Report on Sales Incentives and Responsible Lending

A study of the impact of sales incentives on the sale of credit products

January 2016

Acknowledgements

FinCoNet would like to acknowledge the efforts of Standing Committee 2 in developing and getting this project to finalisation. Standing Committee 2 consists of representatives from Australia, Indonesia, Ireland, Portugal and Spain and had the assistance of staff from the OECD Secretariat. In particular, we would like to thank Colm Kincaid as Chair of the Committee and Sinéad Cawley, Fiona Daly, Pedro Ricardo Dias, Monica Griga, Greta Joice, Greg Kirk, Jennifer Minogue, Alison Molloy, Susana Salvado and Witri Sawitri for their work in writing and producing the survey and report.

The **International Financial Consumer Protection Organisation (FinCoNet)** was established in 2003 as a network of financial consumer protection regulators and supervisors to discuss consumer protection issues of common interest. It is recognised by the Financial Stability Board (FSB) and Group of 20 (G20).

In November 2013, FinCoNet was formalised as a new international organisation of financial consumer protection supervisory authorities.

The goal of FinCoNet is to promote sound market conduct and enhance consumer protection through efficient and effective financial market conduct supervision, with a focus on retail banking and consumer credit.

Members see FinCoNet as a valuable forum for sharing information on supervisory tools and best practices for consumer protection regulators in financial services.

Contents

EXECUTIVE SUMMARY

This Report on Sales Incentives and Responsible Lending represents the output of a detailed survey of regulators in 24 jurisdictions across a range of consumer credit products, as well as a review of international literature published on this topic to date. It forms part of FinCoNet's continuing work on responsible lending, building on the 2014 FinCoNet report on responsible lending: Review of supervisory tools for suitable consumer lending practices.

The Report finds ample evidence that poorly designed sales incentives can cause harm to consumers, individual firms and the financial system. Such harm can include not only unsuitable sales to individual consumers but also a more general erosion of a consumer-focussed culture within individual firms and across an entire sector or industry. The Report also highlights that poorly designed sales incentives are especially prone to cause harm in the case of credit, where the consumer gets the financial benefit of the product up-front (giving rise to particular behavioural risks).

The Report finds that the nature of incentives for sales staff appears to be relatively uniform across jurisdictions. It also finds few specific rules and standards on sales incentives. This uniformity in industry practices, coupled with a relative absence of specific rules and standards, marks sales incentives as a subject where regulatory intervention has the potential to make a significant positive contribution to how credit is sold to consumers.

Based on these findings, FinCoNet will continue its work towards publication of a consultation paper on this topic. This work will draw on the findings of this Report, focusing on the Public Consultation Topics identified (collated on page 7 & 8 of this Report). These include the oversight of sales incentives as a driver of a more consumer focussed culture in financial services and specific areas where, based on these findings, it would appear that regulatory focus might have most impact. This includes seeking to ensure a holistic approach that transcends appropriately the architecture of any given distribution network, issues arising from cross-selling, the role of product oversight and governance, the effectiveness of consumer disclosure and the respective merits of both general obligations and specific requirements.

Through this work, FinCoNet seeks to provide a platform for regulatory authorities to exchange views through the auspices of FinCoNet regarding effective approaches for addressing issues arising from sales incentives and their impact on responsible lending practices. This FinCoNet Report represents therefore an important contribution to the development of consumer protection globally and to safeguarding the stability of financial markets into the future.

PUBLIC CONSULTATION TOPICS

The 2014 FinCoNet Report made a number of general observations of good practice, based on the initiatives of the jurisdictions that responded to the Survey. These good practice observations highlighted useful or common practices among jurisdictions that are consistent with international developments and standards, or reflect regulatory and policy insight into and experience of established or emerging good practice. This was done with a view to providing a useful benchmark for countries and jurisdictions to identify practices that may be useful to promote responsible lending in their jurisdiction, while recognising that the observations in the 2014 FinCoNet Report may not fully reflect the range of experiences or tools and mechanisms available in countries or jurisdictions that did not participate in the Survey.

It is clear from this Report that the field of sales incentives and responsible lending is one where most jurisdictions surveyed do not have specific requirements or measures in place or have only recently started to focus on this area. In other cases, the actions of respondent authorities on sales incentives were in response to a specific harm which had manifested itself in a particular case, rather than being part of a holistic consideration of sales incentives per se. Accordingly, whereas the good practice observations in the 2014 FinCoNet Report typically reflected prevalent or common practices, throughout this Report we identify areas on which supervisors might choose to focus efforts in this field. These will also inform a public consultation paper which FinCoNet plans to publish on this topic with a view to further promoting sound market conduct and strong consumer protection through the efficient and effective conduct supervision of sales incentives and responsible lending.

While this consultation paper will focus on supervisory initiatives, it will also draw out what arose from the findings in this Report as necessary pre-conditions of the regulatory framework if supervisory initiatives are to be effective in this field. These pre-conditions include:

- having one or more oversight bodies (dedicated or not) that are explicitly responsible for consumer protection in relation to consumer credit (referred to in this Report, as in the 2014 FinCoNet Report, as a ‘primary regulator’);
- the scope of primary regulator(s)’ jurisdiction being comprehensive of the various sales channels that might be employed to sell credit; and
- affording the primary regulator(s) with a range of appropriate supervisory and enforcement powers and the resources to exercise those powers.

The areas identified throughout this report which FinCoNet plans to include in a forthcoming public consultation document are listed in the table below for ease of reference.

1	Appropriate oversight	How a primary regulator might effectively include the impact of sales incentives in their approach to responsible lending. This will include the manner and extent to which this oversight should cover: • various types of consumer credit products and sales channels; • promotional incentives to consumers; and • whether incentives to sales staff and/or consumers encourage lending practices that are not in the best interests of the individual consumer or consumers generally.
2	Cross Selling	The manner and extent to which primary regulators' oversight of sales incentives and responsible lending should include oversight of incentives comprised in cross-selling practices.
3	Consumer Focussed Culture	The manner and extent to which primary regulators' oversight of responsible lending should include consideration of the role that sales incentives play in setting the culture within firms, including the extent to which incentive arrangements which are poorly designed from the perspective of protecting the best interests of consumers can act as an obstacle to other consumer protection measures, such as advisory or disclosure requirements.
4	General duties and specific restrictions	The respective merits of general obligations on a firm to act in the best interests of the consumer and more detailed requirements on sales incentives and how these might inform the appropriate conduct supervision approach.
5	Oversight of different sales networks	Approaches by which supervision in this field might transcend appropriately the architecture of any given sales network in order to ensure an appropriately consistent application of regulatory requirements and standards set by the supervisor.
6	Oversight and governance	The manner and extent to which primary regulators' oversight of sales incentives and responsible lending should include an assessment of incentives comprised in how products are designed and targeted at the consumer, as well as the scope and strength of firms' oversight and governance of those arrangements.

7	Monitoring	The manner and extent to which primary regulators' oversight of sales incentives should include an assessment of firms' arrangements for monitoring the operation of incentives within their firm in practice, including appropriate alert systems within the firm to detect high risk situations as they emerge and address them appropriately.
8	Disclosure	The role and effectiveness of disclosure in this field, including its effect on consumers.
9	Benefit of promotional incentives versus cost of the credit product	The role and effectiveness of disclosure or warnings where a promotional incentive is offered to a consumer which is significantly outweighed by the cost of the credit to the consumer, including in cases where the apparent benefit of the promotional incentive to the consumer is in fact illusory.

CHAPTER 1: INTRODUCTION

Background

Responsible lending initiatives

As part of global discussions held in the context of the recent global financial crisis, particular attention is being paid to consumer protection and regulatory and supervisory deficiencies relating to consumer credit, i.e., credit provided for personal, household or domestic purposes. In particular, responsible lending – in terms of both business conduct and product suitability – has been identified as a response to these concerns.

FinCoNet is uniquely positioned to canvas the issue of responsible lending across the full range of consumer credit products provided by a range of credit providers and credit intermediaries, from both a consumer protection and market conduct perspective.

In 2013, therefore, FinCoNet set up a Standing Committee on Responsible Lending to focus on identifying regulatory supervisory tools for supporting appropriate consumer lending practices. The aim of the Standing Committee on Responsible Lending's work is to help jurisdictions share information about current developments in supervisory tools and responsible lending practices, thus enabling jurisdictions to review the adequacy of their responsible lending arrangements. The intended outcome of this work is to see a strengthening in the development and use of supervisory tools aimed at deterring unsuitable or irresponsible lending by helping jurisdictions identify current gaps and weaknesses in their regulatory regimes, including their supervisory and enforcement capabilities.

In July 2014, FinCoNet published a report entitled *Responsible lending – A review of supervisory tools for suitable consumer lending practices*[1] ('**the 2014 FinCoNet Report**') outlining key findings and good practices in the area of responsible lending. Following the 2014 FinCoNet AGM and the adoption of the Programme of Work for 2014 - 2016, it was decided to focus the further work of the Standing Committee on Responsible Lending on the impacts of, and potential consumer detriment from, sales incentives on the selling of consumer credit products.

[1] http://www.finconet.org/FinCoNet-Responsible-Lending-2014.pdf

Overview of the Survey

In 2015, FinCoNet developed a survey entitled '*FinCoNet Survey on Responsible Lending*' ('**the Survey'**) aimed specifically at gathering information on the role incentives play in the sale of credit products. In particular, the Survey sought to gather information on the impact of sales incentives on the credit sales process and on the consequences for consumers of the influencing effects of incentives where they are targeted either at the person providing the credit to the consumer or directly at the consumer.

Survey features

The Survey sought to collect information from regulators on their experience in relation to the role incentives play in responsible lending. The Survey sought the following information from respondent authorities:

a. the types of consumer credit they regulate;

b. the extent to which they regulate incentives whether via disclosure requirements, specific restrictions/prohibitions or otherwise;

c. whether they regulate the offering of promotional incentives on credit products to consumers;

d. the types of incentives offered to regulated lenders' staff and intermediaries, of which they are aware;

e. the types of promotional incentives offered to consumers when purchasing credit products from regulated lenders, of which they are aware; and

f. examples of case studies where:

- the incentive structure for the sale of a consumer credit product led to potential or perceived consumer detriment;
- the incentive structure was potentially beneficial or perceived to be beneficial for the consumer;
- the incentive structure for the cross-selling of a consumer credit product led to potential or perceived consumer detriment in relation to that credit product;
- the design of the credit product or the selling/marketing strategy for the product influenced or could have influenced the consumer's decision-making by highlighting advantages which were not related to the core features of the credit, leading to potential or perceived consumer detriment; and

- regulatory intervention was used to require a lender to change the process by which it remunerates its own staff or third party intermediaries.

From the outset, it was expected that it would not be possible to collate the responses to the Survey in an empirically authoritative manner which sought to provide statistical outcomes or compare jurisdictions. This expectation was borne of a number of factors, including the following:

- Notwithstanding the increasing focus worldwide on consumer protection by policymakers and regulators, there still remains limited recognition/adoption of internationally accepted common terminology, standards and effective practices in the field.
- The scope, mandates and tools of consumer protection regulators vary from one jurisdiction to another, even across the same category of credit.
- The focus on incentives, including in particular the behavioural aspects of incentives, is relatively recent in many jurisdictions.
- Responses may be based on regulatory experience deriving from cases of manifest harm which led to a focus on a particular incentive, rather than a comprehensive review of sales incentives per se. This makes it difficult if not impossible to draw empirical comparisons between the responses from one jurisdiction (where circumstances may have occurred to cause the harm to manifest itself) with another (where they did not).

Nevertheless, in this Report, we have drawn together the responses to the Survey in a manner which we consider best assists authorities interested in this area to understand the types of incentives that merit regulatory focus (and why), as well as the regulatory tools that they might design and deploy in the context of their specific mandate and the circumstances of their credit market. However, where data has been collated for this purpose, this collation must be read in light of the above caveats.

Survey responses

The Survey was issued to a large number of jurisdictions and representative bodies, including FinCoNet members.

A total of 24 responses were received from different jurisdictions, many of whom are considered to be leading developments in the area of responsible lending (see the appendix for a list of the respondent authorities). All figures shown in graphs must be read in the context of the explanation of the Survey above and the caveats therein. In this Report, ‘jurisdiction’ refers to one of the jurisdictions that responded to the Survey.

Purpose of the Report

This Report seeks to provide a holistic view of the role sales incentives play in responsible lending obligations in relation to the full suite of consumer credit products, with a focus on consumer protection. It seeks to build on the work of the 2014 FinCoNet Report by assisting jurisdictions with identifying current gaps and weaknesses in their regulatory regimes, including their supervisory and enforcement capabilities. In doing so, FinCoNet intends that the Report will provide a platform for regulatory authorities to exchange views regarding notable and effective approaches for addressing issues arising from incentives and their impact on responsible lending practices. It also aims to provide regulatory authorities with examples of regulatory approaches to draw on, to strengthen domestic supervisory tools aimed at deterring unsuitable or irresponsible lending, as well as highlighting areas where further work is merited.

In addition to the Survey responses, this Report is informed by a range of existing work on the role of sales incentives in consumer credit and responsible lending, including the work of international standard-setting bodies, regulatory authorities in different jurisdictions, consumer bodies and scholarly literature.

The Report does not seek to provide an exhaustive policy framework on sales incentives and responsible lending. Rather, it seeks to draw attention to the range of current and emerging regulatory practices intended to promote responsible lending.

Structure of the Report

This Report sets out the key results from the Survey (including case studies identified by the Survey) and, more broadly, reflects international developments and experience to date. It seeks to identify useful practices to promote responsible lending through the regulation of incentives.

From amongst the many case studies provided by respondents, a number have been chosen to illustrate particular points in the Report. The inclusion of a case study does not indicate that the respondent referred to in the specific case study used is the sole respondent to have identified a particular issue or corrective measure.

The Report is presented as follows:

- chapter 2 sets out the basis for FinCoNet conducting a review of this area and defines some of the key terms we use throughout the report;
- chapter 3 provides a context to this work by reviewing research studies undertaken by international organisations dealing with the impact of incentives on sales of credit, as well as initiatives taken by regulatory authorities to ensure greater transparency of financial institutions' staff and intermediaries' remuneration structure, and to avoid and manage potential conflicts of interest;
- chapter 4 describes the role sales incentives play and their importance to responsible lending;
- chapter 5 discusses the types of sales incentive that can cause consumer detriment, in terms of both financial and non-financial incentives to sales staff as well as incentives offered to consumers;
- chapter 6 contains observations on the nature of the detriment misaligned incentives can cause;
- chapter 7 describes supervisory tools, techniques and requirements that can be employed to mitigate the risk of such detriment occurring; and
- chapter 8 concludes with some final high level observations.

Contextual matters

Not all of the tools and mechanisms that supervisors, regulators and relevant policy makers may use to promote responsible lending will be useful or relevant to a particular country or jurisdiction.

Contextual matters that will influence whether a measure or approach is useful or relevant to a particular country or jurisdiction depend on a number of policy factors, including:

- the shape and sophistication of the market – for example, if short-term lending is a growing market;
- the legal framework of a jurisdiction;
- economic conditions, such as the availability of credit, interest rate conditions, productivity and growth agendas, and financial stability concerns;
- the general literacy, numeracy and financial literacy of the population – for example, disclosure may be less useful where the general literacy of the relevant consumer population is limited; and

- the desire to promote financial inclusion overall, or among certain groups of consumers.

  This Report does not seek to analyse the policy settings or effectiveness of a particular measure or proposal, but may identify the contextual background in which certain mechanisms were introduced or may be considered useful as well as respects in which their utility may be limited.

CHAPTER 2: BASIS AND SCOPE OF THIS REVIEW

Key points

While international focus on responsible lending for consumer credit is a relatively new phenomenon, the grounds for regulatory involvement are strong. They include promoting market efficiency, consumer protection and financial stability.

This Report looks at the role incentives play in the sale of credit provided to individuals for personal, domestic or household purposes, and not business purposes, including findings from a survey of respondent authorities regulating a wide range of such credit in their jurisdiction.

The way that financial service providers incentivise their staff and their authorised agents can influence how and what they sell to consumers. Sales incentives are therefore an important feature of how financial service providers operate.

It is also important to look at the promotional incentives financial service providers offer to consumers to borrow in order to get a holistic view of the manner by which financial service providers use sales incentives to promote certain behaviours and the detriment that may arise as a result. This includes considering the behavioural impact of such incentives using emerging findings of behavioural studies.

While the impact of sales incentives on responsible lending has been an important area of focus in international literature, there are limited international requirements on it or recommendations as to how best to mitigate the risks arising.

Responsible Lending: An Overview

The 2014 FinCoNet Report noted that, while consumer credit is an integral part of the global economy and plays a central role in most economies, and the case for regulatory involvement is strong, the international focus on responsible lending for consumer credit is a relatively new phenomenon. International responsible lending initiatives have tended to develop in response to specific concerns or in the context of the development of broader consumer protection issues (as opposed to responsible lending specifically). While consumers, credit providers and credit intermediaries all play a central role in ensuring that the decision to lend or enter into a credit contract or agreement is made responsibly, there is also an important role for regulatory involvement to promote and enforce responsible lending. Insights from literature, research, recent events and international developments suggest that there are three broad grounds on which to justify regulatory involvement to encourage responsible lending which significantly interact, overlap and complement each other:

- promoting economic efficiency – to address market failures such as ‘information asymmetry’ between credit providers and consumers;
- consumer protection – taking into account principles of equity and fairness, particularly to overcome any imbalance of power between a credit provider and a consumer that results in abusive or predatory practices; and
- financial stability (prudential) concerns – to prevent systemic risk in the market.

What is Consumer Credit?

