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CFPB Compliance Bulletin 2016-03

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Subject: Detecting and Preventing Consumer Harm from Production Incentives

Financial services companies, including entities supervised by the Consumer Financial Protection Bureau (CFPB or Bureau), may accomplish business objectives through programs that tie outcomes to certain benchmarks, both required and optional. Companies may apply these production incentives, including sales and other incentives, (“incentives”) to employees or service providers or both. The risks these incentives may pose to consumers are significant and both the intended and unintended effects of incentives can be complex, which makes this subject worthy of more careful attention by institutional leadership, compliance officers, and regulators alike. We thus will continue to invite further dialogue and discussion around the issues addressed in this Bulletin.

The Bureau acknowledges that incentives have been common across many economic sectors, including the market for consumer financial products and services. When properly implemented and monitored, reasonable incentives can benefit all stakeholders and the financial marketplace as a whole. For instance, companies may be able to attract and retain high-performing employees to enhance their overall competitive performance. Consumers may also benefit if these programs lead to improved customer service or introduce them to products or services that are beneficial to their financial interests.

Such incentives can affect a wide range of outcomes for employees or service providers, from their compensation levels to whether they will continue to be employed or retained at all. Incentives are found in many markets for consumer financial products and services, and span the life cycle from marketing to sales, servicing, and collection. Common examples include sales or referrals of new products or services to existing consumers (“cross-selling”), sales of products or services to new customers, sales at higher prices where pricing discretion exists, quotas for customer calls completed, and collections benchmarks.

This Bulletin compiles guidance the CFPB has already given in other contexts and highlights examples from the CFPB’s supervisory and enforcement experience in which incentives contributed to substantial consumer harm. It also describes compliance management steps that supervised entities should take to mitigate risks posed by incentives.

A. Risks to Consumers from Incentives

Despite their potential benefits, incentive programs can pose risks to consumers, especially when they create an unrealistic culture of high-pressure targets. When such programs are not carefully and properly implemented and monitored, they may create incentives for employees or service providers to pursue overly aggressive marketing, sales, servicing, or collections tactics. Through its supervisory and enforcement programs, the CFPB has taken action where employees have opened accounts or enrolled consumers in services without consent or where

employees or service providers have misled consumers into purchasing products the consumers did not want, were unaware would harm them financially, or came with an unexpected ongoing periodic fee.

Depending on the facts and circumstances, such incentives may lead to outright violations of Federal consumer financial law¹ and other risks to the institution, such as public enforcement, supervisory actions, private litigation, reputational harm, and potential alienation of existing and future customers. Specific examples of problems include:

- Sales goals may encourage employees, either directly or indirectly, to open accounts or enroll consumers in services without their knowledge or consent. Depending on the type of account, this may further result in, for example:
 - Improperly incurred fees;
 - Improper collections activities; and/or
 - Negative effects on consumer credit scores.
- Sales benchmarks may encourage employees or service providers to market a product deceptively to consumers who may not benefit from or even qualify for it;
- Paying compensation based on the terms or conditions of transactions (such as interest rate) may encourage employees or service providers to overcharge consumers, to place them in less favorable products than they qualify for, or to sell them more credit or services than they had requested or needed;
- Paying more compensation for some types of transactions than for others that were or could have been offered to meet consumer needs, which could lead employees or service providers to steer consumers to transactions not in their interests; and
- Unrealistic quotas to sign consumers up for financial services may incentivize employees to achieve this result without actual consent or by means of deception.

Whether conduct like that described in this Bulletin violates Federal consumer financial law will depend on all relevant facts related to the practices encouraged by the incentives. Further detail on some of the Bureau's work and findings in these areas is recapped below:

Credit Card Add-On Matters

To date, the CFPB has resolved 12 different cases involving improper practices to market credit card add-on products or to retain consumers once enrolled in these products.² The Bureau notes that incentives frequently enhanced the risk that banks would engage in such improper practices. In some cases, employees or service providers received incentives, and a lack of proper controls allowed deceptive marketing practices to continue unchecked for many years. Tapes of sales calls showed that employees and service providers deviated from the prepared call scripts in order to market the add-on products more aggressively, and often deceptively, to sign up more consumers. In all these matters, the companies' compliance monitoring, vendor

