EBA/CP/2015/29

22 December 2015

Consultation Paper

Draft Guidelines

on remuneration policies and practices related to the sale and provision of retail banking products and services

Contents

1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in Section 5.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 22.03.2016. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

The remuneration of staff in general, and of persons directly offering or providing products or services to consumers in particular, is an important means by which financial institutions attract, motivate and retain employees with the skills needed for the institution's success.

However, developments in recent years have shown significant cases of misconduct and mis-selling by staff in financial institutions, with poor remuneration policies and practices having been identified as a key underlying driver. The impact of mis-selling has been considerable, in that it has caused detriment to consumers as a result of inappropriate, unsuitable or excessively priced products; has resulted in unfair pressure exerted on sales staff; has impacted negatively on financial institutions as a result of fines, penalties, settlements, redress, compensation payouts, and litigation; has undermined confidence in financial institutions and markets, and has created economic costs to society through the misallocation of resources.

In order to address this issue, the EBA is issuing a Consultation Paper with draft Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services. The draft Guidelines apply to remuneration paid to staff employed by credit institutions, creditors, credit intermediaries, payment institutions and electronic money institutions, when selling mortgages, personal loans, deposits, payment accounts, payment services, and/or electronic money. They are aimed at providing a framework for financial institutions to implement remuneration policies and practices that will improve links between incentives and the fair treatment of consumers and reduce the risk of mis-selling and resultant conduct costs for firms.

To that end, the draft Guidelines cover the design of remuneration policies and practices, which includes taking into account the rights and interests of consumers; preventing of conflicts of interests; and using quantitative and qualitative criteria for determining the level of variable remuneration. Furthermore, the Guidelines require that remuneration policies and practices are documented, retained for at least five years, made available to competent authorities upon request, and are easily accessible to staff. The Guidelines also provide that the management body retains ultimate responsibility and should seek independent advice in relation to the fulfilment of these Guidelines.

Next steps

The consultation period will run from 22 December 2015 to 22 March 2016. The final Guidelines will be published after consultation.

3. Background and rationale

3.1 Background

1. The remuneration of staff in general, and of persons directly offering or providing products or services to consumers in particular, is an important means by which financial institutions attract, motivate and retain employees with the skills needed for the institution's success.

2. However, developments in recent years, both at a European and international level, have shown significant cases of misconduct and mis-selling by staff in financial institutions, with poor remuneration policies and practices having been identified as a key underlying driver. The impact of remuneration-driven mis-selling has been considerable, in that it has:

   a. caused detriment to consumers as a result of inappropriate, unsuitable or excessively priced products;

   b. resulted in unfair pressure exerted on sales staff, who are incentivized to mis-sell, including through the threat of disciplinary actions, demotion, participation in performance improvement programs or overreliance on bonuses as their primary form of income[1].

   c. impacted negatively on financial institutions as a result of fines and penalties imposed through regulatory proceedings; settlements with regulators; sums paid to third parties as required by regulators, such as redress and compensation; loss of income resulting from conduct failure; or sums paid in relation to litigation proceedings;

   d. undermined confidence in financial institutions and markets through contagion effects spilling over to neighbouring firms;[2]

   e. threatened the integrity of the financial system as a result of penalties imposed on banks following litigation proceedings, deficiencies in capital coverage or provisioning for costs of misconduct and business restrictions either imposed by authorities or voluntarily implemented in order to prevent fines and adverse impacts on reputation[3]; and

   f. has created costs to society overall through the misallocation of resources.