This report uses the definition of ‘consumer credit’ employed in the 2014 FinCoNet Report (in line with the definition used in the questionnaire circulated to members):

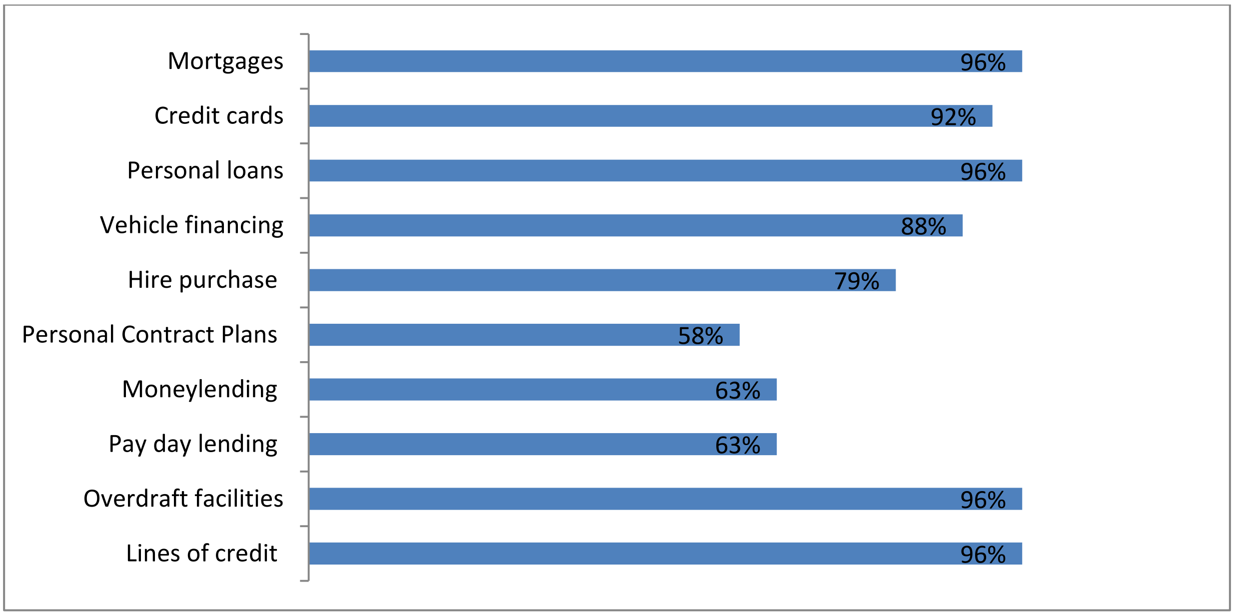
Consumer Credit means “credit provided to individuals for personal, domestic or household purposes, and not business purposes”.

This includes both secured credit (such as mortgage loans and personal loans) and unsecured credit (such as lines of credit, credit cards, overdraft facilities, payday lending and micro-finance).

The following graph illustrates the types of credit regulated by the respondent authorities to the Survey. The responses reflected in the table tell us that the majority of consumer credit products are widely regulated by the respondent authorities.

Table 1: Types of Consumer Credit Regulated by the Respondent Authorities

(This graph reflects the responses received to a request to select the types of consumer credit that are regulated by respondent authorities in their jurisdictions)



What are 'Sales Incentives'?

The range of sales incentives which this Report considers is broad, since incentives may vary from one jurisdiction to the other, depending on the regulatory/legislative framework applicable, and from one firm to the other, depending, in some cases, on the status of the financial intermediaries[2]. In its simplest form, an incentive scheme is *"an arrangement under which a company makes extra payments to employees to reward good performance*"[3]. Hence, a 'sales incentive' is such an arrangement where the element of 'performance' concerned is the sale of a consumer credit product.

Sales incentives therefore include:

- financial incentives, such as a bonus for reaching a particular target; commission on the sale of a particular product; variable part of salary based on performance against sales target(s) or volumes of products sold; sales competition where winner(s) earn additional payments; increase in base pay; stocks or stock options etc.; and
- non-financial incentives, such as performance recognition by management or co-workers; promotion and career development opportunities; flexibility in work hours; training opportunities; vouchers and gifts; extra holidays; company cars etc.; being subject

[2] The Questionnaire sent to members sought to clarify what types of incentives are in place at national level.
[3] Oxford dictionaries - http://www.oxforddictionaries.com/fr/definition/anglais/incentive-scheme

to disciplinary action, enhanced monitoring, performance management, humiliation in front of colleagues and dismissal for failing to meet sales targets.

Sales incentives can also be targeted at consumers to entice them to enter into a contract for credit services. This can include, for example, discounted interest rates or gifts in return for the consumer entering into a contract for the credit product. In the Survey, therefore, respondent authorities were also asked for information on incentives provided to consumers to encourage them to borrow.

Why study sales incentives and responsible lending?

The 2014 FinCoNet Report highlighted that the decision-making process for how and when a consumer can, or should, enter into a credit contract can be very complex. A range of factors, including sales incentives, can influence the consumer's decision and can have extensive ramifications for the consumer, the credit provider and, indirectly, the economy as a whole.

However, the 2014 FinCoNet Report noted that the investigation of specific approaches to a number of issues, including misaligned incentives of credit intermediaries and advisers, were out of scope of that report. Thus this Report follows up on some of the issues in relation to incentives highlighted in the 2014 FinCoNet Report. Complementing the findings of this Report, there is a significant body of authoritative international commentary on the importance of incentives. However, there is limited material available which identifies specific international requirements or recommendations as to how best or most appropriately a supervisor should mitigate the risks raised by sales incentives.

Where this topic has been researched, there is evidence that sales incentives have caused consumer detriment and, where properly designed, incentives could promote good behaviour. For example, in its 2013 *Final Guidance Risks to customers from financial incentives ('***the FSA Guidance***')*, the UK Financial Services Authority[4] identified examples of incentive scheme features that increase the risk of mis-selling, on the basis that the likelihood of mis-selling is higher when the value of incentives available to sales staff increases, or when incentives make up a high proportion of a remuneration package for sales staff. The FSA Guidance also included examples of incentive scheme features that might reduce the risk of mis-selling. Similarly, the Central Bank of Ireland in its

[4] The Financial Services Authority was replaced by the Financial Conduct Authority and the Prudential Regulation Authority ('the PRA') in 2013.

2014 *Guidelines on Variable Remuneration Arrangements for Sales Staff (*'**the CBI Guidelines**'*)* highlighted inherent risks in sales incentive schemes and variable remuneration arrangements which might increase the potential to mis-sell and/or discourage customer needs based selling and financial advice to consumers. A report from Consumers International – *Risky Business: the case for reform of sales incentives schemes in banks* - concluded that inappropriate sales incentive schemes were an important root cause of a significant number of episodes of mis-selling and irresponsible lending across a range of jurisdictions.

Sales Incentives and Behavioural Studies

As with every human activity, the act of selling/buying a consumer credit product is influenced by emotions, psychological experiences, beliefs, cognitive short-cuts, overconfidence, time-discounting effects and social norms. The growing body of work in the area of behavioural economics is pertinent to this field therefore and supports the existence of a relationship between incentives and the behaviour of sales staff. Such research thereby lends additional support to the further study of incentives by regulators. Indeed, even when the culture in an organisation promotes the best interests of consumers and pro-consumer sales policies are in existence, the incentive scheme seems likely to be the biggest driver in how sales staff behave towards consumers. Therefore, if a sales incentive scheme is designed to support the sales objectives of the firm and fails to take account of the interests of consumers, it seems likely that sales staff will employ behaviours which will lead to a poor result for the consumer.

Case Study A:

Slovak Republic – Intermediaries recommending products based on their incentive payment rather than on the consumer's best interests

The regulatory authority identified cases where mortgages recommended and provided by mortgage intermediaries were not the most advantageous to the consumer. According to the consumers who made complaints, mortgage intermediaries were not interested in recommending products by mortgage providers who paid lower commission rates. In some cases, the mortgage intermediary would also charge a service fee to the consumer in addition to the commission received from banks for the sale of the mortgage.

Sales incentives are of interest to the field of behavioural studies in terms of how they impact on the behaviour of both the consumer and the sales person. Indeed, the fact that, in the case of credit, the benefit is typically felt by the consumer up front (e.g. upon acquisition of a new house or car) but the cost is felt later, makes the role of behavioural concepts such as ‘present bias’ especially relevant. According to the “present bias”, consumers are biased towards current consumption and time-discounting is non-linear. Knowing that people overestimate the beneficial impact of purchasing an item, incentives can be designed in a way to enhance the benefit to the consumer from having the product immediately.

A salesperson may ‘frame’ the information about products in a biased way in order to steer consumers towards the option that will generate the most remuneration for that salesperson rather than the most suitable or cost effective option for the consumer. Volume-based sales incentives may even lead to sales people harassing consumers in an effort to generate leads for sales and sales people may also pressurise existing customers to refinance or take out a new loan when it is not really required. One concept that is relevant here is the “availability heuristic”, which represents the mental shortcut that occurs when an event is perceived as simpler / less risky because an example comes to mind easily. For example, a consumer may believe there is little risk attached to a mortgage as a result of remembering a friend who has a magnificent house acquired with credit and who is successful in life. The mortgage broker may use this knowledge to their advantage by encouraging the consumer to apply for a mortgage and buy a house that might not be suitable for the consumer for the purposes of the mortgage broker achieving their sales target. Staff may also know which information should be put forward to help ensure that consumers qualify for a loan. Research in one European bank found that some loan officers manipulated the information about the customer in a way that significantly affected the banks’ internal creditworthiness rating of the consumer and the likelihood of a loan being granted. Loans where the information had been manipulated had higher default rates.[5]

Another important insight highlighted by behavioural experiments is the fact that when faced with complex information, consumers are more likely to choose the default option, especially if it is explicitly presented as a recommended configuration. This well-known fact may be embedded in the incentives created for sales staff. When offering a personal loan sales staff might not disclose to the consumer that, by default, it also includes, for example,

[5] Berg, Puri and Rocholl 2014, *Loan Officer Incentives, Internal Ratings, and Default Rates*

unemployment insurance. Despite not being the best option for him or her, the consumer may accept this on the basis that it is the ‘standard’ package, and the employee sells more insurance products which will give him or her an extra bonus at the end of the month.

In another example of framing, a car seller who is also a credit intermediary can explain to the consumer the terms and conditions of the credit at the same time as the consumer is sitting at the wheel of the potential new car, playing on the concept of “affect heuristic” (reliance on current feelings and experiences in reaction to a stimulus). Inciting this good feeling in the consumer may encourage them to borrow in order to acquire the product despite this not being in the consumer’s best interests.

Case Study B

Indonesia: Outsourced marketing of credit products

Banks outsourced their marketing of credit products to marketing companies. Incentives were granted when the sales force managed to reach the minimum target, in which the greater the target achieved the bigger the incentives received. If the sales force did not reach the minimum target the staff concerned only received fixed salary in a relatively small nominal amount.

Several marketing methods dominated: telemarketing, direct offers to walk-in customers, and offers to the employees of bank partner companies, especially customers using bank services for pay-roll. In general, incentives are granted directly to the sales force every month in the following month. However, several banks provide incentives partly in which the remaining incentives will be given at the end of the year by taking into account the performance of the customer.

Because the sales force is placed under immense pressure by these arrangements to create volume sales, this drives poor behaviour towards consumers including:

- Harassment of consumers and pressure to take out loans.
- Use of consumers' private information by outsourced sales forces to generate leads.
- Information was disclosed in a biased way.
- Disregard for affordability and suitability of products in blind pursuit of incentives.

The incentive scheme has indirectly led therefore to consumers who did not need or could not afford loans entering into contracts, increasing their indebtedness and leading to higher non-performing loans.

Many banks have taken action to mitigate the risks by placing a bank employee at the sales force location to oversee sales operations, and introducing non-performing loans as a qualitative target in the incentive schemes to encourage more consideration by the sales force of affordability and also offering a delayed incentive at the end of the year based on customer performance.

CHAPTER 3: INTERNATIONAL DEVELOPMENTS

Key points

Following the global financial crisis, a number of studies and reports have been undertaken by international organisations and consumer bodies to understand the origin and nature of the detriments caused to consumers by sales incentives.

The G20 and the FSB recognise that misaligned incentives increase the risk that unsuitable credit products might be sold to consumers. In particular, work by the G20/OECD Task Force on Financial Consumer Protection has highlighted the importance of responsible business conduct of financial services providers and their authorised agents and the need for supervisory/regulatory approaches to alleviate the negative impact of sales incentives on consumers.

Research studies conducted by consumer organisations have also highlighted the negative effect of sales incentives on consumers.

The key international studies concur therefore that sales incentives that do not promote appropriate behaviour are an obstacle to consumer protection and financial stability objectives. They also indicate that this risk may not be capable of being overcome by prescribing standards for the giving of advice and disclosure requirements.

However, in general, at an international level, there has been limited detailed analysis of the role of sales incentives or specific requirements in comparison to other regulatory fields.

Introduction

Following the collapse in the subprime mortgage market and the subsequent financial crisis of 2007-2008, greater policy international attention was given to consumer protection issues in financial policies and initiatives. A number of studies and reports have been carried out by various parties including international organisations, academics and consumer bodies to understand the origin of the specific detriments caused to consumers, and make recommendations to promote sound market conduct for the future.

Some international perspectives

The European Commission

As part of the European Union programme to address the impact of the crisis and lead the EU to recovery, the European Commission explored possible measures to deliver responsible and reliable banking markets and restore consumer confidence (European Commission, 2009b).

Stakeholders were consulted on initiatives to improve responsible lending and borrowing. Unfair and unsuitable business practices were reported, in particular in relation to mortgage lending. Cases presented by consumer organisations included details on products sold by credit intermediaries and by lenders whose sales objectives were seen to take priority over the appropriateness of a product for a given borrower.

Conflicts of interests arising as a result of remuneration structures for intermediaries were also mentioned as sources of problems (e.g. intermediaries actively seeking out vulnerable borrowers to earn commissions). Cases were also reported where intermediaries have incentives to encourage borrowers to switch lenders as they would earn commission on a new credit contract, although this might not be in the best interests of the borrower.

Increased transparency in the disclosure of commissions and fees was called for by EU Member States and generally by consumer representatives as a way to address potential conflicts of interest. Some parties also asked for a ban on commission structures altogether, and a move to a purely fee-based system in which the borrower would pay a direct fee to receive advice combined with remuneration structures that reward the employee for client satisfaction or good savings levels. Member States and consumers also supported the application of the same requirements to all distributors, whether bank staff or intermediaries.

The European Commission also reviewed the framework in which credit intermediaries operate, and examined any possible consumer detriments. One of the report's[6] findings is that the most significant source of consumer detriment is the recommendation of products that are either unsuitable to the borrower's personal circumstances or else are not price-competitive. The report noted that the cause of this form of detriment is systemic and stems from conflict of interest.

The report concluded that the widespread use of commissions conditional on the conclusion of a contract creates systematic incentives for intermediaries to provide advice that secures agreements rather than serving the best interests of consumers. The report considered this form of detriment to be particularly relevant for residential mortgages where intermediary involvement in the provision of expert advice is very high. To mitigate this issue, the report identifies potential regulatory interventions which would oblige the intermediary to disclose the remuneration agreement with the lender. It mentions other options such as capping the level of

[6] Europe Economics, 2009 (European Commission, 2009c), *Study (for European Commission's DG Internal Market and Services) on Credit Intermediaries in the Internal Market* http://ec.europa.eu/finance/finservices-retail/docs/credit/credit_intermediaries_report_en.pdf

the commissions, restricting the payment of fees directly from borrowers or regulating the timing of the commissions' payment (for example through monthly instalments over the life of the loan). This work of the European Commission has been followed up by a number of initiatives on remuneration at a European Union level, including most recently the publication by the European Banking Authority of a consultation paper[7] on remuneration of sales staff (aimed at supplementing the prudentially-focused European Banking Authority Guidelines on Sound Remuneration Policies published on 21 December 2015[8]).

The G20, the Financial Stability Board and the Organisation for Economic Co-operation and Development

In 2010, as a contribution to the development of a post financial crisis framework for strong, sustainable and balanced growth, the G20 Leaders requested the Financial Stability Board ('**FSB**') to work in collaboration with the Organisation for Economic Co-operation and Development ('**OECD**') and to explore options to advance consumer finance protection[9].

The work of the FSB in collaboration with the OECD focused on consumer protection in the field of consumer credit, including mortgages, credit cards and secured and unsecured loans. The report[10], finalised in 2011, observed that incentive regimes based on the volume of loans sold, either as a target to earn a commission or as a variable part of remuneration, are not aligned with the aim of providing consumers with accurate and trustworthy information. Such incentives could increase the risk that products are sold to consumers who do not have the capacity to repay the loan. The

7 European Banking Authority (EBA), 2015, *Consultation Paper on draft guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services* http://www.eba.europa.eu/documents/10180/1317073/EBA-CP-2015-29+%28CP+on+the+GL+Remuneration+of+sales+staff%29.pdf

8 European Banking Authority (EBA), 2015, *Guidelines on Sound Remuneration Policies* http://www.eba.europa.eu/documents/10180/1314839/EBA-GL-2015-22+Guidelines+on+Sound+Remuneration+Policies.pdf

9 The G20 leaders asked the FSB to work in collaboration with the OECD and other international organisations to explore, and report back at the next summit, options for advancing financial consumer protection through informed choices that include disclosure; transparency and education; protection from fraud, abuse and errors; along with recourse and advocacy; concentrating on aspects linked to consumer credit and focusing largely (but not necessarily exclusively) on related financial stability issues. https://g20.org/wp-content/uploads/2014/12/Seoul_Summit_Document.pdf

10 Financial Stability Board (FSB), 2011, *Consumer Finance Protection with Particular Focus on Credit*, http://www.financialstabilityboard.org/wp-content/uploads/r_111026a.pdf?page_moved=1

report noted that the inherent problem of mis-selling is not solved by defining advice standards, and information provisions and compensation practices should be aligned with appropriate incentives.

To complement this work and following a call from the G20 Finance Ministers and Central Bank Governors, the OECD in collaboration with the FSB, and other relevant international organisations, were asked to develop common principles on consumer protection in the field of financial services. As requested and agreed upon by the G20 French Presidency and the FSB, the development of the high-level principles on financial consumer protection would be led by the OECD.

The work on developing the principles was channelled through the G20/OECD Taskforce on Financial Consumer Protection, which is open to all G20, FSB and OECD members. Applicable across all financial markets (banking, credit, insurance, securities and pensions), the principles complement existing international guidelines and standards and reflect a consensus within the G20. The High-Level Principles were endorsed by the G20 Leaders in 2011[11] and as a Recommendation of the OECD in 2012, and assist all interested economies (both developed and developing) with enhancing financial consumer protection frameworks in their own jurisdictions.

Of particular relevance here is High-Level Principle 6 'Responsible Business Conduct of Financial Services Providers and their Authorised Agents'[12]. Principle 6 includes a statement that:

"Where the potential for conflicts of interest arise, financial services providers and authorised agents should endeavour to avoid such conflicts. When such conflicts cannot be avoided, financial services providers and authorised agents should ensure proper disclosure, have in place internal mechanisms to manage such conflicts, or decline to provide the product, advice or service.

The remuneration structure for staff of both financial services providers and authorised agents should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest. The remuneration structure should be disclosed to customers where appropriate, such as when potential conflicts of interest cannot be managed or avoided."

