Financial Conduct Authority

Institute of Operational Risk

Financial incentives

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Agenda

- Background
- Incentive scheme features
- Managing the risk
- Key findings
- Areas for improvement
- Discretionary schemes
- Fit with operational risk
- Next steps
- Q&A

Background to FCA work

- Financial incentives: key strategic priority
- Sept 2012 – findings from thematic review
- Incentives risk: not adequately managed
- '18 months'
- Jan 2013 – final guidance

Overview of Incentive scheme features

- Customers more likely to lose out when:
  - Material incentives based on volume
  - Scheme features are hard to manage
  - Scheme features are not understood
  - Eligibility for bonus not affected by poor quality

- Features likely to significantly increase risk include:
  - Variable salaries
  - Inappropriate incentives for additional sales eg PPI
  - ‘Retrospective accelerators’

Managing the risks and governance

- Robust governance and controls
- Identify the features of your own incentive schemes that increase the risk of mis-selling and the likely inappropriate behaviours
- Ensure you have effective controls to address these risks

FCA follow up work: mitigation phase

- Extensive review of incentive schemes
- All C1, C2 and C3 plus sample of C4
- In depth assessments of largest retail banks
- On line assessment

Key messages

What did we find?

- Significant change
- More to be done
- Long term change?

Areas for improvement

- Discretionary schemes
- Incentive related MI
- Sufficiently risk-based business quality monitoring
- Inappropriate behaviour monitoring
- Non-advised sales
- Appointed representatives

Inappropriate Behaviour Monitoring

- By inappropriate behaviour, we mean the way staff might behave during sales conversations.

- Examples of inappropriate behaviour can include:
- Not explaining key information to customers.
- Pressurising customers to buy a product.

- Firms may want to introduce pro-active testing of sales conversations.

- Pro-active testing can include, mystery shopping and/or post-sale customer call-back.

Discretionary Schemes

- Schemes where the link between sales and bonus is not completely formulaic.
- Element of discretion or subjectivity in allocating bonuses.
- Discretion may reduce risk but it does not eliminate it.
- Discretion can be misused.
- Some discretionary schemes are based on a balanced scorecard where sales are still clearly a dominant factor.
- Firms still need to have appropriate controls for mis-selling risks in discretionary schemes.

Operational risk - sales staff incentives

- Relevant to people risk

- Risk function could provide influence and challenge over incentives

Next steps

Next steps for firms

- We expect all firms to:

- Consider our latest publication
- Take appropriate action now to ensure risks are managed
- Read or re-read our guidance, where necessary

Next steps for the FCA

- Continue to focus on financial incentives through our supervision of firms
- More engagement with the smallest firms
- We will be looking at performance management within firms
- Incentive risks at consumer credit firms

Any Questions?