[1] Consumers International (2014), Risky business: The case for reform of sales incentives schemes in banks

[2] EBA/ESMA/EIOPA (2015), Joint Committee Report on Risks and Vulnerabilities in the EU Financial System, March 2015

[3] ESRB (2015), Report on Misconduct Risk in the Banking Sector, June 2015

3. Recent research suggests that between 2004 and September 2015, 10 major global banks alone incurred cumulative conduct-related costs of around USD 210 billion [4], equivalent to 2,8% of their revenues. More than 40 % of the total costs were related to banks' conduct with non-US consumers. The potential risks to the financial system of widespread misconduct of financial institutions have also been identified and analysed in various reports by European authorities[5]. These reports identify a widening number and magnitude of incidents of mis-selling of financial products, and of remuneration policies and practices as one of the underlying drivers. Some national authorities also carried out in-depth analysis in their own jurisdictions and arrived at similar conclusions.[6]

3.2 Rationale

4. For the European Banking Authority (EBA), the topic of remuneration is not new: following work in 2014, the EBA published on 21 December 2015 the Guidelines on Sound Remuneration Policies[7], which are aimed at ensuring that remuneration policies regarding staff of credit institutions are based on sound governance processes, take into account the risk strategy and profile of the credit institutions and align incentives to the interests of all the stakeholders. The Guidelines on Sound Remuneration Policies have a prudential focus and use the mandates conferred on the EBA by CRD IV as a legal basis.

5. In order also to align remuneration incentives with the interest of consumers, the Guidelines on Sound Remuneration Policies had already flagged that the EBA is working on separate supplementary requirements to address remuneration as a driver of mis-selling and consumer detriment (see page 114 of the Guidelines).

6. To that end, the EBA is issuing the present Consultation Paper, with draft Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services. The products covered by the Draft Guidelines consist of all products that fall into the EBA' scope of action, i.e. mortgages, personal loans, deposits, payment accounts, payment services, and electronic money. These requirements apply without prejudice to the requirements established in the Guidelines on Sound Remuneration Policies referred to above.

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[4] See CCP Research Foundation (2014), Conduct Costs Project; http://conductcosts.ccpresearchfoundation.com/; also: Autonomous (2014), Global Banks - Litigation Costs Update. Figure includes conduct costs incurred for reasons other than mis-selling.

[5] EBA (2014), Consumer Trends Report 2014; EBA (2014) Risk Assessment of the European Banking System, EBA / ESMA / EIOPA (2014), Joint Committee Report on Risks and Vulnerabilities in the EU Financial System

[6] See Bank of England (2014), *Financial Stability Report - June*, Financial Conduct Authority (2014), *Risk Outlook 2014*; UK FSA at http://www.fsa.gov.uk/library/communication/speeches/2012/0905-mw.shtml; and Central Bank of Ireland (2014) at http://www.centralbank.ie/press-area/press-releases/Pages/CentralBankinspectionhighlightsinsufficientqualitycontrolsforincentivespaidtosalesstaff.aspx

[7] https://www.eba.europa.eu/documents/10180/1314839/EBA-GL-2015-22+Guidelines+on+Sound+Remuneration+Policies.pdf

7. The present Draft Guidelines provide details on how financial institutions should give effect to specific provisions laid down in applicable EU Directives, such as (i) the mandate conferred on the EBA in Article 74(3) of CRD IV to develop guidelines on remuneration policies and practices, including governance arrangements (as mentioned above), (ii) Article 7(2) of MCD, which requires Member States to ensure that the manner in which creditors remunerate their staff and credit intermediaries and the manner in which credit intermediaries remunerate their staff and appointed representatives put in place incentives for them to act honestly, fairly, transparently and professionally, taking account of the rights and interests of consumers, and (iii) Article 10(4) of PSD and Article 3(1) of EMD that require financial institutions to have in place robust governance arrangements which could be interpreted as requiring sound remuneration practices.

8. These Draft Guidelines are designed to cover the remuneration policies and practices for staff (as natural persons) of credit institutions, creditors, credit intermediaries, payment institutions and electronic money institutions who are directly engaged with consumers, as well as those who manage such staff, both thereafter referred as “relevant persons”.

