EBA REPORT

ON THE APPLICATION OF THE GUIDELINES ON THE REMUNERATION OF SALES STAFF

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1. List of abbreviations

CI	Credit institution
CRD	Capital Requirements Directive
EBA	European Banking Authority
EMI	Electronic money institution
ESMA	European Securities and Markets Authority
EU	European Union
FR	Fixed remuneration
HR	Human resources
KPI	Key performance indicator
MiFID II	Markets in Financial Instrument Directive II
NCA	National Competent Authority
PI	Payment institution
VR	Variable remuneration

2. Executive summary

Developments in the markets for financial services have shown that failures in the conduct of financial institutions towards their customers, for instance mis-selling of retail banking products and services, do not only cause significant consumer detriment but also undermine market confidence and financial stability. In an effort to address one of the many drivers of conduct failures, the EBA issued in 2016 Guidelines on the remuneration of sales staff, with a view to address poor remuneration policies and practices in the industry. Said Guidelines have been applicable for more than three years, which is why the EBA considered it opportune to carry out an assessment on how institutions apply them.

To that end, the EBA conducted a survey amongst a sample of 70 financial institutions from 12 Member States. The assessment of the responses focused on the internal arrangements of institutions for designing, approving, and monitoring the remuneration policy and practices for sales staff, in particular the practices on awarding variable remuneration to sales staff.

The EBA's assessment revealed that financial institutions in the sample focus more on prudential requirements and commercial interests than on consumer protection requirements and that, in terms of governance structures, the design, approval and monitoring of the remuneration policies and practices are often handled by the same function, which gives rise to the risk of an inaction bias when reviewing the remuneration policies and practices.

However, the EBA has also identified 17 distinct good practices that the EBA considers to be compliant with the Guidelines, and that are listed towards the end of the report. For example, it is good practice for financial institutions to involve the HR, compliance and risk management functions in the design of the policies; to involve shareholders before granting variable remuneration (VR) in excess of 100% of fixed remuneration (FR); to apply a mix of quantitative and qualitative criteria when determining the VR of sales staff, and not to make sales performance the determining criterion for the promotion of staff.

It is also good practice for financial institutions to implement measures that explicitly disincentivise sales staff from acting in a way that gives rise to consumer detriment; to include in the key performance indicators that determine variable remuneration some measurements of customer satisfaction or, conversely, customer detriment; and to ensure that payout curves for VR do not set incentives to maximise sales at a specific point.

3. Background

1. Developments in the markets for financial services have shown that failures in the conduct of financial institutions towards their customers can not only cause significant consumer detriment but also undermine market confidence, financial stability and the integrity of the financial system. More specifically, the EBA identified in 2016 in its Final Guidelines on the remuneration of sales staff that poor remuneration policies and practices are key drivers of misconduct and mis-selling by staff of financial institutions.[1] The Guidelines explained that the impact of mis-selling has been considerable, in that it causes 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.

2. To address one of the drivers of mis-selling, the EBA issued in 2016 Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services (EBA/GL/2016/06), which were complementary to the EBA Guidelines on sound remuneration policies under CRD.[2]

3. The 9-page EBA Guidelines on remuneration of sales staff are addressed to credit institutions (CI), creditors, credit intermediaries, payment institutions (PI) and e-money institutions (EMI) and set out detailed provisions regarding the design, documentation and notification, approval, and monitoring of the remuneration policies and practices applicable to 'relevant persons'. 'Relevant persons' are those staff members that engage in the sale of retail banking products and services and persons managing them.[3] The Guidelines aim to put the focus of the institutions' remuneration policies and practices of sales staff on the consumers' interest.

4. As the Guidelines have been applicable for more than three years, the EBA considered it opportune to carry out an assessment on how institutions apply them. To that end, the EBA conducted a survey amongst a sample of 70 institutions from 12 Member States[4], assessed the responses and is presenting the findings in this report.

5. The assessment covers those sections of the Guidelines that are directly relevant for the protection of consumers. These are sections 4.1, 4.3 and 4.4, which relate to the design,

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[1] EBA final report on Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services (EBA-GL-2016-06)

[2] EBA Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013 (EBA/GL/2015/22)

[3] 'Relevant persons' as defined in the Guidelines on the remuneration of sales staff: Any natural person who is: a) working for an institution and directly offering or providing banking products or services to consumers; or b) working for an institution and directly or indirectly managing a person referred to in point (a).

[4] Austria, Bulgaria, Croatia, Cyprus, Czech Republic, France, Germany, Italy, Malta, Poland, Portugal, Sweden,

approval and monitoring of the remuneration policy and practices. They set out requirements regarding the governance structure of institutions when developing and implementing remuneration policies and practices. The present report reflects the assessment based on the survey.

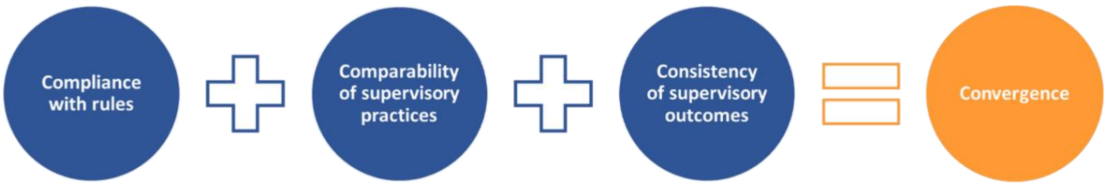
6. In publishing this report, the EBA is fulfilling the objectives and tasks conferred on it in Articles 1(5) and 9(2) of its founding Regulation, in relation to supervisory convergence and the convergence of regulatory practice.

7. By providing a consumer protection perspective, this report complements other remuneration-related publications of the EBA, which primarily have a prudential perspective, such as the high earners report[5] and aforementioned Guidelines on sound remuneration policies under CRD.

