Finalised guidance

FG18/2 Staff incentives, remuneration and performance management in consumer credit

March 2018

Contents

1 Our expectations

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

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

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

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

1.5 Our rules and guidance does not specify how firms should design and run their pay (remuneration) and reward (incentive) schemes. But they must take reasonable care to organise and control their affairs responsibly, effectively and with adequate risk management systems.[5] A firm's business model must be suitable for the regulated activities it carries out.[6] COND 2.7.12G states that our assessment of this threshold condition may not just be limited to a firm's regulated activities, if we believe that its other business activities may have an effect on its regulated activities.

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

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

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

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

Identifying risks

1.9 We expect firms to identify and assess the potential risks to customers that might arise from their consumer credit activities. In particular, we expect firms to consider how incentives or performance management might cause, or increase, the risk that they may not comply with our requirements (we abbreviate this below to 'consumer harm').

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

1.11 Firms may reward staff in different ways. This could include financial incentives (eg bonus or commission payments), praise or recognition (eg in performance discussions with their line manager) or other non-monetary incentives (eg prizes or extra holiday).

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

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

1.14 Section 2 of this guidance sets out some examples of how incentive schemes may increase the risk of customer harm. Section 3 gives some examples of how firms have introduced features into their incentive schemes that reduce this risk, along with guidance on how firms might implement these effectively. Section 4 explains how performance management practices may affect the risks to customers.

Managing risks

1.15 We expect firms to have effective systems and controls in place to manage the potential risks that may arise from their incentive schemes and performance management. It is equally important for firms to have the right culture and policies in place to deliver the right outcomes for consumers. Because the nature of the risks posed by firms' business models and incentive arrangements vary, so does the nature of appropriate controls to manage those risks. A firm's assessment of the controls it needs should take into account its assessment of risks, including those from incentives schemes or performance management as discussed above.

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

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

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

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

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

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

- be supported by senior management to emphasise the importance of controls and business-wide support to ensure the controls have the intended impact on staff behaviours

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

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

Monitoring and reporting risks

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

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

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

1.24 We remind firms of their record-keeping obligations in SYSC 9.1. The purpose of these is to enable us to monitor how well firms are complying with their regulatory requirements.

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

2 Incentive scheme features that increase the risk of customer harm

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

2.2 We recognise that firms may want to incentivise their staff and may choose to implement pay schemes that reward appropriate sales or collections activity. But it is important that firms recognise the risks from their pay schemes so that they can either introduce appropriate controls to manage those risks, or adjust their schemes to reduce them.

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

Volume, profitability or productivity-based incentive schemes

2.4 Incentive schemes based on the volume of sales can increase the risk that staff will seek to secure sales inappropriately. Many firms now recognise that promoting a focus on treating customers fairly can have longer term benefits, such as increased customer loyalty. As a result, they have moved away from sales bonuses that are purely based on sales volumes.

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

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

2.7 Incentives based on productivity metrics (such as average handling time or number of transactions handled) can also carry risks. Firms should treat customers in arrears that are particularly vulnerable, such as those with limited mental capacity or mental health difficulties, fairly and appropriately. Productivity-based incentives could discourage staff from recognising vulnerability if doing so is likely to affect their bonus.

100% variable pay

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

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

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

2.10 There are similar risks if staff receive an element of fixed pay, but a significant proportion of their pay is variable, as staff may depend on the variable pay.

Disproportionate reward from marginal sales/collections

2.11 Where one transaction (eg a sale or collection) can have a very large impact on an individual’s pay, that transaction may be at particularly increased risk. This could happen, for example, where staff earn a bonus for reaching a specific sales target. If a staff member is one sale away from reaching that target, they could have a very high incentive to make that sale. This type of transaction is known as a ‘marginal transaction’.

