Finalised guidance 15/10

Risks to customers from performance management at firms

Thematic review and guidance for firms

July 2015

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1 Approach and findings

Introduction

1.1 The culture of a firm is important in ensuring customers are at the heart of how a business is run. A key driver of culture is how people are rewarded and the behaviours that are valued and recognised by the firm. The way in which staff are incentivised and their performance is managed plays a key role in this, which is why we are interested in it.

1.2 We have previously reported on the risks from financial incentives, noting the positive progress there has been in this area and, in particular, the significant changes that have been made to firms' financial incentive structures for sales staff, as a result.[1]

1.3 Firms' success in reforming culture will be judged by the outcomes that consumers experience over time. Recognising this, we have taken a forward looking approach to our work on performance management and this report aims to help firms improve practices in this area, where needed. Our broader work on individual accountability for banks, and other relevant firms[2], can also help to drive improvements in performance management.

What is this report about?

1.4 This report is relevant to all types of firms with staff who deal directly with retail customers.

1.5 Broadly speaking, performance management is the process through which organisations manage how individuals and teams behave to achieve organisational objectives. It can be an effective tool in helping staff to develop and improve, and ensuring customers get the products and services they need. This is important for a business to be sustainable and achieve growth in the longer term.

1.6 Where, however, incentives are misaligned, or poor performance management practices exist, these can lead to undue pressure on staff to sell products, which can result in mis-selling. We have previously highlighted the importance of ensuring that progress with financial incentive structures for frontline staff is not undermined by other performance management practices.

[1] http://www.fca.org.uk/news/tr14-4-risks-to-customers-from-financial-incentives

[2] Relevant firms are UK banks, building societies, credit unions and PRA-designated investment firms. Our final rules were published on 7 July 2015: https://www.fca.org.uk/news/cp15-22-strengthening-accountability-in-banking-final-rules

1.7 However, we have been made aware of intelligence from whistleblowers to the FCA and media articles suggesting that, in some cases, the changes to reward structures may not have been accompanied by a genuine shift away from a sales-focused culture. Instead, there are indications that in some cases the progress made on financial incentives may have led to an increase in pressure being placed on staff through other means, to achieve sales.

1.8 We have not identified evidence of widespread issues. We have, however, identified instances of poor practice through our follow-up on intelligence from whistleblowers at some firms. As well as addressing these issues, we have engaged with a number of firms to discuss their approach to performance management. We have not undertaken a programme of direct assessments of the way firms manage performance.

1.9 Pressure from challenging and stretching objectives and regular discussions about progress against objectives is not unexpected in any job, financial services or otherwise. However, inappropriate performance management can sometimes lead to an excessive emphasis on sales results. This type of undue pressure may be hidden, which means there is a risk that the reality of daily life for some sales staff can be very different from the tone set at the top by senior staff or Boards.

1.10 Our focus is on the risks that are posed to consumers by inappropriate practices. It is not our role to prescribe how firms manage the performance of their staff. However, we do expect firms to comply with Principle 3 and the applicable rules in SYSC when considering the risks arising from performance management approaches and to have a mitigation strategy in place to manage the risk of mis-selling.[3]

1.11 We are keen to work with industry on this matter. This report sets out the findings from our work, highlighting areas of good and poor practice, and includes guidance to help firms to comply with existing rules and principles in managing the risk of mis-selling from poor performance management practices.

1.12 The guidance in chapter 2 of this report is aimed at helping firms to:

- satisfy themselves that the risk of mis-selling from performance management can be, and is being, managed, and
- monitor performance management in practice and look for indicators of undue pressure to identify poor practices, including encouraging staff to provide feedback and taking appropriate action

1.13 Firms with staff who deal directly with retail customers should read this report and take action where appropriate, to ensure the risks are adequately managed.

[3] Our standards for firms are clear and have been set out previously regarding the related area of financial incentives. Principle 3 of the FCA’s Principles for Businesses states that ‘a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems’.

The Senior Management Arrangements, Systems and Controls Sourcebook (SYSC) of the Handbook sets out organisational and systems and controls requirements for firms.

What do we mean by performance management?

