Financial Consumer Agency of Canada | Agence de la consommation en matière financière du Canada

Financial Consumer Agency of Canada

Domestic Bank Retail Sales Practices Review

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Canada

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Executive summary

This report presents the findings and conclusions of the Financial Consumer Agency of Canada's (FCAC's) review of the domestic retail sales practices of Canada's six largest banks (Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and Toronto–Dominion Bank), which are subject to federal consumer protection legislation overseen by FCAC.

This review focused on retail banking sales practices to identify and evaluate risks to consumers. FCAC examined the drivers of sales practices risk, assessed the effectiveness of the controls put in place by banks to mitigate these risks and recommended ways to more effectively reduce them.

Risks associated with sales practices include the potential for breaching market conduct obligations and mis-selling. Market conduct risk refers to the potential for breaching the legislative obligations, voluntary codes of conduct and public commitments that are overseen by FCAC.

FCAC defines "mis-selling" as the sale of financial products or services that are unsuitable for the consumer; sales that are made without taking reasonable account of the consumer's financial goals, needs and circumstances; and sales where consumers are provided with incomplete, unclear or misleading information. This definition of mis-selling is informed by research conducted by the U.K. Financial Conduct Authority, the Central Bank of Ireland, the G20/OECD Task Force on Financial Consumer Protection and the World Bank.

FCAC's review found that retail banking culture encourages employees to sell products and services, and rewards them for sales success. This sharp focus on sales can increase the risk of mis-selling and breaching market conduct obligations. The controls banks have put in place to monitor, identify and mitigate these risks are insufficient.

FCAC did not find widespread mis-selling during its review. Consumers carry out millions of successful transactions every day without incident and banks and their employees generally strive to comply with market conduct obligations.

Banks are in the process of enhancing their oversight and management of sales practices risk. The findings in this report reflect the status of the risks and controls at the time of the review.

This report does not address alleged breaches of market conduct obligations. These allegations are being investigated on a separate track and FCAC will take enforcement action where appropriate as outlined in its Compliance Framework.

This report was provided to the Minister of Finance to inform policy development in the context of FCAC's mandate to monitor and evaluate trends and emerging issues that may have an impact on consumers of financial products and services.

Key findings

FCAC's review resulted in five key findings:

1. **Retail banking culture is predominantly focused on selling products and services, increasing the risk that consumers' interests are not always given the appropriate priority.**

   The focus on sales has been facilitated by technological innovation, which has made banking more convenient for consumers and enabled banks to transform branches into "stores" dedicated to providing advice and selling products. This shift increases the risk banks will place sales ahead of their customers' interests.

2. **Performance management programs—including financial and non-financial incentives, sales targets and scorecards—may increase the risk of mis-selling and breaching market conduct obligations.**

   Bank performance management programs play a significant role in shaping the way bank employees behave toward consumers. Employees believe strong sales results provide more opportunity to earn incentives and rewards.

3. **Certain products, business practices and distribution channels present higher sales practices risk.**

   The system of incentives and rewards is more developed than the controls to mitigate sales practices risk for mobile mortgage specialists, cross-selling, creditor insurance products and third-party sellers.

4. **Governance frameworks do not manage sales practices risk effectively.**

   Banks generally have robust corporate governance practices. However, measures to reduce the risks associated with mis-selling and breaching of market conduct obligations should be improved.

5. **Controls to mitigate the risks associated with sales practices are underdeveloped.**

   Controls to mitigate sales practices risk have not kept pace with the changing retail banking model. There are opportunities for areas such as compliance, risk management, audit and human resources to improve the oversight of sales practices.

Conclusions

During the course of the review, FCAC identified several measures that would strengthen financial consumer protection:

Enhancements to banks' management of sales practices risk

To improve the management of sales practices risk, FCAC recommends that banks:

- prioritize financial consumer protection, fairness and product suitability
- establish a formal sales practices governance framework that clearly defines roles and responsibilities to ensure all elements of sales practices risk are effectively managed, including the effective monitoring and reporting of mis-selling and market conduct obligations
- improve their oversight, management and reporting of consumer complaints

- ensure financial and non-financial incentives motivate employees to work in the interest of consumers
- ensure internal controls adequately address sales practices risk, particularly for the practices, products and channels that pose a greater risk of mis-selling and of breaching market conduct obligations
- ensure human resources and second and third lines of defence—including compliance, risk management and audit—are adequately resourced to improve the oversight of sales practices risk

Enhancements to FCAC

FCAC will implement a modernized supervision framework that will allow it to proactively ensure banks have implemented the appropriate frameworks, policies, procedures and processes to effectively mitigate the risk of mis-selling and breaching market conduct obligations. It is also increasing its resources to buttress its supervisory and enforcement functions.

FCAC will enhance its consumer education materials to raise consumer awareness about financial products and services as well as to inform consumers of their rights and responsibilities and the importance of asking the right questions. These efforts will help consumers make informed financial decisions and potentially avoid some of the risks discussed in this report.

Background

Banks are businesses subject to federal consumer protection legislation overseen by the Financial Consumer Agency of Canada (FCAC). Following the 2007–08 global financial crisis, international regulators and rule-making authorities developed guidance focused on bank culture. Sound risk cultures, reinforced by a robust “tone from the top,” are now widely considered to be critical controls in mitigating sales practices risk.

Despite the increased focus on achieving the right culture, internationally, some banks have insufficient governance frameworks and controls in place to monitor, identify and mitigate sales practices risk. An important example came in September 2016 when the U.S. Consumer Financial Protection Bureau, the Office of the Comptroller of the Currency, and the Los Angeles City Attorney fined Wells Fargo $185 million for engaging in improper sales practices. In an effort to reach sales targets, bank employees opened more than three million fraudulent credit card and bank accounts. In the five years before the fine, Wells Fargo terminated over 5,000 employees for violating the bank’s code of conduct.

In November 2016, Canadian media reported allegations that a bank was signing up new customers without obtaining their express consent. Following its investigation, FCAC issued a notice to all banks reminding them that the express consent of consumers is to be obtained for all sales of new products and services in a manner that is clear, simple and not misleading. Banks were also reminded of their obligations to provide consumers with the required disclosure. FCAC issued a consumer alert informing consumers that banks were required to obtain their express consent before issuing new credit cards.

On February 3, 2017, FCAC sent a letter to the industry to reinforce and clarify its expectations regarding express consent. Subsequently, in March 2017, FCAC published compliance bulletin *B-5 Consent for new products or services* to reiterate its expectations.[1]

In late-February and March 2017, media reports alleged that Canadian banks were using high-pressure tactics and questionable practices to sell a broad range of products and services, citing information received from current and former bank employees. Subsequently, FCAC announced it would conduct an industry review of the business practices related to the sale of products and services by federally regulated financial institutions. FCAC conducted its review from May 2017 through to the end of November 2017, concurrently but separately from a review undertaken by the Office of the Superintendent of Financial Institutions.