4. Methodology

8. The EBA pursues a three-pillar approach to supervisory convergence, which is defined as a process for achieving comparable supervisory practices across Member States that are based on compliance with applicable EU requirements and that lead to consistent supervisory outcomes (see Figure 1). In the specific context of consumer protection, said supervisory outcomes are those of consumers.

Figure 1: Components of supervisory convergence



9. To advance its work, the EBA sent a questionnaire to a sample of financial institution across 12 EU Member States. The EBA assessed responses from 70 financial institutions comprising 57 credit institutions (CIs), seven payment institutions (PIs) and six e-money institutions (EMI). No on-site visits of financial institutions were carried out, nor was any other form of discussion held with the institutions concerned.

10. Finally, it is worth noting that the aim of this exercise was to assess the consistency of the application of the Guidelines by financial institutions (hereafter referred to as 'institutions'), and not to assess the supervisory practices of each NCA.

[5] EBA report benchmarking of remuneration practices at the European Union level (2017 and 2018 data) and data on high earners (2018 data) (EBA/REP/2020/20) and EBA report on high earners – data as of end 2019 (EBA/REP/2021/23)

5. Assessment of survey responses

11. The assessment of the survey responses shows that not all institutions seem to have fully understood the objectives of the Guidelines on the remuneration of sales staff (henceforth called 'Guidelines'). Institutions appear to focus on the minimum requirements with regards to the governance structures and pay more attention to the prudential requirements resulting from other regulatory requirements such as the EBA Guidelines on sound remuneration policies under CRD and do not give sufficient consideration to the consumers' interest when designing, approving and monitoring remuneration policies and practices for sales staff.

12. The assessment also highlights the fact that the application of the Guidelines varies significantly according to the size of the institutions and their type. Unsurprisingly, the difference was most pronounced between responses provided by CIs, which accounted for most of the responses (57) and those of PIs and EMIs, which accounted only for 13 responses.

13. Also, the number of employees in general and relevant persons in particular vary considerably across institutions. CIs usually have a large number of relevant persons (from hundreds to sometimes tens of thousands). In comparison, the PIs and EMIs in the sample have a much smaller number of employees in general and an even smaller number of relevant persons in particular, often comprising only a low two-digit number of relevant persons. The largest PIs or EMIs in the sample do not exceed the threshold of 1,000 relevant persons.

14. This report provides an assessment of the main findings for the following eight aspects:

    i. The governance for designing remuneration policies for sales staff,

    ii. Other regulatory requirements impacting the governance structure of institutions,

    iii. Variable remuneration (VR),

    iv. The performance criteria used by institutions to determine VR of 'relevant persons',

    v. How institutions respect the rights, and take into account the interests, of consumers,

    vi. The ex-post risk adjustment for variable remuneration,

    vii. The monitoring of risks and

    viii. The review of remuneration policies and practices.

15. The assessment includes examples of good practices considered by the EBA as compliant with the EBA Guidelines on remuneration of sales staff.

5.1 The governance for designing remuneration policies for sales staff

Requirements in the Guidelines

16. Section 4.1 of the Guidelines requires institutions to design their remuneration policies with the participation of the human resources (HR) function. In addition, where established, the risk management and compliance functions should provide effective input (Guideline 1.3). Section 4.3. of the Guidelines requires the management body to approve and retain ultimate responsibility for the institution's remuneration policies and practices (Guideline 3.1). The management body should seek advice from the remuneration committee where established on the institution's remuneration policies and practices in relation to the fulfilment of these Guidelines (Guideline 3.2). Where established, the compliance function should confirm that the remuneration policies and practices comply with these Guidelines (Guideline 3.3).

Observations

17. The design of remuneration policies can involve several functions within an institution. The HR function is the most frequently used function by the institutions surveyed with only six out of 57 CIs, three out of six PIs and one out of five EMIs not explicitly mentioning it in their responses. Concerning the six CIs, five of them indicated that their remuneration committee designs the remuneration policy, while one institution stated that the board of directors and the compliance function, supported by the risk management function, design the policy.

18. According to the respondents, the HR function is frequently supported by the risk management function and by the compliance function. For CIs, 15 out of 57 institutions did not mention the risk management function and 11 out of 57 did not mention the compliance function. However, these institutions often involve the compliance function, which especially for small institutions may be merged with the risk management function, with the review of the policies and practices. For PIs and EMIs, the number of institutions clearly demonstrating how they involve the risk management and compliance function in the design of policies is low, despite in general being required to set up internal control mechanisms. The management body in its management and supervisory function also seems to be frequently involved in the design of the remuneration policy. According to the responses collected, there are also some institutions that involve the marketing, sales, legal and finance functions or even the IT function in designing their policies.

19. 50 CIs set up a remuneration committee. By contrast, only one PI, which is part of a CI, and one large EMI have such a committee, and all other EMIs and PIs have none. For those institutions that specified the composition of the remuneration committee, the committee tends to include several non-executive board members.

20. The policies of all institutions seem to be approved by the management body. In a few cases, it seems that the management of the retail division is also involved in the decision making.

21. Formal involvement of shareholders in the design of the remuneration policy seems to be quite limited. However, several institutions indicated that their shareholders/owners also constitute part of the management body or remuneration committee and as such are involved in the design of the remuneration policy. In only a few institutions, the shareholders' meeting needs to approve either the policy or individual remunerations for sales staff, e.g. when the variable remuneration exceeds 100% of the fixed remuneration. However, all institutions from one Member State require that the shareholders' meeting approves the remuneration policy, which is due to national legislation. The EBA is aware that two other Member States whose national authorities did not participate in the survey also have such national legislation in place, requiring the shareholder meeting's approval for VR exceeding 100% of FR for all staff of CIs.

Main findings

22. CIs are, in general, much larger institutions in terms of the number of staff and therefore have more possibilities to establish and involve more corporate functions in the design of policies compared to PIs and EMIs, which are often smaller and therefore may not have a separate risk management, compliance or even HR function. PIs and EMIs are required to set up 'internal control mechanisms'.

