

Motor finance discretionary commission models and consumer credit commission disclosure – feedback on CP19/28 and final rules

Policy Statement

PS20/8

July 2020

This relates to

Consultation Paper 19/28
which is available on our website at
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1 Summary

- 1.1** In October 2019, we consulted on plans to ban commission models that give motor finance brokers (including motor dealers) an incentive to raise customers' finance costs. We also consulted on minor changes to some of our rules and guidance to ensure that many types of credit broker give consumers more relevant information about commission.
- 1.2** This Policy Statement summarises the feedback we received on [CP19/28](#) and our response to it.
- 1.3** We had committed to publishing a Policy Statement in Q2 of this year. However, we put this on hold as part of our publication moratorium in response to the coronavirus (Covid-19) pandemic.
- 1.4** We have also used this opportunity to consider the impacts of coronavirus on our policy, the motor finance market, firms and consumers.
- 1.5** Having done so, and considered consultation feedback, we are going ahead with our proposals largely as planned. We believe these measures will be the most effective way of addressing the harm we observed during our motor finance review.
- 1.6** However, we are giving firms more time to implement the new rules. Both the ban on discretionary commission models in motor finance and the commission disclosure changes that will apply across all credit sectors will take effect from 28 January 2021.
- 1.7** We have also made some technical changes to our rules to ensure they deliver our aims. They do not differ significantly from those on which we consulted.

Who this affects

- 1.8** Chapter 2 of this Policy Statement is directly relevant to:
- motor finance providers
 - motor finance credit brokers, including motor dealers
- 1.9** Chapter 3 is directly relevant to brokers of regulated credit and consumer hire agreements across all credit sectors.
- 1.10** Chapter 4 is relevant to all the above.
- 1.11** This paper will also be of interest to consumer organisations.

The wider context of this policy statement

Our consultation

- 1.12** In March 2019, we published the final findings of our motor finance review. We identified concerns over the widespread use of commission models that link the broker's commission to the customer's interest rate under the finance agreement and allow brokers wide discretion to set or adjust that rate. This creates conflicts of interest with strong incentives for the broker to earn more commission by increasing the interest rate the customer pays.
- 1.13** We also found high levels of non-compliance with some of our existing commission disclosure requirements in our Consumer Credit sourcebook (CONC).
- 1.14** CP19/28, published in October 2019, set out the following proposals to address this harm.
- A ban on 'discretionary commission models' in the motor finance market. We classed these as discretionary commission models if the amount the broker receives is linked to the rate that the customer pays and which the broker has the power to set or adjust. We estimated that banning discretionary commission models would save motor finance consumers around £165m a year. We proposed that the ban would come into effect 3 months after we published the final rules.
 - Amending parts of our rules and guidance on the disclosure of commission arrangements with lenders. We agreed that our rules and guidance could be clearer to reflect our policy aims. We proposed relatively minor Handbook changes to give consumers in all consumer credit markets more relevant information. We proposed that these changes would come into effect as soon as we published the final rules.

How it links to our objectives

Consumer protection

- 1.15** We aim to make financial markets work well so that consumers get a fair deal and to secure an appropriate degree of protection for consumers.
- 1.16** We believe it is necessary to ban motor finance commission models that incentivise brokers to set customers a higher interest rate to earn more commission. Breaking the strong link between customer interest rate and broker earnings should reduce financing costs for consumers.
- 1.17** We also expect our disclosure guidance changes will mean consumers are more likely to receive appropriate and timely information on interest charges and commission. This would lead to consumers being better able to engage with car finance options.
- 1.18** Our decision to give motor finance firms more time to implement the discretionary commission model ban would, in theory, delay the realisation of benefits and result in delayed consumer benefit in the first year (approximately £41m, as yearly estimated benefits are £165m). However, the benefits delayed are likely to be less than this because we've estimated these figures in reference to a fully functioning market, and even if activity levels bounce back relatively quickly once the economy restarts, the value and volume of business could remain low in the first year of implementation.

- 1.19** Although we want to implement the ban as quickly as possible, we also want to allow more time for those firms that need it to implement these changes in a compliant way, without the need for quick and potentially less effective fixes. We have considered the impacts of coronavirus on firms when deciding what is reasonable.
- 1.20** Further, we can reasonably assume some firms will be able to move towards other commission models before our deadline – a continuation of the trend we have seen over the last year.

Competition

- 1.21** We have an objective to promote effective competition in consumers' interests in regulated financial services. We also have a competition duty. Together, these empower us to identify and address competition problems and requires us to take a pro-competitive approach to regulation.
- 1.22** We believe that banning discretionary commission models will lead to alternative remuneration models where lenders and brokers are incentivised to create and sell competitively priced loans. Lenders will have better control over the interest rate that consumers pay. This should mean that lenders originate more loans, and should be increasingly incentivised to offer competitive financing terms. Our commission disclosure clarifications should mean consumers are better informed and more likely to engage with what is on offer, which should also promote competition.

Outcome we are seeking

- 1.23** To comply with our ban on discretionary commission models, we expect motor finance firms to negotiate alternative commission structures. We are deliberately not specifying which commission models they should use. This will be a matter for firms. It could include firms moving to risk based pricing, provided the broker is not incentivised to set or adjust the rate charged. It could include flat fee models. Broker commission could also vary depending on other factors, such as by product or lender.
- 1.24** Ultimately, once motor finance firms move away from discretionary commission models, we expect to see consumers' financing costs reduce.
- 1.25** The changes to commission disclosure are relatively minor and designed to be low cost and result in refinements to firms' existing practices. We believe our changes will make it more likely that consumers get appropriate and timely information. In turn, this should increase consumers' ability to make more appropriate decisions.