To inspire and encourage jurisdictions to implement the High-Level Principles, the G20 Leaders supported the Action Plan of the

[11] http://www.g20.utoronto.ca/2011/2011-cannes-declaration-111104-en.html

[12] http://www.oecd.org/daf/fin/financial-markets/48892010.pdf

G20/OECD Task Force to develop 'Effective Approaches' to support the implementation of the High-Level Principles[13]. The G20/OECD Task Force developed an approach to identify and present a broad range of Effective Approaches for each High-Level Principle. In this way a toolbox of practice was developed, instead of detailed guidelines. The analysis drew on information gathered through a survey of Task Force Members which provided concrete examples of regulatory and supervisory approaches to support the principles. This information was complemented by factual information gained through an informal consultation with key stakeholders, including consumer and industry associations and additional inputs from various member jurisdictions and other relevant international organisations and standard setting bodies. The Effective Approaches identified represent examples based on individual jurisdictional initiatives.

The Effective Approaches identified by the G20/OECD Task Force were supported by the G20 Leaders at their St. Petersburg Summit in 2013 and identified several innovative and emerging Effective Approaches on the theme of remuneration structures for financial service providers and their authorised agents[14]. It is noteworthy that, whereas 'common'[15] Effective Approaches were identified under every other aspect of High Level Principle 6, the section on 'remuneration structure' did not identify any common Effective Approaches. Rather, all of the Effective Approaches identified in the 2013 document on 'remuneration structure' are in the 'innovative/emerging'[16] category.

The following Effective Approaches were identified:

13 http://www.g20.utoronto.ca/2012/2012-0619-loscabos.pdf

14 http://www.oecd.org/daf/fin/financial-education/G20EffectiveApproachesFCP.pdf

15 The term common effective approaches refers to regulatory, supervisory and self-regulatory measures and practices which have been developed and are considered by the Task Force to effectively implement the key aspects of the G20 High-Level Principles and are consistent with approaches developed by a broader range of jurisdictions. These common effective approaches are drawn from the member's survey and are not classified due to a specific number of jurisdictions undertaking such an approach.

16 Innovative and/or emerging effective approaches are regulatory, supervisory and self-regulatory measures and practices that have been identified in the member's survey and are considered by the Task Force as approaches worth further consideration. These effective approaches represent either innovative, (undertaking a different, alternative or new approach to implement the key aspects of the G20 High-Level Principle) or emerging (the adoption or the specific use of a certain approach as a consequence of a new or emerging challenge to support key aspects of the G20 High-Level Principle). Innovative and/or emerging approaches are not representative across a broader range of jurisdictions but instead are limited to a number of jurisdictions and sometimes they are only applied to certain financial services. The Task Force considers that after taking into account specific national circumstances, these approaches can be of interest to and prove useful for stakeholders engaged in work to enhance financial consumer protection.

- Remuneration policies are designed in such a way as to encourage responsible business conduct with the aim of preventing mis-selling practices, unreasonable risk taking, or other irresponsible conduct.

- When appropriate, regulators ban remuneration structures and other types of incentives that lead to practices which are not in the best interest of the consumer or prescribe remuneration structures that will minimise the risk of conflicts of interest.

- The policy, including the structure of the remuneration under which direct sales staff or authorised agents are remunerated, is disclosed on a company level at the pre-contractual stage to the consumer.

- Financial service providers and authorised agents ensure adequate procedures and controls are in place so that staff are not remunerated solely on sales performance but factors such as consumer satisfaction, loan repayment performance, product retention, compliance with regulatory requirements/best practices guidelines and codes of conduct which are related to the best interest of customers, satisfactory audit/compliance review results and complaint investigation results are also taken into consideration.

- Regulators/supervisors introduce rules or guidance on staff remuneration of financial service providers and authorised agents with the aim of ensuring that remuneration policies reflect the duty of the financial service provider to take due account of the interests of the consumer. For example, remuneration policies are not designed in a way that would incentivise their staff to conclude a given number or type of financial products/services contracts with consumers with no explicit consideration of their interests and needs. Rules also specify that the remuneration received by staff should not be solely dependent on the rate or the type of financial service concluded with the consumer.

Some consumer organisations' perspectives

In parallel with the above, consumer organisations have developed focussed analysis on the impact of sales incentives in the mis-selling of credit products which led to the financial crisis. They have called for a reform of sales incentives schemes and better consumer protection supervision.

The European Consumer Organisation

In 2011**,** BEUC, the European Consumer Organisation, in its analysis of the financial crisis, attributed heavy responsibility to irresponsible credit stimulated by incentives to sell dysfunctional products, and the lack of dedicated supervision to safeguard the interests of consumers (BEUC, 2011a and b).

Consumers International

Consumers International has reported that inappropriate financial institutions' staff incentive schemes and a sales-based culture encourage the conditions for irresponsible lending (CI, 2013 and 2014). It recommended that remuneration of lenders and intermediaries should be product neutral and that incentives should be linked to providing quality customer service. Consumers International concluded that incentive schemes that promote high-risk and short-term gains can conflict with a sales person's responsibility to do their best for customers, as they are driven by their sale targets and the prospect of receiving a bonus. It added that the inherent risks of these schemes have not been properly identified and managed by lending firms, and this situation has contributed to poor product design, mis-selling and irresponsible lending. Consumers International recommended in particular that lenders incentivise their staff on the basis of customer service, not on the volume of sales. It also recommended that senior executives within banks should be responsible for approving the design of sales incentives schemes and face enforcement action from regulators if the scheme leads to mis-selling or risks to financial stability.

National Consumer Organisations

Studies have also been conducted by national consumer organisations. For example, a 2012 survey led by one consumer group in the UK revealed that a sales culture remains even after financial rewards have been taken away and banks have publicly committed to focus on customer service (Which? 2012). This survey showed that there was still significant pressure on sales staff to reach targets, despite decreases in the availability of incentives. A follow up survey in 2015 concluded that, while further improvements have been made, there is still some way to go before banks can truly claim to put customers before sales (Which? 2015). The majority of sales staff surveyed felt that there is now more emphasis on customer service and less pressure on sales. However, the report concluded that practices that may result in mis-selling still remain, such as expectations from management to sell even when it may not be appropriate, or the existence of schemes that are not associated with targets but which still reward strong sales. A consumer organisation in Australia completed research on mortgage brokerage which evidenced poor commission disclosure and inappropriate advice to customers (CHOICE 2015).

Conclusion

This body of work indicates a recognition of the importance of considering the role sales incentives play when designing an effective responsible lending regime. Moreover, there is a consistency across these studies in the topics they raise, the concerns they identify and the nature of the steps they advocate. Nevertheless, it seems fair to say that, with notable exceptions, there is less empirical analysis in the field of sales incentives than is to be found in many other fields of analysis in financial services regulation. There also appears to be less of a consensus on the specific mandatory requirements that should form a minimum standard in an effective responsible lending regime.

Chapter 4: The Importance of Sales Incentives

Key Points

Incentives are a powerful tool in setting the culture of the firm, since by definition they identify the behaviour on which the firm places value.

Misaligned incentives seem especially prone to cause harm in the field of consumer credit where the consumer gets the financial benefit up-front.

Sales incentives tend to be rolled out across a firm or industry, increasing the potential for misaligned sales incentives to cause harm on a systemic basis. This is aggravated by the fact that it may take some time for the damage to manifest itself.

It is reasonable to expect there to be a need for a regulatory intervention in order to change sales incentive practices, given that they tend to be firm or industry-wide and deeply rooted in the expectations of staff.

The nature of the impact of sales incentives, the ability of practices in one jurisdiction to influence participants in other jurisdictions and the relative absence of common standards and approaches make this a topic meriting international attention towards common standards and approaches.

Sales incentives are powerful tools for setting culture

Incentives are a powerful tool in setting and embedding the culture of a firm or industry, since (by definition) they signal the behaviour on which the firm or industry places value. In its *Guidelines on Variable Remuneration Arrangements for Sales Staff 2014*, the Central Bank of Ireland noted that sales incentives and variable remuneration practices are key drivers of a firm's culture. The Central Bank of Ireland considered that, in order to foster cultural change away from short-term sales-based goals towards a long term consumer focussed approach, it is paramount for financial services providers to create remuneration structures that will facilitate such a cultural shift. In their 2013 report, *Changing Banking for Good*, the UK Parliamentary Commission on Banking Standards concluded that remuneration structures in the financial sector had incentivised misconduct and excessive risk-taking, and reinforced a culture where poor standards were often considered normal. The report notes that the scale and forms of variable remuneration as they have been paid to staff in banks encouraged a culture of pursuing high risks for short-term gain, with the long-term effects often ignored. A powerful illustration of the impact of poorly designed sales incentives on the culture of a firm and its staff can be seen in Case Study P of this Report.

The negative impact of a misaligned incentive on culture can be aggravated by the fact that, even a firm that recognises the dangers of an incentive may feel obliged to reward their sales force in the manner of their competitors for fear of losing key salespeople or business to their competitors. Hence sales incentivisation is an area where it is reasonable to expect there to be a need for regulatory intervention in order to bring about positive changes that are in the interests of the consumer and, at a wider credit market level, the stability of the financial system as a whole.

Case Study C

Australia: Vehicle Financing – higher interest rate attracts a higher rate of commission

Australian car dealers and finance houses entered into commission arrangements which permit car dealers to set the interest rate payable by the consumer in a vehicle financing contract. If a car dealer enters into a contract with a consumer which attracts a rate of interest higher than that of the base rate agreed with the lender, the car dealer would earn a higher level of commission from the lender.

This practice creates incentives for car dealers to set the interest rate as high as possible to maximise the commission for the car dealer. The cost to the consumer of the vehicle financing is therefore not linked to the risk of default, but to their financial sophistication and capacity to negotiate.

Motor vehicle lenders do not support the practice as it increases the risk of default by borrowers (due to higher repayments being charged). However, individual lenders have difficulty changing these arrangements unilaterally as car dealers would simply direct applications to another lender who continues to offer this method of paying commissions.

Credit has particular characteristics that make the role of sales incentives an important topic

The 2014 FinCoNet Report identified that consumer credit is distinct from other financial products as it relates to the ability of a consumer to repay money to a credit provider, rather than the use of the consumer's existing funds to invest into or purchase a financial product. This unique characteristic can have a significant bearing on the dynamics of the relationship between the financial service provider (or selling intermediary, if different) and the consumer, especially at the point of sale. As alluded to earlier in the context of behavioural studies, a person may be less sceptical about a transaction where (by its nature) they receive value upfront that can be put to immediate use (e.g. to purchase a car or a house), and more optimistic about its future performance for their needs, than may be the case where the value transfer is the other way around, and the customer hands over hard earned money in the hope of a future return.

This characteristic can also lead to parties aligning in their minds incentives that, when one looks over the term of the contract, are in fact misaligned. For example, the ability of a particular intermediary or sales person to 'get' the customer a greater sum on loan to aid the purchase of a more expensive asset, or put in place a credit arrangement that enables the customer to have a product now that they might otherwise have to save for some time to acquire (e.g. in the case of hire purchase for vehicles or household appliances), can be seen by a customer to be aligned with their interests at the point of sale but can of course result ultimately in over-indebtedness.

Case Study D

Canada: Teaser Interest Rates

Consumers with certain credit cards were offered a finance plan through specific merchants allowing them to purchase a product from that merchant at a much lower interest rate than that of the standard rate of interest on the credit card for a specified period of time. Financial service providers were incentivised to offer the 'teaser rate' to encourage consumers to use their credit cards. Merchants were incentivised to offer the finance plan as it encouraged consumers to purchase products there and then in order to avail of the lower interest rate. The Canadian regulator found that the banks offering this facility were not making clear disclosure to consumers that if the full amount of the credit extended under the finance plan is not repaid within a specific period of time, normal credit card rates interest rates are applied to the outstanding balance. Consumers might have based their decision to purchase goods under the finance plan on being offered a lower interest rate, but could have ended up paying a higher interest rate on some of the balance.

The Canadian regulator released a decision about these financing plans emphasising that financial institutions must fully disclose financing plans terms and conditions, and must do so in the manner required by the Cost of Borrowing Regulations.

Case Study E

Macedonia: **Timing of Teaser Rates**

Banks time the promotion of credit cards to coincide with periods when consumers spend more money. Interest free periods for a number of months or lower introductory interest rates for a specified period may be offered before the summer holiday period for example. Banks will also offer personal loans at this time with discounts of up to 50% on the interest rate for a specified period of time. While consumers do receive the benefit of cheaper credit for a time, they may be influenced to take out a loan that they weren't planning to because of the promotional rate and incur costs they might not have planned to incur.

Misaligned incentives can evolve into the causes of systemic risk

The impact of sales incentives on responsible lending is also an important area of focus in the context of financial stability. This is because sales incentive arrangements tend to be rolled out firm-wide (or at least across a product line) and may even be a systemic feature within a domestic market or internationally. Consequently, where an incentive arrangement is put in place which promotes poor sales behaviour, this behaviour can be expected to become widespread across the firm (in the case of a firm-specific arrangement) or the market (in the case of an incentive that is common in the market). Moreover, given the long term nature of many credit contracts and the tendency to treat the early signs of arrears as idiosyncratic to the borrower(s) defaulting, the impact of sales incentives may go unrecognised for some time.

The potential for misaligned incentives to contribute to widespread negative results is to be seen in the part they played in the recent global financial crisis. Large losses in the US residential subprime mortgage market, that became apparent shortly after house prices began to decline in mid-2007, were one of the most prominent triggers of that crisis. In September 2010, the Chairman of the Board of Governors of the Federal Reserve System, Ben S. Bernanke remarked that '…*the expanded use of [the originate-to-distribute*[17] *banking model] to finance subprime mortgages through securitisation was mismanaged at several points, including the initial underwriting, which deteriorated markedly in part because of*

17 The originate-to-distribute model breaks down the process of credit extension into components or stages – from origination to financing and to the post-financing monitoring of the borrower's ability to repay

incentive schemes that effectively rewarded originators for the quantity rather than the quality of the mortgages extended.'[18]

An international approach is required

In many jurisdictions, credit is available from foreign lenders as well as domestic ones. In 2012, an IMF study on bank ownership for the period 1995 to 2009 found that the market share of foreign banks during this period averaged 20% in OECD countries and 50% elsewhere[19]. Inevitably therefore, sales incentivisation practices in one jurisdiction could be expected to put pressure on other jurisdictions to follow suit and it may be difficult if not impossible for a regulator in a jurisdiction to influence the incentive arrangements of firms operating into its jurisdiction from overseas. This has implications for the supervision of cross-border sales practices and how best these can be mitigated.

This, together with the scope for poor behaviour caused by misaligned incentives to evolve into systemic practices, makes this a topic meriting international attention and common minimum standards and supervisory approaches

18 September 2010 Testimony of the Chairman of the Board of Governors of the Federal Reserve System, Ben S. Bernanke to the Financial Crisis Inquiry Commission, Washington, D.C

19 IMF Working Paper: Foreign Banks: Trends, Impact and Financial Stability prepared by Stijn Claessens and Neeltje van Horen1 January 2012

Case Study F

The Netherlands: Cross-border payday lending

Payday lending is available in many jurisdictions at very high interest rates with lenders focussing on consumers who require instant capital at the end of the month. In the Netherlands, a case was identified where the payday lender required the consumer to provide a guarantee prior to advancing the credit and allowed the consumer to buy off the guarantee in order to receive the credit sooner. This case shows that the consumer focus can be on receiving the credit, rather than assessing what it will cost them in total. This type of situation can cause particularly serious detriment to financially vulnerable consumers.

The Netherlands Regulator managed to resolve this issue (domestically) and there are no longer payday lenders active using this cost structure. In addition, the Regulator prevented two payday lenders from providing services in the Netherlands, and also imposed fines on these lenders. However, some providers are still actively offering services to consumers in the Netherlands from their base in other European countries, through the use of websites.

This case illustrates the difficulties facing jurisdictions when trying to address a consumer detriment in isolation. A joined up approach between regulatory authorities is required across jurisdictions to ensure that the efforts of one jurisdiction in identifying and eliminating practices that cause consumer detriment are not lost due to the practices re-emerging through cross-border channels. This is especially so in an era of increased focus on eliminating barriers to cross-border services and consumer access to services via the internet.

Chapter 5: Types of Sales Incentives that can cause Consumer Detriment

Key Points

The most common financial sales incentives observed by respondents to the Survey were based on firm, divisional/department or individual performance.

Responses to the Survey displayed somewhat greater knowledge of arrangements for lenders own staff than those between lenders and intermediaries.

The design of the product itself and how it is marketed to consumers may also comprise sales incentives which could be detrimental to consumers' best interests.

The Survey highlighted instances of promotional gifts for credit products, in particular where the borrower does not necessarily have to draw down credit at the time of entering into the facility (e.g. credit cards).

In order for a regulatory response to the role of sales incentives and responsible lending to be comprehensive, it must encapsulate all of these elements: financial incentives, non-financial incentives, incentives by product design and promotional incentives to consumers.

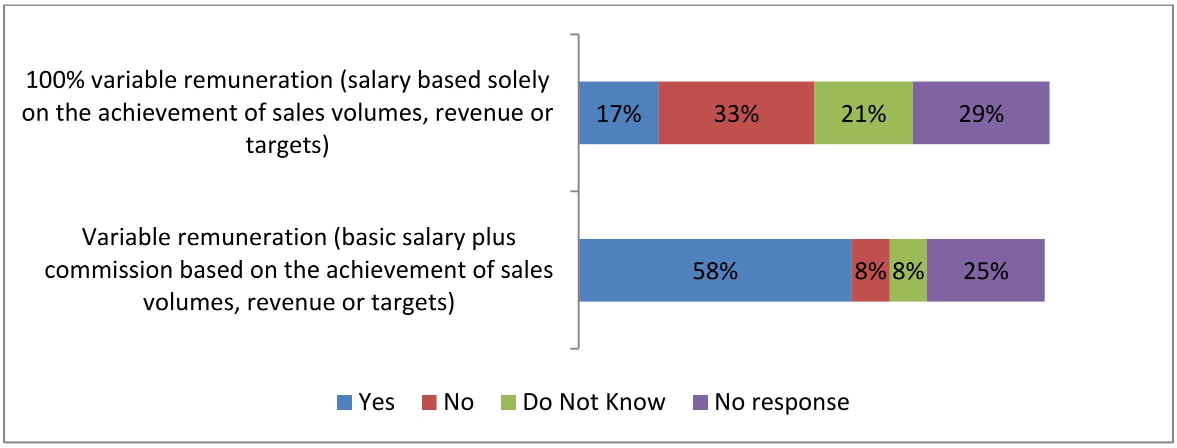
Remuneration Structures

In the Survey, respondent regulators were asked to select from a list the type of criteria observed in their jurisdiction that would have to be met to activate the release of a reward to the direct sales force or intermediary upon the sale of a consumer credit product. The Survey also sought data on the type of sales incentive structures in place for direct and third party intermediary channels of distribution. The remuneration structure is generally recognised as a key source of conflicts of interest between sales forces and consumers and is typically the starting point for any regulatory consideration of sales incentives. Schemes based on the volume of loans sold, either as a goal to get a commission or as a variable part of the remuneration, are particularly targeted both in terms of rules and supervisory focus. So, for example, in covering conflicts of interest, G20/OECD High Level Principle 6 focuses on the remuneration structure for staff and while the phrase 'remuneration' is not restricted necessarily to 'financial/pay' remuneration, the requirement that the 'remuneration' structure should be disclosed seems to indicate a focus on pay (which lends itself to disclosure) over other financial types of incentive (such as promotion criteria/prospects which may not lend themselves so easily to disclosure).

