FINANCIAL SERVICES
INDUSTRY GROUP

The Quantum Dilemma: Unravelling Commission Risks in Motor & Asset Finance

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Contents

Executive summary

The motor finance sector faces significant challenges in 2025 due to ongoing debates over undisclosed commissions and potential redress schemes. The UK Supreme Court is set to rule on whether motor dealers owe a fiduciary duty to customers, which could lead to substantial compensation claims for consumers affected by discretionary commission arrangements. The Financial Conduct Authority is considering an industry-wide redress scheme if the Supreme Court upholds the Court of Appeal's decision, potentially impacting lenders' financial stability and the availability of motor finance options.

The motor and asset finance sectors face significant operational challenges due to litigation and redress threats, leading to increased operational expenditures and cautious lending practices. Lenders might be relying on more expensive funding options, impacting profitability when alternative cheaper and more flexible funding solutions like securitisations should be explored. Ongoing regulatory scrutiny and potential FCA reviews continue to pose operational and financial risks for lenders and brokers. Management teams may face job insecurity, further complicating sector stability.

Finance providers must assess the adequacy of disclosure in sales processes, particularly following the Court of Appeal's emphasis on full disclosure of commissions. The Supreme Court's upcoming decision will clarify the implications of partial disclosure, potentially influencing the FCA's redress approach. Firms should review historical agreements to identify non-compliance risks and prepare for potential liabilities based on the Supreme Court's ruling and any subsequent FCA actions.

- **Efficient Remediation:** Motor finance lenders should be prepared to efficiently and effectively navigate the remediation process.
- **Enhancing Profitability:** Explore cheaper funding options and other solutions to increase profitability.
- **Support at A&M:** At A&M, we are here to help support your various business challenges.

Introduction

Historical commission payments will continue to be the main topic of concern in 2025 for boardrooms of lenders and brokers in the motor finance and asset finance sector, as well as for the regulators. In this article, we look at the current state of play and dive deeper into different approaches to the question of quantifying consumer redress and finding alternative solutions.

Background

The issue of motor finance commissions first rose to prominence in March 2019 when the Financial Conduct Authority (FCA) published the final findings of its review of the motor finance sector.

The study found particular concerns with the use of commission models that link a broker's commission to the interest rate paid by a customer — known as a discretionary commission arrangement (DCA)— as well as with the completeness, timeliness and transparency of commission payments.[1] These findings led to a material increase in consumer complaints about historical motor finance arrangements as well as proceedings being issued in the Competition Appeal Tribunal (CAT) *(Doug Taylor Class Representative Ltd -v- MotoNovo Finance Ltd and Others, now stayed until 31 July 2025)*.

In October last year, the Court of Appeal (COA) materially widened the scope of potential issues with a judgement in three motor finance cases *(Johnson, Wrench and Hopcraft)*. The COA found that brokers owed their customers a fiduciary duty (given the consumer's reliance on brokers to secure an appropriate financing arrangement) and disinterested duty (to provide information and advice on a disinterested basis). This finding was based on the application of common law, equitable principles and the Consumer Credit Act 1974 rather than the FCA rules.[2]

In the run-up to Christmas 2024, three announcements from the judiciary and regulator set the scene for this year:

1. The Supreme Court confirmed it would hear an appeal against the Court of Appeal's judgment, with a judgement awaited as early as late spring;
2. The Administrative Court dismissed an appeal[3] against a claimant-friendly monetary award in a Financial Ombudsman Service (FOS) complaint; and
3. The FCA extended the timeline for firms' responses to complaints regarding non-DCA commission payments to December 2025, in line with the deadline set for complaints concerning DCA commission payments.

In January 2025, His Majesty's Treasury filed an application to intervene in the case, arguing that an unfavourable ruling against lenders could have far-reaching consequences for financial stability. This application for intervention was denied in February 2025. The FCA is also set to consult on an industry-wide redress scheme if the Supreme Court concludes that motor customers have lost out due to the DCA issue.