1.14 For the purpose of this report, when we use the term ‘performance management’ we are including:

- formal processes – such as appraisals and underperformance procedures
- sales targets (or their equivalent), and
- other less formal day-to-day interactions and communications between sales staff and managers about sales results that influence behaviour (both written and verbal) – much of which may not be documented

1.15 Performance management may be part of a broader people strategy, which may include recruitment, training, individual recognition and career progression. It is important that the whole people strategy is aligned with the fair treatment of customers.

Who is this report aimed at?

1.16 This report is aimed at all firms in retail financial services, including smaller firms[4], with staff who deal directly with retail customers, and some small and medium-sized enterprise (SME) customers, where relevant. Trade associations, consumer bodies and consultancy firms may also be interested.

1.17 Our review focused on the performance management of staff in sales or similar roles, which includes:

- those involved in selling products or providing a service
- advisers, and
- intermediary firms and firms with appointed representatives, and smaller firms, whether staff are employed or self-employed

1.18 Where an appointed representative has their own sales staff or advisers, the principal firm is responsible for managing the risks of mis-selling.[5] Therefore, the principal will need to have a sufficient understanding of the appointed representative’s approach to performance management.

1.19 Whether or not a firm operates teams of sales staff or advisers, this report should also be helpful in considering how the poor performance management of staff can impact on customer outcomes in other areas, such as complaints handling, claims processing, mortgage arrears, customer retentions and debt collection departments.

[4] We clarify how the guidance applies to smaller firms in chapter 2

[5] SUP 12.3 contains guidance on the responsibility of firms for their appointed representatives

What we did

1.20 We have:

- Reviewed intelligence that highlights potential poor practices.[6]
- Met collaboratively with a number of firms to discuss their approach to performance management and to understand how they identify and mitigate the risk of mis-selling.
- Met with other stakeholders including trade associations, a consumer group and trade unions.
- Reviewed published information on performance management approaches, previous enforcement cases and submissions to the Parliamentary Commission on Banking Standards.

1.21 We would like to thank everyone who contributed to this work, which has helped us develop a good understanding of the issues firms should be considering. While we have not undertaken a programme of direct assessments of firms, the firms we have spoken to generally thought that more could be done to improve how the risks from performance management are monitored. The examples and other information in the guidance chapter are based on our discussions with firms.

1.22 We recognise that many firms are working to improve their culture and change how they run sales teams, and it may take time for some managers to get used to new ways of working.

Findings

1.23 We have seen an increasing level of intelligence about poor performance management practices during 2014. This has included a growing number of whistleblowing reports to the FCA from staff at firms in different sectors. While we have not identified evidence of widespread issues, we have identified instances of poor practice through taking action on intelligence from whistleblowers at some firms as part of our firm supervision. We will continue to act on whistleblowers' reports where appropriate.

1.24 Despite the benefits of good performance management, there will always be an inherent risk that poorly executed performance management can encourage or drive mis-selling because of pressure to meet individual targets, and/or corporate plan objectives.

1.25 Firms need to manage this risk and should pay particular attention to identifying poor practices that may create an undue level of pressure on staff, which is likely to further increase the risk of mis-selling. Undue pressure can arise when the behaviour of individual managers or senior managers goes well beyond the boundaries of what would be considered reasonable by rational observers. We give some examples of undue pressure later in this chapter.

1.26 Pressure on sales results can be passed down the management line from senior management, due to the commercial drivers of the business and because sales revenue is often a key consideration in career progression and remuneration.

[6] Including whistleblowers to the FCA and media articles

1.27 Middle managers are particularly likely to have to manage conflicts of interest to avoid poor performance management practice. They often have to balance objectives linked to the firm's corporate plan with other objectives, such as the way products are being sold and ensuring the behaviour of staff is appropriate.

1.28 The continuous interactions between different levels of management and with frontline sales staff, which are often not documented, can present the greatest risks and are areas where poor practice may be hidden from direct view. Firms need to ensure that, in practice, the sales results or income generated (the 'what') does not dominate these interactions at the expense of doing the right thing for the customer (the 'how') and the long-term interests of the firm.

1.29 The way sales targets are calculated, and the levels that are set for individuals or teams, is also an important factor in how much pressure staff can be placed under to deliver sales results. Sales targets might be given less prominence by changing terminology, for example where staff are given objectives for how many 'customer needs' are met, but this might still have the same effect as a sales target. Measures around meeting customer needs can be a valid part of an appropriate set of objectives, but senior management need to be aware that the risk of mis-selling will not be reduced by simply removing individual sales targets, if in fact other objectives are still leading to undue pressure on sales results.