Lender Sales Staff Remuneration ('Financial Incentives')

Table 2: Type of remuneration structures paid by lenders to own staff

(This graph reflects the responses received to a request to select the type of remuneration structure observed by respondent authorities offered by lenders to own staff)



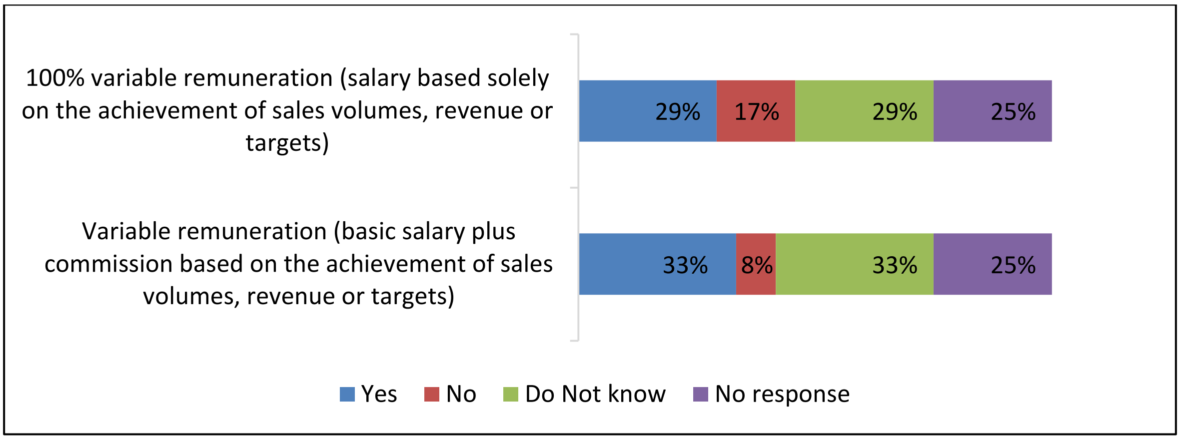
In Indonesia (see Case Study B), many credit institutions outsource the sale of their credit products to third party service providers. The sales force receives a small salary and incentive remuneration is paid only when the sales force exceed a minimum monetary target of the value of loans provided for the period. Accordingly, the sales force is incentivised to try to lend larger loan amounts in order to earn commission. Otherwise, without the commission, the sales provider will only receive a relatively small fixed salary.

In the Slovak Republic (see Case Study A), it was identified that mortgage intermediaries who often took a fee for their services from the consumer, would recommend the mortgage product which generated the most commission for them, rather than more cost effective products which may have been better suited to the needs of the consumer.

Remuneration of third party intermediaries that distribute a lender's products and do not provide independent advice

Table 3: Type of remuneration structures paid by lenders to third party intermediaries that do not provide independent advice

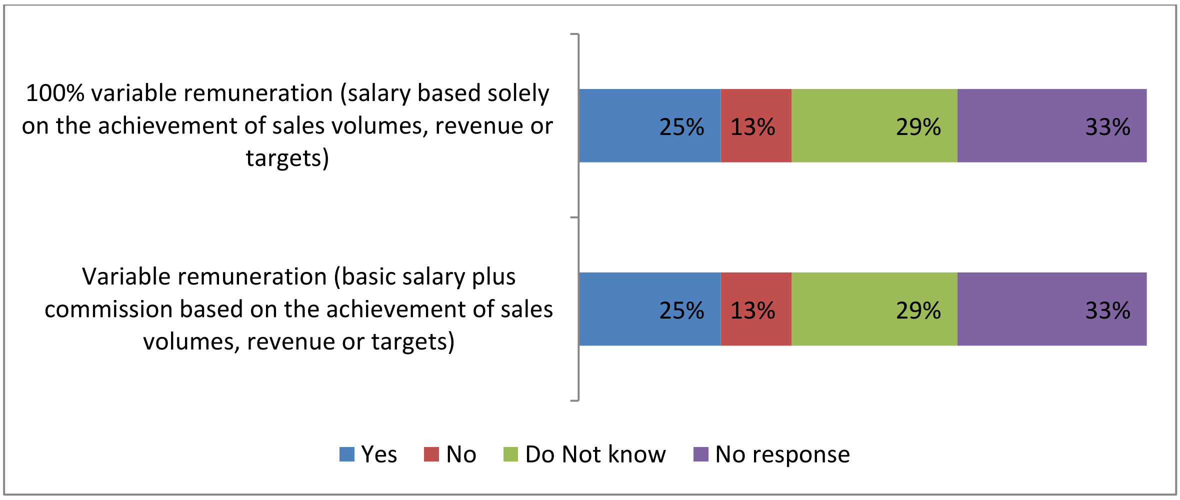
(This graph reflects the responses received to a request to select the type of remuneration structure observed by respondent authorities offered by lenders to third party intermediaries who distribute a lender's product but do not provide independent advice)



Remuneration of third party intermediaries that distribute a lender's products and provide independent advice

Table 4: Type of remuneration structures paid by lenders to third party intermediaries that provide independent advice

(This graph reflects the responses received to a request to select the type of remuneration structure observed by respondent authorities offered by lenders to third party intermediaries who distribute a lender's product and provide independent advice)



These tables highlight that where the distribution channel is more closely linked to the lender (i.e., direct sales staff or third party intermediaries that do not provide independent advice) the most common remuneration structure observed is one of variable remuneration consisting of a basic amount topped up by payments based on the achievement of sales volumes, revenue or targets. Also, the 100% variable remuneration structure based solely on the achievement of sales volumes, revenue or targets observed by respondent authorities is marginally more common in the case of intermediaries distributing lenders' products and which do not provide independent advice.

Case Study G

Brazil: Payroll Lending

Payroll lending is a popular form of credit in Brazil, particularly amongst pensioners, due to lower interest rates compared with other forms of credit. Repayments are made by deducting instalments directly from the salaries of employees of Governmental entities and from the National Pension Fund.

Payroll -deducted personal loans are usually long-term (up to 96 months) and repayment instalments can be as high as 35% of total wage/pension. They are low credit risk products for financial institutions which use agent networks in order to sell this kind of loan to their customers. Agents are commissioned upon loan release. It was observed that the design of the remuneration scheme for agents generates several negative issues, which may result in consumer detriment, such as: (1) harassment of pensioners/employees to take out new loans or refinance their already existing loans; (2) an increase in unnecessary household indebtedness; (3) churn increase as agents try to keep their clients by switching financial institutions in order to increase their commissions, even when there is no change in terms of interest rates in the new financial institution.

In this regard, the National Monetary Council (CMN) updated regulations to implement some new rules, the objective of which is to place controls on the remuneration paid to agents who provide services on behalf of financial institutions, including the reception and forwarding of loans and leasing proposals. Specifically, it was decided that:

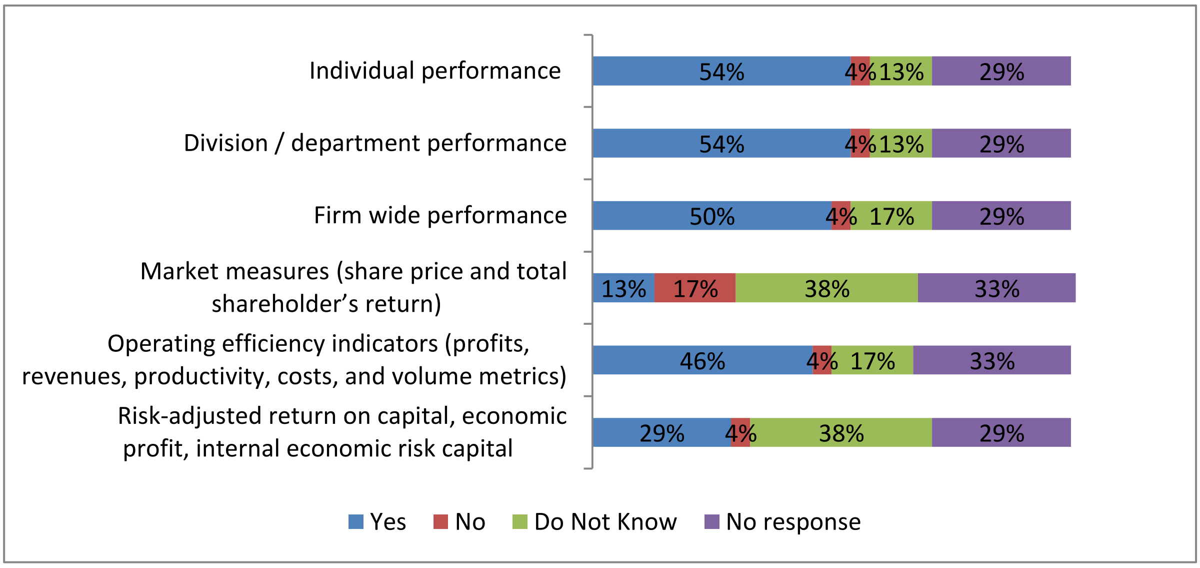
(i) As a general rule, the maximum remuneration paid upfront is limited to 6% of the amount loaned. In cases where a loan is being switched from other credit institutions, that value is limited to 3% of the amount loaned;

(ii) The remaining remuneration is paid on a pro rata basis over the term of the contract, with a condition that, in case of early liquidation, the remaining remuneration must be waived.

Criteria upon which payment of incentives to lender's own staff are based

Table 5: Variable remuneration criteria

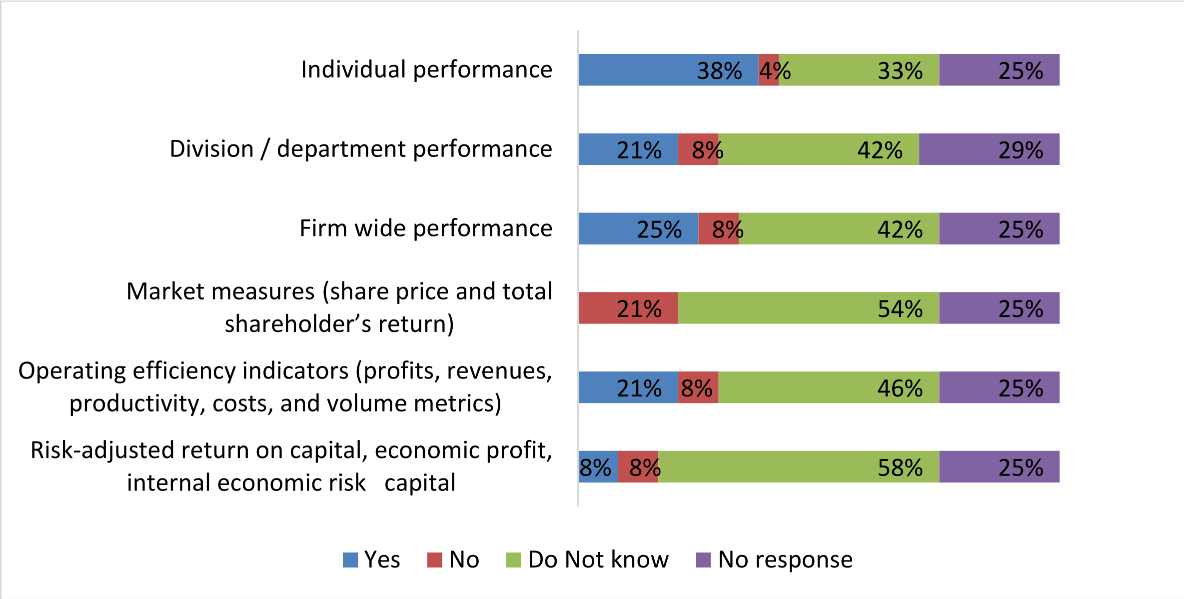
(This graph reflects the responses received to a request to select the criteria upon which lenders base the payment of incentives to own staff as observed by respondent authorities)



Criteria upon which payment of incentives to third party intermediaries that distribute a lender's product but do not provide independent advice are based

Table 6: Variable remuneration criteria

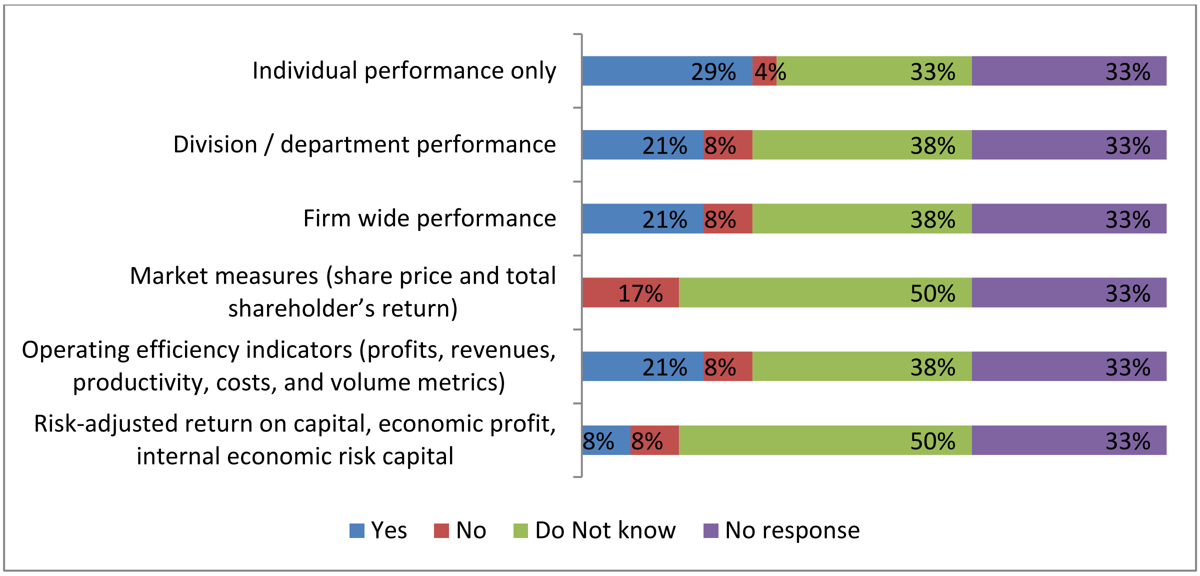
(This graph reflects the responses received to a request to select the criteria upon which lenders base the payment of incentives to intermediaries that distribute a lender's product but do not provide independent advice as observed by respondent authorities)



Criteria upon which payment of incentives to third party intermediaries that distribute a lender's products and provide independent advice are based

Table 7: Variable remuneration criteria

(This graph reflects the responses received to a request to select the criteria upon which lenders base the payment of incentives to intermediaries that distribute a lender's product and provide independent advice as observed by respondent authorities)



These tables indicate an information gap amongst the respondent authorities on the triggers for payment of remuneration by lenders to intermediaries compared to the payment of remuneration by lenders to their own staff. It is likely that the reason behind the information gap is that the regulatory focus is generally on lenders over and above intermediaries, noting also that a number of the respondent regulatory authorities do not currently regulate the credit intermediary sector. Nevertheless, these findings may be indicative of a relative lack of knowledge and/or scrutiny of how lenders remunerate intermediaries compared to the knowledge and/or scrutiny of how lenders remunerate their own staff.

Where information on remuneration triggers is available, the results reflect a clear predominance amongst variable remuneration structures that remuneration is based primarily on individual performance. Following closely is firm wide/division performance and operating efficiency indicators.

Case Study H

Ireland: Variable Remuneration Arrangements – findings from inspection of financial service providers' remuneration structures

Over the course of an 18 month period, the Central Bank of Ireland conducted a themed review of the variable remuneration arrangements in place for direct sales staff in the banking, insurance and investment sectors.

Most of the firms reviewed recognised the importance of properly incentivising staff to sell suitable products. However, firms did not consider the structure of their variable remuneration arrangements to be inherently risky even though each scheme reviewed had a substantial focus on the achievement of sales volumes or revenues in order to determine variable remuneration. Thus each scheme carried the potential to encourage poor sales behaviours in sales staff, as quality measures were not formally linked to unlocking incentives in any meaningful capacity.

Some of the key findings of the review in Ireland support the results reported by respondent authorities in response to the questions in the Survey on variable remuneration triggers above, i.e., that triggers for variable remuneration are based primarily on individual performance followed closely by firm wide/division performance and operating efficiency indicators, as follows:

(a) A high percentage of variable remuneration was paid based on the achievement of sales volumes, revenue or targets. Targets were set based on the needs of the firm or individual seller,

(b) Focus on quantity v quality – insufficient emphasis on linking quality measures and behaviours to unlocking incentives,

(c) Widespread use of risky features such as 'accelerators', sales targets and thresholds, inappropriate product bias and multiple incentives paid for the same sale,

(d) Widespread use of targets and thresholds to measure and unlock variable incentives, whether based on an individual's performance or on a collective basis, for example, bank branches, where incentives are earned on an 'all or nothing' basis.

'Non-financial' incentives

Properly designed, non-financial rewards may be seen as a way to relieve the financial pressure from staff and prevent unsuitable products being sold to consumers on the basis of high variable remuneration due to sellers. On the other hand, if the applicable regulatory regime itself focuses on financial rewards, a move to non-financial rewards can be a means to evade the objective of the regulatory regime in promoting consumer protection. In this manner, non-financial incentives can drive staff to behave in a manner that is not in a consumer's best interests in a way that is less visible to the regulator than financial incentives (and indeed may be less immediately visible to the staff member or intermediary). For example, the G20/OECD High Level Principle 6 on Responsible Business Conduct of Financial Services Providers and their Authorised Agents is not restricted necessarily to 'financial/pay' remuneration.

