account the risks and controls relating to the incentives schemes of line managers of customer-facing staff, since these might have a bearing on how those line managers influence the behaviour of the staff they manage.

High-level findings

2.7 Many firms had taken positive steps in the way they reward and incentivise staff, including some firms that had taken on board the previous FSA guidance on the risks from financial incentives. We have identified examples of good practice where firms have incentivised staff to act in the interests of their customers, or have put in place effective controls to manage the risks from their incentive schemes and performance management. We set out these examples of good practice in our proposed non-Handbook guidance.

2.8 However, too many of the firms in our sample had high-risk elements in their incentive schemes and had either not recognised the risks these posed to customers, or had not taken sufficient steps to manage those risks.

2.9 Additionally, we found that many firms, where consumer credit activities were ancillary to their main business (such as selling retail goods), as well as a number of lenders, had not properly assessed the risks associated with their consumer credit activities, or the impact that staff incentives could have on those risks.

2.10 We identified a number of elements that contributed to the level of risk incentive schemes posed. We used these elements to categorise firms from low risk to very high risk. We found that the combination of incentives, performance management and related controls posed a high, or very high, risk of customer detriment in 40% of firms in our sample. Among firms whose primary business was not financial services (including retailers selling goods on finance) this rose to 64%.

2.11 In our sample of firms, risks arising from incentive schemes arose primarily where staff earned bonus or commission payments based on the volume or value of sales or collections. While we recognise that any such scheme carries risk, we saw some elements which particularly raised the level of risk. These included schemes where:

- commission accounted for the majority (or all) of customer-facing staff's pay
- different rates of commission were earned for different products (particularly substitutable ones) or products sold on different terms or
- the rate of commission varied depending on reaching certain targets

2.12 88% of firms in our sample paid staff some form of variable remuneration. 32% of firms had staff where the variable element made up the majority of their pay, including 15 firms that paid staff on a 100% commission basis.

2.13 Too often, firms in our sample that had these high-risk elements did not have sufficient controls in place to address the particular risks they presented. Six firms indicated they did not have any arrangements in place to monitor or review their sales or collections activities. A further eight firms indicated that the monitoring arrangements they had in place were solely carried out by line managers whose pay was dependent on the performance of the staff they were monitoring. Those managers might, in some cases, overlook conduct or performance issues with their staff given their own bonuses are influenced by the performance of their staff.

2.14 Some firms also had performance management approaches that reinforced and amplified the risks from their incentive schemes, for instance by focusing on the achievement of sales or collections targets rather than on customer outcomes.

2.15 81% of firms in our sample indicated that their staff had defined sales or collections targets. For 75% of those firms, sales or collections volumes featured prominently in appraisal documentation compared with 52% where quality or customer outcomes featured prominently.

2.16 For the 25 firms we carried out a more in-depth assessment of, we assessed the risk of customer harm to be:

Risk	Number of firms
Very High	3
High	9
Medium	3
Low	10

2.17 The firms that we assessed as the highest risk were typically those where:

- incentive and performance management schemes included multiple high-risk elements
- control arrangements had material weaknesses and did not adequately address the specific risks posed by the incentive and performance management schemes
- there was a lack of recognition among senior management about the risks that their incentive schemes could pose

2.18 The control weaknesses in the firms we identified as highest risk went beyond those risks directly related to incentive or performance management schemes and extended to other areas of the business.

2.19 We set out in our proposed non-Handbook guidance (Appendix 2) more details and specific examples of what we found.

3 Proposed new rule and guidance

In this Chapter, we set out our proposals for a new rule and guidance in the Consumer Credit sourcebook (CONC) and non-Handbook guidance on staff incentives, remuneration and performance management in consumer credit.

3.1 In the light of our findings, we consider that some consumer credit firms need to do more and have a better appreciation of the risks their incentives pose and the controls needed to address them.

3.2 We therefore propose the following new rule and guidance on staff incentives, remuneration and performance management to help consumer credit firms:

- identify and appreciate the risks their practices might pose to customer outcomes
- communicate our expectations regarding how firms should mitigate/ control those risks as required by our Senior Management Arrangements, Systems and Controls sourcebook (SYSC)
- establish a level playing field between consumer credit firms and other FSMA regulated firms to which previous guidance applies

New rule and guidance in the Consumer Credit sourcebook (CONC)

3.3 To ensure consumer credit firms identify risks arising from incentives or performance management and to make sure these are managed appropriately, we propose to insert provisions into a new section 2.11 of CONC which would provide:

- A high-level rule requiring firms to put in place adequate arrangements to detect and manage any risk of non-compliance with their regulatory obligations arising from their remuneration or performance management practices.
- A proportionality provision which requires a firm to take into account the nature, scale and complexity of its business, and the nature and range of financial services and activities undertaken in the course of that business, when deciding how to comply.
- Guidance on the purpose of the proposed new provisions. In particular, we propose to make clear that the purpose of the new rule is to amplify firms' existing requirements in Principle for Businesses (PRIN) 3 and SYSC 4.1.1R to ensure they identify and effectively manage risks to customers that may arise out of their policies, procedures and practices for the remuneration and performance management of their employees, appointed representatives and agents who interact with customers.

- Guidance setting out examples of measures and procedures that firms may introduce, where appropriate, to manage such risks.

- A cross-reference to the non-Handbook guidance we are also consulting on (see below).

Non-Handbook guidance

3.4 We propose to introduce non-Handbook guidance as a further, more detailed aid to help consumer credit firms. Specifically, we propose to provide guidance that:

- sets out examples of good and poor practice we observed during our thematic review, while making clear there is no 'one size fits all' model for appropriate incentives and controls

- reiterates some of the messages from our previous guidance (as some of the issues we identified during our thematic review are similar to those found in other sectors), and supplements this with consumer credit-related issues and examples that we consider will benefit firms when managing the risks their schemes may pose

- gives more detailed examples of risks that might arise and how these might be reduced or managed

- sets out our expectations on the types of controls and governance firms should have in place to identify and manage risks arising from their staff incentives, remuneration and performance management policies and practices

Scope

3.5 The proposed new rule and guidance would apply to a firm with respect to its:

- credit-related regulated activity

- unregulated activity that is financed by a credit agreement for which the firm is carrying on consumer credit lending or broking.

3.6 They would not apply to any firm (for example, a firm that is part of a banking group regulated by the Prudential Regulation Authority) that is subject to:

- any of the remuneration codes in SYSC 19A (IFPRU Remuneration Code), SYSC 19B (AIFM Remuneration Code), SYSC 19C (BIPRU Remuneration Code), SYSC 19D (Dual-regulated firms Remuneration Code), SYSC 19E (UCITS Remuneration Code) and SYSC 19F[9] (Remuneration and performance management of sales staff)

9 SYSC 19F comes into effect from 3 January 2018 in relation to MiFID remuneration incentives. See Policy Statement 17/5 published 31 March 2017: www.fca.org.uk/publication/policy/ps17-05.pdf

- remuneration provisions made by an EEA regulator pursuant to any of the following: (i) CRD[10]; or (ii) AIFMD[11]; or (iii) the UCITS directive[12]; or (iv) Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

Q1: **Do you have any comments on our proposed additional rule and guidance in CONC to require firms to have adequate policies and procedures designed to detect and manage risks arising from their remuneration or performance management policies as set out in Appendix 1 of this document?**

Q2: **Do you have any comments on our proposed non-Handbook guidance as set out in Appendix 2 of this document?**

10 www.handbook.fca.org.uk/handbook/glossary/G1966.html
11 www.handbook.fca.org.uk/handbook/glossary/G3100.html
12 www.handbook.fca.org.uk/handbook/glossary/G1199.html

Annex 1
List of questions

Q1: **Do you have any comments on our proposed additional rule and guidance in CONC to require firms to have adequate policies and procedures designed to detect and manage risks arising from their remuneration or performance management policies as set out in Appendix 1 of this document?**

Q2: **Do you have any comments on our proposed non-Handbook guidance as set out in Appendix 2 of this document?**

Q3: **Do you have any comments on our analysis of the costs and benefits of our proposals as set out in Annex 2 of this document?**

Q4: **Do you have any comments on the compatibility statement in Annex 3 of this document?**

Annex 2
Cost benefit analysis

In this Annex we set out our analysis of the incremental costs and benefits that we expect to arise from our proposals

1. Section 138I of the Financial Services and Markets Act 2000 (FSMA) requires us to publish a cost benefit analysis unless, in accordance with section 138L, we believe that there will be no increase in costs or that the increase will be of minimal significance. As part of the cost benefit analysis section, 138I requires us to publish an estimate of the costs and benefits unless they cannot be reasonably estimated or it is not reasonably practicable to estimate them.

Costs

2. In this cost benefit analysis we are assessing the costs our proposed new rule and handbook and non-handbook guidance would impose on the firms to which they apply, beyond the costs of complying with the current regulatory requirements. Our proposals do not prescribe specific actions firms must take; there is a wide variety of approaches that firms might adopt to adequately identify and manage the risk arising from incentive schemes or performance management.

3. Some firms may have risk management approaches which already address the risks arising from remuneration and performance management. Other firms may offer no financial incentives to staff and have performance management that focuses on quality and customer outcomes. In these cases, it is possible that firms will not need to take any further action in response to our proposed rule and guidance, meaning our proposals would result in no, or negligible, incremental costs.

4. We set out below our view of the key areas where firms might incur additional costs. We would not expect most firms to need to make changes, and incur costs in every area.

Costs related to considering our proposed rule and guidance

5. Firms will incur costs when considering if, and how, our proposed rule and guidance are relevant to them. This would include a consideration of if, and how, their incentive and performance management arrangements could give rise to risk of non-compliance, and if so whether their existing policies and procedures are adequate to detect and manage that risk.

6. Firms may also incur costs when considering what changes are necessary to incentive schemes, performance management and/or their policies and procedures for identifying and managing risks.

Costs related to incentive schemes

7. Some firms may choose to review their incentive schemes and amend or remove elements to reduce or eliminate the risk of non-compliance. This may lead to a firm incurring costs.

8. The design of any new or revised schemes may be carried out by a firm's own internal staff or management, resulting in an opportunity cost for the time spent. Some firms (particularly those with large numbers of staff and complex reward schemes) might choose to engage external consultants to assist with this process (which could include external legal advice). While much of this would be a one-off cost, there may be a smaller ongoing costs associated with implementing a regular review of incentive schemes.

9. Changes to incentive schemes could include changing the basis on which payments are made (eg moving to measures of quality rather than quantity of sales) or the value of payments. In either case, a firm may choose to change the level of basic pay to reflect changes in the expected level of incentive payments. The net effect of these changes could therefore be either an increase or decrease in the firm's overall wage bill.

10. Changes to a firm's incentive arrangements could result in a change to the timing of payments, with a consequent impact on the firm's cash flow. For example, if a firm reduces the value of annual bonuses and increases basic salaries by an equivalent amount, the total value of payments may not be materially affected, but a higher proportion of staff costs would be spread over the year rather than concentrated around the year–end.

11. If a firm decides to implement a quality-based incentive scheme, it may be necessary to implement new quality measures on which to base the incentives. There may be an ongoing cost in operating these measures. However, if firms have existing quality measures in place to enable them to effectively identify and manage their risks in accordance with existing regulatory requirements, it may be possible to use those existing measures in any revised incentive scheme.

12. If firms choose to make changes to incentive schemes, they may incur costs to ensure compliance with employment and contract law. There are also likely to be costs involved in implementing the new scheme, including training staff on the new scheme.

Costs related to performance management

13. Some firms may choose to review and amend their approach to performance management in light of our proposals. This review and the design of any revised approach might incur costs similar to those for incentive schemes.

14. Successful implementation of a revised performance management approach may require some firms to invest in developing best practice guidance material and to train people managers in the new approach. Firms may also incur costs in monitoring how the approach has been implemented in practice to ensure it is achieving its aims, which could identify further training needs for some staff.

