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FCA Commission Changes Overview

28th January 2021

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New Commission Rules

The FCA's ban on 'discretionary commission models' and new rules take effect from the **28 January 2021.**

The FCA rules on commission models, and on how they should be disclosed to customers are set out in CONC 3 and CONC 4 in the FCA Handbook. The FCA have set out their expectations across two key areas:-

1. Banning pricing models linked to commission.
2. Clarifying commission disclosure rules on all Financial Promotions and Pre-Contract Information to increase transparency to customers.

To help you comply, it is important to understand the FCA's purpose with the rules, which is to :-

- prevent credit brokers/dealers (including retailers) from being incentivised to set higher interest rates in order to earn more commission;
- incentivise lenders and credit brokers/dealers (including retailers) to create and sell competitively priced loans;
- ensure that consumers receive appropriate and timely information on interest charges and commission, to allow consumers to better engage with car finance options; and
- see customers' financing costs reduce.

To fully comply with the rules Lender have made changes to its pricing and commission approach. As a result, you, as a dealer, will find that you will no longer be offered a price model that allows you any discretion to earn different commission rates based on the interest rate offered to the customer. This means that you will no longer be able to decide or negotiate the commission amount. The types of commission covered by the new rules should be interpreted broadly as it covers any commission, fee, or other remuneration payable under a financial arrangement and covers any fee or other financial consideration.

You must now operate within the commission models that your Lenders have set you. The effect of this is to prohibit discretionary commission models and it will be important that you operate within the models set by the Lenders. The new commission models will take effect from **28th January 2021**. Good customer outcomes are central to the new 'discretion removed' models.

By now, your Lenders should have shared with you its new pricing and commission structures and agreed with you new rates and terms in advance of the regulatory change date. The old models will have been removed, which means that Lenders will have a closing date of 27 January 2021 where it will have the ability to pay out on the old commission models. From 28 January 2021 onwards, Lenders will not be able to pay out on old deals and you will need to re-propose under the new commission model agreed.

Commission disclosure

The new commission disclosure rules apply to regulated credit agreement and regulated consumer hire agreements.

What is important to note is that the new disclosure rules contained in CONC 3.7.4 and 4.5 apply to you as the broker/dealer rather than to the Lenders, so it important that from the 28 January 2021 onwards you comply fully with these rules, not only in terms of operating within the Lenders new commission models but by also having in place sufficient disclosures statement on commissions in your own financial promotions and relevant customer pre-contract documentation.

Please ensure that you take such action ahead of the rules coming into force if you have not done so already.

The disclosure rules apply before the agreement is concluded and at two key stages:-

(i) Financial Promotions and all communications with your customers

It will be important for you to indicate to your customer in a prominent way, the existence and the nature of the commission arrangement(s) and as you may have different arrangements for different Lenders it will be important that you explain all of these prominently.

Where the amount of any commission, fee or other remuneration varies due to a factor specified in the arrangement (i.e. a specific feature of the credit product, level of work undertaken by the broker/retailer) the broker/retailer should make a disclosure in relation to the arrangement.

These disclosures should also be made if the firm's commission varies in respect of two or more products that the customer might be eligible for. These disclosures should describe the extent of your powers and whether you are working exclusively with one or more Lenders or are independent.

You should also disclose prominently the existence and nature of any financial arrangement with your Lenders. The good news is that these disclosures may be made in general terms which means you do not need to provide a full illustration.

(ii) Pre-contractual information.

The requirements here are that you should disclose to the customer, **prominently** and **in good time** before the customer decides whether to proceed with their agreement, the existence and nature of any commission (or other remuneration) arrangement with the Lender and how this may affect the amounts payable by the customer.

Where the amount of any commission, fee or other remuneration varies due to a factor specified in the arrangement (i.e. a specific feature of the credit product, level of work undertaken by the broker/retailer) the broker/retailer should make a disclosure in relation to the arrangement.

These disclosures should also be made if the firm's commission varies in respect of two or more products that the customer might be eligible for. This disclosure may also be in general terms, and there is not a requirement to provide the customer with an individually tailored illustration.

The following is an example of a disclosure statement for a non-recommended sale and where there is a selected panel of Lenders, but it must be tailored to you and the commission models that you operate as the actual content of the disclosure will depend on the circumstances of the arrangements between you and your Lender.

If you do make a recommendation of any finance product, you should take advice on this as there will be things that you should consider if you do and you will need to cover this off in your disclosure statement.

