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HEADLIGHT

Shining a light on the motor finance market

FCA motor finance survey combined with Brexit uncertainty make for a bumpy road ahead

- **How the recent FCA Motor Finance report will impact brokers' businesses**
- **Car buyer confidence crushed by Brexit uncertainty**
- **Buyers more concerned now about monthly repayments than deposit levels**
- **Diesel dilemma puts petrol in the lead**

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JULIAN RANCE
Director of Motor Finance

FCA motor finance survey and continuing Brexit uncertainty make for a bumpy road ahead

Welcome to the summer edition of Headlight, our twice-yearly review of the motor industry. Through an extensive survey of the UK's largest motor finance brokers, we aim to shine a light on the state of the UK motor finance market.

The results show there is something of a perfect storm brewing, with a number of factors combining which could hit the motor industry hard. These include Brexit, uncertainty over fuel types and the recently published FCA report which has some challenging words for the industry. These issues dented customer confidence to such an extent that in June, the month of new car registrations were the lowest in five years.

The manufacturers, looking to protect their figures, have been pre-registering cars. This, in turn, has driven demand for nearly-new vehicles. It is simply the case that canny buyers, aware that the motor industry is freewheeling into a cul-de-sac, are not wanting to pay bumper prices for new cars. As a result, cars are becoming cheaper, putting a squeeze on dealers.

While all this is not exactly a blip, with one bad story after another emerging from the car industry, it is by no means all doom and gloom. We operate in a cyclical industry, and just like in the aftermath of the financial crisis in 2007/8, we will see business start to rev up again when some of the uncertainties holding us back are resolved.

Let's start with the Brexit effect. A full 100 per cent of brokers who said confidence was weak blamed the UK's continuing inability to steer its way out of the EU as the number one factor affecting their businesses. The vast majority of brokers believe a no-deal Brexit and further withdrawal agreement delays would be equally damaging to the industry. On the flipside, a relatively large proportion of brokers do not see different Brexit outcomes impacting the industry at all.

Newly appointed prime minister Boris Johnson is acutely aware that negotiating an orderly exit from the EU is his key priority and everyone will breathe a deep sigh of relief once this issue can be parked.

The FCA motor industry report, set up to address 'unclear' and 'excessive' motor finance costs is generally expected to have the biggest negative impact on brokers' profits and application volumes.

Perhaps surprisingly, the brokers we spoke to do not think the FCA findings will have much impact on their business. Although the FCA has now expressed concerns that brokers should communicate commission agreements to buyers.

We welcome the report's conclusion that it wants introducers to be more transparent in their dealings with customers. And although this may require them to spend time reviewing and updating procedures, we are looking at the report's findings relatively favourably.

Furthermore, it is worth noting that there has been no negative impact on other regulated industries where these sorts of requirements have been suggested. Indeed, we welcome transparency and rigorous due diligence procedures and would like to work with brokers who embrace transparency in the industry. After all, those businesses who adopt best practice are usually the ones who are the most successful.

I think there is reason to be concerned about the growing uncertainty among buyers about which fuel type to go for. Demand for diesel vehicles has all but crashed and while demand for petrol remains strong there is a growing sentiment for greener alternatives, such as hybrid or fully electric vehicles.

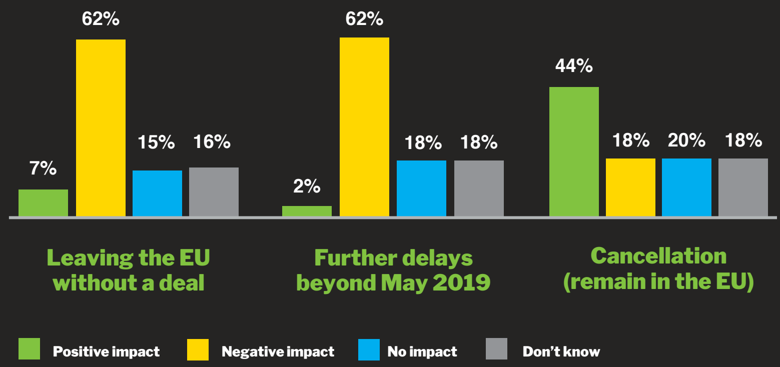
To help build buyer confidence for greener cars, we urgently need action from the Government which needs to invest in a nationwide network of charging points and general infrastructure upgrades.

We, as a funder, would welcome support in funding requirements for these vehicles. What would be particularly helpful, would be if Government were to put a floor on potential losses due to depreciation as new models become available. Without such guarantees, lenders will continue to remain circumspect regarding the financing of electric vehicles.

We hope you enjoy reading more detail about the key findings in this report and I hope it provides some clarity for you about what lies ahead for the British motor finance industry.

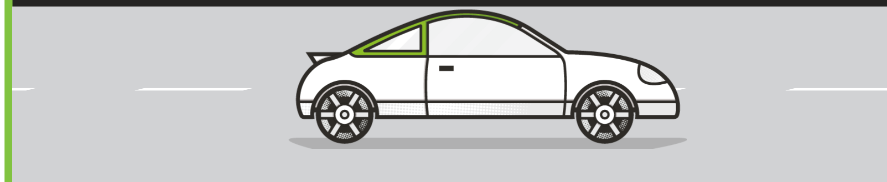
Thank you to everyone who took part in the survey. Your responses show that while car sales and motor finance deals are in for a bumpy ride, the pace should speed up gradually as the issues raised in this report get resolved.

Brexit outcome impact



No deal Brexit and further withdrawal agreement delays equally damaging for the industry

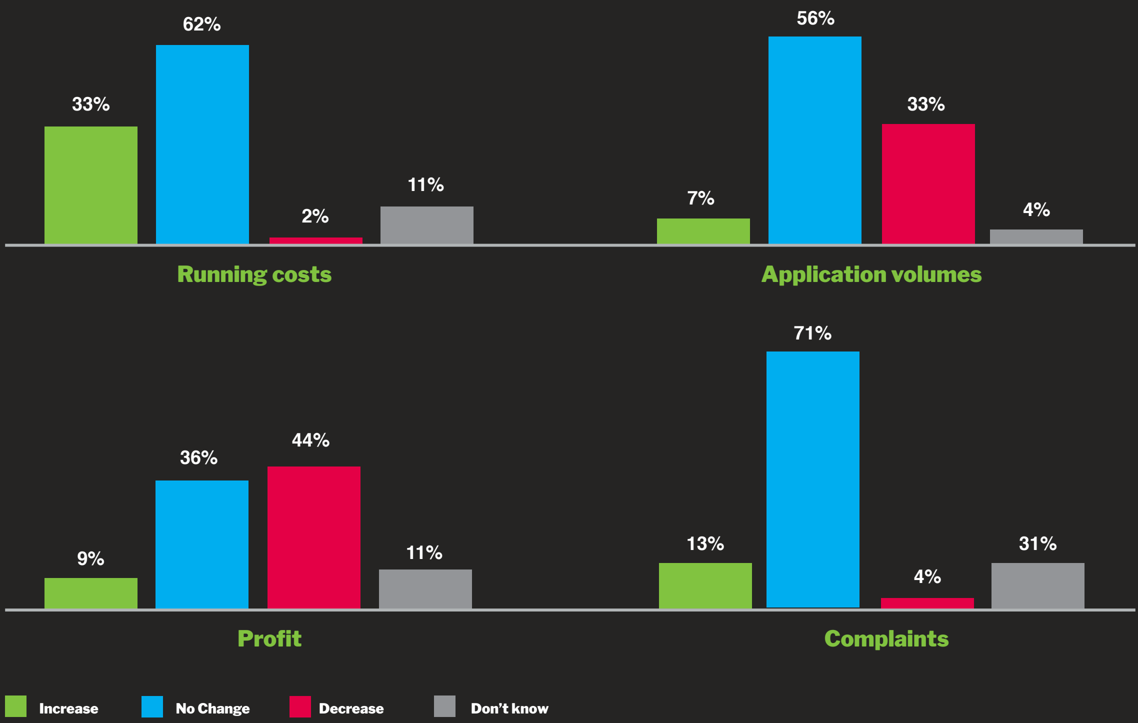
- 62% of brokers believe both leaving the EU without a deal and further delays past May 19 will **Negatively** impact the motor finance market
- Remaining in the EU seems to be the most desirable solution - 44% of brokers think cancellation will have a **Positive** impact
- Relatively large proportions of brokers (Between 15 and 20%) don't see different Brexit outcomes impacting the industry at all or are uncertain about the impact.



How the recent FCA Motor Finance report will impact brokers' businesses

In the wake of the FCA report, published in March, our survey found that 44% of brokers expect its proposals – for brokers to review or amend their policies and procedures and to be more transparent about commission arrangements (among other things) – will have a negative impact on broker profits, as the following chart demonstrates.

Brexit outcome impact



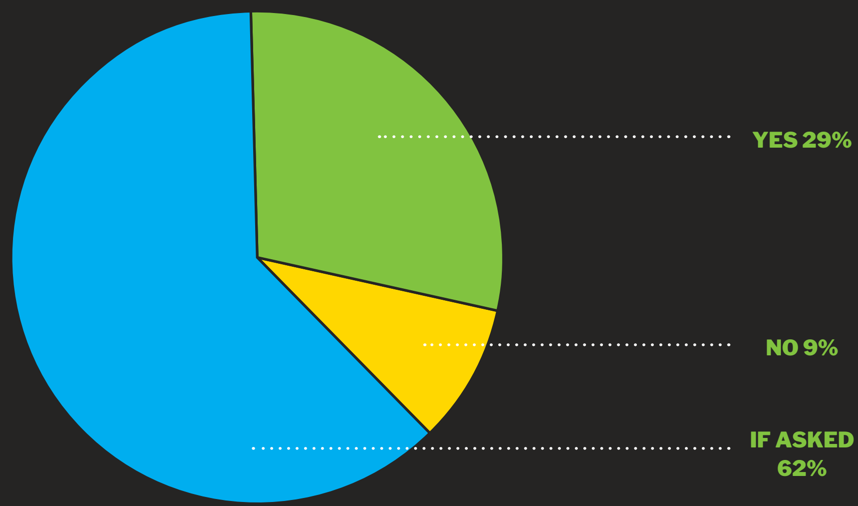
The FCA said it had "particular concerns in relation to commission arrangements, including the structure of commissions (and whether and to what extent they allow broker discretion over the interest rate) and relevant disclosures by brokers".

Around a third of brokers – 33% – expect the FCA proposals will result in lower finance application volumes. Only 13% believe implementation of the proposals will result in lower levels of customer complaints.

The FCA's main concern about commission arrangements is that currently far too few brokers proactively inform customers about their commission arrangements with lenders.

But it is important to note that they are under no obligation to do so.

% of those who INFORM buyers



HEADLIGHT

Shining a light on the motor finance market

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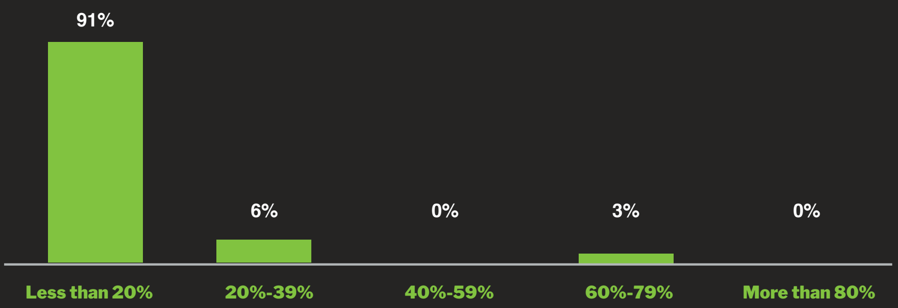
Summer 2019

% customers who ASK

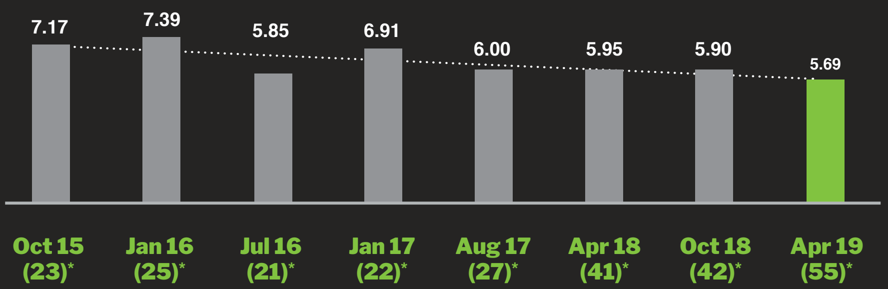


The changes proposed by the FCA require the motor industry to review its operations to ensure it is treating customers fairly.

Industry operators choose a variety of methods to outline commission arrangements, with most supplementing verbal explanation in written terms and conditions and on their websites.

Car buyer confidence and concerns – and the continuing Brexit impact

Car buyer confidence is at its lowest level since 2015 (and after the June 2016 Brexit vote) according to some of the UK's biggest car finance brokers and dealers, scoring an average of 5.69 out of a possible 10.



Number of people responded*

Brexit is the stand-out factor driving weak confidence, cited by 100% of brokers who took part in the survey.

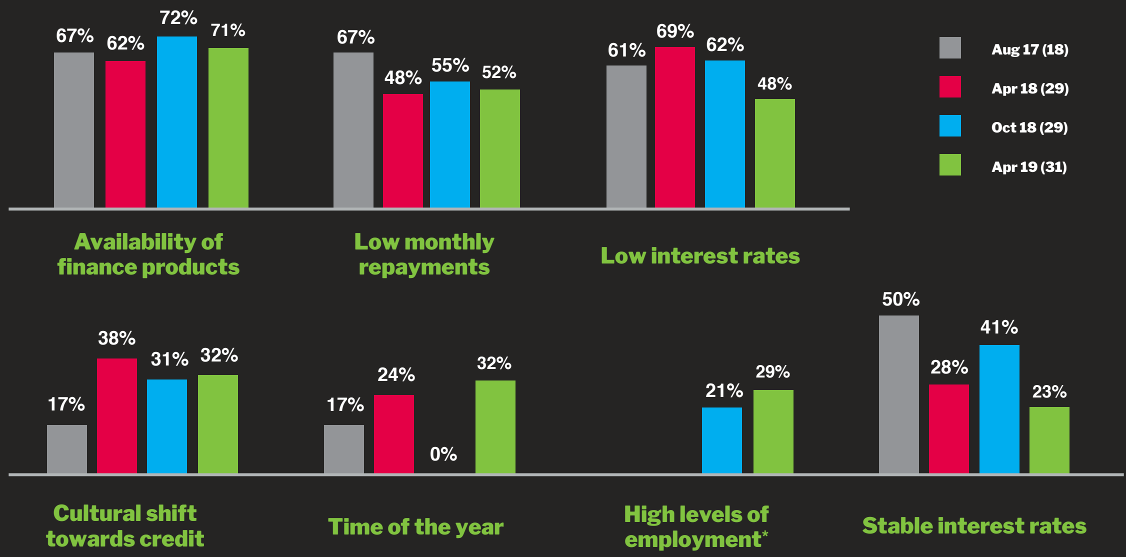
No other factor scored anywhere near, with fuel type uncertainty and employment security being the most important factors – highlighted by 54% and 29% of survey respondents respectively.

Brokers cited good availability of finance products, the opportunity to spread costs via low monthly payments and low interest rates as the key factors underpinning forward momentum.

Significantly, 62% of brokers we surveyed said they expected leaving the EU without a delay or a delay beyond the October deadline would have a further, negative impact.

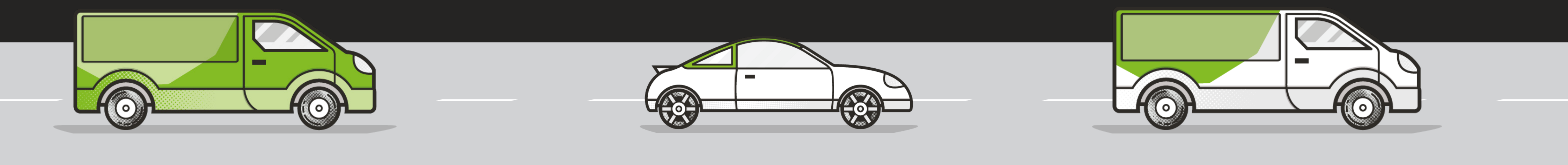
But there are still reasons to be cheerful. A variety of factors give reason to believe the market will hold strong going forward. See the chart below:

STRONG car buyer confidence factors

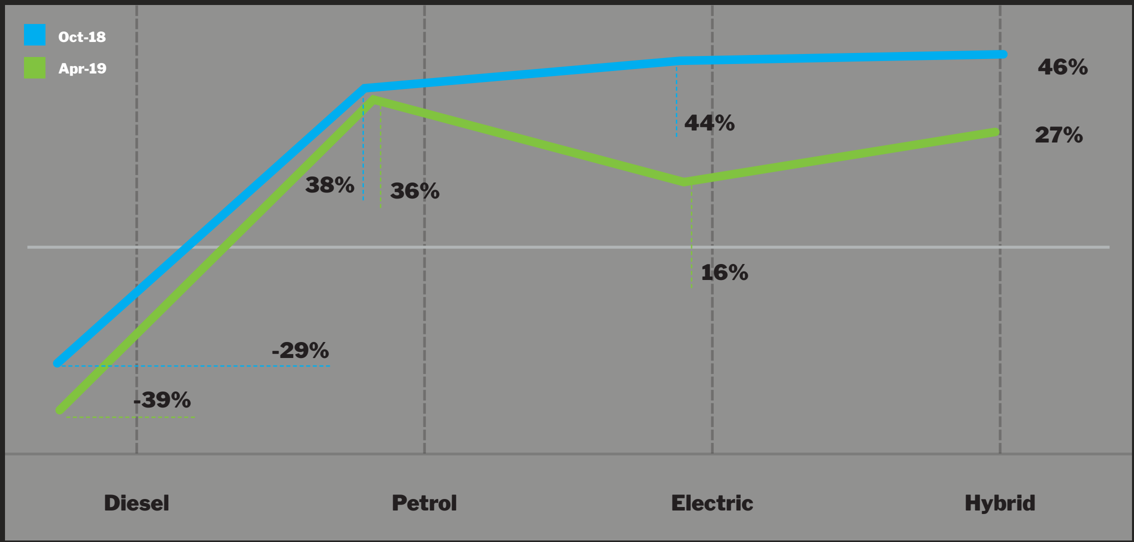


Data not available*

The above chart [Strong car buyer confidence factors] highlights that the combination of the availability of finance products, lower interest rates and lower monthly repayments leads to lower car prices, which we expect in turn will lead to a strengthening in demand and market recovery.



Car applications by fuel | Net results



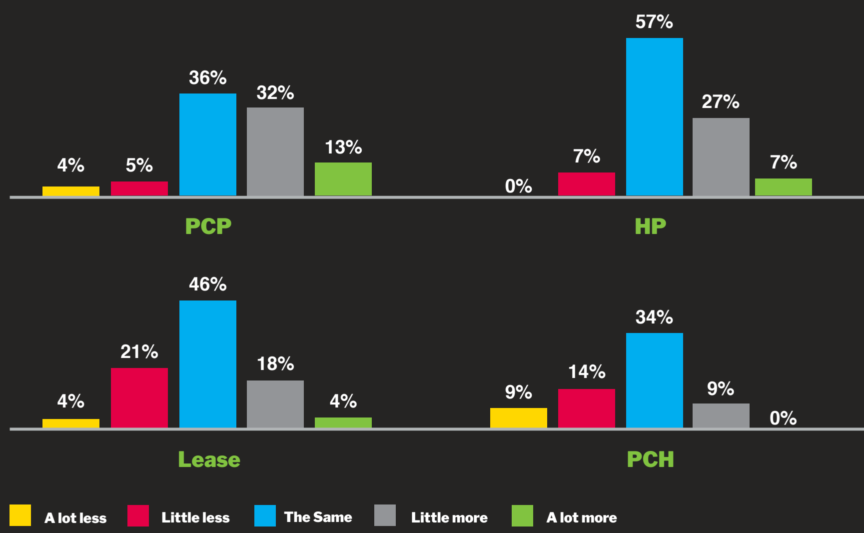
Anticipated car finance applications

- **Negative** predications for new and used car applications volumes in the coming 6 months (-4% net results)
- Over half of brokers do not anticipate a major change for NEW cars
- The proportions of brokers who expect less applications is **8% higher for USED cars (29%)** than NEW cars (21%)

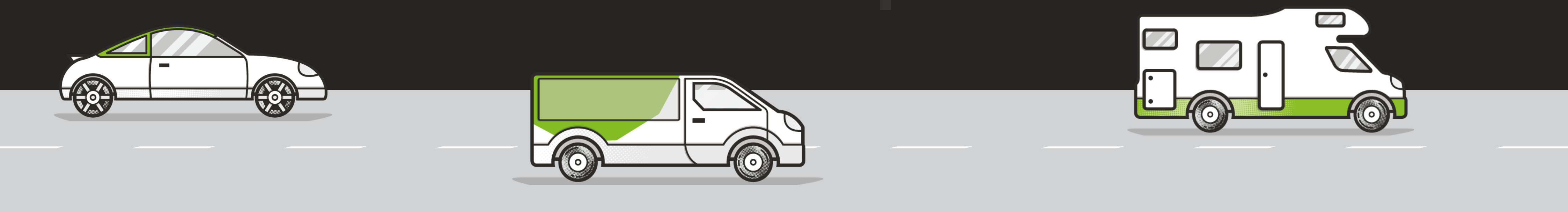
We also found a record low level of brokers who anticipate greater demand for both used and new cars. Monthly repayments are coming down, suggesting people are preferring to put down as much capital up front as possible to keep their monthly outgoings as low as possible.

There has, however, been a high level of stability in financial product selection, as the following chart shows.

Car applications by Finance Products | Vol %



This spring saw a considerable change in the number of customers who refinanced their existing vehicles, with a growing trend for buyers of both new and used cars to keep them longer.



HEADLIGHT
Shining a light on the motor finance market

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Summer 2019

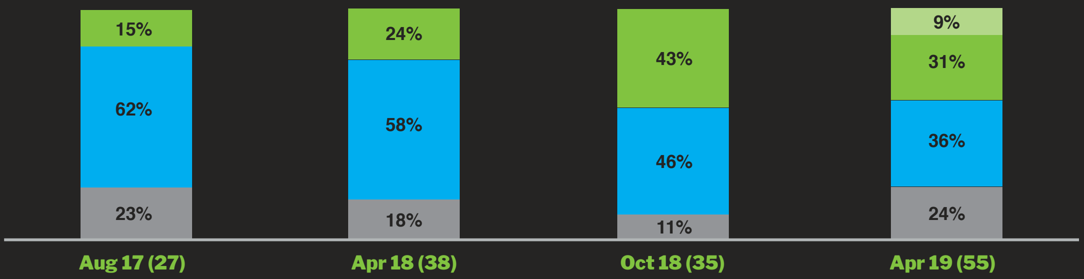
Buyers profiles and deposits vs monthly repayments

It is comforting to note that overall monthly payments for both new and used car applications remain stable, with 36% of brokers saying the payments have remained "about the same" in the last 12 months.

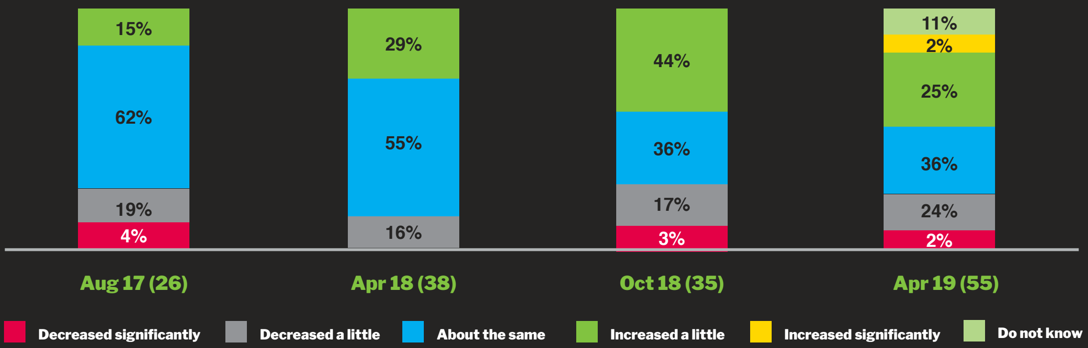
However, in comparison to October 2018, brokers are noticing a considerable decrease in average payments.

This is positive for customers and we would therefore expect demand to increase over time, as they are lured back into the market by the range of deals on offer.

USED cars - AVG monthly payments



NEW cars - AVG monthly payments



We look forward to updating you with more information about the motor industry following our Autumn/Winter survey.

About Headlight Survey

Paragon's Headlight Survey is a six-monthly survey of around 45 key vehicle finance brokers operating in the UK. It includes a wide range of brokers from those who arrange business for car dealers and specialist vehicle retailers to those who arrange finance with customers directly.

About Paragon

Paragon provides motor finance for cars, LCVs, motorhomes and caravans through approved intermediaries and registered dealers.

Paragon Bank PLC is a subsidiary of the Paragon Banking Group PLC, which is a FTSE 250 company based in Solihull, in the West Midlands. Established in 1985, Paragon Banking Group PLC has over £12 billion of assets under management.

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