1.30 Firms also need to be aware that, even where sales staff do not have individual sales targets, pressure on middle management to deliver sales results can and does have a big influence on the behaviour of frontline staff.

1.31 Where balanced scorecards are used for performance management and financial incentives, this can help to reduce risk. However, this approach can be undermined if sales results are, in practice, the most important factor.

Practices that can create undue pressure

Management activities that include assessing missed sales opportunities and monitoring sales results are not inherently inappropriate. What is important is how such activities are carried out and ensuring they are done consistently with putting the interests of customers at the heart of how the business is run. The following examples, taken from whistleblower cases and other intelligence, were reported as activities that had been undertaken in a way that had caused undue pressure on staff.

Intensive micro-measurement of sales results:

- Excessive requirements on staff to continuously report updated sales results to management (e.g. many times a day), without sufficient consideration of customer needs.
- Staff intensively questioned after every client interaction as to why they did not sell anything, without sufficient consideration of customer needs.

Pressure from sharing sales results with peers and the potential for individuals to face humiliation or discrimination:

- Communications about sales results used in ways that cause undue pressure on staff.
- Frequent conference calls (or similar) where staff are required to explain in front of peers why cumulative targets are not being met or to 'pledge' improved results, without sufficient consideration of customer needs.
- A disproportionate focus on individual sales results by managers to influence other decisions, for example if and when annual leave can be taken and which staff have access to development opportunities.
- Sales results are the main consideration when assessing staff for promotion and other forms of recognition, without sufficient consideration of other factors like consumer outcomes.

Performance management practices not reflecting the firm's stated policy and aims:

- Written policies indicate a supportive approach to underperformance against sales objectives but the culture of management is to rule by fear and use threats of disciplinary action.
- Managers stress the importance of treating customers fairly but the day-to-day focus is on sales results alone.
- The 'tone from the top' is good but is not always translated into the day-to-day running of the business, in particular from the middle management level down.

2 Guidance to firms

2.1 This guidance suggests some ways, but not the only ways, that firms can manage the risk of mis-selling being driven by poor performance management practices.

2.2 This guidance is relevant to all types of firms with staff who deal directly with retail customers, and some SME customers, where relevant. It applies to firms of all sizes, including smaller firms, with staff giving advice, undertaking sales or providing a service and where performance management practices are in operation. It does not apply where the business owners are the only individuals selling products or services, or giving advice to retail customers (e.g. sole traders, partners or directors). The approaches that smaller firms might take to managing these risks will depend on the nature, scale and complexity of the firm's business.

2.3 Senior management should ensure that firms identify the risks of poor practices in this area and that controls are in place to adequately mitigate the increased risk of mis-selling they create. They should approve performance management policies with input from appropriate functions, including risk management, compliance and human resources.

2.4 Human resources should play a role in how firms set the performance management approach, challenging how the business implements it and identifies poor practices, as well as helping to ensure any concerns are escalated to senior management.

Reducing the risk from undue pressure

2.5 Performance management practices are likely to result in some level of pressure. This is normal. However, pressure can increase the risk of mis-selling where excessively applied. Firms should review the level of pressure their staff are under and satisfy themselves that the risk of mis-selling can be, and is being, managed. This might include considering:

- how pressure to deliver on sales results passes down the management line, and
- how conflicts of interest for middle management are managed effectively

2.6 In doing this it is important that firms look at what happens in practice, as this may differ from the firm's formal policies and any guidance given to managers.

Good practice

Objectives for sales staff are more balanced and include sufficient 'how' or behavioural measures, including consumer outcomes, as opposed to just the 'what' (e.g. sales results). Some firms have invested in training to help managers be more effective in assessing staff behaviours; this helps ensure there is a focus on these measures in reality, as well as in theory, and the 'what' does not become the dominant factor.

Targets for sales staff are kept under review and might be reduced if conditions outside the control of individuals are impacting on results, for example economic factors affecting demand for a particular product.

2.7 The examples of practices that can create undue pressure in chapter 1 are helpful when considering how to reduce pressure on staff.

Monitoring performance management in practice

2.8 We expect firms to have adequate systems and controls to identify when poor performance management practices may be occurring. This might be across a national sales team, or in a particular region or individual team.