2.12 One type of scheme that can lead to disproportionate rewards for marginal transactions is where the commission for each sale in a period is dependent on the total number or value of sales in that period. This is known as a 'retrospective accelerator'. In this type of scheme there will be a point where one extra sale will both earn commission on that sale and increase the rate of commission on all the other previous sales made in the period. So there is an increased risk of mis-selling where a salesperson is close to reaching the number of sales that will increase their commission rate. Similar risks apply where retrospective accelerators are used for collections staff.

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

Accelerators or stepped payments

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

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

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

Incentives linked to the terms of the finance

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

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

Product bias

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

Incentives for sale of finance

2.17 When customers are purchasing high-value retail goods, they may pay close attention to the features and price, but less attention to the terms of finance to fund the purchase. So if the retailer provides finance to fund the purchase, there may be greater opportunity for staff to influence the sale of finance through inappropriate sales conversations.

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

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

Variable salaries that change based on volume measures

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

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

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

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

Volume-based measures to decide whether incentives are paid

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

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

Competitions or promotions

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

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

Incentive schemes for managers that are linked to team performance

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

2.25 Managers' bonuses that depend on sales or collections volumes, rather than, for example, quality measures, could make managers put pressure on customer-facing staff to achieve those volumes. This creates obvious risks of harm to customers.

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

Example of	A lender employed field-based agents to sell loans and collect repayments. Those agents' managers received bonus payments based on

increased risk	the value of sales and amounts collected by their agents. As agents are field-based, they have limited interaction with the firm other than through their manager. So it may be difficult for the firm to identify if some managers applied undue pressure on agents to sell or collect inappropriately.

Incentives for sales of non-financial products

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

2.28 In these circumstances, even if there is no direct incentive for selling the finance, there is a risk that sales staff might behave inappropriately to earn commission on the sale of the retail goods. This kind of inappropriate conduct could include misrepresenting the terms of the finance product or inappropriately pressuring customers into taking finance.

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

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

2.30 Some firms sell retail goods to customers using an associated rolling credit account facility. An example would be online accounts where customers buy goods through a linked credit account. These firms may choose to incentivise their staff to sell the retail goods. This may lead staff to use high-pressure selling to encourage customers to buy goods using the available credit facility, particularly where the staff can see the amount of credit customers have.

2.31 In these cases, firms should consider whether the incentives could affect how appropriate their approach is to setting or increasing credit limits or monitoring account activity, eg for signs of financial difficulty. If staff are incentivised to sell retail goods, this could lead them to pressure customers to use more of the available credit than they can comfortably repay.

Schemes that combine several high-risk elements

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

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

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

3.1 The way staff are paid can have a significant influence on the way they behave. So incentive schemes that reward staff for achieving appropriate outcomes for their customers can, if properly implemented, reduce the risk of customer harm. But these schemes do not completely eliminate all risk, and firms should still manage the remaining risk.

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

Incentive schemes based purely on quality or customer service measures

3.3 Where staff receive bonus payments based mainly on quality measures that assess customer outcomes effectively, it gives these staff a direct incentive to act in the best interests of customers. This can also give staff a tangible demonstration of the value the firm places on treating customers fairly.

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

3.4 Measures that assess customer satisfaction may not necessarily reflect customer outcomes. For example, if staff misrepresent the terms of a finance product during a sale, the customer may feel very satisfied with the transaction but not be aware that the product terms actually make it unsuitable for their needs.

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

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

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

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

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

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

Poor practice	A retailer made a 5% deduction to the bonus of any staff member who achieved a QA score below 65%. However, a high seller could earn up to

	30% more commission than an average seller before deductions have been made. So a high seller, whose commission is subject to a 5% deduction, would therefore still earn 25% more commission than the average seller.

Deferral or clawback of incentive payments

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

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

3.10 Deferral or clawback arrangements can be most effective where transactions that would trigger a deduction are investigated to understand the reasons. Reasons include whether a customer cancelled a product because they felt pressured to buy, or because of changes in their circumstances that neither they nor sales staff could reasonably foresee at the time of the sale.