23. Judging from the responses to the survey that the EBA received, it is not obvious whether for all institutions the HR function is involved in the design of their remuneration policies. As the Guidelines require the involvement of the HR function in the design of the policies, supervisory authorities should carefully monitor the application of the Guidelines.

24. Furthermore, in compliance with Article 95 CRD and the Guidelines on sound remuneration policies, most of the CIs within the sample have established a remuneration committee, which is mandatory for significant institutions and which these CIs involve in the design of remuneration policies. By contrast, smaller CIs, PMIs and EMIs are not required to set up such remuneration committees and do not seem to establish them for the purpose of these Guidelines.

25. The observation that the remuneration committee tends to be composed predominantly of non-executive board members is due to the application by significant CIs of Article 95 CRD. That article states that the chair and members of the remuneration committee are non-executive members of the management body. The EBA Guidelines on sound remuneration policies further specify the requirement that the majority of the members of the remuneration committee must be independent, too. The EBA Guidelines on remuneration of sales staff do not have a comparable requirement. The EBA views this as a regulatory spillover effect, where one regulatory requirement has a positive effect on the application of another regulatory requirement, i.e. where the CRD and the Guidelines on sound remuneration policies lead to a stricter application also of the Guidelines on remuneration of sales staff.

Good practices

26. The EBA views it as good practice that institutions involve the HR function in the design of the policies and that the HR function is supported by the compliance and/or the risk management function/ internal control function, which should critically assess the policy. Conversely, it is not good practice that the compliance or risk management function leads the process of designing the remuneration policy, as it may lead to that function losing some of its required independence during critical reviews.

27. Furthermore, the EBA views it as good practice that the management body ensures the independence of the risk management and compliance/internal control function when assessing the remuneration policy, also vis-à-vis to the management body itself. Otherwise, these control functions may not be in the position to provide a critical evaluation of the policy proposal, depending on the corporate culture.

28. The EBA opines that the separate Guidelines on sound remuneration policies provide a sensible steer on the internal procedures to develop remuneration policies. It is good practice that institutions take into account the provisions from the Guidelines on sound remuneration policies, even when they are not subject to them.

5.2 Other regulatory requirements impacting the governance structure of institutions

Requirements in the Guidelines

29. Section 4.1 of the Guidelines requires that institutions should avoid unnecessarily complex policies and practices and unclear combinations of different policies and practices (Guideline 1.8).

Observations

30. The analysis of the responses shows that, aside from five PIs, almost all other surveyed institutions (55 CIs, five EMIs) have an integrated remuneration policy covering all legal requirements for the remuneration of all kinds of staff of their institution. Of these, the majority of institutions cover European and national financial regulatory requirements in their remuneration policy. Only a limited number of respondents stated that their group remuneration policy is based only on the EBA Guidelines on the remuneration of sales staff and/or the EBA Guidelines on sound remuneration policies. Consequently, most institutions seem to have an integrated remuneration policy covering all relevant regulatory requirements on remuneration of sales staff.

31. Various regulatory requirements specific to the provision of EU financial services have an impact on the remuneration policy of the institutions. Most institutions mentioned that their remuneration policy covers requirements originating from the CRD, including the EBA Guidelines on sound remuneration policies and the EBA Guidelines on remuneration of sales staff and MiFID requirements including ESMA Guidelines on remuneration policies and

practices (MiFID). Furthermore, some institutions mentioned abiding by the requirements of the Alternative Investment Fund Managers Directive[6], the Undertakings for Collective Investment in Transferable Securities Directive[7], Solvency[8], Insurance Distribution Directive[9], and relevant disclosure requirements mentioned in financial services legislations as having an impact on their remuneration policies and practices.

32. Sometimes, the decisions of the competent authorities also have an impact on the remuneration policy and institutions' remuneration practices, e.g. supervisory authorities' decisions related to capital buffers and capital conservation measures, which may prevent the payout of bonuses. The responses demonstrate that CIs have to comply with more regulatory requirements than PIs and EMIs.

33. Beyond these EU-specific requirements applying to institutions, regulatory requirements related to labour law and collective wage agreements with trade unions also influence the design of the remuneration policy. Four large CIs also referred to the US Dodd-Frank Act (Volcker rule) as a third country financial regulation having influence on EU institutions' remuneration policies.

Main findings

34. CIs are subject to more extensive regulation, which sets minimum standards for the governance structure for designing, approving and monitoring remuneration policies and practices. For instance, as mentioned in chapter 3.1, many CIs have established a remuneration committee in compliance with Article 95 CRD. Such a committee is not required for non-significant CIs or for EMIs and PIs.

Good practices

35. It is good practice for financial institutions to have an integrated remuneration policy for all staff, covering all regulatory requirements applying to them and differentiating according to the type of staff where appropriate.

36. The EBA further asserts that when institutions are in doubt about the appropriate practices with regards to the remuneration policies for sales staff, then it is good practice for them to refer to other regulatory requirements for guidance, such as the Guidelines on sound remuneration policies (see also chapter 3.1).

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[6] Directive 2011/61/EU

[7] Directive 2009/65/EC

[8] Directive 2009/138/EC

[9] Directive (EU) 2016/97

5.3 Variable remuneration (VR)

Requirements in the Guidelines

37. Section 4.1 of the Guidelines requires that where the remuneration policies and practices allow for variable remuneration, institutions 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 (Guideline 1.7).

Observations

38. 37 CIs, two PIs and two EMIs award both monetary and non-monetary forms of remunerations, whereas 19 CIs, four PIs and three EMIs award only monetary form of remuneration.

39. A total of 10 institutions, consisting of four CIs, four PIs and two EMIs indicated not paying variable remuneration to sales staff. Three of these institutions explained that they want to avoid setting the wrong incentives for relevant persons, as this may lead to consumer detriment. Four others cited low profitability (start-up phase), the need to keep pay structures simple or that VR would not fit the business as a reason for not offering variable remuneration. All other institutions pay VR to sales staff. Besides these institution-specific choices for not paying VR, the EBA is also aware that in one Member State – which did not participate in the survey – there are regulatory restrictions in place with regards to paying VR to sales staff.

