IN-DEPTH

FINANCE & FUNDING

Credit, cash and how to keep the wheels turning

An *AM* special supplement on the FCA's motor finance review, DiC schemes, commission disclosure, and business finance

Tim Rose, *AM* editor

Money makes the world go round, so the *Cabaret* song goes. But we have moved on in the almost 50 years since, and maybe credit would replace money in a 21st-century version.

In the business of retailing big-ticket items such as cars and LCVs, the availability of credit for individuals and businesses is crucial, which is why we are examining the subject in 'The Future of Motor Finance' at Automotive Management Live on November 7 and bringing you this in-depth look at finance and funding. In 11 pages of articles, we examine the recent report from the Financial Conduct Authority and we expand on the particular issues of difference in charge schemes and commission disclosure.

We also examine business finance. As the Brexit saga rumbles on, and growth in the UK economy is forecast to slow, business funding and liquidity will become ever more important in supporting daily operations and in picking up any businesses that come on the market.

Adam Mepham, motor sales director

We are proud to be invited to contribute to this special supplement focusing on finance and funding. The motor retail market has been in a constant state of change and progress in recent years, which has meant that dealerships and supporting businesses have had to move at pace to continue to be successful in the industry.

At Barclays Partner Finance, we are hugely enthusiastic about what the future holds. With exciting new strategies, initiatives and solutions, combined with a considered approach, we are looking to deepen existing relationships and establish new strategic partnerships, by leading the way in point-of-sale finance.

In our Q&A on page 16, I give our view on the future of the market and the final findings of the Financial Conduct Authority's review.

Richard Jones, managing director

It was great to see the Financial Conduct Authority publish its long-anticipated report on motor finance. At Black Horse, we welcome the overall findings and the opportunity to work with the FCA and the industry to respond. We felt it important, as a leading industry finance provider, to reflect on the four key areas identified by the report, in this finance and funding supplement.

We have undoubtedly witnessed the market taking a more progressive approach in adopting higher standards since the FCA's adoption of motor finance regulation in 2015, the objective of which was to deliver good and fair outcomes and value to the end-customer.

In discussing the 2019 report and its recommendations, we must remember that its purpose is to ensure the market is working well – for both a sustainable industry and for consumers. This is something we should all welcome.

HOW THE MOTOR FINANCE REVIEW AFFECTS DEALERS

The Financial Conduct Authority's findings on commissions, information disclosure and affordability have big implications for the industry

The Financial Conduct Authority's (FCA) review of the motor finance industry is likely to have wide-reaching implications for the automotive retail sector.

The report, prompted by the FCA's desire to learn more about the sales process and record levels of car finance amid concerns about a lack of transparency and potential conflicts of interest, focused on three main areas – commissions, information disclosure and affordability.

Launched in April 2017, the review analysed loan data from 20 motor finance providers, mystery shops of 122 motor retailers, and a survey of lenders.

David Bilsborough, owner of Cheshire Cars and founder member of the Independent Motor Dealers Association (IMDA), said the FCA's method of mystery shopping was a common practice in retail and retailers should expect it.

But he added that those who comply with FCA requirements had nothing to fear.

"If you disclose the full facts of the finance deal to a potential buyer in a clear and timely fashion before they have signed the agreement or handed over any money, that person can't turn around and say that you didn't give them the pre-contract information they needed to make a decision," he said.

However, Andrew Smith, FCA subject matter expert for consumer credit and motor finance at Paxen Consulting, said it was somewhat unfair and unrepresentative for the FCA to judge the whole market without seeing the complete sales process, including commission disclosure. He believes its conclusions should have been based more on in-depth interaction with lenders and brokers.

COMMISSION MODELS AT RISK

Among the key findings of the report were concerns about the widespread use of commission models that give brokers wide discretion when setting interest rates for customers. This can incentivise the broker to charge a higher rate and lead to conflicts of interest, with a link between higher commissions and increased interest rates, the report concluded.

The FCA estimated that such commission models could be costing customers a combined £300 million more per year than if they had used a flat fee model. For example, on a typical motor finance agreement of £10,000, higher broker commission under the reducing difference in charges (DiC) model can add about £1,100 more in interest charges for the customer over a four-year term.

The review also highlighted concerns that lenders are not doing enough to monitor commissions and protect the customer. And it warned that pricing and affordability for customers could be adversely affected if such commission arrangements break the link between credit risk and the customer's interest rate.

The FCA said it is assessing what action it will take, but possible courses of action include consulting on changes to its consumer credit rules, banning DiCs and

similar models, or limiting broker discretion.

Adrian Dally, the head of motor finance at the Finance and Leasing Association (FLA), said the FCA's findings were broadly in line with issues it had also identified, chiefly DiCs. But he added that the figures were out of date and said the automotive retail industry has made big strides since then.

"When we had a look into DiCs in 2014, we took a clear position that it had had its time," he said.

"The FCA's figures relate to 2017. At the time it carried out its research, half of the near-prime and prime used car market was still using DiCs, but two years down the line we have moved on and the vast majority have exited that model."

Car finance expert and ex-National Association of Commercial Finance Brokers director Graham Hill said in many cases, dealers and brokers will increase the annual percentage rate (APR) to be able to provide customers with the opportunity to pay off the finance owed on a part-exchange, or greater discounts or "freebies" in other areas. These could include tanks of fuel, car mats, GAP and breakdown insurance, roadside assistance, warranties and paint protection, or even options on the vehicle itself, he said.

"The position is by no means as straightforward as dealers upselling the interest in order to line their pockets," he said.

"Setting an arbitrary cap will have a similar effect to what happened with payday lenders, ultimately resulting in less choice for the consumer and jobs and companies going to the wall."

Jerry Page, a director at iComply, said it's only a matter of time before the FCA will require full commission disclosure, to everyone's benefit. He cited the example of independent financial advisers (IFAs), who were subject to similar action by the FCA's predecessor, the Financial Services Authority.

"If you go back 15 years, IFAs were required to disclose commissions and it didn't destroy their business," he said.

"After all, if you get a mortgage or a life insurance policy, you can see how much commission is paid to the introducer, so why shouldn't it be an obligation for motor finance?"

But James Tew, chief executive of iVendi, said this would only add further complexity because both the commission the lender pays the broker and the commission the dealer receives from that broker will have to be disclosed. The bottom line, he said, was that the lender will be required to have greater operational oversight of their brokers and dealers, which is often difficult because the lender only gets involved at the end of a sale when it receives the consumer's application.

"The FCA is more concerned about the total amount of commission received rather than what the dealer and broker earn individually," he said.

"But the important thing is that it's done in a transparent manner.