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

Incorporating quality measures into incentive schemes

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

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

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

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

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

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

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

Cumulative or rolling target thresholds

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

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

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

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

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

4 Performance management practices that might increase or reduce the risk of customer harm

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

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

Focus of performance management discussions

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

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

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

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

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

Volume-based or monetary targets vs quality-based targets

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

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

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

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

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

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

Use of disciplinary action

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

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

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

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

Results affecting other decisions

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

Multiple targets for different elements

4.13 Staff may be measured on a wide range of different measures and expected to meet targets for all measures, or risk being challenged on why they have not met any individual target. This could drive an inappropriate focus on elements of the targets they have not yet met. In the case of sales targets for different products, a salesperson might direct customers to products where they haven't yet made their sales target even if that product is clearly unsuitable for the customer's needs.

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

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

Publicising 'good' or 'poor' performance

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

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

4.16 Conversely, recognising good performance on quality measures or examples of good customer outcomes can help promote appropriate behaviour in the interests of customers and create pride in achieving good customer outcomes.

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

5 Managing the risks from incentive schemes and performance management

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

5.2 Effective governance and controls may include:

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

5.3 We have identified below some examples aspects of governance and controls that may help firms manage their risks effectively. We also give some examples of features that may undermine how effective controls are. Firms remain responsible for ensuring that they have adequate controls in place, regardless of any role a third party may play in the control environment.

Understanding of risks

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

5.5 Some firms may not directly incentivise or measure staff on sales of finance products. In these cases, firms should consider how incentives or targets on other products, such as targets for sales of retail products that can be bought on finance, might have an impact on how the related finance product is sold.

5.6 Some firms were able to demonstrate a clear understanding of the risks in their incentive schemes. They gave a clear explanation of how elements of their incentive schemes, such as minimum quality standards, were designed to mitigate some of the risks, which risks remained, and how their controls were designed to manage them.

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

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

Example of increased risk	A lender paid commission to sales staff at a fixed rate for any loans above a minimum value. But the firm's senior management did not routinely monitor the proportion of the loans staff sold at or near this value. This meant they could not identify if sales staff were trying to qualify for commission by unfairly pressuring customers to take out more credit than they had asked for.

Quality monitoring

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

Focus on customer outcomes

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

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

5.11 Quality monitoring that is based purely on reviewing documents is likely to encourage staff to focus on procedure rather than outcomes. It also runs the risk that documentation might not accurately reflect the substance of staff interactions with customers. Quality monitoring that includes listening to recordings of phone calls, sitting in on discussions with, or directly contacting, customers are more likely to identify a wider range of possible failures.

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

Sampling approach

5.12 Both the number of transactions a firm samples and the way they are chosen affect how effective quality monitoring is.

Transactions sampled should enable management to form a representative view across all transactions. If staff are aware of which transactions will be sampled, they may behave differently for these calls or these face-to-face sales. Similarly, if staff know that some transactions will not be, or are very unlikely to be, sampled, they may be more likely to behave inappropriately for those transactions.

5.13 Transactions sampled should cover key risk areas. These may be risk areas arising from features of incentive schemes or performance management, such as transactions that could earn significant commission. Or they may be transactions that inherently carry greater risk, such as dealing with financially vulnerable customers.

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

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

Impact of quality failures

5.15 Business quality monitoring is most likely to influence the behaviour of customer-facing staff if they believe that any failures detected will be taken seriously and may have serious consequences. Consequences could be financial penalties, such as deductions from bonus, or through performance management, such as disciplinary action for serious or repeated failures.

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

5.17 Quality monitoring is also likely to be ineffective if staff believe that the standard required is so low that any failures detected are unlikely to trigger a financial penalty. It will also be ineffective if testing is not robust or challenging enough to detect inappropriate behaviour. Of the firms in our sample who said they would apply a financial penalty for quality failures by staff, less than half had done this in the past month. One in six had not made any deductions in the last year. While this could be evidence that the control was working well, we found that for some of these firms it was likely to be a result of inadequate controls.