15. If firms have a performance management approach that focuses largely on volume measures (such as total value of sales made or total amount collected) they may choose to introduce alternative, quality-focused measures for discussion during performance management conversations. If such measures do not already exist, there may be a cost in designing, implementing and operating these measures.

16. The ongoing costs of operating any revised performance management approach (such as the opportunity cost of staff time) may either increase or decrease depending on the nature, depth and quality of discussions and the nature of any issues identified and escalated for follow-up.

Costs related to detecting and managing risks of non-compliance arising from incentive schemes and performance management

17. If firms choose to introduce or amend their policies and procedures for detecting and managing risk they may incur design and implementation costs (staff or management time, or external costs). Where firms already have effective controls in place to identify and manage the risk of customer detriment or poor customer outcomes, these might already address any risks of non-compliance that arise from incentive schemes or performance management. However, firms may find that they need to implement additional policies and procedures or strengthen existing policies and procedures.

18. If additional policies and procedures are required, firms may need to employ additional staff.

19. Firms might incur some initial implementation costs to roll out revised controls such as training for staff working in compliance, risk management or quality assurance, and for staff who will be subject to revised controls.

20. There may also be ongoing costs for firms to monitor the adequacy of policies and procedures, taking into account any relevant changes that may happen (for example, changes to a firm's business practices or external environmental factors) and making any changes to incentive schemes, performance management and/or policies and procedures as necessary from time to time.

Costs related to knock-on impact from changes

21. The combined impact of the changes set out above may introduce a range of costs for firms. For example, firms might incur costs to make changes to their IT systems to incorporate the changes to incentives schemes, performance management and/or policies and procedures.

22. The combined impact of the changes on customer-facing staff could lead to some staff members leaving the firm, and therefore additional recruitment costs. It is also possible that any changes could diminish sales or collections performance, though anecdotally some firms who have made changes have indicated that they improved sales or collections.

Value of incremental costs and methodology

23. We surveyed a sample of 35 firms across 15 sectors that may be affected[13] to estimate the incremental costs of our proposals. This ensured that the responses represented a range of different types of consumer credit firm. However, we did not consider it proportionate to include a statistically representative sample from within each of the 15 sectors. In practice, many firms undertake activities across multiple sectors and it is difficult to allocate either those individual firms, or any incremental costs they may incur, against specific individual sectors or activities.

24. We also ensured that our sample covered the full range of credit-related regulated activities.

25. 73% of respondents indicated that our proposals would result in no incremental costs (including firms within each of the 15 sectors). However, a minority of respondents across a range of sectors indicated that there would be material incremental costs. Our thematic review also indicated that a significant proportion of firms had high risk elements in their incentive schemes and had either not recognised the risks of non-compliance or had not taken sufficient steps to manage those risks. While some of the control weaknesses we saw extended past risks directly related to incentive or performance management (for example, broad failings in risk management that encompassed staff incentive risks), we would nonetheless expect those firms to take action in response to our proposals.

26. The level of incremental cost incurred by a firm will depend on a variety of factors, including the risks presented by its staff incentive or performance management arrangements and the robustness of its current risk management approach. Costs presented in this CBA are based on an estimate of average cost across a range of firms, including some firms that will incur significant costs, and some that will incur minimal costs. The cost for any individual firm may therefore differ materially from our estimated average cost. Firms may also face additional cash-flow implications, either from the timing of one-off costs or changes in the timing of ongoing costs over the financial year, on top of the costs estimated in this CBA.

27. For the smallest firms with few employees (or no employees in the case of some owner-managed firms) we would expect the costs of our proposals to be zero or minimal. For many of these firms, the senior managers are also the owners of the firm, have very close oversight of their staff, and play key roles in both performance management and risk management. We would expect some of these firms to make changes in response to our new rule and guidance, but these changes could be made within existing resources without incurring significant additional costs.

28. Every firm with fewer than 15 employees that responded to our survey indicated that there would be no incremental costs from our proposals. For firms with only 1 or 2 employees, or no employees, we expect in most cases our proposals would not be relevant and we expect costs for these firms to be zero or minimal overall. For firms with between 3 and 15 employees, we expect that they may incur some one-off costs to read and consider our messages, but ongoing costs will be minimal. We have estimated one-off costs based on average pay information provided by firms in our thematic review with 10 or fewer sales or collections employees and based on an

13 Sectors covered are: Personal Loans, High-cost Short-term Credit, Home Collected Credit, Catalogues/Mail Order, Store/Credit cards, Logbook Loans, HP/Conditional Sale, Guarantor Lending, Pawn Broking, Primary Credit Broking, Secondary Credit Broking, Credit references / Credit Information Services, Debt Collection, Debt Management, Debt Administration

estimate of 5 hours' work to review and consider how to implement the new rule and guidance. It is likely that many firms may spend significantly less than 5 hours reading and considering the new rule and guidance. However, it is also likely that in some cases this will be considered by an owner-manager whose effective hourly rate may be higher than that used in our calculation and we expect the net overall impact of these two effects to be small.

29. Among firms with between 3 and 15 employees, the majority have 5 employees or fewer, and the new rule and guidance may not be relevant to many of them. While we will attempt to reach as much of the firm population as practical through our communications, we are aware that a number of other small firms may nonetheless not be aware of our proposals and therefore not properly consider whether they are relevant. We believe an estimate based on all firms spending 5 hours considering the new rule and guidance represents a maximum likely cost and have presented our estimate of the number of firms affected based on 50% of firms with between 3 and 15 staff reading and considering the new rule and guidance.

30. We do not hold information for all regulated consumer credit firms on whether they employ staff, or the number of staff they employ. We have therefore estimated the number of firms with more than 15 staff based on the information we do hold. As larger firms are more likely to have provided us with information on their staff numbers, it is likely that we have overestimated the number of firms with more than 15 staff.

31. Of the responses that indicated there would be an incremental cost from our proposals, many of these responses included costs that related to wider risk management and compliance. We have excluded from our analysis two responses in which the majority of costs were not attributable to our proposals. These costs were based on compliance or quality assurance staff being expected to consider compliance with a wide range of regulatory requirements, only a small proportion of which would result from our current proposals. These responses cited net one-off costs of £9k and £438k and net ongoing annual costs of £101k and £757k. We have enough evidence from responses provided by other firms in the same sectors and our broader understanding of relevant affected firms to conclude that these responses are not representative of the incremental costs of our proposals (beyond any costs of complying with existing regulatory requirements) for a typical firm in these sectors.

32. Costs cited by other respondents are also likely to include significant elements that are not specifically related to our proposals (in contrast to the respondents referred to above where we consider that the majority of the costs are not attributable to our proposals), particularly where they relate to controls that cover a range of risks, including those related to staff incentives. As staff incentives are an integral part of firms' business activities, it is difficult to separate or apportion costs that specifically relate to our proposals. We have therefore used the full amounts provided by respondents. While it is likely that these significantly over-estimate the costs of our proposals across the population of firms, they nonetheless give an indication of upper end of the range of possible costs. One firm indicated that its response to our proposal would result in reduced wage costs. We have taken this into account when analysing the costs of our proposals for that firm. We have not made any adjustment to costs in respect of broader indirect benefits such as increased customer satisfaction, reduced complaints, reduced staff turnover or other conduct benefits.

33. For our analysis, we have grouped firms into three broad categories of lending, credit broking and debt (which includes debt management, debt administration and debt collection). Our thematic review suggested that there were firms across all sectors that we would expect to take action in response to our proposals. There are also many firms that operate across several sectors. We have therefore calculated average costs across these three categories.

34. The majority of firms with credit broking permission are relatively small in size. However, there is a small number of large, national chains for which the cost implications of these proposals may be very different compared with smaller brokers. We have therefore split this population between firms with more than, or less than 500 employees. We have included within this category Credit Reference Agencies and Credit Information Services that also undertake credit broking and for whom credit broking is a key consumer-facing activity.

35. For firms in the debt category, no firms indicated that there would be any ongoing cost from our proposals, and only one firm indicated that there would be a one-off cost. However, our thematic and supervisory work suggests that we would expect some firms to make changes, particularly in the debt management sector, which may have ongoing cost implications. We have therefore included responses from lenders to calculate the average cost for firms in the debt category. While there are significant differences in the business models of firms operating in these categories, many of the operational practices involved in paying and managing staff are similar and many of the activities we would expect firms to carry out in response to our proposals are similar. We therefore believe the responses from lenders are helpful in forming our view of the likely costs to firms in the debt category.

36. The table below shows the estimated average costs for each category of firm, and the total estimated costs across the population of firms. Our CBA sample population included two firms which, because they are subject to one of the remuneration codes in SYSC, will not be subject to our proposed rule and guidance. While these firms are not within the scope of our proposals, we believe their activities are representative of many other lenders and their responses give us additional information to inform our view of the cost to impacted firms. Including these responses in our analysis results in a higher overall cost estimate for firms with more than 15 employees.

Category of firm	Estimated number of firms impacted	Average net one-off costs per firm (£)	Average ongoing cost per firm (£ p/a)	Estimated total one-off cost (£m)	Estimated total ongoing cost (£m p/a)
Firms with 3-15 staff	7,398	69	-	0.51	-
Lending >15 staff	1,013	2,231	1,565	2.26	1.59
Credit Broking 16-500 staff	1,814	6,944	1,800	12.60	3.27
>500 staff	98	16,000	4,840	1.57	0.47
Debt >15 staff	415	5,420	1,043	2.25	0.43
Total for impacted firms	**10,738**	**1,786**	**536**	**19.18**	**5.76**

Benefits

37. There are over 35,000 firms authorised to carry out consumer credit activity in the UK, approximately 29,000 of which are credit brokers[14]. We estimate that around 18,000 of these firms have 3 or more employees and our proposals may therefore be relevant to them. At the end of 2016, households owed £193 billion in consumer credit debt[15] reflecting a 36% increase in consumer credit net lending between 2012 and 2016[16]. The most commonly used and widely held retail lending products in the UK are credit cards, personal loans and motor finance. Over 30 million customers have more than £63 billion in outstanding credit card debt[17].

38. The way staff are incentivised can increase the risk that customers in this market may suffer a variety of forms of detriment, including:

- customers being given inaccurate or misleading information on the costs, benefits or features of credit products
- customers being pressured to take out inappropriate or unaffordable products
- firms not treating customers in default or in arrears difficulties with forbearance and due consideration, including collections staff pressuring them into paying unreasonably large amounts

39. We expect the key benefit of the rule and guidance to be improved matching of credit products to customer needs through better management of incentive-related risks. These risks can lead to firms failing to deliver satisfactory outcomes for customers.

40. We expect that firms may be able to reduce the level of detriment suffered by customers due to mis-selling or inappropriate collections activity by:

- reducing or eliminating the elements of incentive schemes that pose a high risk of customer detriment
- more effective targeting of controls in relation to incentive related risks
- making better use of management information to identify trends or patterns that could indicate an increased risk of customer detriment, and taking appropriate action where issues are identified

41. As well as reducing consumer detriment, if firms change their incentive schemes and related controls to effect a shift in focus from sales or collections volumes to customer outcomes and customer service, this may lead to benefits including:

14 FCA Permissions data (April 2017)

15 Bank of England Statistics, Bankstats (Monetary & Financial Statistics), Money and Lending table A5.2 (March 2017). Bank of England data (balances outstanding) are updated each month and may be subject to adjustment due to changes in the reporting population, classification changes reflecting any updated sectoral classification guidance produced by ONS, foreign currency revaluation effects, write-offs, or miscellaneous other causes such as adjustments made on the basis of information provided by reporting institutions. A full explanation can be found here: http://www.bankofengland.co.uk/statistics/Pages/iadb/notesiadb/Changes_flows_growth_rates.aspx

16 Economic and Fiscal Outlook, Office for Budget Responsibility (March 2017)

17 FCA Credit Card Market Study Final Findings report (July 2016) www.fca.org.uk/publications/market-studies/credit-card-market-study

- increased customer satisfaction leading to greater customer loyalty and retention, increased sales, or reduced customer acquisition costs
- fewer complaints from customers and the associated costs of dealing with those complaints
- improved staff satisfaction leading to reductions in staff turnover and associated costs
- improved governance and risk management

42. Most firms that responded to the CBA survey indicated it was difficult or impracticable to estimate the benefits to them and therefore did not give a value for these benefits. These benefits relate in large part to expected changes in customer behaviour, which are difficult to predict before implementing changes.