"I would imagine that the FCA will make these changes in small steps, demanding greater oversight and understanding by lenders of how their product is being sold by their introducers. It also suggests the greater use of digital processes to check how the transaction has been done."

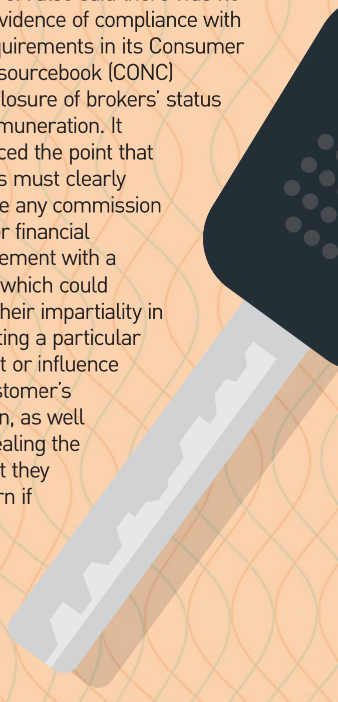
> **IT'S ONLY A MATTER OF TIME BEFORE THE FCA WILL REQUIRE FULL COMMISSION DISCLOSURE, TO EVERYONE'S BENEFIT**
>
> **JERRY PAGE, ICOMPLY**

TRANSPARENCY CONCERNS

The next area the FCA shone a spotlight on was the provision of sufficient, timely and transparent information to the customer. The review's mystery shops found instances where it was unclear whether pre-contractual disclosure and explanations were being made in enough time to enable customers to make an informed decision.

Where customers had been given sufficient time, the FCA found explanations were not always complete, clear or easy to understand.

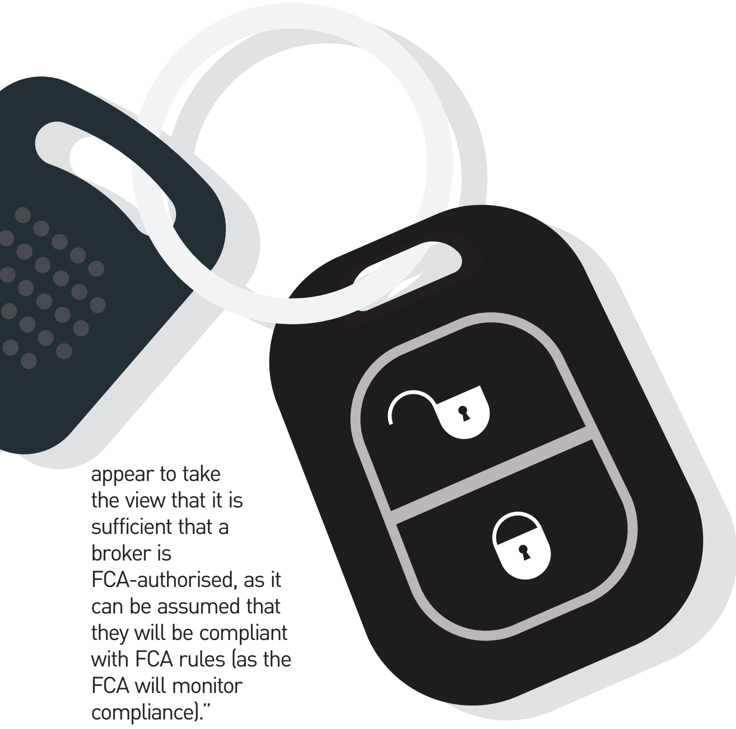
The FCA also said there was no clear evidence of compliance with the requirements in its Consumer Credit sourcebook (CONC) on disclosure of brokers' status and remuneration. It reinforced the point that brokers must clearly disclose any commission or other financial arrangement with a lender which could affect their impartiality in promoting a particular product or influence the customer's decision, as well as revealing the amount they will earn if asked.



On the lending side, the review also raised doubts about whether and to what extent lenders implemented controls to ensure that brokers – and retailers acting on their behalf –complied with CONC.

"Our work suggests that some lenders may be unduly reliant on contractual requirements and the provision of standard documentation and procedures, and may not monitor brokers sufficiently closely or act where issues are found," said the report.

"We were particularly concerned that some lenders



appear to take the view that it is sufficient that a broker is FCA-authorised, as it can be assumed that they will be compliant with FCA rules (as the FCA will monitor compliance)."

The report went on to say that companies should review their policies, procedures and controls to ensure they are complying with all the relevant regulatory requirements and are treating customers fairly.

Martin Hill, the managing director of DealTrak, said it came as no surprise that many lenders were accused of having insufficient oversight of their car dealers and brokers – a specific requirement of the CONC sourcebook.

He said the fact that only five out of the 20 lenders interviewed demonstrated systems and controls 'broadly in line with CONC requirements at the time', meant the majority had dealer and broker arrangements which appear to be unfit for purpose.

Smith said lenders will need to rely on their own individual approaches and judgement when assessing their distribution network. The downside, he said, was that brokers and dealers will have to contend with multiple audits carried out on them for each lender they deal with.

"The FCA will be looking for each individual lender to evidence that they are taking direct responsibility and ownership of their monitoring activity and that of their brokers and dealers, implementing and maintaining a regime of continuous oversight, feedback and improvement, as per CONC," he said.

"The key point here is, as the FCA states, the lenders are potentially exposed to issues of enforceability if introductions have not been made correctly, or if those making introductions are incorrectly authorised."

Another problem, said Smith, was current schemes for internal remuneration and incentives for brokers and dealers to sell financial products. Changing that will require a big shift in culture, he said.

However, he added that evidence from other sectors suggests that once the new processes are embedded and managed properly staff "become motivated and incentivised by quality and good customer outcomes, as well as obviously being financially viable".

"There are a number of approaches and strategies I have devised, for example, which provide a balance between rewarding good productivity and viability along with high-quality work and good customer outcomes."

AFFORDABILITY ISSUES

The third and final issue the FCA identified was around affordability assessment. The regulator said it was not satisfied that all lenders surveyed were complying with its rules for assessing creditworthiness, including affordability.

The regulator also reiterated that businesses are expected to have reviewed their policies and procedures in view of the new rules and guidance it published in November 2018 and to make any necessary changes, adding that it would follow up to make sure it had been done.

"Some lenders still don't ask customers for enough basic information about their income and outgoings," said Page. "There's still a lot of work to do to make lenders consistent in their approach and to demonstrate that the product the customer gets in the end is something they can afford."

INDUSTRY REPERCUSSIONS

As far as potential areas where the FCA could demand change, Hill said lenders could be required to revise and reframe their systems and controls regarding dealer and broker relationships.

