Best Practice

THIRD PARTY FINANCE PROVIDERS GUIDANCE ON OVERSIGHT FOR RETAIL INTERMEDIARIES

Third Party Finance Providers

Guidance on oversight for retail intermediaries

Issue

The Financial Conduct Authority (FCA) issued a Dear CEO letter for Third Party Finance Providers (TPFP) on 9 April 2021. The Dear CEO letter emerged from a review the regulator undertook to better understand TPFP credit products being sold, how they are distributed, and the oversight lenders have over intermediaries.

While it should be noted that intermediaries remain responsible for their own regulated activities for which they are separately authorised by the FCA, the Dear CEO letter outlines **stronger expectations on lenders to oversee brokers and other intermediaries.**

Increasing diversity in the way lenders distribute their products or rely on third parties for the provision of services, leads to further questions about how regulatory risk in third party relationships should be managed.

Monitoring and oversight of these third-party relationships is a key requirement for any lender to ensure it proactively identifies and minimises risks, and demonstrates effective controls are in place. Effective oversight also has commercial benefits from the appropriate management of risk and the engendering of trust with partners and customers.

The introduction of the FCA's Senior Managers and Certification Regime places further emphasis on the conduct and culture of firms, further increasing the need for robust and effective oversight.

A summary of the FCA's expectations for intermediary oversight is summarised at **Section 1**.

Who does the Dear CEO letter apply to?

If a firm provides retail credit to finance the purchase of goods or services through intermediaries such as a directly authorised credit broker (including a Master Broker (MB)), Appointed Representative (AR), or self-employed sales agent, the findings of the review, along with the actions to take, will apply to your firm.

What do firms have to do?

The Dear CEO letter noted that firms are expected to consider the content of the letter carefully and:

- review the controls you currently have in place; and,
- to share the contents of this letter with your intermediaries.

Purpose of guidance

This **non-binding guidance** therefore outlines (**Section 1**):

- The existing legal and regulatory requirements lenders and intermediaries must meet under the FCA Handbook; and,
- The stronger expectation on lenders to oversee brokers and other intermediaries described in the Dear CEO letter.

It is intended to assist members in handling the issues described above and outlines actions lenders may wish to take when appointing intermediaries and defining contractual arrangements at **Section 2**.

This guidance is not intended to prescribe behaviour that firms **must** follow, but rather provide a framework by which firms may include additional elements of oversight where necessary.

It should be noted that intermediaries remain responsible for their own regulated activities for which they are separately authorised by the FCA. This document therefore describes oversight processes lenders may put in place to satisfy lender obligations under CONC 1.2.2R.

Section 1: Regulatory requirements

FCA Handbook

The FCA Handbook places several obligations on lenders and intermediaries. The most important of these are summarised below.

PRIN

Principle 1: A firm must conduct its business with integrity;

Principle 2: A firm must conduct business with due skill, care and diligence.

Principle 3: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems;

Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly.

Principle 7: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

Principle 11: A firm must deal with its regulators in an open and cooperative way, and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice.

SYSC

SYSC 4.1.1R: A firm must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

SYSC 5.1.1R: Firms must employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.

CONC

CONC 1.2.2R: A firm must ensure its employees and agents comply with CONC; and take reasonable steps to ensure that other persons acting on its behalf comply with CONC.

CONC 2.3.4R: A firm must take reasonable steps to satisfy itself that any credit brokers it deals with are properly authorised or appointed representatives.

CONC 2.5.8R: A credit broker must not carry out a number of specified unfair business practices, including (12A) not securing credit for a customer at a higher rate of interest than was requested, where the object of doing so is for, or can reasonably be concluded as having been for, the personal gain of the firm or of a person acting on its behalf, rather than in the best interests of the customer; and (13) not giving particular preference to the credit products of a particular lender where the object of doing so is for, or can reasonably be concluded as having been for, the personal gain of the firm or of a person acting on its behalf, rather than in the best interests of the customer.

CONC 3.7.3R: A firm must, in a financial promotion or a document which is intended for individuals which relates to its credit broking, indicate the extent of its powers and in particular whether it works exclusively with one or more lenders or works independently. The FCA has clarified that this obligation to declare prominently the existence of a commission arrangement applies irrespective of the method of commission employed.

CONC 4.5.2G: A lender should only offer to, or enter into with, a firm a commission agreement providing for differential commission rates or providing for payments based on the volume and profitability of business where such payments are justified based on the extra work of the firm involved in that business.

