Vehicle finance – FOS driving review forward, but is anyone behind the wheel.

In this article, David Allinson, Partner at RPC, has teamed up with Alex Barry, Claims Director at Collegiate Management Services Ltd, to consider a recent Financial Ombudsman Service decision concerning discretionary commission arrangements and vehicle finance loans. FOS has now published a small number of Final Decisions on this topic, which have been picked up by Martin Lewis (MoneySavingExpert.com) and the FCA, and could have wide-ranging consequences for a number of different professions and their insurers.

A recent FOS decision against Black Horse Finance (DRN-4188284) provides an interesting glimpse into how FOS is likely to treat complaints against both lenders and brokers concerning discretionary commission arrangements (**DCAs**). Under such an arrangement, the finance broker has a discretion to adjust the interest rate on a vehicle finance loan, which will in turn impact the level of commission they receive. The FCA banned DCAs in 2021 following a review of the market between 2017 and 2019. More recently, they have amended their complaints handling rules to extend the time a firm has to respond to such complaints and which a complainant has to refer a complaint to FOS. As of December 2023, around 10,000 complaints in respect of DCAs have been referred to FOS and we are now starting to see published final decisions.

The Black Horse Finance Decision – The Background

The complaint concerned a loan of £7,619.13 taken out to purchase a car in 2016. The flat interest rate on the loan was 5.5% – this was in line with the standard flat interest rate under the commission agreement between the broker and lender. However, under the terms of the DCA, the broker had discretion to reduce the flat rate to a 2.49% minimum. Had they done so however, they would not have received any discretionary commission (and would only receive a support payment of £152.38) and would in fact have to pay the lender a subsidy. The broker disclosed to the Complainant that '*Lenders may pay us a fee for these introductions'* but the mechanism for calculating commission (and the level of commission) was not disclosed.

It is also worth noting that the Complainant wanted to part exchange her existing vehicle, which was worth less than the amount required to settle her outstanding finance. The broker made four applications to other lenders for finance (to include a sum to cover the shortfall) but all of the lenders declined.

The FOS Decision

While the Lender argued that it had complied with all legal and regulatory obligations and that the Complainant received a reasonable and competitive rate of interest, FOS ultimately upheld the complaint on the basis that:

- the Lender's commission model created an inherent conflict of interest between the broker and complainant

- that in operating the DCA on the terms it did , the lender acted contrary to the guidance at CONC 4.5.2G, which provided that lenders should only enter into commission arrangements "*providing for differential commission rates or providing for payments based in the volume and profitability of business where such payments were justified by the extra work required*"
- in introducing the agreement, the Lender was in breach of the FCA's Principle 6, as it did not have due regard to the Complainant's interests or treat her fairly
- that a court would likely conclude that the relationship between the Lender and Complainant was unfair under s.140A of the Consumer Credit Act 1974.

FOS also concluded that the finance broker was in breach of CONC 4.5.3R in failing to inform the complainant of the existence of the structured financial arrangement. They also concluded that the failure to do so put the broker in breach of Principles 7 (communications with clients) and 8 (managing conflicts of interest).

FOS concluded that the Lender would have lent at a flat interest rate of 2.49% and that, had the commission model been disclosed, it was more likely than not that the complainant would have questioned the interest rate and would not have agreed to accept a rate greater than the minimum level. The Lender was therefore required to refund the difference between the payments made under the agreement at the flat interest rate of 5.5% and the payments she would have made had the flat interest rate been 2.49% (along with interest at 8% on the award).

Is the decision fair?

The circumstances of the loan here were not straightforward, with existing finance needing to be cleared and four other lenders having rejected the application. However, FOS concludes that, in practice, the Lender would have been happy to accept an interest rate far below the market average and that the broker would have completed the transaction for effectively no commission, other than the £152.38 support payment. This doesn't seem to match with the commercial reality – the Lender themselves submitted to FOS that they did not expect dealers to actually write business at the non-commission paying rate (hence the reason for the subsidy). Had the Lender (or broker) refused to apply the minimum interest rate, it seems fairly likely that the Complainant would have proceeded in any event given the difficulties she had had in arranging finance.

Regardless of how the commission model operated (and whether or not this was properly disclosed), the FOS accepted that the interest rate was competitive. Furthermore, the broker had tried to arrange loans with 4 prime lenders at 8.6% APR to no avail. Given the difficulties with the loan, the actual APR applied to the loan (of 10.5%) does seem reasonable and in line with what the Claimant would have paid, had she been able to obtain finance outside of a DCA. It hardly seems fair to hold the Lender responsible for the additional interest paid over the minimum interest rate when this seems to have been at least in line with what the Complainant could have obtained without the broker's assistance.

