

Motor finance: FCA's review of discretionary commission arrangements

2024



Introduction

The FCA's review into historical motor finance discretionary commission arrangements is triggering a significant increase in customer complaints to firms, with the potential for an industrywide consumer redress scheme.

Complaints relate to discretionary commission arrangements (DCAs) – banned by the FCA in January 2021 – where these DCAs created an incentive for brokers to arrange finance at higher interest rates than the market standard in return for greater levels of commission, to the detriment of consumers.

However, following recent Financial Ombudsman Service (FOS) decisions, the FCA is investigating whether consumers may have a valid claim for compensation relating to loans made before the ban was in place.

It has been estimated that loans sold with DCAs constituted three quarters of motor finance lending between 2007 and 2020, and therefore the FCA expects a significant escalation of consumer compensation claims.

Should 'widespread misconduct' be established by the FCA, the regulator could instigate an industrywide consumer redress scheme under section 404 of the Financial Services and Markets Act.

The FCA had introduced a pause on the statutory response timeline (until 25 September 2024) and originally aimed to communicate a decision on next steps by quarter three of 2024.

However, the planned announcement on the FCA's motor finance investigation has been postponed from September 2024 to May 2025 - because of data delays and pending outcomes of relevant litigation.

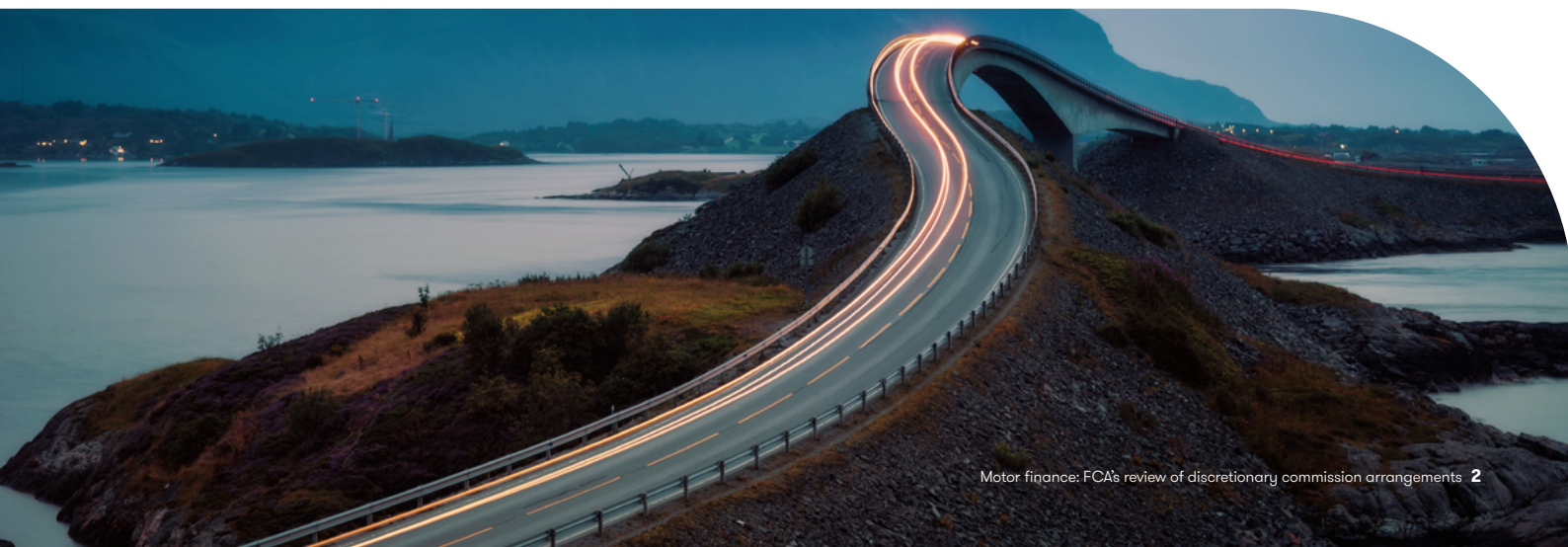
The FCA is also consulting on an extension to the pause on complaint handling until December 2025, meaning affected firms won't have to issue a final response to DCA complaints until after 4 December 2025 at the earliest.

While the FCA's review is ongoing, with associated media coverage, motor finance firms will continue to receive increased complaints. It would be prudent for firms to consider the likely impact the review will have on their business now, and to start preparing.

While there's no official confirmation, this extension of the pause and other commentary within the FCA's consultation paper increasingly point to an industry-wide redress scheme. If this were to be the case, the FCA would need to undertake further consultation, and so considers that the extension to December 2025 will give it the maximum amount of time necessary to implement a statutory consumer redress scheme.

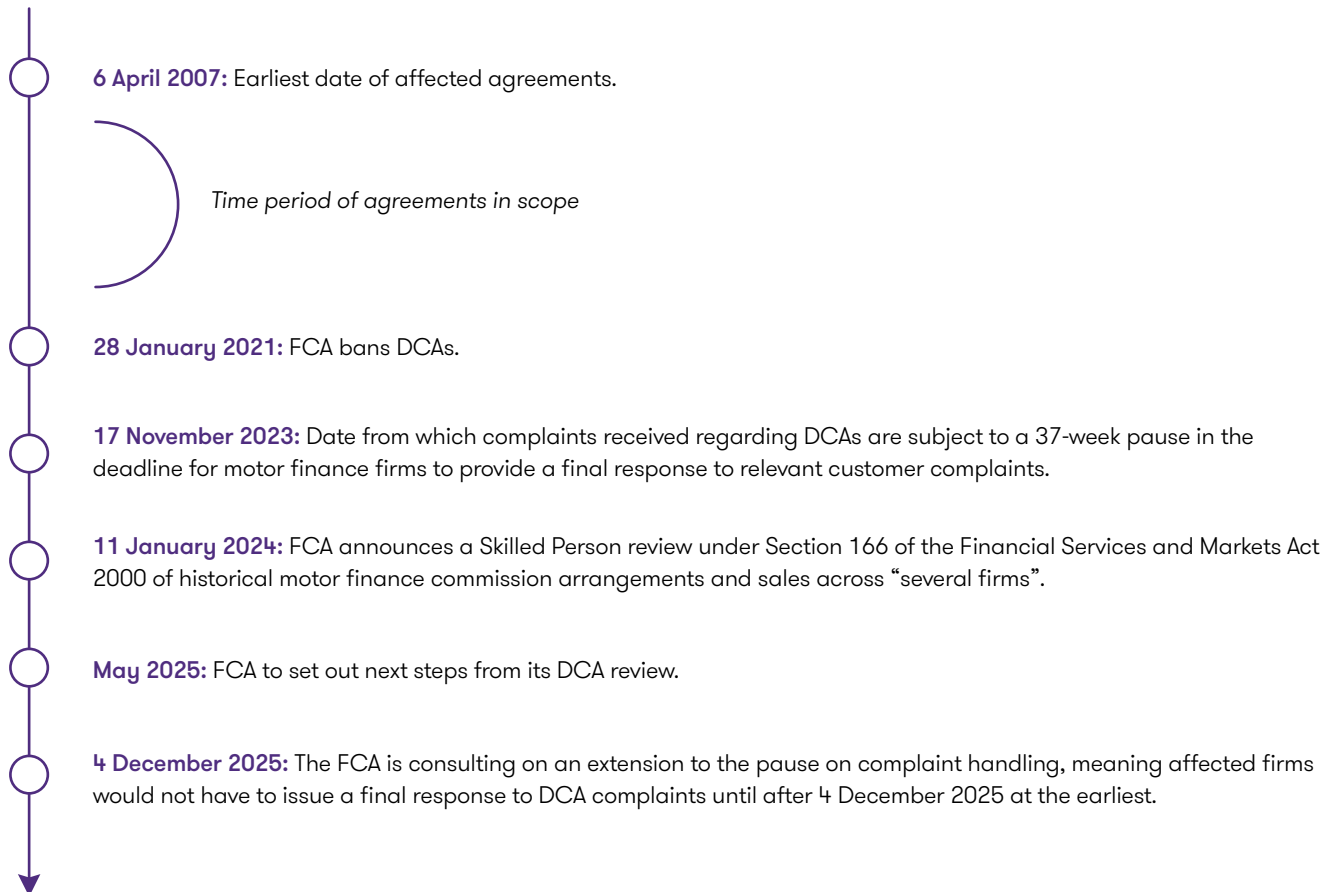
However, the FCA does also note that should it decide that a redress scheme isn't the route forward, it's likely to consult on ending the pause on complaint-handling earlier.