43. Setting out our expectations more clearly will also benefit the FCA. We expect our proposed rule and guidance to make supervision and, where necessary, enforcement more straightforward and cost-effective. The extent of this impact would depend on the degree to which firms change their behaviour in response, and the level and seriousness of any continuing non-compliance. This is difficult to predict before implementing our proposals.

44. The benefits of our proposals, in particular the benefits to consumers, are varied and difficult to quantify. It would take significant resources, involving extensive testing, to understand how staff behaviour, and in turn consumer behaviour, might change when staff at firms have different incentives. This would have to be done for a wide variety of products and firms. Staff incentives are often one contributing factor in consumer detriment. Others can include inadequate training, poor product design or a lack of awareness of regulatory requirements, and it is difficult to isolate the impact of those different factors.

45. Staff incentives (including financial remuneration and performance management) are integral to how many firms operate and can have a significant influence on the culture of firms and the behaviour of staff. However, where a firm's non-compliance leads to consumer detriment, there is no easy way to assess the extent to which staff incentives contributed to the firm's culture or the non-compliance (given the number of other possible contributory factors).

46. Analysing the impact of our proposals would also require us to predict, in some detail, how firms are likely to change their behaviour in response. This would be difficult and expensive, and in our opinion, it is not feasible to estimate the full benefits of our proposals. We do, however, expect our proposals to bring about benefits for consumers, firms and the FCA.

Q3: **Do you have any comments on our analysis of the costs and benefits of our proposals?**

Annex 3
Compatability statement

1. This Annex records our compliance with the legal requirements applicable to the proposals in this consultation. This includes an explanation of our reasons for concluding that our proposals are compatible with certain requirements under the Financial Service and Markets Act 2000 (FSMA).

2. When consulting on new rules, we are required by section 138I(2)(d) to include an explanation of why we believe that making the proposed rules is (a) compatible with our general duty, under section 1B(1) FSMA, so far as reasonably possible, to act in a way that is compatible with our strategic objective and advances one or more of our operational objectives; and (b) our general duty under section 1B(5)(a) FSMA to have regard to the regulatory principles in section 3B FSMA. We are also required by section 138K(2) FSMA to state our opinion on whether the proposed rule will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out our view of how the proposed rule is compatible with the duty on us to discharge our general functions (which include rule-making) in a way that promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.

4. This Annex explains how we have had regard to the recommendations made by the Treasury under section 1JA FSMA about aspects of the economic policy of Her Majesty's Government, to which we should have regard when considering the application of our general duties.

5. This Annex refers to our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA), we must have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions; and have regard to a 'Regulator's Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

Equality and diversity

7. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

8. We have not identified any material issues, but we would welcome your comments.

Expected effect on mutual societies

9. We do not expect the proposals in this paper to have a significantly different impact on mutual societies to the extent that they apply to them. Our proposals, to the extent they apply to mutual societies, would apply in the same way as for other firms, taking a proportionate approach relative to the level of risk of non-compliance.

Our objectives and regulatory principles

10. We consider the proposals in this paper are compatible with our strategic objective of ensuring that the relevant markets function well because we expect them to address the potential detriment arising from consumer credit firms' incentive schemes and failures in those firms' risk management approaches to deliver a better outcome for affected consumers. For the purposes of our strategic objective, 'relevant markets' are defined by section 1F of FSMA.

11. Our proposals are intended primarily to advance our operational objective of achieving an appropriate degree of protection for consumers.

12. Our proposals in relation to staff incentives intend to tackle potential risks arising from the way staff are paid and managed, which may influence how they behave with customers. In particular, high-risk financial incentives and/or performance management, as well as inadequate or ineffective controls and a lack of appreciation or these risks, may encourage high-pressure sales or collections to the detriment of customers.

13. Our proposals for a new rule and guidance on staff incentives, remuneration and performance management are intended to ensure that consumer credit firms identify risks that incentives or performance management give rise to and make sure these are managed appropriately.

14. Section 1B(4) FSMA requires us, so far as is compatible with acting in a way which advances the consumer protection objective, to discharge our functions in a way which promotes effective competition in the interests of consumers.

15. We do not expect our proposals for a new rule and guidance on staff incentives, remuneration and performance management to undermine competition. While they are not directly focused on encouraging greater competition, they may nevertheless do so. This is because the proposals will promote regulatory compliance and so promote a level playing field for firms operating in the credit market. They will also reduce the likelihood of high-pressure sales or collections by staff subject to high-risk incentives and performance management. This may reduce the scope for consumers making inappropriate decisions based on such pressure, and so enhance demand.

Matters we must have regard to under the consumer protection objective

16. Below we explain how we have had regard to each of the eight matters listed in section 1C(2)(a)-(h) FSMA.

Differing degrees of risk involved in different kinds of investment or other transaction

17. Our proposals are rooted in the principle that the types of controls and policies a firm must have in place should reflect the nature, scale and complexity of the firm's business and the nature and range of financial services and activities undertaken in the course of that business. There is no 'one size fits all' approach to incentives and controls that would be appropriate for every firm. Our proposed rule and non-Handbook guidance provide examples of the good and poor practice we have seen at firms, but it is for each firm to assess whether these examples could apply to their business.

Differing degrees of experience and expertise that different consumers may have

18. Our proposals for a new rule and guidance on staff incentives take this into account. We recognise that customers of credit firms are likely to have a wide range of different circumstances, as well as varying levels of financial capability. We expect that customers who may be particularly vulnerable or have lower levels of expertise and experience will benefit from our proposals for a new rule and guidance on staff incentives, remuneration and performance management. These may include, for example, customers of firms that had high-risk elements such as commission accounting for the majority of customer-facing staff's pay, without having sufficient controls in place to address the particular risks they presented. In such cases, we expect that firms may be able to reduce the level of detriment suffered by customers due to mis-selling or inappropriate collections activity by taking steps to reduce the risks that their incentive schemes pose. As above, the emphasis is on proportionality. Firms should decide what is reasonable and appropriate in the circumstances.

The needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose

19. Our current rules set out our requirements regarding the provision of information and we believe the proposals will increase compliance with those rules.

The general principle that consumers should take responsibility for their decisions

20. We have taken this principle into account when developing our proposals on staff incentives. We expect the proposals will be likely to reduce the incidence of high-pressure sales or collections encouraged by firms operating high-risk financial incentives and/or performance management. We expect that a reduction in high-pressure approaches will lead to more appropriate consumer choices and help consumers take more responsibility for their decisions.

The general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question

21. Our proposals were developed with regard to this matter, which is intended to enhance responsible lending by requiring firms to monitor for, identify and manage risks of non-compliance posed by staff incentives and remuneration. Our proposed rule and guidance does not prescribe the nature of firms' incentive schemes. However, a firm must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems. In particular, this should reflect the degree of risk involved in relation to the particular credit product and the financial capability of the consumer concerned.

The differing expectations that consumers may have in relation to different kinds of investment or other transaction

22. Our proposals take this matter into account. We expect consumers to benefit from improvements made by firms to managing risks associated with their staff incentives and performance management that reflects the different kinds of transaction and level of interaction they may have with sales and collections staff.

Any information which the consumer financial education body has provided to the FCA in the exercise of the consumer financial education function

23. This matter is not relevant to these proposals, as we have not been provided with any relevant information by the consumer financial education body on this subject.

Any information which the scheme operator of the ombudsman scheme has provided to the FCA pursuant to section 232A

24. This matter is not relevant to these proposals, as we have not been provided with any relevant information by the scheme operator pursuant to section 232A on this subject.

Our regulatory principles

25. In preparing the proposals set out in this consultation, we have had regard to the regulatory principles set out in section 3B of FSMA. We explain below how we have done this (except where the principle is the same as one of the principles we must have regard to under the consumer protection objective, in which case it is explained above).

The need to use our resources in the most efficient and economic way

26. We consider that the proposals are compatible with this principle. We have identified that high-risk staff incentives and performance management present a risk of detriment to a large number of customers. It is therefore proportionate to use FCA resources to draft the rule and guidance, consult, implement and supervise. Our proposed rule and guidance may also make it easier, and therefore more cost-effective, to take supervisory or enforcement action.

The principle that a burden or restriction should be proportionate to the expected benefits

27. In the cost benefit analysis we set out an estimate of the costs of our proposals, but explained that it is not reasonably practicable to produce an estimate of the benefits. Nonetheless, we expect the proposals to generate benefits for customers, firms and the FCA alike. We expect the proposals will increase compliance with our requirements and, in turn, reduce consumer detriment. For firms subject to the proposals, along with improved customer and staff satisfaction, we expect the proposals to lead to greater certainty. An increase in compliance will promote a level playing field for firms and therefore benefit firms that are currently compliant. We also expected to benefit from the proposals because supervision and, where necessary, enforcement should become more straightforward and cost-effective. In light of the estimated costs, and the fact that the proposed rule expressly requires firms to take a proportionate approach, we believe that the burden or restriction imposed by the proposals will be proportionate to the benefits.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

28. We do not believe our proposals undermine this principle. Affordable credit can drive economic growth, but unsustainable credit can lead to over-indebtedness and other debt-related problems. Our proposals should promote sustainable credit through increased compliance and improved matching of credit products to customer needs.

The responsibility of senior management of persons subject to requirements imposed by or under FSMA including those affecting consumers, in relation to compliance with those requirements

29. Our proposals support this general principle. We are proposing that firms should establish and implement clear, effective and appropriate policies and procedures for identifying and managing the risks of non-compliance associated with staff incentives and performance management. This will help senior management discharge their responsibilities. However, we also expect that senior management will be affected, particularly if their remuneration depends on the performance of managers who are remunerated according to their team's performance.

The desirability of the FCA exercising its functions in a way which recognises differences in the nature of and objectives of businesses carried on by different persons such as mutual societies and other kinds of business organisation subject to requirements imposed by or under FSMA

30. The emphasis on proportionality in our rule recognises that firms may have different products, customer profiles and processes, with different levels of risk to consumers. Firms are best placed to decide what is appropriate and proportionate in the particular circumstances. Our proposals recognise these differences and are not prescriptive.

The desirability of publishing information relating to persons

31. We have had regard to this principle and do not consider our proposals undermine it. We consider that it is unlikely to be relevant given that our proposals do not involve publishing information relating to persons.

The principle that we should exercise our functions as transparently as possible

32. We are an open and transparent regulator. We are publishing our proposals and inviting comments and will have regard to responses when finalising the proposed draft rule and non-Handbook guidance.

Matters about aspects of the Government's economic policy to which the FCA should have regard

33. We have already mentioned how the proposals will have a positive impact on competition and growth, and will secure better outcomes for consumers. We have also had regard to competitiveness, trade and innovation in formulating the proposals, and consider that greater compliance (as expected) and the fact that the rule expressly requires firms to take a proportionate approach and permits firms to adopt a variety of approaches (as opposed to being overly prescriptive) promotes these matters.

Q4: Do you have any comments on this compatibility statement?

Annex 4
Abbreviations used in this paper

CBA	Cost Benefit Analysis
CCA	Consumer Credit Act
CONC	Consumer Credit sourcebook
COND	Threshold Conditions
CP	Consultation Paper
EU	European Union
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
PRIN	Principles for Business
QA	Quality Assurance
SYSC	Senior Management Arrangements, Systems and Controls sourcebook
UK	United Kingdom

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 9644 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Appendix 1
Draft Handbook text

CONSUMER CREDIT (STAFF INCENTIVES, REMUNERATION AND PERFORMANCE MANAGEMENT) INSTRUMENT 2017

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137T (General supplementary powers); and
(3) section 139A (Power of the FCA to give guidance).