40. The maximum VR that institutions award to their sales staff relative to the fixed remuneration (FR) of said staff varies considerably across institutions. Besides those institutions not offering any VR, most institutions grant VR in the range from 5% VR relative to FR up to 100%. Only nine CIs offer more than 100% VR relative to FR, at times up to 200%. Of these, two require shareholder approval for VR for sales staff that exceeds 100% of FR. The seniority of staff is also a determining factor: the ratio of VR to FR for senior management is usually higher than that of entry-level relevant persons.

41. 34 CIs, three PIs and three EMIs use both qualitative and quantitative criteria to determine the promotion of their sales staff. 10 CIs use only qualitative criteria to determine the promotion of their sales staff, such as training courses, quality of customer service and customer satisfaction, compliance with regulatory requirements or leadership skills. Only three institutions stated that promotions depend on quantitative criteria, i.e. level of sales performance. Seven CIs, two PIs and two EMIs do not use any specific criteria. In the majority of cases, promotions depend on the suitability to take on a managerial position such as leadership and communication skills.

42. For 40 CIs, four PIs and six EMIs, promotions, training courses, allowances and non-monetary benefits for sales staff are not related to the sales volume or other performance indicators. In contrast, 10 CIs and one PI award all the mentioned elements in dependency of the sales performance. For the remaining institutions, only some of the above-mentioned elements depend on performance.

43. Finally, 39 credit institutions award VR annually or twice per year to relevant persons. Of these, 12 institutions award the VR for managers annually, and every four months for sales representatives. The frequency applied by PIs or EMIs vary considerably (from monthly to annually basis). 16 Institutions did not provide any response.

Main findings

44. The EBA identified the following regulatory spillover effects: while there are threshold requirements for VR relative to FR for identified staff according to CRD requirement and EBA Guidelines on sound remuneration policies, there are no such requirements for sales staff in the EBA Guidelines or anywhere else. Yet, an implicit threshold of 100% VR to FR appears to have established itself for sales staff that only few CIs appear to cross. Also, the EBA Guidelines on remuneration of sales staff do not require the VR for sales staff to be approved by the shareholders meeting if it exceeds 100% relative to FR, while the CRD sets such a limit for the VR of identified staff. Still, two CIs require the shareholders' approval also for VR of sales staff above 100%.

45. The EBA opines that if promotions, training courses, allowances and other non-monetary benefits depended predominantly on sales figures, these could set incentives for sales staff to act to the consumers' detriment, of which institutions as well as supervisory authorities should be mindful.

46. The EBA observes that sales performance in general is not a determining criterion for being promoted. Some institutions explained that a good salesperson is not necessarily a good manager. Instead, to these institutions, finding a suitable person with adequate managerial skills seems to be more important.

47. With regards to training courses, the EBA is of the view that these are not rewards per se. Linking training courses to sales performances may be sensible when trying to increase sales but are unlikely to be suitable as rewards. As the survey seems to reveal, institutions do not generally link training courses to sales performance and the EBA concludes that institutions do not regard them as rewards.

Good practices

48. The EBA is of the view that it is good practice for institutions to make an internal assessment about the appropriate balance of VR to FR in dependency of the products that the sales staff are predominantly selling and the type of customer for whom these products are intended, e.g. by differentiating according to the financial literacy of the target customers. It is good practice that institutions involve the shareholders' meeting when granting VR in excess of 100% of FR.

49. The 'payout curve' describes the amount of fixed and variable remuneration that a sales staff member is paid depending on this staff member's sales volume. The EBA is of the view that the payout curve is of importance when granting VR and views it as good practice for institutions to analyse whether it offers incentives to maximise sales at a certain point. It is good practice

for payout curves to be continuous, meaning that there is no threshold or jump, e.g. that there is no minimum number of sales required to qualify for VR, or an achievement booster offered above a certain threshold. Instead, the marginal benefit of selling one more unit of a product should be similar to the marginal benefit of selling the previous or next unit.

50. Furthermore, the EBA views it as good practice for institutions to thoroughly assess non-monotonous as well as non-linear payout curves against the possibility of setting wrong incentives. Institutions should not apply exponentially growing payout curves. In the view of the EBA, linear payout curves where the marginal benefit of selling one more unit is constant seem to pose the smallest risk of setting wrong incentives for sales staff.

51. With regards to promotions, the EBA is of the view that sales performance alone should not be the determining factor for promoting a member of sales staff. Instead, as good practice, institutions should identify suitable candidates for positions due to their qualification and the concrete requirements of the position in question. Furthermore, when promoting staff members to a superior position with a higher level of responsibility, it is good practice that institutions pay attention to the integrity of the applicant with regards of their compliance with regulatory requirements and whether they have a track record of acting against the consumers' interest.

52. Allowances are commonly used as a tool to attract and retain staff and, in many cases, would thus be granted independently of performance. However, if some allowances depend on (sales) performance, then it is good practice that institutions check whether these should constitute not FR but VR. This means that institutions would map allowances in alignment with the EBA Guidelines on sound remuneration policies to qualify them as FR or VR and apply the rules on the granting of VR from the Guidelines on remuneration of sales staff to those allowances that qualify as VR.

53. Non-monetary benefits linked to sales performance, e.g. by offering a special parking spot to the best performing salesperson in a competition, can set incentives to boost sales. Depending on the corporate culture, such non-monetary benefits bear the risk of setting wrong incentives by boosting sales to the detriment of consumers. Consequently, it is good practice for institutions to apply the general rules and good practices for also offering VR to such kind of benefits.

