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December 1, 2016

To: Clients and Friends

From: David F. Dulock

Subject: CFPB Bulletin 2016-03, Detecting and Preventing Consumer Harm from Production Incentives

On November 28, 2016, the Consumer Financial Protection Bureau (CFPB) published Bulletin 2016-03 (Bulletin), *click here*, warning financial services companies, including entities supervised by the CFPB, of the detrimental effect incentives for employees and service providers to meet sales and other business goals can have on consumers if these incentives are not properly managed and supervised. The Bulletin describes compliance management steps supervised entities should take to mitigate risks posed by incentives.

The CFPB expects supervised entities that utilize incentives to institute effective controls for the risks these incentives may pose to consumers, including oversight of employees and service providers involved in these incentive programs. These controls include a compliance management system (CMS) that reflects the risk, nature, and significance of the incentive programs to which they apply, with the strictest controls where incentives (i) apply to products or services less likely to benefit consumers or that have a higher potential to lead to consumer harm, (ii) reward outcomes that do not align with consumer interests, or (iii) involve a significant proportion of employee or service provider compensation. The Bulletin sets out the following components and steps of an effective CMS.

Board of Directors and Management Oversight that fosters a culture of strong customer service related to incentives. Board members and senior management should:

- consider not only the outcomes these incentive programs seek to achieve, but also how they may incidentally incentivize outcomes that harm consumers;
- authorize compliance personnel to design and implement CMS elements that address both intended and unintended outcomes, and provide adequate resources to do so; and
- create by leadership and commitment a company climate that empowers all employees to report suspected incidents of improper behavior without fear of retaliation, providing easily accessible means to do so.

Compliance Program that includes:

- *Policies and Procedures* for incentives containing:
  - 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 – *i.e.*, marketing, sales, 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* 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 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 Programs* that track key metrics/outliers that may indicate incentives are leading to improper behavior by employees or service providers. Examples of possible monitoring metrics include:
  - overall product penetration rates by consumer and household;
  - specific penetration rates for products and services, 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.

- *Corrective Actions* that are implemented promptly to address any incentive issues identified by monitoring reviews as areas of weakness, which should:
  - include the termination of employees, service providers, and managers, as necessary, and analyzing these termination statistics for trends and root causes;
  - 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;
  - ensure that the root causes of deficiencies are identified and resolved; and
  - include sending the findings to management and the board, particularly where they appear to pose significant risks to consumers.

<u>Consumer Complaint Management Program:</u> Collects and analyzes 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.

<u>Independent Compliance Audits:</u>

- 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.

Although the Bulletin is non-binding, it is statement of policy that informs the CFPB's exercise of its supervisory and enforcement authority. Therefore, readers of this memorandum are advised not to rely solely on the summary of the Bulletin in this memorandum, but to read the Bulletin in its entirety by clicking on the *click here* hyperlink.

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