If a holistic approach is not taken to this topic, firms may react to a restriction in one area (e.g. bonuses) by incentivising the same behaviour through other means. Undue pressure on staff due to non-financial incentives can also increase the risk of mis-selling, and do so in a manner that is more insidious and, perhaps, less apparent to the regulator than financial incentives. Indeed, non-financial incentives could increase risks due to the downside experienced by the member of staff from failing to meet sales targets. Ultimately, staff who fail to meet sales targets could face disciplinary action or dismissal – losing their entire income.

Case Study I

Ireland: Non-financial rewards built into remuneration scheme

The Central Bank of Ireland's themed inspection on variable remuneration structures for direct sales staff, leading to its 2014 Guidelines, found that there are inherent risks in variable remuneration structures including risks arising from non-financial incentives. The Central Bank of Ireland's Guidelines on Variable Remuneration Arrangements for Sales Staff noted that the use of non-financial incentives such as subsidised trips, promotion opportunity, titles such as 'Top Seller', the distribution of league tables and targeted product campaigns to promote, reward or incentivise staff may encourage poor sales behaviours and possible consumer detriment if the performance metrics are based on the achievement of sales volumes/revenue generation only.

The role of performance management

The *FCA 2015 Finalised guidance 15/10: Risks to customers from performance management at firms – Thematic review and guidance for firms*[20] highlighted the need to ensure that progress with financial incentive structures for frontline staff is not undermined by poor performance management systems which can lead to undue pressure for staff to sell products. In Which? Magazine's 2015 survey of frontline bank staff, many respondents reported that while performance reviews are supposed to look at general performance, the conversation invariably focuses on sales, with a significant number claiming that the practice of naming and shaming poor performers is present in their branch. As such, it is clear that removing sales targets alone will not reduce the risk of mis-selling if the performance management practices place disproportionate amounts of pressure on sales staff.

In 2014, Consumers International also made a number of policy recommendations to both regulatory authorities and lenders to help reduce risks for consumers from performance management schemes. Consumers International's 2014 report recommended that national regulators conduct detailed thematic reviews to assess the risks of sales incentives and performance management schemes in operation for frontline staff, starting with retail banks and then widening out this work to other financial institutions. It also recommended that all banks reform formal and informal sales incentives and performance management schemes for frontline staff to prioritise meeting the needs of customers, providing suitable advice and promoting customer service. Consumers International highlighted that performance management used in a way which would put staff under (implicit or explicit) pressure to improve their ranking by selling more products would not remove the sales-based approach of the customer relationship. It reported that risks still remain, even if sales incentive schemes have been reformed, if employees who fail to meet sales targets could be subject to formal or informal disciplinary action. These may be called 'performance management', 'performance improvement' plans or 'coaching'. These arrangements pose a particular risk when, if sales performance does not improve, staff could face demotion or dismissal.

[19] http://www.fca.org.uk/your-fca/documents/finalised-guidance/fg15-10

The criteria on which staff are promoted or celebrated within an organisation (which can be taken to be an indicator of likely progression within the organisation) is also therefore a form of incentive which can be a powerful signal to staff as to how to behave. Indeed, the prospect of additional remuneration on promotion is a significant *financial* incentive, making the approach to promotion a necessary aspect to any comprehensive view of incentives and their impact on behaviour. The basis for staff to be made redundant, for contracts not to be renewed or for probation not to be cleared are, correspondingly, indicators of under-performance that may act as an incentive to (for example) be amongst those making the most sales even where there is no financial incentive to make those sales. For example, in Spain, the existence of 'negative incentives' have been observed, where sales staff who do not reach their objectives may not be promoted or may not have their salary increased.

Case Study J

UK: FCA 2015 Guidance

The FCA's *Finalised guidance 15/10: Risks to customers from performance management at firms – Thematic review and guidance for firms*, found that the following examples of poor performance management practices were putting undue pressure on staff:

Frequent conference calls (or similar) where staff are required to explain in front of peers why cumulative targets are not being met or to 'pledge' improved results

Managers using individual sales results to influence other decisions, for example, if and when annual leave can be taken and which staff have access to development opportunities

Sales results are the main consideration when assessing staff for promotion and other forms of recognition, without sufficient consideration of other factors like consumer outcomes

Written policies indicate a supportive approach to underperformance against sales objectives but the culture of management is to rule by fear and use threats of disciplinary action

The FCA concluded that:

- Despite the benefits of good performance management, there will always be an inherent risk that poorly executed performance management can encourage or drive mis-selling because of pressure to meet individual targets, and/or corporate plan objectives, and

- Firms need to manage this risk and should pay particular attention to identifying poor practices that may create an undue level of pressure on staff, which is likely to further increase the risk of mis-selling. Undue pressure can arise when the behaviour of individual managers or senior managers goes well beyond the boundaries of what would be considered reasonable by rational observers.

Similarly, the Central Bank of Ireland's 2014 Guidelines identified a risk between ineffective performance management systems and their link to the awarding of sales incentives. While performance management systems, such as a balanced scorecard type approach, may include an element of sales quality metrics as a performance objective, if the majority of other metrics used are based on sales or financial objectives, the effectiveness of the sales quality element can be diminished leading to little or no impact on sales behaviours. Where firms do not formally link performance systems with qualitative metrics and no other deterrents to poor sales related behaviours are utilised, an increased risk of poor practices exists. The 2014 Guidelines set out that, if linking the determination or unlocking of variable remuneration to a formal performance appraisal/performance management process, firms must ensure that the process is robust, including the use of a sufficient weight of qualitative objectives in the process in order to have a meaningful impact on the payment or deduction of variable remuneration. For example, if multiple sections are used a poor score/failure in the qualitative objectives should sufficiently reduce or remove entitlement to variable remuneration that may be earned on objectives not related to quality. Furthermore, it is questionable if someone obtaining a low overall performance appraisal score should receive any element of variable remuneration as a reward, particularly when related to sales.

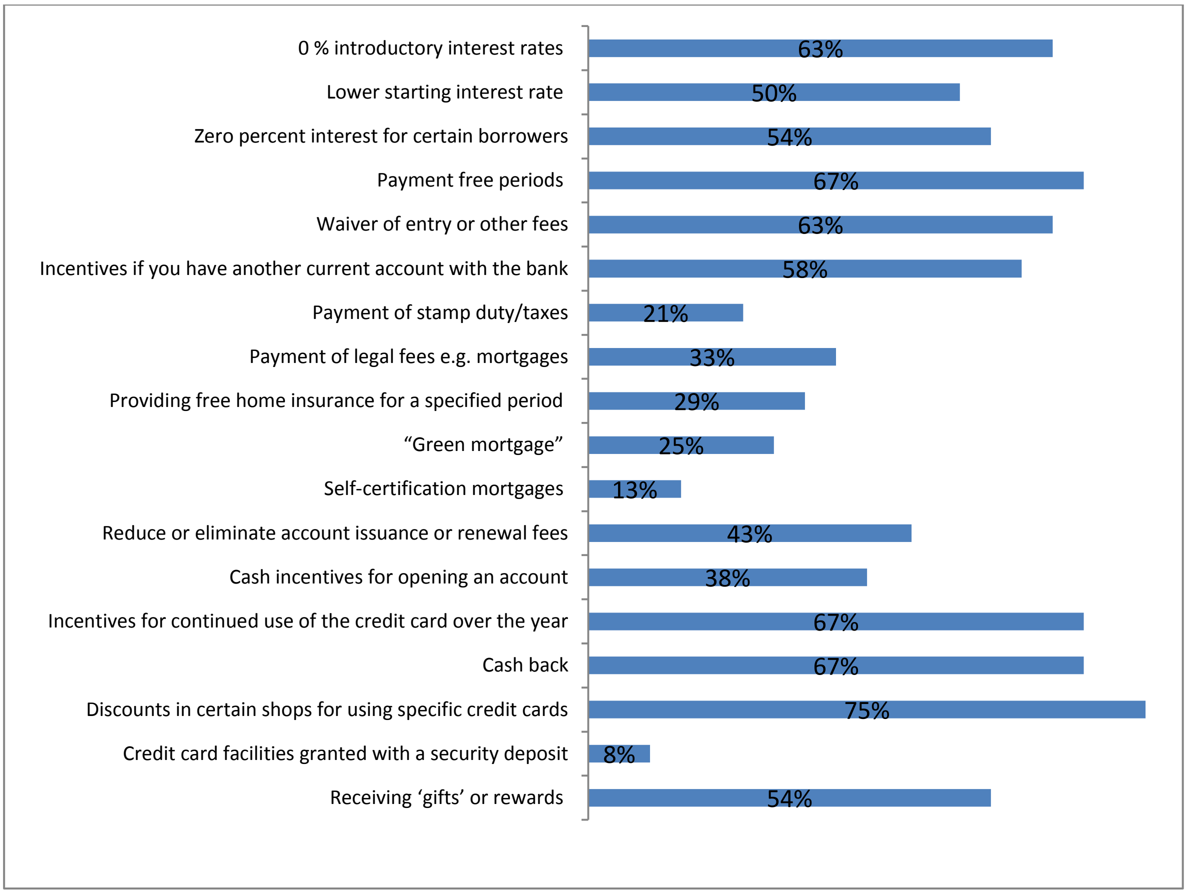
Therefore, a performance management approach to managing sales quality behaviours should not be considered to be an efficient tool unless a sufficient weight is placed on sales quality measures in order to have a meaningful impact on the reduction, suspension or removal of incentives and thus to encourage the right behaviours in the objectives set for relevant staff involved in the sales process that may ultimately lead to unlocking all or part of variable remuneration.

Incentives to the Consumer

The Survey also sought information on the incentives regulators observe being offered to consumers to encourage them to borrow or borrow via a specific product.

Table 8: Types of incentives offered by lenders to encourage consumers to purchase credit products

(This graph reflects the responses received to a request to select from a list of incentives those which are offered in the respondent's jurisdiction to consumers when purchasing credit products)



It is interesting to note that the level of knowledge of incentives offered to consumers by lenders and/or intermediaries seems to be higher amongst respondent authorities than knowledge on incentives offered to the sales staff and intermediaries. Also, the table above highlights a range of incentives offered to consumers by the credit card market, with discounts offered in certain shops for using specific credit cards being the most popular incentive observed. The prevalence of such incentives could indicate a targeted focus by lenders on the credit card market. This could reflect the relative simplicity of arranging the product (and by extension low cost), the relatively high interest rates attaching to credit cards and the relative ease by which consumers can spend the credit amount available on the card.

The Survey responses also listed a number of other concrete examples of incentives to consumers, including:

Jurisdiction	**Product**	**Incentive**
Japan	Personal Loan	Consumers who borrow above a specific amount are entered into a lottery draw for a prize.
Netherlands	Customer Payment Card	Increased spending limits during holiday seasons
Saudi Arabia	Vehicle Financing	Deferred payment periods, free fuel and maintenance for 1 year or free insurance for a specified period.
Slovak Republic	Personal Loan	Deferred payment periods of up to 3 months at particular times of the year such as Christmas.
Turkey	Credit Card	Consumers will receive free air miles if they spend a selected amount on their credit card.

It is interesting to note that these and Case Study K include cases where the credit does not require to be drawn down right away, such as credit cards, and cases where the sales person is not a financial sales person but principally the seller of a non-financial product for which the credit can be arranged (e.g. a car dealer).

There is also an interesting cluster of cases in the Survey responses where the promotional offering is very immediate and finite, perhaps leading the consumer to take out the credit product in the belief at the time that they will never actually use it, thereby resulting in a non-conscious decision to enter into a credit facility. Such a scenario is similar to the behavioural economic theory of “affect heuristic” mentioned earlier, where consumer’s base decisions on the emotions that they feel at the time an offer is being presented to them. In the case of promotional offerings they trigger a positive emotion in the consumer thus influencing the decision making process. People are more likely to judge the risks as low and the benefits high if their feelings are positive.

Case Study K

Canada: Free Merchandising aimed at students

Credit cards are marketed to students, usually from kiosks with charismatic sales staff encouraging students to apply for credit cards by offering rewards points which can be exchanged for tickets to movies, sporting events and travel, merchandise, or university branded clothing. Often, before they can receive the points, merchandise, or clothing, students need to make a purchase with their new credit card and then keep the card open for a period of time (90 days, for example).

Other examples of credit products that offer an immediate value to the consumer and which the consumer might believe he/she will not have to avail of, are finance/hire purchase type products. A consumer who cannot afford a product at a present point in time might be attracted by credit products that offer a payment deferral period.

Case Study L

Ireland: Deferred payment options

Some retailers offer a deferred payment scheme. The option presented to the consumer is that they pay a nominal amount initially to obtain their goods and pay the full amount by the expiry of a specified period of time (e.g. 6 months). No interest is charged for this credit facility provided the goods are paid for within the specified time period. However, if the consumer fails to pay the full cost of the goods within the specified time period, they must then enter into an arrangement to pay for the goods through interest bearing monthly instalments.

This type of credit product takes advantage of a consumer’s desire to have instant access to and use of a product for which they do not currently have the means to pay. If the consumer fails to pay the full cost of the product by the end of the specified timeframe, the interest bearing monthly instalment arrangement is triggered.

Another category of concern observed is where the promotional offering is complex and to be gained later, such as travel points or other loyalty arrangements. Here, there is scope for the consumer to overestimate the value to them of the promotional offering and/or for the financial institution to ensure that any perceived saving by the borrower is clawed back over time through how the incentive is calculated.

Case Study M

Australia: Frequent Flyer points earned by signing up for credit card

Frequent flyer points were offered as an incentive to consumers who signed up for credit cards in Australia. The consumer was in fact paying more by way of annual fee on the credit card than the frequent flyer points gained by signing up to the card were worth (a net detriment to the consumer). The fee also continued on an annual basis.

Finally, the manner in which an incentive targeted at consumers is presented should be balanced and not overshadow the information about the credit product being promoted. A number of the respondents to the Survey highlighted the importance of rules around how financial products are advertised when incentives are being offered to consumers.

Case Study N

Latvia: Unbalanced focus on promotional incentives designed to attract consumers to sign up for a credit product

A firm released a media campaign promoting an incentive to consumers to sign up for a credit product, emphasising the additional benefits which had no relevance to the lending service (the incentive was a chance to win material prizes such as a new car, television, money etc.). However, Latvia's National Normative Act prohibits an advertisement offering a consumer credit that influences or may influence a decision of a consumer on entering into a credit agreement by additionally offering to acquire goods or receive services or other advantages, if they have no direct relation to the use of the credit, or their receipt has or may have a significant meaning in the taking of the decision by the consumer on entering into the credit agreement. The firm in question was fined for this activity.

Public Consultation Topic 1

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of how a primary regulator might effectively include the impact of sales incentives in their approach to responsible lending. This will include the manner and extent to which this oversight should cover:

(i) various types of consumer credit products and sales channels;,
(ii) promotional incentives to consumers; and
(iii) whether incentives to sales staff and/or consumers encourage lending practices that are not in the best interests of the individual consumer or consumers generally.

CHAPTER 6: THE NATURE OF THE DETRIMENT THAT CAN BE CAUSED

Key Points

The Survey results highlight that poorly designed incentives can result in unsuitable credit sales. This can include cases where a salesperson is encouraged to cross-sell, resulting in the purchaser of a product (financial or non-financial) borrowing money which they did not set out to borrow and which may be unsuitable.

Perhaps the most insidious and fundamental detriment caused by poorly designed sales incentives, over and above the direct detriment of a consumer being mis-sold a loan, is the extent to which poorly designed sales incentives erode the consumer focus of the culture of a firm, sector or industry. This makes poorly designed sales incentives a powerful obstacle to the advancement of consumer protection generally. In particular, sales incentives can be an obstacle to other consumer protection requirements, such as advisory or disclosure standards, being effective in practice to ensure that consumers' best interests are protected.

The Survey showed limited cases where respondent authorities observed incentives put in place by firms that were potentially beneficial or perceived to be beneficial to the consumer.

The Survey sought case studies from respondent authorities illustrating when the incentive structure for the sale of a consumer credit product lead to potential or perceived consumer detriment. This included a request for case studies where the incentive structure for the cross-selling of a consumer credit product lead to potential or perceived consumer detriment in relation to the credit element of the transaction, as well as instances where the design of a credit product or the selling/marketing strategy for a credit product influenced or could have influenced the consumer's decision.

The Survey also sought case studies where the incentive structure was potentially beneficial or perceived to be beneficial to the consumer.

In this Chapter, we have sought to group these findings from the Survey into a narrative identifying the key categories of consumer detriment caused by poorly designed sales incentives.

Unsuitable Lending

A credit product may be considered unsuitable for a consumer when the consumer did not really need or want the credit, or where less costly credit options may have been available to the consumer, or where the consumer is not able to afford the credit that has been extended. The purpose of this Report is not to analyse such events in detail, as this would be better done as part of an overall review of these matters, which may occur by virtue of a number of causes.

However, it is clear from the case studies that poorly designed sales incentives can contribute to unsuitable sales. Promotions targeted at the consumer, such as free merchandising for students in Canada, supported by incentives for the sales person, are one example of how consumers are persuaded to take out a contract for a credit product that they don't necessarily need or want. The case in Australia whereby car dealers are incentivised to arrange credit at a higher rate of interest can result in borrowers incurring unnecessary cost. Several case studies such as that of unsuitable sales by mortgage intermediaries in the Slovak Republic or the marketing of credit in Indonesia illustrate the particular danger of sales incentives driving lenders to lend more money to consumers than they can repay.

Unsuitable Cross Selling

Respondents to the Survey also cited cases where the incentive structure for the cross selling of a consumer credit product led to potential or perceived consumer detriment in relation to that credit product[21]. 'Cross selling' for this purpose includes where another financial product is sold in conjunction with a loan, whether the consumer is obliged to accept the other product (tying) or it is an optional extra. However, it can also include a scenario where the person selling the credit is also selling the asset for which the consumer requires the credit (e.g. a car dealer arranging finance).

Personal contract plans (PCPs) are an example of finance contracts sold by credit intermediaries whose primary function is to sell products to consumers, such as cars. PCPs are designed to be attractive to consumers by offering low monthly repayments (effectively only covering the cost of depreciation of the car) at an interest rate that is generally lower than those attaching to personal loans. However, similar in many ways to a hire purchase plan, these low monthly repayments are only made possible by the requirement to pay a large balloon payment at the end of the specified period. Prospective car buyers could be enticed into signing up to such contracts due to the low monthly repayments without considering the consequences of entering into such a contract should they find themselves in financial difficulty down the line (such as the fact that the car can be repossessed as the consumer does not own it until the final balloon payment is paid) or may have to roll the contract over with another PCP with the same dealer to avoid having to make the balloon payment.

---

21 This Report is not concerned with the mis-selling or potential mis-selling of non-credit products (e.g. insurance) in conjunction with a credit sale. It is only concerned with cases where the detriment to the consumer arose from the credit leg of the transaction.

Case Study O

Saudi Arabia: Loans for investments

Consumers were encouraged by banks to take out personal loans to invest in listed securities through brokerage firms operating in capital markets who were also associated undertakings of the bank providing the loans. However, the borrowers had not been informed of the risks involved in capital market financings and following the collapse of the capital market, they suffered great losses.

Public Consultation Topic 2

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of the manner and extent to which primary regulators' oversight of sales incentives and responsible lending should include oversight of incentives comprised in cross-selling practices.

Eroding a Consumer-Focussed Culture

In this Report we have already noted that the manner in which staff are remunerated and otherwise rewarded (e.g. through promotion) or penalised (e.g. within a performance management framework) by definition identifies the behaviour the firm/industry sector values from its staff and agents. Perhaps the most insidious and fundamental detriment caused by poorly designed incentives therefore, over and above the direct detriment to an individual customer of being mis-sold a loan, is the extent to which poorly designed incentives erode the level of consumer focus in the culture of the financial service provider to which they relate, or indeed, the industry as a whole. This includes the ability for poorly designed incentives to reinforce continued poor product design, oversight and sales practices. Hence, in addition to the specific signal of value sent to the individual salesperson when they are rewarded for a sale, sales incentives also send more subliminal signals to staff as a whole which can be seen to override other explicit signals which do not attract financial or other valuable rewards (such as compliance training, regulatory discipline - including fines – or corporate cultural statements or initiatives to promote fair and proper treatment of consumers, ethics etc.).

In a report[22] of the progress the UK's retail banks were making to change their culture, stakeholders often noted a disconnect between how top management view their organisation's culture, and the experience of front-line employees. The report recommended that to get a meaningful measure of culture requires regulators to examine how culture looks at the coal face. This should involve speaking to and surveying frontline staff and reviewing whistleblowing arrangements to explore whether a sales-based culture exists within the bank.

Case Study P

UK: Enforcement case against misselling by Credit Intermediary

While many of the case studies in the Survey results identify cultural issues, one particular case study provided by the UK was a very good example of the impact that a poorly designed incentive scheme can create for consumers and the firm who developed it. This case illustrates how the incentive creates detriment and how the culture of the firm is reinforced by the incentive scheme.

The firm in question specialised in re-mortgages and associated insurance, and their primary business was advising and arranging mortgage contracts. A substantial number of the Firm's customers were 'sub-prime'.

The firm was found by the UK regulator to have a culture that focussed on maximising income by actively placing sales advisers under significant pressure to meet sales targets, and a remuneration and incentive structure that was designed to incentivise and motivate sales advisers through a combination of commission, bonuses and incentives to sell products that were profitable for the firm with no regard to whether those products were suitable for customers. There was also an assumptive approach to the cross selling of payment protection insurance ('**PPI'**), in particular, an assumption that single premium PPI would be suitable for all customers without regard to individual customers' demands and needs.

Mortgages

The firm instructed its advisers to focus on recommending mortgages from a specific mortgage lender ('**the Preferred Lender'**). During the relevant period, the firm placed 42% of its mortgage applications with the Preferred Lender. This was more than three and a half times the amount of business put with any

22 New City Agenda 2014, A report on the culture of British retail banking, http://newcityagenda.co.uk/wp-content/uploads/2014/11/Online-version.pdf

other lender. The Preferred Lender had granted a significant loan facility to the firm, and the firm received financial benefit from this arrangement (such as offsetting repayments against commission due). Throughout the relevant period, the firm instructed its advisers to consider mortgages offered by the Preferred Lender before any other mortgage provider.

The advisers were required to choose between the mortgage products offered by members of the Firm's mortgage lender panel. In order to assist the advisers to select the mortgage product that was most suitable for a customer's particular circumstances, the advisers had access to a software programme that allowed them to compare, contrast and rank the mortgage products offered by the panel members. However, the firm's senior management instructed its advisers to consider speed of service over and above all other factors, including cost, in order to ensure that the Preferred Lender would appear to be the most suitable mortgage product. The firm knew that if advisers followed the instruction to record speed of service as a customer's priority, it would be likely that the software program would show a mortgage from the Preferred Lender to be the most suitable mortgage.

Advisers were separated into two competing teams: one reporting to the Chairman and the other to the Chief Executive Officer. The firm fostered an atmosphere of intense competition between the two teams. This competition was based around which team would make the most sales in each month. The firm's senior management monitored advisers' sales figures daily. Advisers who failed to meet target rates would be criticised by the firm's senior management, while advisers who placed mortgages with the 'Preferred Lender' would receive additional praise in emails sent to them by the firm's senior management.

PPI

The firm designed its remuneration scheme to incentivise advisers to sell single premium PPI over and above regular premium PPI, by ensuring that advisers received more commission for single premium PPI sales. Advisers received approximately three times more commission for selling single premium PPI than regular premium PPI. The cost of a single premium PPI was added to the principal amount borrowed by the customer as part of the mortgage and would have interest charged on it over the term of the mortgage.

In the relevant period, advisers' average commission for selling single premium PPI was approximately £250. The average commission advisers received for selling regular premium PPI was approximately £80. The firm also ran a number of stand-alone incentive schemes. For example, a prize of £1,000 cash for the greatest number of single premium PPI policies sold, and one-off incentives designed to reward sales of single premium PPI and the Preferred Lender.

Findings of the UK Regulator

The UK Regulator undertook a file review which established that in a significant majority of cases the firm failed to ensure that a recommendation was affordable or, in the case of a re-mortgage, whether a customer was better off as a result of the re-mortgage. Further, in a substantial number of cases insufficient evidence had been gathered to demonstrate why the Preferred Lender's product had been recommended as being the most suitable. The firm's failings are particularly serious in view of the fact that a substantial number of the firm's customers were sub-prime in that they had impaired credit histories, restricted access to credit and limited financial means. The financial impact on such customers of unsuitable advice was likely to be significant.

In designing and implementing the remuneration structure, the firm failed to give any consideration to whether the bias inherent within the remuneration scheme would result in advisers recommending Preferred Lender mortgage products and single premium PPI even when it was not suitable for the customer. The firm failed to recognise the risks generated by its remuneration structure and, consequently, failed to take action to mitigate it. For example, the firm failed to give any consideration to whether sales of single premium PPI and/or mortgages with the Preferred Lender should be subject to monitoring over and above that applied to other products. In addition, the firm failed to consider whether the risks generated by its remuneration structure could be mitigated by including factors relating to an assessment of the quality of advice within the remuneration scheme.

The firm also failed to take any steps to consider the extent to which there was any conflict between the higher commission available to advisers for the sale of single premium PPI and the cheaper cost of regular premium PPI for customers. The firm did not put in place systems or controls to monitor and mitigate this risk; on the contrary, the remuneration scheme was deliberately structured to ensure that single premium PPI was recommended by advisers.

The emphasis on sales generally, and sales of specific products generated by the remuneration structure was reinforced by the prevailing culture at the firm. The firm gave no recognition for the quality of the advice that each team gave to customers. The firm's focus on sales was reflected in the type of management information provided to its senior management which focussed on completion figures, daily revenue generated by fees and the number of applications received compared to the previous month.

In its 2014 Guidelines, the Central Bank of Ireland also placed importance on the role of sales incentives in setting culture. The Guidelines set out what it considers to be best practice for firms in aligning their variable remuneration arrangements with a positive cultural focus on needs based selling. The recommendation is that firms should shift the focus away from setting and driving incentives based on sales volumes or revenues and replace such measurements with quality focussed metrics such as individual customer service scores, compliance performance, quality of sales conducted, upheld complaints, training and development performance. The Central Bank of Ireland placed responsibility with those charged with the governance of the firm for ensuring that the design of incentive schemes incorporates these measures to ensure that sufficient weighting is given to quality assurance factors in order to prioritise good sales practices. Practices identified which can erode a consumer focussed culture included:

- widespread use of revenue/sales volume targets and thresholds to measure and unlock variable incentives, whether based on an individual's performance or on a collective basis where incentives are earned on an 'all or nothing' basis;
- while some firms did build quality assurance measures into their incentive schemes, none were used effectively or had a sufficient weight in order to have consistent, meaningful impact on the payment (or deduction) of variable incentives; and
- substantial focus on the short term achievement of sales

Public Consultation Topic 3

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of the manner and extent to which primary regulators' oversight of responsible lending should include consideration of the role that sales incentives play in setting the culture within firms, including the extent to which incentive arrangements which are poorly designed from the perspective of protecting the best interests of consumers can act as an obstacle to other consumer protection measures, such as advisory or disclosure requirements.

Conflicts of interest between the lender and its sales force

The Survey indicates that incentives are also an important area for a lender to focus on if it wishes to lend in a responsible manner which is ultimately in its interest (given that irresponsible lending can be expected to lead to arrears and losses for the lender). It is important to note therefore that, where a salesperson is paid variable remuneration based on sales, a conflict of interest arises not just between the interests of the lender and the best interests of the borrower but also between the interests of the lender (who bears the credit risk) and the salesperson (who typically gets paid regardless of whether or not the loan performs). This can be especially pronounced where the salesperson is an intermediary, physically and organisationally remote from the lender and its commercial interests.

Australia's experience with car dealers in Case Study C illustrates this point. Car dealers have commission arrangements with lenders in which the car dealers can set the interest rate payable by the consumer and earn a higher commission the higher the interest rate above a base rate agreed to with the lender. This practice creates incentives for car dealers to set the interest rate as high as possible to maximise commission payments. The cost to the consumer is a higher cost of borrowing and the cost to the lender is higher risk of default by the consumer.

Of course, many jurisdictions might consider this risk mitigated on the basis that it is ultimately the responsibility of the lender to ensure adequate creditworthiness checks are conducted, and there are several examples of specific provisions of this nature presently in operation or due to come into operation shortly. For example, the Central Bank of Ireland's Consumer Protection Code[23], requires that where the services of an intermediary are availed of, the intermediary must submit information about the consumer to the relevant lender to enable the lender to carry out an affordability assessment on that consumer. In addition, the European Union's Mortgage Credit Directive[24] makes provision for credit intermediaries or appointed representatives to submit the necessary information obtained from the consumer to the relevant creditor to enable the creditworthiness assessment to be carried out. Nevertheless, the findings of the Survey illustrate that firms need to support their stated compliance and responsible lending objectives with properly designed incentive schemes aligned to those compliance and responsible lending objectives, and not merely to sales.

Influencing bad behaviours across a firm, sector or industry

Where sales incentives are poorly designed, there is significant scope for malpractice arising as a result to be widespread across the firm, sector or the industry as a whole (nationally and/or internationally). Firm-wide malpractice was evidenced in the previously mentioned UK Case Study P. It was found that '*The culture at the Firm was focussed, not on the fair treatment of*

23 The Consumer Protection Code is the Central Bank of Ireland set of regulations on conduct of business for financial services providers. See http://www.centralbank.ie/CONSUMER/CPC/Pages/home1.aspx

24 See http://ec.europa.eu/finance/finservices-retail/credit/mortgage/index_en.htm

customers, but on maximising income by actively placing advisers under significant pressure to make as many sales as possible. The Firm's remuneration scheme was weighted in favour of lenders and products that benefited the Firm, not on whether those lenders and products were appropriate for individual customers. In designing the remuneration structure and creating and maintaining a culture focussed on selling, the Firm failed to pay due regard to the interests of its customers…"

The Payment Protection Insurance (PPI) investigation in the UK is an example of how detriment from misaligned incentives can spread across an industry, resulting in that case in 20.5billion pounds sterling of redress being paid to consumers who were mis-sold PPI, as at June 2015. In a smaller market, similar practices in Ireland resulted in the largest instance redress case in the Irish financial services market. In some cases for single premium PPI, the consumer detriment also arose in the credit leg, where the cost of the PPI premium was added to the sum borrowed by the consumer (resulting in consumers taking out a loan to pay for an insurance policy that was of no value to them).

Incentives potentially beneficial or perceived to be beneficial to the consumer

In principle, a properly designed sales incentive should encourage responsible business conduct, fair treatment of consumers and avoid conflicts of interest. However, few if any of the case studies provided in response to the Survey's request for examples of 'good' incentives could be said to fall properly into this category, with examples being primarily cases of qualitative measures added to counterbalance the conflict of interest created in the first place by the fact that the salesperson is remunerated or otherwise rewarded based on volume of sales. For example, the thematic review in Ireland on sales incentives identified that some credit institutions incorporated the use of measures that would disincentivise poor credit sales (e.g. clawback). However, while the deterrents existed, they were not consistently applied, therefore benefits for the consumer were not realised. However, it is noted that if the measures had been properly applied, they had potential to both create benefit for the consumer and to enhance the culture of the firm.

Case Study Q

France: Incentives based on customer satisfaction that lead to benefits for consumers

The Survey response for France noted a scheme where the variable part of staff remuneration depends on the customer satisfaction, which is assessed on the basis of an annual rating given by customers. The scheme was applied across a broad range of credit products. The scheme incentivises staff to develop and maintain good relationships with consumers and to behave in a fair and honest manner when dealing with consumers.

One topic of interest under this heading (but one which this Report does not consider) is whether it is more beneficial for credit intermediaries to be remunerated by lenders (e.g. via commission) or by charging the consumer a fee for providing advice (independent of whether a loan is sold). On the one hand, payment by the consumer should in principle avoid the conflict of interest created by an advisor being remunerated by the lender (assuming of course the intermediary is not also receiving some remuneration or incentive from the lender). On the other hand, some would argue that the need to pay such a fee for advice would be so expensive as to act as a barrier to consumers accessing credit (or at least advised sales of credit). This, it is argued, could result in financial exclusion (especially for smaller sums of credit) and/or consumers accessing credit on a non-advised basis which may not be in their interests.

Promotional incentives which are targeted at consumers can be beneficial to consumers but only if, at the time that the incentive is being promoted, the consumer has a need for credit and can afford to repay it. However, consumers need to be astute enough to evaluate the product on which the incentive is based and compare it with others to ensure that it is the most suitable, affordable and cost effective product for their situation to ensure that they really are benefitting.

CHAPTER 7: SUPERVISORY TOOLS, TECHNIQUES AND REQUIREMENTS

Key Points

The majority of respondents surveyed replied that they did not have requirements of the nature listed in the Survey or did not know if such restrictions are in place. Only one of the respondents replied that they had a ban on such sales incentives.

In terms of legal character, while many national measures will no doubt have a legal framework underpinning them, the specific national measures themselves seem to more typically be of the nature of guidance rather than binding legal obligations.

Credit providers use a variety of sales channels, indicating that requirements on sales incentives are most effective where they apply across channels consistently, to avoid gaming (by either firms or sales personnel). This does not preclude a regulator choosing to focus its supervisory intervention on one sales channel or product range at a point in time, and the lessons learned can be applied across all sales channels.

Properly designed sales incentive frameworks require robust and comprehensive oversight and governance arrangements. Such governance, systems and controls could form a part of a firm's product oversight and governance arrangements and be subject to internal audit review. However, this should not dilute the responsibility of the board.

Proper support and priority for control functions whose input goes towards any qualitative scoring affecting staff incentives is essential, together with on-going monitoring and correction mechanisms.

It is imperative that senior management take ownership of the role of sales incentives in their firm and communicate clearly and regularly with staff the good behaviour that is sought to be incentivised, with demonstrable examples of poor behaviour being addressed and good behaviour being rewarded.

Disclosure alone would only appear to be acceptable as a means of mitigating conflicts of interest that cannot be avoided by the firm. Since conflicts arising from sales incentive arrangements put in place by the firm are, almost by definition, avoidable by the firm, reliance on disclosure alone as a mitigant in respect of incentives should be exceptional. Proper design of the sales incentive arrangement backed up by proper governance oversight, systems and controls would appear to be a more effective mitigant. This does not of course preclude disclosure as an additional measure.

The tools adopted by supervisors can include 'hard' legal powers to investigate, intervene and penalise but also 'soft' supervisory engagements to enhance sales incentive arrangements and encourage firms to lead positive innovations in this emerging field.

The nature and extent of restrictions in place

The Survey sought information from respondents on how their regime regulates the payment of salary, commissions and other incentives to sales staff, across both direct sales channels and the use of intermediaries (including those providing independent advice). In the majority of cases, the respondents replied that they did not have requirements of the nature listed in the Survey in place or did not know if such restrictions are in place. Only one of the jurisdictions, the Netherlands, responded that they had a ban on such sales incentives. Before the ban on commission, inducement rules were applicable to financial services providers. The inducement rules were intended to remove excessive incentives that may be generated by commissions. The Netherlands wished to facilitate a change in culture with financial service providers, a change from product sales to advice in the best interests of the customer. An evaluation of the inducement rules clarified that the rules were helpful but not strong enough to stop the wrong incentives and did not lead to the desired change in culture. Thus, it was decided to introduce a ban on commissions.

On the other hand, jurisdictions may have legislative proposals underway relevant to this topic which are not yet in force (such as the provisions of the Mortgage Credit Directive in the European Union, for example) and the results must be read with the caveat that such restrictions may be in place at an industry level and so do not form part of regulatory requirements.