Measuring success

- 1.26** We will look closely at any attempt by a motor finance firm to introduce a commission model that could lead to the same harm that we have sought to ban.
- 1.27** We will monitor how well firms comply with the ban on discretionary commission models by carrying out supervisory work across a sample of firms. This work will start in September 2021. It will include looking at what commission models firms are using as an alternative to discretionary commission arrangements, and the ranges of interest rates and commission earnings. This information should help us assess whether the potential for customer harm remains and, if so, how we address it.
- 1.28** We will also carry out a point-of-sale mystery shop exercise to measure lenders' control over dealer networks. This work will assess whether firms, where they are required to, have taken appropriate steps to ensure dealers/brokers comply with relevant regulatory requirements.
- 1.29** We plan to review our intervention in 2023/24. Using market research reports, we will track the volume and composition of motor finance agreements contracted over time (by type of agreement and for new/used cars) and the volume of vehicle purchases. This will enable us to monitor finance agreements in new and used car sales.

Summary of feedback and our response

- 1.30** We received 51 responses, including from consumer groups, motor finance lenders and brokers, trade bodies and firms in other credit markets.
- 1.31** Respondents broadly supported – or at least accepted – our overall intentions.
- 1.32** Consumer bodies welcomed our proposed ban on discretionary commission models. They also agreed that firms should do more to give consumers better information on any commissions.
- 1.33** Firms largely recognised that discretionary commission models were a source of harm. Views varied on whether a ban was the right course of action, but most of the largest lenders and brokers, as well as their trade bodies, agreed with our approach. Almost all firms argued that they needed more time to implement new remuneration and commission structures.
- 1.34** Some respondents also argued that our proposed discretionary commission arrangement ban should be broadened to other markets.
- 1.35** Motor finance industry respondents also wanted additional guidance on what types of commission model should be disclosed and how. Many also argued that, to avoid making 2 sets of changes to their commission disclosures, we should delay implementing these to coincide with the discretionary commission arrangement ban. We have taken this and other factors into account in extending the implementation date for both aspects.

Equality and diversity considerations

- 1.36** In CP19/28, we explained that we did not consider our proposals would materially impact any of the groups with protected characteristics under the Equality Act 2010. We did not receive any feedback to alter this view.
- 1.37** However, we will continue to consider the equality and diversity implications of our final rules when monitoring implementation and their effectiveness.

Next steps

- 1.38** All rules and guidance at Appendix 1 come into effect on 28 January 2021. Firms will need to comply by that date.
- 1.39** We will supervise firms' implementation and monitor the new rules and guidance as outlined above.

2 Motor finance – discretionary commission models

- 2.1** This chapter summarises feedback on our proposed discretionary commission model ban, and our original intention to implement this 3 months after publishing final rules.
- 2.2** Having considered that feedback, we are going ahead with our proposed ban. We believe this is the most effective way of reducing the harm we found in our motor finance review. However, we are giving firms a further 3 months to implement. Firms are now required to implement the ban by 28 January 2021.

Feedback received

Q1: Do you agree with our proposed ban on discretionary commission models in the motor finance market?

- 2.3** Respondents broadly accepted that discretionary commission models in the motor finance market create incentives that can lead to consumer harm.
- 2.4** Consumer groups agreed that banning these models is necessary to reduce the harm we observed in the motor finance review.
- 2.5** Generally, the industry accepted that there is a case for banning discretionary commission models in motor finance. However, a minority of firms and their representatives argued otherwise and put forward alternative proposals.

Alternatives to a ban

- 2.6** Some industry representatives argued that banning discretionary commission models is unnecessary. One felt a ban would penalise those firms that use these commission models responsibly. Another felt that brokers should be allowed to continue to reduce the rate and their commission where it delivers customer benefit – the Reducing Difference in Charges (reducing DiC) model.
- 2.7** A firm argued that consumers will take their business elsewhere if they do not want to pay the rate offered. Similarly, a trade body argued that disclosure alone would allow consumers to make informed decisions about the true cost of a product.
- 2.8** One industry representative asked why we did not limit brokers' discretion to adjust the interest rate, similar to the Australian Securities and Investments Commission's (ASIC) approach.
- 2.9** Other proposals from compliance consultancies included a cap on interest rates and preventing a broker from adjusting or setting the interest rate at all.

Our response

Responses have confirmed our view that banning discretionary commission models in the motor finance market is the most effective way of addressing harm.

While some firms may feel comfortable that they can operate these commission models responsibly, they still present brokers with an incentive to charge customers more. The harm we identified in the motor finance review – which looked at Increasing DiC, Reducing DiC and Scaled models – shows that robust, proportionate action is required.

Before consulting last year, we assessed the costs and benefits of a range of options.

We found that, compared to a ban, consumers would benefit less from us limiting how far brokers can set interest rates. While it would reduce some harm, there would still be incentives that work against customers' interests.

Similarly, we do not believe that more extensive changes to our commission disclosure rules would influence consumers' behaviour sufficiently to reduce harm.

While we are very keen to address harm in this market, we also need to act proportionately and rationally. The fact that brokers can set and adjust customers' interest rates is not itself a source of harm, provided the broker isn't incentivised to do so. Nor do we have evidence that prices in this market are inherently too high.