5.4 The performance criteria used by institutions to determine VR of 'relevant persons'

Requirements in the Guidelines

54. Section 4.1 of the Guidelines requires that for the purpose of evaluating the performance of a relevant person, institutions 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 (Guideline 1.4). When designing the remuneration policies and practices, institutions 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 (Guideline 1.5). Institutions should not design remuneration policies and practices that a) solely link remuneration to a quantitative target for the offer or provision of banking products and services; or b) promote the offer or provision of a specific product or category of products over other products, such as products which are more profitable for the institutions or for a relevant person, to the detriment of the consumer (Guideline 1.6).

Observations

55. Most institutions that grant VR do seem to apply a mix of quantitative and qualitative performance criteria and do not rely solely on quantitative targets.

56. Quantitative criteria for individual performance, for instance sales volume, volume of work performed or acquisition of new clients, often represent only one aspect of the final decision of the institutions to grant VR, as team and company performance, such as the net profit of the institution or market share, also seem to play a role to various degrees.

57. Qualitative criteria are also frequently used to assess the individual performance of sales staff, such as number of client meetings, compliance with regulation, quality of documentation and completion of training courses. Furthermore, most institutions apply customer satisfaction metrics in the overall assessment of the performance of sales staff. Such indicators can result from conducting customer satisfaction surveys, measuring consumers' capacity and willingness to promote the institutions, mystery shopping activities, and the evaluation of consumer complaints. In addition, some institutions reported that consumer satisfaction measurements are relevant to assess the performance of sales staff and the institution's services, but do not include them as part of the performance indicators of sales staff. 11 CIs, four PIs and one EMI do not use any consumer satisfaction metric. Some institutions also apply qualitative criteria at the team or company level, such as team cooperation or customer ratings of the company.

58. Not all institutions that grant VR use individual performance criteria. In these few cases, variable remuneration seems to be dependent on the general business development instead of individual performance of sales staff. In these cases, the variable remuneration is linked to the profit of the institution or the growth of its customer base.

59. Institutions apply very different approaches to weighting the various criteria and no general conclusions can be drawn from the responses. Some institutions assign a 50% weight each to quantitative and qualitative criteria. For those institutions applying more than a 50% weight to the quantitative criteria, it seems as if these criteria are more often a mix of individual and team or business performance criteria instead of only relying on individual performance. Other institutions do not specify the weights assigned to each type of criteria, but put emphasis on qualitative criteria by setting minimum qualitative requirements for sales staff to be eligible to receive VR. For example, one institution requires consumer satisfaction to meet at least an 80% ratio before a staff member can be rewarded with VR. For another institution, staff members

must achieve at least 50% of the quantitative targets as well as 50% of the qualitative targets to receive VR.

Main findings

60. In most cases, sales performance does not appear to be the only performance criterion for granting VR, as further quantitative as well as qualitative criteria are applied by institutions. Nonetheless, it is not evident whether all institutions apply the Guidelines correctly with regard to having a proper balance between quantitative and qualitative criteria.

61. Regarding the weighting of criteria, the EBA is of the view that, in general, institutions do not put excessive weight on the sales performance. A weight of close to 100% would have undermined the spirit of the Guidelines, which does not seem to be the case in practice.

Good practices

62. It is good practice to apply a mix of quantitative and qualitative criteria when determining the VR for sales staff. Consequently, the EBA views it as good practice that the weight for the sales performance is considerably lower than 100%.

63. It is also good practice that the VR is subject to a 'gatekeeper provision' (see chapter 3.5), under which compliance with regulatory requirements and acting in the interest of the consumers are strict conditions for granting VR.

64. Furthermore, the EBA views it as good practice to include measurements of consumer satisfaction and/or consumer detriment into the KPI.

5.5 How institutions respect the rights and take into account the interests of consumers

Requirements in the Guidelines

65. Section 4.1 of the Guidelines requires institutions to design and implement remuneration policies and practices that take into account the rights and interests of consumers. In particular, institutions should ensure that monetary and/or non-monetary forms of remuneration do not introduce incentives whereby relevant persons favour their own interests, or the institution's interests, to the detriment of consumers (Guideline 1.1). 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 (Guideline 1.2).

Observations

66. The responses suggest that some institutions try avoiding consumer detriment by applying a 'gatekeeper test' with the aim of ensuring compliance with the sales process quality requirements, such as proper documentation, and preventing a breach of professional conduct requirements: in case of non-compliance with applicable requirements by a member of the

sales staff, e.g. because of insufficient customer due diligence or MiFID customer profiling, they cannot be awarded variable remuneration. Other institutions incorporate customer satisfaction metrics into the KPI for awarding VR.

67. Some institutions explained that they trust that the design of their remuneration policies does not set an incentive to sell products that would be to the consumers' detriment, e.g. because they offer none or only little VR relative to FR, which additionally only depends to a minor degree or not at all on the number of sales.

68. However, it remains unclear from these responses how these institutions set disincentives through the remuneration policy for relevant persons to act against any potential consumers' detriment. Some of these institutions indicated performing specific controls, e.g. on the quality of customer due diligence, which they believe to set a disincentive for sales staff to act to the consumers' detriment. One aspect of how the design of the remuneration policy can set a disincentive to harmful behaviour seems to be the inclusion of customer satisfaction metrics into the KPI. One institution reported to apply only a linear payoff for the sales volume and does not apply payoff function accelerators or thresholds, as that would provide incentives to meet the threshold or reach a 'sweet spot' by pushing sales, which may not be in the consumers' interest but only in that of the relevant persons.

69. Concerning the remuneration of the staff assessing the creditworthiness of consumers, and who are hence forming part of the assessment of whether a product is suitable for a consumer, either they cannot be awarded any VR, or their VR does usually not depend on the sales that they approve. Institutions in at least two Member States that participated in the survey stated that there is a regulation in place preventing their KPIs being the same as those of sales staff. Hence it cannot include the number or proportion of approved applications or sales results as a KPI. It is unclear whether institutions in other Member States also apply these requirements.

Main findings

70. The EBA asserts that most institutions try not to set incentives to act to the detriment of consumers. However, not all of these institutions clearly set disincentives to act to the detriment of consumers, which the EBA views as two different things.