¹ Selected examples of these violations previously identified by the Bureau include the Dodd-Frank Act's prohibition of unfair, deceptive, and/or abusive acts or practices (UDAAPs) (Dodd-Frank Act, §§ 1031 & 1036(a), codified at 12 USC §§ 5531 & 5536(a); the Electronic Fund Transfer Act (EFTA), as implemented by Regulation E (15 USC § 1693 *et seq.*; 12 CFR Part 1005); the Fair Credit Reporting Act, as implemented by Regulation V (15 USC § 1681-1681x; 12 CFR Part 1022); the Truth in Lending Act (TILA), as implemented by Regulation Z (15 USC § 1601 *et seq.*; 12 CFR Part 1026); and the Fair Debt Collection Practices Act (15 USC § 1692-1692p).

² For more information on all of the matters noted in this Bulletin, please refer to the Bureau's website at <http://www.consumerfinance.gov/policy-compliance/enforcement/actions/>.

management, and quality assurance programs failed to prevent, identify, or correct these practices in a timely manner.

Overdraft Opt-in Matters

Incentives played a role in at least one matter where consumers were deceived into opting in to overdraft services. The Bureau found that, as a result of incentives for hitting specific targets, a bank's telemarketing service provider had deceptively marketed overdraft services and enrolled certain bank consumers in those services without their consent.

Unfair and Abusive Sales Practices

In another public enforcement action, a Bureau investigation revealed that thousands of bank employees had opened unauthorized deposit and credit card accounts to satisfy sales goals and earn financial rewards under the bank's incentives. Specifically, the Bureau found that employees engaged in "simulated funding" by opening hundreds of thousands of deposit accounts without consumers' knowledge or consent, which caused consumers to incur improper fees. The Bureau also found that employees issued tens of thousands of unauthorized credit cards that incurred improper fees, opened debit cards and created PINs to activate them without consumers' knowledge or consent, and enrolled consumers in online banking services using false email addresses.

B. The CFPB's Expectations

The CFPB expects supervised entities that choose to utilize incentives to institute effective controls for the risks these programs may pose to consumers, including oversight of both employees and service providers involved in these programs. As the CFPB has emphasized repeatedly, a robust compliance management system (CMS) is necessary to detect and prevent violations of Federal consumer financial law.³ An entity's CMS should reflect the risk, nature, and significance of the incentive programs to which they apply. Accordingly, the strictest controls will be necessary where incentives concern products or services less likely to benefit consumers or that have a higher potential to lead to consumer harm, reward outcomes that do not necessarily align with consumer interests, or implicate a significant proportion of employee compensation. While the CFPB does not mandate any particular CMS structure and recognizes that CMS structures may appropriately vary based on the size and complexity of an organization, the Bureau's supervisory experience has found that an effective CMS commonly has the following components:

- Board of directors and management oversight;
- Compliance program, which includes:
 - Policies and procedures;
 - Training; and
 - Monitoring and corrective action;
- Consumer complaint management program; and
- Independent compliance audit.

³ Supervision and Examination Manual: Compliance Management Review, *available at* <http://www.consumerfinance.gov/policy-compliance/guidance/supervision-examinations/>; Supervisory Highlights, multiple editions, *available at* <http://www.consumerfinance.gov/policy-compliance/guidance/supervisory-highlights/>.

To limit incentives from leading to violations of law, supervised entities should take steps to ensure their CMS is effective. These steps may include, but are not limited to:

- **Board of directors and management oversight:** Fostering a culture of strong customer service related to incentives. In product sales, for example, ensuring that consumers are only offered products likely to benefit their interests;
 - Board members and senior management should consider not only the outcomes these programs seek to achieve, but also how they may incidentally incentivize outcomes that harm consumers. They should authorize compliance personnel to design and implement CMS elements that address both intended and unintended outcomes, and provide adequate resources to do so.
 - The “tone from the top” should empower all employees to report suspected incidents of improper behavior without fear of retaliation, providing easily accessible means to do so.
- **Policies and procedures:** Ensuring that the policies and procedures for incentives contain:
 - Employee sales/collections quotas that, if a part of an entity’s incentive program, are transparent to employees and reasonably attainable;
 - Clear controls for managing the risk inherent in each stage of the product life cycle (as applicable): marketing, sales (including account opening), servicing, and collections;
 - Mechanisms to identify potential conflicts of interest posed for supervisory personnel who are covered by incentives but also are responsible for monitoring the quality of customer treatment and customer satisfaction; and
 - Fair and independent processes for investigating reported issues of suspected improper behavior.
- **Training:** Implementing comprehensive training that addresses:
 - Expectations for incentives, including standards of ethical behavior;
 - Common risky behaviors for employees and service providers to foster greater awareness of primary risk areas;
 - Terms and conditions of the institution’s products and services so that they can be effectively described to consumers; and
 - Regulatory and business requirements for obtaining and maintaining evidence of consumer consent.
- **Monitoring:** Designing overall compliance monitoring programs that track key metrics – and outliers – that may indicate incentives are leading to improper behavior by employees or service providers. Examples of possible monitoring metrics include, but are not limited to:
 - Overall product penetration rates by consumer and household;
 - Specific penetration rates for products and services (such as overdraft, add-on products, and online banking), as well as penetration rates by consumer segment;
 - Employee turnover and employee satisfaction or complaint rates;
 - Spikes and trends in sales (both completed and failed sales) by specific individuals and by units;
 - Financial incentive payouts; and
 - Account opening/product enrollment and account closure/product cancellation statistics, including by specific individuals and by units, taking into account the terms of the incentive programs (i.e., requirements that accounts be open for a period of time or funded in order for employees to obtain credit under the program).

- **Corrective Action:** Promptly implementing corrective actions to address any incentive issues identified by monitoring reviews as areas of weakness:
 - Corrective actions should include the termination of employees, service providers, and managers, as necessary, and these termination statistics should be analyzed for trends and root cause(s);
 - Corrective actions should include changes to the structure of incentives, training on these programs, and return of funds to all affected consumers as appropriate in light of failed sales or heightened levels of customer dissatisfaction;
 - All corrective actions should ensure that the root causes of deficiencies are identified and resolved; and
 - Findings should be escalated to management and the board, particularly where they appear to pose significant risks to consumers.
- **Consumer complaint management program:** Collecting and analyzing consumer complaints for indications that incentives are leading to violations of law or harm to consumers in order to identify and resolve the root causes of any such issues; and
- **Independent compliance audit:** Scheduling audits to address incentives and consumer outcomes across all products or services to which they apply, ensuring audits are conducted independently of both the compliance program and the business functions, and ensuring that all necessary corrective actions are promptly implemented.

For more information pertaining to the oversight of incentive programs, please review the CFPB's *Supervision and Examination Manual*.⁴ Specific modules referencing these programs include: *Compliance Management Review, Unfair, Deceptive, and Abusive Acts or Practices, Debt Collection, Credit Card Account Management, Consumer Reporting, Mortgage Origination, Short-Term Small Dollar Lending*, and the *Equal Credit Opportunity Act*. Other relevant Bureau guidance includes: CFPB Bulletin 2012-06 (Marketing of Credit Card Add-on Products),⁵ and CFPB Bulletin 2016-02 (Service Providers, amending and reissuing CFPB Bulletin 2012-03).⁶

C. Regulatory Requirements

This Compliance Bulletin is a non-binding general statement of policy articulating considerations relevant to the Bureau's exercise of its supervisory and enforcement authority. It is therefore exempt from notice and comment rulemaking requirements under the Administrative Procedure Act pursuant to 5 USC 553(b). Because no notice of proposed rulemaking is required, the Regulatory Flexibility Act does not require an initial or final regulatory flexibility analysis. 5 USC 603(a), 604(a). The Bureau has determined that this Compliance Bulletin does not impose any new or revise any existing recordkeeping, reporting, or disclosure requirements on covered entities or members of the public that would be collections of information requiring OMB approval under the Paperwork Reduction Act, 44 USC 3501, *et seq.*

⁴ CFPB Supervision and Examination Manual, *available at* http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf.

⁵ CFPB Bulletin 2012-06, *available at* http://files.consumerfinance.gov/f/201207_cfpb_marketing_of_credit_card_addon_products.pdf.

⁶ CFPB Bulletin 2016-02, *available at* http://www.consumerfinance.gov/documents/1385/102016_cfpb_OfficialGuidanceServiceProviderBulletin.pdf.