Discretionary commission arrangement definition

- 2.10** Several respondents raised concerns about the risk of arbitrage from our definition of discretionary commission arrangements.
- 2.11** One firm queried whether our ban would extend to an arrangement that would reward brokers based on the interest rate payable – by using the previous year's agreed interest rates as a basis for setting commission levels in the next year, rather than agreement-by-agreement.
- 2.12** Firms and a trade body questioned whether there was a significant or intentional difference between 'commission, fee or financial consideration' in our proposed definition and 'commission, fee or other remuneration' in our proposed rules. These respondents also asked for clarification on what 'financial considerations' would include or exclude – eg training budgets, bonuses.
- 2.13** A trade body asked whether we were going further than intended by capturing arrangements where the broker decides or negotiates any aspect within the total charge for credit, as opposed to just the interest rate.

Our response

Our definition of discretionary commission arrangement should be interpreted broadly. As we noted in CP19/28, our intention is to break the strong link between customer interest rates and broker earnings in order to decrease financing costs for consumers (see also CONC 4.5.5G on which we consulted) and, in accordance with GEN 2.2.1R, the definition and related rule should be interpreted in light of their purpose.

It is not clear how an arrangement, referred to by a respondent, that rewards brokers for future business, but by reference to previously agreed interest rates, would work in practice for all parties.

We have amended the definition of discretionary commission arrangement to make clear that it includes where any commission, fee or other financial consideration is payable directly or indirectly in connection with the regulated credit agreement, and where this is wholly or partly affected by the interest rate (or other item within the total charge for credit) set or negotiated by the broker.

By including 'financial consideration' in our definition of discretionary arrangements, we are looking to ban any practice where a broker is rewarded for adjusting the price a customer pays for motor finance. To prevent gaming, we have deliberately not defined what is meant by 'financial consideration'. Firms will need to satisfy themselves that they are acting within the rules and meeting our intention behind the ban.

We have intentionally captured arrangements where the broker can decide or negotiate any element in the total charge for credit, and is remunerated on that basis. Limiting the definition to just the interest rate could lead to arbitrage and firms attempting to recoup losses, with consumers paying more in fees, charges and other elements that make up the total charge for credit.

Other commission models and commercial arrangements

2.14

In considering the impact of a ban on discretionary commission models, respondents raised points involving other commission models and commercial arrangements, including pricing. Questions included whether:

- commissions linked to loan size could lead to customers being encouraged to buy a more expensive car than they want or need
- interest rates could vary by product – eg depending on deposit levels, special offers or vehicle type
- brokers would be able to negotiate different commission levels between lenders
- lenders would still be able to negotiate different commission levels and interest rates between brokers, while ensuring that commission and rate are not linked
- lenders would be able to price for risk ('rate-for-risk')
- brokers would be able to decide or negotiate the rate with the customer, even if they are not rewarded for it

2.15

Some respondents asked us to develop further guidance on what commission models would be allowed once discretionary commission models are banned.

Our response

Our proposal to ban discretionary commission models in the motor finance market was in response to specific harm that we identified in our motor finance review.

That review did not find harm caused by commission models linked to other factors, such as loan size. So we are not proposing to ban them, nor offer further guidance. Firms can continue operating these models provided they comply with all relevant rules and our Principles.

The same applies to the different commercial relationships that lenders and brokers will enter into. We do not expect - or necessarily want - the industry to move towards a common commission level when a range of different factors will be in play depending on the firms involved. We accept that commission levels will vary across the market. But our ban on discretionary commission arrangements will break that link between brokers' commission and the price consumers pay for motor finance.

Our rules will continue to allow firms to use rate-for-risk models. Brokers will also be free to negotiate rates with customers. However, our rules will prevent brokers from being incentivised to maximise the price consumers pay for motor finance.

Secondary brokers

- 2.16** We received responses from 'secondary brokers' in the motor finance market. Secondary brokers offer 'primary brokers' (eg motor dealers) a range of lenders' products. These products have various rate structures agreed directly with the dealer.
- 2.17** Secondary brokers were concerned that their business model would be caught by the ban on discretionary arrangements, despite not having the ability to directly negotiate the rate with the customer. Firms outlined a range of scenarios where they thought this would be a problem.

Our response

For a broker to be caught by our ban on discretionary commission models, they must be acting as a 'credit broker' as defined in Article 36A of the Regulated Activities Order 2001 RAO. Secondary brokers are not acting as credit brokers where they are not effecting introductions of individuals or relevant recipients of credit who wish to enter into credit agreements to lenders (RAO Art. 36A(1)(a)) or to credit brokers (RAO Art. 36A(1)(c)).

The risk of consumer harm posed by such firms appears weak. We are therefore not proposing to widen the scope of the ban to include them. A broker caught by the discretionary commission model ban would need to be both (i) negotiating or determining what the consumer pays for motor finance and (ii) being rewarded by the lender for doing so. In many of the instances we have seen, it does not appear that secondary brokers would be satisfying both of these points.

Consumer hire

- 2.18** Many brokers, lenders and their trade bodies were concerned that the ban would not apply to consumer hire agreements - commonly known as Personal Contract Hire (PCH) in the motor industry. They argued that this will be exploited by firms already operating in that market and/or incentivise firms to move away from hire purchase (including Personal Contract Purchase (PCP)) towards PCH.
- 2.19** Respondents also said that consumers will have fewer protections and, potentially worse outcomes, using PCH. For example, the regulatory regime for consumer hire does not require firms to carry out an affordability assessment.

Our response

Our ban will apply to those sectors that were in scope of our motor finance review and which formed our evidence base. Consumer hire was not part of this. In any case, a broker in the hire market would seem to have less power to price discriminate, even if they had an incentive for doing so.

However, this is something that we will monitor. If we have evidence that similar commission models exist in the consumer hire market and are leading to harm, we will look at how to act.