Table 9: Regulatory restrictions in place by respondent jurisdictions on the payment of incentives by lenders to own staff

(This graph reflects the responses received to a request to select from a list the type of regulatory restrictions imposed by respondent jurisdictions on the payment of salary/commissions and other incentives by lenders to their own staff)

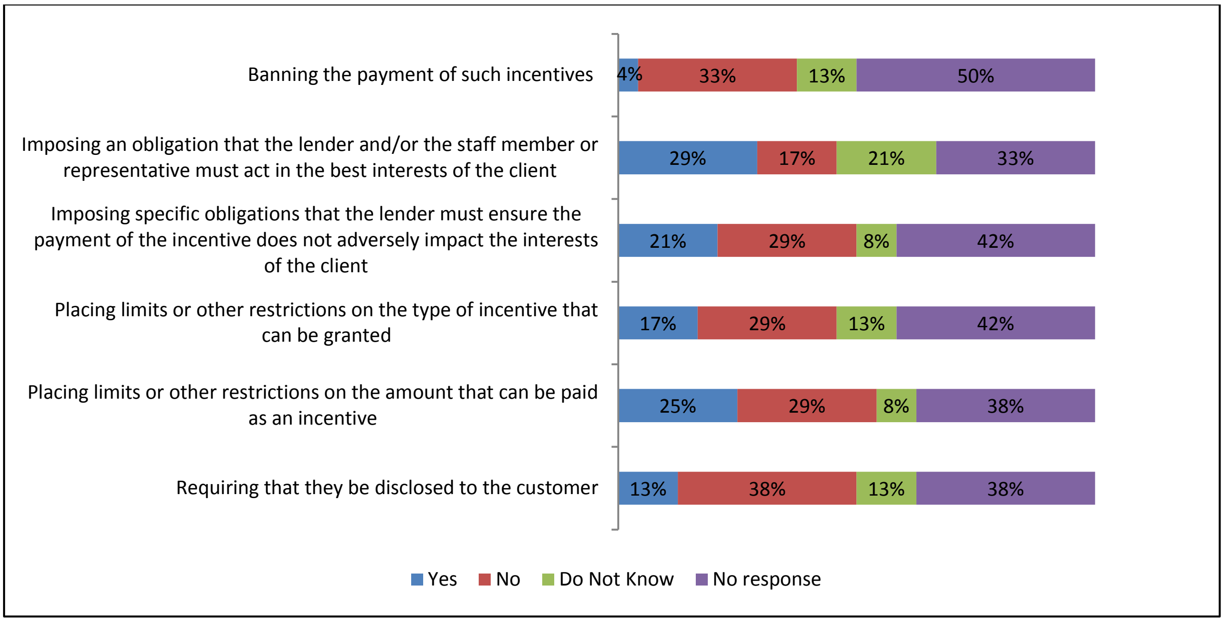


Table 10: Regulatory restrictions in place by respondent jurisdictions on the payment of commissions and other incentives by lenders to third party intermediaries that distribute a lender's product but do not provide independent advice

(This graph reflects the responses received to a request to select from a list the type of regulatory restrictions imposed by respondent jurisdictions on the payment of commissions and other incentives by lenders to third party intermediaries that distribute a lender's product but do not provide independent advice)

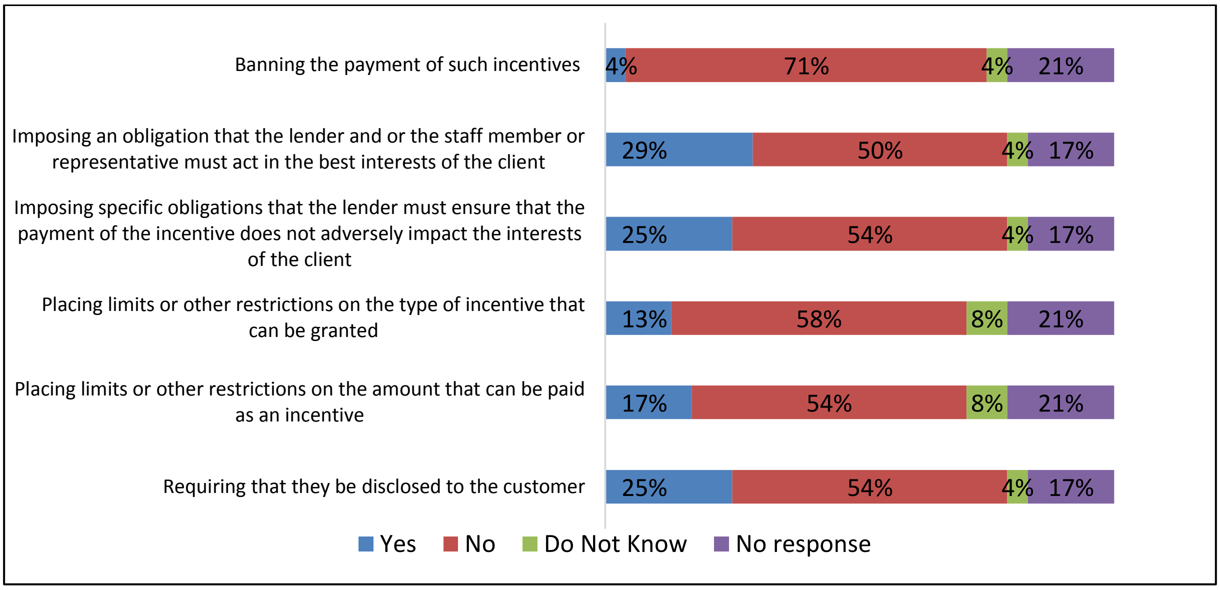
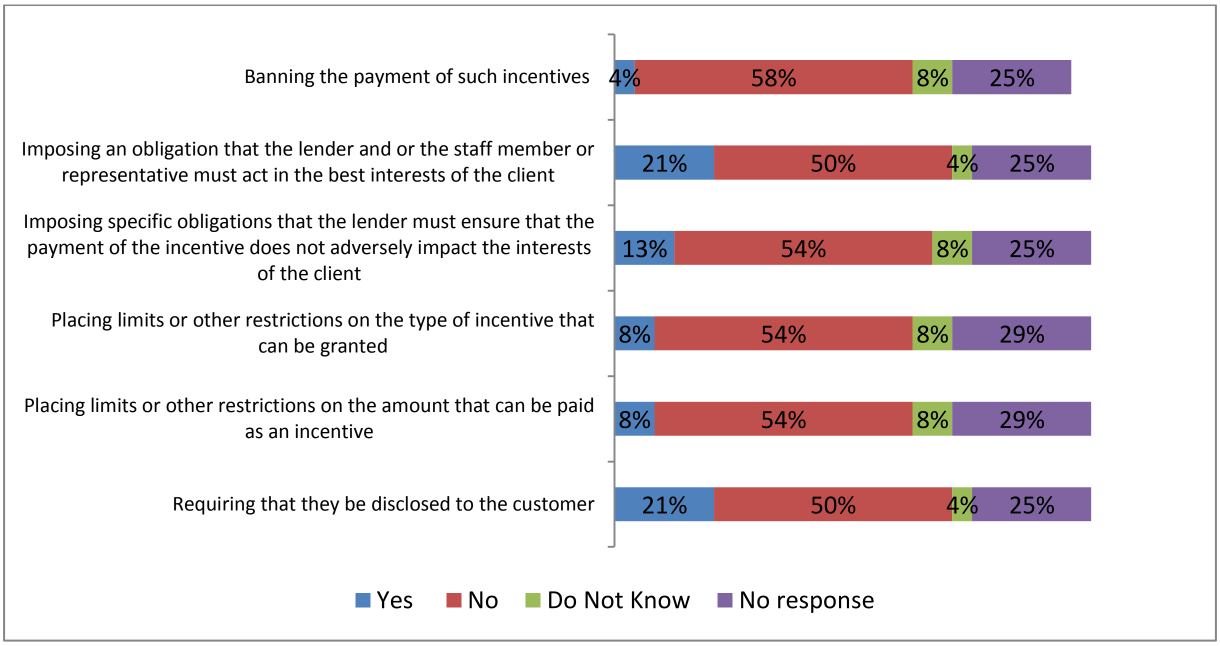


Table 11: Regulatory restrictions in place by respondent jurisdictions on the payment of commissions and other incentives by lenders to third party intermediaries that distribute a lender's product and provide independent advice

(This graph reflects the responses received to a request to select from a list the type of regulatory restrictions imposed by respondent jurisdictions on the payment of commissions and other incentives by lenders to third party intermediaries that distribute a lender's product and provide independent advice)



These graphs can be read to indicate that the majority of respondent jurisdictions have few regulatory restrictions in place on incentive arrangements between lenders and intermediaries. The nature of some of the Survey responses of some regulatory authorities suggest instead that the focus may be on ensuring that the remuneration structures in place for senior management and executives (rather than sales staff) promote appropriate risk avoidance behaviour and are aligned to the long-term objectives of the firm. The graphical finding may also reflect the fact that a number of the respondent authorities do not currently regulate credit intermediaries, although it should be noted on the other hand that the questions posed related to incentives of those intermediaries by lenders.

These results indicate that payment of incentives to direct sales staff attracts a marginally higher level of regulatory intervention with slight increases being reported on the number of respondent jurisdictions imposing restrictions on such payments compared to restrictions on payments to intermediaries. However, with figures of between 10% and 29% of respondents confirming that they have restrictions in place of some nature listed in the Survey, albeit across the range of restrictions listed, based on these figures above, the regulatory response to attempt to address the negative impact of incentives on sales behaviour is low. There is a predominance in the Survey findings of requirements of a qualitative nature, whereby firms or staff are required to act in the best interests of the client or that the lender must ensure that the payment of the incentive does not adversely impact the interests of the client. This can be interpreted to indicate an approach to this topic which is to deal with manifest harms arising from poorly designed incentives after the event by reference to such general provisions, rather than by prescribing specific restrictions or requirements on incentive structures ex ante.

It is surprising perhaps that there was not a higher score on requirements that the payment of an incentive be disclosed to the consumer, given that of the suite of requirements observed in the responses, this would appear to be the measure placing the least burden on firms in terms of restriction to their business and the most straightforward for firms to comply with.

Legal Character of Restrictions

The Survey did not delve into specific frameworks to establish their legal character relative to one another. In general, however, specific measures on sales incentives schemes and responsible lending appear to be organised at national level, although there are examples of specific international requirements such as the provisions on remuneration in the European Union's Mortgage Credit Directive (‘**MCD’**). The MCD recognises that the appropriate management of conflicts of interest including those arising from remuneration is a key aspect of ensuring consumer confidence. The MCD provides rules for staff remuneration, with the aim of limiting mis-selling practices and of ensuring that the way in which staff are remunerated does not impede compliance with the obligation to take account of the interests of the consumer. EU Member States must ensure that, when establishing and applying remuneration policies for staff responsible for the assessment of creditworthiness, creditors comply with the following principles in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities:

a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the creditor;

b) the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the creditor, and incorporates measures to avoid conflicts of interest, in particular by providing that remuneration is not contingent on the number or proportion of applications accepted. (Article 7(3), MCD)

EU Member States must also ensure that where creditors, credit intermediaries or appointed representatives provide advisory services the remuneration structure of the staff involved does not prejudice their ability to act in the consumer's best interest and in particular is not contingent on sales targets. In order to achieve that goal Member States may in addition ban commissions paid by the creditor to the credit intermediary (Article 7(4), MCD)

It can also be gleaned that, although supervisory initiatives might be positioned against the backdrop of legislative requirements on conflicts of interest or treating the consumer fairly, examples cited in the case study responses to the Survey indicate that specific measures imposed on firms tend to be in the form of guidance or guidelines from supervisors (FSA, 2013; CBI, 2014), rather than hard and fast legislative requirements. Strictly speaking therefore, the application of these specific measures can be described as 'voluntary', even if in practice the vast majority of regulated institutions agree to apply those measures and, if they do not, national regulators may have a range of regulatory tools available to insist on compliance.

Public Consultation Topic 4

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of the respective merits of general obligations on a firm to act in the best interests of the consumer and more detailed requirements on sales incentives and how these might inform the appropriate conduct supervision approach.

Scope

Credit providers use a wide diversity of channels to reach out to consumers and sell their products, with or without intermediaries, through tied agents or independent brokers, through face-to-face contacts and remotely. They also sometimes combine several platforms for the sale of a product to a given consumer. The consumer is not always aware of the precise position which his or her seller has in the distribution chain, and how he or she is connected to the provider of the credit product. Looking at the matter from the perspective of protecting the consumer's best interests therefore, as with other consumer protection matters, the supervision of sales incentives should be looked at across all sales channels, be they direct or indirect. This is all the more important in the area of sales incentives, where restrictions by the regulator in one sales channel can be expected to give rise to the incentivisation practice concerned migrating to another sales channel. Moreover, perhaps uniquely, in the case of sales incentives this migration might occur not only at the instigation of the firm but equally at the instigation of its sales staff. For example, sales staff might choose to leave the employment of the firm and become intermediaries because of a perception of remuneration on sales commission being more lucrative as a result of remuneration restrictions on employee sales staff. In this respect, all those involved in selling credit products, including advisers, whatever their status (be they employees, intermediary firms and their staff, tied agents, firms with appointed representatives), should be subject to the rules for the prevention and management of conflicts of interest and the supervision of sales incentives and their impact on consumers' best interests.

It seems important therefore that rules to protect consumers from potential detriment due to sales incentives transcend the architecture of any given distribution network and apply consistently to financial institutions' overall sales forces, from the frontline sales officers of the institution to the intermediaries distributing the institution's products[25]. In Ireland, for example, the Consumer Protection Code includes explicit conflict of interest provisions on both the remuneration by a regulated entity of its employees[26] and the payment by a product producer of commission to an intermediary[27].

This does not of course mean that the supervisory approach should not be to target one area and then apply the lessons from that work to other areas. For example, although the Central Bank of Ireland's thematic review of 2013-2014 leading to its Guidelines across the insurance, investment and banking (including credit) sectors focused on direct sales by employees and tied agents (as did the resulting Guidelines), non-tied intermediaries (including mortgage intermediaries[28]) were notified that the Central Bank of Ireland also expected them to review their remuneration arrangements in the light of the Guidelines[29].

It is also important, for the reasons above, that any regulatory focus on incentives is targeted not just at any pre-conceived notions of what might influence behaviour (such as pay), but also at what the strategy of incentivisation of the firm is and what behaviour it is

---

[25] For example, the Decision of the National Bank of Croatia on employee remuneration only applies to credit institutions' staff (CNB, 2013)

[26] Consumer Protection Code 2012, Provision 3.32

[27] Consumer Protection Code 2012, Provision 3.31

[28] Other intermediaries of consumer credit are not regulated in Ireland by the Central Bank of Ireland. Rather, they are regulated as 'credit intermediaries' by another agency, the Competition and Consumer Protection Commission.

[29] See Central Bank of Ireland "Intermediary Times", February 2015 edition

looking to reward and thereby incentivise. Evidence of elements of such an approach can be found in the UK FCA's 2015 *Finalised Guidance 15/10: Risks to customers from performance management at firms – Thematic review and guidance for firms.* In another example, post the recent financial crisis, Irish banks did not award bonuses. However, there were collective branch and credit targets. It was common for banks to impose collective targets on branches whereby high minimum threshold performance levels were required in order to unlock incentives for staff on an all or nothing basis. Within these targets, product bias may occur, whereby higher weights were applied to some products over others. Target credit/lending levels were also set in respect of products such as mortgages, loans and credit cards. As with the collective branch targets, product bias may occur to meet this target. Higher weights are applied to some products over others, e.g., higher weights applied to mortgage lending over other types of credit. Such measures pose a risk that staff have a constant focus on sales and may push products to meet these targets in order to unlock the collective incentive for everyone in the branch, whether or not the customer need is met.

Public Consultation Topic 5

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of approaches by which supervision in this field might transcend appropriately the architecture of any given distribution network in order to ensure an appropriately consistent application of regulatory requirements and standards set by the supervisor.

Setting adequate management and oversight measures

Many of the aspects of incentivisation shown through the Survey illustrate the role for proper product oversight and governance in this area, and proper oversight of management practices. Based on the Survey responses, such oversight and governance must, if it is to be effective, also encapsulate how sales staff are incentivised to sell the product, and how consumers are incentivised to purchase it. Properly applied, they should also avoid the emergence of cross-selling incentives which are adverse to the consumer's best interests.

There is also a need for governance arrangements when products are offered to consumers on the back of misleading consumer incentives. Such incentives may appear to the consumer to offer an attractive 'free' benefit when in fact the consumer is effectively charged for the benefit through annual fees and charges for use of the product. As referenced in Case Study M, this was also observed in Australia where credit cards were aligned with airline frequent flyer programs but the annual fee for the card was more than the benefit of the frequent flyer program.

In terms of internal systems and controls, there is a need for greater focus on the management of the inherent risks that arise due to sales incentive schemes. For example, when the FSA initiated its work on financial incentives, the lack of effective systems and controls to adequately manage the risks was identified as one of the major findings of the review (FSA, 2013). This is consistent with the findings of the Central Bank of Ireland's thematic review of sales incentive schemes, which found that there is a risk at senior management/governance level that by incorporating product bias into target setting practices, greater risks can be generated, such as driving the needs of the lender/firm over the need of the consumer.

In a European Union context, there has also been recognition of the need for a response to the gap in product oversight and governance arrangements. This response has culminated in the development of cross-sectoral regulatory approaches to product oversight and governance including a set of Guidelines on Product Oversight and Governance Arrangements for Retail Banking Products developed by the European Banking Authority. These support and build on national product oversight and governance regimes that exist already in a number of EU Members States (e.g. the Netherlands and the UK) and elsewhere.

The European Banking Authority Guidelines are applicable to manufacturers and distributors of retail banking products offered and sold to consumers including retail credit products. The Guidelines require the establishment of product oversight and governance arrangements for both manufacturers and distributors as an integral part of the general organisational requirements linked to internal control systems of firms. They refer to internal processes, functions and strategies aimed at designing products, bringing them to the market, and reviewing them over their life cycle. They establish procedures relevant for ensuring the interests, objectives and characteristics of the target market are met. In particular, the European Banking Authority Guidelines include that product oversight and governance arrangements should aim (i) to ensure that the interests, objectives and characteristics of consumers are taken into account, (ii) to avoid potential consumer detriment and - most importantly in the context of sales incentives - (iii) to minimise conflicts of interest. To that end, the Guidelines provide that a manufacturer's management body should endorse the establishment of the arrangements and subsequent reviews, and that senior management (with support from representatives of the manufacturer's compliance and risk management functions) should be responsible for continued internal compliance with the product oversight and governance arrangements.

Public Consultation Topic 6

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of the manner and extent to which primary regulators' oversight of sales incentives and responsible lending should include an assessment of incentives comprised in how products are designed and targeted at the consumer, as well as the scope and strength of firms' oversight and governance of those arrangements.

Ensuring the responsibility sits with senior management

Given the centrality of incentives to the overall culture of a firm, it seems imperative that governance arrangements clearly place the ultimate responsibility for the content and extent of the variable remuneration arrangements and other sales incentives, and their assessment, with senior management. So, for example, following the Central Bank of Ireland's thematic review of sales incentives:

- the Chairperson of all banks was required to report back to the Central Bank of Ireland confirming that they had undertaken a review of sales incentives and remuneration arrangements within their firms against the Central Bank of Ireland's Guidelines, including sales, management, governance and monitoring, and that relevant changes had been implemented by a specified deadline;
- firm-specific issues identified on inspection were addressed to the Chairperson of the relevant firms; and
- each bank was required have their internal audit function conduct a review of the changes implemented by the bank (which would of course be reported to the Board via their Audit Committee), noting that these audit reports would be used by the Central Bank of Ireland in its follow up work.

