Novuna
Business Finance

The **block** starter guide

Tomorrow. Together

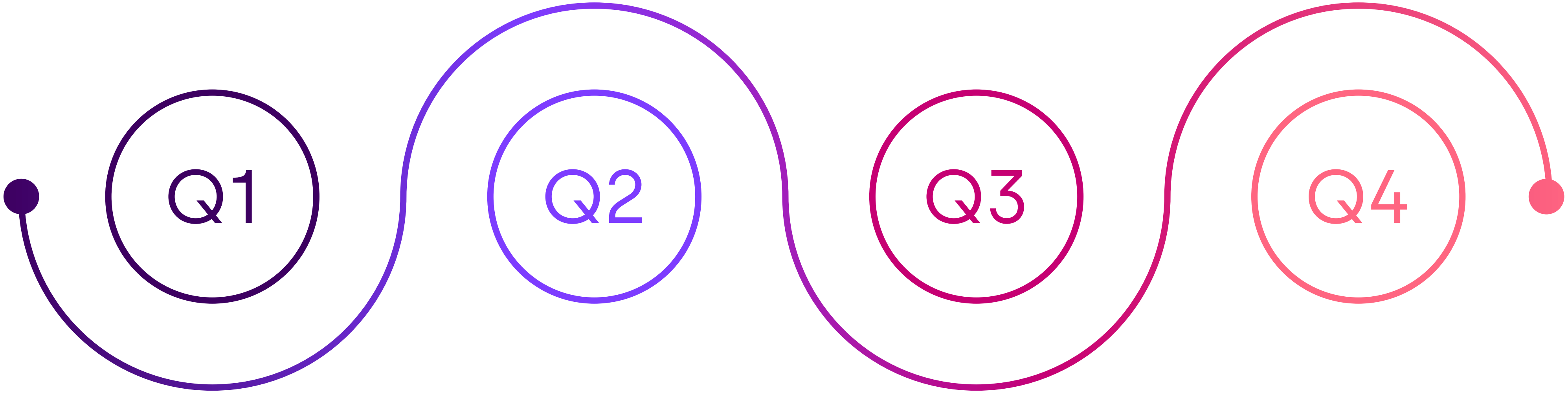
The **block** starter guide

It is often a natural step for a broker to think about building their own book of agreements and creating a valuable asset for their business. The SME market make up a large proportion of UK businesses and providing funding to help these businesses grow is extremely rewarding. However, providing the finance on your own book can feel extremely distant and scary to begin with as it takes time and patience, and of course capital. It's key for those wishing to become a lender to understand that with the right help and guidance, it may not be as difficult and distant as it seems.

Novuna Business Finance have been supporting the Block Discounting community for over 40 years. We've put together some of the fundamental things you may need to think about if you are looking to venture into the world of Block discounting and becoming a funder. This guide will outline some of the points you'll need to consider before getting started.

Please note that this is not intended to be an exhaustive list of the issues to be considered nor is it meant to constitute any form of advice to you. As far as we are able, we exclude all liability for any reliance you or any other party may place on the information and you should seek any specific advice that you feel is necessary to help you make an informed decision.

What is **Block Funding?**



The block client writes the finance agreement

Finance agreements are written between the block client and the end user, the block client administers the finance agreements.

Finance agreements are blocked with Novuna Business Finance

The block client batches several agreements and sends them to Novuna Business Finance, this forms security for the block loan.

Novuna Business Finance releases cash to the block client

A discounted loan agreement is now activated between the block client and Novuna Business Finance.

The block client reinvests cash in new business

The cash from the block means the block client can now lend more and grow their book.

In life monitoring commences, including regular audits, MI to be supplied and an annual review.

An **example** often helps...

- Let's say as a lender you transact 10 agreements totalling £100,000 in advances with an average period of three years at 8% flat, creating future receivables of £124,000.
- You block the agreements, and Novuna Business Finance provides an £80,000 loan secured against £124,000 future receivables giving a day 1 Cover of 155%.
- As part of the process we'll continually monitor Security Cover through periodic audits to check the performance of our agreements.
- Should Security Cover fall below the agreed level then we'll seek Replacement Paper to remedy any shortfall.

As every customer is unique, we would welcome the opportunity to work through a tailored example for your business.

So now you know what **Block Funding** is and how it works, it's good to know **what you might need to consider** before taking the plunge...