Other issues

- One respondent asked whether reference to 'bailed or hired' in the proposed CONC 4.5.1G implied that the discretionary commission model ban applied to consumer hire agreements.
- A respondent also asked whether the proposed CONC 4.5.8G(1) would allow a firm to use a discretionary commission arrangement after the ban came into effect.
- One respondent wanted clarity on what we meant by 'motor vehicle' and whether this was designed to capture agricultural vehicles.
- A broker and a trade body were concerned that our analysis and the proposed ban did not differentiate between motor dealers and online brokers. They felt that online brokers had limited point of sale advantage to exploit consumers.
- A consumer body felt that we should consider a ban on commission models in other markets.

Our response

As explained above, we do not intend the discretionary commission model ban to apply to consumer hire. 'Bailed or hired' refers to hire purchase, which is caught by the ban.

CONC 4.5.8G(1) is designed to make clear that the ban does not affect commissions already earned under discretionary commission arrangements but does affect future earnings under them.

We are not proposing to define motor vehicle. Our discretionary commission model ban applies to regulated credit agreements. Credit agreements relating to agricultural vehicles are likely to be exempt given that they are likely to involve credit exceeding £25k and entered into by the borrower for business purposes.

Our analysis showed that harm occurred regardless of broker type. So we have applied the ban to all firms carrying out credit broking (RAO Art. 36A) in the motor finance market.

Our ban on discretionary commission models in motor finance is a targeted response in follow up to our review of that market. We will consider acting in other markets if we see harm during our work.

Q2: Do you agree with a 3-month implementation period?

- 2.20** CP19/28 proposed that the ban on discretionary commission models in the motor finance market would come into effect 3 months after we published the final rules. In our cost survey to firms, which informed our cost benefit analysis (CBA), we asked them to assume a 3-month implementation period.
- 2.21** Almost all firms that responded argued that 3 months was too short an implementation period. Firms argued that they would need time to renegotiate contracts – eg some lenders have contracts with thousands of brokers.
- 2.22** Provided firms comply with the ban, we are not specifying what commission models and rate structures they move to. Some lenders may opt for flat interest rates but with some variation in commission. Others will move to risk-based pricing, albeit with the broker not being compensated for any variance in the rate charged to customers. So it is feasible that larger motor finance lenders and brokers will have both a multitude and wide variety of different arrangements to consider.
- 2.23** The industry has argued that other changes can only be implemented as a result of settling these contractual arrangements. These include:
- systems changes (some firms contend that legacy systems are a particular problem)
 - communication and training (lenders explained that they are looking to train and educate staff across their broker network, and some have alluded to affecting cultural change among smaller brokers)

- 2.24** Some firms want to use the ban on discretionary commission models to move to risk-based pricing, citing improved consumer choice - although firms' ability to adequately cover the risk while pricing competitively will also be a factor. They were concerned that 3 months would not be enough time to do so. Respondents argue that there are IT deficiencies and lack of platforms to enable comparison across prime lenders. These firms see a fixed rate model, which would be quicker to implement, as not as effective.
- 2.25** Industry respondents generally pushed for an implementation date of 6 months. One argued for 12 months.
- 2.26** Several respondents (including a consumer group, a motor finance broker using other forms of commission and a lender in a different sector) felt that 3 months was too long an implementation period. They felt that firms had been aware for some time that discretionary commission models posed a problem, as highlighted in our motor finance review final findings published in March 2019.

Our response

We want to address harm caused by discretionary commission models as soon as possible. However, in light of feedback, we recognise that firms will likely need more than 3 months to implement.

To ensure that firms of all sizes have enough time to implement, we believe that it would be proportionate to extend the implementation date to 6 months after publishing this Policy Statement and final rules. This additional time will be particularly important as the industry transitions out of lockdown.

This timetable could still be challenging for some firms, but we believe it is reasonable. While firms will feel the after effects of lockdown, operations are beginning to return to business as usual to the point where firms should be able to begin to implement the changes. Transaction volumes might be down in the short-term, giving firms an opportunity to reallocate resources to implement the changes.

Extending implementation of the ban by 3 months will come at a loss to consumers in the short-term. We estimate this would be in the region of £41m benefits delayed in the first year if motor finance transaction volumes towards the end of 2020 are broadly similar to the data we collected for the motor finance review in 2018.

However, while the automotive industry is showing some signs of recovery, we can expect transaction volumes to be lower in 2021 due to continued strain on household finances. The delayed benefits in the first year from extending the implementation timetable are therefore likely to be lower. We do not consider it reasonably practicable to estimate this figure, but provide more details of our analysis in Chapter 4.

We have also looked at the seasonal distribution of car sales and whether the proposed extension would lead to a disproportionate delay in consumer benefit, given that new car sales are concentrated in March and September.

However, discretionary commission models are more common in the used car market where there is no seasonal distribution in car sales. So we do not expect disproportionate impacts, because overall car sales are not particularly seasonal, apart from slower sales in the end-of-year period.

Our CBA estimated firms' one-off costs from implementing the ban to equal £35m. It is possible that firms will find cost savings if they are able to implement the ban over a longer time period – eg by achieving efficiencies in doing so. However, this is not something we can quantify as the responses did not include much evidence on this.

In any case, we can reasonably assume some firms will be able to move towards other commission models ahead of a 6 month deadline, continuing the trend we have seen over the last year or so.