CONC 4.5.3R: A credit broker must disclose to a customer in good time before a credit agreement is entered into, the existence and nature of any commission or fee or other remuneration payable to the credit broker by the lender or owner or a third party in relation to a credit agreement, where knowledge of the existence or amount of the commission could actually or potentially (1) affect the impartiality of the credit broker in recommending a particular product; or (2) if known to the customer, have a material impact on the customer's transactional decision.

CONC 4.5.4R: At the request of the customer, a credit broker must disclose to the customer, in good time before a regulated credit agreement or a regulated consumer hire agreement is entered into, the amount (or if the precise amount is not known, the likely amount) of any commission or fee or other remuneration payable to the credit broker by the lender or owner or a third party.

FCA Vulnerability Guidance (FG21/1)

The FCA's Vulnerability Guidance is issued under PRIN. It sets out the FCA's views of what firms should do to comply with the Principles, and to ensure the fair treatment of vulnerable consumers.

The FCA supervise and enforce against the standards set by the Principles, as well as their rules, taking into account relevant guidance.

Consumer Credit Act

The FCA notes that firms must understand their obligations to the consumer when receiving a claim under Section 75 of the CCA.

It is also worth recalling that intermediaries can be deemed to be 'acting on behalf' of the lender for the purposes of the unfair relationships provisions at section 140A of the Consumer Credit Act (CCA).

Dear CEO letter findings and actions

Oversight and accountability

- In respect of CONC 1.2.2R, the FCA found that in many cases, that lenders had not demonstrated adequate levels of oversight, often having only a limited understanding of their intermediaries' business models.
- The FCA also found that some lenders did not understand how competent or effective their intermediaries' oversight functions and control frameworks were in relation to relevant sales. There was ambiguity in the responsibilities of each party in overseeing the relevant aspects of the sales process. Lenders were not sighted on some of the risks associated with sales activities being undertaken by their intermediaries. Firms need to ensure their oversight is sufficient to satisfy the threshold conditions in relation to business model and suitability.

Competency of staff

- The FCA found that some lenders, after having provided initial intermediary training, did not undertake sufficient follow-up to check that intermediaries, acting as their agents or on their behalf, were meeting the standards set out in CONC. Lenders should be asking for and assessing the results of any compliance monitoring undertaken by intermediaries.
- Lenders should review the quality, consistency and frequency of training delivered across intermediary distribution channels of their credit products.

Affordability

- The FCA is concerned that concerned that lenders may not be undertaking an adequate assessment of individual income and nondiscretionary expenditure, especially in respect of categorising their customers as having 'obvious' affordability. Where lenders are relying on the exception by categorising their customers as having 'obvious' affordability, they must be able to justify this as being appropriate.
- Where affordability is not obvious, a firm must undertake an adequate assessment of individual income and non-discretionary expenditure.

Fees

- In respect of regulated Buy-Now Pay-Later (BNPL) products, the FCA found that some lenders charged early settlement fees if a customer settled the loan during the promotional period. Some customers may not understand the impact of these fees when purchasing the product. This runs the risk that the communications are not clear, fair and not misleading.
- Where lenders are charging multiple fees for a missed payment (eg, a missed payment fee and unpaid direct debit fee) this could lead to a risk of unfair treatment of customers where multiple fees are incurred for a single event. This could result in excessive charges even if the individual fee amounts appear reasonable.
- Firms need to monitor customers' repayment records and take appropriate action where there are signs of actual or possible repayment difficulties.

Section 75 claims

- The FCA found firms had a 'poor understanding of their obligations to the consumer' when receiving a claim under Section 75 of the CCA in respect of misrepresentation of breach of contract by the supplier of goods and services
- Lenders need to take adequate responsibility or interest in claims initially made to them and not simply pass them to the supplier or retailer. This could result in consumer claims not being adequately dealt with where the lender is jointly and severally liable with the supplier for faulty goods or services.

Complaints

- The regulator notes that lenders can be unsighted on poor credit sales practices by intermediaries who have poor quality complaints identification. Lenders should thus focus on their intermediaries' complaints management controls.

Vulnerability

- Firms are reminded to take the FCA's final vulnerability guidance (FG21/1; February 2021) into account not only when assessing the suitability of the customer's needs for the goods and services being provided, but also during the finance aspect of the sale.

Exempt products

- The FCA identified significant growth in lenders selling products that are exempt from FCA regulation. The FCA's emphasis on regulating hitherto unregulated parts of the Buy-Now Pay-Later (BNPL) will likely mean that many more products come under the FCA's regulatory scope.