9. For the avoidance of doubt, with regards to the remuneration of credit intermediaries, these Draft Guidelines do not cover remuneration (also referred as “commissions”) paid by financial institutions to credit intermediaries. However, these draft guidelines are without prejudice to the remuneration rules laid down under the MCD and in particular under Article 7 (2) MCD which requires that where creditors remunerate credit intermediaries, they must take into account of the rights and interests of consumers. The EBA is therefore of the opinion that where institutions rely on credit intermediaries for the provision of retail banking products and services, they should not use credit intermediaries as a way to circumvent these draft guidelines. Furthermore, the EBA may, in the future, review these draft Guidelines and extend them to cover commissions paid to credit intermediaries.

10. Moreover, these Draft Guidelines are without prejudice to any decision made by Member States to ban commissions paid by the creditor to the credit intermediary, as provided in Article 7(4) MCD.

11. The requirements are intended to provide a framework for financial institutions to implement remuneration policies and practices that will improve links between incentives and the fair treatment of consumers and reduce the risk of mis-selling and resultant conduct costs for firms.

12. Remuneration under these draft guidelines encompasses all forms of remuneration, both fixed and variable and including non-monetary forms of reward which may be assigned to the relevant persons of financial institutions. A broad definition of ‘remuneration’ is used in the process, as incentives may arise not only from direct monetary payments, such as bonuses, but also through other means, such as allowances, generous health insurance, contributions to pension schemes, or career progression. This is to prevent institutions from

shifting the pressure on relevant persons away from pure monetary remuneration incentives and making use instead of performance management as a vehicle to promote sales targets or other behaviours that prioritise the interests of the financial institution to the detriment of consumers.

13. The draft guidelines also provide that remuneration should not be solely linked to a quantitative target or promote one specific product or category of products over others to the potential benefit of the financial institution but detriment to the consumer. They also require financial institutions to document their remuneration policies and practices, and require that relevant persons are clearly informed how these policies and practices apply to them before they are allowed to offer or provide services to consumers.

14. The draft guidelines have been developed against the background of numerous undesirable remuneration policies and practices that the EBA has observed and that it wishes to prevent in the future. These include, but are not limited to:

    - The strategic goals of a financial institution focus solely on the total volume of banking products offered or provided to consumers. The remuneration policy is in line with these strategic goals, is based mainly on the total volumes of banking products offered or provided to consumers and does not take into account consumers' rights and interests.

    - Relevant persons receive a remuneration linked to one or several specific banking products offered or provided to consumers. As a result, they offer or provide those products irrespective of the consumers' rights and interests.

    - Increased incentives as the number of sales increases in a particular time period (a so called 'accelerator feature'), so that relevant persons are highly incentivized to offer or provide banking products irrespective of the consumers' rights and interests.

    - A financial institution organises competitions where members of staff of relevant persons are incentivised to outperform their peers or to meet challenging thresholds in a short timeframe, in order for them to receive financial or non-financial remuneration.

    - Managers adjust non-monetary forms of reward of relevant persons solely according to the volume of banking products offered or provided to consumers, for instance when dealing with promotions, training opportunities and annual leave requests.

15. On the contrary, these guidelines aim at developing good remuneration policies and practices that, if applied, might enhance consumers' protection and might, as such, also contribute to the effectiveness of the financial system more generally. These include, but are not limited to:

- The variable part of the remuneration is calculated and awarded on a linear basis, rather than being dependent on meeting a predefined 'all or nothing' target.

- The financial institution pays out the variable remuneration in several tranches over an appropriate time period, in order to adjust for, and take into account, the long term outcomes for the consumers.

- Factors used in the calculation of variable remuneration of relevant persons are common across products offered or provided to consumers and include qualitative criteria, such as the outcomes for consumers (e.g. based on the number and content of the complaints received) or on consumer retention targets.

- The remuneration policy does not place more weight on the offering or provision of some banking products over others.

- A financial institution uses a wide range of information on quality and patterns of the provision of banking products to consumers to identify areas of increased risk of mis-selling. The institution ensures that the results of such analyses are documented and reported to senior management, together with eventual proposals for corrective action.

- A financial institution contacts a sample of consumers through staff independent from relevant persons, after they have been offered or provided a banking product, so as to test whether the institution's remuneration policies and practices are supporting relevant persons in acting honestly, fairly and professionally, and in accordance with consumers' rights and interests.