2.9 This should include pro-actively identifying where ad hoc communications and messages relating to sales performance could be leading to undue pressure on staff. Where a firm has decided to restrict certain practices, like publishing league tables of sales results, monitoring should be used to check localised practices are not continuing contrary to requirements.

Good practice

Senior management actively listen to what frontline staff are saying about the culture within the firm and the pressures they face, and support an open environment where staff are encouraged to speak up and raise any concerns. It is not enough to assume that setting the right 'tone from the top' will encourage staff to report instances of poor performance management and so firms need to be proactive in looking for issues.

Individual performance management records are clearly documented and an appropriate proportion are sampled. This sampling is increased when potential issues are highlighted about how an individual is managing staff.

Good practice

Good relationships are maintained with trade unions and staff bodies who are encouraged to share information about potential performance management issues. These are then investigated by the firm, where appropriate.

Robust moderation processes to assess the fairness and consistency of how staff performance is appraised, particularly around what evidence is used to assess performance against objectives relating to expected behaviours and how products are sold.

Other indicators of undue pressure

2.10 Monitoring the records from formal procedures, like appraisals and one-to-one discussions, may not identify all instances of undue pressure on sales staff and managers. Poor practice may not be documented and is therefore more difficult to identify.

2.11 Firms can, however, put together a range of information to pro-actively create a picture of where undue pressure on staff might be occurring. This could compare individual sales teams or regions, or staff across the firm as a whole, and might include:

- the percentage of staff not meeting formal or informal sales targets
- the percentage of staff on a personal improvement plan (PIP)[7] or disciplinary procedures, where this is linked to individual sales results, and how many then leave the role
- rates of staff turnover and leavers within 12 months of joining
- the length of time staff are in their role and individual attendance rates
- the responses to firms' own staff surveys where questions relate to pressure at work and its causes
- exit interviews and whistleblower cases where concerns about performance management are raised
- 360 degree feedback schemes, and
- records of grievances and other complaints by staff

2.12 Firms may already have some of this information although it may not be used in this way to identify undue pressure.

2.13 For example, if there is one region of a national sales team with particularly high levels of staff on PIPs and high staff turnover compared to other areas of the firm, and information from exit interviews indicating staff are leaving due to feeling under too much pressure, further exploration may be needed.

[7] Personal improvement plans (PIPs), or equivalent processes, might typically be used when an individual is deemed to be underperforming in their role and would include setting out actions relating to improving performance over an agreed period of time. In this report we focus only on PIPs where underperformance is linked to sales results.

2.14 It is important that mechanisms for gathering important feedback from staff, for example exit interviews, are run and seen to run appropriately, e.g. they are independent, protect confidentiality and issues are escalated within the firm and appropriate action taken. Staff need to be made aware of how they can raise concerns and have confidence in the process.

2.15 Bringing this data together should help identify potential issues to explore further, recognising there may be other reasons for the patterns in the data. Firms will also need to consider indicators of potentially undue pressure alongside the results of their own testing of customer outcomes, using other relevant information like the levels of complaints and the root causes.

2.16 Where areas of undue pressure are identified, firms need to investigate further and take action as appropriate to deal with the cause of any poor practice and address the increased risk to consumers.

Good practice examples of improvements being made by some firms

Enhancing the regular staff survey to ask more direct questions about the extent to which staff might feel under undue pressure over sales results and the causes of this.

Making better use of information from whistleblowers. For example, improving the root cause analysis of issues relating to pressure on staff and performance management, and encouraging staff to come forward.

Improving the coverage and quality of information obtained from exit interviews when staff leave employment.

Risk-based monitoring for mis-selling

2.17 We expect firms to take account of how the pressure on sales staff from performance management can increase the risk of mis-selling, when identifying where and how to focus sales quality monitoring.

2.18 Firms should identify where there is an increased risk, for example, where managers and sales staff could be:

- subject to undue pressure about sales results from their own manager or senior staff
- assessed as underperforming (or have only just avoided this), have been placed on a PIP or received a poor appraisal grade, and/or
- subject to disciplinary procedures[8]

[8] We recognise that underperformance and disciplinary procedures can be triggered for reasons other than sales results.