It would be prudent for affected firms to consider the impact of the review and prepare accordingly.



Timeline

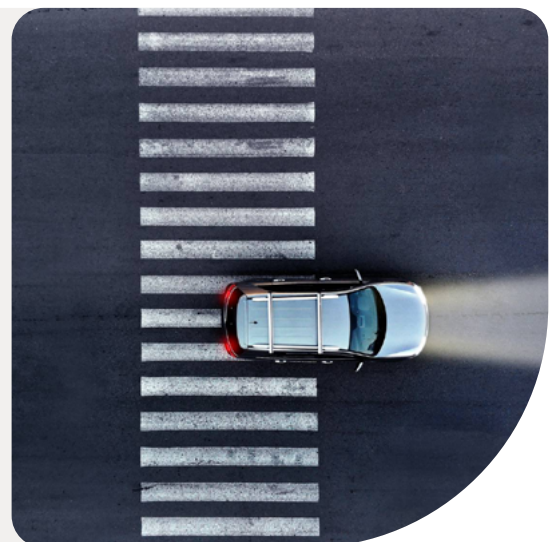
FCA's review of DCA



To note:

Consumers will also have an extended window of up to 15 months to escalate their complaint to the FOS, as opposed to the standard 6-month period. This prolonged duration is applicable to complaints where the customer received a final response from the firm between 12 July 2023 and 10 January 2024, or where a final response is being sent between 11 January 2024 and 20 November 2024.

The FCA is intending to set out “next steps” in May 2025. At this stage, or subsequently, the FCA will decide how best to make sure people who are owed compensation receive an appropriate settlement in an orderly, consistent and efficient way.



Key considerations

While it remains to be seen whether the FCA will instigate a formal industrywide redress scheme, it is clear that, as a minimum, firms will be facing very high numbers of complaints to deal with. Below, we set out some of the key considerations for firms to focus on.

Governance and oversight

- Consider a governance framework to aid decision making and co-ordinate a successful project
- Consider what your MI reporting suite will look like and how timely reporting will be
- Develop a detailed project workplan, identifying tasks, key milestones, roles and responsibilities
- Determine what elements of the process are expected to be outsourced to a third party and what arrangements will need to be put in place to ensure appropriate oversight

Population identification

- Take suitable steps to identify the potential population impacted and its various cohorts
- Ascertain whether you have undertaken any historical debt sales which may have included impacted consumers. Identify whether there are any obligations in the sale and purchase agreement, such as clawback provisions, that need to be considered
- Identify any gaps in your data (e.g. anonymised data) making appropriate assumptions, identify any dependency on legacy systems or the need to access cold data which may impact on identifying the population

Build a document library

- Design and build a document library where all relevant documents (eg credit agreements and commission rate cards) for customers within the potential population can be stored in a logical order to allow ease of access

Build a basic Excel model to estimate the potential financial liability

- Use the data available within the document library and a basic Excel calculator to estimate the size of the potential liability based on the calculation approach set out by the FOS in its recently published decisions