3 Commission disclosure in consumer credit markets

- 3.1** This chapter summarises feedback on our proposed changes to our commission disclosure rules across all consumer credit markets, not just motor finance.
- 3.2** In CP19/28, we proposed the following:
- CONC 3.7.4G is amended so it is clear that firms should disclose the nature of commission in their financial promotions (as well as when making a recommendation). Guidance clarifies that firms should consider the impact commission could have on a customer’s willingness to transact and that firms should consider whether and how much commission can vary depending on the lender, product or other permissible factors and tailor their disclosures accordingly.
 - CONC 4.5.3R clarifies that the existence and nature of commission arrangements where the commission varies depending on the lender, product or other permissible factors should always be disclosed prominently. The disclosure must also cover how the arrangements could affect the price payable by the customer.
- 3.3** We proposed these changes to address failings we identified in our motor finance review. We found commission disclosures were often not prominent nor early enough in the process to influence a customer’s decision making.
- 3.4** Although our mystery shopping exercise was limited to motor finance sales, we were concerned that our disclosure rules could also be being misinterpreted and applied too narrowly by firms in other markets.
- 3.5** We are going ahead with the changes we consulted on subject to a few technical changes. However, we are giving firms until 28 January 2021 to comply.

Feedback received

Q3: Do you agree with our proposed commission disclosure clarifications?

- 3.6** We received a range of responses to our proposals. A number of firms did not believe that any changes were necessary because consumers were unlikely to engage with commission disclosures.
- 3.7** Other respondents felt we should have gone much further – such as requiring verbal disclosure, requiring firms to disclose commission amounts in all cases or introducing more procedures into sales processes.
- 3.8** Generally, firms and their trade bodies wanted our rules to be more prescriptive on what to disclose and how. For instance, some asked for additional guidance on the ‘nature’ of commission models to be disclosed and how ‘prominent’ that disclosure should be.

- 3.9** Some firms were concerned that our proposed changes would require the precise nature of commission arrangements, including amounts, to be disclosed too early in the sales process (eg financial promotions) where some of this detail is unknown.
- 3.10** Two trade bodies questioned whether our use of 'customer' rather than 'consumer' in the rule and guidance inadvertently broadened their application to regulated and unregulated commercial credit agreements.
- 3.11** Some firms felt that all our commission disclosure changes, rather than just the pre-contractual disclosure at CONC 4.5, should apply to consumer hire.
- 3.12** As raised under Question 1, some firms wanted clarity on what 'other remuneration' could comprise – eg. whether this is just linked to the finance transaction, or more general incentives.

Our response

The rules and guidance we consulted on in CP19/28 were not intended to be wholesale changes in how or when firms disclose commission. We have deliberately not proposed material changes in scope.

Our rules and guidance are designed to make firms elaborate on the nature of commission arrangements where they could affect a customer's willingness to transact. This could include, for example, forms of variable commission that we are not banning in motor finance and those that exist in other markets.

We saw evidence in our motor finance review that firms were not giving consumers enough or, in some cases, any detail on the nature of commission arrangements. We have asked firms involved in that review to make improvements. But we believe that the relatively minor changes we consulted on will help firms across all consumer credit markets consider what is right for customers to know.

We accept that disclosure has limited benefits. We are not convinced that issuing more prescriptive rules and guidance would improve customer outcomes in a way that would justify the costs involved. Increased prescription on what to disclose, how and when, is likely to be counterproductive given the range of products and commission arrangements across the entire consumer credit industry.

We consider our rules to be clear enough on issues of 'prominence' (a term that already exists in CONC). Firms need to consider how best to make consumers aware of relevant information.

The same can be said for 'nature'. The Handbook text we consulted on makes clear that firms should disclose any variable commission model. But firms will need to consider whether their commission models could affect a customer's willingness to transact.

Firms will need to use their judgement in how and when they disclose this. The number and nature of commercial arrangements will be a factor.

Q4: Do you agree our proposed commission disclosure clarifications should apply across all consumer credit markets?

- 3.13** Most respondents agreed with our proposal. They agreed that the clarifications should improve standards across all credit sectors.
- 3.14** Some industry respondents did not agree. They felt that consumers would not act on any additional commission disclosures. One trade body considered that those firms who only broker credit agreements as a secondary activity pose the most risk of harm.

Our response

The poor disclosure practices we saw in the motor finance review could just as easily occur in other markets. This is not limited to those markets that use discretionary commission models.

So we are going ahead with our proposal to apply the relatively minor changes to commission disclosure rules and guidance to other consumer credit sectors, not just motor finance.

Q5: Do you agree our proposed commission disclosure clarifications should take effect on the day the rules are made?

- 3.15** Responses to this question were mixed. Some respondents, mostly consumer bodies and individuals, supported our proposal. They did not provide many arguments to support this view, but some argued that immediate implementation was appropriate as firms should have already been disclosing commission in the way we intended.
- 3.16** Most motor finance firms have argued that the staggered implementation dates in CP19/28 would lead them to making 2 sets of changes to their disclosure processes. This is because firms will need to know what commission arrangements they are implementing before they can build systems to disclose them.
- 3.17** Several respondents also felt that we had underestimated the work needed to implement the changes – eg updating product documentation.

Our response

Respondents' feedback and our decision to give motor finance firms more time to implement the discretionary commission model ban has led us to reconsider the implementation date.

We believe it would be more proportionate for these commission disclosure rules and guidance to take effect on the same day as the discretionary commission model ban in motor finance. We estimated that these changes would be low cost for firms, but would also deliver low (and unquantifiable) benefits. Delaying the implementation date for all firms will help ensure that these changes remain net beneficial.

These changes will come into effect on 28 January 2021.

4 Cost benefit analysis (including coronavirus impacts)

- 4.1** This chapter summarises feedback on our CBA not already covered in the previous chapters.

Feedback received

Q6: Do you agree with our analysis of the costs and benefits of the proposals?