B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*] 2018.

Amendments to the Handbook

D. The Consumer Credit sourcebook (CONC) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Consumer Credit (Staff Incentives, Remuneration and Performance Management) Instrument 2017.

By order of the Board
[*date*]

Annex

Amendments to the Consumer Credit sourcebook (CONC)

After CONC 2.10 (Mental capacity guidance) insert the following new text. It is not shown underlined.

2.11 Remuneration and performance management policies, procedures and practices

Application

2.11.1 R This section applies to a *firm* with respect to:

(1) *credit-related regulated activity*; and

(2) *unregulated activity* that is financed by a *credit agreement* in respect of which the *firm* is carrying on *consumer credit lending* or *credit broking*.

2.11.2 R This section does not apply to a *firm* subject to:

(1) any of the remuneration codes in *SYSC* 19A (IFPRU Remuneration Code) to *SYSC* 19F (Remuneration and performance management of sales staff); or

(2) remuneration provisions made by an *EEA regulator* pursuant to any of the following:

(a) *CRD*; or

(b) *AIFMD*; or

(c) the *UCITS Directive*; or

(d) *MiFID*.

Purpose

2.11.3 G (1) The purpose of this section is to amplify the requirements in *Principle* 3 and *SYSC* 4.1.1R to ensure *firms* identify and effectively manage the risks to *customers* that may arise out of *firms'* policies, procedures and practices for the *remuneration* or performance management of their *employees*, *appointed representatives* and such of their individual agents within the meaning of *CONC* 14 who interact with *customers*.

(2) This section does not apply to the commercial *remuneration* or

commission arrangements between two or more separate *firms*.

(3) The risks this section addresses may arise out of a *firm's* policies for remunerating its *employees*, *appointed representatives* or individual agents for performance in carrying on *credit-related regulated activities.* These risks may also arise out of a *firm's* policies for remunerating such individuals for performance in carrying on *unregulated activities* that are financed by *credit agreements* in respect of which the *firm* is carrying on *consumer credit lending* or *credit broking*, for example, where a *firm* incentivises an individual to sell or supply *goods* or services the purchase of which may be financed (in whole or in part) by a *credit agreement* in respect of which the *firm* is carrying on *credit broking* or *consumer credit lending.* The use of incentives in these circumstances creates the risk that the individual may, for example, provide or arrange *credit* to fund purchases when it is not appropriate to do so.

(4) Such risks may arise, for instance, where staff *remuneration* (for example, a bonus or commission) is determined in whole or in part by the volume or value of *credit* provided or debts collected. These risks may, in addition, arise where an individual's formal (for example, annual appraisals) or informal (for example, day-to-day interactions with their line manager) performance management focuses on targets or measures of the volume or value of *credit* provided or debt collected.

(5) Nothing in this section requires a *firm* to act in a way that would be inconsistent with its obligations under employment or contract law.

Requirements

2.11.4 R (1) A *firm* must in relation to any risk of failure by the *firm* to comply with its obligations under the *regulatory system* arising from its *remuneration* or performance management policies, procedures and practices:

(a) establish, implement and maintain adequate policies and procedures designed to detect this risk; and

(b) put in place adequate measures and procedures designed to manage this risk.

(2) A *firm* must, when deciding how to comply with (1), take into account the nature, scale and complexity of its business, and the nature and range of financial services and activities undertaken in the course of that business.

Examples of measures and procedures to manage risks

2.11.5 G Examples of measures and procedures which *firms* might introduce, where appropriate, to manage the risks to which this section applies, include:

(1) undertaking monitoring of the nature of sales activities and *debt collecting*;

(2) collecting management information to enable the *firm* to monitor and identify trends or patterns in *employee*, *appointed representative* or individual agent behaviour that could be used to detect these risks;

(3) establishing procedures to ensure appropriate actions are taken if an *employee*, *appointed representative* or individual agent is found to have behaved inappropriately; and

(4) maintaining arrangements to ensure the approval, oversight and regular review of *remuneration* and performance management arrangements by an appropriate governance committee or senior management.

2.11.6 G In relation to *CONC* 2.11.5G (1), where the activities of an *employee*, *appointed representative* or individual agent are monitored by that *person's* manager, any potential conflicts of interest that arise should be adequately managed (for example, if the manager's *remuneration* is affected by the volume or value of sales or of debt collected by that team member).

Non-Handbook guidance

2.11.7 G A *firm* should also be aware of the finalised guidance [ref to be added] entitled Staff Incentives, Remuneration and Performance Management in Consumer Credit published on [date to be added].

Appendix 2
Draft non-Handbook Guidance relating to Staff Incentives, Remuneration and Performance Management in Consumer Credit

Guidance consultation

GC17/6: Draft non-handbook guidance relating to staff incentives, remuneration and performance management in consumer credit

July 2017

Contents

1 Our expectations

1.1 The way staff are paid and managed may influence the way they behave with customers.

1.2 Before we took over responsibility for regulating consumer credit in April 2014, our predecessor, the FSA, carried out work on financial incentives across a variety of firms including banks, insurance companies and investment firms, issuing guidance in FSA-FG13/01 Risks to customers from financial incentives (January 2013)[1].

1.3 We have reviewed incentives schemes in consumer credit firms and introduced a new rule and handbook guidance as well as this non handbook guidance to specifically help consumer credit firms identify the risks their practices might pose to consumer outcomes and understand what is expected of them.

1.4 Firms carrying on credit-related regulated activities must follow certain rules and take into account relevant guidance about how they manage their business and treat their customers. These are set out in the FCA Handbook[2]. They include provisions in the Consumer Credit sourcebook (CONC)[3], as well as other rules such as the Threshold Conditions and Principles for Businesses[4].

1.5 We do not in our proposed rule or guidance prescribe the nature of firms' incentive schemes. However, a firm must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems[5]. A firm's business model must be suitable for a person carrying on the regulated activities that the firm carries on[6]. COND 2.7.12G makes clear that our assessment of this threshold condition will not necessarily be limited to a firm's regulated activities if we believe that the firm's other business activities may have an impact on the firm's regulated activities.

1.6 The Senior Management Arrangements, Systems and Controls sourcebook (SYSC) of the Handbook sets out organisational and systems and controls requirements for firms. We expect firms to apply Principle 3 (A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems), the Threshold Conditions and SYSC when developing incentive and remuneration schemes for their staff, and to have a mitigation strategy in place to manage any risks posed to consumers.

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[1] www.fca.org.uk/publication/finalised-guidance/fsa-fg13-01.pdf
[2] FCA Handbook: www.handbook.fca.org.uk/handbook/
[3] Consumer Credit sourcebook (CONC): www.handbook.fca.org.uk/handbook/CONC/
[4] See for example Principles for Business (PRIN) www.handbook.fca.org.uk/handbook/PRIN/ Senior Management Arrangements, Systems and Controls (SYSC) www.handbook.fca.org.uk/handbook/SYSC/ and Threshold Conditions http://www.handbook.fca.org.uk/handbook/COND/
[5] Principle 3 of the FCA's Principles for Businesses
[6] paragraph 2F(1) of Schedule 6 to the Financial and Services and Markets Act 2000 (FSMA)

1.7 This guidance does not apply to firms to whom CONC 2.11 does not apply.

1.8 The types of controls and governance a firm must have in place should reflect the nature, scale and complexity of the firm's business and the risk its activities may pose to customers. There is no 'one size fits all' approach to incentives and controls. This guidance gives examples of the good and poor practice we have seen at consumer credit firms, but it is for each firm to assess whether the examples given could apply to their business. These examples are not exhaustive and firms may employ other approaches that are sufficiently effective.

Identifying risks

1.9 We expect firms to identify and assess the potential risks to customers that might arise from their consumer credit activities. In particular, we expect firms to consider how incentives or performance management might cause, or increase, risks of non-compliance with our requirements (for brevity, we refer to this below, where the context admits, as "consumer detriment").

1.10 Risks are likely to occur where staff can be rewarded for actions or behaviours that are contrary to achieving good consumer outcomes and which could result in customer harm. For example, staff who are rewarded for selling consumer credit products regardless of whether the product was sold appropriately. Another example is where staff are rewarded for the sale of retail products in circumstances where the sale of finance was inappropriate and helped secure the sale of the retail products.

1.11 Rewards for staff may take many different forms including financial incentives (eg bonus or commission payments), praise or recognition (eg in performance discussions with their line manager) or other non-monetary incentives (eg prizes or additional holiday).

1.12 Some incentive schemes can result in particular transactions being at greater risk than others. For example, where a staff member is nearing the end of a bonus calculation period, or is close to reaching a sales or collections target. Firms should identify whether any transactions are at greater risk so that they can ensure controls adequately manage the risk to those transactions.

1.13 We consider that firms should assess risks by taking into account how likely a risk is to occur, and the potential level of detriment to customers if it does occur. The level of detriment may vary between customers. For instance, vulnerable customers may suffer greater detriment as a result of inappropriate practices.

1.14 Section 2 of this guidance sets out some examples of how elements of incentive schemes may increase the risk of customer detriment. Section 3 gives some examples of how firms have incorporated features into their incentive schemes that reduce the risk of customer detriment, along with guidance on how these features might be implemented effectively. Section 4 sets out how performance management practices may have an impact on the risks to customers.

Managing risks

1.15 We expect firms to have in place effective systems and controls to manage the risks that may arise from their incentive schemes and performance management. Because the nature of the risks posed by firms' business models and incentive arrangements vary, so does the nature of controls that are appropriate to manage those risks. A firm's assessment of the controls it requires should take into account its assessment of risks, including those identified relating to incentives schemes or performance management as noted above.

1.16 There is a wide range of controls built into the way firms conduct business and the processes staff follow. These vary widely between different firms, but could include having:

- staff with appropriate skills and knowledge to perform their duties
- clear guidance, process manuals or training for staff on how to complete tasks
- restrictions over which staff can carry out specific tasks
- forms staff complete or evidence they record to show they have carried out required tasks or obtained required information
- defined decision criteria (such as lending criteria)
- review, approval or sign-off for certain transactions
- management oversight of, and support for, staff

1.17 Firms should satisfy themselves both that their processes are being followed and that they are leading to appropriate customer outcomes. They may choose to do this using:

- management information that helps to identify potential indicators of risk and can direct other testing or controls to the highest risk areas
- business quality monitoring that reviews whether transactions are completed appropriately and, importantly, whether the right outcomes are achieved for the customer

1.18 Firms should ensure that controls are able to detect and address or prevent serious issues. To do this, controls should:

- be carried out by staff (or outside parties) who are sufficiently skilled and sufficiently independent of the staff and processes they are monitoring
- be sufficiently challenging and robust
- address key risks (including for example, where incentive schemes mean that particular transactions are at greater risk)
- consider customer outcomes as well as the process that was followed
- result in appropriate action where issues are found

- have the support of senior management to emphasise the importance of controls and the support throughout the business needed for the controls to have the desired impact on staff behaviours

1.19 If firms find that it is not practical or cost-effective to manage the risks posed by some high-risk elements of their incentive schemes, they may choose instead to remove or amend those elements.

1.20 Section 5 sets out further guidance on ways firms may seek to manage the risks arising from their incentive schemes and performance management.

Monitoring and reporting risks

1.21 Firms should have effective governance processes in place to assess and regularly review their incentive schemes, the risks they present and the effectiveness of controls. To do this, senior management should ensure they receive sufficient information to effectively assess the extent to which risks are materialising, any likely customer detriment and the effectiveness of any mitigating actions taken.

1.22 Where issues occur that have a significant impact on customers, these should be promptly identified and brought to the attention of senior management. Management should, in turn, assess the seriousness of any issue and whether it is appropriate to notify the FCA at the earliest opportunity[7].

1.23 Section 5 includes guidance on some ways firms may exercise challenge and oversight over controls and use management information to monitor how effectively risks are being managed.