Good practice	A lender implemented a quality 'gateway'. If a member of staff fell below the required average quality score, or had any significant quality failures

	likely to cause customer harm, they would not qualify to receive any bonus in the current month. Depending on the nature of these failures, they might also face disciplinary action.
Poor practice	One retailer deducted 5% from the bonus of relevant sales staff if they found evidence of potential customer harm through quality checking. But as the average salesperson in this role earned around 74% of their total pay as commission, this deduction for quality failures was comparatively insignificant.

Monitoring face-to-face sales

5.18 Face-to-face sales present particular challenges. It is difficult to monitor interactions effectively, and staff could potentially influence customers inappropriately. These challenges are also greater where transactions are carried out in a customer's home.

5.19 Live observations of face-to-face sales can be a useful tool to assess customer-facing staff's ability to perform their role effectively. But some firms may rely on them too much. They are difficult to do without the staff member knowing they are being observed, which limits how useful they are in assessing a sales person's normal behaviour. So some firms have added other controls, such as mystery shopping and calls to customers after transactions are complete.

Good practice	One lender that sold to customers in their homes employed a third party to carry out mystery shopping. This identified a number of serious concerns that had not been identified by other controls, such as high-pressure selling. It was not practical to carry out this mystery shopping on a large enough scale for it to be the firm's primary control over face-to-face sales. But it was useful in assessing how effective the firm's other controls were and in identifying failures in these other controls' ability to pick up some of the issues.
Good practice	One retailer that conducted face-to-face sales in an office environment had installed devices on each desk to record all sales conversations. Such recordings could give a firm valuable information to assess the quality of customer interactions, though this depends on those recordings being used effectively.
Poor practice	Firms may rely too much on face-to-face observations as their only way to monitor staff. One lender that conducted collections activity in customers' homes relied on managers to accompany collections staff on a sample of visits to observe their behaviour and review documents from unaccompanied visits. Staff could easily change their behaviour during

	accompanied visits. They would also be unlikely to record in documentation anything that might suggest they had behaved inappropriately.

Independence and capability of staff carrying out quality monitoring

5.20 For a firm to have confidence in the results of its quality monitoring, it needs to be confident that staff undertaking monitoring can identify issues and will report fairly and accurately on any issues they find.

5.21 Staff carrying out quality monitoring should be competent and experienced enough to understand how risks might happen, assess how serious any issues they identify are and present or defend their conclusions to the relevant part of the firm. They should also have sufficient resources to carry out their quality monitoring effectively, including access to required information and records, and sufficient time to do their work.

5.22 Some firms had put in place measures to separate control functions from customer-facing staff. This helps to ensure the controls remain independent and are fair and objective. For example, this independence makes it less likely that someone will start reviewing a sales call by automatically expecting it will be good because they know and like the person who made the sale. Some firms had implemented other measures to prevent bias in how controls are used, such as choosing telephone calls from a list of reference numbers to prevent staff picking calls of a similar length.

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

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

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

Challenging and overseeing of quality monitoring

5.24 Firms should monitor and review the results of their quality monitoring. This can help to identify common themes or underlying issues which they might need to tackle through procedural changes. It can also enable management to satisfy itself that the quality monitoring is being carried out robustly, is focused on key areas of risk, assesses customer outcomes and raises areas of concern so that the firm can act on them.

5.25 In a number of firms where quality monitoring had not detected significant issues, we found potential weaknesses in the way the monitoring was designed, such as a lack of independence. Many of these firms had not sufficiently questioned whether the lack of issues detected meant these issues didn't exist or if weaknesses in the design of the quality monitoring meant issues were not being detected or reported.

