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Retail Banking Risk Management: Addressing Incentives after Wells Fargo

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It seems almost everyone with a bank account knows the story: a relatively small group of people within a large organization committed fraud by opening unapproved customer accounts in order to earn performance bonuses under a production-based incentive plan. The scandal badly bruised the bank's stellar reputation, forced the CEO to step down, and resulted in a significant loss of shareholder value, before the election turned the tide for many bank stocks.

It has also prompted a widespread industry examination of retail incentive practices. Whether it is through the OCC's horizontal review of sales and marketing practices or board requests at smaller community banks, the industry is taking a look at both the cultural aspects of sales expectations and the design and controls of the programs themselves.

"Four out of five banks have had an internal or external inquiry regarding their retail incentive plan practices."

In November 2016, Pearl Meyer conducted a survey of actions banks are taking to address the potential issues uncovered by the scandal. This study included 57 respondents representing both small and large institutions across the country. The key outcomes indicate that **four out of five banks have had an internal or external inquiry regarding their retail incentive plan practices**. Most banks are unlikely to make significant changes to their retail incentive plan design and instead are focusing on communication and training as well as enhanced documentation, controls, and monitoring.

The aftermath of the Wells Fargo scandal will be that banks are expected to examine their retail incentive programs and the controls supporting them. To that end, we believe there are five questions that banks should ask and answer with respect to their retail incentive programs.

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What does our plan reward? About half of respondents to our bank survey indicated using volume metrics and cross-selling metrics (55 percent and 47 percent respectively), which have been criticized as part of the scandal. However, few are planning to discontinue these metrics (6 percent to discontinue volume and 4 percent to discontinue cross-selling). Use of either metric may put additional pressure on banks to demonstrate how their controls and administrative procedures curtail fraud or misconduct.

Approximately 70 percent of respondents use growth metrics and 34 percent use profitability or revenue, which are much more difficult to manipulate. Nearly one-third have a discretionary component for branch or individual performance that can help reinforce positive behaviors and “right size” awards.

How is our plan monitored? Participants received inquiries from executive management (72 percent) and their boards (51 percent) who may be unfamiliar with the specific details of the retail incentive programs. Banks are addressing the additional oversight through increased monitoring and controls (46 percent) and greater reporting to senior management or the board (42 percent). Reporting elements need to remedy the fact that boards have a responsibility to ensure the bank’s incentive compensation arrangements do not encourage inappropriate risk. Directors often have no visibility into retail incentive plans, have no easy way to quickly understand the impact, do not know what their rights or authority are in understanding, determining, and remedying the risk, and have no plan for how to react. These issues need to be addressed to appropriately monitor the risk.

Are our expectations reasonable? The last element of reporting—how many employees are meeting performance goals—can identify unreasonable expectations or flag the need for better training or management. Collecting performance data over time to see trends in performance, expectations, and payouts may also prove useful.

What are our customers experiencing? More than a quarter of respondents indicated that they will develop or enhance their customer complaint process. The process should not only handle specific complaints but also aggregate the complaint types to identify systematic breakdowns in the customer experience.

Are we staying true to our values? Critics have indicated that perhaps the largest failing at Wells Fargo was an environment where branch staff feared that nonperformance would result in job loss. Monitoring of employee satisfaction by business line and mechanisms to provide feedback without repercussions can help identify problems before they escalate.

Given the large-scale publicity of the Wells Fargo scandal, someone—customers, employees, regulators, or shareholders—will likely ask how your retail incentive program is different and what you have done to protect against fraud or misconduct. Accordingly, banks should conduct an assessment of retail incentive plan designs, risks and controls, as well as gain a better understanding of the branch sales culture and leadership.

About the Author

Laura Hay is a managing director in Pearl Meyer's Charlotte office. She has extensive experience specializing in executive and director compensation and is frequently retained to evaluate the appropriateness of compensation programs. She advises a number of public financial institutions as well as government sponsored enterprises and private banks, including private equity and majority-shareholder owned institutions.

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