2.19 For these areas of increased risk, firms should use risk-based business quality monitoring and inappropriate behaviour monitoring of sales, including undertaking increased monitoring where appropriate. It is important to monitor for inappropriate behaviours that are unlikely to be identified from reviewing a sales file. For example, pressuring customers to purchase a product or failing to make it clear that an additional product is separate and optional (where that is the case).

2.20 The need for firms to have monitoring for inappropriate behaviours in sales situations is explained in our financial incentives guidance.[9] Although it might be harder to monitor face-to-face sales conversations, firms can identify inappropriate behaviours by controls such as contacting a sample of customers shortly after completing a sale or by mystery shopping. For telephone sales, the approach to call monitoring should also aim to identify inappropriate behaviours.

2.21 Assessing the sales patterns of individuals is also an important factor in identifying areas of increased risk. Firms may find the examples of risk-based monitoring in our guidance on financial incentives risks are helpful.

[9] https://www.fca.org.uk/static/fca/documents/finalised-guidance/fsa-fg13-01.pdf

Case study

Investigating concerns about performance management

Action was taken following feedback from staff about excessive pressure in some sales areas. Frontline staff and management were interviewed and a review was carried out of the application of performance management processes.

This found that some managers were using performance management processes to exert undue pressure on staff regarding sales results despite the firm removing individual sales targets. For example, some staff reported:

- excessive focus on sales results in the appraisal process with threats of disciplinary action or dismissal if results did not improve quickly
- daily conference calls for staff to explain why they had not met localised sales targets and the use of 'name and shame' tables
- pressure to achieve sales regardless of customer requirements, for example staff encouraged to favour credit cards instead of personal loans to meet targets that had been set, and
- instances of senior management condoning the use of inappropriate performance management, including the use of localised targets by middle managers after targets had been removed

To address the issues identified a formal programme of work was put in place, including:

- raising the capability of managers through coaching and training while providing practical tools for performance assessment, in particular to ensure the appraisal of staff did not revert to focusing on sales results
- banning the use of localised sales targets and league tables, while developing new reporting on the sales patterns of individual sales staff to indicate areas of increased risk
- developing a best practice model for whistleblowing and taking disciplinary procedures against managers who were found to be acting inappropriately, and
- conducting regular surveys of staff to assess management behaviours

3 Next steps

3.1 All firms with staff who deal directly with retail customers should read this report and consider:

- how their approach to performance management may increase the risk of mis-selling
- whether their governance and controls are adequate, and
- taking action where required to ensure the risks are adequately managed

3.2 Given the inherent risks in this area, we are taking a forward-looking approach. We will continue to focus on performance management and this report is the first step in a dialogue with industry on evolving practice in this area. Through our firm supervision work we will continue to assess how firms are managing this risk and what changes they have made in response to this report, taking action where needed. We will also continue to act on intelligence from whistleblowers where appropriate and we will consider the need for any further work in the future.

3.3 Our broader work on individual accountability for banks, and other relevant firms, can also help to drive improvements in performance management. The proposed regime should have a positive impact on individual behaviour and the general culture within firms, and empower frontline staff and managers to better fulfil their responsibilities to customers and challenge undue pressure.[10] The Parliamentary Commission on Banking Standards (PCBS) made recommendations on this and other areas that needed strengthening, and you will see us progressing changes in the coming year alongside ongoing work to drive cultural change in firms. We have also proposed changes to the Approved Persons Regime for all insurance firms within the scope of Solvency II.

3.4 We believe that the guidance in chapter 2 of this document will help firms to comply with our existing rules and principles, and improve the approach to managing the risks of mis-selling from performance management leading to better consumer outcomes.

3.5 We will consider any impact on this guidance arising from the implementation of MiFID II in the UK, where the new measures will take effect from 3 January 2017.

[10] We are introducing a range of policy changes that aim to increase individual accountability within the banking sector https://www.fca.org.uk/firms/being-regulated/improving-individual-accountability

Further information

3.6 It may be helpful to consider this guidance in conjunction with our previous reports and guidance on the risks to customers from financial incentives:

- Link to FG13/01 – https://www.fca.org.uk/static/fca/documents/finalised-guidance/fsa-fg13-01.pdf
- Link to TR14/4 – http://www.fca.org.uk/news/tr14-4-risks-to-customers-from-financial-incentives

Relevant firms should also see CP15/4: Whistleblowing in deposit-takers, PRA-designated investment firms and insurers