

Staff incentives, remuneration and performance management in consumer credit – Feedback to CP17/20 and final rules

Policy Statement

PS18/7

March 2018



This relates to

Consultation Paper CP17/20
which is available on our website at
www.fca.org.uk/publications.

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abbreviations

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1 Overview

Introduction

- 1.1** In this Policy Statement (PS), we give our response to the feedback we received to Consultation Paper CP17/20 *Staff incentives, remuneration and performance management in consumer credit* (July 2017).¹ We also publish the final rules for consumer credit firms.
- 1.2** We have also finalised and separately published the non-Handbook guidance that formed part of the consultation: FG18/2.²

Who does this affect?

- 1.3** This paper will affect firms that carry out consumer credit activity and have staff who deal directly with customers.
- 1.4** This paper does not apply to any firm (for example, a firm that is part of a banking group regulated by the Prudential Regulation Authority) that comes under:
- a.** any of the remuneration provisions in SYSC 19A (IFPRU Remuneration Code), SYSC 19B (AIFM Remuneration Code), SYSC 19C (BIPRU Remuneration Code), SYSC 19D (Dual-regulated firms Remuneration Code), SYSC 19E (UCITS Remuneration Code) and SYSC 19F³ (Remuneration and performance management of sales staff) or
 - b.** remuneration provisions made by an EEA regulator under any of the following:
 - (i) CRD⁴, or (ii) AIFMD⁵, or (iii) the UCITS directive⁶ or (iv) MiFID
- 1.5** This paper will be most relevant to:
- a.** senior managers who design or approve incentive schemes, performance management processes or related control arrangements
 - b.** line managers who implement incentive schemes, performance management processes or related control arrangements
 - c.** compliance, risk management and quality assurance staff
 - d.** staff who are part of an incentive scheme

1 www.fca.org.uk/publication/consultation/cp17-20.pdf

2 www.fca.org.uk/publications/finalised-guidance/fg18-2-proposals-staff-incentives

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

4 www.handbook.fca.org.uk/handbook/glossary/G1966.html

5 www.handbook.fca.org.uk/handbook/glossary/G3100.html

6 www.handbook.fca.org.uk/handbook/glossary/G1199.html



It may also interest trade bodies that represent firms carrying out consumer credit activities.

Is this of interest to consumers?

- 1.6** This paper may be of interest to consumers and consumer organisations. The final rules and guidance will help ensure that all consumer credit firms take appropriate steps to identify and manage risks from staff incentives and remuneration, and so reduce the risk of poor behaviour from sales or collections activity or both.

Context

- 1.7** In August 2015, we announced we would undertake a thematic review to better understand the nature of staff incentives, remuneration and performance management in the consumer credit market.⁷
- 1.8** In July 2017, we published the findings of the review. We found that a significant proportion of consumer credit firms had:
- financial incentives and/or performance management practices that were high risk and likely to encourage high-pressure sales or collections
 - inadequate or ineffective controls, and
 - little understanding of the risks of these incentives and practices or the controls needed to address them
- 1.9** In light of these findings, we decided that consumer credit firms needed more clarity regarding our expectations and to improve how they identify and manage the risks their staff incentives may pose to customers. We consulted (in CP17/20) on proposed new rules and guidance in the Consumer Credit sourcebook (CONC) and also proposed non-Handbook guidance.
- 1.10** Our proposals were designed to:
- help consumer credit firms identify the risks their practices might pose to customer outcomes
 - explain our expectations of how firms should mitigate and control those risks, and
 - establish a level playing field between consumer credit firms and other Financial Services and Markets Act 2000 (FSMA) regulated firms to which previous guidance applies

These provisions are intended primarily to advance our objective of securing an appropriate degree of protection for consumers.

⁷ www.fca.org.uk/publications/thematic-reviews/tr-staff-remuneration-and-incentives

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

- 1.11** To help ensure consumer credit firms identify risks arising from staff incentives and performance management and manage them appropriately, we consulted on provisions for a new section 2.11 of CONC. This would include:
- A high-level rule requiring firms to have adequate arrangements to identify and manage any risk of non-compliance with their regulatory obligations arising from their remuneration or performance management practices.
 - A proportionality provision requiring a firm, when deciding how to comply, to take into account the nature, scale and complexity of its business. It would also need to take into account the nature and range of financial services and activities it undertakes in the course of that business.
 - Guidance on the purpose of the proposed new provisions. In particular, to remind firms of their existing obligations under Principle 3 of our Principles for Businesses sourcebook (PRIN) and Senior Management, Systems and Controls sourcebook (SYSC) 4.1.1R. This will ensure firms identify and effectively manage risks to customers from their policies, procedures and practices for the remuneration and performance management of their employees, appointed representatives and agents who work with customers.
 - Guidance setting out examples of relevant measures and procedures which firms can introduce to manage these risks.
 - A cross-reference to the non-Handbook guidance.