1.24 Firms are reminded of their record-keeping obligations in SYSC 9.1, the purpose of which is to enable us to monitor compliance with the requirements under the regulatory system.

[7] See Principle 11 'Relations with regulators': www.handbook.fca.org.uk/handbook/PRIN/ and SUP 15.3.8 'General Notification Requirements' www.handbook.fca.org.uk/handbook/SUP/15/3.html

2 Incentive scheme features that increase the risk of customer detriment

2.1 Part of the thematic review considered whether the way firms paid their staff increased the risk of customer detriment. Incentive schemes where staff receive higher pay or commission for additional sales can increase the risk that those staff might cause consumer detriment by breaching their regulatory obligations. Similarly, schemes that reward collections staff for the amount they collect can increase the risk of poor practice such as aggressive collections or inappropriate lack of forbearance.

2.2 We recognise that firms may wish to incentivise their staff and may choose to implement pay schemes that reward appropriate sales or collections activity. However, it is important that firms recognise the risks that their pay schemes present so that they can either put in place appropriate controls to manage those risks, or adjust their schemes to reduce them.

2.3 We have set out below some examples of elements of schemes that increase the risk of customer detriment. This is not an exhaustive list but may help firms to identify and assess the risks posed by their own schemes.

Volume, profitability or productivity-based incentive schemes

2.4 Incentive schemes based on sales volume can increase the risk that staff will seek to secure sales inappropriately. Many firms have moved away from sales bonuses that are purely based on sales volumes, recognising that promoting a focus on the fair treatment of customers can have longer term business benefits, such as increased customer loyalty.

2.5 Incentive schemes for collections staff based on the amount they collect can increase the risk that staff will use inappropriate means to collect repayments. Some firms told us that when they moved away from incentive schemes based on cash collected to schemes based on quality and customer service, they have seen many benefits, including improved staff satisfaction and retention and an overall decrease in default rates.

2.6 Schemes based on other measures directly related to sales or collections volumes, such as profitability measures (eg commission calculated as a percentage of the profit generated by each loan sold), can have a similar effect to volume-based bonus schemes.

2.7 Incentives based on productivity metrics (such as average handling time, number of transactions handled) can also carry risks. Customers in arrears who are particularly vulnerable (such as customers with mental capacity limitations or mental health difficulties) should be treated fairly and appropriately. Productivity based incentives could discourage staff from recognising vulnerability if this is likely to affect their bonus.

100% variable pay

2.8 Where staff receive purely variable pay (such as sales or collections commission with no basic salary) staff may become dependent on making a minimum level of commission. This significantly increases the risk that staff may engage in inappropriate sales or collections practices to earn commission.

Example of increased risk	A lender used staff, who were paid solely on commission, to make loans to customers and collect payments on those loans. While commission was only paid on amounts collected (rather than sales), staff were reliant on making sales to maintain the value of the loan book on which they could earn collections commission. They also had a direct incentive to collect payments (on which commission is paid) rather than exercise forbearance in appropriate cases.
Example of increased risk	A retailer paid staff purely based on commission earned on the sale of retail products. A significant proportion of products were sold on finance. Where customers could not afford to pay cash, sales staff could therefore inappropriately induce those customers to take out finance (for instance by pressuring them or misrepresenting the terms of the finance) to secure sales.

2.9 Risks may be heightened where a member of staff is unable to work for part of a month, for instance because of a period of holiday or illness. They may have very limited time to make the volume of sales or collections they need to earn enough commission to meet their own commitments for that month.

2.10 If staff receive an element of fixed pay, but a significant proportion of their pay is variable, similar risks may exist where staff become dependent on the variable element of their pay.

Disproportionate reward from marginal sales/collections

2.11 Where one transaction (eg a sale or collection) can have a very large impact on an individual's pay, that transaction may be at particularly heightened risk. This could happen, for example, where staff earn a bonus for reaching a particular sales target. If a staff member is one sale away from reaching that target, there could be a very high incentive to make that sale.

2.12 One type of scheme that can lead to disproportionate rewards for marginal transactions is where the commission earned on each sale in a period is dependent on the total number or value of sales in the period (a 'retrospective accelerator'). With such a scheme there will be a point where one extra sale will not only earn commission on that sale, but also increase the rate of commission on all other sales already made in the period. There is therefore an increased risk of mis-selling where a salesperson is close to reaching the number of sales that will increase their commission rate. Similar risks apply where retrospective accelerators are used for collections staff.

Example of increased risk	A collections agent earned commission on the amount they collected. The percentage commission they earned depended on the number of loans that were paid in full and on time. The average amount collected was less than £50, earning less than £5 commission on each. However, when the agent reached the number of collections that would increase the commission percentage on all collections in the month, that single collection could increase their total commission for the month by over £600.
Example of increased risk	A retailer paid sales staff commission on the profitability of sales made (including the profitability of finance sales). The percentage commission earned depended on the number of sales made. If a salesperson reached their target number of sales, the sale that took them over their target would result in them earning 20% more commission on all sales in the month (including previous sales already made earlier that month).

Accelerators or stepped payments

2.13 In some schemes, staff only earned commission on sales or collections above a minimum target level, or earned commission at a higher rate on all transactions above a target level. While this may not present the same level of risk as the 'retrospective' accelerator above (where the increased commission rate is applied to past, as well as future, transactions), it could still encourage inappropriate behaviours.

2.14 Near the end of a bonus period staff could seek to maximise the number of transactions completed before the start of the new bonus period, when their commission rate would drop back down. This could, for example, increase the risk of staff inappropriately pressuring customers to take out finance.

Example of increased risk	A retailer paid staff commission of £25 for every finance product sold up to a target number of sales. Every sale above this level would earn £40 until the end of the month, when the commission rate would drop back down to £25.

Incentives linked to the terms of the finance

2.15 Some firms paid staff incentives that were linked to the profitability of the loan products sold. This created a direct link between the commission earned by sales staff and terms such as the interest rate charged or the amount borrowed. This could increase the risk that staff might inappropriately sell loans that are more profitable for the firm but unsuitable for the customer. Staff might also subject customers to high-pressure selling to take out loans for a larger amount than requested.

Example of increased risk	A retailer paid staff commission based on the profitability of loans sold. The staff had discretion over the interest rate they could offer to customers, with higher interest rates earning them higher commission. There was therefore a risk that staff could give false or misleading information to customers to make them believe they would not be able to obtain a lower interest rate than the rate they had already been offered.
Example of increased risk	A lender paid sales staff commission based on the value of loans sold. When customers applied for a loan, sales staff were shown the maximum amount that the customer would be approved to borrow, as well as whether they had been approved for the amount requested. There was therefore a risk that sales staff could increase their commission by pressuring customers to borrow the maximum amount rather than the amount they had originally requested.
Example of increased risk	A lender paid staff a flat commission amount on any loans sold. However, this was only paid if the loan value was above a set amount. If customers requested a loan for less than this amount, staff might attempt to qualify for commission by subjecting customers to high-pressure selling to increase the loan value.

Product bias

2.16 If sales staff are able to offer different finance products that earn them different commission amounts, there is a risk that staff might recommend a product that earns them more commission – even if it is unsuitable for the customer’s needs.

Incentives for sale of finance

2.17 Where customers are purchasing high-value retail goods they may pay close attention to the features and price of the goods, but less attention to the terms of finance to fund the purchase. Where finance is provided to fund the purchase, there may therefore be greater opportunity to influence the sale of the finance through inappropriate sales conversations.

2.18 Where sales staff receive high levels of commission for selling finance compared with any commission they earn on the main product, there is a greater risk that they might sell the finance inappropriately – for example, by misrepresenting the terms of the finance or not making it clear that the finance is optional.

Example of increased risk	One retailer did not pay sales staff any commission on the sale of the core retail product. However, staff did receive commission on the sale of add-on products, including finance to fund the purchase of the retail product. This commission could form up to 70% of an individual's total pay.

Variable salaries that change based on volume measures

2.19 In some firms, sales staff did not receive commission on individual sales, but were paid a salary that was directly linked to the volume or value of sales made in the previous period. An individual's salary could either increase or decrease based on sales made. We have also seen similar schemes for collections staff based on amounts collected.

2.20 With such a scheme, any change in salary level can have a prolonged effect on individual staff members. For example, if sales salaries are reviewed on a quarterly basis, staff members will know that failure to meet sales targets could affect their pay for the next three months. This effect would be even more pronounced with half-yearly or annual reviews.

2.21 Where there is a clear, mechanical link between sales or collections performance and movement between salary bands, there is an increased risk that staff will engage in inappropriate behaviours to achieve the relevant targets.

Example of increased risk	A lender allocated collections staff to different salary bands based on their position on a collections 'leaderboard'. The difference between salary bands could be as much as 40%. Staff could see their position on the leaderboard at any time and would therefore be aware if they were close to moving up or down a salary band (including near the end of a review period when they would be aware that a few more collections could move them up a salary band).
Example of increased risk	A lender employing staff to sell and collect on loans paid those staff salaries that were reviewed every three months. The salary review was based on the amount of cash collected in the previous 13 weeks. Poor collections performance in any one period could therefore significantly affect an individual's income for the next three months.

Volume-based measures to determine whether incentives are paid

2.22 Where incentives are only paid if all minimum targets are met on a range of different volume-based measures, this can lead to sales or collections activity intended to meet quotas rather than customer needs. Staff may focus disproportionately on meeting one particular target that they perceive to be more difficult, or that they are performing poorly against in the current period.

Example of increased risk	A retailer had a range of targets for the number of (non-finance) retail products sold in several different product categories, and for the finance penetration rate. Failure to meet any of these targets would disqualify them from earning any commission. Where staff had reached their targets for sales volumes in the different categories, there could be a significant incentive to sell finance products to meet their finance penetration target.

Competitions or promotions

2.23 Campaigns or promotions designed to increase sales volumes, amounts collected or similar can increase the risk of inappropriate behaviour. Where staff receive prizes or rewards for their performance during the campaign, the risk of inappropriate behaviour may be related to the monetary value of the prizes available.

Example of increased risk	A retailer gave prizes to staff reaching certain targets for the value of retail goods sold. These included a holiday worth around £2,000 for reaching the top target. Sales staff close to reaching that target level in a period could be tempted to secure additional sales by subjecting customers to high-pressure selling to take out finance.

Incentive schemes for managers that are linked to team performance

2.24 Some managers of customer-facing staff earned bonuses directly related to the performance of the teams they managed. Such schemes are likely to encourage managers to focus on the measures that determine their bonus payments.

2.25 If managers' bonuses relate to sales or collections volumes (rather than, for example, quality measures), this could lead to managers putting pressure on customer-facing staff to achieve those volumes – creating risks in relation to customers.

2.26 Where customer-facing staff and their managers are both rewarded on similar volume-based measures, this can reinforce and amplify the risks.

Example of increased risk	A lender employed field-based agents to sell and collect on loans. Those agents' managers received bonus payments based on the value of sales and amounts collected by the agents they managed. As agents are field-based, they have limited interaction with the firm other than through their manager. It may therefore be difficult for the firm to identify if some managers applied undue pressure on agents to sell or collect inappropriately.

Incentives for sales of non-financial products

2.27 Where sales staff can earn incentives for the sales of non-financial products, finance options can be used to help secure a sale (particularly on high-value products that a customer may not be able to pay for outright). This is particularly common among secondary credit brokers that sell retail goods on finance (eg cars, furniture or home improvements).

2.28 In these circumstances, even if no direct incentive is paid for selling the finance, there is a risk that sales staff might engage in inappropriate conduct (eg misrepresenting the terms of finance or inappropriately pressuring customers into taking finance) to earn commission on the sale of the retail goods.

2.29 If any of the higher risk features noted previously apply to incentives for the sale of non-financial products, these may increase the risk related to the sale of linked financial products.