Section 2: Suggested actions for firms:

Overview

In developing a comprehensive broker oversight control framework, the following features are relevant:

- **Onboarding**: Initial questionnaire, policy/procedure checks and additional checks for higher risk brokers.
- **In life monitoring**: including MI, internal reporting and periodic first line reviews.
- **Second & third line assurance reviews**, broker feedback, annual review, continuation or termination.

Oversight would include reference to:

- Contractual provisions
- Operational controls
- Portfolio information
- Customer feedback

Proportionality: Where broker firms present a higher risk, for example, due to their business models or because they introduce higher volumes of business to the lender, additional checks will be required. By adopting a risk-based approach, firms can apply a degree of proportionality to their broker oversight checks – with greater resource being focused where the risk is higher.

Identifying suitable intermediaries

Considering the principles and rules set out above, members may wish to consider the following 'due diligence' guidance when identifying and bringing on board suitable intermediary firms.

Product Range and Distribution

- Consider the product range and the appropriate means of distribution for each product. Will the lender's product range reach the target audience by working with a particular intermediary firm?
- Decide whether to approach firms which have national or regional coverage, and what size of firm(s) provide the right 'fit' for the lender and the products it offers.

Initial checks recommended for the onboarding process

- Depending on level of risk, firms may wish to conduct proportionate background checks on one or more of the following features of the intermediary firm:
    - registration on the FCA's Financial Service Register to confirm that they have the relevant permissions in respect of the regulated activity they

    - are undertaking and whether any disciplinary action has been taken (see below);
    - company registration with Companies House, including filed accounts and other Companies House information such as the People with Significant Control ('beneficial owners') register;
    - credit status to ascertain, for example, whether there are any county court judgments or risk of insolvency;
    - criminal record checks on key directors, and
    - Data Protection Registration with the Information Commissioner's Office.
- Undertake due diligence in respect of the intermediary's level of compliance. Again, the level and extent of this will be a matter for each individual lender and what is proportionate may vary depending on a number of factors – for example, the profile of customers likely to be introduced, and the nature of the intermediary. The Dear CEO Letter emphasised the need for firms to fully understand how competent and effective their intermediaries' oversight and control frameworks are in relation to the sales to be undertaken.
- Checks such as those suggested below may be appropriate either as part of the onboarding process and as part of the ongoing monitoring process.
    - Ascertain the nature and extent of the intermediary's **compliance function**. Who at the intermediary firm is responsible for compliance on a day-to-day basis? Is a compliance framework in place?
    - Seek information about the initial and ongoing **training and competence** arrangements of the staff of the intermediary. Agree a process to ensure the quality, consistency and frequency of training delivered across the intermediary distribution channels for the credit products is regularly reviewed. Oversight must be appropriate to the risks inherent within those channels. Initial training and ongoing training are needed.
    - Seek information about **complaints levels** and category types. Confirm which staff at the intermediary firm are responsible for handling complaints? Confirm how the intermediary is checking whether a complaint is finance related and how that information will be shared with the firm.
    - Seek information about whether the intermediary has written policies and procedures in place. These might cover, for example, a compliance policy, financial promotions, data protection, anti-money laundering and complaints handling. How often are these updated?
    - Carry out a high-level review of the intermediary's website to check whether there are any obvious and serious breaches of the financial promotions rules (for example, does the firm suggest or state that credit is available, regardless of the customer's financial circumstances or credit status?)

Permissions required

CONC 2.3.4R requires a firm to take 'reasonable' steps (as appropriate to the level of risk posed) to satisfy itself that any credit intermediaries it deals with are properly authorised or are appointed representatives. 'Reasonable' in this context implies verification both at the on-boarding stage and periodically thereafter to ensure that the permissions have remained in place.

A reasonable way of doing this is to check the intermediary's status on the FCA Financial Services Register, and the FCA's Directory (when available) of individuals within the SMCR.[1]

The FCA provides checklists and a set of 'common misconceptions' on how it authorises consumer credit lenders and brokers, which may be useful for both lenders and their intermediaries in this process.

Lenders should ensure that any dealers or brokers operating on their behalf hold the correct permissions and limitations in relation to the activities being carried out on their behalf.

In addition to satisfying itself that the intermediary has the right permissions in place for the *activities* it carries out, the lender should also satisfy itself that the intermediary has the right *level* of permission, namely:

- Full permission: credit broking where introducing customers to lenders or brokers is a main business activity.