Scope a repository to allow customer redress calculations

- Understand the availability and format of account level transaction data, including customer payments, interest charges etc. to ensure that you have all the necessary information available at an account level to calculate redress
- Consider data on legacy systems
- Establish what data from unstructured data sources (e.g. customer contracts) needs to be captured for future work in redress calculations and how that data is captured
- Agree technical details of data cube, i.e. in SQL
- Consider the format in which data should be stored to enable the calculation of redress, either on a case-by-case basis or in larger batches, to prepare for either eventuality
- Perform Extract Transform Load (ETL) of the data into a data cube. The cube should be cleaned and quality checked to ensure the data makes sense and is fit for purpose for future redress calculations

Key considerations

Funding, resourcing and training

- Reflect on the projected population and complaint volumes, and perform detailed scenario analysis to identify the range of the potential financial impact, taking into consideration the operational costs, and potential redress compensation
- Establish how any remediation or complaint handling exercise will be funded while ensuring the business has sufficient liquidity to continue as a going concern
- Consider how liquidity could be improved, including by sourcing new or alternative funding, negotiating with existing funders, restructuring of debt and equity
- Consider alternative restructuring options if funding the cost of remediation at par is problematic
- In times of uncertainty, producing a wind down plan (WDP), or reviewing and updating an existing WDP, can act as a tool to build stakeholder confidence
- Identify headcount requirements across the functions and prepare a resourcing plan
- Consider who will train the review team and customer service representatives, and what the training will consist of

Review methodology

- Ensure your review methodology covers all scenarios and relevant products
- Consider how to handle any anomalies

Quality assurance

- To ensure customers are receiving the right outcome, consider what quality assurance should be undertaken to verify the steps taken, e.g. identify the population, assess a complaint, or calculate any redress
- Consider undertaking a pilot phase over an appropriate time period and sample size. Identify the metrics to use to measure success

Communication and complaints handling

- Develop an extensive suite of customer communications across various mediums (SMS, email, letter, website, call scripts), including FAQs and redress assessment letters communicating the outcome of a customer's complaint



Flexibility in our offering

We can assist you with complaint handling and remediation projects through a range of options to suit your requirements from discrete areas such as practical advice on the design of your redress methodology, assurance on your customer population or redress calculations, through to fully coordinating and managing your redress programme and supporting stakeholder engagement (e.g. FCA, lenders, shareholders) and contingency planning.

We can also second appropriate resources to augment your own team.

'No regrets' actions

We advise taking action now in advance of the FCA setting out next steps in May 2025: at the least, firms should take the following steps:

- 1 Prepare a detailed project workplan and record steps taken
- 2 Identify your population of DCAs issued during the relevant period
- 3 Consider the format, quality and availability of data, including any reliance on legacy systems
- 4 Establish a comprehensive document library of relevant documents stored in a logical order
- 5 Build a basic model to estimate the potential financial liability
- 6 Prepare for increased complaint volumes
- 7 Triage and investigate complaints proactively
- 8 Establish how the remediation or complaint handling exercise will be funded
- 9 Identify third parties to provide any future outsourced support

How our people can help

The teams listed below have extensive credentials supporting firms in this sector. We would be happy to provide examples of our work on request.

Automotive Specialists

Grant Thornton's dedicated automotive team works with a wide variety of clients to achieve their ambitions. We support passenger and commercial vehicle National Sales Companies, distributors, retail, and motor finance providers covering Business-to-Business and Business-to-Consumer and Mobility.



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Financial Services Advisory

Our team has more Skilled Person experience in the consumer finance sector than any of our competitors and we have staff who are ex-regulators and former industry practitioners. We assist firms with meeting the regulatory requirements of the FCA. We know the automotive and consumer credit sector, its value chains and participants intimately.

We are therefore perfectly placed to provide genuinely insightful subject matter expertise and you can rest assured that from a regulator's perspective, our opinion counts. We have supported reviews and remediation programmes for motor finance providers and other consumer finance firms that operate sales distribution networks. Oversight of distribution chains also forms a regular feature of our work.

We therefore believe we have the highest levels of relevant expertise, including the experience our regulatory experts have of working alongside the FCA and our clients in relation to their consumer finance practices, particularly regarding large scale past business reviews that include assessing and rectifying consumer harm.

