A cluster of Court of Appeal decisions has brought the question of commission payments in the secured loan industry back into the spotlight. The decisions in McWilliam v Norton Finance (UK) Ltd (in liquidation) [2015] EWCA Civ 186 has meant the law in relation to secret commission payments has been significantly extended.

This article aims to provide a substantive background to these issues as well as analysing the potential impact on the financial services sector.

It is common practice for the financial services industry to remunerate intermediaries that distribute their products. Insurance or mortgage brokers are paid for introductions to their respective industries. The fact that commissions are paid is uncontroversial, however, where these payments are not disclosed to their client, problems can arise

**Commission Payments In The Secured Loan Sector**

Prior to the credit crunch in 2008, the secured loan sector was a £7 billion a year industry, with the vast majority being introduced by lenders’ intermediary distribution channels. The relationship between lenders and their brokers was an incestuous and symbiotic one, and the market could not have grown to the extent it did without such relationships.

The brokers’ role included:

- Marketing for clients;
- Gathering sufficient personal and financial information from the client to assess their needs;
- Utilising this information to recommend a suitable lender and product;
- Processing the application, which included:
  - Obtaining all borrower information (proof of income, ID);
  - Arranging for the loan agreement and mortgage deed to be signed;
  - Applying to third parties for information such as land registry documents, existing mortgage reference and mortgage valuation;
- Interpreting all information provided to ensure it met the lenders’ underwriting policies;
- Submitting the information to the lender; and

Acting as a liaison point between borrower and lender. For these services they were royally rewarded. Brokers were paid three forms of commission:

1. **A loan commission** – This would normally be calculated as a percentage of the loan amount, typically between 6-10% dependent on the lender and product;
2. **A PPI commission** – Brokers would normally be paid 35-45% of the PPI premium;
3. **An over-ride commission** – In addition to the above, brokers were heavily incentivised to maximise the volume of loans completed
with a given lender. Lenders would set a monthly or quarterly target for brokers to achieve, if the target was met or exceeded they would be paid a further commission which was usually as a percentage of overall volume. Typical over-ride commissions would be 2-5% of overall volume.

The above most certainly implies that brokers were encouraged to maximise the size of loans submitted and ensure wherever possible that a PPI policy was added to secure the best possible financial outcome for the broker.

Whilst the vast majority of lenders advised their borrowers that a commission may be paid (normally by way of an industry standards booklet), it was rare for any of them to disclose how much was being paid. In such a competitive market, this was hardly surprising. In addition to the commission payments, brokers would ordinarily add a ‘broker fee’ to the loan, typically equalling 10% of the loan advance. Given that these sums often exceeded £2,500, it was in both the brokers’ and lenders’ interest that the borrower was not on notice of additional payments which could exceed the level of broker fee because it is at that point that the borrower would have begun to questions the fairness of the agreement.

The Hurstanger Case

The starting point is the judgment in Wilson & Anor v Hurstanger Ltd [2007] EWCA Civ 299. The Claimant, Mr Wilson, was introduced to Hurstanger (a lender operating in the subprime sector) by a credit broker. Mr Wilson was provided with various documents prior to funds being released, these included:

- Confirmation that a broker fee of £1,000 would be deducted from the advance;
- That the broker was acting as the borrower’s agent; and
- That in certain circumstances the lender would pay the broker commissions.

The dispute centred on whether or not the commission payment was secret and if so whether the broker had breached his fiduciary duties. The Court found that a fiduciary relationship existed, in fact in his Judgment, Tuckey LJ (at paragraph 34) described the relationship as “obviously a fiduciary one”. With this point agreed, the remaining issue was whether or not the credit broker breached his fiduciary duties to the borrower. In assessing this the Court looked at both the common law position and the relevant regulatory touch stone provided by the Office of Fair Trading’s ‘Non-Status Lending Guidelines’ issued to subprime lenders in 1997.

The law relating to fiduciaries is clear, in his judgment, Tuckey LJ described it in the following terms, “As a fiduciary the agent was required to act loyally for the defendants and not put himself into a position where he had a conflict of interest”. This judgment further explained that the broker receiving a commission without the informed consent of the borrower will be in breach of his duties. The lender in these circumstances cannot escape blame, where he is aware of the agency and pays such a commission, he will be viewed as being an accessory to that breach.

The legal position was underpinned by the OFT’s Guidance provided in 1997 in reaction to questionable practices by lenders prior to this date. They state:

- [lenders must] warn that the broker or other intermediary may not be in a position to give unbiased advice if they are tied to the lender or are paid a fee or commission by the lender.
- The contract documentation and any customer booklet or leaflet … should … indicate if any commission or other payment is payable by the lender to the broker, and should explain the purpose and nature of any such commission and the basis of
• Disclose both orally and in writing at an early stage, the existence and nature of any commission or other payment payable by the lender...
• they should explain clearly the implications of any such commission for the broker’s role with regard to the borrower
• This is in order that the borrower is clear as to any potential conflict of interest on the part of the broker
• All such disclosures should be made in writing before the borrower enters into the loan agreement and preferably before the loan application is submitted to the lender

In the foregoing circumstances the position for lenders was (or ought to have been) clear. If commission payments were made to intermediaries (as they were in a highly competitive market), the following high level thresholds should have been met out:
1. Confirm that a commission was to be paid;
2. Identify the recipient of those commissions;
3. Explain the type and calculation of the commissions;
4. State the monetary amount of the commission; and
5. Warn the borrower that the payment of such a commission will likely mean that the intermediary will not be able to give unbiased advice.