- 4.2** We received little direct feedback on our CBA, aside from firms' difficulties in meeting our proposed implementation dates – see Chapters 2 and 3.
- 4.3** Several firms questioned whether our CBA took account of weak margins in the sector. Others thought that the ability for firms to recoup revenue from elsewhere would reduce, or even eliminate, the benefits we had estimated.
- 4.4** Several firms argued that we had underestimated compliance costs for firms, although no quantitative information was put forward to challenge our estimates. One firm argued that the benefits of a ban on discretionary commission models would be greater if applied across all consumer credit markets.
- 4.5** Some industry respondents challenged our assumption that motor finance contracts run to term. One respondent highlighted that the average effective duration was around 28 months, because a large proportion of consumers chose to terminate their loan early, whereas we relied on the agreed contractual term from our loans data, whose average is 48 months.
- 4.6** A broker and an industry body were concerned that our analysis did not differentiate between new and used car sales.
- 4.7** A consumer body asked whether our analysis took full account of consumers in Northern Ireland.

Our response

We estimated firms' compliance costs by surveying a range of lenders and brokers prior to consulting. Respondents did not provide us with evidence to suggest that these estimates need revising.

Our decision to delay and align implementation of both the discretionary commission model ban in motor finance, and our commission disclosure changes could result in lower costs to firms. However, as noted in Chapter 2, this is not something that we can estimate.

We have not received any evidence of weak profitability in the motor finance market that would suggest that it would be unreasonable to ban discretionary commission models.

We recognise that brokers may have some ability to recoup revenue lost through the ban by renegotiating their commission revenues with lenders. We took this possibility into account in our "negotiated scenario"¹ when estimating the benefits to consumers and the indirect costs to firms. Further, we have considered the possibility that brokers may recoup some of their lost revenue through other elements of the overall transaction, and we concluded that this development would be unlikely to have material effects. Respondents have not provided evidence that would change this analysis. Overall, as outlined in our CBA, we do not think it's plausible that these effects would result in the ban materially reducing or eliminating benefits.

Applying the discretionary commission model ban to other consumer credit sectors could increase consumer benefits. However, this would also increase costs to firms. Without clear evidence of harm in other sectors there is no clear rationale for extending the ban.

We are confident that our assumption on how long motor finance agreements run remains valid for estimating benefits of the discretionary commission model ban. If a consumer exits a motor finance contract early, we believe it is likely that they will enter into another motor finance contract (eg to finance the purchase of a newer vehicle). That new contract could also involve the broker being incentivised to decide or negotiate the rate the customer pays, which would mean that the harm could persist. We also estimate that, even if all loans were terminated at 28 months, the benefits would still outweigh the costs.

In our analysis we have looked closely at, and controlled for, differences in the used and new car markets. Our analysis also included consumers in all UK regions.

Coronavirus impacts

4.8 We had planned to publish a Policy Statement and final rules in Q2 this year. However, this was postponed as part of our publication moratorium due to coronavirus.

4.9 We have taken the opportunity to review whether our policy remains reasonable and proportionate in light of the pandemic. In particular, we have looked at:

- a. macro-economic conditions and the impact on the motor finance market
- b. the potential effect of our policy on firm viability

4.10 Overall, after assessing the effects of the pandemic, we consider our CBA still stands.

(a) Macro-economic conditions and the impact on the motor finance market

4.11 The automotive industry - and, as a consequence, the motor finance market - has suffered greatly as a result of the pandemic. Car purchases fell substantially during lockdown.

4.12 Though more recently pointing to the risk of a longer and harder recovery, the Bank of England's central recovery scenario estimates that the UK economy will rebound sharply in 2021, albeit with pre-crisis activity levels only returning in 2022. This scenario invites us to assume that the intervention will be implemented in a context of reduced activity for at least one year, but with a significant upward trend.

4.13 Reduced economic activity may keep car sales transactions low in the short to medium-term, however this may be offset (at least partially) by:

- Latent demand, caused by customers unable to buy cars earlier in the year, being satisfied late-2020 into 2021. It is possible that, as the car market restarts during uncertain economic conditions and household finances are squeezed, used cars are preferred to new cars. Given that harm caused by discretionary commission models was higher in the used car market, our proposed final rules would be well placed to address this.
- The government's advice to avoid public transport, which may encourage greater car usage and, potentially, motor finance activity.
- A low interest rate environment, which will encourage sales and borrowing, assuming that lenders are resilient to the crisis (see next section below).

4.14 If market conditions normalise relatively quickly after the lockdown, and if the Bank of England's estimated recovery is accurate, the proposed policy will be implemented at a time where it will be particularly important that consumers are able to benefit from well-functioning markets, particularly in the used car market. We have not adjusted our CBA for these effects but we have considered the potential effects above in reaching our view to go ahead with the policy.

(b) Firm viability

4.15 Given the pandemic's impact on the motor finance market, we have looked at the financial situation of firms and whether our policy could have a material incremental effect on viability.