Non-Handbook guidance

- 1.12** We also consulted on non-Handbook guidance to provide more detailed help to consumer credit firms. The proposed guidance:
- Gave examples of good and poor practice we found during our thematic review. We also made clear there is no 'one size fits all' model for appropriate incentives and controls.
 - Reiterated messages from our previous guidance and that of our predecessor, the Financial Services Authority, as some of the issues we identified during our thematic review were similar to those found in other sectors. We have expanded this with consumer credit-related issues and examples to help firms manage the risks of their remuneration schemes.⁸
 - Gave more detailed examples of potential risks and how firms might reduce or manage them.

⁸ FG13/01 - www.fca.org.uk/publication/finalised-guidance/fsa-fg13-01.pdf and FG15/10 - www.fca.org.uk/publication/finalised-guidance/fg15-10.pdf



- Explained our expectations of the types of controls and governance firms could put in place to identify and manage risks from their staff incentives, remuneration and performance management policies and practices.

Summary of feedback and our response

1.13 The consultation closed on 4 October 2017. We received 13 responses from respondents including firms, trade bodies and consumer organisations. We have given a full list of non-confidential respondents in Annex 1.

1.14 A large majority of responses supported our proposals. As a result, the new rules, guidance and non-Handbook guidance will be published with only minor amendments.

1.15 Chapter 2 provides further details on this feedback and our response.

Next steps

1.16 The final rules and guidance within Appendix 1 will come into force on 1 October 2018.

What do you need to do next?

1.17 Firms affected by the new rules and guidance within Appendix 1 should ensure their business is compliant before 1 October 2018. Final Guidance (FG18/2) aims to support firms' implementation.

What will we do?

1.18 Firms' culture and governance is a key priority for us. Culture in firms plays an important role in setting incentives and remuneration which can be among the most significant drivers of good or poor behaviours. Through our ongoing work with and supervision of firms we will assess how effectively firms are properly managing the risks from their performance management and incentive arrangements.

1.19 At a later date, we may undertake separate work to review how consumer credit firms have responded to the new rules and guidance.

2 Summary of feedback and our response

2.1 In this chapter, we summarise the feedback we received to our questions in CP17/20. We also give our response to this feedback, as well as the final rules and guidance we have made.

2.2 We proposed new requirements and guidance to be inserted into CONC. This would cover both:

- firms' credit-related activity and
- unregulated activity financed by a credit agreement in respect of which the firm undertakes regulated consumer credit lending or credit broking

We also proposed non-Handbook guidance to help firms implement the rules.

Q1: Do you have any comments on our proposed additional rules and guidance in CONC to require firms to have adequate policies and procedures designed to detect and manage risks arising from their remuneration or performance management policies?

2.3 Most responses agreed that staff incentives can create risks and welcomed the additional clarity our measures will provide.

2.4 One respondent suggested we amend CONC 2.11.3G so that it excludes remuneration paid by other FCA-regulated firms unless there is a material risk to customer outcomes.

2.5 One respondent wanted clarification of a firm's responsibility for other firms' remuneration practices. They also asked for further explanation of an 'agent' in this context.

2.6 Another said that if the rules applied to staff undertaking non-regulated activities, this would disadvantage regulated firms. This was because the rules would not apply to wholly non-regulated firms undertaking the same activities.

2.7 Some respondents questioned how the rules would apply when customers are businesses, not consumers.

2.8 One respondent suggested we ban commission-based rewards completely in consumer credit firms.

Our response

We welcome the broad support for our proposals. While we received many comments on the proposals and some suggested changes, we feel they do not justify a change to the rules and guidance we consulted



on. We have therefore made the rules and guidance with no substantial changes.

We believe that CONC 2.11.3G adequately explains the purpose of the new section. There are many ways that firms can structure their staffing arrangements and it is important that the rules adequately capture them. CONC 2.11.3G(1) states that the rules apply to the remuneration and performance management of employees, appointed representatives and agents (within the meaning of CONC 14) and so is consistent with other provisions of CONC. Firm-to-firm commercial remuneration and commission arrangements are excluded, whether or not the firms involved are FCA-regulated (see CONC 2.11.3G (2)).