Review approach

Objective

FCAC examined the drivers of sales practices risk, including banks' sales targets and incentive programs. It also evaluated the governance frameworks and controls put in place by banks to mitigate this risk.

The review focused on two categories of sales practices risk: the potential for breaches of market conduct obligations and mis-selling. FCAC defines mis-selling as sales of financial products or services that are unsuitable for the consumer; sales that are made without taking reasonable account of the consumer's financial goals, needs and circumstances; and sales where consumers are provided with incomplete, unclear or misleading information.

Methodology and scope

The review examined retail banking distribution channels where there is interaction between consumers and bank employees or third-party contractors, whether in person or over the phone. These included the branch channel, the call centre channel, specialist channels[2] and the third-party sellers' channel.

FCAC reviewed more than 4,500 complaints to gain a better understanding of the issues consumers experience when acquiring bank products and services.[3] Over 100,000 pages of bank documents were examined, including those related to training, performance and sales management, compliance, risk management and internal audit. These documents helped identify the drivers of sales practices risk and assess the controls and governance frameworks established to mitigate such risks.

Between May and November 2017, FCAC interviewed more than 400 employees of the six largest banks, including board chairs and directors, senior management, middle management and front-line customer service representatives. In addition, it interviewed over 200 employees in 30 branches. The interviews

[1] FCAC compliance bulletins are intended to guide banks' actions by describing how the Agency views the requirements of legislation, regulations and codes of conduct or public commitments.

[2] Specialist channels include mobile mortgage specialists and investment specialists. Employees in specialist channels usually concentrate on one type of product, such as mortgages or investments, but may also sell other complementary products such as creditor insurance or guaranteed investment certificates.

[3] The complaints included those reported to FCAC by 16 banks and direct consumer complaints to FCAC. The complaints reviewed date from April 2015 to May 2017.

helped FCAC validate and challenge information obtained during the document review. The interviews also helped inform the assessment of bank sales culture and how it shapes banks' sales practices.

Findings

The review focused on retail banking sales practices to identify and evaluate risks to consumers. FCAC examined the drivers of sales practices risk, assessed the effectiveness of the controls put in place by banks to mitigate these risks and recommended ways to more effectively reduce them. FCAC did not find widespread mis-selling during its review.

Banks are in the process of improving their management of sales practices risk. The findings in this report reflect the status of the risks and controls at the time of the review.

FCAC's review resulted in five key findings:

1. Retail banking culture is predominantly focused on selling products and services, increasing the risk that consumers' interests are not always given the appropriate priority.
2. Performance management programs—including financial and non-financial incentives, sales targets and scorecards—may increase the risk of mis-selling and breaching market conduct obligations.
3. Certain products, business practices and distribution channels present higher sales practices risk.
4. Governance frameworks do not manage sales practices risk effectively.
5. Controls to mitigate the risks associated with sales practices are underdeveloped.

1. Sales culture

Retail banking culture is predominantly focused on selling products and services, increasing the risk that consumers' interests are not always given the appropriate priority.

Culture can be defined as the collection of values and beliefs that reflects the underlying mindset of an organization. FCAC found that retail banking culture is focused on selling products and services. While retail banking places value on customer service and community engagement, their retail culture is increasingly sales oriented for reasons explored in this review. Consequently, this may give rise to banks placing their sales interests and targets ahead of their customers' interests.

Technological advances over the last 20 years have led to important changes in the behaviours of financial consumers and the sales practices of banks. Consumers now largely prefer to transact online and use mobile applications and automated teller machines (ATMs). Yet despite the increased prevalence of digital sales, the main conduits for driving sales growth and increasing market share continue to be the branch channels, call centres and specialist channels. Today, consumers primarily interact with bank employees when they acquire new products, seek advice, make inquiries, file complaints and conduct more complex financial transactions. Technology has also made it possible for banks to target product and service offerings to individual customers based on the data they compile about them.

As a result, branch and call centre channels have shifted their focus from processing transactions to selling products and services, providing financial advice and sales-related customer service. Today, most branch employees are either directly involved in selling financial products and services to consumers or have a responsibility to identify sales opportunities and refer consumers to branch employees who are dedicated to sales. Increasingly, call centre employees are required to sell banking products and services in addition to their role of providing customer service.

In recent years, banks have developed specialist channels that play an increasingly important role in the sale of financial services and products to consumers. Employees in specialist channels typically concentrate on one product, such as mortgages or investments, and operate outside the branch environment. Banks also engage the services of third parties to market and sell specific products, such as credit cards. Third-party arrangements are popular as they allow banks to reach consumers in places where they would not typically bank, such as airport kiosks and sporting events.

The shift away from in-person transaction/service models has changed the culture of retail banking. FCAC found that banks expect front-line, customer-facing roles in branches, call centres and specialist channels to sell products and services to consumers. Some employees informed FCAC that they attribute significant importance to “winning,” defined as closing a big sale or replacing the business of a competitor.

Employees who do not meet their sales targets receive coaching, additional training and other forms of support. In general, banks do not terminate employees who fail to reach sales targets. However, front-line employees who stay on and move up tend to be those who thrive in a workplace culture focused on sales.

Furthermore, the lack of transparency about sales targets and commissions makes it difficult for consumers to determine in whose interest bank employees are acting when one product is recommended over another.

More recently, banks’ focus has started to shift from sales results to customer satisfaction and loyalty measures. For example, some banks have complemented sales-volume targets with activity-based targets that reward employees for performing activities that promote long-term relationships with consumers, such as offering financial plans. They have also expanded their use of customer satisfaction surveys to motivate employees to provide good service. These new measures are welcome and may motivate employees to gain a greater understanding of consumer needs and financial goals.

Nonetheless, the movement toward more customer-centric sales practices continues to be intended primarily to help employees identify sales opportunities and to promote long-term relationships with consumers that may lead to additional sales down the road. It is too early to assess whether the increased focus on customer satisfaction and loyalty will sufficiently mitigate the risk of mis-selling and breaching market conduct obligations.

In summary, sales-driven cultures have the potential to increase the risk of mis-selling. The importance employees place on reaching sales targets and qualifying for incentives may lead them to prioritize sales over consumers' interests, which, in turn, may jeopardize banks' adherence to their market conduct obligations.

2. Performance management

Performance management programs—including financial and non-financial incentives, sales targets and scorecards—may increase the risk of mis-selling and breaching market conduct obligations.

Bank performance management programs—which include financial and non-financial incentives, sales targets and scorecards—play a significant role in influencing employee behaviour and shaping corporate culture. The review found that employees' behaviour toward consumers was influenced more by financial and non-financial incentives than by the communications they receive from senior management ("tone from the top") advocating putting the customer first, selling the right way and acting in the interests of their customer.