- 4.16** In this context, it is important to recognise that we have issued guidance setting out our expectation that motor finance lenders should give payment deferrals to customers affected by coronavirus, offer interest waivers to certain customers who receive payment deferrals and temporarily halt repossessions. However, those interventions do not affect all firms that we expect to be impacted by our proposed ban on discretionary commission models. The payment deferral focused solely on lenders and their existing agreements. Our proposed intervention on commissions affects new transactions and both lenders' and brokers' revenues.
- 4.17** Our discretionary commission model ban would only affect firms' cashflow up to the extent of our estimated one-off implementation costs. Not all of these costs will materialise as additional cash expenses, but we have taken a conservative approach here and assumed that they all affect cashflow.
- 4.18** Our original CBA found that one-off implementation costs in the first year would be on average £780k per motor finance lender (between £1m and £2m for large lenders, and between £100k and £200k for medium and small lenders), and £420k per broker-dealer. This represents a total of £13m for lenders and £17m for brokers.
- 4.19** There is a risk that these implementation costs materially contribute to reducing firms' cashflow, and then lead some firms to face liquidity issues. However, our analysis suggests that it is unlikely this will be the case. We estimated firms' current incoming monthly cashflow, based on their lending balances (the industry was responsible for approximately £37bn of new lending last year) and on attrition assumptions due to payment deferrals and defaults (based on early market feedback on the take-up of payment deferrals).
- 4.20** We conclude that first year one-off implementation costs for lenders are well below our estimate of their monthly incoming cashflow, even in the current circumstances. These figures reassure us that the implementation costs are unlikely to create a short-term cashflow constraint for lenders as a whole.
- 4.21** Our consumer relief measures have not affected brokers as such, but these firms could not earn a revenue during lockdown. However, they are eligible for the furlough scheme and, depending on their size and status, other emergency lending measures.
- 4.22** Dealers also booked orders online or by phone during the lockdown. Showrooms were allowed to open from 1 June, and anecdotal evidence suggest that business is resuming reasonably quickly. All of this suggests that the difficulties experienced by brokers and motor dealers, while significant and to some extent ongoing, are not structural enduring impacts that make our implementation costs any more disproportionate in the current climate.

Annex 1

List of non-confidential respondents

Advanced Vehicle Leasing (Stockton) Ltd

Bexhill UK Limited

Blue Motor Finance Ltd

British Gas Services Ltd

British Insurance Brokers' Association

British Vehicle Rental and Leasing Association

Dr Stephen Evans

DSG Financial Services Ltd

Evolution Funding Ltd

Finance and Leasing Association

Financial Services Consumer Panel

Forward Asset Finance Ltd

Keith Medgett

Mann Island Finance

Money Advice Trust

National Franchised Dealers Association

Peter Vardy Ltd

Premier Autocentres

Randhir Basi

Redgate Lodge Ltd

Smaller Business Practitioner Panel

The Compliance Company

The Consumer Council for Northern Ireland

The Law Society of Scotland

The Money Charity

The National Association of Commercial Finance Brokers

Tim Angus

Vanarama

Volkswagen Financial Services (UK) Ltd

Annex 2

Abbreviations used in this paper

CBA	Cost benefit analysis
CONC	Consumer Credit sourcebook
DiC	Difference in Charges
PCH	Personal Contract Hire
PCP	Personal Contract Purchase
RAO	Regulated Activities Order



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We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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Appendix 1

Made rules (legal instrument)

MOTOR FINANCE INSTRUMENT 2020

Powers exercised

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 28 January 2021.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Consumer Credit sourcebook (CONC) is amended in accordance with the Annex B to this instrument.

Citation

- F. This instrument may be cited as the Motor Finance Instrument 2020.

By order of the Board
23 July 2020

Annex A**Amendments to the Glossary of definitions**

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

*discretionary
commission
arrangement*

any arrangement under which:

- (a) a *lender* permits a *credit broker* to decide or negotiate (whether or not within specified limits or subject to conditions or restrictions) the amount of any item included in the *total charge for credit* provided for in a *regulated credit agreement* in respect of which the *credit broker* carries on activity of the kind specified in article 36A of the *Regulated Activities Order*; and
- (b) the amount of any commission, fee or other financial consideration payable to the *credit broker* (directly or indirectly) in connection with that *regulated credit agreement* is affected (in whole or part) by the amount referred to in (a).

Annex B

Amendments to the Consumer Credit sourcebook (CONC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

3 Financial promotions and communications with customers

...

3.7 Financial promotions and communications: credit brokers

...

3.7.4 G A *firm* should in a *financial promotion* or in a communication with a *customer*:

...

- (2) indicate to the *customer* in a prominent way the existence and nature of any financial arrangements with a *lender* that might impact upon the *firm's* impartiality in promoting or recommending a *credit* product to ~~a~~ the *customer* or which might, if disclosed by the *firm* to the *customer*, affect the *customer's* transactional decision in relation to the *credit* product;

...

- 3.7.4A G (1) Where the amount of any commission, fee or other remuneration payable under a financial arrangement in relation to the *credit* product in CONC 3.7.4G(2) that the *firm* is promoting or recommending varies due to a factor specified in the arrangement, for example a specific feature of the *credit* product or the level of work undertaken by the *firm*, the *firm* should make disclosure under CONC 3.7.4G in relation to the arrangement.
- (2) Where:
- (a) the *firm* has entered into arrangements (irrespective of how many other *persons* those arrangements are with) under which it may earn commission, fees or other remuneration in relation to two or more different *credit* products;
- (b) the *customer* could be eligible for two or more of those *credit* products;
- (c) the *credit* product that the *firm* is promoting or recommending is one of those *credit* products; and
- (d) the commission, fees or other remuneration payable to the

firm varies depending on which of the credit products the customer takes out,

the firm should make disclosure to the customer under CONC 3.7.4G in relation to the arrangements.

- (3) The disclosure in (2) may be in general terms, but it should enable the customer reasonably to appreciate the effect of the arrangements.

...

4 Pre-contractual requirements

...

4.5 Commissions

Application

4.5.1 R ...

- (2) CONC 4.5.3R and to CONC 4.5.4R apply to a firm with respect to credit broking in relation to:

...

- (3) CONC 4.5.3R and to CONC 4.5.4R also apply to a firm carrying on the activities specified in article 36A(1)(a) or (e) (b) of the Regulated Activities Order in relation to:

...