We believe CONC 1.2 adequately explains the application of CONC rules and firms' responsibilities for others. CONC 1.2.2R specifically addresses the responsibilities of firms to other regulated persons. A firm must take reasonable steps to ensure that other persons acting on its behalf comply with relevant rules.

We feel CONC 14 adequately explains the application of the term 'agent' for credit-related regulated activity.

We do not agree that the rules will give an unfair advantage to non-regulated firms when FCA-regulated firms are undertaking comparable unregulated activities. To clarify, CONC 2.11.2R(2) only applies when each instance of unregulated activity (such as the sale of a car or other consumer goods) is financed by a credit agreement. Where unregulated activities are not financed by a credit agreement, the rules do not apply. As such, regulated firms can monitor sales that do not fall within the scope of the rules on a level footing with non-regulated firms.

The extent to which the rules apply when customers are businesses depends on whether the activity is regulated for that customer type. For the majority of in-scope activities (CONC 2.11.1R) the rules will apply when a customer meets the definition of an individual.⁹ The proportionality provision (CONC 2.11.4R (2)) refers to 'the nature, scale and complexity of' a firm's business and the type of customer the firm deals with is relevant to this.

We note the suggestion that consumer credit firms should be banned from paying commission-based remuneration to their staff. Although this type of remuneration can involve risks and so requires appropriate controls, we believe that commission-based models within consumer credit firms can operate in a way that complies with the rules. So a ban would not be appropriate or proportionate.

Q2: Do you have any comments on our proposed non-Handbook guidance?

- 2.9** Our non-Handbook guidance was designed to help consumer credit firms to identify and understand the risks to customers their practices might pose and be clear about what we expect of them. The guidance also includes practical examples of good and poor practice we identified during our thematic review.
- 2.10** The majority of respondents had a positive view of the non-Handbook guidance, and most found the practical examples helpful and informative.
- 2.11** Respondents welcomed customer outcomes being a focus for measurement of performance and remuneration.
- 2.12** One respondent challenged the term '100% variable pay'. As employees should receive the National Minimum Wage regardless of commission, '100% variable pay' cannot exist.
- 2.13** Another respondent suggested that paragraph 1.18(1) of the non-Handbook guidance should not exclude team managers from the review of controls and practices within their teams. They felt managers are best placed to understand their team and can actively discover and mitigate poor practice.
- 2.14** A few respondents suggested that the risks from 100% variable pay within paragraphs 2.8 to 2.10 of the non-Handbook guidance do not exist where sales and collections are carried out by the same member of staff.
- 2.15** One response suggested the non-Handbook guidance be integrated into FG15/10 *Risks to customers from performance management at firms*¹⁰, and not be published for consumer credit firms alone.
- 2.16** A number of respondents wanted reassurance that the non-Handbook guidance will not act as a prescriptive checklist for FCA supervisors or be used during the authorisation process.

Our response

The overall feedback from respondents was positive and so we will be finalising the non-Handbook guidance (FG18/2). Although we have amended some wording to align with our Mission¹¹ and improve clarity, there are no substantial changes.

We note the challenge to the term '100% variable pay'. Hiring staff, representatives or agents can happen in a number of contractual forms, some of which may be exempt from the National Minimum (or Living) Wage. In these circumstances 100% variable pay can exist, and so we consider it is an appropriate term to use for such circumstances.

We agree that managers are often in the best position to oversee their team's work and manage the risks from team members' behaviour. The aim of paragraph 1.18 of the non-Handbook guidance is not to prevent line managers from undertaking monitoring work. The key point is

¹⁰ www.fca.org.uk/publication/finalised-guidance/fg15-10.pdf

¹¹ www.fca.org.uk/publication/corporate/our-mission-2017.pdf



that staff undertaking any monitoring should be adequately skilled and sufficiently independent of the staff and processes they are monitoring. CONC 2.11.6G makes it clear that any conflicts should be adequately managed.

We do not agree that the risks from 100% variable pay are necessarily reduced where a member of staff undertakes both sales and collections. It is possible for a staff member to be inappropriately motivated for either or both activities, so the risks will still exist for each.

While we do keep previous guidance under review (such as FG15/10) we do not feel that integration is appropriate on this occasion. We have produced this non-Handbook guidance as a result of our consumer credit work. It is therefore specific to consumer credit firms, not the wider population of retail financial firms. But any firm can use the non-Handbook guidance and may find it useful.

Non-Handbook guidance is meant to help firms comply with our rules – often by illustrating good or poor practice. We do not use it as a prescriptive list during our supervision work or at the authorisations stage. We appreciate that no two firms are the same; our approach will remain proportionate and take this into account.

