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The Hon Kenneth Hayne AC QC
 Commissioner
 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

By email: FSRCenquiries@royalcommission.gov.au

26 October 2018

Dear Commissioner Hayne,

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (“Royal Commission”) Interim Report

Submission by Finance Brokers Association of Australia Limited (“FBAA”)

Introductory Matters

- 1 The FBAA is an association that represents finance brokers, aggregators and other participants in the financial services industry. The FBAA has followed the course of the Royal Commission and having reviewed its interim report released on 28 September 2018 (“Interim Report”), wishes to comment in respect of concerns expressed therein as to the structure under which remuneration is paid to Brokers by Financiers.
- 2 The FBAA submits, for the reasons identified herein:
 - (a) Brokers are currently subject to a number of general and specific obligations which include the requirement to provide lengthy disclosure documents to Clients for their consideration.
 - (b) The significant disclosure obligations imposed on Brokers under the NCCPA are designed to ensure that Clients are well informed about the costs involved and the commissions payable.
 - (c) Clients acknowledge the fees that are disclosed to be paid when they choose to proceed with the credit contracts.
 - (d) ASIC has previously identified that consumers can disengage from a sales process as a result of decision fatigue, information overload and complex product offerings and options which constrains a consumer’s ability to make an informed choice.¹ Requiring further disclosure would increase this risk.
 - (e) Any conclusion to the effect that paying intermediaries a value-based upfront and trail commission might be a breach of section 47(1)(b) of the NCCPA, based on a review of the deleterious consequences of the practice as described in the Interim Report², would be an oversimplification because:
 - (i) It does not take into account the imperfect nature of the use of the term “disadvantaged” in section 47(1)(b), given the difficulty in assessing advantage having regard to each individual Client’s differing cost and non-cost requirements and objectives;

¹ For example, in relation to the sale of insurance through car dealers, see ASIC Report 492: A Market that is failing consumers: the sale of add-on insurance through car dealers, [163] and [174].

² Page 30 of Volume 2 of the Interim Report



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- (f) It would be premature to draw any conclusion on the requirement for structural changes within the broking industry, as the Commission has identified that the vast majority of misconduct has been due to market participants failing to follow the current laws. The FBAA strongly supports an approach of holding all participants to account to comply with existing laws before further reforms should be contemplated.
- (g) All remuneration structures have strengths and weaknesses. Much of the focus on broker remuneration has been on potential weaknesses without acknowledging similar issues with alternative remuneration models. We are concerned that a call to change the existing structure without fully understanding the impact of any proposed model may simply disrupt a stable and important profession with no corresponding improvement. Just as Government must publish a regulatory impact statement prior to recommending legislative reform, we believe the case for any alternative model should be validated before changes are proposed.
- (h) The current remuneration structure is superior to other models. All other models are exposed to the same criticism as the current upfront and trail remuneration model. For example:
- (i) Moving to a “Financier-pay, fixed-fee” structure will still provide Financiers with the ability to set the rates they will pay to Brokers and any disparity between Financiers will give rise to the same conflict of interest criticisms that the Commission has already identified.
 - (ii) Moving to a “Financier-pay, fixed-fee” structure with a mandatory maximum may be viewed as price fixing and anti-competitive.
 - (iii) Moving to a “Consumer-pay, commission” or “Consumer-pay, fixed-fee” structure would not address the conflict of interest concerns already identified and will drive consumers back to bank lenders that can bury their costs in the product offering. Faced with the option of paying a Broker out of their own pocket or dealing directly with a bank that does not separately charge any fees, consumers will migrate back to banks. This is not a positive consumer outcome on any level.
- (i) The FBAA has implemented its own regulation to drive better behaviour of its members. However, this regulation is hindered by the operation of Part IV of the *Competition and Consumer Act 2010* (Cth) and the requirement to obtain authorisation of regulators for each variation.