That way, he said, they will be complying with the FCA's requirement on the provision of clear information and not misleading the consumer.

"Open and transparent disclosure is seen by the FCA as a fundamental prerequisite, and, historically, many dealers and brokers have been uncomfortable with this level of openness with a customer," he said.

"This could be because many customer-facing staff feel inadequately trained or not prepared to have some of the conversations around commissions or finance products, possibly because declaring certain information may cause the customer to ask questions regarding commission or interest rates that the dealer or broker may not feel comfortable answering.

"Fortunately, this is something that can be remedied by formal interventions from senior management at that dealership or brokerage. In other words, senior management decides what compliant performance looks like, and then makes sure their systems and controls are suitable to police and monitor this approach."

Smith said the review could also open the door to claims management companies if the FCA challenges the enforceability of some DiC model agreements. Therefore, he said brokers and dealers need to examine their past sales practices and identify potential exposures.

Gerry Keaney, the chief executive of the British Vehicle Rental Leasing Association, said the FCA needs to take a more active role in supervising lenders, retailers and brokers, particularly around unfair commission models, stepping in with enforcement where required. He added that there needs to be greater focus on affordability assessments and lenders ensuring their brokers comply with CONC.

"The time for excuses has passed," he said.

"There is no place in the motor finance sector for companies that are unwilling to embrace the FCA regime and actively demonstrate their compliance."

ALEX WRIGHT

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>
> **ANDREW SMITH, PAXEN CONSULTING**

blackhorse

The FCA's MOTOR FINANCE REVIEW analysed

It was great to see the long anticipated FCA's report on motor finance being published. Its purpose is to ensure the market is working well for both a sustainable industry and for consumers. This is something we should all welcome.

At Black Horse, we look forward to the opportunity to work with the FCA and the industry to respond.

Commissions

More needs to be done to protect customers from higher risk commission models. It is worrying that the FCA found that customers can pay considerably more due to some forms of commission that generate a higher risk of poor customer outcomes and a greater distribution in customer rate and dealer commission. The regulator implicitly reinforces the fact that a car finance proposition must stand in isolation from both a regulatory and a customer value perspective. Often the finance offer can be considered as one part of an overall package, together with the price of the car being sold, the part-exchange offer and other services such as warranties, servicing and insurance. This enables flexibility in how the overall offer is constructed for any given customer, often to help tailor the package to a customer need. However, the car finance offer must stand up to scrutiny in its own right and will be judged as such.

Product information and disclosures

Intermediaries, brokers, and dealers need to divulge key product features and other regulatory disclosures, including the existence of commission early enough in the sales process to inform customer decisions.

The FCA's report states that it is vitally important that customers receive key regulatory disclosures and product features such as implications of mileage, repayment, and vehicle ownership, before agreeing on the appropriate finance product for their needs. These terms must be explained in clear, plain English and be easily understood by all customers. As per Consumer Credit Sourcebook (CONC) legislation, the existence of commission, in particular, must be disclosed before entering into an agreement. The commission amount must also be disclosed on customer request. It is perhaps widely

assumed that a customer would know or expect a commission payment to be made, but this must not be relied upon. It is incumbent on the intermediary to be as transparent as possible about the benefits they receive for introducing customers to lenders. Only once a customer understands the full package can they determine if it is the right one for their needs.

Lender controls

Finance providers should not assume that FCA authorised intermediaries are fully CONC compliant.

The FCA feels that some lenders are not taking reasonable steps to manage CONC adherence within their intermediary networks. They need to ensure that they have oversight of the sales processes in operation across their networks. They also need to be aware of the information provided to customers throughout these journeys and have confidence that customers get the right outcomes.

- Training and guidance – finance providers have a role to ensure that dealers and brokers have access to up-to-date product guides and training materials. Reinforcing some of these as mandatory will deliver regulatory requirement consistency (for example on key product information and commission disclosures which may impact customer decisions).
- Tools and management information – finance providers can support intermediaries with accessible management information to help them self-regulate on certain items, such as discounting or financial promotions, etc.
- Feedback loops – via programmes such as mystery shopping or customer contact post-sale, finance providers are able to understand who is performing well and who needs more support. This should form part of an ongoing dialogue and enable continuous improvement and the sharing of best practices in the customer journey.

There are no excuses for the lacklustre provision of guidance, information, and support from finance providers to their intermediary partners.

The purpose of the FCA's report is to ensure the market is working well for both a sustainable industry and for consumers.

Affordability

Affordability measures must be aligned with the latest guidance issued as part of PS 18/19.

The FCA's concern here is that some lenders' affordability assessments are not aligned; in particular there were a small number of cases where policies were focused on credit risk rather than affordability. This could have a significant adverse impact on a customer's financial situation.

Lenders and intermediaries have a key role to play in demystifying the finance purchase process for customers. At the time of purchase, this includes assessing current affordability and seeking to reach an understanding with customers on the factors which may impede affordability through the lifetime of the product. It means ensuring that customers are aware of the terms and conditions of their usage. This requires a clear explanation of the benefits of the product and any add-ons such as guaranteed future values, servicing and insurance so that customers do not unknowingly incur additional charges.

In a rising interest rate environment, this becomes all the more pertinent. Lenders must help their customers consider if they can afford the product long-term, particularly if housing costs go up. Half of all customers choose their car finance product based entirely on monthly payment with only passing consideration to overall costs, which could be extremely problematic in the future.

IN THE CUSTOMER'S BEST INTEREST?

The FCA's inquiry raised serious concerns about car dealers and brokers manipulating finance rates to increase commissions

In its report published in early March, the Financial Conduct Authority (FCA) found a lack of evidence linking a customer's interest rate under the Difference in Charges (DiC) commission model and their credit score, because the rate was being determined by the broker or dealer's ability to earn commission.

It added that it was not clear why brokers should have such wide discretion when setting the interest rate under DiC.

In total, the FCA estimated that these commission models could be costing customers £300 million more per year than if they had used a flat fee model. For example, on a motor finance agreement of £10,000, higher broker commission under the Reducing DiC model can add about £1,100 more in interest charges for the customer over a four-year term.

The FCA said the onus was on the lender to prove that any differences in commission rates were justified, based on the work done by the broker or dealer. The review also warned that pricing and affordability for customers could be adversely affected if such commission arrangements break the link between credit risk and the customer's interest rate.

It also raised concerns about commission disclosure, particularly with DiC and similar models, adding that lenders are not doing enough to monitor commissions and protect the customer.

"DiC is a difficult issue to deal with because, in the main, dealers that use it do so appropriately and only a minority don't," said Louise Wallis, head of business development at the National Franchised Dealers Association (NFDA).