Example of increased risk	A retailer paid sales staff commission on the sale of retail goods, which accounted for up to 60% of their pay. A significant proportion of sales were made on finance, and sales staff were found to have deliberately overstated customers' income on finance applications, without the customers' knowledge, to obtain the finance that would secure the sale.
Example of increased risk	Sales staff for a retailer earned over half their pay in the form of commission for the sale of retail goods. In its training material for new sales staff, the firm noted that increasing the number of customers taking out finance was their biggest opportunity to increase sales.

2.30 Where firms sell retail goods to customers using an associated rolling credit account facility (for example, online accounts where customers buy goods on a linked credit account), they may choose to incentivise their staff to sell the retail goods. This may lead staff to use high-pressure selling to encourage customers to purchase goods using the available credit facility, particularly in circumstances where the staff are able to see the amount of available credit.

2.31 In this scenario, firms should consider whether the incentives affect the appropriateness of their approach to setting or increasing credit limits or monitoring account activity (eg for signs of financial difficulty). In addition, if staff are incentivised to sell retail goods, this could lead them to pressure customers to use more of the available credit than they can comfortably afford to repay.

Schemes that combine several high-risk elements

2.32 Where incentive schemes include more than one of the high risk elements noted above, these elements can combine to create a particularly high risk environment. Firms should be aware of how the different elements of their schemes interact and the extent to which they may reinforce or amplify any risks from the individual elements.

Example of increased risk	A lender paid collections staff on a 100% commission basis. The commission scheme included a 'retrospective accelerator' whereby reaching a collections target increased the commission earned on all collections. The line managers of those collections staff also received commission based on the amount collected by the staff they managed.

3 Incentive scheme features that might reduce the risk of customer detriment

3.1 The way staff are paid can have a significant influence on the way they behave. Incentive schemes can therefore be used to reduce the risk of consumer detriment. Incentive schemes that reward staff for achieving appropriate outcomes for their customers can, if properly implemented, reduce the risk of customer detriment. However, these schemes do not completely eliminate any risk, and the remaining risk should still be managed.

3.2 We have identified below some examples of schemes that firms have successfully used to reduce the risk of detriment, as well as examples of where schemes have been poorly implemented, reducing the positive impact they might have had on risks. For the purposes of this report, 'poor practice' may include schemes that do not mitigate risks in the way intended due to being poorly implemented, or may increase risk, or missed opportunities to reduce risk. The incentive schemes featured in this section may not be practical or appropriate for some businesses. Firms should consider whether the features listed might, together with their performance management, governance and controls, reduce the risk to their customers.

Incentive schemes based purely on quality or customer service measures

3.3 Where staff receive bonus payments based purely on quality measures that assess customer outcomes effectively, there is a direct incentive for staff to act in the best interests of customers. This can also give staff a tangible demonstration of the value the firm places on the fair treatment of customers.

Good practice	A lender paid collections staff bonuses based purely on the results of Quality Assurance (QA) assessments for a sample of calls, which were independently scored for customer experience and outcome by an independent team. The bonus paid to line managers was based on the QA results of their team, reinforcing the focus throughout the collections team on achieving the right quality and customer outcomes.

3.4 Measures that relate to customer satisfaction may not necessarily equate to customer outcomes. For example, if the terms of a finance product are misrepresented during a sale, the customer may feel very satisfied with the transaction but not be aware of particular terms of the product that make it unsuitable for their needs.

3.5 However, bonus payments based on customer satisfaction can encourage staff to consider the needs of their customers, particularly where there are no other volume-based bonus payments that could encourage inappropriate behaviour.

Good practice	A lender paid customer-facing staff a fixed salary, plus a bonus based purely on the results of post-transaction customer telephone surveys conducted on a random basis by an external third party.

Reductions in, or disqualification from, bonus for failing to meet quality standards

3.6 Some firms operate schemes where a quality requirement or gateway must be met in order to qualify for any bonus. If a gateway is implemented properly (ie based on robust checks and/or measures that would detect inappropriate behaviour) it can reduce the risk of staff selling inappropriately to earn high bonuses.

Good practice	A lender undertook QA reviews for a sample of calls with customers each month to assess both the process followed and outcome achieved for the customer. Each call was scored and if the overall QA score for a staff member fell below the target level, that individual would not qualify for any bonus in that month. If any call included a severe breach that was likely to result in customer detriment, that staff member would not qualify for bonus regardless of their QA score on any other calls.
Poor practice	Staff at one lender could be excluded from receiving any bonus if their QA scores were too poor. However, the QA was unlikely to pick up many issues as the number of transactions sampled was very low and were unlikely to cover crucial time periods like the end of a bonus calculation period when staff might be under pressure to meet targets. The qualifying QA requirement was set at a low level, which meant that if an issue was identified it was unlikely to result in bonus being withheld, and if severe misconduct was found it would not result in automatic withholding of bonus.

3.7 Some schemes reduced the bonus to reflect poor QA scores. However, effectiveness of these schemes depends on the extent of the reduction relative to the bonus that can be earned based on other measures. For instance, if the increase in commission staff can earn by selling inappropriately is greater than any deduction for QA failures, the part reduction is unlikely to influence their behaviour significantly.

Poor practice	A retailer made a 5% deduction to the bonus earned by any staff member achieving a QA score below 65%. However, a high seller could earn up to 30% more commission than an average seller before deductions have been made. A high seller whose commission is subject

	to a 5% deduction, would therefore still earn 25% more commission than the average seller.

Deferral or clawback of incentive payments

3.8 Firms use a number of objective measures as indicators of potential quality issues. However, in many cases these may not be measurable until some time after the original transaction has been completed. For instance, if a product is cancelled within a short period of the sale, the customer may simply have requested to cancel because they changed their mind. Alternatively, it could be because it was described inaccurately to the customer or the customer was not given sufficient time to consider the terms of an agreement before entering into it.

3.9 To incorporate these measures into bonus schemes, some firms either defer bonus payment until a measurement can be made, or have clawback arrangements to recover commission or bonus payments if a measure later suggests it may have been earned inappropriately. Such arrangements can help to reduce the risks posed by some elements of pay schemes but are unlikely to eliminate risks associated with, for instance, volume-based bonus schemes.

3.10 Deferral or clawback arrangements can be most effective where transactions that would trigger a deduction are investigated to understand the reasons (for example, whether a customer cancelled a product because they felt pressured to buy, or because of changes in their circumstances that could not reasonably be foreseen at the time of the sale).

Good practice	A lender paid collections staff a quarterly bonus based on payment plans agreed with customers. However, this was not paid until the end of the following quarter, at which point the bonus is only earned on qualifying payment plans.
Good practice	A retailer paid staff a fixed amount of commission for every credit agreement sold. However, if the agreement is cancelled or defaults within the first three months on the basis of mis-selling, the commission earned is ‘clawed back’ as a deduction from future commission payments.

Incorporating quality measures into incentive schemes

3.11 Where bonus schemes are based on a number of elements including quality measures (eg ‘balanced scorecards’), this can help balance the risk arising from volume or profitability elements. The more prominence quality measures have in the bonus calculation compared with volume elements, the more effective this is likely to be in reducing risk.

3.12 The most effective quality measures assess customer outcomes (rather than, for instance, just customer satisfaction). While these schemes may reduce the risk associated with other elements of the bonus calculation, they will not remove it entirely. They may therefore be most effective in mitigating risk when combined with penalties for quality failures, such as withholding of full bonus for any quality failures that result in customer detriment.

Good practice	A lender paid collections staff a bonus based on four elements. Only one of these elements related to amounts collected, while the other three elements (which accounted for the majority of the amount available) related to qualifying payment plans agreed with customers, compliance results and customer service. In addition, if an individual's compliance scores fell below a set level, that person would become ineligible to receive bonus for any of the four elements.
Good practice	A lender scored customer-facing staff on two measures – one based on volume measures and one based on quality and outcome measures. Staff would then receive a bonus based on the lower of the two scores. This meant that a staff member could not earn bonus for high sales volumes if they did not also maintain high quality levels.
Poor practice	Sales staff at one retailer earned commission based on the number of finance products sold, and could also earn a 5% bonus for achieving 100% quality scores. However, the sales commission accounted for up to 79% of an individual's pay, which meant the potential quality bonus was insignificant compared with the volume element.

3.13 Staff at some firms received bonuses based in part on their individual performance on quality measures and in part on team performance on volume measures. This can reduce the incentive for any individual to increase their personal sales or collections figures by treating customers inappropriately, as staff face individual penalties for quality failures but would share any reward for increased sales or collections figures.

Good practice	A lender employed 20 collections staff who were eligible for a bonus based on the performance of the team as whole (calculated using a 'balanced scorecard' of different measures). However, if any individual's quality scores for their calls fell below a target level they would not qualify to receive their share of the team bonus.

3.14 However, team bonuses can also lead to peer pressure, which can significantly increase the risk of poor treatment of customers to maintain team performance. This may be a particular problem in small teams where team members are aware of each other's performance figures.

Poor practice	A retailer organised sales staff into teams of three. Individuals received bonuses based on the sales performance of the team. The team members worked closely together and could see clearly the extent to which the other two team members were contributing to the team's sales figures.

Cumulative or rolling target thresholds

3.15 Where a firm pays volume-based incentives, these can be based on cumulative figures or on a rolling average (eg average monthly sales over the last 12 months). This can reduce the immediate impact on an individual if they perform poorly on volume measures in one specific month (and therefore reduce pressure on them to maintain consistent volumes every month to be able to meet their own financial commitments). However, firms employing such a threshold should be aware that potential conduct risks may still arise. For example, where sales staff underperforming in one period seek to exceed averages in the following month to ensure that they meet the target moving average.

Good practice	A firm paid collections staff a bonus based on the cumulative proportion of customers up to date on their payments. If the cumulative target is achieved at any point in the year, bonus is backdated for any previous months where the target was not reached. Where a customer is facing a temporary financial difficulty, a collector who allows them to delay payment to the following month could see an impact on their bonus in the current month. However, if that customer catches up with their payments in the following month, the cumulative target could still be achieved, earning the collector bonus backdated for the current month. This could therefore reduce the risk that collectors might unfairly pressure customers to pay in the current month. This scheme could, however, introduce additional risks at the year-end when a collector may have one last chance to reach their cumulative target for the year and earn backdated bonus for previous months in that year.

Recognising actions that are in the interest of customers within incentive schemes

3.16 With some volume-based incentive schemes, there are scenarios where acting in the best interests of a customer could have a negative impact on a staff member's bonus (eg exercising forbearance that would affect a cash collected target). Some firms have adjusted their bonus scheme so that staff members who take the most appropriate course of action for the customer's circumstances in particular scenarios do not lose out financially. For example, if a customer is referred to debt advice and enters a debt solution, this could be treated the same as if they had paid in full for the purposes of bonus calculation.

Good practice	Collections staff at one lender were paid a bonus based on the proportion of loans that were in a 'positive' status. This included any loans where customers were fully up to date with their payments, but also included any loans where the customer had entered into a payment plan or Debt Management Plan.
Poor practice	One lender paid collections staff a bonus based on the proportion of loans where customers were not behind on their payments. For this purpose, customers on a payment plan for over £25 per month were not treated as being behind. While it was positive that customers on some payment plans were not treated as being behind, the minimum value was high compared with customers' average contractual payment. In practice, this meant that staff could be discouraged from accepting reasonable repayment offers from customers.

4 Performance management practices that might increase or decrease the risk of customer detriment

4.1 While monetary incentives can have a major influence on staff behaviour, performance management can also be crucial. Performance management includes both formal processes (such as documented annual appraisals) as well as informal processes (such as day-to-day conversations between staff and their line manager).

4.2 Performance management is often quite subjective, and is therefore open to variations in the way it is applied locally. Informal performance management processes can make it difficult for senior management to see any local variations. It is therefore important that firms consider risks arising both from the design of their formal performance management process and from the way formal and informal processes are implemented in practice.

Focus of performance management discussions

4.3 Where performance management discussions focus on one particular set of measures or aspects of performance, this is likely to encourage staff to focus on those aspects they will be challenged on. This can encourage appropriate behaviour where, for example, quality and customer outcomes are discussed prominently.