3 In these submissions, the following defined terms are used for convenience:

- (a) **ACL** means an Australian Credit Licence
- (b) **Aggregators** means an intermediary between Financiers and Brokers;
- (c) **Brokers** means both Independent Brokers and Selective Brokers;
- (d) **Clients** means the ordinary consumers of financial products such as home loans;
- (e) **Financiers** means the provider of financial products;
- (f) **Independent Brokers** mean those people and organisations which provide broking services to Clients and have access to a larger number of potential Financiers (for example, more than 6);
- (g) **Licensee** means a person or organisation that holds an ACL
- (h) **NCCPA** means the National Consumer Credit Protection Act 2009 (Cth);



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- (i) **NCCPR** means the National Consumer Credit Protection Regulations 2010 (Cth);
- (j) **Selective Brokers** means those people and organisations which provide broking services to Clients but have access to only a select number of potential financiers (for example, 6 or less);

4 For the purposes of this submission, the FBA A focuses primarily upon credit contracts as defined in the National Credit Code in relation to the home finance sector.

Relevant relationships between Brokers and the law

Function and Role of Brokers

- 5 Brokers perform a variety of functions within a financial transaction. Their functions include:
- (a) Developing relationships with borrowers (that may be people looking for a new loan or looking to refinance) through marketing;
 - (b) Providing access to multiple different financial products from a variety of Financiers;
 - (c) Building relationships with Financiers in order to expedite the finance application process;
 - (d) Reviewing financial products and determining their usefulness based upon particular factors relevant to the Client;
 - (e) Interacting with Clients and identifying the Client's particular requirements and objectives;
 - (f) Identifying lenders and products that the consumer will not be eligible for and steering their applications away from these institutions. Applying for finance takes considerable time and cost and each rejected application causes delays. Most Financiers do not inform applicants why their applications are unsuccessful which leaves consumers unsure about why they are unable to obtain finance; and
 - (g) Facilitating the Client's application with the relevant Financier.

Brokers require an ACL

- 6 A person is required to hold an ACL, or become a credit representative of a person with an ACL that authorises the credit activity that the person seeks to undertake.³ "Credit Activities" include "Credit Services"⁴ which includes both "Credit Assistance" and acting "as an intermediary".⁵
- 7 Credit Assistance will be provided in a number of circumstances including suggesting credit contracts with credit providers and assisting in the application for credit contracts.⁶ Further, where a person acts as an intermediary between a credit provider and a consumer wholly or partly for the purposes of securing credit under a credit contract of a consumer lease for the consumer with the credit provider or lessor, that person "acts as an intermediary" for the purposes of the NCCPA.⁷
- 8 While there are a very large number of Brokers nationwide, only about a quarter hold an ACL whereas the remainder may be credit representatives under an ACL.

³ Section 29(1) NCCPA

⁴ Section 6(1) NCCPA

⁵ Section 7 NCCPA

⁶ Section 8(a) and (d) NCCPA

⁷ Section 9(a) and (b) NCCPA



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- 9 As a Broker ordinarily engages with Clients for the purpose of assessing and applying for credit contracts or will act between a Client and a Financier, they will be providing credit services and consequentially require an ACL or to become a representative under another entity's ACL.

Relationship between Broker and Client

- 10 Broker's services are ordinarily passive. That is, Clients seek out Brokers when they want to transact. The Client relationship arises where a Client engages the Broker for the purpose of identifying an appropriate credit product (such as a credit contract). In this situation, the Broker commences to act on behalf of the Client to identify and assist the acquisition, but does not possess the authority to bind the Client to a credit product.
- 11 Accordingly, the FBAA considers that Independent Brokers act as agents on behalf of their Clients. In the case of Selective Brokers, this is less certain as a Client may be aware of the pre-existing relationship between the Selective Broker and the Financier with whom that Selective Broker deals.
- 12 Leaving aside the distinction between Independent and Selective Brokers and the lack of authority to bind the principal, where a Broker acts as an agent, they may assume fiduciary obligations as agency is a recognized category of fiduciary.⁸

Relationship between Broker and Financier

- 13 The relationship between a Broker and a Financier may also give rise to duties depending on the terms agreed between those parties which may govern how they are to interact and be remunerated. In this circumstance, either the Broker owes clearly conflicting duties, or owes a duty only to the Financier.
- 14 The removal of the Financier-pay commission structure will not remove the possibility for conflicts to arise. Nevertheless, it is accepted that any receipt of benefits by a fiduciary may give rise to a conflict between a Broker's duty to a Client and that Broker's interest in increasing their own remuneration.