The role of penalties and deterrents in an incentive scheme

The design of any incentive scheme should include robust and dissuasive penalties and deterrents. While the Central Bank of Ireland observed the existence of penalties incorporated into incentives schemes when conducting its thematic review of sales incentives, it found that firms did not sufficiently use financial penalties or deterrents, other than the claw back or deduction of initial commission earned, as a threat or mitigant against poor sales related behaviours. It was noted that a 'clawback' function is commonly used to deduct or reduce incentive payments on cancelled or reduced business. However, the level of effectiveness depends on the length of the clawback period and whether the claw back impacts the payment or reduction of all incentives linked to the sale. The use of a claw-back mechanism is considered to be an insufficient deterrent to poor sales related behaviours where it does not reduce or remove all other linked incentive payments, and merely removes commission on a sale that has been refunded or cancelled.

Communicating the objective of the scheme to sales staff

The impact of sales incentives on the culture of the firm has already been noted. It is imperative therefore that good behaviour which a firm seeks to incentivise is clearly communicated to sales staff and others affected by the incentive. This includes explaining the consequences of poor behaviour (e.g. where there are clawbacks and other penalties) and demonstrating that such consequences are a real prospect through robust follow through by the firm's management. This is especially the case where qualitative measures are introduced to counterbalance remuneration for quantity of sales. An energetic and determined campaign is required by senior management to ensure that such qualitative elements are given their proper priority, with real examples apparent to staff where such qualitative elements impacted on remuneration, promotion prospects etc. Consumers International make a number of practical recommendations to lenders in this regard, including ensuring that changes to incentive schemes are part of any cultural change programme and that there are proper whistleblowing arrangements in place for staff concerned about selling pressure on them.

Supporting oversight functions

Where qualitative measures are included in an incentive scheme, it is essential to their success that relevant control staff, such as compliance officers, are given proper senior management profile and support in discharging their role in measuring these qualitative aspects. A well designed incentive scheme should therefore look not just at conflicts of interest for sales staff, but also at avoiding conflicts of interest for other staff within the governance structure. In particular, the incentives for such control staff should be sufficiently independent of the scheme they are monitoring for those staff to have an effective level of independence in discharging their functions.

Monitoring the Scheme

Even assuming a well-designed sales incentive structure is in place, firms must still seek to ensure that their implementation is properly monitored and that poor outcomes are not emerging for consumers as incentive arrangements come to be operated in practice and staff and others become familiar with them (including how they can be gamed).

An effective governance structure should include measures and procedures to adequately and effectively monitor the proper implementation of the incentive scheme, with "alert" systems to detect high-level risk situations and address them appropriately. For example, the FCA found that many firms still need to improve the quality of their incentive related management information systems to help monitor what is being sold and identify individual sales staff who are higher risk (FCA, 2014). Supervisors should have access to this information in order to spot weaknesses as they emerge and challenge the firm to take corrective action.

Regular review and control measures of schemes should be organised along a risk-based approach, taking into account for example the size, complexity, and business strategy of each organization (FSA, 2013).

Public Consultation Topic 7

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of the manner and extent to which primary regulators' oversight of sales incentives should include an assessment of firms' arrangements for monitoring the operation of incentives within their firm in practice, including appropriate alert systems within the firm to detect high risk situations as they emerge and address them appropriately.

The role and effectiveness of disclosure

As noted above, it is perhaps surprising that disclosure requirements scored so low in the Survey amongst the types of requirements and restrictions in place. Requiring that remuneration or other incentive arrangements are disclosed is a simple measure and, done correctly, can be an effective one to raise consumers' awareness of this issue.

Conflicts of interest created by remuneration and incentive arrangements should at a minimum be disclosed to consumers. However, disclosure alone is not an effective mitigant for a poorly designed remuneration arrangement. As much as it might encourage some consumers to question what they are being told, it is difficult for consumers to determine what weight to give to the potential impact of the incentive on the quality of the advice or service they are likely to receive. This can be exacerbated if the type of incentive is widespread amongst the available competing service providers. Research has also indicated that disclosure of conflicts by an advisor or intermediary may in some instances have the perverse effect of increasing the level of trust a consumer places in the advisor or intermediary because they have been so open about their conflict, and give the advisor or intermediary a sense of moral license (having disclosed their conflict) to act in their own interest[30].

On the other hand, where all firms in a market are remunerating their staff in a similar manner, it is of little real benefit for a consumer to have this disclosed to them when they may have no realistic choice but to accept the incentive situation. It is instructive also to note that the G20/OECD High Level Principles state that "*The remuneration structure should be disclosed to customers where appropriate, such as when potential conflicts of interest cannot be managed or avoided*". This too indicates that the most important thing is that sales incentives are designed to encourage responsible conduct and fair treatment of consumers and avoid conflicts of interest. Poor design in an incentive scheme cannot be overcome therefore by disclosure alone. Indeed, one might pose the challenge that, since the lender themselves decides how to remunerate their staff and agents, there should never be a conflict of interest which cannot be 'avoided' by proper design of the incentive.

Public Consultation Topic 8

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of the role and effectiveness of disclosure in this field, including its effect on consumers.

Further work on this topic should also include an analysis of whether or not the potential threats to consumer protection arising from incentives to consumers to purchase credit (e.g. free gifts etc.) outweigh overall the benefits to consumers of such incentives, such that practices of this nature should be restricted. It would be useful

30 Cain, Daylain M., Loewenstein, George and Moore, Don A., 2005, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest* available at http://www.cbdr.cmu.edu/mpapers/cainloewensteinmoore2005.pdf

to develop specific provisions considered necessary to an effective responsible lending regime under this heading (such as a test of scale between the value of the incentive versus cost of credit or a useful disclosure requirement in that regard).

Public Consultation Topic 9

FinCoNet's public consultation paper on Sales Incentives and Responsible Lending will include the topic of the role and effectiveness of disclosure or warnings where a promotional incentive is offered to a consumer which is significantly outweighed by the cost of the credit to the consumer, including in cases where the apparent benefit of the promotional incentive to the consumer is in fact illusory.

Enforcement and supervisory actions

Given past experiences in a number of countries, and the potential harm which poorly designed incentive schemes can cause to consumers, it seems important that, in addition to requiring firms to have properly designed arrangements and governance in place, supervisory and enforcement frameworks offer a credible deterrent against poor practices and the consumer detriment resulting from these practices. Given the subject matter, this should include both 'hard' regulatory powers to investigate, intervene and punish and 'soft' supervisory engagements aimed at enhancing arrangements and incentivising firms to lead positive innovations in this emerging field. In its 2013 Guidance, the FSA indicated for example that it would monitor how firms act on its recommendations, and take action against the worst offenders. It also provided examples of how reward arrangements have featured in a number of previous enforcement cases (FSA, 2013).

CHAPTER 8: CONCLUDING REMARKS

This Report illustrates the importance of considering the role sales incentives play when designing an effective responsible lending regime. It displays a consistency across both the existing material on this topic and the responses to the Survey in the concerns they identify and the case for regulatory oversight. Nevertheless, it seems fair to say that, with notable exceptions, less detailed and specific work appears to have been done on this topic at a supervisory level than in other areas of consumer protection and there is less empirical analysis in this area than is to be found in other fields of analysis in financial services regulation. There also appears to be less of a consensus on the specific mandatory requirements that should form a minimum standard in an effective responsible lending regime or, indeed, whether specific rules are required in this area at all.

By contrast, the findings on lender remuneration practices are strikingly consistent, as are the nature of the issues illustrated by the case studies. Variable remuneration based on firm or individual sales performance was the most common type of sales incentive for staff cited in the Survey. Also, virtually all of the case studies concerning issues arising from sales incentives related to this type of remuneration (in one form or another). Accordingly, the predominant nature of incentives for sales staff appears to be relatively uniform across jurisdictions (at a basic level at least) and the nature of the issues arising from such arrangements are relatively common. This indicates that there is scope for the development of specific requirements on variable remuneration based on sales. This uniformity also indicates that requirements in this area have the potential to make a significant impact on how credit is sold.

The Survey responses indicate that sales incentives for credit products are an area where many jurisdictions do not have specific rules. There appears to be a case, therefore, for an initiative to devise and develop appropriate requirements in this area. It is also interesting to note that, amongst the types of rules in place, the most common rule cited across sales channels is 'placing an obligation on the lender and/or the staff member to act in the best interests of the client'. Given that several of the case studies provided are from jurisdictions where such overarching obligations exist, there appears to be a case to go beyond these overarching obligations and prescribe more specific requirements that might be considered necessary to an effective responsible lending regime. In particular, there appears to be a need to consider the extent to which remuneration should be permitted to vary based on volume of sales and specific controls overseeing and counterbalancing such an arrangement. This is the case given the inevitable conflict of interest such variable remuneration creates and that, unlike many other conflicts of interest, it is the firm itself at a management level that is creating this conflict through the sales incentive arrangements it has put in place. There also appears to be a need to consider how promotional incentives are presented to consumers.

Finally, it is apparent that norms develop in the area of sales incentives across industry sectors, and that the incentive practices of one firm or sector influence the practices in another over time. It is also apparent from the consistency across jurisdictions of incentive practices and cases of concern identified that an international approach is merited, covering all common forms of consumer credit and both financial and non-financial incentives.

For its part, FinCoNet will continue to progress its work towards a public consultation paper on the topics identified in this Report with a view to further promoting sound market conduct and strong consumer protection through the efficient and effective conduct supervision of sales incentives and responsible lending. Through this work, FinCoNet aims to further contribute to the promotion of sound market conduct and enhance consumer protection in the area of sales incentives and responsible lending.

APPENDIX: RESPONDENT AUTHORITIES

JURISDICTION	RESPONDENT AUTHORITY
Australia	Australia Securities and Investments Commission
Austria	Austrian Financial Market Authority
Brazil	Central Bank of Brazil
Bulgaria	Commission for Consumer Protection
Canada	Financial Consumer Agency of Canada
China	The People's Bank of China
Estonia	Estonian Financial Supervision Authority
France	Banque de France
Greece	Bank of Greece
Indonesia	Indonesia Financial Services Authority
Ireland	The Central Bank of Ireland
Japan	Financial Supervisory Authority
Latvia	Financial and Capital Market Commission
Lithuania	Bank of Lithuania
Luxembourg	Commission de Surveillance du Secteur Financier
Macedonia	National Bank of the Republic of Macedonia
Netherlands	The Netherlands Authority for the Financial Markets
Portugal	Central Bank of Portugal
Saudi Arabia	Saudi Arabian Monetary Agency
Slovak Republic	National Bank of Slovakia
South Africa	National Credit Regulator
Spain	Central Bank of Spain
Turkey	Türkiye Cumhuriyet Merkez Bankası
United Kingdom	Financial Conduct Authority

GLOSSARY

Acronyms	Meaning
BEUC	European Consumer Organisation
CBI	Central Bank of Ireland
EU	European Union
FCA	Financial Conduct Authority
FinCoNet	International Financial Consumer Protection Organisation
FSA	Financial Services Authority
FSB	Financial Stability Board
G20	Group of 20
OECD	Organisation for Economic Cooperation and Development

LIST OF REFERENCES

Australia Securities and Investments Commission (ASIC), 2012, *Future of Financial Advice (FOFA) reforms* available at http://asic.gov.au/regulatory-resources/financial-services/future-of-financial-advice-reforms/fofa-background-and-implementation/

Berg, Puri and Rocholl 2014, *Loan Officer Incentives, Internal Ratings, and Default Rates*

BEUC, 2011 (BEUC, 2011a), *Financial Supervision in the EU - A consumer perspective* available at http://www.beuc.org/publications/2011-00396-01-e.pdf

BEUC, 2011 (BEUC, 2011b), *Protecting consumer interests in the retail financial services area: need for independent and efficient national supervisors everywhere in the EU* available at http://www.beuc.org/publications/2011-09879-01-e.pdf

Cain, Daylain M., Loewenstein, George and Moore, Don A., 2005, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest* available at http://www.cbdr.cmu.edu/mpapers/cainloewensteinmoore2005.pdf

Central Bank of Ireland (CBI), 2014, *Guidelines on Variable Remuneration Arrangements for Sales Staff*, available at http://www.centralbank.ie/press-area/press-releases/Documents/Guidelines%20on%20Variable%20Remuneration%20Arrangements%20for%20Sales%20Staff%20July%202014.pdf

Central Bank of Ireland, 2012, *Consumer Protection Code* available at http://www.centralbank.ie/regulation/processes/consumer-protection-code/documents/consumer%20protection%20code%202012.pdf

CHOICE, 2015, *Mortgage broker investigation*, available at https://www.choice.com.au/money/property/buying/articles/mortgage-broker-shadow-shop

Claessens, S. and Van Horen, N., 2012, *IMF Working Paper: Foreign Banks: Trends, Impact and Financial Stability* https://www.imf.org/external/pubs/ft/wp/2012/wp1210.pdf

Consumers International (CI), 2013, *Responsible lending: an international landscape* available at http://www.consumersinternational.org/media/1412472/ciresponsiblelending_finalreport_06-11-13.pdf

Consumers International, 2014, *Risky business: The case for reform of sales incentives schemes in banks* available at http://www.consumersinternational.org/media/1529404/sales-incentive-report_riskybusiness_final2_151014.pdfCroatian National Bank, 2013, *Decision on employee remuneration* available at http://www.hnb.hr/propisi/odluke-nadzor-kontrola/2013/eng/e-odluka-o-primicima-radnika.pdf

European Banking Authority, 2015, *Consultation paper – Draft Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services* available at http://www.eba.europa.eu/documents/10180/1317073/EBA-CP-2015-29+%28CP+on+the+GL+Remuneration+of+sales+staff%29.pdf

European Banking Authority, 2015, *Guidelines on sound remuneration policies* available at http://www.eba.europa.eu/documents/10180/1314839/EBA-GL-2015-22+Guidelines+on+Sound+Remuneration+Policies.pdf

European Banking Authority, 2015, *Guidelines on product oversight and governance arrangements for retail banking products* available at http://www.eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf

European Commission, 2009 (European Commission, 2009a), *Communication for the Spring European Council - Driving European recovery, Volume 1* (COM (2009)114), available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009DC0114&from=EN

European Commission, 2009 (European Commission, 2009b), *Summary of responses to the public consultation on responsible lending and borrowing in the EU* available at http://ec.europa.eu/internal_market/finservices-retail/docs/credit/resp_lending/feedback_summary_en.pdf

Europe Economics, 2009 (European Commission, 2009c), *Study (for European Commission's DG Internal Market and Services) on Credit Intermediaries in the Internal Market* available at http://ec.europa.eu/finance/finservices-retail/docs/credit/credit_intermediaries_report_en.pdf

Financial Stability Board (FSB), 2011, *Consumer Finance Protection with Particular Focus on Credit* available at http://www.financialstabilityboard.org/wp-content/uploads/r_111026a.pdf?page_moved=1

Financial Services Authority (FSA), 2013, *Guidance on risks to customers from financial incentives* available at http://www.fca.org.uk/static/fca/documents/finalised-guidance/fsa-fg13-01.pdf

Financial Conduct Authority (FCA), 2014, *Risks to customers from financial incentives – an update*, available at https://www.fca.org.uk/news/tr14-4-risks-to-customers-from-financial-incentives

Financial Conduct Authority (FCA), 2015, *Finalised guidance 15/10: Risks to customers from performance management at firms – Thematic review and guidance for firms* (FG15/10). http://www.fca.org.uk/news/fg15-10-risks-to-customers-from-performance-management-at-firms

FinCoNet, 2014, *Responsible lending – A review of supervisory tools for suitable lending to consumers practices* available at http://www.finconet.org/FinCoNet-Responsible-Lending-2014.pdf

G20/OECD, 2011, *High-Level Principles on Financial Consumer Protection* available at http://www.oecd.org/daf/fin/financial-markets/48892010.pdf

Hong Kong Monetary Authority (HKMA), 2010, *Guideline for a sound remuneration system*, available at http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2010/CG-5.pdf

National Treasury of the Republic of South Africa, 2014, *Treating Customers Fairly in the Financial Sector: A Draft Market Conduct Policy Framework for South Africa – Discussion Document*, available at http://www.treasury.gov.za/public%20comments/FSR2014/Treating%20Customers%20Fairly%20in%20the%20Financial%20Sector%20Draft%20MCP%20Framework%20Amended%20Jan2015%20WithAp6.pdf

Netherlands Authority for the Financial Markets/De Nederlandse Bank (AFM/DNB) 2009, *Principles for sound compensation policies*, available at http://www.afm.nl/~/media/files/nog%20te%20plaatsen/090506_principles_for_sound_compensation_policies_unofficial_translation.ashx

New City Agenda 2014, *A report on the culture of British retail banking*, http://newcityagenda.co.uk/wp-content/uploads/2014/11/Online-version.pdf

OECD, 2013, *Update report on the work to support the implementation of the G20 High-Level Principles on Financial Consumer Protection* available at http://www.oecd.org/daf/fin/financial-education/G20EffectiveApproachesFCP.pdf and Annex

Parliamentary Commission on Banking Standards, 2013, *Changing banking for good*, available at http://www.parliament.uk/documents/banking-commission/Banking-final-report-volume-i.pdf

US Department of the Treasury, 2010, *Guidance on Sound Incentive Compensation Policies*, available at https://www.fdic.gov/news/news/press/2010/pr10138a.pdf

Which? 2012, *Here to help? Bank staff reveal the truth about working for Britain's big banks* available at http://www.which.co.uk/documents/pdf/our-research-on-banking-staff-pdf-305345.pdf

Which? 2015, *Is Your Bank Mis-selling?* Which? Magazine. September 2015 pp. 52 – 54.

World Bank, 2012, *Good Practices for financial consumer protection*, available at http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Good_Practices_for_Financial_CP.pdf

World Bank, 2014a, *Global Survey on Consumer Protection and Financial Literacy - Oversight Frameworks and Practices in 114 Economies* available at http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Publications/CPFL-Global-Survey-114econ-Oversight-2014.pdf

World Bank, 2014b, *Financial (Dis-)Information Evidence from an Audit Study in Mexico* available at http://documents.worldbank.org/curated/en/2014/05/19611184/financial-dis-information-evidence-audit-study-mexico