Getting **setup**

1. Considering the agreement types you wish to offer

As a broker you may already know that certain permissions are needed to write regulated business. If you're thinking of becoming a funder, you need to make the decision on whether you want to enter into Regulated Agreements. If that is one of your aspirations, then you'll need to comply with the FCA's principles and obtain 'Funder' permissions from the FCA. In addition to rules set out by the FCA any regulated agreements that you enter into must also comply with the Consumer Credit Act. Whilst you are starting out, you may not wish to accept regulated agreements as they can be more complicated to administer.

2. Compliance with the Data protection Act

We all work with our customers most confidential data and should already have a data protection registration in place. As your business is taking on a new responsibility you may want to review your privacy policy to ensure it's appropriate to being a funder and a broker – you'll need to ensure your licenses covers the scope of the information you are controlling and processing.

3. Update your VAT registration

If you decide you'd like to fund your own book, you'll need to make sure you have the appropriate VAT registration in place as you'll have suppliers invoicing you for goods and you'll be invoicing out rentals. If you offer a lease as a product that will have an impact on the volume of VAT invoices you issue.

4. Finding a system

As a funder you'll need to a central system to capture agreement details. The cost and sophistication of the system will not only need to be balanced against the volume and type of business that you write but of course will also be dependent on the product types and other information you may need to capture.

As a minimum requirement, the system needs to record all the basic agreement details to allow you to collect rentals or let you know when someone has defaulted and administer any in life changes that need to happen- from the difficult task of chasing late payments to other administrative tasks such as changing an address to quoting early settlements.

Your system requirements could be relatively simple if you decide to only deal with non-regulated agreements or one product. Your system requirements will likely start to get complex if you need to deal with regulated agreements, multiple products and if you need features such as an accounting tool built in.

The **numbers**

Pricing

The good thing about being a funder is, you get to set your own pricing and manage the margins – remember you'll need to provide fair value to the customer and review your pricing framework regularly. If you are funding from cashflow then you will need to be mindful of the price you pay the finance company that funds your block finance. If you are using an overdraft to fund the initial payment to the supplier and then batching up your agreements to sell as a block, then you will need to consider the additional overdraft costs when you work out your pricing.

Business introductions and commission

If you become a funder, you might find the additional duties take up much more of your time meaning you have less time to find more business. To help grow your business, it's good to decide early on if you'll accept introductions from other brokers and suppliers.

If you do accept business from other intermediaries, you may want to vet them first and decide how you monitor them. It may be a good idea to setup a trading agreement with each of them to ensure they adhere to your requirements. In your trading agreement you may want to outline how you will monitor them, the FCA permissions they require, their complaints procedure, how they deal with vulnerable customers, commission disclosures, website requirements, and whether or not you will allow them to conduct asset inspections.

You may also want to incentivise brokers and suppliers to bring you business by offering commission. Often an uncomfortable thing to do, but you'll need to decide if you'd want to agree a commission refund if the agreement terminates before you have recovered the commission amount agreed.

Accounting

As the book grows, keeping track of the income, expenditure and accounting for the profit will hopefully become a greater challenge. A challenge which may make it unmanageable for one person to deal with, especially with accounting being a very complex task. Another decision you will have to make is whether your system will have a built-in accounting tool and whether it will handle your VAT and tax computations or whether you will outsource to a third party.

It's also worth bearing in mind that you'll need to be able to accept Direct Debit payments from your customers. You'll need to comply with the BACs rules and will need approval from your sponsored bank.

Understanding your customer base, from **onboarding** to **underwriting**

Selecting your customer base

As a broker your existing model is all about finding customers but as a lender, you'll want to be much more conscious of who you lend your money to – not every deal will be a good a one. As a lender you'll need to have an Anti-money laundering policy and complete certain checks before you lend your money. And whilst you're already used to collecting proof of ID and proof of address as a broker you will need to set your standards for address and identity verification and decide what paper documents you will accept or what electronic evidence is appropriate.

There are tools out there that help with Anti-money laundering and ensure you are comfortable with your customer and where their money is coming from.

Underwriting your customers

As a broker transitioning to a funder, you'll need to switch hats and think that the customers and assets you take on will now become your responsibility – they will be yours. Again, it's identifying your customer base and thinking who would you want to lend your money to and is the asset proposed a reliable and sustainable one? During the underwriting stage you'll need consider what your appetite for risk is and where will you get the information on the Customer and the asset you need to make a lending decision on.

You will need to document a credit policy which explains where you will lend and on what terms. Funders offering you a block discount facility will want to see this document as it will help them understand what your book is going to look like as it grows. Here are some questions that may help you frame your credit policy.

1. Do you want to search the Customer? If so, which credit reference agency will you use, how do you set up an account and what are the costs?
2. How will you inform customers / gain their permission for searches?
3. What information on the search will lead to a decline or an approval?
4. What other information will you want to see before you lend your money?
5. What would a good Customer look like? Years established, profitable trading, personal guarantees?
6. Are there market sectors that you know and understand? Are there market sectors that you want to avoid due to the risk, reputational issues, personal convictions? For example, if you introduce a lot of commercial vehicle business and you know the assets and the Customers in that sector. Do you start there and expand your credit appetite as your book grows?
7. Asset appetite and concentration – are some assets out of appetite? Do you really want to take on assets with no tangible security, new to market assets which may or may not have a resale value in 5 years' time? If all your agreements are for commercial vehicles is that acceptable or is having all your eggs in one basket too risky? Understanding your risk appetite and staying within it may give you peace of mind.
8. Do you want to underwrite the suppliers? If so, what is your criteria for an acceptable supplier?
9. Agreement terms. Would you allow balloon payments, can you judge the security value of an asset against a balloon in 5 years' time? What is the minimum deposit you need for it to be a good deal? Do you have a maximum agreement term for different asset categories?
10. If a deal goes wrong, do you have disposal channels available or will you need to develop them? Do you have dealers who give you leads who would take assets back and sale on your behalf? This may influence your asset appetite.

The asset finance **life cycle**

Your customer Agreements

Your customers will require standard form finance agreements. You can either buy these agreements off the shelf, you could work with a solicitor who may have an agreement suite they can sell you or you could develop your own agreement suite with legal advice. Depending on the product type, your agreement should highlight whether you want to collect and pass on maintenance costs, charge for excess usage costs (for example incur a fee for extra mileage) and any other return conditions that the customer needs to comply with.

These requirements may also need to be captured on your system (this could drive costs up slightly too)!

Pay outs

Of course, if you want to become a funder you need to have surplus cash resource to pay suppliers outright and then collect the rentals over a period of time. You need to consider how quickly you'll end up utilising your cash resources.

You may also need to let your bank know that your business model has changed and that significant sums of money will be going in and out of your account to avoid your account being blocked for suspicious activity.

In life support

Another thing you'll need to consider when you become a funder is in life support. Your customer may call in to change their address, submit a request for a reschedule and novation, ask for a settlement figure or even make a complaint.

As your book grows you may want to consider implementing a phone system to help handle high call volumes. As your business evolves, you'll also have to reflect on whether you can handle all the administrative duties yourself or whether you'll need employ someone or people to lighten workloads.

Unfortunately, complaints do happen, so it would be a good time to review your complaints policy and the procedure for handling them including which customers are eligible to complain to the Financial Ombudsman Service (FOS). It would be ideal, and a requirement if regulated by the Financial Conduct Authority to have your complaints policy displayed on your website.

Collections, repossession and disposal

Recovering assets is something that you'll likely have to do, but hopefully not that frequently. It's advisable to think about the steps you want to take for customers that default as you'll instantly know what to do if the situation arises – considered decisions are often better decisions.

When thinking about your process, in the initial stages you may want to get in contact with the Customer to identify if it's a blip, a problem or a real default. If the default is real and the customer is in financial difficulty, you'll probably want to work out a fair plan and get them back to paying on time. If it turns out the asset is no longer suitable for the customer, you'll need to think about terminating the contract and taking your assets back. Your policy should talk about who will conduct the repossession, where the goods will be held and how they will be sold.

Who should I choose for my block funding facility?

Once you have considered or completed the actions outlined in the initial bit of the guide, the next step is to consider which Block Discounting provider to use. With a vast range of block discounting products on the market, you might be thinking '*who's the right provider for me?*'

Do your research

Complete a search to see which Block Funders are in the market. It's also a good idea to speak to your industry contacts to see if they have any recommendations – hearing direct experiences is always more meaningful!

Speak to funders

Get in contact with funders directly to see what they can offer you. You may be able to tell whether a Block Discounting provider is for you from initial conversations.

Consider all aspects of the product offering

It may be appealing to make your decision based on rates but it's often useful to look at other aspects such as service, knowledge and experience.

Novuna Business Finance

Novuna Business Finance have supported brokers who have ventured into the world of Block for over 40 years. We understand block discounting is a huge step for any business and we're happy to work with introducers who are new to the funding market (we all have to start somewhere)!

Your account will be managed by one of our experienced Account Managers (subject to credit approval) and our small team of block auditors who you will have access to talk to.

Conclusion: The progression from finding and writing business to paying out and collecting the payments on that business is often daunting, but when you break down the actions needed **it can be more achievable than you think**.

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