Financial incentives

Most bank employees are remunerated through a combination of fixed base salary and variable incentive pay. For the majority of front-line employees, the base salary comprises the bulk of their compensation, with variable pay representing only a small percentage. Variable pay is based on individual performance, team performance and bank results.

In interviews, banks stressed their view that front-line employees have little to gain from mis-selling in order to achieve sales results, as the variable compensation and annual bonuses at stake are relatively small. However, FCAC found that most front-line employees nonetheless consider their variable compensation important.

Managers, on the other hand, earn significantly higher base salaries, and the variable portion of a manager's compensation tends to make up a larger proportion of their overall compensation package. Additionally, the compensation of certain groups of front-line employees, such as mobile mortgage specialists, consists of 100 percent variable pay with no base salary. As will be explained in more detail later in this report, compensation programs with variable pay as a significant component can lead to mis-selling because employees may look to increase sales to maximize their commissions or rewards.

Non-financial incentives

Non-financial incentives are used to motivate employees to reach promotional campaign objectives and annual sales targets. Banks use a variety of non-financial incentives, such as small-value gift cards, peer recognition forums, all-expenses-paid trips and holidays, career development opportunities and promotions. The review found that employees are motivated to achieve strong sales results in part because they believe doing so provides more opportunity for non-financial incentives.

Regional vice-presidents, branch managers and front-line employees informed FCAC that strong sales results are a key consideration for promotion. Branch managers further advised that, since achieving sales results is fundamental to the performance objectives for more senior positions, they were unlikely to consider promoting staff who did not achieve satisfactory sales results. In their view, strong sales results tend to be an indicator of an employee's potential to fill more senior roles. Bank employees consider promotions key to earning significantly more annual and variable compensation.

Non-financial reward programs generally are subject to limited oversight in comparison with variable compensation programs. When properly designed, non-financial incentives can promote good sales practices and behaviours. The review identified opportunities for banks to significantly enhance the design, monitoring and oversight of non-financial rewards programs.

Sales targets

Banks employ different types of sales targets to motivate employees to sell. Ambitious and product-specific targets can increase the risk of mis-selling significantly. For example, offering employees financial compensation to sell a large number of travel rewards credit cards within a specific time period may lead employees to sell products without making a reasonable effort to determine whether the products are consistent with the consumer's financial needs, goals or circumstances.

Banks track the proportion of employees who fall short, reach or exceed sales targets and use the data to calibrate the targets for the next calendar year. FCAC found that most banks strive to calibrate the sales targets so that approximately two-thirds of front-line employees will reach them. On occasion, some banks have adjusted targets mid-year, usually to take into account external factors such as regional economic events or natural disasters.

As part of the shift toward more customer-centric strategies, a number of banks have introduced, or are testing, activity-based targets to complement sales targets. This can mitigate the risk of mis-selling, as employees are recognized for sales-related activities even in circumstances where consumers choose not to purchase any products or services. In these cases, however, employees are still required to complete a certain number of sales-related tasks, such as reaching targets for telephone calls and meetings with customers.

Some banks have taken steps to integrate more team-based sales targets, which may mitigate the risk of mis-selling by reducing the pressure on individual employees to sell products and services. On the other hand, team-based targets can put additional pressure on top performers to contribute more to help the branch reach its goals. Team-based sales targets can also put pressure on more customer-service oriented roles to contribute to the branch's overall sales goals.

Currently, banks tend to assign greater value to more profitable and complex financial products and services, which may lead to mis-selling and poor consumer outcomes. For example, if the sale of premium travel rewards credit cards garners more weight toward the achievement of sales targets than low-fee and low-interest credit cards do, employees would likely be more motivated to sell the premium cards, perhaps even at the expense of consumers' interests. Product-neutral sales targets could greatly mitigate the risk of mis-selling financial products and services to consumers.

Scorecards

Banks use scorecards to manage performance and inform the calculation of variable compensation. Scorecards comprise variables used to evaluate employee performance based on the roles and responsibilities associated with each position. Variables are weighted, with strategic priorities assigned the highest values.

In recent years, banks have placed greater emphasis on customer satisfaction when assessing employee performance. This shift toward customer satisfaction in retail banking has encouraged the development of new metrics for front-line employees. For example, front-line employee scorecards may include metrics such as:

- 40 percent for customer satisfaction
- 40 percent for sales targets
- 10 percent for compliance
- 10 percent for referring customers to advisors

Banks point to balanced scorecards as a key control to mitigate the risk of mis-selling and breaching market conduct obligations. In practice, however, the metrics used to assess an employee's sales results tend to be significantly more robust than those used to assess other areas of performance.

FCAC found that many employees felt they had greater control over their sales results than over customer satisfaction results, even when both results carried an equal weighting on their scorecards. For instance, customer satisfaction is measured by a net promoter score (NPS) survey, which asks customers whether they would recommend the bank to others based on their recent in-branch or call centre experience. Consumers are randomly selected for surveys, but only a small number complete the survey on a quarterly or annual basis for any given employee. Moreover, consumers may use surveys to express their dissatisfaction with bank practices that are beyond the control of front-line employees.

3. Higher risk sales channels, practices and products

Certain banking products, business practices and distribution channels present higher sales practices risk.

FCAC identified a higher risk of mis-selling and breaching market conduct obligations in areas involving mobile mortgage specialists, cross-selling, creditor insurance products and third-party sellers. The risks associated with these products, business practices and distribution channels are driven by sales-focused cultures and the performance management programs outlined earlier in this report. In general, the controls in place do not adequately mitigate the elevated risks associated with sales practices.

A) Mobile mortgage specialists

Mobile mortgage specialists (MMS or specialists) sell mortgages independently from the branch channel, going out in the community to meet clients and business contacts. This mobility, coupled with 100-percent variable pay, presents a higher risk to consumers, particularly given that controls are underdeveloped and levels of bank supervision are less intense. The proportion of mortgages sold through the MMS channel varies significantly across the six large banks. In some instances, banks sell upwards of 90 percent of their mortgages through this channel.

Variable pay compensation model

Each of the six large banks uses a 100-percent variable pay model to compensate their MMS. This means MMS are paid straight commission and do not earn a base salary. Commissions are calculated mainly by multiplying the dollar value of all mortgages sold—known as mortgage volume—by a commission rate expressed in basis points. For example, 85 basis points of compensation for a mortgage of $500,000 would result in a commission of $4,250.

In addition to mortgage volume, compensation rates for MMS may be influenced by several factors, including:

- mortgage types
- term lengths
- interest rates
- cross-selling of other products as part of the mortgage sale

Most banks also set individual volume and cross-selling targets for their MMS and pay higher commission rates for sales that exceed targets. For example, banks may raise the commission rate by 10 basis points when MMS reach 105 percent of their quarterly volume target of $10 million.

