

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: JULY 2017

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James Ross, Ruth Bala, Thomas Samuels and Lee Finch are all specialist consumer credit counsel at Gough Square Chambers. On a regular basis, they will share their views with Practical Law Financial Services subscribers on topical developments or key issues relating to consumer credit.

In the July column, James Ross considers the FCA's recent consultation paper (CP17/20), which sets out its proposals for how consumer credit firms should manage risks related to how they pay and manage the performance of their staff.

by *James Ross, Gough Square Chambers*

CARROT AND STICK: CONSUMER CREDIT STAFF INCENTIVES

There was a time, not so long ago, when the consumer credit regulatory landscape had quite a different texture. The Consumer Credit Act 1974 (CCA) imposed various strict requirements, breach of which could have serious consequences, especially in the form of irredeemable unenforceability of credit agreements under section 127(3) of the CCA. Otherwise, written standards in the form of OFT guidance and voluntary industry codes were minimalist by today's standards. In that environment, bad practices could flourish.

The misselling of payment protection insurance (PPI) in relation to credit products is a notorious example. The introduction of the rules in the Insurance Conduct of Business sourcebook (ICOBS) in 2005 introduced a degree of structure to sales processes, but did little to stop bad sales practices becoming prevalent. Ultimately, the sale of single-premium PPI at the point of sale of credit was banned by the FSA in 2009. Nevertheless, it has taken years for the industry to deal with compliance issues flowing from the historic sales of PPI. The FCA [policy statement](#) (PS17/3), published in March 2017, on dealing with PPI complaints following the Supreme Court decision in Plevin, imposes a deadline of 29 August 2019 for consumers to complain about how they were sold PPI (for more information, see [Legal update, FCA policy statement and final rules and guidance on PPI complaints](#)). It has been reported that the policy statement is now subject to a judicial review brought by a claims management company, "We Fight Any Claim".

But all that is history; what can be done to mitigate the risks of similar issues arising in the future?

Mitigating future risks

The FCA published proposals, on 4 July 2017, in a [consultation paper](#) (CP17/20) for a new rule and guidance in the Consumer Credit sourcebook (CONC) (CONC 2.11). It also published draft new non-Handbook guidance aimed at managing and reducing risks associated with staff incentives and performance management. It is thought that this type of high-level approach will be more effective in reducing the risk of bad practices emerging in the future.

Certainly, staff incentive schemes have featured time and again in PPI misselling trials over the past few years. This was usually at the instance of counsel acting on behalf of consumer claimants, seeking to paint a picture of sales staff driven by commission and other incentives to engage in poor sales practices. This could be an effective forensic strategy, especially where it could be established that the majority of an employee's pay was incentive-based rather than a fixed salary. Similarly, where a monthly target deadline was approaching, the point could be made that the incentive to sell an unsuitable product was that much higher.

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By contrast, certain more sophisticated staff incentive schemes included a high degree of “quality assurance” checks whereby sales calls would be recorded and reviewed, with any failing potentially resulting in a loss of commission. In those cases, evidence about robust staff training and monitoring procedures could be a real asset for firms facing a misselling claim. Ultimately though, PPI trials rarely turn on evidence about staff incentive schemes; the decisive factor is generally the oral evidence given by the consumer about the specific sale in dispute. However, the potential for staff incentive schemes to be considered by the court as relevant background does provide a useful test for any compliance officer or manager devising such a scheme: if a sale were later challenged in court, would the incentives and structure of the scheme make it more or less likely that a misselling claim would be upheld?

Existing FCA rules and guidance

On one level, the proposals in CP17/20 add little of substance to the extensive rules and guidance that already form part of what is euphemistically called the FCA “Handbook” (the hard-copy subscription costs £3,641 and, running to thousands of pages, is not very “handy” - it is much better to use the free online version). The Senior Management Arrangements, Systems and Controls sourcebook (SYSC) sets out organisational and systems and controls requirements for firms. In addition, the FCA expects 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”, as well as further requirements in the Threshold Conditions (COND) and SYSC when developing incentive and remuneration schemes for their staff.

Aside from sales, the most important area where incentive schemes play a role for consumer credit firms is in the collections department. The OFT first published consumer credit debt collection guidance in 2003. However, before regulation transferred to the FCA in 2014, the industry was more focused on recovery than forbearance and the identification of vulnerable customers. Nevertheless, even before the transfer to the FCA, the tide was turning. It was held by the Court of Appeal that a bank’s conduct in repeatedly using an automatic telephone dialler to call a customer could amount to harassment under the Prevention of Harassment Act 1997. Similarly, the High Court criticised the use of non-traceable calls and said that such conduct had no proper function in the collection of consumer debt, potentially giving rise to an unfair relationship under section 140A of the CCA.

Much of the content of CONC relating to debt collection derives from historic OFT guidance, but there is a strong sense that the industry now places far more emphasis on compliance rather than pure collections metrics. It will always be the case that there is potential tension between regulatory compliance and profit. The FCA points out, in CP17/20, that incentives based on productivity metrics (such as average time spent or number of calls made) can carry risks. Customers in arrears who are particularly vulnerable (such as customers with mental health difficulties) should be treated fairly and appropriately. Productivity based incentives could discourage staff from recognising vulnerability if this is likely to affect their bonus.

Potential for FCA action

The FCA sought to identify a “carrot” for firms by emphasising in CP17/20 that good practice in relation to staff incentives and performance management can increase profits by increasing staff satisfaction and retention rates, as well as customer loyalty. However, the consumer credit market is becoming increasingly competitive. For example, the PRA [statement](#) on consumer credit, which was published on 4 July 2017, noted that interest-free periods offered by credit card providers to win new customers have been increasing steadily since 2011.

In such a competitive market, profit margins inevitably shrink and firms may be tempted to fall back on target-driven performance management to survive. It is at that stage that the FCA will rely upon its “stick” by using its enforcement powers. The existence of specific rules and guidance in relation to staff incentives and performance management will make it easier for the FCA to justify taking action against firms that might already be facing other compliance issues. All firms would be well advised to review their internal procedures in the light of the examples of good and bad practice highlighted in the FCA draft guidance in CP17/20.

The deadline for responding to CP17/20 is 4 October 2017.

For more information on CP17/20, see *Practice note, Consumer credit: areas of FCA focus: FCA consults on staff incentives and performance management in consumer credit firms*. For more information on the PRA's statement on consumer credit, see *Legal update, PRA statement on consumer credit*.

Gough Square Chambers' consumer credit columns

For previous consumer credit columns written by barristers at Gough Square Chambers, see *Practice note, Gough Square Chambers' consumer credit columns*.