"My concern though, is that if dealer discretion is limited too much, you run the risk of reducing competition, so any changes need to be carefully thought through."

THE DIC DEBATE

Martin Hill, the managing director of DealTrak, said that when DiC was introduced, it was seen as a way of dealers providing flexibility in their commissions without being detrimental to the consumer. But he said the FCA now clearly views that model as problematic and open to abuse.

"DiC can encourage some dealers or brokers to maximise finance commissions in a way that is detrimental to the consumer in areas such as affordability and sustainability," he said. "Also, there have been many historical examples of dealers requesting very short [debit-back] or no debit-back terms from their lenders.

"Whereas this can be legitimately requested as part of a balanced rates and terms package for several reasons, it has previously led to accusations that the dealer can hold on to larger levels of commission – even if the customer cancels their agreement early due to the perceived high interest rate they have been paying. This, in turn, may lead lenders to focus on ways in which this risk can be mitigated in their dealings with dealers and brokers."

David Bilsborough, the owner of Cheshire Cars and a founder member of the IMDA, said the dealers who have likely been abusing DiC are those with a large stock that they sell off cheaply in the hope of making up their margin on commission from the finance deal. However, he said most dealers he knew offered fair and affordable interest rates and commissions.

Andrew Smith, FCA subject matter expert for consumer credit and motor finance at Paxen Consulting, said he didn't have a problem with DiC if the broker or dealer could justify their commission. One example of this, he said, was if they had to arrange finance for someone who is self-employed or has just changed jobs or address and further work is required to verify their identity or income.

"If a dealership or broker genuinely has to undertake a greater level of work to secure a particular finance deal for a

customer in difficult or exceptional circumstances, then they should be remunerated accordingly," he said.

"The issue, however, is with brokers whose income relies solely on finance who load the interest rate purely so they can earn a higher commission."

Smith said banning DiC, which the FCA is reportedly considering, would be the wrong move: "In the right circumstances, it genuinely rewards the broker or dealer for their work. Unfortunately, there's not one silver bullet, because motor finance is such a diverse industry with so many different models."

Mel White, business development director at Jigsaw Finance, said: "The market has operated with these models for a number of years and our experience has found that competition within the market has also had a policing effect on the rates offered to customers. In addition, lenders have capped both rates and commissions in recent years, so it is not an open cheque book."

POTENTIAL FIXES

The FCA said it's still assessing what action to take, possibly consulting on changes to its consumer credit rules, banning DiC and similar models, or limiting broker discretion.

Adrian Dally, head of motor finance at the Finance and Leasing Association, believes the FCA will ban DiC and require full commission disclosure in the same way as with mortgages, insurance and investments. In turn, this will help improve consumer confidence, he said.

"The FCA has found clear quantifiable evidence to indicate that if the rules of the market are changed to prohibit the use of DiC type models the consumer stands to benefit," he said. "Now they are looking at all of the options available and doing a cost-benefit analysis of each, which they will consult on before implementing the necessary changes."

One alternative already being used by dealers is a single interest rate, and, in some cases, the same commission rate, regardless of the balance to be paid or the vehicle's age, said James Tew, chief executive of iVendi.

"Many dealerships I have spoken to over the last 12 to 24 months told me that since they introduced a fixed APR model they have actually done a lot better in terms of finance deals," he said. "The problem is that the dealer may still struggle to justify its commission if, for example, the consumer does the whole process online without its help."

> **"MANY DEALERSHIPS I HAVE SPOKEN TO TOLD ME THAT SINCE THEY INTRODUCED A FIXED APR MODEL THEY HAVE ACTUALLY DONE A LOT BETTER IN TERMS OF FINANCE DEALS**
>
> **JAMES TEW, IVENDI**

Another solution is to have a flat fee for every finance deal written with a lender, but that may reduce the revenue dealers make on their car finance. The unintended consequence of all this may be an increase in car prices.

"The elephant in the room, in respect of changes to DiC, is the impact on income," said Shaun Harris, sales director at Codeweavers. "It seems inevitable that there will be some knock-on impact on the price of cars, notably in the used market.

"For this reason, and to ensure an orderly change, I expect that a rapid domino effect will take place as lenders follow one another to reflect the regulator's desired position well ahead of any cut-off date."

THE RISK TO REVENUES

In some cases, dealers who previously relied on DiC will suffer a steep decline in profit. And the small margins made on the vehicle's sale, particularly in used cars, mean ancillary products are often the only area where they can make up the shortfall.

Hill said dealers needed to focus on ensuring any commission they earn from finance and insurance (F&I) sales is derived from a wider selection of products such as GAP insurance, service plans and warranties. This also benefits customers because they have a greater choice of products relevant to their needs, he said.

"Also, selling ancillary products such as insurance can drive more loyalty to other parts of the business, such as aftersales," he said. "This approach demands a wider vision in terms of F&I thinking, and of course can come with additional regulatory responsibilities, especially if the dealer is going to be undertaking general insurance activity." ALEX WRIGHT