It seems that the key issue for FOS was whether or not the broker and / or Lender was required to disclose the nature of the commission arrangement or the amount of this. The Lender's position was that all regulatory requirements were met by the broker informing the Complainant that lenders 'may' pay them a fee. They also stressed that the FCA made amendments to its Guidance subsequent to the transaction, requiring further elaboration on what was to be disclosed, and that this would not have been necessary if there already was a requirement to elaborate. The FOS didn't agree, and concluded that the broker needed to disclose that it would receive commission in two ways, and that part of the commission would be tied to the interest rate set and that higher interest rates would lead to higher commission.

One positive perhaps is that the FOS found that the principles in *Wood v Commercial First Business Ltd & ors and Business Mortgage Finance 4 plc v Pengelly* [2021] EWCA Civ 471, whilst capable of applying to car finance, did no t apply in this case as the broker here was not under a duty to provide disinterested advice, information or recommendations. However, this may provide scant comfort in circumstances where FOS has determined redress is payable despite having accepted that the Complainant received an interest rate that was reasonably competitive.

What this could mean for lenders

As mentioned above, this decision could have a sizable impact on lenders (and their insurers). The practice of using DCAs was so widespread prior to 2021 that some experts suggest the redress bill could exceed £13 billion and Martin Lewis has told prime time viewers on ITV that this could be a bigger scandal than PPI, which cost the banking industry over £40bn.

The FCA has been quick to confirm that it is investigating the issue and has not ruled out a "British Steel"-style s.404 redress scheme, which could involve lenders having to compensate any clients who do not actively "opt out" of a review. In addition, the FCA may also use its power to 'stop the clock' for the purposes of assessing whether any such clients are out of time to bring their complaints, following on from having already extended the complaints handling timeframes for motor finance firms.

In addition, the fact that these decisions have been well publicised means that you only need to type "car finance miss-sale" into Google to be presented with pages of advertised links to claims management firms that are slavering in anticipation.

What about the broker/car dealership?

At present, all we have to go on are two decisions by the FOS that focus on the lender's obligations. Neither go into a large amount of detail on the finance broker's obligations.

Worryingly, the FOS decision does not substantially comment on whether they consider the broker to be an agent of the lender or an agent of the client. From a legal perspective, this clearly has ramifications in assessing who the broker is "working for". In the FCA's consultation paper on motor financing (at page 20) they described the situation as creating a "dual principal-agent problem", however the FOS decisions are notably absent of any legal assessment in this regard.

Of even more concern is the FOS's complete disregard for the effort the broker had clearly put in the Blackhorse matter. It would appear from the FOS decision that the dealer worked hard with a client who may not have had the best credit rating or situation in order to obtain them finance at a reasonable rate. This involved approaching multiple lenders and having to create a package deal in order to get some financing over the line. This does not sound akin to a banker "ticking a box" to sign a client up for Payment Protection Insurance, rather it sounds like someone who put considerable effort into obtaining finance at a reasonable rate. As Blackhorse argued, an ARP of 10.5% was at the lower end of the market (quoted at between 3.49-29.9%) and this is backed up by the FCA's own findings (at page 42) that the average APR charged in car finance transactions would be around 17%.

FOS appear to be detached from the commercial reality of arranging finance. Their decision in the Blackhorse matter appears to suggest that the broker should lend at the lowest possible 'variable' rate available to them, despite this essentially meaning that they do the work for free (discounting the £152.38 support payment, which w ould have been refundable if the broker did not meet their sales quota for the year). In the FCA's consultation on th e issue (at page 23) they did also recognise that it is reasonable for commissions for this type of finance to be higher than others, simply by virtue of the fact that the customer profile differs.

While we are in no doubt that some lenders will have allowed brokers to charge excessive commissions, this does not appear to have happened in this instance and the decision is disappointing for your average finance broker.

Looking further afield

The simple fact that a 64 page decision by the Financial Ombudsman Service does not appear to clarify which party the broker is an agent of should be worrying to all FCA regulated professions, especially in light of the FOS's ability to award up to £415,000 in compensation on newer cases. More specifically, the decision would appear concerning for any industry or profession which charges a commission for its service. Professions such as Estate Agents, mortgage brokers and insurance brokers all charge commissions and could possibly be more transparent with the way they disclose their remuneration structures.

The lending industry must now wait with bated breath to see if they will be subjected to an industry wide review or s.404 redress scheme. Even without these, the FCA states that it is using its investigatory powers under s.166 of FSMA and it looks like the Claims Management Firms already smell blood in the water.

Contacts

David Allinson
Partner
+44 7714 060017
David.Allinson@rpc.co.uk

Alex Barry
Claims Director
+44 7984 667322
Alex.Barry@collegiate.co.uk

rpc.co.uk
collegiate.co.uk