4.4 However, if performance management discussions focus on volume or profitability-based performance measures, with relatively little discussion of quality or customer outcomes, this can encourage staff to focus on volumes at the expense of quality.

4.5 Where performance management discussions are documented, this may give an indication of where the majority of the discussions focused. However, management should be aware that documentation might not reflect the true focus of oral discussions, particularly if those discussions deviate from the direction given by senior management.

Good practice	The monthly appraisals for collections staff at a debt collection agency focused on quality measures (call quality and account audits) and behaviours (eg displaying company values and following procedures). Financial measures were also discussed but these were not given undue prominence, and focused on productivity and qualifying payment plans

	agreed with customers rather than pure cash collected.
Poor practice	The monthly appraisal for sales staff at one retailer recorded weekly performance on 12 different sales volume measures. The line manager challenged the employee on any measure that they felt to be low. They also indicated that the employee should use finance to sell additional products, which could lead to customers being pressurised to take out more finance than they were seeking. There were no quality measures or discussion of quality recorded and only a brief reference to customer feedback.

Volume-based or monetary targets vs quality-based targets

4.6 In some firms, staff were given targets they were expected to meet for a range of different measures. While these were not directly linked to staff pay or bonuses, staff were challenged where they failed to meet the target figures.

4.7 Where targets predominantly or exclusively relate to the number of sales, value of sales, cash collected or similar measures, they can encourage staff to focus on reaching volume targets at the expense of maintaining quality.

Example of increased risk	Collections staff at one lender were set collection targets for each day and for the week as a whole. Performance against each of these targets was recorded on a weekly performance record. The discussions that were recorded focused on missed collection opportunities. Staff were not set targets for quality and there was no discussion of quality recorded.

4.8 However, targets for quality measures that are discussed regularly and prominently with line managers can encourage staff to treat customers appropriately and help reinforce the importance that management places on quality.

Good practice	At one lender, staff were set a target of achieving a minimum 95% quality score. Quality scores were discussed at the start of annual reviews and formed the basis of staff objectives and periodic one-to-one discussions. The focus of performance management was on quality scores, customer outcomes and employee development.
Poor practice	At one lender, staff were given quality targets that were covered in regular one-to-one meetings. However, quality was just one of seven targets, with the others all relating to volume. In one instance a staff member had 3 out of 16 calls reviewed scored as red, with one scoring zero. This indicated serious issues. However, the reasons for these red scores were not discussed and the staff member still achieved their

	overall quality target of 80%, with the number of green and amber calls highlighted as an area of success.

Use of disciplinary action

4.9 Where failure to meet monetary or volume-based targets can result in disciplinary action, or ultimately dismissal, this can provide a very strong incentive to generate additional sales. For example, if a member of staff has received a warning for failing to meet sales targets and knows they will be dismissed if they do not meet targets in the current month, they might engage in inappropriate sales practices to generate additional sales.

Example of increased risk	A lender measured sales staff against the department average sales volumes. If any staff member fell below the average sales volume for two months in a row, or for two out of three months, they would be put onto a performance improvement plan. They would then be given 60 days to improve their performance or face further disciplinary action.

4.10 Even where there is no direct formal link between volume-based performance measures and disciplinary action, managers could still use the threat of disciplinary action to drive sales (or collections) volumes. For example, managers might take disproportionately harsher actions for quality failures by staff who perform poorly on volume measures. Senior management should therefore satisfy itself that disciplinary action is used appropriately to help drive the correct desired outcomes.

4.11 Where disciplinary action is genuinely and fairly based on the results of quality testing or customer outcomes, this can encourage staff to give appropriate consideration to the interests of customers. This can be particularly effective where firms differentiate between quality failures that relate purely to process and those that could result in customer detriment.

Results affecting other decisions

4.12 Where performance against volume targets is used to influence other staff-related decisions, this can increase the pressure on staff to perform against those particular measures. Examples are where managers will only approve leave for staff who reach sales volume targets, or where promotion or development opportunities are dependent on sales volumes without any consideration of customer outcomes.

Multiple targets for different elements

4.13 Where staff are measured on a wide range of different measures and are expected to meet targets for all measures (or challenged for failing to meet any individual target) this could drive an inappropriate focus on the particular elements in which a staff member has not yet met their targets. In the case of sales targets for different products, a salesperson might direct customers to unsuitable products where they haven't yet made their sales target even where that product is clearly unsuitable for the customer's needs.

Example of increased risk	A firm set sales staff targets for the volume of sales in each of a number of different products. Performance against each of the targets was monitored in regular performance meetings. If any individual measure was below the target level, this was discussed and recorded as an area requiring improvement.

4.14 However, monitoring the sales achieved by individual staff down to different product lines may be useful to help identify indicators of risk. For instance, if one staff member consistently sells a particularly low volume of a product where the potential benefits to customers are not immediately obvious, it could indicate that they are targeting customers with unsuitable products.

Publicising 'good' or 'poor' performance

4.15 Publishing individuals' performance on monetary or volume figures (eg leaderboards of highest sellers or most cash collected) can lead to staff feeling significant peer pressure to perform against those published measures – potentially at the expense of quality. Such pressure can be amplified where the 'worst' performers are highlighted for attention, for example by asking them to publicly explain their low performance during team meetings.

Example of increased risk	A lender displayed a table of sales people on screens in the order of their sales performance. This table was visible to all sales staff and updated in real time with sales figures, showing when someone moved up or down the table.

4.16 However, acknowledging or publicising good performance on quality measures or examples of good customer outcomes can help to promote appropriate behaviour in the interests of customers and engender pride in achieving good customer outcomes.

Good practice	A lender implemented an award scheme where staff members could nominate colleagues for an award. These nominations were based on displaying the right behaviours and values, including where a particularly good customer outcome was achieved. As well as winning a prize, winners were publicly recognised among their peers.

5 Managing the risks from incentive schemes and performance management

5.1 Customers can lose out if firms do not have effective governance arrangements and controls to identify and manage the risks arising from their incentive schemes. Firms should assess the adequacy of any controls in relation to the risks they seek to address. The preceding sections give firms guidance on some features that might increase or decrease the risk, though these are not exhaustive and it is important that firms perform their own assessment, taking into account any issues particular to their business.

5.2 Effective governance and controls may include:

- robust risk-based business quality monitoring and adequate controls to mitigate the risk of inappropriate behaviours during sales or collections conversations, or other interactions with customers
- management information to identify, and act upon, trends or patterns in individual staff activity that could indicate an increased risk of customer detriment as a result of incentive schemes or performance management
- proper management of line managers' conflicts of interest
- effective oversight, approval and regular review of incentive schemes

5.3 We have identified below some examples of elements of governance and controls that may help firms manage their risks effectively, as well as some examples of features that may undermine the effectiveness of controls. Firms remain responsible for ensuring that they have adequate controls in place, notwithstanding any role a third party may play in the control environment.

Understanding of risks

5.4 Firms should ensure that they have adequately identified, understood and assessed the risks that may arise from the ways that their staff are incentivised. This should include a proper consideration of the impact of financial incentives, and formal or informal performance management in the context of wider factors that might influence the behaviour of staff, such as recruitment and training.

5.5 Where staff are not directly incentivised for, or measured on, sales of finance products, firms should consider how incentives or targets on other products (eg targets for sales of retail products that may be purchased on finance) might have an impact on how the related finance product is sold.

5.6 Some firms were able to demonstrate a clear understanding of the risks in their incentive schemes. They gave a clear explanation of how elements of their incentive schemes (eg requirements for minimum quality standards) were designed to mitigate some of the risks, which risks remained, and how controls were designed to mitigate those risks.

Good practice	A lender included an element of 'cash collected' in its bonus scheme, but explained that most of the bonus was based on quality and other non-monetary measures to reduce the risk of an inappropriate focus on amounts collected. The controls included call quality monitoring to review for any sign that the 'cash collected' element of bonus was driving inappropriate behaviour, and performance management that focused on and emphasised the importance of quality.

5.7 However, some firms did not demonstrate a clear appreciation of the risks in their schemes and failed to demonstrate either that these risks had been properly considered when designing the schemes, or that that there were controls in place to address these risks. In some firms, one member of staff was able to articulate and explain some risks, but staff directly responsible for controlling the risk did not demonstrate a similar understanding. Where risks are identified it is important that these are effectively communicated to, and understood by, those staff best placed to mitigate the risk.

Example of increased risk	A lender paid commission to sales staff at a fixed rate for any loans above a minimum value. The firm's senior management did not routinely monitor the proportion of loans sold at or near this value to identify whether there were any indications of sales staff attempting to qualify for commission by unfairly pressuring customers to take out more credit than they had requested.

Quality monitoring

5.8 Well-designed business quality monitoring carried out by competent staff can be an effective component of a firm's control environment. For the purposes of this report, quality monitoring includes Quality Assurance (QA) processes. We set out below some of the elements firms should consider to design an effective business quality monitoring approach.

Focus on customer outcomes

5.9 Quality monitoring should consider whether the outcomes for the customer are appropriate. This may include whether the customer was treated fairly, that the products sold were not unsuitable, that the credit offered was affordable, that customers in default or in arrears difficulties were treated with forbearance and due consideration, and that due regard was paid to the circumstances and interests of the customer.

5.10 While process-based quality monitoring may play an important part in the overall control environment, monitoring that focuses on whether the mandated steps in a process have been followed is unlikely to identify a significant proportion of scenarios that could lead to customer detriment. If a process is poorly designed, it could lead to customer detriment even if it is followed correctly. Process-based quality monitoring is unlikely to detect that the process has led to poor customer outcomes and should be revised.

5.11 Quality monitoring that is based purely on the review of documentation is likely to promote a focus on procedure rather than outcomes. It also carries the risk that documentation might not accurately reflect the substance of customer interactions. Quality monitoring that includes listening to recordings of phone calls, observing interactions or directly contacting customers are more likely to identify a wider range of possible failures.

Good Practice	A lender performed a full review of bank statements as part of its affordability checks prior to lending. The quality monitoring reviews of new loans verified that a copy bank statement had been obtained and reviewed in line with the process, but also included a full re-review of the bank statement. In a number of cases this identified items that had been missed in the initial review, and resulted in follow-up work with the customer to assess whether the loan was appropriate. These issues with the quality of the review would not have been picked up by a simple process check that confirmed a bank statement was on file and that the sales person had made a note to say they had reviewed the statement.

Sampling approach

5.12 Both the number of transactions sampled and the way they are selected impact the effectiveness of quality monitoring.

5.13 Transactions sampled should enable management to form a representative view across all transactions. If staff are aware of which transactions will be sampled, they may behave differently for those calls that are monitored or where face to face sales are observed. Similarly, if staff know that some transactions will not be, or are very unlikely to be, sampled, they may be more likely to engage in inappropriate behaviour for those transactions.

5.14 Transactions sampled should cover key risk areas. These may be risk areas arising from features of incentive schemes or performance management (eg transactions that could earn significant commission) or transactions that inherently carry greater risk (eg dealing with financially vulnerable customers).

5.15 The number of transactions sampled should be sufficient to have a reasonable chance of detecting significant issues. Some firms use a combination of transactions chosen at random across the full population, plus a sample of higher risk transactions, to give them sufficient coverage of key risks while also providing a representative view.

Good practice	Managers at one lender could sit at their own desks and listen in to live calls being made by any member of their team. The team member would not know their manager was listening to the call, so could not adjust their behaviour. Managers were able to give prompt feedback immediately after the call.
Poor practice	Collections staff at one lender had three calls per month sampled. Samples were selected at three points during the month and only related to the current month. Staff were therefore aware that once the three samples had been selected, no more calls in that month would be sampled. Calls in the last days of the month were therefore extremely unlikely to be included in any samples. This is a particularly high risk period as it is the end of the bonus period, when staff could be more likely to engage in inappropriate behaviour to meet targets.

Impact of quality failures

5.16 Business quality monitoring is most likely to influence the behaviour of customer-facing staff if they believe that any failures detected will be taken seriously and may have serious consequences. This could be in the form of financial penalties (eg deduction of bonus) or through performance management (eg disciplinary action for serious or repeated failures).