- Limited permission: credit broking where the sale of goods or non-financial services is the main business, and broking is a secondary activity designed to help finance the purchase of those goods or services (such as a vehicle), and credit broking in relation to consumer hire or hire purchase agreements.

- Appointed representative: where a separate 'principal' firm is accountable for the range of activities appointed representatives carry out.

- Introducer appointed representative: an appointed representative whose scope of appointment is limited to effecting introductions to the firm or other members of the firm's group; and distributing non-real time financial promotions which relate to products or services available from or through the firm or other members of the firm's group.

Confirm Lender Expectations

- Explain how the lender handles its intermediary operations e.g. via panel management groups, business relationship managers, etc.
- Outline how often the intermediary firm can expect to be monitored, what management information it will be required to submit, and frequency.
- Explain the behaviours / standards expected from intermediary firms and the performance measures that will be applied to assess whether these are being met.

[1] The FCA have committed to making improvements to the Register, improving search functionality and providing clearer information, including by making it easier to identify whether the FCA has taken action against a firm.

- Indicate what performance measures could lead to disciplinary action and what form such action might take.

Appointing intermediary firms to the panel

- There should be a written contract between the lender and all intermediary firms appointed to its panel, which should usually include the following items:

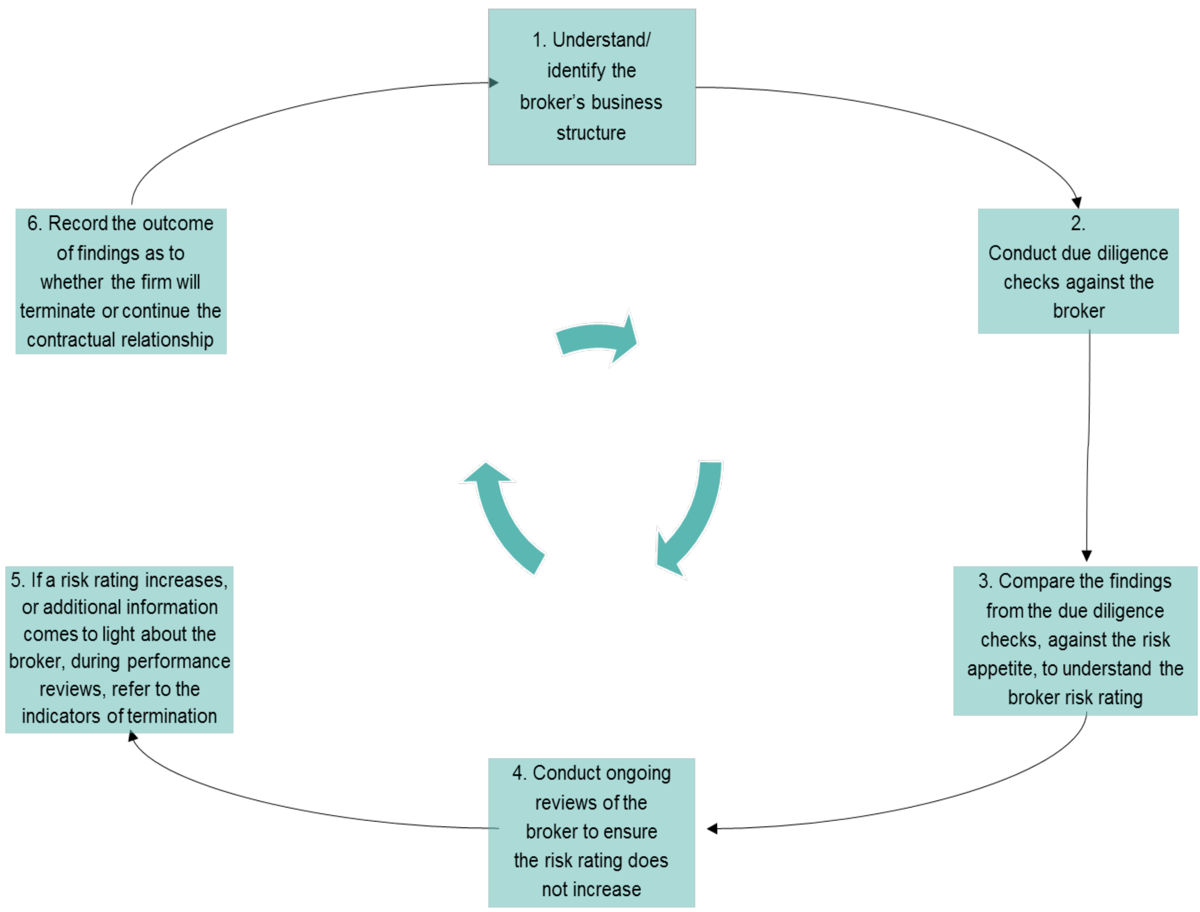
    - the expected levels of service, including the lender's expectation that the intermediary will comply with all relevant laws and regulations. It should also describe the scope of the intermediary's activities;
    - control provisions e.g. oversight rights for the lender to check intermediary compliance;
    - commission arrangements and when payments will be made should be detailed (see also below on Intermediary Remuneration);
    - a provision that, where the customer has been introduced to the intermediary by another introducer, the intermediary will be required to ensure that the introducer has the relevant regulatory permissions required for the activity undertaken (where applicable);
    - where fees are charged to the customer by the intermediary (irrespective of whether commission is also received), a provision that these must not be excessive and reflect the cost of the work undertaken;
    - process for submitting and approving credit applications – including requirements for intermediaries to use up-to-date paperwork provided by the finance company;
    - process for refunds if product is cancelled or terminated by customer;
    - agreed complaints handling process;
    - anti-money laundering process, and
    - data protection and GDPR privacy notice process.