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

- 2.17** The Cost Benefit Analysis (CBA) within CP17/20 sets out an analysis of the costs and benefits that we expect from our proposals. Our analysis surveyed 35 firms across 15 sectors that may be affected¹² to estimate the incremental costs of our proposals. We did not consider it reasonably practicable to develop an estimate of the benefits.
- 2.18** One respondent felt it was appropriate that high risk firms and those with significant control weaknesses should incur these estimated costs to correct their policies and processes.
- 2.19** Two respondents felt 5 hours to read and consider the new rules and guidance is an underestimate and another believed the costs of implementation were also underestimated.

Our response

The costs in our CBA are estimated average costs for each category of firm, and we know that costs to any individual firm may be higher or lower. In light of this, we will not be revising the CBA in CP17/20.

The 5 hours taken to read and consider our provisions apply only to firms with 3 to 15 employees (based on CBA survey results). As outlined in the CBA, we believe disruption to these – and

12 The sectors covered were: Personal Loans, High-cost Short-term Credit, Home Collected Credit, Catalogues/Mail Order, Store/Credit cards, Logbook Loans, Hire Purchase/Conditional Sale, Guarantor Lending, Pawnbroking, Primary Credit Broking, Secondary Credit Broking, Credit References/Credit Information Services, Debt Collecting, Debt Management, Debt Administration.

smaller – businesses will be minimal. We also believe the costs are representative based upon the survey responses we received. For firms with more than 15 staff we expect it will, on average, take longer than 5 hours to consider our provisions, and this is reflected in our estimated average costs for these firms.

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

- 2.20** Our compatibility statement explains the reasons we have decided that our proposals are compatible with our legal obligations and strategic objectives, and advance our operational objectives.
- 2.21** Most respondents to this question welcomed our proposals' proportionate approach and agreed they are compatible with our strategic and operational objectives.
- 2.22** One respondent was concerned the new rules would not promote competition within the market. They believed the proposals may lead to more firms deciding to leave because of increased compliance costs, leaving consumers with fewer choices. They also felt existing FCA rules already prevent any mis-selling to consumers, making the new rules unnecessary.

Our response

We have considered respondents' feedback and concluded that our proposals are compatible with our obligations.

We decided there was a need for proposals covering staff remuneration, incentives and performance management as a result of our thematic work. While there are rules to prevent firms treating customers poorly, they had not led to all consumer credit firms fully appreciating and addressing risks to consumers from staff incentives, remuneration and performance management. In light of our findings, it is clear that new rules and guidance are required.

Our rules and guidance, which we consider to be proportionate, do not prescribe specific actions firms must take. We believe the cost of these proposals to firms will not be so high that consumers' choices will be reduced by many firms leaving the market.



3 Next Steps

Rules, guidance and non-Handbook guidance

- 3.1** The final text of the incentives and remuneration rules and guidance we have made is in Appendix 1. These come into force on 1 October 2018.
- 3.2** We expect firms to check their compliance with the new rules and they must take necessary measures to ensure compliance by 1 October 2018. The Final Guidance (FG18/2) aims to support firms' implementation.
- 3.3** Contact details, for any comments or queries on this Policy Statement, are at the start of this paper.

What will we do?

- 3.4** Firms' culture and governance is a key priority for us. Incentives and remuneration can be among the most significant drivers of good or poor culture and behaviours. Through our ongoing work with, and supervision of firms we will consider how effectively firms are properly managing the risks arising from their performance management and incentive arrangements.
- 3.5** At a later date, we may undertake separate work to review how consumer credit firms have responded to the new rules and guidance.

Annex 1

List of non-confidential respondents

Cabot Credit Management Group Ltd

Chartered Institute of Credit Management (CICM)

Consumer Credit Trade Association (CCTA)

Experian Ltd

Finance & Leasing Association (FLA)

Financial Services Consumer Panel (FSCP)

Loans 2 Go Ltd

Mutual Clothing and Supply Ltd

National Franchised Dealers Association (NFDA)

Premium Credit Ltd

Skyline Direct Ltd

Smaller Business Practitioner Panel (SBPP)



Annex 2

Abbreviations used in this paper

CBA	Cost Benefit Analysis
CONC	Consumer Credit sourcebook
CP	Consultation Paper
EU	European Union
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act
MiFID	The Markets in Financial Instruments Directive
PRIN	Principles for Businesses sourcebook
PS	Policy Statement
SYSC	Senior Management Arrangements, Systems and Controls sourcebook

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

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Appendix 1

Made rules (legal instrument)

CONSUMER CREDIT (STAFF INCENTIVES, REMUNERATION AND PERFORMANCE MANAGEMENT) INSTRUMENT 2018

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 1 October 2018.