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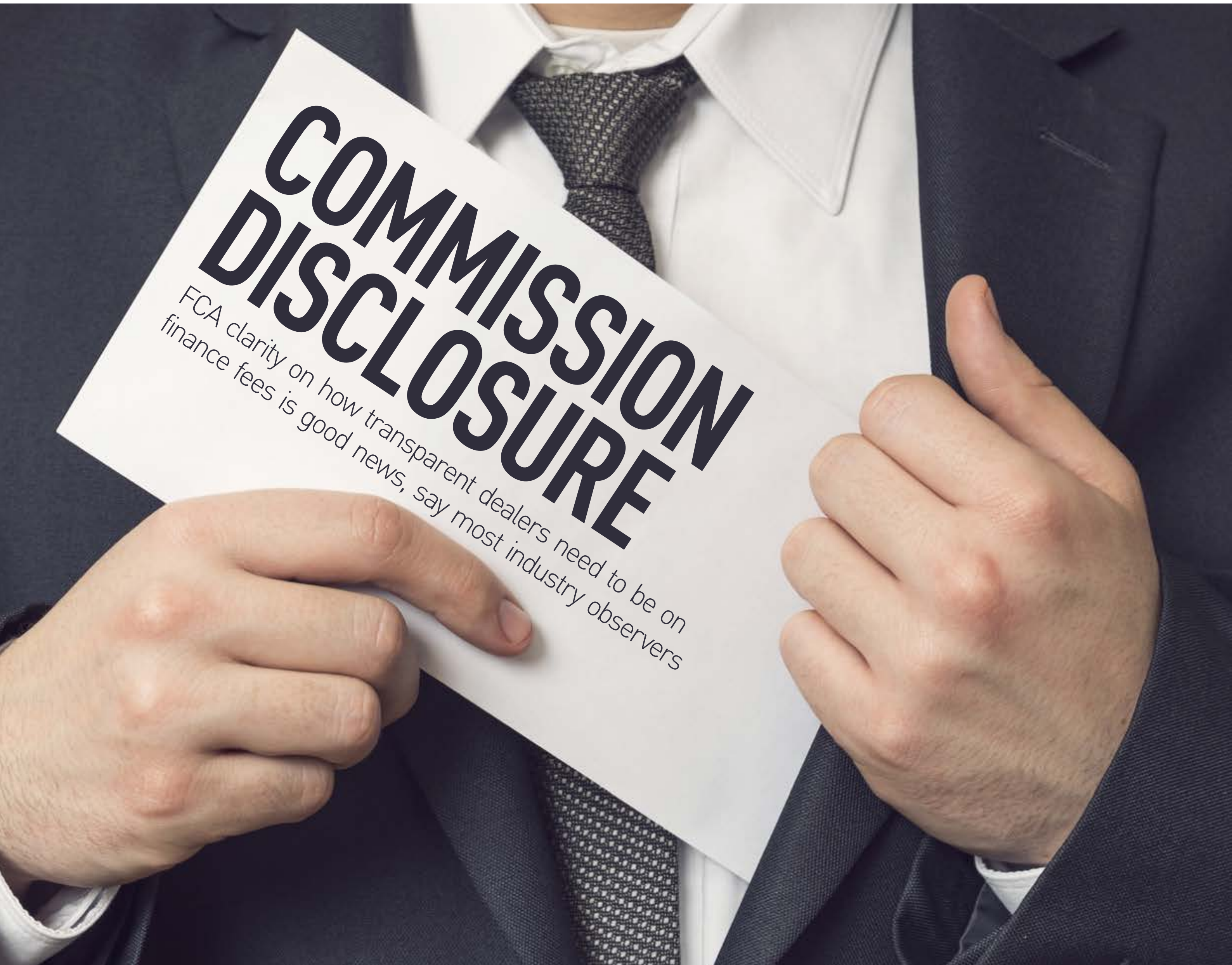

COMMISSION DISCLOSURE

FCA clarity on how transparent dealers need to be on finance fees is good news, say most industry observers

The Financial Conduct Authority's (FCA) review of motor finance has been critical of dealers, as credit brokers, for failing to follow the Consumer Credit sourcebook (CONC) handbook rules on disclosure of commission.

Published in 2014, as the FCA took responsibility for regulating consumer credit, CONC rule 4.5.3 states: "A credit broker must disclose to a customer in good time before a credit agreement or a consumer hire agreement is entered into, the existence 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 the knowledge of the existence or amount of the commission could actually or potentially affect the impartiality of the credit broker in recommending a particular product, or have a material impact on the customer's transactional decision."

CONC rule 4.5.4 continues to set the tone: "At the request of the customer, a credit broker must disclose to the customer, in good time before a regulated credit agreement or regulated consumer hire agreement is entered into, the amount (or if the precise amount is not known, the likely amount) of any commission or fee or other remuneration payable to the credit broker by the lender or owner or a third party."

Adrian Dally, head of motor finance at the FLA, said previous guidance on commission disclosure was "quite grey" and it wasn't specific to motor retail. A lot of the motor finance review is spelling out very specifically what the FCA now expects from dealers.

He said: "Members were doing this voluntarily before, but now this clarifies the FCA's views on how businesses should approach commission disclosure. It levels the playing field and having that certainty and clarity is a benefit for all."

Karl Werner, MotoNovo Finance deputy chief executive, said the FCA's conclusions have been clear. Dealers and other motor finance brokers fell short of the required regulatory standards.

The CONC rules on commission were not warmly welcomed by dealers when first published.

Where dealers do not disclose a commission they may called on by the regulator to defend their decision. This means they must record robust reasoning, and the processes of determining, why they believed a commission or fee would not influence the recommending of any product, nor affect the

customer's decision to sign.

Werner said: "Where any dealer's reluctance to share the availability of commission exists, the review makes it clear that this must end now."

Werner said the FCA has been clear on the kind of controls lenders need to have in place to ensure dealers and brokers are aware of all of their responsibilities.

This includes controls around pre-contract disclosure of the availability of commission.

However, Werner said it is also clear that implementation standards too often fall short – and this needs to change.

He said: "The road ahead outlined by the FCA will require greater oversight by lenders.

"We are committed to ensuring dealers are not just compliant with the FCA requirements, but brilliant at using finance clearly and fairly to create sales. There is nothing to fear from creating a better customer experience."

Werner said transparency for the industry is a no-brainer and compliance with the FCA's rules is simply a hygiene factor.

Dealers are already using finance online as a marketing tool.

Werner said that by building in commission disclosure into the finance process, there will be increased trust for customers choosing dealer finance.

He said: "I have no doubt that we will see a positive impact on consumer trust in dealer finance giving rise to greater confidence in the entire traditional dealer model.

"With this will come sustainability and longevity for the sector in the face of emerging broker models that feed on the back of dealers' efforts."

Ivendi chief executive James Tew also believes better solutions and processes must be put in place: "This is very much a clear shot across the bows for motor finance companies and their approach to operational oversight of introducers [brokers]. The ultimate sanction is probably that full disclosure of commission at the point of sale is made mandatory.

"It may already be too late to avoid this, but the industry could certainly attempt to pre-empt any FCA action."

Neil Smith, operations director at Imperial Cars, said customers understand dealers need to be remunerated for facilitating finance.

He does not see commission disclosure as a deterrent, but as a part of the normal sales process: "We'll do what needs to be done to the letter of what the FCA requires. We're certainly not going to fight it."

Tony Denton, the owner and managing director of Batchelors Motor Group (see our interview with him on page 30), said any dealer reluctance will be due to a lack of understanding of the rules.

"With all sectors, there are always bad apples and the net is closing on them," he said.

"Finance providers and the banks need to be accountable here. If they follow CONC, then car dealers, almost by default, will all become compliant."

Batchelors uses fixed-rate APRs, to help customers' comparisons. Denton said: "Customers expect us to receive remuneration for the work we do. Reputable lenders and dealers have nothing to fear.

"The alternative is for our trade to halt offering convenience and drive everyone to the banks and that would be a really bad outcome for everyone."

A finance and insurance director at a large franchised dealer group, who asked to remain anonymous, believes much of the industry has already moved to flat commission rates in an attempt to make sure sales executives are unbiased.