General Obligations of Brokers under the NCCPA

- 15 Licensee Brokers are required to comply with their general obligations which include doing all things necessary to ensure that authorised credit activities are engaged in a manner that is efficient, honest and fair.⁹ Additionally, Licensees are required to have in place adequate arrangements to ensure that Clients of the Licensee are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the Licensee or its representatives.¹⁰
- 16 The conflict of interest requirements under section 47(1)(b) have two distinct parts. The first part is that conflicts must be identified. The second is that there must be adequate arrangements in place to ensure that a Client is not disadvantaged by a conflict of interest. The FBAA does not believe the second limb of the conflicts of interest provision has received adequate consideration and some of the observations about perceived detriment caused by Broker remuneration are contentious¹¹.
- 17 The Australian Securities and Investments Commission (**ASIC**) publishes Regulatory Guides to assist Licensees to understand ASIC's expectations on how they must meet their legislative

⁸ Hospital Products Ltd v United States Surgical Corporation (1984) 156 CLR 41, 68.

⁹ Section 47(1)(a)

¹⁰ Section 47(1)(b)

¹¹ This includes suggestions that broker remuneration influences brokers to inflate consumer loan applications or that brokers facilitate consumers into inferior loan products when compared to bank introduced products.



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obligations.¹² Whilst Regulatory Guides are not law, they are a clear statement by the regulator as to how it proposes to apply the law. Licensees must closely abide the guidance or assume significant risk in departing from ASIC guidance. The FBA A notes that some of this guidance has not been updated for a significant period of time and may not necessarily reflect modern expectations.

18 RG205 provides the following guidance in relation to managing conflicts of interest:

- (a) This obligation includes managing and monitoring any conflicts of interest;¹³
- (b) The adequacy of such arrangements depends on the circumstances of each case;¹⁴
- (c) The arrangements should ensure that “unsuitable” products are not recommended so that consumers are not disadvantaged by incentives offered;¹⁵ and
- (d) Licensees providing credit assistance relating to third party loans should have a suitably comprehensive product list which is thoroughly researched and reasonably representative of available products.¹⁶

Specific obligations on Brokers

19 Brokers are subject to numerous disclosure obligations under the NCCPA as set out herein.

Initial Disclosure (the Credit Guide)

20 Upon it becoming apparent that a credit assistance provider (such as a Broker) will provide credit assistance to a Client, the Broker must provide a written credit guide.¹⁷ The credit guide must specify the Broker’s name, contact details,¹⁸ applicable ACL number,¹⁹ dispute resolution process and the relevant contact details for the process²⁰ and the Broker’s obligation to conduct a preliminary assessment and not assisting or suggesting unsuitable products.²¹

21 More relevantly to the issues related to remuneration, the credit guide must specify:

- (a) the fees and charges associated as well as the method for determining those fees and charges;²²
- (b) the names of the six credit providers the Broker reasonably believes it conducts the most business or, if the Broker does not do business with more than six credit providers, the names of all credit providers that it does business with;²³ and
- (c) any commissions likely to be directly or indirectly received as a result of credit assistance, a reasonable estimate of the amounts of those commissions or a range of these amounts and a method of determining those amounts.²⁴

¹² ASIC, Regulatory Guide 205 – Credit Licensing: General conduct obligations

¹³ ASIC, Regulatory Guide 205 – Credit Licensing: General conduct obligations , 205.80

¹⁴ ASIC, Regulatory Guide 205 – Credit Licensing: General conduct obligations , 205.82

¹⁵ ASIC, Regulatory Guide 205 – Credit Licensing: General conduct obligations , 205.83

¹⁶ ASIC, Regulatory Guide 205 – Credit Licensing: General conduct obligations , 205.84

¹⁷ Section 113(2)(a) NCCPA

¹⁸ Section 113(2)(c) NCCPA

¹⁹ Section 113(2)(d) NCCPA

²⁰ Section 113(2)(h) NCCPA

²¹ Section 113(2)(i) NCCPA.

²² Section 113(2)(e) NCCPA

²³ Section 113(2)(f) NCCPA

²⁴ Section 113(2)(g) NCCPA, although section 113(3)(a) NCCPA and regulation 27(3) NCCPR removes some of these requirements where the credit assistance relates to credit card contracts.



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- 22** The NCCPR may,²⁵ and does,²⁶ identify further information that a credit guide must contain. This specifically deals with the existence of volume-based commission structure. In particular, the credit guide must disclose the existence of a volume-based arrangement with a credit provider, that additional commission may be received as a result of any arrangement and the payer and recipient of this commission.²⁷

Secondary Disclosure (the Quote)

- 23** The NCCPA also prohibits a Broker providing credit assistance on a fee paying basis unless the Broker has given the Client a quote which the Client has formally accepted.²⁸
- 24** Consistently with the credit guide, the quote must give information in relation to the maximum fee charged to the Client,²⁹ the maximum charges incurred by the Broker,³⁰ the maximum fees and charges paid by the Broker on the Client's behalf³¹ and the maximum amount payable by the Client if the credit contract is not executed.³² The NCCPA also allows for the NCCPR to specify further requirements³³ regarding fees and charges which are payable to the Broker,³⁴ third parties³⁵ and those fees and charges payable by the Client to a third party where the credit contract is not executed.³⁶

Tertiary Disclosure (the Credit Proposal Document)

- 25** Brokers are also required to provide a credit proposal disclosure document at the time of providing credit assistance which documents with greater granularity the commissions, fees and charges being paid as a result of the credit assistance.³⁷
- 26** The credit proposal disclosure document must specify:
- (a) the total fees or charges that the Client must pay the Broker and the method of its determination;³⁸
 - (b) a reasonable estimate of the total amount of any commissions likely to be receive in relation to the credit contract and the method used for working out that amount;³⁹
 - (c) a reasonable estimate of the total amount of any fees or charges that the Client will likely pay to the credit provider or any third parties;⁴⁰
 - (d) a reasonable estimate of the remaining funds available where some of the funds are to be used to pay the Broker or credit provider.⁴¹
- 27** Further requirements can be imposed through the NCCPR. The FBA A notes that some of the provisions referenced in the regulations do not even exist⁴².

²⁵ Section 113(2)(j) NCCPA

²⁶ Regulation 26A NCCPR

²⁷ Regulation 26A(3) NCCPR

²⁸ Section 114(1) NCCPA

²⁹ Section 114(2)(d)(i) NCCPA

³⁰ Section 114(2)(d)(ii) NCCPA

³¹ Section 114(2)(d)(iii) NCCPA

³² Section 114(2)(e) NCCPA

³³ Section 114(2)(f) NCCPA.

³⁴ Regulation 28D(2)(a) NCCPR

³⁵ Regulation 28D(2)(b) NCCPR

³⁶ Regulation 28D(2)(d) NCCPR

³⁷ Section 121 NCCPA

³⁸ Section 121(2)(a) NCCPA

³⁹ Section 121(2)(b) NCCPA

⁴⁰ Section 121(2)(c) NCCPA

⁴¹ Section 121(2)(d)(e) NCCPA

⁴² Regulations 28E-H reference non-existent sections 121(2)(f) and 121(3A)



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- 28** Regulation 28G (which references section 121(3) of the NCCPA) requires for each kind of commission forming part of the total amount commission, the Broker must provide information regarding the kinds of commission,⁴³ an explanation of each kind of commission,⁴⁴ the payer of each kind of commission,⁴⁵ the recipient of each kind of commission⁴⁶ and a reasonable amount of commission.⁴⁷
- 29** In relation to providing further information on the estimates of each commission, such amounts must be expressed in dollars⁴⁸ (or range of dollars)⁴⁹, as a proportion of the borrowed amount and a dollar amount,⁵⁰ as a percentage of the borrowed amount and a dollar amount⁵¹ or in the case of a benefit, its estimated value in dollar.⁵²
- 30** Further, the reasonable estimate of commission must also be assessed in terms of the recipient as the Licensee and its credit representatives.⁵³

Whether continuing with the credit contract in light of significant disclosure amounts to informed consent of commissions

- 31** Ordinarily, a fiduciary will not be liable for a breach of its duties where it can be shown that the principal gave consent on the basis of a full and frank disclosure of all material facts.⁵⁴ As identified in *Commonwealth Bank of Australia v Smith*:
- “The fiduciary will be absolved by the giving of fully informed consent to the existence of what otherwise would be a conflict. There is no precise formula which will determine in all cases if fully informed consent has been given; it is a question of fact in all the circumstances of each case.”*⁵⁵
- 32** This requirement of full and frank disclosure varies depending upon the circumstances of each case.⁵⁶ For example, the depth of disclosure is influenced by the sophistication of the principal.⁵⁷ Accordingly, the FBAA submits that it cannot be addressed in a “one size fits all” manner as the legislature may intend, a fact acknowledged in the NCCPA.⁵⁸
- 33** Courts have accepted that disclosure can occur at different times and in different ways.⁵⁹ Accordingly, the fragmented nature of disclosure of the NCCPA should not diminish its utility.
- 34** Given the significant disclosure mandated under the NCCPA and NCCPR, this raises the prospect that the continuation of the Client in executing the credit contract amounts to an acceptance of the disclosure and consent to the commissions described.