In Hurstanger, the Court found that even though the lender confirmed that a commission may be paid, it did not go far enough. In what the Court described as a “Half-way house case”, it decided that the failure to confirm the monetary amount meant that the borrowers’ informed consent was not obtained. As such Hurstanger were ordered to account to the borrower for the commission paid/received. However, as this wasn’t a “full secrecy case” (as described in the judgment) the Court did not have the full weight of remedies that would have been available in such circumstances, which, amongst other things, may have included rescission of the agreement.

**Recent Developments**

Given the proliferation of commission payments in the secured loan industry and the basis of the Hurstanger Judgment, it was expected that a wave of claims would follow. It didn’t, and has remained somewhat of a sleeping giant. The question is why? In the author’s opinion there were two reasons. First, the nature of this cause of action was relatively complex. Based upon the decision, a detailed factual nexus was required to establish the fiduciary relationship. In fact, a body of first instance decisions (see Yates and Lorenzelli v Nemo Personal Finance/ Sealey and Winfield v Loans.co.uk and GE Money Ltd) between 2010 and 2012 sought to distinguish Hurstanger on the basis that no such relationship existed.

The second and more compelling reason was the beginning of the ‘PPI boom’; this form of claim was attractive to the mass claims management market, it suited their business model, and significantly, could be accessed with far less legal knowledge.

The 2015 Court of Appeal judgment (which approved Hurstanger) in McWilliam v Norton Finance (UK) Ltd (in liquidation) [2015] EWCA Civ 186, has arguably extended the scope of fiduciary duties to cover credit brokers. In this judgment (which was not contested by Norton as they had gone into liquidation by the time of trial), the question of whether a broker owes fiduciary duties was carefully analysed by the Court.

The facts in the McWilliam case were that the Claimants had taken out a second charge loan with Money Partners in the sum of £25,000 plus a payment protection insurance policy of £3,745. The loan had been arranged by Norton Finance, who had been paid a loan commission of £2,675 (10.7% of the net loan amount) and PPI...
commission £1,688.25 (45% of the PPI premium). As in Hurstanger, this was a case where the fact a commission would be paid was disclosed to the borrowers, albeit via the industry standards FISA booklet. However, neither Money Partners nor Norton confirmed the precise amounts that would be paid. As such, this was another ‘half-way house case’.

The key issues for the Court of Appeal to consider were ostensibly the same as in Hurstanger; (i) did Norton owe a fiduciary duty? and; (ii) if so, did they breach that duty? In doing so they restated the test in Bristol and West Building Society v Mothew [1996] EWCA Civ 533 which considered that a fiduciary relationship turns on whether there was the repose of trust and confidence between principal and agent. Tomlinson LJ concluded that the relationship between Norton and the claimants was a fiduciary one and that he was bound by the decision in Hurstanger.

A legal commentary from 2015 by Adam Finch, a litigation partner at Harrison Clark Rickerbys comments “The banking industry had proceeded on the basis that credit brokers remunerated by means of commission payment were not under a fiduciary duty. This ruling overturns that assumption. It will mean that, in general terms, where a commission has been paid there should be a fiduciary duty to obtain informed consent beforehand from customers to retain commission”

This worrying judgment for the lending industry was further compounded by yet another Court of Appeal judgment, Nelmes v NRAM plc [2016] EWCA Civ 49 which involved a secret commission payment (albeit concealed as part of the lender’s fee included in the advance). The critical difference being that rather than couching the claim on the basis of a breach of fiduciary duty, it was alleged that the payment by the lender rendered the relationship between him and the borrower as ‘Unfair’ pursuant to the provisions contained within section 140 of the Consumer Credit Act 1974. This judgment somewhat “lowered the bar” in respect of the test for finding an unfair relationship between lender and borrower.

Pursuant to the judgment in Nelmes, where a secret commission has been paid, that fact is enough to render the relationship unfair within the meaning of Section 140 of the Consumer Credit Act 1974. The court concluded that “A relationship between lender and borrower which involves such a payment deprives the borrower of the disinterested advice of his broker and is, for that reason, unfair”.
What Next

Following the decisions in McWilliam and then Nelmes it would appear that the question of whether a credit broker owes fiduciary duties is settled, and the implications for the lending industry are significant. Whilst lenders began to get their house in order post credit crunch and finally began to comply with the guidelines provided by the OFT which were released some ten years earlier, the fact remains that prior to 2008 lenders did not adequately discharge their duty to ensure the borrowers’ informed consent was obtained.

A cottage industry pursuing these types of claims is beginning to emerge and pre-credit crunch lenders now find themselves exposed for past misdemeanours. Where partial disclosure has occurred, Lenders will likely be found to have procured the brokers’ breach of fiduciary duty. Following the decision in Nelmes claimants may also seek to allege the failure to obtain informed consent has rendered the relationship as unfair pursuant to section 140 of The Consumer Credit Act 1974. Additionally, lenders who provided no disclosure whatsoever are now particularly vulnerable to mass litigation.

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