Impact of credit broking remuneration models at the point of sale

Thematic Review
TR18/2

September 2018

Impact of credit broking remuneration models at the point of sale

Background

The market

£213bn
consumer credit lending outstanding in June 2018[1]

75%
of UK adults hold a regulated credit or loan product (FCA Financial Lives Survey)

Over 30,000
firms authorised to carry out credit broking

1.1 Credit brokers are firms that introduce potential borrowers to firms willing to provide finance. By number of firms, they are the largest population of firms that the FCA regulates. Our 2017/18 Business Plan set out our intention to focus on inter-firm remuneration in consumer credit, for example payments such as commission between lenders and brokers. We were concerned that inter-firm remuneration could result in consumer harm, for example if brokers were selling products to earn higher commission rather than prioritising customers' needs.

Our approach

1.2 We considered whether inter-firm commission affects how consumers are sold credit and whether commission arrangements are resulting in consumer harm.

1.3 There were 3 main elements to this work:

1,208 interviews with consumers who had recently applied for credit to buy a product

Data on commission arrangements gathered from **349** firms

Interviews with **32** credit broking firms

1.4 Our thematic review covered a wide variety of credit brokers offering loans or finance provided by a third party. It did not consider lenders selling their own products directly to consumers, or motor finance firms as this market is subject to a separate FCA review.

1 Bank of England Statistics – Money and Credit, June 2018

Findings

1.5 We did not find evidence that inter-firm commissions are generally resulting in significant harm to consumers.[2] We did identify a small number of issues in individual firms and are addressing these with each firm.

1.6 Credit brokers in our survey did not appear to be seeking to exploit customers by offering them poor or inappropriate products because of the commission they could earn. This does not mean harm may not be occurring for reasons unrelated to inter-firm commission. For example, a minority of consumers indicated they felt pressured during the sales process; were unhappy with their decision to buy on credit; or uncomfortable the credit product they purchased was right for them. Below we set out more detail on our findings for different types of brokers.

Our findings – finance brokers

1.7 The main business of most of the credit broking firms that we regulate is not credit broking. They may be retailers for example, who sell their goods on finance. Credit broking is usually a way to provide customers with another payment option to sell more of their main product, rather than an opportunity to generate additional income in itself.[2]

1.8 We found that most finance brokers in our survey did not receive commission on credit products. For interest-free products, a subsidy was typically paid to the lender. In our sample roughly the same proportion of firms subsidised all their products as those who received commission.

> A retailer had reviewed their customer base, and considered the suitability of the credit products they offered. Following this review, the retailer had engaged with their lender to trial some different credit products that had features that might be more suitable for the circumstances and requirements of their particular customer base.
>
> We consider this to be good practice.

1.9 We did not find finance brokers actively looking to negotiate higher commission rates with lenders, or to switch to lenders that provide higher commission, which might have led them to offer poorer value finance products.

1.10 The majority of finance brokers in our survey only used one lender. Where finance brokers earned commission and offered more than one finance product, their most frequently sold product was usually not the one that earned the highest commission. Where brokers offered both interest-bearing and interest-free products, the majority of loans sold were usually interest-free. Some firms we spoke to were actively looking to move to finance products offering better value to their customers (eg lower interest rates) but also with lower, or no, commission.

> A retailer had identified that their customer base might include vulnerable customers, and had an extensive vulnerable customer policy, which included checking whether customers could be vulnerable throughout and beyond the point of sale including:
>
> - at initial contact
> - with the customer in the home
> - as part of the 'welcome call' once a customer has bought a product
> - quality control checks post sale
>
> We consider this to be good practice.

2 This review did not consider motor finance firms, that are subject to a separate review

1.11 Most brokers did not sell a high proportion of their products on credit. Where firms received commission this typically accounted for less than 10% of the firm's overall profit or loss.

The consumer experience

1.12 We carried out consumer research with people who had recently bought a product on credit, or had been declined for credit to buy a product. We compared their responses based on whether the broker received commission. Overall our research supported our view that commission is not a significant driver of widespread poor practice. Note however that the sample of consumers surveyed does not fully represent the overall population and cannot entirely be extrapolated across the market.

1.13 Our research suggested that most consumers saw their experience of buying products on credit through a finance broker as positive, regardless of whether commission was paid or not.

Most customers were happy with the sales experience

82% felt the salesperson dealt with them professionally

88% did not feel at all pressured during the sale

87% were satisfied the salesperson took their needs into account

Most customers were happy with their credit product

87% were happy they bought on credit

89% were confident the credit product was right for them

82% of accepted customers would apply for the same product if going through the sales process again

1.14 Over a third (37%) of customers were offered a discount if they purchased that day, rather than later. This rose to 46% when a salesperson visited the customer's home. Customers that had been offered a discount were more than twice as likely to say they felt pressured to make the purchase and that they were not confident that the credit product was right for them.