Consumer risks associated with the MMS compensation model

Variable pay compensation models may discourage MMS from making reasonable efforts to assess and take into account a consumer's needs and financial goals. The main risk to consumers in this compensation model is mis-selling. For example, the compensation model may encourage specialists to recommend mortgage products that earn higher commissions even if they are not the best option for the consumer. When commission rates vary with term lengths, interest rates and mortgage type, MMS may be motivated to sell mortgages that yield higher commissions without adequate regard for the consumer's needs.

The opportunity to earn higher commissions for reaching mortgage volume targets may also lead specialists to recommend larger mortgages to consumers. Furthermore, MMS may encourage consumers to acquire a mortgage sooner than they were intending, rather than encouraging them to save for a larger down payment.

Specialists can also earn higher commissions by meeting cross-selling targets. In most cases, banks expect MMS to sell creditor insurance products such as life, critical illness or disability insurance to as many as one in three mortgage borrowers. The risks associated with cross-selling and creditor insurance are discussed later in the report.

Controls and oversight of MMS sales practices

Banks generally impose fewer controls and exercise less-intensive oversight on the sales practices of MMS compared with other bank sales roles. The result can be an increase in sales practices risk. For example, branches and call centres use balanced scorecards to assess employee performance not only on sales results, but also on other criteria such as customer satisfaction survey results. However, balanced scorecards are not widely used to determine the variable pay of MMS and, when they are, the scorecards are much less balanced and more heavily weighted toward sales.

Most banks use, albeit to a limited extent, compensation penalties to retroactively claw back commissions earned by MMS if certain events occur. For example, commissions are clawed back if the mortgage paperwork is incomplete or if the number of defaulting mortgages is too high. Presently, claw backs are primarily used as a control to mitigate credit risk. However, FCAC found limited evidence of claw backs being used to mitigate the sales practices risk associated with MMS during the review.

Direct oversight of MMS sales practices is underdeveloped. As mentioned, given the mobile nature of this role, MMS often operate outside the branch channel. They are expected to spend their time in the community developing business relationships with real estate agents, developers and others from whom they can earn mortgage referrals. This limits opportunities for direct supervision, observation of sales practices and coaching by managers.

In addition, the managers responsible for overseeing MMS often have a vested interest in promoting mortgage sales volume growth. A significant portion of a manager's compensation may be directly tied to the volume of mortgages sold by the specialists they supervise. The scorecards of MMS managers are heavily weighted toward sales.

The competitive market for the services of high-performing MMS can make it more difficult for banks to enforce codes of conduct and take disciplinary action. During the review, FCAC learned there have been cases of MMS leaving their employer before the bank could complete its investigation or take disciplinary action.

B) Cross-selling

Cross-selling is the sale of additional products and services to existing customers by leveraging the relationship. Banks use this sales method to sell more products and increase their market share. Typically, consumers who are using one or two products are targeted and are provided a range of offers. Cross-selling performance is tracked with statistical metrics such as "share of wallet," which allow banks to see how successful they are at turning one-product consumers into multi-product consumers.

There are benefits associated with this practice. Consumers can be made aware of useful products and services. However, cross-selling may also result in the sale of unwanted or unsuitable products or services, particularly when bank employees are responding to sales targets and not making a reasonable effort to assess consumer needs.

Leads-based cross-selling

A common form of cross-selling is a leads- or prompts-based model. When a consumer visits a branch or contacts a call centre, the bank employee's computer screen may highlight as many as 10 leads for that customer. These leads tend to be generated by algorithms, prompting the employee to offer a range of products and services that the consumer does not currently have with the bank, such as:

- travel rewards credit cards
- unsecured personal lines of credit
- credit limit increases
- additional services tied to products currently used, such as overdraft protection or creditor insurance
- other means of accessing their existing services, such as online and mobile banking applications

Consumer risks associated with cross-selling

Banks' heightened focus on cross-selling may increase the risk that they will fail to obtain consumers' express consent. For example, presenting consumers with a large number of different product offers while managing service times increases the risk that bank employees will feel rushed and not communicate in a manner that is clear, simple and not misleading when obtaining a consumer's consent. In other words, cross-selling increases the risk that employees will not take the time to explain important terms, fees and conditions related to the products they are offering. As a result, consumers may not be adequately informed about the products or services they are purchasing.

Cross-selling may also increase the risk of mis-selling, as the sales model may encourage bank employees to offer consumers products without taking into account consumers' financial goals, needs and circumstances. Customer service representatives and sales staff are generally required to offer products they see in the computer-generated leads while also managing their service times. For example, a consumer may visit a branch to cash a cheque and be presented with offers for travel rewards credit cards and credit card balance protection insurance. Because bank employees often have to reach targets for computer-generated leads, cross-selling strategies can discourage employees from identifying consumers' needs and goals and recommending suitable products.

Controls for cross-selling risk

Presently, banks mitigate the risk of mis-selling associated with cross-selling through:

- scripts and conversational cues used by employees to guide offers to consumers
- supervision by branch managers
- quality assurance reviews in the phone channel
- cultural values reflected in bank codes of conduct
- the "tone from the top" set in communications from senior management

Controls to prevent failure to obtain express consent

FCAC found that banks generally have controls in place to ensure that a consumer's consent is obtained when new products and services are sold. However, FCAC also found that controls were not adequate to ensure that the written or verbal communication used to obtain consumer consent is clear, simple and not misleading.

It is important to note that most banks sell a number of products and services (e.g., credit limit increases on personal lines of credit, deposit account plan changes) by obtaining the verbal consent of consumers. Reliance on verbal consent can increase the risk that consumers are sold products for which they did not provide their express consent.

The controls in place to ensure banks obtain consumers' consent through communication that is clear, simple and not misleading are typically weaker in the branch channel when compared to call centre operations. For both channels, employees are provided with conversation cues and scripts, which are intended to ensure that the most important terms, fees and conditions are disclosed to consumers before obtaining their consent. In branches, managers and customer service supervisors are responsible for ensuring that employees read the scripts and cues. However, FCAC found that branch managers and supervisors are not well positioned to ensure that express consent is always obtained in the prescribed manner. For a more detailed explanation, see the "Controls" section.

Banks record most conversations between consumers and call centre employees, which allows them to review transactions to verify whether employees are following the scripts and properly obtaining the consent of consumers. However, the review revealed that banks examine only a relatively small number of calls—too few, in fact, to provide a high level of confidence that individual call centre employees are in compliance with policies and procedures related to obtaining consent.

In most cases, call centre employees who take 60 to 80 calls per day have only a small number of calls per month reviewed for quality assurance purposes, such as adherence to scripts and compliance with market conduct obligations. Moreover, in general, the calls reviewed are randomly selected and not chosen based on risk factors. For example, banks do not review a higher percentage of calls where credit card balance protection insurance was sold to consumers, even if these calls may represent a greater risk in terms of sales practices.