Good practices

71. It is essential that the remuneration policies and practices do not set incentives to act to the consumers' detriment. However, good practice is to go further and explicitly set disincentives for sales staff to act to the consumers' detriment.

72. One suitable approach is to incorporate metrics measuring customer satisfaction and/or consumer detriment into the KPI for the granting of VR, as mentioned in chapter 3.4.

73. Another approach is the implementation of a gatekeeper provision. This would require institutions to ensure that sales staff were compliant with all regulatory requirements, e.g.

proper profiling of consumers' risk appetite, good quality of document, and did not cause harm to consumers, which could be assessed through customers' complaints. If the sales staff were not compliant, then the VR needs to be reduced, in severe cases they would not be awarded any VR at all. In the view of the EBA, such a gatekeeper provision sets a disincentive to sales staff to act to the consumer's detriment and effectively works as a malus.

74. With regards to staff responsible for assessing the creditworthiness of consumers, good practice is for their VR, if at all awarded, not to depend on the volume of sales.

5.6 The ex-post risk adjustment for variable remuneration

Requirements in the Guidelines

75. Section 4.1 of the Guidelines requires that 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 (Guideline 1.7).

Observations

76. The remuneration policies and practices of 36 CIs, three PIs and one EMI institutions do not foresee any mechanisms for deferring the payment of the VR to sales staff (relevant persons) that do not fall under the CRD requirements for 'identified persons'. The reasons these institutions stated are that they either do not believe deferral to be an effective tool or that it would not be compliant with national labour law.

77. By contrast, 20 CIs and one PI have policies in place to defer the payment of VR. However, in the case of several of these institutions, a deferral usually only applies to a VR above a high threshold. In one country, all institutions in the sample have such deferral mechanisms in place for sales staff. Of the 22 institutions having deferral mechanisms in place, 11 CIs and one PI also use malus provisions in relation to the deferred remuneration and generally considered it as an effective tool with regard to sales staff to prevent consumer detriment.

78. 34 CIs, four PIs and two EMIs (with all institutions from one Member State) cannot apply clawback provisions to sales staff that do not fall under the CRD requirements for identified staff. Institutions not applying clawback do not believe it to be an effective tool, e.g. because the level of VR that can be recovered would be low, or do not apply clawback because it would be in conflict with national labour law. In contrast, 17 CIs and one EMI apply the clawback provision also to sales staff who do not fall under the CRD requirements for identified staff. These institutions generally regard the clawback provision as an effective tool to prevent consumer detriment. However, one institution mentioned that its applicability is more challenging when the employee has left the institution than if the employee is still with the institution. Another institution mentioned that clawback can collide with tax regulation, as the part of the remuneration subject to clawback may have already been taxed.

Main findings

79. The EBA acknowledges that institutions consider the application of malus provisions and clawback to be challenging to implement, in the absence of regulatory requirements comparable to those that exist for identified staff according to CRD. As some institutions claim, they may also conflict with national labour law. Even amongst institutions applying such provisions, it is not certain that these provisions can be enforced. This seems to be especially true with regard to clawback clauses.

Good practices

80. Akin to chapter 3.5, the EBA is of the view that implementing a gatekeeper provision is a good practice to at least apply a malus for sales staff in case of non-compliance with regulatory requirements or in case of detriment to consumers.

5.7 The monitoring of risks

Requirements in the Guidelines

81. Section 4.4 of the Guidelines requires that where an institution identifies that a residual risk of consumers' detriment might arise as a result of the design of remuneration policies and practices, the institution should assess under the review whether any of these residual risks are crystallising and causing detriment to consumers (Guideline 4.1). Furthermore, institutions 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 with these Guidelines (Guideline 4.3).

Observations

82. Institutions do not seem to have developed in great detail the mechanisms in place to monitor conflicts of interests and the residual risk from remuneration policies and practices causing detriment to consumers. Some institutions refer to their conflict-of-interest policies, which are monitored by the compliance department or annual review of their remuneration policies and practices. Other institutions emphasise providing additional training for sales staff on company values and conflict of interest policies. Some institutions periodically monitor the trend of claims and legal disputes to identify possible cases of misconduct, including mis-selling. Some institutions reported that the design of their remuneration policies does not give rise to conflicts of interest, e.g. because there is no or little VR for sales staff. Few institutions mentioned the use of mystery shopping activities by the institutions themselves.

83. In addition, most institutions reported taking account of customer complaints, although those complaints may not always have a direct link to the remuneration of sales staff and instead feed into the review of the services of the institutions in general. Some institutions use customer complaints in the KPI for sales staff or to identify compliance breaches by individual sales staff, other institutions explained that these complaints feed more broadly into the review

of customer service strategies and may hence feed into the review of the remuneration policies and practices.

Main findings

84. The EBA is of the view that the mechanisms for monitoring conflict of interest and residual risk in place can be improved. Many institutions merely mentioned the implementation of remuneration policies or generic supervision by the compliance function as a monitoring mechanism for residual risks instead of mentioning specific tools.

85. The EBA also asserts that customer satisfaction indices may not offer a direct indication if consumer detriment is a direct consequence of the remuneration policy. For instance, if customers complain about being sold a product that is not suited to them and, as a result, provide negative feedback, the consumer detriment could be imputed to a variety of reasons, e.g. inappropriate risk-profiling of customers, and not necessarily the remuneration incentives for sales staff.

Good practices

86. In order to monitor conflict of interest and residual risk from remuneration policies and practices, the EBA believes that applying dedicated tools is a good practice. Such tools can comprise mystery shopping activities by the institutions themselves, conducting targeted reviews of sales staffs' compliance, and providing additional training for sales staff.

87. Further good practice would be to establish a whistleblowing procedure, by which staff can anonymously report practices that are to the consumers' detriment.