Our work regularly includes helping our clients to design and implement appropriate remediation methodologies when poor customer outcomes have been identified. Should our clients need a fully managed solution to deliver a program of this nature, we have cost effective, flexible resource arrangements to make this a reality.

We also have significant experience of working with businesses on Data Subject Access Requests (DSARs). We have the capacity to commence a DSARs project at scale and pace, immediately. Working with our South African offshore centre we can provide up to 100 experienced DSARs staff with review oversight immediately. Further resources can be added in short order.



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How our people can help

Data and redress calculation specialists

Our Data Analytics team has extensive experience working with vast datasets from a variety of sources, both structured and unstructured. This work involves Extract, Transform, and Load of the data, cleaning and quality controlling the data, conducting complex analysis and reporting this back to the client for actionable insights and information. Past projects by members of our team include managing a client-based team for a large UK-based bank to redress mis-selling of Payment Protection Insurance (PPI). This included building redress calculators, tools to handle customer complaints and running the end-to-end process from initial complaint to final redress payment.

Our Actuarial and Risk Modelling team specialises in designing, building, testing and validating redress calculators from the basic refund of charges to full account reconstitutions across large customer populations. Outputs include population identification, redress payments, the post-remediation customer position and customer illustrations. Our team has worked on redress calculation programmes with the leading motor finance providers in the UK as well as a range of other banks, lending institutions and other financial services providers.

Restructuring

Our Financial Services Restructuring team offers expert guidance and hands-on assistance to a wide range of Financial Services firms.

We have a market leading Restructuring team for the consumer credit sector, having led some of the largest and high-profile assignments in the high-cost short-term credit sector, which experienced similar challenges associated with a rise in complaints relating to historical unaffordable lending practices. Such assignments include Wonga Group, CashEuroNet (t/as Quick Quid), BrightHouse and acting as Scheme Supervisor for Everyday Lending, as well as numerous other confidential engagements.

We help corporates directly, as well as supporting lenders, shareholders and other stakeholders with issues arising from financial and operational challenges which may arise from regulatory intervention or change in market conditions.

We bring together a multidisciplinary team offering a full spectrum of services, meaning we can readily draw on expertise from our Regulatory, Data Analytics, Actuarial and Risk Modelling, Debt Advisory and Tax Restructuring colleagues, to ensure you receive tailored support to help navigate challenging situations.



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How our people can help

Economic Advisory

Any redress mechanism that the FCA introduces to compensate consumers it believes have lost out due to DCAs will rely on an estimate of what would have happened under a “counterfactual” scenario.

The counterfactual is a common tool in economics. Here the counterfactual asks what outcomes would have been for affected customers if DCAs were not in place. The scenario is counterfactual in that it never happened. The FCA would need to define the counterfactual and then estimate what consumer outcomes would have been under the scenario.

Defining the counterfactual, and estimating what outcomes, such as prices and interest rates, would have been under it, is not trivial. The estimation process can require complex data analysis, including the use of statistical modelling techniques.

Grant Thornton’s economic consulting team is well-versed in the definition of counterfactuals and the estimation of counterfactual outcomes. This experience comes from independent expert appointments in a wide range of disputes including matters concerning alleged unfair pricing in the finance sector, assessing the harm caused by alleged anti-competitive conduct, and assessing the harm caused by allegedly misleading statements made by publicly-traded companies.



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Forensics – Dispute Resolution

Where a claim is being made against another party in relation to alleged mis-selling, independent and defensible evidence of quantum of loss is required by the Court or arbitral body.

Grant Thornton has one of the leading forensic accounting expert witness practices, ranking Band 1 in Chambers and Who’s Who Legal. Supported by industry specialists and economics specialists, our experts frequently prepare reports and give evidence in English Courts and in arbitral forums on the extent of losses suffered by Claimants.



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Indirect Tax

Grant Thornton’s tax team has considerable experience of agreeing favourable methodologies with HMRC to maximise any VAT upside arising from any settlement payments that may need to be made.



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