1 FCA – Our work on motor finance – final findings

2 FCA responds to High Court motor finance judicial review decision, published 17 December 2024

3 Clydesdale Financial Services Ltd, R (on the application of) v Financial Ombudsman Service Ltd [2024] EWHC 3237 (Admin)

Quantum Issues

As the sector awaits the early April 2025 Supreme Court decision and any potential subsequent regulatory action from the FCA, existing FOS decisions and court judgements point to a variety of factors that might be relevant to the determination of liability:

Consumer Duty – the COA's finding on Consumer Duty will be clarified by the Supreme Court. Due to its far-reaching implications, any decision on Consumer Duty would have to be balanced against the proportionality of its consequences on economic disruption and its impact on availability of such arrangements to consumers in the future (in terms of additional cost or restricted access).

Commission model – it is highly likely that DCA commissions will lead to some form of redress, with liability for other forms of commission depending on the Supreme Court's findings.

Sales process – given the concerns already voiced by the FCA around disclosure of commission payments, and wider issues around "secret" commission payments since Wood v Commercial First, consideration of the prominence and appropriateness of information provided to customers on conclusion of their motor finance arrangement will likely be important to determining liability.

The FOS and court decisions highlight some of the complexities involved in the determinations of damages. The FOS considered, in one of the cases, whether the claimant is entitled to a refund of all the payments (i.e. both capital and interest) paid under the financing arrangements as pleaded by the claimant. It found that this would constitute over-compensation as the claimant required or at least considered it appropriate to undertake a financing arrangement and benefitted from such an arrangement.

The FOS found that a fair compensation would relate to the additional interest that the consumers paid on such arrangements compared to what they would have otherwise paid if the motor finance firms had acted fairly and reasonably, and/or properly disclosed the DCAs. The FOS determines the fair interest rate to be the lowest rate at which the claimant "could have" borrowed —i.e., the minimum rate at which a finance provider (such as a bank or a non-bank lender) was willing to lend.

The FOS acknowledges that average interest rates charged to consumers were higher than the minimum rate and that it would not be feasible to lend to everyone at the lowest acceptable interest rate. However, the FOS bases its decision on the interest rate available to the individual claimant in the case before it.

Such an application of the minimum interest rate to all eligible motor finance cases would be unsustainable as it would imply that: (i) every consumer could have obtained financing at the lowest available rate regardless of their personal financial circumstances and loan terms, and (ii) the brokers would have acted as financial intermediaries to these transactions without deriving any financial benefit (i.e., commissions) from the DCAs.

As the FCA considers a redress scheme and/or more such cases are brought before courts, the FOS decision on redress will likely be the subject of debate. It is therefore worth considering alternative methods of determining the redress.

The minimum interest rate that a finance provider would have accepted provides a useful lower bound for the interest rate charged to a borrower, but it may need to be supplemented with additional factors/charges, including:

- The credit risk of the borrower if the finance provider generally employed a premium for such risk in the interest rates charged.
- Any variations in the premiums charged based on factors such as the loan maturity, loan-to-value ratio, insurance costs, inflation rate, etc.
- The commissions that would have been paid to brokers, on average, under a suitable and fair compensation arrangement.

Industry Impact

Litigation and redress threats have significantly impacted lenders and brokers in the motor and asset finance sectors, requiring operational adaptations. Following the COA ruling in late October 2024, many lenders and brokers temporarily paused lending. By early November 2024, most had updated their technology, policies, procedures and lending documents to resume operations. The speed of the industry's overall recovery was notable, considering the unexpected nature of the COA's decision.

Against this challenging backdrop, non-performing loans on lenders' balance sheets have broadly increased. Some lenders have been extremely cautious with collections for fear of receiving FOS complaints. Management teams have been more cautious in their collection processes, potentially leaving borrowers more exposed to accumulating interest, penalties and further debt.

Potential FCA Section 166 reviews, required operational improvements and increased reliance on third-party consultants and legal counsel has created an operational expenditure (OpEx) burden for affected businesses. This increased OpEx will ultimately continue to negatively impact brokers' and lenders' bottom lines across the motor and asset lending sector.

Given the current challenges, management teams in these sectors may face reductions in compensation, or even job insecurity, potentially leading to employee turnover and the abandonment of legacy liabilities. Retaining experienced management may require increased staff expenses at a time when costs are being highly scrutinised. The presence of deep-pocketed private equity firms raises the risk of management team lift-outs. Depending on the size and diversity of the business, reduced compensation could also impact other lending lines within the organisation.

Funding Market

Within the lending community for both asset and motor finance, there are two primary business models: banks and non-bank lenders. Banks, with access to deposits, have more control over when to resume lending. Non-bank lenders typically rely on institutional funding sources such as securitisation solutions and private equity, making it theoretically more challenging for them to restart lending.

Despite the challenging backdrop and economic uncertainty, the securitisation funding market has selectively remained open for asset and motor lenders, with new deals being originated. Securitisation funders are more cautious about lending to thinly capitalised lenders, due to concerns about potential bankruptcy. However, funding channels remain open for businesses with a strong equity base and where representations and warranties on loan buybacks are reliable.

Many lenders in this sector are funding via more expensive corporate loans or block discount facilities, which can be meaningfully more expensive than a securitisation debt structure. Given the larger OpEx burden and potential liabilities, the potential extra margins from a cheaper cost of debt for firms who can access securitisation funding, should be carefully considered.

The Future of Lending

How might the current situation reshape the competitive landscape between banks and non-bank lenders?

Could this lead to new entrants in the market with innovative funding models?

Next Steps

While the Supreme Court judgement will have material implications for the final outcome, a number of steps should be taken now:

01 Review historical commission arrangements and sales processes for potential liability.

02 Review available data, identify and remedy gaps, and prepare data sets amenable to efficient processing of complaints and potential redress payments.

03 Estimate potential liabilities based on different potential outcomes.

04 Assess your options and understand the range of potential solutions to address estimated liabilities.

Commission arrangements and sales processes

Finance providers will need to evaluate the appropriateness of disclosure based on the details of a sales process. For example, the COA judgement highlights that in two of the cases it considered the information provided to customers provided for "partial disclosure" only. It remains to be seen if the Supreme Court may have a different view on "partial disclosure" or if the FCA will apply different remedies or redress based on the extent of the disclosure provided.

At the very least however, affected firms need to distinguish between cases of DCA and non-DCA arrangements and the extent of disclosure provided — whether full, partial or no disclosure — in each of those cases. Consideration of the appropriateness of disclosure might be complicated by cases where different types of commission were paid for a single transaction, such as a DCA commission together with a flat fee commission.

Finance providers may want to undertake a comprehensive review of their historical loan agreements to identify potential areas of non-compliance, including the legal/contractual documents available, commission structures and interest rates charged.

Available data

The COA proceedings highlighted the evidentiary issues which arise when dealing with several historical transactions. In one of the cases, the finance provider had been unable to locate the agreement it had at the time with the dealer and therefore there was no direct evidence on the rates which might have been available.

If this proves to be a persistent problem within the industry or at a particular provider, it may invite further scrutiny of lending practices and may lead to the imposition of higher adverse redress charges, fines for inadequate data management practices, and/or remediation actions.

It is important that the finance providers make every effort to identify the relevant data for all the complaints received as well as potential future eligible cases, which may be partly dependent on the outcome of the Supreme Court review. This will include a forensic examination of historical data tapes and tracing commission payment patterns and interest rates charged.

Estimate liabilities

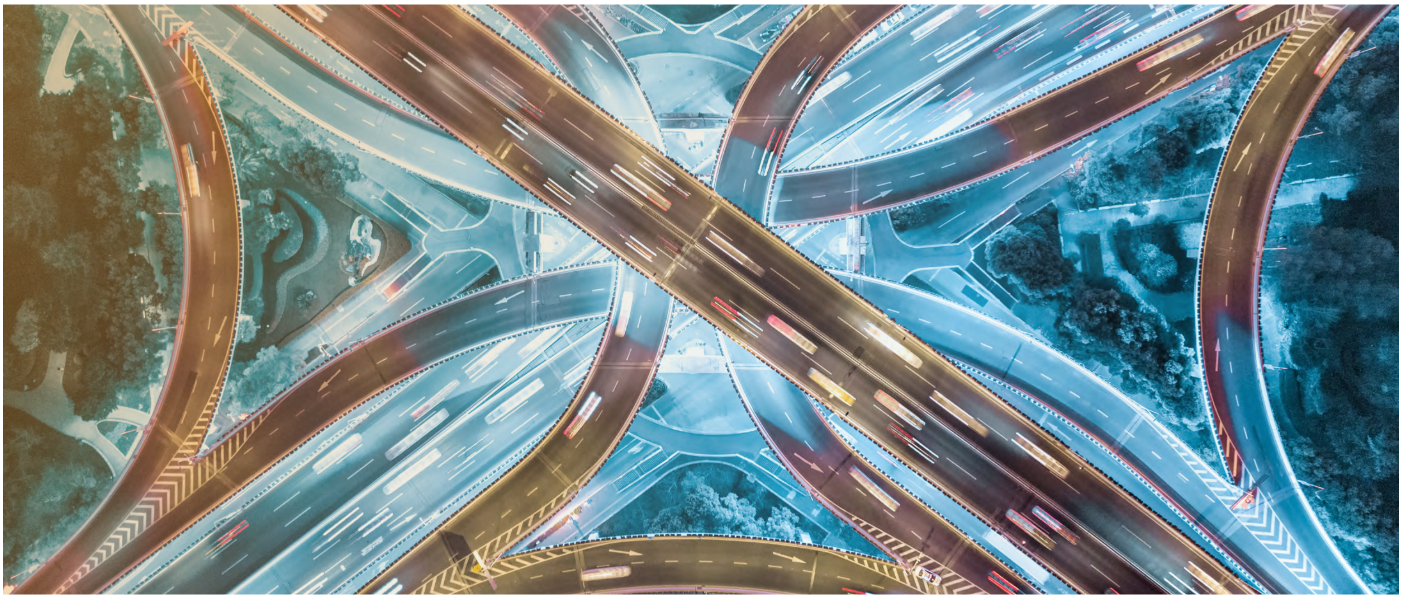
Liabilities will likely include multiple scenarios depending on the Supreme Court decision and the FCA redress scheme. A conservative estimate of the liability would be based on the scope defined by the COA decision, which extends to non-DCA arrangements and covers cases of partial disclosure. Similarly, a conservative estimate of the redress amounts would be based on the lowest interest rate that a lender was willing to accept at the relevant time. With an uncertain look back period the estimation of liabilities can be challenging.

Assessing your options

Upon estimating the likely redress liabilities, it is important for corporates to assess their options ahead of the Supreme Court and FCA findings and provide time to assess and implement any necessary remedial actions in an orderly manner.

In the coming months we expect the industry to be under pressure from external stakeholders (investors, auditors, lenders etc.) to both quantify and plan for the legacy claims, and as such being prepared will be key.

For certain market participants there may be insufficient liquidity within their business to fund the likely claims or redress scheme in full. In these circumstances, exploring restructuring options early is likely to be advantageous.



Looking Ahead

As the industry awaits the Supreme Court's decision, it's clear that the motor and asset finance sector is at a crossroads. The outcome will not only affect current practices but could fundamentally reshape the industry's future. Companies that proactively address these challenges may find themselves better positioned to navigate the changing landscape and potentially discover new opportunities amidst the disruption.

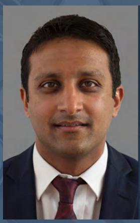
Key questions for industry leaders to consider:

- How can we balance consumer protection with sustainable business models?
- What innovations might arise from this period of uncertainty?
- How can we rebuild trust with consumers while maintaining profitability?

By addressing these questions head-on, the motor and asset finance industry may emerge stronger and more resilient, ready to face the challenges of an ever-evolving financial landscape.

To navigate these complex challenges, companies like FIS® and A&M can provide valuable assistance in reviewing operating models and technology perspectives. Expertise like this can help organisations reach pragmatic, future-proof resolutions, helping ensure that businesses are well-equipped to adapt to the changing regulatory environment and market dynamics.

Key Contacts



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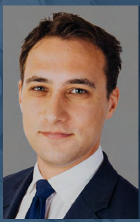

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