5.8 The review of remuneration policies and practices

Requirements in the Guidelines

88. Section 4.4 of the Guidelines requires that institutions review, at least annually, their remuneration policies and practices to ensure compliance with the Guidelines (Guideline 4.1). Where the review reveals that an institution's remuneration policies and practices do not operate as intended or prescribed, the institution should amend its remuneration policies and practices in accordance with these Guidelines (Guideline 4.2). Section 4.3 of the Guidelines requires that changes to the remuneration policies and practices should only be made with the approval of the management body (Guideline 3.4).

Observations

89. The most frequently mentioned function responsible for the review of the remuneration policy seems to be HR, followed by the compliance function, internal audit, the management body, risk management and legal function. In some institutions the regional or sales management is responsible for reviewing remuneration policies and practices.

90. The review of the remuneration policy for sales staff is conducted once a year by nearly all institutions in the sample. More frequent reviews would only occur ad hoc, e.g. to implement new regulatory requirements. One institution stated that the global group remuneration policy is reviewed every five years while the remuneration policy for sales staff is assessed yearly.

91. There are various kinds of internal reports being drafted within the institutions, some focusing more on the remuneration in general, while others focus on the sales numbers, other performance and compliance of sales staff. Amendments to the remuneration policy for sales staff seem mostly limited to implement regulatory changes and the competitive pressure to retain sales staff. Many institutions assign the preparation of internal reports to the HR function. In some cases, reports are drafted by the compliance and risk management function. However, some institutions did identify shortcomings in the compliance culture (for instance, a lack of balance between qualitative and quantitative KPIs or complexity of the retail incentive scheme). They mentioned having adjusted the remuneration policy accordingly.

Main findings

92. The EBA arrives at the view that all institutions seem to be compliant with regards to the frequency of the review of remuneration policies and practices, as they state that they conduct such a review at least annually. Some institutions further mentioned that they would also conduct a review more often if necessary, e.g. due to changes in the regulatory requirements or when identifying a shortcoming in the remuneration policies and practices.

93. However, in many cases it seems that the HR function alone reviews the policy without the internal control functions' critical assessment. Furthermore, reports to the board, in some cases, are just focused on budget questions or commercial goals, not on the protection of consumers.

Good practices

94. Akin to the good practices articulated in chapter 3.1, it is good practice that the function designing the remuneration policy is not alone in reviewing the policies and practices, as there might otherwise be an inaction bias. Consequently, the EBA views it as good practice that the internal control functions are involved in the review of the policies and practices but remain independent, i.e. they should predominantly point to shortcomings.

5.9 Summary overview of good practices identified

95. The following table provides an overview of all good practices that this report has identified and that the EBA considers to be compliant with the Guidelines.

Number	Good practice
1	Involve the HR function in the design of the policies supported by the compliance and/or risk management function/internal control function, which should critically assess the policy.
2	Ensure the independence of the risk management and compliance/internal control function, also vis-à-vis the management body itself.
3	Refer to the Guidelines on sound remuneration policies under CRD for a sensible steer on the internal procedures to develop remuneration policies, also for institutions that are not subject to them.
4	Have an integrated remuneration policy for all staff, covering all regulatory requirements.
5	Carry out an internal assessment about the appropriate balance of variable remuneration (VR) to fixed remuneration (FR) depending on the products that the sales staff are predominantly selling and the type of customer for whom these products are intended.
6	Involve the shareholders' meeting when granting VR in excess of 100% of FR.
7	Ensure that payout curves for VR do not set incentives to maximise sales at a specific point.
8	Do not make sales performance the determining factor for promoting a member of sales staff.
9	Refer to the EBA Guidelines on sound remuneration policies under CRD to determine for each type of allowance whether it constitutes FR or VR when it depends on sales performance.
10	Apply the regulatory requirements applicable to the granting of VR, also when offering non-monetary benefits that are linked to sales performance.
11	Apply a mix of quantitative and qualitative criteria when determining the VR for sales staff and ensure that the weight for the sales performance as part of the overall key performance indicators (KPI) is well below 100%.
12	Implement measures that explicitly disincentivise sales staff from acting in a way that gives rise to consumer detriment
13	When developing KPIs that determine the variable remuneration of sales staff, include in the formula measurements of customer satisfaction or, conversely, customer detriment.
14	Establish a 'gatekeeper provision', i.e. reduce or forfeit the VR of relevant persons when they are not compliant with regulatory requirements or acted to the consumer's detriment.
15	Ensure that the VR of staff responsible for assessing the creditworthiness of customers, if at all awarded, does not depend on the volume of sales.
16	Apply dedicated tools in order to monitor conflict of interest and residual risk from remuneration policies and practices, such as mystery shopping by the institutions themselves, targeted reviews of sales staffs' compliance, additional training for sales staff and whistleblowing.
17	When reviewing the remuneration policies and practices, involve the internal control functions and ensure their independence, to avoid inaction bias.

6. Conclusion

96. Based on the survey carried out, the EBA concludes that institutions in the sample focus more on prudential requirements and commercial interests than on consumer protection requirements. As such, this conclusion is consistent with the conclusion arrived by the EBA in its second report on the application of the guidelines on product oversight and governance[10], which found that institutions are mostly concerned about fulfilling prudential requirements rather than putting the required focus on ensuring that consumers' needs are met.

97. Consequently, institutions should pay more attention to consumer protection and better incorporate consumers' interest into their corporate culture. Furthermore, if the consumer is put more into focus, this could also be beneficial from a prudential perspective, as institutions would be reducing the risk of acting to the consumers' detriment, which might entail costly litigation and compensation, thereby creating conduct costs and undermining the viability of institutions.

98. The assessment also shows that the application of the Guidelines varies significantly depending on the number of relevant staff in, and on the type of, the institution. CIs with a large number of employees have different approaches compared to small EMIs that have only very few employees and relevant staff. This finding is not surprising, as the Guidelines leave some flexibility for institutions on how to comply, depending on the governance arrangements already in place and in line with the principle of proportionality.

