

Inside FCA Podcast: Interview with Nikhil Rathil on the review of the motor finance market

OI: Hello and welcome to the Inside FCA Podcast. I'm Ozge Ibrahim, and today I'll be talking to the FCA's Chief Executive, Nikhil Rathil, about the FCA's review of the motor finance market.

Back in 2021 the FCA banned discretionary commission arrangements, or DCAs. This removed the incentive for brokers to increase the interest rate that a customer pays for their motor finance. The FCA asked firms to review their practices and to address any consumer harm identified. There have been a high number of complaints from customers to motor finance firms, claiming compensation for commission arrangements prior to the ban.

So in January this year the FCA announced a review into whether motor finance customers have been overcharged due to the past use of DCAs. In this podcast I'll be asking Nikhil to explain the detail behind the latest announcement on this work and his expectation of firms at this time.

Hello, Nikhil, welcome to the podcast.

NR: Hello there, good morning.

OI: Can you explain the background to this work, and the FCA's role in reviewing motor finance complaints?

NR: In 2021, the FCA took the step of banning what we call discretionary commission arrangements when motor finance products are sold. Since we introduced that ban the number of complaints about these arrangements has gone up considerably and most firms have been rejecting these complaints and they've been referred to the Financial Ombudsmen Service. And we felt that as the number of complaints was growing so fast, as there's a significant cost to administering these complaints, that it was in the interests of consumers, and also orderliness in the market, for us put a pause in place to help us assess the scale of the issue and what the options may be to address the problem.

OI: And what has the FCA announced now and who does it affect?

NR: In January, we said that while we studied the market, and we've been doing a lot of work with firms to gather the data that will help us understand the scale of the issue, we said then that we would set out next steps by September this year. And what has happened since January is that it's taken a little more time than we had expected for firms to provide all the data we need to properly understand what's been going on in this market. There are also questions of law here. And one firm that was subject to a decision by the Financial Ombudsman Service has decided to launch a judicial review in the courts around that. We have applied to be party to that case and it's unlikely that case will be heard before the autumn and then we'll wait to see when the judgement comes out. There are also a couple of other related cases in the Court of Appeal.

So in light of all that what we have said is that we will now set out next steps by May next year, May 2025, when we will have the opportunity to have looked at all the data, understood what the courts have said as well, and one of the possibilities, although we haven't taken a final decision yet, is that we might put in place what we call a redress scheme, which is a scheme that applies across the market, or part of the market, and allows for a consistent way to manage redress for consumers. If we go down that route that has to be consulted upon and it takes time to put together. And so on a precautionary basis we have extended a pause in complaints all the way to December 2025, but obviously if we can go quicker, we absolutely will.

OI: Nikhil you've mentioned the FCAs involvement in legal cases. Can you talk about that and what that means.

NR: The FCA is party to a judicial review that one firm has launched in the courts, in relation to a decision taken by the Financial Ombudsman Service to uphold one of these complaints. Now, as part of the court process we have given our views to the court on various aspects of the Ombudsman Services' decision and their interpretation of our rules and the Consumer Credit Act. We haven't given a view on the Financial Ombudsman's assessment of redress. And what I'd say at this stage is that listeners should not automatically assume that we would adopt the same approach as the Ombudsman. The Financial Ombudsman looks at individual cases and the circumstances of each specific case. We play a broader role and when deciding what if any action to take, we have to consider our objectives and that includes the impact on the market now and in the future whilst also our objectives to protect consumers and ensure competition.

OI: So, thinking specifically about the review, what exactly are you looking at? And how will you decide whether to introduce an alternative way of compensating customers?

NR: So the question that has arisen is, when these discretionary commission arrangements were used prior to our ban, were they operating in a way which was consistent with the law and regulation that was in place at that time. And some of this is FCA regulation, some of this is law that's in statute. And we are assessing all of that data to understand if there were breaches of law and regulation, and if so, how widespread they were, and if there have been such breaches what the fair route to redress is for consumers.

And in thinking about that we have to understand the scale of the issue, we also have an objective to make sure the market functions well, both now and in the future, so we will also be thinking about how to ensure that any action we take also supports the continued supply of motor finance to millions of consumers who depend on this. Nearly 80% of households in the United Kingdom own a car, so it's really important that we make sure that market continues to function fairly and well in the future too.

OI: And how have firms been cooperating so far?

NR: We've generally found good cooperation from firms. Some firms have had systems that enable them to share with us the data we need relatively promptly. For others, it's taken a little more time. What we have said is that we do need firms to provide us the data in a reasonable timeframe so that we can analyse carefully. We also made it really clear to firms in a letter that we sent in April that if firms are worried that they might have to pay redress it's really important that they maintain their finances in a way that funds are available to pay that redress. So we have said we'd want to know if they're going to make any significant distributions of capital, for example, to their shareholders or in other ways, to make sure that that's not being done in a way which might take away the amounts of money that ought to be available for consumers through this work.

OI: And what does the FCA mean by consistent, efficient and orderly complaint handling?

NR: So one of the reasons we stepped in in January is we saw the numbers of complaints going up very fast and that had the potential to be disorderly. Because firms would be dealing with complaints, they were generally rejecting most of those complaints, a number were going to the Financial Ombudsman Service.

There is a significant administration cost in dealing with these complaints which might have actually taken away from the money that ought to be available for consumers.