Other things that might vary is the disclosure requirement confirming the extent of your powers and whether you are independent or exclusive. For example, we have used the words '*limited number of Lenders*' but this might not be accurate.

Furthermore, we have based this disclosure statement as an example of a particular commission model that might be operating in the market, but you will need to explain the nature and existence of the models that you have with your lending panels as well as their impact in your final version. If you are a franchised dealer for example with an arrangement with a captive, you should change your statement '*We can introduce you*' to include the name of the captive Lender and your approach, that you will introduce them first to the captive Lender and if they are not prepared to make an offer of finance, that you will then seek to introduce them to other Lenders on your panel.

"We are a credit broker and not a lender. We can introduce you to a limited number of lenders and their finance products, which may have different interest rates and charges. We are not an independent financial advisor; we will provide details of products available from the lenders that we work with, but no advice or recommendation will be made. You must decide whether the finance product is right for you. We do not charge you a fee for our services. Whichever lender we introduce you to, we will typically receive commission from them (either a fixed fee or a fixed percentage of the amount you borrow). The lenders we work with could pay commission at different rates. However, the amount of commission that we receive from a lender does not have an effect on the amount that you pay to that lender under your credit agreement".

Lenders should have also made changes to its Pre-Contract Information sheet and to its Regulated Credit Agreements to reflect the new rules on commission disclosure setting out that that will pay commission to you, the nature of the commission and the impact that this commission may have on the customer. For example, some commission models may impact the amount that the customer borrows or may even vary if it is arrived at based on the customer's credit score.

An important point for you to note is that the statement may direct the customer to ask you, as the broker/dealer, to tell them in good time before the agreement is made further information about the nature of the commission, and if requested by the customer, the amount of the commission that you earn as the onus is on you to make an accurate disclosure statement to comply with the rules.

This is an important compliance requirement by you.

Other Important Obligations

It is not just the CONC rules in the FCA handbook that you must comply with. We have set out below some other important principles and rules within the FCA Handbook that also should be adhered to and taken into account, such as:

1. PRIN (Principles of Business)

Principle 1. A firm must conduct its business with integrity.

Principle 3. A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Principle 6. A firm must pay due regard to the interests of its customers and treat them fairly.

Principle 7. A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair, and not misleading.

Principle 9. A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.

2. SYSC

SYSC 4.1.1 R. A firm must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

SYSC 4.1.4 R. A firm must, taking into account the nature, scale, and complexity of the business of the firm, and the nature and range of its services:

- *establish, implement, and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the firm, and*
- *establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the firm.*

SYSC 6.1.1 R. A firm must establish, implement, and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives (or where applicable, tied agents) with its obligations under the regulatory system.

SYSC 9.1.1 R. A firm must arrange for orderly records to be kept of its business and internal organisation, including all services and transactions undertaken by it, which must be sufficient to enable the FCA to monitor the firm's compliance with the requirements under the regulatory system, and in particular to ascertain the firm has complied with all its obligations with respect to clients.

3. Other Key areas of CONC which specifically relate to your duties and conduct of business.

In particular, these are really important for you to implement when managing commission as it will be important in going forward that you evidence/document the reason why you have selected the Lender that you have for your customer especially, but not exclusively, where the finance product that is best for the customer carries a higher commission for example.

It is important that you take into account:-

CONC 2.5.8R. A credit broker (including a retailer) must not carry out a number of specified unfair business practices, including:

- (12A) not securing credit for a customer at a higher rate of interest than was requested, where the object of doing so is for, or can reasonably be concluded as having been for, the personal gain of the firm or of a person acting on its behalf, rather than in the best interests of the customer; and
- (13) not giving particular preference to the credit products of a particular lender where the object of doing so is for, or can reasonably be concluded as having been for, the personal gain of the firm or of a person acting on its behalf, rather than in the best interests of the customer.

The above CONC 2 provisions are important rules for you to manage effectively as it is always important that as a credit broker you ensure that you secure the best finance deal that is in the interest of the customer and not for your own personal gain. It is therefore important that when working with all of the commission models agreed across your lending panel, that your focus is on securing the best deal that is in the interests of the customer, especially if this pays you the most commission.

This guide has been produced with the help and advice of Auxillias. Auxillias specialise exclusively within the consumer, motor, asset finance and leasing sectors.

If you would like further advice or support around the FCA regulations for your dealership, you can contact:

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