99. The differences in application may also be traced back to the different regulatory requirements applying to each kind of institution. As CIs are subject to additional regulatory requirements than other types of institutions, some regulatory spill-over effects can be observed, which the EBA views to be beneficial to compliance with the EBA Guidelines on the remuneration of sales staff. Especially the CRD and the EBA Guidelines on sound remuneration policies under CRD set the foundation for CIs to apply stricter requirements as outlined in the EBA Guidelines on remuneration of sales staff, such as involving the risk management and compliance function in the evaluation of the remuneration policies and practices, setting up a remuneration committee or granting variable remuneration in excess of 100% and up to 200% of the fixed remuneration with shareholders' approval only. Conversely, it also means that, when institutions are not obliged by other regulatory requirements to set up such structures – and the Guidelines on remuneration of sales staff do not require that – then it seems unlikely that institutions will set up these structures. Instead, they exert minimum effort to comply with these Guidelines.

100. Concerning the governance structures, institutions should be more mindful to ensure that the design, approval and monitoring including the review of the remuneration policies and

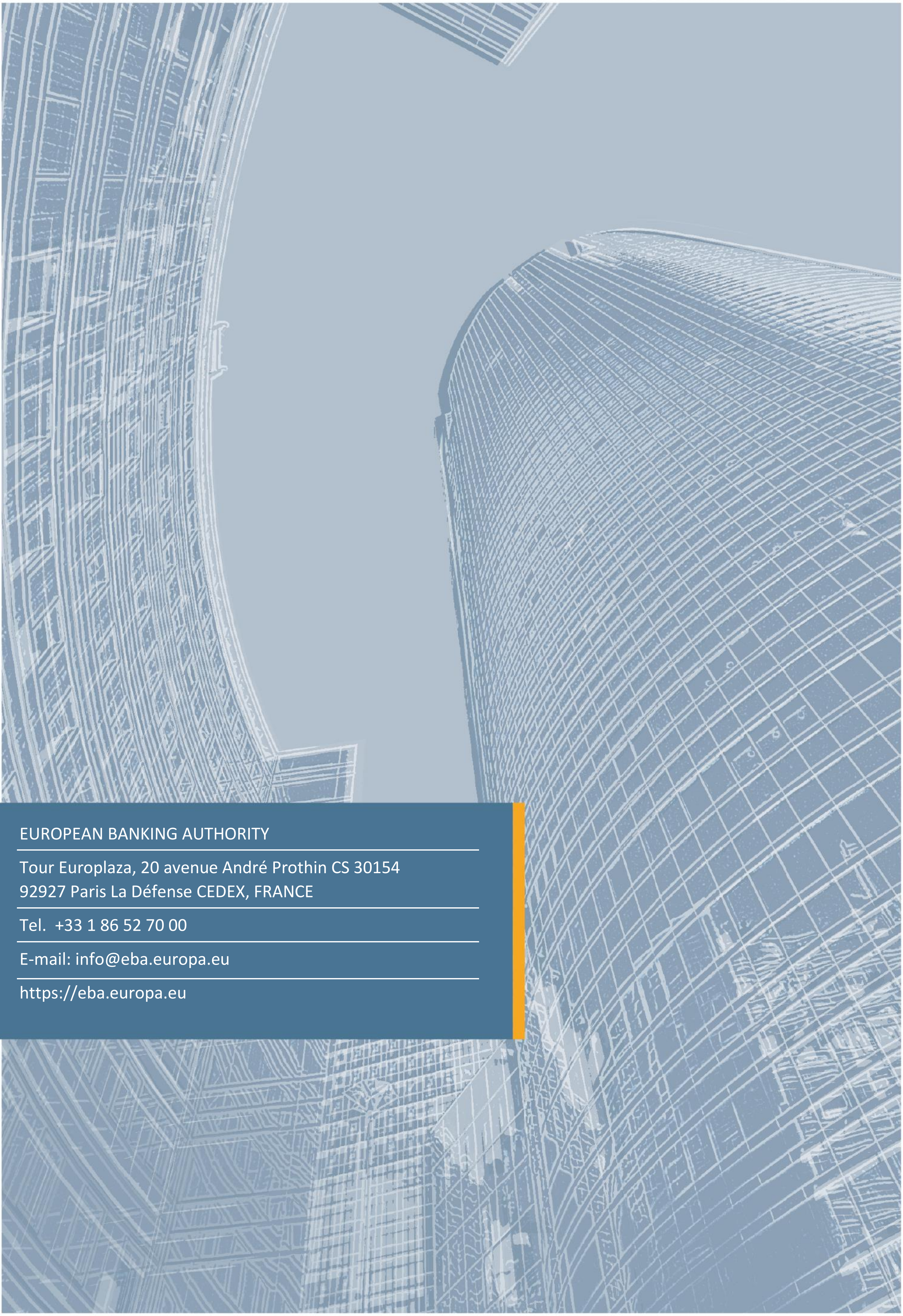
[10] EBA report on the application of the guidelines EBA/GL/2015/18 on product oversight and governance arrangements (EBA/REP/2020/28)

practices are not handled by the same function only and that internal controls and reviews are effective. For instance, the EBA is of the view that the internal control functions should predominantly provide a critical assessment of the policies and practices. Also, the management body should ensure that the control functions can provide critical comments – also vis-à-vis the management body itself – and institutions should be mindful of that when setting up the approval procedures.

101. Regarding the awarding of variable remuneration, institutions should be more mindful of incorporating consumers' interest in the procedures to grant such remuneration. As such, it may not be enough not to set any incentives for sales staff to act to the consumers' detriment, but instead it could be beneficial to set disincentives to do so.

102. Furthermore, when it comes to monitoring residual risk for consumer detriment, the EBA is of the view that institutions can and should do more to implement appropriate and specific control mechanisms.

103. The EBA and relevant competent authorities will continue to monitor how institutions apply these and whether they make use of the good practices identified in this report.



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