⁴³ Regulation 28G(2)(a)(i) NCCPR

⁴⁴ Regulation 28G(2)(a)(ii) NCCPR

⁴⁵ Regulation 28G(2)(a)(iii) NCCPR

⁴⁶ Regulation 28G(2)(a)(iv) NCCPR

⁴⁷ Regulation 28G(2)(a)(v) NCCPR

⁴⁸ Regulation 28G(2)(b)(i) NCCPR

⁴⁹ Regulation 28G(2)(b)(ii) NCCPR

⁵⁰ Regulation 28G(2)(b)(iii) NCCPR

⁵¹ Regulation 28G(2)(b)(iv) NCCPR

⁵² Regulation 28G(2)(b)(v) NCCPR

⁵³ Regulation 28G(2)(c) NCCPR

⁵⁴ *New Zealand Netherlands Society Oranje Inc v Kuys* [1973] 1 WLR 1126; [1973] 2 All ER 1222

⁵⁵ *CBA v Smith* (1991) 102 ALR 453 at 478-78

⁵⁶ *Maguire v Makaronis* (1997) 188 CLR 449;

⁵⁷ *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, [108]

⁵⁸ Section 47(2) NCCPA.

⁵⁹ *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, [107]



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- 35** If a fiduciary can demonstrate that the principal was aware of all the relevant facts (including the fiduciary's interest) and has assented to the fiduciary's proposed conduct, then the fiduciary's duty is not breached.⁶⁰
- 36** In determining whether a principal is aware of all relevant facts, a principal's knowledge of the general nature and extent of the fiduciary's interest then this may be sufficient as if the principal wants further details, then these should be requested.⁶¹
- 37** Significantly, the High Court has determined that while actual consent is usually required, the consent may be implied.⁶² Consequentially, the FBAA submits that where a Broker has disclosed:
- (a) in the credit guide, being prior to the Client entering into the credit contract:
 - (i) the identity of those credit providers with which it does the most business;⁶³ and
 - (ii) a reasonable estimate of the commissions to be received or a range of the commission (including the method of calculation);⁶⁴
 - (iii) the existence of a volume-based arrangement with a credit provider and information on the additional commission which may be received, the payer and recipient of this commission;⁶⁵
 - (b) in the credit proposal document, at the time of providing credit assistance and which may be prior to the Client entering into the credit contract and relevant to each kind of commission:
 - (i) the kinds of commissions;⁶⁶
 - (ii) an explanation of each kind of commission;⁶⁷
 - (iii) the payer of each kind of commission;⁶⁸
 - (iv) the recipient of each kind of commission;⁶⁹ and
 - (v) a reasonable estimate of the total amount of any commissions likely to be received by the Licensee as differentiated from its credit representatives⁷⁰ and only expressible in specific ways,⁷¹

it is at the very least arguable that the Client has been provided with full and frank disclosure and consented to the commissions by proceeding with the credit contract.

Is this disclosure useful?

- 38** The FBAA does not consider the volume of disclosure particularly effective in ensuring consumers are ideally informed because:

⁶⁰ *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399; 1 ARLR 1; 18 ALR 1; 3 ACLR 176; [1977–1978] CLC 40-389 (PC).

⁶¹ *BLB Corp of Australia Establishment v Jacobsen* (1974) 48 ALJR 372 (HCA)

⁶² *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89; 81 ALJR 1107; 2 BFRA 85; [2007] HCA 22, the Court at [107]–[108].

⁶³ Section 113(2)(f) NCCPA

⁶⁴ Section 113(2)(g) NCCPA, although section 113(3)(a) NCCPA and regulation 27(3) NCCPR removes some of these requirements where the credit assistance relates to credit card contracts.