Performance management

Compensation, employee scorecards and other forms of performance management tend not to effectively mitigate the risks associated with cross-selling. In some cases, banks assess employees against ambitious, product-specific and individualized cross-selling targets. This can increase the risk of mis-selling and breaching market conduct obligations.

As discussed earlier, introducing activity-based targets, team-based sales targets and product-neutral financial compensation could help mitigate the risks associated with mis-selling. A number of banks have introduced activity-based targets, compensating employees who offer products or have conversations with consumers even when no sales result. FCAC found that the majority of banks do not have team-based sales targets and there has been only limited implementation of product-neutral compensation.

Data analytics

Most banks are working to implement new technologies to improve controls related to cross-selling and reduce the risk of mis-selling. For example, data analytics can be used to detect unusually high rates of unused credit cards or product cancellations, which may indicate a pattern of mis-selling.

Data analytics could be used to discourage mis-selling by enabling banks to claw back employee compensation in situations where products are sold to consumers who do not use them. This technology could generate reports to support the oversight of employee sales practices by supervisors and branch managers. While banks indicated they planned to increase their investment in data analytics, the technology is still underdeveloped as a control for risks related to sales practices, especially when compared with the maturity of the technology supporting marketing strategies.

C) Creditor insurance

The purpose of creditor insurance is to pay off outstanding credit balances or to make set monthly payments against debts if certain triggering events occur, such as job loss, serious illness or death. In the large majority of cases, consumers can acquire creditor insurance products only from the bank that sold them the credit product. Consumers who wish to purchase credit card balance protection insurance can do so only through the bank that originally issued the credit card.

Similar to most insurance policies, creditor insurance coverage is subject to exclusions, such as employment status and health conditions. At the time of purchase, the underwriting is performed by assessing answers to a handful of broadly worded yes-or-no questions. Depending on how consumers answer these questions, creditor insurance may be granted in a matter of minutes.

Credit insurance products usually offer a 30-day first-look period during which consumers are fully refunded any premiums paid if they choose to cancel the coverage. This feature is described in a variety of ways, such as a "trial period" or "free look." However, it is important to highlight that banks are not required to ask consumers to reconfirm their consent for acquisition of the product after the initial 30-day period.

Consumer risks associated with creditor insurance

There is a risk that consumers and front-line staff may not adequately understand creditor insurance, the exclusions to the coverage or the claims adjudication process. Bank employees may not provide certain details because of an inadequate understanding of the product, in the interest of closing a sale or in response to time constraints. For example, bank employees may sell creditor insurance to post-secondary students to go along with a personal line of credit but neglect to inform them that they need to work a minimum number of hours for the coverage to be in force.

Bank employees are often encouraged to cross-sell, bundle and generally apply more pressure when selling creditor insurance than other banking products and services. Employees can mistakenly or deliberately imply that creditor insurance is sold as part of the credit product or that credit approval is contingent on the purchase of creditor insurance. For example, front-line employees may sell creditor insurance by advising consumers that "the credit card comes with balance protection," which may give consumers the impression that creditor insurance is a card feature, as opposed to what it really is: a separate and optional product.

Banks set product-specific sales targets for creditor insurance. Employees are expected to reach insurance penetration targets, such as selling creditor insurance with 30 percent of credit products sold. Product-specific targets increase the likelihood that sales staff may push a specific product to meet their target, even when the product does not meet the needs of the consumer. Failure to meet a target may lead to reduced variable compensation or negatively impact their eligibility for non-financial rewards.

Bank employees may try to persuade consumers to purchase creditor insurance by failing to provide clear information about the 30-day first-look feature. For example, when consumers ask questions about coverage exclusions, bank employees may encourage them to purchase the product on a trial basis in order to obtain an information package, even though the information is available without purchase. During the review, FCAC found that some consumers forget to cancel the product and incur premium payments.

The industry describes creditor insurance as a "sold" product rather than a "bought" product. This means consumers rarely inquire about creditor insurance, initiate its purchase on their own or educate themselves about its features. Instead, banks rely on employees to offer the product to consumers. Consumers often depend on the information provided by bank employees when deciding whether to purchase creditor insurance.

Controls for creditor insurance sales practices

Banks use scripts and cues, training and claw backs to mitigate the risk of mis-selling creditor insurance and to promote compliance with market conduct obligations. In general, FCAC found that the controls are underdeveloped, particularly in light of the characteristics of creditor insurance and the risks associated with prevailing sales practices.

Scripts and cues

Banks rely on scripts and conversation cues to make sure employees communicate key information to consumers, including the terms and conditions of creditor insurance products. In addition, scripts and cues are used to mitigate the risk of employees applying undue pressure when selling creditor insurance and to ensure employees communicate in a manner that is clear, simple and not misleading when obtaining the consent of a consumer. Employees are expected to use and follow the scripts, which are designed to present information in a logical manner.

However, banks do not have adequate controls in place to ensure employees follow scripts, clearly explain terms and conditions, and avoid using undue sales pressure. Oversight is greater in call centres where calls are recorded, but only a very small number are reviewed for compliance with the bank's code of conduct and market conduct obligations. In the branch environment, banks largely rely on branch managers, assistants and supervisors to prevent mis-selling.

Training

Banks use training to mitigate the risk of employees mis-selling creditor insurance and to prevent breaches of market conduct obligations. The training is intended to supplement scripts and cues, ensuring employees are in a position to adequately answer consumer questions about creditor insurance.

Training on creditor insurance is covered by a voluntary code of conduct adopted by the banks. All code signatories commit to training employees and to taking measures to ensure that the products are sold by knowledgeable staff.

The review revealed that bank employees are not always adequately informed or knowledgeable about creditor insurance products. For example, during FCAC branch visits, employees provided inaccurate and incomplete information about the benefits, coverage and exclusions associated with creditor insurance when answering questions about how they sell the product. FCAC is of the view that there is room to strengthen the training of front-line staff.

Claw backs

Some banks claw back sales commissions when consumers cancel creditor insurance products within 90 days of sale. This measure reduces the risk of mis-selling by encouraging employees to make a reasonable effort to assess consumers' needs when selling creditor insurance. FCAC found that claw backs are more widely employed to control the mis-selling of creditor insurance than they are for other banking products or services.

Banks gather some data on cancellation rates, but it may not necessarily reflect instances of mis-selling as consumers may cancel the insurance for other reasons. Further analysis of cancellations by banks would enable the data to be used to monitor, identify and address sales practices risk.

D) Third-party sellers

In an effort to reach consumers outside the branch environment, most banks have outsourced the sale of certain products, such as credit cards, to third parties. Third-party sellers are required to comply with federal financial consumer legislation when they market bank products and services. Banks are responsible for ensuring the compliance of third-party sellers. In practice, the third-party sales model, along with the limited oversight exercised by banks, lead to an increased risk of mis-selling.