5.17 Where quality failures carry a financial penalty, this may be ineffective in influencing behaviour if the penalty is less than the additional bonus or commission an individual could earn through inappropriate sales or collections activity.

5.18 Quality monitoring is also likely to be ineffective if staff believe that the standard required is so low that any failures detected are unlikely to trigger a financial penalty, or that testing is not robust or challenging enough to detect inappropriate behaviour. Of the firms in our sample that indicated they would impose financial penalties for quality failures, less than half had made any such deduction in the past month and one in six had not made any deductions in the last year. While this could be evidence that the control was working well, for a number of firms in our sample, we found it was likely to be a result of inadequate controls.

Good practice	A lender implemented a quality 'gateway'. If any member of staff fell below the required average quality score, or had any significant quality failures likely to lead to customer detriment, they would not qualify to receive any bonus in the current month and might also face disciplinary

	action (depending on the nature of the failures).
Poor practice	If quality checking at one retailer found evidence of potential customer detriment, the relevant sales person would have a 5% deduction made from their bonus. However, the average salesperson in this role earned around 74% of their total pay as commission, meaning the deduction for quality failures was comparatively insignificant.

Monitoring face-to-face sales

5.19 Face-to-face sales present particular challenges. It is difficult to monitor interactions effectively, and there is the potential for staff to influence customers inappropriately. These challenges are heightened where transactions are carried out in a customer's home.

5.20 Live observations of face-to-face sales can be a useful tool to assess the ability of customer-facing staff to perform their role effectively, but some firms may rely on them too much. They are difficult to do without the staff member knowing they are being observed, which limits their usefulness in assessing a sales person's normal behaviour. Some firms have therefore supplemented live observations with other controls, such as mystery shopping and post-transaction calls to customers.

Good practice	One lender that sold to customers in their homes employed a third party to carry out mystery shopping. This identified a number of serious concerns (for example, use of high-pressure selling to take loans) that had not been identified by other controls. It was not practical to carry out this mystery shopping on a sufficient scale to act as the firm's primary control over face-to-face sales. However, it was useful in assessing the effectiveness of the other controls the firm had in place and identifying failures in the ability of those other controls to pick up some of the issues.
Good practice	One retailer that conducted face-to-face sales in an office environment had installed devices on each desk to record all sales conversations. Such recordings could provide a firm with valuable information to assess the quality of customer interactions, though this depends on those recordings being used effectively.
Poor practice	Firms may rely too much on face to face observations as their sole means of monitoring staff. One lender that conducted collections activity in customers' homes relied on managers to accompany collections staff on a sample of visits to observe their behaviour, and to review documentation from unaccompanied visits. Staff could easily change

	their behaviour during accompanied visits and would be unlikely to record in documentation anything that might indicate if they had engaged in inappropriate behaviour.

Independence and capability of staff carrying out quality monitoring

5.21 For a firm to have confidence in the results of quality monitoring, it should be confident that staff performing monitoring are capable of identifying issues and will report fairly and accurately on any issues they find.

5.22 Staff carrying out quality monitoring should have sufficient competence and experience to understand how risks might materialise, assess the seriousness of any issues identified and present or defend their conclusions to the relevant business areas. They should also have sufficient resources to carry out their quality monitoring effectively, including access to required information and records, and sufficient time to do their work.

5.23 Some firms had put in place measures to separate control functions from customer-facing staff to maintain the independence of the controls. This can help ensure controls are fair and objective – for example, by making it less likely that someone will start reviewing a sales call with a preconceived expectation that it will be good because they know and like the person who made the sale. Some firms had implemented other measures to prevent bias in how controls are operated, for example by selecting telephone calls from a list of reference numbers to prevent staff picking calls that are all of a similar duration.

5.24 If the staff carrying out quality monitoring are not sufficiently independent, this could result in them overlooking issues. This can be a particular concern where staff are in the same department – for instance, where a manager's bonus or performance appraisal depends on the performance of the team they both manage and monitor for quality.

Good practice	A lender used an independent team to carry out quality monitoring on a sample of collections calls. The team sat sufficiently close to the call handlers to be able to generally observe their behaviour towards customers. However, the teams had separate reporting lines and maintained sufficient separation from each other to remain independent.
Good practice	At one lender, the team managers for collections staff performed quality assurance checks on a sample of their team's calls. Calls were randomly selected so that neither the manager nor call handler could bias the selection. Each team manager's bonus was based on their individual performance and was not related to the performance of their team (meaning that if a member of their team received poor QA results, it would not affect the manager's bonus). A separate, independent team re-performed QA checks on a sample of calls that had already been reviewed by the manager. If it was found that the manager was not

	effectively identifying issues, they could lose their bonus.
Poor practice	Managers at one lender were responsible for observing a sample of face-to-face sales transactions carried out by the staff they managed. The managers received a bonus based on the value of sales made by the sales staff they managed.
Poor practice	A lender had established a separate QA team to review a sample of collections calls. Many of the staff in the QA team had progressed from handling calls, which meant they were friends with remaining call handlers. The teams sat next to each other, making it easier to maintain close personal friendships. Call handlers knew who performed the QA on their calls and what scores they gave, including where this resulted in a loss of bonus. QA staff could therefore be reluctant to mark down their friends' calls, or if they found issues on a call, could be tempted to select a different call in its place.

Challenge and oversight of quality monitoring

5.25 Firms should monitor and review the results of quality monitoring. This can help to identify common themes or systemic issues which might require procedural changes to address. This can also enable management to satisfy itself the quality monitoring is being carried out robustly, is appropriately focused on key areas of risk and assessing customer outcomes, and is raising areas of concern so that appropriate actions can be taken.

5.26 In a number of firms where quality monitoring had not detected significant issues, we found that there were potential weaknesses in the design of the monitoring, such as a lack of independence. In many cases, the firm had not sufficiently questioned whether the lack of issues identified meant that those issues had not occurred, or whether weaknesses in the design of the quality monitoring meant the issues that did occur were not being detected or reported.

Management information

5.27 We expect firms to collect sufficient information to be able to properly manage risk with their incentive schemes and performance management arrangements. They should have the right information to monitor the activities of customer-facing staff and identify individual members of staff who are engaged in higher risk transactions.

5.28 Management information may be most effective in identifying risk when it identifies trends not only at a team, department or firm level, but where it monitors the activities of customer-facing staff at an individual staff member level and can identify individuals who are engaged in higher risk transactions. This could, for example, include staff who:

- have exceptionally high sales or collections levels

- have sold a higher than normal proportion of products that attract a higher rate of commission
- are close to reaching a volume target that would earn additional bonus
- are not meeting volume measures, which might trigger a performance review or disciplinary action

5.29 Transactions could also be identified as higher risk for other reasons, such as sales relating to a newly introduced product or customers with patterns of repeat borrowing that could indicate they are struggling to manage their debts.

5.30 Management information can be useful in informing a business's quality monitoring approach, allowing risk-based quality monitoring that ensures those transactions that pose the greatest risk are subject to quality monitoring.

Good practice	Telephone-based sales staff at one broker were able to offer customers different loan products at different interest rates. MI was used to identify any instances where customers bought a product at a higher interest rate than the lowest available to them. That call was then reviewed to check whether the customer has been sold an unsuitable or unaffordable loan.
Good practice	At one lender, team managers in the collections areas regularly ran different reports seeking to identify new areas of risk. Rather than relying on a static suite of MI reports to monitor known risks, they produced new reports which increased their chance of detecting new, emerging risks before they became significant issues.
Poor practice	Sales staff at a credit broker recommended finance products to customers. If staff were aware of any factors that would make a product unsuitable (for example, the customer indicated they were facing likely redundancy so might not be able to maintain payments) the salesperson was responsible for taking this into account. As part of the sales process, staff were required to ask if customers anticipated any change in their income or other circumstances over the period of the loan. However, the firm did not have any way of assessing whether sales staff were doing this in practice. For example, they did not have any MI showing the number of times a staff member had told a customer that a product might not be suitable, or whether they had recorded an anticipated future change in the customer's circumstances.
Poor practice	A lender had high-risk elements in its incentive scheme. These included a 'retrospective accelerator', whereby hitting a specific collections target would have a very significant impact on an individual's total commission

	for the month. The firm's senior management did not routinely monitor the proportion of collections staff who had just reached their collections target for the month, or review transactions by those staff for any sign of aggressive collections.

Line management conflicts of interest

5.31 Line managers of customer-facing staff perform a vital role in overseeing day-to-day conduct and promoting a customer-focused culture.

5.32 However, where line managers' financial incentives or performance appraisals are directly related to the monetary performance of their team, this can lead to line managers encouraging staff to prioritise profitability over the appropriate treatment of customers. It could also discourage line managers from identifying or raising poor conduct if doing so could negatively influence the monetary performance of their team.

Example of increased risk	A retailer paid sales staff on a 100% sales commission basis. Sales managers received a salary, but also received bonuses that made up the majority of their overall pay. Managers' bonuses were based on the sales performance of staff in their area, including finance penetration rates achieved by the staff they managed.

Process barriers discouraging certain action

5.33 Controls to mitigate risks arising from incentive schemes or performance management should be sufficiently effective to mitigate the relevant risks to consumers. If, however, staff must go through multiple levels of review and approval to agree an action in the customer's best interest, they may be discouraged from doing so.

Good practice	A lender had recognised that dealing with vulnerable customers can be difficult and time consuming, and some call handlers may be uncomfortable discussing these issues with customers. The firm had therefore introduced a dedicated vulnerable customer team that had the training and experience needed to deal with these cases properly, and were not measured or targeted on the volume of cases handled. Where an initial call handler identified a potentially vulnerable customer, they could easily flag the customer as such and refer them to the dedicated team.
Example of increased risk	A retailer that employed a 70% collections rate target as a qualifying threshold for its agents' commission used waivers to mitigate risks of those agents being placed under undue pressure to collect

	inappropriately. The waivers allowed agents to reduce the regular payments made by customers while still counting such payments towards its collections target. However, the approval process for such a waiver could be slow and would be unlikely to mitigate risks of poor actions by agents close to achieving their qualifying threshold.

6 Glossary

This glossary sets out some key terms we use and how we have defined them for the purposes of this paper.

Accelerator – an element of an incentive scheme where sales or collections above a certain level earn a higher rate of commission.

Cash collected – the monetary value of payments collected on outstanding loan or finance products.

Collections staff – staff that collect amounts owed under a credit agreement. This may include collecting regular loan payments in line with the terms of a loan agreement, or pursuing amounts owed from customers who have fallen behind on payments.

Customer-facing staff – staff that interact directly with customers e.g. face to face, telephone or email. Examples of customer-facing roles include sales, collections, customer service and complaints handling.

Incentive scheme – a scheme that sets out the pay and reward structure for staff. This may include salary, bonus, commission and non-monetary rewards (e.g. prizes) or benefits (e.g. pension, company car).

Performance management – processes through which a firm manages how individuals and teams behave. This includes formal arrangements such as annual appraisals or regular one-to-ones as well as informal day-to-day interactions between staff and their line managers which may influence how those staff behave.

Quality Assurance or Business Quality Monitoring – processes through which a firm assesses whether transactions have been completed appropriately. This may be by reviewing or observing a sample of sales or collections transactions / customer interactions.

Quality measures – measures which indicate whether a transaction, or group of transactions, have been completed appropriately. This may include whether the correct process has been followed and whether the right outcomes have been achieved for the customer.

Retrospective accelerator – an element of an incentive scheme where reaching a certain target increases the rate of commission not only on sales (or collections) above that target, but also increases the commission earned on all sales (or collections) already made below the target.

Sales staff – staff that sell or recommend a finance product to a customer, including where that finance product is subsidiary to another product (e.g. where retail goods are sold on finance).

Volume targets or volume-based measures – targets or measures that are based on the number, or the total monetary value, of sales made or loan payments collected.

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