⁶⁵ Regulation 26A(3) NCCPR

⁶⁶ Regulation 28G(2)(a)(i) NCCPR

⁶⁷ Regulation 28G(2)(a)(ii) NCCPR

⁶⁸ Regulation 28G(2)(a)(iii) NCCPR

⁶⁹ Regulation 28G(2)(a)(iv) NCCPR

⁷⁰ Regulation 28G(2)(c) NCCPR

⁷¹ Regulations 28G(2)(b)(i) to (v) NCCPR



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- (a) Disclosure is provided in a fragmented form;
- (b) Disclosure is provided at different times;
- (c) Disclosure regarding commissions:
 - (i) is provided early but cannot be more specific as the relevant product has not been identified and the Broker may not have conducted the preliminary assessment on suitability and conducted reasonable enquiries about the consumer;⁷²
 - (ii) more specific information on commissions is provided but this must be at the same time as providing credit assistance;⁷³ and
- (d) As people approach Brokers for the purpose of navigating numerous products, reduce the volume of product information required to be digested and to assist in navigating the lending application process, this volume of disclosure is contrary to this objective.

39 The FBAA observes that the process may be improved by requiring:

- (a) Disclosure of commission information in relation to the product upon which credit assistance will be provided and, say, two close substitutes so that consumers can identify the commission differential between three similar products; and
- (b) Clients to sign and return a copy of such commission disclosure under section 121 as soon as possible in the credit assistance process and as a precondition to proceeding with an application.

40 The FBAA considers that this alternative will require careful consideration so as to align with the strict timeframes in place under ancillary agreements in which credit is required (such as a purchase of a property).

Managing Conflicts of Interest

41 The Commission has expressed concern that paying intermediaries a value-based upfront and trail commission, having regard to the deleterious consequences of the practice had been identified in the Interim Report, might have been a breach of section 47(1)(b) of the NCCPA.⁷⁴

42 The FBAA submits that this interim conclusion is not representative because:

- (a) The interim conclusion was prefaced on case studies related to the activities of Commonwealth Bank of Australia (**CBA**) dealing directly with Brokers and there was no distinction between whether the Brokers it dealt with were Selective or Independent Brokers or whether an Aggregator was involved;
- (b) The interim conclusion was prefaced on the evidence that CBA has used volumes as a basis for revoking a Broker's accreditation.⁷⁵ As a Broker should, and ASIC recommends that a Broker should⁷⁶, maintain access to diverse portfolio of Financiers in order to provide the best service, this behavior of Financiers not only hinders Brokers ability to provide the best service but is anti-competitive. The interim conclusion, in essence, holds the

⁷² Section 113 requires the credit guide "as soon as practical after it becomes apparent to the licensee that it is likely to provide credit assistance to a consumer in relation to a credit contract" whereas section 115 requires a preliminary assessment and reasonable inquiries within 90 days of the assistance date.

⁷³ Section 121 NCCPA

⁷⁴ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report Volume 2, section 2.3.2, page 30.

⁷⁵ Interim Report, volume 2, section 2.2, page 23.

⁷⁶ ASIC, Regulatory Guide 205 – Credit Licensing: General conduct obligations, 205.84



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remuneration structure for Brokers responsible without recognising other conduct which has a material effect;