Performance management and oversight

Once a lender has identified and brought on board an intermediary, CONC 1.2.2R requires that the lender then take 'reasonable' steps to ensure that the intermediary complies with CONC **when it is acting on the lender's behalf**. The lender's obligations under SYSC mean that it must do this by taking 'reasonable' care to establish and maintain such systems and controls as are appropriate. What is 'reasonable' in these circumstances will vary, depending on, for example, the nature, scale and complexity of the lender's or intermediary's business models and the degree of risk associated with these. This may require the lender obtaining sufficient data and other information from the intermediary, as well as drawing on its own internally produced MI, to enable it to identify, measure, manage and control risks to consumers in a timely way.

At all times the lender should ensure that it has effective governance and oversight over these systems and controls, enabling emerging risks to be identified and mitigated and policies reviewed and, if necessary, amended at an appropriate level of seniority, up to and including Board level.

There are many ways in which this can be done effectively, and the purpose of this guidance isn't to recommend any one particular way. The diagram below[2] illustrates how FCA requirements essentially mean that good intermediary oversight involves a self-reinforcing 'virtuous circle' of processes.



A desk-based assessment of risk posed by each intermediary could be carried out, for example by:

- Collating a dashboard with key risk indicators
- Considering as many possible relevant sources of information about each intermediary, such as average and spread of APRs for agreements sold, average length of agreements sold, customer satisfaction and retention rates, loan performance and arrears / default rates, net promotor scores, the number and uphold rate of complaints to FOS, intelligence from Section 75 disputes,

[2] This is a model developed by FLA Associate Member, Addleshaw Goddard.

press and social media coverage, and information about enforcement action by e.g. Trading Standards, Advertising Standards Authority or FCA.

- Ranking by order of risk / outcome, for example through a scoring or 'RAG' (red / amber / green) status approach.
- Reviewing the assessment of each intermediary to consider what (if any) further action is appropriate. Such action might include, for example:
    - visit to the broker firm;
    - requirement for further training and reporting;
    - sector review;
    - mystery shopping;
    - FCA notification[3];
    - restriction of future business;
    - removal from the lender's panel.

For some lenders, an overly complex dashboard may be disproportionate. They might therefore choose a different framework to ensure they are collecting appropriate KPI data. This could take the form of an agreed feedback process, documented by a formalised flow of information and action taken.

Lenders will need consider what form of KPIs/Portfolio information would most effectively support their broker oversight.

Assure

Visits to the broker firm could be undertaken as appropriate and proportionate, in line with a risk-based approach. However, a visit may not be needed where firms have collated sufficient information on which to make an oversight assessment or where the broker only has an online presence.

If a lender decides to include visits as part of its oversight function, the frequency would be based on their assessment of relevant risks posed by each intermediary. Information could be collected via a prescribed return completed by the intermediary and sent to the lender or via on-site field visits. One advantage of a prescribed return could be that the intermediary is able to complete a standard attestation for each lender on its panel. Where the intermediary operates over a number of retail outlets, compliance oversight discussions may be held via Head Office, alongside a selection of visits to the outlets if required. Where the broker operates primarily online, firms may also monitor their websites.