Management information

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

5.27 The most effective management information for identifying risk may be that which does more than identify trends at a team, department or firm level. Being able to monitor the activities of customer-facing staff at an individual staff member level can help identify staff members who carry out higher risk transactions. This could, for example, include staff who:

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

5.28 Firms might also identify transactions as higher risk for other reasons. These might include sales of a newly introduced product, or customers with patterns of repeat borrowing that could indicate they are struggling to manage their debts.

5.29 Management information can be useful in informing a business's quality monitoring approach. It can allow risk-based quality monitoring that ensures transactions that pose the greatest risk are subject to quality monitoring.

Good practice	Telephone-based sales staff at one broker were able to offer customers different loan products at different interest rates. MI was used to identify any instances where customers bought a product at a higher interest rate than the lowest available to them. That call was then reviewed to check whether the customer has been sold an unsuitable or unaffordable loan.
Good practice	At one lender, team managers in the collections teams regularly ran different reports to try and identify new areas of risk. Rather than relying on the same set of MI reports to monitor known risks, they produced new reports which increased their chance of detecting new, emerging risks before they became significant.
Poor practice	Sales staff at a credit broker recommended finance products to customers. If staff knew of any factors that would make a product unsuitable, the salesperson was responsible for taking this into account. These factors could include, for example, the customer saying they were facing likely redundancy so might not be able to maintain payments. As part of the sales process, staff were required to ask if customers expected any change in their income or other circumstances over the period of the loan. However, the firm did not have any way of assessing whether sales staff were actually doing this. For example, they did not have any MI showing the number of times a staff member had told a customer that a product might not be suitable, or whether they had recorded an expected future change in the customer's circumstances.

Poor practice	A lender had high-risk elements in its incentive scheme. These included a 'retrospective accelerator', where hitting a specific collections target would have a very significant impact on an individual's total commission for the month. The firm's senior management did not routinely monitor the proportion of collections staff who had just reached their collections target for the month, or review transactions by those staff for any sign of aggressive collections.

Line management conflicts of interest

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

5.31 Some line managers' financial incentives or performance appraisals are directly related to the monetary performance of their team. This can lead to line managers encouraging staff to prioritise profitability over treating customers appropriately. It could also discourage line managers from identifying or raising poor conduct if this could negatively influence the monetary performance of their team.

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

Processes that discourage action

5.32 Controls to mitigate risks arising from incentive schemes or performance management should be sufficiently effective to manage the risks they pose to consumers. If, however, staff must go through multiple levels of review and approval to get agreement to act in the customer's best interest, they may be discouraged from doing this.

Good practice	A lender had recognised that dealing with vulnerable customers can be difficult and time consuming, and that some call handlers can be uncomfortable discussing these issues with customers. So the firm had introduced a dedicated vulnerable customer team with the training and experience to deal with these cases properly. This team was not measured or given targets based on the volume of cases they handled. Where an initial call handler identified a potentially vulnerable customer, they could easily flag up this customer and refer them to the dedicated team.

Example of increased risk	A retailer used a target of a 70% collections rate as the threshold for its agents to qualify for commission. It used 'waivers' to mitigate the risks of these agents coming under too much pressure to collect inappropriately. The waivers allowed agents to reduce customers' regular payments while still counting these payments towards its collections target. But the approval process for such a waiver could be slow. Because of this it would be unlikely to mitigate risks of poor actions by agents close to achieving their qualifying threshold.

6 Glossary

This glossary sets out some key terms we use and how we have defined them for this guidance.

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

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

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

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

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

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

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

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

Retrospective accelerator – an element of an incentive scheme where reaching a certain target increases the rate of commission both on sales (or collections) above that target, and also increases the commission earned on all sales (or collections) already made below the target.

Sales staff – staff that sell or recommend a finance product to a customer. This includes where that finance product is subsidiary to another product, for example, when the firm sells retail goods (such as furniture, cars or electronics) on finance.

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