Third-party sales models

Third-party sellers and their sales staff are often limited to selling one product or one type of product, such as travel rewards credit cards at airport kiosks or creditor insurance in outbound call centres. Consequently, their sales targets tend to be product specific. Contracts between banks and third-party sellers may also set specific and ambitious targets, such as requiring the third-party seller to sell thousands of credit cards per month.

Third-party sellers typically divide sales targets among sales staff and locations. Sales staff are often required to sell a minimum number of products per shift or hours worked. In addition to a base salary or hourly wage, third-party sales staff may receive commissions based on the number of units sold. Even when their employees are compensated without regard to volume or units sold, third-party sellers may be compensated by banks on a per-unit basis, which could lead the third-party seller to increase the sales pressure on their staff.

Consumer risks associated with third-party sales

Third-party sales pose several risks to consumers. First, ambitious and product-specific sales targets may encourage third-party sales staff to use high-pressure tactics to sell credit products to consumers. For example, FCAC reviewed complaints where consumers alleged that third-party sales staff ignored their objections or failed to obtain a clear "yes."

Second, third parties may not make reasonable efforts to assess the suitability of a financial product or service for consumers based on their needs. As third parties typically are contracted to sell one or two banking products and services, they may be less motivated to identify consumer needs and financial goals. The limited number of products offered by third-party sellers also means they are not well equipped to offer alternate products or types of products.

Third, the circumstances under which third parties interact with consumers can affect the way consumer consent is obtained. Third-party sellers typically encounter consumers in locations such as grocery stores, airport terminals, gas stations and coffee shops. Under these circumstances, consumers are not actively seeking bank products and may not be prepared to make important financial decisions. These environments can be more conducive to mis-selling given that consumers are often busy and distracted.

Finally, third-party sellers may add to consumer confusion by offering rewards, gifts and prizes in exchange for a consumer's signature on an application. Third-party sellers may not always make it clear to consumers that they are completing a credit application or entering into an agreement in exchange for a gift or prize. Some sellers have been known to describe the agreements as surveys.

Controls over third-party sellers

Bank oversight of third-party sellers is significantly weaker than that which banks exercise over their branch and call centre operations. Banks rely heavily on their cultural values and managerial oversight to prevent mis-selling and ensure compliance with market conduct obligations in their branches and call centres. These tools are less effective for the oversight of the sales practices of third-party sellers.

When banks outsource sales to third parties, they rely on the third parties for most aspects of control and oversight. For example, third parties are typically responsible for the day to day management of the sales locations, establishing culture and tone, hiring and training staff, and ensuring staff do not mis-sell or breach market conduct obligations. In some cases, third parties perform their own quality assurance, call monitoring and investigations of potential breaches of market conduct obligations in response to consumer complaints and report their findings to banks. In general, banks rely on the third-party sellers to manage sales practices risk.

Some banks are currently rethinking their use of third-party sellers and have taken steps to enhance their oversight. Banks employ data analytics to monitor and compare third-party activity with their own sales data. For example, banks monitor early cancellation rates as an indicator of low quality sales. Banks have also begun requiring third-party sellers to use customer satisfaction surveys. It is important to note that banks generally can terminate their contracts with third-party sellers if they fail to meet contractual obligations.

In conclusion, and notwithstanding recent efforts, bank oversight of third-party sellers remains underdeveloped and weaker than the oversight exercised over their own retail sales operations. Considering the elevated risk posed by third-party sellers, banks would benefit from buttressing their oversight of third-party sellers.

4. Governance of sales practices

Bank governance frameworks do not manage sales practices risk effectively.

The quality of bank corporate governance practices is an important factor in maintaining consumer and market confidence. Media reports alleging high-pressure sales practices in Canada provided the impetus for FCAC to review bank corporate governance structures in the area of sales practices and consumer protection.

The *G20/OECD Principles of Corporate Governance* state:

> "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."[4]

Corporate governance frameworks provide the structure to assign roles, responsibilities and accountabilities in the furtherance of corporate objectives and performance monitoring.

FCAC's review identified opportunities to strengthen bank governance of sales practices going forward:

- develop governance frameworks that specifically address the management of sales practices risk
- establish clear mandates, roles and responsibilities for oversight of sales practices
- set clear expectations for reporting on sales practices risk to allow for a more informed and holistic perspective of the risks

[4] OECD (2015), *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264236882-en, p. 9.

- facilitate more effective oversight of bank controls with respect to sales practices and market conduct obligations

Governance frameworks

FCAC found that, compared with the management of other forms of risk, bank governance frameworks do not adequately address the management of sales practices risk. As a result, banks lack a consolidated and holistic view of the risks associated with sales practices. Boards, senior management and control functions are limited in their ability to identify, measure, monitor and address risks related to mis-selling, poor consumer outcomes and breaches of market conduct obligations. Some banks, however, have begun to develop and implement frameworks to manage sales practices risk, but this work is in its early stages.

Mandates

There is no specific board committee mandated to oversee sales practices. Board oversight of financial consumer protection is dispersed among a number of committees. The absence of clear roles and responsibilities to oversee sales practices and consumer protection has hindered the ability of boards to adequately oversee and challenge senior management with respect to these matters.

Reports

FCAC has determined that the sales practices-related reports submitted to boards are largely inadequate. In general, boards do not receive comprehensive data or root-cause analyses of sales practices risk, such as complaints, disciplinary actions, terminations and exit interviews. For example, each bank’s internal ombudsman’s annual report to the board on consumer complaints provides only a high-level summary of the small number of consumer complaints that reach the ombudsman level. As the reports contain little explanation or root-cause analysis of potential issues, it may be difficult for boards to monitor and challenge the action plans proposed to address the consumer complaints.

Because of the limited information provided, boards are less likely to be informed of employee issues related to sales practices. During the interviews conducted for this report, board members expressed surprise at the allegations in the media that were made by current and former employees about high-pressure sales practices and mis-selling. This suggests that the channels established for employees to escalate concerns with regards to sales practices and other issues may not be functioning as well as intended. Employees who feel their issues will not be heard or dealt with may choose to take their concerns to the media.

Oversight of controls

Boards oversee and monitor the effectiveness of banks’ internal control systems. They perform this role by challenging and advising on the soundness of these systems. Internal control systems provide the rules, policies and procedures, and organizational structures that support the achievement of banks’ objectives.

During the review, boards expressed a high degree of confidence in their banks’ management of sales practices risk. However, the controls in place to mitigate the risks associated with sales practices were found to be underdeveloped in comparison with other areas, such as credit risk.

5. Controls for sales practices

Controls to mitigate the risks associated with sales practices are underdeveloped.