- Top earners among relevant persons are recognised as having a high mis-selling risk profile and, as a result, additional scrutiny is given to them. The outputs of this scrutiny have an impact on the design and review of the remuneration policies and practices.

16. The National Competent Authorities will apply these Draft Guidelines in a proportionate manner as a general principle of Union law. However all financial institutions should comply with these Draft Guidelines and should ensure at all time the alignment of their remuneration incentives with fair treatment of consumers. Where these Draft Guidelines indicate an outcome, the outcome may be achieved by the financial institution through different means. The appropriateness of the means used by the financial institution will be assessed by competent authorities, according to the business model, scale and complexity of the financial institution.

4. Draft Guidelines

EBA/GL /20XX/XX

DD Month YYYY

Guidelines

on remuneration policies and practices related to the sale and provision of retail banking products and services

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010[8]. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.

2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by [dd.mm.yyyy]. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to compliance@eba.europa.eu with the reference 'EBA/GL/xxxx/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.

4. Notifications will be published on the EBA website, in line with Article 16(3).

[8] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

2. Subject matter, scope and definitions

Subject matter and scope of application

5. These guidelines specify requirements for the design and implementation of remuneration policies and practices, in relation to the offering or provision of banking products and services to consumers by institutions as defined in paragraph [13]. These guidelines do not cover remuneration paid by financial institutions to credit intermediaries (often also referred to as "commissions"). However, these guidelines are without prejudice to the remuneration rules laid down under the MCD and in particular under Article 7 (2), MCD which requires that, where creditors remunerate credit intermediaries, they must take into account the rights and interests of consumers.

6. Relevant banking products and services are those which fall within the scope of the legislative acts under which institutions are authorized or admitted to carry out their activities as defined in paragraph [13].

7. Competent authorities may wish to consider applying these guidelines also to entities other than institutions as defined in paragraph [13], in particular to:

    a. intermediaries other than credit intermediaries as defined in Article 4(5) of Directive 2014/17/EU;

    b. 'appointed representatives' as defined in Article 4(8) of Directive 2014/17/EU.

8. Competent authorities may wish to consider applying these guidelines in relation to persons other than consumers as defined in paragraph [13], such as micro-enterprises and small and medium-sized enterprises (SMEs).

9. Finally, competent authorities may wish to consider extending the remuneration principles set out in these guidelines also to remuneration (also referred as "commissions") paid by financial institutions to credit intermediaries.

10. Where these guidelines indicate an outcome, the outcome may be achieved through different means.

Addressees

Addressees of these Guidelines

11. The guidelines are addressed to :

a. competent authorities as defined in Article 4(2)(i) of Regulation (EU) No 1093/2010 (EBA authority). With respect to creditors and credit intermediaries referred to in the definition of 'Institutions' in paragraph 13 which are not credit institutions, payment institutions or electronic money institutions as referred to in that definition, the guidelines apply to the extent that those authorities have been designated as competent for ensuring the application and enforcement of the provisions of Directive 2014/17/EU to which these guidelines relate; and

b. financial institutions as defined in Article 4(1) of Regulation (EU) No 1093/2010.

Addressees of information requirements

12. Irrespective of whether an EBA authority is addressed under paragraph 11, where a Member State has designated more than one authority in accordance with Article 5 of Directive 2014/17/EU and one of them is not an EBA authority, the EBA authority designated under that Article should, without prejudice to national arrangements adopted under Article 5 (3) of Directive 2014/17/EU:

   a) inform without delay the other designated authority of these guidelines and their date of application;

   b) ask that authority in writing to consider applying these guidelines;

   c) ask that authority in writing to inform either the EBA or the EBA authority within two months of the notification under subparagraph (a) whether it applies or intends to apply these guidelines; and

   d) where applicable, forward without delay to the EBA the information received under subparagraph (c).

Definitions

13. Unless otherwise specified, the definitions provided in the legislative acts referred to in this paragraph have the same meaning in these guidelines. In addition, for the purposes of these guidelines, the following definitions apply:

Consumer	A natural person, who is acting for purposes which are outside his trade, business or profession.
Institutions	a) 'Credit institutions' as defined in Article 4(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms;

	b) 'Creditors' as defined in Article 4(2) of Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property; c) 'Credit intermediaries' as defined in Article 4(5) of Directive 2014/17/EU; d) 'Payment institutions' as defined in Article 4(4) of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market; e) 'Electronic money institutions' as defined in Article 1(1) of Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions.

Banking products and services	a) 'credit agreements' as defined in Article 4(3) of Directive 2014/17/EU;
	b) 'deposits' as defined in Article 2(3) of Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes[9];
	c) 'payment accounts' as defined in Article 4(14) of Directive 2007/64/EC;
	d) 'payment services' as defined in Article 4(3) of Directive 2007/64/EC;
	e) 'payment instruments' as defined in Article 4(23) of Directive 2007/64/EC;
	f) other means of payment, as listed in Annex 1(5) Directive 2013/36/EU ;
	g) 'electronic money' as defined in Article 2(2) of Directive 2009/110/EC; and
	h) other forms of credit, in addition to that in (a) in line with Article 1(5)(e) of Regulation (EU) No 1093/2010.

Management body	An institution's body or bodies, which are appointed in accordance with national law, which are empowered to set the institution's strategy, objectives and overall direction, and which oversee and monitor management decision-making, and include the persons who effectively direct the business of the institution.

[9] Deposits include all forms of deposits. The Markets for Financial Instruments Directive 2014/65/EU (MiFID2) has extended, in line with its Article 1(4), certain organisational and conduct of business rules to the subset of deposits called structured deposits, as defined in point (43) of Article 4(1) of MiFID2. MiFID 2 remuneration rules, including future delegated acts setting further specifications in relation to Articles 16(3) and Article 24(10) of MiFID2, will apply to structured deposits and therefore these Guidelines will not apply in relation to them after the application date of MIFID2.

Relevant persons	Any natural person working for an institution and who is: a) directly offering or providing banking products or services to consumers; or b) directly or indirectly managing a person referred to in point (a).
Remuneration	All forms of fixed and variable remuneration, including payments made or benefits, monetary or non-monetary, awarded directly by or on behalf of institutions to relevant persons. Non-monetary benefits may include, but are not limited to, career progression, health insurance, discounts or special allowances for car or mobile phone, generous expense accounts, seminars.

Outsourcing

14. In the case where the activity of the institution is in whole or in part outsourced to third parties, or carried out by another entity in other ways, institutions should ensure that, in doing so, that they comply with the requirements established in the CEBS Guidelines on outsourcing[10]. This includes, in particular, CEBS Guideline 2, which provides that 'the ultimate responsibility for the proper management of the risks associated with outsourcing or the outsourced activities lies with an outsourcing institution's senior management'.

[10] CEBS, *Guidelines on outsourcing*, (2006).

3. Implementation

Date of application

15. These guidelines apply from 3 January 2017.

4. Guidelines on remuneration policies and practices

1. Design

1.1. The institution should design and implement remuneration policies and practices that take into account the rights and interests of consumers and prevent conflicts of interest from arising whereby relevant persons favour their own interests, or the institution's interests, to the detriment of consumers.

1.2. When designing the remuneration policies and practices, institutions should consider whether these policies and practices introduce any risks of detriment to consumers and should mitigate such risks from arising.

1.3. The human resources function of the institution should participate in and inform on the design of the remuneration policies and practices. In addition, where established, the risk and compliance functions should provide effective input for the design of the remuneration policies and practices.

1.4. For the purpose of evaluating the performance of a relevant person, the institution should define in the remuneration policy and practices the appropriate criteria to be used to assess performance, taking into account the rights and interests of consumers.

1.5. When designing the remuneration policies and practices, the institution should consider both, qualitative and quantitative criteria for determining the level of variable remuneration to ensure that the rights and interests of consumers are adequately considered.

1.6. The institution should not design remuneration policies and practices that:

a. solely link remuneration to a quantitative target for the offer or provision of products and services; or

b. promote, to the potential detriment of consumers, the offer or provision of a specific product or category of products over other products, such as the offer or provision of products which are more profitable for the institutions over others which are less profitable.

1.7. Where the remuneration policies and practices allow for variable remuneration, the institution should ensure that the ratio between the fixed and variable components of the remuneration is appropriately balanced and takes into account the rights and interests of consumers. Furthermore, the remuneration policies and practices in place should allow the operation of a flexible policy on variable remuneration, including the possibility to pay no variable remuneration where appropriate.

1.8. When designing remuneration policies and practices, the institution should ensure that monetary and/or non-monetary forms of remuneration do not introduce incentives for relevant persons to favour their own interests, or the institution's interests, to the detriment of consumers.

1.9. The institution should avoid unnecessarily complex policies and practices and unclear combinations of different policies and practices.

2. Documentation, notification and accessibility

2.1. The institution should document remuneration policies and practices, keep them for audit purposes for at least five years from the last date that they applied, and make them available to the competent authorities upon request. This documentation should include, but is not limited to:

a) the objective of these policies and practices;

b) the staff within scope of these policies and practices.

2.2. The institution should record how remuneration policies and practices have been implemented in practice, in order to demonstrate compliance to Competent Authorities.

2.3. Before being allowed to offer banking products or services to consumers, relevant persons should be clearly informed in a simple and transparent manner of the remuneration policies and practices that are applicable to them.

2.4. The remuneration policies and practices should be easily accessible to all relevant persons of the institution.

3. Approval and monitoring

3.1. The management body retains ultimate responsibility for the institution's remuneration policies and practices.

3.2. The management body should seek a sound independent advice on the institution's remuneration policies and practices in relation to the fulfilment of these guidelines. Where established, the remuneration committee may provide this independent advice.

3.3. Where established, the compliance function should confirm that the remuneration policies and practices comply with these guidelines.

3.4. Changes to the remuneration policies and practices should only be made with the approval of the management body, or someone formally delegated from the management body.

3.5. The institution should review, at least annually, the remuneration policies and practices and confirm that they continue to be fit for purpose. Where established, the supervisory function should conduct this review.

3.6. The institution should establish effective controls to check that their remuneration policies and practices are being adhered to, and to identify and address incidents of non-compliance.

3.7. Where the institution identifies that a residual risk of consumers' detriment might arise as a result of the design of remuneration policies and practices as referred to in paragraph 1.2 of these guidelines, the institution should check at least annually, whether any of these residual risks are crystallising and causing detriment to consumers.

5. Consultation questions

Question One:	Do you agree with Guideline 1 on design?
Question Two:	Do you agree with Guideline 2 on documentation?
Question Three:	Do you agree with Guideline 3 on approval and monitoring?
Question Four:	Do you see a need for any additional requirements?
Question Five:	Do you have any other comments?

6. Accompanying documents

6.1. Draft cost-benefit analysis / impact assessment

A. Problem identification

1. The market for financial services such as retail banking products is prone to failures[11] and the market outcome influenced by behavioural biases[12]. Recent research has shown that EU consumers perceive the market for banking services as the worst performing segment of the Internal Market[13]. Poorly designed and overseen policies and practices for remuneration of sales staff can play an important role in reducing the misconduct and mis-selling of retail banking products[14] by financial institutions.

