MOTOR FINANCE

"We are concerned that there may be a lack of transparency, potential conflicts of interest and irresponsible lending in the motor finance industry. We will conduct an exploratory piece of work to identify who uses these products and assess the sales processes, whether the products cause harm and the due diligence that firms undertake before providing motor finance.

Following the review we will assess whether and how to intervene in the market."

Financial Conduct Authority, 2017

Since assuming responsibility for regulating consumer credit in 2014, the FCA has been extremely active in its work to better understand the consumer credit sector. This has been demonstrated by a myriad of consultations, calls for input, thematic reviews and market studies which have been undertaken, covering a diverse range of consumer credit products and business practices.

The recently published FCA 2017-18 Business Plan, which sets the regulatory agenda for the year ahead, is essential reading for market participants and wider interested parties. One of the stand out areas of focus for the Regulator in respect of the consumer credit sector is that of motor finance, and, in particular, whether that area of the market is working well for consumers.

So what are the implications for motor finance providers in the wake of the FCAs plan to conduct an "exploratory piece of work" in motor finance sector?

The FCA does not make such statements lightly and we understand that a significant amount of work has already been conducted through the use of the multi-firm reviews. As such it would appear that the groundwork for this "exploratory piece of work" may have already been completed, however we are left, at this stage, to second guess the likely direction of travel, and how the findings of this activity will be presented back to the industry.

Taking the FCA's recent form into account, one would envisage a market study or thematic review to be the delivery mechanism – and the focus? Conduct.

In consideration of how such a regulatory review may land, it is important to recognise that this is far from a homogenised sector. That said the market can be broadly divided into two, captive finance houses who solely support the distribution of vehicles by their manufacturing partner or parent, and a host of large and small lenders supporting the rest of the market.

So what could the FCA's comments about the motor finance industry mean for these different finance providers?

Taking first the captive finance houses. It is likely that the FCA will seek to establish whether or not the influence of the manufacturer is leading to a conflict in respect of both motor finance product design and robust underwriting /affordability checks with lending being waived through to support movement of vehicles. In addition, focus can be expected in the use of both term and residual values (RV) in setting monthly payments which whilst they meet affordability criteria, may lead to unrealistic RV and extended terms. The issue of inflated RV's is also a concern for the Bank of England and therefore we can expect this to be an area that attracts further regulatory attention.

These lenders will need to demonstrate that they have considered these risks and mitigated against them to ensure good outcomes for consumers.

For the other type of motor finance providers in the market, who are subject to the same risks as already described above, they will have the added challenge of overseeing diverse distribution channels and will need to ensure that they have robust oversight of the sales practices across a multitude of partners.

Both types of finance providers will also have the challenge of in-dealership sales practices that must demonstrate adherence to the FCA's conduct rules, and specifically, they must ensure that the customer is given adequate explanations of the product and be able to demonstrate that their sales process is compliant.

The FCA are also likely to consider whether sales process or behaviour in play are reducing customer choice, particularly where barriers exist that may reduce the customers propensity to shop around for alternate funding options.

More holistically, one would assume that the FCA will also want to understand the movement from traditional loans toward PCP products which the consumer may not understand. Given the penetration of PCP, particularly in the new car market where it accounts for 86% of the finance market, the FCA are likely to question whether it is possible for any single product to be suitable for such a wide demographic.

Whilst there are many unknowns in terms of how this exercise will play out, what is clear is that that the policies, procedures and controls (which formed your compliance framework that you set out in your Regulatory Business Plan to the FCA), are now to be subjected to the 'implementation test ' – have they been embedded into the business, and how is compliance with these being monitored and tested?

Motor finance firms should not only be asking themselves, does our compliance framework meet regulatory expectations, but does the output from control activity enable us to demonstrate the consistent and robust delivery of fair outcomes for customers?

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