

Proposed Western Australian Code of Conduct for Finance Brokers – Version 4.2A.1

Despite press releases and articles in the Finance Industry periodicals that a discussion paper is being circulated for comment on the future regulation of our industry, Brokers may not be aware of another discussion paper. This relates to a new Code of Conduct that is to be implemented to replace the current Finance Brokers Control Act 1975 code, which by weight of popular opinion has been superseded to meet the changing regulatory needs of 2006 and beyond.

There is also open discussion indicating a strong feeling that the new code when accepted and released in Western Australia will be the code outline to be adopted nationally. It is felt a major concern arises for all associated financial services professions that will be effected by this code, is the misinterpretation of the intent implicit in the drafting. This will certainly lead to anti competitive, restrictive trade practices and confusion. Some may think that I have made a rather brave statement but let us consider what the new code plans to introduce.

Bear in mind, once the code is adopted, the only way the regulations can be changed is through appeal to the Supreme Court. This will be a rather expensive exercise for self employed or small business owners across the whole financial services industry when defending themselves against breaches of the code that does not match industry standards or common sense.

Many financial services businesses providing a holistic service (full or partial financial services offering) to clients may well be in breach of the new code of conduct. If this happens many brokers' Licenses may be suspended for merely carrying out their required prudent fiduciary duties and meeting the client's needs.

The current West Australian "code" was originally written in 1975 and is irrelevant to today's needs. The new proposed code does not take into account that businesses are now offering a wider range of Financial Services products. Notwithstanding this they are also faced with the stringent requirements of ASIC, ACCC, REI, DOCEP and the new proposed Finance Brokers code. The problem here I believe is that the regulations required by the various controlling bodies exhibit contradictory and confusing messages. This leaves the Broker/Advisor open to legal action being instituted against them by any of the regulatory bodies.

Examples of this are as follows;

Section 7- Limited Ability to Waive Compliance- Sophisticated Borrower

7.2 Article 7.1. Does not apply if;

(c) The borrower is commercially sophisticated (1) or independently professionally advised and fully understands the effect of the waiver.

- (1) Described at the code page footer as, “A borrower is likely to be commercially sophisticated where it is shown that the borrower is a person who regularly engages in and is conversant with loans of money (secured or unsecured) and by their experience over a reasonable period of time, fully appreciates and understands the risks involved and their consequences.”

Issue- The above interpretation of 7.2(c) is too open to challenge and question, a Finance broker would have great difficulty defending action against himself/herself as the interpretation of 7.2(c) as described in 7.2(c)(1) does not give any clear guidelines or understanding of what a sophisticated borrower is.

If however you used the statutory guidelines for Financial Advisers, where a Sophisticated Investor is clearly described for the purpose of uniformity and common sense, it would eliminate doubt in all parties' minds and be less open to challenge by a hostile barrister. The sophisticated borrower could then be modeled along similar lines and not leave the matter open to manipulation or error of judgment by the finance broker or professionals involved within the transaction.

Section 6- General Provisions- Cold Calling/Canvassing-

Here we have a code centered on the Door to Door Trading Act of 1987; however there has been an updated release of the “ANTI HAWKING” act. This was released in line of the Financial Services Reform Act of March 2002. One would feel that this act was more relevant to today's needs and given the diversity of the financial services industry, more relevant to meet the business requirements of 2006. This Anti Hawking Act could be modified for the Finance Brokers and be relevant nationally to suit all states' requirements, just as the UCCC works successfully nationally.

5.4 Provision of Information to Borrowers- Remuneration- Maximum 2%.

3.13 Shared Remuneration-

These two sections are of grave concern when the following issues are taken into account;

Today's Finance Brokers either on their own or in conjunction with other parties internally or externally to their businesses, are offering more holistic services by way of loans, insurances, planning, budgets, investment property products, investment property sales, Taxation advice, Managed Funds etc.

The 2% rule captures all transactions that occur in conjunction with the loan approval and hence the following, but not limited to the following, issues do arise;

- When a client is advised by their accountant to see a Financial Planner to look at negative gearing to assist with their wealth creation, the planner will more than likely suggest the client uses the equity in their family home via way of a loan, then invests the funds into a managed fund. The planner will charge a fee for the financial advice, a fee for the investment lodgment, an upfront and trail commission will be received for the loan written. At the same time to make sure he/she operates within the ASIC guidelines the planner will also look at the clients risk position and no doubt sell some life insurance cover as well. How can the finance writer not exceed the 2% RULE and given that a hostile barrister would certainly take the Finance Broker/Planner to task if he/she did not ensure the clients' risk was covered and something went wrong. This can be a "no win" situation for the broker/planner.