Other information should be already held by the lender. Once collated, this information should be actively reviewed, for example using a dashboard approach as described above, with each intermediary's performance benchmarked against the panel as a whole, and judged against policies set by the lender's governing body which describe the intended outcomes and standards sought. Some lenders support this by operating an intermediary panel management group, with representation from across the

[3] The FCA has extended its [Information From Lenders]() scheme to the consumer credit. IFL is a voluntary scheme that enables lenders to report intermediaries they suspect of committing fraud to the appropriate FCA team for further investigation.

lender's business, for example from risk, compliance, fraud, sales and service functions.

- Visits could include, as appropriate and proportionate, documented review of items such as those listed below, in accordance with the risk-based approach agreed:

  - Business performance. Does the intermediary over- or under-perform against targets and is this indicative of a wider risk?
  - Quality. The quality of cases introduced by each intermediary: are the loans performing well and are arrears / delinquencies within acceptable limits?
  - *Churning. Are cases introduced by any particular intermediary being refinanced quickly (for example within six months), and might this be indicative of poor creditworthiness and affordability policies?*
  - Governance. Do management have clear oversight and control over business functions and staff, including keeping policy and procedures updated and performing internal monitoring?
  - Introducer network. Can the intermediary demonstrate their introducer network is compliant?
  - Regulatory checks. Are relevant FCA permissions and authorisations in place, along with any limitations?
  - Sales staff remuneration. Are commission structures incentivising inappropriate behaviour? Are appropriate systems and controls in place?
  - Treating Customers Fairly. Can the intermediary demonstrate and evidence the delivery of fair outcomes for consumers, including in relation to commission arrangements?
  - The customer journey. Can the intermediary demonstrate and evidence its sales processes and regulatory disclosure?
  - Affordability assessments. Does the intermediary follow lender requirements?
  - Vulnerable customers. How are vulnerable customers identified and protected? Is information shared with the lender with consent?
  - Complaint handling.
  - Fraud prevention and anti-money laundering. Does the intermediary comply with the FLA industry standard for financial crime prevention in motor finance credit application processing?
  - Advertising and Financial Promotions. Are financial promotions in line with FCA and ASA rules?
  - Client and staff training. Can the intermediary demonstrate and evidence a training record and quality of training?
  - Record Keeping. Are full and appropriate records maintained and retained?

- There are a number of practical considerations firms should be mindful of when planning a visit, including:

  - The timeframe in which a field visit should be undertaken, dependent on the level of risk identified by the assessment. There may be lower-risk

situations where a visit is not required – or where the broker operates online only and contact would be made via Head Office.
   - The period of time between field visits.
   - Contract issues: issues of customer consent.
   - Business spikes: spikes in consumer demand.
   - Availability of key intermediary staff.
   - Interaction with third party compliance providers.
   - Cost and logistics associated with planning a visit.
   - Resource: skills, knowledge and experience of staff to conduct effectively.

Lenders could also employ one of the following checks, depending on the level of risk identified in the earlier assessment:

   - *Ad hoc* (focussed) visit: to examine specific issues identified through desk-based research or field visit for specific issues only.
   - Review of specific intermediaries where wider concerns are suspected.
   - Mystery shopping
   - FCA notification: in certain cases it may be appropriate to refer an intermediary to the FCA.

Act

If the assurance activity reveals or confirms issues with the intermediary's processes, practices or conduct, prompt action should be taken, following the steps below:

- Remedial actions agreed, including client contact where necessary, as soon as possible after issues identified. Remedial action tasks should have clear ownership and resolution timeframes, and be tracked and reported.
- Results and issues discussed and tracked in senior leadership meetings.
- Ongoing monitoring and tracking of improvements via MI and monitoring reports.
- It is for lenders to decide the appropriate course of action whilst issue resolution is in progress, but this may include suspending acceptance of business from the firm pending resolution of the issue.
- An open and transparent appeals process should be adopted.
- If fraud by the intermediary is suspected or proven, the lender should report the details to their own FCA supervisor.

Vulnerability guidance

It can be difficult for both intermediaries and lenders to identify and support vulnerable customers, frequently due to lack of disclosure from customers.

The FCA's Vulnerability Guidance (FG21/1; 2021) provides practical advice on managing consumer vulnerability.

Additionally, some lenders have chosen to train a pool of intermediary staff in vulnerability (a 'vulnerable customers hotline') so providing an additional layer of support in identifying and supporting vulnerable customers.

September 2021