1.15 Our rules state that firms should not inappropriately offer an incentive or inducement to enter, immediately or quickly, into a credit agreement.[3]

1.16 Customers that were visited by a salesperson in their home were usually positive about the experience, but this channel had significantly more people feeling pressured during the sales process. This group were more likely to be unhappy with their decision to buy on credit or uncomfortable that the product they purchased was right for them.

1.17 In our guidance (FG18/2) on staff incentives, remuneration and performance management in consumer credit, we highlight that the way firms incentivise their staff to sell retail goods may cause risks for the way that finance is sold.

3 Consumer Credit Sourcebook: CONC 2.5.8R(9)

1.18 The majority of customers in our research were satisfied both with their sales experience, and with their finance product. However, by specifically targeting respondents who expressed the most dissatisfaction across the 1,208 participants, we identified some who felt they had been mis-sold to and had suffered harm as a result. While these are not representative of a typical customer journey they do illustrate the risks present in this market.

Case study 1

A customer was sold patio doors in her home. She could have paid cash, but took a loan because she had been reassured that the loan was interest free and could be paid off after the sixth payment without incurring interest. When she called the bank after 6 months she found out interest had been charged throughout, costing an extra £800.

So I've ended up accruing £800 in interest for something that I never, ever would have agreed to, if it had not been mis-sold.

Case study 2

A salesperson spent over two hours with a customer in their home selling blinds, and offered a discount if the customer took finance.

She arrived on a Sunday and the difficulty I had somewhat with it was the fact that she was there for a such a long period of time – it was brow beating.

She told me that the credit agreement would save me money and of course that's completely untrue... I don't think their sales technique is ethical. I spent thousands more than I intended.

She didn't look at us as an individual, she didn't look at our income.

Case study 3

A customer received a cold call regarding new central heating, and received a home visit from a salesperson the next day.

He didn't really explain what the system did or how it operated... He also said how it would save me money and save my boiler. I'm not sure if it has saved me any money yet.

When he came out I wasn't going to buy anything at all – but he was overly friendly and very persuasive. Once he knew what you could afford it all centred around that.

After seeing it in black and white that it's nearly £4,000 in interest, I'd rather not have had it.

Case study 4

A customer took out a store card for a £30 purchase because she was offered a discount and didn't feel she could say no to the salesperson.

The only reason I took the card was because I felt pressured.

It just sits in my purse gathering dust. It isn't going to make me shop there more. It's just another piece of plastic in my purse.

1.19 We have taken action against a number of consumer credit firms in the past for inappropriate sales practices. Where we become aware that a firm – whether a credit broker or a lender – is engaging in practices that are likely to result in significant consumer harm we will take appropriate action. For example, where we suspect serious misconduct we will refer to our Enforcement Division for an enforcement investigation.

Our findings – loan brokers

1.20 Some business models include broking unsecured loans, credit cards or other credit products as a key focus of the business. These include online loan brokers, price comparison websites and commercial finance brokers.

1.21 Credit broking is usually an important source of income for these businesses. However, the likely suitability of the products to the customer's requirements appears to be the main factor influencing the information presented to them. The level of commission generally appears to play little, or no, part.

1.22 Many brokers in our survey only offer products where they have a commercial relationship with the lender. We did not see evidence that this is likely to restrict customer choice so that they will be presented with significantly worse products than they could obtain elsewhere. These brokers allow many customers to obtain better value finance products than they would by approaching a number of lenders directly.

An online credit broker had invested in technological innovations in order to help present customers with products that were best suited to their circumstances and requirements. The firm presented information on a customer's likelihood of being accepted by a lender, and was working with lenders to provide customers with information on the actual product and terms which that individual customer would be offered. For example, where a customer may be offered a lower credit amount or a higher APR than the quoted representative example.

We consider this to be good practice.

1.23 For consumer finance, some brokers earn commission for leads referred to a lender, while some only receive commission when a loan is paid out to a customer. In contrast, in the commercial finance market (borrowing for business purposes), commission earned by brokers may be dependent on the interest rate charged to the customer – for example, using what is known as an 'increasing difference in charges' model. This means the more interest the customer is charged, the more commission the broker will earn. This model is being considered as part of the motor finance review.

An online credit broker prioritised the amount of commission they received from lenders when determining which product to present to a customer. It is a breach of our rules[4] to give preference to the products of one lender because they pay more commission rather than being in the best interests of the customer.

Next steps

1.24 We will continue to monitor credit broking activity as part of our ongoing supervisory strategy and address harm in individual firms where we see it. We will publish the findings of our motor finance project later this year.

4 Consumer Credit Sourcebook: CONC 2.5.8R(13)

Pub ref: 005788

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk