Re: Motability

Thank you for your letter of 9 February 2018. You previously asked me some questions on Motability during my appearance in front of the Treasury Select Committee on 7 February 2018, which I replied to in my letter to the Chair dated 20 February 2018. I have set out answers to the additional questions below.

I understand that you asked an Urgent Question of the Secretary of State for Work and Pensions in Parliament on the 8 February 2018. As a consequence, you have asked the Financial Conduct Authority (FCA) to respond to a number of questions you have regarding Motability.

You asked whether the Financial Conduct Authority would expect an organisation like Motability to hold £2.4bn in reserve to cover risk. The simple answer is no.

Subject to our Threshold Conditions\(^1\), (particularly Condition 2.4 - appropriate resources) all FCA-authorised firms are required to have adequate resources. It is an obligation of the firm and its management to ensure that they have sufficient financial resources to meet their liabilities as they fall due. When the responsibility for regulating the consumer credit market transferred from the Office for Fair Trading (OFT) to the FCA in April 2014, a decision was taken not to set out a detailed set of rules and guidance on top of this fundamental requirement.

Therefore, for a firm such as Motability (a credit broker), there is no prudential requirement to hold an amount of money in reserve to cover risk. However, as the firm is required to have sufficient financial resources to meet their liabilities as they fall due, we would expect the senior management of the firm to assess the adequacy of their resources in the context of their size, risk profile, complexity of regulated activities, strategy and circumstances.

You also want to know if we would expect a bank making a loan to Motability to price in the £2.4bn in reserves when assessing the risk to set an interest rate on a loan.

It is reasonable that a bank making a loan to Motability would take into consideration the £2.4bn in reserves, as part of assessing the financial soundness of Motability and the firm’s ability to repay the loan, when determining the interest rate to charge.

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1. [https://www.handbook.fca.org.uk/handbook/COND/2/?view=chapter](https://www.handbook.fca.org.uk/handbook/COND/2/?view=chapter)
Your third point asked us if we would consider it appropriate for both Motability to hedge against the risk of a Motability contract via reserves and for the bank to also do so via the interest rate on a loan.

In principle, reserves do serve as a constituent of the capital of a firm, and therefore, reserves can act as a source of funding to assist a firm in its loss-absorbing capacity, reduce the probability of financial distress and provide the firm with resilience to a shock. This helps to ensure that the firm has adequate financial resources to meet liabilities as they fall due. Our focus would be on helping to ensure that firms have sufficient financial resources to satisfy Threshold Condition 2.4.

To determine the appropriateness of Motability’s hedge against the risk attaching to a Motability contract via reserves would require an individual risk assessment of Motability’s circumstances including the nature of any specific Motability contract vis-à-vis its risk characteristics. Therefore, we would be unable to comment on individual cases such as Motability’s appropriateness to hedge via reserves.

Finally you wanted to know if the FCA had made any recent assessment of Motability’s operations and whether we were satisfied that it was fully compliant.

When Motability applied for authorisation in February 2016 the FCA carried out an assessment of the firm at that time and found that its activities presented a low risk to consumers. The review will also have ensured that the firm met our threshold conditions. Our continuing supervision of all firms and their activities is also aligned to the risks posed to consumers. This approach is designed to be proportionate. We routinely monitor firms through their reporting and post-authorisation we have not received any adverse information for Motability that would have prompted a heightened level of proactive review.

Therefore based on information we hold on Motability we have no reason to believe that our original assessment of the firm at authorisation should be any different.

I hope that this is helpful.

Yours sincerely,

Andrew Bailey
Chief Executive