We also saw some potential risk of inconsistent outcomes, so firms that were dealing with similar situations coming up with different solutions for the consumers that were affected. So when there's a potential market-wide issue, like the one we're dealing with today, we want to look at the data, and we've got powers if we need to use them to try to make sure that consumers in similar positions are treated consistently, and then we can put in place provisions to ensure this is done in an orderly timetable, with everybody being clear what's expected of them by when.

OI: You've mentioned consumers. How is it in their interest then to pause complaint handling?

NR: We looked at the growth in complaints coming through and it was clear that it was going to overwhelm the system potentially, in terms of the ability to process that number of complaints, and that there were some issues of legal uncertainty that could take quite a bit of time to resolve. And we didn't feel allowing everything to play out without some kind of intervention would have been in the interest of the market, in the interests of consumers, and we have to make sure we balance all of our objectives, the important objective to protect consumers, integrity of the market competition, and ensuring the market functions well in the future. And therefore we thought a pause while we assess the matter, while we heard from the courts on the issues that they are considering will enable us to think about a really constructive and clear way forward, which we will set out by May 2025.

OI: Nikhil, you've talked about the review, what have you found so far?

NR: This work has been underway now for a number of months and what we have found is that there are issues and there have been issues in this market. And what we're looking at is the scale and breadth of those issues. That's why I've said it's unlikely at the end of this that, you know, we're going to find nothing. One option is potentially for us to allow firms to continue to process complaints in the normal way, and that might be a route we choose for some situations. At the same time, what I'd say is it's more likely now, although we haven't taken any final decisions, it's more likely now than when we started this work that some kind of structured redress mechanism may be necessary.

Now, there are a number of legal tests that we need to demonstrate before we put in place such a scheme, and that is something that we are looking at, and the data work that we are undertaking will help us with, we will also have hopefully some more information about important points of law coming through the court cases I talked about earlier.

OI: And are you worried firms might fail?

NR: That's a really important point. And we have worked really hard to understand the financial position of different firms, particularly given that motor finance is not a product that is covered by the Financial Services Compensation Scheme, and that's why in April we wrote to firms to ask them to pay particular attention to their financial resilience. Under FCA rules, a regulated firm must always make sure it's got adequate financial resources to meet its obligations, to meet its liabilities. And any firm that may be thinking that it could have a redress liability coming up in the future needs to make sure that it maintains the appropriate level of funds to prepare for that liability, so we've asked firms to make sure they tell us if they're thinking of any significant distributions to their shareholders or any other way in which their funds may be dissipated.

OI: What does no FSCS cover mean?

NR: The Financial Services Compensation Scheme is a statutory scheme that provides protection for different types of financial services products, so, for example, for deposits in a bank in the event that a bank fails. But for most types of consumer credit, including motor finance, there is no Financial Services Compensation Scheme cover. So that means that if a firm that has a liability to pay compensation or redress to a consumer, if that firm fails and no longer has the funds available, then there won't be recourse to the Financial Services Compensation Scheme. It's for that reason that we've acted early, by writing to all firms in April, to ask them to make sure that they keep adequate financial resources available.

OI: And you've just mentioned the market impact. What would you say to investors?

NR: We've sought to be quite open in our communications with the firms, with the market, about why we've taken this action. We've encouraged firms as well to be clear about how they are cooperating with us. And when these situations arise it's important that we seek to get certainty at the earliest opportunity, and that is what we have been doing. And I have said that I don't expect the motor finance issue to be of the scale of redress exercises like PPI, which some people have compared it to in the past, nor would I say though that it's likely that we're going to find nothing.

And so investors will want to think about the different scenarios, and we're certainly working to make sure that we have a consistent outcome, efficient outcome, and that we're able to give some clarity as soon as we can using the legal powers available to us.

OI: And how will this work relate to the Consumer Duty?

NR: The Consumer Duty was a really important piece of regulation that we put in place last year to improve the standards of consumer protection in financial services, make sure that consumers are receiving good value for the product, and that the products are communicated clearly and sold honestly.

The review that we're doing of the motor finance market is looking at how these products were sold before our ban came into force on discretionary commissions in 2021. So we're looking specifically at whether the rules and the laws that were in place at the time have been complied with.

The Consumer Duty will be relevant though going forward in terms of how firms handle complaints. We always expect firms to communicate clearly and transparently and promptly with their customers, and that will be the expectation under the Consumer Duty for the future.

OI: Finally, what's your advice to any motor finance customers who might be listening to this?

NR: Well, firstly I'd say thank you to all consumers for their patience as we work through these issues. We know how important this work is to millions of people around the country. And while we have paused the requirement on firms to process complaints within eight weeks consumers can still complain, should you wish to do so, and we're looking into the arrangements that were in existence before 28th January 2021. So if you want to check whether you have such an arrangement applying to your agreement you can do so. We have more information available on our website. I'll give you the website address, it's fca.org.uk/carfinance, and there you'll be able to find out more information that might be specific to you.

And I'll end by saying we absolutely understand the uncertainty that this work has caused for consumers and the market, and we are working really hard to make sure we can resolve these issues and give a clear path forward as soon as we can.

OI: Thank you for your time today, Nikhil. You can find more about this work on the FCA website, including information for consumers at fca.org.uk/carfinance. I'm Ozge Ibrahim, join us again soon on the Inside FCA Podcast.

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