Can you imagine if a court case arose and the Planner/Finance Broker stated that he/she did not sell the client any insurance because he/she would have breached the 2% rule as stated in the Brokers Code, I am sure that would bring more than a smile to the prosecutors face. Or if ASIC was to prosecute a Planner because he/she failed to undertake his/her required duties because of the fear of breaching the 2% rule, as a mortgage was part of the process.

The statutory requirements that ensure clients receive proper advice, plans and or budgets in concert with prudential obligations can be misconstrued by the regulators of the Code. One must remember that to prepare and monitor these plans/budgets entails costs to the Broker/Advisor, who must charge a fair and reasonable fee which would no doubt assist in exceeding the 2% rule. In today's competitive business environment it is only fair to charge a fair and reasonable price as reward for the advice and risk reward when satisfy the clients needs.

Mortgage Finance Brokers are considered to have the necessary expertise along with the obligatory fiduciary duty to advise their clients that they need to consult an appropriately qualified person to ensure they (the clients) have adequate cover in place for both personal risk and general insurance. Given this is all in conjunction with the loan being settled and that the complementary services generate fees/commissions, how will this matter be resolved when one is acting in the clients' best interest and consequently the 2% commission rule is breached?

Because of the current financial market place and the integration of the financial services, Real Estate Agents are now becoming more active in either writing loans or having loan writers involved in their business structure. It would be difficult not to assume that commission earned on the sale of a property coupled with the upfront payment for the loan settlement would not breach the 2% rule on most transactions. This is another example that needs to be clarified and resolved.

There are numerous examples that could be highlighted in relation to the Maximum 2% rule. However there appears to be an apparent lack of understanding that the Code, first written in 1975, does not relate to today's modern and advanced financial services industry. One acknowledges that ASIC controls credit under the Corporations Act, but they do not control the delivery of or the advice offered process for finance. Credit or finance advice should be treated in the manner that complies with the required regulatory conditions and must be seen to operate within the considered guidelines that meet the needs of the financial services industry in 2006 and thereafter.

It goes without saying that industry participants wish to be compliant with the statutory regulations. However, with so many grey areas and ambiguity in what changes have been proposed to date, one does not wish to create issues that could conceivably lead to unnecessary litigation due to the current confusion that exists.

Some other issues in the new code that need further clarification to ensure everyone clearly understands the intent are as follows;

Finance Brokers Control Act 1975- Exceptions to “finance broker”

Section 5 (1)-

(ab)- An insurance company authorized under the law of the Commonwealth or State to carry on insurance business-

Does this cover their authorised representatives?

(d)- A financial services licensee-

Does this exempt their authorised representatives and can they deal freely when licensed to write credit and hence not be constrained with the 2% maximum remuneration?

(g)- does this section cover Real Estate Agents and equipment/car financiers that hold the appropriate Finance Brokers Licence?

The above three questions relative to Section 5 (1) go unanswered and would require a proper ruling from the authors of the code. However from several discussions held recently, it appears that the full ramifications of the effect that the introduction of the proposed code will have a detrimental effect on the ability of the financial services industry to meet the needs of the clients, as is not clearly understood.

Given the strong regulatory environment to which the whole Financial Services Industry is being directed, I feel it would be very opportune to adopt a consultative approach to industry regulators, spokespersons of Associations and knowledgeable professionals for a summit. The aforementioned have vast industry experience and would welcome the opportunity to contribute to such an important change that will have such a large impact on the industry that affects so many ordinary people.

Current trends demand good products and above all service, honesty and integrity. Over recent times there has been an integration of financial services which is calling out for help. Why can't we bring about a national regulatory authority, which would allow interstate business's to operate or transfer of personnel to be able to transact all finance services business in any state now?

In conclusion, it is trusted and hoped that these thoughts are accepted in the manner in which they are expressed as I personally hold grave fears for the ability of the every day financial professional to be able to undertake their passion of meeting their client's needs in such an uncertain regulatory environment.

Disclaimer: This article represents only the views of the author and is not to be considered as advice.

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