Yet isn't the FCA's concern aimed at dealership level? Manufacturers' finance houses continue to incentivise their franchised dealer networks to achieve high volumes of PCP renewals and repeat business, at the same time as making their offers attractive to prime customers through low APRs and deposit contributions.

The FCA hinted that these manufacturer-driven finance sales demands are a concern. Its research found PCP dominated discussions for new car sales, and in some cases the customer's clear desire to own the vehicle outright was ignored or not given sufficient weight in the process.

"Lower monthly costs associated with PCP were generally promoted as the most attractive feature for customers when compared with other HP products. However, it was not always clear that there was sufficient balance between the benefits and downsides of various finance options offered or available," said the FCA review.

While other dealers were confident commission disclosure would not affect the sales process, the anonymous dealer thinks it will become a barrier to getting a deal done with the customer.

"The number of questions we now have to ask during the sales process is phenomenal. You have to ask yourself if we're doing all this for the customer or reluctantly covering ourselves for a future scenario where we could get sued?"

COMPARING COMMISSIONS

Neither Smith nor the dealer group F&I boss envisage a scenario where customers are shopping around to see which dealer has the lowest commission.

Smith said the key thing for consumers is whether they are happy with the deal, the APR and the monthly payments.

He said: "Consumers are fully aware of interest rates at the dealership, and personal loans. They know what's reasonable and what isn't. If a dealership set an APR at 19%, they simply wouldn't sell any vehicles.

"Yes, finance is an additional revenue stream, but as long as it's not an abhorrent level of profit and it's not to the detriment to the consumer, I think that's OK."

The growth of websites such as Carwow suggests consumers want transparent pricing, and confidence that they are getting a great deal. Some industry observers question why this trend wouldn't apply to point-of-sale finance – consumers can already visit aggregator websites to compare offers on personal loans and insurance.

The F&I boss said he thinks consumers would be surprised by how little commission there is in a car deal, so added clarity could help increase trust. He thinks part of the process should also explain that if a finance deal is ended early, the dealer will lose a percentage of their finance commission.

He said: "Customers aren't going to go through the process of finding the right vehicle, building the deal and then do that across all other suitable vehicles to compare the level of commission at different dealerships or groups.

"They want to know they are happy with the overall deal and it's right for them. If it's a reasonable deal, the commission disclosure is just wallpaper, it's there in the background." TOM SEYMOUR

> **WHERE ANY DEALER'S RELUCTANCE TO SHARE THE AVAILABILITY OF COMMISSION EXISTS, THE REVIEW MAKES IT CLEAR THAT THIS MUST END NOW** KARL WERNER, MOTONOVO FINANCE

The FCA review is an opportunity for dealers

Motor retailers are increasingly vital to the sale of motor finance, says Barclays Partner Finance's Adam Mepham, and lenders will work with them to achieve better customer outcomes

Q Were the findings of the FCA's review of motor finance a surprise?

A The interim FCA Motor Report, published in March 2018, pointed to a focus from the regulator on commission structures. The final findings, unsurprisingly, have indeed called out commission arrangements, affordability assessments and disclosure of information, which gives the industry a clear steer on what lender standards are expected. We welcome the review and findings, as ultimately we are working together to provide better customer outcomes. From our perspective, anything which drives greater transparency and, therefore, consumer trust, is a good thing.

Q How has Barclays evolved the way it works with its dealer partners in recent years?

A We made a strategic decision three years ago that our focus would be on the AM250 dealer groups and the largest independents in the UK market. Our approach is to share a close working relationship, helping to create stronger ideas and innovative new strategies. If we are able to provide a relationship where the customer benefits and the dealer benefits, then that is success.

Q Commission disclosure and difference in charges (DiC) products were identified by the FCA as problem areas. What is Barclays doing, or has it already done, in these areas?

A In 2016, we identified that DiC models were no longer fit for the market and since then we have moved away and developed commission constructs that support good customer outcomes.

Additionally, it was clear to us that we needed to apply strong client oversight in the marketplace, so we created a dedicated team reviewing business practices and ensuring standards are met. We are able to take a step back, review with a Barclays lens and use our experience to identify potential improvements. Importantly, this area of our business seeks to work with dealers and support them in developing their systems, controls and approach to offering finance.

Q What's the key challenge to the sector?

A For me, the key challenge to our sector is the rise of non-traditional lenders from the fintech (financial technology) community. I believe that legislation such as the new EU Payments Services Directive, PSD2, rightly encourages other sectors to look to consumer lending as an opportunity. What I believe we will see are new entrants from some surprising areas. As a result, it is key that lenders are putting consumers at the heart of what they do and understanding what a consumer is looking to achieve. That way, we can develop products and services that will naturally be attractive and engaging to the end user. A good example of this is our Sign Anywhere product, which uses plain English to help customers understand their finance agreement, which they can then sign digitally on their mobile device. In particular, when we combine this with an end-to-end customer journey, it significantly supports what customers are looking to achieve in the buying journey.

Q Should dealers see the FCA's review as an opportunity?

A If we can continue to drive trust and transparency within the market, this can only be a good thing. So yes, I would encourage all dealers and lenders to see this as an opportunity. We should all be reviewing our products, services, systems and controls to make sure they are driving consumer experience forwards. In essence, this is an opportunity for us all to improve and that can only be a good thing for the consumer and our dealers.

Q Do you see the dealers' role in the sale of motor finance becoming more or less important in the medium term, and why?

A The expectations of the modern consumer are high. I believe this is largely down to us all spending so much time in the digital world, where we can expect quick answers, access information pretty much whenever we want and products are just a click away. I don't see that the human element in all of this has degraded, in fact I see that the human element has been elevated and is now more important than ever. With this in mind, it is critical that dealers have fantastic digital experiences for their customers, but, importantly, this needs to be matched and hopefully exceeded by the physical experiences dealers deliver. These physical experiences, such as the enquiry process, product demonstration and explanation, handover of vehicles and more, must be executed at the highest possible level of quality to exceed the expectations of customers. Yes, dealers are incredibly important to the sale of motor finance and I feel their importance will continue to grow.

Q How can finance companies work even more closely with their dealer partners in the future?

A A key call-out from the FCA review is that lenders need to take more control on dealer oversight. We need to apply a collaborative approach, guiding dealer partners by calling on expertise from our own business and the wider Barclays group, which will deliver real added value in areas such as conduct. What is key is how we support our partners here and now, but also focus on the long-term plan

COMPANY PROFILE

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BARCLAYS

A KEY CALL-OUT FROM THE FCA REVIEW IS THAT LENDERS NEED TO TAKE MORE CONTROL ON DEALER OVERSIGHT. WE NEED TO APPLY A COLLABORATIVE APPROACH

ADAM MEPHAM, MOTOR SALES DIRECTOR

for all of our partnerships and it is right that dealers look to lenders for support and guidance.

Q What tools and systems have you developed to support your dealer partners as consumers explore their car purchase options online?

A With the motor industry moving ever closer to a retail model, customers are expecting to be able to self-serve to some degree. We have to be at the forefront of this demand and an example of this is through our latest solution, Sign Anywhere, which gives customers complete control of the finance application journey and enables them to start, review and complete the agreement wherever and however they choose, using the device of their choice.

Q What helps to differentiate Barclays from your rivals?

A Of course, we have great technical ability and a strong brand; however the core strength for me are our area sales managers and regional sales directors. The passion, experience and love of the sector is incredible and constantly makes me feel proud to be part of the business we work for. I am not the only one who is impressed – our dealers tell us that each year when we measure the performance of our relationship through client surveys. We are also a business that wants to give back and stewardship is a core value across the whole of Barclays. We engage with our wider communities in many ways, for example by taking part in fundraising initiatives, offering skills development sessions in local schools and community initiatives. Importantly, we have seen how these activities translate into a great culture in our daily work.

FUNDING YOUR BUSINESS IN A MARKET DECLINE

Cost controls and transparent performance updates are essential to retain lenders' confidence

In an uncertain market, forecast to continue its decline from the 2016 peak of 2.7 million new car sales, business funding may become more challenging for motor retailers as banks become more cautious, but investment in stock, people and manufacturer standards remains high.

The International Monetary Fund warned this month that "the credit cycle is maturing" and challenged global financial institutions to "act now to head off the growing risk of a major downturn".

"Corporate debt and financial risk-taking have increased. The creditworthiness of borrowers has deteriorated… loans to highly indebted borrowers continue to be of particular concern," said Tobias Adrian, the IMF's financial counsellor and monetary and capital markets director.

David Kendrick, partner at UHY Hacker Young in Manchester, believes banks are taking a more pessimistic view of the automotive sector now.

"They are definitely nervous about the automotive space, whether that's linked with the demise of High Street retail or property or the potential onset of electric vehicles, I am not sure. Stronger businesses are getting supported, but there is selectiveness about new funding.

"The ways dealers are combating that is looking at all funding lines, whether that's utilising all their used car vehicle funding or leveraging the balance sheet to generate working capital. People are looking at their own businesses and being a bit more savvy utilising their capital."

Kendrick said his clients are very conscious of costs now: "Some businesses have had a good 10-year run of strong profits and when profits are strong, it's amazing how costs can creep and additional head count seep back into the business."

> "[BANKS] ARE DEFINITELY NERVOUS ABOUT THE AUTOMOTIVE SPACE... STRONGER BUSINESSES ARE GETTING SUPPORTED, BUT THERE IS SELECTIVENESS ABOUT NEW FUNDING
>
> DAVID KENDRICK, UHY HACKER YOUNG

He believes manufacturers have begun lowering the capital expenditure pressure on dealers, with a 'softening of manufacturer requirements', which frees up capital for investment elsewhere, such as in digital technology.

John O'Hanlon returned to motor retail in 2017 with his new venture, Waylands Automotive. Some 18 months after the sale of Ridgeway, the AM100 dealer group he ran with owner David Newman, O'Hanlon bought Wayland's first Volvo franchise, in Reading, from Jardine Motors. He has since acquired three more Volvo dealerships at Oxford, Swindon and Newbury, and relocated the Reading operation into a new £6m VRE-compliant site.

O'Hanlon said: "We work with both HSBC and Volvo Financial Services to fund the acquisitions. We fund capital expenditure from bank loans (for larger projects) and retained profits of the business.

"With a business that can demonstrate medium-term profitability and strong cash flow, a reasonable business case can be provided to funders that allow the investments to be made. It's important that the funders understand your business and not just the headlines.

"The new car market is down overall, but, as a Volvo dealer in the Thames Valley, we have a real opportunity to grow the business. By sharing our ambitions and our progress against these ambitions we demonstrate that we can be relied on and that they can have confidence in our business."

O'Hanlon believes by ensuring Wayland's key funders understand its short- and medium-term strategies and performance relative to the market, their confidence to invest in the business will continue.

Transparency, no surprises and regular updates on operational performance and achieving strategic goals means O'Hanlon maintains a trusted relationship with funders.

It includes sharing budgets and plans in detail before the start of the year and updates every month alongside quarterly meetings to discuss strategy – although more regularly if a transaction is ongoing.

O'Hanlon instils good business practice at his sites and insists that the basics are covered every day without compromise. Maintaining strong management controls over the company's working capital means all stocks are funded and debts are paid when due. Weekly meetings to a strict agenda drive rapid operations decisions from Wayland's management team.
DEBBIE KIRLEW

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IS CASH KING?

Dealer groups are increasingly looking to shed debt and review practices around working capital to brace against falling new car sales and an unpredictable political landscape

While automotive leaders cannot predict the UK's future relationship with Europe, they are clearly building up cash reserves to face the challenges ahead.

A recent report from UHY Hacker Young, the national accountancy firm, shows the top 100 dealerships in the UK have reduced their debts by 22% over the past 12 months, to £9.7bn, down from £12.5bn in the previous year.

Dealers understand that if confidence wobbles and the car markets sour, the danger will come from lack of cash flow, not short-term lack of profits.

UHY Hacker Young said the debt reduction has significantly improved the financial strength of the sector ahead of the expected Brexit-related slowdown in car sales.

Paul Daly, partner at UHY Hacker Young, said UK dealerships have been gradually de-risking since the 2016 EU referendum, in the knowledge that big-ticket purchases such as cars are the first to suffer when consumer confidence fails.

"MORE AVERAGE DEALERS THAT PERFORMED WELL IN GOOD TIMES... WILL STRUGGLE AS THE MARKET COMES UNDER PRESSURE"
STEVE LE BAS, BDO

The fall in sales of diesel cars following the Volkswagen dieselgate emissions-cheating scandal also prompted dealers to start reducing risk.

Daly said dealerships have managed to shed debt by reducing capital investment, off-loading property assets (through sale and leasebacks) and becoming more focused on cash generation. In some cases, non-core overseas assets have also been sold.

Daly said: "The cutting of debt among UK dealerships has put them in a much stronger position.

"To date, dealership results have fared well despite the fall in new car sales, owing to the strength of the used vehicle and aftersales markets. However, preparing to weather any post-Brexit storm through debt reduction seems a very sensible move by the sector."

Daly said the risk of a post-Brexit sales slump and the potential 10% tariffs on EU-manufactured vehicles is fairly severe, but added that lower gearing would certainly help to manage any challenges that occur.