- (c) The Commission focused on the nature of the relationship between Broker and Client when determining a conflict existed. There was little analysis of the impact of that perceived conflict. There is no question that a differential in fees between lenders will always provide the basis for an observation that a conflict may exist but the fee differential between main product providers is not significant enough to be material. Consumer need is the main determinant of which product and which lender is selected.
- 43** The FBAA submits that the volume of disclosure required may assist in ensuring that a Broker's activity is honest but is not efficient because:
- (a) It is delivered in multiple tranches and does not take into account any disclosure required by non-credit related legislation;⁷⁷
- (b) Information about commissions on a likely product cannot be provided until that product is identified so a consumer's ability to digest this information is restricted.
- 44** Considering the volume of disclosure regarding commissions and costs identified above, the FBAA submits that this assists in complying with the obligation to maintain adequate arrangements to ensure a Client does not suffer disadvantage as a result of conflicts of interest. As the Commission has already identified, some market participants do not follow the law. In these instances, if a Broker does not provide the mandatory disclosure, then demonstrating the presence of adequate arrangements becomes more difficult.
- 45** Further, the FBAA submits the NCCPA is not breached by virtue of the existence of a commission structure because:
- (a) The Commission's conclusion relates to where deleterious consequences had been identified. A conclusion on the consequences and the causation of those consequences cannot be drawn from a single incident, rather it requires multiple incidents to become statistically relevant. It follows that while a conclusion about the compliance of an entity can be drawn from multiple incidents relating to that entity, those conclusions cannot be extended identify a problem inherent in an entire industry.
- (b) The section does not prohibit conflicts of interest. In fact, the expression "management of conflict of interest" has been interpreted as not requiring the elimination of conflicts.⁷⁸ Rather, the section prohibits conflicts of interest causing disadvantage.
- (c) The term "disadvantaged" is an imperfect term. While it is easy to show disadvantage in circumstances where only one cost variable differentiates two products and a Broker recommends the worse product on the basis of higher commission, it is much more difficult to assess disadvantage when considering all cost and non-cost variables across multiple products against all of a Client's requirements and objectives. Additionally, the Client's own preferences must be taken into account and these can include specific lenders to avoid or to use based on the consumer's previous experiences or other factors.
- (d) Even where disadvantage may be caused by conflict of interest, the NCCPA is not breached unless there is an absence of adequate arrangements designed to ensure that such disadvantage does not occur. While the FBAA accepts that multiple incidents of disadvantage within a single entity would demonstrate any arrangements are not adequate, the NCCPA is not breached as a result of isolated or unconnected incidents.

⁷⁷ Such as the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) and the *Privacy Act 1988* (Cth).

⁷⁸ *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35, [445].



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- 46 The FBAA also observes that the differential in commissions between Financiers is not material and is dependent upon many variables. The FBAA's analysis of the perceived price differences identified by ASIC as 'evidence of conflict' amounted to immaterial differences to a Broker's potential remuneration. When balanced out against the risk of the deal falling over and the Broker receiving no remuneration at all, the reality is that Brokers are not motivated by small differences in the commission rates between products. Where two products produce the same outcome for their Client and the remuneration on one product is higher than the other a Broker may choose the higher remuneration product without there being any disadvantage to the Client however it is rare that such perfection exists in the marketplace.

Difficult Position of Brokers

- 47 As identified above, Brokers may owe duties to both Clients and Financiers simultaneously. Accordingly, the strict application of the laws of fiduciaries create an untenable position for Brokers given the requirement for fiduciaries to avoid or eliminate all conflicts.⁷⁹
- 48 In the FBAA's view, the current law, which requires management of conflicts of interest to prevent disadvantage attempts to strike an appropriate balance.

Variation of remuneration structures

- 49 The FBAA does not consider that a change to remuneration is necessary or will practically drive the desired outcomes.

Is variation necessary?

- 50 The Commission has already identified that changing the current laws or adding new laws when the current laws are not being followed would not create any positive change.⁸⁰ The FBAA agrees with this conclusion but considers that this is an important issue to be addressed at the stage that all market participants are complying with the current laws.

Would changes to remuneration structure drive positive change?

- 51 The FBAA does not consider that removing commission structures would ultimately drive better outcomes. As identified, Brokers are likely subject to both a conflict of duties as well as a conflict of interest.
- 52 If a commission-based remuneration structure is removed and placed with a fixed-fee commission structure, this will still provide Financiers with the ability to set their own fees that they will pay to Brokers. Accordingly, any disparity between what each individual Financier will pay to a Broker will give rise to the same conflict of interest that the Commission has already identified. In short, replacing the commission structure, without more, will not address the underlining issue.
- 53 To remedy this issue, a regime could be commenced such that a price ceiling is implemented on amounts that can be paid to Brokers. Without dealing with the economic issues associated with price ceilings, the FBAA observes that this behavior would amount to price-fixing, a behavior which is already prohibited by Part IV of the *Competition and Consumer Act 2010* (Cth). Further, this behavior is considered to be reprehensible that it is not required to show the behavior impacts competition for the offence to be maintained. Consequentially, any implementation of price ceilings in this industry would require the legislature to mandate a breach of its own laws or for Financiers to willfully breach those laws.

⁷⁹ *Breen v Williams* (1996) 186 CLR 71, 108.

⁸⁰ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report Volume 1, pages (xx) and 290.