In general, banks rely on organizational culture, human resources and the three-lines-of-defence model to mitigate sales practices risk. The three-lines-of-defence model comprises operational management, compliance and risk management, and internal audit.

Bank controls to mitigate the risk of mis-selling and breaching market conduct obligations have not kept pace with the shift toward a significantly greater focus on sales and advice in branch and call centre operations. The controls in place to manage the risks associated with sales practices are less developed than those in place to manage other forms of risk. Underdeveloped controls may result in a failure to detect and prevent non-compliance or mis-selling.

Organizational culture as a control

Banks cite organizational culture as a key control for mitigating the risks associated with sales practices. They are confident that the importance of integrity and appropriate behaviour has been communicated successfully to bank staff. They rely on strong employee and customer satisfaction scores and relatively low incidences of code of conduct violations to illustrate the soundness of their sales culture.

Banks also point to on-boarding, training and codes of conduct as being among the supports shaping cultures that mitigate the risks associated with sales practices. However, FCAC's review found that the organizational cultures promoted by banks lack the maturity to be effective tools in detecting and reducing the risk of mis-selling and breaching market conduct obligations.

The measures banks use to assess their cultures are not designed to assess sales practices risk. For example, employee surveys tend to exclude important questions, such as whether employees are feeling pressure to reach sales targets. Similarly, customer satisfaction survey scores are not designed to measure whether consumers feel the products and services they purchased were suitable.

FCAC found that communications from senior management about integrity and "selling the right way" do not always cascade down to the front line in a consistent manner. Senior management teams' attempt to ingrain messages such as "putting the customer first" and "customer-centric sales." However, while customer-facing employees generally are aware of the messaging about the importance of customer satisfaction and "doing the right thing," they are not always clear on how this messaging applies in the context of sales practices.

Although the tone from the top consistently focuses on the consumer, the review found that middle management is in a much stronger position to shape the sales culture in branches and call centres with daily sales meetings, morning huddles, coaching, leaderboards highlighting sales achievers, promotions and recognition, and non-financial incentive programs. Following its discussions with front-line staff, FCAC found that the messaging from middle management to front-line staff is not always consistent with the tone from the top. Some employees relayed experiences of working for ambitious middle managers who were rewarded for cultivating an aggressive sales culture focused on results and volume rather than on customer service or customer satisfaction.

First line of defence: Operational management

Branch channel

Primary responsibility for sales conduct in the branch channel rests with branch managers, while in call centre environments, it rests primarily with team leaders who are supported by a quality assurance process. These managers and leaders monitor the sales practices of front-line employees. The involvement of senior management and head office control functions (such as compliance) for this channel tends to be limited.

Branch channel managers have complex and wide-ranging responsibilities. They run the day-to-day operations, including security matters, staffing and coaching. They ensure that sales targets, both for the individuals and the branch as a whole, are met while ensuring a high level of customer service.

In addition, branch managers play a pivotal role in the internal communications of branch offices, exercising a high degree of influence with front-line employees. Depending on how managers communicate, they may exercise undue pressure on front-line employees to meet specific sales revenue targets or exceed growth expectations. During interviews, some employees disclosed feeling pressured to sell or witnessing mis-selling while working for other banks or at different branches of their current employer.

FCAC has concerns regarding the tools and resources available to branch managers to manage sales practices risk in their branches. Although branch managers informed FCAC that they can detect mis-selling and breaches of market conduct obligations, the Agency observed that branch managers have limited line of sight into interactions between consumers and employees, particularly in comparison with the telephone channel, where all interactions are recorded.

Branch managers receive limited reports for areas other than sales results and customer satisfaction surveys. In general, they receive insufficient reporting on areas that could help detect mis-selling and market conduct breaches, such as consumer complaints. For example, banks have not made adequate investments in data analytics tools to help business lines identify low rates of product use or high rates of product cancellation, which may indicate a pattern of mis-selling.

Moreover, branch managers are afforded a large degree of discretion in how they respond to mis-selling. Most mis-selling issues are identified and addressed by managers, giving rise to the possibility of similar problems being treated differently depending on the manager and the employee involved. And while branch managers may be required to seek the advice of human resources in cases of mis-selling, most are managed by the employee's direct supervisor through informal coaching.

Telephone channel

Team leaders and quality assurance are key controls for sales practices risk in the telephone channel. Team leaders listen to calls in real time and review a sample of the calls taken by each employee every month to inform coaching and performance management.

Banks record most calls in and out of their call centres, but only a small number of calls are reviewed for quality assurance purposes, such as to verify whether employees are following sales scripts and complying with market conduct obligations. For example, FCAC found that in bank call centres where employees take 1,400 calls per month, generally up to 4 calls are reviewed for quality assurance purposes. The recordings are archived, which means banks can choose to review a larger number of calls if further investigation into employee conduct is necessary.

FCAC found opportunities to improve quality assurance in call centres to better detect and prevent mis-selling and breaches of market conduct obligations. Banks should review a higher number and larger proportion of calls for quality assurance. Implementing voice analytic technology could reduce the costs associated with reviewing more calls. In addition, call selection should be risk-based instead of random. When sales practices issues are identified during call reviews, banks should perform significantly more root-cause analyses. These analyses should not be restricted to individual employees but should encompass the work environment and the sales culture.

Consumer complaints

Consumer complaints have great potential to provide insight into the consumer experience. Banks are required to have an escalation process in place to handle these complaints. Effectively managing and monitoring consumer complaints is an important component of the first line of defence. Weaknesses in policies, procedures and systems for handling complaints limit the ability of banks to adequately monitor, identify and report complaints to management, boards and FCAC.

Line of sight

Currently, banks resolve approximately 90 to 95 percent of consumer complaints at the first point of contact as part of providing good customer service. However, complaints resolved at this level are generally not logged into a central database because of technological constraints or inadequate policies and procedures. This process weakens a bank's line of sight into consumer complaints and issues and reduces the opportunity to identify trends.

Most banks recognize the need to improve their line of sight to these complaints. They are exploring solutions to enhance the data received from employees who routinely handle and resolve complaints.

Escalation and reporting

With 90 to 95 percent of consumer complaints resolved at the first point of contact, consumers escalate only a small percentage of complaints beyond that point, in part because the escalation process is often complicated and cumbersome. Even when escalated, a complaint may be returned to the first point of contact for resolution and not logged in a manner that would allow for trend analysis.

Moreover, there are limited resources in place to monitor escalated complaints and ensure they are classified correctly. As a result, it is difficult to interpret the meaning of the small number of escalated complaints and to assess whether they are representative of the broader consumer experience. Boards and senior management only receive reports on escalated complaints, and the small numbers may give them a false sense of confidence about consumers' experiences with sales practices.

Banks are required to report escalated complaints to FCAC. The weakness noted above with escalated complaints also limits FCAC's ability to use the information in monitoring sales practices risk.

