



Dealer Introductory Commissions Regulatory Risk Advisory Services

The Financial Sector Conduct Authority seeks to understand if commission arrangements in the motor finance industry may be leading to significant levels of consumer harm.

There is currently increasing pressure on the Motor Finance Industry as the Financial Sector Conduct Authority (FSCA) has requested motor dealers and financial institutions operating in the Vehicle Asset Finance (VAF) to complete a questionnaire about Dealer Introductory Commissions (DIC), which was due at the end of June 2022. Failure to provide the information by the deadline mentioned above would be an offence under section 267 of the Financial Sector Regulation Act.

The Request For Information (RFI) by the FSCA was to obtain detailed information about how the sector operates, being

information from the Banking Association of South Africa (BASA), the National Automobile Dealers' Association, the Independent Dealer Association, all the major banks and other credit providers who are operating in the VAF space.

The above information is considered critical to provide context and guidance to the FSCA regarding the regulation of DIC processes, to support and enhance customer wellbeing which may be considered necessary by the FSCA.

So why the focus by the FSCA on DIC processes?

The FSCA is aware of the global views in respect of DIC processes, following regulatory investigations undertaken in the British and Australian VAF markets.



The Global View in respect of United Kingdom and Australia is discussed below:

United Kingdom

The area of concern was the commission arrangements between credit providers and the brokers.

Brief Overview

- Some of the commission arrangements allowed brokers to determine the customer's interest rate, which very often resulted in higher commission paid to the broker. This behaviour could lead to consumers paying significantly more for their motor finance
- The Financial Conduct Authority (FCA) considered:
 - ◇ If these commission arrangements have led to higher finance costs for consumers; and
 - ◇ The effectiveness of the credit providers systems and controls by conducting a survey to assess the systems and risk controls of commission structures and broker incentives.
- The FCA concluded that:
 - ◇ Commission arrangements used by the motor finance industry in its discretion to set interest rates and resulting in large commissions due to the broker caused huge potential harm to the consumer;
 - ◇ Credit providers were not doing enough of its responsibility to limit risk to consumers based on the commission arrangements they used; and
 - ◇ Disclosures and or explanations given during the initial visit of the consumer were incomplete and sometimes potentially misleading.

Australia

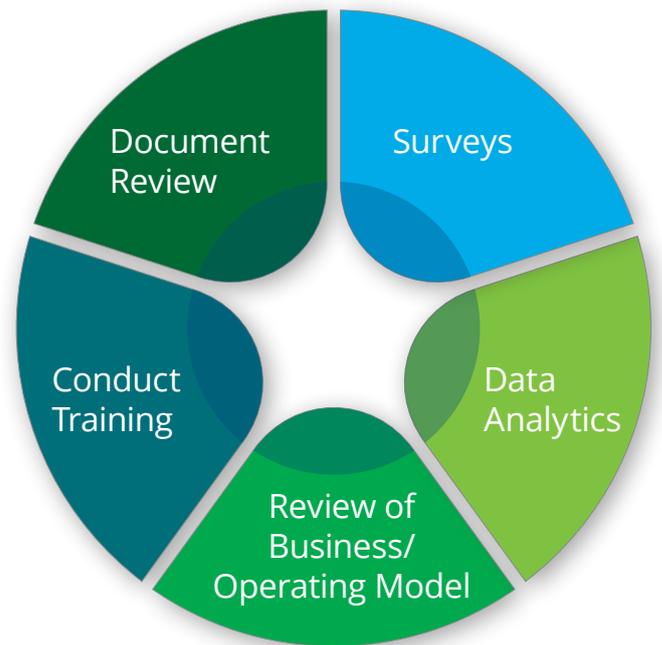
Area of concern was the flex commissions used mainly by dealerships.

Brief Overview

- The way in which flex commissions work is that a customer would approach the dealership for motor finance. The dealer would be incentivised by the credit provider by getting a commission for the deal. The higher the interest rate the dealer negotiated with the customer for the loan, the larger the commission they would receive from the service provider. Essentially, the dealership is given a wide discretion to set the interest rate, resulting in high commissions for the dealer. The practice was therefore unfair to the customer because the interest rate linked to a customer's loan, was not necessarily linked to their credit rating.
- The Australian Securities and Investments Commission (ASIC) concluded that:
 - ◇ They would ban the use of flex commission by car dealerships in Australia. Further the ASIC found that the use of these commission arrangements led to consumers paying excessive interest rates on their car loans and its conduct was unfair for customers.
 - ◇ Significant remediation was instituted to ensure clients who had received unfair outcomes were reimbursed. The remediation efforts were hugely damaging both from a reputation and financial perspective.
 - ◇ Remediation efforts included retrospective application and assessment of transactions going back for a significant period, assessment of transactions for contraventions, reporting of the identified transactions to the regulator, as well as determining the quantum of the contravention and the amount to be refunded. This included remediation payments, interest on current contracts and the need to rectify any negative credit bureau files.

The Strategic Approach

- Deloitte offers a key strategic approach, which can assist in a number of ways including review of your operating models and contractual arrangements in the context of fair customer outcomes.
- Operating models and contractual arrangements across the value chain must hold the customer at the centre of firm's business model. There are a number of interventions which can support this approach.



Impact on Business

Have you considered the impact on your business, in respect to Dealer Introductory Commissions?

- Does your current operating model support good outcomes for customers in the VAF space?
- Are your controls sufficient and fit for purpose?
- Do your remuneration practices (including incentivisation's) support good outcomes?
- Do your contractual arrangements ensure fair outcomes for customers and reflect the organisations operating model?
- Are clients receiving fair, clear and appropriate disclosure?
- Can your operating model withstand a potential change to commissions if necessary?

Why Deloitte?

Deloitte understands the global view in respect of DIC and the potential FSCA concerns. We understand the regulatory landscape and particularly have deep conduct risk skills and solutions to ensuring customers are at the centre of the organisation strategy and operating model.



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