There are risks involved with focusing too much on cash rather than profit, such as depressing return-on-sales (RoS) figures, particularly in an industry where average ROS is below 1%.

Daly said: "There's clearly a balance to be had, but I think if you look historically at the sector, they are highly geared businesses, so I don't think there's a risk of too many businesses going too far with focussing on building up cash."

Steve Le Bas, audit partner at BDO, said while it was good practice for dealer groups to build up cash reserves to absorb any shocks, there has been no specific push in this direction by the groups he is working with, which range from £100m-£1 billion in annual turnover.

Le Bas said dealers have told him Brexit is less of a concern to consumer confidence than a potential change in Government through a general election.

BDO has not recorded any significant movements in the market to sell off property or reduce headcounts either.

Le Bas said: "It's actually quite difficult to build cash, particularly if your stock is funded, it's not going to release much cash. You can sell excess property or close sites if you're in a position to do so.

"Dealers have had a good five or six years and I think where we'll see businesses caught out are those more average dealers that have performed well in good times, but will struggle as the market comes under pressure."

Le Bas said cash generation can start with cost control, although this will not result in massive change overnight.

He said: "Some dealers are looking at costs more closely than others and the need to build cash is a concern, but we're not seeing businesses in dire straits that have woefully unprepared."

Le Bas did say that dealers are looking to take their destiny into their own hands and there has been less of an appetite to invest in facilities or start multi-million-pound dealership developments.

While Daly said he doesn't think there will be large redundancies hitting the sector this year, he does think dealers need to review headcounts.

"Headcount is unfortunately one of the areas that does need looking at. It's not until you take a step back and look at how the headcount has expanded over the last years that it can become clear that things aren't in balance," he said.

"I think it's more likely that if people move on from a site, they may not get replaced, rather than lots of job cuts."

Daly said UHY Hacker Young has tracked an increase in sale and leaseback deals in the industry as a way for groups to generate some cash.

"There is an appetite from the pension fund market to invest in dealership property right now, particularly if it's a site that has been newly refurbished," he said.

"Dealers have always been of the mindset that they want to own their property, but I don't think it [sale and leaseback] should be discounted as an option, particularly with some of the returns available."

John Clark, John Clark Motor Group chairman, said the ability to free up cash in de-stocking vehicles is difficult due to many manufacturers pumping product into the market for Q1 and Q2 to absorb any Brexit fallout.

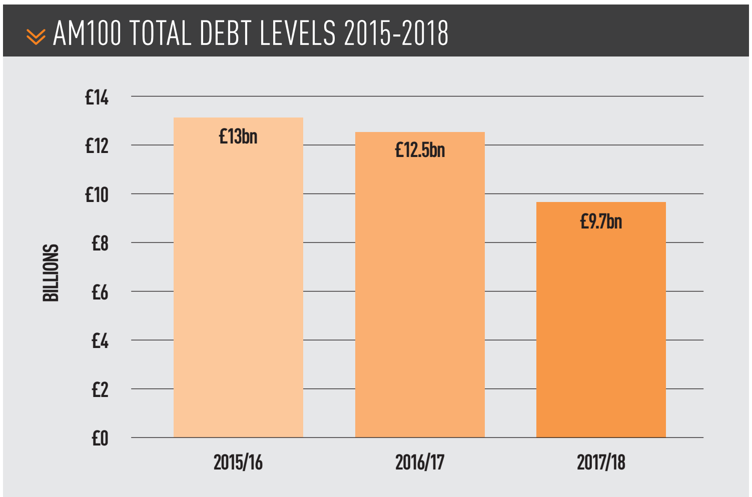
Clark agreed with Le Bas's view that

"A FAST AND THOROUGH EVHC... INSTANTLY INCREASES CUSTOMER SPEND"

KARL DAVIS, COACHWORKS CONSULTING

"I DON'T THINK IT [SALE AND LEASEBACK] SHOULD BE DISCOUNTED AS AN OPTION, PARTICULARLY WITH SOME OF THE RETURNS AVAILABLE"

PAUL DALY, UHY HACKER YOUNG



more dealers are sitting on their hands over dealership investment due to the political uncertainty, so that is safeguarding some level of cash.

Clark said reviewing headcount is difficult because "how can you do that if you're still busy with customers?"

He said dealers' fleet departments in particular could be hit due to the 8% downturn in the market in 2018.

Daly said a review on working capital may reveal many potential improvements: "'Back to basics' is a cliché, but we are still seeing big disparities between dealerships from the level of cash in their businesses and it all comes down to tight processes."

HOW SHOULD DEALERS BUILD RESERVES AND LIQUIDITY?

Clark said dealer groups have had an eye on building cash and controlling costs "for a long time" due to continued pressure on margins and profitability. He said Brexit has not changed that.

John Clark Group is reviewing all of its supplier contracts to make sure they provide the best value for money. It has cancelled several digital marketing contracts this year after realising it can tackle some areas more efficiently internally.

Karl Davis, the managing director of Coachworks Consulting, said while not every dealer will have the opportunity to significantly cut their debt, all can examine practices that may have slipped when the market was buoyant.

At an operational level, Davis said, dealers need to scrutinise processes and behaviours in both sales and aftersales because there are "easy wins" in boosting cash flow and liquidity.

"In car sales, for example, ensuring finance customers sign their paperwork at least 48 hours before taking delivery of their car can speed up the transfer of balance payments from the finance houses, which is particularly critical during peak trading periods such as month-ends and especially in plate-change months," he said.

Davis added that retailers can set a policy of taking bigger deposits for new cars and where lead times are long, such as with premium and luxury brands, this can easily amount to hundreds of thousands of pounds being held by a retailer over a period of time.

"Setting a policy of larger minimum acceptable deposits is best practice in any business, as it not only improves cash flow but also strengthens the customers' commitment to see the purchase through to delivery, with the anticipated profit being more likely to eventually land."

Davis said retailers should reconsider cash-consuming corporate deals where payment terms leave dealers waiting for a month after delivery of the car to the fleet customer until full payment is made.

In aftersales, actively promoting and selling service plans at handover can also provide a major boost, especially if the plan is self-administered and cost collected as a one off up-front payment.

Davis said: "One of our best-performing clients consistently does this and has built up a £1m fund of customer prepayments.

"And let's not forget the opportunity to generate revenue as each car enters the workshop, as undertaking a fast and thorough eVHC, then sharing best advice with the customer in a compelling and expert manner instantly increases customer spend."

A volume brand Coachworks Consulting has been working with has seen revenue increase by £15,000 per month per site in labour sales alone. Davis made it clear this was not overselling, but just effectively advising the customer. TOM SEYMOUR

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