Amendments to the Handbook

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

Notes

- E. In the Annex to this instrument, the “note” (indicated by “**Note:**”) is included for the convenience of readers but does not form part of the legislative text.

Citation

- F. This instrument may be cited as the Consumer Credit (Staff Incentives, Remuneration and Performance Management) Instrument 2018.

By order of the Board
22 March 2018

Annex

Amendments to the Consumer Credit sourcebook (CONC)

After CONC 2.10 (Mental capacity guidance) insert the following new section CONC 2.11. The text is not shown underlined.

2.11 Remuneration and performance management policies, procedures and practices

Application

- 2.11.1 R This section applies to a *firm* with respect to:
- (1) *credit-related regulated activity*; and
 - (2) *unregulated activity* that is financed by a *credit agreement* in respect of which the *firm* is carrying on *consumer credit lending* or *credit broking*.
- 2.11.2 R This section does not apply to a *firm* subject to:
- (1) any of the remuneration provisions in SYSC 19A (IFPRU Remuneration Code) to SYSC 19F (Remuneration and performance management of sales staff); or
 - (2) remuneration provisions made by an *EEA regulator* pursuant to any of the following:
 - (a) *CRD*; or
 - (b) *AIFMD*; or
 - (c) the *UCITS Directive*; or
 - (d) *MiFID*.

Purpose

- 2.11.3 G (1) The purpose of this section is to amplify the requirements in *Principle 3* and SYSC 4.1.1R to ensure *firms* identify and effectively manage the risks to *customers* that may arise out of *firms'* policies, procedures and practices for the *remuneration* or performance management of their *employees*, *appointed representatives* and such of their individual agents within the meaning of CONC 14 who interact with *customers*.
- (2) This section does not apply to the commercial *remuneration* or commission arrangements between two or more separate *firms*.

- (3) The risks this section addresses may arise out of a *firm's* policies for remunerating its *employees, appointed representatives* or individual agents for performance in carrying on *credit-related regulated activities*. Such risks may arise, for instance, where staff *remuneration* (for example, a bonus or commission) is determined in whole or in part by the volume or value of *credit* provided or debt collected. These risks may, in addition, arise where an individual's formal (for example, annual appraisals) or informal (for example, day-to-day interactions with their line manager) performance management focuses on targets or measures of the volume or value of *credit* provided or debt collected.
- (4) These risks may also arise out of a *firm's* policies for remunerating such individuals for performance in carrying on *unregulated activities* that are financed by *credit agreements* in respect of which the *firm* is carrying on *consumer credit lending* or *credit broking*. An example is where a *firm* incentivises an individual to sell or supply *goods* or services the purchase of which may be financed (in whole or in part) by a *credit agreement* in respect of which the *firm* is carrying on *credit broking* or *consumer credit lending*. The use of incentives in these circumstances creates the risk that the individual may, for example, provide or arrange *credit* to fund purchases when it is not appropriate to do so.
- (5) Nothing in this section requires a *firm* to act in a way that would be inconsistent with its obligations under employment or contract law.

Requirements

- 2.11.4 R (1) A *firm* must in relation to any risk of failure by the *firm* to comply with its obligations under the *regulatory system* arising from its *remuneration* or performance management policies, procedures and practices:
- (a) establish, implement and maintain adequate policies and procedures designed to detect this risk; and
 - (b) put in place adequate measures and procedures designed to manage this risk.
- (2) A *firm* must, when deciding how to comply with (1), take into account the nature, scale and complexity of its business, and the nature and range of financial services and activities undertaken in the course of that business.

Examples of measures and procedures to manage risks

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

- (1) undertaking monitoring of the nature of sales activities and *debt collecting*;
- (2) collecting management information to enable the *firm* to monitor and identify trends or patterns in *employee, appointed representative* or individual agent behaviour that could be used to detect these risks;
- (3) establishing procedures to ensure appropriate actions are taken if an *employee, appointed representative* or individual agent is found to have behaved inappropriately; and
- (4) maintaining arrangements to ensure the approval, oversight and regular review of *remuneration* and performance management arrangements by an appropriate governance committee or senior management.

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

Non-Handbook guidance

- 2.11.7 G A *firm* should also be aware of the finalised guidance entitled Staff Incentives, Remuneration and Performance Management in Consumer Credit.

[**Note:** see <https://www.fca.org.uk/publications/guidance-consultations/gc17-6-proposals-staff-incentives-and-performance-management>]