- (4) CONC 4.5.5G to CONC 4.5.8G apply to a firm with respect to consumer credit lending and credit broking in relation to a regulated credit agreement the purpose of which (in whole or in part) is to finance the purchase of a motor vehicle or under which a motor vehicle is bailed or hired.

...

Commissions: credit brokers

4.5.3 R A credit broker must prominently disclose to a customer in good time before a credit agreement or a consumer hire agreement is entered into, the existence and nature of any commission or fee or other remuneration payable to the credit broker by the lender or owner or a third party ~~in relation to a credit agreement or a consumer hire agreement~~, where ~~knowledge of the existence or amount of the commission, fee or other remuneration~~ could actually or potentially:

- (1) affect the impartiality of the credit broker in recommending a ~~particular product~~ the credit agreement or the consumer hire

agreement; or

- (2) if made known to the customer, have a material impact on the customer's transactional decision to enter into the credit agreement or the consumer hire agreement.

[Note: paragraph 3.7i (box) and 3.7j of CBG and 5.5 (box) of ILG]

- 4.5.3A R In circumstances where the credit broker is required to disclose the existence and nature of any commission, fee or other remuneration under CONC 4.5.3R, it must also disclose to the customer, at the same time and with equal prominence, how the existence and nature of this commission, fee or other remuneration may affect the amounts payable by the customer under the relevant credit agreement or consumer hire agreement.
- 4.5.3B G (1) Where the amount of any commission, fee or other remuneration in CONC 4.5.3R varies due to a factor specified in the arrangement or agreement under which the commission, fee or other remuneration is payable, for example a specific feature of the credit agreement or consumer hire agreement or the level of work undertaken by the credit broker, the credit broker should make disclosure under CONC 4.5.3R in relation to the commission, fee or other remuneration.
- (2) Where:
- (a) the firm has entered into arrangements (irrespective of how many other persons those arrangements are with) under which it may earn commission, fees or other remuneration in relation to two or more different credit agreements or consumer hire agreements;
- (b) the customer could be eligible for two or more of those agreements;
- (c) the credit agreement or the consumer hire agreement the firm is recommending is one of those agreements;
- (d) the commission, fees or other remuneration payable to the firm varies depending on which of the credit agreements or consumer hire agreements the customer enters into,
- the firm should make disclosure to the customer under CONC 4.5.3R in relation to the arrangements.
- (3) The disclosure in (2) may be in general terms, but it should enable the customer reasonably to appreciate the effect of the arrangements.
- (4) The credit broker is not, under CONC 4.5.3AR, required to provide to the customer an individually tailored illustration of how the commission, fees or other remuneration in CONC 4.5.3R may affect the amounts payable by the customer under the credit agreement or

consumer hire agreement.

...

Prohibition on discretionary commission arrangements in the motor finance market

Purpose

- 4.5.5 G The purpose of CONC 4.5.6R to CONC 4.5.8G is to prohibit *credit brokers* and *lenders* to whom they introduce *customers* wishing to enter into *regulated credit agreements* to finance the acquisition of motor vehicles from making or relying on arrangements under which *credit brokers* are given authority to decide or negotiate the prices of those *regulated credit agreements* on behalf of *lenders* and the amount of commission the *credit brokers* earn is affected by those prices.

Prohibition

- 4.5.6 R A *lender* or *credit broker* must not:
- (1) enter into or have rights or obligations under a *discretionary commission arrangement*; or
 - (2) seek to exercise, enforce or rely on rights or obligations under a *discretionary commission arrangement*, including any rights or obligations to receive or tender payment of commission, fee or other financial consideration.

Examples of discretionary commission arrangements

- 4.5.7 G The following are examples of *discretionary commission arrangements*:
- (1) An agreement under which the *lender* sets a minimum rate of interest and the commission payable by the *lender* to the *credit broker* in respect of a *regulated credit agreement* entered into by the *lender* is calculated by reference to the difference between the rate of interest negotiated by the *credit broker* and payable by the *customer* under the *regulated credit agreement* and the minimum rate of interest. These types of arrangements are often referred to as “increasing difference in charges” or “interest rate upward adjustment” arrangements.
 - (2) An agreement under which the *lender* sets a maximum rate of interest and the commission payable by the *lender* to the *credit broker* in respect of a *regulated credit agreement* entered into by the *lender* is calculated by reference to the difference between the rate of interest negotiated by the *credit broker* and payable by the *customer* under the *regulated credit agreement* and the maximum rate of interest. These types of arrangements are often referred to as “decreasing difference in charges” or “interest rate downward

adjustment” arrangements.

- (3) An arrangement or agreement under which the commission payable by the lender to the credit broker in respect of a regulated credit agreement entered into by the lender varies (within set parameters) according to the rate of interest negotiated by the credit broker and payable by the customer under the regulated credit agreement. These types of arrangement are often referred to as “scaled models”.

Accrued commissions

- 4.5.8 G (1) CONC 4.5.6R does not affect commissions under discretionary commission arrangements liability for which accrued before the date on which CONC 4.5.6R came into force. CONC 4.5.6R does affect, however, commissions under discretionary commission arrangements that became due on or after the date on which CONC 4.5.6R came into force, irrespective of whether the relevant discretionary commission arrangement was entered into before or after the date on which CONC 4.5.6R came into force.
- (2) Accordingly, commissions under a discretionary commission arrangement relating to regulated credit agreements entered into before the date on which CONC 4.5.6R came into force are not affected by CONC 4.5.6R.
- (3) However, commissions under a discretionary commission arrangement relating to regulated credit agreements entered into after the date on which CONC 4.5.6R came into force (whether or not the discretionary commission arrangement was entered into before that date) are affected by CONC 4.5.6R.