2. Conflicts of interest and misalignment of the incentives of sales staff with consumers' interest bear the potential to exacerbate principal-agent problems inherent in the market for financial services.[15] In particular, variable remuneration elements entail a significant risk of the sales staff exploiting, rather than alleviating, information asymmetries prevalent in credit intermediation.[16] The problem is aggravated by the observation that the majority of consumers are not provided information about the remuneration structure of the sales person.[17] Mis-selling of retail banking products have recently led to significant consumer detriment.[18] Beyond the consumer protection perspective, significant deterioration in consumer confidence in the market for financial services and losses incurred by credit institutions as a result of misconduct-related costs are of concern also from a prudential perspective.[19]

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[11] Europe Economics (2007): *An analysis of the issue of consumer detriment and the most appropriate methodologies to estimate it – Final report for DG SANCO*

[12] Chater et al: Consumer decision-making in retail investment services – A behavioural economics perspective (2010)

[13] European Commission (2013): *Monitoring consumer markets in the European Union* (

[14] European Commission (2009*): Staff working document on the follow up in retail financial services to the consumer markets scoreboard*

[15] Synovate (2011): *Consumer market study on advice with the area of retail investment services – Final report for DG Health and Consumer Protection*

[16] Europe Economics (2009): *Study on credit intermediaries in the Internal Market – Final report for DG Internal Market and Services (2009)*

[17] European Commission (2012), *Special Eurobarometer 373 – Retail Financial Services)*

[18] EBA (2015), *Consumer Trends Report (2015)*

[19] EBA (205): *Risk Assessment of the European Banking System (June 2015),*; Joint Committee of the ESAs (2015): *Report of Risks and Vulnerabilities in the EU Financial System (March 2015*); ESRB (2015), *Report on Misconduct Risk in the Banking Sector (2015)*

B. Policy objectives

3. In general terms, these GL aim at improving the protection of consumers and the functioning of the market for retail banking services in the EU[20]. More specifically, the requirements contained are developed with a view to facilitating a closer alignment of the incentives of sales staff with the interest of consumers of retail banking services.

4. At the operational level, these GL should ensure that the design, documentation, approval and oversight of remuneration policies and practices for staff selling retail banking products improve links between incentives and the fair treatment of consumers, and reduce the level of risk and potential for mis-selling[21].

C. Baseline scenario

5. Without regulatory intervention, the risk of consumers experiencing detriment and problems in the functioning of the market for retail banking services identified above would most likely persist. More precisely, incentives of sales staff could continue to be misaligned with consumers' interest and biased remuneration policies and practices be a cause for misselling of products[22].

D. Options considered

6. In developing these GL, a number of technical options are considered regarding the:

- Necessity of EBA regulatory intervention

  Option 1.1: Abstaining from regulatory intervention;

  Option 1.2: Developing and issuing Guidelines on remuneration policies and practices related to retail banking products.

- Coverage of remuneration elements

  Option 2.1: Focussing on monetary remuneration elements;

  Option 2.2: Including non-monetary remuneration elements.

[20] EBA (2015), *EBA Work Programme*, EBA (2014), *Annual Report*;

[21] European Commission (2009), Recommendation on remuneration policies in the financial services sector;

[22] European Commission (2014), Conference on emerging challenges in retail finance and consumer policies – final report;

- Proportionality in the context of these GL:

  Option 3.1: requiring compliance in outcome, leaving freedom of means according to business model, scale and complexity

  Option 3.2: prescribing specific means, but only requiring compliance of certain categories of more relevant institutions

E. Cost-Benefit Analysis and preferred options

7. Generally, the incremental costs and benefits of these GL – one-off as well as on-going – predominantly affect consumers of retail banking products, institutions and the sales staff providing those services and the wider market for retail banking products in the EU.

8. Regarding the necessity of EBA regulatory intervention, the European Commission's *Monitoring of Consumer Markets*[23] (2013 edition) reveals that EU consumers perceive the market for banking services (constituted of loans, credit and credit cards, mortgages, investment products, private pensions and securities and bank accounts) as the poorest performing segment of the Internal Market. Investment products, private pensions and securities, and mortgages are the two poorest rated amongst the entire selection of services in the view of experienced consumers. EU consumers particularly express a very low level of trust and expectations in the banking services market, combined with an above-median percentage of problems and complaints. In addition to the adverse financial impact on purchasing experienced consumers, the low levels of trust and expectations could in the end dampen market activity in retail banking.