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- 54** Alternatively, the industry could adopt a “consumer-pays” model. Irrespective of whether this model is commission-based or fixed-fee, this would not address the conflict of duties identified while simultaneously hindering access to Brokers. This hindrance is caused by the following circumstances:
- (a) Currently, fees paid to Brokers are described as a “supply-side” cost, which results in them not factored into the price of a loan. If a person requires a \$100,000.00 loan and a Broker’s fee is \$1,000.00, the Client does not borrow \$101,000.00.
 - (b) Requiring Clients to pay the fees to Brokers would change the cost to a “demand-side” cost. Consequentially, if a Client does not have the funds available to pay the Broker’s fee, then either:
 - (i) They will be required to borrow additional funds to pay for this thereby increasing the amount of interest required to be paid; or
 - (ii) Not approach a Broker thereby requiring Clients to conduct market research themselves or applying for financial product they already know about through “well-known” channels which would not enhance competition between Financiers. Without the same level of competition, there is less factors driving lower borrowing costs for consumers.
 - (c) The justification for requiring Clients to pay Brokers is often that this would result in a lower cost of borrowing and therefore cheaper loans. The FBAA is skeptical of this result because major Financiers are historically slow to pass on savings a result of a cheaper cost of borrowing (such as cuts to the Reserve Bank of Australia official cash rate) while they are historically quick to pass on increases in these costs. Further, the Commission has identified that Financiers may not necessarily act independently.⁸¹ Accordingly, as Broker fees are already integrated into how Financiers will charge for a loan, the FBAA does not consider that a Financier will pass this saving on to Clients. There is a risk, however, that they may use any support for changes to Broker remuneration as a basis to reduce commissions whilst attributing such reductions to external pressures.

The role of self-regulation

- 55** The FBAA provides numerous services to its members including, advocacy, continuing professional development and dispute resolution services. Accordingly, there is significant value in a Brokers becoming a member of such an association compared to being a Broker without such membership.
- 56** As an association of Brokers, it is in the FBAA’s interests to ensure that its members act diligently, appropriately and in compliance with the law. Recognising that no membership vetting process is perfect, the FBAA implemented a regime to regulate the conduct of its members. The FBAA Code of Conduct implements obligations on FBAA members which in some respects go beyond the expectation under the NCCPA. The FBAA Disciplinary Rules allows for Clients or other members to make misconduct complaints regarding a particular member for reasons including breaching the code of conduct or acting contrarily to any piece of legislation that imposes obligations on members for the benefit of Clients.
- 57** The consequences of misconduct complaints can include investigation, referral to government agencies, referral to dispute resolution services and expulsion from the FBAA. As a result of the potential expulsion and the value of FBAA membership, the arrangement could amount to anti-competitive conduct and therefore required authorisation from the Australian Competition and

⁸¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report Volume 1, page 60.



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Consumer Commission (ACCC). This authorisation was obtained on 21 February 2017 for a period of 5 years.⁸²

- 58** The impact of self-regulation is that it provides a further avenue to Clients where they consider the actions of their Broker is contrary to law. This is important, considering it is unlikely that a government agency like ASIC will take action as a result of a single isolated incident. The FBAAA is able to act in these instances.
- 59** In observing the benefits of this self regulation, the FBAAA submits that it cannot be as agile in responding to changing community expectations. This is because any significant variation to the code of conduct or disciplinary rules will require the authorisation of the ACCC prior to effect. This takes significant time and expense. The Royal Commission should note that industry is attempting to regulate itself to drive greater consumer outcomes, but is prevented as a result of restrictive government regulation.

Closing remarks

- 60** The FBAAA observes that the current regime could be improved. The FBAAA would support variations which:
- (a) Simplify the disclosure requirements or consolidate this disclosure so that Clients are provided with access to information on specific commissions earlier;
 - (b) Allow greater action to be taken for breaches of section 47(1)(b) of the NCCPA than is currently possible.
- 61** The FBAAA will continue to follow the activities of the Royal Commission and looks forward to the Commissioner's final report.

Should the Commissioner seek further clarification on the matters raised herein, please contact the writer.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Peter J White'.

Peter J White CPFBI FMDI MAICD

Managing Director

⁸² Authorisation A91554 and A91555, available from <https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/authorisations-register/finance-brokers-association-of-australia-authorisation-a91554-a91555>