Investigation

The Agency found numerous instances of inadequate bank investigations of consumer complaints, particularly when those complaints had been resolved at the first point of contact. Investigations are performed only to the extent needed to resolve a complaint and banks make little effort to identify root causes. For example, if a consumer complains about undisclosed service charges, the employee may reverse the fee to please the customer but not investigate to identify whether there were any breaches of disclosure obligations.

When banks do not investigate the root causes of complaints, it may result in a failure to identify and address sales practices risk.

Second line of defence: Compliance and risk management

Banks have established risk management and compliance functions to ensure that the first line of defence is properly designed, in place and operating as intended. The second line of defence includes a risk management function that monitors the implementation of effective risk management practices by operational management and a compliance function that monitors bank compliance with applicable laws and regulations.

Compliance and risk management oversight of consumer protection in retail banking is underdeveloped in comparison with the level of oversight afforded to other areas of the bank, such as the sale of investment products. Risk management and compliance staff monitor bank adherence to market conduct obligations. However, compliance and risk management do not adequately monitor mis-selling or the risk of poor consumer outcomes related to sales practices in retail banking.

Risk management and compliance track fines and other regulatory activity that may indicate the level of risk associated with breaching market conduct obligations. In the past, this risk has been deemed low; therefore, it has been subject to less rigorous oversight. In response to reports about Wells Fargo and allegations in Canadian media, banks elevated the risk rating associated with the obligations related to obtaining express consent.

Banks have undergone rapid growth, but their investment in control functions does not appear to have always kept pace. Understaffing and underinvestment in technology and systems hinder the compliance and risk management functions' ability to monitor sales practices risk effectively. For example, this scarcity of resources can limit the capacity to identify and respond to new regulatory requirements, review new products and business strategies, and supervise the efforts of business lines to adhere to market conduct obligations.

In general, compliance reports to boards lack adequate detail on sales practices risk. More specifically, these reports tend to lack root-cause analyses of trends and issues. They also tend not to include the status of action plans related to sales practices. Risk management reports do not adequately capture the key risks associated with sales practices, such as mis-selling and breaching market conduct obligations.

Third line of defence: Internal audit

Internal audit provides independent assurance to the board's audit committee and to senior management of the quality and effectiveness of a bank's overall internal controls, risk management and governance framework. Support for this assurance should include internal audit's assessment of the key controls and processes within the business units and support functions as they relate to retail sales practices.

While banks cite culture as a key control for risks related to sales practices, FCAC did not find evidence that internal audit has assessed the degree to which culture mitigates sales practices risk. Considering the role of internal audit, some banks have acknowledged the opportunity to have internal audit review culture.

Some market conduct obligations are included in internal audit's coverage of retail banking, but the related risks have been considered low and audits have been infrequent and lacking in rigour. Similar to the second line of defence, internal audit increased the risk rating for sales practices risk in response to Wells Fargo and allegations in Canadian media. However, gaps remain in the audit coverage of banks' market conduct obligations. For instance, FCAC found that internal audit does not review the controls in place to ensure the communication to obtain consent is clear, simple and not misleading.

In general, sales practices have not been identified as a separate audit unit by internal audit. Following media reports raising concerns about sales practices, the internal audit functions at Canadian banks examined past audits to identify elements that touched on sales practices. It is important to note, however, that these audits were not focused on sales practices and did not examine sales practices risk in sufficient detail.

Human resources as a control function

Bank human resources departments do not adequately leverage the tools and data available that could provide insight into sales practices, such as surveys on employee engagement, exit interviews, attrition, turnover rates and employee conduct monitoring.

FCAC found that employee onboarding and training do not adequately address risks associated with market conduct obligations or mis-selling. Some banks recognize there are opportunities to improve the consistency of the disciplinary process when issues related to sales practices are identified. Human resources reporting to senior management and boards lacks the detail and context necessary to support the oversight of sales practices.

FCAC also concluded that banks lack the personnel, technology and operational support required to enable human resources to monitor and reduce the risks associated with sales practices.

Conclusions and a look forward

The findings of this review are well summarized by the following statement from the *OECD/G20 High-Level Principles on Financial Consumer Protection*:

> "Rapid financial market development and innovation, unregulated or inadequately regulated and/or supervised financial services providers, and misaligned incentives for financial services providers can increase the risk that consumers face fraud, abuse and misconduct."[5]

FCAC found that retail banking culture is focused on sales. Bank performance management programs, in particular the financial compensation and non-financial incentives provided to employees, play an important role in supporting this culture. This environment increases the potential for mis-selling products and services that may be incompatible with consumer needs and financial situations, as well as breaching market conduct obligations. These risks are particularly prevalent in the cases of mobile mortgage specialists, third-party sales channels, and in practices and products such as cross-selling and creditor insurance.

[5] OECD (2011), *OECD/G20 High-Level Principles on Financial Consumer Protection*, https://www.oecd.org/daf/fin/financial-markets/48892010.pdf, p. 4.

FCAC found that governance frameworks and control mechanisms do not effectively manage or mitigate the risks inherent to cultures that are so heavily anchored in sales. Operational management, compliance and risk management, internal audit and human resources lack the frameworks needed to adequately address sales practices risk. Robust governance frameworks that provide greater oversight by boards and senior management would strengthen the ability of banks to manage the risks related to sales practices.

In the course of the review, FCAC identified several measures that would strengthen financial consumer protection and result in closer alignment with OECD/G20 principles.

Enhancements to banks' management of sales practices risk

To improve bank management of sales practices risk, FCAC recommends that banks:

- prioritize financial consumer protection, fairness and product suitability
- establish a formal sales practices governance framework that clearly defines roles and responsibilities to ensure all elements of sales practices risk are effectively managed, including the effective monitoring and reporting of mis-selling and market conduct obligations
- improve their oversight, management and reporting of consumer complaints
- ensure financial and non-financial compensation strategies motivate employees to work in the interest of consumers
- ensure internal controls adequately address sales practices risk, particularly for the practices, products and channels that pose a greater risk of mis-selling and breaching market conduct obligations
- ensure human resources and second and third lines of defence—including compliance, risk management and audit—are resourced adequately to improve their oversight of sales practices risk

Enhancements to FCAC

FCAC will implement a modernized supervision framework that will allow it to proactively ensure banks have implemented the appropriate frameworks, policies, procedures and processes to effectively mitigate the risk of mis-selling and breaching market conduct obligations.

FCAC will increase the resources devoted to its supervisory and enforcement functions.

FCAC will enhance its consumer education materials to raise consumer awareness about financial products and services, and to inform consumers of their rights and responsibilities and of the importance of asking their banks the right questions, particularly when purchasing financial products. These efforts will help consumers make informed financial decisions and potentially avoid harm.