9. The Commission's *Eurobarometer* (Special 373) indicates that when purchasing a financial product, most consumers are not told whether the sales person receives a bonus or any other form of additional remuneration if they take a particular product. That lack of transparency towards consumers as regards staffs' sales incentives is particularly prevalent in the distribution of mortgages, current bank accounts, personal loans and credit cards.

10. According to recent ESRB estimates (ESRB 2015), a sample of 20 major globally active banks has incurred misconduct costs of around 200 bn EUR since 2009. Half of that amount (100 bn EUR) is estimated to be related to misselling (to retail or professional customers). Misconduct costs of EU banks are estimated to represent a quarter of the total amount (50 bn EUR).

11. Analysis conducted by EBA staff for a sample of 56 major EU banks resident in 21 jurisdictions based on public statements estimates litigation and misconduct costs amounting EUR 75 bn since 2009. EBA's assessment confirms remuneration policies and practices and misaligned incentives of sales staff to be a relevant driver of conduct risk in the banking sector.

[23] For the purpose of these GL, the term "banking services" is defined slightly different from the referred study.

12. The UK Financial Conduct Authority (FCA) also reports that by end July 2015 (since January 2011) banks have paid out their customers 20.8 bn GBP (refunds and compensation) as a result of misselling of payment protection insurance (PPI). According to the same source, in the first half of 2015 almost 740 000 new complaints were opened in relation to banking and credit card products. Almost 280 000 of those complaints were related to the advising, selling and arranging of those products[24].

13. Taking into account the large amounts of direct and indirect costs related to misselling for consumers as well as providers of retail banking products observed in the recent years, and the causal link with sales incentives and remuneration policies and practices, the development and issuance of guidelines on EBA own-initiative is expected to create net benefits for consumers and the market for retail banking services in the EU and is thus the preferred option (Option 1.2).

14. Regarding the coverage of remuneration elements, remuneration of staff selling retail banking products consists of monetary and non-monetary elements. According to a study conducted for the EU Commission's DG Internal Market, non-financial incentives tend to be more long-term oriented, strengthen the retention of staff and provide the supplier the possibility to use tax advantages. [25] By nature, they are less transparent to consumers than financial incentives. Although it is difficult to precisely estimate the proportion of non-monetary elements in staffs' total remuneration package, for staff selling financial products in the EU it is estimated to lie in a range between 1 and 2% of total remuneration. Based on this analysis, it is preferred that these GL cover monetary and non-monetary remuneration elements to restrict circumvention and facilitate effectively achieving the policy objectives stated above (Option 2.2). This approach is consistent with remuneration requirements for sales staff in other areas of financial services[26,27].

15. Regarding proportionality in the application of these GL, requiring compliance with these GL only from a specific category of institutions, for instance systemically important institutions (SII), would not be appropriate and insufficient to address the risks described above. The potential for misselling and consumers experiencing detriment in retail financial services is amongst others a function of the institutions' market share more than of their size or complexity. In addition, market shares in retail banking can change quite dynamically over time.

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[24] FCA (2015), *Complaints data* (June 2015), FCA: Monthly PPI payouts (July 2015)

[25] Institut fuer Finanzdienstleistungen (2013)*: Study on remuneration structures of financial service intermediaries and conflicts of interest – Final report* ;

[26] Europe Economics (2010): S*tudy on costs and benefits of potential changes to distribution rules for insurance investment products and other non-MiFID packaged retail investment products – Final Report for DG Internal Market and Services*

[27] EU Commission (2011) Impact assessment accompanying the proposal for a Directive and Regulation on the Markets in Financial Instruments;

16. Furthermore, depending of national specificities, national markets for retail banking services may exhibit a rather low degree of concentration with many players active, including small and fast growing “challenger institutions”[28]. The protection of EU consumers of retail banking services is going to be fostered more effectively by requiring general compliance with these GL from all institutions as defined above. However, proportionality is achieved by ensuring that where the guidelines indicate an outcome, the outcome may be achieved by the institution through different means.

[28] ECB: Banking Structures Report (2014)